

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

**by Mary L. Schapiro**

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**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.