

**POTENTIAL CONFLICTS OF INTEREST  
AT THE SEC: THE BECKER CASE**

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**JOINT HEARING**  
BEFORE THE  
SUBCOMMITTEE ON OVERSIGHT  
AND INVESTIGATIONS  
OF THE  
COMMITTEE ON FINANCIAL SERVICES  
AND THE  
SUBCOMMITTEE ON TARP, FINANCIAL  
SERVICES AND BAILOUTS OF PUBLIC  
AND PRIVATE PROGRAMS  
OF THE  
COMMITTEE ON OVERSIGHT AND  
GOVERNMENT REFORM  
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## POTENTIAL CONFLICTS OF INTEREST AT THE SEC: THE BECKER CASE

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Thursday, September 22, 2011

U.S. HOUSE OF REPRESENTATIVES,  
SUBCOMMITTEE ON OVERSIGHT  
AND INVESTIGATIONS,  
COMMITTEE ON FINANCIAL SERVICES,  
JOINT WITH THE  
SUBCOMMITTEE ON TARP,  
FINANCIAL SERVICES AND BAILOUTS  
OF PUBLIC AND PRIVATE PROGRAMS,  
COMMITTEE ON OVERSIGHT  
AND GOVERNMENT REFORM,  
*Washington, D.C.*

The subcommittees met, pursuant to notice, at 2:56 p.m., in room 2128, Rayburn House Office Building, Hon. Randy Neugebauer [chairman of the Subcommittee on Oversight and Investigations, Committee on Financial Services] presiding.

Members present from the Subcommittee on Oversight and Investigations: Representatives Neugebauer, Fitzpatrick, Pearce; Capuano and Miller of North Carolina.

Members present from the Subcommittee on TARP, Financial Services and Bailouts of Public and Private Programs: Representatives McHenry, Guinta, Buerkle; Quigley and Maloney.

Ex officio present: Representatives Issa and Cummings.

Also present: Representatives Garrett and Ackerman.

Chairman NEUGEBAUER. The hearing will come to order. This is a joint hearing. I am proud to have my colleagues from the Committee on Oversight and Government Reform joining us in this joint hearing of the Subcommittee on Oversight and Investigations of the Committee on Financial Services and the Subcommittee on TARP, Financial Services and Bailouts of Public and Private Programs of the Committee on Oversight and Government Reform.

I remind all Members that we may have some Members who want to join us. We may have some others who join us after the votes. We are going to try to get the opening statements out of the way here. I think there will be a vote shortly. I think there are two votes. We will go do those quickly and then come back and begin the hearing.

Without objection, all Members' opening statements will be made a part of the record.

Today, we are having this hearing in order to look into matters at the SEC on how ethics are handled within the organization. The Inspector General has just released a report, and he will go over

that. I think one of the things that is alarming about this hearing today is that the SEC really holds the entities that they regulate to very high standards, particularly when it comes to conflicts of interest. And I think it is extremely important that the organization that holds others to these standards must have those same standards within their organization.

As we look at the Inspector General's report, he thinks there were some holes in that system, and one of the things we are here for today is to discuss that.

I think it is alarming to find out that someone who may have had a financial interest in the Madoff settlement was actually handling many of the very high-level discussions that were going on at the SEC. Many of us believe that was probably not appropriate behavior.

As we move forward with this, I think one of the things we have to understand is that the SEC is entrusted to protect shareholders and investors, and that some of the behavior that was going on within the organization would probably be behavior that would not be tolerated by some of the companies and entities and individuals that fall under the SEC's jurisdiction.

Ultimately, I think the findings of the Inspector General, as we will hear, is that there were some lapses and that there are some changes that need to be made within the organization, and that the leadership on this issue really needs to come from the top. We look forward to hearing from Chairman Schapiro on some of her reflections on the report and things that she thinks need to be happening within her organization moving forward, to make sure these kinds of issues do not happen in the future.

I think there is a high expectation that this issue will be dealt with and that hopefully things like this won't happen again, because this was a very high-profile case to begin with and had a lot of attention through the Madoff issue; and then to kind of follow up and find out that within the organization, we were having lapses in other internal control areas was somewhat disturbing for a lot of us.

So I look forward to this hearing today.

Now, it is my pleasure to yield 2 minutes to the the ranking member of the Subcommittee on Oversight and Investigations, Mr. Capuano.

Mr. CAPUANO. Thank you, Mr. Chairman. I would just like to welcome the people who are going to give testimony today, the members of the panel. Thank you for being here and thank you for your patience with our schedule and the demands of our schedule, which I know you both know.

Obviously, I want to know more about this particular incident. But I read the report and I actually think it is pretty clear. I will find it surprising if you shed additional light. Maybe. For me, everybody make mistakes. Even I have made an occasional mistake or have interpreted something wrong or applied something wrong. That is one way to judge people. And if it is all about perfection, then let anyone who wants to, stand up and be perfect. That is one part of the judgment, though; how bad was it; did innocent people get hurt, and if they did, what was it? But the other part of the judgment is to find out what has happened since the problem

came to light; what has been the reaction; has the reaction been proper; has it been appropriately timed; have innocent people been protected? Have any wrong decisions been corrected? Again, I think I know some of these answers, nonetheless, I would like to hear them today, because to me, that is the real judgment. Making a mistake is one thing, but how you react to a mistake, to me, is usually more important.

I look forward to hearing the testimony.

Thank you, Mr. Chairman.

Chairman NEUGEBAUER. I thank the gentleman.

Also, I am pleased to have the chairman of the Oversight and Government Reform Committee joining us on the panel as well, Mr. Issa. We appreciate your being here.

I now yield 3 minutes to the chairman of the Subcommittee on TARP, Financial Services and Bailouts of Public and Private Programs, Mr. McHenry, whom I look forward to working with on this hearing. Thanks for your cooperation.

Chairman MCHENRY. Thank you. Thank you for this joint hearing today. I want to thank our panel for being here and complying with our schedule. I certainly appreciate that. I want to thank you both for your service in government.

In May 2010, then-Ranking Member Darrell Issa released a report that explained how the SEC's unworkable structure, lawyer-driven culture, and technological backwardness helped to cause one of its high-profile failures such as the Madoff scandal. This joint committee hearing continues the ongoing efforts of congressional oversight.

The matter at hand today originates with Bernie Madoff's elaborate Ponzi scheme. Mr. Madoff admitted guilt nearly a decade after questions had been raised to regulators about the Madoff firm which operated a Ponzi scheme with over \$60 billion of fraud and thousands of clients. It was clear the SEC's reputation had taken a blow.

In 2009, Mary Schapiro was named Chairman of the SEC and stated her commitment to rebuild the SEC's reputation. Soon after her arrival, she welcomed back David Becker to the SEC as General Counsel. Upon arriving at the SEC in early 2009, Mr. Becker informed Chairman Schapiro about his status as a net winner from a Madoff fraud case. Despite learning this, Chairman Schapiro never asked Mr. Becker to recuse himself from Madoff-related matters or to disclose his financial interests. This was unfortunate and this was a mistake. That is now clear.

Since then, a series of missteps by high-ranking officials of the SEC, ranging from Mr. Becker's communication with the SEC's Counsel to his personal participation in matters in which he had a personal financial interest, have put into question the reputation of the management and decision-making of the SEC. That is what this hearing is really about. We also note, for example, that the SEC's five Commissioners, advised by Mr. Becker, voted on an issue that affected Mr. Becker's personal financial interest, and only Chairman Schapiro knew about that, and perhaps not to the full extent that she now does. Just yesterday, the SEC's Inspector General referred the Becker situation case to the Department of Justice.

Chairman Schapiro, you have had a distinguished career. You have had a long service in government service, and we certainly appreciate that. We appreciate your contribution to Federal service. You have a wonderful reputation.

What is clear about this situation is that you did make a mistake. You admitted such, and you said had you known then what you know now, you would have acted differently. What we want to know in terms of Federal congressional oversight is how we prevent this from happening again; what policies are you going to put in place, what actions you have taken, and what actions you will take going forward to make sure this never happens again?

Thank you for being here. Thank you for your testimony. And thank you for your service.

Chairman NEUGEBAUER. I thank the gentleman. I yield 2½ minutes to the gentleman, Mr. Quigley.

Mr. QUIGLEY. Thank you, Mr. Chairman. Earlier this year, this subcommittee held a similar hearing on the SEC. At that hearing, we acknowledged a number of issues facing the SEC, including budget cuts and the ability of the SEC to complete its responsibilities after they are done. We also discussed internal challenges, including the David Becker potential conflict of interest in handling high-profile cases. But at that time, at our last hearing, we didn't have the benefit of the extensive record that we do now, thanks to the Inspector General's report.

In order to fairly address this important issue and restore the public's confidence in the SEC, we welcome a thorough discussion of these matters. To that end, we also welcome the voluntary appearance of David Becker and hope his testimony will advance our discussion.

This case exemplifies how even the appearance of impropriety can undermine public confidence in vital institutions like the SEC. According to the Inspector General, "Becker participated personally and substantially in particular matters in which he had a personal financial interest." That demonstrates the importance of transparency and of ethical decision-making in the agency process, an imperative for an objective, independent, and competent Ethics Counsel at all government agencies.

In closing, I look forward to this discussion as well as our consideration of the Inspector General's recommendations for reforming the SEC's Ethics Office. I would also like to observe that Chairman Schapiro deserves credit for steps she has already taken to deal with this issue and future issues. She called for the Inspector General's investigation and has moved to revamp the SEC's Ethics Office. I hope we can build on her work and restore trust in the SEC, a vital public institution that is critical to the soundness of our financial markets.

Thank you, and I yield back.

Chairman NEUGEBAUER. I thank the gentleman.

The chairman of the Committee on Oversight and Government Reform, Mr. Issa, is recognized for 2 minutes.

Chairman ISSA. Thank you, Mr. Chairman. Thank you for convening this joint hearing today. It is in fact always a pleasure to see Chairman Schapiro. We consider her to be a consummate professional who, as Chairman McHenry said, has made a mistake.

Also, I would like to welcome Inspector General Kotz. Your report is important to the reform that this joint group wants to do. I recognize that although the reform is in the name of our committee, ultimately a great deal of what is going to be done, overseen, and fixed will be under the Financial Services Committee.

We are deeply concerned that we now have had two strikes on Bernie Madoff; that in fact today many of my questions will be not only how did it happen, but how are we going to make sure we don't have a third. It is extremely important that this committee, this joint effort, begins looking and saying, how do we get the maximum confidence in the process; how do we get capital moving again; because ultimately, dollars sitting on the sideline is in fact a national problem. And there is no better place to ensure the confidence comes back than to our public market.

So I look forward to the hearing. It is going to be tough. There are going to be tough questions because mistakes were made.

Mr. Chairman, as you know, our committee is also working on "Operation Fast and Furious" with a different part of government in which they are still claiming that no problem really occurred; that it was simply a botched operation. This was not a botched operation. There were mistakes made that we have to ensure do not happen in the future as a process, not just for individuals. So I thank you for holding this hearing and I look forward to the questions and answers, and I yield back.

Chairman NEUGEBAUER. I thank the gentleman.

I now am going to yield 2½ minutes to the gentleman, Mr. Cummings.

Mr. CUMMINGS. Thank you, Mr. Chairman, for calling today's hearing, and I welcome the opportunity to work with the members of the House Financial Services Oversight and Investigation Subcommittee on this very important issue.

The IG report, which I commend Chairman Schapiro for requesting, clearly describes a procedural breakdown within the SEC's ethics process that undermines the public's trust not just in the Madoff matter but also in any other matter before the Commission. This is simply unacceptable.

The victims of the Madoff scheme deserve to know that the SEC's decision in this case was not tainted by conflicts of interest. I am heartened by reports that Chairman Schapiro has already adopted the IG's recommendations to revisit the SEC's position regarding the method used to calculate the value of each Madoff victim's accounts, a method that was advanced by Mr. Becker and adopted by the SEC.

I am also encouraged that Chairman Schapiro took action last year to overhaul the Ethics Office, hire new Ethics Counsel, and provide the office with greater resources.

However, I, like other members of this panel, continue to have grave concerns and serious questions about the procedural breakdown in the SEC's ethics process. It is so important that we reestablish trust in this very important office.

Ms. Schapiro, you have said it yourself, that trust is very very important for everything you do. There are so many Americans who are depending on this office to do the right thing, and they have to know that things are functioning the way they are sup-

posed to function. And so I look forward to your testimony, and thank you again, Mr. Chairman.

With that, I yield back and I look forward to the testimony.

Chairman NEUGEBAUER. I thank the gentleman.

Mrs. Maloney is recognized for 1 minute.

Mrs. MALONEY. Thank you, Mr. Chairman, and ranking members, for calling this important hearing on the potential conflicts of interest at the SEC and the Becker case. This is an important case. But even more important than this are the steps we can take to prevent a Bernie Madoff scheme from happening again and hurting American taxpayers.

The Dodd-Frank Act implemented a strengthened public accounting board, strengthened independent auditors, because the information in the accounts were fraudulent in the Madoff case. It strengthened whistle-blower protections, it lowered the aiding and abetting standard, and it strengthened the requirement that examiners talk to law enforcement in order to move forward. I very much agree with the IG's recommendation that the vote should be reconsidered in a process that is free from any possible bias or taint.

I look forward to hearing from you, Chairman Schapiro, on what steps you are taking to ensure that this time the Madoff victims and the American people can be confident that this process is untainted and unbiased. Our markets run more on trust than on capital, and restoring trust is extremely important. This is an important hearing.

Thank you, Mr. Chairman. I yield back.

Chairman NEUGEBAUER. I thank the gentlewoman.

Our first panel consists of: the Honorable Mary Schapiro, Chairman of the U.S. Securities and Exchange Commission; and Mr. David Kotz, Inspector General of the U.S. Securities and Exchange Commission. Without objection, your written statements will be made a part of the record and you will be recognized for 5 minutes to summarize your testimony.

**STATEMENT OF THE HONORABLE MARY L. SCHAPIRO,  
CHAIRMAN, U.S. SECURITIES AND EXCHANGE COMMISSION**

Ms. SCHAPIRO. Chairmen Neugebauer and McHenry, Ranking Members Capuano and Quigley, and members of the subcommittees, thank you for inviting me to testify regarding the report of the Securities and Exchange Commission's Inspector General concerning the Commission's former General Counsel, David Becker. Last March, I requested that the IG conduct this review. I wanted to ensure that there was an independent analysis of all relevant facts surrounding Mr. Becker's involvement in Commission matters relating to SIPC's liquidation of the Madoff broker-dealer. Among other things, the IG identifies concerns about Mr. Becker's participation in the Commission's resolution of those issues, and also makes a number of recommendations, several of which propose ways to improve the Commission's already much-improved Ethics Office. The Commission's new Ethics Counsel and I concur in those recommendations and agree on the need to take immediate steps to implement them.

The IG also has indicated he will refer, or has referred, the results of his investigation to the Department of Justice. While it would be inappropriate for me to comment on that referral, I can talk about what I recall of Mr. Becker's communications to me soon after I became Chairman in January of 2009.

Mr. Becker informed me that his mother had had an account with Madoff before she died, and that it had been closed a number of years before he returned to the agency. At the time, I was focused on identifying and remediating failures in the agency that had allowed the fraud to go undetected for many years, and I was focused on the plight of the many victims, some of whose heart-breaking letters I had recently read. It simply did not occur to me then that his deceased mother's account, closed years ago, could present a financial conflict of interest.

There were a number of important facts about Mr. Becker's situation that I did not either know or appreciate at the time; principally, that he personally could be subject to a clawback suit or that the resolution of the SIPC issues affecting the victims of the Madoff fraud could potentially affect his financial interest. What I did know is that Mr. Becker was a dedicated public servant and experienced attorney who had ably served as General Counsel to three Chairmen.

As compliance with ethical obligations is each employee's responsibility, I assumed that he would seek guidance from the agency's Ethics Counsel, and, indeed, the IG's report describes how Mr. Becker did that on two separate occasions. But while I understand that Mr. Becker did obtain clearance from the Ethics Counsel, I also realize that as Chairman, I need to have a broader vision that goes beyond what may be required in any situation. On such matters I need to be acutely sensitive to any issue that could potentially distract from the Commission's ability to fulfill its mission with the full confidence of the investing public.

I was sworn in as Chairman on January 27, 2009, a month-and-a-half after Madoff was arrested. My highest priority at that time was to make whatever changes were needed to ensure that another Madoff could never happen again. But I was equally concerned about how to provide the most effective relief for the Madoff victims, so that within the contours of the law, we could get the most money to investors who were literally losing their homes. That issue crystalized for the Commission around the question of how the bankruptcy court presiding over the liquidation should calculate the net equity in a Madoff victim's account.

In December 2009, after internal discussions and a vote, the Commission expressed its position to the bankruptcy court. The Commission's position had two components. First, the Commission determined that due to the nature of Madoff's fraud, customers' net equity could not be based on the fictitious amounts shown on their final account statements. Instead, they should be measured by their net investment with Madoff—the money-in/money-out approach.

Second, given the extraordinary duration of the fraud, the Commission concluded that the way to treat different generations of victims most fairly was to adjust their claims to account for the effects of inflation over time, what we call the constant-dollar approach.

The bankruptcy court has ruled on the first question, agreeing with the money-in/money-out approach, a decision that the Second Circuit Court of Appeals recently affirmed. The bankruptcy court, however, has not yet addressed whether the customers' claims should be measured in constant dollars. The IG recommends that the Commission conduct a re-vote on its determination that Madoff customers' net equity be calculated in constant dollars. I agree that a re-analysis and a re-vote of this issue is appropriate.

The report also discusses a decision in late 2009 to have a witness other than Mr. Becker testify on behalf of the Commission at a congressional hearing concerning the Commission's views on how net equity should be determined in Madoff. The witness at that hearing was there to represent the Commission's legal and policy position on a complex, novel question of law.

When this issue arose, I believed, were Mr. Becker to be the witness, he should disclose to the subcommittee that his mother had had an account. Thereafter, it was suggested to me that, notwithstanding Mr. Becker's clearance by Ethics Counsel, his participation could distract from the core legal and policy positions of the Commission, and that therefore our Deputy Solicitor, an experienced litigator and the principal attorney on the Madoff liquidation matters, should be the Commission's witness. And I concurred.

Ensuring that the agency has the strongest possible ethics program has been a priority of mine. Over the past 2 years, we have revamped the structure, function, and personnel of the Commission's Ethics Office. The IG report makes recommendations on ways to further improve our ethics program, including having the Chief Ethics Counsel report directly to the Chairman instead of to the General Counsel. Notwithstanding the improvements we already have made, I recognize there is more that can be done, and we will take immediate steps to implement the report's recommendations.

I am proud of how much we have accomplished at the SEC over the past 2½ years and I am proud to have the opportunity to work alongside an extraordinary staff who work tirelessly to protect investors in the markets. Critical to the performance of our mission is protecting the integrity—and the perception of integrity—of our decisions and our processes. I can say to you with assuredness that we have learned from this experience and are taking and will continue to take all actions necessary to earn and maintain the trust the public places in us.

Thank you for the opportunity to be here today. I am happy to answer your questions.

[The prepared statement of Chairman Schapiro can be found on page 92 of the appendix.]

Chairman NEUGEBAUER. Thank you.

Mr. Kotz, you are recognized for 5 minutes.

**STATEMENT OF H. DAVID KOTZ, INSPECTOR GENERAL, U.S.  
SECURITIES AND EXCHANGE COMMISSION**

Mr. KOTZ. Thank you for the opportunity to testify before the subcommittees on the subject of potential conflicts of interest at the SEC, the Becker case, as the Inspector General of the United States Securities and Exchange Commission.



On March 4, 2011, Chairman Schapiro requested that my office investigate any conflicts of interest arising from the participation of David Becker, the former General Counsel and senior policy director of the Commission, in determining the SEC's position in the liquidation proceeding brought by the Securities Investor Protection Corporation, SIPC, of Bernard L. Madoff Investment Securities, the Madoff liquidation. The Chairman's request came after she received congressional inquiries prompted by press reports beginning on February 22, 2011, that the trustee administering the Madoff liquidation had brought a clawback suit seeking to recover fictitious profits that had accrued to Mr. Becker and his brother as beneficiaries of their mother's estate when a Madoff account she held was liquidated after her death. We opened an investigation that same day we received the Chairman's request.

During the course of our investigation, we obtained and searched over 5.1 million emails for a total of 45 current and former SEC employees for various time periods pertinent to the investigation, ranging from 1998 to 2011. We also obtained and analyzed internal SEC documents, documentation provided by the Madoff trustee, court filings, and press reports. In addition, we conducted testimony or interviews of 40 witnesses with knowledge of relevant facts or circumstances surrounding the matter.

On September 16, 2011, we issued to the Chairman of the SEC a comprehensive report of our investigation in the conflict of interest matter that contained nearly 120 pages of analysis and 200 exhibits. Overall, the OIG investigation found that Mr. Becker participated personally and substantially in particular matters in which he had a personal financial interest by virtue of the inheritance of the proceeds of his mother's estate's Madoff account and that the matters on which he advised could have directly impacted his financial position.

We found that Mr. Becker played a significant and leading role in the determination of what recommendation the staff would make to the Commission regarding the position the SEC would advocate as to the calculation of a customer's net equity in the Madoff liquidation.

Under the Securities Investors Protection Act of 1970, SIPA, where SIPC has initiated the liquidation of a brokerage firm, net equity is the amount that a customer can claim to recover in the liquidation proceeding. The method for determining the Madoff customer's net equity was therefore critical to determining the amount the trustee would pay to customers in the Madoff liquidation.

Testimony obtained from SIPC officials and numerous SEC witnesses, as well as documentary evidence reviewed, demonstrated that there was a direct connection between the method used to determine net equity and clawback actions by the trustee, including the overall amount of funds the trustee would seek to claw back and the calculation of amount sought in individual clawback suits.

In addition to his work on the net equity issue, we also found that Mr. Becker, in his role as SEC General Counsel and Senior Policy Director, provided comments on a proposed amendment to SIPA that would have severely curtailed the trustee's power to bring clawback suits against individuals like him in the Madoff liquidation.

After we concluded the fact-finding phase of our investigation, we provided to the acting Director of the Office of Government Ethics, OGE, a summary of the salient facts uncovered in the investigation as reflected in our report. After reviewing the summary of facts we provided, the acting Director of OGE advised us that in his opinion, as well as that of senior attorneys on his staff, Mr. Becker's work both on the policy determination of the calculation of net equity in connection with clawback actions stemming from the Madoff matter and his work on the proposed legislation affecting clawbacks should be referred to the United States Department of Justice for consideration of whether Mr. Becker violated 18 USC Section 208, a criminal conflict-of-interest provision.

Based on this guidance from OGE, we have referred the results of our investigation to the Public Integrity Section of the Criminal Division of the United States Department of Justice.

Based on the findings in our report, we have also recommended that in light of David Becker's role in signing an advice memorandum and participating in an executive session at which the Commission considered the recommendation that the Commission take the position that net equity for purposes of paying Madoff customer claims should be calculated in constant dollars by adjusting for the effects of inflation, that the Commission should reconsider its position on this issue by conducting a re-vote in a process free from any possible bias or taint.

We have also made several recommendations with respect to the Ethics Office, including that the SEC Ethics Counsel should report directly to the Chairman rather than to the General Counsel, and that necessary steps, including the implementation of appropriate policies and procedures, be taken to ensure that: one, objective, complete, and consistent ethics advice is provided; two, ethics officials have all the necessary information in order to properly determine if an employee's proposed actions may violate rules or statutes or create an appearance of impropriety; and three, all ethics advice provided in significant matters such as those involving financial conflict of interest are documented in an appropriate and consistent manner.

I am confident that under Chairman Schapiro's leadership, the SEC will review our report and take appropriate steps to implement our recommendations to ensure that the concerns identified in our investigation are appropriately addressed. I also believe the fact that the Chairman asked my office to conduct this investigation, and we completed an exhaustive investigation and issued a thorough and comprehensive report in a timely fashion, demonstrates that the Inspector General process within the SEC is working effectively.

In conclusion, I appreciate the interest of the chairmen, the ranking members, and the subcommittee and the SEC and my office and, in particular, in the facts and circumstances pertinent to our conflict-of-interest report. I will be happy to answer any questions. Thank you.

[The prepared statement of Inspector General Kotz can be found on page 71 of the appendix.]

Chairman NEUGEBAUER. Thank you.

We will now go to questions from the members. Each member will be recognized for 5 minutes. I recognize myself for 5 minutes.

Ms. Schapiro, you advised Mr. Becker that he would have to disclose his interest in the Madoff interest if he testified before Congress, but you didn't feel it was necessary to disclose information before the Commission when Mr. Becker made a presentation on his proposed formula for the liquidation. I am a little confused as to why you felt that it was important that he disclose that to Congress but not disclose it to Commission members. Can you shed some light on that for me?

Ms. SCHAPIRO. I would be happy to, Mr. Chairman. I thought it was very important that any information be disclosed to Congress in the context of his potentially being a witness, so there would not be any surprises. He apparently did not tell the Commissioners, and it frankly did not occur to me to directly tell the Commissioners, because generally it is not our practice to tell the Commission or to talk about it when somebody does not have a conflict of interest and Ethics cleared that he did not have a conflict of interest from appearing and that he did not need to recuse. So we generally haven't told people when somebody is not recused.

I wish that he had told them. After we all learned, obviously, from reading the newspaper that he had in fact been sued in a clawback suit, and, myself included, were very surprised by this news, I did go to each Commissioner and apologize to them for not having thought to direct David to do exactly that and inform them of it. But it simply was because we just don't have a practice of telling people when somebody is not recused.

Chairman NEUGEBAUER. I think one of the issues about this hearing is that some of these practices that were in place at the Commission seem to be the problem. There wasn't that much distance in time between when the Commission voted and when Mr. Becker was asked to potentially testify before Congress. So in a short period of time, we had an epiphany that, oh, maybe we should start telling people about this.

I think Commissioner Aguilar expressed extreme disappointment—I think “incredibly disappointed” were the words he used—that he was not made aware of the conflict that existed. So I think that is one of the things we are talking about today; we are going to hear people say that it didn't seem important.

You did mention that when you originally reached out to Mr. Becker, he disclosed that to you. You had just been made the SEC Chairman at a time when a very high-profile case was something you knew you had to address, and yet one of the people you brought into a senior staff position was someone who said, “You know what? I may have a conflict here. My family had an account with Madoff.”

I guess the question is: Did you make the decision to pull Mr. Becker as the witness when he was going to testify?

Ms. SCHAPIRO. Mr. Chairman, the decision about who would testify was actually made by our Legislative Affairs Office, but I did concur in it. The staff came to the conclusion that it could potentially be a distraction to have this disclosure, even though it had been cleared by Ethics. It was a public forum, and it was likely to

divert attention from the really important technical legal issues that the subcommittee was trying to explore at that hearing.

In addition, Mr. Becker had never testified before. And I think there were some concerns about whether he would be a very good witness. We had a second great choice in our Deputy Solicitor, who was in fact deeply involved in the Madoff litigation issues. So I was comfortable with David Becker being the witness, so long as it was being disclosed, but I was comfortable with the determination that he might not be the best witness. And our goal was to put the best witness in front of Congress to explain the Commission's legal and policy analysis.

Chairman NEUGEBAUER. I am just curious why you weren't comfortable saying to Mr. Becker, when you make your presentation to the Commission—if it is relevant for a person who is testifying before Congress, I would think it is also—these Commissioners, you all are charged with making very important decisions—why it wasn't relevant for you to disclose that, or for Mr. Becker to disclose that to the Commission members when he made his presentation?

Ms. SCHAPIRO. Of course. Had I thought of it, I would have directed him to do that. It didn't occur to me. I was thinking about this in the context of the testimony, and I wasn't thinking separately about the context of disclosing it to the Commissioners. There certainly was no intention to hide it, and I wish it had been disclosed. That is one reason why I think it is important that we do a re-analysis and re-take the votes so that there can be no question, before the court actually considers this issue, about whether there was any taint to the decision.

Chairman NEUGEBAUER. Thank you. My time has expired. Mr. Capuano?

Mr. CAPUANO. Thank you, Mr. Chairman. Mr. Kotz, did you make specific enumerated suggestions on how to address the problems that you found?

Mr. KOTZ. Yes, we did. As indicated, we first had the recommendation that the entire process be reconsidered and that a re-vote be taken.

Mr. CAPUANO. Did you make a number of specific recommendations?

Mr. KOTZ. Yes.

Mr. CAPUANO. How many recommendations did you make, approximately? Do you know?

Mr. KOTZ. Four separate recommendations. We made three separate recommendations with respect to the Ethics Office and then a recommendation overall about the process.

Mr. CAPUANO. So, four specific recommendations. Usually, the way these things work is you make a recommendation—not you, but any IG makes a recommendation, and whomever they are recommending to has a response. Was there any disagreement with any recommendations you made?

Mr. KOTZ. No. We follow up. We actually ask for a corrective action plan to demonstrate that the recommendations have been implemented. But in this case, the Chairman has already indicated that she plans to implement the recommendations.

Mr. CAPUANO. So, to your knowledge, everything that you recommended has either been done or is being done?

Mr. KOTZ. Correct.

Mr. CAPUANO. Do you have any plans to do a follow-up to that in a month, 6 months, or a year from now, to see if they have in fact been implemented?

Mr. KOTZ. We may do a follow-up to look at the Ethics Office overall. It will depend on the information we get about the recommendations being implemented. But if there is any question about the complete and full implementation of the recommendations, we will follow up.

Mr. CAPUANO. Ms. Schapiro, would you have any objections to a follow-up again in 6 months or a year from now?

Ms. SCHAPIRO. No. I would actually welcome it, because we have made some very significant changes in our Ethics Office and I think it would be very valuable to have the IG's perception of whether those are effective and the appropriate changes to have made.

Mr. CAPUANO. Again, obviously, there were mistakes made. We all know that. I actually commend you, Madam Chairwoman, for accepting the fact that you made mistakes. It is hard to do. I have done it. It is hard to do. At the same time, I also commend you, and commend you, Mr. Kotz, for making positive recommendations out of a bad situation. And hopefully, this will be better. My expectation is that not only will the process be better, but the implementation of the process. You can have the best processes in the world, but if they are not implemented properly and they are not taken seriously—not just at the SEC, but anywhere—they are worthless.

Again, that is what I came for, to make sure that there seems to be no malice here. There seem to be screw-ups. But the screw-ups seems to have been addressed. And they are being addressed. I would strongly suggest, Mr. Kotz, that you do a follow-up, even if you don't think it is necessary. If the Chairwoman has no problem—whether she is the Chairwoman a year from now, who knows—if not you, then your successor, do the follow-up. Even if it is a 1-page follow-up saying, everything is great, or if it is a 1-page follow-up that says, nothing has been done, it will certainly make me feel better and hopefully it will put a final period at the end of this particular issue.

Mr. KOTZ. We will do that.

Mr. CAPUANO. With that, I yield back.

Chairman NEUGEBAUER. I thank the gentleman. Now, Mr. McHenry is recognized for 5 minutes.

Chairman MCHENRY. Thank you for your testimony. Chairman Schapiro, thank you for the work you have rendered to your government and your service. As I said, this is an unfortunate situation. There are a few things that we have in terms of what appeared to happen. I just want to confirm that those are in fact the case. You can answer how you see fit.

When Mr. Becker returned to government service in about February of 2009, he disclosed that his late mother's account was in fact a Madoff account. Did you ask him to recuse himself from Madoff-related issues at that time?

Ms. SCHAPIRO. No, I didn't.

Chairman MCHENRY. Why?

Ms. SCHAPIRO. Because he had told me his mother had had an account years ago; that she had passed away 5 or 6 years before he returned to the Commission. I don't remember the exact number. The account had been closed. It seemed to me to be so very remote to anything we were working on at that time.

If I can give you have a little context, I had just arrived at an agency that was in disarray, quite honestly, and deeply demoralized. We were coming out of a financial crisis. There were a thousand things to do. There was virtually no senior staff on board. And I was focused on lots of other things. And I was also focused on trying to get the maximum amount of allowable recovery to victims who had nothing; who had lost everything; not people whose accounts had been closed 5 or 6 years before, but people who were literally moving into their children's basements because they lost their homes because of what this man did. And I was not thinking about David Becker's deceased mother's account through any of this.

I assumed that as an experienced government lawyer, he would go to the Ethics Office, he would do what needed to be done, and make a decision about his participation. But honestly, it seemed so remote to me to the issues that the agency was facing at that moment coming out of the failure to stop the Madoff Ponzi scheme.

Chairman MCHENRY. You understand the account valuation method would determine how these clawbacks would function. And you also knew that he had an account that could possibly be subject to clawbacks. Why didn't you ask him to recuse himself at that time?

Ms. SCHAPIRO. Sir, not really then did I understand that. At that time we weren't thinking about people whose accounts had been closed years before. We were thinking about people who were in extremis right at that moment, who needed to have funds returned to them as best could be done as a result of the fraud. So I wasn't connecting clawbacks to the issues we were facing at that particular moment. I certainly wasn't thinking about what was going on with his, again, deceased mother's account from years before. I just wasn't connecting those dots and I didn't have that kind of information.

Frankly, I didn't even know how much was in the account, whether it had earned a lot of money or a lot of money had been taken out. I just didn't have that kind of detail. And certainly, I didn't know that he could be subject or that account could be subject to a clawback at that time.

Chairman MCHENRY. According to the notes that were part of this report, you in fact did know about this; is that correct, Mr. Kotz?

Mr. KOTZ. Our report showed that when David Becker initially had a conversation with Chairman Schapiro, it wasn't necessarily clear that he told her that he could be subject to a clawback suit here. That was some information that he provided to the Ethics Counsel.

Chairman MCHENRY. But June of 2009, there are notes that you are aware that it could affect—

Ms. SCHAPIRO. Mr. Chairman, I was speaking to the time—I thought you prefaced your question to when he came back to the Commission in February. At that time, I made absolutely no connection. I will tell you, though, that those notes reflect a discussion with staff in preparation for a meeting with the management of SIPC about the different methodologies that could conceivably be used: last account statement; money-in/money-out or money-in/money-out in constant dollars. And there is a note that says clawbacks are not possible under the broader approach, I believe.

I still will tell you I wasn't connecting that and hadn't, frankly, thought about his mother's account in many, many months. It was a moment in time when he mentioned it to me in February, and I just didn't think of it again in that context.

Chairman MCHENRY. Let me ask you a different question, Ms. Schapiro. Have you recused yourself? In your time in public service, have you taken it upon yourself to recuse yourself?

Ms. SCHAPIRO. Absolutely.

Chairman MCHENRY. Absolutely. So you had the judgment to do this, and you assumed that Mr. Becker had the same judgment.

Ms. SCHAPIRO. Each employee's ethical obligations are their own. And their duty is theirs.

Chairman MCHENRY. And here's the challenge. What is the process to put in place to ensure this doesn't happen again? I appreciate the fact you have taken the IG's recommendations and accepted them. What are you going to do, going forward, to ensure this doesn't happen again?

Ms. SCHAPIRO. Mr. Chairman, we have a significantly stronger Ethics Office today, I believe, than maybe at any time in recent history. In fact, our new Chief Ethics Officer is here with me today. We have new leadership at the highest level of the Ethics Office. We have allocated additional resources to that function.

We have the first Chief Compliance Officer ever at the SEC operating in that office. We have had a significant expansion of the education of employees and training of employees about these kinds of issues. We have a new ethics handbook that has been released to employees. And we have a number of ongoing initiatives through the Ethics Office, including much more rigorous and routine consultation with the Office of Government Ethics on issues as they come up so that we are getting a bit broader input into these more technical or more difficult decisions.

I think across-the-board, we have strengthened this office. And we are doing it very much with the goal of preventing exactly this kind of thing from happening, which distracts us from important work we have to do.

Chairman MCHENRY. Thank you.

Chairman NEUGEBAUER. I thank the gentleman.

Mr. Quigley for 5 minutes.

Mr. QUIGLEY. Thank you, Mr. Chairman. Let me ask that question in a different light, for either one of you. Walk us through the scenario of what happened with Mr. Becker and why the new and improved system would catch this before it gets this far. At what point and why would the current system, training, education, what have you, have stopped this particular instance?

Ms. SCHAPIRO. I might let the Inspector General speak to walking through with Mr. Becker. I can say that I believe now somebody coming to the Ethics Office with a question like this—first of all, I believe my sensitivity to the sort of toxic nature of anything related to this is heightened. But even if I don't know about it—and we have 3,800 employees—I don't know about everybody's ethical calculations that they have to make about whether they can participate in a matter. But going to the Ethics Office now, we have centralized all of our ethics guidance under the Ethics Officer. They would get a more collaborative look, much more required information and documentation about all of the issues that surround the ethical question. There might be consultation with the Office of Government Ethics about whether it would be appropriate for a person to participate or not participate. There would be documentation of the advice that is given, so that if the issue comes up again, we can be consistent in the advice that is rendered.

Mr. QUIGLEY. When you get put in a position like his, aren't there written documents about his financial situation and his family so this would be caught automatically?

Ms. SCHAPIRO. I believe that because this was so long ago—and I don't know this, so I am surmising—it would not have been captured in current financial disclosure documents.

Mr. QUIGLEY. Have you altered the financial disclosure document for your agency, Mr. Kotz, that would get to this sort of thing, recognizing now that the recent past may not be far enough back?

Mr. KOTZ. I think that is a very good idea. The other point I would make in terms of how things would be different, implementing our recommendation that the Ethics Counsel should report directly to the Chairman I think would change things.

We had great concerns about the process used where David Becker went to a subordinate and got the advice with respect to whether he had to recuse himself from that matter. Several months later, he performed a performance evaluation of this individual. And so, I have to think there is a concern about when you have to give ethics advice for your boss where it is a matter that a person wants to work on. So if you move that person out from under the General Counsel, then I think in this case the ethics official who makes the decision would maybe feel more comfortable giving appropriate advice. I think if that recommendation is implemented, which I understand it will be, that that could potentially make a significant difference.

Mr. QUIGLEY. You mentioned this as potentially a good idea. How far back do you go now on your current recommendations in a person's financial background, who make decisions like Mr. Becker was?

Mr. KOTZ. There are Office of Government Ethics forms that everyone fills out government-wide, and it has current interests that you have for that year, so as long as you continue an interest. I think that perhaps since this was his mother's account, the estate's account, that it may not have been picked up for that purpose. That may be something that needs to be looked at to add to the financial disclosure form, because obviously if you are inheriting money, it becomes yours.



Mr. QUIGLEY. Right. It may not apply to all government employees, but clearly with the decisions like Mr. Becker's, the people in those positions may have to have a different sort of form.

Mr. KOTZ. I agree. There should certainly be a heightened standard for a senior person in an agency like the SEC. The SEC holds itself out—its code holds itself out for the highest level of integrity. I think that is an important standard that the SEC has to keep.

Ms. SCHAPIRO. Congressman, if I could just add, I think one of the important things we can do, and it goes back to the comment about setting the tone at the top, is really heightening our employees'—all of our employees'—awareness to the impropriety or the appearance issues generally. The current Ethics Office is very engaged in exactly that kind of education of our employees.

Mr. QUIGLEY. I appreciate that. Mr. Kotz, a final point. The recommendation that was made to refer this to the Justice Department—that decision, how was it, if at all, influenced by the fact that you had made this decision after getting advice from legal counsel within the SEC?

Mr. KOTZ. According to the regulation, that is a factor that the Justice Department looks at in determining whether to bring a case. But that is not an absolute bar. In other words, notwithstanding the fact that you have sought ethics advice, that is not a bar to engaging—

Mr. QUIGLEY. Not only sought it, but you got advice.

Mr. KOTZ. That is right. We provided that information to the Office of Government Ethics, and their determination was it still should be referred to the Department of Justice.

Mr. QUIGLEY. Given that this was a goof-up on many levels that compounded itself, it seems to have a very chilling impact on people in the future that maybe they can't necessarily rely upon this advice and not worry about their own situation a little more personally.

Mr. KOTZ. I think that is why it is very important that the Ethics Officer gives appropriate consistent advice. And that is one of the reasons why we have made recommendations to the Ethics Office, because you are right; people are relying on this and they need to make sure that they are getting the appropriate advice so they don't get into trouble because of something that somebody said that may not have been entirely accurate.

Mr. QUIGLEY. Thank you, Mr. Chairman.

Chairman NEUGEBAUER. Mr. Issa is recognized.

Chairman ISSA. Thank you, Mr. Chairman.

Mr. Kotz, I am going to follow up right where that left off. If I give you bad information about something, I want an ethics opinion on, and you give me a clean bill of health, that doesn't preclude later recrimination, right?

Mr. KOTZ. Absolutely. Because in that case you could use the process to get yourself out of some later recrimination.

Chairman ISSA. Ultimately, Mr. Becker, whom we will hear from later, is a senior attorney with independent knowledge of many things, including, quite frankly, he is a member of the bar. These are independent actions which the Justice Department is going to look at—whether he knew himself.

Mr. KOTZ. In fact, he was the alternate designated agency ethics official.

Chairman ISSA. Thank you. You have taken me to the next question, which is: Inherently throughout government, not just in whatever Ms. Schapiro wants to fix, but throughout government, don't we have a need for a greater level of independence that, in fact, the head of all the lawyers whom in fact may have lots of lawyers working with them and so on, who goes to another person who works for them for an ethics opinion, isn't that a level of independence that is government-wide to be re-thought by this committee?

Mr. KOTZ. I think it would apply to other agencies as well. Absolutely. It is very hard to be completely independent when you are subordinate to somebody, when they are reviewing and evaluating you. It is a very difficult thing to do.

Chairman ISSA. From your study, from your investigation, is there an inconsistency in this answer, in your opinion, that Mr. Becker got versus similar answers that somebody else would have gotten?

Mr. KOTZ. Yes. We do relate some concerns we have about other individuals where, even with respect to the Madoff liquidation, there was a much broader request to recuse. And with respect to Mr. Becker, the determination was one aspect shouldn't necessarily impact the other. When it came to a lower-level staff attorney in the office of the General Counsel, just a small amount of work in her law firm on an unrelated bankruptcy matter, the determination was made she should be recused from all Madoff-related activities.

Chairman ISSA. So they erred on the side of caution, except in the case of Mr. Becker.

Mr. KOTZ. That was the concern, certainly.

Chairman ISSA. Madam Chair, you oversee a great many public companies. Do those public companies have to declare contingent assets and contingent liabilities that they have on their financial statements? In other words, under GAAP accounting, don't you have to actually disclose the fair contingent liability or a contingent asset? If you sign, for example—famously, we are all looking at this in our companies, and I do have some companies falling under some of these requirements—if you have a lease, you have a value on that lease, even if you are making the payment every year. You have to evaluate that. So all those contingent assets and liabilities, public accounting is trying to grapple with how to state them, correct, even though they are not always liabilities that have any effect this year on the P&L?

Ms. SCHAPIRO. Right.

Chairman ISSA. In a sense, for this committee, and particularly for the reform committee that would be looking government-wide, shouldn't ethics disclosures very much reach out and say, what are your contingent liabilities and your contingent assets? Are you the signer on your child's credit card; are you the signer on your mother's home?

Aren't those in fact things which could very much affect, just as Mr. Becker had a \$140,000 or so contingent or \$130,000-some contingent windfall if he convinced a standard to be in his favor?

Ms. SCHAPIRO. I think it is a great question. I think some of that is actually already required to be disclosed; some of the things that

are not just personal to you, but to your spouse, your children, trusts you might manage for a disabled family member, those kinds of things. But I think it is very much worth looking at because anything that has the potential to create a conflict of interest, even if it is not directly owned by you, is something we should be looking at.

Chairman ISSA. Mr. Kotz, was there any indication on Mr. Becker's disclosure of this contingent value or contingent liability if the Madoff clawback came in?

Mr. KOTZ. I think that is an excellent point. In this case we found that the ethics official's advice was based on some incorrect assumptions. But we also found that there wasn't an effort to seek out that contingent information. In other words, there wasn't an effort when Mr. Becker came in and gave Mr. Lenox the information to try to understand exactly what this means, how will this impact this, what if this happens, what if that happens, just like you are saying, in a contingent fashion.

Had he done that, he would have seen that there was this connection between what Mr. Becker was working on and his financial interests.

Chairman ISSA. So the candid disclosure that we expect from public companies didn't occur in this case.

Mr. KOTZ. It did not.

Chairman ISSA. Thank you. Thank you, Mr. Chairman.

Chairman NEUGEBAUER. I thank the gentleman. Now the gentleman from Maryland, Mr. Cummings.

Mr. CUMMINGS. Thank you very much. I want to just pick up where Mr. Issa left off.

Let me make sure I understand this. Having represented a lot of lawyers in private practice, Mr. Kotz, we had at least seven SEC officials who had been informed at one time or another about Mr. Becker's mother's estate account, including the Chairman, then Deputy General Counsel, the current General Counsel, the Deputy Solicitor who testified at a hearing in Becker's stead, the Director of the Office of Intergovernmental Legislative Affairs, the Special Counsel, the Chairman and two ethics officials, but none of those individuals saw a duty to take further action to disclose Becker's interest to others at the SEC or to see that Becker recuse himself from the Madoff-related matters; is that correct?

Mr. KOTZ. Yes.

Mr. CUMMINGS. And Mr. Issa said something that was very interesting. He said if somebody gives bad information—and I am asking you because I am sure Justice is looking at this hearing—are you saying that Mr. Becker gave any of these folks bad information? The reason why I am getting at this is because I want to make sure as other members of this panel have said that it doesn't happen again and that we do—that your recommendations are able to catch these kinds of problems from happening again.

But I can tell you if seven people tell my client to do something, assuming he hasn't given them bad information, I have to wonder about that. So you are saying that he—remember, Mr. Issa talked about bad information. Are you saying that Becker either did not tell the truth, did not tell the whole truth? What are you saying?

Mr. KOTZ. There was no information that Mr. Becker gave that was incorrect.

Mr. CUMMINGS. Say that again?

Mr. KOTZ. There was no specific information that Mr. Becker gave that was incorrect. With respect to five of those seven people, there was very limited information given.

Mr. CUMMINGS. Okay.

Mr. KOTZ. So there wasn't a lot of information upon which you might be able to make that determination. With respect to the ethics officials, there was more information given. The ethics officials had a misunderstanding nevertheless of the gravity of the situation, but no, Mr. Becker did not provide any false information per se.

Mr. CUMMINGS. All right. And did—so—and one other thing you said that I was just wondering about. You talked about this whole thing of people being subordinate, that is, under him, and you all—with the recommendations I think we have gotten, we have addressed that. Is that correct?

Mr. KOTZ. Yes, they are planning to address that.

Mr. CUMMINGS. Okay. Are you doing that?

Ms. SCHAPIRO. Absolutely. We will change the reporting line of the Chief Ethics Officer.

Mr. CUMMINGS. And when is that going to happen? You keep saying we are going to. I thought we had done that.

Ms. SCHAPIRO. It is a matter of however quickly I can get the Commission approval to do it, but I would say in a matter of a couple of days.

Mr. CUMMINGS. Oh, good. Would you let us know when that is done?

Ms. SCHAPIRO. I would be happy to.

Mr. CUMMINGS. Because I think that is very important. But did you refer anybody else to the Justice Department for prosecution possibly?

Mr. KOTZ. No, no.

Mr. CUMMINGS. I guess what I am trying to get at is that you imply that somebody, or somebodies, because of their subordinate position may have done something that was not proper. Was there any testimony based on what you found of somebody saying, because this Mr. Becker was my superior that I felt some kind of pressure or that I needed to do this or is this your conclusion?

And again, I am just trying to figure out how to make sure this doesn't happen again.

Mr. KOTZ. Yes. Mr. Lenox did not say that he felt pressure. He did say that part of the factor that he used in making his determination was how important it was for Mr. Becker, whom he considered to be a very, very talented individual, to work on this specific significant matter for the Commission.

Mr. CUMMINGS. I see. And was the ethics advice provided to Mr. Becker by the SEC's Ethics Counsel at the time demonstrably flawed?

Mr. KOTZ. I believe it was flawed, yes.

Mr. CUMMINGS. Would you agree with that, Ms. Schapiro?

Ms. SCHAPIRO. I think that is actually now a question for the Department of Justice given the referral. So I would be—

Mr. CUMMINGS. I understand.

Ms. SCHAPIRO. —reluctant to answer that. Congressman, could I just add one thing—

Mr. CUMMINGS. Please do.

Ms. SCHAPIRO. —about the other employees? I think it is important to note that it wasn't—they might have known a little bit. They might have had some understanding that Mr. Becker's mother had had an account, that he had received ethics clearance. It wasn't their duty to opine on the ethics of what he was doing. While I am certainly not condoning anybody turning their back on a potential conflict, I am not aware of any of those other employees having done that.

Mr. CUMMINGS. Thank you very much, and thank you, Mr. Chairman. I yield back.

Chairman NEUGEBAUER. I thank the gentleman, and now the vice chair of the Oversight and Investigations Subcommittee, Mr. Fitzpatrick, is recognized for 5 minutes.

Mr. FITZPATRICK. Thank you, Mr. Chairman. Mr. Kotz, in his email to Mr. Becker clearing him to work on the Madoff victim formula, the SEC Ethics Counsel did not discuss whether it would create an appearance of a conflict if Mr. Becker worked on the Madoff matters. Is a conflict of interest and an appearance of a conflict of interest the same or are they different things?

Mr. KOTZ. No, they are different, and one should do a different analysis as to whether there is an actual conflict or whether there is an appearance issue.

Mr. FITZPATRICK. Can you expand on the differences between what—how they—

Mr. KOTZ. Sure. In fact, the same Ethics Counsel in this case who did not state in the email to Mr. Becker that he was doing an appearance analysis actually issued an ethics NewsGram. He talked about what the appearance analysis would be, and he actually did it in terms of the New York Times or Washington Post test: How would it look; what are the optics of the situation; what is the context of facts and circumstances; would it pass what has often been referred to as the New York Times or Washington Post test; if what you propose doing becomes the subject of an article in the press, would you not care or would it not look like you were doing something wrong; even if you wouldn't care, what effect would the story have on the SEC and your fellow employees.

That was the test that Mr. Lenox himself set forth for appearances. That is very different from what the Justice Department is looking at with respect to an actual conflict.

Mr. FITZPATRICK. What would have happened if Ethics Counsel found, which I believe any reasonable person would have seen, that there was an appearance of a conflict?

Mr. KOTZ. At that point, there could have been a request made for an authorization or waiver for Mr. Becker to go forward and work on it, notwithstanding the concern. That would have had to have been elevated to the Chairman of the agency to make a determination. All the facts would have had to have been disclosed to the Chairman in order for her to properly determine whether that was appropriate. But that was not done here, and in fact, the ap-

pearance issue did not come up in the email, and there was never an opportunity to look at it further.

Mr. FITZPATRICK. Mr. Kotz, are you familiar with the condition of or the state of recordkeeping within the Ethics Office?

Mr. KOTZ. I do know that one of the recommendations we made was that things be documented more. One of the things that the previous Ethics Counsel who gave the advice in this case said was he didn't document generally ethics advice, and we think in order to ensure that there is consistent advice given to different people that there be some documentation.

Mr. FITZPATRICK. So you believe that deficiencies in recordkeeping could result in inconsistent advice?

Mr. KOTZ. Yes.

Mr. FITZPATRICK. Were all the staff at the SEC treated the same?

Mr. KOTZ. We found that there were other instances of individuals who sought ethics advice about the Madoff liquidation matter for whom there was a much broader analysis and there were recusals in a much broader way than for Mr. Becker, which is why we had the concern with respect to Mr. Becker and Mr. Lenox being a subordinate of Mr. Becker.

Mr. FITZPATRICK. Was there special treatment?

Mr. KOTZ. I believe that there were different decisions made when it came to this decision with respect to Mr. Becker and when it came to decisions with respect to other employees in the Office of General Counsel.

Mr. FITZPATRICK. And then if there was an appearance of a conflict of interest in the Becker case, could he have continued to work on the matter?

Mr. KOTZ. If he had gotten a specific authorization or waiver to continue to work on that matter.

Mr. FITZPATRICK. And that waiver would have come from whom?

Mr. KOTZ. The Chairman.

Mr. FITZPATRICK. Nothing further. Thank you.

Chairman MCHENRY. Would the gentleman yield?

Mr. FITZPATRICK. Yes.

Chairman MCHENRY. Thank you. Mr. Kotz, can you document the Annette Nazareth situation that you have, that you mentioned in your report?

Mr. KOTZ. Sure. In May 2010, Annette Nazareth came forward—I am sorry, May of 2009—Annette Nazareth, along with many other lawyers, came forward and wrote a letter to David Becker requesting that the SEC consider the so-called last account statement approach. Under the last account statement approach, fictitious profits would be factored in. Essentially, Madoff victims would get compensation for the amount of their fictitious profits. That was a matter that David Becker looked at, analyzed, and eventually rejected, but it was brought forward by Annette Nazareth, who was a former Commissioner of the SEC, and other attorneys representing Madoff victims.

Chairman MCHENRY. And she, in fact, knew that Mr. Becker was heir to a Madoff account?

Mr. KOTZ. Mr. Becker had informed Ms. Nazareth about his mother's estate account, yes.

Chairman MCHENRY. Did that raise concerns?

Mr. KOTZ. It did. And we looked at that. We did not find any evidence of preferential treatment for Ms. Nazareth.

Chairman MCHENRY. But the appearance.

Mr. KOTZ. But the appearance is something that is a concern, and that is why all of Mr. Becker's activities in this matter have that appearance concern, and when you have a situation where you allow something to occur, even in the space of an appearance issue, there becomes sort of a taint or a potential bias, and it erodes the credibility of the profits and that is exactly why these questions are asked. The Washington Post, New York Times test is one to ensure that there isn't even the appearance of impropriety, and that was a concern in this case.

Chairman MCHENRY. Thank you.

Chairman NEUGEBAUER. The gentleman's time has expired. The gentlewoman from New York, Mrs. Maloney.

Mrs. MALONEY. Chairwoman Schapiro, according to the IG report, Mr. Becker's alleged conflict of interest in the Madoff case arose primarily due to his "significant and leading role in the determination of what recommendations the staff would make to the Commission regarding the position the SEC would advocate as the determination of a customer's net equity in the Madoff liquidation."

So the method used to calculate net equity was, and remains to this day, a critical issue because it dictates how much each Madoff victim ultimately receives. So, as one who represents many Madoff victims who lost their homes, lost everything, and are destitute, this is absolutely critical.

Furthermore, for Mr. Becker's purposes, the method used to calculate net equity would likely determine whether or not he was subject to a clawback to recover the \$1.5 million in fictitious profits credited by Madoff to his mother's \$500,000 investment, which he then inherited in her estate.

As noted earlier, Mr. Becker rejected the last account statement method which was advocated by a number of Madoff clients and, if adopted by the Madoff trustees, would have likely protected him from the current clawback suit of which he is now a party. Instead, he recommended that the Commission adopt the so-called constant dollar method which calculates each victim's net equity position as the amount they originally invested minus any withdrawals adjusted for inflation. The IG calculated that this approach would reduce by \$138,000 the amount sought in Mr. Becker's clawback suit.

But the fact that Mr. Becker did not seem to be acting in pursuit of his own financial interests, I agree with the IG's recommendation that the Commission should reconsider its position on this issue by conducting a re-vote in the process so that it is totally free of any taint or bias, and I commend you, Chairwoman Schapiro, for announcing, I believe yesterday, that you would call for such a vote. I think that is important.

When do you expect the Commission to have this vote?

Ms. SCHAPIRO. It would be my hope that we could do it in the next several days.

Mrs. MALONEY. And—

Ms. SCHAPIRO. I am sorry, the changing of the reporting lines in the next several days. We actually want to do more than just re-vote. We want to have a re-analysis of the issue. The issue is not

before the bankruptcy court yet. They have told us that they will set a briefing schedule for it at some time in the future. So we have a little bit of time, but the staff will have to do a re-analysis and then we will schedule a vote for the Commission, but I have already instructed that the re-analysis be started.

Mrs. MALONEY. On Tuesday, you stated that, "you believe the decision the Commission made on the net equity issue was appropriate under the law and in the best interests of investors." However, even if the Commission's outcome was appropriate, we now know the process was flawed, and therefore, you are calling for this re-vote just to make sure the process is not tainted, but you agree with the outcome of the vote previously?

Ms. SCHAPIRO. I certainly agreed at the time that it was the most equitable way to treat Madoff investors, that the final account statement method probably was not supported by the law, that cash-in/cash-out probably was. But there is generational unfairness because somebody who invested very early on and is quite elderly and unable to earn back any of this money that was stolen from him would be at a disadvantage to a much more recent investor. So that is why constant dollars, which I think is permitted under the law, was appealing to me.

All of that said, I obviously want to see the re-analysis before I would declare that I would be in exactly the same place because I think it is important to make sure that the analysis is completely untainted.

Mrs. MALONEY. You are taking additional steps to make sure the process is unbiased?

Ms. SCHAPIRO. Right.

Mrs. MALONEY. Inspector General, do you have any additional recommendations of the Commission to ensure that we can have confidence in this vote and in this process in addition to what the chairwoman has outlined?

Mr. KOTZ. We would be happy to certainly play a role in monitoring or looking at that process of vote to ensure—I think it is actually a good thing that they are going to take their time to do it, to do a re-analysis. I think that the recommendations and the discussion, the debate has to be done without the involvement of somebody with the potential bias or taint, and so I would be happy to help in any way I can to ensure that process is completely free of any taint or bias.

Chairman MCHENRY. [presiding]. The gentlelady's time has expired. With that, Mr. Guinta is recognized for 5 minutes.

Mr. GUINTA. Thank you, Mr. Chairman. I yield my time back to the Chair.

Chairman MCHENRY. Thank you. Ms. Schapiro, I asked Mr. Kotz this question about former Commissioner Nazareth. She had knowledge of Mr. Becker's Madoff accounts. There was a letter that would, in standard form, be addressed to the Chair of the SEC. She specifically addressed it to the General Counsel. These things were noted in the IG's report. What are your thoughts on that process?

Ms. SCHAPIRO. Mr. Chairman, I should say that I did not know that she knew of Mr. Becker's mother's account until I read the IG's report.

Chairman MCHENRY. What do you think now of that situation?



Ms. SCHAPIRO. I guess I don't know what to think of it. I was surprised by it. I believe that they are friends and—but I don't know.

Chairman MCHENRY. Was it disappointing? Did it reek of insider doing?

Ms. SCHAPIRO. No, not to me. We have people come back, and one of the things the new Ethics Office does extremely well is counsel people on their post-SEC employment obligations and requirements to disclose the work that they are doing that might have them appearing before the Commission. We do have people who have been at the agency who have left and come back, and so long as they follow the ethics rules and there is—and they don't come back within the prohibited time period, it is a fact of life we live with. I think it is very important, and I think staff is quite attuned to this, that there be no special treatment ever for people who are former employees of the agency.

Chairman MCHENRY. Sure. But Ms. Nazareth knew of his account and knew what was she recommending would benefit him. That certainly has the appearance of impropriety, does it not?

Ms. SCHAPIRO. It is hard—I am sorry, it is just hard for me to judge that.

Chairman MCHENRY. Okay. Then let me ask you a different question. I want to give you plenty of time to answer. You testified before that knowing what you know now, had you known then what you know now, and you have referenced that before and you have been very forthright about it, tell me what you should have done or what you would like to have done if you were able to rewind the clock. Walk us through that because—and the reason why I ask and I ask you about your personal recusal. We are not here judging your ethics. There was a decision made that we think was inappropriate, that the record shows raised real questions, and so you have recused yourself on matters that weren't even an ethics violation, you just were concerned and you recused yourself. So rewind and just walk us through that.

Ms. SCHAPIRO. Sure, I would be happy to. Even understanding that every employee's ethics obligations are their own—and this is a senior government attorney with lots of experience—in hindsight, I wish I had asked questions. I wish I had—when he had said his mother had an account, she died 6 years ago, it was closed, I wish I had thought to say, let's play this out, what are all the possible things that could happen down the road if we were thinking very aggressively and very creatively that could impact the fact that this account, which seems so remote to me when he told me about it, could have any implications whatsoever for your personal financial interests or for an appearance issue for the SEC as we deal with these issues. In hindsight, I wish I had asked more questions.

Chairman MCHENRY. At the time, you were coming in to clean up the SEC after dealing with all the kinks of the Madoff situation, that this was an SEC failure, that they didn't see it happening; that citizen watchdogs had tried to point this out to the SEC and the SEC didn't take action. So, when the former Chairman, Chairman Cox, said those on the SEC staff who even donated to a charity connected to the Madoff situation had to recuse themselves, do

you think in hindsight you should have simply said step aside, simply because of the appearance?

Ms. SCHAPIRO. I would say, I wish I had known about Chairman Cox's memo to the staff. It was obviously before I arrived. He was still the Chairman, and I didn't know about it. But I think, as I said back in March when I testified, that in light of what I know now, yes, I wish he had recused. I wish I had thought to ask him to do that but I didn't.

Chairman MCHENRY. Did you ask for the IG report before or after the hearing back in March?

Ms. SCHAPIRO. I believe it was before the hearing. Yes, I am confident it was before the hearing.

Chairman MCHENRY. Okay.

Ms. SCHAPIRO. We can double-check the days but I am confident.

Chairman MCHENRY. Okay. Thank you for your testimony. Mr. Miller for 5 minutes.

Mr. MILLER OF NORTH CAROLINA. Thank you, Mr. Chairman. My questions are not about Mr. Becker's conduct or the decision—the investigation by the SEC or the decision to refer, but about the SEC's investigation of conduct generally and decisions to refer to the Department of Justice.

The speech at the Academy Awards by the producer of "Inside Job" can sound superficially like an appeal to mob rule, "Why has nobody gone to jail?" We don't put people in jail in this country because something went really wrong and we need somebody to blame. Politicized prosecutions really are incompatible with democracy and with the rule of law.

On the other hand, the Teapot Dome scandal was in part about the ability to use—by political insiders to use their political clout to keep a prosecution from happening, to protect people from prosecution who clearly were guilty of criminal conduct. And the Supreme Court at that time said that it was a proper role of Congress, Congress' oversight powers, to investigate how the Executive Branch used criminal prosecution powers.

There is now a lot of civil litigation pending around the country—I am sure you are aware of it—arising out of mortgage securitization in the last decade. The allegations in those lawsuits are pretty similar, and some of it seems to be very serious and, if true, is hard to imagine that it does not rise to the level of crimes.

There is now a lawsuit in New York by MBIA and Ambac to mortgage insurers against—it is against Chase but for conduct that Bear Stearns, that was later purchased by Chase, and the allegations are that Bear Stearns bought mortgages from the originators, put those mortgages in a pool, sold bonds based on the pools, no longer really had any interest in the mortgage, any beneficial interest in those mortgages, and at that point went back to the originators and said those mortgages were not what you said they were and we could require you to buy those back from us, but instead we will settle for money. And they did settle for money. They kept the money and said not a word to the mortgage investors.

Also, the allegation is that their due diligence firm, Clayton Holdings, found lots and lots of mortgages that did not comply with the representations and warranties, and what they did was take those out of the pool because 1 in 10 came—they examined 1 in 10

but put them in the next pool, knowing that exactly the same representations and warranties, knowing that those mortgages did not comply but figured there is only 1 in 10 chance that that mortgage would actually be examined by the due diligence firm.

Those appear to be allegations of criminal conduct. Is the SEC investigating that conduct or the other similar allegations around the country, and if not, why not?

Ms. SCHAPIRO. Congressman, as you know, we don't have criminal authority although we work closely—

Mr. MILLER OF NORTH CAROLINA. But you can investigate and refer?

Ms. SCHAPIRO. Yes, and we do work very closely with the U.S. Attorney's offices around the country and State Attorneys General. I can tell you that we have a pipeline full of active cases coming out of the financial crisis that include issues around the quality of mortgages that have been pooled, the adequacy of the disclosure, and about whether those mortgages met the representations and warranties that were given. And we have brought a number of cases, about 70, coming out of the financial crisis naming CEOs and CFOs in fact, and we will continue to see those cases from the SEC. We are moving very aggressively.

Mr. MILLER OF NORTH CAROLINA. Has the Inspector General's Office looked at any of these decisions?

Mr. KOTZ. That wouldn't be within our area. We as the Inspector General's Office look at decisions involving SEC employees. I am happy to explain the process we went through in determining to refer this matter to the Department of Justice.

We essentially gathered the facts in this investigation and provided that information to the Office of Government Ethics. The Office of Government Ethics is the leading body that understands and interprets ethics matters, and obviously there were different factors to consider in this case. One that was mentioned earlier is that Mr. Becker sought ethics advice, another is that we didn't find evidence that Mr. Becker intentionally sought to financially profit from this. On the other hand, there were concerns about his personal participation in a matter that could affect his financial interest.

So, we gathered up all the evidence. We provided it to the Acting Director of the Office of Government Ethics. He came back and recommended that we refer it to the Department of Justice for a potential criminal review. We felt it was our obligation that once the Office of Government Ethics indicated that it should be referred that we do so.

Chairman MCHENRY. The gentleman's time has expired. I recognize the chairman of the Oversight Subcommittee of the Financial Services Committee, Mr. Randy Neugebauer of Texas.

Chairman NEUGEBAUER. Thank you, Mr. Chairman. Chairman Schapiro, in Mr. Kotz's report, he makes it clear that before Becker's arrival, the Commission had been twice briefed on the money-in/money-out proposition and that the specific payout plan would follow and that—and according to Steve Harbeck, he went so far as to say that the SEC and SIPC had verbally agreed to move forward with the money-in/money-out method; yet, shortly after Mr. Becker arrived, the Commission made a 180-degree turn.

Can you explain why that happened and Mr. Becker's influence on that process?

Ms. SCHAPIRO. Sure. I think it is correct to say that very early on in the process, the Commission was generally comfortable with money-in/money-out, and that was the recommendation of the staff in Trading and Markets, but what coincided, actually, I believe, roughly with Mr. Becker's arrival at the Commission, is lots of victims coming forward through letters and emails and in other ways very, very unhappy, profoundly unhappy, about money-in/money-out because it limited the amount of their recovery. And really pushing very hard for the Commission to consider whether a final account statement was a better way to calculate net equity.

I think it is incumbent upon us as a government to not just say, forget it, we have already made up our minds and even though you might be bringing us a new theory, a new legal theory, a new idea, we are not going to listen to you. And so the Commission took the time to hear out those victims and understand their legal arguments. We concluded nonetheless at the end of the day that money-in/money-out was the right way to go, that final account statement wasn't appropriate, but I think we have an obligation to hear people.

Chairman NEUGEBAUER. One of the things that I kind of wonder about from your other testimony, you said you had to think about whether Mr. Becker's account had lost or made money; it didn't really dawn on you. But if you were familiar with Mr. Madoff's scheme, everybody always made money, and so, if you got out early, then those people who got out early showed in many cases substantial gains. In fact, I think Mr. Becker's family account started off with an initial investment of \$500,000, and I think when they cashed it in, it was for \$2 million. And so, from a perspective of looking at a different settlement matter basically for those people who got out early, meant that changed the clawback calculation.

I am having a hard time. You are a very smart person and you have been in this business a long time. When you keep telling me it didn't dawn on you that there was an issue here, I am shocked.

Ms. SCHAPIRO. I didn't know when the account was opened. I didn't know how much was put in. I didn't know how much was taken out at the time it was liquidated because apparently it was liquidated as a result of a death. I had none of that information. Of course, we all know that Ponzi schemes do make money until they don't anymore, but I had no sense of how long it had been open, what had been deposited, and what had been withdrawn. It just was not information that I had.

Chairman NEUGEBAUER. So when Mr. Becker said that his family had an account with Madoff, early in that process, it didn't cross your mind to ask, how much money are we talking about here; are we talking about \$250 or \$2.5 million? It didn't dawn on you to ask because—

Ms. SCHAPIRO. I know. I understand your frustration, but it didn't. To me, it was an account of a deceased relative from 5 or 6 years ago. It just didn't seem to have a live financial component to it, to me, at that time, as we were dealing with all these other issues.

Chairman NEUGEBAUER. So when Mr. Becker then later on in the process when he is—there are some accounts and some conversations that you had and I think after it was determined he shouldn't testify because of the conflict, you said, "I believe this, that don't worry, you will have other opportunities." You were all kind of making light of the fact that he didn't get to testify. At that point in time, didn't it dawn on you then, or when did it dawn on you, I guess is what I am asking? When the newspaper account came out, did it dawn on you then or did it dawn on you before then?

Ms. SCHAPIRO. Obviously, when I read that he had been sued in a clawback suit, it very clearly dawned on me, which is why I asked the Inspector General to look at it. It did not occur to me at the time that he would have a personal financial interest in how this issue was resolved. I had nothing to gain by this.

Chairman NEUGEBAUER. I know that. I am just trying to—I am trying to make sense of it, really is what I am trying to do because quite honestly a lot of this just seems so commonsense that through this whole process, it raises the question of, if these kinds of things are falling through the cracks, are there other kinds of things that are falling through the cracks here that haven't come to light yet, that we are just quite not aware of. Do you follow what I am saying?

Ms. SCHAPIRO. I do. I won't tell you there is nothing going wrong anywhere in the SEC at any given moment, but I will tell you that we have worked tirelessly to improve the operations of the agency in almost every aspect of it, and I think we have tremendous results to show for that.

Chairman NEUGEBAUER. I thank you.

Chairman MCHENRY. The gentleman from New York, Mr. Ackerman.

Mr. ACKERMAN. Thank you, Mr. Chairman. I must confess, I am not totally amazed. As with almost anything Madoff, nothing is really what it seems, and it is quite understandable once you view the entire picture what is and what isn't going on and how easy it was to miss so much of this. It seems to me, though, in all fairness that this appears to be, from what everybody has looked at, a pretty isolated case within the agency with very limited damage most likely done, if any damage whatsoever.

This is everything being relative, I think we are going to find from what I have read from what Mr. Becker has said and from my conversation with him some time ago, that he is a fairly substantial financial person from a fairly substantial family, and the amounts of money that he might have even benefited from is a relatively, if I could use the word, piddling amount compared to the net worth of what he was looking at.

I do have some concerns, though, about what it looks like from an ethical point of view. In the Annette Nazareth case, he actually turned down the opportunity to agree with her argument and those of her clients that would have, had he accepted those arguments, benefited him to the tune of \$1.5 million. Instead, he came down on the side, as did you, that it appeared that the reasonable way to go was with money-in/money-out, plus the cost of constant dollars at the time, which would have benefited him, as I understand

the back of the envelope calculation shows \$138,500, which in Mr. Becker's circumstance, having been a person who took a 90 percent cut in salary to take the job, assuming he is making \$200,000 a year in this position meant he was making \$2 million a year previously, which my calculator says he makes up in 24.9 days, had he done this for the money, he would have worked a month longer in his old job instead of taking this one. A question of judgment, yes.

My question is, as a result of his not recusing himself, was there any damage done to anybody at all?

Ms. SCHAPIRO. I think the answer to that is the damage done is unfortunately to Mr. Becker's reputation, and he is a fine lawyer—

Mr. ACKERMAN. And your agency.

Ms. SCHAPIRO. —and was a committed public servant; and to the agency and the time that we are all spending sorting through this issue.

Mr. ACKERMAN. The decision made to switch him out as a witness is troubling to me. As I am sure you will recall, there was a hearing shortly—I think it was the week of your becoming Chairman and it was a disaster of a hearing, I think, from the point of view of the witnesses who were testifying, and there was a lot of acrimony going on. And by the time I reached my office that day, there was a message from you expressing that you were aghast at the way top people in the agency conducted themselves before our congressional committee and you said you were going to clean that up. I believe that was on a Wednesday, and I went home for the weekend and saw in the newspapers on Sunday that you had fired almost everybody who was at that table because of the way they conducted themselves before this Congress, and I have to tell you that I was impressed and remain impressed with what you do.

So I have a concern about switching out the witnesses because of the fact, as I believe you stated, he would have been a distraction in having to reveal that he had a conflict of interest or that he had a Madoff account. Is that distraction because—not doing that has caused this whole distraction. Is that because Congress would have now known and exercised its oversight earlier?

Ms. SCHAPIRO. No, not at all, Congressman. We didn't think there was a conflict, and recall that our Legislative Affairs Office knew that he had, in fact, been cleared by Ethics and determined not to have a conflict, but I believe there was a worry that it would take away from the focus—

Mr. ACKERMAN. But his not having—we might have probed it a lot more—not having to report to him, we might have probed it in a different way than the Ethics Counsel advised him that he didn't have a conflict.

Ms. SCHAPIRO. I guess that is possible. It just—it didn't occur to me. We actually had a better witness for the subject matter, someone who was very involved with SIPC on the liquidation issues. I think there was a concern if you have two great witnesses or one great witness and one good witness, you pick the one who does not have personal circumstances that can be distracting because this was the Commission's witness to speak to the Commission's legal and policy analysis. And so it was genuinely, I believe, a concern

that it not distract from the important substance of what the subcommittee was going to be discussing at that hearing.

Chairman MCHENRY. Thank you. The gentleman's time has expired. I recognize myself for 5 minutes.

Mr. KOTZ, the criminal conflict statute, does it require a large or small financial interest for it to be applicable? Will you explain that to us?

Mr. KOTZ. No, it does not. There is no requirement that it be over a certain sum. Any sum at all, where there is a potential conflict, is a potential criminal matter.

Chairman MCHENRY. Even if you are working against your own financial interests?

Mr. KOTZ. That is right. In addition to that fact that I just mentioned, it is irrelevant for ethics purposes whether you are working for or against your interests. You are not supposed to be involved in a matter that affects your financial interests whether it is pro or con.

Chairman MCHENRY. So, in this light, it doesn't matter if the gentleman had a high net worth or a low net worth, if he made a high salary or a low salary; is that correct?

Mr. KOTZ. For the purposes of an ethics analysis, that is correct.

Chairman MCHENRY. Okay. And what I would say furthermore is it goes beyond just one individual's reputation. It goes to the trust and reputation of the agency and institution they are a part of.

There is time and the last question here for this panel and the last 3 minutes for the panel, Ms. Schapiro, I will give you an opportunity to say whatever you didn't get an opportunity to say.

Ms. SCHAPIRO. Thank you, Mr. Chairman. I think this is a tragic series of events. I think we have taken great strides here to improve the operations of the Ethics Office of the SEC. We have tremendous new personnel there, very talented, very sophisticated, very, very committed, very tough and aggressive in their interpretation of the ethics rules, and I feel confident that we have in place the processes and the procedures that will help us prevent something like this from happening again.

Chairman MCHENRY. Thank you. Mr. Kotz, do you have any cleanup you want to make?

Mr. KOTZ. No. I appreciate the fact that the Chairman is implementing our—or plans to implement all our recommendations. I would say that, as I said in my opening statement, the process worked with respect to the Inspector General's Office in this case. The Chairman asked us to do an investigation. We did an investigation in a timely manner. The information was brought out there, and there are going to be changes to the SEC's operations as a result.

Chairman MCHENRY. Thank you. With that, Mr. Garrett just arrived so he is entitled to 5 minutes. Mr. Garrett is recognized for 5 minutes.

Mr. GARRETT. Thank you. I appreciate the Chair.

So a lot has been made by some, at least, Mr. Becker through his conflict of interest on the Madoff-related matter and participation in SEC policy responses regarding Madoff victim compensation stood to gain personally from the compensation proposal put for-

ward by the SEC versus the one put forward by SIPC and its trustees—the SEC proposal was not adopted by SIPC trustees proposal, however. One reason it may not have been adopted, even though as Mr. Kotz’ testimony alludes to, is the SEC has the power to overrule SIPC. It is because SIPC’s CEO knew of Mr. Becker’s conflict of interest and used this leverage to keep the SEC, from what? More aggressively pursuing its alternative net equity formulation.

Additionally, while much has been made of Mr. Becker’s conflict of interest, no one that I am aware of has focused on the major conflict of interest that SIPC and its trustee has in formulating a net equity formula for Madoff victims compensation.

SIPC obviously on behalf of its member broker-dealers wants to protect its fund from being drained—understandable—so would have an interest in a formula that was less protective of the victims. The trustee has an interest in the formula as well. He has an interest to have a formula that produces a lot of litigation. Which does what? It then drives up his, and I guess his firm’s, fees as well.

Now, clawback heavy formula, which the trustee openly adopted, is indeed very lawyer intensive, and by the trustee’s own calculation, his firm will ultimately bill over \$1 billion for the Madoff liquidation.

So my question then is in your investigation, Mr. Kotz, did you go down this road that I have talked about here in any way to investigate SIPC and its trustee, some would say, the clear conflict of interest in this case?

Mr. KOTZ. We did not. Our jurisdictional purview is that of SEC employees. We did not look at the issue of a potential conflict of interest on the part of SIPC in this case.

Mr. GARRETT. Okay. So you are saying it is outside of your purview or outside of your authority?

Mr. KOTZ. Right. My job as Inspector General is to conduct investigations and audits of SEC employees and contractors. We would not normally conduct an investigation of someone who doesn’t work for the SEC.

Mr. GARRETT. All right. So how about then investigating Mr. Harbeck’s use or knowledge of Mr. Becker’s financial interest?

Mr. KOTZ. Yes. We weren’t aware that Mr. Harbeck was aware of Mr. Becker’s financial interests. While we did interview Mr. Harbeck in this investigation, he indicated to us that he was not aware of Mr. Becker’s personal interest until it was reported in the press.

Mr. GARRETT. Okay. So you were not aware of it from information provided to you or is there a back of the envelope approach I guess to see if there was interest in—

Mr. KOTZ. Yes. I have not heard before this allegation that Mr. Harbeck was aware of Mr. Becker’s interest and there was a conflict of interest as a result. This is the first I am hearing of it, and because I wasn’t aware of that allegation, we didn’t have any evidence, although we didn’t look for that in this case, it wasn’t part of our investigation.

Mr. GARRETT. I understand. I guess I know the answer, but did you investigate the trustee’s interest then and the potential for



compensation as being a factor or a potential driving factor in the equity formula that he was advocating?

Mr. KOTZ. We didn't look at the entire process of how either the trustee or SIPC arrived at their particular approach. We looked specifically at the conduct of Mr. Becker, who was an SEC employee.

Mr. GARRETT. I see. So clearly then, SIPC did not intend the financial conditions of SIPC to drive the handling of the victim claim not before or after the failure of the regulator broker-dealer as a result of the fraud then?

Mr. KOTZ. Again, I don't know—I can't say with certainty what SIPC's motivations were either way because that wasn't an issue that we looked at in our investigation.

Mr. GARRETT. I appreciate that. I will say this then. The GAO study that I requested will then hopefully shed some more light on some of these issues, not only for me, but then the SEC will also benefit from that information and should then, therefore, I would think, defer its reconsideration vote on the net equity until the report is complete. Do I see you shaking your head?

Ms. SCHAPIRO. No, I just—I hadn't thought about that and I wasn't sure when the GAO report was due.

Mr. GARRETT. Okay. So even though not knowing, what do you think you want to do then?

Ms. SCHAPIRO. I guess I would like to think about that.

Mr. GARRETT. Okay.

Chairman MCHENRY. The gentleman's time has expired. I thank the chairman of the Capital Markets Subcommittee. I want to thank the panel for your testimony. Thank you for your service to our government, to our people. Thank you for your time today.

This panel is dismissed. We will recess for votes, and when we return, we will take testimony from Mr. Becker and have a series of questions.

[Recess.]

Chairman NEUGEBAUER. The hearing will resume. Our second panel consists of Mr. David Becker, the former General Counsel of the U.S. Securities and Exchange Commission. Mr. Becker, welcome. Just to let you know, your written statement will be made a part of the record, and you are recognized for 5 minutes to summarize your testimony.

**STATEMENT OF DAVID M. BECKER, FORMER GENERAL  
COUNSEL, U.S. SECURITIES AND EXCHANGE COMMISSION**

Mr. BECKER. Thank you very much, Mr. Chairman. Chairman Neugebauer, Ranking Member Capuano, Chairman McHenry, I appreciate the opportunity to testify before you, and I thank you for listening to me. I welcome all your questions.

I am eager for this because for the past 6 months, there have been many incomplete, misleading, or just plain false things written about me, and I am eager to answer any and all questions to put this matter to rest once and for all.

At all times during my service at the Securities and Exchange Commission, my abiding goal was to advise the Commission as to the course that provided the greatest benefit to investors and that was consistent with the law. I am confident that any fair review

of my actions will demonstrate that this was the only motivating principle behind them. Such a fair review has not yet been forthcoming.

In sum, I was informed by the SEC's Ethics Office that I had no conflict of interest in the Madoff liquidation and that there was no appearance of such a conflict. I did precisely what I was supposed to do. I identified a matter that required legal advice from the SEC's Ethics Office, as was my usual practice. I almost never started a new matter without getting clearance from the Ethics Office. I sought that advice because I firmly believe that no one should be the sole judge of the ethics of his own actions.

I have followed the advice of the Ethics Office completely. The Office of Inspector General report contains no findings to the contrary. Indeed, the report confirms that I disclosed the existence of my deceased mother's Madoff account to at least seven people at the SEC, including my boss, Chairman Shapiro. I took no steps to conceal the existence of that inheritance.

The apparent recommendation of the Office of Government Ethics that this matter be referred to the Department of Justice is, upon review of the Office of Government Ethics, less than it seems. The recommendation stems from the fact that OGE is precluded by law from making any determination that the criminal conflicts of interest laws may or may not have been violated. And here I am quoting from their letter, a sentence that appears in a footnote in the next to last page of a 118-page report. And in fact, the Office of Government Ethics expressed no opinion on that issue.

I came back to the SEC because I care deeply about the agency and its people, because my friend Mary Shapiro asked me to, and because I thought it was my duty. I knew the SEC was in crisis and in need of revitalization and reform. I was flattered that Chairman Shapiro thought I could help. And I thought so, too.

While I had enormous affection for the SEC, my years of SEC service and of representing clients before the agency had given me a clear-eyed view of its shortcomings and of the measures that might be taken to revitalize it. I still care deeply about the SEC, and I have seen firsthand how the process I have been through over the last 6 months harms the agency and the public interest.

This has been a dreadful experience for me in ways that there is no need for me to detail here. I am extremely depressed and very sad that this has been a dreadful experience for my friend Mary Shapiro and the SEC as well. I feel that this process has been very damaging to the public interests in ways that just cannot be apparent to the subcommittees. And so I thought I would comment a little bit about that. I am going to comment about that simply by repeating what I said to Commission members and the staff about this very point when I took my leave of the SEC last February. And I quote from my remarks here.

"From the day I walked in the door 2 years ago, until today, I have been asked how this time around is different than the previous time. The answer is that it is a hell of a lot harder. In some ways, we have made it harder on ourselves. In others, we live with constraints not of our own making. And in other ways we just live in times that are much meaner than they were 10 years ago. It is riskier to work here than it used to be. As you may know, I am

having some experience with this myself. Unfortunately, too many people have experienced those risks firsthand.

“This time around, I have had more than a few people in my office weeping with fear about what might happen to them because one person or another was looking into their behavior. I have been shocked by that. That shouldn’t be. It is a symptom of the times and a political culture that is quite frankly seriously ‘nuts.’ To some extent, this enrages me. But mostly it makes me very sad. I am sad for the agency and for my friends, and I feel terrible that I haven’t been able to help people more. And it is the source of my biggest worry for the Commission as I leave.

“When I left here in 2002, I worried a bit that the agency might be too complacent. I have the opposite worry today. I worry that all the risks that people run will make the institution gun shy. It is only natural, but I hope I am wrong. I hope people here have the capacity to listen to the agency’s critics, be intensely self-critical, keep an open mind to a better way to do things, and in the end never ever back off from doing what we believe to be right. No one should take imprudent risks, and we shouldn’t sugarcoat what may befall the best intention of us. But in the final analysis, we can’t live scared.

“In the end, what has made this agency great is people who say ‘the hell with it,’ I am going to do what is right, knowing that we are imperfect beings who often can’t know what is right, and knowing that the risks are real that we will be called to account for our failures, or for our successes, or just for being here. It is so important that people here bring cases, drop cases, adopt rules, walk away from rules, solely on the basis of what is best for the people we serve.

The people in this room believe that, I know. That is why I love you all and why the privilege of having been with you for a time leaves me deeply in your debt.”

I spoke from the heart when I said those words. I will speak from the heart today.

I welcome your questions.

[The prepared statement of Mr. Becker can be found on page 58 of the appendix.]

Chairman NEUGEBAUER. Thank you, Mr. Becker. You made a couple of points—and I wanted to go back to that—that you came to the SEC for the second time at the request of the Chairman, with good intentions. Would you say that was correct?

Mr. BECKER. I would say they were good intentions, yes.

Chairman NEUGEBAUER. But I think one of the things we have to differentiate here is good intentions and good judgment don’t always coincide. Would you agree with that?

Mr. BECKER. As a general proposition, sure, I would agree with that.

Chairman NEUGEBAUER. So the point of this hearing today is about people using good judgment. Because as you know—and you have been around the SEC for a number of years. You represented people before that. You know the very high standard that the SEC requires of the people that they oversee. Is that a fair statement?

Mr. BECKER. Yes, it certainly is.

Chairman NEUGEBAUER. I think the point that a lot of us are concerned about is someone with your intelligence and your background, your reputation, coming into the agency at a time when they were obviously under a lot of scrutiny, very high-profile case, they missed it. They screwed up. So you come in, Mary has brought you in, and you obviously have some financial interest or consequence or benefit from the outcome of some of the distributions to the victims of this. Because I believe if these numbers are correct, I believe your testimony is that I guess it is your dad or your mom put about \$500,000 in the Madoff and cashed it out at about \$2 million. Are those close numbers?

Mr. BECKER. Those are numbers that I first heard of in late February of this year. When I arrived at the SEC, all I knew was that some time before my father died—my father died in 2000—he had opened an account in my mother's name. I didn't learn directly that my father had opened it, but my mother was a social worker and an academic, and she didn't do any investing. I didn't know what he had put in. I didn't know when he put it in.

Chairman NEUGEBAUER. But the question is: Are those fairly accurate numbers?

Mr. BECKER. No, actually, I don't think so. I think—

Chairman NEUGEBAUER. Are they more, are they less?

Mr. BECKER. I will be delighted to tell you. I believe the records show that my—the account was opened for \$500,000, and that when my brother, acting in a representative capacity for my mother's estate, liquidated it, there was about \$2 million in the account. The amount that came to me was much, much less than that because what I got from my mother's will came after estate taxes were paid. The money went to everybody else designated in the will. So I got my share. And I don't remember what the number was.

Chairman NEUGEBAUER. Let me just go—

Mr. BECKER. Much, much less than that.

Chairman NEUGEBAUER. So are you familiar with the concept of net equity?

Mr. BECKER. Yes, I am.

Chairman NEUGEBAUER. What is that?

Mr. BECKER. Net equity is a statutory term in the Securities Investors Protection Act that determines how a customer's claim—that is, how much is paid out to the customer. Customers who have open accounts at the bankruptcy, how much they get.

Chairman NEUGEBAUER. So basically, if I understand net equity, your basis is what you paid in less what you were paid out?

Mr. BECKER. I think that was the issue.

Chairman NEUGEBAUER. And the SEC before you came had already kind of had an informal agreement with SIPA that the number that they would use, the net equity position. But shortly after they got there, you were arguing that they should consider the constant dollar approach. So my question is, if you use those two methods and you assume that the trustee is successful in his lawsuit against you and your estate or however they are bringing that, would those two methods have a different impact on you?

Mr. BECKER. There is so much sort of thrown into a basket in your question. Let me see if I can take—

Chairman NEUGEBAUER. I don't have a lot of time. It is either a yes or no. Yes, there would be different calculations.

Mr. BECKER. I can't give you a yes or a no because there are all sorts of premises in your question about what the SEC agreed to that just aren't factually accurate.

Chairman NEUGEBAUER. Let's not talk about what is agreed to. Let's talk about using those two methods. Would there be a difference in the amount of settlement that you would have with the trustee?

Mr. BECKER. I had no idea that was the case.

Chairman NEUGEBAUER. I didn't ask you—

Mr. BECKER. The principal method that we were—

Chairman NEUGEBAUER. Excuse me. I didn't ask you if you had any idea. What I am asking is, would it have had an impact?

Mr. BECKER. I have been told that circuitously by SIPC. I do not know that to be true. I think it is probably true to a relatively small amount.

Chairman NEUGEBAUER. What is relatively small to you?

Mr. BECKER. I would say \$10,000, \$15,000.

Chairman NEUGEBAUER. The clawback under the cash net equity would be, based on what you just told me a while ago, about a million and a half dollars.

Mr. BECKER. No, I don't think I told you that. I think I told you that that is what the trustee has claimed. I think that the numbers that the trustee is using are just wrong. But I knew none of this at the time.

Chairman NEUGEBAUER. Should you have known that?

Mr. BECKER. No, I don't think so. I did not even know at the time that this was knowable.

Chairman NEUGEBAUER. And so your defense of all of this is that you went to the Ethics Officer and said, "I might have a conflict," and he said, "You're fine."

Mr. BECKER. I told him everything I knew. And I said, "Tell me what to do." And he said, "You should participate in this."

Chairman NEUGEBAUER. So if I am an entity or broker or dealer or something that the SEC is investigating and I make a trade that you find fault with, my defense is that I asked my supervisor if I could make that trade and they said it was all right, and so I am vindicated?

Mr. BECKER. In most individual cases, I would say that is right. Certainly, when it is advice of counsel, absolutely. I have had many cases like that.

Chairman NEUGEBAUER. But if I have broken the law because somebody in my organization thought it was all right, that doesn't change my guilt, does it?

Mr. BECKER. But the notion of knowledge is, in the case of this particular law, included in the law. It is what an employee does to his knowledge. An employee has to know that there is a direct and predictable effect on his financial interest by virtue of the action that he is asked to participate in. And interestingly enough, I did not hear the words "direct and predictable" at all in the first panel.

Chairman NEUGEBAUER. I think my time has more than expired.  
Mr. Capuano.

Mr. CAPUANO. Thank you, Mr. Chairman. Mr. Becker, first of all, thank you for being here, though I have to be honest, I am a little surprised that you would come to testify in an open hearing like this when you have another matter pending. But it is your prerogative.

Mr. Becker, I want to be clear. From my perspective, I don't really concern myself too much with your specific details, if you want the truth. My concern here, as I said earlier, is whether the overall process within the SEC is working as myself and other Members of Congress think it should be working. The outcome of a given case raises questions about whether the process worked.

I am not here as one member to judge you. I am not qualified to do it. I don't know enough information to do it. And there are other entities that will do it. So be it. I will tell you that from the limited review I did read within the IG's report, there was no indication that I read there, no hint, no indication, of anything of any criminal wrongdoing. So my expectation is that maybe it was kicked up simply to pass the buck along. But we will see.

For me, I would have to tell you that regardless of your specific actions or the actions of the ethics lawyer at the time, knowing what I now know, it strikes me that the process of ethical review within the SEC at the time was the shortcoming. And that has been my focus. That is why I asked the first panel: What did you learn, what are you doing about it going forward? Not so much your specific case. But it strikes me that anybody with an investment in somebody they are investigating, no matter how it is, no matter how much it is, somebody should have said, wait a minute, maybe you shouldn't be doing this.

I have recused myself. I know you have recused yourself in other matters. I have recused myself on matters in my professional life because it was maybe somebody would see it differently. I would be honest, I wouldn't expect you as an individual to make that judgment. That is what the Ethics Office is for. And that is why that office should be very clear and very precise about its actions. And that is why, to me, I think some of the proposals that have been made by the IG have been pretty good.

From that perspective, sitting where you are today, having been through these difficult situations—I know you read the IG's report.

Mr. BECKER. I have read it once.

Mr. CAPUANO. The proposals that were made relative to fixing the process, moving forward, would you agree that they are good proposals or bad?

Mr. BECKER. I haven't thought hard about them. They look fine to me. I would not—if it were my call, I would say having Ethics report to the Chairman is not a good idea. If you are worried about the impact of having a superior, someone giving advice to a superior, I would worry more if the superior is the head of the agency than I would if the superior wasn't the head of the agency.

I have to say lawyers, the Attorney General gives legal advice to the President of the United States. Every General Counsel, just about, of large companies reports to the CEO. Every lawyer in private practice gives legal advice to people who can hire and fire them, retain them or not. I don't see this as this big red flag.

Mr. CAPUANO. I appreciate your opinion, but I would respectfully disagree, based on—and there is no perfect process because there is no way you can have somebody who doesn't answer to somebody somewhere along the line. The question is, as far as I am concerned, getting them to answer to as few people as possible. It has nothing to do with you or anybody else. I think the IG should report directly to the head of whatever agency they are in, anyway. It has nothing to do with you or the SEC. Even then, I know it is not a perfect system. We have an ethics system here in Congress that is not perfect. But you do the best you can. That is a matter of opinion.

Again, I want to thank you for coming. I want to wish you good luck because I know it is a difficult situation. From what I saw, your record is pretty good. I am hoping there were no lines crossed. But that will be decided by other people. I want to tell you that I respect you for coming here today and talking about what I know is a difficult matter for you.

Mr. BECKER. Thank you very much.

Chairman NEUGEBAUER. I thank the gentleman.

Chairman McHenry.

Chairman MCHENRY. Thank you. I thank you for being here today. You certainly had a distinguished time in government over a period of years, and you certainly have had a long and distinguished career in private practice as well. Today, though, this is a subject matter that is very sensitive. With hindsight, I think people are looking at this stuff differently.

But back in March, in my subcommittee, Representative Mack asked Chairman Shapiro, "Do you believe that Mr. Becker was sufficiently aware of the need to avoid actual or apparent conflicts of interest?" Chairman Shapiro responded, "Do I wish now that he had been more sensitive to the potential of this issue to raise an appearance of conflict? Yes. I wish that had happened."

Do you agree with this judgment?

Mr. BECKER. I certainly agree that she wishes it hadn't happened, and I personally found that statement extremely distressing to me. I don't like to think that I let her or the agency down in any way or that anybody feels that way.

Having said that, when you go to a doctor, you put yourself in the doctor's hands. When you go to—when you seek legal advice, you seek—you put yourselves, in this case the Ethics Counsel's hands. I followed that advice.

If the question is, notwithstanding that advice should I have said well, it is just too risky for me or for the agency, I will say I didn't predict in any way what happened. I didn't think the trustee was going to sue me. I didn't think the sports section of the Daily News in New York was going to make a big deal out of this. I didn't think, frankly, that this committee would respond in the way it did. I didn't anticipate any of that.

Would it have been better if I did? You bet.

Chairman MCHENRY. In February of 2009, were you aware that Madoff trustees were considering clawbacks?

Mr. BECKER. I don't think so. I think what I was aware of was that there had been clawbacks recently instituted in very large

amounts for people whom the trustee alleged had been complicit in the fraud.

Chairman MCHENRY. So you are not aware of clawbacks of Madoff beneficiaries, outside of large beneficiaries?

Mr. BECKER. Large beneficiaries who the trustee said had been involved in the fraud. That is correct.

Chairman MCHENRY. So in that March hearing that I mentioned before, Chairman Shapiro was asked whether she regretted your situation. Her response was, "I wish Mr. Becker had recused himself, absolutely."

Do you agree with that judgment?

Mr. BECKER. Again, I take that as a sincere statement of her views.

Chairman MCHENRY. I am not asking your judgment on her sincerity. Do you agree with that judgment that you should have recused yourself?

Mr. BECKER. Forgive me. I know I talk in a little bit of a round-about way, but I am getting there. I think—still think—that I did what I was supposed to do. I will just have to live with the fact, unhappily, that Chairman Shapiro has a different view.

Chairman MCHENRY. Is it your view that you should have recused yourself at that time, knowing what you know now?

Mr. BECKER. I don't know what you mean by knowing what I know now. Do you mean knowing the trustee would sue me? If I had known the trustee was going to sue me, of course I would have recused myself.

Chairman MCHENRY. You said you did not know that certain items were knowable about the inheritance you received; the nature of the Madoff account.

Mr. BECKER. Yes.

Chairman MCHENRY. Do you know more about the nature of that inheritance today than you did in February of 2009?

Mr. BECKER. Sure. I didn't know—

Chairman MCHENRY. With that knowledge, knowing the details of that inheritance and that Madoff account, with that knowledge, would you—with the knowledge that you possess today just simply about that transaction, would you have recused yourself?

Mr. BECKER. I don't know the answer to that. I truly don't. I don't know exactly or even close to exactly what the rationale of the Ethics Office was. I did not, for example, see the link—just didn't see it—between taking a position on measuring the amount that folks in the bankruptcy can claim and clawbacks. I don't know how important that was to the Ethics Office. I don't know how important the sense of imminence of a lawsuit was. I don't know that merely the fact of the account would have changed my view.

Chairman MCHENRY. Thank you.

Chairman NEUGEBAUER. The gentleman from Maryland, Mr. Cummings.

Mr. CUMMINGS. Thank you very much, Mr. Chairman. First of all, I want to thank you for being here today. I know that this must be difficult, considering the fact that your case has been referred to Justice. I must tell you that I kind of agree with Mr. Capuano. This case troubles me from a standpoint as a lawyer and one who



is giving advice many times to many people, that you went and got the advice of folks and now you find yourself in this difficulty.

So I want to go to some things that were testified to earlier and just to clear up some things.

Earlier, Mr. Kotz talked about subordinates. And you had gone to subordinates. One of the things that they have cleared up in the new recommendation—I know you have been concentrating on other things—is to make it so that I guess you would report directly, these kinds of things, to the top person.

Did you in any way feel when you were being interviewed and you talked to these seven other people who cleared you, said you were okay to do this, that they were under any pressure whatsoever?

Mr. BECKER. No. In fairness to them, I think the point of my talking to those seven other people is that I didn't make any effort to conceal this. In fairness to them, not all of them were people who would have had any responsibility to clear me or not. I did think it was inappropriate of Mr. Kotz to say in his report that he saw seven people and none of them said anything about this. This had nothing to do with most of their responsibilities.

Mr. CUMMINGS. Let me get through these questions because I want to make sure we are clear.

Mr. BECKER. Yes, sir.

Mr. CUMMINGS. You have people who are probably going to look at this film 50 million times.

Mr. BECKER. I may reconsider, then.

Mr. CUMMINGS. Okay. Mr. Becker, who exactly had a duty to identify that there was a potential conflict of interest and disclose that information appropriately throughout the Commission to Commissioners and the relevant staff? Who would have that duty? Can you answer me very briefly?

Mr. BECKER. I don't think anybody has a duty to report things that aren't conflicts of interest. You either have a conflict of interest or you don't.

Mr. CUMMINGS. You didn't believe that you had a conflict?

Mr. BECKER. That is correct.

Mr. CUMMINGS. As the IG found in his report, you seem to not believe there was a strong possibility that the Madoff trustee would bring a clawback action against you. Specifically, as you explain in a May 2009 email to the SEC Ethics Counsel, Mr. Lenox, "your instinct is that any claim would be much too small and of dubious merit to bring in any event."

Could the fact that you viewed the possibility of a clawback suit to be remote have led you to misjudge whether or not you had a conflict of interest?

Mr. BECKER. I was very careful not to make that judgment. That judgment was made by the Ethics Office. I just told them what I knew.

Mr. CUMMINGS. A little earlier there was a question by Mr. Issa, and he asked a question about—I guess it would be referring to you—if you presented bad information to the people you talked to—it talked about what the result would be. In your mind, did you present any misleading information or something that was not true?

Mr. BECKER. No.

Mr. CUMMINGS. Could the fact that others also viewed the possibility of a clawback suit to be remote have led them to misjudge whether or not you had a conflict of interest?

Mr. BECKER. I just can't say what was in their head.

Mr. CUMMINGS. If you thought that you would be subject to a clawback lawsuit, what would you have done differently, if anything?

Mr. BECKER. It's hard to say, but I probably would not have participated in the matter.

Mr. CUMMINGS. If others at the SEC thought you would be subject to a clawback lawsuit, do you believe they would have done things differently?

Mr. BECKER. I guess you mean the Ethics Office. They probably would have, yes.

Mr. CUMMINGS. Why did you come here today to testify? I know we asked you to come. What is your objective?

Mr. BECKER. My objective is to get the truth out. As simple as that. I have nothing to hide.

Mr. CUMMINGS. And you believe that you did nothing wrong, is that right?

Mr. BECKER. That is correct.

Mr. CUMMINGS. You informed William Lenox, head of the SEC's Ethics Office, of your mother's Madoff account—shortly before—or after I arrived at the SEC—“and I never asked Chairman Shapiro or Mr. Lenox not to share the information about my mother's account.”

What was that all about?

Mr. BECKER. I didn't treat this as some deep, dark secret. I went to the Ethics Office for advice. I didn't say, “Don't tell anybody.” I didn't tell lots of people just because I frankly didn't think about it. But I didn't take any steps to protect this information or conceal it or anything like that.

Mr. CUMMINGS. Mr. Chairman, I see my time has run out.

Chairman NEUGEBAUER. I thank the gentleman.

Mr. Becker, in a letter you wrote me and my colleagues you stated that you recognized that it was conceivable that this issue could affect your financial interest because the issue could affect the trustee's decision to bring clawback actions against persons like you.

Mr. BECKER. Correct.

Chairman NEUGEBAUER. Mr. Becker, you concede it might affect your financial interest. If you had recognized that, wouldn't that have triggered that maybe this will have an appearance of a conflict? Let's just get past the legal part. It goes back to what I was saying a while ago. Sometimes good intentions and good judgment—as a lawyer who has been practicing for a number of years, particularly in an agency like the SEC, where you are very sensitive to either actual conflicts of interest or appearance of conflict of interest, that didn't resonate with you?

Mr. BECKER. Appearance is used in two senses. There is a rule that talks about appearance. I don't think it is a close question; that I was well within the four corners of the rule. There is appearance in the sense we have heard talked about earlier today as the

Washington Post test, the New York Times test. That is very subjective. You can't even get people to agree which newspaper is the relevant one.

Sure, I thought of that. But in all candor, I did not anticipate either that the trustee was going to sue me or the reaction would be what it has been.

Chairman NEUGEBAUER. But you—if I misunderstood your letter—you did anticipate that was a possibility, did you not?

Mr. BECKER. "Conceivable," I think was the word I used, which means there are a whole bunch of things conceivable. The level of probability is what governs.

Chairman NEUGEBAUER. But when you conceive of it, you are thinking about it, right? So you are aware of it. In other words, you had knowledge that you potentially could be subject to a clawback lawsuit in this matter.

Mr. BECKER. Yes, conceivably, possibly, maybe. But I did not think that was going to happen.

Chairman NEUGEBAUER. And so, I want to go back to there was someone—Congress asked you to come and testify. You all had a little team meeting and it was decided that you would have to disclose these interests in the Madoff issue. It was determined that you should not testify, is that correct?

Mr. BECKER. No, not quite. That is not quite how it worked. What happened was I was going to testify. I came to the head of the Office of Legislative Affairs, just like I went to Ethics, and said, "Listen, this is a political calculus. This is not the world I know. I want to know what you think about it." He first said, "Oh, I think it is fine." Later in the day, he called me up and said, "Well, I am a little worried that it is going to be a distraction." I said, "If it is going to be a distraction, you can be—"

Chairman NEUGEBAUER. What is going to be a distraction?

Mr. BECKER. The fact that my mother had an account.

Chairman NEUGEBAUER. So you disclosed that to the Legislative Affairs folks?

Mr. BECKER. Sure. I also told them that I would mention it up-front to take any question that I wasn't disclosing it off the table. And I said, "You guys make the political judgment." Later in the day he called me and said, "I don't think it is such a good idea. Let me check with the Chairman." He checked with the Chairman and that evening said to me, "I spoke to her and I think we would be better off with somebody else." I saw her the next morning and she confirmed that. That is basically all that happened.

Chairman NEUGEBAUER. You all had a conversation and some kind of laughing and joking that oh, you will get another opportunity.

Mr. BECKER. Yes. I don't think this is what she had in mind. But, yes.

Chairman NEUGEBAUER. Here is the other question, then. If you felt like it was appropriate to disclose to the Leg Affairs people before you went to Congress, I am still trying to reconcile why you didn't think when you are making a very important presentation to the Commission between encouraging them to use constant dollar, that you didn't think it was appropriate to say to those folks, and by the way, this could impact me. If I was a Commissioner or

if you were a Commissioner, wouldn't you? Because subsequently to this all those Commission members were not happy that you did not disclose that.

Mr. BECKER. I don't know the questions that were asked of them. The quotation from Commissioner Aguilar said he was upset that this conflict wasn't disclosed to him. I didn't think I had a conflict. I was told I didn't have a conflict. And you don't generally make a habit of going to people and saying, "I don't have a conflict, but I think you ought to know about it." You say that to them and they think: What message is he trying to send me?

When it came to Congress, which is not the world that I am familiar with, I needed to take someone's advice.

Chairman NEUGEBAUER. But you are familiar with the world at the SEC?

Mr. BECKER. I am indeed.

Chairman NEUGEBAUER. Going back to the high standards of ethical behavior that you hold, the people the SEC regulates, and the fact that you stated in that letter that it was conceivable that you had an issue there and that you had felt later on to disclose that. I agree with my good friend Mr. Capuano that it is a process here, but there is some personal responsibility that goes with these positions. And that you didn't think that there was some potential conflict there, I am still having a hard time reconciling that.

Mr. BECKER. I take complete responsibility for my actions here. Frankly, it is easy for me because I think I behaved appropriately. It is passing strange, I think, to say to people, I have something to tell you that I have been told doesn't affect my judgment, that I don't believe affects my judgment, that doesn't color the advice that I have given them. I don't think it would have been inappropriate to tell them. It is not a bad thing to tell them. But I didn't think of it. And I think the reason I didn't think of it is it really was not germane to what they were doing.

Chairman NEUGEBAUER. I see my time is up. The gentleman from New York.

Mr. ACKERMAN. Thank you, Mr. Chairman. Mr. Becker, count me among those who are surprised you are here today and also impressed with the fact that you are here today. You have been very thoughtful with us. You were very forthright with me when I spoke to you when the story first broke in the New York Daily News, despite the fact that it was your scheduled last day to be on the job. And I appreciated that.

Mr. BECKER. I was glad to do it.

Mr. ACKERMAN. Am I correct in restating that it was your father who opened the account for your mother?

Mr. BECKER. I believe so. I don't know who else it could have been. I am quite certain that it wouldn't have been my mother.

Mr. ACKERMAN. It had to be somebody other than your mother, and that logically would have been your father?

Mr. BECKER. Yes, it would have.

Mr. ACKERMAN. Nobody else was going to give her half a million dollars in an account?

Mr. BECKER. My father traveled from time to time. Nothing that I knew about.

Mr. ACKERMAN. He also opened accounts for charities that he gave money to?

Mr. BECKER. I don't know whether he opened accounts for charities. I know he gave money to charities.

Mr. ACKERMAN. He had a particularly favorite charity in Westchester, a Jewish seminary; a rabbinical school?

Mr. BECKER. Outside of Philadelphia.

Mr. ACKERMAN. I am sorry, outside of Philadelphia.

Mr. BECKER. It was a rabbinical school to which I believe he gave a great deal of money.

Mr. ACKERMAN. He gave a great deal of money to them. They did have a Madoff account that they sold the year after he died, I understand.

Mr. BECKER. As I mentioned to you on the telephone in February, that is the first I had heard of it. It may be that someone that he knew there was recommended—

Mr. ACKERMAN. But he endowed that seminary.

Mr. BECKER. He contributed money to them. They were endowed from many sources.

Mr. ACKERMAN. Did your father know Madoff?

Mr. BECKER. No. I shouldn't say that. I would be amazed if he did.

Mr. ACKERMAN. You do not know how he or your mother wound up with a Madoff account? The Madoff game was, he played hard to get. You had to know somebody who knew somebody.

Mr. BECKER. I don't know. When you are 85 years old and you have a lot of money to invest—\$500,000—I suspect it was much easier than it appeared.

Mr. ACKERMAN. Would you have thought your father had a reason to know that it was a Ponzi scheme?

Mr. BECKER. My father? No. My father was the most ethical man I have ever met. And I am 64 years old, so there still may be others. But, no.

Mr. ACKERMAN. Your mother would not have suspected that she had an investment in a Ponzi scheme?

Mr. BECKER. No.

Mr. ACKERMAN. When did you suspect that Madoff was a Ponzi scheme?

Mr. BECKER. I never suspected until I read it in the newspapers or however—when it broke.

Mr. ACKERMAN. You knew who Madoff was?

Mr. BECKER. I had heard the name when I was at the SEC the first time, that—

Mr. ACKERMAN. There were indeed reports to the SEC that it was a Ponzi scheme by Mr. Markopolos and others?

Mr. BECKER. Not that I saw, not that I heard of. We now know there were. But I had no idea of that.

Mr. ACKERMAN. So you had no way of knowing or should have known that it was a Ponzi scheme.

Mr. BECKER. That is correct.

Mr. ACKERMAN. Could anybody have known that it was a Ponzi scheme?

Mr. BECKER. Could anybody? I think once the thought enters your mind that it is a Ponzi scheme, it is not that hard to figure out.

Mr. ACKERMAN. When it was brought to your attention by Annette Nazareth that there was an alternative view to last statement, she brought the case to your attention, is that not accurate?

Mr. BECKER. I don't want to insult Ms. Nazareth—and she may be sorry to hear this—but I don't remember that she brought anything to my attention on this. I remember other lawyers who were involved.

Mr. ACKERMAN. I think the report had stated that she wrote a letter on behalf of her clients.

Mr. BECKER. That is interesting. That is, I have to say, a characteristic of this report. She was one of, I don't know, 10, 12 signatories to that letter. She didn't write the letter.

Mr. ACKERMAN. But there were others who had that view?

Mr. BECKER. Yes.

Mr. ACKERMAN. Indeed, there is a subcommittee Chair on our committee who has a bill that says that we should be using that methodology.

Mr. BECKER. Yes. I am aware of that.

Mr. ACKERMAN. If you had gone along with that suggestion, which is a bill before this Congress, and proposed by people and written to the Commission, among others, if you had adopted that view, you would have been a greater beneficiary?

Mr. BECKER. That is what I have been told. I guess that is correct. But, frankly, the thought never crossed my mind.

Mr. ACKERMAN. Why did you decide that the view should be the cost of money?

Mr. BECKER. We struggled through that literally for months. We were very worried about the impact of this.

Mr. ACKERMAN. You knew at that time you were the beneficiary of an account?

Mr. BECKER. I knew I was the beneficiary—I knew that I got money from my mother's estate. I didn't get an account.

Mr. ACKERMAN. Your brother handled it, from what you said, and your brother never said there was a \$2 million account?

Mr. BECKER. I learned that in February of 2009.

Mr. ACKERMAN. At the same time you came back to the SEC, the same month?

Mr. BECKER. Slightly before, yes. I had already agreed to come to the SEC.

Mr. ACKERMAN. Your brother liquidated a \$2 million asset within an account to which you were a beneficiary without you knowing there was even that account. Is that what you are telling us?

Mr. BECKER. That is exactly what I am telling you.

Mr. ACKERMAN. There was a lot more money in that account, that \$2 million was not a significant thing to tell you?

Mr. BECKER. I don't know why my brother didn't tell me. I think the money, when he did tell me about it, was basically he called me up and said, isn't this interesting, in effect. This guy Madoff, we sold out of his account to pay estate taxes a few years ago. That is all he told me. And that is when he told me.

Mr. ACKERMAN. And at that point, you felt no compunction to reveal that again—is that when you revealed it to the ethics people?

Mr. BECKER. Yes, pretty much. Yes. When I arrived at the SEC, I sat down with them for, I don't know, an hour, 2 hours, and reviewed anything and everything.

Mr. ACKERMAN. And you knew what clawback was at that time?

Mr. BECKER. Yes, I knew what it was.

Mr. ACKERMAN. Do you think that the people in the ethics business knew what clawback was at that time?

Mr. BECKER. I don't know the answer to that.

Mr. ACKERMAN. They are not necessarily the sophisticated person in finance as are you, though?

Mr. BECKER. I really don't know what they knew.

Mr. ACKERMAN. But even though there was only a slight possibility of you being subject to clawback, you did not think that it was appropriate to suggest to them that you might have that problem?

Mr. BECKER. Oh, I am sure that when it became relevant to anything that I was doing, that I did mention that to them.

Mr. ACKERMAN. You went back to them and told them that you might be subject to clawback?

Mr. BECKER. Absolutely.

Mr. ACKERMAN. And they did not suggest at that time a different answer than they gave you the first time? Because if there was clawback, you would be subjected to legal action.

Mr. BECKER. No. No, they didn't. The short answer is no, they didn't.

Mr. ACKERMAN. My time is up, Mr. Chairman.

Chairman NEUGEBAUER. I thank the gentleman.

Now, Chairman McHenry.

Chairman MCHENRY. Thank you. The Commissioners all told the Inspector General in his report that by November 9, 2009, when you recommended the constant dollar approach to them, that they understood that this choice would affect the amount that the trustees could seek in clawbacks. Did you?

Mr. BECKER. No, I didn't. I read the Inspector General's report in reference to all sorts of things, conversations that apparently took place before I got to the SEC. And no, I did not know that.

Chairman MCHENRY. You did not know that the Commissioners testified knew what effect the amount the trustees could seek in a clawback. You didn't know this?

Mr. BECKER. That is correct. And I have to say—

Chairman MCHENRY. I wasn't saying like your account. I am just saying generally speaking that this constant dollar approach would affect the value of what they could seek in clawbacks.

Mr. BECKER. The only area that we as an office and I as a human thought about that was clawing back moneys that had been paid by SIPC. I am not sure at all that in fact the definition of net equity will control what you can get in clawback cases. I know very well that if I were representing the trustee, there are a lot of arguments I could come up with that it wouldn't.

Chairman MCHENRY. That is being argued right now in court.

Mr. BECKER. Yes.

Chairman MCHENRY. Now, in terms of, you said that the possibility of a clawback for the account you are an heir to was remote, right?

Mr. BECKER. I thought of it as remote.

Chairman MCHENRY. In February of 2009, just for context.

Mr. BECKER. Correct.

Chairman MCHENRY. This is what I am trying to understand.

Mr. BECKER. Sure.

Chairman MCHENRY. The SEC Commissioners within the IG's report say that they are angry that you didn't disclose this to them. They were your client, in essence. You are General Counsel. But you disclosed this as a matter of optics, is really the discussion; as a matter of appearance, to the Legislative Affairs Office. You mentioned it to the Chairman at the very beginning. You went to the Ethics Office. They said it was fine. But then you bring it up later to the Legislative Affairs Office. Why not just tell the SEC Commissioners?

Mr. BECKER. I don't remember considering telling this to the SEC Commissioners. I will say that this is a different arena requiring different judgments. Frankly, when you are testifying in front of Congress, politicians have been known to be political. You think about things differently than when you think about simply what do I need to tell my clients. I was out of my depth when it came to political judgments.

Chairman MCHENRY. Interesting. I just have to ask you this.

Mr. BECKER. Sure.

Chairman MCHENRY. With the mess that you were coming back to the SEC to help clean up, which is the ramifications of this missing Madoff, right? Why not just recuse yourself? Why not just say, look, I know Ethics says I am fine. I have disclosed this to the Chairman. You know what, it is such a hot button issue, and this is the SEC. We want to be above reproach. I am just going to recuse myself.

Why wouldn't you do that?

Mr. BECKER. I think that is a great question, and I am glad—

Chairman MCHENRY. Thank you. I thought so, too.

Mr. BECKER. Excellent. So we agree on that. There are two sides of this. If I am looking—I am trying to think of a delicate way to put this. I worry sometimes that people spend too much time worrying about covering their rear ends rather than doing the right thing. I had a job. And I wanted to do my job. Sure, if my principal concern was I want to take no risk that I am going to be criticized and the agency is going to be criticized, that is what I would have done. But the risk that what would happen happened, that this would get all this press, that David Kotz would write a dreadful report, and that we have two hearings on the same subject did not occur to me.

Chairman MCHENRY. So you just didn't consider recusing yourself?

Mr. BECKER. Oh, I considered it. That is why I sought guidance from Ethics. I was told, in effect, there was no need for me to recuse myself.

Chairman MCHENRY. Have you recused yourself previously?



Mr. BECKER. I would say when I was at the SEC, I recused myself 50, 100 times from things.

Chairman MCHENRY. Was it because Ethics Counsel said you must every time?

Mr. BECKER. I would never say never to any question, but I would say certainly the vast majority of the times.

Chairman MCHENRY. Were there some where you just said, out of appearance sake, I shouldn't. So I should recuse myself.

Mr. BECKER. I can't remember a time when I didn't follow the advice of Ethics. And frankly, Inspector General Kotz mentioned that I got treated differently from other people, and he couldn't be more wrong. But yes, I always followed Ethics' advice. I guess as a lawyer, I expect my clients to follow my advice. And as a non-hypocrite, I behave the same way.

Chairman MCHENRY. And because you are a member of the Bar, you should have a higher ethical standard as well?

Mr. BECKER. I will match my ethical standards against anybody in this room in a heartbeat.

Chairman MCHENRY. Do you see how people have a problem with the appearance that you are an heir to a Madoff account, that a decision that you recommended to the SEC, a governmental regulator, then affected your financial well-being, even if it is small? Do you think that is a problem?

Mr. BECKER. The problem with this is the standard that you are using as sort of an appearance standard is it is almost like a perpetual motion machine. You say, I think it is a problem, so it must not look good. And in truth, over my career, I have been pretty careful about ethical matters. I do see what has happened. I am not pleased about what has happened. I think that there is a whole range of reactions ranging from absolutely sincere to a lack of understanding as to the facts, a lack of understanding as to the legal standards, and some people whose motives I must say I don't trust entirely.

Chairman MCHENRY. Finally—thanks for the Chair's indulgence—knowing that you were subject to a clawback, knowing that if you knew just that fact, would you have recused yourself?

Mr. BECKER. If you mean subject to a clawback that I was—that someone was going to institute an action against me, I do believe I would have recused myself.

Chairman MCHENRY. Okay. Thank you.

Chairman NEUGEBAUER. I thank the gentleman. The gentleman from New York, Mr. Ackerman.

Mr. ACKERMAN. You were in the agency previously?

Mr. BECKER. Yes.

Mr. ACKERMAN. You left?

Mr. BECKER. Yes.

Mr. ACKERMAN. You went into the private sector?

Mr. BECKER. Yes.

Mr. ACKERMAN. You were earning a lot of money. Why did you come back?

Mr. BECKER. It is sort of hard to answer that in a non-self-serving way. I came back because Mary Shapiro asked me to, because I care a lot about what the agency does, because I saw Madoff—Madoff was a kick in the gut to the agency. I represented clients

before the agency for a long time, and I thought the agency needed to look at things differently and do things differently. And I thought it was my duty to do it. Mary called me up and her words were, David, your country needs you. How do you refuse that?

Mr. ACKERMAN. You came back because it was a challenge?

Mr. BECKER. That, too.

Mr. ACKERMAN. You came back because your talents were needed?

Mr. BECKER. I was flattered into believing that, yes.

Mr. ACKERMAN. If you would have recused yourself, you would have taken yourself out of the action and your ability to help, which is the reason you came back, evidently?

Mr. BECKER. I think that is correct, yes.

Mr. ACKERMAN. In your exuberance to do that, do you think that colored your view as to whether or not you should have recused yourself?

Mr. BECKER. That is why I didn't rely on my view. That is why I basically had someone else make the decision. Because I truly believe when it comes to one's own conduct, no one is a very good judge.

Mr. ACKERMAN. The fact that you stood to gain even what to you might be a small amount didn't color your view to make that decision to go with constant dollars or the cost of money, or however you want to phrase it?

Mr. BECKER. I can honestly say I did not give that a thought.

Mr. ACKERMAN. Why did you decide that constant dollars was the best of the various proposals? In support of that, you wrote an amicus, submitted it to the court, supporting that position. Why did you think that was the best way to go?

Mr. BECKER. Our attitude, frankly, was to find theories that would enable us to get as much money as possible within the law to victims. And we sort of bumped around into other things—among other things and we came up with something. We came up with constant dollar, and the more I thought about it, the more I became convinced that where I had judged I would say that is the right interpretation of the law. So I said, let's go with it.

Mr. ACKERMAN. I will reveal to you that I am among a group of people and the main sponsor of legislation because I came to the same conclusion you did and thought that would help the greatest number of people who were Madoff victims and have introduced legislation to use constant dollar. So I have now laid that on the table and revealed it.

If I now said to you that I discovered that I have a Madoff account, what do you think I should do? I just made that up, by the way.

Mr. BECKER. Yes. I think it is time to sell it. I don't know.

Mr. ACKERMAN. I made the second part up. The first part is true. My question is, is it easier to see it on me than it is on yourself?

Mr. BECKER. I think that is a fair question, and this is a part of the country in which one's motives are constantly questioned, and as I said, I did not see this coming, and if I had, it might well have affected my judgment.

Mr. ACKERMAN. Nobody asked me but I will tell you what I think. I think you got blindsided slightly while trying to do the

right thing and are paying a personal price for it, and that is politics and it happens here very often. But if I am a judge—and I am not and I hope you don't have to have a real one give you a determination—but it seems to me that you acted on the best of instincts in exercising judgment that some people may want to question for political reasons and for judgmental reasons and appropriate reasons as well, but if it means anything—and it certainly doesn't in a court of law—but I think your dad would be proud of you.

Mr. BECKER. Thank you very much. That is a very kind thing to say.

Chairman NEUGEBAUER. I thank the gentleman, and now Chairman McHenry.

Chairman MCHENRY. Thank you. I just have a few questions. Commissioner Nazareth was mentioned earlier in the testimony and early in questioning, and I just wanted to ask you about this because former SEC Commissioner Annette Nazareth told the Inspector General that she knew that you had received proceeds of your late mother's Madoff account; is that true?

Mr. BECKER. She says it; it must be true. I have no recollection of that, but she is a completely honest woman.

Chairman MCHENRY. Did you discuss your mother's Madoff accounts with Commissioner Nazareth?

Mr. BECKER. As I say, she—if she says so, it must be true. I don't have any recollection of it.

Chairman MCHENRY. Okay. And so by your own omission, according to the SEC's Inspector General's report, that is what she said. So when she is an attorney and these other lawyers wrote in May of 2009, looking through the typical correspondence with SEC, it was a little odd that it was directed to you as the General Counsel rather than the Chairman or the board but—

Mr. BECKER. No, not at all. It is asking for the SEC to take a certain position in court, and so I would be the one who got that.

Chairman MCHENRY. Oh, okay. Then I will accept what you are saying, but they asked for a particular intervention on the Madoff's trustee's choice of an account evaluation, the last account statement method, didn't she, if you recall?

Mr. BECKER. I believe so, yes.

Chairman MCHENRY. Okay. So isn't—did you consider your—the account you are an heir to in light of this, did this enter into your thought process when you were considering this?

Mr. BECKER. First of all, I wasn't the heir to an account. I got a check—I got a check that included—

Chairman MCHENRY. You were the heir to the proceeds of the account. I am so sorry, but it is a big difference.

Mr. BECKER. And I got a check and the proceeds of that—and that check included money that apparently came from an account that I didn't know anything about. That letter was what led me to consult with the Ethics Office. So, yes, I did consider that.

Chairman MCHENRY. Okay. So you consulted in May of 2009 with the Ethics Office?

Mr. BECKER. I consulted twice. I consulted at or about the time I came and on this particular matter in May.

Chairman MCHENRY. Okay. And they cleared you again?

Mr. BECKER. Yes.

Chairman MCHENRY. Okay. So did you consider—so obviously—so you considered that this could have an effect on you at that point or potentially?

Mr. BECKER. I considered, as my email says, that it was conceivable that it could have an effect.

Chairman MCHENRY. Okay. So why didn't you recuse yourself at that point?

Mr. BECKER. Because there are all sorts of things that are conceivable, and it is all about probability, and based—I did not know facts. I basically put all the facts in front of the Ethics Office, said here is what I know, advise me as to whether this falls within the relevant statute and rule, and I was told, no, it doesn't.

Chairman MCHENRY. Okay. And you said that you—that certain items about this, about the proceeds of this account which you were the heir of, just to say it correctly, that you didn't know it was knowable to have this information about the account?

Mr. BECKER. Correct.

Chairman MCHENRY. Why not in May when this came up and you went back to the Ethics Office did you ask further questions of your brother, executor of the estate?

Mr. BECKER. I don't remember what I asked my brother and whether I did or I didn't. I now know for certain that he did not know and simply did not have the information as—when the account was opened and how much was put into the account. So that information just wasn't available.

Chairman MCHENRY. In terms of estate tax, that wasn't important information?

Mr. BECKER. No. Estate tax isn't based on the gain during the lifetime of the decedent. It values the assets as of the time of death. So it was not relevant at all.

Chairman MCHENRY. Okay. Do you think it was troubling, though, that Commissioner Nazareth, knowing that you had received these proceeds of a Madoff account, that you could be subject to this clawback, do you think that was—and actually taking official action, do you think that is questionable?

Mr. BECKER. I think you are attributing a lot of knowledge to me and all knowledge that I had to Commissioner Nazareth, and I doubt that was the case. I am a professional. Commissioner Nazareth is a professional. We represent clients, and we advocate the views of clients, and had she thought about it, I am sure she would have thought that recusal or not was between me and the Ethics Office. I don't know that she thought about it.

Chairman MCHENRY. Okay. Professionals make mistakes.

Mr. BECKER. Yes, they do, and thank God for that or I wouldn't have a living.

Chairman MCHENRY. That is correct. But knowing what you know now, you would have recused yourself, wouldn't you?

Mr. BECKER. No—you say knowing what I know now, if I knew that I was going to be sued, sure.

Chairman MCHENRY. You are testifying before Congress because of this appearance of impropriety. You have an Inspector General's report that has been referred to the Justice Department because of

this. You have been sued. You would recuse—if you were able to rewind the tape, would you have recused yourself?

Mr. BECKER. I would have recused myself if I knew I was going to be sued for legal reasons. The fact that Inspector General Kotz is making a big fuss about having sent something to the Justice Department doesn't move the needle as far as I am concerned. I have seen Inspector General Kotz do this before, make a big fuss, lots of publicity about sending reports to the Justice Department. Nothing has happened with any of them, and some of them that I recall from my time at the SEC were laughable.

Chairman MCHENRY. Is this laughable?

Mr. BECKER. They say comedy is what happens to someone else and tragedy is what happens to you. So this is a tragedy.

Chairman MCHENRY. Should I review it as a comedy?

Mr. BECKER. I think you should review this as someone who shoots straight, did what he was supposed to do, and is not deserving of the type of public criticism that he has gotten. That is how I think you ought to look at this.

Chairman MCHENRY. Thank you.

Chairman NEUGEBAUER. I thank the gentleman. I also want to thank the gentleman for having the joint hearing with us. I think it has been a very good day. We have had a lot of good testimony. Mr. Becker, we appreciate you coming.

Mr. BECKER. My pleasure.

Chairman NEUGEBAUER. And for giving us your time. The Chair notes that members may have additional questions for this panel which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses and to place their responses in the record, and Mr. Capuano, thank you.

This hearing is adjourned.

[Whereupon, at 6:53 p.m., the hearing was adjourned.]



# **A P P E N D I X**

September 22, 2011

Opening Statement  
**Chairman Randy Neugebauer**  
Financial Services Committee

Subcommittee on Oversight & Investigations  
“Potential Conflicts of Interest at the S.E.C: The Becker Matter”

September 22, 2011

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Thank you for attending this very important hearing, which will examine the S.E.C.'s handling of a conflict of interest regarding David Becker, the former General Counsel at the S.E.C. The Becker matter raises serious questions about the leadership of, and decision-making by, senior management at the S.E.C. The matter also illustrates significant flaws in the Commission's policies and procedures related to ethical conflicts.

For an agency that holds businesses and individuals to the highest standards of ethical conduct, it is highly concerning that the Commission may not apply those same standards of honesty, integrity, impartiality and conduct to its own leadership. This is particularly troubling because in order for the S.E.C. to carry out its mission, it must be held in high esteem by the general public. And the tone of the organization is set at the top.

There are many aspects of this case that are very concerning. For instance, how can an agency that endeavors to avoid any appearance of ethical impropriety allow Mr. Becker to lead an effort to advocate for higher recoveries for Madoff victims when this affected his own financial interest in a Madoff account?



After being informed of Mr. Becker's conflict, why was he allowed to participate personally and substantially on matters in which he had a personal financial interest?

Why did the Commission feel the need to disclose Mr. Becker's conflict to Congress; yet decided not to disclose that same conflict to the very Commissioner's tasked with voting on Mr. Becker's recommendation on net equity?

And why did the Commission's ethics office apply more conservative ethical standards for staff attorneys versus a more accommodative stance for senior management?

I believe the answers to the questions raised today will illustrate a Commission that has lacked strong leadership and that has amassed a troubling record of giving ad hoc ethical advice. As a result, we are left with an S.E.C that is sapped of credibility. I look forward to working with Mr. McHenry and the rest of my colleagues on this Committee to ensure the full Inspector General's report, and the recommendations contained within, are shown the light of day. I also look forward to working with Chairmen Bachus and Garrett to push through a reform agenda that finally cleans up the Securities and Exchange Commission.

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Testimony of David M. Becker

Before The Oversight and Investigations Subcommittee of the House Committee on Financial Services and the TARP, Financial Services and Bailouts of Public and Private Programs Subcommittee of the House Committee on Oversight and Government Reform

September 22, 2011

Chairman Neugebauer, Ranking Member Capuano, Chairman McHenry and Ranking Member Quigley:

I appreciate the opportunity to testify before you, and I thank you for listening to me.

I will speak to you this afternoon about my service at the Securities and Exchange Commission, and in particular about my role in advising the Commission on an issue of statutory interpretation that arose in the bankruptcy of Bernard L. Madoff Investment Securities (BLMIS). My sole goal was to advise the Commission as to the course that provided the greatest benefit to investors and that was consistent with the law. I am confident that any fair review of my actions will demonstrate that this was the only animating principle behind them.

I have only recently seen the report of the SEC's Office of Inspector General (OIG). To the extent I am able, I will comment on that during my testimony.

In sum:

- I did precisely what I was supposed to do. I identified a matter that required legal advice from the SEC's Ethics Office. I sought that advice, received it, and followed it. The OIG report contains no finding to the contrary.
- The apparent recommendation of the Office of Government Ethics that this matter be referred to the Department of Justice stems from the fact that OGE "is precluded by law from making any determination that the criminal conflicts of interests laws may or may not have been violated." The most OGE was willing to say was that the information provided by the OIG is "relevant," and then only "to the extent" it shows elements of a violation.
- I was advised that I had no conflict of interest in providing legal advice to the SEC about the interpretation of the legal standard in the Securities Investment Protection Act (SIPA) that governed the net equity claims of holders of BLMIS securities accounts, which might permit these customers to obtain advances from the Securities Investors Protection Corporation (SIPC). For ease of reference I will refer to this matter as the "SIPC matter."

- I asked for and received legal advice from the SEC's Ethics Office before working on the SIPC matter. I discussed with the head of the Ethics Office the possibility that the SIPC matter could indirectly affect my financial interest because after my mother's death in 2004 my mother's estate had liquidated a BLMIS account, and I and my brothers had inherited money from my mother. I was told that there was neither a conflict of interest nor an appearance of a conflict within the meaning of the applicable ethics statutes and rules.
- I had no financial interest in the position that the Commission took regarding how to determine net equity claims in the SIPC matter. I had no such claim and never thought that I would have such a claim in the future. And it never occurred to me to look after my financial interest. If anything, on balance the positions the Commission took on its interpretation of SIPA were contrary to what others have characterized as my financial interest.

In the pages that follow, I describe some background about who I am and the circumstances of my return to the SEC in 2009. I then explain the nature of my rather tenuous connection to the BLMIS liquidation and provide a chronology of my involvement in the SIPC matter.

#### My Background

I am a lawyer. I came to Washington 38 years ago for judicial clerkships on the United States Court of Appeals for the District of Columbia Circuit and then the United States Supreme Court. Since 1975 I have held a variety of positions in private practice and in government. Approximately 25% of my career has been spent in government.

I served at the SEC twice. I was General Counsel under Chairmen Arthur Levitt and Harvey Pitt, as well as Acting Chair Laura Unger. From February 23, 2009, until February 25, 2011, I was General Counsel and Senior Policy Director under Chairman Mary Schapiro. In this capacity, I reported directly to Chairman Schapiro.

Throughout my career I have tried to bring honor to the legal profession. I have tried to exemplify the best traditions of the profession: scholarship, attention to detail, civility, an understanding of our common humanity, an absolute insistence on operating within the rules, and an abiding passion for justice.

#### My Decision To Rejoin the SEC in 2009

In January 2009, shortly after Mary Schapiro was nominated by the President to be Chairman of the SEC, I received a telephone call from SEC Commissioner Elisse Walter. I have known Ms. Walter for nearly 40 years. Ms. Walter called me to sound me out on returning to the SEC as its general counsel. I declined. I had done that job before, I was

enjoying my law practice, and returning to the Commission would involve considerable sacrifice, not the least of which was financial.

Mary Schapiro called me the next day. Ms. Schapiro and I were professional friends. We had had many interactions during my first tour of duty at the SEC, and I liked and admired her. We kept up our friendship after I left the SEC the first time. When, in 2008, I was interviewed by the President's Transition Team and asked who I thought the President should appoint as SEC Chairman, Ms. Schapiro was my first and only recommendation.

When Ms. Schapiro telephoned me, her first words -- which she knew I would find impossible to resist -- were "David, your country needs you." I told Ms. Schapiro that it was a terrible time for me to return to government service, but I agreed to talk to her about it. I accepted her offer a week later.

I came back to the SEC because I care deeply about the agency and its people, because my friend Mary Schapiro asked me to, and because I thought it was my duty. I knew the SEC was in crisis and in need of revitalization and reform. I was flattered that Ms. Schapiro thought I could help, and I thought so too. While I had enormous affection for the SEC, my years of SEC service and of representing clients before the agency had given me a clear-eyed view of its shortcomings and of the measures that might be taken to revitalize it.

For those who think I acted in my financial interest, I would point out that I took a pay cut of over 90% to return to the SEC; I was 62 years old; I returned to a job that I had already had; and I, like many others, forfeited millions of dollars to serve my country. I agreed to a two-year commitment and left after two years, despite Chairman Schapiro's repeated requests that I stay.

When I left, after I had been sued by the Madoff Trustee, and after the first waves of negative press, Chairman Schapiro said this:

"I asked David to return to the agency because I knew that his wise counsel could help us do our jobs better. He came here at a tumultuous moment because he embraced our mission and he felt that he could help us achieve it -- and that's exactly what he did. He is a committed public servant -- someone willing to make sacrifices and take chances to make our country better. We are all fortunate to have had the opportunity to work with him, and he leaves this agency in better shape for the additional two years he gave to us. David, as you leave the SEC once again, you leave with the agency's appreciation and my own deep personal gratitude..."

Madoff

I have never met Bernard L. Madoff. I have never had any dealings with him or with BLMIS. My only “relationship” with him is that in 1995 he defrauded my then 85 year-old father into opening an account at BLMIS in my mother’s name, just as he defrauded so many others over the years.

My “financial ties” with Madoff derive entirely from the fact that my mother died in 2004, some years before Madoff’s fraud became known. Her estate did not have an account at BLMIS at the time of its bankruptcy in December 2008, since my brother had liquidated the account in 2005 to pay estate taxes. My brothers and I were each designated executors in my mother’s will. Executors are the persons with the legal powers to wind up the affairs of a decedent. I did very little as an executor and absolutely nothing with respect to financial matters.

I was one of the beneficiaries of my mother’s estate, along with charitable institutions and other family members. I “benefited” from her account at BLMIS, in the same sense that all the beneficiaries of the estate benefited from all activities during my parents’ lifetimes that added to my mother’s wealth at the time of her death.

It is simply incorrect to say that at any time I had an “interest in” a Madoff account.

What I Knew About My Mother’s Madoff Account

After my return to the SEC was announced, but before I started work, I learned from my brother that my mother had had an account at BLMIS that he had liquidated several years earlier to pay estate taxes. While he knew that the gross proceeds in the account had been \$2 million, he did not know when the account was opened or the size of the original investment. We both assumed that my father had made the investment, because my mother was an academic and a social worker, and she did no investing.

I did not learn any more facts about the account until I received the SIPC Trustee’s “clawback” complaint two days before I left the SEC in 2011.

The Potential For Clawback Liability

While I never had any interest in a Madoff account, by the time I started work at the SEC I was aware of the possibility that the Madoff Trustee might try to “claw back” from me any funds that could be traced to my late mother’s account, though as the OIG’s report confirms, I regarded that possibility as unlikely. In a clawback case (what lawyers call an “avoidance action”) a bankrupt estate seeks the return of assets that were wrongfully distributed by the bankrupt entity. People holding those assets must, under certain circumstances, return them, even if they were completely without fault in receiving them. The clawback action that the Madoff Trustee instituted against me and my brothers in February 2011 makes no allegation of wrongdoing by me or my brothers, nor could it. Again, we knew nothing about the account until after my mother died.

I certainly knew that I was no expert in bankruptcy law, but I thought it doubtful that the Trustee would institute a clawback action against me. That was because, I thought, that I plainly had nothing to do with the account, the event that occasioned the withdrawal (my mother's death) certainly did not suggest any complicity in the fraud, and all of the funds generated upon my brother's liquidation of my mother's Madoff account were used to pay estate taxes.

As noted, I did not know the amount, if any, of fictitious profits that were in my mother's account at her death, and I had doubts about whether that information was ascertainable. Initial reports were that the Madoff Ponzi scheme spanned several decades. I had no idea whether the records were available to reconstruct my father's initial transaction opening my mother's account, what money (if any) had been taken out, and the amount of any purported gain.

One reason I did not think much about clawback actions is that they were really beside the point to me. I was confident that the Trustee would never find it necessary to sue me. If it turned out that there were indeed fictitious profits in my mother's account, all the Trustee had to do was notify me and explain his calculations, and I would return any excess funds in my possession. I came to the SEC twice to help defend the victims of fraud, and I never, ever would have held on to money that came from fraud victims.

I have been asked why I did not contact the Trustee, to let him know that my mother had been a Madoff customer and to ask him to research the particulars of my mother's account. The short answer is that it never occurred to me, though I did know that the Trustee was aware of an account in the name of the Estate of Dorothy G. Becker. Nevertheless, I am not at all sure that it would have been appropriate for me to have contacted the Trustee. There are strict ethical prohibitions on using one's public office for private gain. Given the SEC's close involvement with SIPC in the Madoff liquidation, I am doubtful that any contact between me and the Trustee could have been perceived as totally divorced from my official responsibilities.

#### Disclosure of My Mother's Account

The OIG report confirms that I never made a secret of my late mother's Madoff account. To the contrary, I was the one who brought the matter to the attention of the Ethics Office. Indeed the OIG report counts seven people at the Commission to whom I spoke about it. There may have been more. Each time, I was the one who raised the subject for the attention of others. I told Chairman Schapiro everything I knew about my mother's Madoff account shortly before or immediately upon my arrival at the SEC. I do not remember the details of the conversation, but I am certain that I told her everything, both because there was not much to tell and because Chairman Schapiro and I had an extremely candid and broad-ranging professional relationship.

I also informed William Lenox, head of the SEC's Ethics Office, about my mother's Madoff account shortly before or after I arrived at the SEC. Again, I did not know very much, and I told him all that I knew. Mr. Lenox advised me that the mere fact that proceeds from the liquidation of a Madoff account might have been included in the

money I had inherited from my mother some years earlier did not require my recusal from any and all matters that touched upon Madoff. We agreed that we could consult again as particular matters came up.

I never asked Chairman Schapiro or Mr. Lenox not to share the information about my mother's account. I had every expectation that they would share the information to the extent that, in their judgment, their duties required it.

#### The SIPC matter

In May 2009, I became aware of a matter that I believed counseled consideration of whether I should participate. I received a letter from several law firms taking issue with the Madoff Trustee's stated view that, under SIPA, the amount of a defrauded investor's "net equity" in his account -- and therefore the amount of any entitlement to a payment for the loss by the Securities Investor Protection Corporation -- should be determined on a "money in, money out" basis -- that is, on the basis of the amount of money initially deposited by an investor less any amounts withdrawn. Some claimants believed that the legally appropriate measure of "net equity" is the amount of securities and cash shown on an investor's account statement on the date the bankruptcy proceeding was filed, a significantly larger amount. The law firms wanted the Commission to take the position in bankruptcy court that the Trustee was incorrect in his view of the law and asked for a meeting to explain their position.

The first thing I did was to consult with the Ethics Office about whether it would be appropriate for me to participate in responding to the letter. I did so out of what I believed to be an abundance of caution. The question as to the proper measure of SIPC advances had nothing to do with me. SIPC advances were available only to the customers of Madoff who had open accounts at the time of the bankruptcy. My mother had no such account at Madoff. Hers had been closed by operation of law at the time of her death, then transferred to her estate, and then liquidated in 2005. There was no way that I would share in any SIPC advances.

I raised the question of my participation in the SIPC matter because of the possibility that its resolution might have an impact on a possible clawback action, even though that seemed extremely remote at the time. I did not know how much, if any, fictitious gain was in my mother's account. I did not know whether these matters were knowable to the Trustee. I did not know the standards the Trustee would be using for determining when to bring avoidance actions. Mostly importantly, the determination whether to bring an avoidance action, the legal standards on which it would be based, and the factual circumstances that would warrant litigation were in the exclusive control of the Trustee, and he did not make his intentions clear on those matters until literally two days before I was to leave the SEC. I asked Mr. Lenox for advice even though I did not think the SIPC matter had anything to do with me. I did so because I avoid making professional judgments that involve my own conduct without consulting with a colleague. With respect to ethics matters in particular, I strongly believe that no one should be his own lawyer and that one has to seek advice of those more expert and detached and then follow it. I used to conduct ethics training for young lawyers at a Washington law firm in which I was a partner. I opened each session with the admonition that the three most important rules for avoiding ethics issues were "consult, consult, consult."

I did not ask Mr. Lenox for approval of my participation in the SIPC matter. I asked for his advice as to the appropriate course of action. My request for advice was open-ended. The reason for this is simple: it was in my best interest and the Commission's for me to follow the law wherever it led. I had neither desire nor reason to skate close to any line. Accordingly, my question to him was not "would you permit me to do this," but rather "let me know, please, what I should do."

I had known Mr. Lenox for years, from my previous tour of duty at the SEC and from asking for his approval (not advice) as to whether I could represent clients in certain matters before the Commission after I returned to private practice. I believed Mr. Lenox to be a person of complete integrity and that the quality of his ethics advice was high, if at times a bit conservative.

The OIG has suggested in his report that there was something inappropriate in my asking for legal advice from Mr. Lenox, since I made plain that I respected him and his professional judgment. The OIG notes that "just seven months" after Mr. Lenox gave me advice on the SIPA matter, I gave him an excellent work evaluation. I fail to see any evidence of impropriety. I did think Mr. Lenox was very capable. That is why I went to him. I continued to think he was very capable. That is why I gave him a good evaluation. The implication of the OIG's comments is that I should have spoken to an Ethics lawyer I regarded less highly or I should have not evaluated him in accordance with his just desserts. I do not comprehend his point.

Mr. Lenox advised me there was no conflict and that any interest I might have in the outcome of the "net equity" issue was too remote and too contingent to affect my judgment on the issue. Government officials are prohibited from participating in matters only if the impact on their financial interests is "direct and predictable." For the same reason, it appeared that my participation would not involve an appearance of impropriety -- namely, that a reasonable person with knowledge of all the relevant facts then available to me would conclude that I was capable of advising the Commission fairly and objectively on the proper resolution of the "net equity" issue and to present the Commission's position to the courts.

Mr. Lenox's advice seemed sensible to me. But I did not know the full extent of his rationale for his advice or the extent of the research and consultation he did in order to reach his conclusion.

#### The "Brief Review"

The Subcommittees have copies of an email that I sent to Mr. Lenox on May 4, 2009, and his response some 26 minutes later. From this, some have concluded, wrongly I believe, that this email reflects the number of minutes that it took Mr. Lenox to consider the matter. I cannot say for certain, because I do not remember having sent this email or any conversations surrounding it, but I would very surprised if it represented our only interchange. It probably does, however, provide the best evidence of my contemporaneous thinking about the matter.

Looking today at the email exchange between Mr. Lenox and me, my strong belief is that it reflects two lawyers memorializing the outcome of a consultation. In other words it



reflects the culmination of the consultative process rather than a blow-by-blow account of it. It is unlikely that I would have simply shot Mr. Lenox an email out of the blue asking for written guidance on a matter of this significance. More likely, I think, is that I would have called him up and met or talked with him about it; and then he would have done whatever research he thought necessary. He would have given me his advice orally and then confirmed it writing. While I caution that I remember none of this, it would be consistent with my practice and that of most lawyers, and it is certainly a more plausible reading of the email than one that suggests that this was our only communication on the matter and that it took only 26 minutes.

#### Mr. Lenox's Reporting Relationship To Me

Press reports have insinuated that Mr. Lenox's advice is suspect because he reported to me. The Ethics Office in fact was resident in the Office of General Counsel (OGC). But as to the content of Mr. Lenox's advice -- whether to me or to anyone else at the Commission -- Mr. Lenox reported only to the Commission and had the final say on any matter. In form and in fact, Mr. Lenox was the Designated Agency Ethics Official, and I was the Deputy Designated Agency Ethics Official.

Mr. Lenox and I had a working relationship of mutual respect: I would certainly explore with him matters of particular importance to the Commission or matters in which I did not initially understand his conclusions. But he had the final call. And where the matter concerned me, I never failed to follow his advice. And this included instances where I disagreed with his judgment.

Lawyers throughout the government and private sector give legal advice to their superiors about their conduct. Mr. Lenox was no more disabled from giving me good advice than the Attorney General is disabled from advising the President, or the General Counsel of our country's businesses are disabled from advising CEOs or boards of directors.

#### I Kept The Chairman Informed

Though I have no recollection of having discussed with the Chairman my consultation with Mr. Lenox, I am quite certain that I did so promptly. The Madoff matter was important to the Commission and, as a result, the Chairman. I had an extremely open and candid relationship with the Chairman. I usually saw the Chairman every day she was in town, most often in the morning before others arrived as well as in the evening before I left. Our conversations were by no means limited to matters coming within my responsibilities as General Counsel, but could cover any matter occurring at the Commission.

My Work On The SIPC Matter

This was a legal issue. It concerned the position the Commission should take in court on an issue of statutory construction of SIPA. Naturally, it fell to me to lead the team that formulated a recommendation to the five lawyers on the Commission as the legally appropriate position to take.

There were, sadly, many investors who were affected by the resolution of the “net equity” issue. As noted above, the Madoff Trustee, supported by SIPC, had taken the legal position that the only investors who were entitled to advances from SIPC were those investors who, at the time of the Madoff bankruptcy, had not taken out of their Madoff accounts more cash than they had put in. But there were many more investors who had maintained accounts with Madoff over an extended period. Many over that time had taken out more money than they had put in, but they had used the money to support themselves over the years and were counting on the money that they thought was in the Madoff accounts to support them in their retirement or, even more tragically, in their old age. The Trustee had taken the position that these people were entitled to no money from SIPC, no matter how desperate their circumstances.

Shortly after Chairman Schapiro arrived at the SEC in January 2009, and before I arrived at the Commission, the SEC’s Division of Trading and Markets had informed the Trustee that it believed his interpretation of the statute was correct. On February 12, the Division of Trading and Markets briefed the Commission about this but did not seek and did not get approval of its view. The view it presented was its alone, and not that of any other SEC division. It was not the view of the Office of General Counsel, which would have to present the view of the Commission in court. Thus, contrary to the OIG’s conclusion (pp.4,6), the SEC had taken no position on this matter.

As noted above, I got involved in this issue in May 2009, upon the request of several law firms that the Commission instruct the Trustee to change his position. I am quite certain that I told Chairman Schapiro of this request, and I kept her apprised of my progress.

I am certain that I kept her fully informed because I am clear what her direction was -- to do the best within the constraints of the law to make sure that as many Madoff victims as possible got the maximum SIPC advances possible. I agreed fully. Chairman Schapiro and I were horrified at the suffering of Madoff victims. We believed that the Commission had a deep and urgent obligation to these investors. And we wanted to do everything we could.

But we had to act within the constraints of the law. The Commission is charged with the responsibility of enforcing the statutes that Congress writes and the President signs. It is not free to re-write them. The law is capacious but it is not infinitely elastic. We had to do the best we could with SIPA as written.

With those goals in mind, OGC did its best to formulate a recommendation for the Commission that was well within the law and that was consistent with the remedial purposes of SIPA. We met with lawyers from all interested parties. We met with the

Trustee. My style with all of them was to question them aggressively and with civility about their views. In so doing, I hoped to learn the strengths and weaknesses of all arguments and arrive at the right view. I also hoped that by pushing hard, and by not tipping the Commission's hand (which I was not authorized to do in any event), the parties might see it in their interest to reach agreement on the "net equity" issue. Unfortunately, that did not happen.

Mostly, what we did within OGC was to research the law, its history, and the way it had been applied. This was a collaborative effort among several lawyers in OGC and myself. We tried out approaches and we tested them among ourselves. I was enormously impressed with the quality of lawyering within our office and the intellectual ruthlessness with which we tested and then modified all premises and all arguments. I thought then -- and I think now -- that we did a splendid job.

Towards the end of the process, we came to believe that there was no principled alternative to the "money in, money out" test for discerning who was entitled to SIPA advances and in what amounts. We did, however, come up with a slight modification. We believed that, in a Ponzi scheme in which the securities accounts were a total fiction and that had transpired over many years, "money in, money out" should be calculated on the basis of constant dollars. That is because "money" represents purchasing power. We believed that SIPC had not given enough consideration to the fact that over the duration of the Ponzi scheme, the purchasing power of the dollars invested by long-standing Madoff investors had eroded and that SIPC's advances should reflect what customers had lost in real terms, and not just in terms of unadjusted numbers. In simple terms, a defrauded investor who invested \$10,000 in 1998 suffered a greater loss than one who invested \$10,000 in 2007. The constant dollar approach addresses this inherent inequity.

Accordingly, in late October 2009 OGC recommended to the Commission that it urge the Bankruptcy Court to interpret "net equity" as meaning "money in, money out" and to require that "money in, money out" be calculated in constant dollars. Our recommendation as to constant dollars was neither opposed nor supported by the Division of Trading and Markets, which said that it "did not necessarily agree." It was supported enthusiastically by the Division of Risk, Strategy, and Financial Innovation, which is composed principally of economists.

OGC presented its recommendation to the Commission at two meetings. There was general support at the first meeting. Some Commissioners wanted more information about the impact of the constant dollar modification to "money in, money out." Chairman Schapiro and at least one other Commissioner made clear that they would not support "money in, money out" without the constant dollar modification. At a second meeting, the Commissioners approved OGC's recommendation.

The Commission's position on "money in, money out" recently has been approved by the Court of Appeals for the Second Circuit. The constant dollar modification has not yet been considered by the Bankruptcy Court.

Throughout the process of formulating OGC's recommendation, I do not remember giving any consideration to how the various proposed outcomes would affect me. As noted, I thought that any analysis of how the Commission's recommendation on the availability of SIPC advances would affect a possible clawback action against me was speculative at best. OGC did inform the Commission that our recommendation could have an impact on those making claims for SIPC advances who were also subject to a clawback action, but as I recall we neither considered nor made any comment to the Commission about how the position would affect clawback actions against persons who were not Madoff customers at the time of the bankruptcy.

I have read that my recommendation to the Commission was to my financial disadvantage, by rejecting the "last account statement" method of calculating "net equity" in favor of the "money in, money out" method. I also have read that OGC's recommendation was in my financial interest, by adding the much smaller constant dollar modification to the "money in, money out" method.

The truth is I deserve neither credit for selflessly recommending "money in, money out" nor condemnation for recommending the constant dollar modification. I did not think about myself at all. My only concerns were to serve investors and to follow the law. I would note, though, that if I had thought that I had a financial stake in our recommendation, the "last statement" method would have been many times more advantageous to me than the relatively minor constant dollar modification to "money in, money out."

#### Testimony Before the House Financial Services Committee

I have been asked why I did not testify before the House Financial Services Committee on December 9, 2009. Given the participation of OGC in formulating the Commission's position on the SIPA advances issue, it was natural that I testify on behalf of the Commission. Before preparing to do so, however, I sought guidance on the *political* wisdom of my doing so from the head of the Commission's Office of Legislative Affairs (OLA). Again, I believed that I was not in the best position to judge my own conduct. This was particularly so in making judgments about political matters.

I told OLA about my mother's Madoff account, just as I had previously told the Chairman and the Ethics Office. I told OLA that I had been cleared to work on this matter by the Ethics Office and was prepared to go forward with testimony about the Commission's position in the SIPC liquidation proceeding. The Trustee's position, which the Commission largely supported, was quite controversial. I was (and am) convinced that the position was legally compelled, but I was concerned that some might use the existence of my late mother's closed account as a means of attacking the Commission's position without dealing with it on the merits.

I made clear to OLA that if I testified I would mention my mother's account at the outset of my testimony. I had nothing to hide and did not want to open myself to accusations that I did.

OLA's initial reaction was that there was no reason I should not testify. Later, however, I was told that, subject to confirmation by Chairman Schapiro, it might be more prudent if I did not testify, to make it more likely that the focus of the Commission's testimony would be on the merits of the Commission's position. Shortly thereafter, I was told that the Chairman agreed with this judgment.

The next morning I discussed my participation in the hearing with the Chairman during one of our frequent informal conversations. She told me that she agreed with OLA's judgment. I made clear to her my willingness to testify and expressed concern that she might think I was avoiding what might become an intense hearing. She assured me that I had no reason to be concerned and laughed and teased me that I would get additional opportunities to testify.

#### Participation In SIPC Clawback Amendment

The OIG has suggested that I participated "personally and substantially" in a "matter" involving the SEC's position on an amendment to SIPA that someone apparently intended to introduce. Apparently, the amendment would have seriously curtailed the ability of a Trustee in a SIPA proceeding to institute clawback actions. By email sent at 11:30 pm on the night of October 27, 2009, I was asked by an OLA staff member whether the Commission should "weigh in" if the amendment was proposed.

I sent an email in response at 6:30 am the following morning. I expressed no view on the question asked (whether the Commission should "weigh in"). I said instead that I did not understand the amendment, if I understood it correctly it seemed unfair, and that I was forwarding the matter to the bankruptcy experts in OGC to see if I had read the amendment correctly.

That was it.

#### Reflections and Conclusion

This has been a dreadful experience for me, in ways that there is no need for me to detail. I fear that it also has been a dreadful experience for the public interest. The public needs a Securities and Exchange Commission that is encouraged to make hard decisions and to make the right decisions. I understand that there are different visions of the public interest and different views about matters of public policy.

But surely no vision of the public interest contemplates a Securities and Exchange Commission whose members and whose staff are afraid of making *any* decision, lest they be subject to intense personal attacks and investigations whose targets are random and whose outcomes are unpredictable. A Commission whose members and staff rightly fear for their professional lives is in no position to concentrate solely on the public.

I make these observations as someone who, as much as he cares for the Commission, is not the slightest bit sentimental about its shortcomings. The need for reform is urgent, but it will not succeed if unrelenting attacks take the place of constructive and civil engagement.

I spoke to Commission members and the staff about this very point when I took my leave last February:

From the day I walked in the door two years ago until today I've been asked how this time around is different than the previous time. The answer is that it's a hell of a lot harder. In some ways we've made it harder on ourselves; in others, we live with constraints not of our own making; and in other ways, we just live in times that are much meaner than they were 10 years ago.

It's riskier to work here than it used to be. As you may know, I'm having some experience with this myself. Unfortunately, too many people have experienced those risks first hand. This time around I've had more than a few people in my office weeping with fear about what might happen to them because one person or another was looking into their behavior. I've been shocked by that. That shouldn't be. It is a symptom of the times and a political culture that is, quite frankly, seriously nuts. To some extent, this enrages me. But mostly it makes me very sad. I'm sad for the agency and for my friends, and I feel terrible that I haven't been able to help people more.

And it is the source of my biggest worry for the Commission as I leave. When I left here in 2002 I worried a bit that the agency might be too complacent. I have the opposite worry today. I worry that all the risk that people run will make the institution gun shy. It's only natural, but I hope I'm wrong. I hope people here have the capacity to listen to the agency's critics, be intensely self-critical, keep an open mind to a better way to do things, and in the end, never, ever back off from doing what we believe to be right. No one should take imprudent risks, and we shouldn't sugarcoat what may befall the best intentioned of us, but in the final analysis we can't live scared.

In the end, what has made this agency great is people who say, the hell with it, I'm going to do what's right, knowing that we are imperfect beings who often can't know what's right, and knowing that the risks are real that we will be called to account for our failures, or for our successes, or just for being here. It is so important that people here bring cases, drop cases, adopt rules, walk away from rules solely on the basis of what is best for the people we serve. The people in this room believe that, I know. That's why I love you all and why the privilege of having been with you for a time leaves me deeply in your debt.

I spoke from the heart when I said those words. I will speak from the heart today.

I welcome your questions.

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



**Before the Subcommittee on Oversight and Investigations,  
Committee on Financial Services, and Subcommittee on  
TARP, Financial Services and Bailouts of Public and  
Private Programs, Committee on Oversight and  
Government Reform, U.S. House of Representatives  
Thursday, September 22, 2011  
2:00 p.m.**

**Introduction**

Thank you for the opportunity to testify before the Subcommittees on the subject of “Potential Conflicts of Interest at the SEC: The Becker Case” as the Inspector General of the U.S. Securities and Exchange Commission (SEC or Commission). I appreciate the interest of the Chairmen, the Ranking Members, and the other members of the Subcommittees, in the SEC and the Office of Inspector General (OIG). In my testimony, 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.

I would like to begin my remarks by briefly discussing the role of my Office and the oversight efforts we have undertaken during the past few years. The mission of the OIG is to promote the integrity, efficiency, and effectiveness of the critical programs and operations of the SEC. The SEC OIG includes the positions of the Inspector General, Deputy Inspector General, and Counsel to the Inspector General, and has staff in two major areas: Audits and Investigations.

Our audit unit conducts, coordinates, and supervises independent audits and evaluations related to the Commission’s internal programs and operations. The primary purpose of conducting an audit is to review past events with a view toward ensuring compliance with applicable laws, rules, and regulations and improving future performance. Upon completion of an audit or evaluation, the OIG issues an independent report that identifies any deficiencies in Commission operations, programs, activities, or functions and makes recommendations for improvements in existing controls and procedures.

The Office’s investigations unit responds to allegations of violations of statutes,



rules, and regulations, and other misconduct by Commission staff and contractors. We carefully review and analyze the complaints we receive and, if warranted, conduct a preliminary inquiry or full investigation into a matter. The misconduct investigated ranges from fraud and other types of criminal conduct to violations of Commission rules and policies and the Government-wide conduct standards. The investigations unit conducts thorough and independent investigations in accordance with the applicable Quality Standards for Investigations. Where allegations of criminal conduct are involved, we notify and work with the Department of Justice and the Federal Bureau of Investigation, as appropriate.

#### **Audit Reports**

Over the past three and one-half years since I became the Inspector General of the SEC, our audit unit has issued numerous reports involving matters critical to SEC programs and operations and the investing public. These reports have included an examination of the Commission's oversight of the Bear Stearns Companies, Inc. and the factors that led to its collapse, an audit of the Division of Enforcement's (Enforcement) practices related to naked short selling complaints and referrals, a review of the SEC's bounty program for whistleblowers, an analysis of the SEC's oversight of credit rating agencies, and audits of the SEC's real property and leasing procurement process and the SEC's oversight of the Securities Investment Protection Corporation's activities.

#### **Investigative Reports**

The Office's investigations unit has conducted numerous comprehensive investigations into significant failures by the SEC in accomplishing its regulatory mission, as well as investigations of allegations of violations of statutes, rules, and

regulations, and other misconduct by Commission staff members and contractors. Several of these investigations involved senior-level Commission staff and represent matters of great concern to the Commission, Members of Congress, and the general public. Where appropriate, we have reported evidence of improper conduct and made recommendations for disciplinary actions, including removal of employees from the federal service, as well as recommendations for improvements in agency policies, procedures, and practices.

Specifically, we have issued investigative reports regarding a myriad of allegations, including claims of failures by Enforcement to pursue investigations vigorously or in a timely manner, improper securities trading by Commission employees, conflicts of interest by Commission staff members, violations of the applicable laws and regulations regarding post-employment activities, unauthorized disclosure of nonpublic information, procurement violations, preferential treatment given to prominent persons, retaliatory termination, perjury by supervisory Commission attorneys, falsification of federal documents and compensatory time for travel, and the misuse of official position and government resources.

In August 2009, we issued a 457-page report of investigation analyzing the reasons why the SEC failed to uncover Bernard Madoff's \$50 billion Ponzi scheme. In March 2010, we issued a 151-page report of investigation regarding the history of the SEC's examinations and investigations of Robert Allen Stanford's \$8 billion alleged Ponzi scheme. In May 2011, we issued a 91-page report of investigation into the circumstances surrounding the SEC's decision to lease approximately 900,000 square

feet of office space at a newly-renovated office building known as Constitution Center, at a projected cost of over \$550 million over ten years.

More recently, on September 16, 2011, we completed a report entitled, “Investigation of Conflict of Interest Arising from Former General Counsel’s Participation in Madoff-Related Matters,” which is the subject of this hearing and is discussed in greater detail below.

#### **Commencement and Conduct of the OIG’s Conflict-of-Interest Investigation**

On March 4, 2011, Chairman Mary Schapiro requested that the OIG investigate any conflicts of interest arising from the participation of David M. Becker, the former General Counsel and Senior Policy Director of the Commission, in determining the SEC’s position in the liquidation proceeding brought by the Securities Investor Protection Corporation (SIPC) of Bernard L. Madoff Investment Securities, LLC (the Madoff Liquidation). The Chairman’s request came after she received Congressional inquiries prompted by press reports beginning on February 22, 2011, that the Trustee administering the Madoff Liquidation had brought a clawback suit seeking to recover fictitious profits that had accrued to Becker and his brother as beneficiaries of their mother’s estate when a Madoff account she held was liquidated after her death. The OIG opened an investigation the same day it received the Chairman’s request.

During the course of its investigation, the OIG obtained and searched over 5.1 million e-mails for a total of 45 current and former SEC employees for various time periods pertinent to the investigation, ranging from 1998 to 2011. The OIG also obtained and analyzed internal SEC documents, documentation provided by the Madoff Trustee, Irving H. Picard, Esq., court filings, and press reports. In addition, the OIG conducted

testimony or interviews of 40 witnesses with knowledge of facts or circumstances surrounding the Madoff Liquidation and Becker's work at the SEC.

**Issuance of Comprehensive Report of Investigation in Conflict-of-Interest Matter**

On September 16, 2011, we issued to the Chairman of the SEC a comprehensive report of our investigation in the conflict-of-interest matter that contained nearly 120 pages of analysis and 200 exhibits. The report of investigation detailed all of the facts and circumstances surrounding the SEC's former General Counsel and Senior Policy Director David Becker's participation in issues in the Madoff Liquidation and other Madoff-related matters, notwithstanding his interest in the Madoff account of his mother's estate.

**Results of the OIG's Investigation**

Overall, the OIG investigation found that Becker participated personally and substantially in particular matters in which he had a personal financial interest by virtue of his inheritance of the proceeds of his mother's estate's Madoff account and that the matters on which he advised could have directly impacted his financial position. We found that Becker played a significant and leading role in the determination of what recommendation the staff would make to the Commission regarding the position the SEC would advocate as to the calculation of a customer's net equity in the Madoff Liquidation. Under the Securities Investor Protection Act of 1970 (SIPA), where SIPC has initiated the liquidation of a brokerage firm, net equity is the amount that a customer can claim to recover in the liquidation proceeding. The method for determining the Madoff customers' net equity was, therefore, critical to determining the amount the Trustee would pay to customers in the Madoff Liquidation. Testimony obtained from

SIPC officials and numerous SEC witnesses, as well as documentary evidence reviewed, demonstrated that there was a direct connection between the method used to determine net equity and clawback actions by the Trustee, including the overall amount of funds the Trustee would seek to claw back and the calculation of amounts sought in individual clawback suits. In addition to Becker's work on the net equity issue, we also found that Becker, in his role as SEC General Counsel and Senior Policy Director, provided comments on a proposed amendment to SIPA that would have severely curtailed the Trustee's power to bring clawback suits against individuals like him in the Madoff Liquidation.

The following is a summary of the findings of our investigation. We found that Becker, along with his two brothers, inherited an interest in a Madoff account owned by his mother's estate after she died in 2004. Becker testified that he became aware of his mother's estate's Madoff account in or about February 2009 and knew that the account had been opened by his father prior to his death in 2000, was transferred to his mother's estate after her death in 2004, and was liquidated for approximately \$2 million. According to the complaint filed by the Madoff Trustee against Becker and his brothers in February 2011, approximately \$1.5 million of the \$2 million in the Madoff account constituted fictitious profits and, therefore, should properly be clawed back into the fund of customer property for distribution to other Madoff customers.

The OIG investigation found that at the time Becker participated on behalf of the SEC in the net equity issue presented in the Madoff Liquidation, he understood there was a possibility the Trustee would bring a clawback suit against him for the fictitious profits, but asserted that he did not know the likelihood of such a suit. He also acknowledged at

the time that it was at least “theoretically conceivable” that the determination of the extent of SIPA coverage to be afforded Madoff customers could impact whether the Trustee would bring clawback actions against “persons at the margin,” which he considered himself to be. Notwithstanding this knowledge, Becker, who also served as the SEC’s alternate Designated Agency Ethics Official (*i.e.*, the alternate official responsible for coordinating and managing the SEC’s ethics program), worked on particular matters that could impact the likelihood, and even possibility, of a clawback suit against him, as well as the amount that could be recovered in such a clawback action.

Specifically, the OIG investigation found that after Becker rejoined the SEC as General Counsel and Senior Policy Director in February 2009, the SEC’s approach with respect to the net equity determination changed. SIPC and the Trustee proposed to pay customer claims based upon a money-in/money-out method of distribution, under which a Madoff investor would be able to make a net equity claim only for the amount initially invested with Madoff, less any amounts withdrawn over time (Money In/Money Out Method). SIPC and the Trustee believed that the Money In/Money Out method was the only method that was consistent with SIPA as a matter of law, and that SIPA did not allow customers to receive any amount over and above their initial investment with Madoff, *i.e.*, the fictitious returns shown on their Madoff account statements. As of February 2009, SEC officials concurred with SIPC and the Trustee that the Money In/Money Out Method was the appropriate method for determining customer net equity and SIPC officials understood that the Commission was likewise in agreement with this approach.

After Becker rejoined the Commission in late February 2009, and the SEC received submissions from representatives of Madoff claimants who disagreed with the Money In/Money Out Method for determining net equity, including a May 1, 2009 letter to Becker, which advocated a last account statement method for determining customer net equity. Under that method, customers would receive the amount listed as being in their accounts on the last Madoff account statement the customers received (*i.e.*, including the fictitious profits reflected on their statements) (Last Account Statement Method).

The OIG investigation found that after receiving the May 1, 2009 letter, Becker and the Office of General Counsel (OGC) initially gave serious consideration to the Last Account Statement Method. The OIG investigation further found that the prevailing opinion within the SEC and SIPC was that using the Last Account Statement Method would have eliminated the Trustee's ability to bring clawback suits such as the one brought against Becker. Becker himself testified to the OIG that he recalled that one of the reasons given by the Madoff Trustee for his opposition to using the Last Account Statement Method was that if this method was adopted, "we couldn't do any clawbacks." Becker and OGC eventually rejected the Last Account Statement Method and variations of that approach, determining that they could not be reconciled with the law, but continued to consider other methods that would allow Madoff customers to receive more than the amount of their initial investments with Madoff. After consultation with officials from Division of Risk, Strategy, and Financial Management (Risk Fin), Becker ultimately decided to recommend to the Commission a method under which an inflation rate, such as the Consumer Price Index, would be added to the amount of Madoff

customers' initial investments with Madoff to determine the amount they would receive (Constant Dollar Approach).

Accordingly, in late October 2009, eight months after Becker rejoined the Commission, Becker signed an Advice Memorandum to the Commission, which proposed that the Commission support the Madoff Trustee's Money In/Money Out Method, but adjust this approach in a manner that accounts for the "time value" of funds invested in Madoff's scheme pursuant to the Constant Dollar Approach. At an Executive Session of the Commission convened to consider this matter, Becker requested that the Commission authorize the staff to "prepare testimony and write a brief taking the position supporting the trustee on [money-in/money-out], but saying the [money] needs to be described in constant dollar terms." Based upon Becker's recommendation and representations made in the Executive Session, the Commission ultimately voted not to object to the staff's recommendation of the Constant Dollar Approach to the net equity determination.

The OIG investigation found that neither SIPC nor the Trustee believed that the Constant Dollar Approach was appropriate or in conformance with the statute. The President and Chief Executive Officer (CEO) of SIPC stated to the OIG that he specifically recalled telling Becker, in a telephone conversation during which Becker informed him that the Commission would use the Constant Dollar Approach, that there was no justification for such an approach under SIPA. Moreover, the SIPC President and CEO made clear that every proffered methodology, other than the Money In/Money Out Method that was agreed upon by the SEC prior to Becker's rejoining the Commission, would have directly affected Becker's mother's estate's account, and every proffered



methodology would have improved Becker's financial position or the financial position of the account. The SIPC President and CEO explained that using the Constant Dollar Approach would increase the amount that customers' accounts were owed, and accordingly, decrease any amount the Madoff Trustee could have recovered in a clawback suit.

The SIPC President and CEO also stated that, upon learning of Becker's mother's Madoff account, he performed "back of the envelope calculations" to determine the difference of bringing clawback suits under the Constant Dollar Approach, as opposed to the Money In/Money Out Method. Under this calculation, the SIPC President and CEO concluded that by utilizing the Constant Dollar Approach, the amount sought in the clawback suit against Becker and his brothers would be reduced by approximately \$140,000. The OIG recreated the analysis and calculated that a benefit to Becker and his brothers of approximately \$138,500 would result from applying the Constant Dollar Approach in the Becker clawback suit, by adjusting the amount of principal invested of approximately \$500,000 by a percentage inflation adjustment calculated from the Department of Labor's Bureau of Labor Statistics Consumer Price Index Table.

The OIG investigation also found that Becker participated in another particular matter while serving as SEC General Counsel and Senior Policy Director that could have impacted his financial position. In October 2009, the SEC's Office of Intergovernmental and Legislative Affairs (OLA) forwarded Becker a draft amendment to SIPC, as well as TM's analysis of that proposal, and asked Becker if there was "any reason SEC staff should weigh in tomorrow on an amendment to be considered during a House Financial Services Committee markup regarding the ability of the SIPC trustee to do clawbacks."

The proposed amendment entitled, “Clarification Regarding Liquidation Proceedings,” would have amended SIPA to preclude a SIPC trustee from bringing clawback actions against a customer “absent proof that the customer did not have a legitimate expectation that the assets in his account belonged to him.” The effect of this amendment would be to preclude the Trustee from bringing clawback actions like the one against Becker, which were the majority of the clawback suits brought, *i.e.*, suits that did not rely on any knowledge of the alleged wrongdoing.

Although the OIG investigation did find that Becker consulted with the SEC Ethics Office regarding his interest in his mother’s estate’s Madoff account on two separate occasions and that Becker was advised that there was no conflict, we identified concerns about the role and culture of the Ethics Office at the time it provided Becker with clearance to work on the Madoff Liquidation. William Lenox, the now-former Ethics Counsel with whom Becker consulted on both occasions about whether he should be recused from working on the Madoff Liquidation, reported directly to Becker. In fact, just seven months after Lenox provided advice regarding Becker’s participation in the Madoff Liquidation, Becker provided a performance evaluation of Lenox, which concluded, “The performance of the ethics office has been superb . . . . The quality of the ethics advice is very high . . . .” Lenox also held Becker in extremely high regard. He testified that he had “[g]reat professional respect” for Becker and “an appreciation for his humor and his abilities as a lawyer,” and further described Becker as a “great man and a great lawyer.” Lenox also testified he factored into his analysis of whether Becker should be recused from the Madoff Liquidation the fact that “he was a reputed securities

lawyer who was making a decision to come back and serve the public and protect investors, and he was here to do this sort of analysis.”

In addition, Lenox explained his belief that as Ethics Counsel, the most important thing was that people trust him, and noted that people trusted him with “incredibly personal information.” He viewed his job as “to create a culture where people would seek advice, and to alert those employees – all employees – where the danger lines were, and to encourage them to come and seek ethics advice, because that provides a level of protection.” He stated, “The people who, in the ethics community, that I respect the least are the ones who always say no. If you are a constant naysayer, one, nobody comes to secure advice; two, you’re not actually doing your job.” He further noted, “The key, as I saw it in my job as [Designated Agency Ethics Official] and as ethics counsel, was to make decisions. That’s the reason I was promoted. I was willing to make decisions. That requires a certain amount of willingness to be second-guessed by other people. If you always say no, you’ll never be second-guessed. That was not what I saw my role to be.”

Lenox specifically discussed Becker’s mother’s estate’s Madoff account with him on two separate occasions: first, upon Becker’s return to the SEC in February 2009, and, second, when he received the May 1, 2009 letter advocating the Last Account Statement Method. Only the second discussion was documented in writing, but at no time did Lenox advise that Becker should not participate in any Madoff-related matters and, as discussed below, this advice appears to have been based on incorrect assumptions. The OIG investigation further found that Becker never advised Lenox of the request for his opinion of the SIPA amendment, which would have precluded clawbacks against

individuals in Becker's position, and never sought his advice on whether providing advice on the amendment was improper.

In the second discussion in early May 2009, Becker disclosed to Lenox the details of his mother's account with Madoff, including generally when it was opened and closed, and approximately how much money was invested. He also explained to Lenox that the Madoff Trustee had been bringing clawback suits and that a clawback suit could "[i]n theory" be brought against him. Becker also acknowledged that it was possible that the extent to which SIPA coverage would be available could make it "less likely that the [t]rustee would bring claw back actions against persons at the margin" like him.

Lenox responded, in part, "There is no direct and predictable effect between the resolution of the meaning of 'securities positions' and the trustee's claw back decision. For this reason, you do not have a financial conflict of interest and you may participate." When the OIG interviewed Lenox in this investigation, we learned that Lenox's opinion was based upon the incorrect understanding that the SEC's participation in the Madoff Liquidation was solely an advisory one, when, in fact, the SEC is a party to the liquidation proceeding and may request the court to compel SIPC to do as it wishes. Becker himself acknowledged in his OIG testimony that consistent with its role as a party, the SEC's participation in the net equity issue in the Madoff Liquidation was not theoretical. Becker noted that it was his understanding that if SIPC disagreed, the SEC should eventually recommend that the court adopt the SEC's position, not SIPC's position, and indicated that "[t]he Commission had done that in the past and may do it again."

We found that Lenox's advice was also based upon the incorrect assumption that the interpretation of SIPA for purposes of claim determination was a separate and distinct legal question from the trustee's decision of from whom to institute a clawback suit, and completely ignored any impact on the calculation of the amount to be clawed back. We also found no evidence that Lenox took any further steps to better understand the extent and nature of Becker's involvement in the Madoff Liquidation, and Becker testified that he did not recall Lenox asking for additional facts or directing him to seek additional guidance if new facts arose.

The OIG investigation further found that notwithstanding the importance Lenox had placed on appearance matters in his communications to SEC employees, he did not even reference appearance considerations in his May 2009 written advice to Becker. Nonetheless, Lenox testified that he did consider appearance issues when advising Becker and, in fact, concluded that Becker's participation in the Madoff Liquidation matter passed the "appearance of impropriety test." Lenox himself had described that test in an ethics bulletin issued to all SEC employees as follows:

What are the optics of the situation; what is the context of the facts and circumstances? Would it pass what has often been referred to as the *New York Times* or *Washington Post* test? If what you propose doing becomes the subject of an article in the press, would you not care or would it look like you were doing something wrong? Even if you wouldn't care, what effect would the story have on the SEC and your fellow employees?

Even with the advantage of hindsight and given the intense press scrutiny and criticism of Becker's work on Madoff-related matters in the *Washington Post* and *New York Times*, Lenox indicated in testimony before the OIG that he stands by his conclusion that Becker's involvement in the SEC determinations in the Madoff Liquidation passed this appearance test.

The OIG investigation further found that the Ethics Office considered Becker's participation differently in other matters than it did in the Madoff Liquidation and that Becker himself took a more conservative stance on recusals in other non-Madoff matters. Moreover, the OIG investigation found that the Ethics Office considered recusals in Madoff-related matters differently in situations that did not involve Becker. In fact, shortly after Madoff confessed, Lenox, as Ethics Counsel, sent a memorandum to all Commission employees regarding mandatory recusal from *SEC v. Madoff* in a broad variety of circumstances. The memorandum stated, "[A]ny member of the SEC staff who has had more than insubstantial personal contacts with Bernard L. Madoff or Mr. Madoff's family shall be recused from any ongoing investigation of matters related to *SEC v. Madoff*." The memorandum further set forth certain contacts that required recusal, including being invited to or visiting any Madoff family members' homes or being an active member of the same social or charitable organizations.

The OIG investigation found that with respect to employees within OGC besides Becker, the Ethics Office took a more conservative approach for recusal from Madoff-related matters, including the Madoff Liquidation. For example, the Ethics Office advised an OGC staff attorney that she had a conflict from working on any aspect of the Madoff Liquidation because she "spent a very small amount of time in private practice working on a question related to the Madoff bankruptcy."

The OIG investigation also found that former Ethics Counsel Lenox was not the only individual in the Commission who was aware of Becker's mother's estate having an account with Madoff prior to the time this issue appeared in the press in February 2011. Both Becker and Chairman Schapiro recalled that, around the time of his return to the

SEC in February 2009, Becker discussed his mother's estate's Madoff account with her. While their recollections of the substance of the conversation are not entirely consistent, the evidence clearly shows that Becker advised Chairman Schapiro that his mother had had an account with Madoff, she had died several years before, and the account had been liquidated. Chairman Schapiro did not recall asking Becker any questions after he told her about his mother's account, and did not recall whether Becker said anything about seeking advice from the Ethics Counsel regarding the account, although Becker testified he must have mentioned to her that he would consult with Lenox. At that time, Chairman Schapiro did not consider Becker's personal financial gain "in any way, shape, or form" or whether he would be subject to a clawback action. Indeed, Chairman Schapiro testified that she would have had Becker recused from the net equity determination if she had known he was potentially subject to a clawback suit or "understood that he had any financial interest in how this [was] resolved . . . ."

In addition, the issue of Becker's mother's estate's Madoff account was discussed by several SEC senior officials in the fall of 2009, when the SEC learned that the U.S. House of Representatives Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises was scheduling a hearing on SIPC and Madoff victims. Shortly after the SEC learned that the Congressional testimony would focus on legal aspects of the SIPC/Madoff issues, Chairman Schapiro suggested that Becker testify on behalf of the SEC at the hearing. The OLA Director then had a conversation with Becker, during which Becker informed him that his mother had a Madoff account from which he "had gotten an inheritance." Becker also testified that he told the OLA Director that "if [he did] testify, [he] would put at the beginning, [he] would mention [his], the fact of [his]

mother's account with Madoff." Becker testified that after this conversation, the OLA Director contacted him later in the day and said, "You know, now that I think about it, I think it would be better if somebody else testified. My concern is – not that there's anything inappropriate, but my concern is [ ] that when you're in a political environment, people might want to make something of that, and it would be a distraction rather than focusing on what the Commission's position was and why."

Becker testified that either the evening of his conversation with the OLA Director or the following morning, he spoke with Chairman Schapiro about his mother's account. Chairman Schapiro recalled the conversation with Becker and stated, "I recall saying that if David [Becker] did testify, we needed to make it absolutely clear to Congress that there was this connection, remote though I believed it to be, that his long-deceased mother had had an account at Madoff, so that nobody would be surprised by that, so that we were completely forthcoming with Congress." Becker testified that he was certain that it was he who said in the meeting with Chairman Schapiro that if he were to testify, he would disclose his mother's account with Madoff. The OIG investigation found that eventually, the OLA Director made the decision not to have Becker testify. The SEC Deputy Solicitor, who had been suggested by Becker as a possible replacement witness, testified in Becker's stead at the subcommittee hearing which occurred on December 9, 2009, and involved discussions of clawbacks. In the end, Becker's Madoff interest was not disclosed to Congress.

Moreover, the OIG investigation found that although the decision was made that should Becker testify before Congress, he would disclose his mother's Madoff account, during this November 2009 timeframe, the fact of Becker's interest in his mother's



estate's Madoff account was not disclosed to the Commissioners or the bankruptcy court, notwithstanding the fact that the Commission was considering Becker's recommendation on the net equity position to take in court at this very time. SEC Commissioner Aguilar testified that it was "incredibly surprising and incredibly disappointing that there was enough awareness to know that the conflict existed to prevent [Becker] from giving [this] testimony, yet the decision-makers at the Commission were not provided that information."

In all, the OIG investigation found that, prior to the public disclosure of Becker's mother's Madoff account, at least seven SEC officials were informed at one time or another about that account, including the Chairman, the then-Deputy General Counsel and current General Counsel, the Deputy Solicitor who testified at the hearing in Becker's stead, the OLA Director, a Special Counsel to the Chairman, and two Ethics officials (Lenox and one of his colleagues in the Ethics Office). Yet, none of these individuals recognized a conflict or took any action to suggest that Becker consider recusing himself from the Madoff Liquidation.

After we concluded the fact-finding phase of our investigation, we provided to the Acting Director of the Office of Government Ethics (OGE) a summary of the salient facts uncovered in the investigation, as reflected in our report. We requested that OGE review those facts and provide the OIG with its opinion regarding Becker's participation in matters as the SEC's General Counsel and Senior Policy Director that could have given rise to a conflict of interest. After reviewing the summary of facts provided by the OIG, the Acting Director of OGE advised us that in his opinion, as well as that of senior attorneys on his staff, Becker's work both on the policy determination of the calculation

of net equity in connection with clawback actions stemming from the Madoff matter, and his work on the proposed legislation affecting clawbacks should be referred to the United States Department of Justice for consideration of whether Becker violated 18 U.S.C. § 208, a criminal conflict of interest provision. Based upon this guidance, the OIG has referred the results of its investigation to the Public Integrity Section of the Criminal Division of the United States Department of Justice.

#### **Recommendations of the OIG's Investigation**

Based upon the findings in our report, we recommended that, in light of David Becker's role in signing the October 28, 2009 Advice Memorandum and participating in the November 2009 Executive Session at which the Commission considered OGC's recommendation that the Commission take the position that net equity for purposes of paying Madoff customer claims should be calculated in constant dollars by adjusting for the effects of inflation, the Commission reconsider its position on this issue by conducting a re-vote in a process free from any possible bias or taint. We further recommended that once the re-vote has been conducted, the Commission should advise the United States Bankruptcy Court for the Southern District of New York of its results and the position that the Commission is adopting.

The OIG also recommended with respect to the Ethics Office that:

- (1) The SEC Ethics Counsel should report directly to the Chairman, rather than to the General Counsel.
- (2) The SEC Ethics Office should take all necessary steps, including the implementation of appropriate policies and procedures, to ensure that all advice provided by the Ethics Office is well-reasoned, complete, objective, and consistent, and that Ethics officials ensure that they have all the necessary information in order to properly determine if an employee's proposed actions may violate rules or statutes or create an appearance of impropriety.

- (3) The SEC Ethics Office should take all necessary actions to ensure that all ethics advice provided in significant matters, such as those involving financial conflict of interest, are documented in an appropriate and consistent manner.

We are confident that under Chairman Schapiro's leadership, the SEC will review our report and take appropriate steps to implement our recommendations to ensure that the concerns identified in our investigation are appropriately addressed.

#### **Conclusion**

In conclusion, I appreciate the interest of the Chairmen, the Ranking Members, and the Subcommittees in the SEC and my Office and, in particular, in the facts and circumstances pertinent to our conflict-of-interest report. I believe that the Subcommittees' and Congress's continued involvement with the SEC is helpful to strengthen the accountability and effectiveness of the Commission. Thank you.

**Testimony Concerning “Potential Conflicts of Interest at the SEC: The Becker Case”**

**by Mary L. Schapiro**

*Chairman*

*U.S. Securities and Exchange Commission*

**Before the Subcommittee on Oversight and Investigations of the U.S. House of Representatives Committee on Financial Services and the Subcommittee on TARP, Financial Services and Bailouts of Public and Private Programs of the U.S. House of Representatives Committee on Oversight and Government Reform**

**September 22, 2011**

Chairmen Neugebauer and McHenry, Ranking Members Capuano and Quigley, and members of the Subcommittees:

Thank you for inviting me to testify today regarding the recent report of the Securities and Exchange Commission’s Inspector General concerning the Commission’s former General Counsel, David Becker.<sup>1</sup>

I requested last March that the Inspector General conduct this review because I wanted to ensure there was an independent analysis of all relevant facts surrounding Mr. Becker’s involvement in Commission matters relating to the Securities Investor Protection Corporation’s (SIPC) liquidation proceeding of Bernard L. Madoff Investment Securities, LLC. Among other things, the Inspector General identifies concerns about Mr. Becker’s participation in the Commission’s resolution of those issues, and also makes a number of recommendations, several of which propose ways to improve the Commission’s already much-improved Ethics Office.

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<sup>1</sup> The views expressed in this testimony are those of the Chairman of the Securities and Exchange Commission and do not necessarily represent the views of the Commission.

The Commission's new Ethics Counsel and I concur in those recommendations, and agree on the need to take immediate steps to implement them.

This past March, I testified before this Oversight and Government Reform Subcommittee concerning what I recalled about Mr. Becker's communications to me soon after I became Chairman in January 2009. In that testimony, I described how Mr. Becker informed me, I believe shortly after he arrived in 2009, that his mother had had an account with Madoff before she died, and that it had been closed a number of years before he returned to the agency. At the time, I was focused on understanding and remediating the failures in the agency's examination and enforcement programs that had allowed the fraud to go undetected for many years, and on the plight of the many victims, some of whose heartbreaking letters I had recently read. It simply did not occur to me then that his mother's account, closed years ago, could present a financial conflict of interest.

There were a number of important facts about Mr. Becker's situation that I did not either know or appreciate at the time, principally that he personally could be subject to a claw-back suit or that the resolution of the SIPC issues affecting the victims of the Madoff fraud could potentially affect his financial interest. What I did know was that Mr. Becker was a dedicated public servant and experienced attorney who had ably served as General Counsel under three Chairmen. As compliance with ethical obligations is each employee's responsibility, I assumed that he would seek guidance from the agency Ethics Counsel and, indeed, the Inspector General's report describes how Mr. Becker did seek and obtain such advice from the Commission's Ethics Office on two occasions in 2009.

But while I understand that Mr. Becker did obtain clearance from the Ethics Counsel, I also realize that, as Chairman, I need to have a broader vision that goes beyond what may be required in any particular situation. On all such matters, I need to be acutely sensitive to any issue that could potentially interfere with the Commission's ability to fulfill its mission with the full confidence of the investing public.

I was sworn in as Chairman on January 27, 2009, a month and a half after Madoff was arrested. My highest priority at that time was to make whatever changes were needed to ensure that another Madoff could never happen again. But I was equally concerned about how to get the most effective relief to the Madoff victims so that, within the contours of the Securities Investor Protection Act (SIPA), we could get the most money to investors who were literally losing their homes.

That issue crystallized for the Commission around the question of how the bankruptcy court presiding over the Madoff liquidation should calculate the "net equity" in a Madoff victim's account. In December 2009, after internal discussions and a vote, the Commission expressed its position to the bankruptcy court on how net equity should be calculated.

The Commission's position had two components. First, the Commission determined that, due to the nature of Madoff's fraud, customers' "net equity" could not be based on the fictitious amounts shown on their final account statements, but should be measured by their net investment with Madoff – the "money-in/money-out" approach. Second, given the extraordinary duration of

the fraud, the Commission concluded that the way to treat different generations of victims most fairly was to adjust their claims to account for the effects of inflation over time – the “constant dollar” approach. The bankruptcy court has ruled on the first question, agreeing with the “money-in/money-out” approach, a decision that the Second Circuit Court of Appeals recently affirmed. The bankruptcy court, however, has not yet addressed whether the customers’ claims should be measured in “constant dollars,” and there has been no briefing on the merits of that question.<sup>2</sup>

The Inspector General recommends that due to Mr. Becker’s participation in the Commission’s deliberations the Commission conduct a re-vote on its determination that Madoff customers’ net equity should be calculated in “constant dollars.” I agree a re-analysis and re-vote of the issue is appropriate.

The Inspector General’s report also makes recommendations on ways to further improve our ethics program, including having the chief Ethics Counsel report directly to the Chairman instead of the General Counsel, strengthening Ethics Office policies and procedures, and increasing the documentation of ethics advice. I agree with these recommendations. Even before receiving the report, our Ethics Counsel has worked to ensure that she and her staff have access to the information they need to give the best possible advice, and the Ethics Office has greatly increased the documentation of that advice.

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<sup>2</sup> The bankruptcy court informed the parties that it would schedule briefing on this question later in the liquidation proceeding.

Ensuring that the agency has the strongest possible ethics program has been a priority of mine. Over the past two years, we have revamped the structure, function, and personnel of the Commission's Ethics Office. Some of our recent improvements include:

- **Hiring new leadership:** We have brought new leadership into our Ethics Office, naming Shira Pavis Minton as the Commission's new chief Ethics Counsel in August 2010 and hiring the Commission's first-ever Chief Compliance Officer. Ms. Minton was formerly the Deputy Assistant General Counsel for Ethics at the Treasury Department, where she managed the Department's ethics program and oversaw ethics programs at all Treasury bureaus.
- **Top-to-Bottom Review:** Ms. Minton recently completed a top-to-bottom review of our ethics program and has made a number of improvements within the Ethics Office, including:
  - Improving education and outreach to all SEC employees regarding their ethical obligations. Among other things, the Ethics Office has distributed agency-wide a new, comprehensive Ethics Handbook, as well as plain-English guides to various complex legal requirements;
  - Improving review of financial disclosure documentation;
  - Improving controls over the review of requests by former employees to make appearances before the Commission;
  - Heightening review of Commission requests for travel reimbursement from non-federal sources;
  - Improving processes for the review of gifts and conference attendance; and
  - Streamlining the process for publication clearance review.

These and other steps have elevated the profile of the Ethics Office across the agency and helped to emphasize the personal responsibility that each employee carries to avoid conflicts, whether actual and apparent.

- **Devoting More Resources to the Ethics Program:** We have allocated additional resources to the Ethics Office, including additional staffing slots for Ethics attorneys and compliance staff and additional resources to allow Ethics to design and distribute outreach materials agency-wide. I also made our chief Ethics Counsel a Senior Officer, helping to ensure our ability to recruit and maintain the best ethics leadership.



- **Regularly Consulting with the U.S. Office of Government Ethics (OGE):** Ethics staff is closely engaged with the OGE and has regular contact with that office on complex legal and analytical questions.
- **Improving Employee Trading Rules:** We have put in place new supplemental ethics rules that make a number of significant improvements to our oversight of employee securities trading:
  - Employees are prohibited from trading in the securities of any company under investigation, whether or not they are aware of the investigation;
  - All trades must be pre-cleared; and
  - Employees now are prohibited from trading in the securities of all regulated entities, including securities issued by exchanges, transfer agents, and ratings agencies, just as they have long been prohibited in trading in the securities of other regulated entities such as broker-dealers.<sup>3</sup>
- **Strong Post-employment Controls:** We have taken several steps to address potential conflicts of interest that can arise when agency employees seek post-Commission employment:
  - In October 2010, I issued a directive requiring that all Senior Officers at the Commission seek ethics counseling before commencing any search for post-Commission employment;
  - We have implemented a new requirement that all outgoing employees receive a post-employment briefing and a packet of post-employment ethics materials outlining their obligations before leaving the agency; and
  - The Ethics Office regularly distributes agency-wide guidance concerning post-employment rules.

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<sup>3</sup> There are certain limited exceptions to this prohibition, including trading in securities that were earned as compensation from a former employer, securities issued by the U.S. government, and securities of a trust in which the employee is solely a vested beneficiary.

Notwithstanding these improvements,<sup>4</sup> I recognize that there is more that needs to be done, and we will take immediate steps to implement the report's recommendations in this regard.

I am proud of how much we have accomplished at the SEC over the past two and a half years, and I am proud to have the opportunity to work alongside an extraordinary staff who work tirelessly to protect investors and the markets. Critical to the performance of our mission is protecting the integrity – and the perception of the integrity – of our decisions and our processes. I can say to you with assuredness that we have learned from this experience and are taking, and will continue to take, all actions necessary to earn and maintain the trust the public places in us.

Thank you for the opportunity to be here today. I am happy to answer any questions.

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<sup>4</sup> Just last week, the SEC received the Excellence and Innovation Award from the Office of Government Ethics, a recognition of the renewed strength and vitality of our current program.

