

January 9, 2002

[addressed to members of the Senate Banking Committee]

Dear Senator:

It is essential that the Senate confirm a new chairperson of the Securities and Exchange Commission (SEC) who will be able to command the support and trust of the American people, particularly the millions of pensioners, workers and investors who have lost their jobs and much or all of their lifetime savings as a result of the recent corporate fraud and accounting scandals.

The new SEC Chairperson must be willing to support key corporate reforms if the Commission is to regain and maintain its status as a vigorous regulatory agency with the ability and integrity required to protect the public interest.

During confirmation hearings, we urge you and your colleagues on the Senate Banking Committee to determine the new nominee's willingness to:

Ensure that the SEC is adequately funded. As the Senate Committee on Government Affairs concluded in October, the SEC “ultimately failed to fulfill its mission to protect investors” in the Enron debacle. In large part this was due to the inability of the agency’s overburdened staff to fulfill its ordinary duties. For instance, SEC officials admitted that the last year the company’s books had been reviewed before it went bankrupt was 1997. This was not atypical: before Enron collapsed, the SEC’s Finance Division was checking only 1 in 10 annual reports filed with the commission. (See “Financial Oversight of Enron: The SEC and Private-Sector Watchdogs”, Report of the Staff to the Senate Committee on Governmental Affairs, October 8, 2002).

As the GAO reported last March, not only has the SEC’s meager resources hamstrung its ability to serve as the cop on the corporate crime beat, but it also has the potential to hurt the economy: “[C]ritical regulatory activities such as reviewing rule filings and exemptive applications and issuing guidance have suffered from delays due to limited staffing. According to industry officials, these delays have resulted in foregone revenue and have hampered market innovation.” (“SEC Operations: Increased Workload Creates Challenges,” GAO-02-302, March 2002)

Unless the resources made available to the SEC are increased, this situation is likely to continue. This past year the SEC filed a record number (598) of enforcement

actions, 100 more than the previous fiscal year. Concerning financial fraud alone, the SEC brought 163 cases involving allegations of improper accounting, inadequate or misleading disclosures, or outright financial fraud by public companies, their officers or employees, more than double the number filed the previous year (79). These numbers can't begin to convey the resources the agency will require to bring these cases to trial.

Moreover, the regulatory agency has suffered in recent years from high turnover - twice the overall government average at critical positions such as attorneys, accountants and examiners. While the markets were exploding from 1992 to 2001, the size of the SEC's enforcement staff grew only 11%, or from 918 to 1014 people. This staff is responsible for enforcing securities laws for close to 700,000 brokers with Series 7 licenses, 14,000 publicly traded companies, 7,900 brokers/dealers, and 34,000 investment company portfolios.

Although the bipartisan-approved Sarbanes-Oxley law authorized a \$776 SEC budget for 2003, attempts have been made to delay this increase until 2004. Any delay in appropriating this bipartisan-approved increase in the SEC's budget appropriations process will surely hinder its ability to meet the requirements of Sarbanes-Oxley.

Facilitate a cultural change in corporations with incentives for long-term planning. By now it is well recognized that options were the steroids of corporate greed, motivating executives towards planning for short-term growth at the expense of long-term value. As the *Wall Street Journal* reported on December 17, "in a handful of cases, over-reliance on expected option wealth led desperate executives to commit fraud." ("Options Frenzy: What Went Wrong?" by Matt Murray, *Wall Street Journal*, December 17, 2002) And as Alan Greenspan observed, "the incentives [options] created overcame the good judgment of too many corporate managers. It is not that humans have become any more greedy than in generations past. It is that the avenues to express greed had grown so enormously." (Gretchen Morgenson, "Bush Failed to Stress Need to Rein In Stock Options," *New York Times*, 7/11/02.)

Former Federal Reserve Chairman Paul Volcker has suggested that options be eliminated as a form of executive compensation. At a minimum, options should be redesigned in order to make them more accurately reflect and reward executive performance. (Such proposals include indexing the strike price to the Dow or Nasdaq). Outgoing SEC Chair Harvey Pitt said in a speech at the National Press Club in July that he considered it inevitable that publicly-traded companies will have to treat stock options as an expense. As a member of the International Organization of Securities Commissions, the SEC should adopt the International Financial Reporting Standards for Share-Based Payments proposed by the IASB in November. This is one case where global standards can result in a "harmonizing up" of U.S. standards. The SEC should also require that executive compensation packages (including any "re-pricing" of options) be put to a shareholder vote.

Support market transparency by improving corporate disclosure requirements. A fair and efficient securities market depends on good information and thorough disclosure. When companies like Enron and WorldCom can conceal the true nature of their finances, investors are the true losers. The new SEC chairperson must be dedicated to disclosure, both by enforcing the new rules in the Sarbanes-Oxley Act and expanding disclosure standards. For example, as Sen. Charles Grassley (R-Iowa) suggested last October in a letter to President Bush, companies should be required to disclose to investors what they paid in federal taxes, since the profits reported to the IRS and to shareholders often vary greatly. Disclosure should also extend to environmental and social impacts and liabilities, which will allow investors to make better-informed decisions and protect them from being blind-sided by hidden liabilities. (For more information see www.corporatesunshine.org). This information is very important to the growing sector of socially-responsible investors, which now accounts for one out of every eight dollars invested.

Support new laws that make it easy to prove aiding and abetting liability in private lawsuits under Section 10(b) of the Exchange Act. As Columbia Law Professor John Coffee has explained, a key factor behind the recent corporate crime wave was the diminished threat of civil lawsuits against corporate financial fraudsters and their co-conspirators. This was the direct result of the Securities Litigation Uniform Standards Act of 1998 ("SLUSA") and the Private Securities Litigation Reform Act of 1995 ("PSLRA"), which established a difficult standard of proof, imposed a freeze on plaintiffs' ability to discover evidence until much later in the legal process, and replaced "joint and several" liability with "proportionate" liability. ("The Enron Debacle and Gatekeeper Liability: Why Would the Gatekeepers Remain Silent?" Testimony by Professor John C. Coffee before the Senate Committee on Commerce, Science and Transportation, December 18, 2001) Therefore we believe that the new SEC chairperson should be committed to strengthening the legal rights of defrauded investors by supporting the repeal of the Private Securities Litigation Reform Act of 1995 (PSLRA).

Support and enforce a complete ban on non-auditing work by accountants. We know that the recent accounting scandals were in many cases facilitated by auditors who went easy on the books because they didn't want to jeopardize other business with the same client. Although the Sarbanes-Oxley Act prevents accounting firms from providing various services to their publicly-traded clients, including bookkeeping, information-system design and appraisal and valuation work, the law still allows auditing firms to sell some non-audit services to clients. Although some of our groups will submit comments regarding the SEC's new auditor independence rules, we believe it is important for the new SEC chair to recognize that Sarbanes-Oxley doesn't go far enough. If we want honest financial accounting we need to eliminate all possible conflicts of interest. That includes barring audit firms from providing any other services to their auditing clients, as well as providing other arms-length safeguards, such as prohibitions on auditors going to work for their former clients for a specified period of time. The responsibility for appointing, evaluating, disciplining, dismissing and paying auditors should ultimately reside in an entity independent of the companies being audited.

To demonstrate his or her ability to restore investor and public confidence in our markets we believe the new SEC chairperson will need to demonstrate his or her support for these critical reforms.

Sincerely,

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