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U.S. Report Faults Agency That Oversees Investor Claims

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The Securities Investor Protection Corporation, set up to protect the nation's investors from theft or fraud if their brokerage firms collapse, has significant deficiencies, according to a study by the General Accounting Office released yesterday. In addition, the Securities and Exchange Commission, charged with oversight of the corporation, has been lax in its scrutiny of SIPC activities, the report said.

Representative John D. Dingell, the Michigan Democrat who requested the study, said the corporation should be changed and called on Congress to sponsor hearings on the need for changes in the investor protection program.

"SIPC's mission is to promote confidence in securities markets by facilitating the prompt return of missing customer cash and/or securities held at a failed firm," Mr. Dingell said. "However, the large number of claims denied in several recent high-profile SIPC liquidation proceedings has raised concerns that SIPC policies may unduly limit the actual protection afforded customers."

In 1999, Mr. Dingell asked the G.A.O. to examine how the corporation determines the legitimacy of investor claims and whether oversight of the corporation by the S.E.C. is adequate. Yesterday's report found that both SIPC and the S.E.C. have failed to advise investors of the limitations to the coverage offered by the corporation and that the lack of disclosure has harmed investors who were unaware of the hurdles they must clear before they can gain protection under the Securities Investor Protection Act. The report also noted that insufficient disclosure has caused many investors to conclude that SIPC is similar to the Federal Deposit Insurance Corporation. Unlike the F.D.I.C., which is government-run, SIPC is a private corporation financed by the brokerage industry.

"According to the G.A.O., both the SIPC and the S.E.C. have fallen short in their duty to make sure that investors are informed on the actions they need to take to protect their interests," said Representative Paul E. Kanjorski, Democrat of Pennsylvania. "Both Congress and the administration must address these concerns and deficiencies promptly, especially as more Americans than ever -- roughly 50 percent -- are invested in the stock market."

The Securities Investor Protection Corporation's brochure, updated in 1994, provides no information on how investors should protect themselves against unauthorized trading, the G.A.O. study noted. Yet this type of fraud is common among brokerage firms that fail, accounting for nearly two-thirds of liquidations begun by SIPC from 1996 through 2000. While the corporation does provide protection to investors who have been victims of unauthorized trading, few investors realize that to prove their claims the corporation requires them to provide extensive documentation of complaints made in a timely fashion to brokerage firms. As a result, many investors have had their claims denied.

The corporation should revise its brochure and Web site to include a detailed explanation of the steps necessary to document an unauthorized trading claim, the study concluded. The corporation should also provide sufficient details about what it covers and what it does not, so investors can distinguish it from other insurance programs, the G.A.O. said. And the S.E.C. should require that brokerages distribute the SIPC brochure to their customers rather than rely on investors to secure it themselves.

Stephen P. Harbeck, SIPC's general counsel, said the organization would begin to address the G.A.O.'s recommendations. "We've never focused in until relatively recently on investor education as something we should become actively involved in," Mr. Harbeck said. "We've thought long and hard about it and we've decided that it is a good idea."

The study examined the corporation's practice of denying claims of investors who had purchased securities through a failed firm that was not a SIPC member but that was closely affiliated with a firm that belonged to the organization. While the act that established SIPC requires investors to trade through a brokerage firm that is a corporation member to recover on a claim, the G.A.O. pointed out that the corporation has had difficulty defending this position in court recently.

Several securities frauds conducted through related firms that were not technically members of SIPC left investors to fight the corporation in court to try to recoup their losses. While certain courts have provided favorable precedents to investors trying to recover such losses, the study said: "Opportunities exist to improve disclosure to investors about the risks that may be associated with certain SIPC members and their nonmember affiliates."

Finally, the S.E.C. must improve its oversight of the corporation, according to the report. While the commission instituted a pilot program last September to monitor liquidations, the report recommended that the S.E.C. expand its sample of cases under scrutiny to include those involving unauthorized trading and nonmember affiliates. The report also noted that the S.E.C. had no formal procedure among its various units to discuss SIPC-related issues. Officials at the commission said they would begin holding quarterly meetings to discuss SIPC's operations.