important social insurance program is not weakened by reports that privatization proposals would not alter or reduce their benefits. Instead, they fight on, trying to ensure the benefits of Social Security will be there for others for years to come.

I have always been impressed with the degree to which our elders contribute to American society. Our Nation's older generations are an ever-growing resource that deserve our attention, our gratitude, and our heartfelt respect. As observance of Older Americans Month comes to a close, I look forward to working with my colleagues in the Senate to implement public policies that affirm the contributions of older Americans to our society and ensure that they all live their later years in dignity.●

FALLOUT FROM ENRON: LESSONS AND CONSEQUENCES

● Mr. HOLLINGS. Mr. President, when I was chairman of the Senate Budget Committee I worked closely with Henry Kaufman, who has, in my judgment, the most respected opinion on the economy. We can all benefit from his views, and I encourage my colleagues to read this speech that he gave last month to the Boston Economic Club, entitled ''The Fallout from Enron: Lessons and Consequences.''

I ask that the speech be printed in the RECORD.

The speech follows.

THE FALLOUT FROM ENRON: LESSONS AND CONSEQUENCES—AN ADDRESS BY HENRY KAUFMAN, PRESIDENT, HENRY KAUFMAN & CO., INC. TO THE BOSTON ECONOMIC CLUB, APRIL 3, 2002

Today I would like to talk about an event that has rocked the financial community: the collapse of the Enron Corporation. Much has been said and written about Enron in recent weeks, but it seems to me that too little attention has been paid to either the underlying issues posed by the demise of the Enron Corporation, or to the likely consequences of this failure for financial markets.

Not very long ago, Enron was widely heralded in the business and financial community for its spectacular growth, its innovative achievements, and its future potential. All of that changed suddenly and dramatically late last year. Since then, many pundits have pointed the finger of blame at Arthur Andersen. But it would be wrong to conclude that Enron's failure stemmed chiefly from the accounting shortcomings of its outside auditors. To be sure, Andersen probably was derelict in carrying out its responsibilities. No accounting firm should have the kind of intimate and conflicting relationship that Andersen had with Enron. Auditing and concurrent consulting arrangements with clients just don't mix, for they pose very real conflicts of interest that compromise objectivity and independence.

Even so, I am not convinced that a complete dismantling of Arthur Andersen would serve the larger interests of all stakeholders. To be sure, any senior officers and managers at Andersen found to have compromised sound accounting standards should be fired. But from a social perspective the thousands of Andersen employees who were innocent of high-level misdeeds do not deserve to be displaced.

The issue here is even more complicated. On the one hand, dismantling Andersen would push forward by a giant step the concentration in the accounting business that already is quite high. On the other hand, no business organization should be considered to be too-big-to-fail. Otherwise, competition, which should be the market equalizer, will be distorted. In addition to these considerations is the fact that focusing on Andersen simply deflects the spotlight away from the misdeeds of Enron itself. It offers Enron's officials and all the others involved in the Enron relationship, from the private sector to people in government, a convenient scapegoat, and increases the likelihood that we will fail to learn important lessons form the energy trader's debacle. That would be very unfortunate.

The failure of Enron is a drama with many dimensions. It encapsulates a remarkable number of the kind of misbehaviors, shortcomings, and excesses that have plagued business and financial life in the last few decades. Even if we look back over financial crises in the half-century since World War II, it is difficult to find one with as many salient elements as the Enron failure.

Consider, for example, the volatile decade of the 1970s. The calamities began in 1970, with the staggering collapse of the Penn Central Railroad. The Pennsy was derailed by its excessive short-term borrowing, mainly in the form of commercial paper, supported by weak earnings. Later on, the Hunt brothers succeeded in cornering the silver market, but financed their manipulations with heavy short-term borrowings. Many of their lenders used silver as collateral, which led to a massive sell-off in the silver market when the hunts exhausted their borrowing capacity. Then there were the oil crises of the 1970s, which set off a crippling around of defaults among key Latin American nations that had borrowed heavily from large money market banks. Because these banks had failed to exercise prudent credit judgment, the financial pressure of the oil shocks plunged debtors and creditors alike into serious trouble.

The 1980s had its share of financial excesses. The decade's economic boom had been fed in large measure by the liberal lending policies of banks—especially savings and loan associations—and by the massive leveraging of many corporations through junk bond financing. These financial splurges later made it initially difficult to jumpstart the economic recovery in the early 1990s.

As for the 1990s: the serious financial strains in Mexico and in several Asian countries, as well as the recent debt default of Argentina—all remain fresh in our memories. Then, as the decade drew to a close, the financial world was rocked by a financial debacle that threatened the very viability of key money market institutions. I am referring here, of course, to the dramatic fall of Long Term Capital Management in late 1998. Enron's collapse, however, did not pose a *systemic* risk to the financial system the way LTCM's failure did, although some of Enron's senior managers and creditors have suggested as much during their negotiations with government officials. To their credit, regulators and central bankers did not step in to rescue the faltering energy giant from its own misdeeds.

Which brings us back to the lessons to be derived from the Enron case. It seems to me that Enron—by bringing together a range of issues and problems that have plagued the U.S. financial system for decades—raises a host of questions that we simply must address:

How effectively do boards of directors discharge their responsibilities?

What are the inadequacies of senior managers?

Are lenders conducting effective due diligence?

Are sell-side analysts objective in their analysis, or are they compromised?

Should employees be permitted to invest a high portion of their pensions in the equity of the corporations that employ them?

Is official oversight adequate?

Can elected officials be objective in dealing with financial excesses given that they may be conflicted by contributions?

Should the public accounting firm serve a client a both an auditor and a consultant?

These vexing questions lie at the heart of the Enron debacle. To a large extent, they point to a fundamental problem that has been festering for some time, namely, the separation of corporate ownership and control. This problem has become more acute in recent decades because of structural changes in finance and investments. But this issue hardly is new. In fact, it is a symptom of advanced industrial capitalism, in which firms become too large to be owned and managed by individuals or even wealthy families.

One of the most penetrating critiques of the concentration of corporate control appeared back in 1932, when Adolf Berle, a law professor and reformer, and economist Gardiner Means published their landmark book, The Modern Corporation and Private Property. As Berle and Means noted vividly:

''It has often been said that the owner of a horse is responsible. If the horse lives he must feed it. If the horse dies he must bury it. No such responsibility attaches to a share of stock. The owner is practically powerless through his own efforts to affect the underlying property. The spiritual values that formerly went with ownership have been separated from it. . . . [T]he responsibility and the substance which have been an integral part of ownership in the past are being transferred to a separate group in whose hands lies control.''

In the financial markets of the last few decades, this problem has become more acute with the rise of hostile takovers, leveraged buyouts, golden parachutes, green mail, and many other financial innovations that are associated with corporate control. Many corporate raiders have become instant celebrities.

At the same time, there have been some significant changes in the role that senior managers play within the corporation. In recent years, many are given incentives that encourage them to strive to achieve near-term objectives through a variety of compensation schemes. Rarely is management actually penalized for failing to achieve their objectives. Their cash bonuses may be reduced, but they still are entitled to stock options. If the price of the company's stock is down, many firms in the past lowered the exercise price of the outstanding options. More recently, many corporations simply issue more options at the lower prevailing price level. The gatekeepers for many of the compensation awards are outside consultants who rarely exercise strong control over the compensation process. Very often they merely codify what others are doing in the industry.

For their part, equity investors rarely are involved in the affairs of a corporation. Indeed, portfolio practices today have a short-term fuse. Portfolio performance is measured over very short-term horizons—monthly, quarterly, or at most yearly. Underperformance is penalized very quickly. Today, day trades and portfolio shifts based on the price momentum of the stock are commonplace. Institutional investors now hold a majority of outstanding stocks, but they rarely want to be involved in their portfolio companies. Instead, a novel but powerful alliance often exists between the highest bidder in a corporate takeover and many of its institutional shareholders. Thus, stockholders are largely temporarily holders of a certificate that legally is called "equity."

This is clearly demonstrated by the huge increase in the turnover of the stocks listed on the New York Stock Exchange. As shown in the accompanying Figure 1, the turnover of these stocks has escalated sharply over the last forty years—from an average of 20% from 1960 to 1980, to 75% times in the 1990s, with last year's average reaching 94%. Only a few large investors, such as Warren Buffett, truly are involved as stockholders. In today's financial marketplace, they are a rare breed.

Because corporate control typically rests in the hands of senior managers, they and directors assume responsibilities that are difficult to fill in the current structure of the marketplace. Let me try to explain what I mean here by referring to the management of large financial institutions, where I spent a good part of my career. And much of what I have to say in this regard is applicable to the problems of Enron.

I first realized the enormity of the challenge of managing large financial institutions when I joined Salomon's board following our merger with Phibro in 1981. The outside members of the board brought diverse business backgrounds to the table. With the exception of Maurice "Hank" Greenberg, none had strong first-hand experience in a major financial institution. How, then, could they possibly understand, among other things: the magnitude of risk taking at Salomon, the dynamics of the matched book of securities lending, the true extent to which the firm was leveraging its capital, the credit risk in a large heterogeneous book of assets, the effectiveness of operating management in enforcing trading disciplines, or the amount of capital that was allocated to the various activities of the firm and the rates of return on this capital on a risk-adjusted basis? Compounding the problem, the formal reports prepared for the board were neither comprehensive enough nor detailed enough to educate the outside directors about the diversity and complexity of our operations.

Today, this problem is magnified as firms extend their global reach and their portfolio of activities. In recent years, quite a few major U.S. financial institutions have become truly international in scope. They underwrite, trade currencies, stocks, and bonds, and manage the portfolios and securities of industrial corporations and emerging nations. Some of the largest institutions contain in their holding company structures not only banks but also mutual funds, insurance companies, securities firms, finance companies, and real estate affiliates.

The outside directors on the boards of such firms are at a major disadvantage when trying to assess the institution's performance. They must rely heavily on the veracity and competency of senior managers, who in turn are responsible for overseeing a dazzling array of intricate risks undertaken by specialized, lower-level personnel working throughout the firm's wide-flung units. Indeed the senior managers of large institutions are beholden to the veracity of middle managers, who themselves are highly motivated to take risks through a variety of profit compensation formulas. It is easy for gaps in management control to open up between these two groups.

Unfortunately, the accounting profession has been of little help to outside board members. Few audit reports truly reflect a firm's range of risk taking. Reports on assets and liabilities would be far more meaningful if they were shown in gross terms instead of net figures. The off-balance-sheet activities most often cited in footnotes should be integrated into reports to reveal the total flow of activities and liabilities. Unfortunately, when the FASB proposes conservative accounting rules, operating managers generally oppose them. This is because such rules tend to reduce stated profits and encourage conservative lending and investing policies, thus infringing on the stated profits. But managers should recognize that such rules, over the long run, will strengthen their institution's credit quality.

What often is missing for new directors is an intensive orientation program. Large financial institutions are very complex. As I noted earlier, they engage in a wide range of activities—traditional banking, underwriting and trading of securities, insurance, risk arbitrage, financial derivatives from the simple to the complex, and domestic and foreign transactions. The new directors should be given a detailed analysis of the institution's accounting procedures. They should be educated about exactly the kind of activities that Enron directors failed to appreciate: (1) transactions with affiliated companies, (2) transfer of assets/debts to special-purpose entities in order to achieve "off balance sheet" treatment; (3) related-party and insider transactions; (4) aggressive use of restructuring changes and acquisition reserves; and (5) aggressive derivative trading and use of exotic derivatives; and (6) aggressive revenue recognition policies.

Directors of financial institutions also should be familiarized with their institution's quantitative risk analysis techniques. Indeed, the risk analysis group should be independent of the trading and underwriting department. It should be well compensated and have reporting responsibilities to the chief executive, to the chief operating officer, and to the board of directors itself. As part of the orientation process, new directors should be required to meet with members of the official supervisory agencies such as the Federal Reserve, the Comptroller of the Currency, and the Securities and Exchange Commission, all whom should explain what these agencies require from the institution. Legal counsel should also meet with new directors to explain their responsibilities and liabilities from a legal perspective.

But this kind of orientation process alone is not enough to achieve effective board oversight. Board meetings should be allotted more time. Directors should be given more detailed information than highly sanitized and summarized financial information. Board expertise in accounting, quantitative risk analysis, and information technology will become more and more essential in our complex world of finance.

To be sure, the primary task of boards is to define strategy and set policy, to represent the interests of the shareholders and creditors, not to operate the institution. But unless boards devote enough time to handle their responsibilities, the financial industry will suffer even more upheavals, forcing government to step in to clean up messes—and, increasingly, to regulate and control.

I want to turn now to the question, "Can sell-side research be objective?" As many of you here know, when I was at Salomon I managed for many years a large research group that grew to more than 450 professionals by the time I left in 1988. In formulating my own forecasts over those many years, I was never urged to modify my views to confirm with the immediate underwriting or trading activities of the firm, and I know of no researcher in my department who was coerced to change his analytical conclusion.

To be sure, there were occasional complaints from trading and underwriting desks because of one or another view I expressed publicly (usually in written form); but as head of research, I was in a unique position to fend off any criticism. I was a senior partner and a member of the firm's Executive Committee, where no member ever asked that research accommodate the underwriting or trading activity.

In recent decades, however, the objectivity of sell-side research has been compromised more and more. One obvious result is that it is hard to find negative reports these days. Few, for instance, warned of the speculative bubble in the high tech industry. Many analysts wrote glowingly about companies with no earnings, high cash burn rates, and shares selling at high prices relative to sales volume and distant profit prospects. In place of rigorous analyses of firms and industries, one usually saw reports that parroted the views of corporate management and that of historical evaluation norms.

And the scope of the problem is vast. Public attention is most focused on the role that sell-side analysts play in attracting new issues of securities. But very few, if any, seem concerned about the potential for the sell-side institution to front-run trading positions on the basis of soon-to-be-released research reports. The fact is, traders typically have many opportunities in their conversations with equity analysts to ferret out a change in the analyst's view or to learn of the timing of upcoming press releases.

I believe that these problems facing the sell-side analyst can at best be mitigated. To begin with, my experience strongly suggests that the head of research should be a member of senior management. This would establish his authority to deal with research issues at the highest level. Of course, I agree with the suggestion that the relationship of the sell-side institution with the company being analyzed should be stated in the report in bold letters. But it would also be helpful if the analyst stated the performance of the company and the price movement of the stock since the last report, and drew explicit conclusions.

The logical solution to this conflict is for sell-side institutions to provide no research reports to clients. Research would serve only an in-house function by providing analyses that would help the institution assess the merits of the securities it is underwriting and trading. Institutional investors and independent research firms would then fill the gap. This method presumably would lower the cost of research at sell-side firms, which in turn would lower trading and underwriting costs and offset a healthy portion of the increased research costs on the buy side.

Let me also comment briefly on another matter raised by the Enron debacle. Should employees be required to limit their employee retirement investments in the stock of their company? Considering the losses suffered by the Enron employees, the tendency is to respond positively. There is, however, no simple quantitative rule that will be an equitable solution for all employees. They possess vast differences in ages, compensations, personal responsibilities, health, and person net worth. What government regulation can do justice to all of these factors? The alternative solution is for the employer to provide investment counseling where these characteristics are reviewed and discussed before the employee decides on the size of the investment to be made in the shares of the corporation.

While many of the consequences of the Enron's demise already are manifest in the market, it seems to me that the most important one is really unpredictable. This is whether more ''Enrons'' will surface in the near future. If they do, market participants will pull away from equity markets and high yield bonds, because new doubts will be raised about the quality of earnings and the accuracy of other reported financial information.

But already we can see other repercussions from Enron's fall quite clearly. In the securities industry, merger activity has slowed and—by the standards of recent years—will remain at a low volume for the foreseeable future. No conglomerate that is on the brink of going below a credit rating of ''below investment trade'' will be able to gain ready access to funds for sometime to come. And while initial public offerings of stock are trickling into the market again, I think we have seen the end of the kind of huge speculative offerings that have been fairly common in recent years. Meanwhile, financial institutions, with lower near-term profit margins, will be encouraged to shed more overhead. Research analysts will be particularly vulnerable if institutions cannot use them to help market new issues and trading positions.

For business corporations, financing costs are rising. This began last year when corporations issued a huge volume of bonds and reduced short-term debt, mainly outstanding commercial paper. In doing so, they paid off lower-cost debt and increased higher-cost debt. The financial problems of Enron and of a handful of other companies late last year has inspired commercial paper investors to become more discerning, thereby forcing corporate issuers to activate bank lines or new bond issuance to pay off maturing paper. The paper market is now virtually closed to all issuers below the top credit rating.

The liquidation of outstanding commercial paper held by nonfinancial corporations has taken place on an unprecedented scale (see Figure 2). Since 2000, it has declined by $175 billion, or a remarkable 49%. This trend has reduced commercial paper to levels that were outstanding in 1997. Moreover, this $175 billion shift in borrowing probably has boosted corporate financing costs by anywhere from $6 billion to $8 billion. Financing costs probably also will rise, as banks raise their fees for back-up lines of credit, although these lines have an uncertain value. On the one hand, they do provide liquidity for the corporate issuer of paper when investors want their money. On the other hand, the runoff of paper tends to accelerate when market participants become aware of the utilization of the bank line.

While creditors generally will increase their alertness to corporate credit quality as a result of Enron, credit rating agencies surely will intensify the scope of their work and the speed of their responsiveness to changing corporate credit conditions. Already, we hear of the likely issuance of corporate liquidity ratings by the ratings agencies. This closer scrutiny will occur on top of another year in which more corporate credit ratings will be lowered rather than raised.

Yet another likely outcome from the Enron Episode is improved accounting standards. This will lower reported corporate profits in the short term, but the more conservative profit data will enhance investor confidence in the long run. Let us also hope that there may be an effort to put some of the off-balance-sheet financing onto the balance sheet. If so, the corporate debt data that I spoke about earlier will look worse—but again, the long-term effect for investors will be positive.

Incidentally, two other costs not related to financing costs are likely to rise as a consequence of Enron's travails. These are audit fees and the cost of liability insurance for directors and officers.

Of course, all of these costs could be more than offset through a sharp increase in corporate profits. I suspect that this is unlikely. Business does not have pricing power. Excess capacity is high here and around the world. Unfortunately, Enron unraveled at a time when the general financial condition of nonfinancial corporations was probably the worst—for the end of a recession and the start of a new economic recovery—for the entire post-World War II period. From 1995 to 2001, the equity position (retained earnings plus new issuance or minus retirement of stock) of non-financial corporations has contracted by $423 billion, while net debt has increased by $2.3 trillion in the same period. Indeed, this exceeded the debt-leveraging binge in the 1984–90 period when net equity contracted by $457 billion and debt rose by $1.3 trillion. Due to time constraint, the chart can't be printed in the RECORD. (See table.)

The combination of the cyclically weak financial position of corporations, moderate profit recovery, and closer scrutiny of corporate activity by management, auditors, creditors, rating agencies, and officially supervisory agencies will—in the near term—inhibit corporate activity, especially capital expenditures. Thus, once the current inventory restocking ends a few months from now, the economic recovery will moderate significantly.

In short, there are likely to be some difficult adjustments in the near-term horizon, several of them a direct result of Enron's wayward ways. But all would be a modest price to pay for a return to more reasonable and responsible conduct in business and financial markets.

FIGURE 3.—NET CHANGE IN EQUITY BOOK VALUE AND IN DEBT U.S. NONFARM NONFINANCIAL CORPORATE BUSINESS, 1982–2001

[In billions of dollars]

	1982–83	1984–90	1991–94	1995–99	2000	2001
Pre-Tax Profits	$291.4	$1,446.1	$1,163.5	$2,303.8	$502.2	$379.3
Less:						
Taxes	105.6	606.7	409.0	768.4	186.0	141.8
Dividends	116.9	589.3	565.0	1,074.8	267.3	302.7
Plus:						
IVA	(19.1)	(66.3)	(14.5)	8.8	(12.4)	4.4
Net New Equity	21.9	(640.7)	21.7	(652.7)	(159.7)	(55.7)
Net Change In Equity	71.7	456.9	196.7	(183.3)	(123.2)	(116.5)
Net Increase In Debt	186.1	1,274.1	129.9	1,547.6	429.1	267.9

Source: Federal Reserve Board, Flow of Funds.•

IN RECOGNITION OF THE VALOR, DEDICATION, AND PATRIOTISM OF THE KERR FAMILY VETERANS

• Mr. LEVIN. Mr. President, this weekend communities will gather to pay tribute to the men and women who lost their lives while in service to our Nation. Throughout America, parades will be held on Memorial Day which will honor the soldiers, sailors, airmen and Marines who have served to protect our Nation and preserve our freedoms. The City of Royal Oak, in my home State of Michigan will be hosting its annual Memorial Day parade on Monday, May 27, 2002, and this year four brothers from the Kerr family, who are all Vietnam veterans will serve as the Grand Marshals of this parade. These four brothers all voluntarily joined the U.S. military, and went to Vietnam to bravely serve in our nation's armed services. These brothers have proudly carried the ''Warrior'' American flag in the Royal Oak parade in past years to honor their tribe, the Chippewa Tribe of Sault Sainte Marie, and to honor all of the American heroes who fought so fearlessly and valiantly in past conflicts to preserve our liberty and democratic values.

John Kerr, U.S. Marine Corps, Tom Kerr, U.S. Air Force, and Harvey Kerr, U.S. Navy, served in Vietnam simultaneously. Upon their safe return, a fourth brother, Michael Kerr, U.S. Army, voluntarily served in Vietnam and returned safely. These brothers reportedly owe their courage to their beloved mother, Rena Kerr, whose strength and conviction moved her to persevere beyond her personal challenges as a young widow and mother of nine children, to serve the needs of her fellow Americans. She was a devoted civil rights activist and committed herself to helping others. She taught her seven sons and two daughters to highly value their priceless freedoms and the proud Chippewa heritage of their late father, Ted Kerr. With so great a legacy, four Kerr sons were impressed to respond courageously and patriotically to the wartime call, and chose to stand and valiantly serve their country in the Vietnam War. Tom Kerr, who bravely flew a State Flag of Michigan in a F–4 on a combat mission over North Vietnam, was honored to present that flag after his return to Governor William Milliken in 1968.

The Kerr brothers have made it a tradition to annually salute America's fallen heroes of past conflicts and wars on the national day of observance. They proudly carry the flag to honor those who gave the ultimate sacrifice in service to our country, and to join with their many families and friends to honor their memory. The Kerr brothers