COMMENTARIES

Why Do We Need the SEC?

by Jim Powell, May 19, 2009

FDR established the Securities & Exchange Commission to protect people in securities markets. Yet there already were plenty of laws against theft and fraud, crimes that are seldom exposed by government regulators.

Consider the succession of big Wall Street scandals since the late 1990s. It's hard to find a single case that was exposed by the SEC. Typically, Wall Street scandals seem to be exposed by savvy investors, disgruntled employees, financial analysts, internal auditors, or investigative reporters. The SEC tends to arrive on the scene only after a story is out and investors have suffered losses. For example:

- In 1998, Cendent disclosed that the income of one of its component companies had been over-stated by $500 million during the previous decade. Presumably the purpose was to inflate the value of the stock of founder Walter Forbes. He denied knowledge of the fraud even though he had been paid $100 million a year as chairman and CEO. In 2007, he was sentenced to 12 years in prison. Where was the SEC?

- In May 2000, Xerox announced that it discovered accounting irregularities in its Mexican subsidiary. The company conducted an investigation, fired 13 managers, and announced a $120 million write-off for 2000. Xerox' assistant treasurer James Bingham insisted this wasn't the whole story, and he was fired. He subsequently sued the company. The SEC heard about the lawsuit and became involved in the case. Xerox turned out to have over-stated income by $3 billion and earnings by $1.5 billion.

- In 1997, Gary Winnick established Global Crossing, a telecommunications company. He raised large sums of money and went on an acquisition spree. By 2000, the stock peaked at $61. But investors became increasingly concerned about all the debt. They began to unload the stock, and it fell to $5. The company filed for bankruptcy in January 2002. Although the SEC conducted an investigation, all they did was levy $100,000 of fines on three top executives. Winnick got off, in part, because of campaign contributions to both Republicans and Democrats.

- During the mid-1990s, Houston-based Enron adopted increasingly risky strategies for which it borrowed more and more money. But when their bets backfired, executives tried to hide the losses by cooking the books. *Fortune* magazine raised serious questions about the company in March 2001. Investors became suspicious, and the stock declined. On August 14, President Jeffrey Skilling resigned mysteriously. A $618 million loss was reported for

the third quarter of 2001. The SEC opened an investigation not long before the company collapsed.

- Over the course of 15 years, Bernard Ebbers acquired 65 communications companies with $60 billion of borrowed money and made WorldCom a high-flying stock. But he wasn't very good at integrating all those companies, and he was a reckless spender. The company spun out of control. In March 2002, WorldCom internal auditor Cynthia Cooper began to investigate the company's accounting practices. Some $11 billion of accounting fraud was discovered. The stock plunged. Ebbers was sentenced to 25 years in prison.

- Dennis Kozlowski became Tyco CEO in 1992, and he launched an aggressive acquisition program. By 1999, Tyco's market value was greater than General Motors and Ford combined. Investors became increasingly uneasy, however, about his free-spending ways. In October, investment manager David W. Tice challenged the accuracy of Tyco's financial reports. The stock dropped about a third. The SEC investigated but didn't find anything. Nonetheless, in June 2005 Kozlowski was convicted of looting $150 million from Tyco. The Manhattan judge said: "the heart of the case is basic larceny."

- During the stock market boom of the 1990s, John Rigas and his sons Timothy and Michael launched an aggressive expansion program for Adelphia, their family-held cable TV company. They nearly quadrupled their debt. But they couldn't manage what they had put together. Many investors became wary. On March 27, 2002, the company disclosed that their debt was $2.2 billion greater than had been previously reported. The stock lost two-thirds of its value. The company filed for bankruptcy. Investigations by the SEC and others revealed fraud.

- For nine years, accountant Harry Markopolos sent the SEC evidence suggesting that investment advisor Bernard Madoff might be a fraud. Madoff was socially well-connected to the former chairman of NASDAQ. The SEC didn't do anything. In 2001, *Barron*'s ran an article about Madoff's suspicious secrecy and unusually high returns. The following year, a whistle-blower claimed there were irregularities at Madoff's firm. The SEC intervened only after December 11, 2008 when Madoff's sons reported that he had confessed to a Ponzi scheme.

Would we be safer if the SEC had more power? Doubtful, because even in Nazi-controlled Europe, there were plenty of smugglers, document forgers, resistance fighters, black markets, safe houses. and escape networks. The Gestapo couldn't keep up with them all.

It's a mistake to imagine that the SEC will protect us. As investors, we must take responsibility for due diligence to protect ourselves. In which case, what do we really need the SEC for?

Jim Powell is policy advisor to the Future of Freedom Foundation and a senior fellow at the Cato Institute. He is the author of ***FDR's Folly, Bully Boy, Wilson's War, Greatest Emancipations, The Triumph of Liberty*** *and other books.*

DONATE TO FFF

Printer Friendly PDF Format
Subscribe to FFF Email Update
Subscribe to *Freedom Daily*

Home | About Us | Freedom Daily | Commentaries | Web Audio/Video
Books & Tapes | What's New | Spreading the Word | Links
Subscribe & Support | Contact Us

© 2001-2009 The Future of Freedom Foundation. All rights reserved.