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United States House of Representatives
Committee on Financial Services
2129 Rayburn House Office Building
Washington, D.C. 20515

MAXINE WATERS, CA, RANKING MEMBER

M E M O R A N D U M

To: Members of the Committee on Financial Services

From: FSC Majority Committee Staff

Date: November 18, 2013

Subject: November 21, 2013, Subcommittee on Capital Markets & Government Sponsored Enterprises hearing on "A Legislative Proposal to Amend the Securities Investor Protection Act"

The Subcommittee on Capital Markets and Government Sponsored Enterprises will hold a hearing on "A Legislative Proposal to Amend the Securities Investor Protection Act" at 9:30 am on Thursday, November 21, 2013, in Room 2128 of the Rayburn House Office Building. This will be a one-panel hearing including the following witnesses:

- Stephen Harbeck, President, Securities Investor Protection Corporation
- Ira Hammerman, General Counsel, SIFMA
- Angie Kogutt, Stanford Victims Coalition
- Ron Stein, President, Network for Investor Action and Protection

This hearing will examine H.R. 3482, the "Restoring Main Street Investor Protection and Confidence Act," introduced by Representatives Scott Garrett, Carolyn Maloney, and others on November 14, 2013.

Background

In 1970 the Securities Investor Protection Act (SIPA) established the Securities Investor Protection Corporation (SIPC), which reimburses customers of a failed broker-dealer for cash and securities missing from their customer accounts after they have received a distribution from the failed broker-dealer (if such broker-dealer is a member of the SIPC). SIPC has paid claims of up to $500,000 per customer; of that $500,000, up to $250,000 can be a claim for cash, the rest being a claim for securities.

SIPC is a nonprofit membership-based corporation. Its members are, with some exceptions, all persons registered as brokers or dealers under Section 15(b) of the Securities Exchange Act of 1934 and all persons who are members of a national securities exchange.

A board of seven directors determines SIPC policies and governs operations. Five directors are appointed by the President of the United States subject to Senate approval. Three of the five represent the securities industry and two are from the general public. The sixth director is

appointed by the Secretary of the Treasury and the seventh by the Federal Reserve Board from among the officers and employees of those organizations. The Chairman and the Vice Chairman are designated by the President from the public directors.

Self-regulatory organizations and the Securities and Exchange Commission report to SIPC concerning member broker-dealers who are in or approaching financial difficulty. If SIPC determines that the customers of a member require the protection afforded by SIPA, the Corporation commences a customer protection proceeding. This requires that SIPC apply to a federal district court for appointment of a trustee to liquidate the broker-dealer.

The SIPC collects fees from its members to finance a fund (the "SIPC Fund") that is used to carry out its statutory duties. If the SIPC Fund becomes insolvent, SIPC is authorized to borrow from the U.S. Treasury. The Dodd-Frank Wall Street Reform and Consumer Protection Act (Pub. L. No. 111-203) increased SIPC's borrowing limit to $2.5 billion. The Dodd-Frank Act also changed the minimum assessment of a member to an amount not to exceed 0.02% of the gross revenues from its securities business.

In 2010, following the liquidation of Lehman Brothers and the discovery of the Madoff Ponzi scheme, SIPC's Board of Directors created the SIPC Modernization Task Force to review the SIPA, assess SIPC's operations and policies, and propose reforms to modernize the SIPA and SIPC. On February 22, 2012, the SIPC Modernization Task Force released a report that set forth 15 recommendations to improve SIPC. Pending and potential SIPC reforms included in the Task Force's recommendations were: (1) increasing SIPC protection from $500,000 to $1.3 million, which is equal to $500,000 in 1980—when the $500,000 level was set—adjusted for inflation; (2) eliminating the different levels of protection afforded to claims for cash and claims for securities; (3) amending the Act to provide pass-through protection for individuals who invest indirectly in securities through their participation in qualified plans under the Employee Retirement Income Security Act; and (4) adjusting the minimum SIPC member fee to the greater of $1,000 or an amount set by SIPC, not to exceed 0.02% of the member's gross revenues from its securities business.

H.R. 3482, the "Restoring Main Street Investor Protection and Confidence Act"

Introduced on November 14, 2013 by Representatives Scott Garrett, Carolyn Maloney, and other cosponsors, H.R. 3482, the Restoring Main Street Investor Protection and Confidence Act, amends the Securities Investor Protection Act of 1970:

- (a) to provide that a customer's "net equity" shall be determined using the information contained in the last statement issue by the firm to the customer before the liquidation filing date and any additional written confirmations of the customer's positions received after such last statement. However, if the books and records of the broker-dealer indicate the net value of a customer's positions is greater than the net value described above, then the customer's net equity shall be done using the books and records instead of the customer's last statement. The above shall not apply to a customer that knew the firm was involved in fraudulent activity, or a person that was registered as a broker or dealer

or an investment adviser and knew or should have known that the firm was involved in fraudulent activity and did not notify SIPC, the SEC or law enforcement;

- (b) to provide that allocation of customer property shall be made based on (i) the net equity of a customer, as determined using the last statement issued by the firm, (ii) the trustee in consultation with theSEC, and (iii) approved by the court. If the trustee determines this method is unfair and inequitable to a substantial segment of customers, and would not serve the remedial purposes of this Act, allocations of customer property shall be based on a fair and reasonable methodology with special consideration for the "typical, non-professional investor." Before approving the methodology, the court shall (i) notify customers and other interested parties and (ii) provide the customer and interested parties an opportunity to provide comments on the proposed methodology.

- (c) to prohibit the trustee from recovering any property transferred by the firm to a customer before the liquidation filing date unless such customer knew the firm was involved in fraudulent activity or was a person that was registered as a broker or dealer or an investment adviser and knew or should have known that the firm was involved in fraudulent activity and did not notify SIPC, the SEC or law enforcement.

- (d) to require that the SEC shall maintain a current list of trustee candidates. A trustee may not be appointed if the trustee is currently serving as trustee on another liquidation. The court shall determine the amount of allowances granted to the trustee and attorney. SIPC shall disclose all payments made by SIPC to the trustee and all other costs in connection with the liquidation proceedings and the nature of the expenses.

- The remainder of the bill includes (e) definition of customer status, (f) determination of need of protection, (g) timing of SIPC advances and results of delay, (h) timing of payments to customers, (i) Commission authority to require SIPC action, in the event SIPC refuses to act, without court approval, (j) limitation on SEC loans to SIPC, and (k) inspection of SIPC members by SEC and SROs. Section (k) tasks the SEC and SROs with periodic inspections of SIPC members to assess the financial stability of such members and ensure that the information provided by the firm to its customers, including information contained in account statements and transaction confirmations, is accurate, and requires the SEC to issue a report on this information. Finally, the legislation's SIPA amendments shall apply to any liquidation proceeding that either was in progress on the date of enactment; or is initiated after the date of enactment. The amendments made regarding the duties of the trustee would take effect for future liquidations.