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Corporate Governance and Securities Law Responses to the Financial Crisis

FOREWORD

ECONOMISTS HAVE CALLED THE CURRENT GLOBAL FINANCIAL CRISIS the worst such financial crisis since the Great Depression.¹ While many factors precipitated the crisis, its proximate cause was the bursting of the U.S. housing bubble and the subsequent collapse of the sub-prime mortgage industry.² These events had a significant impact on the financial solvency of mortgage lenders, financial firms, banks, and other entities that had invested heavily in the housing market and financial products based on that market. In September of 2008, this impact came to a head with the failure of many major banks and institutions, including Lehman Brothers, American International Group, Fannie Mae, Freddie Mac, and Washington Mutual. Such failures triggered a severe credit crisis followed by unprecedented government intervention aimed at preventing a more significant crisis and shoring up the market.³ Government intervention has taken several forms, from hundreds of billions of dollars in financial assistance to the “nationalization” of Fannie Mae and Freddie Mac.⁴ The significant level of government intervention has far-reaching implications for corporations, the market, and the broader economy.

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1. See *Three Top Economists Agree 2009 Worst Financial Crisis Since Great Depression; Risks Increase If Right Steps Are Not Taken*, REUTERS, Feb. 27, 2009, <http://www.reuters.com/article/pressRelease/idUS193520+27-Feb-2009+BW20090227>.

2. See Ben S. Bernanke, *The Crisis and the Policy Response*, Speech at the Stamp Lecture, London School of Economics (Jan. 13, 2009), available at <http://www.federalreserve.gov/newsevents/speech/bernanke20090113a.htm> (“The proximate cause of the crisis was the turn of the housing cycle in the United States and the associated rise in delinquencies on subprime mortgages . . .”).

3. See David Wessel, *In the Great Panic, the Fed Gets the Credit*, WASH. POST, Aug. 16, 2009, at B01 (noting that during the financial crisis, “the Fed either carried out or supported some of the most sweeping government interventions ever”).

4. See, e.g., Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, 122 Stat. 3765 (codified as amended in scattered sections of 12 U.S.C.) (establishing a \$700 billion program to assist troubled financial firms); American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, 123 Stat. 115 (enumerating a \$787 billion economic stimulus plan); Zachary A. Goldfarb et al., *Treasury to Rescue Fannie and Freddie; Regulators Seek to Keep Firms' Troubles from Setting off Wave of Bank Failures*, WASH. POST, Sept. 7, 2008, at A01.

In April 2009, the Business Law Program⁵ and the *Journal of Business & Technology Law*⁶ of the University of Maryland School of Law co-sponsored a Roundtable entitled “Corporate Governance and Securities Law Responses to the Financial Crisis.” The Roundtable, held in the midst of the ongoing crisis, brought together law professors from around the country to provide some initial thoughts and insights about how the crisis impacts issues related to corporate governance and securities law. In addition, Roundtable participants explored the manner in which the crisis impacted pedagogy and examined methods for incorporating the lessons of the crisis into the classroom. This volume of the *Journal of Business & Technology Law* includes articles reflecting some of the Roundtable discussion on these important topics. As Professor Joan Heminway notes, “those of us who research, write about, and teach law—especially business law—now have more salience, more status in the wake of the current economic crisis.”⁷ And hence we have a unique opportunity to shape the reform agenda and engage the student population.

The articles and essays in this volume recognize that there were a wide range of factors that caused the financial crisis. On the one hand, Professor Robert Rhee emphasizes the importance of understanding finance and financial industry.⁸ Professor Rhee provides critical insights about the five major independent investment banks that existed before the crisis—none of which have remained intact. Professor Rhee’s preliminary insights reveal that the business model of banks evolved to rely increasingly on trading, and that such evolution played a key role in the ensuing financial crisis. On the other hand, Professor Michelle Harner not only illuminates the role enterprise risk management played in the crisis, but also provides a thoughtful exploration of varying approaches to enterprise risk management, and how a company’s approach may have contributed to its survival or failure.⁹

The scholarship in this volume also highlights the manner in which the U.S. government’s response may exacerbate the crisis or otherwise lead to additional corporate governance and securities issues that must be resolved. Thus, Professor

5. The Business Law Program focuses on innovative teaching, practical experience, research, and scholarship in the fields of business organization law, securities regulation, intellectual property, tax, business transactions, and related areas. The Program provides students with the legal, practical, and ethical skills necessary to advise and represent for-profit and not-for-profit businesses, as well as the opportunity to engage in critical and innovative thinking about cutting-edge issues in business law. More information about the Business Law Program can be found at <http://www.law.umaryland.edu/specialty/business/index.asp>.

6. The *Journal of Business & Technology Law* examines issues at the intersection of business and technology law. As the first publication to examine these issues together, the *Journal* seeks to add an important voice to the nation’s legal scholarship and to provide a rewarding educational experience for its members. Each issue of the *Journal* is a rich collection of scholarly analysis on the latest developments in this important area. More information about the *Journal* can be found at <http://www.jbtl.org>.

7. Joan MacLeod Heminway, *The Best of Times, the Worst of Times: Securities Regulation Scholarship and Teaching in the Global Financial Crisis*, 5 J. BUS. & TECH. L. 59, 60 (2010).

8. Robert J. Rhee, *The Decline of Investment Banking: Preliminary Thoughts on the Evolution of the Industry 1996–2008*, 5 J. BUS. & TECH. L. 75 (2010).

9. Michelle M. Harner, *Ignoring the Writing on the Wall: The Role of Enterprise Risk Management in the Economic Crisis*, 5 J. BUS. & TECH. L. 45 (2010).

Omari Scott Simmons cautions that our heavy reliance on lawmakers should not prevent us from appreciating that lawmakers also may need reform.¹⁰ In so doing, Professor Simmons demonstrates the manner in which credence characteristics (i.e., service attributes whose quality cannot be fully determined even after significant use) create the risk that lawmakers may camouflage reforms to maximize political capital or conceal regulatory incompetence. In this regard, credence characteristics may undermine the effectiveness of corporate reform. In a similar vein, Professor Nicola Faith Sharpe highlights issues posed by the government's increasing capital investment in private companies, particularly issues related to corporate boards and corporate governance.¹¹ Professor Sharpe first pinpoints some limitations in our current understanding of corporate boards, their functions and capabilities, and then offers some ways for rethinking the board and its functions. Finally, Professor Sharpe explores the government's recent involvement in corporate governance, and its likely impact on corporate governance reform.

Focusing on securities regulation, Professor Jena Martin Amerson discusses the proxy access rule, and the manner in which the rule could facilitate enhanced oversight by shareholders.¹² Professor Amerson suggests that the Securities and Exchange Commission's failure to provide shareholders with proxy access in 2007 may have represented a missed opportunity that could have empowered shareholders to play a more pivotal role in combating the current crisis. Professor Heminway addresses securities regulation more broadly, highlighting several interesting questions that the crisis raises for securities regulation as well as the role the investing public should play in "casting and recasting regulation."¹³

With respect to teaching, Professor Afra Afsharipour provides a very thoughtful account of the pitfalls and benefits of integrating the financial crisis into the traditional Business Associations course, including the need to balance current events with fundamentals as well as the need to overcome the hurdles of providing relevant course materials.¹⁴ In addition to this important guidance, another essay emphasized the importance of integrating global perspectives into classroom discussion. Thus, Professor Heminway highlights the importance of interacting with our counterparts in other parts of the world to enhance both student and faculty understanding of the global marketplace.¹⁵ In this regard, there was some general consensus that the crisis may represent an opportune moment to develop; or further enhance understanding of comparative law and governance systems.

10. Omari Scott Simmons, *Corporate Reform as a Credence Service*, 5 J. BUS. & TECH. L. 113 (2010).

11. Nicola Faith Sharpe, *Rethinking Board Function in the Wake of the 2008 Financial Crisis*, 5 J. BUS. & TECH. L. 99 (2010).

12. Jena Martin Amerson, *In Praise of Process: Examining the SEC, Rule 14a-8(i)(8), and AFSCME v. AIG*, 5 J. BUS. & TECH. L. 23 (2010).

13. Heminway, *supra* note 7, at 65.

14. Afra Afsharipour, *Integrating the Financial Crisis in the Business Associations Course: Benefits and Pitfalls*, 5 J. BUS. & TECH. L. 5 (2010).

15. Heminway, *supra* note 7, at 59.

While the financial and corporate landscape continues to shift in response to the ongoing crisis and recovery effort, the collection of articles and essays in this volume reflects some early, but critical insights about that effort.