

# Is Sarbanes-Oxley a failure?



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Interview by [Katie Benner](#), writer

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(Fortune) -- The McGuffin in the highly readable, [2,000-page report](#) on what went wrong at Lehman Brothers was a bit of accounting magic called Repo 105. The transaction was based on the repurchase agreement, or repo deal, a common practice where a bank uses a security it owns as collateral for a short-term cash loan.

But Lehman used repo deals to actually pretend to sell securities at a profit, according to the report, making the firm's finances look rosy at the end of each quarter. The company would then borrow to repurchase the securities and repeat as necessary.

The last time accounting sleight of hand was so widely discussed was during the Enron and Worldcom era, when special purpose entities and shady limited partnerships were used to hide liabilities and exaggerate asset

values. To stamp the practices out -- and stop future Enrons -- congressmen Paul Sarbanes of Maryland and Michael Oxley of Ohio crafted Sarbanes-Oxley, which was enacted in 2002.

The fact that Sarbanes-Oxley didn't keep Lehman out of trouble made us wonder: Is it possible to ever close these loopholes, or are bills like Sarbanes-Oxley just the legal equivalent of fighting the last war?

With this in mind, Fortune spoke with Oxley, who is now working at law firm Baker Hostetler in D.C. He talked about why 'Sarbox' is still worthwhile, what makes global regulation highly improbable, and how current government leaders might go about restoring investor confidence.

**Lehman has been accused of using an accounting loophole to massage its books. Can regulators ever anticipate and prevent malfeasance?**

The point of regulation is to increase transparency. You can call it regulation, but you're just shining a light on a murky

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opaque process that, most recently, brought this economy down.

If you read any of the books that have come out, from Hank Paulson's book [On the Brink] to Too Big to Fail, the common thread is an incredible lack of transparency and no accountability.

That said, it is very difficult to regulate a relatively free market with a lot of innovations and some folks who don't necessarily want to play by the rules. But that doesn't mean we should stop trying to regulate and prosecute wrongdoers. We have laws against homicide and people kill one another every day. That doesn't mean that you back off and stop fighting.

**The report talks about Lehman's use of its European arm to avoid U.S. regulation. Are we doomed to see things like this repeated until there's global harmony?**

First, I'm encouraged by the fact that a number of countries have adopted regulations similar to Sarbanes-Oxley, including Japan, the European Union, Canada, and Israel. Virtually every industrialized country has adopted stronger and higher standards on dealing with accounting fraud.

But they're also all different and some regulations are stronger or weaker from country to country.

Global regulation would help matters, but I'm not enthusiastic or optimistic that it will happen. There have certainly been discussions between the U.S. and Europe, particularly regarding International Financial Reporting Standards.

**What would prevent regulation from being better synchronized in the future? Is it a matter of red tape and politics?**

You're dealing with sovereign countries that have different legal systems and different regulatory structures. This is a tough slog. I applaud leaders for trying to harmonize these things but it's not going to be easy.

**Do you think Sarbanes-Oxley has been a success?**

Sarbanes-Oxley was all about accountability and transparency and restoring investor confidence. We lost almost \$8 trillion in market capitalization in 2001 and 2002 because of fraud at places like Enron and Worldcom.

Even though the recent meltdown has hurt confidence again, things could have been much worse if accounting regulations had been as lax as financial regulations.

**How can the Obama Administration and Congress restore investor confidence?**

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We need to figure out financial reform. In the wake of AIG ([AIG](#), [Fortune 500](#)) and Lehman, it's very difficult today to make the case that the market will take care of itself and that we don't need a lot of transparency or even a minimal regulatory structure.

For example, even the most fervent free-marketer has to admit that we need transparency for over-the-counter derivatives. This is a \$600 trillion market worldwide that is essentially unregulated and opaque, but it has had an enormous negative impact on the economy. When the bottom fell out of the housing market, no one could really determine the value of products; and without price discovery, everything froze.

Information about derivatives needs to go through independent clearinghouses and the instruments need to be traded on open exchanges.

### **The financial crisis is long past. Has Congress moved too slowly in creating new regulation?**

This is a no-win situation. Critics and the financial press said that Sarbanes-Oxley was rushed through, even though it actually took eight months from the time of the first hearing on Enron until the passage of the bill.

Now, more than a year since the financial crisis, Congress hasn't dealt with regulation and people are criticizing politicians for moving too slowly. But by taking more time Congress has had a chance to delve into complicated and multi-faceted issues like too-big-to-fail, over-the-counter

derivatives, and bank regulations. This is heavy lifting and I give the Congress a lot of credit for working hard to put something together.

Also, the public outcry hasn't been nearly as intense as after Enron and Worldcom. Back then, we had faces we could put with the problem and prosecute them.

### **Does it surprise you there have been no criminals in the current meltdown?**

It's possible that this whole thing with Lehman could develop into a situation with criminals; but I don't want to comment on Lehman on the basis of just one report. There is also a Congressional hearing next week. I won't prejudge that issue. We have to wait and see.



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