Senate Judiciary Hearings Expose Hedge Fund Perfidy

by John Hoefle

In a rare burst of public service, the Senate Judiciary Committee held a hearing on June 28, shedding some badly needed light on the deliberately murky world of hedge funds. The stated reason for the hearing was to examine the problem of collaboration between the hedge funds and so-called independent stock analysts, to drive down the stock-prices of companies in which the hedge funds have taken short positions, an activity which committee chairman Arlen Specter (R-Pa.) said "has enormous potential for very major impact on the markets."

While *EIR* supports movement to restore proper regulation to the financial markets as an essential element of restoring sovereignty and rebuilding our economy, we must clearly state up front that tweaking around the edges will not do the job. As Lyndon LaRouche has repeatedly stated, the hedge funds are but a manifestation of a bankrupt financial system, and it is that bankruptcy with which our government must deal. The system which allows hedge funds to flourish, must be shut down and replaced with American System economics, as identified by Alexander Hamilton and further developed by LaRouche. Partial measures will not do the job.

Connecticut Attorney General Richard Blumenthal called hedge funds "a regulatory black hole, lacking even minimal disclosure," especially after a court decision overturning Securities and Exchange Commission (SEC) rules requiring hedge funds to register under the Investment Advisors Act of 1940. The more than 13,000 hedge funds, with assets exceeding $24 trillion, provide "fertile opportunity for potential fraud," Blumenthal said, urging Congress to increase its oversight.

'A Grotesque Industry'

The panel really got rolling with the testimony of Gary J. Aguirre, a former investigator with the SEC, who said he was fired for doing his job too well.

"The illegal flow of insider information from investment banks to hedge funds was the primary focus of the hedge fund investigation I headed," he testified. "Senior SEC officials halted the investigation, as I was told, because the suspected tipper had powerful connections. Indeed, he does at the highest level. When I raised the propriety of that decision with the most senior enforcement officials, they fired me. When I appraised [SEC] Chairman [Christopher] Cox of these events, he did not lift a finger."

That powerful tipper, according to Aguirre, was Morgan Stanley Chairman John Mack, and the hedge fund Pequot Capital Management, a $7 billion hedge fund run by Arthur J. Samberg. The SEC investigation showed that Morgan Stanley President Mack leaked information to Samberg about Morgan Stanley client GE Credit's takeover bid for Heller Financial, allowing Pequot to profit at the expense of other market participants. Rather than allow Aguirre to go after Mack, the politicos at the SEC fired him. Mack, who left Morgan Stanley for Crédit Suisse a few years ago and recently returned as chairman, also served a brief stint as chairman of Pequot.

"Powerful interests want the SEC to stay just the way it is or, better yet, become even weaker," Aguirre told the panel. "Those interests are not just the hedge funds. They include the financial industries that are receiving tens of billions of dollars in revenues for helping hedge funds cheat other market participants or close their eyes to the carnage. At the top of that list are the big investment banks, e.g., Goldman Sachs, Morgan Stanley, Merrill Lynch, and Bear Stearns. Those interests know how to reward friends and punish enemies. Their tentacles reach far. They stopped the hedge fund investigation. They cost me my job."

That power was also suggested by a letter to the Senate Judiciary Committee from the Senate Banking Committee, telling them to keep their hands off the hedge funds.

Aguirre compared the hedge funds to the unregulated money trusts and pools of the 1920s, whose market manipulations "were instrumental in delivering the 1929 Crash. They were, among other things, skilled at using various devices to manipulate stock market prices to trick the public. There is growing evidence that today's unregulated pools—hedge funds—have advanced and refined the practice of manipulating and cheating other market participants."

Hedge funds have indeed become a dominant and cancerous force in the financial markets. Aguirre said that they execute up to 50% of the daily trading on the New York Stock Exchange, and do 70% of the trading in the U.S. distressed debt market. They are also becoming major players in the derivatives markets. Investment banks reportedly collected $15 billion in revenues and made $6 billion in profits, either directly from hedge funds or because of them. Goldman Sachs, whose $21 billion Goldman Sachs Asset Management hedge fund group is the largest in the world, according to *Institutional Investor,* earned a quarter of its profits last year from hedge funds, with Morgan Stanley not far behind.

Aguirre put his finger on the predatory nature of hedge funds, saying that "in the Darwinian hedge fund world, cheating other market participants has its benefits. . . . To survive, a hedge fund must learn to siphon. One after another, hedge funds learn the trick." Or, as New York Attorney General's Office investigator David Brown said about an earlier scandal, there is "a whole grotesque industry growing up based on screwing small investors. It's about as bad as it gets."

That's not a bad characterization of the financial system as a whole, if you expand the target group to cover nearly all of mankind.

Documentation

LaRouche Says 'We Must Eliminate Hedge Funds'

In an article published in the Feb. 17, 2006 issue of EIR, *Lyndon LaRouche bluntly stated that, "In this moment of onrushing threat of early general financial collapse . . . the prompt first actions to be taken by governments, must be to eliminate the existence of so-called 'hedge funds' and related expressions of so-called 'financial derivatives' from the national and international economy." Several days later, on Feb. 23, LaRouche addressed an international webcast on behalf of the Lyndon LaRouche Political Action Committee, where he identified today's hedge funds as the instrument of fascist bankers, like Felix Rohatyn, to destroy the nation-state. On June 23, 2006, the Federal Court of Appeals in Washington, D.C. overturned regulations that had been imposed on the hedge funds by the Security and Exchange Commission (SEC), which had required them for the first time to identify their principal owners, and directors. After the Court of Appeals ruling, some headlines read, "Hedge Funds Free To Run Wild."*

LaRouche's call to make hedge funds illegal is now more urgent than ever. His comments on hedge funds, from the Feb. 23, 2006 webcast, are excerpted below:

Now the intention, therefore, is to destroy the nation-state, to concentrate wealth, as it is being concentrated now, by all this rape of industry. Industry is being raped internationally, by hedge funds, that are taking over and looting corporations, so the corporations either don't exist, or they become simply creatures of the hedge-fund interests. The hedge funds are the major banks! The major banks are the hedge funds. The hedge funds are their creation. They are running around the world pirating, stealing everything like Biche and Mouche from the House of Bardi in the early part of the 14th Century! Their idea is to set up a permanent system, like the Venetian system, with Norman chivalry, during the medieval period, in which the power of the state is virtually non-existent, except by consent of the bankers. And the bankers run the world. And, the bankers have an enforcing arm, such as the Norman chivalry, to do the killing.

That is Cheney's policy. That's the Bush Administration policy. That's the policy of George Shultz. That is Felix Rohatyn's policy! What does he say? He says, "private interest, private interest, private interest!"

You want private money?

Yeah, I got a hedge fund, that is ready to come in and take over your firm, in a take-over operation, based on what Scalia calls shareholder value, move in next to a corporation with a big show of money; say, "Now we represent the stockholders." Take the firm, loot the firm . . . by paying big dividends, or big portfolios to people; loot the place; run it down into bankruptcy, and throw the carcass away, and move on with the gathered wealth, and move on to the next place!

That's what's happening to the automobile industry right now! That's what's happening to the industry of Europe right now. This is fascism! Felix Rohatyn is a fascist! And the key thing, to learn the lesson from the fact that some people don't realize he's a fascist: You understand now how Hitler came to power in Germany! Because, nobody thought Hitler was a Nazi.