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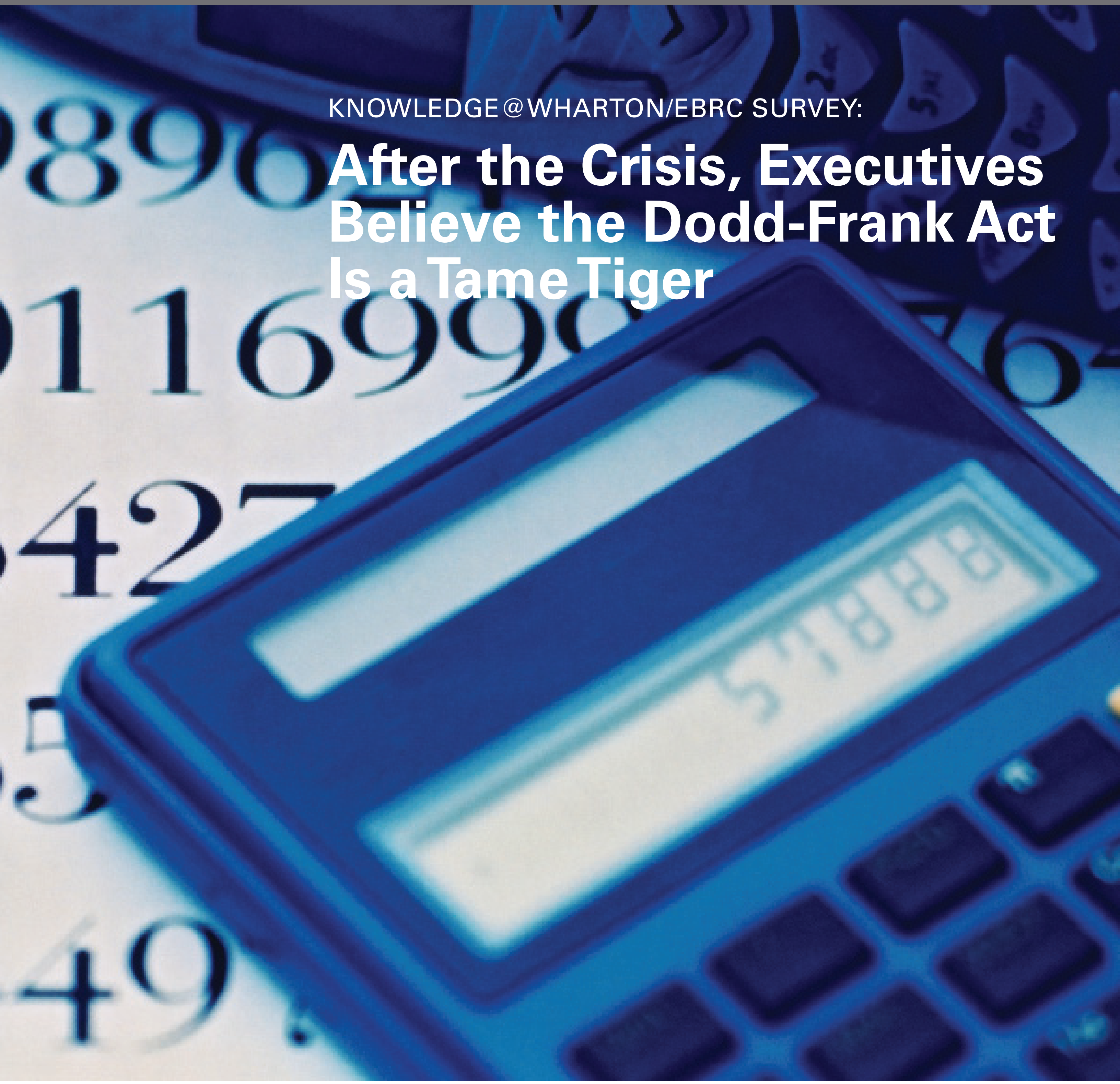
KNOWLEDGE@WHARTON/EBRC SURVEY:

After the Crisis, Executives Believe the Dodd-Frank Act Is a Tame Tiger



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Knowledge@Wharton/EBRC Survey:

After the Crisis, Executives Believe the Dodd-Frank Act Is a Tame Tiger

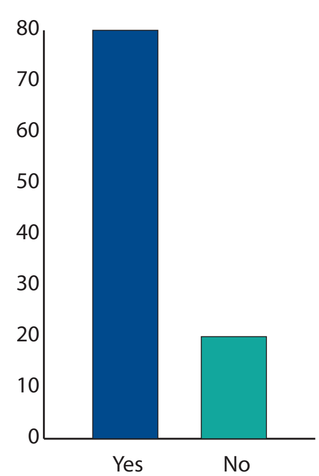
Two years ago, governments in the Western Hemisphere looked into a financial abyss of unprecedented scope. The U.S. housing bubble had burst on the back of subprime loans, those given to the least credit-worthy customers, and the ripple effect of the securitization of those loans sent shockwaves across the globe. It eventually led to the demise of some of Wall Street's most venerable names, Lehman Brothers and Bear Stearns, as well as to a financial meltdown that consumed one country, Iceland (now appearing finally to be headed for recovery). Governments extended bailouts to financial institutions deemed "too big to fail" as taxpayers fumed. A global catastrophe was averted – at least temporarily – but developed economies are still dealing with the fallout today.

With U.S. popular sentiment running hot against trillions of dollars in bailouts, it was inevitable that Congress would act. The Dodd-Frank Wall Street Reform and Consumer Protection Act, aimed at strengthening the oversight of exotic financial instruments to prevent a similar financial crisis from recurring – and at protecting consumers – became law in July. Few doubt that some kind of reform is needed. The question is what kind and how much. But U.S. businesses generally do not appear to have much confidence in the legislation crafted by former Democratic Senator Chris Dodd of Connecticut and Democratic Representative Barney Frank of Massachusetts.

A recent survey by Knowledge@Wharton and the Enhanced Business Reporting Consortium (EBRC) of middle to top corporate management ranks showed a "yes, but" attitude about the Dodd-Frank reforms. A majority applauded attempts to boost oversight of derivatives as well as hedge funds and private equity advisors. They also gave a thumbs-up to the Volcker rule, named after former Fed Chairman Paul Volcker, which would stop banks and certain financial institutions from engaging in proprietary trading and restrict relationships with hedge funds and private equity firms.

In one notable survey finding, respondents agreed that a failing financial company should end up in bankruptcy and not as taxpayer-funded bailout. Executives also applauded

Should the FASB/IASB make specific recommendations on what changes, if any, are needed to make financial statements decision-useful in the future?

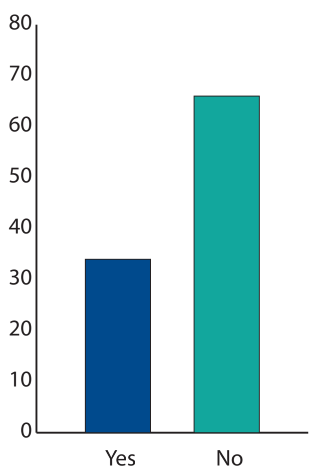


greater oversight of credit ratings agencies and a boost in power for the Securities and Exchange Commission, largely seen as failing to act as Wall Street's top cop in the crisis.

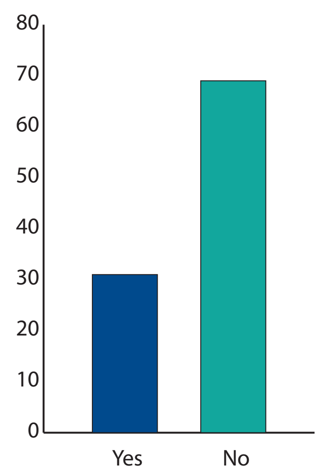
But businesses surveyed balked at the creation of more federal offices, such as the Consumer Financial Protection Bureau, the Financial Stability Oversight Council and the Federal Insurance Office. They were divided about reforms to the Federal Reserve's emergency lending powers, which would limit its lending activities and subject it to audits and improved disclosure. Survey respondents also believe the new financial regulations should have required greater transparency in financial statements, especially a more current and accurate valuing of assets on their books. They also want stiffer punishment and penalties for top executives who lie to investors and hide bad assets. The bottom-line view that emerged from the survey is that the Dodd-Frank act is a tame tiger, a shadow of what it could have been.

"Much of what is proposed in Dodd-Frank consists of knee-jerk additions rather than a sensible review of the existing regulatory mess," wrote one respondent. Another opined that "a more radical restructuring" is needed to strengthen systemic weaknesses. A third noted that ignoring safety checks also hurt: "The systems in place to safeguard bank assets are good – unfortunately, they were overridden and ignored prior to the meltdown. Good systems, audit processes and dual controls are good only if they're followed." Another participant was more blunt: "This entire bill is a joke. What was needed is more enforcement of existing regulations, not more paperwork creating regulations that no one will monitor."

Financial statements – are these adequately meeting the needs of users today?



Have your views of these statements changed since the financial crisis?



Richard J. Herring, Wharton finance professor and a co-director of the Shadow Financial Regulatory Committee, points out: "What's totally missing is any kind of way to hold regulators accountable to do what they were supposed to do. If they had simply applied the laws on the books, most of this would not have happened."

The Good, Bad and Ugly

Survey respondents gave their highest mark to Dodd-Frank's plans to boost regulators' authority over the derivatives market in order to avoid future economic crises and encourage more transparency. Forty-one percent gave it a grade of 5 on a scale of 1 to 5, with 5 being "very important." Sixty-one percent gave it a 4 or 5 rating. That's notable because four out of 10 respondents reported working at a bank, an insurance company or at some other type of financial services firm – big users of derivatives. The call for change came mainly from top executives, with 29% of the 133 participants at the chief officer level.

Executives also gave a thumbs-up to the implementation of the Volcker rule and allowing companies to go bankrupt instead of bailing them out with taxpayer money – 57% gave them the top two grades. Increased scrutiny of credit ratings agencies also captured 57% of the top two ratings, and respondents didn't balk at the creation of

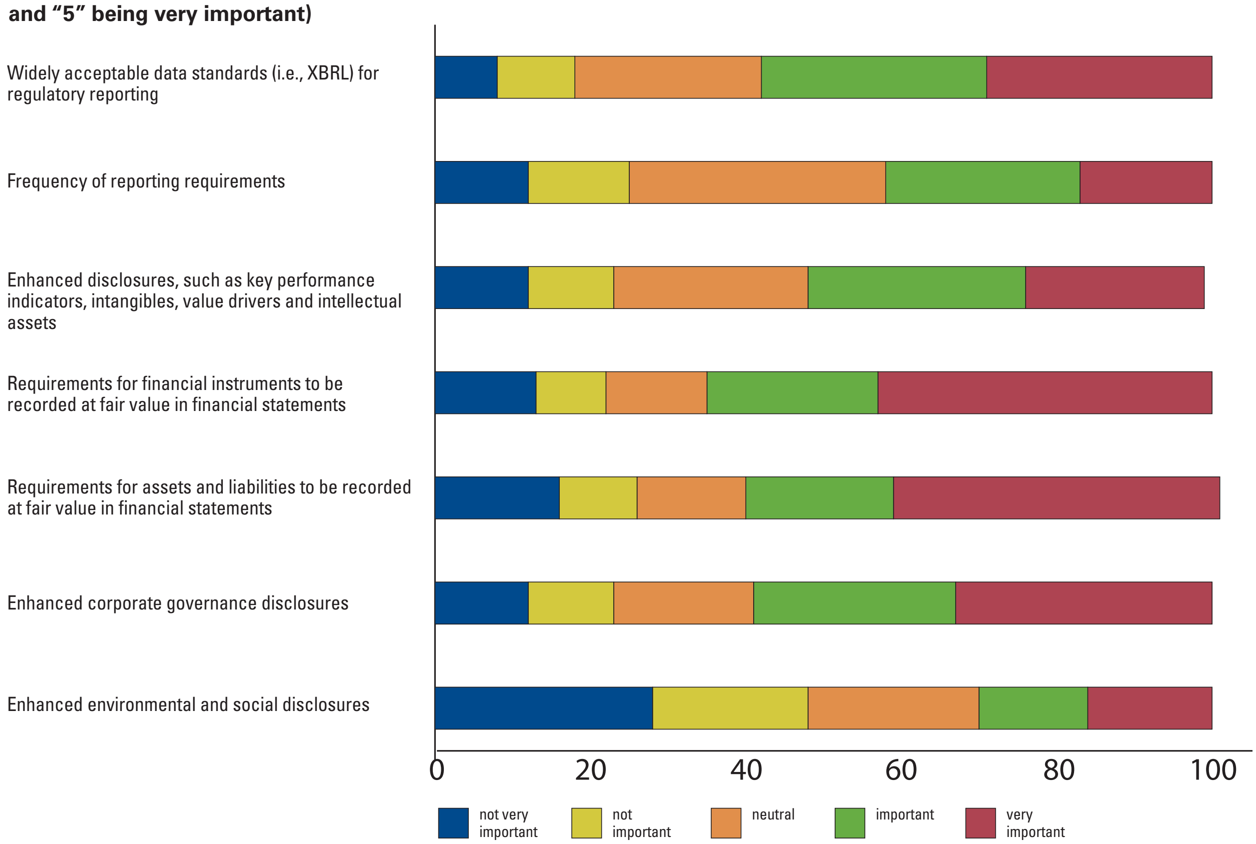
A new financial regulatory regime in the U.S. became law in July. Highlights are listed below. Please indicate which areas you think do the most to encourage more transparency and to help to avoid future economic crises ("1" being not very important and "5" being very important).

the Office of Credit Ratings to monitor them despite a general resistance to more bureaucracy. Meanwhile, boosting the SEC's oversight of hedge funds and private equity advisors, and transferring some of this monitoring responsibility from the federal government to the states received a 52% approval. About the same number – 51% – liked improvements at the SEC, including encouraging whistleblowers. Still, there are skeptics. One participant said, "the SEC missed (convicted con artist Bernie) Madoff. So how are they going to do this stuff better?"

What didn't they like? Executives panned plans to create more federal offices. Asked about the idea to start a Federal Insurance Office, 68% said it wasn't that important or were lukewarm about the idea. Businesses weren't so keen about the creation of a consumer financial protection agency either – 29% gave it the lowest mark, not very important, compared with 26% saying it was a good idea. As for the creation of a Financial Stability Oversight Council, an equal 23% gave it the top and lowest ratings, with a fifth sitting on the fence. In terms of reforming the Fed, more people liked the idea than not – 45% vs. 37% – but the plan did not garner a majority either way.

The survey also polled executives on what they

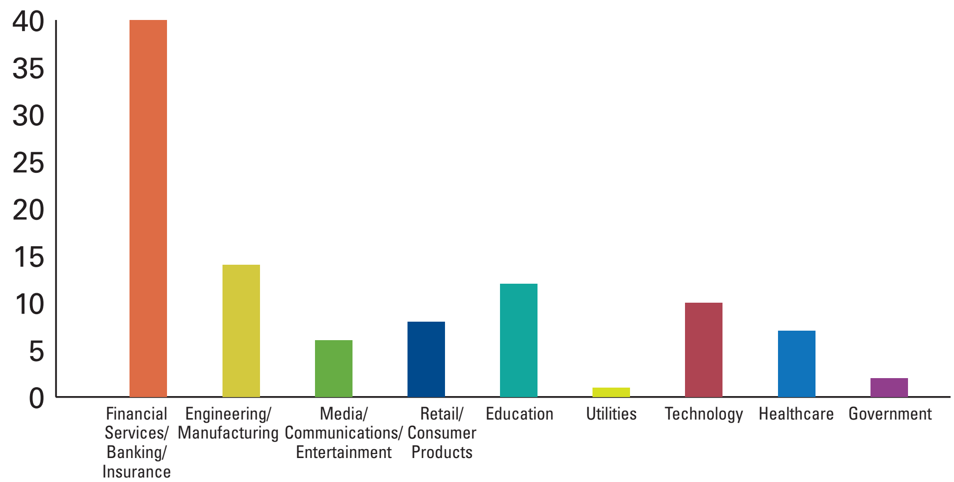
The following areas are not part of the approved reform legislation. Rate how important you think each of the following would be – had they been included in the legislation – in providing more transparency and avoiding future economic crisess ("1" being not very important and "5" being very important)



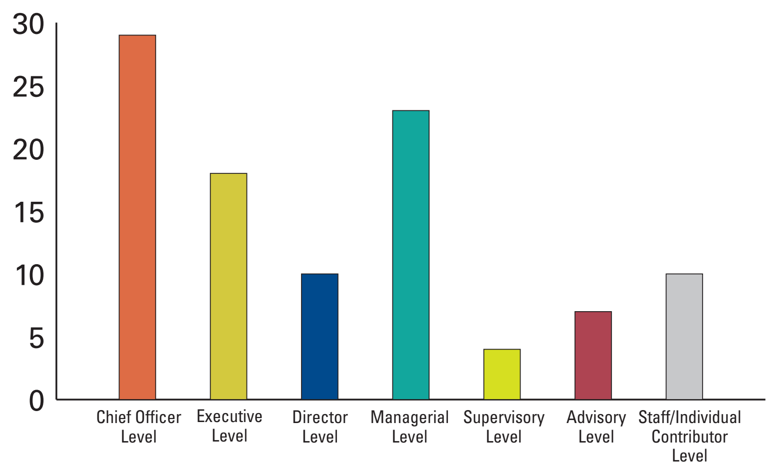
thought about certain issues not included in Dodd-Frank. The overwhelming response – 66% did not believe financial statements are adequately meeting the needs of users today. What's more, 51% ranked the need for enhanced disclosures, such as key performance indicators, intangibles, value drivers and intellectual assets as important, with close to one in four indicating that it was very important. On responder commented, "It's more difficult than it should be to obtain an accurate financial picture of a company." Such a lack of transparency is probably why 80% of respondents want the Financial Accounting Standards Board and the International Accounting Standards Board to recommend changes to financial statements to make the reports more useful to decision makers. Interestingly, only 30% ranked the need for enhanced environmental and social disclosures as important (16% as very important).

Respondents also would like better corporate governance disclosures, with many demanding that directors and chief officers be held directly accountable for mistakes and lies. "Management is adept at responding to investor and shareholder challenges and giving misleading information. No one lies anymore, they misspoke!" wrote one survey participant. Others said directors and executives should be personally liable for failing to act in the best fiduciary interest of the firm, including facing the threat of indictment. Another said shareholders should be given a stronger voice in vetoing executive compensation packages: "Say on pay, with teeth." Dodd-Frank gives shareholders a non-binding vote on pay.

What is your organization's main area of business?



What is your job category?

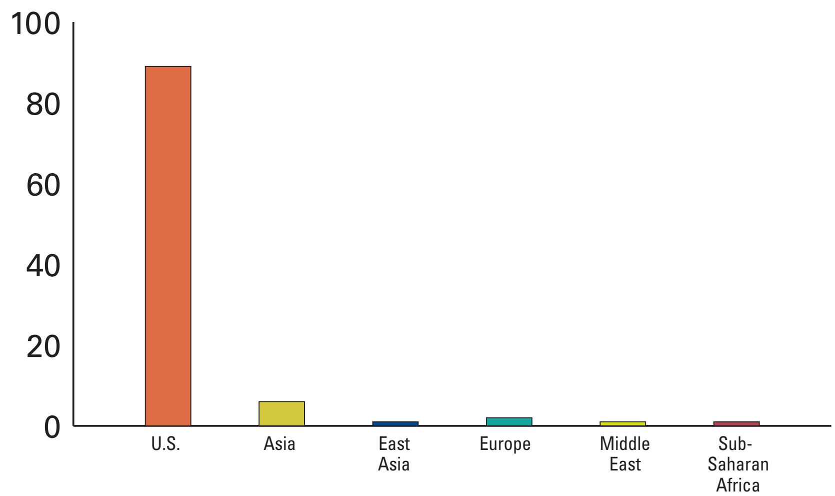


Herring points to another missed opportunity: not consolidating a "byzantine" regulatory system. "No other country in the world has so many different regulators looking at similar institutions," he said. While Dodd-Frank did end one agency, the Office of Thrift Supervision, it created the Financial Stability Oversight Council. The council has 10 voting members, including agencies that have no competency or experience with systemic risk. In addition, other agencies will sit in as observers. "Thus it is unlikely (the council) can move either as quickly or as decisively as may be necessary," he said.

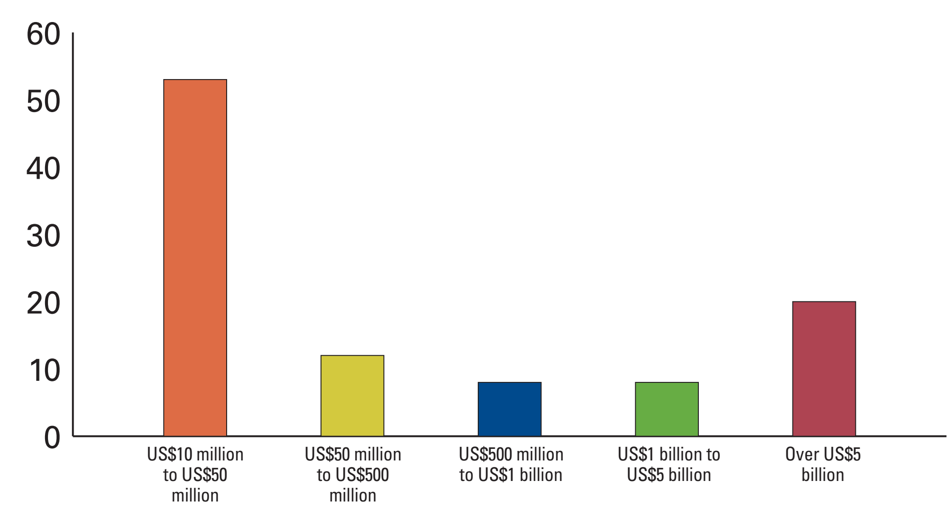
Whatever Dodd-Frank's shortfalls, Wall Street probably saw some level of new rules coming as a result of the financial crisis. Taxpayers who bore the cost of the bailout demanded change and politicians responded. Meanwhile, *The Los Angeles Times* says lobbyists have already swooped down on regulators to soften the blow of Dodd-Frank as details are hammered out. But however many laws are enacted, it is only a matter of time before savvy traders for good or ill find a way around the rules again to make money, according to some respondents.

As one participant noted: "No system is foolproof and there will always be criminals; honesty can't be legislated. Investors always need to understand they need to be vigilant, skeptical and prepared to deal with the risks associated with their investments."

Where is your company based?



What are your organization's annual revenues?



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EBRC

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