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TESTIMONY BEFORE THE HOUSE FINANCIAL SERVICES COMMITTEE

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Good afternoon, Chairman Oxley and Ranking Member La Falce, my name is Damon Silvers, and I am an Associate General Counsel of the American Federation of Labor and Congress of Industrial Organizations. The AFL-CIO believes today's hearing on H.R. 3818, the Comprehensive Investor Protection Act of 2002, is an essential part of a much needed effort at comprehensive reform of the capital markets and is grateful to the Committee for the opportunity to participate in this hearing. We note that this Committee was the first to address the issues raised by Enron in December of last year, and we would like to thank the Committee for giving the AFL-CIO at that time the opportunity to brief the Committee on the impact of Enron's collapse on both Enron workers and America's working families more generally.

Enron is a window into a set of pervasive conflicts of interest that defeat the purposes of corporate governance and threaten the retirement security of America's working families. At Enron the management, the board of directors, the outside auditors and the Wall Street analysts all failed to protect investors. Similar events have occurred on a smaller scale at

Global Crossing, Cendant, Waste Management, McKesson and other public companies. The source of these failures lie in the unregulated conflicts of interest that permeate the relationships between the management of these companies and the people who were supposed to be protecting investors.

This Committee has heard in prior hearings from those who still would have you believe what Enron used to preach – that unregulated markets will solve all problems. Now that may be the view from the K Street offices of those who do the heavy lifting for the Big Five. But it is not how things look for thousands of working families in Houston and Portland, Oregon and Rochester, New York who have lost their retirement savings and in some cases their jobs and their health care because they believed what they were told -- by their employers, their employers' accountants and the analysts that interpreted the accountants' numbers.

H.R. 3818 is the most comprehensive legislation introduced in this Congress in response to the conflicts of interest in the capital markets and in the boardrooms of America's public companies. However, I would note however, that H.R. 3818 and H.R. 3673, the Corporate and Auditing Accountability, Responsibility, and Transparency Act of 2002, both reflect what appears to be an appropriate consensus in this Committee that the structure of our markets needs reform – that doing nothing is not an option.

Let me then review the areas where Congress needs to act and the provisions of H.R. 3818 that respond to the need.

Corporate governance starts with boards of directors. Public company boards need strong independent directors who are accountable to investors. Part of the problem at Enron was that Enron touted directors as independent who really had significant ties to Enron management, ties that Enron did not have to disclose. So investors first need complete disclosure of all ties between board members, the company and company management. H.R. 3818 requires just that, while H.R. 3763 has no such requirement.

While this provision in H.R. 3818 is a very important part of the bill, we would encourage the bill be further strengthened to require that this higher standard of independence be the relevant standard for measuring the independence of auditor and compensation committees. Furthermore, with genuine independence from management must come genuine accountability to shareholders. Shareholders should have access to management's proxy, not just for shareholder proposals on a handful of subjects, but for director candidates that a substantial number of shareholders want to see on the board of the company they invest in. Investors also deserve the right to bring before the annual meeting through management's proxy any proposal that is legal and can be shown to enjoy significant shareholder support. We would urge these corporate governance provisions be added to any reform package.

The second area in need of reform is the practice of public accounting. There are three issues here -- independence, oversight, and the process by which the accounting rules are made. On independence, the simple fact is that you cannot be a public auditor with an

obligation to get the numbers right for a public audience and also be a consultant whose aim is to advise executives on how to optimize the numbers. The tension between those goals is too severe and the rewards for compromising the public audit responsibility are too great. It's just too easy for an auditor seeking to blend those roles to end up like Arthur Andersen at Enron, structuring SPE's as a consultant and auditing those same structures as an auditor.

The Big Five now to be arguing that if they can't earn the big money as consultants they won't be able to attract top people. From an investor perspective, we would say the opposite is true-- that unless audit and consulting functions are separated, the Big Five will not be able to attract anyone with any integrity to their audit practices, and integrity is what worker funds want in an auditor.

Here H.R. 3818 takes the right approach by giving the SEC the authority to ban a wide range of consulting by auditors, and requiring that the audit committee or the full board approve in advance the provision of by the company's audit firm of any consulting services allowed by the SEC. By contrast H.R. 3673 bars only certain types of consulting. It would still allow the involvement of auditors in creating Special Purpose Entities of the sort at issue at Enron. The result is auditors passing on the accounting treatment in the public audit of the very entities they helped create, as Anderson did at Enron.

H.R. 3818 also requires rotation of audit firms and limits the revolving door between audit firms and their clients. H.R. 3673 has no such provision. The AFL-CIO requested the SEC adopt mandatory audit firm rotation in our December 11, 2001 rulemaking petition to the SEC. We believe the formulation in H.R. 3818, which ties the period after which a change in auditor is required to oversight by a public oversight board, is an appropriately flexible way to prevent public audit firms from becoming captive to their client companies.

The next issue after independence is oversight of auditors. Former SEC Chair Arthur Levitt has outlined in testimony before the Senate Governmental Affairs Committee what we believe are the key characteristics of an much needed auditor oversight body -- members independent of the Big Five, full investigative and disciplinary powers, and independent funding. H.R. 3818 creates a Public Accounting Regulatory Board that meets these three tests. H.R. 3763 envisions a Public Regulatory Organization which does not meet these tests.

Finally, there is the rulemaking process. Anyone familiar with the political pressures brought to bear on FASB around accounting for executive stock options in the mid-1990's, not to mention the decade long paralysis on SPE accounting knows that FASB is too open to pressures from issuers and those beholden to issuers. Here there are a variety of options available for how to make FASB more independent -- ranging from merging with a public auditor oversight body to closer ties with the SEC. Because of jurisdictional issues, neither bill under consideration addresses the structure of FASB.

However, ultimately we would urge the House to include in any final bill the provisions reforming FASB in Representative Dingell's Truth and Accountability in Accounting Act of 2002 (H.R. 3970).

Then there are the Wall Street analysts. These people play a vital role in our markets- they interpret the numbers. But analysts have become captive to the investment banking side of their firms. That's why part of a comprehensive package of reforms would be a provision banning basing analyst compensation not just on specific investment banking transactions, but also barring tieing analyst compensation to investment banking performance generally. H.R. 3818 requires the SEC to ban analyst compensation tied to investment banking performance. H.R. 3763 goes no further than requiring a study.

All these reforms are of little benefit if there is no enforcement. The Securities and Exchange Commission has been underfunded for years, and has not been able to pay enough to attract and retain the experts they need to do their job. Congress has passed pay parity for the Commission, but has not yet funded it. H.R. 3818 both provides adequate resources to fund pay parity and allows the Commission to expand its oversight and enforcement activity. The Commission needs this kind of increase in resources to take up the needed work of expanding its review of issuer disclosure. H.R. 3763 has no such provision.

Finally, I want to address the ultimate accountability measures available to shareholders -- recourse to the courts. The AFL-CIO and worker funds view litigation as part of a

continuum of tactics for holding the management of the companies we invest in accountable and for recovering money fraudently taken from us. As such, we strongly believe that the current immunity from civil suits in the law for those who aid and abet securities fraud is outrageous -- and directly connected to the rise in accounting restatements and accounting fraud since the Central Bank of Denver case in 1994. We are thus particularly supportive of H.R. 3763's restoration of investors' right to sue those who aid and abet securities fraud and its restoration of the doctrine of joint and several liability in private securities cases. In contrast H.R. 3763 has no such provisions.

The AFL-CIO believes a comprehensive approach to capital markets reform is needed to address the problems that led to Enron's collapse. While H.R. 3818 still could use some strengthening in the area of corporate governance, on the key issues of auditor independence, auditor oversight, analyst independence and investors' right to recover for losses due to fraud, the bill gets at the heart of the problem. In contrast, while H.R. 3763 has a number of positive provisions, it avoids dealing effectively with each of the central conflicts of interest at work in our capital markets.

In closing, the labor movement does not view what happened at Enron as the product of a few bad people at Enron or any other company, for that matter. While those individuals who have been given the responsibility to manage workers' and the public's money need to be held to a single high standard, we believe at the heart of what happened at Enron are systemic problems that need systemic solutions. These solutions will offend powerful interests, but they will protect America's working families. H.R. 3818 contains within it

many of these necessary solutions, and has our strong support. The AFL-CIO is grateful for the opportunity to share our views with the Committee on these bills and welcomes the opportunity to continue to work with the Committee as you move forward in addressing these issues. Thank you.