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## Ross Roundtable Debate: Regulate Broker-Dealers and Investment Entities?

APRIL 20, 2009 - NEW YORK -The debate surrounding the regulation of broker-dealers, hedge funds, private equity firms and other investment entities is heating up as government officials and the media continue their pursuit of "who's to blame" for the economic crisis. On April 20, academics, practitioners, industry experts and representatives from the press gathered for the NYU Stern Ross Roundtable on "Regulating Broker-Dealers and Other Investment Entities."


FROM LEFT TO RIGHT: STANLEY SIEGEL, MARK LILLING, SEYMOUR JONES.

Stern Clinical Professor Seymour Jones and co-host Mark S. Lilling, CPA (BS '72), president and chief executive of the CPA firm Lilling & Company LLP, fostered a discussion on whether or not regulation has produced adverse effects on the economy, and what steps policy makers and accounting standard setters should take to mitigate those effects.

"The aim of regulation should be to prevent, not to punish," said Professor Jones. "And it seems to me that before now, that hasn't been the case."

Arthur Felsenfeld of the law firm Andrews & Kurth LLP pointed to the broad impact of hedge fund failures, including damage to market prices and the negative effects on the financial system as a whole. Despite Senator Grassley's efforts to impose new regulatory measures on all investment companies, Felsenfeld expressed concern about federal agencies not having the resources to evaluate each and every hedge fund. He argued that risk management systems need to be bulked up, which could be good news for auditors.

Stern Professor Roy Smith discussed regulatory forbearance and why regulators often look the other way from unsavory dealings for fear that investors might remove their money from banks if they knew what was going on. He pointed to the conglomeration of banks as a key part of the problem in today's financial sector, and called for "de-conglomeration."

Board member of the Public Company Accounting Oversight Board (PCAOB) Charles Niemeier argued, "We need to identify risk and understand it, so that we are forced to address it." He cited several lessons learned from the current economic crisis: Models work until they don't. Liquidity does matter. Don't shoot the messenger. The culprit is off-balance-sheet accounting.

Professor Stanley Siegel of the NYU School of Law asked, "When will directors be held accountable for stupidity, and not just unlawfulness?" He pointed to a central theme in the current regulatory framework — disclosure — and argued that there are several issues with this approach:
1. Flaws in accounting 2. An inaccurate assumption that the market is rational and profit-seeking 3. A naïve assumption that management and incentives always work toward favorable shareholder outcomes.

"SEC auditors aren't trained today," said Michael Koblenz of the law firm Mound Cotton Wollan & Greengrass. "And that's partly to blame for the Madoff scandal." Koblenz urges Congress to "beef up" its staff of regulators and to pay them better wages.

Stern Executive-in-Residence and Former Chairman of TIAA-CREF John Biggs turned the spotlight onto the regulation of complex institutions, citing AIG and GE as examples. He argued that the collapse or failure of such large institutions bears huge systemic risk, and that oversight of such large institutions by the Office of Thrift Supervision is not adequate.

Stern Professor Joshua Ronen argued that the probability of enforcement is crucial in the effectiveness of regulation. He proposed a system that creates incentives, encouraging honesty, transparency and a reliance on high quality of auditors and rating agencies.


MARK LILLING

Miklos Vasarhelyi of Rutgers University called attention to the fact that auditors are measuring risk and evaluating investments using "stone-age tools." He stressed the need for analytic technology to simplify and expedite the auditing process.

Stern Visiting Scholar Kim Schoenholtz argued for the development of new regulation based on the principles of consumer protection and the prevention of systemic impact on the financial systems.

Mr. Lilling offered some closing remarks: "We've been through these crises before, and regulation is always chasing after the crisis. It seems to me that we never fix the problem."

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