

**Statement of Proposed Testimony**  
**of**  
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**President and Chief Executive Officer**  
**Securities Investor Protection Corporation**  
**Before the**  
**United States House of Representatives**  
**Subcommittee on Capital Markets, Insurance, and**  
**Government Sponsored Enterprises**  
**Committee on Financial Services**

**December 9, 2009**

Chairman Kanjorski, Ranking Member Garrett, and Members of the Subcommittee, thank you for the opportunity to appear before you today to discuss the work of the Securities Investor Protection Corporation or “SIPC” and possible improvements to the Securities Investor Protection Act or “SIPA.”<sup>1</sup> My name is Stephen P. Harbeck and I am the President and Chief Executive Officer of SIPC. I have worked at SIPC for 34 years and have served in my current position since 2003.

SIPC is a non-profit membership corporation that was created under SIPA in 1970. With some narrow exceptions, every registered securities broker or dealer is a member of SIPC. Membership in SIPC is not voluntary; it is automatic upon registration as a broker or dealer. By statute, SIPC is not a government agency or establishment. Its policies are set by its seven-member Board of Directors, five of whom are appointed by the President of the United States and confirmed by the Senate. Three of the five Directors are selected from the securities industry and two are non-industry Directors. The remaining two Directors, respectively, are representatives of the United States Treasury and the Federal Reserve.

A central goal of SIPC is to protect customers of failed securities brokerage firms that are members of SIPC and that are in liquidation under SIPA. A firm is placed in liquidation upon an application by SIPC in federal District Court. In this regard, SIPC works closely with the United States Securities and Exchange Commission and securities self-regulatory organizations. Because SIPC has no investigatory or regulatory authority, these entities must notify SIPC when a broker-dealer is in financial trouble and unable to meet its obligations to customers. Once a District Court places a firm in SIPA liquidation and appoints a trustee to administer the liquidation, the case is removed to Bankruptcy Court where the matter proceeds like a bankruptcy case but with special customer protection features.

SIPC administers a Fund which is comprised of assessments paid by its members. The Fund is used to support SIPC’s mission of customer protection and to finance SIPC’s operations. Should the Fund become inadequate for its purposes, SIPC may borrow against a \$1 billion line of credit

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<sup>1</sup> 15 U.S.C. §78aaa et seq.

from the United States Treasury. In its nearly 40-year history, SIPC has never drawn upon the credit line.

Every customer is protected by SIPC up to \$500,000 against lost or missing cash and securities deposited with the broker or dealer for the customer's account. Of the \$500,000, up to \$100,000 may be used to satisfy a claim for cash only. SIPC advances also may be used to pay the expenses of administering the liquidation proceeding where the debtor's general estate is insufficient.

To date, SIPC has overseen the administration of 322 customer protection proceedings which have involved the distribution, through 2008, of roughly \$160 billion of assets for customers. Of the \$160 billion, approximately \$159.6 billion has come from debtors' estates and \$323 million from the SIPC Fund.

### **Lehman Brothers Inc.**

A little over 11-months ago, I appeared before this Committee and reported on two of SIPC's largest and most complex cases to date. I am pleased to report substantial progress in both of those proceedings.

In the early days of the Lehman Brothers Inc. proceeding, the Trustee in that case, with oversight by SIPC, established the framework that would allow him to transfer, in very short order, approximately \$92 billion in customer assets for the benefit of more than 110,000 former Lehman customers. Since that time, the Trustee has addressed the resolution of accounts that were not part of the transfer. This resolution, through a "claims process," has involved the submission and review of approximately 12,700 claims, over 8,000 of which have been determined by the Trustee. Many of these claims involve the reconciliation of securities positions, claims related to accounts with a foreign affiliate or related entity, or claims for which there is no SIPC protection because they are subordinated or involve transactions that are not "securities" under SIPA.

In addition to resolving claims, the Trustee continues to pursue the recovery of assets for the benefit of customers and to investigate the Debtor and its activities in order to identify further sources of recovery. The Trustee also continues to coordinate and to discuss issues of common concern with Lehman's parent company and foreign affiliates located throughout Western Europe, Asia, the Middle East, and the Cayman Islands. The Trustee reports that as of November 11, 2009, he has approximately \$18.7 billion in assets under his control.

### **Bernard L. Madoff Investment Securities LLC**

In less than one year, the Trustee for the Bernard L. Madoff Investment Securities LLC proceeding also has made significant progress in this large and complex proceeding. Much attention has been paid to the claims process and to resolving claims as promptly as possible under challenging circumstances. Over 16,000 claims have been filed in the case. I am told that before the end of this week, determination letters with respect to more than 11,500 claims will have been issued by the Trustee. These 11,500 claims represent more than 71% of all claims filed.

The value of allowed claims in the case is \$4.6 billion and will be satisfied partly with funds provided by SIPC that total more than \$559 million. This is more than the amount that has been advanced by SIPC in all of its 322 customer protection proceedings. With respect to claims, the Trustee has implemented a Hardship Program to accelerate the review and satisfaction of claims of victims suffering from the worst financial circumstances. A central issue relating to claims determination, namely, the calculation of the customer's net equity, is currently before the Bankruptcy Court in the case.

Much work also is being done on the recovery of assets for the benefit of customers. The Trustee has brought 14 lawsuits seeking to recapture more than \$14.8 billion from various feeder funds, Madoff friends and families and related parties. To date, the Trustee has collected more than \$1.1 billion for the benefit of customers. The Trustee believes that a number of the pending lawsuits will add substantially to the amount already recovered.

In answer to a question posed by the Subcommittee, the total Trustee fees paid in the case for services from December 2008 through September 2009 is \$1,275,867. It must be emphasized that none of the fees will reduce the amounts available for customers. All administrative expense advances in the Madoff case, including fees, are paid with SIPC funds.

I would add that, like Lehman, the Madoff case has vast international implications. In this regard, the Trustee continues to investigate, and to seek to recover assets, in no fewer than eleven different foreign jurisdictions.

## **Legislative Measures**

More than 625,000 claims have been satisfied under SIPA since SIPC's inception in 1970 through 2008. SIPC has proposed various legislative measures aimed at enhancing, even further, customer protection and ensuring the adequacy of the SIPC Fund. Among other things, SIPC has proposed that the limit of protection for cash claims be increased from \$100,000 to \$250,000 and adjusted periodically for inflation. It has recommended that the line of credit from the United States Treasury, which has not been adjusted since the enactment of SIPA in 1970, be increased. It also has proposed an increase to the maximum "minimum assessment" paid to SIPC by member broker-dealers. As of November 30, 2009, the balance of the SIPC fund was \$1,188,000,000. At an assessment rate of 1/4 of 1%, SIPC anticipates revenues totaling \$480 million for 2010. SIPC's borrowing from the Treasury, if any, cannot be forecast at this time. Recently, SIPC's Board of Directors authorized a change to its Bylaws that would increase the size of the target balance of the SIPC Fund from \$1 billion to \$2.5 billion.

The Subcommittee has asked that I address various proposals for improving SIPA. To the extent not already discussed above, SIPC's views on the proposals are as follow:

- Extending SIPA coverage to individual investors in ERISA plans up to \$500,000 per investor.

Only “customers,” as defined in SIPA, are eligible for protection. In the case of pension plans or “trusts,” SIPA provides, and the case law supports, that there is only one customer and that customer is the trust or plan itself. There is no protection for individual participants in the plan. The proposal to extend protection to the participants is an important one, but one that warrants study by SIPC and consideration by its Board before a position can be taken by SIPC. Protecting individual participants has substantial implications for other customers in a liquidation because all customers share, pro rata, in any fund of customer property. The increased protection also has implications for the SIPC Fund. There has been no risk management analysis of the consequences for either SIPC or the line of credit with the Treasury. Among other questions raised under the proposal are the cost to the SIPC Fund; the necessary changes to the assessment basis; the consequences of treatment of the individual participant as a “customer” with respect to “clawbacks” or avoidance actions and the individual’s submission to the jurisdiction of the bankruptcy court; the justifications for limiting the expanded protection to only one group of claimants with pooled assets; whether the expanded protection would cause a plan’s administrators to be less vigilant or exercise less due diligence in reliance upon the SIPC protection.

The above are just some of the issues needing consideration. SIPC welcomes the opportunity to work with Congress in studying this proposal.

- Prohibiting any recovery of principal or interest from an investor without proof that the investor did not have a legitimate expectation that the assets belonged to him or her.

I urge the Subcommittee to reject this proposal in the strongest possible terms. If this proposal were currently in place in the Madoff liquidation, it would cost the victims in that case literally billions of dollars. The Madoff Trustee has used the avoiding powers granted to him by SIPA and the Bankruptcy Code judiciously. He has not sued small investors. He has urged any Madoff customer who has received more money than he placed with Mr. Madoff to open discussions with him. He has instituted preference and fraudulent transfer proceedings against large investors who received disproportionate returns. But the weapons in the Trustee’s arsenal include the fact that all he must prove is the disparate return, without any issue of “legitimate expectation.”

The only situation in the Madoff case where small investors have been sued were three instances where the claimants ignored the claims filing procedure that has been in place for 39 years and initiated a lawsuit against the trustee. The Trustee was compelled to assert mandatory counterclaims. In short, the proposal addresses a problem which has not arisen, and would do extensive damage to the very people it seeks to help.

- Requiring SIPC to make SIPC advances based on the customer's statement balance up to \$500,000 per customer within 60 days of a customer filing a claim.

SIPC supports the prompt determination and satisfaction of customer claims and every effort is made toward that end. For example, in the Madoff case, claims are being satisfied promptly with advances from SIPC even if the claimant has objected to some portion of the determination of his claim. Thus, if the claimant deposited \$500,000 with the brokerage but is claiming \$2.5 million based on his last fictitious account statement, the claimant is being paid \$500,000 by the Trustee pending resolution of the dispute.

The determination of claims, however, should not be based solely on account statements. Under SIPA, a broker's obligation to a customer must be verifiable from the debtor's books and records or otherwise established to the satisfaction of the trustee. To give blind adherence to account statements may be to endorse fictitious profits, backdated trades or other fabrications by a wrongdoing broker-dealer.

As to the timing of SIPC advances, SIPC can only advance funds to satisfy a claim once the trustee has determined that the claim is valid. A 60 day limit for determining a claim is impractical and ignores the realities of a liquidation. To correctly determine claims, a trustee must be able to compare them against the debtor's books and records, and to assure himself that records are reliable. In many instances, however, the records may be in poor condition or incomplete. The records may not be immediately available because they have been seized by regulatory or criminal enforcement authorities. In those instances, the trustee's use or access to the records may be limited and require coordination with other authorities. There may be a very substantial number of claims or highly complex claims that require more time to be researched and determined. There may be questions of fact presented by a claim or incomplete information submitted by the claimant. This will require the claimant to supplement his claim with additional information which may take time. These are just some of the considerations that argue against a set time limit and in favor of a more flexible standard.

- Extending SIPA coverage to investors who purchased securities through a SIPC member broker or dealer, but whose securities were eventually transferred to an affiliate entity, such as Stanford Financial Group ("Stanford").

SIPA protects customers against the loss of cash and securities custodied by or for them with the broker. Once the customer's property has been delivered off of the broker's books and records, with the client's consent, it is unclear why the brokerage would continue to be responsible.

With respect to the facts in Stanford, it is SIPC's understanding that a related entity,

Stanford International Bank, Ltd., an Antiguan entity not regulated by any U. S. authority, issued certificates of deposit (“CDs”) directly to investors, most of whom took possession of the CDs or had them held for them at a different firm. The investors suffered a loss when the CDs lost or had no market value.

SIPC opposes any proposal to extend protection to investors against the loss in value of their securities, including those issued by an offshore entity beyond the reach of U. S. regulators and whether the loss is market loss or the result of fraud. Such protection would change substantially the mandate of SIPA, create an incentive to commit fraud, require a massive increase to the size of the SIPC Fund, and be an undue burden on SIPC members and their customers.

- Requiring any of the proposals above be applied retroactively for liquidations occurring after December 1, 2008.

Enacting and making retroactive any of the above proposals would be fundamentally unfair to SIPC, its members, their customers, and potentially the American taxpayer.

The adequacy of the SIPC Fund is a matter that is consistently considered and evaluated by SIPC. The size of the Fund is based upon SIPC’s obligations under the law as the law exists. To impose suddenly additional obligations upon SIPC that have not previously existed, would require an unplanned and potentially massive infusion of money into the Fund and trigger a host of real problems. The availability of SIPC funding for known obligations in existing SIPA liquidations, and the availability of monies for future SIPA liquidations, would be compromised. SIPC’s budget would be jeopardized. Members of SIPC who would have factored the SIPC assessment into their planned budget, would be required to find funding for an unexpected and sizeable liability. The use of taxpayer money would be a reality.

SIPC submits that favoring one group of investors retroactively has consequences that when weighed against the benefits, simply cannot be justified. Any change in SIPA protection should have prospective effect only, and should be made only after considered deliberation on the need for and the consequences of such change, and the ability of the SIPC Fund to sustain it.

Thank you for the opportunity to express SIPC’s views. I welcome any questions that the Committee has.