

HEARING OF THE SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE AND GOVERNMENT
SPONSORED ENTERPRISES OF THE HOUSE FINANCIAL SERVICES COMMITTEE; SUBJECT: "ASSESSING
THE LIMITATIONS OF THE SECURITIES INV



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BODY:

HEARING OF THE SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE AND GOVERNMENT SPONSORED ENTERPRISES OF THE HOUSE FINANCIAL SERVICES COMMITTEE SUBJECT: "ASSESSING THE LIMITATIONS OF THE SECURITIES INVESTOR PROTECTION ACT" CHAIRED BY: REPRESENTATIVE PAUL E. KANJORSKI (D-PA) WITNESSES JOSEPH BORG, DIRECTOR, ALABAMA SECURITIES COMMISSION; ORLAN JOHNSON, CHAIRMAN OF THE BOARD, SECURITIES INVESTOR PROTECTION CORPORATION; JOHN COFFEE, ADOLF A. BERLE PROFESSOR OF LAW, COLUMBIA LAW SCHOOL; IRA HAMMERMAN, SENIOR MANAGING DIRECTOR AND GENERAL COUNSEL, SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION; STEVEN CARUSO, PARTNER, MADDOX, HARGETT, & CARUSO LOCATION: 2128 RAYBURN HOUSE OFFICE BUILDING, WASHINGTON, D.C. TIME: 10:00 A.M. EDT DATE: SEPTEMBER 23, 2010

REP. KANJORSKI: (Sounds gavel.) This hearing of the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises will come to order. Pursuant to committee rules and prior discussions with the ranking member, each side will have 10 minutes for opening statements. Without objection, all members' opening statements will be made part of the record. And I yield five minutes to myself.

Nearly two years have passed since the massive \$65-billion Madoff Ponzi scheme came to light. Since then, we have enacted the Dodd- Frank Wall Street Reform and Consumer Protection Act. Among many other things, this law amended the Securities Investor Protection Act, the statute that works to return money in securities to customers of failed brokerages.

To better protect the customers of failed brokerages going forward, the Dodd-Frank Act increases cash protection limits, and bolsters the resources of the reserve fund used to replace customers' missing cash and securities. This new law also quintuples penalties for misrepresentations of membership in or protections offered by the Securities Investor Protection Corporation.

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Moreover, the statute makes important changes to prevent, rather than simply replace the loss of customers' property, including new custody safeguards for customers' assets held by certain financial professionals. The Dodd-Frank Act additionally requires the auditors of broker dealers to register with the Public Company Accounting Oversight Board. And this body has the authority to regulate these market gatekeepers. This change ought to put incompetent and unscrupulous one-man auditor shops, like the one which blessed the books of the Madoff brokerage out of business before investors get harmed.

Much more, however, remains to be done to protect investors. The victims of the Madoff Ponzi scheme and the Stanford Financial fraud include many hardworking families and frugal retirees who invested their hard-earned money with now-imprisoned or indicted con artists. Numerous press stories have relayed accounts about how these victims who sought to play by the rules have now had to greatly modify the way they live. The victims of these frauds believe that SIPC has fallen short in meeting the responsibilities, and they want change. I do too.

We, therefore, have many questions to explore today. For example, although SIPA protections do not currently extend to customers of investment advisors, we must explore the issue of expanding SIPA's coverage, as investment advisors may also commit fraud. In any serious efforts to reform SIPA, we must also consider what responsibility SIPC has to honor the broker statements that customers receive.

SIPC has denied the claims of customers based on seemingly legitimate paperwork provided to them by the brokers. Yet SIPC expects customers to use those very same statements to report unauthorized trading in their accounts. This inconsistency is unacceptable and we must work to resolve it. Investor trust, for which SIPA was designed to preserve, has been seriously eroded by SIPC's narrow interpretations of its statutory mandate.

While SIPC's actions may follow the letter of the law, many would argue that SIPA has ignored the spirit of the law. We therefore must consider the best way to change the tone of SIPC, and refocus this body on maintaining confidence in the financial system, and promoting investor protection. In the extent -- to the extent possible, we ought to also explore how SIPC could learn from the success of the Federal Deposit Insurance Corporation in maintaining the public's trust.

To address these questions and many others, SIPC has focused on modernization taskforce, and several members of this panel will appear before us today in their personal capacities. I for one, expect this taskforce to complete its work with great transparency, considerable outreach, and much speed. Moreover, this taskforce must view its mission as broadly as possible, and work to provide Congress with a comprehensive plan or reform.

In closing, we can further improve SIPA by building on the reforms of the Dodd-Frank Act. The witnesses before us today are recognized securities experts. Their recommendations, along with those offered by the Madoff victims, at our hearing last December, will undoubtedly help us in our work to update SIPA and better protect investors.

The chair recognizes the gentleman from New Jersey for 10 minutes.

REP. SCOTT GARRETT (R-NJ): Thank you.

As mad as I am at Madoff, I'm even more upset at my own government, over the way I've been treated in the aftermath of this fraud. That is gist of a quote from one of my constituents who was defrauded by Bernie Madoff, and who feels failed by the SEC and FINRA in protecting him while the fraud was going on, and who now faces a SIPC trustee who is threatening to clawback funds he withdrew from his Madoff account over the course of the last 15 or 20 years.

In a sense, these are -- innocent investors are being held to a higher standard. And both the government that was supposed to protect them and that gladly took their tax payments, and the organization, SIPC, that was supposedly set up to protect them by installing -- instilling greater confidence in our securities market.

We are holding today's hearing to assess the limitations of the Securities Investor Protection Act, SIPA, and the Securities Investors Protection Corporation, SIPC, and to identify whether there are potential reforms that would better protect the investors. It would seem to me that one major and fundamental reform would be for them, through the actions of the trustee that's been appointed, to see itself as an advocate for rather than an adversary against innocent defrauded investors, so that they feel as though they are being assisted by the SIPC process, rather than hunted down and accused somehow of them doing some sort of wrongdoing.

So, there's one piece of legislation that's out there that could go at least part of the way in making things right for once, and potentially twice victimizing the Madoff investors.

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A colleague of mine, in New Jersey, Bill Pascrell, has introduced the bill, H.R. 5058. It's called the Ponzi Scheme Victims' Tax Relief Act, and what it would do is liberalize the ability of those who are victims of theft to receive their refund for taxes, that they paid on gains, that the SIPC trustee is now trying to take back from them. I'm a cosponsor of this bill, which I feel should perhaps go a little further than the 10-year look-back, since their trustee is going back further than the 10 years in calculating the so-called net winners and losers.

Another aspect of the trustee's handling this case are now in the process of working a way through the court system, which matters will be decided. I'm concerned though about a looming deadline that's coming up, and that's in December, when the trustee will decide whether to go forward, with potentially thousands of clawbacks from these innocent, defrauded investors.

SIPC leadership and the trustee have indicated that they will not be going after the so-called ordinary people, people who are not leading a lavish lifestyle, and who had no knowledge of the fraud. But if you hear from my office and staff, that's not what I'm hearing from my constituents and others, and the people that I talk to when I come back at home. I spoke with one gentleman who, years ago, withdrew money to pay for college, and who lives a very modest lifestyle now.

He contacted a trustee's firm to get clarification what he wouldn't be plowed back -- that he wouldn't be plowed back. But he was told that others, and for giving a small percentage of what the trustee had calculated that he owned, he otherwise looked like he would be on the hook for the rest. In addition, he was told that anything he might recover in the form of tax refund, that too might be subject to seizure by the trustee.

So, I'm also concerned that, while these court cases are underway, the SIPC trustee has denied access to Madoff's records for the victims and their attorney. So access to these records is important for several key aspects of the case, including whether or not, at all, transactions reported by Madoff, over the years, were actually fraudulent transactions. If some of them weren't, then the trustee's net equity formulation would completely be called into question.

Inequitable access to these records results in a fundamental imbalance of the scales of justice in this case, and also calls into question whether ultimately there will be fair trial at the end of the day in this case.

So all of this, when you think about it, should make all of us feel very uncomfortable. The SIPC decal was supposed to mean protection, the SEC was supposed to provide protection. The IRS taking the tax payments also serve as a government imprimatur. SIPC is supposed to provide up to \$500,000 in protection based on quote "reasonable expectation of customers."

In fact SIPC was created at the behest of the securities industry to encourage confidence in a more efficient paperless process, where investors would no longer have the -- a piece of mind one gets from holding on to the actual stock certificate, like we used to do in the old days. In their place, customers grew accustomed to depending on trade confirmations and account statements, which were regulated of course by the SEC and FINRA to set their reasonable expectations that they should have.

So as I said earlier though, instead of SIPC's meeting investors reasonable expectations, now it seems as though that they're blaming their victims instead. Instead of customers being able to rely on their account statements to calculate their SIPC protection, they're basically at the mercy of the trustee's formulation of net equity that doesn't take into account or consideration interest, earning, or the time value of money. Nor does the so-called customer-friendly methodology take into account the receiving SIPC protection as separate and distinct from the distribution of assets recovered. One of the results, unfortunately, is that SIPC has clearly lost the trust of many investors, as well as the trust of many members here of Congress as well.

So this hearing, Mr. Chairman, is timely. SIPC clearly needs the SIPC modernization taskforce to assist in its refocusing on its proper role, going forward. So I do look forward to the testimony we'll hear and the questioning from this panel. And with that, I yield back.

REP. KANJORSKI: Thank you, Mr. Garrett.

We'll now hear from the gentleman from New York, Mr. Ackerman.

REP. GARY ACKERMAN (D-NY): Thank you very much, Chairman Kanjorski, for calling this very important hearing. It's been nearly two years since Bernard Madoff confessed to masterminding the largest and longest-running Ponzi scheme in history, and turned himself in. After that fateful day in December 2008, the Securities Investment Protection Corporation, which is tasked with ensuring victims of broker fraud or failure and recovering assets from the

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fraud of those victims, received over 16,000 insurance claims from Madoff's innocent victims. Of them, to date, SIPC has granted only 2,200.

That means that right now, at this very minute, many, if not most of the over 13,000 innocent victims of Bernard Madoff, who for years reasonably thought that they were entitled for SIPC insurance on the balance in their accounts in the unlikely event that their investments were entangled in a broker-dealer fraud or failure, instead are destitutes and out of luck. And those are just the investors who filed actual claims.

What crime did these investors commit? These 13,000 people and their families like millions, and millions of people who invest in our markets, put their trust in our financial system, its regulators, and its safeguards. Two years after Madoff turned himself in, two years after these 13,000 people have been turned away, time and time again, from the protection to which they reasonably believed they were entitled. It has become very clear that Madoff robbed them, our system betrayed them, and our government failed them.

Who's responsible? Who caused this problem? Who do we turn to? Who do the victims turn to? Now, people have reasonable expectations of government, its agencies, and the organizations that are created by them.

Where I come from, if the police don't do their job and stand idly by when terrible things happen; if a doctor just stands around and doesn't do what he's supposed to do; if emergency responders show up in the ambulance they just sit and watch the accident, people wind up suing those agencies, and the city and the municipality and the government for negligence. Someone is liable, whether it's because of incompetence or misfeasance or malfeasance, somebody is responsible for not fulfilling the reasonable expectations that people have, and come to rely on.

And here, in the federal government, if there's not a legal responsibility, there certainly is a moral responsibility for creating the climate that people depended on. That we have failed these investors is heartbreaking enough in terms of human tragedy. But the damage that has been done to investor confidence at this critical time in our economic and financial recovery as a result of our failure to safeguard and protect these innocent Madoff victims, and our country's negligence in leading them to believe that they were insured is as frightening as it is self-defeating.

Today's hearing will focus on the Securities Investor's Protection Act, and the present and future role of SIPC in providing assurance to investors in our markets that they are protected, really protected -- not fake protected, against broker-dealer fraud or failure.

It is my strong hope that this hearing is a prelude to the subcommittee's consideration of the Ponzi Scheme Investor Protection Act, a bipartisan bill that I've introduced along with numerous members of this subcommittee in the House to provide some relief to many of those innocent victims of Ponzi schemes of all kinds, who have been burned by SIPC, and to proactively assure investors in our securities market that they are protected against fraud, regardless of its scope or longevity.

Mr. Chairman, thank you very much again for scheduling the hearing, and I too look forward to hearing from our witnesses. And I yield back the balance of my time.

REP. KANJORSKI: Thank you, Mr. Ackerman.

Now, we'll hear from the other gentleman from New York, for two minutes, Mr. King.

REP. PETER KING (R-NY): Thank you, Mr. Chairman. At outset let me thank you very much for holding this hearing.

And I know it's important to get on to the hearing, so I'll keep my remarks brief. I want to fully identify myself with the statement of Mr. Garrett, both in precise content, and also in spirit. The fact is that the investors of Madoff were let down, were failed by our government -- by SEC, by FINRA. Despite numerous reasons why this fraud should have been stopped, it wasn't.

So these investors made the mistake of, number one, relying on Madoff, but number two, and more importantly, relying on our federal government. And now that they are victims, they are being treated by the trustee as if they were coconspirators of Madoff, rather than victims. And I've done some practice of law over the years, and when you listen to the investors and realize it -- and you listen to the tactics and methods being used against them by the trustee, it's similar to people under indictment or under investigation by a grand jury, by United States Attorney, by the SEC.

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There are years of records that are being demanded, going back 10, 15, 20 years. Every excuse, every possibility has been looked up by trustees to try to suck people into this and bring them in, not giving them the benefit of doubt, but again, treating them as if they were criminal defendants rather than victims.

And to me, as my good friend Mr. Ackerman said, at a time when we're trying to rebuild investor confidence, we are sending the worst possible message to the -- to investors that show that not only did the government let them down, but then in effect, the government allows the trustee to go after them when they are victims, as if they are guilty themselves.

And we're talking about people who have already lost millions of dollars because of this Ponzi scheme of Madoff, now having to spend millions and millions of dollars in legal fee to defend themselves. When our government should be working to help them, the government is going out of its way and the trustees are going out of its way to make them victims again. I find this entire process wrong.

I think sometimes we can get caught in our own universe, and we start debating how many angels can dance on the head of a pin, and not realizing that good, good people who've been hurt once are now being hurt even worse by the tactics of this trustee.

So I think it's important to keep that in mind as we go forward, and debate the technicalities and legalities, realize the moral harm that's being done here. And with that, I yield back the balance of my time.

REP. KANJORSKI: Thank you, Mr. King.

The gentleman from Colorado, Mr. Perlmutter, is recognized for one minute.

REP. ED PERLMUTTER (D-CO): Thank you, Mr. Chairman. I agree with one point raised by Mr. Garrett, Mr. King, and I disagree with another point. I'll start where we disagree. In terms of the timing of this; it was under an SEC and under administration of George Bush, and there was really not a lot of police on Wall Street, even though Mr. Markopolos or Markopolos raised the red flags a dozen times. So, got to take a look at who's in office to decide whether the system is working or not.

But it did not work well at that time. I agree with the gentleman that this is insult added to injury. And that really is what we're talking about here. And that seems to be the unfairness of the system that individuals, who through no real -- you know, they weren't active participants in a fraud. They were innocent victims of a fraud perpetrated by Mr. Madoff. There should be an opportunity for them to recover either through their taxes, through claims with SIPC, or to not have to face a clawback if they're not active participants.

And the law, I think, is a real problem in this arena, and needs to be changed. And I look forward to working with the gentlemen on these very subjects. Thank you.

REP. ACKERMAN: The chair will recognize Mr. Childers for three minutes.

REP. TRAVIS W. CHILDERS (D-MS): Thank you. I want to thank the Chairman first for holding this important, and very timely, I think, hearing to address the Securities Investor Protection Act. I will thank our witnesses for being here today. This subcommittee has looked at a number of issues related to SIPA during this Congress, focusing on the Madoff Ponzi scheme, as well as the Stanford Financial Ponzi scheme.

I'm here today as an advocate of the victims of the Stanford Financial scheme, while the victims of the Madoff scheme and the Stanford Financial scheme live throughout our country. I realize that, but too many of those Stanford Financial scheme victims live in the district that I serve, the Northern Portion of Mississippi. There are North Mississippi families who now live an uncertain future. They invested much of their life savings in certificates of deposit with the Stanford group company, a SIPC member and registered broker-dealer.

It is estimated that in Mississippi alone, our families lost \$68 million, that is no small matter to me, and to the state of Mississippi. SIPC has denied coverage to the Stanford victims, when the SEC had the jurisdiction to file enforcement action against Stanford in 2009.

These investors purchased securities they didn't get. They purchased them from a SIPC member. SIPC's entire function is to return securities to customers of a broker-dealer when a firm becomes insolvent. There are several legalities to the case for extending SIPC coverage to Stanford victims, and I don't want to get into all of that.

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But these investors are ordinary Americans -- ordinary Mississippians who planned and saved for a retirement that they may never enjoy. And they deserve the protection assured by the SIPC member, Stanford Group Company. As we examine ideas to improve SIPA and work towards a resolution for making these Stanford victims whole, I urge all participants to keep these victims and their hardworking families in mind, and the fact that they worked, many times -- a lifetime to accumulate this money that they've lost.

I yield back my time. Thank you, Mr. Chairman.

REP. ACKERMAN: Thank you very much. We will now hear from our panel of witnesses.

Thank you very much for appearing before the subcommittee today. And without objection, your entire written statements will be made a part of the record. You will each be recognized for five minutes. Summarize your statements or present it in any way you see fit. We'll get right down to it.

First, we have Mr. Joseph Borg, director, Alabama Securities Commission.

Mr. Borg.

MR. BORG: Thank you Mr. Chairman, Ranking Member Garrett, and members of the subcommittee. I'm Joe Borg, director of the Alabama Securities Commission, and thank you for the invitation to participate today.

Our office has administrative, civil, and criminal authority under the Alabama Securities Act, and we've brought dozens of investigations of Ponzi and pyramid schemes, illegal blind pools, fraudulent private placement offerings, and other scams which have led to numerous enforcement cases and criminal prosecutions.

I've submitted written testimony which has additional details and discussion of the bullet points I will outline here today. Here are some of my particular areas of concern. First is the levels of protection.

It is my belief that the level of protection with regard to the SIPC fund should be increased from 500,000 (dollars) to \$1 million. A large portion of retirement savings consist of securities investments, and most people just do not leave huge amounts of retire money in banks; it's at the brokerage house. The \$1-million level of protection would also match SIPC's Canadian counterpart, the CIPF, Canadian Investor Protection Fund, which is currently at \$1 million Canadian.

I also believe that the levels of protection should be indexed to inflation. And indexing would allow some incremental measure of increased protection, going forward.

On the issue of fictitious securities, a major issue is the treatment of claims based on securities position which never actually existed.

There are conflicts between decisions from the Second, and Sixth Circuit Court of Appeals, and I believe that part of the problem stems from SIPA's distinction between cash and securities. The disparate protection between claims for cash and securities -- and claims for securities should be eliminated.

For example, if I have \$500,000 of securities, I sell \$350,000, and the brokerage house has closed before I either cash the check or the money is still in the account, I've just lost \$100,000 because of the \$250,000 limit. I would also note that the Canadians eliminated the distinction between claims for cash and claims for securities, back in 1998. In a discussion with SIPC staff, a change in favor of eliminating the cash versus securities distinction would not alter the risk models used by SIPC.

The next item is the increase in the line of credit from Treasury. If we expect continued growth in the securities market, and a change of coverage to perhaps \$1 million cash and securities, and you index it to inflation, it may require an increase in the line of credit from Treasury. I know it hasn't been tapped so far in history, but we've asked the SIPC staff to review the effect of protections at the \$1 million-level.

It's my personal feeling that a line of credit of \$5 billion matched with reserves of \$5 billion from the industry would be an appropriate amount going forward.

At the current level of assessments, it will take a number of years to reach the \$2.5 billion level -- I think the staff has told us about five years. But I think if we target for \$10 billion and we start to be -- let's be realistic and start planning for them now, that planning should start now.

On assessments -- prior to the enactment of Dodd-Frank, SIPC had a floor of \$150, ridiculously low. There are now some SIPC members though who pay zero assessments because of the change in the law. I think that's just an un-

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intended consequence. It's my belief that there should be a minimum assessment of some amount, perhaps \$1,000. I'd prefer a range somewhere of \$2,000 to \$2,500.

Also, I was very surprised to learn that in computing assessments, that revenues on mutual funds are not included. And I'm of the opinion that since all investors benefit from protection or should benefit from protection and broker-dealers benefit from SIPC availability, that revenues on mutual funds should be included for assessment purposes as well. I would also suggest that anytime that a target level is reached, whether it's \$1 billion, \$2.5 billion or \$5 billion, there should be another determination of whether assessments are adequate, based on the current level of investor assets in the market.

Let me suggest that the current arrangement with the Treasury for the line of credit that exists, which is now a term loan, should actually be a revolving loan in order to ensure continuity and flexibility and the ability of SIPC to protect investors where and when needed.

On investor education, the general public has the misconception that SIPC is some type of insurance, just like FDIC insurance for banks. If we're going to make a change, it's going to change the entire dynamic. And I'm not suggesting we don't change it. But I think that the parameters of what this taskforce is going to look at will change depending on congressional intent.

If it was not intended to be insurance for fraud, but only for replacing cash and securities, I think this misconception was exacerbated by references to FDIC, tying the amounts of coverage to the same levels as FDIC, and a comparison by the broker-dealer community who tout the SIPC protection levels.

Suggestion to fix it -- TV ads, and seminars, and publications are great, but that's not how you're going to educate the public. Include in the brokerage statements, every quarter, or every month that they go out, a section on SIPC protection. What it is, but more importantly what it's not. I think you're going to need a constant education effort on a regular basis to get over the misconceptions that have occurred.

And I wouldn't do an insert. You know what I do with inserts; you throw them away, you read the statement. It needs to be part of the brokerage statement. I know that SIPC does not have the power to do that. That would have to come from the SEC and FINRA.

I know my time is up. I have submitted materials with regard to indirect investing, with regard to retirement plans and hedge funds; I think they ought to be matched up to the way that FDIC and FICMA are looking through those procedures at the present time, utilizing the IRS Code 401(d), 408, and including 457 plans.

And I would lastly say in conclusion that under international relations, I've been specifically tasked by the taskforce to look into matters involving -- international involvement of SIPC. There is -- SIPC just became a member of the IOSCO, international securities organization, as an affiliate member. Some of the things we're going to look at, I think, would be formal rules on cross-border protection, create a dispute resolution mechanism with a team of experts -- this is from the Lehman Brothers matter -- establish cooperative principles and develop a platform for exchange of information.

I thank you again for the invitation and the opportunity to be here today, and I'll be happy to answer any questions. Thank you.

REP. ACKERMAN: Thank you, Mr. Borg.

Next, we have the Honorable Orlan Johnson, the chairman of the board of Securities Investors' Protection Corporation. Chairman Johnson.

MR. JOHNSON: Thank you, Mr. Chairman.

Chairman Kanjorski, Ranking Member Garrett and members of the subcommittee, I'd like to thank you for the opportunity to appear before you today, and discuss the work of SIPC and the possible improvements to the Securities Investor Protection Act.

I'm Orlan Johnson and I'm the chairman of SIPC. And I also serve as chairman of the SIPC Modernization Taskforce which is conducting a complete and comprehensive review of SIPC's operations as well as the changes to SIPA.

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The taskforce was convened on June 17th of this year and it consisted of a very wide range of experts. And we're in the midst of review of all the considerations that are necessary from a statutory standpoint, from a procedural standpoint and other reforms as it relates to SIPA and SIPC.

At my confirmation hearing before the Senate Banking Committee last December, I made crystal clear that my intent from the beginning was to come in and to have a comprehensive review and this review is being undertaken.

Chairman Kanjorski thereafter contacted us and suggested a number of important topics for the taskforce to consider. And today, I'll briefly describe SIPC and the work of the taskforce, in addition to providing responses to issues that the subcommittee presented to me in their letter dated of September 16.

The taskforce has drawn its members from all ranks, from all parts of the United States. We've drawn ranks from the ranks of state regulators, attorneys who represent investors, academia, the securities industry, trustee of the largest securities brokerage insolvency in history. We've included also the chairman of SIPC's counterpart in China, an observer from the SEC.

We anticipate the diversity of viewpoint results and what I would call the rigorous analysis of the issues that concern investors today. We've begun our work in earnest. And we are examining the extent of the protection and also the problems that have been occurred as a result of indirect investors, the use of bankruptcy avoidance powers and other fundamental issues of concern to investors and the Congress.

We anticipate that some of our recommendations are not going to make everyone happy. Nevertheless, it is the role of this taskforce to have everything on the table -- all aspects of what we need to be looking at, all aspects of what needs to be reviewed.

We have also created a public input platform on our web in which the public is invited to share their comments and for all to see. We've also undertaken a major public outreach to ensure that many investors as possible would learn about this process and get an opportunity to participate.

In using our website portal, we have conducted an open online forum. We did our first one on September the 14th. We have a next one that's going to be taking place fairly soon. We also are hoping to organize a live event so that we have members of the public present their views directly to the taskforce.

After discussion of some of the issues, several members of the taskforce has volunteered to help us draft a number of recommendations, which we intent to present to the SIPC Board. And it's our goal to get a full set of recommendations sometime in the early part of the first quarter of 2011.

My written submission to the committee addresses a number of those specific issues of concern to Congress. And SIPC's work is the focus of attention as it never has been in the last 40 years. Dodd- Frank Wall Street Reform and Consumer Protection Act amended SIPA and gives SIPC a new and different role in the wind-down of systemically significant financial conglomerate where a SIPC member brokerage firm is involved.

I would hope that the taskforce will soon present additional recommendations that will lead to additional legislation and to further enhance and update the SIPC program in -- of investors.

In conclusion, I want to assure the subcommittee that the taskforce is making progress and will continue through its work aimed at developing and recommending substantial reforms to SIPA and SIPC. I'd like to thank you for their time.

And I would like to thank you for having members of our taskforce with you. And I'd be pleased to answer any questions that the members of the subcommittee may have. Thank you again, Mr. Chairman.

REP. ACKERMAN: Thank you very much, Chairman Johnson.

Next we have Mr. John Coffee, the Adolf A. Berle professor of Law at Columbia University. Mr. Coffee.

MR. COFFEE: Chairman Kanjorski, Ranking Member Garrett, fellow congressmen -- (off mike.)

Are we now on? Okay, thank you.

I've only two points to make in my brief remarks. There are things Congress should do to amend, extend and modernize the Securities Investor Protection Act. But two, there are things Congress should not do. My hopes for what Congress could do must be balanced against my fears of what Congress might do.

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The first rule always has to be, do no harm. And I think there are -- some harm is here in some of the potential reforms. Let me start with my hopes. I agree very much with Mr. Borg's comments. I think I won't cover the same ground he's covered.

So let me start with a different point. Congress should extend the definition of customer to reach beneficial and indirect owners in a variety of collective investment vehicles. Americans today invest through collective investment vehicles.

The highest priority should be to cover the smaller pension funds and other collective investment vehicles where typically the legal owner has failed or neglected to inform the covered broker of all of the individual accounts that are represented in that collective fund.

The presumption, the strong presumption should be in favor of a pass-through approach. That is what both the Federal Deposit Insurance Corporation Act and the Federal Credit Union Act already adopted over a decade ago.

SIPA, the Securities Investor Protection Act is behind the pack in not having adopted a pass-through approach that reaches the beneficial and indirect owners. Such a pass-through approach is superior to what is being provided in proposed H.R. 5032, which only amounts to a \$100,000 advance to the indirect owner.

And it requires the indirect owner to waive their right to sue the feeder funds who put them into the Ponzi scheme. I can see no reason in the world why Congress wants to exempt bodies like Fairfield Greenwich that appeared to have behaved very, very recklessly at the least.

Now, I realize that what I'm saying that we should cover beneficial or indirect donors would be costly for SIPC. And thus I think it's necessary to prioritize. I don't think I would initially try to cover the large mutual fund or the very large pension fund because they are, by law, diversified and cannot suffer really significant losses from a Ponzi scheme. But the smaller funds and the smaller pension funds would be my priority to cover first.

And yes, this may require some increase in the assessment, which right now starts at one-half of 1 percent of your growth revenue until the fund reaches a certain size. I think the average small businessman in America spends more than one-half of 1 percent of their gross revenues on covering insurance and similar cost.

My basic point though is we now have a system that doesn't cover the smaller person, because they're more likely to be the person who is in the indirect position of being a beneficial owner.

Next point which Mr. Borg also said -- and I'll just say it very briefly. I think we should abolish the distinction between cash and securities. It produces arbitrary distinctions because it's just a happenstance, what your account consists of on the moment that the broker-dealer failed.

Now, on the other side of the ledge, there are proposed reforms that I would urge Congress not to adopt. Particularly, I would advise you against limiting the powers of the SIPC trustee to sue the net winners in a Ponzi scheme because in reality Ponzi schemes are composed of net winners and net losers.

To the extent we protect the net winners, we injure the net losers. When Mr. Picard, the Madoff trustee, sues the net winners, he's not giving that money to the federal government; he's seeking to aid the net losers.

Although I can sympathize with the position of some of the net winners, their experience was far less tragic and far less traumatic than that of the net losers. And I don't think Congress should subordinate the net losers to the net winners.

I note that Mr. Picard has filed, as of April, some 14 actions seeking \$14.8 billion. Those 14 actions are not against poor, unsuspecting people. They are against very large entities. And if 5032 passes in its current form, I think the settlement value of those cases would be dramatically reduced.

Thus I'm urging you in my written testimony that if you want to do something for the net winners that you think are unsuspecting, unfortunate victims; it would be better to create either a de minimus exception saying no recovery until the fictitious profits go above a certain level, or use what I call an imputed interest factor.

Say if you put money in 10 years ago, you're entitled to at least a 10 percent return a year. And that would double the recovery. But if you use the current approach, there are going to be people who -- according to a published article in the Wall Street Journal -- have offered to settle in the neighborhood of \$2 billion in just one case, who are going to find that the -- we're going to find that the settlement value of that kind of recovery will be greatly reduced. Because it's go-

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ing to be difficult to prove anybody was complicit in Madoff fraud or that they were negligent where they'll say they were relying upon audited financial information.

Lastly, in just one second, I do think that the approach taken in the financial services appropriation bill, which would compel the SIPC to cover all the losses in the Stanford scandal, probably goes beyond what the SIPC can possibly handle. It was established to cover securities that were in the custody of the broker or that were in the broker -- on the broker's books. Asking the SIPC to cover all fraud-related losses could threaten the solvency of the SIPC; that should not be done retroactively.

On this point, I'll stop. Happy to answer further questions.

REP. ACKERMAN: Thank you very much, Mr. Coffee.

Next we have Mr. Ira Hammerman, senior managing director and general counsel, Securities Industry Financial Markets Association. Mr. Hammerman.

MR. HAMMERMAN: Thank you, Mr. Chairman, Ranking Member Garrett and members of the subcommittee. I'm pleased to testify on behalf of the Securities Industry and Financial Markets Association on this important subject.

My testimony focuses on SIFMA's preliminary recommendations regarding revisions to SIPA in light of issues emerging from recent liquidations and the effects of the Dodd-Frank Act. SIPA's fundamental purpose is to promote investor confidence in the capital markets by protecting customers against the loss of cash through securities in the failure of the broker holding such property

It is not intended to protect investors against losses on their investments, only against losses of their investments. When a broker fails, SIPA provide for the distribution of the customer property pro rata to all customers. And to the extent there are shortfalls, \$500,000 from SIPC is available to restore to each customer's missing cash or securities.

Investors who lose money because of a decline in the value of the securities purchased for their account, however, are not protected by SIPA against such losses, whether the decline is due to market forces or even due to fraud.

In this regard, SIFMA opposes the Culberson Amendment as it would extend SIPC's protection to cover fraud by the issue of securities, which are neither lost nor stolen, but in fact, they're in the customers' possession.

SIPA's customer protection framework has been challenged like never before by two recent events. The Madoff Ponzi scheme -- a massive long-term fraud that inflicted significant harm on many investors including individuals, families, charitable and educational institutions -- highlighted questions about the scope of customer protection under SIPA, especially as it applies to the calculation of a customer's net equity in a Ponzi scheme and the application of SIPC's protection to indirect investors.

The insolvency of Lehman brothers exposed inconsistencies between SIPA and the SEC's Customer Protection Rule. When a failed broker was operated as a Ponzi scheme, we believe that customer property should be distributed to the victims, based on the net amounts entrusted to the failed broker, reduced by any distributions received without regard to fictitious profits shown on fraudulent account statements.

The property held by a Ponzi scheme and available for distribution to the investors is simply the pooled property of all the victims and distributions based on anything other than their net investment would be fundamentally unfair.

Indirect investors who do not have accounts with the failed broker, but invested in another entity like a hedge fund that had an account are not eligible for SIPC's protection. SIPC generally should not provide greater protection to institutions than to individuals. And accordingly, SIFMA opposes an increase in the protection provided to customers that are hedge funds, corporations or partnerships.

This principle, however, may not apply to trusts or employee benefit plans, which represent the interests of their beneficiaries in a more straightforward way. Before expanding SIPC protection to these indirect investors, however, Congress should consider the additional cost.

SIPA and the SEC's Customer Protection Rule should work together. This rule requires each broker to maintain possession of its customers' fully paid and excess margin securities and deposit into a reserve account, an amount generally equal to its net monetary obligation to customers.

In a SIPA liquidation, the customer securities and the reserve account are available for distribution to customers. If SIPA and the customer protection rule are harmonized, a failed broker that complied with the rule should have sufficient

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customer property to satisfy the net equity claims of all of customers. Unfortunately, the two are not fully harmonized today.

Additionally, as the SEC begins to develop the requirement applicable to securities-based swap dealers, the divergences between the SEC's customer protection requirements and SIPA will only increase.

Dodd-Frank amended the liquidation provisions of the bankruptcy code to treat accounts holding securities-based swaps as securities accounts, but no similar amendment was made to SIPA, leaving unclear the treatment in a SIPA liquidation of customers' security-based swaps and related margin.

Lastly, SIPA provides for the distribution of a single pool of property, pro rata, among all customers, which may unfairly impose risks of the more complex types of accounts like portfolio margin accounts on the customers who have simpler accounts like cash accounts.

To protect customers with the simpler accounts, customers should be divided into separate account classes, the rules tailored to create a separate pool of customer property for each account class, and SIPA and the Bankruptcy Code should provide for the distribution of each such separate pool to the customers in the related account class.

The best way to harmonize the customer protection rules with the liquidation process, and to tailor both to separate account classes is for Congress to authorize the SEC to make appropriate rules under SIPA, the Bankruptcy Code and the Exchange Act. We also believe that the basis on which members contribute to SIPC's fund may be outdated and should be reviewed in light of the manner in which members currently operate.

In conclusion, SIFMA is strongly committed for working constructively with the SIPC taskforce and this subcommittee to recommend ways to better protect investors and thereby increase investor confidence in the financial markets. I would be pleased to answer any questions you may have. Thank you.

REP. ACKERMAN: Thank you very much, Mr. Hammerman.

Finally, we have Mr. Steven Caruso, partner in Maddox, Hargett & Caruso. Mr. Caruso.

MR. CARUSO: Thank you.

Chairman Kanjorski, Ranking Member Garrett, members of the subcommittee, my name is Steven Caruso. I'm an attorney from New York City with the law firm of Maddox Hargett, & Caruso. Our law firm represents investors. That is what we do.

I'm also now a member of the SIPC Modernization Taskforce. And I view my role on that taskforce as looking forward, what can we do to make sure that what we have experienced in the past few years does not happen again. There's a lot of blame to go around. We can blame the SEC, we can blame FINRA, we heard earlier somebody blaming the prior administration. That doesn't answer the question. There are in my mind two questions when we leave here today.

One, what do we do to keep anything tragic from happening as we move forward. And two, what do we do to remedy what has happened to investors in Madoff, in Stanford and in a host of other situations where investors have been screwed, plain and simple. That in my view is what this committee needs to consider going forward.

We have heard from other colleagues on this panel about increasing SIPC coverage that has to be done. We have heard about increasing the target level; that must be done.

Just think over the past few years what we have all seen. Lehman Brothers is gone, Bear Stearns is gone. Who's next? And what happens if somebody needs to step up to cover the exposure associated with those firms?

You need to eliminate the distinction between cash and securities. Every investor, for covered securities, should get plain and simple at least a million dollars of coverage. That is the only fair and decent thing to do.

There are other suggestions and other questions that I have put in my material. But make no mistake about it, Madoff will happen again.

There are people out there who are greedy. Stanford will happen again. Lehman Brothers, it's going to happen again.

So what do we do? We build in protections going forward, but it begs the question what do we do about all these people who have been hurt in the past. Now, I'm not aware of any legislation having been introduced by the Congress

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that would provide any financial restitution to these people. And it's very convenient to make SIPC the whipping boy for what's happened.

But if we want to take care of those people, then I today call on Congress to introduce legislation in addition to the tax relief that would provide a means of restitution away from the SIPC process. That's the most equitable and the fairest thing to do.

I thank you for inviting me today. And I'd be pleased to answer any question.

REP. ACKERMAN: Thank you very much, Mr. Caruso.

And I thank the entire panel for your testimony. I know -- I think we all have some questions. And I'll begin with my own. And we'll take five minutes each. And we'll go as many rounds as anybody would like.

I'll go backwards and start with a statement that Mr. Caruso just made and that is, seeing the mission as looking forward. When I look forward, I see before me some of the wounded warriors of the past, the victims, at least a thousand of whom were traumatized by Bernard Madoff and are now being terrorized by the trustee.

That's what I see looking forward to some people. And I believe it was Professor Coffee who said, recalling the Hippocratic Oath of first do no harm, to look at the situation that we are doing tremendous harm with the issue of the clawback to many, many people.

I think one of the terrible things that we've done here is because of the way the zero-sum game equation works that we have created classes of victims. I don't understand really -- and I know the math, net winners and net losers.

Except for the few who have yet to be identified, should there be those who are complicit with Madoff, everybody else is a victim. People who might have taken more money out of money that they think is theirs have been victimized.

People who put their money in a bank -- and I know that's a different system when you're talking about the FDIC and not SIPC -- who are using their own money, and suddenly somebody says that wasn't really your money because you wasn't -- weren't entitled for that 7 percent interest or whatever it was, they're victims.

If you're telling people their whole lifestyle -- not just in the future, but in the past -- has to be reversed, that they can no longer live in their house or maintain their business or drive in their car or continue to pay for their children or grandchildren's education, they are victims. That's traumatic. And to create classes of people by saying some are rich, wealthy entities and some are not. A guy died, and the insurance company ain't doing so well; so you say to the widow, I know you had a policy, but you're okay, I'll give it to someone else.

If you think the money is yours and you've paid for the premium -- and I don't know what kind of premium. By the way, you think you get \$500,000 worth of insurance for a \$150 a year. And the system pretends that people had real insurance.

And the SEC agrees that that's real insurance after they're supposed to be supervising the agency and the U.S. Congress which is complicit in this thing as well because we're supposed to be overseeing -- everybody is just pretending.

You know, at least during the commercials, the guy says, I'm not a real doctor; I'm just playing one on TV. Well, this isn't real insurance -- we're just making believe to make you feel better.

My question is about clawback. If we're going to move forward, how do you move backward? That's question number one, clawback. Anybody? Everybody?

MR. CARUSO: I'll offer a suggestion. I think anytime you get into the issue of clawbacks, you not only implicate SIPC and SIPA, but you also do the Bankruptcy Code. Is it fair to go back to somebody who took out money to pay taxes? Is it fair to go after somebody who may have taken money to pay for a grandchild's education? I mean, I don't think anybody in this room would say it's necessarily fair.

And I think Congress has the power to step up and say, that's not fair, that is simply not fair, whether you should be able to go back a year or two years. Clearly for insiders, it would be different. But for other people, to go back five, six, seven years, in my personal opinion, I find that to be stretching the limit.

But I don't think SIPC or the taskforce has the power to change that. I think it rests with the Congress. And maybe I'm wrong on that, but if --

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REP. ACKERMAN: And what would you suggest as a policy the Congress do? Do we have a responsibility to those people?

MR. CARUSO: I think you clearly have a responsibility to those people. And I heard earlier, a suggestion about distinction about how much of a clawback would you go after, you know, would there be a threshold limit. Clearly, if there is somebody like a feeder fund who benefited by millions or billions of dollars, there should be no limitation on the ability to get the money back.

REP. ACKERMAN: Isn't this a moral question and not a means- tested thing. I mean, I'm sure without knowing anything -- or maybe I shouldn't be so sure. But I'd be willing to bet that there are people who took nothing out of their account, who are much wealthier, much wealthier than some people who took a 150 percent out of their account because they had to live on it.

Do we means-test this thing or do we make a policy decision and try to do what's right? I mean, this is a real Solomonic question that's before us. And I think we need some policy guidance. And you all are looking at this thing prospectively how to protect people in the future. But you know, when you come up with a cure for a disease, it's our obligation not only to inoculate people yet who've not gotten the disease, but to treat the people who are suffering from it at the same time. How do we deal with these people?

MR. COFFEE: May I try to address that question -- (off mike) --

REP. ACKERMAN: Professor Coffee, please. And then I'm going to --

MR. COFFEE: I would --

REP. ACKERMAN: -- I'll yield to Mr. Garrett because my time is up.

MR. COFFEE: I would just suggest to you that we look at all the participants who fall into this heading of net winners, who took more cash out and put more -- than they put cash in. There is a continuum.

There may be people that Congress wants to protect. You could protect them with a de minimus test saying that only fictitious profits over dollar sign X could be recovered. You could protect them with what I call an imputed interest test, because if you put this money in 10 years ago, the fact that you've made 10 percent a year would entitle you to take out a 100 percent or more above the money you put in.

But you do not need to protect the feeder funds and the other people who look like they behave irresponsibly and probably corruptly. Those names are well known to the financial press whether it's Fairfield Greenwich, Mr. Merkin, Stanley Chais, Jeffrey Picower.

Those people are cheering you on right now because if you move the standard up, any time you make the recovery harder for the trustee, you'll reduce the settlement value of the trustee's claims against them and the trustee can get billions of dollars back from them for the net losers.

I don't think Congress should make it harder to recover by the trustee on behalf of the net losers, from the people who I think were very culpable. And they were number of those people.

Thus if you would protect the people you want to protect by instead using a de minimus test or an imputed interest test, I think you'll recover -- you'll achieve most of your objective without protecting those people who are culpable.

REP. ACKERMAN: I'll respond in a different round -- probe that a little bit in different round.

Mr. Garrett.

REP. GARRETT: Thanks.

So going forward, does anyone have a recommendation with regard to the SIPC logo? And some people have suggested that we put a little asterisk by saying that -- warning you that the statements that you're receiving may be interpreted in a different way, and that you'll be subject to clawbacks in the future or other interpretations.

Well, I say that facetiously, but maybe not because couple of your comments -- everyone's comments seem to imply that the investor had a misinterpretation of exactly what they were getting when they -- if they understood that SIPC was there and what they were relying upon.

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And -- but some of you have suggested -- Mr. Hammerman, if I was following I guess, you were going into the weeds in some of that, I think you said different pools or classifications or what have you. Mr. Coffee, you're a professor, you were talking about it, and not in those terms, but in a similar approach, getting to -- in place.

I, as the typical little investor, going into my local shop to make my investment and seeing the SIPC logo there probably is not going to know right away, Mr. Hammerman, do I fall on pool number A, B, C or is there no water in my pool at the end of the day because I miscalculated.

And someone over there, Mr. Coffee or Mr. Johnson, somebody made the comment about -- no, it's Mr. Borg -- about not reading all the disclaimers and everything that you get in your mail like -- just like none of us read our disclaimers that we get from the credit card companies and all those things. So how do we address that? We're going to create a whole bunch of different classifications, also Mr. Hammerman there, and then for me, the little guy that just doesn't follow this to begin with?

MR. HAMMERMAN: I think at the heart of your question is investor education and informing the public to a better extent than we've been doing historically as to what SIPC is all about. And again, when I talk about SIPC, it's the SIPC of the last 40 years. There is a lot of discussion about where this should go in the future.

But certainly, from the industry standpoint, we would be willing to work with all experts SIPC, NASA, the SEC, FINRA, consumer groups, whoever the right people in the room are, if there is a way to do a better job of investor education so that investors understand. And it's not just a one-time thing, so it's not just a disclosure at the opening of an account. As Mr. Borg said, this needs to be ingrained over time.

REP. GARRETT: And realistically, I mean, I don't have view. I get my statements regularly and I get them all the time. And I look at the number, oh, I'm doing pretty good, or right now, I'm doing pretty poorly, I'm not reading through the rest of all the fine print. Maybe I'm abnormal in that regard, maybe other people will read through all that sort of stuff, but I don't.

So if we do try to reeducate folks and tell them that in the future, and I think we should -- I think I agree on this -- in the future, the American public should not rely upon the federal government to be protecting them to the extent that they thought that the federal government was protecting them in the past as we've shown that the federal government in these areas -- the various agencies can't do it. So I think that's one learning lesson that the American --

MR. COFFEE: It's a very good question. I think your question --

REP. GARRETT: Yeah.

MR. COFFEE: -- is a profound one because when you give investor education, and you show that there are some arbitrary lines, it really becomes incumbent upon Congress to change those lines and not insist upon arbitrary distinctions.

Mr. Borg, I and others have told you that the definition of customer is too limited. Rather than tell all investors that the definition of customer is limited and arbitrary, it is better to change the definition of customer, so it makes a little bit more sense. And it includes the smaller person who's already at coverage, but doesn't.

REP. GARRETT: I appreciate -- maybe you could do a round, but I want to get another question for Mr. Johnson.

In your statement, you claimed that in the past the courts and SIPC have rejected using a customer's last statement as a guide for the SIPC coverage in cases where fictitious profits are involved, okay. But in a leading case in the second circuit that New Times won, in fact, a customer's final statement was used, I understand, in calculating their SIPC reimbursement. Comments?

MR. JOHNSON: We have a number of cases and also the bankruptcy courts have always looked at whether or not there was reason to believe that the last statement that you had received actually was the information that was accurate.

REP. GARRETT: True.

MR. JOHNSON: One of the things that we've been doing is trying to figure out how do we make sure that we can utilize these statements in a way that we're protecting all the investors. What -- the primary concern is regarding the final statement is making sure that we don't create an environment where a wrongdoer actually has an opportunity to create the form for who'd successful and who'd not be successful.

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The reason that is important is because you could have a situation -- let's take Madoff case, where you have someone that tells you something that from the beginning was not true. But the final statement they tell you -- but guess what, you've nothing to worry about because whatever I got on that final statement is what you're going to be protected from. That would be the only true statement that would come out of their mouth.

And what we would do is be creating an environment where the wrongdoer now gets an opportunity to set the tone for how the government then will be responsible for responding.

And so, the primary issue that we're concerned with is making sure that whatever message that we use are going to ensure that we're not going to allow the wrongdoer to actually set the parameters of how we would go about making final decisions, and putting Congress in a position where they end up doing something that may be unintended as well.

REP. GARRETT: Okay. But you're sort of going down a slightly different road on that, but I understand what you're saying. But there is case law now that says the final statement can be used by you for the reimbursement purposes. So, going forward on that case law contrary to the position of SIPC then.

MR. JOHNSON: There is case law that has said that. There is also bankruptcy rulings that have mentioned the fact that you can look at things from a different standpoint as it relates also to not only whether or not you've got this fictitious statement, but also whether or not you're a net winner or a net loser. And part of that calculation takes into consideration whether or not this fictitious statement or the statement you have is one that's valid.

Now, whether or not it should be taken into consideration, it should be. But at the end of the process there has to be some analysis to determine whether or not that actual statement is what you should end up using as the basis of how you would go about making a payment on a claim.

REP. GARRETT: But you're going to continue to reject the use of that as a guide for your coverage in cases?

MR. JOHNSON: When we -- what we will do is we'll continue to look at the statements that come in, and then we will continue to look at what we would call the global aspects of what happened in a particular set of circumstances. And then if there is a conflict, we will take it to the court and allow a third party to help us to make a decision whether or not we should move it forward or not.

All we're trying to do is hopefully, vigorously pursue the law as we understand it and interpret it. And we understand that there can be reasonable minds that may differ in how you may interpret the law. But once we are told from a third party or anyplace else that we should be operating differently, then we intent to vigorously move forward in that vein as well.

REP. GARRETT: Mr. Caruso, I don't want to put you on the spot on that one and respond to that since -- considering where you come from. If not, fine.

MR. CARUSO: Well, I think clearly, there are going to be difference of -- different opinions from different circuits, from different courts. Part of the confusion that exists is that there is no well-defined standard that is universal throughout the country. And the only way that I know of that that finally could be resolved would be through the Congress of the United States, because you're going to have different court opinions on every issue.

MR. JOHNSON: I think one of the point that's worth mentioning regarding the second circuit case is, it also points out the fact that where the decision regarding what those amounts on the statement are arbitrary. And in this case we're looking at a situation where the numbers, for example, in the Madoff statements were arbitrary and that would be taken into consideration in terms of coming to a final analysis as well.

REP. ACKERMAN: Thank you.

Next my co-collaborator and cosponsor of the Ponzi Scheme Investor Protection Act, Mr. King.

REP. KING: Thank you, Mr. Ackerman.

You know, as I'm listening to this I don't think we're getting the full input or impact of the reality that was SIPC was set up to protect investors. In too many cases right now, the trustee is acting as a prosecutor of victims. And we can try to explain it anyway we want, but the fact is that these people were victims, and they are now being subjected to the same type of treatment that defendants are put through in massive criminal conspiracies.

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And yet there's no evidence that any of these people are co-conspirators; they are victims. And you know, I look at the SIPC website and it says, although not every investor is protected by SIPC, no fewer than 99 percent of persons who are eligible get their investments back from SIPC.

So clearly, what -- the dawning reality is different from what people would -- had every reason to expect. They relied on the statements they received from Madoff. They relied on statements from SIPC that 99 percent of investors would be protected. And yet they -- in addition to all the money they've lost, because of Madoff, they are now running up an incredible legal fees.

They're being required to produce documents going back 25 and 30 years. And it's being done in, I believe, a very arbitrary and highhanded way, and a very heavy-handed way which is just perpetuating the turbulent justice which was inflicted upon them in the first place. Now, as far as going forward with SIPC, if I could just be clear in my mind. How is the trustee, how's Picard appointed?

MR. JOHNSON: Well, he is really appointed by the bankruptcy court. They have an opportunity to review who the potential trustees may be. There will be recommendations that'll be made. They will check to see if there are any conflicts of interest, and then they will go forward and go through that selection process. Mr. Picard is obviously someone who has been involved in this industry for --

REP. KING: Let me stop you because, you know, time will be running. Did SIPC make any recommendation on who the trustee would be?

MR. JOHNSON: Yes, we do make a recommendation regarding who we think would be a good trustee.

REP. KING: And who would you recommend?

MR. JOHNSON: Who did we recommend?

REP. KING: Yes.

MR. JOHNSON: I believe we recommended Mr. Picard.

REP. KING: Picard. So in effect, we have the court selecting a trustee that you recommended, and the argument could be made that he is now putting a tremendous effort into protecting SIPA's funds; that rather than protecting investors, he's actually working to protect SIPA. And to me, there's almost an inherent conflict of interest in that.

I know the court made the final decision, but the recommendation was made by SIPA. And it seems to me, if we're going forward with recommendation to the future, maybe trying to correct the investors of the present, we would find a way to have a much more independent person appointed as trustee in which SIPA would have no input whatsoever.

MR. JOHNSON: Well, let me make one thing clear. I don't think that we need a trustee to protect SIPC funds under any circumstances, because these funds from my standpoint don't belong to any of us. These are funds that should be utilized in order to protect the customers.

What we're trying to do is to make sure that whatever the role the trustee is going to be utilizing, it's going to be in compliance with the law. Now, we do have a certain responsibility as we manage this fund. But we're not in the business of trying to figure out how to get as few people helped as possible, but we are in the business of making sure that whatever policies and procedures that we use can be protected under the law.

REP. KING: But to me, looking at the record, what the trustee is doing is not trying to protect as many people as possible, but he is using this -- apart from the fact that he has already gotten, I believe, \$36 million in fees authorized to himself, it's -- I just think, you know, I've seen runaway prosecutors, special prosecutors. And to me what I'm seeing in this is a runaway trustee who is putting innocent, wounded people through increased suffering. And I know that even the -- maybe as Professor Coffee made a statement; he said people who we might think are innocent -- well, don't we have to assume they're innocent?

I mean, is there any reason to think that any of the people in this room who lost millions of dollars are now being put out in a rack, is there any reason to assume they're not innocent? There's almost an inference here that the trustee is being hired because -- he's been appointed or his job is to find out those who may have been involved. And we think others are involved when there's no evidence that they were.

And to me, the presumption should be that these people are innocent. How do we help them and not put them through the incredible ravages and suffering as they're going through right now? Is something wrong about the system?

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I think somehow we are standing back at, you know, 30,000 feet and we're saying, okay, well, we dropped the bomb, there may be collateral damage, but we're not really, you know -- that's what happens in a war.

Well, the fact is there is a lot of collateral damage right now, and it's from people who are already damaged are now being collaterally damaged again. And I don't know if we're really addressing that -- the inequity, the injustice, the horror there.

MR. JOHNSON: I think, Congressman King, the point is well taken. And one of the things that I've tried to do as chairman is to make sure that we start out with the proper tone as to how we're going to go forward dealing with any of the individuals who have been victimized.

I think the role of the trustee is one that is difficult and complex in that when you begin to start to go through the process, it's unclear who may be complicit, who may have engaged in wrongdoing, and who has not.

But the one thing we have made clear is that we wanted to make sure that everyone had an opportunity even if you've got, quote, unquote, "received a service of a document" that you had an opportunity to come in and speak with the trustee because our goal is to make sure that we are going after the correct individual.

We are not trying to simply just go after anybody for the sake of going after anybody. We understand that this is a very sensitive issue, and we sympathize with some of the horrors that individuals have gone through. And we want to make sure that at the end of the day that that process is taking place in a way that we will all be comfortable. And that's basically the commitment that I'd like to continue to make here today.

REP. KING: If -- Mr. Ackerman, just give me time for one more question or one more statement.

If that's the case, then I think someone should tell Mr. Picard -- because I've spoken to many of these people and they described to me what they're going through. They are not being treated as citizens. They are being treated as defendants. They are being treated as criminals.

And it's a highhanded arrogant attitude by the trustee towards these people. And I think something has to be done, if the message should come from you or from the court or someone, but telling them to knock it off and treat them like victims, not as criminals.

MR. JOHNSON: Point is noted, Congressman King.

REP. ACKERMAN: And I will also note for the record that there are compassionate conservatives.

(Laughter.)

REP. KING: I'll take exception to that.

(Laughter.)

REP. ACKERMAN: Well, you are exceptional.

Several things -- these letters that are going out aren't, "Hey, I'm from the government. I'm here and I want to help you." These letters set the tone of a very adversarial relationship and it's scaring a lot of people.

It's now us against you or you against us, and these are people -- not if they might have been victimized, they're victims. I mean what kind of attitude is it they might have been victimized? Is there any question that they've been victimized? People who directed their entire lives and the future of their families after working hard with their lives and doing the right things wind up with nothing in an account -- and being told they're accomplices spending stolen money. I mean, that's pretty adversarial.

And you got to give it back even if you don't have it, and you've got a problem with that, come and talk to me. You know, I mean I understand your argument, Chairman Johnson that you don't want to put the crooks in charge of setting the dialogue by having the Ponzi scheme operator send you a statement. And -- but you know, just because the guy lied and put that as a bottom line on the statement, you believed it and therefore you're guilty of something, and therefore the crooks are in charge of the agenda.

And it's your fault for believing the bottom line. Well, let me tell you something. Your government, my government, our government -- the Internal Revenue Service was very pleased, was happy, was delighted to rely on the bottom line in collecting taxes and going after them if people didn't pay based on that bottom line.

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We empowered that bottom line as being gospel. And telling people they had to pay based on that bottom line because that bottom line was the bottom line. And why didn't the government investigate? Why didn't the government do? I mean this whole thing is bizarre, it's Kafkaesque.

I mean "first do no harm" should be the rule. I mean it was cited here and properly so. But instead of the Hippocratic Oath, we've taken the hypocritical. And we're saying first do no harm and then we're going after these people. The whole notion is weird. You know, my colleague, Mr. Garrett, you know, talked about the SIPC logo. This is the SIPC logo.

People look -- you know, people look in shorthand. They look for symbols, they look for things and they -- this is the way we conduct our lives fortunately or not. And we all get those little statements, you know, from our financial institutions 15 times a week with all that fine print and it's folded in 16 pieces, and we don't read it and we throw it out. And sometimes I say who made these people send this out, and I scratch my head and I say oh, my God, what have we done.

But we don't read those things. We do the shorthand. You know, and it says, you know, people go into the bank. It says protected by the FDIC and people believe they know what that is. It's the government standing behind and they got insurance up to a certain amount that we just increased in this last Congress.

And they know they got insurance and the government standing behind it. And then they go to their broker and they see this and it looks kind of like the same kind of deal. And you go to your guide and make an investment, and he hands you his business card and we just pull two out of the fish bowl that we got, and on it, it says he's a member of the NASD and he is a member of SIPC.

And everybody's business card, they're proud they are a member of SIPC. That's code for you're protected and Uncle Sam and the government is standing behind. And you go -- you go into the guy's shop, and you go to your broker-dealer and you got this on the door. And if you've looked him up like I used to do not too many years ago, and those of us who were technologically challenged, and you go to Yellow Pages. His ad has this in it; his stationery has this on it. His radio ad tells you. His TV ad tells you.

You go to the Internet and he's advertising he's a member of SIPC. And you see what it says right under the logo, security investor, that's me; protection, that's what I need; cooperation, that's what I got. And instead of a dot on the 'I,' guess what we got? We got the American eagle. Just like on my stationery and on the shield, the president of the United States and the Supreme Court. That's shorthand for your government is standing behind this, and we've allowed this to happen.

If I'm not a real doctor, but I'm playing one to fool you and your government is accepting it, and you got insurance for \$500,000, except you ain't got nothing. And we got a moral responsibility to these people, do we not? Or am I missing something? Question mark.

MR. JOHNSON: I think we do have a responsibility to these people. And I think when we look at things, we have a responsibility to every victim that was part of the scheme. And one of the things that we have to figure out how we balanced and whether we do it the right way or do it the wrong way is, how do we ensure that we are not simply going to benefit those that by the luck of time got out at the right time. As opposed to those individuals they may not have been that fortunate.

REP. ACKERMAN: Well, if you got a transfusion, first we should take out the blood to give it to somebody who is a pint short?

MR. JOHNSON: Well, I wouldn't take out the blood, Congressman, in order to have somebody take their life away, but we do give blood to others from time to time who are in need. And one of the things that we're simply trying --

REP. ACKERMAN: But shouldn't that be a collective decision that we do as a society, and not have a trustee decide to who to go after and take that blood back?

MR. JOHNSON: Well, and I think maybe the role that Congress will end up taking is to help us to get more specific guidelines as to how that needs to take place. And I think we'll be more than happy to vigorously follow that rule in whatever way Congress decides to move forward.

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REP. ACKERMAN: Yeah, but we're looking to you. I mean, this is not you know King Solomon's court, and you know, none of us pretend to be that. And it's an awesome responsibility. And you, by virtue of the fact that the roles that you have looking forward, which I agree is your role, and sometimes we have to see how to fix the problem looking forward, what we'd do about the collateral damages Pete King said that we've left behind, the carnage here. We shouldn't be trampling on the bodies of those who are injured in order to help people in the future.

We have to try to help everybody. And you don't do that by further wounding those people who are suffering. You know, it's not taking away -- you know, we are where we are. It's a static situation right now. You go in and further probe the wounds of those people who may or may not have the wherewithal to do anything to give the people who are, quote, "net losers" who may be richer than the net winners.

I mean, I don't know how you figure this thing out. I mean, you know, we have some legislation on the people who went through broker-dealers and third parties and all that, you know, give them up to \$100,000 insurances. And we have to -- you know, as a society, maybe we who are complicit in it which is society and us and you and everybody else for letting this happen. To say, okay, this is -- you know, this is the help we have to give people. And we all bore the responsibility and we have to pay for it.

It's not just voter education. You know, we all know you can't go over the speed limit, but we still put cops out there. And people rely on the cops to enforce the law and our cops haven't done that. Everybody thought they were doing what they were supposed to be doing and then find out that their whole world is topsy-turvy. And my time is up.

REP. GARRETT: Thank you.

REP. ACKERMAN: (Off mike.)

REP. GARRETT: So I wasn't sure where you were going with this King Solomon's reference. But you know in the case of King Solomon of course -- we all know the story from the Old Testament -- at the end of the day of course, he didn't slice the baby in half and the baby survived.

I thought he was going to go and suggest that in this case we are slicing the baby in half and making that wrong decision, and then the penalty is on both the mother and the dead child. So just to file along, and also where Peter -- the gentleman from New York, excuse me -- was saying with regard to the trustee, just two quick questions there.

One question that we get oftentimes is do we know -- do you know what the trustee has billed SIPC so far? And where do those funds come from actually?

MR. JOHNSON: Yeah. I think he's billed the court about \$39 million.

REP. GARRETT: Thirty-nine million dollars. And where --

REP. : Does he get paid on time and --

REP. GARRETT: Yeah, okay. The question is from the -- (off mike) -- from my colleague here is that does he get paid on time, and where do those funds come from?

MR. JOHNSON: They come from fees that are paid by SIPC members.

REP. GARRETT: Okay. So same -- in that sense it has to be right from the same pot of -- the same pot of money. And Peter was -- I'm sorry. The question was asked by the gentleman from New York with regard to the appointment of the trustee, and I understand your answer.

But over time, not just in this case, is it just a norm with regard that SIPC makes the recommendation for a trustee, and is it the norm that the judge would approve that --

MR. JOHNSON: It's the norm for SIPC to make the recommendation and it's simply up to the judge. I can't say that I know all the circumstances where the judge may not have accepted that recommendation, but at the end of day, it's completely in the judge's discretion.

REP. GARRETT: Because do we know in -- as in other cases, does the investor class or anyone else make recommendations to the court as to how they would --

MR. JOHNSON: Well, we make the designation basically by statute. So if the statute was different, then it would allow others to be able to make the call. But we're designated by statute to do so. So that's why we really don't have any other third parties that are involved.

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REP. GARRETT: You haven't --

MR. JOHNSON: I don't believe investors would have the right to propose their own trustee at least initially.

REP. GARRETT: Okay. And just as an -- quick question, does anyone --

MR. CARUSO: Your statement was correct. It is SIPC who makes the recommendation of the trustee; the court simply decides if the proposed trustee is qualified. So there's a strong presumption in favor of the SIPC nominee.

REP. GARRETT: Does anybody here on the panel suggest that that is good, bad or should be changed?

MR. CARUSO: I think SIPC is very much overseen by the SEC in this regard, and it's the SEC who has asked SIPC to generate a list of potential trustees in advance. So I think this is a combination of the SEC and SIPC that has developed this approach of developing a list of potential trustees in advance.

REP. GARRETT: Okay. And does anybody suggest that that is not the appropriate -- yes, some of you said looking forward, so looking forward is something that we should be looking at.

MR. JOHNSON: Well, in terms of that whole process, I mean that's on the table in terms of what we're looking at during the taskforce. The way we're looking at the taskforce is we want to take a look at everything that we're doing from top to bottom.

We just went and had a complete full view of the operations of the staff, which was something that I wanted to have an opportunity to take a look at. So we've got everything on the table in terms of how we think we can best protect investors and customers when this is all said and done.

REP. GARRETT: Okay. Would -- one of those other things and anybody can answer this question is -- and this was in my opening statement, it was the question regarding how net equity should be calculated. And the question as far as access to the records to the investor class in order to help make those determinations I understand that -- well, obviously it will be critically important for the investor class to be able to make -- have those information as well as SIPC to have them. But right now, I guess, they're not done.

I understand that SIPC trustees -- SIPC's formulation, it could be called into question if you were to look at the -- have access to those records. And to look at those records and to say, you know, the examples that some of you are raising that, well, yes, some of these transactions over the last -- how many years -- couple of decades -- were actually legitimate transactions, right.

And so when I got my statement, they'd put in \$0.5 million dollars on and said \$3 million, maybe 750,000 of them were actually legitimate transactions, right. So when you all figure out the net evaluation on that, you want to know that, right. But if the investor folks don't have access into the information, they are not in a position to argue that. So what are we doing with those records?

MR. JOHNSON: Well, that point is well noted. And I think, from my standpoint, I don't really see a reason why they shouldn't have access to that documentation. And that's one of the issues that we'll be looking at and making recommendations potentially with the taskforce.

REP. GARRETT: And but where are we right now on that, I mean --

MR. JOHNSON: I'm sorry.

REP. GARRETT: It's in the court right now. I mean, is this something that can be changed for with regard to that's going on right now or is this just -- and I'm not talking about -- Mr. Caruso's fine comment of saying what do we do in the future on the next Madoff?

We're taking about the situation right now. I guess for some of the folks behind you, can we say that, you know, tomorrow these -- this information is available or where are we?

MR. JOHNSON: Well, in terms of where we are right now --

REP. GARRETT: Yeah.

MR. JOHNSON: -- I'm not sure if we've got the authorization to make that available, but that's something that we can take a look at, and if we have the authorization to do so, we will.

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REP. GARRETT: All right. So there is a question whether SIPA itself needs -- may need to be amended in order for that to occur. Is that the -- (inaudible)?

MR. JOHNSON: That's clearly the case. I mean, I think I want to --

REP. GARRETT: It is.

MR. JOHNSON: I'll make -- yeah -- very clear that this is a statute that really hasn't been reviewed for about 40 years in a serious way. And that's part of the reason that we're trying to figure out how to get this statute to be more flexible, to be able to deal with the issues that we're currently, you know, dealing with in this type of market, in this type of investment climate, and understanding the type of investors that we're dealing with right now.

REP. GARRETT: Okay. Just so I'm clear then, so that needs to be done and we -- you don't have flexibility under the current language. Is that --

MR. JOHNSON: Well, we're reviewing it and we'll determine whether we're not -- we have the flexibility under the current language. So what if -- in the event that we do not, that may be a recommendation that we may move forward with.

REP. GARRETT: Well, you then just opened up the next question then when you said we're trying to determine this. How long does that take in order to determine because I sort of think that that's the information that I'd want yesterday?

MR. JOHNSON: Well, that's the information that we can find out very quickly, and as soon as I have that response I can get it back to you, Congressman. But I'd have to imagine it should take us a long time to make that determination.

REP. GARRETT: Thanks. And the gentleman next to you would like --

MR. BORG: Congressman, I was going to make an analogy to summer vacations that are non-SIPC. Most of the cases I prosecute -- my office prosecutes are Ponzi schemes with fictitious securities and whatnot. But there is no SIPC coverage, or there hasn't been in the past.

You know, I'd like to see nothing better than everybody get all their money back, I'm not too sure how you would do that.

REP. GARRETT: Can you just -- before you -- hold that thought. Can you just explain why they -- how do they come about it that they're not going through a SIPC?

MR. BORG: Historically, because the securities are not either held by a broker-dealer. For example, private placements --

REP. GARRETT: Okay.

MR. BORG: -- which is a big area for us, the reg D's. We've complained about this many, many times. The sales would occur through a broker-dealer.

REP. GARRETT: Okay.

MR. BORG: It might be a private placement where they get a LLC partnership, a limited-partnership type certificate or something. The certificate is not held at the broker-dealer. It's not in the inventory. They do get account statements because there is a report and they'll actually get -- say that according to your oil and gas well or whatever it may have been, you've got XX dollars. Historically, that has not gone through SIPC. And I guess -- I've tried this discussion with SIPC since the mid-'90s on that, but there was no interest from any government party at the time to take that on up. This goes back to the microcap area that I testified to in the Senate back in 1996.

As a practical matter though, the Ponzi schemes that we oversee, end up having a very limited pool of funds. Although we very rarely see the clawback issue come up because quite honestly, these Ponzi schemes usually till last 20 years. The ones we see on a more local level are a lot shorter in duration.

And therefore the time value of money is not really that significant. And let's face it; most of these folks don't want the cheese. They just went out of the trap and get their money back if they can. Most of the time, it's pennies on the dollar.

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I am going to suggest though that if we're looking at things like covering the Stanford matter, I've got five cases right now in the last year. That's another \$7 billion that need to be added to that. What is not reported is that Stanford and Madoff, just because of the sheer size, are not unusual cases.

They are unusual because of the size. I've got one case that had 18,000 victims in it, but the dollar numbers were small because we caught it early. But that being said, there was no coverage there.

I think that as much as I would like to get everybody coverage, if you're going to cover the fictitious securities outside of the broker-dealer custody area, you're probably going to look at a several-hundred-billion dollar fund that needs to be funded. And that's going to take the time depending on what you do with the assessments.

I would love that to happen. I don't think it's practical, at least under the current standards. But I do think -- let's not forget, I think, that -- there are other frauds out there that if we are going to expand coverage; we need to do it for all Americans and all frauds, not just a Stanford fraud or a Madoff fraud. And you know, I can give you a list of 20 that we've prosecuted in the last 12 months, with a range anywhere from half a million dollars to a couple of hundred million dollars. And the effect of losing your retirement fund to a Madoff --

REP. GARRETT: If I might I think -- I think one of the legislations that we've cited here, that we've proposed are not Madoff-specific, but they apply to all the Ponzi schemes, or such schemes, some of them within a timeframe of --

MR. BORG: And I think that's something that really does need to be looked at, and I compliment you to that.

REP. ACKERMAN: Mr. King.

REP. KING: Thank you, Mr. Ackerman.

Mr. Johnson, what weight if any does SIPC give to the final statement?

MR. JOHNSON: I'm sorry?

REP. KING: I said what weight if any does SIPC give to the final statement in Madoff?

MR. JOHNSON: Oh, well, the final statement has to be part of the analysis because that's where we begin to determine exactly how we got to this point and then we start to look back from there.

So in terms of the final statement, we have to begin with something, and then once we start to go through the analysis regarding how did we get to that point, that's when we have to determine whether or not it's fictitious. And the bankruptcy courts, and SIPC and the trustees have reviewed this issue for a number of years, and we have found that in instances where it is fictitious that the courts will come in and make a decision that that's something that we have to look through and go to find out what the real loss is going to be.

So we do have to begin with that. And then hopefully, try to draw some type of analogy as to where we're supposed to end up.

REP. KING: Does it weigh at all in determining a reasonable expectation of the investor, or what their -- you know, reasonable belief of the investor was?

MR. JOHNSON: Oh sure. I mean, no one's saying that we have a situation where you get this statement that someone is complicit and therefore should not have had some type of reason to believe. What we're trying to do is to make sure that even when we go through that analysis that we have a bigger picture to understand that although you may believe this was the case -- and in most Ponzi schemes, you have a lot of individuals that believe that something actually belonged to them.

And the responsibility of the third party is to come in and to make clear what really belonged to somebody else, and try to figure out how do you balance that equation so that more people are going to be benefited when it's all said and done. And that's the same practice that we'll go through.

REP. KING: Okay. Moving on, as my concern is -- and first, I thank all of you for your testimonies. Obviously, it's a very complex situation, but I'm just wondering if all of this -- if another Madoff scheme occurs 10 years from now, is there any reason to believe that investors would receive any more equity than they are right now?

I mean, would all of the -- even the recommendations that are coming out here, unless we set up what -- a fund of several hundred billion dollars, it would appear that we could be back at the same place 10 years from now, where you

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have innocent people who took the money out relying on the statements, which they thought was guaranteed by the government.

And they then get clawed back, and then others who left their money and also and that -- they're in a terrible situation too. I mean, but are we -- is there anything that's coming out of this hearing or any of the review that would make it any -- the situation any better 10 years from now for innocent people in a Madoff-like scheme?

MR. JOHNSON: That would be the hope. The idea is, is that, you know, when you look back to when the first Ponzi scheme came into play, we would have hoped that we would have never had to see that happen again. And our primary goal is, hopefully trying to put in place some modernization that will make our statute flexible enough to be able to deal with those things that we can imagine.

The biggest issue that we have is the 1970, the current statute we had --

REP. KING: Right.

MR. JOHNSON: -- could not have anticipated this. And we're hoping we're going to put something in place that will be --

REP. KING: But now that we know, I guess what I'm saying is besides hope, is there any reasonable expectation?

MR. JOHNSON: Well --

REP. KING: -- for the hope that we would be able to protect a person who took his money out, or say, systematically relying on the statement, took the money out over the years, and now is suddenly confronted with a massive claw-back which is going to destroy that person, destroy their family, destroy their business, and also destroy any hope of financial security for their children or grandchildren?

Is there any -- do you see anything coming out of the discussion so far which would protect those people in the future; in a large PL (ph) scheme such as this?

MR. BORG: I think -- and I listened to Professor Coffee's idea. I don't think -- I don't think that under the current system, if another Madoff happened in 10 years, you would be any different. I think where you would be different is if you do set the limitations on the clawback that Professor Coffee has suggested, because that -- from point of view, there is always a limited pool of money.

And historically, in the cases that we have -- again, the non- SIPC, because that's where most of our experience is, we always have, for example, \$10 million. That's what I've got. That's every asset, we've taken the houses and the land and whatnot, and I've got \$100 million for the claims.

The only fair way I've been able to do it without having any SIPC coverage is to say if you put in \$100,000 and you took \$50,000 out, yes, I know that you were expecting that was interest. But I've got somebody over here who put \$100,000 in and never took anything out. Therefore your loss has got to be \$50,000, and their loss is 100 (thousand dollars). And then when I do the mathematics pro rata, you're all going to get the same sort of share of the loss, as opposed to trying to make your whole.

If you have an unlimited fund or a fund of \$500 billion or something like that, then of course you can do different. If you have that expectation and you can cover everybody's expectation, I don't think it's practical to cover everybody's expectation for the full amount without some limitation -- 10 years, 5 percent, 10 percent, whatever it is.

Well, I do think 10 percent is high in the current economy. I'd love to get 10 percent on a CD at a bank if I could. But whatever the number is, I think the important thing is that we have a finite number to start with, and that's a finite number that has to be divided.

If I've got five people in my family and there is a lemon pie, I can cut it into five pieces. But if somebody has already got a piece, I'm not sure they are entitled to a full piece the next time around. And --

REP. KING: Let me just follow-up with Professor Coffee on that. Have you done any of the math if that reasonable expectation was built in over the years, how that would --

MR. CARUSO: Let me take Mr. Borg's example and take it one step further.

REP. KING: Sure.

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MR. CARUSO: If you put in 1 million (dollars) and you take out 50 million (dollars) -- and there are those cases in Madoff -- I do not want to totally disarm the trustee. Trustees and bankruptcy, for the last 500 years, have had the power to attack fraudulent conveyances.

I think we would be sweeping too broadly if we totally disarmed the trustee. I understand your concerns. I think the better way to deal with the people you're most sympathetic to is to create either a de minimis testing if it's only 500,000, 700,000, some number like that that you took out that's immune, or your personal assets. Your home is immune.

Or we could say we're going to give you a minimum return of 10 percent a year because you've been invested in here for 10 years. All of those techniques would reach most of the people you're talking about. But if we were to disarm the trustee entirely, the next case may come along and you're going to be heading a congressional hearing as to why this trustee couldn't do anything when there was real fraud going on here. So I'm saying, be careful about how broadly you disarm the trustee.

REP. KING: I realize that -- so let me just ask. I'm just wondering has anyone done any research on what the impact would be if it was -- 8 percent or 9 percent or 10 percent have been built in as the reasonable rate of return over the years, how that would affect Madoff investors?

MR. CARUSO: Because Madoff went on for 20 years -- Madoff went on for over 20 years, may be 25 years or more. If you use compounded interest, you'd be able to get up to four -- three or four times what you invested and be exempt from any kind of clawback.

REP. KING: Okay. Thank you very much.

REP. ACKERMAN: Can I come back to the pie? What if you discovered suddenly that you had more pie than you thought?

MR. BORG: I can tell you from my personal experience on the occasion where we do have more pie than we thought, we make the pro rata distributions go up. It's almost like all the victims would get -- you get a dollar, dollar, dollar --

REP. ACKERMAN: Would you --

MR. BORG: -- and you raise it all up.

REP. ACKERMAN: Would you continue to try to stomach pump the guy that ate the first piece of pie?

MR. BORG: If I had enough to go around, I personally wouldn't. I do not like clawback. I have very, very rarely ever done a clawback. But again, most of my Ponzi schemes are not 20 year long Ponzi scheme. So the clawback haven't been significant enough to even make that determination. But if you've got more assets and you can cover all folks then why do the clawback?

REP. ACKERMAN: Well, if you somehow discover that you have more pie, I'm sure it's not going to be enough to cover everybody's total expectations and probably not even if you do the imputed interest that my colleague Mr. King was enquiring about. But would you discontinue doing harm to those people who already ate the pie?

MR. BORG: I would --

REP. ACKERMAN: I mean, they could have eaten that pie three years ago.

MR. BORG: That's true. But there are some folks who tried to save that pie and put it over in the fridge and didn't need it and now they don't have it at all. So they never got the benefit of the first piece of pie in the first place.

REP. ACKERMAN: Yeah, but those people may have six other pies.

MR. BORG: Yes, but you know, the problem with that is we don't get into -- at least I haven't and I'm not talking about the Madoff situation because I'm not involved in the Madoff trustee case, that's why I don't know the details.

But in the cases we have where we've seen that someone else has a lot of assets, the point is they're still entitled to protection under my statute and they're entitled to --

REP. ACKERMAN: Exactly.

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MR. BORG: -- to cover that. If I have excess property, I probably don't have much of a case to worry about because I've got enough money to go around.

REP. ACKERMAN: No, not excess, but more than you thought you had.

MR. BORG: But then I think --

REP. ACKERMAN: Nobody is going to get excess because there wasn't enough money generating by --

MR. COFFEE: We do have a \$50 billion loss here. And even if there is more pie, it's going to add just a few more pennies, a few more dollars to the recovery of the entire class of victims.

REP. ACKERMAN: One of the things that I think we'd like to look to you towards your task with the responsibility of what we do in the future. So to make this situation better for future investors and you guys are looking at this in a lot more depth than the total Congress or even this committee.

I mean, we have lots of other legislation and stuff we do despite the fact that the victims would like to think that we're doing this in this exclusively full time. I mean, everybody knows we have a lot of other loads that we're trying to keep in the air.

So you guys -- this is your job as well. We're not backing off at all. But it would be useful for us to hear your suggestions for the future why -- to treat people fairly and equitably and justly. Why wouldn't those recommendations that hopefully you will make sooner than later be applicable to the people that were already victimized as far as how we approach this?

If this is the way we should have done it because we're going to do this in the future, why can't we backfill and see if we could be helpful to these people that way?

MR. JOHNSON: Well, I mean, really what that boils down it will be a legally question. If it turns out that pursuant to the law that we can look back then that's something that we can take into consideration. But if the law, for example, set some specific guidelines, like for example, we've been talking about how far back the trustee can go, the law actually has a limit to how far back the trustee can go and that's six years. You can't get beyond that timeframe in terms of doing an analysis.

So what we would be looking to do is really to be in compliance with the law. If it turns up that the law allows us to be able to look back in some way then that will have to be taken in consideration as we go forward making recommendation. But that basically would be what we would use as the -- hopefully the parameters as how we would make a decision --

REP. ACKERMAN: No, my --

MR. JOHNSON: -- what we would do retroactively.

REP. ACKERMAN: If your tasked with the responsibility of looking forward, it doesn't mean that you can't look over your shoulder.

MR. JOHNSON: Well, I don't think we can really adequately know what to do for it unless we have looked back over our shoulder to do a real analysis to where we came from.

REP. ACKERMAN: My question is if you're making judgments based on what is -- what you believe is just, I'm asking a theoretical question, why should not that be applicable, why should not we use that as a standard?

MR. COFFEE: We sympathize. We are not saying we can't, but this is a private insurance system. And if you suddenly decide you want to cover loses that the insurance system never reserved for, you're going to sink the insurance system. That is the problem of Allen Stanford. If you ask broker-dealers to cover fraud related damages, that's a kind of liability that dwarfs within the fund.

REP. ACKERMAN: Well, I don't want to go back and beat a dead horse, but I know that we all know that this private insurance system was inadequately funded. You know, whose fault that is a matter of speculation on people's part and I think there is a big shared responsibility here.

Who I would say it is not the fault of is the guy that walked into a broker's office and saw this. It's not his fault or her fault. We've allowed that to perpetuate in a myth that these people were adequately protected.

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You know, hospital hires a guy that's not a real doctor and he operates on your kid, God forbid, there is a liability here. You know, this guy that hung up this certificate operate on your finances wasn't protected with the insurance that you thought he had. And your goal is to try to fix that in the future.

But the way that you fix it in the future I would think would set a moral tone to the responsibility that we have to look at as far as how do we help the people that already took ahead. And not only that they already took ahead, but with the clawback thing are going to continue to be traumatized.

And before I move on to my colleague, I just want to -- and this is not your responsibility either, but the government should not be the ultimate beneficiary of the ill-gotten games of Bernard Madoff. And that's our job try to figure out how to fix that. Some of us have some legislation that's moving forward in the Congress.

Mr. Garrett.

REP. GARRETT: Thanks.

And so -- just to wrap up, so gentleman from New York hold that banner or the logo up and what have you, and the issue of what the expectation was. As I sit here listening to that and sit here also thinking about what we have done in Congress over the last year-and-a-half and what the federal -- Fed has done and what have you, I think we're probably even in a more difficult position than ever before as far as lowering the level of expectations.

Regardless of what SIPC did or didn't do in this situation, if I can make the suggestion, oh, we really should do -- just send out a blanket notice to everyone who comes in the dealer's office and says you're not protected for x, y, and z in big bold letters or something like that so everybody would know and you all say education what have you.

But we already had law to that affect actually on something that I use and that is the money market fund. And every time I called up my money market fund, I would get an automatic recording at the beginning or the end of the phone call that says, these are not FDIC insured, so there is no protection by the federal government.

And I knew that going in that there was absolutely no guarantee. But guess what, at the end of the day, when the reserve fund had a problem and there was a problem on Wall Street, all of a sudden they basically were guaranteed. And they didn't want all the funds to break the dollar at that point.

And we just created something and I guess to the point that was made this past week of a new CFPB, Consumer Financial Protection Bureau or Agency or something like that. So now the American public really doesn't have to worry about anything.

If you've listened to the testimony over the last several months because we had an agency out there that will protect us from ourselves and any investment or any -- not security per se under the CFPB, but any investment, any financial product that's out there because the CFPB is going to do watching out for us.

So regardless of, I guess, what SIPC does in this regard we know that the good faith and credit of the United States federal government will be behind any future financial activities that I engaged in and I should be able to look to the federal government.

I think that is a problem that you will have going forward to be able to actually whatever your recommendations are is delineate exactly what your responsibilities are whether it's 500,000 (dollars) or \$1 million as some people say or something else.

Folks at home are going to think, no, it's not, the Fed is going to step in, Congress is going to step in just like they did in these other situations and it's irrelevant. So you have a difficult job ahead of you to try to reeducate and convince the public that there is limitations to this.

One question on that though and I know you weren't around back then, but back in '03 you weren't -- where you were around some place else, right. But --

MR. JOHNSON: I hope so.

REP. GARRETT: But you weren't here. The GAO and members of Congress warned that the size of the fund wasn't the right size, I guess, and it should be increased. I guess, that was done.

So do you, a, want to comment on your understanding of what may have occurred back then to the best of your analysis, your best opinion on that, but more to the point where you are right now. Now you have 2.5 billion (dollars),

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is there a statistics or an actuarial analysis to say that that's right the size because I think some other folks here were suggesting that that should be a much higher figure.

MR. JOHNSON: Well, that's actually one of the -- I would say one of the real conversation points that we have as it relates to the taskforce how do we right size that number. And a lot of it really boils down to what would be the ultimate responsibilities that we would be taking on SIPC.

If, for example, Congress were to decide that SIPC should be in the business of protecting against fraud then that number would have to be a completely different analysis that we would have to go through. It could be a situation where you take the number up to \$10 billion maybe that we're raising from fees and therefore you never tap the Treasury line.

That would be an analysis of how we could figure out what number of we need to be at. But part of what we're going through at the taskforce is really going through an analysis and hiring those who'll be part of the process to help us figure out how do we right size what that number is.

And what it really boils down to is what are the responsibilities that Congress want us to take moving forward. And that would help us to be able to get to that point.

REP. GARRETT: And, of course, the issue of fraud most people coming into the brokers doesn't differentiate what he's being protected for right now --

MR. JOHNSON: Right.

REP. GARRETT: -- they just like -- I don't think, differentiate under FDIC what I'm being protected, I'm just protected to the limit, which goes to a question. Mr. Borg was saying that you dealt with cases outside of SIPC, right.

So it seems to me that we're talking maybe two different things here when you're talking about clawbacks and what have you because in your non-SIPC case then you're just dealing with what -- an estate, right?

And you're taking this little estate or big estate and saying how am I going to divide it up and maybe use some -- if it was long-term present value of money you might have done that. If short-term, you're not going to do that, right?

MR. : That's correct, cash-in, cash-out basically (cross talk).

REP. GARRETT: Exactly. But here we're dealing with that. And so you have to make those decisions and I understand that. And with regard to the issue about the statements and everything and you understand that.

But you're talking about something else with SIPC, right, because you're dealing with what -- sort of my way of thinking, an insurance policy, but a separate part of funds that you've collected over the years from the dealers, there that's different in my estimation with regard to how that should be treated because that's really where the expectation.

When I come in, I see that thing. I think if I'm smart enough, I bet you most people don't even ask how much I'm covered for, but if it's up to 500,000 (dollars), then it goes to Mr. Coffee's comment. If I invested 500,000 (dollars) 20 years ago and I put -- and now it is 50 billion (dollars), and I took out 50 billion (dollars), I still have an expectation, just like I have, I'm sorry I used the word an insurance policy for \$500,000 worth of coverage regardless of whether I took it out or not.

That's different in my estimation of what you were doing or you are also doing with the state residual, is that correct?

MR. BORG: Yes, sir, that's absolutely correct. That's why I was trying to distinguish the SIPC coverage from the non SIPC coverage.

REP. GARRETT: Yeah.

MR. BORG: Only from the point of view of anything over that amount, we still have to do some sort of proration. My point was really that the coverage is going to depend on how big you've got a path to deal with.

REP. GARRETT: But only for the residual, example the 500,000 (dollars).

MR. BORG: I think we are saying the same thing.

REP. GARRETT: (Cross talk) -- okay.

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MR. BORG: But I'm using that as an example to show what else is out there --

REP. GARRETT: So Mr. Coffee, when you are making --

MR. BORG: -- on the net value, on the net equity type calculations.

REP. GARRETT: Right, so when you give the example, you did before you invested -- if somebody invested in million bucks, but he thinks he has the 500,000 (dollars), right, and he took out what you say \$50 million over the last year. But the statement comes out and it still says I have a million dollars on my statement today right.

That person should still have the correct interpretation that he has the \$0.5 million worth of coverage or protection and there should be absolute no clawback for that \$500,000, correct?

MR. COFFEE: (Off mike) --

REP. GARRETT: Right.

MR. COFFEE: The clawback is for the amounts that were early --

REP. GARRETT: Only for the --

MR. COFFEE: -- detected through fraudulent conveyances arguably.

REP. GARRETT: Right. And that's what I wanted clarification on Mr. Borg's comment. Thank you.

And thanks to panel too. I think that is the last that I can say that.

REP. ACKERMAN: I have one question --

REP. GARRETT: Oh, I'm sorry.

REP. ACKERMAN: -- and then we have Mr. Klein. Has any thought been given to, as you pointed out, private sector because this is private sector insurance? The private sector that made so much money over the years on people's investments, huge profits, underpaying insurance to give people -- that in effect gave people a false sense of confidence that they stepping up to the plate and increasing the size of the pie by putting in whatever -- by whatever formulaic circumstance additional amounts perhaps based on a recalculation of what a reasonable premium should have been because they indeed gained the profit -- made a profit and stand to profit additionally by restoring investor confidence in the market.

MR. JOHNSON: Well, I think the role of --

REP. ACKERMAN: Or that too sensitive an issue for you guys to go to?

MR. JOHNSON: Well, you know, I think the role -- I guess, what I was trying to kind of multiply in my mind is the role of private insurance, it's sounds like what we are talking about to actually act as an additional backstop. Is that where we are going with that, Congressman?

REP. ACKERMAN: No, I'm saying, hey, boys, let's chip in and make this thing good.

MR. JOHNSON: Oh, I see what you are saying. Well, you know, what we end up doing really is increasing the assessments because increasing the assessments at some point is the only way that we will actually end up --

REP. ACKERMAN: No, I know, but we've made a decision that the assessments should have been a heck of a lot larger to begin with. We are going to fix that in the future. But has anybody given any thought to saying the guys that are going to profit by keeping investors as investors making good to restore confidence in paying what they should have paid in the first place into the fund?

MR. JOHNSON: That's an area that we can't take under consideration in terms of how that road would be going forward. I'm unclear on how it'd play out. But that is something that we can take a look at.

REP. ACKERMAN: I think that might be a good thing.

Mr. Klein from Florida.

REP. RON KLEIN (D-FL): Thank you very much, Mr. Chairman.

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And I thank the panel and people here today in support of a full understanding of what can be done to fix this. Obviously, there is the going forward assessment of what can we do to avoid something in the future, but I think we've all heard from in our communities the people that have suffered and have lost these resources and had certain expectations based on the SIPC sign on the door and all the rest of these things.

So I -- first I want to associate myself with Mr. Ackerman and Mr. King's comments. I think they were strong and I agree this certainly don't have to be repeated. Certainly representing South Florida where I'm from, we've had a whole lot of people that are very, very concerned about the whole clawback issue.

Again based on expectations, based on the fact they paid taxes on monies they've received, and you know, there doesn't seem to be any relief from that whole story. This is a serious problem.

And the fact that there is a limited amount of pooled resources available is making it even more complicated, particularly based on Mr. Ackerman's last comment that there was an underassessment in the first place. And I would agree with that. I think that it was a ridiculously under-assessed issue.

So I guess I want to stress the point about addressing the clawbacks and even if we have to change the definition of net equity to get to the right place here.

I think, again, the people that have come to me and talked to me about this and there've been on both sides of the equation there, but again just in what's fair in terms of trying to make it whole and make sure the SIPC lives up to its obligations, maybe Mr. Ackerman's comment is the way to get there.

But I certainly want to encourage, you know, as quickly as possible. This has taken a long, long time to get through all these things. People have been suffering, you know, through having lost these resources, don't know will return.

Some of them had to make pretty dramatic changes in their lives. I also want to mention the Stanford issue also because although it's complicated, again it seems to me that these victims also should be compensated under the SIPC as well.

So, again, I don't -- I think the questions have been asked and I just want to be here to support very strongly as quickly as possible. A lot of frustration has gone on to this whole thing and again I look at the victims and that's one level, but I also look at the investor public that really depends and our country's economy depends on confidence in investing.

And if we don't have that kind of confidence, it creates a whole lot of other problems and we're not looking to go back to the point in time where people put in money in their mattress. We want people to feel that when they invest, and they get a statement, and they're dealing with people then the absence of fraud that you know, they know where this money is and how they can recompense themselves.

And we have to have a structure going forward that is set up in a way to make sure that the resource and those people who are benefiting from it, the companies, have to stand up for it and you know I think that that's just part of the deal.

So Mr. Chairman I won't take up more time, but I do want to reflect on that and the issue as strong as possible statement to get the SIPC right on this and to get our folks that have been impacted made whole.

REP. ACKERMAN: Thank you, Mr. Kline.

The committee would just like one clarification. It is something I think Chairman Johnson might have said on the issue of clawback. Did you say that the trustee was looking on going back limited to only six years on the clawback?

MR. JOHNSON: We have a statute of limitation, I believe, as to how far back we can go.

MR. COFFEE: Six years is the New York rule and the statute let's you use to the federal rule or the state rule. Six years is New York's.

REP. ACKERMAN: So we're on the New York law on this?

MR. COFFEE: The statute let's you use either the federal rule which I believe is two years or the state rule which is in New York's case six years.

REP. ACKERMAN: So you have chosen the New York statute?

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MR. COFFEE: I show they're nothing. I'm just a humble academic.

(Laughter.)

REP. ACKERMAN: Mr. Johnson.

MR. JOHNSON: That's what the trustee has chosen, yes.

REP. ACKERMAN: So the clawback go back six years and no further?

MR. JOHNSON: That's correct.

REP. ACKERMAN: Okay. Well, let me thank the panel. You've been very, very helpful. This is a very complicated and emotionally charged issue. We appreciate all the thought and the work that you've put into it. We know that everybody is going to not be completely satisfied. Some people will be emotionally as well as financially scarred forever. And we know you're doing the best that you can. We have to do some work as well, but you've been very helpful to us in our deliberations.

I thank the members of the committee as well. The chair would also note that some members may have additional questions for the panel and they will submit them to you. If you would answer them in writing to us, we would be appreciative and that would be made a part of the official record.

Without objection the hearing therefore will remain open for 30 days for members to submit those questions in writing and for the answers to be placed in the record. Without objection that is so ordered.

There being no further business before the committee, the panel is dismissed with our thanks.

I got a script. Before we adjourn, the following written statements will be made part of the record of this hearing. The statement of Mr. Ron Stein, president, Network for Investor Action and Protection; the statement of Ms. Ronnie Sue Ambrosino, coordinator of Madoff Victims Coalition; a letter dated February 22, 2010, from Mr. Stephen Harbeck, president of Securities Investor Protection Corporation in response to members questions during December 9, 2009 hearing entitled additional reforms to the Securities Investor Protection Act.

A letter dated March 4, 2010, from Chairman Kanjorski to Mr. Stephen Harbeck, president of SIPC encouraging the broad representation on the newly created taskforce to consider SIPA reforms; a letter dated August 20, 2010, from Chairman Kanjorski and Ranking Member Scott Garrett to Mr. Stephen Harbeck, president of SIPC requesting claims data; and finally a letter dated September 7, 2010, for Mr. Stephen Harbeck, president of SIPC in response to a request from Chairman Kanjorski and Ranking Member Garrett requesting claims data.

Without objection that is so ordered. The panel is dismissed with the thanks of the committee and the Congress and the hearing is adjourned. (Sounds gavel.)

LOAD-DATE: September 25, 2010