Network for Investor
Action and Protection

Chairman Neugebauer, Ranking Member Capuano, Chairman McHenry, Ranking Member Quigley and Members of the Subcommittees:

Thank you for giving our organization, the Network for Investor Action and Protection (NIAP) the opportunity to submit this for the record. NIAP was formed to enhance protections for all investors, as well as educate the public about fraud and misconduct in the securities industry. With over 1200 members, it has looked into the origin and initial passage of the Securities Investor Protection Act (SIPA) of 1970, the amendments to the Act in 1978, and the performance of the Securities Exchange Commission and the Securities Investor Protection Corporation (SIPC) under the Act.

After failing miserably for 16 years to detect and stop Madoff's fraud (and failing for many years to stop Stanford's fraud), the SEC has now failed to prevent SIPC and its Trustee, Irving Picard, from further injuring innocent small investors who were already decimated by Madoff. The SEC did this by supporting the desire of SIPC and Trustee Picard to use the cash-in/cash-out method of determining net equity and by allowing SIPC and the Trustee to seek clawbacks from *admittedly* innocent, now oft-destitute small investors. The SEC, which has supervisory authority over SIPC, and can therefore supervise and control both SIPC and SIPC's Trustee, completely ignored Congress' intent to restore investors' confidence in markets, to assure that investors receive payments from the SIPC fund, and to insure that investors receive such payments *promptly*, not after years and years. It ignored that this Congressional intent was expressed time and time again on the floor of Congress by many of the leading Senators and Representatives of the 1970s.

The SEC allowed SIPC's Trustee to venture down a dangerous path for investors. Even a cursory review of the legislative history demonstrates a congressional desire to create the same bullet-proof confidence that bank customers had in their statements. Imagine telling bank depositors across America that their statements not only may not be valid in certain circumstances, they may be sued by the US government to return withdrawals they innocently made from savings. As a result of the SEC's actions, investors face added uncertainty they may be unjustly subject to clawbacks because of the misdeeds of their brokers.

Instead of following the intent of Congress, the SEC allowed SIPC and its Trustee to use a method of determining net equity that the SEC knew, or certainly should have known, (i) had never before been used in a SIPC case involving customers of a broker-dealer, (ii) would be a defacto change in the definition of net equity though the SIPA statute explicitly says that SIPC shall *not* change that definition, (iii) would result in a large percentage of small investors getting nothing from the SIPC fund, thereby thwarting the intent of Congress, and (iv) would result in a

www.investoraction.org
P.O Box 2159, Halesite , NY 11743 Phone (800) 323-9250 Fax (631) 223-1123

large percentage of small, innocent investors getting nothing from customer property -- again frustrating Congressional intent -- while gigantic institutions would receive perhaps 80 percent of the customer property even though the Trustee has publicly admitted that a number of these institutions kept Madoff's fraud going for about a decade by constantly feeding him money, thereby enabling him to continue at times when his scam would otherwise have collapsed due to *lack* of money.

The protection of the SIPC fund clearly was a driving factor. After years of the SEC permitting SIPC's charging the brokerage industry a mere $150 per year per firm, after several GAO recommendations of increasing the SIPC funding, neither SIPC nor the SEC were motivated to put investors' interests first by paying SIPC claims based on account statements, particularly after the egregious failures of oversight by the SEC that helped promulgate the fraud. Instead of SIPC and the brokerage industry rightfully bearing the cost of SIPC payments based on account statements, a significant portion of that cost *is now shifted to the American taxpayer* – once again the victim of financial regulatory and industry failure.

All this the SEC knowingly did, without exercising its supervisory authority and responsibility to ensure that SIPC honored its obligations to aggrieved investors.

In all these ways, the SEC failed to supervise SIPC and, indeed, continued its nearly 40 year history of *not* supervising SIPC, but instead letting SIPC and its Trustees do as they wish, and allowing SIPC to do what helped SIPC save its funds rather than do what Congress intended it to do to help investors, especially small investors.

Mr. Chairman, the internal processes by which all this occurred -- the conversations, memoranda and relationships between and among the SIPC, Trustee Picard, and the SEC and the decisions that were taken by the SEC because of those conversations, memoranda and relationships -- have been shrouded in secrecy for three years, secrecy vigorously sought and fought for by those groups. It is long past time that the disinfectant of sunlight be shined upon the processes by which the SEC came to allow SIPC's position to be taken, instead of demanding, in the exercise of its supervisory power, that SIPC and the Trustee fulfill Congress' oft-stated intent to protect investors and build -- instead of destroy -- confidence in markets. To begin to shed light on these now-still-hidden processes, it raises a number of questions.

1. When the Madoff fraud was first revealed, in December 2008, didn't the SEC believe, *in accordance with uniform history in SIPC cases*, that net equity would be determined in accordance with the final statement method?

2. When did the Trustee and SIPC begin to try to persuade the SEC to allow them to use the cash-in/cash-out method? Whom did they deal with in the SEC, and when? Did they provide memos on the subject to the SEC, or were all the conversations oral. (If there are memos, or notes of conversations, please provide them to me.)

3(a). During the course of discussions about using CICO rather than the final statement method, did the subject arise of whether the SIPC fund was then large enough to accommodate payments to Madoff victims if the final statement method were used? What was said by SIPC, the Trustee, the SEC in this regard?

(b). Was concern expressed that, if the FSM were used, the SIPC fund might be exhausted by payments to Madoff victims, and/or that SIPC would therefore have to seek more money for its fund from Congress, the securities industry, or via a line of credit? Were memos written or notes taken with regard to the question of the sufficiency of the fund? (If so, please provide them.)

(i) Was the SEC at all concerned that if SIPC turned out to be underfunded based on FSM, the SEC would be criticized for not requiring SIPC to increase the size of the SIPC fund when prominent Congressmen urged this in approximately 2003? Was SIPC concerned about possible criticism for not increasing the size of the fund then?

(ii) Were SIPC or the SEC concerned that for years SIPC had assessed industry members, no matter how huge they were, only $150 per year for the SIPC fund?

4. When the SEC was considering what position to take in regard to net equity and clawbacks -- when they were considering, for example, whether to support CICO or instead, in the exercise of supervisory power over SIPC, demand the use of the final statement method:

(i) Did the SEC search the legislative history for insights as to what Congress intended?

(ii) Did the SEC take account of the fact that use of CICO would be a defacto change in the definition of net equity, *although the SIPA statute explicitly says SIPC shall not change the definition*?

(iii) In making a change to the definition of net equity by taking the position that final account statements invalid measures of net equity, did the SEC take into account the possible impacts to investors generally and confidence in the financial markets, when it became apparent to the investing universe that the SEC and SIPC would not, under certain circumstances, protect them in the manner they understood to be the case?

(iv) When the SEC was considering that they were denying expected SIPC protection to thousands of investors, did they factor into consideration that those protections in place had not been increased since 1978, and already were far lower than what might have been appropriate?

6. Why did the SEC allow SIPC and its Trustee to use CICO when the SEC must have known (i) that if CICO were used rather than the FSM, a very large percentage of small investors who are innocent victims would get nothing from the SIPC fund, thereby vitiating the oft-expressed will of Congress, and (ii) that a very large percentage of the customer property fund -- perhaps 80 percent of it -- would go to huge banks and hedge funds, the very type of institutions, and sometimes the *very* institutions, that the Trustee has admitted prolonged the Madoff fraud by providing him with money when otherwise the scam would have ended because he would have run out of money?

7(a). When the SEC decided to allow SIPC and the Trustee to use CICO, didn't it understand that this would greatly diminish the value of final statements, which now could not be relied on ever because there might be an unknown fraud in the background, and how did it square this with the fact that it had itself wanted Wall Street to switch from physical delivery of securities to customers to holding securities in street name, with customers receiving only account statements instead of physical securities, as they are proof of ownership?

(b). When the SEC chose to use CICO, how did it reconcile representations made over the years by SIPC, NASD/FINRA as well as the general public understanding that investors were protected based upon their investment statements? Did the SEC consider the potential impacts to the general investor community and financial markets should it become broadly understood by investors that their assumptions of protection were incorrect?

(c). When it agreed to allow SIPC and the Trustee to use CICO, why did the SEC ignore the fact that CICO would result in the Trustee and his law firm making hundreds of millions of dollars -- it is now estimated the firm will make about one billion dollars -- because CICO requires extensive work to reconstruct and argue over accounts, whereas this is not required under the final statement method?

(d). If Mr. Becker had a perceived conflict, doesn't the Trustee and his law firm have the same financial conflict except multiplied a thousand-fold?

(i) Did Mr. Becker not understand that promulgating or supporting this idea was a conflict of interest for him, since he and his family would benefit from it?

(ii) Just how does the SEC propose that the time value of money should be calculated? Why would the SEC choose a cost of living factor instead of the rate of return methods customarily used in both legal and arbitration circumstances?

8(a). Since it has supervisory control over SIPC, if the SEC believes victims should be awarded the time value of money, why doesn't it *order* SIPC to do this?

(b). Isn't the SEC's failure to *order* SIPC to do this simply another of its failures to supervise SIPC?

(c). Isn't it a fact that, although Congress intended the SEC to supervise SIPC, the SEC has for practical purposes failed to do so since SIPC began circa 1970?

(d). How many and what person or persons in the SEC were charged with the specific duty of overseeing SIPC? (Was it more than one person?) How did these persons go about their duty? How often did they do so? To reiterate, isn't it a fact that SEC supervision of SIPC has for practical purposes been nonexistent?

9. In lawsuits brought against the SEC under the Federal Torts Claims Act due to its malfeasance in the Madoff case, why is the SEC aggressively suing to dismiss cases brought against it, thereby preventing discovery and the proper legal process to shed light on the SEC's behavior in the Madoff case? How does this comport with the desperate need for transparency and accountability? Instead, the SEC claims that it is immune from suit because everything it did is a matter of discretion. It is therefore claiming, isn't it, that although it is supposed to protect investors, it nonetheless has discretion *not* to undertake even the simplest, most mundane actions that all investigators take as a matter of course? For example, it is claiming, isn't it, that it had discretion *not* to inquire of the Depository Trust Corporation about Madoff's securities there, had discretion to ignore the Barclay Bank's statement that there was no activity in Madoff's account there, and had discretion to ignore the fact that the NASD told it Madoff had not traded options on days when he told the SEC he had traded them?

Sincerely,

Ron Stein, CFP, President
Network for Investor Action & Protection
September 22, 2011