Opening Statement of Ranking Member Spencer Bachus, Full Committee Meeting Entitled "Assessing the Madoff Ponzi and the Need for Regulatory Reform"

January 5, 2009

Thank you, Mr. Chairman, for convening this meeting to begin the Committee’s examination of the alleged $50 billion Ponzi scheme perpetrated by Bernard Madoff. The “Ponzi scheme” in connection with Madoff’s activities is not a recent coinage. It was first used by Harry Markopolos some 10 years ago in a complaint to the SEC.

As we learned earlier this decade when the Enron episode was followed in short order by WorldCom and other corporate scandals, events like Mr. Madoff’s alleged scam do not typically occur in isolation. More recently the troubles at Bear Stearns were indicative of similar troubles at other investment banks. There is no reason to think that “this time is different.” It seldom is, and therefore there is every reason to believe other cases of fraudulent investment schemes may exist. At a time when the government is trying to stabilize markets, the Madoff affair and concern that other similar frauds lurk over the horizon threaten to further undermine investor confidence. That is why I wrote to Chairman Frank shortly after the scandal broke to request that the Committee convene hearings early in the 111th Congress to examine the effectiveness of government and self-regulatory efforts to protect investors and police fraud.

Every day brings more news of the devastating impact of the Madoff affair on charities, private foundations, and government entities, as well as on individual and corporate investors. Although every detail about the Madoff scandal has not emerged, enough is known at this stage to conclude that one factor that allowed his alleged fraud to continue as long as it did was the differential regulatory treatment of broker-dealers and investment advisers. The Financial Industry Regulatory Authority, or FINRA, inspected Mr. Madoff’s broker-dealer, which supported his market-making and proprietary trading operations, at least every other year beginning in 1989. But because FINRA’s jurisdiction is limited to broker-dealers, it had no authority to inspect his affiliated investment adviser. And while the SEC has the authority to inspect investment advisers, it typically inspects only a small percentage of the 11,000 federally registered firms in any given year. In fact, Mr. Madoff’s firm was never subjected to such an examination.

In its Blueprint for Regulatory Reform issued last March, the Treasury Department highlighted “the rapid and continued convergence of the services provided by broker-dealers and investment advisers and the resulting regulatory confusion due to a statutory regime reflecting the brokerage and investment advisory industries of long ago.” Independent studies have reinforced this conclusion, finding that many investors simply cannot distinguish between the obligations and responsibilities of brokers, investment advisers, financial planners, financial advisors or consultants. As part of its consideration of reforms to our financial regulatory structure, this Committee should examine whether the Madoff scandal argues for harmonizing the regulation of broker-dealers and investment advisers, so that schemes like Mr. Madoff’s do not go undiscovered and are limited in their scope before causing such catastrophic consequences. All parties must commit ourselves to make every good faith effort to see that this alleged fraud of epic proportions is not repeated.

Chairman Cox should be commended for immediately commissioning an investigation into the SEC’s handling of this matter, and we look forward to hearing today from the Inspector General who will be conducting that probe. One of the Inspector General’s tasks will be to assess the performance of the SEC’s Office of Compliance, Inspections and Examinations, or OCIE, which appears to have missed several red flags that might have led to earlier detection of the alleged fraud. The fact that the accounting firm responsible for auditing Madoff’s complex trading activities was a three-person shop operating out of a suburban New York storefront should have been one such red flag.

Let me conclude, Mr. Chairman, with a word of caution. While the failures of regulatory and private sector due diligence exposed by the Madoff matter are obvious, they do not lead me to conclude at this stage of the inquiry that what is needed are broad new legislative or regulatory mandates on the rest of the securities industry. What we may have in the Madoff case is not necessarily a lack of enforcement and oversight tools, but a failure to use them.

Thanks to our witnesses for being here today. We look forward to your testimony.

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