

# Verbatim

## The Ex-Men

Three former  
SEC chairmen  
discuss  
striking the  
right  
regulatory  
balance.

*Former Securities and Exchange Commission chairmen are a little like ex-presidents: they generally leave public office to pursue endeavors outside the shadow cast by their former role, they are occasionally asked to weigh in on issues of the day, and they generally refrain from heaping too much criticism on each other or the current administration. In December, at the Directorship Institute, an annual gathering of directors and corporate-governance experts, three former SEC chairmen—Richard Breeden, Harvey Pitt, and William Donaldson—let down their guard a little and engaged in a friendly debate on the current regulatory environment.*

*Breeden, who since 2006 has managed a hedge fund from which he serves as one of the country's most assertive activist investors, recently secured a large stake in jeweler Zale Corp. and last fall was named chairman of the board at tax firm H&R Block.*

*Now a partner at Kalorama Partners in Washington, D.C., Pitt is credited with working to reopen the financial markets in the wake of 9/11 and began the SEC's efforts to implement Sarbanes-Oxley.*

*Pitt was succeeded by William Donaldson, whose own storied career includes co-founding the investment bank Donaldson Lufkin & Jenrette, serving as chairman and CEO of the New York Stock Exchange, and helping to found the Yale School of Management.*

***Hedge funds, private-equity firms, and now sovereign wealth funds are estimated to control about \$20 trillion, or will in the next five years. Are the federal securities laws and the SEC, in particular, equipped to deal with them?***

**Pitt:** We need a significant overhaul of our approach to financial markets. We are working on models that are more than 70 years old, and as I get closer to the age of 70, I'm less willing to criticize that, but I do believe the federal securities laws are being tortured and twisted. The marketplace today not only consists of different investors, it consists of different instruments. If you look at the subprime market, which is now the cause of so many problems, what you have is a marketplace that should have evolved,

and did evolve, and was creative, but also had players taking unprecedented risks. The very bright people who created that market weren't capable of assessing just how leveraged they were, or how much risk they had incurred, and there was no government body that said, "What we really need is an independent economic analysis of what's going on in this market."

**Donaldson:** I totally agree with Harvey. Our institutions were set up a long time ago; the kinds of instruments out there now don't fit into neat categories the way the SEC and the Federal Reserve do. The subprime problem, for example, fell between the regulatory authorities. I would say that the Federal Reserve, in many ways, has lost control. It used to be able to exert control over instruments out there through the banking system, but they've lost control of that. Also, we're going to have to face up to our own regulatory structure in terms of coming up with some sort of global regulation. If not, we are going to have a running to the lowest common denominator and there could be serious trouble in our global capital markets.

**Breeden:** I don't think it's the age of the system that's the problem. The U.S. constitution has been with us a lot longer than the securities laws, and it's still serving the country pretty well. I think the bigger danger—and risk—is if institutions lose sight of the values that gave rise to their birth.

The SEC, like the Federal Reserve, is a unique institution. It's a government agency that was created, in large part, to give voice to values, transparency, fairness, and equal access. If it ever forgets those values, and that its mission is to protect shareholders and capital markets, then we'll need a change in the laws.

I'm an optimist. I hope the Commission continues to be the truly unique institution it has always been...We all have a stake in trying to keep the SEC healthy and vibrant. But the most important regulator of every company is its own board of directors. They're the people who should be worried about short-term and long-term risk management, and seeing around corners and being ready. If we have great boards, the regulatory system will sort itself out.

**What do you think of the current regulatory environment?**

**Breeden:** I'm focused much more on individual investments these days...and we invest in badly performing companies, so if you don't want Breeden Partners as an investor in your company, just stay in the top half of performance. Should you fall into the southern hemisphere, expect to get a call, if not from me, then from Ralph Whitworth, or from any of the other so-called activist shareholders.

I'm a little biased, but one of the good developments over the last couple of decades has been firms that focus on badly performing companies who say, "Look, we don't all have to stand back and wait until they go bankrupt and wait until a lot of people lose their jobs and a lot of collateral damage is done. Let's get in, figure out what's wrong with that company, and fix it."

**Pitt:** My impression of governance is that people are paying more attention to it, but it's not yet clear whether everybody's gotten the message. Recent events raise very disturbing questions. When we see two of the largest financial services organizations [Citigroup and Merrill Lynch] fail to have a viable succession plan in place when an emergency occurs, that is shocking to me. And that is what corporate governance is really about: It's about protecting the values in a corporation, and it seems to me that the most critical factor confronting directors today is the question of risk assessment, risk

management, and learning what their companies do and what the issues are, and learning to ask the right questions.


When a company loses \$11 billion in a short period, that cannot be the fault of only one or two individuals. It has to be the fault of more people than that. Somebody should be asking, "How did we get here? How did these things happen? Why did they happen? What can we, as directors, do to improve our ability to perform in advance?"

**Many believe shareholder activism, coupled with post-Enron reforms, has swung the pendulum too far, creating an environment where there is undue emphasis on short-term performance. Critics say directors are being stripped of their role to govern the company on a long-term basis. How would you respond to that?**

**Breeden:** Poppycock! That's not the world I live in. If the arrival of an impatient shareholder disturbs the tranquility of a board member who's been collecting his fees for a number of years and maybe not doing such a good job, that's just too darn bad. Boards should be more

open to listening to real shareholders. They should see themselves as independent of the executive and have their own leadership. That doesn't mean you do what every cranky shareholder asks, but you should always listen, and your actions should be predicated on a thoughtful analysis. Ask yourself, "What's the best interest of this company in the short, medium, and long term?"

**Has short-termism been allowed, to borrow a phrase, "run amok"?**

**Donaldson:** I think that we are in a serious period of short-termism. There's too much emphasis on quarterly earnings, and too much time figuring out what quarterly earnings are going to be. And the reason is that directors have not aligned management incentives with long-term goals. I've seen many surveys of managers who say they would sacrifice short-term investment to make their quarterly earnings. It's not just corporate managers who are responsible for this: it's investors, institutional investors, and institutional research people. 



Harvey Pitt (left),  
Richard Breeden,  
and William  
Donaldson