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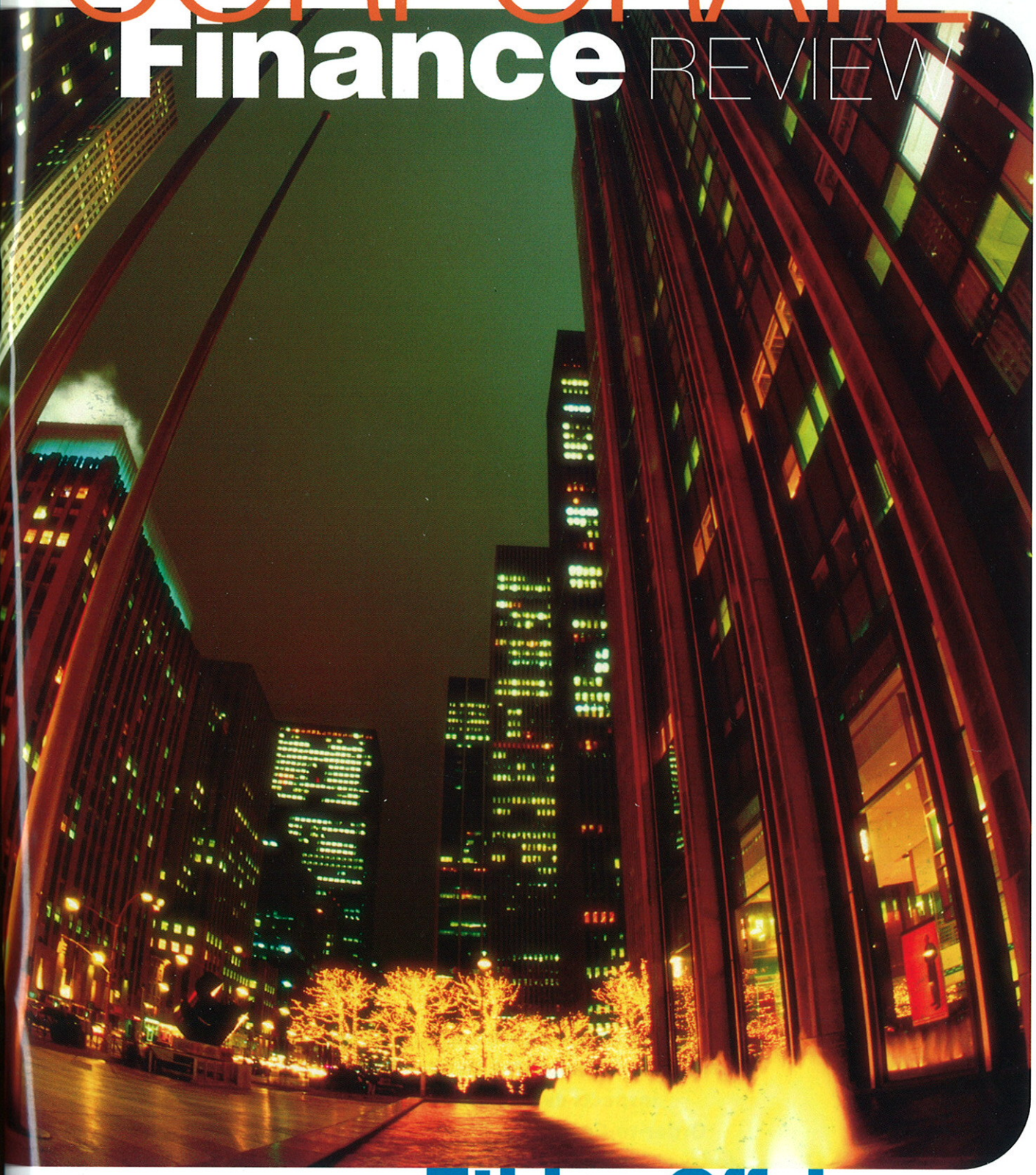

Ethics Offshore

Foreign Exchange and the US Dollar

Strategic FCPA Compliance:
The Role of Continuous Monitoring as a Proactive Control

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THE SPECTACLE OF THE MARKET COLLAPSE INQUIRIES

In ancient Rome, once the western world's undisputed capital of politics, government, commerce, culture, and entertainment, there was often an uneasy truce between the rulers and the empire's population. To divert the populace's attention, the emperors would frequently present spectacles—burly battle-hardened gladiators pitted against each other or perhaps even ferocious animals; there would parades of captives and treasures carried to Rome from far-off lands; and then there was always the "circus" (named for a giant circular amphitheater built between the hills of Rome) where spectacular performances of all kinds titillated the senses of the Roman people.

"Let the games begin!" the cry would go up in the wondrous cathedral of sports, the Colosseum, and the population would thus be temporarily diverted from the cares of the day as the battles began.

And so it is today, twenty centuries later in modern America. The circus has begun, in terms of delving into the root causes of the over-speculation and chicanery that brought down the mighty gladiators of Wall Street and finding the guilty parties. We have been here before, historians remind us daily in various print and electronic commentaries, in previous decades and centuries.

The circus, twenty-first century

The usually predictable onslaught of a serious crisis in the US financial markets, or in the national economy, may follow this course:

- A crisis occurs (think of the October 1929 crash, or the present-day credit seizure crisis that began in February 2008), and individuals and business organizations are immediately and dramatically affected.
- Once the dazed leaders and supposed market overseers are able to recover, they begin asking, What happened? Who did this? How can we prevent this from happening again? How should we punish the guilty?
- And so the serious inquiries begin. Many times this becomes the modern day version of the Roman Circus. Commissions are formed; inquiries are organized at the highest levels of government. Government officials gnash their teeth and express their wrath and posture for the electorate—even those who looked away as the previous laws they passed were violated or ignored. The supposed "guilty" are summoned to the hearing room; today, these events will be televised, web casted, Twittered events. The circus is broadcast by digital means to every corner of the nation, as well as the globe.
- The list of potential reforms is drawn up; *this must never happen again*. The proposals are immediately attacked by a modern corps of twenty-first century gladiators: paid lobbyists battling for supremacy in the deliberations going on in the Congressional committees.
- Proposed reforms go through a tortured process that in the end really

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satisfies no one and neither "cures" the problem, nor can effectively serve as a preventive for the next time around. The Congress negotiates a course toward the adoption of new statutes and amendments of old laws.

- Then the public process begins anew; the new laws must be hammered into enforceable regulations. After weeks of consideration and public process, the regulatory agencies (also created by statute) will have a set of rules and regulations to enforce. (The agencies to enforce the measures include the Securities & Exchange Commission (SEC) for many capital markets activities; the Federal Deposit Insurance Corp for banking; and the Commodity Futures Trading Commission among the leading regulators; in the current crisis we can expect to see new agencies authorized, further confusing the regulated as well as the regulators.)
- The professional membership organizations for such disciplines and functions move into high gear to meet the needs of their constituencies—including those serving the corporate executives (the Financial Executives International); investor relations officers (National Investor Relations Institute); and of course, the American Bar Association and its various sections and committees for the corps of lawyers who will feast at the banquet of new regulations set before them. (The United States is a *nation of laws,* we are constantly reminded. Never stated overtly is that these laws are frequently ignored, bent, or violated when huge capital flows are at stake.)
- An army of consultants creates advisories, workshops, conferences, and other learning devices to inform clients and potential clients of the real and potential consequences of the new laws and regulations. Publishers will commission books and magazine articles on the new environment—thus this column was born after the Sarbanes-Oxley Act (SOX) was ushered into law.
- Meanwhile, the Wizards of Wall Street will be fashioning still newer products and services to keep the magic going in the capital markets. After SOX we saw investors of all stripes and types rush to embrace credit default swaps, collateralized mortgage obligations, exotic derivatives of a bewildering array, and other innovative approaches enthusiastically marketed by, well, the *disappeared* . . . Merrill Lynch, et al.
- And in time, perhaps very quickly in the scheme of things, we will hear that *this time it will be* different. That these Wall Street and banking innovations meet investor needs. While others will proclaim that the laws and regulations and enforcement actions will always lag the market's innovations.
- And then, predictably enough, investors will gradually lose their caution; the captains of industry and mighty enterprises will once again relax their risk management; the populace's attention will be diverted (there is always another circus in American life); outsized returns will be pursued by all types of investors; outsized rewards for the innovative will be granted. And as caution is abandoned to the winds (in the late stages of the bubble) the wisest and most experienced will climb on the circus wagon, to the cheers of the crowds. For a time.

This is not a pessimistic view of the US capital markets. Some things are done right; after all, as much as half of the world's $200+ trillion of capital market wealth is situated in the United States markets. The total holdings of individual retirement accounts alone in the US are more than the US hedge-fund industry's holdings. In this millennium, the American capital markets are the eighth wonder of the world, and yet they are also subject to the most dramatic and calamitous events, affecting billions of people in the United States and around the world.

IN THIS MILLENNIUM, THE AMERICAN CAPITAL MARKETS ARE THE EIGHTH WONDER OF THE WORLD, AND YET THEY ARE ALSO SUBJECT TO THE MOST DRAMATIC AND CALAMITOUS EVENTS.

CONGRESS HAS CREATED A TEN-MEMBER FINANCIAL CRISIS INQUIRY COMMISSION THAT WILL BEGIN HEARINGS THIS FALL.

And so the questions are on the table in the declining days of 2009: What happened? Who did this? How can we prevent this from happening again? How should we punish the guilty?

Let the games begin!

In the wake of the US markets' meltdown, a study group was formed, headed by two former chairs of the SEC: Arthur Levitt, Jr. and William H. Donaldson. At its first meeting in April 2009, the Investors' Working Group (IWG) examined current political and special-interest pressures placed on the Financial Accounting Standards Board (FASB) to change fair value accounting standards. The IWG found this threat to the FASB's independence "unacceptable and very troubling."

Consider that the FASB was a creature of the US Congress back in the early 1970s and was granted special powers by the Congress when SOX was passed in 2003 (only the FASB and the SEC can issue new accounting rules under SOX). Although the chairman of the House of Representatives' financial markets oversight committee declared that the Congress would not interfere in the setting of accounting rules, he and the committee then did just that by bowing to the financial-services sector's demands for a relaxation of the fair market value rules (i.e., "mark-to-market" valuations). In the first quarter following this, American banks recorded profits, which investors and analysts immediately mocked.

The Investors' Working Group issued a report (sponsored by the CFA Institute Centre for Financial Market Integrity and the Council of Institutional Investors (CII), which set out the framework for the focus or near-term "reforms":

> Strengthening and reinvigorating existing federal agencies responsible for policing financial institutions and markets and protecting investors and consumers. . . . The will to regulate must be restored. Light-touch federal regulation has met with disastrous results, as has starving agencies of needed resources. For example, the U.S. Securities and Exchange Commission's (SEC) funding has not kept pace with the explosive growth of the securities markets over the past two decades.[1]

The IWG set out recommendations for specific areas of investor and consumer protection:

- Strengthening existing federal regulations (and regulators);
- Closing the gaps for products, players and gatekeepers;
- Addressing securitized products; and,
- The necessary oversight of hedge funds, private equity, and investment companies.

The Commission is coming!

And an official inquiry is born: Congress has created a ten-member Financial Crisis Inquiry Commission (FCIC) that will begin hearings this fall. The commission head is Phil Angelides, formerly California state treasurer, whose state is now in very serious financial condition with billions of dollars of debt; the California treasury is just about bare and as we write this, there are 300,000 IOUs outstanding representing billions in unpaid monies owed to individuals and businesses.

The FCIC will hold hearings—and haul in the presumed or alleged guilty parties to testify in the glare of the public spotlight—on more than twenty areas related to the current financial crisis. These include fraud or abuse in the financial sector; the condition (and need for) state-level and federal regulatory enforcement; the activities of the small corps of credit risk rating agencies (Moody's, Fitch, S&P); corporate governance; executive compensation; and more.

Reminiscent of prior hearings in 1932 headed by a former New York State prosecutor, Ferdinand Pecora, "the FCIC will examine the downfall of major financial institutions and what caused them to fail" (quoting the Commission). Those hearings over seven decades ago led to the establishment of the FDIC, and the Glass-Steagall Act, which separated investment banks/brokerages and depository (commercial) banking. In 1999, that act was dismantled and replaced by the Gramm-Leach-Blilely Act, from which many governance experts trace the current market debacle as banking and invest-

ment banking services once again merged under the unitary managements of bank holding companies. (As commentator Ariana Huffington has asked, "why not just reinstate Glass-Steagall as a starting point of reforming the system?")

Speaker of the House Nancy Pelosi indicates that the commission's deliberations could go on well into 2010 when the specifics of securities and banking legislation will emerge from the mists of legislative process. (Many of the same committee members are dealing with another crisis in the United States: addressing health care system reforms.)

And so the first decade of the twenty-first century nears to a close, the IWG, the FCIC, and other public and semi-public forums are focusing the nation's attention on ways to define the problems that occurred and still exist in the capital markets and the measures that need to be taken: address risk management; restore investor and consumer trust; develop effective new or enhanced market regulations; ensure that such market calamities as the 2007–2009 market crash do not happen again; create greater transparency in the markets; restore the flow of capital; extend regulation to newer elements of the markets (such as hedge funds and private equity) . . . and more.

All this, a "once-in-a-generation reform effort," in the words of Kurt Schacht, managing director of the CFA Institute Centre for Financial Market Integrity.

Hear ye now, citizens of Rome and the world: The games have officially begun! ■

NOTE

[1] *U.S. Financial Regulatory Reform: The Investors' Perspective: A Report by the Investors' Working Group* (July 2009): 1. Currently available on the IWG's homepage: http://www.cii.org/iwgInfo.