

Madoff fraud case raises questions about SEC

By Marcy Gordon
AP Business Writer

WASHINGTON — The stunning fraud Wall Street pillar Bernard Madoff is accused of has raised questions about whether federal regulators were lax in failing to scrutinize his operations and respond to alarms raised about them.

Securities and Exchange Commission enforcement attorneys were in federal court on Friday to seek emergency relief for investors, including an asset freeze and the appointment of a receiver for Madoff's firm, in an alleged \$50 billion fraud that could be the largest ever pinned on an individual.

Federal prosecutors in Manhattan charged Madoff with a single count of criminal fraud, while the SEC accused him of civil fraud.

Madoff, a former chairman of the Nasdaq Stock Market, was influential and his self-named securities firm cut a high profile in Wall Street circles. SEC inspectors would have performed regular inspections of his securities brokerage operations as part of the agency's oversight program.

SEC officials stress that it was Madoff's separate and secretive investment-adviser business that was used to perpetrate the alleged scheme, and that examinations of the securities operations wouldn't necessarily have detected irregularities. The hedge fund business didn't register with the SEC until September 2006.

"If the SEC didn't come in and inspect (the Madoff hedge fund), then they have a hell of a lot to answer for," said James Cox, a Duke University law professor and securities law expert.

Other SEC critics questioned how Madoff could pull off, without the agency's notice, such an audacious fraud that prosecutors said amounted to a giant Ponzi scheme.

"The agency can't help but look bad," said Barbara Roper, director of investor protection at the Consumer Federation of America. "It does raise questions ... about the quality of the enforcement division generally. It's obviously something that the new (Obama) adminis-

tration has to get to the bottom of."

The SEC wasn't the only regulator to be criticized over the Madoff affair. Bill Singer, a securities lawyer in New York who represents investors and firms, cited the role of the Financial Industry Regulatory Authority, the securities industry's self-policing organization.

The organization, known as FINRA, only has authority to inspect and discipline securities firms and brokers; its jurisdiction doesn't extend to investment advisory firms.

"Everything ... apparently went on right under the nose of FINRA," Singer wrote on his blog. "When its staff did its yearly examinations, either things were disregarded, missed or overlooked."

FINRA spokesman Herb Perone declined to comment.

A wrinkle in the case is the complaint dating back nine years to the SEC by a securities industry executive named Harry Markopolos. He contacted the agency's Boston office in May 1999, telling SEC staff they should investigate Madoff because it was impossible for the kind of profit he was making to have been gained legally.

The SEC's Boston office has been accused in the past of brushing off a whistleblower's legitimate complaints, in a case that brought the resignation of the head of that unit in 2003.

Markopolos's intervention was first reported in Friday's editions of *The Wall Street Journal*.

"There's no question the SEC had the authority to investigate fraud" in the investment adviser part of Madoff's business as well as the securities operation, William Galvin, Massachusetts' secretary of state and its top securities regulator, said in a telephone interview on Friday.

Galvin, like other state regulators, has been pushing for tighter government supervision of hedge funds, vast pools of capital holding an estimated \$2.5 trillion in assets that are opaque, scantily regulated and partly blamed for the global financial crisis.

The SEC has been "somewhat bureaucratic" and less than fully effective in its enforcement efforts, Galvin said. Still, "they've made a lot of progress" in recent years, he added.

In 2003, Galvin pointedly criticized the SEC's handling of the case of Peter Scannell and his allegations against mutual fund giant Putnam Investments.

Scannell has said he went to the agency's Boston office that year with evidence of trading abuses at the firm and was met with disinterest from the SEC investigators there. It took seven exchanges with his lawyer before the SEC staff met with him, for about 90 minutes, Scannell told Congress in 2004.

He later got a hearing from Galvin's office, which acted on his disclosures. Enforcement actions eventually were brought against Boston-based Putnam by the state regulators and the SEC.

It wasn't immediately known whether the SEC had looked into Markopolos's allegations and drawn conclusions about them. Agency spokesman John Nester declined to comment on the matter Friday.

"Someone should have asked harder questions, but I'm not really sure" it was the SEC, said Peter Henning, a law professor at Wayne State

University who was an SEC enforcement attorney. "Their hands were tied" by not initially having oversight of the Madoff hedge fund, he said.

The investors in Madoff's business were not asking questions while the fabulous returns were coming in — and maybe they should have, Henning said.



Bernard L. Madoff, chairman of Madoff Investment Securities, is seen on his Manhattan trading floor in 1999. The former Nasdaq stock market chairman was arrested on a securities fraud charge on Thursday.

AP PHOTO

Printing imperfections present during scanning