Statement of SEC Inspector General Walter Stachnik
"Examining Enforcement of Criminal Insider Trading and Hedge Fund Activity"
Hearing on December 5, 2006

I am pleased to provide this statement and to respond to the questions posed as a follow-up to the Senate Judiciary Committee hearing on December 5, 2006, on the subject of "Examining Enforcement of Criminal Insider Trading and Hedge Fund Activity."

The Securities and Exchange Commission (SEC) Office of Inspector General (OIG) is responsible for investigating allegations of misconduct by SEC staff or contractors. It is important that all SEC personnel conduct themselves professionally, impartially and objectively and that their official actions reflect the merits before them. To that end, the OIG thoroughly investigates allegations of misconduct by Commission staff and does so independently and impartially.

During my tenure as Inspector General, I have served six Chairmen, including members of both political parties. The OIG has conducted investigations of Commissioners, senior executives and officers, and division and office heads. We approached these investigations objectively and on the merits, regardless of the individuals involved. Based on our investigations, senior officials and managers have been terminated, or resigned or retired, or have been reassigned or reprimanded.

Allegations of political influence have been raised regarding the Division of Enforcment's (Enforcement's) investigation of the hedge fund Pequot Capital Management (PCM). A former Enforcement attorney, Gary J. Aguirre, alleged that a suspected tipper received preferential treatment because of political considerations and that the former attorney was terminated in retaliation for complaining about the alleged preferential treatment. The OIG investigated those allegations and found them to be unsubstantiated.

As Inspector General, I recognize my duty to report to Congress and respect the oversight of the Senate in this matter. I have cooperated fully with the Committees by: responding as quickly as possible to requests for documents and information; obtaining authorization from the Commission to disclose non-public materials to the Committees; authorizing OIG staff to be interviewed by Committee staff; appearing before the Judiciary Committee on December 5, 2006; and cooperating fully and timely with the Government Accountability Office evaluations requested by the Senate.

Mr. Aguirre's initial letter to SEC Chairman Christopher Cox raised serious allegations of misconduct by senior SEC officials, and the OIG opened an investigation promptly upon receiving that letter. We subsequently expanded the scope of the investigation when we received a second letter from Mr. Aguirre to Chairman Cox. We conducted the investigation in good faith, following professional standards and guidelines. I assigned a senior attorney to investigate the matter. She was not subject to any extraneous pressure or influence and conducted the investigation independently and impartially. Moreover, this attorney's work was reviewed both by me and the Counsel to the Inspector General, who has extensive experience in conducting internal investigations.

Although reasonable people can disagree on methods and evidence, I believed the initial investigation of Mr. Aguirre's allegations was professional and independent.[1] At the time, I thought we knew enough about Mr. Aguirre's allegations from his two letters to Chairman Cox to investigate them. In hindsight, however, I realize I should not have relied so heavily on the two letters to identify Mr. Aguirre's concerns and that it would have been better for us to interview him. I am responsible for the decision to close the initial investigation without interviewing Mr. Aguirre.

As a result of new allegations and information and the concerns expressed by Senators Specter and Grassley about shortcomings in our initial investigation, and at the request of Chairman Cox, I decided to reopen the investigation. Neither I nor the OIG is infallible. We take seriously the concerns expressed during the oversight process and will rectify any errors or omissions made in the initial investigation. I have made the reopened investigation a matter of priority. The current investigative approach is very comprehensive, and the OIG is dedicating significant resources to it. We will examine all of the evidence objectively and thoroughly, and we will decide whether the evidence warrants referral of the matter, without regard to outside influences.

The OIG subpoenaed documents from Mr. Aguirre in the reopened investigation because he would not voluntarily produce relevant documents and we could not obtain them from other sources. We must ensure that we have all of the relevant information needed to conduct a thorough investigation of Mr. Aguirre's allegations. The subpoena was in no way punitive or retaliatory. Rather, we took this action as a last resort, after numerous attempts to obtain the information on a voluntary basis. Although Mr. Aguirre wrote a 42-page letter, with attachments, to Senator Shelby on August 21, 2006, he refused to provide that or any other documentary or testimonial information to the OIG on a voluntary basis. Only after the Department of Justice filed the subpoena enforcement action on the OIG's behalf did Mr. Aguirre provide us with his letter to Senator Shelby, with the attached documents.

I am pleased to report that we recently reached a settlement with Mr. Aguirre that we believe will meet the needs of the OIG and accommodate the interests of Mr. Aguirre and the Senate. Under this settlement, Mr. Aguirre is not required to produce copies of his communications with the Senate Committees, but only pre-existing materials that support his allegations regarding the PCM investigation and his termination. As a consequence, the document production required by the settlement will not intrude upon any communications Mr. Aguirre may have had with the Senate Committees.

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[1] The initial investigation led to an OIG audit of Enforcement's general compliance with performance management procedures. Preliminary results of that audit indicate that Enforcement: (1) did not consistently perform parts of the performance appraisal process, especially for new, reassigned and detailed staff; and (2) failed to retain performance documentation for the required time. We also found that the SEC's written policies and procedures did not provide adequate guidance regarding the performance management process. We are recommending that Enforcement ensure its supervisors adhere to the required process and that the Office of Human Resources (OHR) improve its written guidance and provide additional training. Enforcement and OHR management have preliminarily indicated that they recognize the need for improvement in these areas and plan to take the necessary corrective actions.