On June 28, 2018, the SEC issued an 183-page document proposing amendments to the whistleblower program mandated by Dodd-Frank. While the changes are framed as improvements to the program, if adopted they will serve only to enhance the SEC’s ability to selectively enforce the law. The SEC lacks both the integrity and intelligence to manage the whistleblower program effectively. It should be removed from the SEC’s jurisdiction completely and administered in an independent grand jury setting. The changes suggested in Section III are testament to the program’s twisted sense of purpose, little more than the rationalizations of a spoiled child unwilling to clean their own room.

Most offensive among the proposals (and cleverly placed at the very bottom of the press release) is the SEC’s desire to exclude whistleblowers providing analysis that “would be reasonably apparent to the Commission from publicly available information.” Here’s the problem, you idiots: Failing to act on things that should be reasonably apparent is the hallmark of the SEC. It’s what you do best. The whistleblower inbox is overflowing with analysis of public information not so much because people are greedy but because the SEC is a cesspool of incompetence and corruption. Get it?

Giving crooked cops unchecked power to investigate only matters they choose to and distribute reward money as they see fit is a recipe for disaster. Here’s a compelling example of probable malfeasance that is ironically, “reasonably apparent from publicly available information.”:

In February 2011, the SEC announced the Whistleblower program created by the Dodd-Frank Act had been funded with $452 million and would be headed by Sean X. McKessy. (Link) In September 2014, McKessy announced an award of more than $30 million (the largest award ever at the time). (Link) The SEC provided minimal details, but the same day, Washington-based law firm Phillips & Cohen proudly announced it represented the whistleblower and that the settlement was actually over $32 million. (Link) Less than two years later, McKessy left the SEC to join Phillips and Cohen. (Link) (Link)

The whistleblower program is currently headed by Jane Norberg, who served as deputy chief under McKessy. We would speculate that McKessy was instrumental in Norberg’s hiring. (Link)

Can you smell that?

Contrary to the Hollywood cloak and dagger fantasies of those who designed and currently administrate the whistleblower program, the footprints of graft and abuse can often be found in plain sight by citizens not complicit in wrongdoing. No “cool stuff” (wire-tapping, plea-bargaining, undercover assignments in the Caymans) is required to take action, just an inclination to step up and do the right thing.

Open source investigators (i.e. people using publicly available information to uncover potential wrongdoing) need a forum where their concerns can be objectively reviewed and acted upon. It is painfully obvious the SEC is incapable of providing such a forum, primarily because the commission’s failings are usually part and parcel of the wrongdoing reported. In other words, they’re blowing the whistle on the SEC itself. Anyone evaluating such concerns must be prepared to confront that the SEC
has screwed up again. When the evaluators are employees of the SEC, no one can expect them to be objective.

Anyone thinking the SEC openly welcomes internal criticism is unfamiliar with the saga of Kathleen Furey, an SEC attorney whose struggles against her employer came to light in May 2013. (Court docs) (Taibbi) (Bloomberg) (HuffPo)

Furey’s exemplary career was derailed in late 2007 when she expressed concerns that investigations into a certain investment manager (the name is redacted) begun in December 2004 had stalled. George N. Stepaniuk, Assistant Director of the New York Regional Office (NYRO) told her “We don’t do investment management cases in this group,“ which Furey considered “a violation of law, gross mismanagement, and abuse of authority.” Furey’s complaints were ignored by her superiors, so she became an internal whistleblower, taking the allegations to SEC inspector General H. David Kotz, who was also indifferent. Reprisals against Furey began shortly thereafter.

A year later the Madoff scandal exploded on the NYRO’s doorstep, giving those involved much bigger worries than Kathleen Furey.

Furey began requesting documents under the Freedom of Information Act (FOIA) in late 2011. The requests were made regarding both the public interest and her case specifically. Frustrated with the commission’s inadequate responses, she took legal action against her employer in May 2013. Furey’s case was settled quietly in August 2014, with the SEC releasing 13,000 unredacted records for her use exclusively and approximately 3,500 redacted pages for use publicly. (Court documents can be found at PACER)

While we applaud Ms. Furey’s courage and integrity, we believe them to be an outlier at the SEC. We still see a dearth of cases brought against sizable investment managers, so we assume regulatory capture is alive and well. We know of no efforts to slow the revolving door between the regulator and the regulated. We could tell countless Where Are They Now? stories to illustrate the blatantly self-dealing (Honorable Mary Schapiro, we’re looking in your direction). (Link) (Link) (Link) (Link) (D’oh!)

The whistleblower program is campaigning for the right to dismiss open source submissions on technicalities. Not original! Reasonably apparent! Not probative enough! Low quality analysis! Frivolous! Like they’re judging a science fair or something. At no point does the proposal entertain the notion that these submissions often contain highly-compelling facts that the SEC missed, opting instead to refrain “We don’t have to listen! We don’t have to listen!”

Consider the following example:

“Everyone at my church has been putting money into an investment fund run by a long-time member of our congregation, and other members keep approaching me to invest as well, because he has made at least 10% every year for the last 15 years. I feel pressured and think there might be something fishy going on. Please help.”

Not a sophisticated submission, but anyone with a novice level understanding of fraud knows this is most certainly one (99.99% is close enough). You don’t give it the benefit of the doubt, you go kick the
doors in. It is horrifying to know that such a tip will likely be discarded because it doesn’t meet certain meaningless “standards.” From this moment forward, the SEC is obstructing justice, whether it understands that or not. It may as well be a co-conspirator.

Bernie Madoff is credited with operating the largest Ponzi scheme in world history, but to be precise, he should probably only be credited with the largest known Ponzi. It is critical to recall federal agents arrested Madoff in late 2008 only after he confessed to his crime. Despite government posturing in the media, he was not “caught” by authorities. (Don’t forget that)

In the days following Madoff’s arrest, reports began to surface that a citizen named Harry Markopolos had been warning the SEC of Madoff fraud for more than eight years. Markopolos has stated repeatedly that he knew that Madoff’s returns were not real after examining the strategy for “about 5 minutes” in 1999. He first contacted the SEC in May 2000. In November 2005, Markopolos submitted a 25-page account of his suspicions to the SEC, entitled The World’s Largest Hedge Fund is a Fraud. The opening paragraph states “...every single one of the senior managers I spoke with told me that Bernie Madoff was a fraud.” On page two, he declares it “highly likely” that Madoff is “the world’s largest Ponzi,” and that he is alerting the SEC not because he is expecting to be rewarded, but “because it’s the right thing to do.”

In response to the admirably articulated Markopolos allegations, the dimwits at the SEC did less than nothing, they defended Madoff and focused instead on Markopolos’ “motives,” because serving justice (doing “the right thing”) was alien concept to them. An SEC accountant named Peter Lamore wrote “I think he is on a fishing expedition and doesn’t have the detailed understanding of Madoff’s operations that we do.”

Fun Facts:

- The aforementioned “detailed understanding” was derived from the SEC’s comically insane and completely unverified notion that Madoff traded in Europe (Madoff said it in May 2005 and the SEC believed). Not only is Peter Lamore still employed by the SEC, his base salary has risen from $76.1k at the time of the dismissive remarks above to $206.6k in 2017. Note that incompetent boobery of this magnitude is generally not so richly rewarded in the private sector. [Citation Not Really Needed]
- Armed with the Markopoulos report in 2006, Peter Lamore and William D. Ostrow, examined Madoff’s operation onsite for two months...and completely whiffed again. Madoff was “astonished” that they did not ask for Depository Trust Company (DTC) records and said that they "spent 90% of their time looking through emails." (Sweet Mother of Mercy)
- Shana Madoff (Peter Madoff’s daughter, Bernie’s niece) served as a compliance officer and attorney at Bernard L. Madoff Investment Securities (BLMIS) from 1995 until Madoff’s confession and arrest in 2008. She is married to former SEC attorney Eric Swanson. They met in 2003, during one of the SEC’s many botched Madoff investigations. (Ain’t love grand?). Shana Madoff was never criminally charged in connection with the Madoff scandal.
• S7-16-18 devotes three pages to pontificating on the merits of Harry Markopolos’s extensive work on the Madoff case and concedes that it qualifies as “independent analysis.” *Thanks a lot, pinheads.*

**Conclusions**

• Darwinian forces do not exist at the SEC. As a result, the agency has no ability to accurately access threats, set priorities or achieve results efficiently. The SEC is uniquely unqualified to manage the whistleblower program and we reject the idea that the commission is capable of evolving into an organization that can honestly address its own failings.

• The whistleblower program should be focused solely on determining what action needs to be taken and seeing that appropriate action is taken swiftly, regardless of source. Pondering the probative merits of the information shouldn’t be part of the process, nor should considering what embarrassment the SEC might face.

• We believe the SEC is presently sitting on a powder keg of valid whistleblower submissions that it is deliberately delaying taking action on for a variety of reasons. We suspect that investment manager cases comprise a large percentage of the stalled actions.

• We believe that the public interest would be best served if the whistleblower program was administered in a grand jury setting, completely independent of the agency. The grand jury will evaluate submissions in secrecy, determine courses of action and monitor results.

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**About the author**

Arthur “Two Sheds” Jackson (pseudonym) is a seasoned private fund due diligence researcher who recently became unemployed through no fault of his own (*Swear to God!*). He was employed by a pension consultant and performed over 250 “deep dive” investigations into hedge funds and other alternative investments based in the US, Europe, Asia and various offshore tax havens. His work relied heavily on details gleaned from open sources (Registrations, regulatory documents, leak databases, public profiles, news stories and other media), which he considers indispensable in constructing an accurate opinion of these funds and the people who run them.

His duties included performing a daily news sweep of the financial world with a focus on private funds, reporting key developments to clients. Conservatively he has read 50,000 news stories on hedge funds.

His work has occasionally uncovered clear evidence of fraud, but in the words of Forest Gump, “*that’s all I have to say about that.*”

He hopes to continue protecting investors in relative obscurity and is seeking a suitable position at another consultancy firm or family office. If interested contact [contact information redacted].