

**OPENING REMARKS OF CHAIRMAN PHIL ANGELIDES
AT THE PUBLIC HEARING OF THE FINANCIAL CRISIS INQUIRY
COMMISSION: “THE SHADOW BANKING SYSTEM”
WEDNESDAY, MAY 5, 2010
WASHINGTON, D.C.**

Good morning. I am honored to welcome you here today. I want to thank Vice Chairman Thomas and our fellow commissioners for all their hard work as we strive to fulfill our mission on behalf of the American people. I particularly want to thank Commissioners Born and Holtz-Eakin for serving as the lead commissioners on this hearing.

Today, we begin two days of public hearings. They’ll focus on what’s been called shadow banking and how it affected the financial and economic crisis that continues to grip our nation

It’s largely forgotten now but for much of American history we had a banking system that was unstable and prone to panics. In the 19th century, runs on banks came every few years, plunging our young nation into frequent financial crises. In the first half of the 20th century we brought stability to the banking system: After the panic of 1907 we created the Federal Reserve; after the great crash of 1929 we instituted reforms like deposit insurance and more federal oversight. For decades, we had a sound banking system that provided capital for businesses and consumers alike. It was one of the foundations of our prosperity.

Over the past few decades, though, a parallel--or shadow--banking system has arisen that's become a linchpin of our economy.

However it's largely unregulated and, as we saw in the financial crisis, much more unstable than anyone had thought. This world of shadow banking is some \$8 trillion in size and almost as large as the traditional banking sector. It includes investment banks, off balance sheet entities, money market funds, and hedge funds as well as some affiliates of the traditional banks.

During this financial crisis we've seen the shadow banking system upended --first by a liquidity crisis in 2007 as mortgages went bad at an accelerating rate and building to a crescendo in the fall of 2008 when there was a 19th-Century style panic, a run on the short term, often overnight, loans that fund so much business financing in America and around the world. The market froze. Interest rates soared on the short-term loans. Our financial system was on the verge of collapse.

How could this have happened? Consider Bear Stearns which we'll examine today in its own right--and as a participant in the shadow banking system. Like many other institutions, Bear took extraordinary risks. It invested heavily in mortgages and mortgage securities, was thin on available capital and dependent on the good graces of its creditors for overnight loans. By one measure its ratio

of assets to tangible equity was 38 to 1, a precarious position, to say the least. When their funding dried up, the company stood on the verge of collapse and finally had to be purchased by JP Morgan Chase & Co. with more than \$29 billion in government assistance.

We will also be examining the Securities and Exchange Commission which had oversight over much of the shadow banking world under a 2004 program that ended in 2008 when the five financial giants under its purview either failed, were acquired, or turned into bank holding companies. We'll have questions of Treasury Secretary Geithner who used to head the Federal Reserve Bank of New York which was charged with serving as the Federal Reserve's eyes and ears on Wall Street. We'll also have former Treasury Secretary Paulson here and we'll ask him how and why this shadow banking system grew and came to pose a risk to our financial system and our economy.

While considerable attention by journalists and historians has, with good reason, focused on the rescue of various financial institutions, we want to explore why these kinds of risks developed in the first place. What could have been done --what should have been done -- to prevent them?

To use a metaphor, yes, there's general interest in how the fire was brought under control but our job is to find out why the fire started.

What warning signs were ignored? What building codes, if you will, could have prevented the fire in the first place? Where were the firefighters? Who was playing with matches? On behalf of the American people, we've been charged with getting the answers to these questions and we will.

You'll find more information on Shadow Banking on our website, F-C-I-C . GOV, where our research staff has prepared an excellent preliminary report. Again, thank you for being here today and I'll turn the microphone over to the Vice Chairman.