

**Written Testimony of H. David Kotz
Inspector General of the
Securities and Exchange Commission**



**Before the U.S. Senate
Committee on Banking, Housing and Urban Affairs**

**Thursday, September 10, 2009
2:30 p.m.**

Introduction

Good afternoon. Thank you for the opportunity to testify today before this Committee on the subject of “Oversight of the SEC’s Failure to Identify the Bernard L. Madoff Ponzi Scheme and How to Improve SEC Performance” as the Inspector General of the Securities and Exchange Commission (SEC). I appreciate the interest of the Chairman, as well as the other members of the Committee, in the SEC and the Office of Inspector General (OIG). In my testimony today, I am representing the OIG, and the views that I express are those of my Office, and do not necessarily reflect the views of the Commission or any Commissioners.

Since being appointed as the Inspector General of the SEC in December 2007, my Office has issued numerous audit and investigative reports involving issues critical to SEC operations and the investing public. These have included comprehensive audit reports on important topics such as the factors that led to the collapse of Bear Stearns, the Division of Enforcement’s (Enforcement) efforts pertaining to complaints about naked short selling, and the SEC’s oversight of credit rating agencies. We have also issued investigative reports regarding a wide range of allegations including claims of improper securities trading by SEC employees, preferential treatment given to high-level securities industry officials, retaliatory termination, Enforcement’s failure to vigorously pursue an investigation, and perjury by supervisory Commission attorneys.

Request to Undertake Madoff Investigation

On the late evening of December 16, 2008, former SEC Chairman Christopher Cox contacted me and asked my Office to undertake an investigation into allegations made to the SEC regarding Bernard L. Madoff (Madoff), who had just confessed to

operating a multi-billion dollar Ponzi scheme, and the reasons why the SEC had found these allegations to be not credible.

Commencement of our Madoff Investigation

We began our investigation immediately. On December 18, 2008, we issued a document preservation notice to the entire SEC, stating that the OIG had initiated an investigation regarding all Commission examinations, investigations or inquiries involving Madoff, and/or any related individuals or entities. We formally requested that each SEC employee and contractor preserve all electronically-stored information and paper records related to Madoff in their original format.

We also took immediate steps to begin gathering evidence. On December 17, 2008, we initiated our first request for e-mail records from the SEC's Office of Information Technology (OIT). Over the course of the investigation, the OIG made numerous requests from OIT for e-mails, including: (1) all e-mails of former Office of Compliance Inspections and Examinations (OCIE) employee Eric Swanson during his tenure with the SEC; (2) all e-mails of six staff members who were involved in the SEC's investigation of the Madoff firm that was initiated in 2006 for the period from January 2006 through January 2008; (3) all e-mails for SEC Headquarters, New York Regional Office (NYRO) and Boston Regional Office (BRO) staff members from January 1, 1999, through December 11, 2008, that contained the word "Madoff"; (4) additional e-mails for approximately 68 current and former SEC employees for various time periods relevant to the investigation, ranging from 1999 to 2009. In all, we estimate that we obtained and searched approximately 3.7 million e-mails during the course of our investigation.

On December 24, 2008, we sent comprehensive document requests to both Enforcement and OCIE, specifying the documents and records we required to be produced for the investigation. We followed up with memoranda to OCIE in April, May and June of 2009. We also had follow-up communications with Enforcement on January 21, 2009 and July 22, 2009. We further had numerous e-mail and telephonic communications with both OCIE and Enforcement regarding the scope and timing of the document requests and responses, as well as meetings to clarify and expand the document requests as necessary.

We collected all the information produced in response to our document production request. We then carefully reviewed and analyzed the investigative records of all SEC investigations conducted relating to Madoff, the Madoff firm, members of Madoff's family, and Madoff's associates from 1975 to the present.

During the investigation, we also reviewed the workpapers and examination files of nine SEC examinations of Madoff's firms from 1990 to December 11, 2008. Where documents from the examinations were not available, we sought testimony and conducted interviews of current and former SEC personnel who had worked on the examinations.

We also sought information and documentation from third parties in order to undertake our own analysis of Madoff's trading records. During the course of the OIG investigation, we requested and obtained records from: (1) the Depository Trust Company (DTC) relating to position reports for Madoff's firm; (2) the National Securities Clearing Corporation (NSCC) relating to clearing data records for executions effected by Madoff's firm; and (3) the Financial Industry Regulatory Authority (FINRA) Order Audit Trail System data (OATS) submitted by Madoff's firm for six National

Association of Securities Dealers Automated Quotations (NASDAQ)-listed stocks and the NASDAQ Automated Confirmation of Transactions (ACT) database for a trading period in March of 2005.

Retention of Experts

In order to assist us in the Madoff investigation, we retained two sets of outside consultants. In February 2009, we retained FTI Consulting, Inc. (FTI engagement team) to assist with the review of the examinations of Madoff and his firms that were conducted by the SEC. Members of the FTI engagement team engaged by the OIG included Charles R. Lundelis, Jr., Senior Managing Director, Forensic and Litigation Consulting; Simon Wu, Managing Director, Forensic and Litigation Consulting; John C. Crittenden III, Managing Director, Corporate Finance Group; and James Conversano, Director, Forensic and Litigation Consulting. Each individual member of the FTI engagement team brought a unique and specialized experience to the analyses that FTI engagement team conducted, including expertise in complex financial fraud investigations, securities-related inspections and examinations, hedge fund operations, cash flow analysis and valuations, market regulation rules, market structure issues, accounting fraud, investment suitability, the underwriting process and compliance and due diligence practices.

At our direction, the FTI engagement team conducted a thorough review of all relevant workpapers and documents associated with the OCIE examinations of Madoff's firm, scrutinized the conduct of the Madoff-related SEC examinations and investigations, and analyzed whether the SEC examiners overlooked red flags that could have led to the discovery of Madoff's Ponzi scheme. The FTI engagement team also replicated aspects of

the OCIE cause examinations of Madoff to determine whether the SEC sought the appropriate information in the examinations and analyzed that information correctly.

In addition, OIT advised us during the course of our investigation that there were substantial gaps in the e-mails we were seeking to review as part of our investigation because of failures to back up tapes, hardware or software failures during the backup process, and/or lost, mislabeled or corrupted tapes. In order to ensure that we were able to conduct a thorough and comprehensive investigation, in June 2009, we retained the services of First Advantage Litigation Consulting Services (First Advantage) to assist us in the restoration and production of relevant electronic data. First Advantage's team had significant experience in leading numerous large-scale electronic discovery consulting projects, as well as assisting with highly sensitive and confidential investigations for corporations and the Federal Bureau of Investigation.

In connection with its retention on the Madoff investigation, First Advantage provided consulting and technical support to the OIG and the SEC, and was able to successfully preserve and restore potentially relevant data within the universe of electronic data we had requested from OIT. As a result, we were able to review additional Madoff-related e-mails that were pertinent to our investigation.

Testimony and Interviews Conducted in the Madoff Investigation

We also conducted 140 testimonies under oath or interviews of 122 individuals with knowledge of facts or circumstances surrounding the SEC's examinations and/or investigations of Madoff and his firms. We interviewed all current or former SEC employees who had played any significant role in the SEC's significant examinations and investigations of Madoff and his firms over a period spanning approximately 20 years.

The OIG's Investigative Team

I think it appropriate to acknowledge the extraordinary efforts of the OIG Investigative team that I have been honored to lead in conducting this important investigation. These included Deputy Inspector General Noelle Frangipane, Assistant Inspector General for Investigations David Fielder, and Senior Counsels Heidi Steiber, David Witherspoon and Christopher Wilson. Additional assistance was provided to this investigation by my Assistant, Roberta Raftovich, in coordinating many of the administrative aspects of compiling the report. Without the incredible devotion and exceptional work of these individuals, we would not have been able to complete this investigation and present a thorough and comprehensive report within such a short period of time.

Issuance of Comprehensive Report of Investigation

On August 31, 2009, we issued to the Chairman of the SEC a comprehensive report of investigation (ROI) in the Madoff matter containing over 450 pages of analysis. The ROI detailed the SEC's response to all complaints it received regarding the activities of Madoff and his firms, and traced the path of these complaints through the Commission from their inception, reviewing what, if any, investigative or examination work was conducted with respect to the allegations. Further, the ROI assessed the conduct of examinations and/or investigations of Madoff and his firm by the SEC and analyzed whether the SEC examiners or investigators overlooked red flags (which other entities conducting due diligence may have been identified) that could have led to a more comprehensive examination or investigation and possibly the discovery of Madoff's Ponzi scheme.

Our ROI also analyzed the allegations of conflicts of interest arising from relationships between any SEC officials or staff and members of the Madoff family. This included an examination of the role that former SEC OCIE Assistant Director Eric Swanson (Swanson), who eventually married Madoff's niece Shana Madoff, may have played in the examination or other work conducted by the SEC with respect to Madoff or related entities, and whether such role or relationship in any way affected the manner in which the SEC conducted its regulatory oversight of Madoff and any related entities.

We have also considered the extent to which the reputation and status of Madoff and the fact that he served on SEC Advisory Committees, participated on securities industry boards and panels, and had social and professional relationships with SEC officials, may have affected Commission decisions regarding investigations, examinations and inspections of his firm.

Results of the Madoff Investigation

The OIG investigation found that between June 1992 and December 2008 when Madoff confessed, the SEC received six substantive complaints that raised significant red flags concerning Madoff's investment adviser operations and should have led to questions about whether Madoff was actually engaged in trading. We also found that the SEC was aware of two articles regarding Madoff's investment operations that appeared in reputable publications in 2001 and questioned Madoff's unusually consistent investment returns.

Our report concluded that notwithstanding these six complaints and two articles, the SEC never conducted a competent and thorough examination or investigation of

Madoff for operating a Ponzi scheme and that, had such a proper examination or investigation been conducted, the SEC would have been able to uncover the fraud.

The first complaint, which was brought to the SEC's attention in 1992, related to allegations that an unregistered investment company was offering "100%" safe investments with high and extremely consistent rates of return over significant periods of time to "special" customers. The SEC actually suspected the investment company was operating a Ponzi scheme and learned in its investigation that all of the investments were placed entirely through Madoff and consistent returns were claimed to have been achieved for numerous years without a single loss.

The second complaint was very specific, and different versions of it were provided to the SEC in May 2000, March 2001 and October 2005. The complaint submitted in 2005 was entitled, "The World's Largest Hedge Fund is a Fraud," and detailed approximately 30 red flags indicating that Madoff was operating a Ponzi scheme, a scenario it described as "highly likely." These red flags included the impossibility of Madoff's returns, particularly the consistency of those returns and the unrealistic volume of options Madoff represented to have traded.

In May 2003, the SEC received a third complaint from a respected hedge fund manager identifying numerous concerns about Madoff's strategy and purported returns. Specifically, the complaint questioned whether Madoff was actually trading options in the volume he claimed, noted that Madoff's strategy and purported returns were not duplicable by anyone else, and stated that Madoff's strategy had no correlation to the overall equity markets in over ten years. According to an SEC manager, the hedge fund manager's complaint laid out issues that were "indicia of a Ponzi scheme."

The fourth complaint was part of a series of internal e-mails of another registrant that the SEC discovered in April 2004. The e-mails described the red flags that a registrant's employees had identified while performing due diligence on their own Madoff investment using publicly-available information. The red flags identified included Madoff's incredible and highly unusual fills for equity trades, his misrepresentation of his options trading, and his unusually consistent, non-volatile returns over several years. One of the internal e-mails provided a step-by-step analysis of why Madoff must be misrepresenting his options trading. The e-mail clearly explained that Madoff could not be trading on an options exchange because of insufficient volume and could not be trading options over-the-counter because it was inconceivable that he could find a counterparty for the trading. The SEC examiners who initially discovered the e-mails viewed them as indicating "some suspicion as to whether Madoff is trading at all."

The SEC received the fifth complaint in October 2005 from an anonymous informant. This complaint stated, "I know that Madoff [sic] company is very secretive about their operations and they refuse to disclose anything. If my suspicions are true, then they are running a highly sophisticated scheme on a massive scale. And they have been doing it for a long time." The informant also stated, "After a short period of time, I decided to withdraw all my money (over \$5 million)."

The sixth complaint was sent to the SEC by a "concerned citizen" in December 2006, and advised the SEC to look into Madoff and his firm as follows:

Your attention is directed to a scandal of major proportion which was executed by the investment firm Bernard L. Madoff . . . Assets well in excess of \$10 Billion owned by the late [investor], an ultra-wealthy long time client of the

Madoff firm have been “co-mingled” with funds controlled by the Madoff company with gains thereon retained by Madoff.

In March 2008, the SEC Chairman’s Office received a second copy of the previous complaint, with additional information from the same source regarding Madoff’s involvement with the investor’s money, as follows:

It may be of interest to you to that Mr. Bernard Madoff keeps two (2) sets of records. The most interesting of which is on his computer which is always on his person.

The two 2001 journal articles also raised significant questions about Madoff’s unusually consistent returns. One of the articles noted his “astonishing ability to time the market and move to cash in the underlying securities before market conditions turn negative and the related ability to buy and sell the underlying stocks without noticeably affecting the market.” This article also observed that “experts ask why no one has been able to duplicate similar returns using [Madoff’s] strategy.” The second article quoted a former Madoff investor as saying, “Anybody who’s a seasoned hedge-fund investor knows the split-strike conversion is not the whole story. To take it at face value is a bit naïve.”

The complaints all contained specific information and could not have been fully and adequately resolved without a thorough examination and investigation of Madoff for operating a Ponzi scheme. The journal articles should have reinforced the concerns expressed in the complaints about how Madoff could have been achieving such unusually high returns.

According to the FTI engagement team, the most critical step in examining or investigating a potential Ponzi scheme is to verify the subject’s trading through an

independent third party. The OIG investigation found that the SEC conducted two investigations and three examinations related to Madoff's investment adviser business based upon the detailed and credible complaints that raised the possibility that Madoff was misrepresenting his trading and could have been operating a Ponzi scheme. Yet, at no time did the SEC ever verify Madoff's trading through an independent third party and, in fact, SEC staff never actually conducted a Ponzi scheme examination or investigation of Madoff.

The first examination and first Enforcement investigation involving Madoff were conducted in 1992 after the SEC received information that led it to suspect that a Madoff associate had been conducting a Ponzi scheme. Yet, the SEC focused its efforts on Madoff's associate and never thoroughly scrutinized Madoff's operations even after learning that Madoff made all the investment decisions and being apprised of the remarkably consistent returns Madoff had claimed to achieve over a period of numerous years with a basic trading strategy. While the SEC ensured that all of Madoff's associate's customers received their money back, it took no steps to investigate Madoff. The SEC focused its investigation too narrowly and seemed not to have considered the possibility that Madoff could have taken the money that was used to pay back his associate's customers from other clients for which Madoff may have had held discretionary brokerage accounts. In the examination of Madoff, although the SEC did seek records maintained by DTC (an independent third party), they obtained those DTC records from Madoff rather than going to DTC itself to verify if trading occurred. Had the SEC sought records from DTC, there is an excellent chance it would have uncovered Madoff's Ponzi scheme in 1992.

In 2004 and 2005, the SEC's examination unit, OCIE, conducted two parallel cause examinations of Madoff based upon the hedge fund manager's complaint and the series of internal e-mails the SEC had discovered. The examinations were remarkably similar in nature. There were initial significant delays in the commencement of the examinations, notwithstanding the urgency of the complaints. The teams assembled were relatively inexperienced, and there was insufficient planning for the examinations. The scopes of the examination were in both cases too narrowly focused on the possibility of front-running, with no significant attempts made to analyze the numerous red flags about Madoff's trading and returns.

During the course of both these examinations, the examination teams discovered suspicious information and evidence and caught Madoff in contradictions and inconsistencies. However, they either disregarded these concerns or simply asked Madoff about them. Even when Madoff's answers were seemingly implausible, the SEC examiners accepted them at face value.

In both examinations, the examiners made the surprising discovery that Madoff's mysterious hedge fund business was making significantly more money than his well-known market-making operation. However, none of the examiners identified this revelation as a cause for concern.

Astoundingly, both examinations were open at the same time in different offices without either office knowing the other one was conducting a virtually identical examination. In fact, it was Madoff himself who informed one of the examination teams that the other examination team had already received the information being sought from him.

In the first of the two OCIE examinations, the examiners drafted a letter to the National Association of Securities Dealers (NASD) (another independent third party) seeking independent trade data, but they never sent the letter, claiming that it would have been too time-consuming to review the data they would have obtained. The OIG's expert opined that had the letter to the NASD been sent, the data collected would have provided the information necessary to reveal Madoff's Ponzi scheme. In the second examination, the OCIE Assistant Director sent a document request to a financial institution that Madoff claimed he used to clear his trades, requesting trading done by or on behalf of particular Madoff feeder funds during a specific time period, and received a response that there was no transaction activity in Madoff's account for that period. However, the Assistant Director did not determine that the response required any follow-up and the examiners working under the Assistant Director testified that the response was not shared with them.

Both examinations concluded with numerous unresolved questions and without any significant attempt to examine the possibility that Madoff was misrepresenting his trading and operating a Ponzi scheme.

The investigation that arose from the most detailed complaint provided to the SEC, which explicitly stated it was "highly likely" that "Madoff was operating a Ponzi scheme," never really investigated the possibility of a Ponzi scheme. The relatively inexperienced Enforcement staff failed to appreciate the significance of the analysis in the complaint, and almost immediately expressed skepticism and disbelief about the complaint. Most of the investigation was directed at determining whether Madoff should register as an investment adviser or whether Madoff's hedge fund investors' disclosures were adequate.

As with the examinations, the Enforcement staff almost immediately caught Madoff in lies and misrepresentations, but failed to follow up on inconsistencies. They rebuffed offers of additional evidence from the complainant, and were confused about certain critical and fundamental aspects of Madoff's operations. When Madoff provided evasive or contradictory answers to important questions in testimony, the staff simply accepted his explanations as plausible.

Although the Enforcement staff made attempts to seek information from independent third parties, they failed to follow up on these requests. They reached out to the NASD and asked for information on whether Madoff had options positions on a certain date. However, when they received a report that there were in fact no options positions on that date, they did not take any further steps. An Enforcement staff attorney made several attempts to obtain documentation from European counterparties (another independent third party) and, although a letter was drafted, the Enforcement staff decided not to send it. Had any of these efforts been fully executed, they would have led to Madoff's Ponzi scheme being uncovered.

The OIG also found that numerous private entities conducted basic due diligence of Madoff's operations and, without regulatory authority to compel information, came to the conclusion that an investment with Madoff was unwise. Specifically, Madoff's description of both his equity and options trading practices immediately led to suspicions about his operations. With respect to his purported trading strategy, many private entities simply did not believe that it was possible for Madoff to achieve his stated level of returns using a strategy described by some industry leaders as common and unsophisticated. In addition, there was a great deal of suspicion about Madoff's

purported options trading, with several entities not believing that Madoff could be trading options in such high volumes where there was no evidence that any counterparties had been trading options with Madoff.

The private entities' conclusions were drawn from the same red flags regarding Madoff's operations that the SEC considered in its examinations and investigations, but ultimately dismissed.

We also found that investors who may have been uncertain about whether to invest with Madoff were reassured by the fact that the SEC had investigated and/or examined Madoff, or entities that did business with Madoff, and found no evidence of fraud. Moreover, we found that Madoff proactively informed potential investors that the SEC had examined his operations. When potential investors expressed hesitation about investing with Madoff, he cited the prior SEC examinations to establish credibility and allay suspicions or investor doubts that may have arisen while due diligence was being conducted. Thus, the fact the SEC had conducted examinations and investigations and did not detect the fraud lent credibility to Madoff's operations and had the effect of encouraging additional individuals and entities to invest with him.

We did not, however, find evidence that any SEC personnel who worked on an SEC examination or investigation of Madoff or his firms had any financial or other inappropriate connection with Madoff or the Madoff family that influenced the conduct of the examination or investigatory work. We also did not find that former SEC Assistant Director Eric Swanson's romantic relationship with Bernard Madoff's niece, Shana Madoff, influenced the conduct of the SEC examinations of Madoff and his firm. We further did not find that senior officials at the SEC directly attempted to influence

examinations or investigations of Madoff or the Madoff firm, nor was there evidence any senior SEC official interfered with the staff's ability to perform its work.

As I discussed earlier, we did find that despite numerous credible and detailed complaints, the SEC never properly examined or investigated Madoff's trading and never took the necessary, but basic, steps to determine if Madoff was operating a Ponzi scheme. Had these efforts been made with appropriate follow-up at any time beginning in June of 1992 until December 2008, the SEC could have uncovered the Ponzi scheme before Madoff confessed.

As a result of our findings, we have recommended that the Chairman carefully review our report and share with OCIE and Enforcement management the portions of this report that relate to performance failures by those employees who still work at the SEC, so that appropriate action (which may include performance-based action) is taken, on an employee-by-employee basis, to ensure that future examinations and investigations are conducted in a more appropriate manner and the mistakes and failures outlined in this report are not repeated.

Additional OIG Reports

While the report we issued to the Chairman on August 31st describes in detail the factual circumstances surrounding the Madoff-related complaints received by the SEC and the SEC's examinations and investigations of Madoff over the years, my Office plans to issue three additional reports relating to these matters. Because our investigation identified systematic breakdowns in the manner in which the SEC conducted its examinations and investigations, we plan to issue two separate audit reports providing the

SEC with specific and concrete recommendations to improve the operations of both OCIE and Enforcement.

With respect to recommendations concerning OCIE, our expert, FTI, has conducted extensive fieldwork to analyze further the adequacy of OCIE's examinations of Madoff. The FTI engagement team reviewed our August 31, 2009 Report of Investigation, as well as related findings, exhibits, witness testimony and other supporting documentation (i.e., OCIE examination staff work papers), and interviewed over a dozen key personnel representing OCIE's broker-dealer, investment adviser and risk assessment programs. In addition, the FTI Engagement Team reviewed OCIE's policies and procedures with regard to its examination processes and other third party records, including FINRA order and execution data and DTC and NSCC records. The FTI Engagement Team also was granted access to OCIE's various Intranet sites, including the Broker-Dealer, Investment Adviser/Investment Company, Office of Market Oversight, and Training Branch sites, in order to view its examination policies and procedures.

The FTI engagement team is currently finalizing a report that will describe its analysis of OCIE's examination process and provide numerous "lessons learned" arising from its analysis, with specific recommendations to improve OCIE's operations. While these recommendations are currently in draft status, I can report that the recommendations we are considering include the following:

- Establishing a protocol for SEC examiners to identify relevant information from industry news articles and other sources outside of the agency;
- Establishing a protocol that explains how to identify red flags and potential violations of securities law based on an evaluation of information found in industry news articles and other relevant industry sources;

- The implementation of an OCIE-related collection system that adequately captures information relating to the nature and source of each tip or complaint and also chronicles the vetting process to document why each tip or complaint was or was not acted upon and who made that determination;
- Mandating procedures for review of credible and compelling tips and complaints;
- Mandating timelines for the vetting of tips and complaints, as well as for the commencement of cause examinations;
- Requiring proper procedures for the use of scope memoranda to ensure that examinations conducted in response to tips and complaints that are received are not too narrowly focused;
- Establishing procedures for the timely modification of scope memoranda when significant new facts and issues emerge;
- Ensuring the appropriate review and analysis of planning memoranda for cause examinations to ensure that cause examinations are thoroughly planned based upon the tip or complaint that triggered the examination;
- Creating procedures to ensure that all steps of the examination methodology, as stated in the planning memorandum, are completed before the examination is closed;
- Requiring the documentation of all substantive interviews conducted by OCIE of registrants and third parties during OCIE's pre-examination activities and during the course of an examination;
- Prescribing procedures for the preparation of workpapers for an OCIE examination to ensure sufficient detail to provide a clear understanding of its purpose, source, and the conclusions reached;
- Establishing, reviewing and testing procedures for logging all OCIE examinations into an examination tracking system;
- Ensuring that the focus of an examination is determined in an appropriate and thoughtful manner, and not simply based upon on the availability or the skills of a particular group of examiners;
- Ensuring that personnel with the appropriate skills and expertise are assigned to cause examinations with unique or discrete needs;
- Requiring that a Branch Chief, or a similarly-designated lead manager, be assigned to every substantive project including all cause examinations;

- Requiring the development of a formal plan within OCIE to ensure that OCIE staff and managers are obtaining and maintaining professional designations and/or licenses by industry certification programs that are relevant to their examination activities;
- Recommending the development and implementation of interactive exercises to be administered by OCIE training staff or an independent third party and reviewed prior to hiring new OCIE employees in order to evaluate the relevant skills necessary to perform examinations;
- The training of OCIE examiners in the mechanics of securities settlement, both in the United States and in major foreign markets;
- The training of OCIE examiners in methods to access the expertise of foreign regulators, such as the United Kingdom's Financial Services Authority, as well as foreign securities exchanges and foreign clearing and settlement entities;
- Requiring OCIE examination staff to verify a test sample of trading or balance data with counterparties and other independent third parties such as FINRA, DTC, or NSCC whenever there are specific allegations of fraud involved in an examination;
- Recommending the training of OCIE examiners jointly with the Office of Economic Analysis economists by FINRA, other self-regulatory organizations (SROs) and exchange staff in understanding trading databases, regional exchanges, option exchanges, and DTC/NSCC, etc.;
- Ensuring that OCIE staff have direct access to certain databases maintained by SROs or other similar entities in order to allow examiners to access necessary data for verification or analysis of registrant data;
- Mandating procedures to ensure that when an examination team is pulled off an examination for a project of higher priority, the examination team return to the previous examination upon completion of the other project and bring the prior examination to a conclusion;
- Implementing procedures for tracking the progress of all cause examinations, including the number of cause examinations opened, the number ongoing and the number closed for each month; and
- Requesting OCIE management provide express support to their examiners regarding the examiners' pursuit of evidence in the course of an examination, even if pursuing that evidence requires contacting customers or clients of the target of that examination.

We are also finalizing a report that analyzes “lessons learned” from the investigations conducted by the SEC’s Enforcement Division of Madoff and prescribes concrete recommendations for improvement within Enforcement. For this analysis, we launched an extensive survey questionnaire to Enforcement staff and management in both headquarters and the regional offices. This survey was designed to obtain feedback from Enforcement staff on numerous topics, such as allocation of resources, performance measurement, case management procedures, communication, adequacy of policies and procedures, employee morale, and management efficiency and effectiveness.

The Enforcement-related recommendations that we are currently considering include the following:

- Establishing formal guidance for evaluating various types of complaints (e.g., Ponzi schemes) and training of appropriate staff on the use of such guidance;
- Ensuring that the SEC’s tip and complaint handling system provides for data capture of relevant information relating to the vetting process to document why a complaint was or was not acted upon and who made that determination;
- Requiring tips and complaints to be reviewed by individuals experienced in the subject matter to which the complaint or tip relates, prior to a decision not to take further action;
- Establishing guidance to require that all complaints that appear on the surface to be credible and compelling be probed further by in-depth interviews with the sources to assess the complaints’ validity and to determine what issues need to be investigated;
- The training of staff to ensure they are aware of the guidelines contained in Section 3 of the Enforcement Manual and Title 17 of the Code of Federal Regulations, Section 202.10, for obtaining information from outside sources;
- Requiring annual review and testing of the effectiveness of Enforcement’s policies and procedures with regard to its tip and complaint handling system;
- Implementing procedures to ensure that investigations are assigned to teams comprised of individuals who have sufficient knowledge of the pertinent subject matter (e.g. Ponzi schemes);

- The training of staff on what resources and information are available within the Commission, including how and when assistance from internal units should be requested;
- Mandating that planning memoranda be prepared at the beginning of an investigation and that the plan include a section identifying what type of expertise or assistance is needed from others within and outside the Commission;
- Requiring that after the planning memorandum is drafted, it be circulated to all team members assigned to the investigation, and all team members then meet to discuss the investigation approach, methodology and any concerns team members wish to raise;
- Conducting periodic internal reviews of any newly-implemented policies and procedures related to information sharing with divisions and offices outside of Enforcement to ensure they are operating efficiently and effectively and necessary changes are made;
- Requiring that the planning memoranda and associated scope, methodology and time frames be routinely reviewed by an investigator's immediate supervisor to ensure investigations remain on track and to determine whether adjustments in scope, etc. are necessary;
- Ensuring that sufficient resources, both supervisory and support, are dedicated to investigations up front to provide for adequate and thorough supervision of cases and effective handling of administrative tasks;
- Establishing policies and procedures to ensure staff have an understanding of what types of information should be validated during investigations with independent parties such as FINRA, DTC and the Chicago Board Options Exchange;
- Updating Enforcement's complaint handling procedures to ensure complaints received are properly vetted even if an investigation is pending closure; and
- Conducting periodic internal reviews to ensure that Matters Under Inquiry (MUIs) are opened in accordance with any newly-developed Commission guidance and examining ways to streamline the case closing process.

Both of these reports containing recommendations to OCIE and Enforcement will be finalized and issued within the next few weeks. We also plan to issue an additional report analyzing the reasons that OCIE's investment adviser unit did not

conduct an examination of Madoff after he was forced to register as an investment adviser in 2006, and prescribing recommendations as appropriate to improve this process. We plan to issue this report by the end of November 2009.

My Office is committed to following up with respect to all the recommendations that we will be making to ensure that significant changes and improvements are made in the SEC's operations as a result of our findings in the Madoff investigation. We are aware that improvements have already been begun under the direction of Chairman Schapiro even prior to our report being issued. We are confident that under Chairman Schapiro's leadership, the SEC will carefully review our analyses and reports and take the appropriate steps to implement our recommendations and ensure that fundamental changes are made in the SEC's operations so that the errors and failings we found in our investigation are properly remedied and not repeated in the future.

Conclusion

In conclusion, we appreciate the Chairman's and the Committee's interest in the SEC and our Office and, in particular, in the facts and circumstances pertinent to the Madoff Ponzi scheme. I believe that the Committee's and Congress's continued involvement with the SEC is helpful in strengthening the accountability and effectiveness of the Commission. Thank you.