



“Sox, TARP and the Road Ahead”

Michael Oxley

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Thank you so much and Jim, thank you again for your hospitality, I'm glad to be here and particularly glad to have taken over the position of Chairman here at ERC. I didn't know a whole lot about ERC prior to having some conversations with Pat and the more I learned the more I was impressed. Learned a little about the Fellows program and I'm certainly proud to serve and I was able to chair my first meeting of the board about a month or so ago and I'm looking forward to more in the future as well as recruiting some board members as well who share our interest and passion for ethics. One of the things that really impressed me was last night's dinner. I originally wasn't able to go, but as luck would have it I was able to change the schedule and attend.

I'm so glad I did. At the Stanley Pace Dinner, the honoree, Carol Marshall-- I never had the chance to meet Carol Marshall-- and so, when I came in and looked at the program and I looked at her biography, it turns out that she and I share the same alma mater, Miami University in Oxford Ohio. She graduated a few years after I did, but she and her record are incredibly replete with accomplishments throughout and I thought the heartfelt comments from Norm [Augustine] and from others last night really for all of us there made us think about the contribution she made and I think makes us all proud of what we're trying to accomplish. So Carol was a wonderful leader and, from everyone I've talked to quite an outstanding individual -- and an Ohio native. We had a chance to talk to her family last night at the table and it was just a wonderful dinner and something I'll always remember. It gave me some things to think about as we move forward with our goals here at ERC.



As Pat said, I'm the Ox in SOX. The Act has given me a new first name. After the bill passed, about two years later I got a call from my mother in law and she said "Mike! Mike! You're on Jeopardy!" and I said "I'm in jeopardy?" She said "No, no. Jeopardy, the Alex Trebek show." And I said, "Yeah, I know. I watch it occasionally."

“Well, the question was, “The law that was passed after Enron.””

There were three panelists, of course -- two Americans and one Canadian and only the Canadian got it right.

I had a chance to go to the World Economic forum in Davos shortly after we passed the bill -- must've been 2003 -- and I was invited to speak at the conference and there was a reception beforehand and I had my nametag on like I do now. I was talking to different people and this young man was kind of staring at my name tag and was kind of holding back but eventually he came over and said, "I want to shake hands with Sarbanes Oxley." I said why do you want to meet me? And he said, "I didn't get to meet Mr. Glass-Steagell and I didn't want to forego the opportunity."

I also want to thank Pat and the wonderful staff at ERC

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Let me just take you back to 2001, 2002 time period when the 7th largest company in the US with a several billion dollar market cap. We started hearing stories about Enron earlier in 2001. If you recall, Enron was feted in all the business magazines, the leaders of Enron were featured on business magazine covers, Enron had just announced the strongest code of ethics, they claimed, of any company in America. Their leaders became household names and Enron became a real player in the American economy.

About sometime in the early summer of '01 Enron filed a restatement of earnings, later in the fall submitted another restatement of earnings and by late fall had filed for bankruptcy. An amazing series of events that truly took the nation by storm. The media was full of stories about Enron. I think there was one cable channel that was all Enron all the time. So you could just save yourself time following those stories. Interviews with people who had not only lost their jobs at Enron but had lost their life savings with Enron. It really did captivate the American media attention and of course the public's attention.

Obviously it also caught the attention of Congress. I had just taken over as chairman of the [House] Financial Services Committee and because of the Speakers' leadership we were able to merge the jurisdiction I had beforehand in the Commerce Committee where we had jurisdiction over the securities and exchanges issues as well as over insurance, and move that to the old banking committee and form the new Financial Services Committee in recognition of what had gone on in the financial sector previously.

And so we had the first hearing on Enron in December of '01 and that was the first time we tried to get our hands around what really had gone haywire at Enron. It was later then, into the next year- and as you recall the board at Enron had commissioned a study as to what had gone wrong at Enron and it was led by Dean William Powers who at the time was the Dean of the University of Texas Law School, along with Bill McLucas who many of you know was head of

enforcement at the SEC for a number of years and now has a private practice here in Washington.

Those two gentlemen and their compatriots really did a superb job in delving into what went wrong at Enron. They testified in front of our committee and that was the first time, I think, that the committee, Congress and the policymakers really had a chance to delve into what had gone wrong. Ultimately, what Dean Powers said at our hearing was that at every opportunity the gatekeepers at Enron had failed in their obligations, whether it was the attorneys, the accountants, the analysts, the credit rating agencies, the board... they didn't spare anybody. They went into excruciating details about some of the opaque activities that went on, the off-the-books accounting, and it became pretty clear that not only was there a lot of unethical behavior going on but probably some real violations of the law, and of course we ultimately found that out.

Some eight months later, the president signed the legislation into law. The interesting thing about that is that there's been a lot of criticism saying Sarbanes-Oxley was passed in haste, in a matter of weeks. It was eight months. Admittedly, by congressional standards that's pretty fast but eight months is still eight months. It was a serious effort going forward. Another myth about the bill was that it was controversial. It wasn't controversial. I didn't get one letter, one phone call at the time about what we were doing. The public was on board. The Business Roundtable endorsed the bill. The [U.S.] Chamber of Commerce, while they didn't openly endorse the bill, certainly didn't oppose it because the public outrage was so immense. It wasn't controversial to the point where it passed 423-3 in the House and it passed 98-0 in the senate. So I love some of these revisionist histories about how controversial this was.

I can go into some detail if you want or you can ask some questions about how [Section] 404 came to be. Frankly, it wasn't in the House version but during that period when the public -- and a lot of this was media driven -- wanted blood. So when the House passed our bill it was after Enron but before WorldCom. By the time WorldCom became evident- by the way, at the time WorldCom was the largest bankruptcy in American history, and was four times larger than Enron and featured some colorful individuals, including Bernie Ebbers, that really caught the media's attention. The press at the time was writing that our bill was "weak" and the Senate, pushed by what happened at WorldCom, as well as Tyco and Adelphia, Global Crossing- it became pretty evident that there were an awful lot of bad things going on in corporate America.

I always felt most corporations and their leaders are dedicated, honest, hard working, doing the best for the best for their employees, the stakeholders, the shareholders, obviously. But our goal really was to restore investor confidence. After all, we lost almost \$8 trillion in market capital. We had changed immensely in our country in the last 30 years from a nation of savers to a nation of investors. When I came to Congress in 1981 about a third of American households owned equities. In 2001, 54% of American households held stock. 401ks were invented, IRAs, people like my son are trading online. There was a lot more participation in the capital markets by the average guy. No longer the prominence of the elite and the well to do in the stock market but the

average guy on the line who wanted to own a piece of America, wanted to have a future, wanted to create a retirement for himself, maybe wanted to put his kids, who in many cases would have been the first in their family to go to college. They had worthy goals and they felt empowered by the ability to create a nest egg and build it up based on trust that the information they were getting and the decisions they were making were honest and correct. Imagine the shock that these people had that were pretty much new to the system, new to being investors, probably didn't even think of themselves as being investors in the common sense that we understand it, but they were indeed investors.

Then we lost 8 trillion in market capital. Virtually every stock, it didn't matter if they were Enron, WorldCom, it took virtually everyone down. Virtually all of your company's stocks went in the tank during that time because people had lost confidence. So the goal we had, ultimately, was "how do we restore consumer confidence?" The goal was to do that through more transparency and accountability and better corporate governance. That was really our goal. To the extent that we were able to accomplish that on a broad, bi-partisan basis -- you hear everything today is partisan, "you can't do anything bi-partisan" -- that was the ultimate bi-partisan legislation. You may not like it but it was a bipartisan piece of legislation that passed overwhelmingly in both houses and was driven and supported by the president. That's the way, in my estimation, the system ought to work. So we're pretty proud of that, in the sense that, in many cases in the last several years, probably the only piece of bipartisan legislation that made a difference.

So, I'm always asked, "What's the difference between what we have now, what went on in 2008, and what went on with Enron, WorldCom and some of the other businesses?" At the end of the day, of course, the Enrons of the world were accounting fraud- out and out, illegal activity that people are in jail for and will be for a long time. Today, even though the media is searching desperately for villains, you don't have the guys doing the perp walk that you had eight years ago. Many of the CEOs on Wall Street are now gone. There is, at least from my perspective, very little indication that there was out and out illegal activity going on during that period of time.

It's clear that the over the counter derivatives market was opaque, unregulated, cowboy capitalism at its worst. But at the end of the day I would be surprised, frankly, if you saw people going to the slammer. The commission that was set up by the Congress to look into what went wrong had their first public hearing a week or so ago. Phil Angelides who was the chairman, made the point that should they uncover illegal activity, obviously, they would turn it over to the Justice Department. Which is obviously the thing they need to do, but, I must say, was probably made more as a gesture. The poster boy for the last two years, which we don't have a good term for -- meltdown? Credit crunch? I don't know- what concerns me, frankly, is when historians look at this period there is going to be one guy that is perceived as the face of this recent fiasco, and his name is Bernie Madoff.

Now Bernie Madoff did a lot of bad things, but at the end of the day it's a classic Ponzi scheme that's been around for decades. It wasn't accounting fraud, near as we could tell. Actually, it appears Bernie paid his taxes on the ephemeral gains he made in the market. As a matter of fact a trustee of the Madoff case who was Baker Hostetler's partner, my law firm, has recently found \$270 million, at last count, money given to the IRS on phony earnings. Which tells me that Bernie Madoff feared the IRS more than he feared the SEC. Isn't that something Jim? But it's amazing he literally feared the IRS more than he feared the SEC. Well, my point is that this is an entirely different thing.

I see articles all the time that say "Sarbanes-Oxley was supposed to stop these things." Well, no it wasn't. Sarbanes-Oxley was about stopping accounting fraud. That's why we created the Public Company Accounting Oversight Board. It didn't have anything to do with Ponzi schemes. It didn't have anything to do with unregulated, opaque over the counter derivatives. By the way, if you haven't already, read *Too Big to Fail*- Andrew Ross Sorkin of The New York Times took several months off from The New York Times to write this book. I tell you, you say "It's a book about business, meetings, and all this kind of stuff." It's not exactly a bodice-ripper if you know what I mean, but I tell you what -- it's a great read. He puts it in like you were at all of these meetings. Particularly that last weekend in New York, when they're trying to figure out what to do with Lehman Brothers, and all that action with Paulson, Ben Bernake, Tim Geithner and all the players... just absolutely fascinating. But, at the end of the day this was an unregulated, opaque market in which these credit default swaps and other sophisticated arrangements were clearly not understood at the very top of these institutions.

Going back to what Dean Powers said, in terms of the gatekeepers -- the obvious question to me is, if you're trying to link the Enrons of the world with the current situation, the question that always comes back to me is- where was the board? Who was asking the questions- "What is a credit default swap? What does this do? How much is it worth? Who are the other counterparties?" Because, at the end of the day, Lehman Brothers died because no one knew the value of AIG's credit default swaps that they had sold to these companies. If you read the book they talk about ethical behavior versus illegal behavior. Goldman-Sachs was selling these products -- over the counter derivatives -- to their customers at the same time they were shorting all of these on their own account. Now, if I'm a customer of Goldman-Sachs and they say "Boy, do I have a deal for you. Great yields, almost no downside on the risk." They're all over it, right? Now, all of a sudden, the whole place falls apart. They lose a lot of money but Goldman says "Hey, not to worry because guess what? We shorted all this stuff and we made a lot of money." The bottom line is these guys, these institutions became hedge funds. Publicly traded hedge funds, that's really what they were. We were told time and time again when I was in Congress that you don't need to regulate hedge funds because we're dealing with sophisticated traders and there's no down side. I said, "What about Long-Term Capital [Management]?" Which is prominently mentioned in the book. That was kind of the first bailout, if you recall. And guess what? We lost another \$8 trillion of capital during this whole fiasco.

Now you say to yourself, the average investor in the last eight years has been subject to this kind of activity in the corporate world. What kind of confidence do you think the average investor has in the market? I'm flabbergasted by how the market has responded, frankly. Given the fact that there is a lot of angst out there in the public as they've had their 401(k)s cut in half or sometimes more, it makes you wonder. The exciting thing about it, and Chairman Greenspan always talked about it when he testified to the committee, was the incredible resiliency of the American system. That is true, we have the ability, as clumsy as it sometimes is, to renew and to reform, to recognize mistakes, try to fix them -- sometimes not necessarily perfectly, but to fix those situations so they don't happen again. That's really the job Congress has before it today, and it's not easy. They're basically asked to reset our regulatory apparatus that hasn't been done for 80 years. In those 80 years a lot has happened. Essentially, we're relying on an early 20th century model of regulation in the era of the 21st century. Anyone in business would say that doesn't make sense. You can't rely on an early 20th century technology or whatever it is in your business in today's competitive marketplace, but that's really where we are in terms of the regulatory structure. I think the hearings the commission began are a great start. I think some of these books, like Sorkin's or Charlie Gasparino's book called *Sellout*. So that's what I'm reading, I'm reading Gasparino's book and it's absolutely fascinating what's going on. You say to yourself "what were these people thinking at the time?" and the sad thing is that the culture was all about, and only about, money. It wasn't about serving their customers, their clients. It was only about how much money you could bring through the door, and nobody wanted to question it. Frankly, we're all at fault. We were all living above our means, we were taking too much risk. So nobody cared as long as the cash register kept ringing, you know? My predecessor used to have a saying, "Nobody shoots the bartender when the drinks are on the house." So there was no real impetus for reform, and really the only way you bring about reform in this country is when something really bad happens and you get the public agitated and believe me, the public is agitated for the second time.

I think they're agitated in a different way this time because you don't have the mugshots of guys, you don't have them doing the perp walk, but all the same, it's pretty much -- in terms of effect on the average investor -- the same whether it's Enron or Goldman Sachs and so the job the Congress has is enormous in terms of trying to put together a regulatory structure that makes sense in the 21st century. I don't envy them in that job because it's very, very difficult. I give Barney Frank, who is my successor, a lot of credit. He got a bill through the House. I don't necessarily subscribe to all the tenants of it but the fact is that the House acted. The Senate a little slower as they usually are and Chris Dodd is providing some leadership and I think we're going to get a bill. Particularly now that it looks like healthcare is on its last legs. It looks like regulatory reform will step up. And also, cap and trade is dead so it really opens the door in some respects for what's going to happen in regulatory reform. It's important that they get it right, so whether a financial consumer protection agency is the right way to go, I think they need to work their way through. But clearly, in over the counter derivatives the old argument that you don't need to regulate, you don't need transparency is totally out of the question. I mean, any reasonable observer would say, "Wait a minute, there were a lot of mistakes made in terms of the

SEC granting a higher percentage of risk to the investment banks.” Investment banks traditionally had participated in a risk basis ration of about 8 [or]10 to 1. At one time Bear Stearns was at 40 to 1 -- 40 to 1 -- and some of the riskiest paper that you can possibly imagine went on basically unregulated and unknown.

So when the bottom dropped out of the housing market and... we had that bubble, everyone's housing values were going up and up, people were flipping houses in Florida, Arizona, California and frankly, a lot of those people thought it was never going to end. I got my first sense of what was going on with this bubble a couple years ago when my wife, who's a realtor in Virginia, said she got a client from Chicago, an executive who was being transferred here. Showing them this house that was pretty much what they had in the Chicago suburbs and they said, "This is the house, we want to put in a bid for it." She said, "Okay, but this market is so hot that you need to waive all the inspections and you need to bid the asking price. Don't mess around with a counter-proposal or anything because you won't get it." So that very night -- and the house had been on the market for about a week -- that very night, they signed a contract. Full asking price, waived all the inspections... They were seventh in line. The people who got the house bid 20 percent over the asking price as well as waiving all the inspections. So, you know, I should have thought at the time "this is kind of a microcosm of what's going on all over the country." I was too dumb to figure it out but that's really what happened. There was this idea that it could never end, that these housing prices would keep going up and up. Once that bubble burst obviously all hell broke loose.

So we're again in the process of trying to renew, trying to make some changes to make sure this kind of thing doesn't happen again. So in some ways it's a replay of what we did eight years ago, but it's also different. This is going to be a huge undertaking. There's a lot of speculation about what will happen on the banking side to just have one banking regulator. I know Chris Dodd has talked about that. I know the administration has their own ideas on that. A lot of this is going to be a lot of heavy lifting on the part of the administration and on the part of Congress. I applaud them for taking their time to try to get this right because ultimately what's at stake is the future of our economy in this country.

I present you with that just as an overview of kind of the ups and downs of what we've had in our economy. The classic though is that we are an amazingly resilient people that are some point willing to recognize our mistakes, work to solve them, and move on to bigger and better things. I think that's what drives the American economy -- the entrepreneurial spirit, the understanding that if you work hard and you do the right things and you're ethical you're going to do well and your stakeholders are going to do as well as you are. And I truly think that that's what our goal should be here at ERC. We can be the undergirding of some of these decisions. We're going to talk this afternoon about whether you can really pass laws to make people ethical. I think the answer is pretty obvious, I know this is a set-up. I figured that out, but the discussion we'll have with Ken Feinberg and John Castellani will be really interesting because if you do, as I do, believe that you can't legislate morality and ethics, you can still set standards. We have examples

galore – Carol [Marshall], Norm [Augustine] and others that have been there, been successful and have a track record of doing that. So the more we can do that and push that forward the more we can get people to understand that power of individuals to change the course of history and change the way we do things is really an enlightening and exciting proposition.

--Beginning of Question and Answer period--

Question 1:

I'd like to thank you for your remarks and especially your leadership of ERC which plays such a critical role, I think, in the corporate ethics profession.

SOX brought about a change in the behavior of board audit committees- what's your prognosis for Congress bringing about a similar change in compensation committees with its proposed legislation?

Oxley: That's a great question. First of all, you've seen a movement toward more independent board members on some of the more important committees, like compensation. Not as much as we focused on with audit committees. The reason we focused on the audit committee was to break that hold of the ability of the CEO to hire the outside auditor. So now you've got an arms length transaction between the independent board, independent audit committee hiring the auditor, and I think it's worked pretty well and it's avoided a lot of potential problems.

As far as compensation is concerned I think there's a lot of pressure today for members of the board to step up to the plate and do the right thing. I think they've got a relatively narrow window to do that because... I think it'd be a good question for Ken Feinberg -- one thing that's impressed me with Ken Feinberg, and I've been on two or three committees with him -- is that he makes it clear it's his job to follow the statute and really only has control over seven companies and while a lot of people try to bait him into saying his actions will be a template going forward -- no, no he's a good lawyer and he stays within the bounds of the statute as he is bound to do, which means the boards have an enormous responsibility going forward to change the way that executives are compensated.

This issue, the compensation issue is the one red hot-button issue with the public because they understand it. They may not understand -- and who does -- CEOs and all these things but they understand the fact that executive compensation is now 400 to 1 vs. the average worker whereas it used to be like 40 to 1. They understand that, not necessarily across the board, but certainly on Wall Street. That is the driving force behind the public's outrage and I guess you can't blame them. When you see some of the executives that have failed walk away with millions of dollars in their pocket -- for what? Bringing the company to its knees and costing people their jobs and their life savings? I don't think so. So we really have to rethink that.

Look, I'm a conservative, pro-business kind of guy that's been somewhat radicalized by what's going on and I got 100 percent from the Chamber of Commerce every session, all the business groups I was supportive of, but I'll tell you -- you can't justify what's going on now. You just can't. The boards got to understand that, if you don't you're going to have a revolt on the part of the shareholders because if the board's not going to stand up for the shareholders, who's going to do it? That's why you see a lot of push by [The] Corporate Library and others for access to the proxy, the ability to put your own slate up. That is a direct result of public outrage as well as consumers voting with their feet and getting out of the market, which isn't healthy.

That's part of the problem we've seen recently. That because of the low interest rates it was easier to raise money in the debt market than it was in the equities market. Yet the debt market was far more opaque and difficult than the equities market. With the equities market, when you buy that stock you know exactly what it's listed for. You may not, you probably don't know what you're paying for some of these products. Just ask AIG. I was on a panel for the NACD [National Association of Corporate Directors] and we did a report that just came out a month or so ago, it was a blue ribbon commission and it was mostly about risk and the board's role in assessing and managing risk. Obviously, it had repercussions as far as compensation as well. I made the point at the last meeting that this is a ticking bomb as far as the public is concerned and you ignore that at your own peril. I think some of the more enlightened boards have started to figure that out. The good thing is now, with more of an emphasis on independent board members, you've got something going. The great quote in Gasparino's book *The Sellout* about Jimmy Cayne at Bear Stearns was that he said, "This is my board. I mean this is MY board." You know exactly what he meant. Those days ought to be over, and if they're not then there are a lot of companies like Bear Stearns that are going to pay the price.

Question 2:

I wanted to follow-up and ask you about this blame and identifying who was involved. I mean, you mentioned with Enron there were figures, there were companies, and you mentioned Madoff but he's not really the person who's at fault here. In this case, perhaps if you think about it as the government was at fault because it wasn't regulating enough or was it the companies and their policies that were at fault? So, when the finger is finally pointed how to think the reaction will be perceived?

Oxley: Yeah, that's a great question. Right now, you've got this New York vs. Washington thing. If you read the Wall Street Journal you'd think it's all the government's fault. If you read the Washington Post you'd think just the opposite. You'd think it's Wall Street's fault. It's probably a wicked combination of both. There is a woman by the name of Brooksley Born who was the head of the Commodities Futures Trading Commission, and she saw what was going on with over the counter derivatives and she was very public about the fact that it should be more transparent and be regulated. She was basically run out of town by the Clinton Administration, by then-SEC chairman Levitt and she's looking pretty smart right now. But, the power of the

investment banks was so great- I mentioned the SEC, by a unanimous vote to increase their level of risk beyond anyone's imagination. Bear's was at 40 to 1 at one point. So, that's part of that picture. I guess it's just a natural consequence, you're going to have that "Wall Street says this and Washington doesn't get it," or "Washington says this and Wall Street doesn't get it." It's that kind of thing. You have to get past that to really delve into what's really going on.

For example, part of Sarbanes-Oxley that no one thinks about is how we dealt with backdating stock options. Frankly, I was surprised at how prevalent that practice was. It was almost always illegal, although there were ways you could kind of... But, in the old days if you were a corporate insider you had up to 90 days to report to the SEC about your stock activities; buying, selling, stock options and all that. In some cases, depending on what time of year it was it could be much longer than that. So, we heard stories about this kind of thing. This is the type of thing that was often illegal and certainly unethical because it gave corporate insiders the ability to do something average shareholders couldn't do. So the average shareholder is saying, "I don't get this." It's like winning money on the [TV] replay with your neighbor. You know how the game came out, then your neighbor comes over and you say, "I bet you the Wizards win this game at the buzzer," then the guy loses money. You know, this was a fairly common practice, as we found out. A lot of people went to jail, a lot of people paid a lot of fines and it became pretty evident. So, that activity -- the best way we could do it was to provide immediacy and transparency. So we said, "You get 48 hours on a stock option or any kind of stock. You have to post it on the SEC website within 48 hours." That was the end of it. There have been no, as far as I know, cases of backdating stock options since July 30, 2002. You talk about an effective deterrent, that's it. We didn't try to put anyone in jail, we just said, "You've got 48 hours. Put it on the SEC website. Go for it." So, a lot of the cases that were high profile essentially took place before the bill was passed. So I think it was effective.

But, you hit on a very interesting point, which is this tension between Washington policymakers and Wall Street. There was not that tension, by the way, after Enron. The business community got it. I remember Hank Paulson delivered a speech at the National Press Club that we called his "mea culpa" speech. He basically apologized to the American public for the activities that were going on at Enron, WorldCom and some of these other companies. Great, courageous leadership. I'm sure a lot of the business types are saying, "Oh, great..." but he's an honorable guy to say that. I've always appreciated that. As a matter of fact, Hank Paulson, when he became Treasury Secretary, the first thing that happened was a lot of the investment bankers went to Hank and said, "Why don't you repeal Sarbanes-Oxley?" He said, "I'll read it over and get back to you." He read it over and came to me and said, "I don't see anything in that act that I would change." Pretty gutsy. No one's ever written about that as far as I know, but that's a fact. So, there are some honorable folks out there. A lot of them. But, this will get done. As far as the political process, which sometimes isn't pretty... but, it'll get done.

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