U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON SCIENCE AND TECHNOLOGY
SUBCOMMITTEE ON INVESTIGATIONS AND OVERSIGHT

Hearing on

The Risks of Financial Modeling:
VaR and the Economic Meltdown

September 10, 2009

Opening Statement of the Honorable Paul Broun, M.D. (R-GA)
Ranking Member

Thank you Mr. Chairman.

Let me welcome the witnesses here today and thank them for appearing.

Today's hearing on Financial Modeling continues this Committee's work on the role of science in finance and economics.

As I pointed out at our previous hearing in May, over the last 30 years Wall Street has increasingly leveraged mathematics, physics, and science to better inform their decisions. Even before Value-at-Risk (VaR) was developed to characterize risk, bankers and economists were looking for a silver bullet to help them beat the market.

Despite the pursuit of a scientific panacea for financial decisions, models are simply tools employed by decision-makers and risk managers. They add another layer of insight, but are not crystal balls. Leveraging a position too heavily or assuming future solvency based on modeling data alone is hazardous to say the least. Conversely, it stands to reason that if we could accurately predict markets, then both losses and profits would be limited since there would be very little risk involved.

Modeling is a subject this Committee has addressed several times in the past. Whether it is in regard to climate change, chemical exposures, pandemics, determining spacecraft survivability, or attempting to value complex financial instruments, models are only as good as the data and assumptions that go into them. Ultimately, decisions have to be made based on a number of variables which should include scientific models, but certainly not exclusively. As a witness at a previous hearing stated, "science describes, it does not prescribe." No model will ever relieve a banker, trader, or risk manager of the responsibility to make difficult decisions and hedge for inevitable uncertainty.

This Committee struggles enough with the complexities of modeling, risk assessment, and risk management regarding physical sciences. Attempting to adapt those concepts to economics and finance is even more complex. Appreciating this complexity, and

understanding the limitations and intended purpose of financial models is just as important as what the models tell you.

We have two esteemed panels of witnesses here today who will discuss the appropriate roles and limitations of models such as VaR. They will explain how these models are used and shed some light on what role they may have played in the recent economic crisis. I look forward to their testimony and yield back my time.

Thank you.

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