



HOW INVESTORS CAN RESTORE INTEGRITY TO OUR FINANCIAL MARKETS

Jessica Riggs
State Treasurer's Office, Executive Office

California State Treasurer Phil Angelides recently published a new report – “*The Power of the Purse: How Investors Can Restore Integrity to Our Financial Markets*” – in which he called upon institutional investors across the nation to aggressively use their clout to step up the pressure for corporate reform.

The report notes that the financial crisis resulting from the breakdown in ethics and accountability, exemplified by the scandals at Enron, WorldCom and others, has had a dramatic impact on California and the nation as a whole. For example, the FBI has reported that the take from every bank robbery in the United States between 1996 and 2001 totaled \$208 million. By contrast, WorldCom's accounting fraud cost California's teacher and public employee pension systems over \$850 million.

What fraud of this magnitude does to investor confidence and market stability is undeniable. Without a doubt, the deceptions perpetrated at WorldCom and others are only outward signs of a greater ethical crisis in corporate America today. Not since the Crash of 1929 has this country seen its financial institutions so heavily battered by revelations of corporate malfeasance, deception, and fraud concludes the report.

Renewing public trust in American corporations and in the nation's financial institutions will require the full commitment of public and private sector leaders asserts Angelides. Central to this commitment must be the reestablishment of a federal regulatory and enforcement system, which ensures that the financial markets function in the public interest.

However, stresses the Treasurer, of equal importance, the owners of U.S. corporations, both institutional and individual shareholders, must also commit themselves to reform by exercising the power of the purse to bring about a new era of corporate responsibility.

Following are six basic tenets put forth by the Treasurer for an emboldened shareholder movement, taken from “*The Power of the Purse: How Investors Can Restore Integrity to*

Our Financial Markets.” These principles are based on a simple premise: investors can use their market force to help restore integrity to our financial system if they are willing to mobilize and take action in the cause of corporate reform.

Highlights of “*Power of the Purse*” Related Actions the Treasurer has Taken

- In July 2002, Treasurer Angelides joined New York Attorney General Eliot Spitzer, North Carolina Treasurer Richard Moore, and New York State Comptroller Carl McCall in adopting a set of Investment Protection Principles which require investment banks and money managers to meet new standards of disclosure and eliminate their conflicts of interest or risk losing the right to do business with their states. At the Treasurer's urging, these principles have since been adopted by both the California Public Employees' Retirement System and the California State Teachers' Retirement System
- In August 2002 Treasurer Angelides co-convened an “Investor Summit” of public financial leaders from 14 states to develop an agenda for common action aimed at improving corporate accountability.
- The California State Treasurer's Office already is sending a message by prohibiting investment and business dealings with expatriate U.S. corporations that relocate offshore – in name only – to avoid taxes and escape legal protections for shareholders.

Demand Ethical Conduct

Institutional investors must use their market strength to demand the highest standards of ethical conduct and transparency.

Act Like Owners

Shareholders should start acting like the owners they are. They must make the most of the voting power that they possess today while they mobilize to strengthen their rights to have a meaningful say in the companies they own.

Reward Value, Not Greed

Shareholders have an obligation to restore rationality to the realm of executive pay – rewarding effective corporate leadership, while curbing excesses that undermine the long-term health of the American economy and jeopardize the faith of the investing public.

Pursue New Investment Strategies

Institutional investors must examine innovative strategies that protect their interests from corporate malfeasance and that alert public companies to the fact that they are more thoroughly examining the companies in which they hold a stake. Ultimately, investors must be willing to cease investments in companies resistant to reform.

Send a Message: Company Conduct Counts

Investors must send a clear message: company conduct counts. They can no longer ignore the relationship between good corporate citizenship and good investments.

Reward the Creation of Long-Term Value

Investors need to help good companies do the right thing. Quarter-by-quarter expectations need to be replaced by shareholder and management commitment to the creation of true wealth over the long term.

Treasurer Angelides concludes by noting that only when American investors work to restore integrity to our financial system will we see the restoration of the open, fair, and free economy that has always been part of our national heritage.

For a copy of “*The Power of the Purse*,” go to www.treasurer.ca.gov.

This Offprint was previously published in DEBT LINE, a monthly publication of the California Debt and Investment Advisory Commission (CDIAC). CDIAC was created in 1981 to provide information, education, and technical assistance on public debt and investment to state and local public officials and public finance officers. DEBT LINE serves as a vehicle to reach CDIAC's constituents, providing news and information pertaining to the California municipal finance market. In addition to topical articles, DEBT LINE contains a listing of the proposed and final sales of public debt provided to CDIAC pursuant to Section 8855(g) of the California Government Code. Questions concerning the Commission should be directed to CDIAC at (916) 653-3269 or, by e-mail, at cdiac@treasurer.ca.gov. For a full listing of CDIAC publications, please visit our website at <http://www.treasurer.ca.gov/cdiac>.

All rights reserved. No part of this document may be reproduced without written credit given to CDIAC. Permission to reprint with written credit given to CDIAC is hereby granted.