

Statement
Of
Stephen P. Harbeck
President and Chief Executive Officer
To The
House Financial Services Committee
Subcommittee on Capital Markets & Government Sponsored Enterprises
November 21, 2013

Chairman Garrett, Ranking Member Maloney, and Members of the Subcommittee:

Thank you for the opportunity to brief you on the progress SIPC has made since the beginning of the 2008 financial crisis. I believe the results achieved to date are impressive, given the scope of the challenges presented.

Lehman Brothers, Inc.

Lehman Brothers is the largest bankruptcy proceeding of any kind in history. With securities customers' accounts essentially frozen and substantial customer assets at risk, SIPC initiated a customer protection proceeding on September 19, 2008. That same day, under the Securities Investor Protection Act ("SIPA"), the United States Bankruptcy Court for the Southern District of New York approved the transfer of 110,000 customer accounts containing \$92 billion in assets to solvent brokerage firms. The actual transfer of those accounts took place over the next ten days.

The trustee proceeded to close the complex, worldwide business operations of Lehman. Among the highlights of that work was a victory for investors in the Supreme Court of the United Kingdom requiring assets that should have been segregated for customers, but were not, to be deemed segregated.

Today: All Lehman Brothers customers have been made whole. No SIPC funds were required for either the administrative expenses of the case or to supplement account balances.

In short, the bankruptcy processes imbedded in SIPA have worked well under a severe stress liquidation case, and should be considered as a viable option to the Dodd-Frank “Resolution Authority” where practicable.

Bernard L. Madoff Investment Securities LLC

I first testified before the Committee in January 2009. Since that time, the trustee’s methodology for determining claims has been approved in all respects by the courts and, in accordance with that methodology, the trustee has approved 2,514 claims. A total of 1,267 of those claims...the smallest claims in the case...have been fully satisfied by a combination of advances from SIPC and a distribution of funds amassed through litigation, and settlements reached, by the trustee.

Every customer who left \$875,000 or less with Madoff has received all of his or her money back from the trustee. Customers with larger claims have received 43% of their initial investment plus \$500,000 from SIPC. Thus, a claimant who left \$10 million with Madoff has already received \$4.8 million from the trustee, including SIPC advances. It is important to note that no customer funds have been used to pay expenses or the cost of the work that went into generating these significant returns. SIPC has paid for all of the administrative costs of the case.

There are two major additional sources of funds to be distributed. The trustee will be in a position to distribute to customers an additional \$1.95 billion, currently in his possession, as soon as certain legal impediments are resolved. Working in conjunction with the United States Attorney for the Southern District of New York, the trustee estimates that yet an additional \$2.3 billion will be returned to customers from the United States Attorney’s forfeiture funds.

Finally, the trustee is engaged in litigation which, if successful, will benefit those who have not yet received all of their net deposits with Madoff.

In summary, the trustee has maximized the returns to victims given the tools available to him. He has worked in cooperation with regulatory and criminal authorities, and will continue to do so. There will be additional distributions as additional funds are added to the fund of “customer property.”

MF Global Inc.

A bit of perspective is useful in a discussion of the MF Global case. This is the eighth largest bankruptcy in history. \$1.6 billion that should have been set aside for commodities claimants was not properly segregated. The Commodity Futures Trading Commission has no analog to SIPC to protect commodities customers. Because securities customers were at risk,

SIPC was contacted by the SEC before dawn on October 31, 2011, a mere two years ago, and initiated a proceeding that same day. The case has not been without controversy. SIPC was criticized by some for appointing as trustee James Giddens, who also served as the trustee in the Lehman Brothers SIPA proceeding. There were international impediments to recovery of funds. Yet, Bankruptcy Judge Martin Glenn recently stated that “At the outset of the case, nobody thought that customers would recover everything they lost.”

The results to date:

All securities customers were satisfied early in the proceeding.

Having won a case concerning the proper segregation of assets in the Supreme Court of the United Kingdom in Lehman Brothers, Mr. Giddens was able to shortcut objections to his resolution of a virtually identical issue in MF Global. This was critical to full satisfaction of the commodities customers.

The cost to SIPC is expected to be zero. There will be no need for SIPC funds for either securities customer claims satisfaction or administrative expenses. Although SIPC advanced \$10,000,000 early in the case, that sum has been returned to SIPC.

The trustee and SIPC litigated a number of issues interpreting SIPA, some of which were issues of first impression, and have been uniformly successful.

Asset recovery efforts on behalf of the general creditors will continue, but costs of collection will not be borne by SIPC.

In short, the process worked, and worked well.

SIPC’s Financial Condition

In January 2009 a number of members of the Committee expressed concern about the financial condition of SIPC. I am pleased to report that SIPC has performed all of its statutory duties during the financial crisis, and that it continues to be in sound financial condition. In December 2008, the SIPC Fund stood at \$1.7 billion. Immediately upon the commencement of the Madoff case, the SIPC Board prudently increased the assessments on SIPC member firms to .0025% of net operating revenues. At the close of this year SIPC will have \$1.9 billion. Even including all expenses of the financial crisis, this demonstrates that SIPC has the ability to raise funds as needed to meet its statutory obligations. The SIPC Board has currently set a “target” balance for the SIPC Fund at \$2.5 billion, which matches the increased line of credit SIPC has with the United States Treasury.

New Cases

Since December 2012, SIPC has initiated four customer protection proceedings, each of which is very modest in size. SIPC was able to serve as trustee in three of the cases, and use the statutory “direct payment procedure” in the fourth case. This has had the effect of expediting claims determination and satisfaction, in order to return customer assets as promptly as possible.

SIPC Cannot Support The Proposed Restoring Main Street Investor Protection and Confidence Act

The “Restoring Main Street Investor Protection and Confidence Act” contains provisions that have a number of unintended consequences. SIPC cannot support these proposed amendments to SIPA. Some of the problems presented by the proposal include:

- The bill requires SIPC to accept as accurate a financial statement known to be intentionally fraudulent. Under the bill, SIPC must accept whatever statement a thief issues to his customers.
- The bill not only legitimizes Ponzi Schemes, it guarantees that the phony profits of a Scheme are backed by federal taxpayer funds.
- The bill makes Ponzi Schemes a better investment than legitimate securities markets.
- The bill’s limitations on the “avoidance powers” in a SIPA case result in demonstrably inequitable distributions of “customer property.” For example, had Mr. Madoff’s fraud been detected and closed a mere two days later, the \$175,000,000 in checks on his desk would have gone to arbitrarily favored clients at the direct expense of similarly situated other clients. This was more than half of the liquid assets the firm had when it failed. Further, as the United States Court of Appeals for the Second Circuit correctly noted, “any dollar paid to reimburse a fictitious profit is a dollar no longer available to pay claims for money actually invested.”
- Attached is a graphic presentation demonstrating the inequitable consequences of eliminating the avoidance powers.
- The bill provides a complex mechanism for ignoring a fraudulent final account statement in the interest of equity. In reality, this is an invitation to extended litigation by various claimants with disparate, conflicting and competing interests in a finite corpus of customer property. This will delay return of customer property to injured claimants on a timely basis.

- The bill gives unprecedented and unlimited power to the SEC to compel the expenditure of both private and public funds. That power includes the authority to require SIPC to initiate the liquidation of any brokerage firm or other institution regardless of whether statutory criteria are met.

- The bill gives the SEC unlimited authority to change the definition of the term “customer.”

- The bill renders the SEC’s authority unreviewable by the judiciary.

- The bill operates retroactively. It would throw the Madoff case, and the remarkable results achieved to date, into chaos and uncertainty.

- The bill forbids using a trustee on two SIPA cases simultaneously. This eliminates efficiencies and denies customers the benefits of expertise in the most significant cases. SIPC has eight ongoing proceedings. Only one individual serves in more than one case. SIPC designated five different law firms in the six ongoing New York cases. SIPC matches the size and resources of the trustee and the trustee’s counsel with the nature and scope of the problem.

- The bill makes it impossible to determine future costs and risk.

SIPC cannot support the bill to the extent it would reverse the judicial outcome in the Stanford-Antigua Bank Fraud Case.

- As to Stanford, the bill requires SIPC to underwrite, guarantee, and pay the debt obligations of a foreign bank in an offshore tax haven. The Antigua Bank CD purchasers knowingly sent their money AWAY from a SIPC member to an Antigua Bank where, in the words of the SEC, the claimants received “high rates of return on CDs that greatly exceeded those offered by commercial banks in the United States.”

While SIPC has sympathy for the victims of this or any other fraud, SIPC was not designed to refund the original purchase price of any bad investment, even where the investment was induced by fraud.

I hope this summary has been helpful to the Subcommittee. I would be pleased to answer any questions the Subcommittee may have.

EQUITABLE TREATMENT OF INVESTORS

H.R. _____

An Analysis of the

**“Restoring Main Street Investor Protection and
Confidence Act”**

**Prepared for the House Financial Services Committee
Capital Markets Subcommittee**

Stephen P. Harbeck

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The Securities Investor Protection Corporation

November 21, 2013

This presentation demonstrates that the “avoidance powers” used by a SIPA trustee are essential to a fair and equitable distribution of assets in a Ponzi Scheme such as the Madoff case.

- ▶ Assume three individuals deposit the same amount, on the same day.
- ▶ No actual investments are made for the three customers.
- ▶ All three are credited with completely fictitious investment returns.
- ▶ Just prior to a discovery of the fraud, one customer makes a substantial withdrawal of his original investment, and some of the fictitious profits.
- ▶ The other two customers make no withdrawal.
- ▶ The fraud is exposed.

- Under current law: All three customers receive identical returns.
- Under the proposed legislation:

One customer receives:

- All of his principal investment.
- Fictitious profits, in the form of money taken from the other two customers.

The other two customers receive:

- Far less than their original investment.

The Facts

DATE	Customer A	Customer B	Customer C
01/01/10	Deposits \$2 Million	Deposits \$2 Million	Deposits \$2 Million
01/01/12	Receives Statement \$4 Million	Receives Statement \$4 Million	Receives Statement \$4 Million
02/01/12	Withdraws \$3 Million	Withdraws Nothing	Withdraws Nothing
03/01/12	Receives Statement \$1 Million	Receives Statement \$4 Million	Receives Statement \$4 Million
04/01/12	Ponzi Scheme Exposed and Customers Are Innocent of Knowledge Broker's Assets and Other Customer Property Completely Dissipated on Filing Date		

WHAT DOES EACH CUSTOMER RECEIVE?

Hypothetical 1: Assume total of \$6 million deposited and nothing available to distribute.

Results Under Current Law

	Customer A	Customer B	Customer C
Customer’s Net Equity After \$3 Million Withdrawal by “A” Is Avoided	\$2,000,000	\$2,000,000	\$2,000,000
Customer Property Distributed After Avoidance of Transfer to “A”	\$1,000,000	\$1,000,000	\$1,000,000
Amount Received From SiPC Advance	\$ 500,000	\$ 500,000	\$ 500,000
Total Amount Received Based on \$2 Million Deposit	\$1,500,000	\$1,500,000	\$1,500,000

Hypothetical 1: Assume total of \$6 million deposited and nothing available to distribute.

Results Under the Restoring Main Street Investor Protection and Confidence Act,”

	Customer A	Customer B	Customer C
Amount Withdrawn Pre Liquidation	\$3,000,000	-0-	-0-
Amount Received From SIPC Advance	\$ 500,000	\$500,000	\$500,000
Total Amount Received Based on \$2 Million Deposit	\$3,500,000	\$500,000	\$500,000

- Cost to SiPC: Identical in Each Instance
- Which is More Equitable?
- The Avoidance Powers That the Bill Takes Away Are Exactly What Makes the Distribution Equitable.

Hypothetical 2: Assume Subsequent Recovery From Wrongdoer of \$1,000,000

Results Under Current Law

	Customer A	Customer B	Customer C
Customer's Net Equity After "A's" \$3 Million Withdrawal is Avoided	\$2,000,000	\$2,000,000	\$2,000,000
Customer Property Distributed After Avoidance of Transfer To "A"	\$1,000,000	\$1,000,000	\$1,000,000
From SiPC	\$500,000	\$500,000	\$500,000
From Wrongdoer	\$333,333	\$333,333	\$333,333
TOTAL AMOUNT RECEIVED BASED ON \$2 MILLION DEPOSIT	\$1,833,333	\$1,833,333	\$1,833,333

Hypothetical 2: Assume Subsequent Recovery From Wrongdoer of \$1,000,000

Results Under the “Restoring Main Street Investor Protection and Confidence Act.”

	Customer A	Customer B	Customer C
Customer’s Net Equity Based on Last Statement	\$1,000,000	\$4,000,000	\$4,000,000
Amount Withdrawn Pre-Liquidation	\$3,000,000	-0-	-0-
From SiPC	\$500,000	\$500,000	\$500,000
From Wrongdoer	\$111,111	\$444,444	\$444,444
TOTAL AMOUNT RECEIVED BASED ON \$2 MILLION DEPOSIT	\$3,611,111	\$944,444	\$944,444

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