

In this issue . . . we look at Congressional responses to the Enron crisis, and revisit the wisdom of Aesop.

WASHINGTON CONFRONTS THE ENRON LEGACY

In the December 2001 edition of this newsletter [www.cug.com/about/cug_com/12_01.asp], we suggested that the Enron debacle might mark a turning point for the financial services industry. Six months later this appears even more likely. Enron's own bankruptcy process is underway, Andersen is in ruins as it faces Federal charges of justice obstruction and the SEC is petitioning for more power and money. Meanwhile, legislators in Congress cannot be accused of standing idle: ten Congressional Committees have held Enron related hearings, thirteen Enron-inspired Bills have been introduced to the House of Representatives and four have been brought in the Senate.

H.R. 3763: 'Magna Carta' ?

Of the House measures, two stand out because of their scope and sponsors. The first, H.R. 3763 was introduced by the Republicans under Michael Oxley, Chairman of the House Committee on Financial Services. Its full title is The Corporate and Auditing Accountability, Responsibility and Transparency Act of 2002, known as CARTA for short.

CARTA touches on wide-ranging issues that include accounting and auditing services, off-balance sheet transactions, insider trading, credit rating agencies, equity research and analyst conflicts, the role of the SEC, and corporate governance.

This bill appears to have the official support of the SEC.

Chairman Harvey Pitt, testifying in favor of the bill before the House Finance Committee on March 20 said: "The proposed CARTA addresses many of the key issues facing our capital markets today... We commend Chairman Oxley... for this effort to improve and modernize our system of financial reporting and regulation of the accounting profession in a comprehensive and deliberate fashion."

H.R. 3763 - which was passed by the House on April 24 - has been touted as an appropriate response to the circumstances that produced the Enron debacle. In his closing comments urging passage of the bill, Chairman Oxley said, "We're going to review corporate governing practices to ensure that they adequately protect shareholders and employees. ...CARTA really gets to the heart of what went wrong."

Not Everyone is Happy

It might appear as though H.R. 3763 will do the job, but not to Rep. John LaFalce, the ranking Democrat on the House Finance Committee. Before the day was over he had issued a press release that began, "Today Congress has squandered an opportunity to address the serious problems in our capital markets raised by the collapse of Enron..." He went on to itemize the areas where he believed H.R. 3763 falls short, including, "...making it harder, rather than easier, for the SEC to bar officers or directors who have committed securities fraud from serving in other public companies." "Moreover," he continued, "it fails to empower the SEC to require corporate wrongdoers to disgorge their bonuses and other compensation after committing securities fraud."

Rep. La Falce went on to propose his own solution, a bill that will, "cure many of the defects of the Republican bill." Rep. LaFalce's bill is H.R. 3818, the Comprehensive Investor Protection Act [CIPA].

Duelling Bills: CARTA vs. CIPA

How you view the rival bills probably depends on your political leanings as much as anything. Lined up behind the LaFalce bill is the AFL-CIO as well as several consumer protection groups. H.R. 3818 is clearly a more sweeping reform than H.R. 3763: whether it goes too far is a more subjective call.

Although the Democrat's H.R. 3818 may be closer to many of the reforms sought by the Bush administration, Republican supporters of H.R. 3763 seem satisfied with the progress already made. "CARTA restores fairness and honesty to the system, while leaving its main tenants in place... This legislation will take us on a path to transparency and legitimacy, where rules are valued and fraud is exposed and prevented.." *Rep. Felix Grucci (R-NY)*.

One thing common to both bills is extra funding for the beleaguered SEC. In a separate measure [H.R. 3764] Chairman Oxley offers \$700 million for the 2003 SEC budget, up from \$480 million, while Rep. LaFalce proposes raising their funds to \$876 million.

The Senate also Stirs

The Senate has been taking its own steps in a mirror image of the House activities. For Rep. Michael Oxley [R] read Senator Phil Gramm [R], and for Rep. John LaFalce [D] read Senator John Sarbanes [D]. Sen. Sarbanes has drafted a bill that appears to push as hard as that of LaFalce. Sen. Gramm meanwhile is both hurling criticisms at the measure and working on his own, less drastic alternative. Supporters are lining up behind their champions: the American Institute of Certified Public Accounting is firmly in the Oxley / Gramm camp, while Sarbanes can count ex-Federal Reserve Chairman Paul Volcker, Mr. John Bogle, founder of the Vanguard Group, and C. Michael Cook, former chairman of Deloitte & Touche as high-profile allies.

Where Will it End?

It would appear that some form of legislation is assured, although at the time of writing the Sarbanes bill was hung up in the Senate Banking Committee, victim of an intense opposing lobbying effort. Any new law eventually passed will probably be a carefully negotiated amalgam of Oxley, LaFalce, Gramm and Sarbanes.

What might this mean for the D&O market? It is significant that both the Oxley bill and the LaFalce bill begin with the words, "To protect investors." Of course, investors have a lot of votes. But what may be good for investors may not be so good for D&O carriers. Imposing stricter standards for financial reporting and corporate governance could result in more companies failing to meet those standards, leaving them potentially more exposed to litigation from aggrieved stockholders. In addition, a beefed-up SEC may find itself able to pursue more investigations of suspect companies.

More protection for the investor and good for public policy? Almost certainly, but for those in the business of protecting executive behavior, a more ambiguous outcome. ✍



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AESOP

The insurance and reinsurance markets continue in a state of controlled turmoil that affects buyers, brokers, insurers and reinsurers. For some timeless perspective we turned to the fables of Aesop, the legendary Greek fabulist who lived in the 6th century B.C. In this issue we print one of his over 300 fables, and will print one more in each of our next three editions of CUG.COMments. Although Aesop provided morals to his tales, everyone can find in them their own message and relevance.

The Serpent and the Young Girl

A young girl was walking along a path during very cold weather when she saw a snake on the ground. The snake spoke to her, saying, "I am freezing and about to die. Please put me under your coat and take me with you." "No," replied the girl, "You are a snake and if I pick you up you will bite me." "Oh no," said the snake, "If you help me I promise to be your friend and treat you differently." The girl looked at the snake's beautiful markings and took pity on the frozen creature. "I will save you," she said, and reached down and put the snake gently under her coat. The snake soon warmed up, and as soon as it had done so it bit the young girl. "How could you do this?" she cried, "You promised that you would not bite me if I helped you!" The snake hissed and slithered away, saying, "You knew what I was when you picked me up."



Moral: A snake is a snake and should only be expected to behave like one.



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