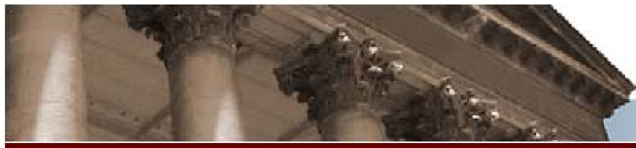

Opening Statement of Senator Sam Brownback
Joint Economic Committee Hearing
The Economic Outlook
April 2, 2008

Thank you, Mr. Chairman. I appreciate you scheduling this hearing and appreciate a very busy Federal Reserve Board Chairman taking time to share his views on the state of our economy and our financial markets. I am certain that when you scheduled this hearing back in February, you were unaware of how dramatic the preceding three weeks were going to be for our financial markets.

While I have some questions and philosophical concerns over the actions taken by the Federal Reserve in conjunction with Bear Stearns, based upon what I know, it appears that the Federal Reserve's swift and decisive actions were both appropriate and necessary. Chairman Bernanke, thank you for your strong and decisive leadership. I do not believe there is a single member of this committee that does not recognize that liquid and properly functioning financial markets are critical to the Nation's economic future.

Following the news of events unfolding at Bear Stearns, your response at the Federal Reserve, the markets' response to those actions, and Treasury's proposal to revamp the financial sector's regulatory structure provided a stark reminder of how important confidence in markets is to their efficient operation. And recent events provided a warning as to how fragile markets become when confidence evaporates.

There has been a great deal of finger pointing as to who is to blame for the current situation: unscrupulous mortgage brokers, dishonest borrowers, incompetent actions by rating agencies, irresponsible speculators, greedy investment bankers and commercial bankers. Putting aside the finger pointing for a moment, it appears to me that the failure to quantify accurately the true risk of highly leveraged transactions lies at the epicenter of the current situation.

Unfortunately, there does not appear to be a learning curve associated with financial crises, because we seem to repeat them every decade or so. We can look to the popping of the dot com bubble in the late 1990s, the stock market plunge in October 1987, the S&L crisis in the 1980s, Continental Illinois before that, and on and on. In each case, in the euphoria of good times, we appear to not adequately acknowledge that what seem to be improbable outcomes can actually arise. And we seem not to adequately protect against the risk of those improbable events coming to fruition and resulting in very large losses.

I do not think that you can always spot speculative excesses that lead to asset price bubbles. But when we observe things like escalator clauses in real estate contracts and no

documentation mortgage lending, we should start to get concerned. And I fear that the regulators, in the euphoria of good times, simply fell asleep at the wheel. We described real estate markets as being characterized by pockets of "froth." But what turned out to be gambles on real estate prices ended up influencing the financial stability of our Nation's financial system.

We find that the Fed accommodated financing for the acquisition of Bear Stearns because that company effectively faced a crisis of confidence and their claimants staged a run on the institution. Evidently, the Fed deemed Bear Stearns as too big to send to bankruptcy, for fear of threats to the systemic stability of the Nation's financial system. If the Federal Reserve is going to take private-sector assets onto its balance sheet, I would hope that we at least have the Fed and others monitoring what the people who bought those assets were doing.

If private institutions engage in highly leveraged bets, and those bets turn out to go sour, we are putting U.S. taxpayer funds at risk when the Fed ends up effectively guaranteeing some or all of the value of those bets. If that is what we are going to do, then don't we at least need oversight into what bets are allowable? With the advent of hedge funds, off balance sheet financial entities, sovereign wealth funds and the like, who's bets are we willing to back? These are important public policy questions that need definitive answers if the world is to have faith that promises made in U.S. financial markets will be honored without imposing undue risk from rogue speculators.

While you have a lot of smart people working at the Federal Reserve, I am concerned when the taxpayer's money becomes the "skin in the game" to rescue supposedly sophisticated investment and commercial banks from the results of their own poor decision making. I am extremely interested in learning more about what processes the Federal Reserve will utilize to quantify the financial risk to the taxpayer resulting from the Fed's $29 billion backstop to the Bear Stearns – JP Morgan marriage.

As the Federal Reserve continues to study the meltdown in the subprime mortgage market, I hope that you will undertake an evaluation of the degree to which the failure to implement quality control standards on mortgage originating activity contributed to the current crisis.

I know that there are individuals at the Federal Reserve and in other regulatory agencies that will likely argue that the current system of rules, examinations, and audits are more than adequate. Current circumstances suggest that they were not.

Specifically, I would like the Federal Reserve to determine if instituting a system of rating originators for the completeness and accuracy of the data they provide lenders and making that part of a loan's rating would, based on an evaluation of real world data, have prevented some of these loans from being made or from being securitized.

From my perspective, this would add exactly the kind of transparency and more granular information called for in the President's Working Group report. The essence of meaningful quality control and risk management is to constantly test those systems for material weaknesses.

As you know, the Senate is considering housing legislation this week. One of the issues under consideration is whether or not to amend the bankruptcy code to allow bankruptcy courts to amend the terms of mortgages on principal residences. I am interested to know if you believe such a change would add additional uncertainty to the market for mortgage-backed securities in a way that would impair the ability of those markets to recover from their current state and provide reasonable risk-based financing to deserving low credit borrowers.

On another note, I would like to express for the record my continuing concern over the Senate's failure to give you a full complement of Federal Reserve Governors and the President a full Council of Economic Advisers at this critical juncture for our economy.

Again, Mr. Chairman, thank you for scheduling today's hearing. Chairman Bernanke, thank you for being here and for your continuing vigilance. I look forward to your testimony and the exchange during the question and answer period.