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ECONOMIC NEWS UPDATE

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“Democrats can get things through the Congress, but we’ve got to get the President to sign them. It seems to be in our mutual interest to start working together.” No, this Democrat was not referring to the President’s plan for a troop surge in Iraq, more’s the pity. This was Barney Frank talking, the very liberal Massachusetts Democrat who now chairs the House Financial Services Committee.

Frank says he is ready to deal. He will give those Republicans who want an immigration reform bill what they want, if they will make it easier for new immigrants to join trade unions. He is willing to support new trade-opening measures, but they must contain provisions that protect “working-class people”. He wants Medicare for everyone, and is willing to go along with increasing co-payments by patients if those reflect incomes. He would like to regulate pension fund investment in hedge funds, but has no desire to prevent people from investing in such funds. In an interview with Business Week, from which the above combination of reporting and inference

is derived, Frank gave a ringing statement of his libertarian philosophy, “If you’ve got \$10 million and want to invest in a hedge fund, smoke three packs of cigarettes a day, and ride your motorcycle without a helmet, good luck to you. All my energy goes to try to protect people from other people. I have zero energy left to try to protect people from themselves.”

Which leaves open the question of just where he stands on the important questions of corporate governance that fall within his committee’s jurisdiction and are due to roil the usually calm annual meetings of many corporations. Frank is for corporate democracy, but with a twist: he wants to enact legislation that will empower “fairly responsible people with a lot at stake.” This includes those who manage mutual funds, equity-fund managers and others with the ability and clout to make certain that corporate managers operate in the interests of their shareholders.

This would substitute more corporate democracy for more government regulation, consistent with the movement afoot to relax the

regulatory regime that many see as driving business from US exchanges to London. There might not be a panic on Wall Street in the usual sense of plummeting share prices, but there is a panic about the role of New York City as a player in world financial markets. So Treasury Secretary Henry Paulson is planning to convene a conference on capital markets, and New York's leading Democratic politicians, Senators Chuck Schumer and Hillary Rodham Clinton are joining with Republican (in name only) Mayor Michael Bloomberg to lobby for a more relaxed regulatory regime, with specifics to follow at some point.

To add to the impetus for a review of the rules regulating director and executive behavior we have congressman Paul Kanjorski, the new chairman of the House subcommittee on capital markets, insurance and government-sponsored entities (the so-called GSEs, most prominent of which are Freddie Mac and Fannie Mae). Kanjorski wants to go one step further than Frank and give *all* shareholders greater power, but has not yet figured out how to do that. Which he may never do, if American Enterprise Institute scholar Michael Novak is right. Novak argues that the government model of democracy, with its checks and balances designed to limit executive action, cannot work in the private sector, where CEOs need some unchecked power to react quickly to events and take risks when opportunities present themselves.

Kanjorski also wants to increase shareholder rights because "if we had better shareholder rights we wouldn't have as much litigation". Frank sees increased shareholder power as an antidote to regulation; Kanjorski sees it as an antidote to litigation. Both

antidotes appeal to corporate leaders who feel the business atmosphere has been poisoned with too much of both those diseases.

Kanjorski is prepared to undergo the rigors of a junket to find answers to the tough questions he faces. He is headed for Europe because "Europe has shown that they have a greater investor-rights concept and its working fairly well.... We're really going to have to look at ... the UK and Europe." My guess is that he will be impressed by the talk in London of principles-based regulation, as opposed to the rules-based regulation that is supposed to be causing such headaches for companies listed on American exchanges.

But talk to directors in London, where Kanjorski will be exposed to praise for principle-based regulation, and you find that their enthusiasm for broad principles as opposed to specific rules is more limited than their public comments suggest, or than they will let on to congressional junketeers. Directors read reports of extradition and jail sentences, and quake. Frank O. Bowman III, a former federal prosecutor who is now a law professor at the University of Missouri, writes in the recent issue of *The American Lawyer*, "The rules governing high-end federal white-collar sentences are now completely untethered from both criminal law theory and simple common senseFederal law now classifies an officer of a publicly traded corporation who accedes to a fraudulent accounting fiddle as worse than a murderer ...[Convicted CEOs] will serve the functional equivalent of life sentences..." since parole was abolished in these cases in 1987, and the convicted executives must serve at least 85% of their sentences.

So, as they head for their board rooms, Britain's corporate chieftains are feeling very uncomfortable with only a generalized set of principles to guide them, as will their American counterparts who think that such light-touch regulation beats all heck out of Sarbanes-Oxley. The Brits are asking their solicitors for rules, which will provide a safe harbor from the stormy seas of stockholder suits and fraud prosecutions. They will rail against too many rules, but in the end will not feel any more comfortable without them in this day and age than they did without their bowler hats and brollies (umbrellas, over here) in years gone by.

So look for American legislators and regulators to go abroad in the hope of discovering why London is beating out New York, and to leave believing all the talk about principle-based regulation -- while Britain's directors privately demand that their advisors provide them with the reassuring certainty of rules. The visiting legislators will miss the most important point, that in the end there is no substitute for regulators who know how to strike the delicate balance between the need for intervention, and Ronald Reagan's warning, "Don't just do something, stand there."



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