

Financial Reform Legislation Improvements Still Needed
Investors' Interests Only Served in Few Key Areas

New York, January 4, 2010 –[The Investors' Working Group](#) (IWG) stated today that “it is pleased that the House of Representatives’ “Wall Street Reform and Consumer Protection Act of 2009” includes a number of changes we suggested in our report, “[U.S. Financial Regulatory Reform: The Investors' Perspective](#)” (PDF). However, while the bill includes many important improvements, investors want significant upgrades to provisions relating to SEC funding; systemic risk oversight; over-the-counter derivatives; private fund regulation; nationally recognized statistical rating organizations (NRSROs); and corporate governance. We are hopeful that the following suggested improvements will be given careful consideration by the members of the Senate Committee on Banking, Housing, and Urban Affairs as they begin to consider the “Restoring American Financial Stability Act of 2009.”

SEC Funding: The House bill includes a provision that provides the SEC with an increased budget. In contrast, the Senate discussion draft provides the SEC with a self-funding mechanism.

Investor Reaction: The IWG believes that the SEC should have both (1) more stable long-term funding and (2) a self-funding mechanism that maintains sufficient resources and enhances independence. The SEC’s funding has simply not kept pace with the explosive growth of the securities markets over the past two decades. Today, the agency monitors 30,000 entities, including more than 11,000 investment advisers, up 32 percent in only the last four years. Even so, from 2005 to 2007, the SEC’s budgets were flat or declining. On occasion, the Commission has shown reluctance to exercise its authority in certain areas out of fear of political budget retaliation.

It is no coincidence, therefore, that these pockets of poor oversight proved to be sources of great risk. Sufficient, stable, long-term funding that is removed from the Congressional appropriations process is critical to strengthening the independence and effectiveness of the SEC and would address one of the major contributing factors to the financial crisis.

Systemic Risk Oversight: The House bill creates a Financial Services Oversight Council, while the Senate discussion draft calls for an Agency for Financial Stability. In both cases, the Fed, the Treasury, and the same functional regulators who failed to prevent systemic failure in recent years would play significant roles. The purpose of both would be to track market activity and, where appropriate, take action to reduce risk and increase regulatory oversight, particularly for firms that could pose a threat to financial stability.

Investor Reaction: The IWG believes both approaches fail to address the need for an independent and robust review of risk factors that could lead to systemic failure. To achieve this level of independence, the IWG has proposed a Systemic Risk Oversight Board (SROB) that would be supported by an independent full-time staff and panel of experts to help it provide unbiased and informed perspectives on market risks.

Regulation of Investment Managers: The way in which both houses of Congress are handling oversight of asset managers is truly a mixed bag. While the House bill requires a single fiduciary standard for all parties providing investment advice, it exempts hedge funds with less than \$150 million of assets under management from SEC registration. The Senate’s discussion draft eliminates the broker/dealer exemption under the Investment Adviser’s Act, while at the same time calls for a study of whether a

single fiduciary standard is feasible and beneficial. On the other hand, the draft does require hedge funds both to register with the SEC and to report their positions to the Commission.

Investor Reaction: The unregulated activities, lack of transparency, and questionable practices of these private asset management firms continue to be significant concerns to investors. The omission of a registration requirement may ultimately delay the kind of true market reform that investors want.

To overcome these concerns, the IWG urges the Senate to serve investor interests by requiring all investment management firms, including private fund managers, without regard to size or domicile, to register with the SEC and be subject to oversight. Ultimately, this will help regulators understand the overall risk exposure of these firms and help the SROB monitor systemic risk issues more effectively.

OTC Derivatives: Provisions of the final House bill dealing with over-the-counter derivatives closely reflect the proposals contained in the Senate discussion draft. In both cases, a potentially large number of derivative transactions, including certain swaps, remain exempt from exchange-trading and central-clearing requirements. The customized instruments that benefit from these exemptions would, at best, only have to report on their pricing to a swap repository.

Investor Reaction: The IWG report expressed investors' concerns about the lack of oversight and controls for many customized derivatives. The report expressed the need for a more transparent and regulated market than the one that currently exists, with very limited exceptions to the requirement for all standardizable contracts to trade on exchanges and to clear centrally. The IWG urges the Senate to ensure that its final bill takes a more comprehensive approach to federal oversight of all derivatives, one that includes enhanced transparency and capital requirements for derivative activities.

NRSRO Oversight: The House bill and the Senate's discussion draft include a number of important provisions regarding NRSROs, including provisions that increase internal controls, require greater transparency of rating procedures and methodologies, provide the SEC with greater enforcement tools, and provide for SEC examination of NRSROs.

Investor Reaction: The IWG generally supports the provisions of the House bill and Senate discussion draft on NRSROs. However, we note that the House bill, in contrast to the Senate's discussion draft, includes a provision that renders credit rating agencies experts subject to Securities Act liability in the same manner as accountants and other parties when ratings are included in a registration statement. We believe this provision would make rating agencies more diligent about the ratings process and, ultimately, more accountable for sloppy performance. As the discussion draft is improved, we are hopeful that the Senate will incorporate this valuable provision in the legislation.

Corporate Governance: The House bill and the Senate's discussion draft appropriately amend the federal securities laws to affirm the SEC's authority to promulgate rules allowing shareowners to place their nominees for directors on the company's proxy card. The House bill, however, unlike the Senate

draft, fails to include a provision that would require directors to be elected by a majority of the votes cast.

Investor Reaction: The IWG generally supports the House bill and Senate discussion draft's analogous provisions to reaffirm the SEC's authority to issue a uniform proxy access rule. Those provisions would reduce the unnecessary legal costs that would likely otherwise be incurred in connection with the SEC's issuance of a final uniform proxy access rule. A uniform proxy access rule is necessary to effectuate shareowners' fundamental right to have the ability in appropriate circumstances to place their nominees for director on companies' proxy cards.

The IWG also believes it is critical that any regulatory reform legislation also include a provision, similar to that contained in the Senate draft, requiring that directors be elected by a majority of the shareowner votes cast. Such a provision would help eliminate "rubber stamp" elections that effectively prevent shareowners from removing those directors that fail to fulfill their oversight responsibilities.

Both the reaffirmation of SEC authority and majority-voting provisions provide investors with basic tools to better hold corporate officers accountable for their actions—a necessary component of any effective reform of the U.S. financial regulatory system.

About the Investors' Working Group

Launched in February 2009, the Investors' Working Group (IWG) is an independent panel formed to provide the investors' voice in the ongoing national debate about overhauling the U.S. system of financial regulation. This diverse, non-partisan panel of experts is co-sponsored by the Council of Institutional Investors and the CFA Institute Centre for Financial Market Integrity. It is co-chaired by former SEC chairmen Arthur Levitt and William Donaldson, CFA.