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Regulating Broker-Dealers & Other Investment Entities

Co-Moderator Mark Lilling

APRIL 20, 2009 - NEW YORK -The Vincent C. Ross Roundtable (Stern NYU) convened a distinguished panel of leaders representing academia, financial institutions, the accounting and legal professions as well as regulators to analyze the role of regulation in the current crisis and discuss measures to both stabilize current markets and avoid a future collapse.

The public has alleged that lack of or improper regulation has recently caused adverse effects in our economy. The roundtable of experts addressed the merits of these allegations and what concrete steps policy makers as well as accounting standard setters can and should take to mitigate these effects.

Professor Seymour Jones (NYU Stern) provided the foundation for the discussion by asking: "Do we need more regulation? What kind of regulation are we talking about? Stop talking about the problems and start solving them."

Mark Lilling (Lilling and Company, LLP) said he was a strong proponent of proposed legislation for PCAOB oversight of brokers and dealers. He supported his views based on the fact that broker and dealers are currently responsible for approximately five billion shares of NYSE & NASDAQ shares.

Arthur Felsenfeld (Andres Kurth LLP) answered the question of why we care if wealthy individuals put their money into risky and unregulated hedge funds. The definition of client has included funds. Funds include pensions, universities, and charities which translates into thousands of individuals. Furthermore, a market position of $1.8 trillion (2008) puts the entire financial system at risk. The proposed regulation that will include more companies is a step in the right direction, but ongoing oversight is of major import.

Prof. Roy C. Smith (NYU Stern) noted that the repeal of the Glass-Steagall Act paved the way for regulatory forbearance and the current relaxation of fair value rules bolsters accounting obscurity. In his opinion, the collapse of high standards makes it more difficult to get back to normal. What is needed is to de-conglomerate banks.

Charles Niemeier (PCAOB) posited that poor lending practices, executive compensation schemes, and off-balance sheet accounting that permitted risk to be hidden were the culprits in the current crisis, and not fair value accounting. He urged legislators to carefully address the issues to avoid adding time-consuming efforts that provide little or no benefit.

Prof. Stanley Siegel (NYU Law) predicted changes in regulation at the federal level. The focus should be on preemptive measurements; the justice system is costly with inefficient time lags. The Efficient Market Hypotheses,

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rational decision making, and the assumption that management's objective is to increase shareholders' wealth are naïve assumptions that do not mimic reality. Failure to use fair values and fully disclose risk is a recipe for failure. Carefully crafted regulation and enforcement of capital levels, conflicts of interest, and executive compensation is needed.

Michael Koblentz's (Mound Cotton Wollan & Greengrass) Madoff encapsulation included what should have been a red flag to auditors: $17 billion in assets with only 23 clients. Lack of training by SEC auditors, reliance on reputation, and the use of feeder funds all played a major role in the debacle. He strongly urges merger of the regulatory agencies to achieve systematic risk regulation.

John Biggs (NYU Stern) commented that 10% of GDP is comprised of insurance premiums. Industry giants, e.g. AIG, too big to fail, are regulated by the state. We need appropriate regulators for complex institutions that carry enormous risk. To avoid further economic consequences, the industry should be regulated at the federal level.

Prof. Miklos Vasarhelyi (Rutgers U) said we are using stone-age tools to measure highly- complex systems. He noted that the Dutch government adopted XBRL making it possible to collect, record and exchange financial reports more efficiently and to record data once only. Analytic technology must be placed in the hands of more staff, and indices that achieve standardized measures must be put into place.

In the discussion that followed there was a consensus of opinion that there have been rampant inefficiencies in communication and oversight. Although not everyone agreed that increased regulation is required, the importance of upgrading the caliber of regulators and the enforcement team was uncontested. Does President Obama have the power to put the new rules into place? The power of executive action should not be underestimated.

"Do we want such a powerful president?" (Sy Jones). "Rest assured, that Barack Obama will follow the rule of law" (Stanley Siegel)

This Ross Institute Roundtable was made possible by the generous support of Mark Lilling and The Audit Committee Consulting Team LLC (ACCT).