# Corporate America and Congress: Has Sarbanes-Oxley Restored Investor Confidence?

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Panelists: Senator Chuck Hagel (R-NE), Chairman, Subcommittee on Securities and Investment; John J. Castellani, President, Business Roundtable; William J. McDonough, Chairman, Public Company Accounting Oversight Board; Alyssa Machold Ellsworth, Managing Director, Council of Institutional Investors

IAN KELLER (vice president, U.S. News & World Report): Good morning. I am Ian Keller, vice president of U.S. News & World Report. I would like to welcome you to this morning's National Issues Briefing entitled, "Corporate America and Congress: Has Sarbanes-Oxley Restored Investor Confidence?"

I would also like to welcome you to the National Press Club, where our National Issues Briefings have been held since their inception. Our alumni include senior administration officials, members of Congress, and leaders from business, think tanks, and the media who participate with us to discuss a range of topics of national importance. Essentially these briefings allow us to expand, if you will, on the pages of the magazine, with a more in-depth look at often very complex issues. Our moderators are asked to keep the discussion as candid and free flowing as possible in order to get past the sound bites that seem to dominate much of the news coverage today.

I would very much like to extend our thanks to today's corporate sponsor, the Altria Group, who has shown a great interest and commitment to sound corporate governance and accounting practices. And conveniently, it leads me to introduce David Greenberg, senior vice president and chief compliance officer at Altria, who we are pleased to have joining us this morning and who will offer a few welcoming remarks before introducing the panel. Thank you. (Applause.)

DAVID GREENBERG (Altria Group): Thanks, Ian, and good morning. On behalf of the 190,000 employees of Altria Group companies around the world, it is a pleasure for us to partner with U.S. News on today's briefing. We really believe in discussion of complex and important national issues. And obviously, it goes without saying, that Sarbanes-Oxley is complex, important, and vital to the public, the investment community, and corporate America. In fact, last night, many of us watched the White Sox, the Red Sox. But what everyone was really looking forward to was hearing about this SOX. (Applause.)

And since Sarbanes-Oxley was signed into law in 2002, it has probably affected more far-reaching change in corporate governance, financial disclosure, and auditor independence than anything in the last 50 years. It established the PCAOB. It changed the relationship between accounting firms and their clients. It created the CEO, CFO certifications of

financials. It requires the new and sometimes controversial section 404, process on documenting financial controls. And it ensures that companies provide anonymous mechanisms for employees and others to report concerns about financial and auditing matters. I have to say it has been a good thing for the career development of chief compliance officers.

But more broadly, its impact has reached into every public company in America, many private ones, and its impact is even felt in the non-profit sector. To the extent that Sarbanes-Oxley has focused us all on systems to prevent and detect misconduct, that cannot be anything but good as we as society are still dealing with the aftermath of the shocks of the scandals of companies like Enron, Global Crossing, WorldCom, and too many others.

While it is clear there always be a need for tight scrutiny and transparency in our public companies, there is also deep concern, especially among smaller companies, about the costs and complexity of Sarbanes-Oxley. Moreover, there is the question of whether SOX has had unintended consequences: for example, diverting resources from audit committee and senior management oversight to too much process. The bottom line then is that Sarbanes-Oxley is having a tremendous effect on the bottom line, the ability of our nation's companies to compete and ultimately on America's future economic health. And it is for that reason that I am so pleased we have today's panel to discuss the present state of Sarbanes-Oxley and what lies ahead.

We are privileged to have joining us one of the key figures in the Sarbanes-Oxley debate, Senator Chuck Hagel of Nebraska. Senator Hagel serves on four Senate committees. And most important for our discussion today, he is chairman of the Banking Committee's Subcommittee on Securities and Investment.

In addition, we are fortunate to have William McDonough, who of course is chairman of the Public Company Accounting Oversight Board, a job created by the Sarbanes-Oxley Act, a job created by Bill McDonough. Prior to his appointment at the PCAOB, Chairman McDonough served for 10 years as president and CEO of the Federal Reserve Bank of New York.

John Castellani will I'm sure offer a unique perspective from in the trenches on the effect of Sarbanes-Oxley on America's public companies. Mr. Castellani is the president of the Business Roundtable, the association of CEOs of leading corporations, companies with a combined workforce of 10 million employees and $4 trillion in annual revenues.

Also joining our discussion is Alyssa Machold Ellsworth, managing director of the Council of Institutional Investors. The council represents large public, labor, and corporate pension funds, and seeks to address investment issues, the effect, the size, security, and future of planned assets of tens of millions of Americans.

Finally, I am pleased to introduce Brian Kelly, who is out there somewhere -- oh, there he is -- editor of U.S. News & World Report, who oversees the weekly magazine and the U.S.

News website. An author of three books himself and a former editor at The Washington Post, Brian will serve as today's moderator. I know we are all looking forward to this session so without any further ado, let me turn it over to Brian. (Applause.)

BRIAN KELLY (executive editor, U.S. News & World Report): Good morning. Thank you, David. Small correction. I'm the executive editor of U.S. News. The editor is still in bed this morning. (Laughter.) This is what executive editors do.

MR. : (Off mike.)

MR. KELLY: Yeah, right. That is why I'm here and he is sleeping. But that is okay. He would love to be here I'm sure.

I'm going to try to dispense with some of the preliminaries here because this is a really great panel and I think it's a really great issue that just as a journalist, as a reporter, when they asked me to do this I thought, wow, that is a great idea. This is a very ripe topic and I think has only gotten more ripe in the last couple of months. Fascinating on a couple of levels. It is a monumental piece of legislation obviously that was intended to correct a huge problem that was affecting society on many levels in this country.

We have now got three years of tenure on that, and we can look at -- it's a good time I think to evaluate what really transacted, what has really occurred. But I think obviously simultaneously from the -- particularly from the inside-Washington perspective, there is a lot of churn and a lot of motion in the direction of maybe trying to make some changes to this law. So I think on both levels it's a pretty interesting story and pretty interesting subject to pursue.

So what I would like to try to do is engage our panelists as quickly as we can. We had agreed I hope to dispense with opening statements here. We are going to try to throw a couple of quick questions at folks to fix their positions on this and then work from there. I would like -- we obviously would like to hear a general sense of whether they think this has worked. And then I would like to try to move into some of the real practicalities here, which is, is there a need for change in this legislation, what do the constituencies want, what does the competing landscape look like on this, and what are the chances that something actually might change in the next timeframe, whatever that turns out to be. We have got all of the experts who can answer those questions for us here.

So let me, if I can ask to start -- I'm going to start with the senator, in deference, and ask in one paragraph to answer the basic question of this panel, which is has Sarbanes-Oxley worked?

SEN. HAGEL: I think it has worked when you ask the question, which is not always asked when we go forward with prescribing legislation to fix a problem, what is the objective. And that objective is less clear than one would like. But overall, I think Sarbanes-Oxley has worked. It is not any different from any piece of complicated legislation dealing with complicated issues, in that it is in a dynamic sense always in flux and is always in need of

recalibration and reframing. And that means a center of gravity, an equilibrium, which I am not sure we have yet established with Sarbanes-Oxley and I'm not sure we will with some time to come.

The last point I would make. In my opinion, it's important to let the SEC and the PCAOB have an opportunity to play this out. We can, the Congress can, I think over activate and over stimulate, and in a strange way over regulate the regulators. And we have to be careful on this that we don't do that.

MR. KELLY: Thank you, Senator. John Castellani, on behalf of you and your members, has this done what it set out to do?

MR. CASTELLANI: It has. Now, remember that the primary objective when it was being considered was to restore investor confidence in our systems of corporate governance. And I think in that sense our members would agree that it has gone a long way to do that. I think the important thing also is to recognize that there have been other actions that have done the same and helped do the same thing. The new listing standards at the New York Stoke Exchange, and the NASDAQ, which are in part mandated by some of the provisions that Sarbanes-Oxley have also gone a long way of improving transparency and improving governance.

As importantly, the actions of the companies themselves, the publicly traded companies -- remember, while we were talking about scandals that affected all of us, the large majority of companies year in and year out have been doing the right thing in a transparent way on behalf of their investors, their shareholders, their customers, and their employees. We have seen dramatic actions and dramatic attention over the last three years to improving transparency, to complying with the listing standards, complying with the PCAOB requirements, for complying with the Sarbanes-Oxley requirements in a way that we have seen more change in the last three years than we have seen in the previous 30 years. All of them together have worked.

MR. KELLY: Thanks. Alyssa, I'm going to ask you now, if you could.

MS. ELLSWORTH: Well, I would like to follow up I think on also what John has just been saying, which is that one of the issues that I think we have been seeing is a little bit of a collective amnesia about what really drove Sarbanes-Oxley. And I think it's just worthwhile to point out that we are talking about losses by some estimates -- I think Public Citizen put it at about $236 billion over a short period of time. When you think about that in sort of a more global context, that is more than the GDP of all but the 35 largest countries in the world.

It is worth mentioning that, yes; it is good that Sarbanes-Oxley is in the process of being implemented. I think we have yet to see what certain provisions are going to look like. I know that there is a group now at the SEC that is looking at the impact on small business that you referred to earlier. But we are also still seeing -- how can I say this -- but a new little engine going up the hill, which is that we don't know what it is going to look like

when it is fully in motion. And from the investor perspective, Sarbanes-Oxley has gone pretty far towards patching up a security net that I think was getting a bit frayed. But we certainly wouldn't want to see the next changes only brought about when another scandal hits.

MR. KELLY: Thank you. Bill McDonough, if you can address that.

MR. MCDONOUGH: This may be the first time that I have ever been in a position where I think the placing of the participants is ideological -- (laughter) -- because I'm substantially to the right of the representative of the Business Roundtable, my good friend John Castellani, slightly to the right of my favorite United States senator, Chuck Hagel -- (laughter) -- slightly to the left of this lovely lady, Alyssa. Why do I say that? The reason that I accepted the chairmanship for the PCAOB is that I believe perhaps as fervently as my dear friend Alan Greenspan that the wonders of the American economy is we have the best model and the best private sector in the world.

However, the Congress of the United States, '97, had nothing in the Senate, three negative votes in the House, and a conservative president calling it the most important legislation, securities legislation since 1934. It was pretty clear that these representatives of the American people decided that the private sector had gone a bit astray and thus Sarbanes-Oxley.

It is to protect investors. I believe great progress has been made in doing that. The principle challenge that faces us that Sarbanes-Oxley so far has been very cost effective for issuers that are very, very well managed and have a good, mature relationship with their auditors. For other issuers for which especially the internal control requirement was new and difficult, or for auditors who didn't get it quite right the first year, there has been real cost- effectiveness issue. And I believe that is the one that the FCC and the PCAOB working with the private sector have to devote our attention to improving.

MR. KELLY: Let me stay with you if I can, Bill McDonough, and ask the other -- the real issue at hand with Sarbanes-Oxley was Enron, was the precipitating cause, among other things. But I think that sort of a question people have in their minds is will Sarbanes-Oxley prevent another Enron.

MR. MCDONOUGH: No. It makes it less likely but it does not prevent it. It is the major challenge that we at the PCAOB have and the accounting profession has, and that is can even the best audit in the world guarantee the prevention of fraud, and the answer is no. A good audit will pick up your garden-variety fraud and certainly should. However, if you have, say, four or five tightly organized, thoroughly evil people, they can carry out a fraud.

Now, if you make it less likely and people marching off to jail, and not exactly country club jails, that raises the fear quotient if you say that human beings are driven by some mixture of fear and greed. The fear quotient was very low in the late 1990s and the fear quotient is very high now. But still, at the end of the day, if people are evil enough and greedy enough, and perhaps even dumb enough to think that they can get away with fraud,

they will try it. And the likelihood is lower that we have another Enron. But we would be kidding ourselves to think that it is important.

MR. KELLY: Alyssa, a question that also underlies this is this notion of investor confidence. Do you take that temperature? Can you give us a sense of what you think Sarbanes-Oxley has done for or not done for investor confidence at this stage?

MS. ELLSWORTH: Of course.

It's a little bit hard to screen out for what I'll say is our sort of collective amnesia, and our desire to believe that the few apples have been taken care of and that things are back on track. But I think if you do sort of screen out for that, what we have seen is that -- well, I think the numbers sort of speak for themselves. A lot of people talk about whether this has impacted innovation or the like. But we actually, during the year of the scandals, we saw, for example, IPOs go down to one-fifth of their pre-2000 levels. And they are now in the rebound. They are coming back up. In 2004, we saw 242, which is a little bit less than half of the 451 level from 2000.

I think it's worth noting that the money is going back in the market. We have seen a return of -- once SOX was introduced and what not, that market cap of the two major exchanges increased by about 50 percent or about 5.8 billion. So we are seeing a return to the markets, a little bit more confidence.

But I would like to pick up I think on what Bill was saying, which is that we would like to see this as a check-and-balance system. And dealing with Enron, dealing with specific scandals like that, you can always in retrospect try and set up systems that would catch the crime that you have already seen. But obviously investors are also looking out for crimes that we haven't seen yet or perhaps new varieties of these potential frauds and what not, to make sure that the system of tomorrow can help provide a check-and-balance system against that.

MR. KELLY: John, there are obviously costs imposed, not just financial cost, in changes of behavior in terms of your members. How has that altered the landscape do you think?

MR. CASTELLANI: Well, what we have seen has been a tremendous level of activity particularly by boards of directors to ensure compliance with Sarbanes-Oxley and the other requirements. We see now more than 80 percent of our boards are 80 percent independent, and that is independent both in fact and in appearance. Our boards of directors are spending more time, particularly in the key committees of audit, compensation, governance, or nominating, meeting, digging deeper into the companies. We have seen a dramatic increase in both the amount of time directors are spending on these issues, as well as a dramatic increase in the cost that they are incurring in compliance issues.

All of our members now have at least a lead director, if not a presiding director, or a chairman who is different than the chief executive officer. Every one of our members' boards of directors meet at least once a year, some of them five times a year in executive

session without the management. So you have seen a dramatic change in both the directors and the management activities.

I think the challenge going forward is have we found the right balance because, after all, the objective here is to ensure that we increase shareholder value. And that issue of balance -- that is, the ability for businessmen and women, entrepreneurs to be able to take risks and fail -- has been the part that has been probably the most concerning for our companies going forward. Are we in danger of criminalizing risk taking? I don't think we're there, but that needs to be the question that we ask ourselves going forward.

MR. KELLY: Senator, if I can ask you. Is there any appetite on Capitol Hill for any kind of modification? And related to that, how much pressure are you getting from business constituencies to do something?

SEN. HAGEL: Well, I think the focus has been and most likely will continue to be on and come from small business on changes. And I agree that we do need to pay some attention to small businesses as to the enforcement and the costs, and the return. John used the term objective as I did in my opening comments. We shouldn't lose sight of objective here, and we shouldn't be regulating just to regulate in kind of this mindless sea of nonsense that we unfortunately get into in this town, and especially in regulatory agencies that the Congress creates and the president signs into law. So we all have to take some responsibility for that.

But I, for example, think the SEC did the right thing this month when it made the decision that they would allow an extra year of compliance for smaller companies. And it may well require. And the Congress would take a serious look at this -- additional changes in the law, if we can't do that through the regulatory process and through the SEC. I'm very pleased and hopeful that with Chris Cox over at the SEC, he will bring a wide-angle-lens view of these issues to the practicality of what I think is always in the intent of legislation but also the objective.

And, again, something that John said is really critical here for Alyssa's people and all investors and shareholders and managers, and all who are associated in this business, and that is let us not forget what we're trying to accomplish here, and that is value for the stockholders and value for the investors. And that is the key dynamic that drives us.

One additional point that John made and it relates to the question you asked him. I do think that the one of the great successes of Sarbanes-Oxley has been a more focused and intense and better quality of individual board member, not just the independence of that board member, but as John noted, more active participation, accountability from these board members. What is your role? What are your responsibilities? You have to clearly define those responsibilities because there are some penalties here are as you all are well aware if you don't do your job. And there should be.

MR. KELLY: I'm trying to get a sense of the temperature level here on this issue. Among the issues you are dealing with, on a scale of one to 10, let's say if the Harriet Miers nomination is number 10 -- (laughter) -- just to pick something out of the hat, where does

Sarbanes-Oxley rate in the -

SEN. HAGEL: Well, because our dear friend Bill McDonough and his people over at PCA have done such a marvelous job and the SEC is doing a good job, Sarbanes-Oxley is not high on the list of immediate issues that we need to attend to. Are there issues, which you have heard some here already -- and there will be more I suspect that will role out this morning that bothers small business and others -- sure.

But I think overall, when you look at the scope of Sarbanes- Oxley, and as was noted by Bill in his opening comments about the most significant securities law change probably since 1934, I think this has gone amazingly well. Not that it doesn't need, as I noted, some calibrations and changes and modifications, and I think that will go on for some time to come.

But overall, I think most in the Congress, and obviously most supported this bill, are pretty pleased with the way this has gone -- not perfect. None of these bills are; none of these laws are, and we need to stay tuned to that. But I don't see any great overwhelming shift to immediately bring Sarbanes-Oxley back up and we'll put Harriet for a while. (Laughter.) I doubt if that is going to happen. We are running huge deficits and we have got other problems that I think are probably in the queue a little ahead of Sarbanes-Oxley.

MR. KELLY: Alyssa, the point about slipping the small business provisions for a year -- fairly substantial loophole. Arguably, the senator says this is the kind of thing that needs to happen on an administrative level. Where do you guys come down on that?

MS. ELLSWORTH: Well, I think as my colleagues here know, we have written on two occasions now to the SEC regarding -- in this regard. A couple of issues. First of all, we are dealing with something that is fairly new. I mean, most people, whether it's -- if you want to use the analogy of changing your workout routine. The first couple of times you try Pilates it's going to take you a lot longer than once you get the kick of it, right. And we all know that Sarbanes-Oxley is still very much in its early days.

My colleagues at the Business Roundtable -- I have had the pleasure of talking on other panels with Tom and what not -- I think have done an excellent job of also pointing out that some of the costs of Sarbanes-Oxley, really focusing on the cost of 404 in particular are expected to go down immensely over the next couple of years, by some estimates from our audit and accounting firm -- compatriots, colleagues, whatever you would like to say -- they estimate that they will go down by about 40 percent. And I think that this something that is worth noting, is that some of the push is for the sort of high-cost services -- has been introduced by the service industry itself.

I think it's worth focusing on the fact that the one group that isn't complaining about the cost of Sarbanes-Oxley are the shareholders who are in essence the ones who are paying for it. In particular, if there are higher costs, disproportionately a higher cost for small businesses, then obviously we do need to look at that, and we have to figure out why.

My personal opinion is that this is most likely something that in the next year or so the cost will be going down, and perhaps guidance will help in particular areas. But the way it's currently being looked at, we're talking about 85 percent of the U.S. market; 85 percent by numbers, not by market cap, but 85 percent of the U.S. market. Now, when I speak on behalf of investors, we are talking about the long-term patient capital, and they are not just invested in the big companies in the U.S. So the idea that 85 percent of the market would be somehow under a SOX (light ?) or a 404 (light ?) is something that I think that a lot of investors feel very anxious about.

MR. KELLY: Bill, if you could address that?

MR. MCDONOUGH: Well, I think, as I said, not unusual for her has hit exactly the right issue. It's pretty clear that the first year of Sarbanes-Oxley 404 application did not go very well. It was costly, there was waste work on the part of the issuers from what we can see from our audit inspection. Sometimes the auditors did work that didn't need to be done. Sometimes they didn't do work that one would think should have been done. So one has to hope, and we, in addition to hope, do a lot of pushing, cajoling, and kicking to make sure that the auditors do better the second year. They will do better. Will they do as well as one would wish? I doubt it. So we will be on their backs again, or my successors will be for the third year and the fourth year.

The big issue is, say if you look at market cap, the fortune 500, we ought to just leave Sarbanes-Oxley and 404 alone. It will be implemented just fine within the next year or so. And the case of many companies, it's being implemented perfectly well already. Where you run into the problem is that large number of companies that are accelerated filers so they got market cap of more than 75 million, but up to, say, 300, 400 million.

Now, if we say there is going to be something like Sarbanes-Oxley -- 404 (light ?) -- what are we saying? Foreign investor -- I think there is a truisms, which like most truisms aren't always true, that larger companies are better managed because they can afford the overhead of more and more diversification of services and so on. The middle cap company has always the issue of whether they can afford to be as tightly managed as the larger companies can. So you're already looking at the likelihood of an investor saying I better have a higher return from that sort of investment ergo the cost of capital to that sort of firm goes up.

If we say there is also a better legal climate for the large firms than there is for the medium-sized firms, the cost of capital takes another ratchet up. So rather than saying, well, let's go to 404 (light ?) because that will reduce the costs and that will be a good thing, if it ratchets up the cost of capital by a greater amount, it is in fact a negative. In the real world is none of us knows for sure exactly how to handle the problem. The important thing is we now I think rather clearly know there is an issue. But exactly how we solve it, I'm not sure.

So as Senator Hagel suggested earlier, I think probably what we need is another year or two of patience on the part of the Congress, probably continuing impatience on the part of

the private community, and there should be impatience on the part of the SEC and the PCAOB to try to use every tool that we can to make Sarbanes-Oxley more effective, including for the medium-sized companies. That is not going to be easy and it will be a continuing work in progress.

MR. KELLY: John, can you wait a year or two?

MR. CASTELLANI: Well, I agree with the chairman. We don't believe that this is an issue that requires legislative -- reopening the legislation of Sarbanes-Oxley in and of itself. We think with the SEC, within the PCAOB, within the companies and the audit community, we have -- there is a flexibility to adjust this so we get a cost- effective environment. You know, there is a fair amount of flexibility that could be injected into 404 that certainly Bill and his chairmanship in the PCAOB have recognized and we have been advocating.

Part of what we have seen in the first years of its implementation have been a very defensive environment. And a lot of that defense comes from the other side of the issue of corporate governance that we are not talking about, and that is enforcement, and the enforcement environment.

We think that there are changes that could be made to, say, 404 that are in tone, that are in latitude, that are in reliance on great professional judgment that will keep the objective as being attained, yet reduce the costs. It would be more cost-effective. We don't have to test every system in a zero-risk tolerance mode every year. We can use that kind of risk management that makes sure that we're looking at the systems that are the most likely to, if they fail, to cause the most amount of damage -- so using professional judgment.

But our view has been this can be done regulatorily; this can be done in tone; this doesn't need a legislative change at this point. We still need to absorb all of the things that we have changed over the last three years to find out whether or not it is working and how it can work better.

MR. KELLY: Senator, maybe you can go now and maybe we could just work this out right here. (Laughter.) I think we're getting to a point where -- but let me -- I mean, that is pretty provocative. If I could get you respond to that. Bill, does that make sense?

MR. MCDONOUGH: Yes, I think that essentially the PCAOB and the SEC have a view, which is we should work with the private sector make this thing work better. I have a very good working relationship with John. When I took over the PCAOB, I decided that I was not going to be afraid of dealing with the heads of the major firms. I deal with the heads of the major firms constantly. I spoke to the ENY worldwide partnership meeting on Monday of last week, with the Deloitte and Touche meeting on Wednesday, with the Grant Thornton out in Chicago.

And there are people who say, well, if one of these firms does something really stupid, the PCAOB and you are fried. Well, you can't deal with people. You can't make people move to a more virtuous path unless you're willing to talk to them. So it may sound a little bit

corny, but when I deal with the bit accounting firms' meetings, I say to them, I want you to compete not only to be the best accounting firm, I want you to be the most virtuous accounting firm, and I want every other accounting firm to be trying to beat the hell out of you -- (laughter) -- at being the most virtuous. Nobody laughs. Everybody just nods his head.

And then I look around and I say, by the way, the fact that the head of the firm who is sitting next to me is saying the right thing -- what else is he going to do except say the right thing. I can make his life very difficult if he doesn't. But the important thing is every engagement partner for that firm, every manager for that firm, every little guy, three years -- lady, three years out of college who are working on the audit, each and every one of you all have the reputation of the firm on your hands. So you have got to be in the virtue gang.

I think what that kind of approach, which is basically we trust the American people who work in the private sector, we can fix this thing.

MR. CASTELLANI: Before, you think -- if I can inject something -- before you think the chairman is too cozy with big business, you should know that his opening remarks at the Business Roundtable, when he came to address us for the first time, were you guys make too much money, you're paid for failure, and if you don't fix that, this problem is going to continue. So he is also very good at chastising us for what he sees we do wrong.

MR. KELLY: Alyssa, I have got to let you get in on this too because -- (laughter) -- we don't want to just broker this deal here while you're silent.

MS. ELLSWORTH: I think I have lost the question at this point. I think that is a lot of -

MR. KELLY: The question -- if we're into a back-and-forth administrative tinkering here, it's not a legislative issue any more, what role do your constituents play?

MS. ELLSWORTH: As I said, I think that we're still in the first couple of years.

We would like to see how this plays out. Now, obviously you can't look at this in a vacuum. I think that one person so far has already mentioned enforcement. And I think that is something that a lot of eyes are on now, which is how is this going to look on the enforcement horizon. And one thing that we have seen is that hand in hand with the changes of Sarbanes-Oxley, we're actually currently seeing a lot of changes over at the SEC right now. And a lot of those are staffing changes. But those will change the tone at the top. And I think a lot of eyes are going to be watching to see if the SEC keeps up and maintains its current levels of enforcement.

As you probably know, in the last four years, enforcement at the SEC has sky rocketed. They are taking on a lot -- number wise, a lot more cases, but also size wise, much larger cases. And the penalties that they are exercising have been much larger. Outgoing commissioner Harvey Goldschmid used to do a lovely lecture -- he is a professor so he does lecture -- on the exact numbers and it's been incredible.

So the investors are very interested to see that be maintained. We still think that there are a lot of people who are learning that the tone of the top matters, and that -- and I think as Bill was saying earlier, a couple of high-profile cases do a lot to make some of top management realize that they really are on the line.

MR. KELLY: One of the hot-button issues that has emerged from this is the question of CEO pay. I know Bill McDonough has made a number of statements on that. In some ways, it is as much I suppose of a political issue as a financial issue. And I would like everybody to kind of jump in on that topic, but maybe if we could start with the senator on that. Do you see a role, a continuing problem there that needs to be addressed?

SEN. HAGEL: Well, first I want to go on the record saying that I am for virtue. (Laughter.)

MR. MCDONOUGH: That is why he is my favorite senator. (Laughter.)

SEN. HAGEL: So I can support the chairman's call for virtuous conduct and I appreciate what he has to say about those things. I have always believed that the marketplace sets the remuneration of not only top corporate officials, but all who participate in the marketplace. Now, that always, I believe, as everything in this country, or in a democracy or a free society, comes, in a market economy, comes within some bounds of propriety. And I think that again is always a balance you strive for. I think shareholders have an awful lot to do and will continue to have an awful lot to do with having the last say in shareholders, or in CEOs and top corporate executive salaries and their benefits.

I also think that when you're dealing with these kinds of issues that transparency is absolutely critical. No side deals, no compensation committee, arrangements that the rest of the board or shareholders do not know about. I know we have regulations on this and laws on this especially with public companies, but I'm not sure we always follow those right down the line.

I have always believed, just like campaign financing, or money and politics, as long as you are transparent and the American people and the press know where the money is coming from, where it is going, and they know what the deal is, then I think it's up to the shareholders and those who represent shareholders to make their voices known. And if the individual is overpaid or people think he or she is overpaid, then I think the board needs to attend to that. But I think that finds its own level and always will in our market or any market economy -- CEO salaries and corporate salaries.

MR. KELLY: Bill, you have been pretty tough, outspoken on that topic. Can you give us a little sense of where you are coming from on that?

MR. MCDONOUGH: I first spoke out on the topic when I was asked to give the first anniversary lecture or 9/11 at Trinity Church, which came very close to being destroyed on 9/11. I don't have any idea how much a CEO of company X should be paid. So I very

much agree, as usual, with what Senator Hagel just said. When I appeared before the Business Roundtable, as John Castellani mentioned, I said that I don't know how much you should be paid. But what you need is a process which should be peculiar to each company because each company is in fact unique, where the compensation committee and the full board of directors comes up with a methodology, which the average human being can understand because it's sufficiently straightforward, and which rewards for success.

I think the worst cases have been where somebody gets paid a load of money when the company is in fact doing very poorly and the shareholders are losing value. I tend to use an example, a company that is well regarded for being well managed, General Electric. In 2003, Jeff Immelt, its CEO, made $7.3 million; 2004, he made $8.4 million. Now, there are lots of people on Wall Street who make three and four times that much.

There is a part of his pay package, which in 2008 for '03 and 2009 for '04 says that there are 250,000 shares, and if there are some very tough demands met, Jeff Immelt will make a load of dough, but only the shareholders really do extraordinarily well. I think that is a great program. And I sincerely hope for the sake of the American economy that he makes a lot of money in 2008 and 2009. By the way, I am not a GE shareholder. (Laughter.) But that is the kind of model you need.

Now, John Castellani's Business Roundtable put out a very significant sensible report on executive compensation and setting up a methodology, which you put out, John, in December '03. And John told me, which I'm sure he'll share with you, they are updating -- that is what the business leadership should be doing. The last thing in the world we need is a piece of legislation saying let's figure out how to control executive compensation. Nobody could figure out how to craft the legislation. Nobody could figure out how to exercise it. And if that sounds as if I'm rather vehement on that topic, my fear is if they ever pass the legislation, they put me in charge of implementing it -- (laughter) -- and I don't know how.

MR. KELLY: Alyssa, please.

MS. ELLSWORTH: Oh, I could just send the rest of the panel home and just talk about this for the rest of the day. This has been again and again for the last couple of years, even in the light of scandals and everything else, shareholders continually raise this as their single most -- well, basically the issue that makes them see red. And I think part of it is that I think we have just heard a lot of the pay packages we have seen are not tied to performance. The system for setting pay packages for top executives for a long time has been sort of in a vacuum.

I would actually differ from the senator. I wish that the shareholders had been more involved in exercising some sort of approval or disapproval of the payment methodologies. But what we have seen as a continual -- these studies that every company wants to be paying their CEO and needed the 50 to the 75th percentile or in the top quartile, which means that you have a continual perpetual race to the top -- well, the top being the most egregious pay packages, not particularly wise ones.

But I completely agree with Bill, that this is something that should not be legislated. I think after the 1992 tax code changes, which essentially, as I think most of you know, was the day that most CEOs in the U.S. started making exactly $1 million and the rest of their pay was in pay-for-performance measures, and what we have found so far and through our observations is that those pay-for-performance measures are almost non-existent, or in some cases comical.

We have actually had things tied to increases in property or short-termism through earnings per share on a quarterly basis. There are a lot of reasons that we believe that good pay-for-performance should be based on long-term criteria. As investors, we are there on average four or five times longer than the CEO is. So we would like to make sure that the returns that the CEOs get -- is getting are rewarding him or her for good performance, but not at the expense of taking away a good portion of the company when they leave.

MR. KELLY: John.

MR. CASTELLANI: Well, we are in violent agreement on one thing. If you ever want to see how a regulation an distort and in fact have the wrong effect, look at what has happened since the IRS limited the deductibility of compensation of CEOs to $1 million. It really is an example of how well intended regulation has gone bad.

As Chairman McDonough referred, our members took a very hard look at their own compensation systems.

We can't say what the CEO of any company can make anymore than we could say what the weak-hitting shortstop for the -- or a strong- hitting shortstop for the New York Yankees should make. But we know that it should be set by a compensation committee that is made up completely of independent directors, that can have outside -- its own outside expertise in determining.

We know that it absolutely has to be tied to performance, long- term performance. We know that it has to be balanced. Part of the problems we have gotten into have been an over-dependence on one kind of compensation, most notably stock options and a distortion of the system because of that over reliance -- (audio break, tape change) -- they need to understand. They need to be able to explain every circumstance of the employment circumstance and the compensation circumstance for that senior executive. And we know it needs to be transparent and explained to the shareholders. If you can't explain it, then you probably shouldn't be doing it.

That said, I want to raise an interesting phenomena because we are, in fact, faced with a situation where we may be our own worst enemies. Interesting statistic -- in 1985, the average tenure of a Business Roundtable CEO in his or her position as CEO was eight and a half years. It's now five years. 30 percent of our members have had their jobs for less than two years, and 25 percent of those 30 percent came from outside entities, in other words, from a company other than the one that they currently lead. Now I know of no

board of directors -- when it wants to make a change in chief executive officers' positions -- who says to a recruiter, go out there and find me the second or third best person to run this company. Typically, you want the best person to run the company, and typically and most likely that person is doing something else and is very good and is being very well compensated for it. So you have a circumstance where the pressure to change the identity of the chief executive officer coming from investors who are impatient with the performance of a company is in itself driving up compensation because you're constantly trying to go out and recruit the best person from a very good position. And that's something that we also need to understand and need to focus on because that in part has driven a lot of the compensation issues.

MR. KELLY: Does anybody want -- I know there's going to be a last word. My incentive package only lets me do this for about another half hour so I'm trying to move this along. But I do want -

MS. ELLSWORTH: I just have to jump in for one second, which is I do think I agree that it should be set by independent directors. I do think that there has to be a strong process. But I think all of us on the panel agree that current disclosure -- you look like a very bright person, but if I gave you an annual report and a 10K, I can promise you, you go through it until Friday and still not figure out exactly what that CEO is making nine times out of 10. And I think what we've seen is some interesting studies this year alone. One from, for example, professors of Harvard, Bebchuk and the like, who are talking about pension packages.

Well, this was an issue that wasn't even appearing on a lot of the financial statements, which is if you're a CEO and you're staying -- okay, let's say you're staying for five years -- if you're getting a, you know, a golden welcoming handshake, if you're getting a golden parachute and along the way you're getting a promise of a lifetime pension of -- I think the average was -- over $3 million a year for the rest of your life, plus you're getting your annual compensation, plus the stock options, plus the other things that -- who knows what they're tied to nine times out of 10.

Again, we run a list of 25 focus list companies, companies that are underperforming in their sector, the S&P 500 -- whatever qualities you want to look at, they're underperforming. And I'd say the majority of those 25 have CEOs who have been paid bonuses over the last couple of years even if they're cutting their workforce -- paid bonuses based upon performance. And I think that this is something -- I very much join my colleagues in saying that this should be an area where better disclosure -- we definitely encourage the SEC to take a look at a disclosing, not doing any sort of rollbacks on stock option expensing, and really try to make this transparent. We'd like to see that this is actually something that shareowners are involved in setting.

I couldn't resist. I'm sorry to jump in like that, John.

MR. KELLY: No it's fine. If anybody else wants to -- if not, we've got such a great collection of folks up here, and I don't want to monopolize this on my part. I'd really like

to see some questions that you might have out there. We've got a little bit of time to address some of that. So if we can -- if you can please stand up, state your name and affiliation, that would be great. And why don't we start back there with the gentleman. Yes.

Q Irv Chapman (sp), I work for Bloomberg. Mr. McDonough, for months after you took this office, you complained that to your surprise, despite the frauds and the scandals, a lot of chief executives just didn't get it. Well, now that you are leaving, do more of them now get it? What is the state of getting it? And I wonder if Mr. Greenberg could tell us what a chief compliance officer does for a Fortune 500 company and what differences Sarbanes-Oxley has made for the life of that company?

MR. MCDONOUGH: I think that the business leadership in general is getting it, excuse me, with the possible exception of CEO pay. And I think we've been through that enough to say that that's mainly a disclosure issue. I admit -- I suspect even Senator Hagel was thinking, wow, the opportunity costs of being a United States senator or the opportunity costs of being the chairman of the PCAOB is awfully high. Three million bucks a year in retirement for all eternity? Whoa. But I think in general the corporate governance is improving greatly, and I think that's much to the credit of the leadership of the private sector. I have no question that in my own area of responsibility that the leaders of the accounting profession are getting it. They're having difficulty carrying it out throughout the whole membership of their firms, but that's a work in progress. So I believe that in the sense of Sarbanes-Oxley as a wakeup call by the American people to the leadership of the private sector, it's been dramatically successful. And if we iron out some of the knits and gnats in executing it, then we'll have a very fine piece of work by the American people and a very attentive Congress and president in listening to what the American people were saying and bringing out a restoration of the kind of well-functioning, basically honest, straightforward American private sector that has made this country so enormously successful.

MR. KELLY: David, did you want to take that question? I don't know of the ground rules here. We can, you know, rule that out of order if you want.

DAVID GREENBERG: It's in order. I think that everyone on the panel has referred to the fact that sort of behind the scenes quietly in a lot of companies there's huge amount of effort going on, and I see that as the first chief compliance officer of what's now a $150 billion company. It's one of the great jobs in corporate America and also one of the scariest because we've got 190,000 employees. As many people on the panel said, there's no doubt that in any town of 190,000 there are a few bad guys and girls. And so the question is do you have the systems in place that are meant to prevent, detect, and take action against misconduct. And I think that, from what I've seen, there has been a greater expansion in thinking and effort on that since Sarbanes-Oxley then at any time in history. And I think it's one of the -- I talked in my introduction about not the unintended consequences, but sort of the unwritten consequences of Sarbanes- Oxley. You can't find any of that in the legislation, but it's created a huge amount of positive activity inside.

MR. KELLY: Thanks. We had another question over there.

Q I'm Ned Powell (sp). I'm president and CEO of the USO, which I realize is a little different, but I come from an entrepreneurial background. And, John, this is for you. I just want to make sure I understood something that you said. When you were talking about Sarbanes compliance interfering with risk, I was not clear. In my world, risk meant introducing new products and services and innovation, not compliance with statute. And it seems to me going back to Bill's point about virtue. Much of Sarbanes has to do with disclosure and accounting, not innovation and risk. Did I miss that?

MR. CASTELLANI: No, let me be very clear in what I was saying. This goes to the roles of management and the roles of boards of directors. Boards of directors and management have a number of different roles that they need to undertake on behalf of the shareholders. Clearly compliance and transparency and the accurate reporting of the circumstances of the company are paramount. But so are product development, so are market development, so are leadership development.

And what the concern is -- if you look at the amount of time that boards of directors are spending on compliance and balance that with how much time they're spending on those other very important roles, what our concern is that we get the balance right so that we don't end up with the best governed and worst managed companies and so that the shareholders suffer because while we are tremendously transparent and we comply with every regulation that anybody can think of, we have neglected to develop the products, the leadership, and the markets that in the long term bring shareholder value.

So that's the balance that I'm talking about and that's the risk taking -- the risk to be able to invest in a product or invest in a market, which may in fact fail, without fear that somehow that failure done right in a transparent way -- which may cause some diminution in shareholder value -- would be translated into a failure of the governance statements.

SEN. HAGEL: May I respond to that? Ned, I just would add -- and I see this every day here in the job that I have as United States senator. And before I was a senator, I had legitimate work -- a real job -- and so I have some sense of this business from my past life. But what we have to be very careful about -- and I think this is a point that John makes and a very good one. And it's under the radar, and it's a subtle point. But I think it's one that we have to always pay attention to, and that is that we do not unintentionally develop a risk-free culture in our companies, in our industries because at a time when the world is becoming more and more competitive -- and I think the real challenge for America is not terrorism -- the real challenge for this country over the next 25 years is to not just maintain but enhance our competitive position in the world. And regulation will kill competition faster than almost anything and initiative and imagination. And if you over-regulate an industry or a company, then you do in fact intentionally or, more dangerously, unintentionally develop a risk-free culture. And that will be, in my opinion, a disaster for our competitive position in the world. And I think that's part of what John was getting at, and I just wanted to add my perspective to that because it is something we don't see clearly enough or view or inject into our analysis in the legislative process. It's a more oblique

dynamic of all this, and we are more frontal in our efforts. But it's real, and the Sarbanes-Oxley thing could, if left unchecked and not put into some balance and perspective in how we implement it -- it could in fact do that -- inhibit our risk taking.

Q I'm sorry. I just wanted to follow up with a question.

MR. KELLY: On that one -- Jim, I'm sorry -- that has sparked some discussion. We want to get everybody to weigh in and then we'll hear from you. Yeah please, Bill.

MR. MCDONOUGH: I think there's -- we can ask ourselves, is there any macroeconomic evidence that there is risk aversion in the leadership of the private sector already? And I think the answer to that is yes, but it's very difficult to quantify. And what I'm looking at is the absolutely incredible buildup of cash in many companies. Now normally when you have that level of cash, you can do things more productive in my view than buying back shares, although that's a sensible thing to do, and it's good for the remaining shareholders. But there appears to be a situation in which the level of investment by the private sector in new products, new services is not as high as you would normally expect it to be. And you can figure out, well, are people concerned about terrorism? Maybe, but I agree with the senator. The real issue is keeping the economy competitive. The real issue is, are we educating our children so they're the workforce of the future. But the level of investment by the private sector impresses me as being lower than it would be, and I cannot find adequate explanation for it. And so I'm inclined to think that there is an element of risk aversion, of fear in the leadership of the private sector that may well be coming from a reaction to the scandals, to the Sarbanes-Oxley legislation, to the level of enforcement that's going on all around the country. If that's the case, which I fear it is, then we all have to figure out, how do we keep the virtue that came from Sarbanes-Oxley but get business leaders back to the business of taking risk. That's ultimately what they're getting paid for.

MR. KELLY: Thank you. Alyssa, you as well.

MS. ELLSWORTH: Yes, it's sort of interesting to be playing this role on the panel. But wearing my old hat before I went back to the council, I was actually working at the World Bank for a number of years on corporate governance issues. And I can tell you that the global perspective is that the U.S. markets are the envy of the world not because they are, you know, drenched in bureaucracy, not because they are a booming place for innovation and IPOs. It's because they have some of the best transparency, best disclosure practices in the world. And I think what happened is that Sarbanes-Oxley was trying to put things back on track. Essentially it was writing a check and balance system that had become a little bit -- well, frankly, flaccid -- a little bit broken. So I think that the regulation -- I think going back to that, you know, new Pilates student -- I think what we're seeing is that some CEOs, some boards are still trying to figure out what their new roles are and what kind of time demands that they have to put in on different issues. But I still think that these are some of the most vibrant -- I mean this is the most vibrant market in the world, and I think Sarbanes-Oxley is only going to strengthen that.

What I've seen around the world is that a number of countries have actually beaten us or

raced us to the Sarbanes-Oxley punch. They have the equivalents. And those are the markets that are growing. Those are the markets that are really going to be the ones that we're competing with tomorrow, which is where there is a strong level playing field, one where we don't have the kind of potential backroom, don't trust the accounts, don't know what's going on lack of transparency.

MR. KELLY: Jim, you had a follow-up?

Q Truly the panel just addressed my question, which was essentially the global convergence question and how the economic competitiveness -- how S-Ox really is relating to the E.U. and other issues. Is there a danger or is there a competitive issue in global convergence with possibly different sets of accounting standards here and, let's say, the E.U. or Pacific rim?

MR. KELLY: Question over here on the left, yeah.

Q Russell Mokhiber from Corporate Crime Reporter. I have a question for the panel, a two-part question. One, there's been a lot of talk about transparency. Senator Hagel said transparency is critical. And I'm sorry I missed the first par -- first 10 minutes of this. If it was addressed, let me know. But on the question of the sponsorship of this conference by a tobacco company -- what's the deal exactly between U.S. News and Altria? What are the details of the sponsorship? And for Alyssa, I know that many of your members refuse to invest in tobacco companies. Members of the social responsibility community refuse to invest in tobacco companies. Did you find it a little odd that a panel on social corporate responsibility is being sponsored by a tobacco company? Thank you.

JAMES LONG: I'll be glad, as the executive producer, to address your question absolutely.

Q What's your name?

MR. LONG: It's Jim, Jim Long. And as far as the actual underwriting of these discussions, we do them throughout the year, U.S. News and World Report as a magazine. But the actual events are underwritten by corporate sponsors because they are bipartisan in nature, because they are information-driven rather than agenda driven. So I'll be glad to speak to you afterwards and give you a little bit more detail on that.

MR. KELLY: We work with a variety of companies in a number of different kinds of forums. We operate obviously as a magazine, as a journalistic institution, but we also are a forum for advertisers. So there are often events we do that are not directly related to our news coverage -- something like this, which we think has a public policy purpose. So we've done this on various corporate financial issues, healthcare issues, a whole variety of things throughout the year. There's nothing unusual about it. It's very consistent with what we've done. Altria is a very large company that makes a lot of products and has been an advertiser in the magazine in various capacities so, you know, we don't see anything unusual about this.

Our interest again is it's an important issue. We're in the business of surfacing issues and provoking discussion, whether it's in our news columns or our commentary or in special events.

So that's really where we're coming from here.

MR. MCDONOUGH: Could I make a comment? Jim had a question, which I think could deserve a comment, and that is the international aspect of Sarbanes-Oxley and of corporate governance worldwide. When I arrived at the PCAOB in June of '03 we had intercontinental ballistic missiles -- I didn't know they were still alive and well -- reigning in on us from various parts of the world, especially from Brussels saying Sarbanes-Oxley is extraterritorial. Well, of course it is because there are 1,200 companies incorporated outside the United States which sell securities in our market. Wisely, the statute said investors in those companies should be just as protected as investors and issuers of securities incorporated in the United States. So what we did is we took advantage of the fact that I've spent my entire life in international finance, and I took myself off to Brussels. And I said, look, a lot of the investors in U.S. securities are not Americans. A lot of investors in securities sold in the European Community stock markets are not European. I assume you want to protect those investors. My job under the statute is to protect investors. Don't we have the same mission? Fritz Volkestein (ph), the delightful Dutchman who was the internal control commissioner of the European Community said, yes. I said, well then why don't we agree to agree? And so we turned over to our staffs how we do this.

Six months later in March of '04, he and I had a press conference, and a gentleman -- not from U.S. News but from one of your rivals -- came up and said, there's only one thing you guys don't agree on. He thinks you're a greater statesman. You think he's a greater statesman. The whole problem was resolved. How was it resolved? Because we -- if you represent the United States of America in any conversation, you're the guy with the big bat in your hand. And you can put the bat on the floor and say, let's work together to try to have this help everybody, everywhere. The net result is we now -- for example, if we had to have -- if we had to do inspections in the 80 countries around the world where you have accounting firms registered with the PCAOB, we'd never have enough staff. I have a vested interest. I'm the only fluent speaker of Spanish and French in the PCAOB. I don't want to do all those inspections myself. So the deal we've made is, which we have working perfectly with the Canadians -- more than a third of the foreign companies registered in our markets are Canadian. The deal is that the inspections of Canadian accounting firms that audit Canadian companies that sell Canadian securities in our market are done on our behalf by the Canadian audit overseers. The most I've had to do is send two people up to Canada to make sure they understand how our system works. And we're working out similar arrangements with the British, with the French, with the Mexicans, Japanese, Chinese, Israel, and other countries where we have to work in common.

And I think it's the perfect example how you have a global economy, you have the fact that regulation and protection of investors is at the level of legislation at the nation-state, and if

you have sensible people who decide they're going to make love not war, you can solve this entire problem for the protection of investors everywhere in a way which actually helps not only the investors, but the relationship of the United States with the rest of the world.

MR. KELLY: Do we have maybe one or two more? Yes, right there if you could get a microphone.

Q Hi, Stephanie Kirchgaessner from the Financial Times. I actually have two questions. One for the panel -- given that we've talked a lot about transparency, what's the view on hedge fund regulation give the recent news on Bayou and, well, that's probably enough for now. The second question just for Mr. McDonough -- on KPMG, given the level of fraud that was acknowledged by that accounting firm and the deferred prosecution agreement, do you think that was the correct decision -- the deferred prosecution agreement -- or do you think it's an acknowledgment by prosecutors or by the SEC that some companies are too big to fail and that the accounting profession couldn't handle just three accounting firms.

MR. MCDONOUGH: Well, my first observation is you look like such a nice young woman until you asked that question. (Laughter.) It would not be appropriate for me to comment on the agreement reached between the Department of Justice of the United States and KPMG because that was freely entered into by two parties. Neither we and, by the way, the SEC had nothing to do with it. So that was something that the two parties agreed upon.

Do I think that the justice department or the SEC or the PCAOB or I personally believe that there is an accounting too big to fail? The answer to that is no, and it must be no. When I was a banking supervisor, I always said, there is no such thing as a bank to big to fail. Why? As soon as the authorities say there is something too big to fail, you've de facto nationalized it. And if it still belongs to shareholders, you've got the taxpayers of the United States supporting free shareholders. That doesn't make sense. Now, KPMG and an accounting form is not a corporation. It's a limited liability partnership so the issue is not quite the same.

Is there a public interest in the continuation of four large accounting firms? Yes. We all agree. I can find nobody, including the people in the accounting firms, who do not believe that it would be better if we had more than four big accounting firms. There is not free market solution to that because if you put number five, six, seven, and eight in this country together, they would be considerably smaller than KPMG, which is number four. So what? The problem is that if you're a large corporation, there are only four accounting firms that are big enough and have the worldwide scope enough to do your audit. So if you come down to three, it is a matter of public interest as to whether then you get the concentration even greater. That's a problem that we would have to work with if, in fact, one of them goes out of business, which could happen because of a criminal prosecution. The case of Arthur Anderson -- it never got to trial. It was dead before it got there or de facto dead. And there is also the risk these companies have, these firms have of a civil suit that would

reach a judgment that is so high that they just couldn't pay it so they'd be put out of business financially.

It is, I believe, in the public interest that that doesn't happen. But it could happen, and we are doing everything we can to say to the four companies -- and believe me, I say it enormously blatantly; that's really the background for my virtue speech -- the way that you assure yourselves that you stay in business is to recognize that the peccadilloes of pre-Sarbanes-Oxley are something that could live to haunt you. But you sure in hell better not be doing something criminal or criminally stupid in the present which would jeopardize your existence. They have to protect themselves. They're not too big to fail. Do I think that the leadership of the companies -- certainly the large aid firms which I know very well -- have that message? You bet. We do bring it to their attention that there are two ways of saving you souls. You can either do it voluntarily or you can do it the way that Savonarola and the Spanish Inquisition had in mind. It's a lot more pleasant to do it voluntarily, and we are -- I am convinced that they have that message very loud and very clear and are behaving accordingly.

MR. KELLY: I guess I wasn't really clear on your specific question about hedge funds. That may be a little bit far afield here. If anybody really feels like they want to jump in on the hedge fund topic, be my guest. But I'm afraid that may be a separate subject if maybe you want to grab somebody afterward. Senator, I don't think you want to talk about hedge funds right now.

SEN. HAGEL: I don't know what I could say. I know that's normally not a standard for a senator -- whether we know anything or not, we say something. (Laughter.) I think I would just defer it because I'm not aware of any move in any of the committees of jurisdiction on Capitol Hill that are looking at any serious legislation.

MR. KELLY: We'll make that our next panel discussion. That's a whole separate -- somebody else had a question here? Yeah, over there.

Q Hi, my name is Jay Heflin, and I'm with Tax Notes. Mr. Hagel, this question is for you. What would it take for Congress to put Sarbanes-Oxley back on the front burner?

SEN. HAGEL: I suspect that if there was indication of abject failure that corporations, corporate America, large and small, were rising up in rebellion across our great country about implementation, about the various features that we would then be forced to take a look at it. I don't see that happening -- just the opposite. And I think as reflected by the comments this morning here in the last hour, there's some rather significant indication that Sarbanes-Oxley has worked and is working now that we are into it over three years. It's not perfect. As I said, we still need to address issues.

And we are going to be, I suspect, calibrating and recalibrating as I noted in my earlier comments -- not necessarily Congress doing that, and I don't see any reason Congress needs to reenter that arena. I think the SEC an the PCA -- both are perfectly capable and have shown that capability to deal with whatever adjustments need to be made. So the only

answer I could give you is if there was just some explosion out there or some complete failure or breakdown of our public companies and auditing and accounting and responsibility and all that goes with it, then sure we would get back into it. But I just don't see that happening.

MR. LONG: Brian, we have time for maybe one or two more questions.

MR. KELLY: Yeah, okay over there on the far side.

Q Hi, I'm Phil Kerpen with the Free Enterprise Fund. I'd like to direct this question to John. How have the 302 criminal provisions affected CEO recruitment, and how might that relate back to the CEO pay issue?

MR. CASTELLANI: Interesting question. I have no evidence from my own observation nor have I heard from our members that the 302 provisions in and of themselves have affected recruitment. What they have affected has been the intensity and the depth of the focus by CEOs and CFOs on the internal process by which all of the financial statements are rolled out. In fact, many companies -- there is a -- there has been an establishment of a chain of responsibility from the lowest reporting levels within the company all the way up to the CEOs to ensure that everybody is invested in the transparency and the accuracy of the financial statements.

I think what has happened more broadly though is something that bares watching, and that is the impact may be more on boards of directors and people willing to serve on boards of directors. Not just the 302 requirements, but all of the sum total of the focus whether it's civil or criminal on members of the boards of directors. The big recruiting firms for board members are telling me on a regular basis it's getting more and more difficult to find people who are willing to serve because of the time requirement, because of the potential exposure to liability, because of the fact that more and more companies are restricting their own executives in terms of number of boards on which they can sit, and because of some things that are occurring. For example, though it didn't go through, look at the very unique nature -- I'm sorry this is the wrong example, but it happened to be WorldCom and Enron -- for the director liability with no finding of malfeasance, with no finding of any activity that violated any securities law or regulation. That proposed settlement, which was a civil settlement, would have imposed on those directors a personal financial penalty that could not be covered by the company and the boards on which they sit -- no finding of a violation of business judgment. That seems to be having more of an impact on directors that the certification 302 process is having on management.

MR. KELLY: Thanks, John. We promised we would get you all out of here by 9:30 I'm sure to go to your compliance meetings. I know I'll be going to mine. But this was, I thought, a really great panel. I really want to thank our panelists for being not only clear but concise. There was an amazing amount of information was put forth here in a short time. I've done these panels before, and sometimes they do sound like a filibuster. But there was great deference and respect on everybody's part to let everybody have their say, and I appreciate that. I appreciate your being such an attentive audience. Thanks very

much. (Applause.)