THE COMMITTEE ON FINANCIAL SERVICES

THE SECURITIES INVESTOR PROTECTION CORPORATION:

PAST, PRESENT, AND FUTURE

WEDNESDAY, MARCH 7, 2012

9:30 A.M.

INDEX

[BEGINNING OF RECORDING]

Mr. Garrett: This hearing is entitled “The Securities Investor Protection Corporation: the Past, the Present, and the Future”. This hearing will now come to order and I recognize myself for four minutes to give the opening statement.

So, with regard to today’s hearing, today’s hearing is fashioned, as I just mentioned, in a broader oversight hearing of the, of Securities Investor Protection Corporation, SIPC. And it’s not meant entirely to be focused solely on a particular aspect of SIPC’s work.

But, to me, the failure of SIPC in regards to the Madoff liquidation are so fundamental, relative to the protections that SIPC is supposed to provide to investors. And so, antithetical to the goals that SIPC and Congress set out to achieve at their beginning, that I would like to focus much of my time, and my thoughts, and my energy, and my comments on the circumstances surrounding that particular case.

I also think that it’s worthwhile to hear today about SIPC’s work in regard to the Lehman bankruptcy. And also, what we -- examining the long-awaited and recently-released report of

SIPC's Modernization Task Force as well. And going through that task force and looking at it, unfortunately, is that it's somewhat of a missed opportunity, if you will, and it seriously studies some of the shortcomings of SIPC exposed by the recent failures of the broker-dealer.

So, let's return now to the failure of the Madoff firm and let's examine the facts of that case. As we're all probably too familiar.

The Madoff firm was regulated by both FINRA and the SEC. And they repeated received government stamps of approval that it was operating basically legally. The firm proudly displayed the SIPC logo, which again implies government backing since SIPC is backed by the US Treasury.

Madoff investors paid taxes to the IRS, US Government, for years. Again, another government agency saying that its investors and profits were, well, real.

Just around the same time SIPC was enacted, investors no longer held stock certificates.

So, the only proof of ownership they have, or had, was the statement that they received from a government-regulated broker-dealer.

So, what does it mean? So, the Federal

Government both provided a stamp of approval and relied upon that stamp of approval and yet, innocent private citizens now, as investors, are being held to a higher standard than them. So, instead of being provided protection by SIPC, as Congress did intend in order to increase confidence in investment in our markets, innocent investors in this case are being sued by the very same Trustee chosen by SIPC.

Now, am I the only one when you go down that whole litany of facts that are here to say that, "Well, something is simply not right here"?

Now, an additional irony is that if the Trustee is successful in suing individual investors, who will go to, who will the money go to? It will largely go to pay off institutional investors. Now, this is the same class of investors that the Trustee has repeatedly tried to sue because he believes, well, that they should have known better. But they'll be paid.

It's because of my concerns over these issues I've introduced H.R. 757, the Equitable Treatment of Investors Act. This legislation would reaffirm and clarify key protections for ordinary investors that were put in place when

Congress passed and amended the SIPC.

In particular, the bill aims to shield innocent individual investors, who have already been defrauded and financially devastated by the Madoff situation, from further clawbacks by the SIPC Trustee. In addition, the bill clarifies that for purpose of SIPC protection, customers of registered brokers are legally entitled to rely on their broker statements as evidence of what their broker owes them. Indeed, in a world where customers do not any longer hold the physical stock certificates, how can it be done any other way? Finally, H.R. 757 would end an ongoing conflict of interest by having the SEC, rather than SIPC, select Trustees for the SIPC liquidation.

Now, several of my colleagues already joined me in cosponsoring this legislation and I encourage my other colleagues to look at it and consider it as well. So, I look forward to today's testimony of our witness, and all the panels that we have, and a hearty discussion on SIPC activities and roles, those of the past, and the present, and the future as well.

And, with that, I yield back and I yield to the gentlelady from New York for three minutes.

Ms. Maloney: Okay. Thank you. Thank you, Mister Chairman. I thank you for your deep concern on this issue, which is a major concern for many of us on this committee. And, I welcome Senator Vitter. You honor us with your presence. We look forward to your testimony.

As a representative of New York City, the financial industry is a very important part of our economy. The massive fraud that was put forth by Bernard Madoff is very personal to me and it hurt many of my constituents and certainly violated the trust of the public for the industry. So, it was a tremendous blow to many people on an individual basis and to the industry at large.

My constituents, many of whom are victims of this fraud, from union workers who lost their pensions, to charities that lost their operating funds, to investors large and small who lost their life savings, literally lost their homes, lost absolutely everything, the experience has been absolutely devastating and they are devastated.

Even worse, the confidence of investors around the world in the system of regulation and law enforcement of our financial markets was visibly shaken by this scandal. Just yesterday, Mister Stanford, another perpetrator of a Ponzi scheme who cheated his investors out of over $7 billion was convicted on 13 out 14 counts that he faced. This should be some comfort for the people he defrauded, but we want to make sure that if this ever happens again, there are tools in place so that victims can be made whole and SIPC can do its job.

I believe that markets run as much on confidence as they do on capital. And this is a serious blow to investors' confidence at a critical time. We still see that many people are holding their money back from investing and going forward with our financial system.

The reason we are here today is to look at the Securities Investor Protection Corporation, SIPC, and to shed light on the reform proposals that are out there, including several pieces of legislation that are pending before the House.

I know this committee is looking closely at the SIPC Modernization Task Force Report, which was released at the end of last month. So, this hearing is very timely.

I know that my colleague, Mister Ackerman, and the Chairman have put forth thoughtful bills. I'm interested in seeing how their bills coincide or reflect, go further, or not as far as the SIPC Modernization Task Force Report's recommendations. And I look forward to working with them on these bills. I hope we can explore both of these legislative proposals and hear from the witnesses, what they believe is the right, is the better approach, or the right approach we should be taking.

I look forward to the hearing. It's one that's very important to our country. And I thank the Chairman for calling this important hearing and his work on his legislation. And also, I compliment Mister Ackerman for his hard work. I reserve the balance of my time and turn it back to the Chairman.

Mr. Garrett: Okay. Gentlelady yields back. The gentleman from New York is recognized now for three minutes.

Mr. King: Thank you, Mister Chairman. Thank you for calling today's hearing. It's very timely for the representative from SIPC to come before the subcommittee. After several years, they've finally produced the recommendations of their Modernization Task Force and this hearing and report come against the backdrop of the Madoff liquidation, which you have referenced and which Miss Maloney has referenced.

This was unearthed three years ago and for the past three years that process run by SIPC has gone profoundly amuck. This is tragic, this is wrong. From my perspective, at least four takeaways from this liquidation.

One, the Trustee, Irving Picard, is out of control. He interprets SIPA as he desires, not as intended by the courts. And on several occasions, has been slapped down by the courts. He intimidates innocent victims, brings spurious clawback suits against them, maligning their reputations in the process, and leaking spuriously to the media. Even Chairman, Chairwoman Mary Schapiro expressed surprise as the initiation of the baseless lawsuit.

Just the other day, in an order dated March 5th in the Southern District of New York, Judge Rakoff in the case *Irving Picard versus Saul Katz* made a finding, "The Court remains skeptical that the Trustee can ultimately rebut the Defendants' showing of good faith, let alone impute bad faith to the Defendants. More generally, the Court is concerned that much of 'the evidence' that the parties proffered on summary judgment did not comport with the Federal Rules of Evidence. Conclusions are no substitute for facts, and too much of what the parties characterized as bombshells proved to be nothing but bombast." And that's what that lawsuit has been from beginning to end, bombast.

Two, the victims are being treated unfairly. A very few victims have received the statutory mandated SIPC advances. The Trustee has hatched an accounting mechanism that disregards real-world, cuts reputations on broker-dealer protocol, it's lawyer intensive, and it has run up the fees of $300 Million, paid to Mister Picard. $300 Million. He has an open piggybank here for himself.

It's not an exaggeration to say the victims have been victimized twice, once by Bernie Madoff and now by Irving Picard.

Three, the Trustee is not being properly supervised. Where were the regulatory bodies tasked with oversight over this Trustee, SIPC directly and the SEC indirectly? Moreover, where was the Statutory Mandate Report on the liquidation required of the Trustee? The Trustee of the Lehman liquidation has completed and filed such a report. The broker-dealer failure is arguably much more complex and complicated than the Madoff debacle.

Lastly, this miscarriage of justice endured by the Madoff victims could happen to any investor if a broker-dealer fails for any reason.

We need to restore some reason and some rationality to the unwinding of failed brokerage firms, and that's why I am proud to sponsor with Chairman Garrett H.R. 757, a proposal enjoying bipartisan support.

Chairman, thank you for your leadership on 757. Thank you for holding this hearing. I look forward to hearing from the witnesses.

I yield back.

Mr. Garrett: And again, I thank the gentleman from New York. Thank you for your work in this legislation as well and for this issue, leadership.

Mister Green is recognized for two minutes.

Mr. Green: Thank you, Mister Chairman. I'd like to thank my colleague and friend from Louisiana, my home state. While I represent Texas, I was born in Louisiana. So, I'm honored to have you with us today.

Mister Chairman, I, too, am concerned about investor confidence. I think it's exceedingly important that investors understand that we desire to impose proper protection for their investments. As I weigh this issue of whether we are going to base our payments on account statements or actual net cash investments, my concern is the actual statements. Because as you know, in the Madoff case, his statements were misrepresentations and they were actually fraudulent in and of themselves. That causes a degree of concern. I'm eager to look at the legislation and make some decisions. My thoughts are rather ambivalent right now.

I do want the investors to be protected and I stand for investor protection. I would like to peruse legislation to ascertain how we manage these statements that are fraudulent, that themselves are misrepresentations. And, we are talking about tax dollars to a limited extent. So, for this reason, I thank you and I look forward to hearing more so that I can come to a final conclusion.

Mr. Garrett: And thank you. The gentleman yields back. Mister Dold for two minutes.

Mr. Dold: Thank you, Mister Chairman. Certainly appreciate you holding this hearing and for your leadership. I want to thank Senator Vitter for being here as well and our other witnesses.

We all have tremendous sympathy for all of the direct and indirect Madoff victims, and all other Ponzi scheme victims as well, which is why we’re all here, to see how we can improve available protections in a balanced way, without creating unsustainable, unfair, and otherwise negative, unintended consequences.

The fundamental reality of the Madoff Ponzi scheme, and every other Ponzi scheme, is that money is stolen from many innocent people and there isn't enough money to make everyone whole. That’s a difficult and complicated situation. And there aren’t any perfect answers or perfect solutions. People suffer in those circumstances and we need to find the most balanced way to minimize the losses and the suffering among a large group of innocent victims.

But all innocent victims aren't in the same position. Many innocent victims have great conflicts of interest with many other innocent victims. Some victims ended up getting more money than they put in. In some cases, much more money than they put in. Their profits were, I would argue, all fake, were fraudulent, stolen by the Ponzi schemer from other innocent victims. Those other innocent victims received absolutely nothing and instead lose everything. And their stolen money has gone to pay for those fraudulent profits to others.

What do we do in that situation? There's no perfect, or even good answer. But, historically, we'd recover the fake profits from the innocent victims who received them to partially repay the actual losses of other innocent victims. In that way, nobody gets to profit from the Ponzi scheme. There might be a better way, or more fair way, or a less unfair way to handle this difficult situation and I hope that we hear one today.

And if no investor should profit from a Ponzi scheme, the Federal Government should also never profit from the Ponzi scheme. For decades, innocent people paid very real taxes on totally fake profits. When the fraud is exposed, the IRS says that the innocent victims can only get refunds for the taxes paid during the last five years. So, ironically, the Federal Government benefits more and more from a long-term Ponzi scheme the longer it continues. Why shouldn't the innocent investors be able to recover all taxes that were wrongly paid on totally fake or fraudulent profits?

I have a number of other questions and I see my time has expired, but I do hope we have an opportunity to ask them during the question and answer period.

I certainly want to thank those that are coming here today testifying. And again, Mister Chairman, I thank you for your work.

Mr. Garrett: Thank you. Thank you for your comments.

The gentlelady from California for the remaining time on her side at least.

Ms. Waters: Thank you very much, Mister Chairman. And thank you for holding this hearing on the Securities Investor Protection Corporation.

The past few years have been very challenging for SIPC. During the height of the financial crisis, the Corporation was forced to liquidate Lehman Brothers, one the world's largest brokerage firms. Shortly thereafter, the Madoff Ponzi scheme was uncovered. In the years since Madoff, we've also seen the case of the Stanford Group Company and the failure of MF Global.

Following the liquidation of Lehman Brothers and the discovery of the Madoff Ponzi scheme in 2008, SIPC's board of directors created the SIPC Modernization Task Force to review whether any changes to the law of the SIPC's operations were needed.

Today, we're considering the report published by this task force. Their recommendations include items that is requiring acts of Congress and items that can be pursued administratively. I'm interested to hear from the Corporation on the rationale behind these recommendations, as well as any areas where certain task force members may have alternatives to what was presented in the consensus report.

It's also important to know how we can increase investor understanding of SIPC and make certain that investors realize that it does not offer the same protection as FDIC insurance.

I'm also interested in exploring how we can ensure the most equitable outcome for investors who put their savings into Madoff, Stanford, and MF Global.

I understand that Chairman Garrett and Representative Ackerman have legislation that would attempt to provide additional assistance to certain victims of the Madoff fraud. I'm very curious to hear more about this bill, but I'm also very mindful that Congress should be very careful in this area since any changes to how customers' claims are calculated will inevitably make certain investors winners and others losers.

Finally, I'm very curious to hear more about SIPC's rationale for not paying out claims under the Stanford Group Company fraud and this issue that the SEC has contested. The timing of this hearing is all the more apt in light of Allan Stanford's conviction yesterday on 13 counts related to his $7 billion Ponzi scheme.

Thank you, Mister Chairman. I yield back the balance of my time.

Mr. Garrett: Thank you, gentlelady. And that's an interesting point on the last one you raised there.

And we have one other member who, Doctor Cassidy, who would, without objection, would like to serve, or sit on the panel later on today once we get into the panels, without objection.

PANEL I

Mr. Garrett: So, we will now go to our, to our first panel. And we welcome the gentleman from the other side of the Capital. Welcome back to a former House Member, Senator Vitter. I know you serve on the Senate Banking Committee and I know also that coming from where you do, down south, that you have a number of your constituents who were more than adversely affected, not by the, well, some may by the Madoff case, but more often by the Stanford case, and that you have been a leader in trying to bring a equitable solution to that situation. So, we thank you to coming and joining us in this committee. Senator.

Mr. Vitter: Well, thank you very much, Chairman Garrett and Ranking Member Waters, and all of you for the invitation. I really appreciate it. And even more importantly, thank you for your important work and partnership on all sorts of issues, this, as well as a lot of challenges that have confronted Louisiana. Hurricane Katrina and Rita, the BP Oil Disaster, all of you have been wonderful and generous in terms of our working partnership. Thank you for that.

And it is great to be back on the House side. I remain a House Member in spirit. I brought a healthy House skepticism to the Senate, which I still don't drink from the water fountains over there and that's not going to change any time soon. So, it's great to be here.

I am here, of course, because this is a very important issue and I have been particularly involved in the case that you mentioned, the Stanford case. I'll submit my full comments for the record and I'll summarize here. And because of that focus, of course, my comments are going to be very informed by the Stanford case in particular, although I certainly acknowledge the importance of many other cases and share all of your concerns, including, in particular, about the Madoff case.

I'm very involved in the Stanford case because, unfortunately, there are thousands of victims nationwide, and many of them, many retired oil and gas workers and executives are in Louisiana. So, I'm talking personally to dozens and dozens of them. Like in the Madoff situation, many lost their entire life savings. Many have literally had to sell their homes, go back to work well after normal retirement, things like that. They are real victims that have been taken advantage of.

In the Stanford case, as you know, SIPC has denied coverage completely. And that’s the fundamental problem. SIPC is basically taking the position, “While these were valid CDs, that were lowered in value, lost value, and we don’t cover market losses.” Well, I think that position’s just flat-out wrong. And through the Stanford experience, I’ve come to the conclusion that there is a need for major SIPC reform.

It isn't to change their coverage. It isn't to change the parameters of the statute. I’m not here to argue that that should be broadened.

Again, I think there is clearly coverage in the Stanford case under the present statute. And I don’t propose that SIPC should cover market losses or every evil or bad situation under the sun. Rather, I think reform is needed in a different way, and in some ways a much more fundamental one.

I reached the conclusion that SIPC, if it were a true regulator, would, in the [inaud.], is the, a situation of complete regulatory capture. I do not think SIPC is focused enough on following the law and executing the law. I think it’s far too focused on serving the industry and its member companies and looking after their interests. And my experience in the Stanford case in particular, has led me to that unfortunate conclusion.

First of all, let me talk briefly about why there is coverage. As was mentioned, Allen Stanford was found guilty just yesterday of 13 criminal counts. He was found guilty of basically fraud, stealing customer funds. Instead of purchasing Stanford International Bank CDs, the Stanford Group Company, which was a SIPC member, acquired control of its customer funds and the funds were stolen by Allen Stanford. The SEC and courts have taken the position in litigation that the Stanford companies operated a Ponzi scheme and “a Ponzi scheme is, as a matter of law, insolvent from its inception.” So, it’s not a matter of real CDs losing value, it’s a matter of a Ponzi scheme, a fraud, and Allen Stanford stealing those funds.

There are several other precedents in law and other cases that back up this point of coverage that are in my written testimony. I won't go into it exhaustively.

But, my first point is that there is coverage. Now, people can disagree about legal points, but what I've really been [inaud.] about isn't simply that SIPC has disagreed, but the way they have acted again has led me to conclude that they're not primarily focused in the right spirit on executing the law and protecting people properly covered under the law, but they're really focused on protecting their fund and their member companies.

Let me give you some examples. The very first meeting I ever had with SIPC, the Chairman was there, top staff were there, the first concern mentioned about the Stanford case was the amount of money it would drain from the fund and the reaction of member companies to the need to replenish the fund through other assessments. That was the first thing that came out of their mouths, quite frankly, before we talked about, what's the right thing to do, what the law says. Later, after they had dug in their heels for months and months denying all coverage, after the SEC finally acted and did the right thing, they entered into settlement negotiations and were willing to settle, albeit for far less than a hundred cents on the dollar. So, apparently, their view of the law changed if it was going to preserve more of their fund. When they couldn't reach a settlement, they went back to court and are presently, in my opinion, dragging their feet and prolonging court action as much as possible. This includes spending $200,000 of what is there for ultimate recovery by the victims on certain discovery. This includes presently asking for more prolonged discovery, rather than getting to the heart of the issue in the legal proceeding.

You put all of that together, Mister Chairman, in my opinion, that is not a picture of an agency or an entity trying to meet its responsibility to covered victims under the law. It's more of a picture of what would be akin to an industry trade group, or association, an active party litigant, if you will, just trying to preserve as much as they can of their resources and their fund. And I believe that's the fundamental problem and that's the most fundamental need for reform.

So, Mister Chairman, again, thank you for this hearing and calling attention to this important matter, including the Madoff case, including the Stanford case. I think this discussion will promote important reform. I hope, in the meantime, that SIPC still does the right thing in the Stanford case and that it doesn't prolong the court activity and the litigation and we get to that bottom line as quickly as possible for the good of all of the victims. And I really appreciate the invitation to be here and all of your partnership on this important issue and other important issues. Thank you very much.

Mr. Garrett: Senator, I thank you for coming to join us today and speak on the first panel. I thank you also for your concern for your constituents and other constituents around the country as well for this matter. I appreciate also and thank you for your work and leadership in the Senate on this matter. As you see from the questions and by the opening statements, I think we, it is a bipartisan concern on this issue in general. And as you can see with the legislation that is here partly to be considered, you can also see that it is a bipartisan initiative as well.

Still open questions as to the finality of some of these things, but I think we're going to try to do it in a bipartisan manner.

I understand that we're already at the top of the hour and I was told by staff that you have, as always for Senators, a commitment back on the other side of the House. So, I appreciate your coming over and appreciate accepting our invitation and look forward to working with you and the other side of the House as well on this issue.

Mr. Vitter: Thank you very much and appreciate it.

PANEL II

Mr. Garrett: With that, then we will move on to Panel II.
And they can come to the table.
At the table, we will have President and CEO of what we've just been talking about, the Securities Investor Protection Corporation, Mister Harbeck. And also, we have Miss Bowen, the Acting Chairman of the Board, Securities Investor Protection Corporation as well.
I'll let you get situated there.
And welcome, again, to the committee hearing today. I appreciate both of you coming, joining us to talk about this very important topic.
Your completed, written testimony, of course, as always, will be made part of the full record.
We will recognize each of you on the stand for opening statements for five minutes each.
Mister Harbeck? Usually, we start from left to right.

Mr. Harbeck: If you wish, I'll begin. Chairman Garrett, Ranking Member Waters, and members of the subcommittee, thank you this opportunity today.
My name is Steve Harbeck, and I am the President and CEO of SIPC.
Since the collapse of Lehmen Brothers' entities,

mentioned by Ranking Member Waters, in 2008, SIPC has been at the center of the financial crisis. I'd like to give you an overview of what SIPC has done between 2008 and the present day.

First, the guiding principle SIPC has used in this period is the greatest good for the greatest number consistent with the law. I'd like to briefly highlight some of the matters in both Madoff, Lehman, MF Global, and Stanford.

The Madoff case is the largest Ponzi scheme in history. The people who have not received funds from SIPC are those people who have either received a hundred percent of their investment back or people who must repay a portion of what they received before receiving funds. The courts have uniformly confirmed that SIPC's method of computing what is owed to customers is, in fact, correct and in accordance with previous precedent.

I'm pleased to note that the GAO Report on Page 31 that was just issued within the last day indicates that the driver of administrative expenses in the Madoff case is asset collection for those people who have not received a hundred percent of their investment back. The Trustee has used the so-called "avoiding powers" wisely, judiciously, and effectively. The avoiding powers are precisely what makes the Trustee's distribution in that case among innocent investors truly an equitable one. The Task Force on SIPC Modernization agreed and Exhibit B to my written statement demonstrates that SIPC doesn't benefit from the avoiding powers, but those people who are most damaged are the people who benefit.

The Trustee has also adopted a hardship program to discontinue any avoidance suit that should be dropped given the nature of a defendant's circumstances. It's very important to note that no customer money is used for administrative expenses. And there has been an incredible benefit to investors.

I first appeared before this body in January of 2009. And if I had told you then that the Trustee would recover $9-$10 billion for the Madoff investors, you would not have believed me. But that is already what's been what has accomplished to date. And the driver of the $300 million of administrative expenses is the recovery of that $9 billion.

Those who would expand the distributions to net winners in the Madoff game should recall that the distribution in a Ponzi scheme is a zero sum game. And the Trustee's plan distributes benefits to those who have been most damaged by Mister Madoff's theft. If other victims, and they are victims, but people who are net winners, who have received a hundred percent of their assets back, share in that fund, it is mathematically ineluctable that the people who are most damaged will suffer on a dollar-for-dollar basis.

Turning to Lehman. Lehman is the largest bankruptcy in history. And in the early days of Lehman, or under SIPC's initiation of the liquidation proceeding, 110,000 customers received $92 billion in ten days. Second, the Trustee in that case has been extremely successful in lawsuits. He's won $2.3 billion from Barclays Bank, settled a suit for over $700 million with JP Morgan Chase, and lastly, the Trustee scored a major victory in the Supreme Court of the United Kingdom that will benefit American investors directly.

The impartial observer closest to the case, the bankruptcy judge, states that the case has been an extraordinary success and it is coming to a successful conclusion.

In the MF Global case, SIPC acted to protect investors and did so demonstrating that we can act quickly and decisively. SIPC placed a fiduciary in charge of the firm less than 12 hours after being notified that customer protection was warranted. As I outline in my written statement, significant distributions to both commodity investors and security investors have been made.

And that brings us to the most difficult subject. And that is the Stanford case. SIPC protects the "custody" function that brokerage firms perform. Let me say that again. SIPC protects the "custody" function that brokerage firms perform. The investors in the Stanford case, unlike the investors in the Madoff case, knowingly sent their money away from the brokerage firm to an offshore bank. They were specifically told, in writing, that SIPC does not protect their investments. They each opened a bank account in a bank of Antigua. And they now seek rescission of that investment and have SIPC pay the original purchase price of their investment using SIPC and, if necessary, taxpayer funds.

Simply put, Congress never intended, and the statute has never been held, to refund the purchase price of a bad investment. That is absolutely not what the law mandates. And while there are other legal reasons as well, that is why SIPC has not initiated the customer protection proceeding for the firm.

SIPC has acted to protect and benefit investors in those three cases, but SIPC's protections are not available to restore the purchase price of a bad investment on a CD issued in an overseas bank.

Mister Chairman, if I could mention, or if I could respond to one of your comments at the beginning of this case, you mentioned that institutional investors would receive most of the money in the Madoff case. This is a point made by Mister Stein in his written communiqué. And I think we're failing to connect some dots here that very, very much need to be connected. Mister Stein mentions that a number of investors received zero in the Madoff case and that is quite true. So, there are thousands of investors who did not receive money. But then, when you say 75 to 90 percent of the assets in Madoff are going to institutional investors, you must connect the dots by saying the thousands of people who did not receive anything are the people who own those institutions, and they will be satisfied by distribution to the institution. So, I wanted to make that clear so that we realize that when the indirect claimants are not paid, they will receive their proportionate share of the distribution when the funds they own receive the distribution from the Trustee. And another point made in the written comments concerning SIPC's actions in this case, is that the distribution was not prompt. The Trustee stands ready to make a $9 billion distribution as soon as he can, but the people who have initiated litigation to allow net winners to share in that money, have delayed that distribution. And if you don't connect those dots, you don't get the complete picture. SIPC's done a great deal, we've advanced $800 million for the investors in Madoff. And we think, in that sense, the process is coming to a sound conclusion.

I'd be pleased to take any other questions you have. Thank you very much.

Mr. Garrett: And I thank you for your statement. Miss Bowen is recognized for five minutes and welcome to the panel.

Ms. Bowen: Thank you. Chairman Garrett, Ranking Member Waters, and members of the subcommittee, thank you for the opportunity to appear before you today to discuss the important work of the Securities Investor Protection Corporation. My name is Sharon Bowen, and I am the Acting Chair of SIPC. Because I also served as the Vice Chair of the SIPC Modernization Task Force, I will focus on the forward-looking issues raised by that report.

SIPC was created in 1970. With some narrow exceptions, every registered broker or dealer is a member of SIPC. Membership in SIPC is automatic upon registration as a broker or dealer. SIPC is not a government agency. Its policies are set by its seven-member Board of Directors, five of whom are appointed by the President and confirmed by the Senate.

SIPC administers a fund, which is comprised of assessments paid by its members. The fund is used to support SIPC's mission of customer protection and to finance SIPC's operations. Should the fund become inadequate for any purpose, SIPC may borrow against a $2.5 billion line of credit from the Treasury. In its nearly 40-year history, SIPC has never drawn on that line of credit.

Every customer at SIPC is protected up to $500,000 against lost or missing cash or securities deposited with the broker or dealer for that customer's account. Of the $500,000, up to $250,000 may be used to satisfy claims for cash only.

To date, SIPC has overseen the administration of 324 customer protection proceedings, which have involved a distribution, through 2010, of roughly $109 billion of assets for those customers. Of that sum, $108 billion has come from the debtors' estates and $1.1 billion has come from the SIPC Fund.

Former SIPC Chairman, Orlan Johnson, promised Congress at his confirmation hearing that he would form a task force to conduct the first comprehensive review of the Securities Investor Protection Act and SIPC's operations, since the amendments of 1978. The SIPC Modernization Task Force has completed its work, and the Report and Recommendations of the task force are attached. The task force reached out to obtain a broad input. It conducted a live forum in New York City to receive the personal views of individual investors. It held an internet question and answer forum with investors as well. A website was also established to advise the public of the issues being considered and to solicit input from investors.

In particular, the task force reviewed issues raised by recent complex litigation. In some instances, the task force recommendations will require legislation. And others will require rule changes. And some of the recommendations can be implemented directly by SIPC. We also considered areas where we decided there should be no change.

Let me quickly cover some of the key recommendations. First, the task force concluded that SIPA should be amended to allow for inflation since 1980. In that year, the maximum SIPC advance was set at $500,000. In inflation-adjustment dollars today, that level of protection would be $1.3 million and the task force has concluded that sum should be used and should be adjusted for inflation periodically.

Second, the task force was presented with numerous cases where cash was being “caught” at a moment just before a security is purchased, or subsequent to a security’s sale, and thus was subject to a lower protection. Because these results are somewhat arbitrary, the task force has recommended that we eliminated the treatment of cash for securities.

Third, since smaller investors often have so much of their wealth in pension plans, the task force has recommended that we extend “pass-through” protection for pension plan participants that currently does not exist today.

Fourth, and what we believe was an unintentional consequence of an amendment to SIPA, some SIPC members actually had their assessments reduced. We recommend correcting this oversight.

Fifth, the task force recommended that SIPC assist in creating an international association of investor protection entities. While SIPC has memorandum of understanding with a number of these organizations, the Lehman and MF Global cases show that international issues will only increase in the future.

Finally, the task force allocated that SIPC continue to develop programs to fully educate investors about SIPC protections and limitations on those protections.

These are a few of the recommendations. I would like to take the opportunity to thank the members of the task force for their work. And I'd be happy to take any questions.

Mr. Garrett: And I thank you for your testimony. And so, I'll recognize myself to begin with just a couple questions.

And maybe, I'll throw it out to Mister Harbeck, but it certainly goes with the last comment that Miss Bowen was making as far as educating the investors and the like. So, Mister Harbeck, you made a comment, which was an interesting one, with regard, and I'll bring this all around, with the Stanford case that, in that case that there was actually written notice -- well, your first comment was to the effect that the coverage and insurance, if you will, as protection is for the securities that are held by the broker. And you, in that particular case, I think you made comments just now saying the fact that actually written notice was made to the investors that they were investing and their money was going, as you put it, offshore. Correct?

Mr. Harbeck: In the Stanford case, as a part of the investor package that each investor received from the Stanford International Bank in Antigua, the investors, most of whom never gave money to the SIPC member firm at all, but some did, but all when they gave their money to the brokerage firm, the money went to the Stanford International Bank in Antigua, and that bank issued a statement saying that the brokerage firm is not liable and that SIPC does not protect the investment.

Mr. Garrett: Right. Okay. So that's good to know on that particular case. In all other cases, or the average situation is when the investor goes into the broker's office, there's the SIPC logo there and the implication and whatever that comes with that as well. And I remember when we met for the first time, I guess, the comment was made is that there's a perception that you are covered and insured, if you will, up to $500,000. I remember you saying at that time, "No, not in all cases." So, and I think that's the message that you're delivering today as well from your testimony. No, you're not covered in, for $500,000, in all cases.

So, I guess a very seminal question here is, should we go back to the days of allowing, or requiring that people actually have the stock certificate in their hand so that they can be guaranteed that this is actually what they have, if, and if without that, you're not really sure what you have?

Mr. Harbeck: Congressman, that would solve the problem, but that's just not going to happen. It's not the way the world works. Transactions are done instantaneously at this juncture and in order to physical, take physical possession of securities, I think is an impractical --

Mr. Garrett: Right. So, if -- and I would agree with you. But, if that's the case that we can't really be sure of what I have in my hand, as I used to in the old days, then I have to be guaranteed of something, assured of something. And, in this case, the IRS was, or in certain of these cases, the IRS is ensured of something because they see the statement, I guess it's a 1099 or what have you, that goes to them saying this is what the dividends or payments out, so they're assured of it. I, as an investor, hypothetically, or an investor would say, "I have the certificate" or "I have the statement saying this." If you can't rely on, if the investor can't rely on the statement, what should he rely upon then?

Mr. Harbeck: The, one of the problems here, of course, is that the investors in Madoff gave discretion as to what to buy to Mister Madoff.

Mr. Garrett: Well, in any case, in any case --

Mr. Harbeck: Yeah, but it --

Mr. Garrett: -- what can I rely -- if I can't rely on the statement, what should I be able to rely on?

Mr. Harbeck: In the overwhelming majority of instances, you can. But what you cannot rely on is that when you give discretion to someone to buy securities and he backdates statement and generates fictitious profits again and again, month after month after month, it is --

Mr. Garrett: But the investor wouldn't know about the backdating.

I only have a minute left already. As far as discretion, I mean, we can get right to the point on this one, the discretion right now as far as in this situation, when you have a situation like this and the appointing of a trustee, is the selection, the nomination of that process is by SIPC, correct?

Mr. Harbeck: Correct.

Mr. Garrett: Would it be a better process to take that step away from SIPC and have it to a so-called neutral party, which would be the SEC, let that, let them make at least the nomination of it, so you would avert any idea whatsoever, real or otherwise, of any conflict that SIPC would have? If not, why would that be bad?

Mr. Harbeck: Well, I think SIPC has an extended body of knowledge concerning who has expertise on this, number one. And number two, that knowledge and expertise has to be applied on about an hour's notice. The MF Global case is a perfect example of that. I --

Mr. Garrett: So, if we could set up something within SEC that they would, A, get the knowledge, and, B, have a mechanism to be able to make these things quickly, could that address most of the situations?

Mr. Harbeck: I'm not sure it could, but there's a further reason. And the further reason is that the people who are saying that these trustees are not comporting with the law are being unsuccessful in that position in courts. It would be different if these trustees were advancing positions in courts and the courts were saying, "No, you are incorrect." But, in Lehman, and in Madoff consistently, the trustee has upheld the law as Congress has written it. And the courts have said that that is the case. So, I don't think there is anything broken about the process. Experts are being put in place and they are doing a good job.

Mr. Garrett: Well I -- my time has expired. I'm always mindful of my colleagues. I guess the question not necessarily is whether they are breaking the law, but whether they are, whether the intention of Congress is being fulfilled as far as how the trustee is managing the case. With that --

Mr. Harbeck: In 1978, Congressman, the Congress investigated that precise point and chose to strengthen SIPC's ability to designate trustees.

Mr. Garrett: Thank you.

Gentlelady from California's recognized.

Ms. Waters: Thank you very much, Mister Chairman. And let me thank our witnesses who have appeared here today to help us better understand some of the discussions about SIPC and these cases that have been mentioned here today that have played out in the press.

I want to understand -- can I get a summary of the areas where SIPC and the SEC disagree about how to resolve first the Robert Allan Stanford case?

Mr. Harbeck: Certainly. The essential dispute is that the SEC's position is a change in the 40-year interpretation of the statute. For the first time, the SEC is saying that SIPC should pay rescission damages to people who are in physical possession of the security that they purchased. That's never been the law, and it is not the law. And the reason that SIPC has not been involved for two years is because the SEC staff looked for instances where individuals left assets at the SIPC member brokerage firm and did not receive those assets. There is no such investor.

The investors who lost money knowingly and willingly sent their money to an offshore bank. And, saying that there is some vague connection between -- well, it's not a vague connection. To say that there is, you can just sort of smush everything together and say therefore the brokerage firm must have had custody of the investors' assets is factually incorrect. The fact is, the investors got what they paid for and they were defrauded. But, SIPC does not pay that as a damage claim. These are victims, but they are not covered by the statutory program.

Ms. Waters: Well, I must say, Mister Harbeck, you make a very good case. What is the current status of SEC's effort to force SIPC to initiate a claims procedure for Stanford's victims?

Mr. Harbeck: The SEC delivered a letter to SIPC on June 15^{th} of last year. Our board examined the issue very, very carefully. The board did not take the staff's recommendation without hiring outside counsel to make sure that the staff recommendation not to start a liquidation proceeding, under these circumstances, comported with law. We did attempt to resolve the problem. We were unsuccessful in resolving the problem with the SEC. And, as a result, the SEC filed suit to compel SIPC to take action. But we have yet to have been presented with someone who left custody of their assets with the SIPC member brokerage firm, and that's why we feel we must go forward with the lawsuit.

Ms. Waters: Thank you very much. Let me just ask about the Madoff case. How -- can you discuss how clawbacks have been treated by SIPC as it relates to Madoff's scam?

Mr. Harbeck: Yes, I'd be happy to.

Ms. Waters: Fraud, I'm sorry.

Mr. Harbeck: Ever since Charles Ponzi enacted his own Ponzi scheme, there have been avoidance powers that allow a trustee to reach back to people who have already received assets out of the fraudulent scheme and bring them back into a common pool. That is exactly what the Trustee has done and that's exactly what the task force has looked at with respect to whether that should continue under the Securities Investor Protection Act. And the task force concluded that if any bankruptcy trustee has that authority and right, then a SIPA trustee, under the Securities

Investor Protection Act, should have that right. And the reason is, the common pool is expanded and it, we don't let the luck of the draw, by getting out the day before, or withdrawing profits and even your principal just before the collapse of the scheme, gives you an advantage over people who are stuck.

And so, the trustee has used those avoiding powers and by starting one particular lawsuit, he's brought back billions and billions of dollars into this estate for distribution to the people who need it the most.

Ms. Waters: Mister Chairman, I yield back.

Mr. Garrett: The gentlelady yields back.

Mister Dold, start please.

Mr. Dold: Thank you, Mister Chairman.

Miss Bowen, even though almost 11,000 indirect investors lost their money in the Madoff fraud, not one single indirect investor was invited to be on the Modernization Task Force. Why is that?

Ms. Bowen: The task force actually was comprised of a broad group of people with expertise including two lawyers who represent investors, such as the ones you've mentioned. So, we felt that their voice was being heard at the table. In addition, we created a website and we had the internet forum as well. And we had a live presentation where we had an open forum in New York City. I was there at that forum. Investors showed up and they did speak to the task force. And we heard their words and we took their comments to heart.

Mr. Dold: Mister Harbeck, do you believe that President Nixon, and Senator Muskie, and the other supporters that led the 1970 passage of SIPA to provide financial relief for all investors?

Mr. Harbeck: That’s a statement of extraordinary breadth. It -- the fact is the statute as originally drafted in 1970 was intended to protect the custody function performed by brokerage firms. And that is -- we’ve been following that mission for 40 years.

Mr. Dold: Do you believe that it’s fair and equitable to differentiate between direct and indirect investors?

Mr. Harbeck: The indirect investors that you’re referring to are people who I was referring to with respect to comments to Chairman Garrett. The Trustee did not pay them, but they -- the reason he did not pay them is he will pay the institution that they owned, the feeder funds that they owned. So, if five people own a feeder fund, they will each get whatever portion they get in terms of their ownership.

Mr. Dold: And that, will that be considered a single entity? Because I know we're talking about each individual entity has certain abilities to receive resources back. Will that fund that has five individuals be counted as one or will that be counted as five?

Mr. Harbeck: It would be counted as one. And two points --

Mr. Dold: And you think that's fair and equitable?

Mr. Harbeck: Yes, I do and here's why. There's two points on that. First of all, the task force considered that and considered the fact that small investors in pension funds might well be considered your small investors that are supposed to be protected by this statute. But moreover, the big protection is not the advance from SIPC. The big protection is the share of customer property. And in the Madoff case, this is precisely what Trustee Picard is trying to expand using the avoiding powers and those funds will, if numbers hold, will receive 50 cents on the dollar, which is, was an unthinkable result, an unthinkably positive result in 2008.

Mr. Dold: I just -- I understand what you're talking about, but I think my concern is that the assumption is that these are going to be smaller investor. Could you not see a situation where actually a group actually with a large investor is coming in and will all be now be treated as one?

Mr. Harbeck: The size of the individual investor --

Mr. Dold: Obviously there is.

Mr. Harbeck: -- is not relevant. What is relevant is whether they had a direct relationship with the brokerage firm.

Mr. Dold: Are you saying --

Mr. Harbeck: And many of the indirect people had no direct investment.

Mr. Dold: Well, are you then trying to pick winners and losers in terms of who, in determining the direct or indirect?

Mr. Harbeck: Absolutely not.

Mr. Dold: You don't believe that there's any difference there?

Mr. Harbeck: No, if a large investor owns a share of a feeder fund, he will get a proportionate share.

Mr. Dold: Capped at what, $500,000, is that correct?

Mr. Harbeck: No, sir. The fund itself will get $500,000 plus a share of its prorated share of the fund. And the prorated share of the fund is the lion's share of what any investor will receive.

Mr. Dold: Mister Harbeck, let me just move on then a little bit. How does the net equity of, or the cash in minus cash out computation protect all customers of a failed broker-dealer?

Mr. Harbeck: This is the methodology that's been used in every single case under the Securities Investor Protection Act dating back to the '70's where fictional statements have been involved. S.J. Salmon in 1973, Adler Coleman in the '90's, many cases in between. These -- the money in, money out methodology is not new to Madoff. It is historically what has always been used when brokers enter fictional transactions to benefit customers.

Mr. Dold: Thank you. I realize my time has expired, Mister Chairman, but I do -- hopefully, we'll have another round to talk about some clawbacks, which I think is important when you talk about some of these Ponzi schemes. I yield back.

Mr. Garrett: Gentlelady from New York is recognized for five minutes.

Ms. Maloney: First, I'd like to thank you for your testimony and voice my support for the task force's recommendation that the 500 be raised to, with inflation, to $1.3 million and to provide pass-through protection to some indirect investors. I think that was a thoughtful recommendation and I support it.

I would like to ask a question on H.R. 757. It is one of the bills that we are debating and is before this committee. And, in that bill, the last statement would be used when determining a customer's eligible claim. As was stated, the courts have recently ruled that this standard in a Ponzi scheme is not appropriate. And that the standard that SIPC is using, net investment money in, money out, is more appropriate. And I do think that there could be some problems with this and I ask you to comment on it. And one example that came into me was investors that most use in this case -- basically, the claim could be based on fraudulent information to begin with, so if you're using, you know, the last statement, it could be based on fraudulent information and it could be a fraud in the first place. And, for example, if you invested $1 million ten years ago and your statement says you now have a fictitious earning and that you now have $10 million, you would be treated the same as someone who invested $10 million yesterday. So, the former has $9 million in fictitious earnings, the latter had no fictitious earnings, however both are treated the same. So, if the pot of money actually in a Ponzi scheme was $5 million, each would get $2.5 million and that doesn't seem fair because it doesn't reflect the reality of what is behind that. I ask you to comment on that and other ideas of why you think your recommendation of money in, money out is better and that that, of course, is what the courts are saying.

But, I also would like to ask, how do you and Trustee Picard determine when it would be a hardship to clawback funds?

Mr. Harbeck: I'd like to speak to your first issue first, if I may, Congresswoman. Exhibit D to my written testimony goes through the examples of why the avoidance powers resolve the problems and actually do equity. And that H.R. 757, while well intentioned, creates actually inequitable results.

Ms. Maloney: Thank you. And though we will read that, but now could you answer how do you and Trustee, or how does Trustee Picard determine when it would be a hardship to clawback funds?

Mr. Harbeck: The hardship program is one where anyone who has been sued, under the avoiding powers, can demonstrate financial hardship and there, those are as unique as the number of individuals involved. And I think the Trustee, first of all, made a decision not to sue certain of these, of the people who received relatively small amounts, although they're, in absolute terms to me, they're somewhat sizeable. But he didn't sue everyone who received more than they put in.

But when he did, he was more than willing to listen and apply a rule of reason. That's the only way you can really describe it to a situation. It makes no sense to sue someone when they have no assets or they're extremely elderly.

Ms. Maloney: And my time is almost up. Can you discuss the task force's recommendation to provide pass-through protection to indirect investors and certain ERISA qualified plans, but not investors in other funds?

Ms. Bowen: Making that determination, we start at least with the ERISA plans that those trustees have a fiduciary obligation. Those were retirement funds.

We also thought that, you know, the whole purpose of SIPC is to protect the small retail investor. And, given how people invest money today, most people's savings are tied up, frankly, into their retirement accounts. And so, we were attempting to, to address that by really limiting it to that short list of people, frankly. And not to extend it to large institutional investors.

Ms. Maloney: Thank you. My time has expired.

Mr. Garrett: Thank you. The gentlelady yields back.

Mister Hurt is recognized for five minutes.

Mr. Hurt: Thank you, Mister Chairman. I want to thank you all for being here today as we try to understand and deal with these important issues.

I had three things I wanted to cover and maybe each of you could address it as appropriate.

The first is, can you give us some concrete idea of what the financial solvency of the fund is, especially with the pressures that you face in wanting to raise the maximum reimbursement or the maximum claim amount, and, I hope, also considering the fact that you want to keep these assessments as low as possible?

The second question deals with the assessments themselves. How are you dealing with the fact that, you know, a lot of these broker-dealers are part of a small, smaller outfits, smaller firms? And how do you account for the pressures that they face as small business people?

And then finally, just a general question, is, are these reforms things that will require Congressional action or are these things that you all, from your standpoint, would prefer to be able to do from within?

Mr. Harbeck: Well, let me take a attempt to answer that. First of all, in terms of SIPC's financial solvency, prior to the start of the Lehman Brothers case, SIPC had $1.7 billion. Even after paying $800 million to Madoff investors and paying administrative expenses of $300-$400 million that have brought in $9 billion for the Madoff estate. Because we, in effect, turned the spigot back on off assessments, we now have a fund of $1.5 billion. And that is adequate to perform the statutory functions that Congress has assigned to --

Mr. Hurt: Has anything been drawn down from the Treasury?

Mr. Harbeck: No, we have never used Treasury funds. But I hasten to add that if SIPC is to be tasked with some new and radically different level of protection or rescinding bad investments as in the Stanford case, I would anticipate that the Treasury line of credit may or may not be sufficient. And we would have to assess the industry.

To your second point about assessing the smaller, independent members, I have met and other SIPC staff members have met with the National Association of Independent Broker/Dealers to brief them on these issues. And we understand the nature of the problem. They are currently being assessed at one quarter of one percent of their net operating revenue.

Mr. Hurt: Well, and if I could just interrupt. Before, it was at $150 per member. $150 annually for each member, is that right?

Mr. Harbeck: We assessed on net operating revenues through the 1990's when we reached a target of $1 billion, we cut back to a very nominal sum. But, with the onset of the Lehman and Madoff cases, we reestablished a higher target of $2.5 billion that we would like to have on hand.

Mr. Hurt: So, what does that mean? Is there a way to characterize that as it relates to the smaller firms?

Mr. Harbeck: Yes, if we were to continue --

Mr. Hurt: In a cash number?

Mr. Harbeck: On a cash number, it's very difficult because the, frankly, the large brokers --

Mr. Hurt: Is it 500 bucks? $1000?

Mr. Harbeck: It varies dramatically and as Miss Bowen has said, some of the very smallest brokers have now actually, inadvertently, had their assessments reduced to zero.

Mr. Hurt: Okay.

Mr. Harbeck: But, and the basic point is that we will be assessing if we continued at the current rate of one quarter of one percent of net operating revenues, we would reach our target of $2.5 billion between the years 2015 and 2016.

Mr. Hurt: And then, the last question -- well, are -- well, the last question deals with Congressional action. Is it -- are these things -- is -- are

these things that you all are inviting
Congressional action or are these things that
you feel like you can handle with in-house?

Mr. Harbeck: I think the task -- well, some of the things can be done in-house, but the most -- changes concerning the limits of protection require Congressional action and when Former Chairman Johnson issued the task force, he requested that, and raised at the board meetings, that we do some empirical studies as to the effect on the industry and on investors before we go to Congress and ask for those changes.

Mr. Hurt: Thank you. I don't -- my time's about to expire. Miss Bowen, do you have anything to add to that?

Ms. Bowen: The only other thing I would add with respect to the assessments is that obviously that number's determined based on litigation when and if it happens in time. And so, we can't predict necessarily if there's going to be another big failure tomorrow. But so, the concept of assessments really depends on, you know, the likelihood of litigation, the outcome. Stanford obviously would definitely be a huge problem.

Mr. Hurt: Thank you.

Mr. Garrett: The gentleman yields back?

Mr. Hurt: Gentleman yields back. Thank you.

Mr. Garrett: Mister Green, is recognized. I think you're next.

Mr. Green: Thank you, Mister Chairman. I thank these witnesses for appearing as well. And, I do concur and believe that we should raise the amounts that investors can assume that they may acquire if there is some scheme that's uncovered. Now, let's focus specifically on Mister Madoff and I'd like to speak to you if I may, Mister Harbeck. Sir, is it true that Mister Madoff had with malice aforethought statements issued that were misrepresentations?

Mr. Harbeck: Absolutely.

Mr. Green: And, is it true that these statements, and I'm not sure that you've added them, but if you did add them, that they would total probably billions and billions more than you're capable of paying if you pay based upon statements?

Mr. Harbeck: The -- on a money in, money out basis, the customers of the Madoff brokerage firm deposited between $17 billion and $20 billion. The final statements totaled about $63 billion. He had on-hand virtually nothing.

Mr. Green: Before going on, let me make it very clear that I'm, I really am in sympathy with people who've been defrauded. This is a dastardly deed, perpetrated by a criminal mind, without question. The question, however, becomes how do you compensate these victims? And this is why I said my thoughts are somewhat ambivalent because I'm trying to do equity. I want to make sure that people can have some confidence in capital markets and confidence in, that when they go to these brokers that they're going to get some degree of equity.

Just address it, please, given that the wide chasm between the statements and the money in, money out methodology.

Mr. Harbeck: The difficult answer, but the correct answer, which the courts came to, is that the to base the payments on the last statement is to allow the fraudulent actor, the dastardly criminal who you correctly characterized, the final say as to who wins and who loses. If you, and further, if you go by the last statement, the unintended consequence of that is you make Ponzi scheme participation a good thing. You make it a -- you make it profitable.

So, in one of the comments that I made to one of the bills, it was to create a dialogue between a fraudulent salesman and someone who, who is questioning, "Well, if this is a fraud, will I get money back?" And the answer is, "Don't worry about that, SIPC will pay for it. Even if it goes down, even if it's fraudulent." So, it's a difficult question.

But, the courts that considered it, the Trial Court, the Bankruptcy Court, and the Second Circuit Court of Appeals, came to the conclusion that, and this is not my words, this is the words of the four judges who have considered this, that it would be absurd to let the thief determine who wins and who loses, and consequently, you can't use the last statement.

Mr. Green: Now, I concur with the Chairman with reference to the statement and to this extent, I want the person receiving the statement, the investor, to have some belief in that statement and to rely on that statement. Is there any means by which we can use technology, or somehow cross-reference, or give that person receiving the statement the opportunity to -- as an aside, are all or most of these person sophisticated investors?

Mr. Harbeck: We make the assumption that they are not.

Mr. Green: Okay. Now, they're not sophisticated investors, how can we, perhaps with technology or some other means, give them a greater degree of confidence in that statement? Because the Chairman makes a good point. I have my statement. I've -- I'm relying on my statement. To a certain extent, there are other entities that rely on the statement. How can we strengthen the statement?

Mr. Harbeck: I think you've put your finger on it. I think technology is the answer. In this case, Bernard Madoff, acting as an investment advisor, used his own firm as the custodian of the securities supposedly held for his clients. If you divorce the custody function from the investment advisor function, as is done by most investment advisors, then the problem solves itself. Then the brokerage firm with custody has the securities. It's a check on the system. And I think the SEC is, has located that as one of the problems in the Madoff case.

Mr. Green: Thank you. Mister Chairman, I yield back.

Mr. Garrett: And I thank you. The gentleman from New Mexico is recognized for five minutes.

Mr. Pearce: Thank you, Mister Chairman. Miss Bowen, the -- as I'm reading through Senator Vitter's testimony, he alleges that SIPC is dragging its feet on solving the cases. Do you have a rebuttal to his testimony?

Ms. Bowen: Yeah, obviously, I think you're referring to the Stanford case.

Mr. Pearce: He's talking also, saying he says you're dragging your feet on the Madoff case also.

Ms. Bowen: I would say just given the outcome with the Madoff case that we haven't been dragging our feet and we've been maximizing on the returns to the investing public.

With respect to Stanford, it's a very complicated issue. We decided that we did not have the authority to change the law or to change the statute. And our reading of the statute is such that we felt we had to go to court. I believe that court has decided to be as expeditious as possible in reaching a resolution. And we'll follow the law.

Mr. Pearce: Does the SEC agree with your position? Or SEC oppose your position?

Ms. Bowen: It opposes our position as to whether or not --

Mr. Pearce: So, they feel like it -- you -- it -- they feel like it is not required to change any law?

Ms. Bowen: I believe, again I haven't really read their filings, but I believe they think that there is, there may be a customer who is entitled to recovery. We don't see a customer of a broker-dealer.

Mr. Pearce: Do you all get involved at all in the nullifications up front that investors are worried about, about their investment? Do you all -- are you all notified at all? Or you just come in later as the insurers?

Mr. Harbeck: The -- well, first of all, we are not a regulator in any way, shape, or form. And, unlike the FDIC, one of the questions earlier was, you know, concerning the FDIC. We are not an insurer. And that's in our name. We do come in, and you are correct, only after the firm has failed.

Mr. Pearce: So, are you involved in the MF Global case at all?

Mr. Harbeck: Yes, sir. We -- I was notified at 5:20 a.m. on Halloween Day that MF Global's customers were in need of protection and one of the gentlemen in this room, who was on the legal staff of SIPC, was in court and had a trustee appointed that afternoon.

Mr. Pearce: Who notified you at 5:20 a.m.?

Mr. Harbeck: A member of the trustee -- pardon me. A member of the trading and market staff of the Securities and Exchange Commission.

Mr. Pearce: You remember the name?

Mr. Harbeck: Yes, his name was Mike Macchiaroli.

Mr. Pearce: The -- you received the SEC's email at 7:29 on October 31st and that email set forth the basis that they thought that a settlement was going to be reached. Is that correct?

Mr. Harbeck: I think you're conflating two cases, sir. The old -- oh, a settlement in the MF Global case?

Mr. Pearce: Okay.

Mr. Harbeck: Yeah, at 7:29 on October 31st of last year, that was a written confirmation that MF Global had failed and was in need of protection.

Mr. Pearce: Okay.

Mr. Harbeck: Subsequent to my, the 5:20 call from the Securities Exchange Commission, Mister Macchiaroli in New York. We put an attorney on a plane that day. And that day, we took over the firm or, and placed a trustee in position. I think that demonstrates that we don't drag our feet. We had no idea whether we had billions of dollars worth of exposure in that situation, and we did it because that was the right thing to do.

Mr. Pearce: The -- you were discussing in another circumstance about the professionals that you all contacted. Who are the professionals that you all contacted? Can you give us the list of that? And, what were their positions?

Mr. Harbeck: We contacted attorneys from Weil, Gotshal, and Manges. We contacted attorneys from several other law firms, the names of which escapes me. Several of them had conflicts of interest. And we felt that, as it turned out, that MF Global was the eighth largest bankruptcy of any kind in history, that that would be a poor time to put in someone who had no previous experience in this case.

Mr. Pearce: Do you -- let me get one question before my time is out. I'm sorry to interrupt. But, you talked about going and getting settlements from -- say people had received a payment, they had cashed in their account, and you go back and you, you're not going to let them succeed just because they got paid out the day before the bankruptcy. Do you ever go after the personal assets of the people, the principals involved in these decisions? In other words, Mister Corzine?

Mr. Harbeck: Well, since no lawsuit's been started against Mister Corzine, I'd rather speak to either past cases or theoretically.

Mr. Pearce: I was just using that as an example. You do go after person- --

Mr. Harbeck: We go -- the SIPC trustees are financed by SIPC to take every -- we think it's a good lesson for people who steal money to be held accountable for it and we will finance litigation to do that and take those people down to their last cent.

Mr. Pearce: All right. Thank you, Mister Chairman. Appreciate it.

Mr. Garrett: Thank you. Mister Royce, you're recognized.

Mr. Royce: Thank you, Mister Chairman. I guess what's caught all our attention is, among other things, is the report of the Office of the Inspector General Office of Audits where they have some very pointed things to say about the oversight. They say, "We found that significant criticism and concern have been expressed about the amount of trustee fees awarded in the two largest liquidations in SIPC’s history, Lehman and Madoff.” Here’s what they say about that. And I’ll ask -- we’ll have a comparison up on the board in terms of the way Lehman in the UK has been handled versus the US up there, but here’s the observation from the report. “To the Lehman liquidation, SIPC’s trustee fee chart combined both the trustees and the counsel’s time, and the hourly rate ranged from $437 to $527 an hour. Moreover, the fees paid to date for both the Lehman and Madoff liquidations are a mere fraction of the amounts that will be eventually sought.” Well the fees paid to date, I think, are in the order of $600 million. And, I guess, my question is the same question that the Office of Inspector General is getting to, and that is, do you believe the $600 million-plus in legal fees is reasonable?

Mr. Harbeck: Yes, sir, I do.

Mr. Royce: And then, let me ask you, if this is reasonable, what would you deem reasonable for a completed Lehman liquidation? Because, as they point out again, again “it’s a mere fraction of the amounts that will eventually be sought…significant work relating to customer claims with pending litigation remains to be done." Now, this is after three-plus years. And, of course, they point out that they would like additional oversight, that they would like SIPC to negotiate with outside court-appointed trustees more vigorously to obtain a reduction in these fees.

So, they've got a little different take than this, on this than you do. What do you think the final cost will be?

Mr. Harbeck: The cost estimation for Madoff case in administrative expenses is $1 billion. To date, I believe somewhere in the vicinity of $400 million has been expended in legal fees.

Two important things to note. One, not one penny of that came from customers or diminished customer assets. SIPC paid for it all. So, SIPC paid for the litigation, which drove, which the GAO Report, which was issued yesterday or today, indicates brought in billions and billions of dollars in the Madoff case. Customers haven't been diminished in any way, shape, or form by that.

Mr. Royce: I understand that.

Mr. Harbeck: As to the Lehman Brothers case, there is, this is the largest bankruptcy of any kind in history. And what I would refer you to in terms of the person closest to the facts on the legal fees is Bankruptcy Judge Peck in New York. And I've included in my written statement his comments at the Chapter 11 Confirmation Hearings where he says the case is coming to an unbelievably successful conclusion and that he congratulates all of the professionals involved. So, I -- my God, the hourly rates these people charge are staggering. Everybody knows that. But, in that one instance, with, and I'm familiar with that, the SIPA trustee did an outstanding job and I think the fees are reasonable.

Mr. Royce: Well, one of the unique situations here is that we can compare and contrast with a situation in the UK. And, in terms of return of customer assets, you've got a situation in the UK, where of the $21.8 billion of client assets, $20 billion was returned. In terms of settlements with foreign affiliates, in terms of the UK, you have a situation where they have settled with US affiliates, with Lehman Hong Kong, with affiliates around the world, that process hasn't gotten underway here.

In terms of general unsecured estate, in the UK they've resolved the majority of its unsecured claims, whereas in the US, they've yet to review unsecured claims.

But, most importantly is the fees. And you look at the difference, and you look at the timeframe, three-plus years versus what's occurred in the UK, and it truly grabs one's attention in terms of the cost, but also the criticism of the Office of Inspector General brought to process about the oversight and the way in which we're conducting this, and especially the way in which, you know, you're down to two firms doing some pretty major work. Or one firm is handling MF Global and Lehman simultaneously, reportedly in the financial press, that is causing some backlog in terms of the ability to push this through. I'd like to get your response.

Mr. Harbeck: If I could respond.

Mr. Royce: Yes.

Mr. Harbeck: Actually, the fact that the Trustee in the Lehman Brothers case and the MF Global case has leveraged their work incredibly well. The

Lehman Brothers Trustee just won a case for American investors over Lehman Brothers, Inc. Europe before the Supreme Court of the United Kingdom last week. And the exact same issue arises in the MF Global case. This is an example of picking a veteran staff and a veteran trustee who knows what they're doing and does it well.

Mr. Royce: I'll close with this. Reportedly, part of the problem in terms of making progress is that you've got people pulled off of one case to work on the other case because you've got one firm. But my time's expired.

Mr. Harbeck: I can speak to that. I asked that exact same question on the morning of October 31st to make sure that the Trustee's staff would not affect either case. I was assured that it would not and our supervision of the case indicates that it has not.

Mr. Garrett: Thank you. Gentleman from Colorado. And then you'll -- you'd like to come back to you? Sure. What's then -- gentlelady from New York then.

Ms. Hayworth: Thank you, Chairman. If we could just leave that slide up for a moment. And, Mister Harbeck or Miss Bowen, I am intrigued by the difference in the, in the differences between the two columns. To what do you attribute -- is there a matter of the laws being different in the UK? Or, how does --

Mr. Harbeck: It's apples and artichokes. They're just not comparable. The size and scope of the operations are incomparable, the laws are different, the administration of bankruptcies are different. The fact that they both have the name "Lehman Brothers" is the reason they're both in the same chart.

Ms. Hayworth: Understood. Now, is there something that we can use from the UK -- I mean, it, although two different entities, it's obviously the Lehman Brothers applies to two different entities, but is there something we can take home from that as legislators in terms of our approach to these kinds of problems.

Mr. Harbeck: Well, let's think about Lehman Brothers and MF Global, and the Dodd-Frank Act. I think the eighth largest bankruptcy in history was not a Dodd-Frank event. And that's a good thing. So, the fact is I think the system works, it is an expensive system. Bankruptcy is an expensive process in financial institutions. But by and large, the system is working in the United States.

The, again, the Lehman Brothers Holding bankruptcy judge comments on this case really strike home for those of us who have been living with that situation for several years.

Ms. Hayworth: In terms of Madoff, I've met a couple of folks who've been directly affected by the Madoff situation. Is there any shred of hope we can offer people who --

Mr. Harbeck: Well, that's --

Ms. Hayworth: -- trusted their Madoff accounts and --

Mr. Harbeck: Well, one thing that the Trustee has run across when he has sued financial institutions saying that those financial institutions knew or should have known of Madoff's problems, he has been running into a defense that he does not stand in the shoes of all of the individual customers. I think he does under the law. Some courts have held to the contrary. If we get some clarity on that, then SIPC could use its funds to set, to prosecute lawsuits against entities that should be held financially responsible and that would benefit customers at no expense to them.

So, if the courts do not see it our way, perhaps legislation to give the Trustee an overruling of old, old case called Kaplan versus Marine Midland would be a tool in the Trustee's [inaud.] that he could use to benefit investors.

Ms. Hayworth: Miss Bowen, any --

Ms. Bowen: Nothing to add to that, no.

Ms. Hayworth: Thank you. Mister Chairman, I yield back.

Mr. Garrett: Well, the gentlelady will yield to me. Right. Just a couple quick points. On the point that Mister Royce was raising, or, and Nan was raising as far as the two entities, UK and US, if you convert these to dollars, are they the size of the assets, are the bulk of these companies apples and artichokes? What are the --

Mr. Harbeck: No, I think -- I think the answer to your question is the overwhelming majority of assets were in the United States. For example, SIPC, the Trustee, transferred $92 billion in the first week. And the wind-down of the other assets, the non-liquid assets, is being conducted in the Chapter 11 proceeding of Lehman Brothers Holding.

Mr. Garrett: I understand that.

Mr. Harbeck: Not the liquidation of the SIPC member firm.

Mr. Garrett: Yeah.

Mr. Harbeck: But it's much, I think the American entity is larger by a factor, I don't know the factor sitting here, no.

Mr. Garrett: All right. And as long as there's time. So, part of your position is as well the, that SIPC has done such a tremendous job, your point of saying, well, $9 trillion (sic) at, now, I guess, at a cost of a billion dollars in fees in this particular case, ballpark figure.

Mr. Harbeck: But that's projected out into the future, sir.

Mr. Garrett: Right. But, I mean, out of that $9 billion, isn't the bulk of that just through one case? I mean, the very great case. The Jeff Picower matter. There was net equity in that case of my understanding on Madoff's books, basically saying, "Hey, you really owed this money back to us," meaning Madoff from Picower. So, that's 99% of that net equity, in the bulk, was from the Picower case. And that was around a little over $7 billion, is that right?

Mr. Harbeck: The overwhelming majority of it was, absolutely.

Mr. Garrett: So it --

Mr. Harbeck: But the Trustee is not done yet, sir.

Mr. Garrett: Right. So, but when you -- yeah, you have $200 million on top of that, I guess from the kids of the Picower family, which is all good. But, I mean, but to come and say, "Well, we spent a billion bucks," which, as you agree, is amazing fees, $500 or so an hour. That's good work if you can get it. I used to be an attorney. I billed at, I guess, a tenth of that or so, or a little more than that. But, yeah, so out of the $9 billion when you came here, I thought, at first I thought, "That's great," but, you know, seven-plus billion dollars of that is one case and the other -- so, a little over a billion dollars comes from all the rest. So, I guess, you would have to put that in perspective as to exactly what the trustee has accomplished. But for that case, you'd be spending a billion dollars to get about $2 billion.

Mr. Harbeck: And the answer to your, the answer to your point is we're not done yet.

Mr. Garrett: Well, I think --

Mr. Harbeck: The Trustee hopes to get back, he hopes to get back 100 cents on the dollar. Will he do that? I don't know.

Mr. Garrett: And I guess -- and that's -- that's the concern.

Mr. Harbeck: But, if you say, I think if you said to anyone from any source that you were going to get back $9 billion --

Mr. Garrett: Right. We keep going back to that, yeah. But we never knew the Picowers were out there and there was a negative equity that there, out there that one individual had. But, and we -- and this is when you say, “They’re not done yet,” and there is the rub, there is the concern is that they’re not done yet. There’s probably not that many more Picowers, if I’m saying the names correctly, out there anymore, so the rest are going to be the smaller ones, the rest are the other people that we’re concerned about in this panel, and that is, or some of us are concerned on this in this panel, are going back to those people who, as Mister Green was saying and shares with me the concern, all they did was rely upon what was sent to them. And, to your comments that that makes power, makes Ponzi schemes a good thing, only if there’s the intention of, or knowing that that’s a Ponzi scheme.

But I’m going over my time. If the gentleman is not ready from Colorado yet, then Mister Stivers is recognized for five minutes.

Mr. Stivers: Thank you, Mister Chairman. My first question is for, I think it's probably Mister Harbeck, although probably both, maybe both of you could answer this one. What would the impact on the SIPC Fund be if every indirect investor expected to receive SIPA coverage?

Mr. Harbeck: At the start of the case, at the start of the Madoff case, we made an effort to tell every person who thought they even remotely was damaged by the Madoff case to file a claim. Thousands of people did so, who had, who didn't even know that they were invested in Madoff. Some of the people who have testified in front of this body bought a feeder fund that bought a feeder fund that bought a feeder fund that bought Madoff and said that they were an indirect investor. So, that's like throwing a ping-pong ball into a bunch of mousetraps loaded with ping-pong balls. I couldn't possibly tell you what the cost would be because the cost would be capped at the net equity of $17 billion, assuming that they were all owed by feeder funds.

But, the relationship between broker and customer is really, it's -- that's not -- that's the one part about this that isn't rocket science. “Did you open an account? Yes? Okay. If you didn’t open an account, you’re not going to be a customer.”

Mr. Stivers: Miss Bowen, do you have anything to add to that?

Ms. Bowen: No, I don’t.

Mr. Stivers: Well, do you say -- do either of you think that SIPC has a responsibility to warn customers about possible signs of fraud or conduct that might indicate fraud?

Mr. Harbeck: Whether we have an obligation to do so or not, it’s a good thing to do and Miss Bowen has recommended and championed on the task force an investor education program. I’ve been doing what I would call “dog and pony shows” with members of the North American Securities Administration Association on fraud. And I have in the back of my mind a program that I want to use at Walter Reed Hospital because you’d be surprised at the fact that people will steal money from entities. And the, you know -- I, I’ve seen enough different kinds of these schemes. I’ve been doing this for 35 years. And I’ve seen enough of these things to put together a program where we could say these are some red flags that you should have. And, actually, I enjoy doing that.

Ms. Bowen: So, I would add to that to that with the task force we did have some securities regulators who were part of our task force. And we'd talk about --

Mr. Stivers: Was it the SEC or FINRA, or who was that?

Ms. Bowen: Well, Mister Borg is here from Alabama.

Mr. Stivers: Oh, so state regulators. Sorry. Thank you.

Ms. Bowen: Yes, state regulators. And so, we talked about having forums, maybe throughout the country, you know, to get the word out. And also, to, frankly, if there's a way for us to work with the SEC and FINRA to maybe change the language that's in the broker statement, although we know, frankly, that's, that may not solve the problem in terms of education.

And then, part of what the task force did recommend that we have a person dedicated to investor education who would work with us to figure out a way to get the word out much more effectively.

Mr. Stivers: Right. Do either of you think that SIPC should be empowered to conduct spot audits to ensure that cash and securities are really in the custody of broker-dealers?

Mr. Harbeck: The an-, the one-word answer is no, but I'd really like to explain why.

Mr. Stivers: You got a minute and six seconds.

Mr. Harbeck: There are five levels of review of that issue. The internal auditor at the brokerage firm, let's assume he's corrupt. The outside auditor, let's assume that that auditor is either corrupt or incompetent. A state audit, a self-regulatory organization audit, and the SEC. If you added SIPC as a sixth, SIPC would have to hire the experts who are already doing it. And I'm not sure that we --

Mr. Stivers: Can I do a quick follow-up on that?

Mr. Harbeck: Sure.

Mr. Stivers: Like, in Madoff's case, he was not covered by FINRA, so he wouldn't have had an SRO, he would have only had an SEC, and they actually do it once every 10 years for firms of his size?

Mr. Harbeck: I don't believe you're correct, sir. I believe he was -- every brokerage firm is a member of a self-regulatory organization. It's required.

Mr. Stivers: Okay.

Mr. Harbeck: So, yeah, FINRA did not find this, nor did the SEC.

Mr. Stivers: I yield back the balance of my time, Mister Chairman. Thank you.

Mr. Garrett: The gentleman yields back. Gentleman from Colorado is ready and recognized.

Mr. Perlmutter: Thanks, Mister Chair. And thanks to the panel. I guess, let's just sort of -- and I know you have broken it down into two categories. You got the situation where it's a fraud from the outset or more or less a fraud, insolvent as a result of it being a fraud, and then it's insolvent as a result of things falling apart, it wasn't a sham to begin with.

Well, let's deal with the fraud one first, the Madoff, the Stanford, the Peters or Petters, whatever they're called. In Colorado, we had a number of investors who invested in, you know, Company A that invested in Company B that then invested in Madoff, or Stanford, or some other Ponzi artist. As I'm looking at the recommendations of the task force, those in-, you know, everybody calls them "indirect investors" are sort of out of luck based on the law today, the SIPC law today or the task force recommendations, except for those that might be pension plan. Am I right? Wrong?

Ms. Bowen: That --
Mr. Perlmutter: And I'm asking both of you, so.
Ms. Bowen: Yeah, that's correct. That is the recommendation.
Mr. Harbeck: Sir, if I could elaborate, though. The indirect investors will share, and I believe in my written comments I speak to this specifically because I know this is of particular concern to you, if you take a look at Exhibit B to my written comments, it is a letter that I wrote to you and to Congressman Ackerman to make sure that when we settle with one of those feeder funds on a preference of fraudulent transfer, that the money flows directly through to the indirect holders.
Mr. Perlmutter: Okay. But, I guess, I'm just trying, from a policy standpoint, to understand why the pensioners -- and, you know, and they're a sympathetic, obviously a sympathetic group. I think the firefighters lost some money or their pension initially was in the Madoff mess. So, why the pensioners? I mean, I, I guess I'm happy if they get it, but I'd like to see others, indirect investors, be entitled to some recovery directly from the fund. What's the

policy distinction you all make?

Ms. Bowen: I can -- one of the things we considered is the fact that, with the pension plans that we suggested was the pass-through, there is already a level of fiduciary obligation under ERISA. You know, so we spoke to that level of protection, that they will -- gave us some comfort. If you're talking about people who may invest in a hedge fund, for example, we wouldn't be privy to what the, you know, what their arrangement is in terms of, you know, they may have been invested in a huge hedge fund in Connecticut.

Mr. Perlmutter: And I guess what I'm saying -- and Mister Harbeck, I understand you're sort of black and white position that you know who's opened an account with Madoff. You can go back, you know, so and so, so and so, and so and so. But, the reality of how the system works these days is that you're going to have -- or, at least in that instance, and I think in many, you've got a number of different investors who invest in Company A, who then conglomerate into Company B, who then Company B invests with the Madoff, with the broker-dealer. So, I understand your wanting to have a black and white line there, but that's not how it works. And the guys who are really getting clobbered are these, the little investors back here and the indirect investors.

Mr. Harbeck: Again, if you focus on the common pool of assets known statutorily as customer property, that's where the lion's share of any customer's assets is typically restored. Not the advances from SIPC. So, typically, the person who is an indirect holder will not be clobbered because the entity that has the account will get, typically, not in Madoff granted, but typically, that entity will get a large share of its assets because, typically, and here I find myself reluctantly, very reluctantly, defending the SEC, they usually find these things at a point where the amount of missing assets is small. And that means that the common pool of assets is in the 95, 98 percent range.

In Madoff, there was an egregious failure that proves that rule. So, ordinarily, the entity would receive a substantial portion. There have only been, prior to Madoff, somewhere in the vicinity of 350 customers, entities or any kind, whose claims were not 100 percent satisfied. Individuals, entities, whatever. And the total amount that those claimants did not receive, again this is prior to Madoff, was somewhere in the vicinity of only $47 million.

So, I am not sure that, you know, pounding the Madoff issue is the reality for most people who get caught in one of these unfortunate situations.

Mr. Perlmutter: Thank you. And, Mister Chair, if I could introduce, if it hasn't been already, the letter dated March 2nd, 2012 from the Agile Fund's Investor Committee.

Mr. Garrett: Without objection.

Mr. Perlmutter: Thank you.

Mr. Garrett: And the gentleman yields back. [inaud.] Cassidy?

Dr. Cassidy: I just want to first thank the Chairman and the Ranking Member for allowing me to ask questions. Mr. Harbeck, I am not a securities attorney, I am a doctor. So, your knowledge greatly exceeds mine and if I say something stupid, it won't be the first time, it won't be the last, and please forgive me. That said, let me first ask, was there a settlement offered by SIPC to SEC on

behalf of the Stanford victims?
Mr. Harbeck: There were settlement discussions, yes, Doctor.
Dr. Cassidy: And was one offered?
Mr. Harbeck: We made an offer, but I would hasten to add that I won't go into the details on that.
Dr. Cassidy: That's fine. That's fine. But the fact that you offered, even though you categorically deny the rationale for your testimony, gives me a little bit of a pause regarding your testimony. Secondly, let me ask you this. There -- it seems as if you have two objections to SIPC extending coverage. One, that SIPC does not cover losses of an investment. And two, the custody issue.
So, let me take the first. You quoted a court case earlier in your reply to Mister Green, clearly you're an attorney, you defer to court. Do you disagree with the Fifth Circuit Court, which found that a Ponzi scheme is, as of a matter of law, insolvent from the inception, that the value is fictitious, there is no value to lose because the value is not there at its inception? Do you disagree with the Fifth Circuit?
Mr. Harbeck: The fact that it is insolvent from the initial

moment does not detract from the fact that the instrument received by the Stanford people was a real Certificate of Deposit issued by --

Dr. Cassidy: It was a --

Mr. Harbeck: -- issued by a real bank in a real country that is in a real --

Dr. Cassidy: Let me finish. It is a piece of paper, all agree with that, but whether or not the value is real or fictitious seems to be the point. And the fact that it's insolvent at inception suggests that the value is fictitious. And I would just make that point and we, you can hash that out in court. But I --

Mr. Harbeck: The other thing I'd like to say, Doctor, is this matter is in litigation.

Dr. Cassidy: I understand that. But one other --

Mr. Harbeck: And, and I --

Dr. Cassidy: And I think --

Mr. Harbeck: -- I'm constrained by that.

Dr. Cassidy: Your testimony written and spoken really went after this case as if it were in case, and I think it's important on behalf of the victims, to make the counter-argument, if you will. So, if the first point is that indeed the value is fictitious and there may not have been value to lose, let's move to the second regarding custody. Again, knowing that you're an attorney and that you've previously quoted court cases in reply to Mister Green, you spoke earlier about how you would have to fold in these different entities in the Stanford Financial Group to, if you will, give the Stanford victims standing. And yet, there is a US District Court for North Texas that said that the Stanford International Bank and Stanford Financial should be collapsed together. That, indeed, that they should be folded. And it is, again, a fiction to pretend that they are different. Now, that affects, and my understanding -- again I'm a gastroenterologist, what do I know? Although, I feel like I'm kind of in the sweet right now. What, what -- that would not give them standing as a customer?

Mr. Harbeck: For a wide variety of legal reasons, the answer is no. Among other things, the independence of the entity in Aruba has been recognized in several other countries, separate, who have not turned over assets to the receiver in Texas.

Dr. Cassidy: Now, let me just point out, though, that the Stanford Group Company was broker-dealer registered with Commission and a SIPC member, that both that and the Stanford International Bank, Limited were wholly owned and directed by Stanford, that the Stanford Financial Group was a brand name under which STC, SIBL, and others operated to give credibility to SIBL, and that domestic clients purchasing Stanford International Bank, Limited CDs dealt substantially, if not exclusively with Stanford Group Company brokers. And that some SGC's, if you will, accountholders received consolidated statements from SGC regarding their Stanford International Bank loan investment.

I can go on, but I think I'm making the point. It does seem as if there is a case for them to be folded together. As the North Texas District Court suggests, this would be the one to do so. Then I just kind of go on for a couple other things because I'm almost out of time, I apologize. I have to admit, you give the hypothetical of well, you have a salesman that says, "Go ahead, invest in the Ponzi scheme and you will be covered," and I have to say that there isn't a victim yet who I have learned would have invested in this Ponzi scheme should

they have known it was a Ponzi scheme.
Now, I will just frankly dispute that and the idea that somehow, “Don’t worry, you give your $500k to us and we’ll cover it on the backside,” forget the fact that you’ve lost the investment value of the period of time it’s with them. I will just make that point.
But, one last thing, since there was a settlement offer, and since there has been discussion as to the amount of money it would cost for such a settlement, can you give us the cash figure that SIPC thought would be involved in such a settlement?

Mr. Harbeck: No, sir, I will not. That is a matter in litigation.

Dr. Cassidy: But I will presume because you are a fiduciary agent, it would not have been one that would have broken the bank and I think that point needs to be made.
You’ve been generous with your time. I yield back. Thank you.

Mr. Garrett: I thank the gentleman. All questions have been asked. No, strike that. All members have been, had the opportunity to ask questions, but a couple members have asked just for follow-ups.

So, what we thought we would do is just put five minutes on either side to split however the members want to on either side. And -- oops. I reclaim that false statement. And we'll start with the gentleman from California for his five minutes.

Mr. Sherman: Last and, probably in this case, least, what is the financial position of SIPC and how is that affected by how you determine whether the Madoff investor is, when pooled, is eligible for one $500,000 limit or several?

Mr. Harbeck: We didn't take SIPC's financial situation into consideration in the slightest in making those determinations. Those determinations are made by the law. The laws --

Mr. Sherman: Yeah. No, not that -- I'm asking a financial question, I'm not asking for legal defense. What's your financial position assuming your position on the Madoff claims is upheld by the courts as I'm sure you think it will be.

Mr. Harbeck: Our financial position would be that we've already paid all of the customers who are entitled to protection. We've paid every --

Mr. Sherman: So, what's the net worth of SIPC right now?

Mr. Harbeck: $1.5 billion.

Mr. Sherman: And that's after paying all of the Madoff claims?
Mr. Harbeck: Correct.
Mr. Sherman: And if you were to lose on the arguments that have been raised for Madoff, how far under water would you be?
Mr. Harbeck: Which arguments, sir? There are several.
Mr. Sherman: The argument that each participant in a pool is a separate investor.
Mr. Harbeck: I'll preface this by saying we've never lost that issue.
Mr. Sherman: Right.
Mr. Harbeck: And I believe it -- the outside is $17 billion because that would, you know, I assume --
Mr. Sherman: That would be the pool of -- yeah.
Mr. Harbeck: -- that all, everybody would get paid 100 cents on the dollar.
Mr. Sherman: Okay. And do you have different rates for, in effect, what is insurance based upon whether the securities are being held in one of the generally accepted depository houses or whether they, the member of SIPC just says, "Hey, I got a safe in the back room"?
Mr. Harbeck: First of all, since it's almost all done electronically now, almost all securities

positions are held at a common facility, such as the Depository Trust Corporation or something like that. But, we have tried, and many members have proffered the fact that our kind of brokerage firm poses less risk. And every time a group of brokers says that, I can come up with an example of -- well, large firms --

Mr. Sherman: So, you charge the same amount for --

Mr. Harbeck: We charge the same amount for everybody. It doesn't work --

Mr. Sherman: What portion of your members do the, "we've got our own safe" approach rather than using one of the established depository --

Mr. Harbeck: I don't think it's possible to go back to the days of the 1960's where --

Mr. Sherman: Well, I mean, Madoff did it.

Mr. Harbeck: Well, no, Ma- -- oh, I see your point.

Mr. Sherman: Yeah.

Mr. Harbeck: I --

Mr. Sherman: If Madoff had had all his securities --

Mr. Harbeck: Many brokerage firms, you know, self-custody positions, but, in turn, the positions should be reflected at the Depository Trust Company, DTCC, and, in Madoff's case, if any examiner had bothered to check between the positions shown on

Madoff’s records and what was in DTTC (sic), they would have dropped dead on the spot.

Mr. Sherman: If anybody had bothered to notice that he had an audit letter from a one-person CPA firm on a $17 billion balance sheet, that would have been caught, too.

But I yield back.

Mr. Garrett: The gentleman yields back. And seeing no one else coming in at the last moment, we will then go, just close with five minutes, if there is five minutes of questions on either side to be split up. I’ll begin with gentlelady from New York and then Mister Pearce and then Mister Stivers.

Mr. Pearce: Thank you, Mister Chairman. The -- you’ve brought almost a thousand clawback suits. How many of those were against institutional investors?

Mr. Harbeck: I don’t know the answer to your question or the percentage. They -- it was done specific --

Mr. Pearce: Do you ever bring clawbacks against hedge funds or the big guys?

Mr. Harbeck: Oh, absolutely. And, in fact, if I could speak to your question and simultaneously to a point made by the Chairman, many of the clawback suits are in sums that, in the hundreds of millions of dollars that have been settled.

Mr. Pearce: The one speculation is that -- well, the Trustee has said that 75 percent of the property that's going to be distributed to institutional investors in the Madoff case. What happens to all the little guys?

Mr. Harbeck: That statement was made by, I believe, Mister Stein in his written statement. The Trustee is going to distribute the money pro rata in the --

Mr. Pearce: No, I understand, but what happens to the little guys?

Mr. Harbeck: If there's a claimant who is owed, regardless of the nature --

Mr. Pearce: So, the big guys get protected and the lawyers get 500 bucks an hour and make about a billion bucks.

Mr. Harbeck: No, sir, everyone gets the same pro rata share.

Mr. Pearce: And you give 75 percent to the big guys, it looks like the little guys are going to get left out, but I suspect I've used my minutes there, Mister Chairman.

Mr. Harbeck: No, sir, I'd like to respond.

Mr. Pearce: Let me --

Mr. Harbeck: If I may.

Mr. Pearce: Let me --
Mr. Harbeck: Every customer gets --
Mr. Pearce: The Chairman owns the time, sir.
Mr. Garrett: Yeah, let me go to the gentlelady from New York first. Do you have any other questions for them Mister Stivers since --
Mr. Stivers: Thank you. I have one quick follow-up because when I was talking to Mister Harbeck about the Madoff portion, I believe Mister Madoff had two sides of his business. He had a broker-dealer side and an investment advisor side. And most of the problems were in the investment advisor side, but that's the side that's not regulated by FINRA and you indicated that his entire business was regulated by FINRA, or at least gave that impression, and I just want to make sure everybody in the room, and everybody that might see this, understands that the investment advisor side was not regulated by FINRA and that's where most of the losses were. Is that correct?
Mr. Harbeck: No, sir, because the custody of the assets would have been at the brokerage firm and that should have been discovered.
Mr. Stivers: The brokerage firm had the custody of the

assets, but it may or may not have had the custody of the assets.

Mr. Harbeck: It did not, that's the entire problem.

Mr. Stivers: But that's the point, it may or may not have in the first place.

Mr. Harbeck: But FINRA --

Mr. Stivers: There was no requirement that the investment advisor firm keep all of its assets at that broker-dealer firm, was there?

Mr. Harbeck: No, but they did.

Mr. Stivers: Okay. Well, if it's -- well, but there was no requirement, so therefore they could say, "Well, they're, we got them somewhere else." And FINRA doesn't -- you have to -- there's too much coordination required and FINRA, you know, doesn't have the ability to look at everything, so they're looking at the broker-dealer side of the business and, you know, maybe they missed some stuff, but the whole point is there's not really an SRO on all of the Madoff business, is there?

Mr. Harbeck: No.

Mr. Stivers: Thank you.

Mr. Harbeck: Okay.

Mr. Stivers: I yield back my time.

Mr. Garrett: Mister Green?

Mr. Green: Thank you, Mister Chairman. When the individual investor makes an investment through an institution and that institution benefits from the common pool of assets, does the institution that benefits from the common pool of assets receive instructions as to how it is to distribute the funds to the individual investor?

Mr. Harbeck: That's done by contract between the individual investor and the fund. But, in response to Congressman Perlmutter's concerns, when we have settled, when the Trustee, rather, has settled with a fund, perhaps on a fraudulent transfer or preference, thus allowing the fund to share in the pool, one of the things that we, the Trustee has done is as part of the settlement get an agreement from the fund that the money flows straight through to the individual investors.

Mr. Green: Thank you. I yield back to the Chair.

Mr. Perlmutter: Thank you. And, you know, I think the, sort of going back to the preference fraudulent transfer piece of all this is, question is, let's say I put $100 in, I get, to a fraud, I get 50 bucks back, so I've still lost 50 bucks. Somebody else puts $100, they get nothing back because they were the last guys in the game. Question is, I've, I'm out 50, but I got 50 more than the other guy who got robbed. So, the question is should we all get robbed equally? And I think that's where this clawback stuff comes in and the policy behind the clawback. As we do these preferences, let's say Tremont settled with the Trustee, recovers all sorts of money, goes to Tremont -- and when I'm looking at your letter, and I thank you for your letter of September 11th actually, or September 30th, how will my, all these investors from Colorado know that if they're going to get treated proportionally as to Tremont's share?

Mr. Harbeck: We don't.

Mr. Perlmutter: In terms of the preferential or fraudulently transfer recovery.

Mr. Harbeck: Oh, well, once -- the way it works is Tremont would have returned a preference or fraudulent transfer to the Trustee, thus enabling them, freeing up, if you will, the entire amount of their valid claim. To -- in the settlement of that preference, the Trustee said that he would only enter into this settlement if the, if Tremont or the other entities similarly situated would agree that regardless of any contractual commitments between the individual investors and the fund, that they would pass the money straight through. There are -- you've demonstrated one of the harsh, hard problems of, you know, what happens when somebody pulls out of the fund itself, not out of the Madoff case? And all of that has to be done at the level where the books and records are for that particular fund.

Mr. Perlmutter: Thank you.

Mr. Garrett: The gentlelady from California.

Ms. Waters: Thank you very much. Miss Bowen, I see that you have described to us your work with the task force and I'm looking at Recommendation Number 3, "Protect Participants in Pension Funds on a Tax-Free Basis". And I happen to have a communication here from Colorado, from one of your constituents, was to -- and, let me just read it to you. "My name is Peter J. Leveton. I live in Lakewood, Colorado, a Denver suburb, in Congressman Perlmutter's Seventh District and I'm a direct investor victim of the Bernard Madoff investment securities Ponzi scheme and a Co-Chairman of the Agile Funds Investor

Committee of the Agile" -- is it Agile? "Agile Group, LLC, Boulder, Colorado. In December, 2008, Agile had 205 investors and managed three primary hedge funds. The group and its fund are currently in liquidation." Now, listen to this. "A large portion of Agile's funds under management were invested by Agile into wide, select broad market prime funds, prime funds, managed by Tremont Holdings, Incorporated, or Tremont Group and invested by Tremont with Madoff BLMIS. Tremont is a subsidiary of Oppenheimer Funds, it's separate subsidiary of Massachusetts Mutual Life Insurance Company." I'm trying to read this so I can get it all in very fast. Is this what you're referring to when you're rejecting the idea of pass-through to all who would claim that they should be considered for protection?

Ms. Bowen: Yes. You mean outside of a pension, we would say other indirects would not be entitled, would not be using direct customer relationship in that case.

Ms. Waters: What moves me about this is, he goes on to say, "Many of us placed a lifetime of savings in what we believed were safe investments, but were ultimately invested with BLMIS often without our knowledge. Many of us are now devastated financially and psychologically. So many of us have sold or are trying to sell our homes just to obtain money to live on without becoming wards of the state. Many of us in our sixties, seventies, and eighties and have been retired but have had to or are attempting to go back to work." On and on and on. The pension funds that, where you have a protection, they're more sophisticated and, of course, they should have a lot more knowledge about investment. But, these people who appeared to have invested in some small entities who were managed by other entities, that were managed by other entities, had no idea this was going on. So, do you feel that they have no right to some kind of protection?

Ms. Bowen: I do empathize with them. They obviously have recourse against, you know, the [inaud.] in this instance. But, SIPC is not, was not really created to reimburse victims such as that, you know, who unfortunately suffer because they put money into the wrong place. It's really unfortunate, but that's not what we're entitled to do.

Ms. Waters: All right. Given that, I understand exactly what you're saying, but, for those who are members of SIPC --

Ms. Bowen: Mmm-hmm.

Ms. Waters: -- are they advised or told, or any regulation, or rule about who they represent and how many they represent and who these people are? I mean, what's the responsibility of SIPC to the, their members who are covered?

Mr. Harbeck: I'm not certain I know what you mean unless you're talking about the Agile to Rye, the Tremont situation, something like that?

Ms. Waters: Yeah. I am talking about this situation.

Mr. Harbeck: Well, you know, the fact of the matter is, there would be no way for SIPC to know what those relationships --

Ms. Waters: I know and that's my question. In your task force review, did you consider this aspect of it that you have your members who don't -- I mean SIPC would not know the relationship of the members that are protected to all of these other entities that are involved with them.

Ms. Bowen: Yeah.

Ms. Waters: Was that considered?

Ms. Bowen: It was considered by the task force and we did hear from investors, such as the one that you mention. We also, with some of our participants on the task force, particularly the state securities regulator, rightly pointed out, you know, there are Ponzi schemes and frauds that occurred throughout their state all the time and those folks are not entitled to SIPC protection because it's not a broker-dealer. So, unfortunately we do have, you know, really bad people who are taking money from other people, but that's not the role that SIPC is supposed to be protecting.

Ms. Waters: So SIPC has no responsibility in this, whatsoever, in terms of educating the kinds of --

Ms. Bowen: Yes.

Ms. Waters: -- forums that you are talking about --

Ms. Bowen: Yes. Yes. You know, that's -- yes. That, and that's something we did spend a lot of time talking about because there is a misperception as to what SIPC is and what SIPC is not. And, so, one of the recommendations is that we work with the SEC, with federal, with the state regulatory agencies to try to, you know, broaden the educational pool to, in fact, to hire someone whose job is to work with these entities to better get the word out to the investing public as to what it is that SIPC does protect as well as what it does not protect.

Ms. Waters: Does the broker dealer have any responsibility to tell them that?

Mr. Harbeck: The only responsibility is to display the symbol. We, at one point, many, many years ago tried to expand the investor education levels by the SEC and we were not met with very enthusiastic results.

Ms. Waters: Well you need some congressional help.

Mr. Harbeck: Well, let's see what we can do on our own first, and then we'll try.

Ms. Waters: Thank you.

Mr. Garrett: Thank to the gentlelady. And thanks to the panel for your testimony and fielding questions today. Thank you.

Ms. Bowen: Thank you.

Mr. Harbeck: Thank you, sir.

Mr. Garrett: And then we, following that, move on to our third and final panel for the day.

PANEL III

Mr. Garrett: Welcome. And as you're getting ready, we have four members of the panel, Joe Borg, Director, Alabama Securities Commission; Steven Caruso, Partner, Maddox, Hargett & Caruso; Ira Hammerman, Senior Managing Director and General Counsel, Securities Industry and Financial Markets Association; and Ron Stein, President, Network for Investor Action and Protection.

I assume that gave all of you enough time as I read that to get your papers oriented.

I thank the members of the panel for coming forward today and we look forward to your statements. As you know, your complete record, your complete statement is put into the record and you'll be recognized for five minutes.

Mister Borg.

Mr. Borg: Good morning, Mister Chairman and Ranking Member Waters, and members of the subcommittee. Thank you for the invitation. I'm honored to be back before the committee in these hearings. I am Joe Borg, the State Securities Regulator at the State of Alabama. Our office has administrative civil and criminal authority under the Securities Act and in addition to the examinations of the audits of broker-dealers and investment advisors. We do quite a bit of investigation on Ponzis, pyramids, illegal blind pools, off-shore and tax scams, fraudulent private placements under Reg. D, oil and gas, and everything.

I have filed my written testimony with the committee and I will briefly go over some of the points in that and I'll try to skip over some of the points that were discussed in the earlier panel.

Direct equity investments, retirement plans, mutual funds, and similar investment vehicles have become the primary method by which Americans save for their future, accumulate wealth, and plan for a secure retirement. Financial fraud in and form threatens the future security and wellbeing of our citizens, destroys the hopes and dreams of families, and destroys what should be the golden years of our life-experienced seniors.

As I previously testified back in September, the committee was charged to -- the task force was charged to look at 12 particular areas and out of that, we have a report covering 15 specific recommendations. The task force was split into two working groups. My particular subgroup covered recommendations 1 through 4, 14 and 15. So I will briefly talk about those particular points.

The $1.3 million reflects my original opinion of an increase to $1 millions plus an adjustment for indexing to inflation. Americans are looking to markets and investments to secure their long-term future goals. The days of realizing the America dream of a secure future by saving only in a bank account or a Certificate of Deposit are long gone, especially with current rates generally below 40 basis points. Interestingly enough, in meeting with the Federal Banking Authorities, they had concerns about SIPC diverging from the historical relationship between FDIC and SIPC protection levels. In my opinion, the historical ties between SIPC and FDIC levels have contributed to the lack of understanding of the differences of FDIC and SIPC coverage. The insurance of FDIC to bank accounts and the coverage, non-insurance, of SIPC to securities is fundamentally different both in statutory application and practical application, at least under existing law. The reality is that my future security and retirement is not going to come form my savings and checking account, but from my investment accounts.

Recommendation Number 2 had to do with distinction of -- eliminating the distinction for cash and securities. This is outdated. It's meaningless in today's markets. Consider that money market accounts were relatively small in 1978, now they're $2.7 trillion. Brokerage cash sweeps into money market accounts or bank accounts overnight, and back and forth with substantial investor cash routinely held in brokerage accounts. Those funds deserve the full amount of SIPC protection. This distinction has caused inconsistent court decisions, investor confusion, and in some cases, lost the customer funds. Interestingly enough, the Canadian counterpart to SIPC did away with the distinction back in 1998.

Again, banking authorities expressed concern that SIPC will offer greater protection against cash losses than FDIC. This is an artificial connection. And, again, maintaining parity does not benefit investors. The recommendation allows the realities of today's markets to determine the actual and appropriate means for the benefit of all investors.

Recommendation 3 had to do with the pensions funds on a pass-through basis. There's a lot of Americans whose investments are not, right now, covered by SIPC protections, but they should not be discriminated against because they have generally small accounts, they are part of a defined benefit, defined contribution, or a deferred profit sharing plan. The recommendations made comports with the trust and fiduciary provisions under ERISA and we also took into consideration certain pension plans and employee benefit plans have been covered by FDIC and NCUA on a pass-through basis since 1978.

On the minimum assessments, according to the staff at SIPC, 25% of the membership paid a flat $150 based on net operating revenue. After Dodd-Frank, the 0.02% of gross revenues, many of the same members are actually going to pay less than $150. I think this has to do with accounting issues.

If members are utilizing SIPC in marketing materials, and benefiting from the SIPC program, they should pay some minimum amount. I personally thought the $1,000 was a little low, but the general consensus was that $1,000 would be reasonable in the current environment.

The task force also discussed whether mutual fund dealers and assessments on mutual fund reserves should be included. SIPC currently exempts mutual fund revenue representative of the mutual fund industry made a case that there was no significant history of loss to the investment. I did not agree with the majority of the task force not to assess mutual fund revenues because the mutual fund industry utilizes the SIPC logo, touts the SIPC coverage and billions of dollars of mutual fund shares are held in street name. However, the fact is there is a history of minimal losses and that was persuasive to the majority of the task force, and I respect the decision.

Concerning International Relations. It’s a global economy. Geographical boundaries have no meaning. Cross border effects of a failure, like a Lehman or a Global, have local, national, and international implications. The resolution depends on the respective national jurisdiction. That is not, doesn't work. The task force recommendation encourages SIPC to elevate the program in taking the lead in development of a new international association.

I think investor education has already been covered. I proposed a suggestion with regard to adding information into brokerage accounts. The task force considered that recommendation, but were unable to govern the costs. The issue is left with the SIPC Board.

The invitation also asks for views on pending legislation. I will try and cover that very quickly. The purpose of fraud is simple; deprive honest people of their funds to benefit the crook. Look, in a perfect world we want anyone so injured to get back what they lost. The question is, is it the actual investment that was stolen and distributed as profits to other victims, less the amount taken by the crook, or what was promised? That is, the representations of potential profit. Our office investigates numerous Ponzi, pyramid, and other scams. I currently have 48 defendants awaiting trial for various forms of securities fraud. Right now, mostly Ponzi and pyramids and that type. The past year we've convicted 16. The problem is always the same, limited assets to distribute. And while the intent of 757 is noble, I think it is not equitable and confers an unequal benefit to some victims over the other. And unfortunately, early investors may benefit at the expense of later investors and may receive distributions in excess. So, with a limited amount of assets to distribute, we must find a way to treat every investor equitably by first attempting to make everyone whole on their initial investment. That's the amount invested minus amount received equals actual cash lost. Unless there is an endless supply of funds to pay promised returns it becomes impossible from assets available to cover all promises. The fundamental problem with the last statement approach is that when thievery is involved, the statements will match the fraudulent misrepresentations, historical or otherwise, regardless of reasonableness, market conditions, or reality. And H.R. 757 attempts to fix a terrible problem.

I have a suggestion with part of it. During the September 23, 2010 hearings, Professor Coffee and I, and I will give most credit to Professor Coffee, it was his idea. Here's a suggestion to consider the creation of a de minimis exemption, exception instructing the SIPC trustee not to bring a suit against persons whose withdrawals exceeded their investment by a set amount, a given amount. This would give peace of mind to many, but would not impede the trustee in his pursuit of the very large net winners.

Another possible exemption is giving early investors credit for the imputed interest on their investments. Such amounts should not be regarded as fictitious profits. Congress can immunize some minimum amount of rate of return from the concept of fictitious profits. I don't know what that rate would be, 5%, 7%, 2%, or adjusted to some sort of standardized index. But whatever the basis is used, it should maintain equitable balance between the victim of a Ponzi scheme.

H.R. 1987 contains similar concepts as H.R 757. My commentary will be the same. I would say, again, there's no real profits in a Ponzi scheme. The payments to early investors are proceeds of a crime unbeknownst to both the earlier and later investors.

For a second, let me discuss indirect --

Mr. Garrett: Before we do that second, since you're four minutes over time, let us allow the other members of the panel to do that and we'll come back.

Mr. Borg: [inaud.]

Mr. Garrett: Thank you.

Mr. Caruso, welcome.

Mr. Caruso: Thank you, Mister Chairman, Ranking Member Waters. My name is Steven Caruso. I'm with the law firm of Maddox, Hargett, & Caruso in New York City. And as you may recall from our last appearance before this committee, our representation is of investors, people who have been defrauded, whether, it's through some of the examples that we've discussed today, what I'm going to call the "trifecta of criminality", the Madoffs, the Stanfords, the MF Globals. But we see this every day. And in serving on the SIPC task force, one of the overriding considerations is, what are we going to do the next time one of these blow up? And we've already, today, discussed the finances of SIPC. And, if the Stanford case alone goes against the SIPC Fund, that fund is gone. That fund is gone. The Federal Government backup of the SIPC Fund is gone. And I would submit to you, investor confidence in our entire capital market system is going to be gone.

So one of the primary things I think that needs to be looked at is how do we pay for what needs to be done? And clearly, there are victims of Madoff, there are victims of Stanford, but the time I would suggest has come, for this committee to consider requiring brokers and investment advisors to have insurance. It is too easy today to become a stockbroker. It is too easy to become a registered investment advisor. But, none of those folks are required to have insurance. So when we're entrusting them with millions of dollars, in some cases hundreds of millions of dollars, there is no requirement for any insurance whatsoever. And, I think, as part of any legislation, that is something that needs to be considered. There is no free lunch in this world and asking for insurance when we have to have insurance to drive a car, when we have to have insurance to rent an apartment. I think when we have a fiduciary who is out there as an investment advisor and investment professional, requiring insurance will go a long way towards helping potential victims. I will yield the rest of my time given Commissioner Borg running over. And I thank you for the opportunity to appear here today.

Mr. Garrett: There you go. Thank you Mister Caruso. Mister Hammerman, please.

Mr. Hammerman: -- the subcommittee. Thank you for the opportunity to testify as a member of the SIPC Modernization Task Force. I am appearing here today in my individual capacity and not speaking on behalf of my fellow task force members. I'd like to highlight some of the important pro-investor changes recommended by the task force, mainly expanding and increasing the protection available to customers in three important ways. First, when a brokerage is liquidated and the customer property marshaled by the trustee is inadequate to return all customer funds and securities, SIPC makes advances from its own funds to assure the return of the customers' property. For over 30 years these advances have been capped at $500,000 per customer. The task force recommends increasing the maximum advance to $1.3 million to adjust the limit to reflect inflation since 1980.

Second, SIPA currently distinguishes between claims for cash and securities, setting a lower $250,000 limit on claims for cash entrusted to the broker-dealer. The task force recommends eliminating this distinction, which has been a subject of controversy and unproductive litigation.

And third, the task force recommends a limited pass-through of SIPC protection to make individual pension plan participants eligible for advances with respect to their share of the plan’s account at a failed broker-dealer.

While I support these recommendations, I wish to note that they were made without any real consideration of their cost. This cost will be funded by the members of SIPC and, ultimately, by the investing public. Before implementing these recommendations, I suggest Congress obtain a reasonable estimate of the cost of the expanded protection and consider whether these costs would be justified by the increased investor confidence.

I am disappointed by the task force's failure to take action with respect to several critical areas previously identified by SIFMA. It is essential to ensure consistency between SIPA and the SEC's rules that determine the property a broker is required to reserve or segregate for its customers. Inconsistencies between the two may result in an insolvent brokerage holding an inadequate customer property to satisfy all the customer's claims for the property entrusted to it.

To take just one example, discrepancies in the treatment of the proprietary accounts of broker-dealers may result in a multi-billion dollar short fall in the property available for distributions to customers of Lehman Brothers, as we've heard earlier today. The current discrepancies were briefly addressed by the task force's report, which recommended further study. The task force missed an opportunity to recommend a solution to a problem that is only going to become more urgent as the SEC promulgates rules for the protection of securities-based swap customers.

Although the Dodd-Frank Act addressed the treatment of these customers in a liquidation under the bankruptcy code, it did not address their status under SIPA, where their status is highly uncertain. If they are not protected as customers under SIPA, securities-based swap customer protection rules may be futile. On the other hand, if they are protected as customers under SIPA, regular securities customers may be exposed to risks arising out of this swap business. The SEC should be authorized to make rules under SIPA so that it can promulgate harmonious rules addressing both the requirements for brokers to set aside property for customers and also the distribution of that property in a liquidation. The SEC should consider tailoring the customer protection and distributive schemes so that customers with simple securities accounts are not unduly exposed to the risk of newer and more complex types of transactions.

Finally, to the question of fraud committed by a broker-dealer, I would like to note, as intended by Congress, SIPC’s funds are available only to replace missing customer property that was in the custody of a failed broker-dealer.

I share in the sympathy with, and outrage on behalf of, the many innocent victims of massive frauds by the likes of Madoff and Stanford. Financial fraud undermines confidence in our markets and our regulatory system. However, SIPA is not intended to protect investors against losses on their investments, only against losses of their investments in the event of a broker-dealer failure. Investors who lose money because of a decline in the value of the securities are not protected by SIPA against such losses, whether the decline is due to market forces or even due to fraud.

In conclusion, SIFMA appreciates the opportunity to participate in the work of the task force and is committed to working constructively to modernize SIPA, to better protect investors and thereby increase confidence in the financial markets. We look forward to continuing to work with the subcommittee on these important investor protection issues.

Thank you.

Mr. Garrett: Thank you, Mister Hammerman. Mister Stein.

Thank you, recognized.

Mr. Stein: Thank you. Chairman Garrett, Ranking Member Waters and Members of the subcommittee, my name is Ron Stein, and I am the President of the Network for Investor Action and Protection, NIAP, a national nonprofit organization comprised of small investors dedicated to improving our nation's investor protection regime. I'm also a registered investment advisor, certified financial planner, and a member of the Financial Services Community.

NIAP's primary constituents are individual, non-institutional investors who are often the least equipped to deal with the fallout arising from Madoff-like catastrophes, but include an increasing number of regular investors concerned about protecting their assets.

To supplement my written testimony, which goes into great detail about the Madoff liquidation and the urgent need for H.R. 757, I wish to emphasize the following points.

First, a majority of the Madoff victims have not, and will not receive any of the SIPC advance guaranteed by Congress under SIPA statute due to the misguided and inequitable methodology adopted by SIPC and the Trustee, which minimizes investor protection and the amount that SIPC needs to pay to defrauded investors. Despite assertions to the contrary, the payment of SIPC advances has nothing to do with investor-to-investor fairness, or parity, nor does it reduce the amount of the customer fund available for distribution to customers. SIPC advances come from the SIPC Fund not from the customer property.

Over three years into the fraud, it appears as though the Madoff liquidation has protected SIPC and enriched the Trustee and the Trustee's law firm at the expense of the customers. The Trustee has acknowledged in court filings that his method for calculating net equity has saved SIPC over a billion dollars. Money that should be paid to the victims. At the same time, the cost of the liquidation has exceeded $450 million and this committee has been told to expect that an additional billion dollars will be spent before the process is complete. Ironically, it would have cost approximately the same amount to pay each Madoff victim the full measure of SIPC advances guaranteed by Congress when it enacted SIPA.

SIPC and it's Trustee have fashioned a net equity methodology which consciously ignores reasonable customer expectations as reflected in customer account statements, destroys the certainty Congress intended under SIPA law and virtually ensures that no rational investor can have confidence in our capital markets or in the protections that SIPC promises, but fails to deliver.

These core principles of basic investor protections were the fundamental reasons, indeed the stated purpose of enacting SIPA, despite an explicit Congressional prohibition to the contrary. And in the Madoff liquidation, the Trustee has been given carte blanche to create whatever definition he wants of net equity, including the one which favors SIPC over customers. As a result, customers can never be sure, until long after the fact, what protections they have if their brokerage firm fails. Moreover, in light of the clawback cases the Trustee has brought, no investor will be able to safely withdraw funds from their brokerage account for fear that years later some

SIPC trustee will sue to recover those monies under the rational that it was other people's money. Victims who have lost everything are now forced to defend against lawsuits that treat them as thieves and victimizes them yet a second time.

How can investors be asked to rely on a system which leaves, wide open, whether, and to what extent, SIPC will provide coverage and which investors remain subject to clawback in perpetuity even though they withdrew funds from their own accounts in good faith, under the reasonable assumption that it was their own money. Simply put, as of now, no investor can have confidence in the validity of their statements.

Enactment of H.R. 757 is a crucial step in restoring sanity to the SIPA process. It will make clear that account statements, which reflect positions in real securities, will be honored in the event of a brokerage firm failure. It will end the use of clawbacks against innocent victims, and it will end the cozy relationship between SIPC and their shortlist of trustees.

I also commend Congressman Ackerman for his legislation, which, among other things, would aid indirect investors, who are often just as damaged both financially and emotionally from an event like Madoff.

Thank you for allowing me to testify. I would now be pleased to respond to any questions.

Thank you.

Mr. Garrett: Thank you. Thanks panel. I'll recognize myself and I was going to say because -- well, I'll begin on this point. We're all in agreement that there's untold number of victims that are out there. But the, some of the beginning comments from this panel, this leads me to a different set of, I don't know if I, I don't use the word lightly, "victims", that is that the conversations with regard to what happens as far as the fees, if you will, or the cost to the brokers because, the broker-dealers, because of the money that is being paid out now and trying to build up the fund going forward, what have you. Well, it's interesting to hear, first of all, as far as the previous figure that $150 and that may actually be less in certain circumstances, but we have also heard from certain broker-dealers that the assessment figure could be substantially higher. And these are the, usually still the smaller guys who did absolutely nothing wrong in this situation and did nothing wrong in any other situations. They might say, from their perspective, and ours as well, perhaps, that they are now being penalized for the errors of others. So, I guess I'll throw that out to Mister Caruso because I believe you were talking about the idea of mandating the idea of insurance. Is this a different, is this another class of "victims" that we have to consider because of the ills and the bad behavior of others?

Mr. Caruso: Chairman Garret, one of the ways I would respond to your question is, I've never had a car accident in 35 years of driving and yet, through my insurance coverage I'm certainly paying for the ills of others.

Mr. Garrett: Uh-huh.

Mr. Caruso: Again, looking at our financial system, somebody is going to need to focus on how we finance what we're discussing in this hearing and in similar hearings, whether we provide restitution, the money is not endless. Although, I guess in this city sometimes people think it is endless. But, if you look at the SIPC Fund, there is not enough money to accomplish, I would submit, what needs to be accomplished. The Madoff investors, they are victims because, quite honestly, the government let them down. They did not, the SEC did not pick up on what was going on. I think they deserve to be treated differently then the Stanford investors or the ML (sic) Global investors. But clearly where the government's at fault and allowed certain things to go on longer than it clearly should have, those people are, indeed, being victimized twice.

Mr. Garrett: Thank you. On another note, the whole panel is here, obviously all day listening to the previous panel, Mister Stein, you heard Mister Harbeck discuss several reasons why, or three or four reasons why he had concerns with, or problems with 757. Would you like to run down some of those? His positions versus whether he is correct in his opposition?

Mr. Stein: Well, I think Mister Harbeck has a slightly different worldview then we do at NIAP. I think what we've all clearly heard from Mister Harbeck today is that the SIPC Fund, instead of perhaps saying, "How can we help?" says, "How can we not help?" I think, in Mister Harbeck's worldview, there is equitability in denying SIPC protection for 75% of the victims, of the innocent victims, of a fraud. I think in Mister Harbeck's worldview, suing a thousand innocent victims on a clawback claim is an equitable solution. I think in Mister Harbeck's world, making sure that close to 90% of the recoveries of customer property go to the highest, most wealthy, institutional, and institutional investors is equitable.

I think what Mister Harbeck is missing is the point that there are basically two pots from which to provide restitution for victims, or benefits to victims. You have the SIPC Fund, which has a responsibility, it has a responsibility to pay victims based upon their final account statements or the reasonable expectations of those final account statements. And I would say that that is a very, very core principle underlying the creation of SIPA and that is step one. Step two is finding and seeking some equitable solution to dealing with the distribution of money from the recovery of customer property. But to focus on customer property, we believe is a red herring.

Second of all, the, Mister Harbeck seems to feel that in some way, by paying SIPC benefits in a Ponzi scheme empowers the fraudster, it legitimizes the fraudster. I would suggest to you that the only thing that legitimizes the fraudster is the failure of the regulatory apparatus to catch the fraudster. And to say that the protection of -- that giving funds to a customer or a victim of a fraud in a situation like this enables the fraudster is akin to saying a fire truck and a fireman putting out a fire that was caused by an arsonist in some way legitimizes the arsonist. It's an absolute absurd twisting of the concept.

At the core, we are talking about protecting customers. We are protecting small customers, people that are at the core of our financial system. And it doesn't sound to me that Mister Harbeck has really addressed those core principles because that, in fact, is what's needed for Madoff victims now.

Mr. Garrett: And I have a few more questions but, Mister Hurt.

Mr. Hurt: Thank you. Just following up with Mister Stein. What I thought I heard Mister Harbeck talking about, though, was that, in his opinion, that SIPC was not designed, financially, in a fiscal way to be able to address all of the inequities that could possible occur and that, with respect to the Stanford case, that if you follow the rules, as he interprets them, that it was not designed to do that. Now, if Congress or SIPC wants to expand that authority, then suddenly you're going to have to build a different model and there's going to have to be more capital involved. I think what he said was, you'd end up having to have, have to draw down on the equity line with that, with the Treasury to be able to guarantee that. Can you -- I mean, I think that's what he was saying. Can you help talk about it in terms of that, because I think that is what he was saying?

Mr. Stein: Yeah, well let me speak to that briefly, Congressman. I think, first of all, we are in great sympathy with a vast majority of the victims of the Stanford fraud. The vast majority of them had no knowledge that they were investing in something that was not going to be protected, that they were investing through a broker-dealer that was not going to properly manage their funds. They are truly victims. And, what I think is important for SIPC to do in a situation like this is to address the situation in a way that says, "What can we do to help?" and "What do we need to do in the future to prevent these sorts of calamities from happening again?" And frankly, that's something that requires all parts of the regulatory apparatus to work together on. The fact of the matter is, Mister Harbeck was correct. There were major failures of regulatory oversight that allowed the SIPC, I'm sorry, the Stanford fraud to continue and that is something that we have to pay very, very significant attention to. That said, I think we also have to find a way to think about how we can help the Stanford victims rather than do them further damage.

Mr. Hurt: Another question that I would like to address, or have addressed is a question that I asked the previous panel. And that is, when you look at the broker-dealers that are paying for these, for this protection for the public, which I think everybody understands and agrees is appropriate, but at some point it seems to me, you have to be concerned about how much you're asking those individuals to contribute, because at the end of the day, that comes out of their bottom line. It makes them either more profitable or less profitable, allows them to stay in business, and provide that protection. But it is something that I'm aware of because as I travel across my district, I hear from people in every line of work who say, these little fees, they sound good when you're talking about them in the committee meeting in Washington, but once they all pile up on us, they have a devastating effect on our ability to be competitive. And I was wondering if you all, if maybe just each of you could speak to that topic. What is the appropriate level of assessment and does that assessment take into account the size and relative risk that perhaps each dealer-broker exposes the fund to.

Mr. Stern: Well I -- I think Mister Caruso has spoken well to that issue. But, the fact that, for the last, for the better part of the last 20 years, that every member of SIPC has been charged a paltry $150 per year, and that ultimately led to the potential trauma that is now being experienced by the SIPC fund is beyond comprehension. And by the way, the SIPC fund, as is presently constituted, has more than sufficient assets to pay off the advances to all the Madoff victims, just as a point to be made. But you get to a very important point, and that is, why were the members of SIPC resistant to increasing SIPC fees for the last 20 years when this committee and other committees recommended an increase to the SIPC assessment over the last 20 years. We would have a SIPC fund that would have multiples of billions of dollars more than capable of paying for the Stanford and the Madoff and potentially even some of the MF Global situation had there been a proper assessment on the SIPC members.

Now, the second part of this that Mister Caruso alluded to is the process of underwriting. If you are going to take on a SIPC member who increases by their very practice the level of risk, it's important that we find some method to increase the cost for that individual. A high-risk insurance -- a high-risk driver should be charged a higher rate than a low-risk driver.

An investment advisor that has custody of their own assets should probably be charged a different rate than one that doesn't. So I think to end, to get to the ultimate part of it, I think we have to find an assessment level that is consistent with the risk and also begin the process of bringing in the private sector to add and improve the quality, the extend of the --

Mr. Hurt: Well -- thank you, Mister Chairman. My time is expired, but I don't know if, without objection, if there were others that had, could add to that point?

Mr. Hammerman: Thank you, Congressman. I just wanted to echo the concern raised by your question. There are approximately 5,000 different broker-dealers, many of whom are small business operators, which is why in my oral statement I indicated that while as a task force member I agreed with the notion of the increasing the level of protection to the $1.3 million. One piece that we, as a task force, just did not really analyze is the cost. What will these costs ultimately require for all the broker-dealers from the smallest firms, up to the largest? I just think that's a relevant question and part of the data analysis that should occur.

Mr. Hurt: Mister Caruso?

Mr. Caruso: Thank you, Congressman. I mean, obviously, we don't have access to the member assessments from SIPC, as far as who's paid what over the past number of years. But looking back just a few years ago realized Citigroup Global Markets, Smith Barney, Merrill Lynch, Morgan Stanley - those firms paid a total of $150 apiece. So, does the system have to be changed? Certainly. You can't have a firm of that size with thousands of brokers paying $150. To come down here today, the shuttle cost me $800. Now, at $150 a year, I would have paid my SIPC dues for almost six years. That is insanity. And that is what's at the core of the problem today and why I would suggest the SIPC Fund with just one more catastrophe will not be viable any longer on its own or with the Treasury backstop.

Mr. Hurt: Mister Borg?

Mr. Borg: Thank you. The question of assessments really depends on what the focus of the fund is to do. If it's going to be limited to where it is now, at least under the current interpretation, that's going to be one assessment. If you're going to expand it to cover potential losses on statements that may be inflated, especially 20 years worth of Bernie Madoff, that’s going to be a completely different assessment. I think the committee, the task force, when looking at this made recommendations not knowing what those costs would be. So, we took what was the current law, the Dodd-Frank .02, quarter of one percent on revenues and said, “That’s what the law is now.” And what we only did was say, “Look, it’s ridiculous to have $150. At least have some minimum.” But, I think it’s incumbent upon congress to decide where the parameters are and I think a lot’s going to depend on this SIPC, SEC versus SIPC lawsuit. Because, quite honestly, if the SIPC, if SIPC is required to pay the Stanford or the accounts stated on accounts statements, then I would submit to you that I’ve got about $4 or $5 billion worth of Reg. D 506’s sold through broker-dealers, on oil and gas deals, and medical facilities that also would be required to pay. What my concern is on the bills is not what you’re trying to accomplish, it’s that they only cover certain Americans, in certain situations.

You've got to -- everybody's entitled to equal protection of the law. If you're going to cover Stanford, which, in essence, is going to cover an overseas bank, basically turning SIPC into FDIC insurance for an overseas bank, what about one of my cases? Mallory In-, is a now defunct broker-dealer. I put them all in jail. There's no assets. But I've got probably $600 million worth of account statements and folks invested in U.S. projects that were fraudulent. There is no SIPC coverage for that. I can't give them their money back.

Let's cover it for all Americans. But, at that point, you have to look at what that universe is. You cannot partial the universe and say, just Stanford or just Madoff. Cover everybody or decide not to cover anybody. Or, try and find some level of protection that everybody can participate in.

Mr. Hunt: Thank you, Mister Chairman.

Mr. Garrett: Just on that last line, I'm sorry, I wasn't familiar with that case. That's -- so this -- so that was not a securities case? It was an --

Mr. Borg: Most of --

Mr. Garrett: Is that my -- they were --

Mr. Borg: Yeah, Mallory was a broker-dealer out of California.

Mr. Garrett: Okay. Yeah.

Mr. Borg: It was FINRA registered, however they sold, they specialized in the private placements under Regulation 506.

Mr. Garrett: Okay.

Mr. Borg: Which is exempt from state security jurisdiction, except for enforcement, there's no gatekeeper function. And what we discovered was that out of Southern California, they were running a operation where they would do multiple 506's.

Mr. Garrett: Uh-huh.

Mr. Borg: 75, 72 to 75 percent of all the money went to the company, salaries, bonuses, salesmen. There was never any money for projects. They'd open up a new project and there was no chance it would ever succeed because there was no money to fund it. And this was a primary fraud.

We see the same thing with capital broker-dealers in the oil and gas industry where an oil and gas developer will set up a broker-dealer and sell only oil and gas placements. DBSI out of Idaho was a real estate pool.

Mr. Garrett: And that come, and that doesn't come under, would not come under, under the SIPC then.

Mr. Borg: No, because it's all, it's all fraudulent statements with false profits. It's identical to the Stanford situation.

Mr. Garrett: Yeah.

Mr. Borg: But, if the case turns out that it's covered, then I think all those have to be covered as well.

Mr. Garrett: Yeah. I mean, I have a couple of particular questions, but let me -- I guess there goes -- well Miss Bowman actually raised some of that point before as to that there are other, there are other classes, there are other activities of fraud that are out there and we're trying to address where this fraud is, should be covered. And I, I appreciate that. Part of the problem, in this particular area is, is where you're, where you were clearly, in Madoff, which is the more infamous one, where you're looking at that situation, there, there was an expectation -- there, A, was covered, right? And B, there was an expectation of coverage. Now we're getting to the two issues that we have in that particular case, obviously the one that the gentleman from Colorado takes up the most, which is the, this feeder fund situation. And what was the expectation in that situation as far as the unlearned, that the average investor on that situation? And the other is the situation about the, the various pools of funds that are available for this, for recovery.

And so that's, to those separate points, Mister Borg, you raised the point, I guess in your opening comment, you took the side line on this is, is to how mutual funds are treated under this and the fact that they have the, you know, the logo there, so to speak. Although, I guess, most people really don't see that since you're doing a lot of this over, online and what, nowadays. And you're position was, and I'll get to the rest of the panel, as to what the solution is dealing with mutual funds? The exemption is appropriate or is the exemption, or the simply removing of that logo and say since they're not going --

Mr. Borg: Mister Chairman, I disagree with the rest of the task members on this point. I thought mutual funds because they do, one, use the logo and, two, because money is going back and forth in brokerage accounts and there's all these mutual funds being held in street names. For that matter, all those shares that back up the mutual funds. I just thought they should not be an exemption. I don't know what that kind of money would bring in, but that's a huge industry.

Mr. Garrett: Does anybody else want to, just, since we know where you were on that, just so I understand where the rest of the panel is.

Mr. Caruso: The only thing I would offer, Mister Chairman, is when we explored that issue in part of the task force --

Mr. Garrett: Yeah.

Mr. Caruso: One of the things we looked at were how often did mutual funds fail. Yes, they all use the SIPC logo, but they don't pay anything for it. And the counter argument from the investment company institute, you know, the trade association for mutual funds, was "None of our members ever fail." As Commissioner Borg indicated, mutual funds are a huge business in today's day and age. And they are part of the securities industry. But, you know, historically they have been carved out.

Mr. Garrett: Right.

Mr. Caruso: Revenues from mutual funds, and I think given the current financial position in the environment, it's something that needs to be re-visited.

Mr. Garrett: Right. Anybody else?

Mr. Hammerman: The only thing I would add, Mister Chairman, is that many mutual fund complexes have broker-dealers as part of the complex. That's how they sell the mutual funds. So, there would be SIPC coverage and assessment at that level.

Mr. Garrett: To -- okay. The magnitude of those funds would -- well the magnitude, I guess, is still the minimis based upon the current configuration. Mister Stein?

Mr. Stein: I would agree exactly with what Mister Hammerman just said on that.

Mr. Garrett: Yeah, okay. As long as I'm down here and since I gave myself as much time as I want, but I'm mindful of your time. So, SIPC says what with regard to the payment method, cash in, cash out, right? When you're dealing in net equity calculation. Do you just want to spend a moment on the appropriateness of that? And then, to bifurcate that issue, and the rest of the panel, I'll throw it out to you as well. To bifurcate that issue to the fact that you can you can bifurcate that as far as to whether you have one pool or two, right? It advances or the other assets clawed back and show -- your answer, your comment would on in general, A, and B, should there be a distinction when you're dealing with both pools?

Mr. Stein: Sure.

Mr. Garrett: Okay.

Mr. Stein: Sure, Let me get to that.

Mr. Garrett: Okay.

Mr. Stein: All right, so when Congress passed SIPA law in 1970 at the same time that it was moving away from the use of physical securities that you referred to earlier today, it was doing so at the same time it was making an agreement with the American public of offering a degree of assurance that what was going to be replacing that physical security had to be meaningful. It was intended to be modeled on the kinds of assurances that were provided by the Federal Deposit Insurance Corporation, FDIC. In fact, the original legislation was essentially a cut and paste from the original FDIC legislation. At the upshot, it was trying to establish for the small investor, to protect the smaller investor and create a state of certainty, so that an investor knew that when we were dealing with something that was on an account statement, it was a true, and honest, and legitimate reflection of what they owned. Congress made this recommendation amidst the backdrop of failed brokers, of Ponzi schemes, of thefts. The circumstances all existed that we're talking about today in various forms. And Congress still said, "We are creating a SIPC Fund. This fund is going to protect the net equity based on," understood to mean, "final account statement," so that an investor knew when they looked at their statement that they owned something. And it was necessary. Because, after all, we were looking at protecting the smaller investor. And Richard Nixon's statement when he signed that legislation is a profoundly powerful one. And what it does tell us, very clearly, is that investors that are in their later years, that are now living on their retirement funds cannot afford to think that their protections are being reduced by the amount of money that they pull out of those funds. That the profits that their hard earned savings had made on those funds in those accounts, whether it's at a bank or financial institution, has to be protected. And that we're still, somewhere down the road that no trustee can come in 20 years hence and say, "No, you've got to give that money back." That's precisely what's going on now. So the SIPC Fund itself has to be based upon reasonable expectations of final account statements. And frankly, if the statements are outrageous or wrong, then we really have to get to whether or not a person receiving those statements was willfully turning a blind eye, and the courts have the ability to say, "No. You're getting 40 percent return, maybe you don't get that protection." But when we come to the issue of the recovery of customer property, and I think that's where so much of the time has been spent, maybe there is a different standard. And the Trustee has had the flexibility to apply a standard, and a reasonable standard. And that standard could incorporate the time-value of money. It could find some way to equitably determine what the fair distribution would be of the recoveries of those monies.

But it should not eliminate the use of final account statement and reasonable expectations on the core of this protection, which is the SIPC Fund. So, customer property has an opportunity to have all kinds of equitable, ratable methodologies applied to it to come up with a good solution, based upon what the Trustee sees at that particular time. The fund, however, that belongs to SIPC, the SIPC Fund, is inviolate. It cannot be modified or changed. It is what the customer has to be relying upon for their protection.

Mr. Garrett: Thanks for the comment.

Mr. Caruso: The only thing I would add, Chairman Garrett, is the one thing that's been clear from today's hearing is how do you stop this problem? You don't allow people to prepare their own account statements. If Madoff had not prepared his own account statements on one side of his floor, none of this would have happened. So, a very simple solution, if we want to keep this from happening again, is, "I cannot prepare my own statements." That solves the problem.

Mr. Garrett: Mister Borg.

Mr. Borg: In my office, investment advisors are looked at once every three years on a rotating cycle. We use a risk assessment. If they have custody and control, they go way to the top of the list and they are looked at a lot sooner and a lot quicker. If they are strictly financial advisors, they just give advice and they have no custody, no control, no physical assets, no physical custody of the property, then they go to the bottom of the list because there's a clearing firm or someone else out there.

The comment was made, and we try and encourage at least the investment advisors under our jurisdiction, Madoff would have been under the SEC jurisdiction, is that "Get a clearing firm." And, again, I agree. A lot of these problems with these Ponzi schemes, if they're going through either a brokerage or using an IA, can be eliminated by actually having a dual or triple control because now you have three entities that have got to conspire, to make it all work.

Mr. Garrett: Unless, of course, you control all three entities as in the Madoff situation where --

Mr. Borg: In that case, I would consider that as a unitary control because Mister Madoff actually had control over both ends of his business. There has to be a Chinese wall between the two. Even where there are clearing firms that self-clear, we look at the controls between the two. Usually it's an outside auditor or an outside advisor, or some other third party that has to certify that they have looked at those systems, and those systems are intact.

Mr. Garrett: Have you ever had the case where you have a separated, a situation like that where there is collusion that it doesn't solve the problem as Mister Caruso suggests?

Mr. Borg: I have not seen -- yes, one time that I can think of. In fact, it gets tied up with that Mallory case because they, it was a separate organization called Capital Guardian which handled the trust accounts.

Mr. Garrett: Okay.

Mr. Borg: In other words, if you had an IRA.

Mr. Garrett: Yeah.

Mr. Borg: And there was collusion between the two. There was joint-ownership.

Mr. Garrett: Okay.

Mr. Borg: But, it was so cleverly disguised, it took us a little while to find.

Mr. Garrett: Find it, yeah.

Mr. Borg: But it didn’t last 20 years.

Mr. Garrett: Yeah. Yeah, well, that’s because he has good folks over there digging into it on a regular basis.

Mr. Borg: Thank you, Mister Chairman, I appreciate that.

Mr. Garrett: Sure. Well, if Mister Hurt does not have any other questions, I will, at this time, I will dismiss the panel and thank you all very much for your testimony today. As always, there may be, and there will be, other questions that we’ve thought of, so the record’s always open for another 30 days to submit questions to you. So, I appreciate the opportunity to do that.

And, without objection, I’ll put into the record from, a statement for the record, for today from the Financial Services Institute and also from BDA, Bond Dealers of America. Without objection, that’s so ordered.

And again, I very much appreciate this entire panel for your information and discussion today. Thank you. Meeting is adjourned.

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