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ONE HUNDRED ELEVENTH CONGRESS

Congress of the United States

House of Representatives

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

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September 3, 2009

Ms. Mary L. Schapiro
Chairman
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-2736

Dear Ms. Schapiro:

In March, Bernard Madoff pled guilty to a massive Ponzi scheme that wiped out the life savings of thousands, bankrupted charities, and duped hedge funds and large institutional investors out of billions of dollars. Between mid-1992 and December 2008 when Madoff confessed, the Securities and Exchange Commission (SEC) received at least 6 credible complaints from third parties detailing Madoff's improprieties. On August 31, 2009, SEC Inspector General David Kotz released a report of investigation of SEC's failure – over a period of at least 15 years – to uncover Bernard Madoff's Ponzi scheme. Despite repeated credible tips and complaints received from third parties going back as far as 1992, and despite undertaking three nominal examinations and investigations into Madoff's operation, SEC never detected the fraud.

The first paragraph of the Inspector General (IG) report absolves SEC of conflicts of interest and improper influence in connection with its perfunctory Madoff investigations. But the balance of the 22-page IG report tellingly chronicles a series of conspicuous failures by SEC officials.

The SEC's failure to uncover the Madoff fraud is not an isolated example of regulatory failure at SEC. The IG has issued several other reports criticizing major SEC enforcement oversights.[1] The discernable absence of SEC involvement throughout the financial crisis is further evidence of decline in SEC's effectiveness. These repeated failures raise serious

[1] SEC IG, "SEC's Oversight of Bear Stearns and Related Entities: Consolidated-Supervised Entity Program"(Report No. 446-A, Sept. 25, 2008); SEC IG "Failure to Vigorously Enforce Action Against W. Holding and Bear Stearns at the Miami Regional Office" (Report of Investigation:Case No. OIG-483, Sept. 30, 2008); SEC IG "Re-Investigation of Claims by Gary Aguirre of Preferential Treatment and Improper Termination" (Report of Investigation: Case No. OIG-431, September 30, 2008).

questions about SEC's internal culture and monitoring, the possibility of regulatory capture and the wisdom of the self-correcting market paradigm.

The most recent example of specific SEC shortcomings, the IG's Madoff report, makes repeated reference to the inexperience of the staff assigned to the investigations, that "there was no training," examiners "weren't familiar with securities laws" and did "not have much experience in equity and options trading." SEC enforcement staff "did not understand enough about the subject matter to take Madoff's testimony." Key SEC personnel on these examinations had "recently graduated from law school" or had "joined the SEC as his first job out of school." In short, the Inspector General found that SEC staff did not have the experience necessary to conduct a proper investigation of the very specific and credible evidence the agency received that Bernard Madoff's investment operation was entirely fraudulent.

These findings are particularly troubling in light of the expanded pay authority that Congress provided to SEC in 2002 to solve the problem of high turnover and inexperience among SEC attorneys and examiners. At the time, SEC argued that it was unable to retain experienced and talented employees under the general schedule pay system that applies to federal employees, and that this problem could be solved by exempting SEC from the general schedule and authorizing it to pay employees at higher rates commensurate with other federal financial regulators.

Congress provided this authority in the Investor and Capital Markets Fee Relief Act, and since 2002 SEC professionals have been compensated on a salary schedule that is considerably higher than the schedule for most federal employees. The findings of the Inspector General, however, call into question the effectiveness of this legislation and the ability of SEC to recruit and retain employees experienced in the financial markets.

The Committee on Oversight and Government Reform had broad jurisdiction under House Rule X to investigate "any matter," and has specific jurisdiction over the federal civil service, including compensation. Pursuant to this authority, the Committee is reviewing policies and practices related to recruitment and retention of experienced professional staff at SEC. In light of the alarming findings related to the Bernard Madoff matter, I expect to convene hearings in the near future. As an initial step in our investigation, please provide a briefing to the Committee that will address the following issues:

1. What is the level of experience of SEC's professional staff, and has the experience level increased, decreased, or stayed similar since the 2002 pay reforms?

2. How are decisions made on staffing investigations to ensure that professionals with the appropriate level of experience are assigned? How frequently are investigations led by employees with less than five years of professional experience?

3. What is the role of senior managers in supervising cases? Which senior officials were responsible for supervising the Madoff investigations and evaluating the performance of the frontline professional staff? What training, advice, and guidance did senior managers make available to frontline staff in the Madoff case?

4. What was the effect of the 2002 pay reforms on retention of experienced employees? Compare turnover rates prior to pay reform with current turnover rates. How many vacancies have existed and how many applications have been received for such vacancies prior to and after pay reform?

5. What is SEC's plan for strategic human resources management?

Please provide this briefing no later than Friday, September 11, 2009. To arrange this briefing, contact Joanne Royce with the Committee staff at (202) 225-5051.

Sincerely,

Edolphus Towns
Chairman

cc: The Honorable Darrell Issa
Ranking Minority Member
Committee on Oversight and Government Reform