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Will Corporate Reform Stop with the Enron Trial?

Four and a half years have elapsed and Enron's former bosses meet their judges at last. In the Houston federal court since the end of January, together they form a colorful group: with Andrew Fastow the whiz-kid CFO who thought up the now infamous off-balance-sheet partnerships; Jeffrey Skilling, arrogant and sanguine, who left as Chief Executive in August 2001; and above all Kenneth Lay, the founder and chairman whose grandfatherly manners hide outstanding manipulative skills, if prosecutors are to be believed.

Even though the verdict may not come immediately, it is unlikely that these once all-powerful men will escape any punishment. Therefore, the trial looks like the climax of a spectacular sequence of corporate reform from 2002 onwards, including the Sarbanes-Oxley Act and its reinforcement of managers' responsibility and of auditors' oversight; reforms of Wall Street equity research and of the New York Stock Exchange (NYSE); new governance rules for mutual funds; more rigorous accounting standards on stock options expensing and on off-balance-sheet items; record fines and settlements slapped on the major investment banks; and the forced departure of a whole generation of iconic CEOs, including Dick Grasso (NYSE), Franklin Raines (Fannie Mae), Carly Fiorina (Hewlett-Packard), Maurice Greenberg (AIG) or Michael Eisner (Disney). No wonder that many observers see this as the most sweeping reform of American business since the New Deal which seventy years earlier created the key institutions that regulate US capital markets, starting with the Securities and Exchange Commission (SEC) in 1934.

But it already seems that such initiatives belong to the past. At federal level, most of the thrust came from the Senate (under a Democratic majority until late 2002) and afterwards from William Donaldson's SEC; but the respected Wall Street veteran was replaced in June 2005 by an elected politician, Christopher Cox, who for the whole year has stayed so cautious as to be nearly immobile. The ebullient New York Attorney General, Elliot Spitzer, now shies away from opening new cases and devotes himself mostly to his political career. Business organizations such as the US Chamber of Commerce attack some of the new rules and try to overturn them, on the basis of the undoubtedly high administrative burden they create. They have recently had some successes, such as the possibility of a partial exemption from Sarbanes-Oxley rules for medium-sized enterprises, the reexamination of mutual fund reform, or the Supreme Court ruling in March which restricted the scope of class action lawsuits on financial cases at State level.

The problem is that many structural problems revealed by Enron and other post-bubble scandals have not really been fixed. The quality of financial

disclosures is still potentially affected by a context in which the major audit firms desperately seek a limitation of their liability, with no public regulator willing to take the risk of one of them disappearing. The conflicts of interests that affect institutional investors have not disappeared by any means. Annual General Meetings of shareholders remain in most case a parody of a representative system, and shareholders can only rarely have any influence on who sits on corporate boards. Executive compensation is rising at a breakneck pace (+27% in 2005 for CEOs according to the New York Times, with an average above $11 million): even the prudent BusinessWeek expresses concern. While Wall Street has returned to the euphoria of the good old days, such persistent tensions at the heart of the financial system bear the risk of future crises that the enfeebled Bush administration is less than ever capable of handling.

The unfinished character of corporate reform is an issue for Europe as well as the United States. Even though only few observers fully realize it, European and American capital markets are increasingly profoundly integrated, as the battle over the London Stock Exchange well illustrates. In this emerging transatlantic market, most of the regulation that exists comes from the US because of the institutional fragmentation of the European side. With the notable exception of the decision to adopt IFRS accounting standards (made during the previous market boom in early 2000), almost all significant reform moves originated in America. However, it may be the case that European companies need discipline even more than do American ones, as regards both investor protection and managers' accountability.

Corporate reform is not dead. It might be rekindled by a change in the US political context, or (less likely in the short term) by ambitious new initiatives in Europe. In any case, let us hope that the current apathy will not open the way to new turmoil and to another loss of trust in a global financial system which is already made fragile by global imbalances and geopolitical uncertainty.