

An incentive for prudence

There were legislative milestones along this road to economic calamity.

There was the Gramm-Leach-Bliley Act of 1999, which dismantled the barriers between banks, insurance companies and securities dealers. Out of it was born too-big-to-fail financial behemoths like AIG and Citigroup, with the speculative culture of the investment banks infecting the risk-averse tendencies of traditional banking.

There was the Commodity Futures Modernization Act of 2000, which dramatically increased speculation in commodities and is implicated in both the Enron bankruptcy and the liquidity crisis that erupted in September 2008.

Add to that list the Private Securities Litigation Reform Act of 1995. That act, which was passed over President Clinton's veto, has made it far more difficult for shareholders to recover civil damages from investment fraud.

The bill was written and promoted largely to protect Arthur Andersen from going down the tubes for signing off on Enron's fantasy accounting practices. "It was the ultimate in special-interest legislation," James D. Cox, a professor of corporate law and securities regulation at Duke University, told The New York Times in 2002.

The current upshot is that those people who peddled dubious derivatives can't be held liable by the people who lost money on them. According to the people who revisit that law - including managers of some of the country's largest pension funds - even the people who sold Bernie Madoff's wares may be exempt from civil litigation.

The Private Securities Litigation Act tilted the playing field in favor of those selling securities, and repealing it as part of a broader regulatory reform package would, the argument goes, restrain those who take unacceptable risk with investors' money. While the SEC must do a better job on enforcement, repealing the PSLRA would create a private enforcement mechanism by empowering the attorneys for pension funds and other large scale investors to make sure they aren't being taken for a ride by companies hiding critical information about their accounts.

This is one part of what must be a comprehensive and careful re-regulation of the securities markets. Most agree that excessive risk on the part of the financial sector played a large role in this disaster. The answer is not to wag a finger and say "be more careful next time." It's to create incentives for prudence, including opportunities for victims of investment fraud to hold the perpetrators accountable.

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