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October 3, 2011

The Honorable Mary Schapiro
Chairman
Securities and Exchange Commission
100 F St., NE
Washington, DC 20549

Dear Chairman Schapiro:

As Chairman of the House Financial Services Committee's Subcommittee on Capital Markets and Government Sponsored Enterprises, and sponsor of H.R. 757, bi-partisan legislation that reinforces what Congress intended when it passed the Securities Investor Protection Act (SIPA), I am profoundly concerned with the current treatment and status of the Madoff fraud victims, who I believe have not been well served by the actions of the Securities Investor Protection Corporation (SIPC), the SIPC Trustee, or the Securities and Exchange Commission (SEC). In that vein, significant questions have been raised about the Commission's policy development processes and its oversight of SIPC and the SIPC Trustee in the aftermath of the Madoff fraud. Your recent decision to reevaluate some of the policy decisions made by the SEC relating to the Madoff fraud is a necessary first step to restore trust, transparency, and justice to this unique liquidation process.

Policy decisions adopted by the Commission during the period covered by the recent SEC Office of Inspector General (OIG) report were flawed for at least two important reasons: one, the SEC's embracing the cash-in cash-out methodology to determine a customer's "net equity" was based on standards and information not found in, allowed or permitted to be considered under the SIPA; and two, the aggressive advocacy and lobbying of the Commission by the SIPC and its Trustee regarding the definition of "net equity" was patently self serving, created an inherent conflict of interest, and misled the Commission regarding the statute's parameters and Congress' intent.

Specifically, the Inspector General's report reveals on pages 49 to 51 that the underlying motivation for SIPC and their Trustee's zealous advocacy for cash-in cash-out was their over-riding concern that other methods might "drain the fund," "necessitate the SEC going to Congress," or cause "dramatic fee increases for broker-dealers." These concerns might raise legitimate issues of oversight by the SEC, or possibly Congress, regarding the SIPC fund's financial condition, but none of those factors are articulated in the statute as a basis for defining a customer's "net equity". Indeed, SIPA contains an explicit definition of "net equity". The

statute prohibits the SEC, SIPC or the Trustee from creating a new definition to serve its own purposes, a power reserved exclusively for Congress. By redefining "net equity" using these extraneous factors, SIPC, its Trustee, and the Commission, have violated the statute and disregarded the expressed intent of Congress.

While the Inspector General's report focuses on the alleged conflict of interest of the SEC's former General Counsel, it also exposes a process employed by the Commission to create policy recommendations that are replete with problems and pitfalls, fostering potential conflicts of interest. SIPC and its Trustee are depicted in the Inspector General's report on pages 49 to 51 as the driving forces in crafting and marketing to the Commission the cash-in cash-out methodology to define a customer's "net equity". Ironically, the unquestionable beneficiaries of the cash-in cash-out definition are SIPC and its Trustee – not the victims who the SIPC fund is intended to protect. SIPC benefits from the methodology by insulating the insurance fund it oversees and masking the insurance fund's precarious financial condition. The Trustee benefits from the methodology by the gratuitous creation of a compensation-centric paradigm, one riddled with time delays and hardships for victims.

The methodology additionally creates a complicated process that results in unnecessary, costly, and time consuming litigation, which the Trustee is pursuing against innocent individual victims. Interestingly, I note on page 47 of the Inspector General's report that you were of the opinion that these "clawback" lawsuits would be brought only against large institutions and not against innocent individuals. The Trustee's pursuit of innocent victims seems inconsistent with your own beliefs, and is also at odds with any reasonable interpretation of SIPA. As an aside, I am encouraged by a District Court decision earlier this week that would seem to be a significant first step in limiting the ability of the Trustee to pursue clawbacks against innocent victims of the Madoff fraud, in violation of the relevant statutes and the expressed intent of Congress. It is, however, only a first step – more remains to be done to protect these innocent victims from the Trustee's remaining overreaching clawback efforts.

As you are aware, I have requested the Government Accountability Office (GAO) to conduct a review of some of the issues engendered by SIPC and its Trustee's handling of the Madoff debacle. While the Madoff SIPC liquidation is unprecedented in its size and complexity, Congress nonetheless established rules and processes to be followed and observed in these unfortunate situations – rules and processes designed to reestablish order, expedite liquidations, protect innocent victims and strengthen confidence in our financial markets. The information and analysis from the GAO will aid the subcommittee in determining if SIPC and its Trustee have met their statutory roles and responsibilities. Additionally, the information will benefit the subcommittee as it reviews and considers H.R. 757, The Equitable Treatment of Investors Act. I would therefore hope and expect that the GAO work product will benefit the Commission as it reevaluates several of the important policy questions resulting from the Madoff fraud. To that end, as I mentioned to you in last week's hearing on these issues, I recommend that the Commission delay reconsideration of these matters until the GAO has completed its work and the Commission subsequently reviews it.

It is my expectation that the Commission will consider all relevant information before a new decision is officially rendered, including the new policies' impact on the many victims of this tragedy. To that end, I am available to meet and otherwise be of assistance to you and the Commission during this important process.

Thank you for your consideration and I look forward to working with you on these and other issues.

Sincerely,

A handwritten signature in cursive script that reads "Scott Garrett". The signature is written in black ink and is positioned above the printed name.

Scott Garrett
Chairman

Subcommittee on Capital Markets
and Government Sponsored Enterprises