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EXECUTIVE SUMMARY

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PANEL 1

Shop Talk: CEOs on Law and Business

Guhan Subramanian, AB ’92, MBA ’98, JD ’98, Joseph Flom Professor of Law and Business, Harvard Law School, and Douglas Weaver Professor of Business Law, Harvard Business School – *moderator*

David Bonderman, JD ’66, Chairman and a founding partner, Texas Pacific Group

Bill Donaldson, MBA ’58, Chairman, Donaldson Enterprises, and Chairman, Financial Services Volunteer Corps (FSVC)

Steve Miller, JD ’66, President, CEO and Director, International Automotive Components Group

David Sorkin, JD ’84, General Counsel, KKR

OVERVIEW

CEOs have a lot on their plate. They are concerned about the challenging political environment, rising nationalism, regulation, short-termism, and activist investors. Still, they see significant opportunities in the US and abroad, particularly in India and China. Realizing these opportunities, navigating the minefields that exist, and transforming their organizations takes a new kind of entrepreneurial leadership. Entrepreneurial leaders have integrity, focus on the long term, and create team-based non-hierarchical organizations.

KEY TAKEAWAYS

Most business leaders are opposed to government bailouts, though at times they are necessary.

Most business leaders struggle with the government intervening to bail out companies in crisis. Still, the panelists agreed there are times when government intervention is in the country's best interests.

Steve Miller thought the Chrysler bailout was the right thing because had the company failed it would have taken down a great deal of industrial America. Likewise, had the government not bailed out AIG there would have been enormous damage of the entire financial system. Mr. Miller commended then-Treasury Secretary Henry Paulson and Tim Geithner, then President of the Federal Reserve Bank of New York, for having the courage to act at a time of crisis with inadequate information. This action prevented the failure of the entire financial system—and ultimately taxpayers got their money back.

David Bonderman said the government's bailout of General Motors was also necessary and was even more central to the economy than Chrysler. Had GM gone under, hundreds of thousands of jobs would have been lost and the Midwest would have been devastated long term. Mr. Bonderman acknowledged that Paulson and Geithner stepped up with AIG, but they failed to bail out Lehman Brothers, which was a mistake.

Dodd-Frank won't prevent future economic crises and will make them harder to deal with.

Conventional wisdom and the perception of the public is that Dodd-Frank eliminates or reduces the possibility of future crises and the need for future bailouts. However, the panelists see it differently. They don't believe Dodd-Frank decreases the likelihood of future financial crises and believe Dodd-Frank takes away tools that were used for previous bailouts. Mr. Miller anticipates that in the next crises government leaders will do what they did previously—make it up as they go. Leaders "stretched" the law in 2008, as needed to preserve the system, and will do so again if necessary.

> *"Dodd-Frank has taken away the tools that used to exist to do the bailouts the way it was done in 2008."*
>
> *– Steve Miller*

David Sorkin commented that regulation such as Dodd-Frank reflects the public's mistrust of business, which is demonstrated by the rhetoric of Congress. Mr. Sorkin was hopeful that the level of trust and confidence between government and business will improve before the next crisis.

Governance at the SEC and other regulatory agencies is a mess.

While the day-to-day functioning of the SEC is strong, former SEC Chairman Bill Donaldson views the governance at the SEC as a politicized mess. The politicization stems from the SEC's basic structure, with three commissioners from the President's party and two commissioners from the other party. This structural politicization is not unlike other parts of the government.

Mr. Sorkin observed that regulation post-financial crisis is an international effort. US regulation has traditionally been disclosure based, while non-US regulation has been more prudential or substantive, saying what can or can't be done. There is tension for businesses in trying to reconcile these two methods of regulation.

There is a disconnect in how business leaders and the public think about trade.

The panelists are generally free traders who believe that trade has been beneficial for America and the world. Mr. Miller termed NAFTA "an incredible blessing" that has brought efficiency to all three NAFTA markets. Unwinding NAFTA would not be beneficial or practical. Mr. Miller also believes that TPP has great promise and is disappointed it has been politicized.

> *"I think we have been a winner as a country, even though certain sectors may have been disadvantaged by a particular item moving its production to Mexico. But that's offset across our country by all the things that are going well."*
>
> *– Steve Miller*

Without debating the macro benefits of trade, Mr. Bonderman believes the trade policies of Western governments have created political problems. Trade policies have benefitted consumers at the expense of workers. Consumers can buy cheap goods from China at Walmart but employees at American manufacturing companies that previously made goods are now unemployed. Western nations have not understood or grappled with this.

> *"Governments from the West, Europe and the United States, inadvertently or otherwise, have followed policies which substantially benefitted consumers at the expense of workers."*
>
> *– David Bonderman*

The political reaction of nationalism and isolationism is also taking place across the globe, as reflected by the UK's Brexit vote, as well as elections in the United States, France, and Hungary.

The geographic market with the most opportunity may be India.

Markets remain fragile everywhere, and per Mr. Bonderman, in times of fragility and uncertainty, the US is the best place to invest.

> *"In times of uncertainty, capital flows to the US. The fear factor overcomes the greed factor."*
>
> *– David Bonderman*

Outside of the US, a favorite location for many investors is India. India has always been seen as a market with significant potential growth, but historically India has had corruption, has been badly governed, and has had a poor infrastructure. While the infrastructure is still lacking, corruption has decreased and the country's new political leadership is inspiring confidence among investors. Also important is that India is not a principal trading partner with China, which means that China's downturn has a minimal impact on India. Other panelists shared Mr. Bonderman's optimism about India, but remain more optimistic about China.

Mr. Sorkin, taking a general counsel perspective, sees challenges in moving into jurisdictions where the rule of law is less developed. This puts pressure on businesses to pick the right partners in these jurisdictions. It also puts pressure on companies to comply with the Foreign Corrupt Practices Act.

Organizations need more long-term, entrepreneurial leadership.

Mr. Donaldson argued that the biggest problem in business is short-termism, with companies focused on quarterly earnings. To address this, companies need a new way of organizing and operating, and a new kind of leadership that is team based and long-term oriented.

> *"The biggest problem we have in the business world is short-termism, not just in the marketplace, but in the way companies are run."*
>
> *– Bill Donaldson*

The private equity industry grew up as an antidote to quarterly capitalism, with the belief that private companies could be more patient and long-term focused, and could employ strategies that might go against conventional wisdom. This was stated by Michael Dell as a motivation for going private. However, the SEC and others are now demanding that private equity firms publish quarterly results, which diminishes one of the benefits of being private.

> *"There are still places where a model of private long-term ownership can be very effective."*
>
> *– David Sorkin*

Activist investors can help companies.

Mr. Miller has seen benefits from activist investors as they cause boards to be proactive in rigorously assessing their company's performance to preempt an activist attack. In situations where an activist sits on a board, Mr. Miller has seen activist investors behave as part of the team and bring creative ideas.

The private equity representatives on the panel have seen both good and bad activist investors. A common theme is that when an activist investor targets a company the CEO often responds by approaching private equity firms about going private.

PANEL 2

Main Street, Wall Street & K Street: Relations Among Business, Finance & Government

Marshall Sonenshine, JD ’85, Chairman, Sonenshine Partners – *moderator*

Rodgin Cohen, AB ’65, LLB ’68, Senior Chairman, Sullivan & Cromwell

Richard Fenyes, JD ’95, Partner, Simpson Thacher & Bartlett

John Finley, JD ’81, Chief Legal Officer, The Blackstone Group

Stephen Friedman, JD ’62, President, Pace University

Julius Genachowski, JD ’91, Managing Director and Partner, The Carlyle Group

Ed Haldeman, MBA ’74, JD ’74, Non-Executive Chairman, S&P Global and KCG Holdings

OVERVIEW

As is the case when free financial markets go to excess, and as occurred following the most recent financial crisis, legislators and regulators impose rigid rules in an attempt to satisfy the public that such a problem will never occur again. These rules add costs and greatly limit the flexibility of markets, as has occurred. The current regulatory situation is compounded by a toxic political environment that has made the regulatory landscape partisan, acrimonious, and unproductive.

Reasonable people agree on the need for the regulation of financial markets, with a goal of "smart regulation." But today we are far from achieving that goal. What is needed is a more open dialog and an improved relationship between government and business. The tone of the discussion must change.

KEY TAKEAWAYS

Regulation is an important, necessary part of a free market system. Needed is *smart* regulation.

These thoughtful panelists concurred that financial market regulation is necessary.

> *"I think most of us think regulation is something that is necessary. Having people work closely together is I think far more likely to result in smart regulation."*
>
> *– Richard Fenyes*

Stephen Friedman has seen major regulatory changes arise from two situations:

1. **To accommodate market changes.** The markets are constantly changing and these changes leave the regulatory system behind. It takes a long time—often a decade—for the regulatory system to adjust. Meanwhile, the markets continue to change.
2. **In response to a disaster and excess.** By their nature, free financial markets go to excess, which happens every eight to ten years. Excess is often driven by players being compensated based on the top line, and occurs when market events exceed the parameters of models.

These excesses make regulation an essential part of the free market system. However, when regulatory change comes in response to excess there is a demand by the public and Congress to ensure it will never happen again. We inevitably end up with rules that are much too rigid.

> *"Financial regulation is a constant search for the right balance between rule making and enforcement."*
>
> *– Stephen Friedman*

John Finley advised considering the costs of regulation, which are often underestimated. Costs include having to create huge compliance departments that can be bureaucratic dead weight. Regulation also has unintended side effects, and can disadvantage smaller and midsized firms. Mr. Finley advocated for smart regulation that is well tailored, cost effective, and proportionate.

A cooperative, collaborative relationship between regulators and business is the ideal.

The regulatory environment has become much more politicized, polarized, partisan, and acrimonious. Reasons include constant political fundraising, gerrymandering that has made House seats non-contestable, a changed media landscape that has complicated the political debate, a reluctance by Congressional committees to approve regulatory reorganization, a diminishment of independence of regulatory agencies, a decrease of centrist think tanks, and perceptions of "regulatory capture" where regulators are seen as captured by industry.

> *"Washington has become much more polarized and it has affected [regulatory agencies like] the FCC."*
>
> *– Julius Genachowski*

A response to concerns of regulatory capture, which Rodgin Cohen argued is rare, has been greater distance between regulators and who they regulate, greater skepticism, and even confrontation, which is counterproductive.

> *"A long-distance relationship filled with tension inhibits rather than enhances information flows and the ability to make informed and thoughtful judgments. . . . Such an environment undermines rather than promotes a strong financial system."*
>
> *– H. Rodgin Cohen*

There was strong agreement of the need for regulators and regulated industries to engage in constructive dialog and collaborate on smart, effective regulation.

"You need a really good dialog between the regulators and the industry that's being regulated."

– John Finley

Much can be learned from examples of regulating too late, as well as regulating too much.

Case Study #1: Waiting too long to regulate derivatives

The lack of regulation of derivatives in the late 1990s is an example of regulating too late.

In 1998, Brooksley Born, an accomplished lawyer and regulator, was chair of the Commodities Futures Trading Commission (CFTC). Derivatives had grown to a nominal value of $27 trillion, but were exempted from regulation. Born proposed having the CFTC issue a concept release, which is a routine process that involves studying a sector of the market and considering whether regulation is needed.

Her proposal was met with a strong and immediate negative reaction from the large banks and financial institutions, as well as Treasury Secretary Robert Rubin, Assistant Treasury Secretary Larry Summers, and Fed Chairman Alan Greenspan. They argued that just issuing a concept release would drive the derivatives business offshore, with the American financial markets losing this business.

As a result of fierce political infighting, Born's proposal was quashed. Essentially, these champions of the booming economy (Rubin, Summers, and Greenspan) didn't see any problems, believed if problems occurred the free market would sort them out, and didn't believe derivatives needed to be regulated. The derivatives market proceeded to grow to hundreds of trillions of dollars before the bubble burst, which contributed to the financial crisis.

"There was an element of 'if it ain't broke, don't fix it' . . . this is not atypical behavior."

– Stephen Friedman

Some panelists argued that Born should have defied the political pressures and issued a concept release, as that was her job. Others felt that as part of a larger ecosystem, Born should have done a better job of persuading stakeholders of the need to look at derivatives. All agreed that supporting markets does not mean giving markets an unlimited free pass. Strong, healthy markets require some degree of smart regulation. In this case, completely ignoring the need to regulate derivatives was a mistake.

Case Study #2: Overzealous regulation of Freddie Mac

Regulation focused on the Government Sponsored Entities (GSEs) Freddie Mac and Fannie Mae is an example of the wrong form of regulation.

Ed Haldeman, who joined Freddie Mac in 2009 and stepped down as CEO in 2012, said that before the financial crisis there was "crony capitalism" at the GSEs, as members of the government would step down and become senior executives at a GSE. There was big lobbying and substantial fundraising taking place there, which created difficulty for regulators. Also, the implicit government guarantee of Fannie and Freddie's debt led profit-maximizing executives to see arbitrage opportunities. At each enterprise they created a huge portfolio that became trillion-dollar arbitrage funds, separate from the basic business of the GSEs.

During the financial crisis the GSEs were put into conservatorship. There was tremendous management turnover, with four CEOs at Freddie within 12 months. There was a new management team and a new board, the Treasury Department owned 80% of Freddie's stock, and the regulator—the Federal Housing Finance Agency (FHFA)—was granted all powers previously granted to Freddie's stockholders, officers, and directors. As a regulator, the FHFA made tremendous changes.

"This was one of the worst examples of public/private partnership that one could come up with, both before and after the financial crisis."

– Ed Haldeman

Even now, eight years after the GSEs were put into conservatorship—which was intended to be temporary—they remain there, in limbo. This has become a permanent condition of nonresolution.

PANEL 3

Global Business and Global Crises

Ed Greene, LLB '66, Senior Counsel, Cleary Gottlieb – *moderator*

Mohammed Bin Mahfoodh Al Ardhi, MPP, Executive Chairman, Investcorp

John Buretta, Partner, Cravath, Swaine & Moore

Carlo Croff, LLM '81, Senior Partner, Chiomenti

Wanda Felton, MBA '84, Vice Chair, Export Import Bank

Najib Mikati, Co-chairman and founding partner, M1 Group

OVERVIEW

Global crises abound. The 2008 financial crisis has shaken confidence in the financial system and financial institutions, and has produced a regulatory tsunami. There is rising global populism and nationalism, as the benefits of free trade, globalization, and technology have been unequal. Government policies have not adequately assisted those who have been left behind.

Regional crises exist, particularly in Europe and the Middle East. The Brexit vote in the UK—a backlash to globalization and immigration—is accompanied by tremendous economic uncertainty. The Middle East is experiencing both a humanitarian crisis and economic concerns. Changes are needed to diversify away from oil and take steps to fight terrorism. These steps will be slow and difficult.

KEY TAKEAWAYS

The 2008 financial crisis has produced continuing global disruptions.

An ongoing series of crises has followed the 2008 global financial meltdown. This includes a crisis in confidence, as there is an environment of less confidence in the world's financial system and financial institutions. This has led regulators to respond with regulation after regulation.

> *"An overarching effect for our business and others from the financial crisis is an environment of less confidence in the whole financial system of the world."*
>
> *– Mohammed Bin Mahfoodh Al Ardhi*

While there is general consensus among economists that free trade has benefitted economies, the gains have not been distributed equally; some have benefitted while others have been hurt. The effects of trade have been compounded by technologies, which have exacerbated job losses, particularly in manufacturing. For a 50-year-old who is displaced after years in manufacturing, finding a job is extremely difficult. These individuals don't see their life improving, and governments have not implemented adequate social policies to help.

These factors have resulted in heightened economic uncertainty, blaming globalization, and a rise of populism and nationalism. In the United States there is little support for TPP, and negotiations between the US and EU for a trade agreement are on hold.

> *"While free trade may have benefitted global economies, it's had a disproportionate effect."*
>
> *– Edward F. Greene*

In some developing countries, such as Lebanon, which have followed developed countries in pursuing globalization, benefits have not been seen. Former Lebanese Prime Minister Najib Mikati said that after 30 years of embracing globalization, the economy is still not doing well. The country is not creating jobs and people are leaving the country.

> *"The rich are getting richer and the poor are getting poorer in this emerging market. . . . Today we can say that globalization is not the solution."*
>
> *– Najib Mikati*

The impact from the Brexit vote is highly uncertain.

Thus far, outside of the vote in the UK for the Brexit referendum to leave the EU, nothing has happened legally. However, this vote is being treated as a political imperative and Prime Minister Theresa May has indicated she will sign documents by March 2017 legally triggering Brexit, which will occur within two years. (Parliament is challenging the process, asserting that Parliament must agree; a decision is expected by late 2016).

Since the formation of the European Common Market in 1957, Europe has taken continuous steps towards greater unification. Brexit is the first step backwards—and no one knows what will happen.

> *"The main problem is uncertainty. We don't know what will happen. . . . A local crisis may become a global crisis."*
>
> *– Carlo Croff*

The UK wants full control over immigration, wants to stop paying subsidies to the EU, and wants to make its own laws. But in exchange for access to the eurozone market the EU wants free movement of people. It is not clear how this will be resolved. One possibility is a bilateral trade agreement between the UK and EU, which will take time. Another possibility is trading under the WTO, which would limit the UK's rights and freedoms. However, these options don't deal with financial services and don't address a common passport.

Despite the uncertainty, investor Mohammed Bin Mahfoodh Al Ardhi expressed optimism. He is continuing to invest in the UK, sees opportunity, is hopeful that logic will prevail, and believes the UK and EU will reach agreements that prevent the financial services industry from fleeing London.

Other panelists expressed concern that European countries with nationalistic tendencies will follow the UK in exiting the EU. And, if special efforts are made to keep financial institutions in London, other countries will want comparable deals.

The Middle East is experiencing significant economic disruptions and a tragic humanitarian crisis.

Major financial institutions in the Middle East came through the global financial crisis in good shape. Banks were mainly local, regulated, and well capitalized, and didn't have the same exposure as Western banks.

However, in the aftermath of the financial crisis, global demand for oil and the price of oil have been weak. This has been a big hit to the Middle East and the Gulf nations, where economies are reliant on oil. While oil will continue to drive economies in the region, recent years have been a wake-up call for governments in the region, such as Oman, to diversify their economies. Oman has focused on tourism, logistics, and renewable energy.

The true crisis in the region is the refugee crisis. Mr. Al Ardhi commented that the international community is responsible and has not lived by its values in responding to it. Germany has taken in over one million refugees, but other countries have not responded with adequate aid or assistance, including the United States. Mr. Mikati said the refugee crisis is "outside of the interest of the United States today."

Ed Greene observed that despite growing anti-immigrant sentiment, it is important to do a better job educating people about this crisis. John Buretta agreed, claiming there is not enough visibility in the US about the depth and scope of the problem, which receives little media coverage.

> *"When we have one-on-one interactions, it's a very generous country. I think the more people learn about the personalities and individual situations, and extend empathy to them, the better off we'll be."*
>
> *– John Buretta*

However, even with education, more terrorist attacks will drive increased nationalism, producing a call for immigration restrictions, even though few refugees are involved with terrorism. Fighting terrorism must occur, per Mr. Mikati, along multiple tracks:

1. Peace must be imposed in the Middle East, which requires negotiation between the Palestinians and Israelis. This must be led by the United States. Also, political systems in the Middle East must be reformed by fighting dictatorships.
2. Iran must decide if it is a state or a revolution. Iran must realize it can't dominate the Arab world and the Arab world must realize it can't isolate Iran.
3. There must be reform of Muslim society. There has been a kidnapping of Islam. Islam has to be transferred into a way of behaving as a community.
4. There must be focus on economic development and opportunity.

Mr. Al Ardhi agreed that Muslim countries must step up and lead, improve education, create good jobs, and reduce poverty.