



Consumer Federation of America

For Immediate Release:
November 30, 2006

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Reaction of Consumer Federation of America's Barbara Roper to Recommendations of the Committee on Capital Markets Regulation

Committee Misdiagnoses the Problem, Prescribes the Wrong Cure

Today the Committee on Capital Markets outlined 32 steps Congress and federal regulators should take to improve the global competitiveness of U.S. securities markets. “Unfortunately, because the committee has badly misdiagnosed the problem, it has proposed a dangerous and harmful cure,” said Barbara Roper, CFA Director of Investor Protection.

“If we were to adopt every one of the committee’s recommendations tomorrow, we would have done absolutely nothing meaningful to reverse recent IPO trends,” Roper said. “In the process, we would make it far more difficult for regulators, enforcers, and defrauded investors to hold corporate criminals accountable for their crimes.”

“Members of the committee appear to be so intent on proving their pet theory that excessive litigation and regulation are harming our markets’ competitiveness that they ignore or gloss over literally masses of evidence that contradict their conclusions,” Roper said. For example:

- The U.S. share of the world IPO market, the number of foreign companies listing here and the amount of money they have raised here have all increased since passage and implementation of the Sarbanes-Oxley Act – a period when high-profile private lawsuits and state and federal enforcement actions were dominating the headlines.
- The recent “explosion” in awards to defrauded investors through private litigation is the direct result of an explosion in fraud several years earlier. Despite that fact, awards to investors represent a tiny fraction of their losses, which can be measured in the hundreds of billions or trillions of dollars.
- Shareholder lawsuits are down, and down dramatically in the past two years, despite the fact that the number of financial restatements are at record levels. Although roughly two-thirds of the cases filed in the first half of 2006 alleged accounting violations, the auditor was cited in only one case. Auditors were cited in only five cases in all of 2005, despite on-going scandals related to stock option backdating, for example.

In reaching to blame excessive litigation and regulation for the recent decline in foreign IPOs listing in the United States, the committee dismisses the notion that the growing strength of foreign markets can entirely account for this phenomenon. While it is true that other factors come into play, this is clearly the dominant force behind recent trends. A closer look at recent IPO statistics clearly

shows, for example, that the vast majority are choosing to list in home markets – whether because of convenience or national loyalty. Adopting the committee’s recommendations would do absolutely nothing to change that.

For those relatively few companies that choose to list away from home markets, a variety of other factors unrelated to either excessive regulation or litigation clearly come into play. These include:

- investment banking fees, which are roughly twice as high here as they are in London or Europe;
- questions about the wisdom of having a dollar-denominated stock when sky-rocketing federal budget and trade deficits continue to raise concerns about the stability of the U.S. currency;
- the geographic isolation of the United States, which is located far from emerging markets in Asia and the former Soviet Union;
- the difficulties of doing business in New York in a post-9/11 world.

“All of these factors are at least as significant as concerns about regulation and litigation,” Roper said. “Because the committee’s recommendations would do nothing to address these complex issues, they have no hope of being effective in promoting the competitiveness of our markets.”

“Finally, the committee’s recommendations are based on a misplaced notion of what forms of competition will benefit investors,” Roper said. This shows in the committee’s odd conclusion that the existence of a thriving private equity market is bad for investors, because it deprives them of the opportunity to invest in companies that would otherwise be forced to go public. “In fact, the existing of the thriving private equity market helps to ensure that companies have ample means to grow and innovate and can therefore delay their decision to go public until they are prepared to meet the responsibilities that entails. I’m sure many investors wish that more tech stock companies that went public in the 1990s before they were remotely ready had waited a little longer to do so,” Roper added. “It could have saved investors hundreds of billions of dollars in losses.”

“London’s AIM market actually offers a perfect example of what happens when very small, very speculative companies rush to go public,” Roper said. Over a third of the companies that have listed there since it was founded are no longer listed. The market’s performance has been abysmal, down 2.53 percent over ten years when U.S. markets soared. “This is what the existence of a thriving private equity market spares U.S. investors. We should be grateful, not seek to change that.”

At the other end of the spectrum are the very large companies that have recently listed on the main London Market. London competes for these listings by exempting them from the laws that provide basic protections for minority shareholders. These include limits on the amount of IPO proceeds that can be siphoned off by owners, minimum requirements for representation of independent directors on corporate boards, and restrictions on related party transactions. Only a wholesale abandonment of U.S. legal protections would allow us to attract such issuers, something that this committee adamantly denies seeking.

“Under no circumstances should Congress or federal agencies adopt the misguided recommendations of this committee,” Roper concluded. “They would do great harm to investors – by limiting both the power of regulators who seek to protect their interests and the ability of defrauded shareholders to recover even a small portion of their losses – while providing no benefits in the form of more competitive markets.”

CFA is a non-profit association of 300 organizations that, since 1968, has sought to advance the consumer interest through research, advocacy and education.