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ADDITIONAL REFORMS TO THE SECURITIES INVESTOR PROTECTION ACT

HEARING

BEFORE THE

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE, AND GOVERNMENT SPONSORED ENTERPRISES

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

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ADDITIONAL REFORMS TO THE SECURITIES INVESTOR PROTECTION ACT

Wednesday, December 9, 2009

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON CAPITAL MARKETS,
INSURANCE, AND GOVERNMENT
SPONSORED ENTERPRISES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:08 a.m., in room 2128, Rayburn House Office Building, Hon. Paul E. Kanjorski [chairman of the subcommittee] presiding.

Members present: Representatives Kanjorski, Ackerman, McCarthy of New York, Baca, Maloney, Klein, Perlmutter, Speier, Minnick, Adler, Kosmas, Himes, Peters; Garrett, King, Manzullo, Posey, and Jenkins.

Also present: Representatives Ellison and Maffei.

Chairman KANJORSKI. This hearing of the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises will come to order.

I ask unanimous consent that permission be granted to any nonmember of the subcommittee who is present today to sit with the subcommittee.

Pursuant to committee rules, each side will have 15 minutes for opening statements. Without objection, all members' opening statements will be made a part of the record.

Good morning, everyone. One year ago this week, Federal authorities arrested Mr. Bernard Madoff for participating in the largest Ponzi scheme in U.S. history. It is therefore appropriate for us today to meet for the third time to examine this massive securities fraud.

As my colleagues know, I have sought to use the $65 billion deception as a case study to guide our work in reshaping and reforming our financial services regulatory system.

Last month, our committee passed H.R. 3817, the Investor Protection Act, and we have now rolled this important securities reform bill into H.R. 4173, the Wall Street Reform and Consumer Protection Act, which the House will begin to consider today. Both bills contain a number of provisions that directly respond to Mr. Madoff's substantial swindle.

The repeated failures of the U.S. Securities and Exchange Commission, despite having received several leads from a number of sources, to detect the Madoff fraud allowed the hoax to continue for more than a decade. A lack of effective coordination, sufficient

funding, and staff expertise each contributed to this unfortunate regulatory breakdown.

In response, our bills double the authorized funding of the Commission for 5 years, to ensure that the Agency has the resources it needs to hire staff with appropriate expertise, and to get the job done. The bills also provide for an expeditious, independent, and comprehensive review of the entire securities regulatory structure by a high-caliber entity with experience in organizational change. This study will identify specific reforms and improvements that the Commission and the other entities that oversee our securities markets must put in place to ensure superior investor protection, going forward.

Mr. Madoff's episode also revealed the need to elevate the importance of whistleblowers like Mr. Markopolos, who made repeated entreaties to the Commission regarding Mr. Madoff's con, by establishing incentives, so that more of them will come forward.

Our regulatory reform package, therefore, includes a bounty program, to help identify wrongdoers in our securities markets, and reward individuals whose tips lead to successful enforcement actions. With the bounty program, we will effectively have more cops on the beat.

In studying the Madoff case, we have additionally learned that the Public Company Accounting Oversight Board lacked the powers it needed to examine and take action against the auditors of the broker-dealers. Our legislation closes this loophole, so schemers like Madoff will no longer be able to rely on inept or corrupt accounting firms to rubber stamp their criminal activities.

Through our investor protection reforms, we have further sought to strengthen the Securities Investor Protection Act, the law that helps investors to recover funds when a broker or dealer fails. We have increased the resources available to the Securities Investor Protection Corporation to fund liquidations, bolstered the level of cash coverage an investor is entitled to, and raised penalties on brokerages for violations of the law. We have also broadened the eligible types of investments covered.

We can, however, do more to reform this law. Today, we will continue to move this process forward, as we examine the ongoing efforts of the Securities Investor Protection Corporation to mitigate the sizeable losses of Mr. Madoff's victims, as well as the casualties of the $8 billion Stanford Financial fraud.

We will also explore the intended and unintended consequences of several proposed changes to the Securities Investor Protection Act that aim to address problems that some Madoff and Stanford Financial victims, including retirees, pension funds, charities, and others, have encountered.

While each of these amendments seeks to fix a perceived deficiency in the law, each proposal would also benefit from a robust debate in order to identify potential problems and possible refinements. Some, for example, have advocated that the Securities Investor Protection Corporation should not claw back the profits taken by earlier investors who unwittingly partook in a Ponzi scheme.

I have concerns that such a plan, if implemented, would treat later investors unfairly. That said, clawing back profits already

used by charities could prove especially devastating. As such, we must walk a fine line in determining how to proceed, if at all.

In closing, I would like to extend my appreciation to my colleagues from New York, Mr. Ackerman and Mr. Maffei, as well as Mr. Ellison of Minnesota, Mr. Klein of Florida, and Mr. Perlmutter of Colorado, who have helped to select today's witnesses, and advance discussions on reforming the Securities Investor Protection Act. Together, I hope we can learn more from these troubled events, and figure out how we can further improve our regulatory system.

Now I would like to recognize our ranking member, Mr. Garrett, for 5 minutes for his opening statement.

Mr. GARRETT. I thank the chairman, and I thank all of the witnesses, too, for joining us today to testify before our subcommittee. And from people similarly situated as yourself, I have been informed and made keenly aware of the suffering that has been suffered and inflicted on so many investors in my area in the fifth district of New Jersey, and across the country as well, due to the Madoff situation and the Stanford fraud, as well.

And so, Mr. Chairman, it is important that we hold this hearing today to hear firsthand from some of the victims, not only just to get a better understanding of their situation and their plight, but also to hear your ideas, having been through this experience personally, on how to make the SIPC process work better and, perhaps more importantly and appropriately, for all the interested parties involved.

Before I do that, let me just take a moment on my statement. I would like to seek unanimous consent to enter two statements into the record from constituents of mine, Robert Jerome and Lenore Shupak, into the record. Both of them have been adversely impacted by the Madoff fraud.

Chairman KANJORSKI. Without objection, it is so ordered.

Mr. GARRETT. Thank you. Now, the frauds themselves were, of course, tragedies for so many innocent victims. And so the purpose of today's hearing is to examine ways to improve the SIPC process so that the victims don't have to needlessly suffer once again.

Now, as the chairman says, there are a number of proposals in front of us today to reform the process. One idea is to offer SIPC coverage to individual investors in a pension fund or other fund, rather than the standard half-a-million dollars in coverage for the entire fund, under current law.

Others have put forward ideas to reform the so-called clawback process, in which the trustee is seeking to recover funds redeemed by some Madoff investors in the name of equity, returning funds to all the other Madoff investors.

There are also calls for a more timely process and advances in extending coverage to affiliates of SIPC-registered brokers, as well, that we should consider.

All of these ideas, I think, deserve to be fully explored and vetted by this subcommittee, with a frank discussion of the pluses and some of the minuses, as well. This is the least, I think, that we can do for the many investors affected by the past frauds, as well as future ones, as well.

Because, quite honestly, unfortunately, there will be future schemes that will try to bilk unsuspecting investors. And the SEC's failure to detect the Madoff situation, despite all the red flags and warning signs and testimony that came to them, is well documented. So we know that this is the type of thing, unfortunately, that could happen in the future.

And, unfortunately, as Professor Coffee has indicated in his testimony, the level of loss justifies more than just the serious reforms that have already been adopted by the SEC. And there I agree. I am committed to exploring other ways to improve the performance of that agency. And so I welcome any insights that you may have on this, in regard to the hearing today and going forward, as well—the rest of the panel, as well.

One thing I don't think—and I will close on this—we should be doing, as far as the solution to that problem, is just saying, "Let's see if we can just throw more money at the SEC," and not asking for any more results from them.

Unfortunately, as you probably all know, as part of the Investor Protection Act that was approved by this committee—and that is also a part of the package of bills that will be going to the House Floor this week—there is an authorization for the SEC to be doubled with basically no strings attached, as to where the money goes.

My colleague, Congressman Neugebauer, offered an amendment during the committee process here, and I cosponsored that amendment. And what that would have done would have scaled back future authorization increases for the SEC, and instead, would have tied any of those increases and money going to the SEC to—first, for them to have to fulfill some of the recommendations that were made by the Inspector General, basically saying, "You have an organization, you didn't do the job, we are not going to reward you by sending you more money, unless you can prove to us that you already, over the last year now, have begun to implement some of those changes. And if you want to get additional funding in the future, you will have to continue on in a better path."

So, that's one other area I would appreciate your comments on. I have a number of other questions related to the witnesses' written testimony. And so I look forward to hearing your testimony, and answering some of those questions.

With that, I yield back, and I thank you.

Chairman KANJORSKI. Thank you very much, Mr. Garrett. And now I would like to recognize Mr. Ackerman for 3 minutes.

Mr. ACKERMAN. Thank you very much, Mr. Chairman, for your continued pursuit of this issue and this series of hearings that you have chaired.

It has been a full year since Bernard Madoff folded his own house of cards, and admitted that he had operated the largest Ponzi scheme in history. You would think that by this week, a full 12 months removed from Madoff's admission, our financial regulators, some of whom have admitted they were negligent in protecting investors from Madoff's fraud, would have helped as many victims as they could.

You would think that, given the enormity of Madoff's Ponzi scheme, and the human tragedy that it has caused, they would

have been as generous as possible. And you would think that, because Madoff's investors received detailed, genuine-looking statements, his victims had every reasonable expectation that the money in their accounts was really there, belonged to them, and that they were thus fully protected by the securities laws.

Sadly, you would be wrong. Instead, in the years since Madoff turned himself in, the largest and most sophisticated advanced financial system in the world, rather than providing restitution to the investors in the largest fraud in history, has managed to create classes of victims who have turned against one another, forced to fight tooth and nail over only pennies on the dollar of what they reasonably thought belonged to them. And there is no end in sight.

If there is anything we have learned in the year since Bernie Madoff turned himself in, it's that the confidence that investors had in the system, from the SEC's ability to police our markets to SIPC's guarantee of protection against fraud, was misplaced.

Today's hearing begins in earnest the process of providing additional legal remedies to Madoff's victims. In my view, there are two issues that this subcommittee must address as we clarify and expand the Security Investor Protection Act: a limitation of SIPC's ability to claw back assets from innocent victims, who are neither complicit nor negligent in a Ponzi scheme; and finding some mechanism by which SIPC insurance may be provided to defrauded feeder fund investors.

I look forward to working together with you, Mr. Chairman, to address these issues in the coming weeks, and to hear from our witnesses today.

I would also like to acknowledge our witnesses who are Madoff victims, and to thank them all for appearing before the subcommittee. There are hundreds more, Mr. Chairman, who wanted to appear. Most of them just couldn't afford the car fare, the bus fare, the train or plane fare to get here. We appreciate the witnesses who are here with us this morning, and testifying. And I look forward to hearing their testimony.

And, Mr. Chairman, I would ask unanimous consent that at the appropriate place, this folder of statements from additional witnesses be placed in the record.

Chairman KANJORSKI. Without objection, it is so ordered.

Thank you, Mr. Ackerman. And now we will hear from the gentleman from New York, Mr. King, for 5 minutes.

Mr. KING. Thank you, Mr. Chairman, and let me thank you for holding this hearing, and thank you for your attention to this matter. And let me also thank my colleague from New York, Mr. Ackerman, for the energy and drive that he has shown on this matter.

Mr. Chairman, the first time I heard the name Bernard Madoff, I think, was December 10th. I was actually stopping by a holiday event on the North Shore to meet with some constituents. When I walked in, the person hosting it told me that shock was through the room, because they had just learned that day that their life fortunes, which had been handled by this Mr. Madoff, whom I hadn't even heard of before, had been part of a Ponzi scheme. And, of course, the next day the arrest was made and the story broke.

So, in my first encounter with it, I could see the shock on people's faces. I could see the pall that was over the room. And since then, the situation has only gotten worse.

I have a number of questions regarding what has happened over the course of the last year. Like Mr. Ackerman, you see a tragedy like this unfold, and then you see, over the course of the next year, the victims being victimized again. And I know there are no easy answers to this, but to me, there has almost been an imputation of fraud to the victims themselves, somehow implying and imputing Madoff's offenses to them, that somehow they should have known, or somehow they are co-conspirators with Bernard Madoff. And yet there is no evidence to suggest that at all.

So, we have the redefinition of net equity. We have the clawback, which could be devastating. We have the fact that taxes have been paid over the years, for many years, on nonexistent profits. We have the feeder fund issue, where many, including a former Member of Congress, called me. He never heard of Bernie Madoff, he lived as far from New York as anyone could, and it turns out that his life savings, through a broker, had been invested by Bernard Madoff. And he has lost everything.

And then, there is the whole issue of what appears to be almost unfettered power being given to the trustee to change definitions, decide who he is going to go after, why he is going to go after them, whether or not there is specific authority for him to do it or not.

So, these are all issues. Because, as the chairman said and I believe the ranking member also said, this will not be the last Ponzi scheme. This will not be the last massive fraud. And I don't think enough attention—and all of us share responsibility for this—has been given over the years to what do you do when a massive fraud like this develops. We have to address it. And, in addressing it to the future, I think we also have to find ways to protect those who are currently the victims.

So, I look forward to the hearing. I look forward to working with all the members of the subcommittee and committee, in trying to come up with legislation to address the real needs of the victims, and also to do what we can to ensure that there is much better enforcement in the future, and much stricter enforcement, to make sure this does not happen again.

And with that, Mr. Chairman, I look forward to the testimony. I thank the witnesses for being here today. I thank the victims who have taken the time to be with us here today. And I yield back the balance of my time.

Chairman KANJORSKI. Thank you very much, Mr. King. And now we will hear from the gentleman from Florida, Mr. Klein, for 2 minutes.

Mr. KLEIN. Thank you, Mr. Chairman, for holding this important hearing. And again, we would also like to thank the witnesses and the victims who have come forward with their stories, and with their rights to be made whole in different ways.

Mr. Madoff's Ponzi scheme, which was thought to be the largest securities fraud in modern history, has defrauded thousands of people in my congressional district in south Florida, as well as charities, and lots of other people around the United States.

This episode was not only an embarrassment to the SEC, as they allowed this massive fraud to continue for well over a decade, despite repeated warnings, but time and time again, the SEC "investigated" Mr. Madoff, and pronounced his business to be sound. And if you're an investor, and you have an investment in a particular security, you would think that this would be a sound investment, with the SEC stamping its regulatory approval.

There have been lots of issues that have already been mentioned by Mr. King and others: clawback; taxes paid; how do we—how were we made whole from this terrible situation. And the fact that this has gone on for over a year is really something. It's a moral outrage that hasn't been resolved in some successful way.

Now, I think the most important thing we have to recognize is, as citizens and as Members of Congress, and even people who are victims, is we have rule of law in the United States. And we have a responsibility, as Members of Congress and as Americans, to make sure the SIPC and the SEC are living up to their statutory responsibilities.

Ensuring that the Madoff victims receive some protection from the government is important in restoring confidence in our entire investment system. Some investors, we know, were complicit, and they should be prosecuted to the fullest extent of the law, yet most others were not.

Many hard-working Americans have invested their life savings, and the SIPC symbol in the window has to mean something. The SEC repeatedly gave Madoff a clean bill of health. Investors relied on this analysis. And the SIPC symbol, as I said, has to mean something when you move forward and you make an investment in the United States system.

To go after these investors who lost everything now violates most people's sense of fairness on a consistent level. How can they be held to a higher standard than professional analysts at the SEC?

Irving Picard has determined that investors who have drawn more money out of the account than they originally put in are not entitled to full SIPC coverage. And, further, the trustee can claw back money from them. And, again, I see an inconsistency in interpretation here, which needs to be resolved.

The purpose of the SIPC is to honor legitimate expectations of customers, and instill confidence in our capital markets. And it's important to provide SIPC protection up to $500,000, not only for the victims of this fraud, but to ensure, on a going-forward basis, that Americans can have confidence in the securities markets in the United States.

I look forward to the testimony, and a productive discussion, and an appropriate conclusion. Thank you, Mr. Chairman.

Chairman KANJORSKI. Thank you very much, Mr. Klein. And now I ask unanimous consent that Congressman Ellison be permitted to provide an opening statement. If there are no objections, Congressman Ellison is recognized for 2 minutes.

Mr. ELLISON. Thank you, Mr. Chairman. Let me thank all the witnesses, as well. I don't think I will need 2 minutes.

I simply want to say that the amount of disruption that this massive Ponzi scheme has caused Americans cannot be overestimated.

In my own district, the fifth congressional district of Minnesota, I have heard from people who thought they were in qualified ERISA plans who now learn that maybe things are not going to be as they expected, because of definitions in the law.

I have heard from people who run charities for charitable work who have been devastated by this, the impact of this lapse.

And so, I look forward to this hearing. I look forward to hearing from the witnesses. I want to thank the witnesses for all the work that they have done, and I want to thank the members of the committee, as well.

And I also just want to thank Mr. Maffei for his work. He and I have been working together on what may bring relief to some people. And I want to, again, thank you, Mr. Chairman, and the ranking member for the hearing. Thank you very much.

Chairman KANJORSKI. Thank you very much, Mr. Ellison. Now, it's up to the panel. I want to thank the panel for appearing before the subcommittee today. And, without objection, your written statements will be made a part of the record.

You will each be recognized for a 5-minute summary of your statement. And please contain your remarks to 5 minutes.

I would now like to recognize Ms. Jeannene Langford, an investor in the MOT Family Investors, and an indirect investor in Mr. Madoff's fund.

Ms. Langford?

STATEMENT OF JEANNENE LANGFORD, INVESTOR IN MOT FAMILY INVESTORS

Ms. LANGFORD. Chairman Kanjorski, Ranking Member Garrett, and members of the subcommittee, thank you for holding these hearings, and looking into the SEC's complicity with Bernard Madoff investments.

My name is Jeannene Langford, and I live in San Rafael, California. As one of the more than 16,000 victims of the Madoff Ponzi scheme, I am grateful to have the opportunity to present how financially devastating this scandal was to me, personally. It shattered my trust in my government's ability to serve and protect us. My hope is that Congress will choose to recognize and protect all indirect investors such as myself, who were victimized by this scandal.

I have worked for 30 years as an art and design professional in the stationery and craft industry. The past 17 years, I have been a single parent working to provide for myself and my daughter. In the areas where I have little expertise, I recognized the necessity to hire a specialist. Personal investment was one of those areas. And I knew that there were systems such as the SEC in place to protect me.

From my research, there was no reason to believe that this investment was not a viable place to put my life savings. I had no way of knowing the partnership where I placed my money was invested with Madoff. The money I had invested with Madoff represented my life savings. It was my retirement, a downpayment for a house, investment for the business I was starting, and it was my daughter's education. In short, it was the foundation for my future.

I do not have another 30 years to earn this money again. If the SEC had done its job, I would have my savings, and I would not be looking at working the rest of my life just to get by. I was shocked to find out my money was gone, and I was outraged to find out that the very governing body that sanctioned this business did not protect me.

I need help in understanding how the SEC could ignore expert testimony, be lax in its investigations, be influenced by the aura of Madoff, and not carry out its duties. I find it tragic and ironic that the interpretation of the language by the SIPC leaves out the indirect, hardworking people like myself, who are not wealthy, and who are now struggling to keep up because their lifetime of hard-earned savings or their pension has been stolen. These are the very investors for whom the SIPC insurance protection is most important.

Congress needs to take action to restore confidence for all future investors. I understand an update to the definition of the word "customer" in the SIPA to include indirect investors would ensure that the SIPC symbol protects both indirect and direct investors in the financial markets, and would begin to restore a sense of trust.

If nothing is changed, the current situation would be similar to having a catastrophic landslide, and the government came in to assist those on one side of the street, but not the other. I cannot believe this is the intent of this committee or of Congress.

Though I appreciate extending the SIPC coverage through the Maffei-Ellison amendment to investors in ERISA plans, this does not go far enough. All of us who invested through family partnerships, trusts, hedge funds, feeder funds, and pension plans are victims of this crime. All of us who invested are also victims of the SEC's inability to find the fraud. We are all victims of the same crime, and we all need to be granted equal protection.

The SEC's Web site reads, "The mission of the U.S. Securities and Exchange Commission is to protect investors, maintain fair, orderly and efficient markets, and facilitate capital formation." I urge you to rectify this current disparity of protection, by carrying out the mission you set forth. Thank you.

[The prepared statement of Ms. Langford can be found on page 130 of the appendix.]

Chairman KANJORSKI. Thank you very much, Ms. Langford. I would now like to recognize my colleague from Minnesota to introduce our second witness. Mr. Ellison?

Mr. ELLISON. Thank you again, Mr. Chairman. I am pleased to introduce one of the witnesses, Mr. Joel Green, of Upsher-Smith Laboratories, a pharmaceutical company in Minnesota.

I have heard from many people in my district and State who were victims of the Madoff scam. Those people weren't high rollers. They were regular people, ordinary people who work hard every day and make America great, people like the ones Mr. Green represents, and his colleagues, who are part of a pension profit plan that invested with Bernie Madoff.

They thought they were protected by the Securities Investment Protection Corporation, SIPC. Unfortunately, SIPC held itself out as the FDIC of the investment world. It hasn't followed through on the protection, in many cases.

That is why I am pleased to work with my colleague from New York, Mr. Maffei, on an amendment to clarify why SIPC protection should extend to individual participants of pension and profit sharing plans. I look forward to continuing to work with you, Mr. Chairman, and others in the committee on this reform, and others, to ensure that SIPC makes good on its promises. Mr. Green?

STATEMENT OF JOEL H. GREEN, GENERAL COUNSEL, UPSHER-SMITH LABORATORIES, INC.

Mr. GREEN. Thank you, Congressman Ellison, Mr. Maffei, Chairman Kanjorski, and members of the subcommittee. Thank you for the opportunity to address your subcommittee.

As Congressman Ellison said, my name is Joel Green, and I am with Upsher-Smith Laboratories of Minnesota. I am here to ask for your support for legislation that will protect working people throughout America whose retirement security is imperiled by the Madoff fraud, including current and former employees of Upsher-Smith Laboratories.

I urge your support for the legislation prepared by Mr. Ellison and Mr. Maffei to extend SIPC protection, to cover the losses of individual participants in pension plans, profit sharing plans, and other qualified plans lost in the Madoff fraud.

Upsher-Smith Laboratories is a family-owned pharmaceutical company. The company was formed in 1919, and has approximately 550 employees in the Twin Cities, Denver, and around the country. In 1974, our owners established a profit-sharing plan to share the profits with our company's employees. And, beginning in 1995, the plan assets were invested with Mr. Madoff.

Over the next 12 years, the company contributed over $8 million to the plan for the benefit of our employees. On December 11, 2008, Mr. Madoff was arrested for fraud. And approximately 615 of our current and former employees lost their retirement savings that had been in the profit-sharing accounts invested with Mr. Madoff.

Our plan, and our plan participants, are representative of the average American workers whose retirement savings ERISA was intended to promote, and whose investments SIPC was intended to protect.

Of our 615 plan participants, approximately 550—that's about 89 percent—had contribution balances of less than $50,000. This plan covers the average American worker. Yet SIPC has stated that only a single recovery of $500,000 is available. This is because the plan's account with Mr. Madoff was held in the name of the plan trustee. But this was required by an administrative requirement imposed by ERISA that plan assets must be held in the name of the plan trustee, and not in the name of individual plan participants.

Our plan lost in excess of $8 million in contributions in the Madoff fraud. If one includes the false Madoff profits, that number would be in excess of $18 million. A single SIPC recovery of $500,000 will not go far to cover the losses of our individual plan participants.

The administrative rule of ERISA requiring that plan assets be invested in the name of a plan trustee cannot be allowed to defeat the public policy behind ERISA to promote retirement savings of average American workers, nor can it be allowed to defeat the pub-

lic policy behind SIPC, to protect the investments of average American investors.

For most Americans, their primary investments are held in their pension plans, profit-sharing plans, and other qualified retirement plans. If the administrative rule of ERISA is allowed to defeat SIPC protection for the losses of individual plan participants, then SIPC fails to protect the investments of the average American worker, as Congress intended when it adopted the Securities Investment Protection Act, and created SIPC.

This, in turn, undermines the public policy of promoting savings and providing retirement security for average American workers through pension, profit sharing, and other qualified plans, as Congress intended when it adopted ERISA.

The FDIC offers a parallel for what we propose here. If a profit-sharing plan invested its assets in FDIC-insured deposits, even though the deposits were held in the name of the plan trustee, the FDIC would cover each plan participant up to the FDIC limits.

We were asked by a congressional staffer in the spring whether it's possible, as a matter of policy, to extend SIPC protection to cover the losses of individual participants of pension plans invested with Madoff, and not also extend such protection to individual investors of feeder funds who invested with Mr. Madoff. With great compassion for those individual investors, and great compassion for Ms. Langford, we believe that the answer is "yes." As a matter of public policy, a distinction can be made. Though we, of course, support any relief that can be given to the individual investors in feeder funds.

ERISA prevents individual plan participants from investing their retirement accounts directly in their own names. The situation differs for individual investors in feeder funds. They are not prevented by Federal legislation from investing directly in their own names, nor is their investment governed by the public policy of encouraging workers' savings, as embodied in ERISA.

For these reasons, if a distinction must be made on a policy basis, we believe it is possible to provide SIPC protection for the losses of plan participants of ERISA plans. Though, again, we do support relief for investors in feeder funds.

Thank you for your time and attention and consideration of this important legislation to extend SIPC protection to the claims of individual participants of pension, profit sharing, and other qualified retirement plans.

[The prepared statement of Mr. Green can be found on page 119 of the appendix.]

Chairman KANJORSKI. Thank you very much, Mr. Green. And now I turn to my colleague from Florida, Mr. Klein, to introduce the third witness. Mr. Klein?

Mr. KLEIN. Thank you, Mr. Chairman. It's my honor to introduce Helen Chaitman, who is a partner in Phillips Nizer, a limited liability partnership in New York.

She is the author of, "The Law of Lender Liability," is counsel to the Madoff Coalition for Investor Protection, which is a combination of a number of investors who lost assets in the Ponzi scheme, and has been someone who, I think, has had a fairly good crystalized view of the issue, and has been helpful to me and many

others in understanding the nature of what went wrong, and what should be done to resolve it. Ms. Chaitman?

STATEMENT OF HELEN DAVIS CHAITMAN, MADOFF INVESTOR AND LEGAL ADVISOR, MADOFF COALITION FOR INVESTOR PROTECTION

Ms. CHAITMAN. Thank you, Congressman Klein. Chairman Kanjorski, thank you so much for having me here. Distinguished Representatives, I thank you as well.

It was just about a year ago that I learned that I had lost my life savings and my grandson's college fund in Mr. Madoff's limited liability company. It took me a little bit of time to get over the shock and devastation. And when I did, I realized that I was one of the lucky ones, because I am still working and able to support myself. And I devoted myself for the next 6 months to working completely on a pro bono basis, helping hundreds of destitute Madoff investors in their 70's, 80's, and 90's, who had been hit by a financial tsunami from which they can never recover.

This committee has dealt with that financial tsunami in the Investor Protection Act of 2009. And I am not here to speak about that. But, unfortunately, the Madoff investors whom I represent—and I represent hundreds of them—have been hit by two additional financial tsunamis that this committee can do something about.

My client profile is a person in his 70's, 80's, and 90's who worked hard his whole life, and who trusted this government. Many of my clients served in the Second World War with distinction. I have clients who were disabled in the Korean War, and received medals for their service. They trusted this government, and they worked as honest, law-abiding citizens. They worked in professions, they built up businesses. And when they reached retirement age, they retired and they put their money in an entity that had been blessed repeatedly by the SEC.

Mr. Madoff bragged to potential investors that jealous funds had complained to the SEC about his results, and he had been repeatedly investigated, and always come out clean. These are people of whom we should be proud, and whom we should be protecting. And, instead, these people have been victimized by the government since December 11, 2008.

The second tsunami that hit my clients was the announcement by SIPC, with the blessing of the SEC, that the statute that this committee played a key role in drafting in 1970 doesn't mean what it says.

My clients relied upon the promise of SIPC insurance, as required by the Securities Investor Protection Act. They invested in Madoff, knowing that the first $500,000 in their accounts was insured by SIPC. They invested in Madoff, knowing that Congress mandated that, upon the liquidation of a broker, SIPC must promptly pay up to $500,000 by replacing securities in a customer's account.

The statute mandates how a customer's claim is to be determined. Net equity is clearly spelled out in the statute. It is clearly spelled out on SIPC's Web site, even today. And yet, SIPC has decided that it doesn't insure the first $500,000 in the accounts, it only insures the net investment going through generations of inves-

tors—because a lot of my clients are people whose grandparents invested in Madoff.

And what SIPC is doing is going back 3 generations to net out investments, and they are discounting inherited balances, unless the investor can come forward and prove how much the grandfather deposited into the account in 1970, a virtual impossibility. Nobody keeps records going back that far. And nowhere did the government put people on notice that, if they want to have an SIPC claim, they have to keep their records going back 30 and 40 years. So, the second tsunami was SIPC's defiance of net equity.

And we know from Mr. Conley's testimony, which was posted yesterday on the Web site, that the SEC doesn't feel it's bound by the statute. American citizens have to trust in the laws. If the statute gives them a promise of insurance, they have to rely upon that. And how can we, as a country, instill confidence in the capital markets if we don't stand by our laws, and if we fund a governmental agency which defies the law?

The SEC has now taken a position that people who delegate to their broker investment decisions don't get insurance, as defined by the statute. They don't get net equity. The SEC announced yesterday that they get their net investment plus some adjustment for the decrease in the buying power of the dollar over a period of 30 or 40 years.

Well, what's the purpose of this committee deliberating so carefully on a statute, if the SEC can then, after there has been a big loss, decide, "We don't think Congress got it right, and we don't feel we have to go back to Congress. We're going to decide what the law is." How can we make people feel comfortable that they are protected by this government, which they served and to whom they paid taxes, if the SEC, funded by taxpayer dollars, can thumb its nose at this institution?

The third tsunami that my clients have been hit with is that the SIPC trustee has taken the position that he can demand repayment of all withdrawals within the last 6 years, even mandatory withdrawals from IRA accounts on which people pay taxes, if the net investment going back for generations is a negative number?

So, let me give you one very simple example.

Chairman KANJORSKI. Time is—

Ms. CHAITMAN. My time is up?

Chairman KANJORSKI. Yes.

Ms. CHAITMAN. All right. You will have to look at my written testimony, then, for the example. Thank you so much.

Chairman KANJORSKI. If you want to state the example, we will take that.

Ms. CHAITMAN. Thank you so much. If my grandfather put $500,000 into Madoff in 1970, and he died in 2003, at which time the account was worth $3 million, and I took $1.5 million out of that account to pay the estate taxes, and then from 2003 to 2008, the account went from $1.5 million to $2 million, Mr. Picard would be saying to me, "Pay me back $1 million. Your grandfather put in $500,000, you took out $1.5 million to pay estate taxes, you owe me $1 million."

So my clients, who have lost their life savings, who were forced to sell their houses in a down market, and who are cherishing the

tax refunds that they have received as the only funds they have to live on for the rest of their lives, now are faced with giving up those monies in order to do what?

Nobody wants that. I, as an investor, never took money out of my account. And I, in theory, am the beneficiary of the clawbacks. I, and many of my clients who are just like me, never took money out, don't want this money. This is blood money.

These people are entitled to keep what they took out. Thank you.

[The prepared statement of Ms. Chaitman can be found on page 65 of the appendix.]

Chairman KANJORSKI. Thank you very much.

[applause]

Chairman KANJORSKI. The rules do not allow demonstrations. I appreciate it. I know this is an emotional time, so we will be a little lenient with the rules. But, really, that is not appropriate.

And now we will hear from our friend from Colorado to introduce the fourth witness. Mr. Perlmutter?

Mr. PERLMUTTER. Thank you. I appreciate the witnesses being here today, and the straightforward testimony that you are giving to all of us.

And I just want to lead with this: I think that we have four things that we have to consider. One of them actually is on the Floor of the House today. And the first is, where was the examination? Where was the investigation? Where was the oversight? And where is the prosecution of swindlers, crooks, bums, cheats, whatever you want to call them?

In Colorado, we had at least 3 in this last 8 or 10 years: Petters; Stanford; and Madoff. They victimized hundreds and hundreds of people in Colorado. Some of my closest friends and colleagues lost their life savings to one of these three crooks. And so, what kind of an environment led to these giant Ponzi schemes and frauds?

I would like to thank the chairman and the ranking member for bringing forward the Investor Protection Act, and some of the precautions and safeguards that are built into that, that we will hear on the Floor of the House today.

Now, the other three aspects of this, which is what this testimony and your—this hearing is about is the bankruptcy aspects and the clawback, the reach of SIPC to anybody who was swindled and victimized by this. And, finally, what tax ramifications are there. Can somebody take an immediate loss when they have been defrauded in this respect?

And so, we have today a constituent of mine and a friend, Mr. Pete Leveton, from Lakewood, Colorado. Pete is co-chairman of the Agile Funds Investor Committee, which represents over 200 indirect investors of Agile Group, LLC, a Colorado investment group. I have been working with Mr. Leveton and members of the Agile Funds Investor Committee for months, trying to develop remedies to the inequities between direct Madoff fund investors, and those indirect investors like the Agile Group.

The individuals invested with Agile—and, indeed, more than 15,000 individuals who invested in other hedge funds who also invested in Bernard L. Madoff securities—are ordinary folks who invested their life savings in what they believed to be safe pension plans, trust funds, and investment accounts. They did their own re-

search to determine the best investment group for their personal situations, and believed that groups like Agile best suited their savings plan needs. They trusted groups like these investors to turn investments into safe, legal funds.

Unfortunately, Agile and other investment firms like them were defrauded by Bernard Madoff, by Stanford, by Petters, and all of the savings in funds from these individuals was lost.

Under the law as written, direct investors of—except now with this net investment rule—from SIPC are eligible to recoup up to $500,000 on each investment account. But indirect investors are not.

Mr. Chairman, we have the opportunity to restore a piece of dignity to the indirect investors. Through no fault of their own, they lost their life savings and some are losing their homes. They were acting responsibly, in trying to plan and save for their future and retirement.

And I look forward to the testimony of Mr. Leveton today to describe some of the travails of the people in Colorado.

Chairman KANJORSKI. Thank you, Mr. Perlmutter.

Mr. Leveton?

STATEMENT OF PETER J. LEVETON, CO-CHAIRMAN, AGILE FUNDS INVESTOR COMMITTEE

Mr. LEVETON. Chairman Kanjorski, Ranking Member Garrett, and members of the subcommittee, as Congressman Perlmutter just said, my name is Peter J. Leveton. I live in Lakewood, Colorado, a Denver suburb in Congressman Perlmutter's seventh district. I am an unpaid co-chairman of the Agile Group, LLC Investor Committee. Agile was a hedge fund manager based in Boulder, Colorado.

Thank you for giving me this opportunity to testify on behalf of Agile's 205 investors, several hundred Ponzi Victims' Coalition indirect investors from more than 20 States, and by extension, all Madoff indirect investors who filed more than 11,000 SIPC claims on or before the bar date of July 2nd.

It is clear, from the statements that the Congressmen made earlier in this hearing, that you have a clear understanding of many of the issues, and I am going to try not to belabor those.

The indirect investors are not a homogeneous group. It includes farmers, doctors, teachers, lawyers, businessmen, entrepreneurs, and other hard-working Americans who have, over a period of years, diligently saved for their retirement.

Many of us are your constituents. Many of us are now devastated financially and psychologically. Many of us have sold or are trying to sell our homes, just to obtain money to live on. Many of us are retired. Some indirect investors have had to beg for support from our siblings and our children.

Discrimination is not a word that any of us in this room would use lightly. However, because only direct investors are considered SIPC customers, discrimination is exactly what indirect investors are facing—clearly not Congress' intent when it passed SIPA and created SIPC in 1970.

Pursuant to the current interpretation, direct investor victims who knowingly invested with Madoff have an opportunity to recoup

up to $500,000 for each of their accounts. Indirect investors—many, maybe most of us—had never heard of Bernard L. Madoff until it was too late. We are not considered customers. We will recoup zero. I ask you, where is the justice in that kind of an interpretation?

Because the SEC has admitted extreme culpability in missing the warning signs of the Madoff scam and others, and because the IRS essentially endorsed Madoff in 2004, by naming his firm as a non-bank custodian of IRAs and other tax-deferred retirement accounts, we believe that Congress has a duty to ensure that equal SIPC relief be provided to all victims, not just some victims, as is currently the case.

The concepts outlined in the Maffei-Ellison amendment would be a wonderful solution if it were expanded to include all indirect investors. Unfortunately, it addresses only ERISA plan victims, and excludes thousands of other indirect victims, including those in self-funded retirement plans, such as IRAs. I ask you again, where is the justice in that kind of an approach?

We see no moral basis for Congress to amend SIPA to provide customer status to a relatively small special interest group of indirect investors in ERISA plans, and exclude all other indirect investors. We indirect investors lost our savings to the same fraudulent Ponzi scheme, suffered the same financial devastation as the ERISA plan members, and the direct investors.

We firmly believe that Congress should end this discrimination, not perpetuate it, as the present draft of the Maffei-Ellison amendment would do, if passed as-is. We urge Congress to enact legislation which clearly defines SIPA customers as all investors who place their money in SIPA-protected Ponzi scheme operations.

With regard to the proposed clawback amendment, we endorse an amendment that prohibits clawbacks from investors who withdrew their money in good faith, and can prove it.

With regard to the 60-day payment amendment, we agree that SIPC payments should be based on the customer's account balance as of their last statement—again, assuming that they did not know, and had no reason to believe that the Madoff operation or other Ponzi schemes were fraudulent operations.

Regardless of what processing period is determined to be reasonable, we suggest that strict parameters and guidelines be established, and that SIPC be required to—and be held accountable for meeting those standards and guidelines.

In closing, I suggest that this could happen to you. As Congressman Perlmutter mentioned, it did happen to one of the Agile investors who was a previous Member of Congress. We look to you and your colleagues to carry out Congress' original intent to protect all investors when it enacted SIPA, and to help us recover a portion of our tax-deferred retirement account losses.

Thank you again for the opportunity to present these matters. I would be pleased to answer any questions that you may have.

[The prepared statement of Mr. Leveton can be found on page 133 of the appendix.]

Chairman KANJORSKI. Thank you very much, Mr. Leveton. And now we will hear from our friend from New York, Congressman Maffei, to introduce the next witness.

Mr. MAFFEI. Thank you very much, Mr. Chairman, for holding this important hearing. And thank you especially for allowing those of us from other subcommittees to sit in. Just listening, I want to thank all of the witnesses.

And, Mr. Leveton, I assure you we will be—I'm sure Mr. Ellison and I will be discussing with Mr. Perlmutter and others your suggestions. We are informed by the plight of our own constituents, and don't necessarily know all of the different aspects of this.

And to represent some of the folks in my constituency today, I am very pleased to introduce a very good friend of mine, Greg Lancette, the business manager for the Plumbers and Steamfitters Local 267 in Syracuse, New York.

Mr. Lancette has served as chairman of Local 267's jointly administered multi-employer trust fund since 2005. He is also the president of the Central and Northern New York Building and Construction Trades Council, representing 16,000 pensioners and their families from other unions in central New York.

Mr. Lancette, thank you for coming to speak with us. I look forward to hearing your testimony.

I also want to thank Local 267's counsel, Michael Herron, for also coming down from snowy upstate New York to be with us here today.

The Plumbers and Steamfitters Local 267 pension fund suffered serious losses because of the Madoff scandal. While the headlines have been full of wealthy and prominent investors who lost money in the Madoff Ponzi scheme, the pension funds of approximately 60,000 union workers and retirees in central and upstate New York were also exposed, and suffered grave losses. Central New York unions lost at least $350 million. And as Mr. Lancette, I'm sure, will tell us, Local 267 lost approximately $37 million.

It is important to help these hardworking men and women recover some of the funds they have lost. While the Investor Protection Act could have provided the means to do that, I urge the chairman to continue working with me and others on the committee to address these issues after regulatory reform has passed the full House.

Currently, the Securities and Investor Protection Corporation, SIPC, is allowed to advance only up to $500,000 per fund, not $500,000 per individual in a pension fund. Funds meant to support the retirement of hundreds of thousands of retirees are only eligible for the same investor protection as one person.

This makes no sense. And that is why I have introduced an amendment to help workers and retirees whose pension funds were exposed to recover that money.

I especially want to thank my colleague from Minnesota, Mr. Ellison, for working with me and others to get relief to the innocent workers, retirees, and business people who have become Madoff's victims.

Again, I want to thank the chairman for holding this very important hearing, and Mr. Lancette for sharing his story with us.

Chairman KANJORSKI. Thank you very much, Mr. Maffei.

Mr. Lancette?

STATEMENT OF GREGORY LANCETTE, BUSINESS MANAGER, PLUMBERS AND STEAMFITTERS LOCAL 267 OF SYRACUSE, NY

Mr. LANCETTE. I would like to first thank Chairman Kanjorski, Ranking Member Garrett, and the members of the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises, and Representative Maffei, for having me here.

As you heard, my name is Gregory Lancette. I am currently the business manager of the Plumbers and Steamfitters Local 267, Syracuse, New York, and chairman of the jointly administered multiemployer trust funds. I have served in these capacities since 2005. Local 267 is a chartered local union of the United Association of Journeymen and Apprentices in the plumbing and pipefitting industry in the United States and Canada.

I am here today on behalf of not only my 1,115 pension participants and their families, but I also stand here today as president of the Central and Northern New York Building and Construction Trades Council, which represents nearly 16,000 pensioners and their families, also from central New York.

Today, I would like to discuss the direct relationship between SIPC and Bernard Madoff's Ponzi scheme. SIPC today provides coverage to individuals with an individual limit of $500,000.

But my members' pension investments have no real coverage. Because my members, like millions of workers across the country, rely on pooled investments for their future retirement, SIPC coverage does not currently protect them.

The Local 267 benefit funds first invested with Madoff Securities in the mid-1990's. When I was elected in 2005, the Madoff investment was approximately 30 percent of our pension fund. We received regular confirmations that our money was invested in S&P 500 companies. While the return on the account slightly trailed the S&P 500 index, we were assured that the strategy offered adequate diversification and lower volatility. We believed that the U.S. securities market, monitored by the Securities and Exchange Commission, provided protection for our members.

Plumbers and Steamfitters Local 267 benefit funds, at the time of Madoff's arrest, had a market value of approximately $34 million invested with Madoff's direct brokerage.

Also, Local 267 had $6.5 million invested with Beacon and Associates. Beacon is a fund consisting of a basket of investments which was comprised of up to 40 percent of total assets invested in Madoff.

Under the current formula of SIPC reimbursement, Local 267 will receive $500,000 for the Madoff direct account. The reimbursement for the Beacon account will only be approximately $900, due to the fact that the amount of Local 267's portion consisted of only 1.8 percent of Beacon's total assets. To summarize, Local 267's pension lost almost $37 million and is expected to recover $500,900 from SIPC.

As the chair of the board of trustees of benefit funds, I am regularly solicited by investment managers seeking to advise the funds. Our collective funds pay hundreds of thousands of dollars in fees each year. The securities industry welcomes our collective investments, and should be prepared to provide adequate SIPC coverage in the event of a fraud.

I must take a moment to reiterate that the only reason why I am here today is that we had money invested with Bernie Madoff. Mr. Madoff has stolen billions of dollars and the Securities and Exchange Commission failed to recognize this criminal behavior, even after investigating him half-a-dozen times.

The reason behind the proposed amendments regarding SIPC treating each pension as an individual investor is that pension funds would be made closer to whole. To compare with what is currently being paid back to pension plans in central New York currently, if all 30 funds received $500,000 reimbursement from SIPC, a total of $15 million will be returned to the central New York area, compared to nearly $350 million in losses—$15 million returned, $350 million gone.

To further illustrate Local 267's pension loss of nearly $37 million, that equates to approximately $33,183 per participant. This protection of pooled investors would not be unique. Similar pass-through account protection is available to individual account retirement plans with funds in the FDIC-insured banks.

The portion of the amendment that would require SIPC to reimburse within 60 days would benefit all plans in many ways. This would be accomplished by either returning assets to invest, or to pay benefits to retired members.

Numerous pension and health funds that were affected by the axe of Bernie Madoff are facing insolvency. The Securities and Exchange Commission was not able to identify the fraud that took place in a timely manner, which resulted in much more significant losses as the criminal act progressed.

The Pension Protection Act of 2006 requires pension funds to amortize debt in a 15-year period. I would ask for consideration or relaxation of the Pension Protection Act, allowing a pension plan to amortize the Madoff-related losses at a 30-year rate. That would help ensure pension stability. The plans could recover naturally, instead of the plan solvency being jeopardized, which may ultimately result in the plan being turned over to the Pension Benefit Guaranty Corp.

In summary, I strongly urge the consideration for multiple investor groups or participants in multi-employer ERISA plans or any multi-employer investments to be considered as an individual investor, and that SIPC be funded to operate and reimburse in this manner.

I also strong urge that pension plans be allowed the proper time frame before the Pension Protection Act to amortize losses.

Thank you very much for your time.

[The prepared statement of Mr. Lancette can be found on page 128 of the appendix.]

Chairman KANJORSKI. Thank you, Mr. Lancette.

And next we will hear from Mr. John Coffee, the Adolf A. Berle professor of law at Columbia University Law School. Professor?

STATEMENT OF JOHN C. COFFEE, JR., PROFESSOR OF LAW, COLUMBIA UNIVERSITY LAW SCHOOL

Mr. COFFEE. Thank you, Chairman Kanjorski, also Ranking Member Garrett and fellow Congressmen. I am pleased to be here, but disappointed that on this first anniversary of Mr. Madoff's ar-

rest, the Federal Government has done so little, so very little, to prevent the recurrences of future Ponzi schemes.

Ponzi schemes are predictable. They appear to cost American investors, on average, something like a billion dollars a year. Before we even heard of Mr. Madoff, in 2002, the Ponzi scheme losses in that year alone were $9.6 billion. So this is not a trivial problem, it's a recurrent problem. And I think it will continue, as long as the government persists in allowing investment advisors to be their own custodian.

I will put this just in a sentence, because it's not the topic today, but mutual funds have to use an independent custodian. So do hedge funds. Investment advisors are permitted by—under the Investment Advisor Act rules to use a self-custodian. That is, Mr. Madoff used his own brokerage firm. That means his own brokerage firm, Madoff Securities, was serving as the watchdog of Bernie Madoff, the investment advisor. When you are your own watchdog, nothing works.

The SEC has made some modest efforts this year to discourage the use of self-custodians, but they have already backed off, under industry pressure. We need a true watchdog over investment advisors, and that can only come from requiring an independent custodian.

That's not the topic today, so I will move on to the Securities Investor Protection Act. Here, I want to make three suggestions. All of them involve compromises, all of them involve line-drawing, and all of them will be painful. But I think we have to make some compromises, because insurance is costly, and we can't insure all investors to the full extent of their losses.

So, every member of this panel has told you that the definition of "customer" under the Securities Investor Protection Act is too limited. I agree that you can expand it. It's understandably limited, because if we cover all indirect investors, this system will collapse. CalPERS alone has over $700 billion in assets, and that's just one customer. And there were larger, private pension funds.

But in looking at who to protect, I think we should look at the continuum of injured victims, and see who has been the most injured, and is the least able to protect himself. In my judgement, using two criteria, I think that is the pensioner in smaller pension funds. Such pensioners suffer the most concentrated loss, because they are losing their retirement security. And smaller pensioners can do nothing to guard their own interests, nor do small pension funds have any in-house capacity to monitor. What they do, instead, is they hire someone like Madoff to be their investment advisor.

So, on that kind of criteria, who suffered the most concentrated loss? Who is least able to monitor and protect himself? I would think the first category that you might think of including, were you to expand the definition of "customer" under SIPA, would be the smaller pension fund, both Taft-Hartley funds, public funds, and private employer funds. But only, I would suggest, defined contribution plans, because that's where the loss really falls on the individual pensioner, and not on the corporate employer who is contingently liable.

I think you can feasibly define "customer" to include smaller ERISA plans, but you will have to put some financial limit on it. That will be painful. And I'm not going to tell you what that number should be; that's a question for the actuaries.

Second point, equally controversial—and you have heard from everyone else already—this is clawbacks. The SIPA-appointed trustee, both in the Madoff case and earlier cases, like Bayou Funds, will use the fraudulent conveyance actions under the Bankruptcy Code to go after those people who received very large distributions within the statute of limitations.

This morning's Wall Street Journal estimates that Irving Picard will eventually bring suits seeking a total of $15 billion from people who received distributions within the statute of limitations. That's $15 billion against total losses that Mr. Picard estimates of roughly $19 billion.

In other words, fraudulent conveyance statutes have the capability of restoring as much as 80 percent of the investors' total losses. That's not to say he will get the 80 percent, but he has the capacity to sue for 80 percent of these losses. Maybe if he brings these suits, maybe he will get 25 percent, 30 percent. That's how litigation usually settles. But even $5 billion dwarfs any other source of recovery that the injured investors will receive.

Therefore, I am advising you that you should be very careful before you disable the trustee and cut off his effort to restore these alleged fraudulent conveyances and put them in one common pool for the benefit of all investors.

The language that has been offered, the language that says that you cannot bring a fraudulent conveyance action unless "the customer did not have a legitimate expectation that the assets in his account belonged to him" is really language that I, as a law professor, believe means you're going to have to show that this person was a co-conspirator of Madoff before you will be able to bring a fraudulent conveyance action. That would reduce this recovery from $15 billion, in my judgement, to well under $1 billion. Be cautious about stopping the trustee, going against the largest source of recovery.

That doesn't mean you can't do something. Again, this is a matter of line-drawing. I would suggest we start with, who are the victims who might be most injured by fraudulent conveyance actions? I would focus here first on charitable organizations.

In fact, the Bankruptcy Code, if you look at section 548, which is the section that principally deals with fraudulent conveyances, has long given an immunity against fraudulent conveyance actions to charitable contributions. Now, charitable contributions are not at issue here. They are usually what's at issue in fraudulent conveyances. Here, these are charities who had an account. They are trying to get their own money back, rather than hold on to a charitable contribution.

But the principle is there. Congress has recognized in the past that charitable organizations are a special category, and I would suggest that if you're going to do anything in the field of cutting back on fraudulent conveyances, you extend the immunity of charitable organizations beyond simply the contribution, and say that a charitable organization cannot be sued for fraudulent conveyance

unless it can be shown that either: (A) they had actual knowledge of the fraud; or (B) the charity was established by, in effect, the crook himself.

Let me say one last word about fraudulent conveyances. No one has explained their purpose. They go back to the time of Queen Elizabeth. They have been around for a very, very long time. And they serve one fundamental purpose: They prevent the crook from choosing the victims who will bear the loss.

If we don't have fraudulent conveyance statutes, a crook at the 12th hour can still decide to permit some victims to recover by hinting to them they should redeem, and letting other people bear the loss. If we don't have fraudulent conveyance statutes, we're going to create very strong incentives for the crook to, in effect, direct who will be the real victims and who will be the token victims. I don't think you want to do that. I don't think you really want to stop Mr. Picard.

I think you can use a statute that has a different language, a recklessness test. Today, anyone who is sued in a fraudulent conveyance has a good faith defense under the Bankruptcy Code. The case law has construed that to mean that you have to show not just subjective good faith, but that you have the good faith of an objective reasonable person. It's a negligence test. You could soften this down to a recklessness test, as I suggested in my prepared testimony.

I think my time has expired. The last sentence I will say is I want to congratulate you, Mr. Chairman. For the first time, Congress, in your section 511, is trying to move SIPC from being a rather strange non-insurance system to a true insurance system that will charge risk-adjusted premiums. You want to charge risk-adjusted premiums, because otherwise good brokers are subsidizing crooked brokers. We can't have everybody pay the same amount. We want the riskier broker to pay more.

On that note, I will stop.

[The prepared statement of Professor Coffee can be found on page 89 of the appendix.]

Chairman KANJORSKI. Thank you very much. And I want to thank all the witnesses for their testimony. Each and every one of you have told a compelling story on its own.

And any of the questions, particularly mine—I am going to be sort of a devil's advocate, if you will, and not intending to downplay your sufferance, but trying to get to some of the core issues that we are going to have to decide. I think the professor clearly laid it on the line. This is not an absolute guaranty program.

And so often we run into, whether you are a victim of a fraud or you are a victim of the market, people want to be made whole. That's a natural human instinct. Our problem is that, with the crisis that we have just gone through for the last year, depending on who makes the estimations, the loss in the United States was somewhere between $7 trillion and $14 trillion in capital.

And if you had been an investor in one of the major banks in the United States that went from $50 to $2 a share because of maybe bad judgement, perhaps investments in the wrong area, or some people would even say potential fraud or participation in fraud—we do not know; that has never been proven—but that would have

been a great disappointment. It would have been the temptation of every shareholder to say, "I want to be made whole at the price I either got in at," if it were above $2, "or the high price, because I was counting on that for something." Obviously, it was their savings or their retirement.

Well, that is not a bad argument. I cannot fault you for having it, but I sort of would pose the question, who among us in the population will turn over the assets of their homes, their pension fund, their bank accounts to their fellow citizens to make them more whole? I do not see a long line out here in front of the Capitol. They have not shown up for this testimony to suggest that they are willing to provide their fair share of your loss. And I doubt that they will.

Our system—and our decision, it seems to me—will go to the question of, is it intended that we have a system that has no risk? And that may not be the worst system in the world. But if we are, then we really should not have pension funds with investment advisors. We could have a governmental pension fund we would pay into, and somebody would then lend that money to the U.S. Government at a guaranteed rate. An investor would get very little upside, but also very little downside.

If an investor wants to enjoy the benefits of the capital system, the free market system, and its extraordinary upside, there are risks to the market. One may say, "But I did not lose my money in the market; I lost it to a fraud." That is part of the market. I mean, caveat emptor is still a principle, I believe, Professor.

It may be vicious. It may be because an investor did not even understand or know who was investing his/her money. But there is no way in the world he can say it was the government's responsibility. Our system does not say that. Our system says it is each individual's responsibility to protect his or her assets as they will.

I was here when the Enron disaster occurred. And their people had invested their life savings in their 401(k)s that absolutely disappeared, almost overnight, to the tune of hundreds, if not millions of dollars. And we were all sorry for them. But they had to take their licks. That was the problem, that is our system. Not the best—well, I still think it is the best system in the world. Not a good system, if you are on the losing side. If you are on the winning side, it is absolutely the best that was ever constructed.

Our problem is, how do we lessen the impact on everyone? Well, we just cannot, it seems to me, guarantee everybody is insured, or everybody is guaranteed their return. I do not know how we do it. I do not see how our system would afford that opportunity.

If we were to tax the payment of the loss of $14 trillion in capital, just for the last recession, what would it be per head? Who is the mathematician on the board? It would be extraordinary, the amount of dollars every individual American would have to come up with to make some of our fellow citizens whole.

Probably all of us have lost in some way. You, in particular, have lost a great deal. There is no question about it.

Now, what do we do? We have done several things. We have now provided changes in the Investor Protection Act that will require more in-depth investigative processes, that the SEC have a stronger chain of command, that information go up the information lad-

der and the leadership ladder at the SEC. Our future legislation will help future thinking on all of these things. There is not an awful lot in there that is going to make you whole.

Can we come up with some equitable position? Going particularly to Mr. Maffei's witness, the pension fund is a tough situation. But if we were to honor $500,000 per pension member of the pension fund, we would soon end the Guaranty Corporation. We just do not have the funds in there to do it.

I do not think that was ever the intent. I think we probably have to have much more lively—and I think it will result, probably from the experience that we have all had—we have to have closer eyes on the subject. Do we force pension funds to do certain things with the assumption they will be able to carry them out correctly, and they probably cannot in certain instances?

Those individuals who did not know that Madoff even had a touch on your funds, that is a tragic thing. But it is the responsibility of each individual to find out.

I will leave with this. My time has expired. But if you think in terms of real estate, you can go out and buy a $500,000 home. And you can buy it from your lawyer, your doctor, your minister, your priest, your rabbi, or your friend. And if you are not smart enough or clever enough or sensitized enough to have it searched out, then that individual has title to your home, and you buy the home and you pay your money and then you find out that the person who purported to be the owner did not own it, then it is lost. The government cannot be sued. You cannot hold anybody else responsible. It is important to search out the ownership of title.

What difference is that in a pension fund, in terms of who is handling the pension fund, who is making the investment? It is really the same policy.

Certainly, our hearts go out to someone who pays $500,000 for a home that they do not own and cannot live in, as our hearts go out to those people who lose their life savings because of a fraud perpetrated by someone who appeared to have all the indicia of respectability.

But the Federal law doesn't provide that, because a company has to register with the SEC, and the SEC is supposed to test out and investigate, it doesn't say that it guarantees that the SEC has eliminated all frauds. We cannot afford to do that.

In some respects, if we look back historically, it is a lot better today than it was in 1929. I hope it is going to be a lot better tomorrow, when we pass the new reform regulatory bills than it was a year ago. But it is not going to be perfect. We are not going to accomplish that end. And those of us who have the desire or wish are going to be grossly disappointed.

I am not going to ask any particular questions, because I have exhausted my time. But we wanted to have this hearing today because so many of the fellow members of the committee have expressed their thoughts on the subject of the losses of their constituents. They have suffered. They are looking for a remedy. And the commitment, as chairman of the subcommittee, that I have made to them is that we are going to work as hard as we can to close some of the holes, some of the weaknesses in the system.

But I just want to caution you all, we are not going to solve and create a perfect system. You may not be happy with the end result, because the possibilities and the exposures to the government and to the people are far and above what we can possibly provide as protection.

So, we will work toward getting equity and fairness. But as the law professor will tell you, there is no equity, and there is no complete fairness in this world.

The gentleman from New Jersey, Mr. Garrett.

Mr. GARRETT. Thank you. There may not be fairness. What we can try to do, I guess from the government's perspective, is to make sure that there is justice, however.

[applause]

Mr. GARRETT. No, no, no, no. You will use up my time. We need to strive in order to get justice. And I do agree that, at the beginning of the day, everyone should be held accountable for executing their own due diligence in their investments, right?

And part of that due diligence, as Professor Coffee would say, changes from who you are. If you are the proverbial little old lady, at one level. Conversely, the union official who might have more resources than the little old lady would be at a slightly different level to a fund of some sort, or an association somewhere in between those.

So, the level of due diligence is going to vary. But we do expect in this country that everyone exercises due diligence. And to the extent, then, that due diligence doesn't work out as far as investments going up and down, that is your responsibility.

Added to that, however, is when that due diligence is in reliance on the government in certain areas, then that is a responsibility of the government to come forward. So when you do your due diligence, as Ms. Chaitman is saying, looking into the SEC, has the SEC done their job, well, you are appropriately relying on the SEC to do their job. And when you look to—that's before the fact, right? And after the fact, you should be able to look to SIPC to do their job, because they are quasi-government entities.

See, this is a whole issue. There is a bill on the Floor this week, today and tomorrow, which, in essence, does what occurred here. It creates what I will call a moral hazard, if you will, by relying on the government, as you did, because the government says, "We are going to protect you with the SEC." And so, you have a right, then, to rely on that. Maybe you would have done more due diligence if it wasn't out there, but we told you that you can rely on it. So you did. And that's right. You should.

Also, we set up the SIPC and said, "You can rely on it." And you did. Had we never set those things up, you may have made other investments, or made other decisions. But because we set those entities up, now we have created a different investment strategy—a decision is what we call moral hazard.

And the bill that we're going to be voting on, just for your information, today and tomorrow, expands those involvements or intrusions or activities by the government so you in the future maybe even say, "I can be more reliant on the government and less on due diligence," which I think is not a good thing.

For example, one of the comments from one of the people that I entered into the record said, with regard to clawbacks—and let's do a quick show of hands. If I understood the testimony, everyone except for Mr. Coffee, on this panel, believes that we should not have clawbacks. Is that correct? If you're in favor of clawbacks potentially, in any one shape or form or another, as Mr. Coffee—okay, and I understand that.

But one of the testimonies was—a letter I entered into the record from a gentlelady from Bergenfield said, "Indeed, any clawbacks, if we're going to have them, should begin with the SEC," and clawing back from the SEC because you were in reliance upon them, and maybe we should be clawing back from them.

And that's why I gave my opening comments, that we're not asking much from them in the bill that's passing tomorrow. In fact, we are doubling their salary and their authorization, and saying, "Hopefully in the future you will make some changes. But we are going to increase it."

So you might just want to take a look at what's coming down on the Floor tomorrow and today, because we are really not asking for those things, what I think we should be. We should be holding them accountable for what they did wrong in the past, and holding the people particularly accountable for the failures that they made. And before we give them any more money, we should be making sure that they make some changes.

Now, Ms. Chaitman, you said—just to get into the weeds on one little—not a little point. But in one point in some of the material you supplied us with, you said that the trustee—and correct me if I'm wrong—the trustee and SIPC are running administrative expenses of approximately $100 million per year. But Mr. Harbeck says, in his testimony, that the trustees have only paid $1.2 million so far. Can you—

Ms. CHAITMAN. Well, I think I can—

Mr. GARRETT. —clarify that? Yes.

Ms. CHAITMAN. Yes. The trustee's legal fees have been approved for the first 15 weeks at the rate of $1 million a week. He then filed an application for another 23 weeks, and he is running again at $1 million a week. So, if you project that for a year, it would be $50 million a year.

And Mr. Harbeck has said publicly that the non-legal fees, the forensic accountants, etc., who were going back through generations to figure out the net investment—which, of course, is not required by the statute—Mr. Harbeck had said in the press that those expenses are running at the rate of $1 million a week.

Mr. GARRETT. Right. So it's one of those cases that's a typical—I see my time has come up already—cases where there is almost an incentive for—and I'm not saying that there is; I'm just—on the face of it, there is an incentive for things not to move at an expedited basis, because you have a pretty good fee there that's guaranteed to be paid for the period of time—

Ms. CHAITMAN. There is an inherent conflict of interest in the way the statute is set up.

Mr. GARRETT. Yes. And if I can just—I just want to make one statement, that we—some of these aspects are—may have impacts

upon getting more fees in, may have impacts upon broker-dealers, of course, right?

And we did suggest to SIFMA that they might want to come and testify, or at least be at the hearing today. They declined to do so. So we would certainly like to hear from them at some point in time, what they see as the impact.

Because if you want to do—and I think I'm on board with where most of you are—and, Mr. Coffee, I understand if you want to go where you need to, and I will close on this—we have to be really tight in that language. Because what you don't want to do is to come up with language that—and I'm a lawyer too—has any wiggle room in it that then puts somebody here on the spot, that they even have to go out and go to the aggravation of hiring a lawyer in a—where they really shouldn't have to go through that aggravation. And I think you probably would agree that you want to be able to draw that line clearly enough so that they would not just have mass lawsuits under this thing, that it would just be very targeted.

And I would think that target would be very, very limited as to ones that the government has any evidence whatsoever on, that there is—or even was—potential for collusion, whether it's family members or other business associates or just something like that. Is that where you're going on that?

Mr. COFFEE. The charitable—

Mr. GARRETT. Not the charitable—well, maybe the charitable, but just for any of the other lawsuits that they would potentially—

Mr. COFFEE. I think you could move from the current good faith defense, which is based on a reasonable person—

Mr. GARRETT. Right.

Mr. COFFEE. —to more of a recklessness standard. That would make it somewhat harder to recover under a fraudulent conveyance statute.

Mr. GARRETT. Yes. You just don't want an overly zealous SIPC going after people and saying, "Well, now, we have a reckless standard, and we're going to still go after people who"—

Mr. COFFEE. I understand.

Mr. GARRETT. Because I know how—

Mr. COFFEE. I just remembered that Mr. Picard is suing on behalf of small investors. There is no villain here. This is a zero sum game between some large investors and the smaller investors. And I hope he is able to recover a good deal from some of those larger investors to benefit the smaller investors.

Mr. GARRETT. But remember, some of those are not villains. I would assume the vast majority of them are not villains either, right?

Mr. COFFEE. They could have been reckless, however.

Mr. GARRETT. They could have been reckless. But if they're not villains, then you have to make that case. And we don't want to have the other people be swept into that, and incur the expense—

Mr. COFFEE. If you're simply negligent—

Mr. GARRETT. Right.

Mr. COFFEE. —you don't get the good faith defense.

Mr. GARRETT. I agree with you on that. Thank you, Mr. Chairman.

Chairman KANJORSKI. Thank you, Mr. Garrett. We will next hear from the gentleman from New York, Mr. Ackerman.

Mr. ACKERMAN. Thank you, Mr. Chairman. We don't really know the full extent of the number of victims. What we do know is that the first victim was the public trust, the trust of people in their government, the trust of people in us, the trust in the system that we set up that they believed would protect them and have every reasonable right and expectation that it was going to.

We know the number of claims that have been filed. We know the number of people who have been named. We know the number of entities that are on the list. But as we can see from just one local union, that they are named as a victim. But a lot of these groups, organizations, trust funds, investment groups represent thousands and thousands and thousands and thousands of Americans, some of whom think they are very lucky, because they have no stake—or had no stake—or investment in Madoff. But they do.

A lot of people don't understand this issue. And they don't look sympathetically at the victims, because these are people who they think had more money than they did, who didn't do due diligence, who were getting a high interest rate, and therefore they should have known better.

This is part of what we usually call blame-the-victims mentality, that it's the victims' fault that they're in the predicament that they're in, where nothing could really be further from the truth, because there is no way—show of hands. How many of you knew Mr. Madoff? Only the person who is not a victim.

[laughter]

Mr. ACKERMAN. Not one of the other people who are victims knew Mr. Madoff. That's the problem. How could they do due diligence? They relied on their government to do due diligence. Maybe we should take away the right of the government agencies to do due diligence, and pronounce people like Mr. Madoff, or even people not like Mr. Madoff, free of sin, crime, culpability, ill intention, incompetence, or anything else.

Maybe we should let the little old lady from Peoria be able to do due diligence and go and personally audit Mr. Madoff. Every citizen should be able to do due diligence, if that's what the American people think. How do we do it?

Well, we do it by doing what we did—obviously, not effectively enough—by empowering government agencies and entities and people with badges to go in and investigate and make pronouncements that other people trust. That's what we do in a sophisticated financial system, in a civilized society such as ours. Everybody can't investigate everything. You don't have a right, the way the system stands.

And the only people who think in the blame-the-victim mentalities are people who are not victims, because they think they were lucky. And some of them were not. There are so many victims here that we don't even contemplate right now, because you put money in your bank and your bank invests through a brokerage and puts money in something safe. And we know the first line of defense, because those are all public, if your bank invested in Madoff.

But if your bank invested in a brokerage which went through somebody else and they invested in Madoff, so many other thou-

sands of people may lose money that we're never going to hear of, in the end. And the system loses all this money.

Obviously, there is not enough money in this insurance fund that people thought that they had to make them whole to the extent of at least $500,000, those people who had that much money, whether it was the initial investment or money that grew to that amount or greater, but really didn't.

We have a mess on our hands. First of all, we have a large group of American investors who were first robbed by Mr. Madoff, abused by the government and the system into thinking that they were insured, and they were not. They were then devastated by the IRS if they paid taxes on the money that they thought they had.

They didn't have the investment returns, and the government then robbed them by charging them tax that they can only go back a few years and not the full 13, as some of us have proposed, to get the tax back that the government illegally robbed them of.

And then, so many of them are now being raped by the clawback provision for reliably, understandably thinking that they had this money in their account that they didn't have in there, and then they spent to live on, because that's what it was for.

I have met people who have contempt for the victims, because they should have known better. How?

You know, I represent the North Shore of Long Island, the base from where Mr. Madoff operated, the country clubs that he belonged to. And thousands of people who thought they were lucky to know such a nice man who was so reliable, received all the accolades that society can heap upon an individual, who is making a company and returning investments and interest to people for so, so many years.

These are the people who thought they were lucky. And they were probably the unluckiest people of all. Besides having fallen into the categories that I named, they were further ripped apart because they personally knew this guy who they thought was this wonderful human being, and how lucky were they. And now they are personally, personally devastated because of the abuse of the relationship, in addition to all of that.

So, for those people who look upon the victims and say, "I'm lucky I'm not there, and they should have done better, and how smart am I, and how stupid are they," they really don't get it. And some of them are involved in this fraud personally, and with their finances, as well. We have to be able to somehow do better.

I think it's interesting—and I see that my time has expired also—that so many of us have such strong opinions. Maybe that's because almost everybody on the panel, or most of us at this hearing today, have actually selected witnesses that—myself included—appear before us today, so that we understand who the victims really are.

But keep in mind that what we have to do is try to fix the system so that it makes sense, and brings the things that I think we all know. We can't treat everybody equally. We have set people upon themselves, against each other like a bunch of piranhas, because of whether or not they needed to live off their interest, or were able to continue working so they didn't need to live off the interest. Which group is luckier? It behooves us to figure it out.

I think that, despite the fact that this is the more marketable, I would call it, of the panels for the American people to understand what happened, but I think we're going to have a lot more questions of the next panel, Mr. Chairman. I think we all look forward to hearing from them.

I thank the people who have come here today and shared their tragic stories with America, and to keep in mind that we all bear some culpability here in this situation in which we all find ourselves. And I yield back the balance of my time.

Chairman KANJORSKI. Thank you very much, Mr. Ackerman. I just want to throw out the figure I mentioned. If the loss that we have just suffered in the last recession—or in this recession—$14 trillion, it would break down to $46,666 per man, woman, and child in America. And bear in mind what that would mean if we try and make up for everybody's losses and everybody's failings who has been in the system.

That money was lost by a lot of people in a lot of different ways, some through fraud, some through error, some through bad judgement. I just wanted to throw that out. Even if it's half that, it's $23,000 per man, woman, and child. That's a lot of money.

Let's see, Mr. King of New York.

Mr. KING. Thank you, Mr. Chairman. Again, I want to thank the witnesses.

Mr. Coffee, I don't want to relive the anxiety of being back in law school class and debating the professor, so I will ask my question in a very respectful way. But my question is for you and for Ms. Chaitman, primarily.

I agree with the overriding principles that you are enunciating. But we also have competing principles. To me, one of the main purposes of SIPC is to maintain consumer confidence, to encourage people to invest, to give them at least some reasonable assurance that they're—if they invest in good faith, if they do use reasonable diligence, that their investment will be protected. If the stock collapses, that's part of the game, you lose.

Now, when I look at the SIPC Web site, you know, it states the SIPC mission: "When a brokerage firm is closed due to bankruptcy or other financial difficulties and customer assets are missing, SIPC steps in as quickly as possible and, within certain limits, works to return customer's cash," etc. "Without SIPC, investors of financially troubled brokerage firms might lose their securities or money forever, or wait for years while assets are tied up in court."

And it does have the caveat on there, "within certain limitations," but then the next sentence goes on to say, "Although not every investor is protected by SIPC, no fewer than 99 percent of persons are eligible to get all their money back." So, we have the government implicitly stating that if you play by the rules you will be protected.

And so, when we have people who have played by the rules, it appears to me that we have a trustee who seems to be taking—is trying to make villains. Whether he calls them villains or not, the fact is he is creating one category of villains and one category of victims, when 99 percent of these people are all victims.

And so, I would ask you and Ms. Chaitman how you—let me just ask the question, first question. Are either of you aware of any in-

stance in which SIPC has defined net equity the way the trustee is doing in this case? Mr. Coffee, and then Ms. Chaitman?

Mr. COFFEE. Do you want to go first, or—

Ms. CHAITMAN. Yes, I would be happy to. I can assure this committee that there has never been a case in a SIPA liquidation where SIPC or the SEC has taken the position that SIPC does not have to comply with the law. This is the first time in SIPC's history that SIPC has taken the position that net equity, as defined by Congress, does not apply to SIPC.

Mr. KING. Professor Coffee?

Mr. COFFEE. I want to start with your point that SIPC should not misrepresent what it is doing to the American public.

We have to understand that, until recently, SIPC was extremely underfunded insurance, because broker-dealer firms paid only $150 a year. That's awfully cheap. I think when you look at this insurance system, you should look at what most small businesses do. They may spend one percent of their revenues on insurance or surety bonds. So this has been an awfully cheap and somewhat illusory system of insurance. It has never been under great stress before the Madoff debacle, but it could happen again.

The other point I would make about change over time is that in the old days when this was set up, most investors were individual investors. That has changed. Only about 25 percent of investors today are individual retail investors. Most of them invest collectively, through pension funds, mutual funds, etc.

I agree entirely with what Chairman Kanjorski is saying, that we cannot give insurance to everyone. And I think if we tried to give insurance to hedge fund investors, it would look like socialism for the rich. But I do think there are special categories where we could recognize that if we're going to make any change we should start at the end of the continuum where we have the most exposed victims. And I am suggesting that's the smaller pension plan.

But in answer to the final part of your question—

Mr. KING. Right.

Mr. COFFEE. —because I do think there has been some misrepresentation here to the public about what SIPC can do and is doing, I think the SEC is probably consistent with the prior law in what they're saying. It's just never come up before in this dramatic a way.

Mr. KING. I would just comment on that, that to me, any time you get beyond the specifics of the law, you're taking a chance. And to say, "Well, maybe these people are more deserving than those, maybe we can set up a different category," to me it's a very risky path to allow a government official to go down.

My time is starting to run out. Let me just ask one other question on the issue of taxes. If both of you could, address the issue of reimbursing people who paid taxes on nonexistent profits, paying taxes on money which they never received.

Mr. COFFEE. I'm not a tax lawyer, but I do think that the legislation that has been proposed would allow you to carry these losses forward and back, and that would be a way of at least reducing some of the bite.

And I think it was an illusory profit that you were paying taxes on, so I think we should be very sympathetic in that context, because it was a phony tax that you were paying.

Mr. KING. And Ms. Chaitman?

Ms. CHAITMAN. Thank you. There are two things I would like to say.

First, we are not seeking a total bailout or restitution. All we are seeking is that the SEC and SIPC comply with the law. We are seeking the $500,000 in SIPC insurance that we were promised.

And I am not asking for coverage for indirect investors, because I don't think the statute, as it's presently drafted, contemplates that. But the statute clearly contemplates that a customer who deposits money with a broker for the purpose of purchasing securities is entitled to $500,000 in SIPC insurance, based upon the customer's last statement. That's what the statute says, that's what the SEC has said in every case until now. That's what SIPC has said in every case until now. When a customer had a statement which showed the purchase of real securities, that customer was entitled to replacement securities up to $500,000, even if those securities had tripled in value.

And how can we trust our government if Mr. Harbeck, the president of SIPC, can assure a court, as he did in the southern district of New York in the New Times case, that even if the securities which were never purchased—because it was another Ponzi scheme—even if those securities tripled in value, SIPC would replace the securities up to $500,000? We had a right, as law-abiding citizens, to rely upon that statement, and rely upon the law.

Now, with respect to the taxes, there is no question that, economically, the Internal Revenue Service was the largest beneficiary of Madoff's Ponzi scheme, because he was generating short-term capital gains, and people were paying taxes on the income they thought they were receiving at the highest tax rate.

But I think that the Internal Revenue Service and Congress have done a great deal to help investors on the tax side. There are proposals—Congressman Ackerman has a bill, Kendrick Meek proposed a bill. Senator Schumer announced the other day a proposed bill in the Senate which will give Madoff investors a great deal of relief. It's not 100 percent. We're not asking for 100 percent.

But on the SIPC issue, we are asking that SIPC be required to comply with the law.

Mr. KING. Mr. Chairman, could I have 5 seconds, please, just to—Mr. Chairman?

Chairman KANJORSKI. Yes.

Mr. KING. I will just make one final statement, because I may not be able to be here for the second panel of witnesses.

I have real concerns about a trustee being able to receive $1 million a week in legal fees. To me it's encouragement for him to keep litigation going, to go after—now, whether it is or not—let's assume he is acting totally honorably. But the fact is, it does put an appearance of evil, if you will, an appearance of a conflict of interest there, to pay someone for the more energetic he is in going after one class of victims, as opposed to another. And I just want that on the record. I yield back. Thank you, Mr. Chairman.

Chairman KANJORSKI. Thank you, Mr. King.

Mr. Leveton, do you have something to throw in, just briefly, in response to that?

Mr. LEVETON. No, I want to take the conversation in a different direction.

It seems that there is a dialogue going, and it's an excellent dialogue. But the attorneys at this panel are, with all due respect, dominating the dialogue.

Chairman KANJORSKI. Okay.

Mr. LEVETON. So—

Chairman KANJORSKI. Point well taken.

Mr. LEVETON. May I make a couple of comments?

Chairman KANJORSKI. Yes.

Mr. LEVETON. Okay.

Chairman KANJORSKI. We will have Mr. Perlmutter ask you some questions, so you will get a response.

Mr. LEVETON. Okay.

Mr. PERLMUTTER. Okay.

Chairman KANJORSKI. We will now hear from the gentlelady from New York, Mrs. McCarthy.

Mrs. MCCARTHY OF NEW YORK. Thank you, Mr. Chairman, and thank you for holding this hearing. I agree with some of my colleagues on the committee, and I disagree with others.

The bill that is on the Floor today and tomorrow was put in place mainly because, in my opinion, the government certainly has failed in many, many ways. Also, it is our job to protect the average citizen.

So, Mr. Leveton, I will give you a chance to talk about what you want to talk about, because I have to say, you know, my husband was a stock broker for close to 30 years, and he used to come home all the time and basically say, "Number one, brokers shouldn't get commissions. That only drives them to buy and sell and line their pockets." He said, you know, they should get a good salary and whatever.

But with that being said, what we have seen in the last 2 years—let's go back to Enron. There has been a slow deterioration of moral obligation with large corporations. And, if anything, we have seen that, unfortunately, with the meltdown of the economy that we have right now. We have seen victims.

And as far as helping some of those victims with a tax break, tax credit, they don't have any money left to pay taxes, or they don't even need a tax credit. The money is gone. And the ones who were injured were a lot of people who did everything right.

And as far as, consumer beware, I'm one of those who will read everything that comes into my house. And you know what? I'm not a lawyer, and I don't understand it all. And if I ask my broker a question, he has to look up the answer. So, as far as consumer beware, we trust—we try to trust—businesses. And unfortunately, that has not worked out.

But I will give Mr. Leveton a chance to speak about anything he wants in the remaining balance of time.

Mr. LEVETON. Thank you very much. I have a couple of comments.

Do you remember the camel trying to put its nose in the tent example? That's where the indirect investors are. I totally understand

the issues of net equity and clawbacks, and a number of other things that I think are very valid. However, for the indirect investor, unless they are in the SIPC customer definition, for lack of a better way to say it, none of those things are relevant. They're not going to get any benefit anyway.

I think that this is not so much a legal issue as it is an issue of fairness, because you're distinguishing between the direct investors on one hand, and the indirect investors on the other hand. And now there is a further definition here, and that is the pension fund investors, as separated from the other indirect investors.

Everybody lost their money in the same way with the same fraud.

I can't speak about the wealth of the direct investors. And I can really only speak about the wealth of the indirects in our particular hedge fund. These are people who have worked all their lives, played by the rules, saved diligently, and accumulated enough money to invest in a hedge fund at a level that was over the minimum requirement. They are not rich, by any means.

To the extent that they might have more investable and liquid assets than the example of people who were only able to scrape together $50,000 in a pension fund, that may well be right. But from the standpoint of this discussion, to distinguish between those people—who, by the way, have created many, many jobs over the years—but to distinguish between the indirect hedge fund investor and the direct investor seems to me to be totally unfair and not appropriate.

I think, Congressman Ackerman, that you understand. I think what you said was right on.

My reading of the discussion in 1970, when Senator Muskie, for example, said the SIPA legislation will protect all Americans—he didn't say direct investors and indirect investors; he said all Americans—from brokerage firm fraud and that is what was intended. Whoever drafted the SIPA legislation didn't do it clearly enough to indicate that. But that was the intent.

And now, what is happening, Chairman Kanjorski, is just what you have said. And Congressman Ackerman, it's just what you have said. You have group A against group B against group C. That clearly was not the intent.

And I think that there is no way that SIPC can rectify that, regardless of how good our arguments are. But Congress can. And it can start right here, because you have taken the time and effort to allow this group to talk with you very freely. Thank you.

Chairman KANJORSKI. Thank you, Mr. Leveton. Our next member is Mr. Posey.

Mr. POSEY. Thank you very much, Mr. Chairman. I think it is clear that the heart of every Member aches for the experiences that the indirect investors have suffered. There is no doubt about that, whatsoever.

I think we also ache because, despite the fact that Mr. Markopolos tipped the SEC off almost a decade ago to the fact that Madoff was trying to pull a Social Security-like Ponzi scheme off, they ignored him. And he was allowed to do it, and allowed to do it, and allowed to do it.

And, although I don't think it's realistic to expect that we can ever have laws that guarantee people won't become criminals, and they won't try and exploit other individuals, the deterrent to that is swift and sure punishment. And I am very sad to say that, to this day, despite the numerous inquiries, the testimony, the investigations, I don't know that anyone at the SEC has had their wrist slapped yet. I don't even know that there has been a verbal reprimand. I don't think anybody has been fired. We just don't know how they have addressed it.

The only way to deter criminal activity—I mean, you police it the best that you can, and when you find it you must have swift and sure punishment. Even if the government is in on it, you still must have swift and sure punishment if you want to deter bad activity.

You already made it illegal to perform bad activity. We have plenty of laws there right now that were violated. Madoff wouldn't be any less or any more of a crook if we have another couple of books of statutes piled up that he violated. The damage was done. It could not have been much worse, I don't think.

But I think we need to focus on having a day of reckoning for that kind of bad behavior, which seems to have permeated industry. They referred to Enron earlier.

The whole reason that this economy is in the dumps that it is now, and that future generations, in addition to this, are facing the uncertainty that they are now, boils down to just one word, and that's greed. It's a lack of respect for the process, it's a lack of respect for your fellow man. It's a lack of respect for your investors. It's a lack of respect for everybody. It's putting the dollar first. And a lot of people have a right to be greedy, but they don't have a right to steal from other people.

And so, until we see that—besides just one man, Bernard Madoff, until we see that there is justice dealt out for everybody who is culpable in letting him pull off that scheme, it's just going to encourage more activities of the same, despite how many laws that we enact.

Thank you, Mr. Chairman. I yield back.

Chairman KANJORSKI. Thank you very much, Mr. Posey. Our next member is Mr. Klein of Florida.

Mr. KLEIN. Thank you, Mr. Chairman. I have some specific questions. But just a quick note on Mr. Posey's comments.

Part of the frustration I think most Americans have, as well as the people who were defrauded here, is the fact that there hasn't been enough punishment. Accountability is one thing, and there is the responsibility within our government agencies to follow through, and those people need to be removed if they can't do their job.

And one of the big explanations that has come forward on this problem is the fact that there weren't enough people, at least in my view, providing regulation. The quality people—many over the years—were pushed out. And bad decisions were made. Mr. Markopolos is a perfect example of the fact that information was presented. This should have been shut down a long time ago, yet people didn't make decisions. And those people need to be punished.

But there is a second line on this that goes into the private sector. And I don't think, personally, that there is enough punishment, criminal punishment, for people who break the laws and defraud the American public.

Part of it comes down to Mr. Madoff. Yes, sure, he is in prison. He couldn't have done this by himself. I just can't accept that. I mean, there are too many other people involved in this process. And there needs to be swift punishment, I agree with that. That sends a very strong message.

But let's get to the specifics here. Thank you for your testimony, both as individual investors and as professionals, to give your thoughts on this. One of the problems that I see is that there seems to be some inconsistency in interpretation by the SEC and the SIPC.

One of the things that I said before is, people need to know that on their Web site, and on the door, that SIPC symbol means something. The investor public needs to know that it means something.

And if the—if we look back at the original language in the SIPC series rules—and there is a Federal regulation 300.500—it says, "The rules provide for the classification of claims in accordance with the 'legitimate expectations' of a customer, based upon the written transaction confirmations sent by the broker-dealer to the customer." Seems pretty obvious to me.

Did you get a statement?

Ms. CHAITMAN. Yes.

Mr. KLEIN. Was it a reasonable expectation that your statements, one after the other, looked like any other statements you got from Merrill Lynch or anybody else?

Ms. CHAITMAN. That's right.

Mr. KLEIN. I think the answer is probably yes. There probably weren't any big signals going the other way. So, again, I think this is—this set of expectations that you all had in this process.

One of the interpretations—I guess I will ask Ms. Chaitman this question—of the SEC seems to be talking about, based on this lack of precedent, is that there is no case law that really talks about the fact that the interpretation should be that if an investor told a broker to purchase specific securities, that seems to be a very clear case where the SIPC can come in and fund.

But if you didn't have that specific line of securities requested—and most of us go into a broker, and there is a sort of a risk assessment of, "I want some bonds and some of this and some growth, and everything else," that doesn't seem to be covered.

Ms. Chaitman, do you have a thought on what is the SEC's view—and why that doesn't seem to make sense?

Ms. CHAITMAN. Well, the first I learned of the SEC's position was last evening, when I saw their written testimony. And I have to tell this body that there is no authority in the statute for the SEC's position.

In other words, you can read SIPA from beginning to end, from the first word to the last word, and nowhere does it say that the full protections of this statute are reserved for customers who make their own investment decisions, but not for customers who rely upon financial advisors.

And if you analyze the economics of what the SEC is suggesting, instead of protecting investors—which is what we, as taxpayers, fund them to do—they are protecting the industry-funded insurance company, because the vast majority of Americans don't make their own investment decisions. My clients are in their 70's, 80's, and 90's. They don't have the capacity to decide whether they should buy something one day and sell it the next day. They hire financial advisors, and they go to brokers who make those decisions for them. They invest through Fidelity or Vanguard, and they buy funds. And those fund managers make investment decisions for them.

Mr. KLEIN. Is it your view that if this interpretation were held up, and this was the SEC's interpretation throughout, that—it would seem to me that millions of investors who just give a more general parameter of investment authority to an investment house may not be covered by a failed account, a failed broker whom the SIPC steps in on.

Ms. CHAITMAN. Precisely. They wouldn't be covered for the full $500,000. And the purpose of the statute was to instill confidence in the capital markets.

If the FDIC tomorrow, in the next bank liquidation, decided, "You know what? We don't insure the accounts, except for the net investments, so we're eliminating all interest that may have accumulated over the last 30 years, and we're only going to pay the net deposit," there would be a run on the banking system.

And the SEC's filing yesterday for this committee could create a run on the securities firms, because no investor in this country has any idea what kind of coverage they have, in the event that they are dealing with a dishonest broker.

Mr. KLEIN. Professor Coffee, you had a comment about zero sum game, where—if the SIPC assessed its members to provide for the—you made a—I agree with your comment, that it is illusory, and the amount of actual cash in the bank—

Mr. COFFEE. I congratulate—

Mr. KLEIN. What did you say, sir?

Mr. COFFEE. I congratulate this committee, because you are raising the assessment from 150 to 0.2 percent.

Mr. KLEIN. Well, it seems to me, Professor Coffee, that one of the problems here is there is a certain amount of money, and we're sort of backing our coverage into that amount of money, as opposed to creating—

Mr. COFFEE. It's how you're funded. You are quite right.

Mr. KLEIN. Right. The law is the law. And if it happens to be underfunded, then there ought to be an assessment, or some way of making the people whole, not saying, "Well, it's not $500,000 because we don't have enough cash in the bank to make this thing whole."

And again, I would just go back to how important it is, how strategic and essential it is, for the public to know that if they invest, that the money—there is a fund there to protect them, if there is fraud and insolvency in those things out there.

Mr. COFFEE. I think you are quite right. I want to make one little comment. To the extent that you raise the amount of assessment that the brokerage industry has to pay, you will also give

them an incentive, through organizations like FINRA, to cut back on risky behavior by brokerage firms such as Mr. Madoff.

Right now, they have no interest in stopping Mr. Madoff from being a cowboy, and doing what he is doing. But if they have to pay higher assessments, and the prospect of higher payouts will raise those, then they will have an interest in controlling the outliers within the broker community.

Mr. KLEIN. Right. And, Mr. Chairman, just to conclude, again, my view of this is, let's follow the law. If the protection is there, the $500,000 protection is there, those people should be given that full $500,000.

The clawback, we have already been through this discussion. Nobody is looking for $8 million to $10 million back. I mean, if they are, it's not reasonable. But the SIPC has a responsibility, and the SEC has a responsibility, to make sure the law is followed correctly.

Ms. CHAITMAN. May I make one response to something Mr. Klein said?

Chairman KANJORSKI. I think we are going to hold, because Mr. Klein already did run off—

Ms. CHAITMAN. Okay.

Chairman KANJORSKI. —and we allowed that courtesy. But we want to get Mr. Perlmutter in. So just hold. Maybe he will come to you with a question. Mr. Perlmutter?

Mr. PERLMUTTER. Thank you, Mr. Chairman. And I would like to start with Mr. Green. He has had his hand up a couple of times. So if you, sir, would sort of share what you are going to share, and then I will launch into my tirade.

Mr. GREEN. Thank you, Mr. Perlmutter. I wanted to comment—well, two things. One is I wanted to acknowledge, because at the beginning of my remarks I did not comment that I was a lawyer, so I just wanted to comment that I will participate, though I did not before, as a lawyer in the dialogue.

But in this discussion about how decisions will be made, Mr. Chairman, you raised the issue that some tough choices are going to have to be made. And I would like to again try and focus on some of the prior policy considerations, public policy considerations, particularly embodied in ERISA. ERISA was created as one of the three legs of the stool to promote the retirement savings of the average American worker, the other ones being individual savings, Social Security, and qualified plans.

The concept of qualified plans was the public policy was to encourage employers to create plans to put funds into retirement, instead of having profit sharing funds go at the end of the year just into dollars for workers to spend. There was a keen observation by Congress that workers were not saving those funds for retirement. And so, incentives were created that there be qualified funds, that they be put into retirement.

The type of fund we have is known as an eligible individual account fund, which means that for each participant, there has to be an individual account that has to provide for individual accounting of income, individual accounting for expenses. The only purpose for which it is aggregated is for investment purpose. It is an adminis-

trative requirement. And it is for that reason alone that the investments go in the name of the trustee.

Now, the consequence—because we have talked about consequences of decisions that will be made by this committee and by Congress on this issue—if, in fact, we undercut the confidence in ERISA-qualified plans because we do not extend SIPC protection to them, then we will discourage the confidence of employers of putting those funds into the qualified plans, will instead encourage them to give them directly to the workers, which is phenomenal for those employers who do profit sharing like that, but—

Mr. PERLMUTTER. Let me ask you a question on that, then.

Mr. GREEN. Yes.

Mr. PERLMUTTER. For each person in the plan, you think there should be $500,000 in insurance?

Mr. GREEN. What I would say is for each participant, there ought to be coverage for the plan, up to the account for each individual, subject to whatever the SIPC limit is.

Mr. PERLMUTTER. Okay. So, under today's SIPC levels, it would be up to $500,000 per person in that plan.

Mr. GREEN. Yes. Now, I am not going to comment on the net equity issue. I am not qualified to do that.

Mr. PERLMUTTER. And that's okay. Let me just—

Mr. GREEN. Right.

Mr. PERLMUTTER. —and then I have some questions for Ms. Langford.

Mr. GREEN. Yes.

Mr. PERLMUTTER. Just so you all understand my background, I represented bankruptcy trustees in Ponzi schemes, okay, and I represented investors who were victimized, and who were either—had received more than they had put in, had invested $100,000, got $50,000 back, but other people got zero back. So, I understand where Mr. Coffee is coming from in some of his comments.

And so, where I—what I am trying to figure out is going back to those three things that I brought up earlier: bankruptcy; how far, and who should be subject to the clawback; and SIPC, how far should the insurance reach?

So, in my State, and in my area, I have the indirect investors that Mr. Leveton has talked about, who didn't know Madoff, they didn't know Petters, they didn't know any of these guys, they invested through a fund that then invested in these particular entities. How far should this SIPC insurance reach? I mean, that's the policy decision we have to make.

And then, tax-wise, when can somebody take a loss—can you take those illusory gains and get a net operating loss carry-back so that might give you at least some recovery?

Those are the three big policy questions I have. But I also am just interested—like, Ms. Langford, how did you get into the Madoff network?

Ms. LANGFORD. How I got in was by looking for a vehicle to—I had just sold my house. And it was my retirement. I asked a friend, I said, "I want something safe, liquid, and diversified." And he said, "Hands down, this is the safest place you can put your money." So I entered into it that way.

Mr. PERLMUTTER. So you were a direct investors with Madoff, or—

Ms. LANGFORD. No, no, in—

Mr. PERLMUTTER. —did you come through something else?

Ms. LANGFORD. It was indirect. It was a partnership. And—a limited partnership—and so, technically, it wasn't a—technically a retirement account. But it was my retirement money. So—

Mr. PERLMUTTER. Okay, thank you. And I just—one more point to Mr. Coffee's statement.

Mr. Kanjorski's bill that we're going to hear today and tomorrow and Friday does, I think, at a $10 million level, separate custodial accounts from investment advisor accounts, to try to separate those things so that somebody isn't posting you phony statements and advising you at the same time, or—hopefully that kind of separation will work, as you have suggested.

Chairman KANJORSKI. Thank you very much, Mr. Perlmutter.

At this point, we are waiting for the House to go back into session, at which time we will have three votes. And certainly rather than tie this panel up with any further questions, my intention is to dismiss the panel and thank you very much for your examination, and then to stand in recess until 30 minutes after the call of the next vote. So, we anticipate that the call may occur within the next 10 to 15 minutes, and then we will return to take the second panel 30 minutes after that call.

Without any other further comments or objections, the committee will stand in recess.

[recess]

Chairman KANJORSKI. This hearing will come to order. I am pleased to welcome our second panel. But before I introduce members of the panel, may I caution the audience that it is against the rules of the House to have demonstrations of emotions. We understand how feelings run high, but we would appreciate that you extend the same courtesies to the witnesses in this second panel, as you did to the witnesses in the first panel, with the absence of cheering. And that being said, we will address it no more.

And now I am pleased to first recognize Mr. Michael Conley, Deputy Solicitor for the Securities and Exchange Commission. Mr. Conley?

STATEMENT OF MICHAEL A. CONLEY, DEPUTY SOLICITOR, U.S. SECURITIES AND EXCHANGE COMMISSION

Mr. CONLEY. Chairman Kanjorski, Ranking Member Garrett, and members of the subcommittee, thank you for the opportunity to appear before you today on behalf of the Securities and Exchange Commission. My name is Michael Conley, and I am the SEC's Deputy Solicitor.

There are a number of issues being discussed here today, but I wish to focus my limited time on explaining the Commission's views regarding the SIPC liquidation of Bernard Madoff's securities firm. We at the SEC are keenly aware of the devastating losses incurred by the thousands of investors who entrusted their money to Madoff. Many, if not most of his victims, have had their lives upended.

At the SEC, Chairman Schapiro has urged all of us to learn from that experience, and reform the way we operate. Over the past year, we have taken significant steps in that regard, reinvigorating the Enforcement Division, enhancing our inspections, bolstering our training program, revamping our tips and complaints process, and hiring personnel with new skill sets. And we will continue to reform.

With regard to the Madoff liquidation, the Commission and its staff have been analyzing SIPA, its legislative history, and case law to determine how to properly value the claims of the investors. While claims for losses suffered by investors are determined under SIPA, the statute does not expressly address how to calculate the net equity in a customer's account when a broker-dealer has engaged in the sort of fraudulent scheme Madoff perpetrated.

As a result, the bankruptcy court will soon hear arguments on the various theories proposed for valuing customer claims. In the end, the court will decide how the investors' claims should be valued.

The Madoff liquidation raises a new question. Specifically, how does SIPA apply when a customer's brokerage statements show nonexistent positions in real securities that the broker concocted after the fact to support pre-determined fictional investment returns?

Two primary approaches have been proposed. The first is known as the final account statement method. Under this method, the net equity in customer accounts would be based on the securities positions shown on the final account statements customers received before the firm was placed in liquidation.

The second principal approach is the cash-in/cash-out method. Under this approach, net equity is determined by crediting the amount of cash the customer deposited in the account, and subtracting any amounts withdrawn from the account.

Based on our analysis, the Commission will recommend to the bankruptcy court that customer claims in this case should be determined through the cash-in/cash-out method advocated by the trustee and SIPC. However, we believe that the amount should be adjusted to constant dollars, to ensure that investor claims in this long-running scheme are valued most accurately and fairly.

The Commission decided not to recommend the final account statement method on the facts of this case, because it believed it would result in claims based on account balances that Madoff himself concocted, and that bore no relation to reality. Madoff essentially promised customers that he would pick winning stocks for them, did not tell them which stocks he would purchase, waited to see which stocks did well, and then falsely reported that he selected stocks that met their investment expectations.

Through no fault of investors, the account statements Madoff sent were illegitimate tallies of a fraudulent scheme. Neither SIPA, nor any of the cases interpreting it, can be read to support an approach that would value claims based on the fictitious investment returns of such a scheme.

As a result, the Commission has concluded that the fairest and most reasonable way to measure the value of the Madoff customers' net equity is to look to the money those customers invested with

Madoff as a proxy for the unspecified investments in securities Madoff told them he would make for their accounts.

To do otherwise would have the effect of favoring early investors—many of whom withdrew all or more than the principal they invested with Madoff—over later investors—some of whom will not receive a distribution equal even to their principal.

At the same time, the Commission is sensitive to fairness concerns raised by the cash-in/cash-out method. That method favors later customers at the expense of earlier customers, by treating a dollar invested in 1987 as having the same value as a dollar invested in 2007. In our view, it is appropriate to convert the dollars invested into constant dollars. We believe that approach, rooted in the economic concept of time value of money, will result in greater fairness across different generations of Madoff investors—in effect, treating early and later investors alike, in terms of the real economic value of their investments.

The Commission understands that the total pool of money available to distribute claims is limited, and that there will not be enough to compensate all victims. That means that money allocated to one Madoff victim will affect the amount of money available to compensate other victims. The bankruptcy court's task, and the Commission's goal in making its recommendation, is to arrive at the fairest way, consistent with the law, of dividing that limited pool.

I thank you again for the opportunity to appear before you today, and would be pleased to answer any questions you may have.

[The prepared statement of Deputy Solicitor Conley can be found on page 104 of the appendix.]

Chairman KANJORSKI. Thank you very much, Mr. Conley.

Next, we will hear from Steve Harbeck, president and chief executive officer of the Securities Investor Protection Corporation.

Mr. Harbeck?

STATEMENT OF STEPHEN P. HARBECK, PRESIDENT, SECURITIES INVESTOR PROTECTION CORPORATION (SIPC)

Mr. HARBECK. Thank you, Mr. Chairman. Chairman Kanjorski, Ranking Member Garrett, and members of the subcommittee, thank you for giving me an opportunity to discuss SIPC's work over the last year, and to discuss possible amendments to the Securities Investor Protection Act. My name is Stephen Harbeck. I am the—I have worked at SIPC for 34 years, and I became president in 2003.

SIPC has no role in the investigation and regulation of brokerage firms. That duty falls to the SEC and the self-regulators. When SIPC is informed that a brokerage firm has failed, we institute a customer protection proceeding in district court, and then refer it to the bankruptcy court. Customers of brokerage firms are protected within statutory limits.

The first such source of protection is a prorated distribution of customer property. As Professor Coffee noted this morning, that makes it a zero sum game. SIPC can supplement customer property by as much as $500,000 per customer, with a limit of $100,000 for cash.

SIPC has overseen the return of approximately $160 billion to customers, and has advanced more than $323 million, prior to the Madoff case, to do so.

About 11 months ago, I appeared before you to report on the two largest brokerage firm failures in history, Lehman Brothers and Madoff. I would refer you to my written comments for progress with respect to Lehman Brothers, which I think is substantial.

In the Madoff case, unlike the Lehman case, a transfer of accounts was simply impossible. Through the claims process, the following is the status of the claims. The trustees allowed $4.6 billion worth of claims. That represents returns to 1,600 claimants. SIPC has committed, and has advanced most of, $559 million. This is more than in all previous SIPC liquidation proceedings combined in the past.

There have been 16,000 claims filed, and there have been 11,500 claims determined, or 71 percent of the claims. The trustee has thus far collected $1.1 billion, and he has filed 14 lawsuits seeking the return of $14.8 billion. And we will discuss that again in just a moment.

The subcommittee has asked specifically for information on the fees in this case. As you heard this morning, the trustee has been paid $1.275 million, and the law firm of Baker and Hoestetler has received $37.5 million. I remind you that this is the largest Ponzi scheme in history. And most of the trustee's and legal fees efforts that are being expended here are for the purpose of recovering assets.

In terms of the legislative initiatives that are before you, SIPC has proposed a number of amendments to SIPC, and these include: increasing the amount that SIPC can advance for claims for cash to $250,000, and to index that dollar figure to inflation by a specific formula; we would increase SIPC's line of credit with the Treasury from $1 billion, where it has been since 1970, to $2.5 billion; we would increase the number of cases where SIPC can use a streamlined procedure. And I would suggest to you that the members of this morning's panel should agree with all of those changes.

But there are other proposals that I must address. One is extended coverage for participants in pension funds, which was extensively discussed this morning. On a going-forward basis, this certainly deserves study. However, the proposal lacks any analysis in terms of risk management, or possible cost to either SIPC or the Treasury. And, as both the chairman and the ranking member implied this morning, it is imprudent to enact a measure without that analysis, and knowing what it would cost, as a possible drain on the Treasury.

SIPC cannot take a position on this without the appropriate due diligence. And my written statement contains a great deal more on that issue.

SIPC is a complex law, but the pension fund issues shows the current state of the law is somewhat in accord with common sense. If you have an account, and you can call your broker and make a purchase or trade and get a statement, you're a customer. Granted, the statute was drafted in a simpler time, when that was the standard. But that is still the law.

In terms of extended coverage for other—indirect claimants, one of this morning's panel members testified that he is an indirect victim, and he certainly is. But I think I have to elaborate. He placed his money with a hedge fund which invested in another hedge fund which invested in another hedge fund, which invested in Madoff. Again, as Professor Coffee said, it would be very, very difficult to craft legislation that would cover that situation and expand the coverage of the statutes beyond what was ever intended to be.

Now I would like to address a point that I feel personally very strongly about, and that is depriving a trustee in the prospective legislation of the right to recover preferences in fraudulent transfers in certain instances. Ms. Chaitman testified about this issue.

Mr. Chairman and members of the subcommittee, I cannot urge you strongly enough to reject this amendment. If enacted, it would deprive the victims Ms. Chaitman represents of, literally, millions of dollars. Mr. Coffee noted that this morning, and he is absolutely correct in that regard.

The Madoff trustee has used the awarding powers granted to him by SIPA and the Bankruptcy Code judiciously. He has not sued small investors. He has sued 14 large investors. He has urged any Madoff customer who has received more money than he placed with Mr. Madoff to open discussions with him. And he is open to reason.

This is a man who is extraordinarily practical. He has served as a trustee in more of these cases than any other human being, ever. He has instituted preference in fraudulent transfer proceedings against large investors who received disproportionate returns. But the weapons in the trustee's arsenal include the fact that all he must prove is disparate return, without any issue of legitimate expectation arising.

Ms. Chaitman's written statement, at page 17, says that the trustee in Madoff has already sued several elderly, virtually destitute investors. Ms. Chaitman is a vigorous advocate, but she is factually incorrect. The only situation in the Madoff case where small investors have been sued were three instances where the claimants ignored the claims filing procedure that has been in place for 39 years, and initiated a lawsuit against the trustee. In short, the trustee was required to institute mandatory counterclaims. And those are the only small investors who have been sued.

In short, the proposed legislation addresses a problem which has not arisen, will not arise in this case or any other, and would do extensive damage to the very people it seeks to help.

Indeed, it would actually encourage Ponzi schemes in a real sense, because it would allow people to be free of the prospect of what you have heard today called clawback, and what are more accurately described as congressionally-mandated equitable distributions. It would deprive the trustee of the ability to get money back from someone who has gotten all of their money back, someone who has kept stolen money from others, and who will share in that common pool of assets at the direct expense of other people who have not gotten all their money back. That is wrong, as a matter of both law and policy.

In the written questions submitted by the subcommittee, you asked if extending SIPC coverage to the victims in situations such

as the Stanford Financial Group make sense. And there is legislation to deal with that situation. SIPC protects the custody function that brokerage firms perform. And, in the Stanford case, investor assets were not located at the SIPC member firm.

Instead, in the Stanford case, investors sent money, at their own request, to a bank in Antigua. The bank issued certificates of deposit. The investors have physical possession of those CDs, and the bank defaulted, due to fraud.

The investors are not covered by SIPC. I do not believe the subcommittee should make the SIPC fund, and the United States Treasury, the insurer of the underlying value of any security, and I don't believe the subcommittee wants the United States Treasury to guarantee the debts of an offshore bank.

Retroactive application of any of those amendments, particularly with respect to the Madoff case, would change the advantage from one group to another in a completely arbitrary way. For the reasons given in my written statement, any amendments, should you consider them, should be prospective.

I would like to address Mr. Conley's mention of the constant dollar theory. The first time SIPC was presented with this theory was November 23rd. The concept simply isn't in the statute. Congress knows how to write a law in constant dollars. And, in fact, we have, in our amendments, asked for an index to inflation with respect to the cash protection under our statute. It creates arbitrary results, different arbitrary results from the ones that the statute now has.

The consequences for your constituents are that if you back a concept of constant dollars, you would have to say that a person who received all his money back, and who received stolen money, will get even more at the direct expense of people who have not been made whole.

In a limited sample of about 2,000 of those accounts, we located in New York 138 people who had received net—given what we expect the trustee to recover—$19 million less. So we don't think that is the best of all possible worlds. It is a zero sum game. That said, you know, because this is an issue of first impression, we will continue discussions with the SEC on that matter.

So, with that, I would be pleased to answer your questions.

[The prepared statement of Mr. Harbeck can be found on page 122 of the appendix.]

Chairman KANJORSKI. Thank you very much, Mr. Harbeck.

I am just going to ask a few questions, perhaps unrelated to the testimony this morning. But in the particular instance you were mentioning, Stanford Financial, did they at any time advertise that they were insured?

Mr. HARBECK. The SIPC member may have. But the SIPC member, with respect to actual customer assets, custodied them at a clearing brokerage firm. And the people who had their assets at the clearing firm now have them all back.

The folks who are missing—and I met with the receiver for Stanford last weekend to discuss this matter with him, and I have had extensive discussions at various levels with the SEC on this subject—and the problem is that since SIPC protects the custody function that brokerage firms perform, and since those people have

physical possession of the CD that is the security, what you would be giving them back is the initial purchase price of a fraudulent security. And that has never been the law.

Chairman KANJORSKI. I understand. But those who bought the securities in the offshore banks, in their place of business or on their stationery, did they indicate to the customer that they were insured by your corporation?

Mr. HARBECK. I don't know the answer to that.

Chairman KANJORSKI. Do you not think it would be sort of important that you do know that?

Mr. HARBECK. On the facts of this case, no, because the—

Chairman KANJORSKI. Well—

Mr. HARBECK. The determining factor—go ahead, I'm sorry.

Chairman KANJORSKI. Yes. Why is it not important for you to find out whether or not there are some people fraudulently using your potential insurance to entice customers into their establishment?

Mr. HARBECK. It would be interesting, but we could do nothing about that, because we don't have any enforcement powers. That is the SEC.

Chairman KANJORSKI. Well—

Mr. HARBECK. The fact of the matter is, even if people are defrauded into believing they have coverage, that does not make it so.

Chairman KANJORSKI. No, that is true. But I do not recall—and I have been sitting here a long time, and sometimes we miss all the mail that comes into the committee, or into our various subcommittees—but I do not recall any letters from your organization indicating that you needed additional authorities, that you felt there were loopholes in the law, that there were failures in the system in all of the 25 years that I have been sitting here. Did I miss a lot of that communication?

Mr. HARBECK. Of course you didn't, Mr. Chairman. And the reason you didn't is until September of last year, the system was gliding along very, very well. And we had protected 99 percent of the investors who went into liquidation.

Chairman KANJORSKI. While times were good, it was no problem. When times get bad, that is usually the case. When the water goes down after the flood, that is when we find the bodies.

Did anyone in your organization not anticipate that the water was not going to stay up all the time, and that in fact there may be some victims of the flood?

Mr. HARBECK. The—well, again, if you're referring to Stanford, the fact of the matter is that if Stanford—even if the bank was in the United States, the—I don't think you want us to—and we never have been in the business of—giving people back money when they—the value of their investment goes down for any reason.

Chairman KANJORSKI. No, and I am sympathetic to that, and we want fairness to the whole system, as best as possible.

I guess what I am getting to is, did you hear the outrage of the panel that we had earlier this morning?

Mr. HARBECK. Mr. Chairman, I hear it every day.

Chairman KANJORSKI. Okay. Well, I have to believe that outrage was sincere, and somewhat based on reason.

There was a statement there by these people that they felt there were representations made by the individuals they dealt with, whether they were dealers, whether they were banks, whomever they were, that the U.S. Government was in some way was watching out for their best interests and, in fact, in some instances under the law, insuring them. And it was not until after the fact they found out that they were totally misinformed, or they misunderstood, or that they just were not supported.

And prospectively, I guess they are asking us to look at this. And that is one of the things we clearly can do.

Mr. HARBECK. Certainly.

Chairman KANJORSKI. What we can do to prevent or to recompensate them for some of their losses is very questionable. I do not know how far we're going to get there. But there are probably some things we can do, and we will be directed toward that end.

But I think what I am particularly disturbed about this whole last 15- to 18-month disaster that we have been in, is an attitude at the governmental level, or quasi-governmental level that it is not our problem, we do not have to take preventative steps, investigative steps.

And I think you do. It is our problem. It is the committee's problem. It is the Congress' problem. It is the President's problem. You know, we just, as a matter of course, cannot accept in this country that some people feel that their government let them down, wrongly so, and that they were not acting in its best—and in many of these instances—and I hear their testimony—there is very little that they could have done.

I raised the question, caveat emptor, and I am a great believer in that. But, in some of these instances, I do not care what actions they took—somebody mentioned to me, and I will not identify Mr. Ackerman by name—

[laughter]

Chairman KANJORSKI. —that during the stock market crash, Mr. Madoff was getting calls from officials of the United States Government, and asked what his recommendation—should they close the market, what should happen? That is understood. Was he not the president of NASDAQ at one time? He was a pretty substantial person in this country.

But after we see what happened, what are we doing to prevent this in the future? Are we checking out some of the things that some of these very substantial people are involved in? Are they trading on that? Are they enticing relatively innocent people to trust them, and give them their life savings and their pension funds, and everything else? What have we done?

For instance, what has your corporation done—across the country, all these workers' pension funds, and ask them how are they getting advice as to where to invest, what advice is being made? Who are they using? Are we finding some method to check these people out? Or are we just saying it is up to them, and if they get cleaned, they get cleaned?

It seems to me that once you see something like this happening, being either in the government or quasi in the government, we have more of a responsibility to do something. We cannot cure it all. We cannot save everybody. We cannot prevent all injury. But

obvious injury, obvious things that are at fault, or failures that exist, we have an obligation.

When I first started this long discourse on my part—and I see my time is up—I feel offended that more Federal agencies, or quasi-Federal agencies such as your own, are not coming forward to tell us what they need. What authorities do you need? What could we do better? How can we change the law? How can we better educate people?

It is not enough to just say, "Gee, tough luck." Fifty, sixty billion dollars, thirteen, fifteen thousand people got clipped by a very professional artist. We have to learn from that, and we have to take actions to find out there are not other Madoffs out there, there are not other Stanford Financials out there. And I am not sure I am getting the impression that the two agencies are doing that.

I am not putting all my weight on you, Mr. Harbeck. I think I have taken some action in the legislation that is on the Floor today against the SEC on that very substance.

Let me point out, Mr. Deputy Solicitor, what I found so offensive in this whole thing, is that you are so channeled over there that you have no chain of command.

I cannot believe that you can do three, four investigations over more than a decade and come up with some really, I think, important questions of the credibility and viability of a person—although very highly thought of on Wall Street—but it never goes up beyond 1 or 2 levels in an organization that has 10 levels. You have no chain of command.

What would we do to a four-star general who put a lieutenant in the field who killed 150 innocents? If he did not know about it within 24 hours and take action, he would be gone—or should be gone. Sometimes, now that I think about it, no one at the SEC has been disciplined in any way.

But we have to have a chain of command, whether it is in the military or whether it is in civilian life. If it is the government, we have to find out what is happening at the lowest level. If it violates good sense and acceptable practices, we have to take action. And we have to make sure that chain of command has good communications up and down.

And I think the SEC—I saw the Chairman the other night, and Mary and I are very good friends, so we had a heart-to-heart discussion on that very subject. This is something I want you all to take back to the SEC. We want you to do a study, not inside, but outside, of the most thorough type, to study where the dysfunctional nature of the SEC exists.

And if there is anybody over there who does not think the organization is dysfunctional, then read the Inspector General's report on Madoff. It is the most classic bit of evidence I have ever seen that shows a dysfunctional operation. And it is just not Madoff, it is in other areas of the organization. We have to clean that up.

And I do not believe you can do it from the inside. I am not going to speak for Chairman Schapiro, but my impression is she tends to agree, too, that you really have to go out and do an honest thing here.

And as I said to her last night, I do not want to even stop at the SEC. All related agencies around the SEC should be so studied and

investigated and disclosed, and a report sent to Congress for remedial action.

But I think that should be the beginning point for what I am sensing from the American people. They are not going to take it any more, that we in government just said, "Well, we cannot do anything about it. It happened. We are sorry." That is nice. We did not lose. These people lost. That does not make them feel too good—it would not make me feel good, if I lost $5 million, $10 million, or $50 million. It does not matter. I lost, and I should not have.

If everybody had been performing their function the ideal way, it would not have happened. But they obviously were not. And the number of security people who were asleep at the switch is incredible in this instance. So, I want you to take that message back.

I have eaten up more than my 5 minutes. And I will be very lenient—since we have no Republicans, look how lenient I can be to my friend from New York. Gary?

Mr. ACKERMAN. Notice, Mr. Chairman, I didn't tell you your time was up.

[laughter]

Mr. ACKERMAN. I could not agree with more of what you said, and the way you put it, Mr. Chairman. Everybody, including the people who are testifying in this panel, has been trying to get us out of this muddle somehow. And I think all of their intentions are beyond question.

I think there is a—this is a very difficult Gordian Knot to untie. And trying to make some sense and understanding it, listening to what you have just said, Mr. Chairman, I just wanted to note that for a long number of years, nobody came to us to confront our obligations and responsibilities from any Federal agency, including that which is before us today—or those which are before us today—saying that, "We need more resources."

As a matter of fact, the previous Administration seemed to have a philosophy, if not an agenda, for deregulation, rather than more regulation, and did not want to provide the resources. Chairman Frank, as a matter of fact, had a proposal to more fully provide assets to the SEC and SIPC for additional resources to be able to do the kinds of investigations that were obviously needed, and that was moving forward until it was scuttled at the time by Mr. DeLay during a different congressional leadership.

It wasn't until Chairman Schapiro came along, and doing the fine job that she's doing, started asking for additional resources so that we could do a better job, prospectively. But that does not necessarily resolve the situation that is before us right now, as it has already regrettably occurred.

I think there is a difference between the average citizen investor being told that they didn't do due diligence—which certainly many of them did to at least 100 percent of their capability, ability, and legal limits of what they could do for due diligence—but certainly our agencies could have been doing a little bit more of a better job, including coming to us and telling us over a large number of years, a long number of years, that they couldn't handle the workload, that with the complications and the large number of investments

and investors, and the complications of the system, that they needed additional assets.

We did not see that. We did not hear that. And we rely upon the Administration. We don't have the tools. That's not the function of the Congress. We do oversight, which means we rely heavily on what the agencies tell us, and ask, and try to supervise whether they're applying their resources, which they didn't ask for in this case.

I have several questions to ask. In what we have just heard in our testimony from this panel about the smaller investors versus the larger investors, is there a distinction in either of your minds in the morality of larger investors versus middle-sized investors versus small? Are one more immoral than the other?

Mr. HARBECK. I—

Mr. ACKERMAN. I'm not talking about specific individuals.

Mr. HARBECK. No, I simply—

Mr. ACKERMAN. If you're wealthy and make investments, does that make you immoral?

Mr. HARBECK. Absolutely not.

Mr. ACKERMAN. Are they more suspect, because they had—

Mr. HARBECK. Absolutely not. I think that is why the trustee—you know, in the Madoff case in particular—has done a rigorous investigation of very complicated facts, and started 14 lawsuits. Some of those lawsuits assert knowledge or a newer should-have-known standard. Others do not.

So, certainly with respect to the former, the trustee is doing his job, and he is trying to return to the common pool of assets—defined in this case as customer property—the largest amount to distribute to the greatest number of people, consistent with the law. And he is doing that.

To get to your point on morality, I would like to turn it to a case of practicality and compassion. The trustee has taken the position that you—that—he sent a letter to everyone who received more than they put into this scheme, and said, "Come and talk to me. If it's something that you withdrew over time, and you can't pay"—but the trustee isn't going after you. That makes no sense in any—

Mr. ACKERMAN. What's the difference if you withdrew it over time, or if you withdrew it late in the game, rather than earlier in the game?

Mr. HARBECK. The answer to that is in all Ponzi schemes, going back to the original Ponzi scheme with Charles Ponzi, people who get out the day before—and Professor Coffee spoke to this rather eloquently—should do no better than the person who didn't have that good luck. And that has just been the law, as enacted by Congress since at least the 1920's.

Mr. ACKERMAN. So it's a matter of luck?

Mr. HARBECK. No, it should not be a matter of luck, sir. It is—that's the whole concept behind bringing money back in. And I think, in this case, the trustee has exercised his avoidance authority with discretion and compassion. He hasn't reached back to the small investors, particularly people who have no—

Mr. ACKERMAN. Is it possible, in your mind, speaking of compassion, that there are large investors—and I'm not advocating for anybody here, I'm just trying—and there is a problem, because this

is a zero sum game when somebody gets—somebody—it's coming out of the same pot of money, of people who are all losers—is it possible in your mind that you can conceive of situations, many of them, where larger investors are more desperate than some of the smaller investors?

Mr. HARBECK. I haven't seen that in this case, sir.

Mr. ACKERMAN. You think there are no larger investors—say someone with $100 million—who is doing something and invested the rest of another $100 million, because they're that big an investor, and is now upside down in their real estate, or house, or business, or property, despite the fact that they took money out, and now they wind up paying—having paid $50 million in taxes to which the government should not be entitled, have borrowed from the banks to do things on a business, have invested other people's money along with their own to do something, and are now being told that not only do they have nothing, but they owe back $200 million?

Mr. HARBECK. I can speak to a number of those points, the—

Mr. ACKERMAN. That is at least as desperate as the other people for whom I have great sympathy, who had $200,000 and invested $100,000 and lost it. They only lost $100,000. A lot of people aren't sympathetic, because they think that's a lot of money.

But they might still have—so it's—how do you morally make a distinction here? And is it possible in all this formulation that somehow you can come up with some kind of solution, and splitting, according to some formulaic way, how to deal with all these people?

Mr. HARBECK. Congressman Ackerman, I don't think a formula is the answer. I think analyzing individual situations is the answer. And I think that's—

Mr. ACKERMAN. Each case individually?

Mr. HARBECK. Yes, sir. I think that's exactly what the trustee—

Mr. ACKERMAN. If I was getting paid $1 million a week, I would like that.

[applause]

Mr. HARBECK. I believe that this trustee is—

Mr. ACKERMAN. I'm not questioning the trustee; I'm just pointing out the irony in this situation.

Mr. HARBECK. Two points. First, no customer money goes to pay attorneys' fees or trustee's fees. That's point number one.

Mr. ACKERMAN. Where is that money coming from?

Mr. HARBECK. It comes from the Securities Investor Protection Corporation. We have taken the view that every paperclip that gets sold will be designated to monies that go to the victims.

The second point is that, you know, looking at these cases individually, our statute was designed to protect the small investor. And I think that's exactly what Mr. Picard is doing.

Mr. ACKERMAN. As I understand it, brokers and investment advisors are required to put $150 into the fund to be covered by SIPC.

Mr. HARBECK. That is not correct. Currently, the assessments by our bylaw require each brokerage firm to be assessed one quarter of one percent of their net operating revenues.

When we started paying Madoff claims, we instituted, effective April 1st, assessments based on revenues, rather than—

Mr. ACKERMAN. Beginning when?

Mr. HARBECK. April 1st.

Mr. ACKERMAN. April Fools Day?

Mr. HARBECK. Yes, sir.

Mr. ACKERMAN. Well, some people think that is when you identify the people who have been April-fooled. That is after the Madoff Ponzi scheme fell apart because he turned himself in.

Mr. HARBECK. Well—

Mr. ACKERMAN. I mean, how does—before that it was $150?

Mr. HARBECK. When we reached $1 billion, which our risk—

Mr. ACKERMAN. But before Madoff, it was $150?

Mr. HARBECK. When we reached the figure of—

Mr. ACKERMAN. I don't have a lot of time left, so if we could just focus on a couple of more—

Mr. HARBECK. The answer is, based on revenues, until 1990, when we reached $1 billion, then from 1990 through April of this year, it was a flat fee.

Mr. ACKERMAN. Of?

Mr. HARBECK. $150. And we have—and we will have—

Mr. ACKERMAN. That wasn't hard. So, before then it was $150. So, if I was one of those brokerage firms or investment advisors, I would have to pay $150 to get that $500,000 worth of insurance?

Mr. HARBECK. Investment advisors are not part of the statutory program at all.

Mr. ACKERMAN. Okay. So if I was a brokerage, I would have to pay $150 at that time?

Mr. HARBECK. At that time, yes.

Mr. ACKERMAN. So if I had, say, 600 clients or customers, that would—give me a second; I'm a junior high school math teacher, but—$.25 an account. So for each of my accounts, I was—in premium I was paying, I would get a half-a-million dollars by charging people two bits each?

Somebody should have come down here and sounded the alarm and said, "I am paying too little for insurance." How much insurance can I really buy for $.25 an account? If somebody was charging me $.25 an account for my car insurance, I would suspect that I wasn't getting a lot of coverage. No?

Mr. HARBECK. The—

Mr. ACKERMAN. Asked and answered. Let me go on to something else.

Mr. HARBECK. Okay.

Mr. ACKERMAN. If I may, Mr. Chairman?

Chairman KANJORSKI. We will give you just a couple more minutes.

Mr. ACKERMAN. Okay, thank you.

People relied heavily on SIPC and the SEC, very heavily, for stuff that you can't expect them to be able to do themselves. That's the reason for SIPC, and that's the reason for the SEC. People can't become attorneys and investigators, and spend their whole life investigating something, whether or not—so, you know, if you don't know if something is kosher, you ask the rabbi. And if the rabbi says it's kosher, by me it's kosher.

You guys are the rabbi to all these people. When you said a guy was legitimate, he was legitimate. They relied on that. It was the

indicia of your agency and your agency and my government that was on these products that—and the person who presented them—that said that they were fine.

People thought they had the insurance on money, whether or not it was the interest—if my account is insured, I don't differentiate between how much I put in, I figure my account is insured for up to $100,000 in my bank—now $250,000 for the rest of this year or whatever—and I don't say my interest isn't insured, only my principal is insured. Everything is insured. So, it becomes a different number for everybody who had an investment over a long period of time.

And, as a matter of fact, it was you and your agency that testified—and your testimony in the New Times case—where you say, "Reasonable and legitimate claimant expectations on the filing date are controlling, even when inconsistent with transaction reality"—I am quoting you—"Thus, for example, where a claimant orders a security purchase and receives a written confirmation"—which every Madoff victim did with every statement—"reflecting that purpose, the claimant generally has a reasonable expectation that he or she holds securities identified in the confirmation, and therefore, generally is entitled to recovery of those securities within the limits imposed by SIPA"—that's the financial limitation of $500,000 or whatever it is—"even when the purchase never actually occurred, and the debtor instead converted the cash deposited by the claimant to fund the purchase."

It seems that these people were again reassured that the way we wrote the law, the way the regulations existed, and the way you interpreted them, telling them that they are entitled to that money, even if—and I won't go on reading—even if their money tripled and there was no money there. Even if they didn't have real money in the account, because somebody fraudulently stole it.

Now what has happened is we go to a different court case, and you change your view, saying that the money was stolen and not invested. This is a shell game that you are playing with investors who have—I mean, this is over the heads of most of the people on our committee, I would think, how this happened, and that this is being done.

People relied on you, and they were let down. And we have to all collectively figure out a way to make all of them as whole as we can make them.

Chairman KANJORSKI. Thank you, Mr. Ackerman. We will now hear from the gentleman from New Jersey, Mr. Garrett.

Mr. GARRETT. Thank you, and I appreciate it. I think I just have a couple of questions, because I understand some of the other questions were covered.

Mr. Harbeck, you raised—just as I was walking in—your line that you are here to help the small investor. And I think that's what the message is, and—throughout the hearing, that is what we're trying to look out for. But I raise the three questions: time; money; and who.

The time aspect of it is, if we're really trying to help out the small investor—and I guess we can define who that is later—how long does it take, and still say that we're helping them out? Obviously, if it takes 10 years to do it, then we're not helping out the

small investor. Obviously, if it takes 5 years—now it has been about a year. And at some point in time, we can just say we are not helping the small investor.

So what is the timeline that, if we were to say we invite you back here for another hearing such as this, that you can say that, "We are done, and the folks have been compensated to a large extent?"

Mr. HARBECK. There are two points to that response. First, in the two largest cases prior to the Madoff case, the overwhelming majority of investors were in complete control of their accounts within 10 days of the failure, and we're very proud of that result. In both Lehman Brothers and in MJK Clearing, which collapsed—

Mr. GARRETT. And I understand that. I'm not—

Mr. HARBECK. —right after. In this case, the utter lack of records makes it very, very difficult to answer your question. There are still 7,000 boxes of records in the controls of the prosecutor that—it's difficult to access, and they aren't digital records. We are working with that as fast as we can.

Mr. GARRETT. So you haven't—

Mr. HARBECK. Seventy-one percent of the people have been—have had their claims determined, and we will get the rest of them out as fast as we can.

Mr. GARRETT. Around three—

Mr. HARBECK. The complications involve when accounts are tied to others, when accounts are tied to insiders, when accounts are split. And those are very, very difficult accounting procedures.

Mr. GARRETT. So there are problems just getting those records from the prosecutor. Is that what I'm hearing?

Mr. HARBECK. I think we have transparency back to some time in the 1980's. But we don't have complete transparency on all the records.

Mr. GARRETT. Because?

Mr. HARBECK. The sheer volume is one answer.

Mr. GARRETT. And what about the prosecutor? You said 7,000 records are—

Mr. HARBECK. I believe the prosecutor still has—on their ongoing criminal investigation—a large segment of the records.

Mr. GARRETT. And you—

Mr. HARBECK. We access those, but we don't have complete access to them.

Mr. GARRETT. All right. So, to try to give me a short answer, which I'm sure the folks behind you are watching—would be you would anticipate, in light of all the constraints, in light of the fact that this is the largest case you have ever handled like this, and in light of all the difficulties, a reasonable answer to—a reasonable timeframe would be, in light of all those hardships, would be?

Mr. HARBECK. A year.

Mr. GARRETT. Okay. Secondly, with regard to the money—and I think I was just coming in on this question, as well, and the gentleman from New York was asking about the old fee and the new fee, and what have you—the new fee that is out there, two questions.

One, based on what you know now—and I understand from your last answer, you don't have all the information—but based on what

you know now, is that fee an adequate fee to compensate, as you're planning to pay out?

Mr. HARBECK. The answer to your question is yes.

Mr. GARRETT. Okay.

Mr. HARBECK. The fee is adequate to pay on what we anticipate paying, as we understand the claims.

Mr. GARRETT. You have heard the testimony of the panel before you, and I think some of the questions were along this line of—and some of us would take that view, that it should probably—to go back to your point of helping the small investor—it should be more expansive than what you are intending to pay out right now.

If the definition of who—third point of who should be paid—the question of saying that it should—I forget the gentleman who was sitting over here before, I'm sorry—it's not just the direct investor, but one who has gone through a fund, and what have you, and so to their point of saying that it's not just for this—each case could be a small investor, right? Each case could only have $10,000 in the fund, either direct or through one of these funds.

If the definition is broadened as to who you should pay out, as some would suggest that it should be, would that fee be adequate to cover for that?

Mr. HARBECK. If it is—if the definitions are expanded in some of the ways we heard this morning, the answer is no.

Mr. GARRETT. Okay. And then, would you be able to come up with an estimation of what the fee should be to adequately cover that?

Mr. HARBECK. It's probably doable, but it would be difficult, because of the way some of the large hedge funds have their claims, and how often—how many iterations you would have to go down, in terms of treating individuals. So it would be very hard.

Mr. GARRETT. Okay. I would suggest, if you could—I know that—is to try to give some sort of ballpark. But I think that would go to one of the other questions.

As you heard, I invited some broker-dealers and others to come in. If we were to go down that road, that would have impact not only on what you have to do, but would have impact upon who the fees would be assessed against, and they might want to have some input on that, as well.

So, if you're able to do that—and I believe—I see my time is up.

I think some of the other questions were touched on before. I got into the netting aspect, the clawback provisions. And I don't want to repeat myself on the comments that I made earlier, that we are obviously not looking necessarily for fairness, because I don't know that you can get fairness.

But what we're looking for with the folks here is justice in the reliance that they made, not on independent investment decisions that they were making in the normal course of things, but on their reliance, and what the government assured them through—both through this program after the fact, and through the assurances that—these being registered in the fund—his fund coming under the SEC as well. Thank you.

Chairman KANJORSKI. The gentlelady from California, Ms. Speier.

Ms. SPEIER. Thank you, Mr. Chairman. I guess my first question is to you, Mr. Harbeck.

I have only been around here for less than 2 years. But my take on what happens is basically, the industry gets a license to do a lot of things, and then fails at it, and we are left to pick up the pieces.

If you look at why SIPC was created, it was created because there were these huge bankruptcies that occurred in the early 1970's, and money was taken from investors, and we wanted to make investors whole. So then SIPC was created. And, as you pointed out, for a long period of time—because you thought you had ample funds—these brokers were only paying $150 a year. For 19 years, they were paying $150 a year.

Now, you have increased it recently because of the Madoff scandal. But I have one question, which is I think the insurance product is out of date. I think that it's very important for you to go back and reformulate an insurance product that reflects the way people invest today. People invest today through mutual funds and hedge funds. And if you're going to offer a product that has no relevance today but had relevance in 1970, I don't believe you are doing your job.

Now, secondly, I have a question for you, which is if now you are charging one quarter of one percent of the revenue, the net revenue that's generated by a broker to refill the fund, what would prevent you from coming up with a one-eighth of one percent of revenue to create a fund to pay the Madoff victims some kind of compensation? There is nothing that precludes you from doing that, is there?

Mr. HARBECK. It would have to be statutory, Congresswoman.

Ms. SPEIER. It would have to be—

Mr. HARBECK. Yes.

Ms. SPEIER. Well, you were able to make this change from $150 to 1/4 of 1 percent with no trouble, right?

Mr. HARBECK. Yes, by bylaw.

Ms. SPEIER. You did that by law?

Mr. HARBECK. By bylaw.

Ms. SPEIER. By bylaw.

Mr. HARBECK. When—

Ms. SPEIER. Couldn't you create a new bylaw?

Mr. HARBECK. We can only expend our money in one particular way, to supplement the fund of customer property in the way that the statute describes. Our bylaw says that when our fund is in danger of reaching $1 billion or less, that we can reinstitute for that purpose.

But what you are saying is that we would have to repurpose the statute to create a fund specifically for these victims.

Ms. SPEIER. And you're saying that would require statutory, not something you could do—you're a separate corporation. There is—I am having a hard time understanding why you, as a corporation, can't just decide that, because of this travesty, that—and because the insurance product that you offer is inadequate today, and it should have been reformulated anyway—that you cannot create a new fee that would be imposed. It would be a modest fee, but it could help immeasurably a lot of people.

Mr. HARBECK. We are, in fact, a creature of statute. We are not a government organization, but the statute creating us was a Federal statute.

Ms. SPEIER. Well, you know, that's the problem. We do—we are really great at passing laws, creating these entities outside of government to operate—FINRA is another one that I can't quite understand—and yet you have to come back to government to fix things.

Either you should be a Federal agency where we have responsibility and the ability to act immediately, or you should be an independent corporation, and then would have the ability to do things that you do, independent of statute.

But having said that, I have a question for Mr. Conley, and we're about to go for a vote.

Mr. Conley, from my perspective—and this may predate your involvement at the SEC—but having observed over the course now of these 2 years the Madoff fiasco, the travesty that it has created, not just for the American people, but for the Federal Government, the SEC failed. It failed miserably.

When you—when we had the whistleblower before us, I was astonished at the degree by which he continued to pursue this. I mean, he came before the SEC 5 or 6 times, seeking the SEC to take some action against Mr. Madoff.

And even when the SEC went out to see Mr. Madoff, Mr. Madoff has now admitted that when he—the question was asked of him, "Who is your custodian," and he rattled off a name, and he was convinced that within the next 3 days, he would be shut down because the custodian did not provide those services to Mr. Madoff, but then the SEC never even made the phone call to find out whether or not Mr. Madoff was operating through that custodian.

So, from my perspective, the government, the Federal Government, failed miserably, and the SEC, in particular. So, my question to you is this: Since we were responsible for this travesty, shouldn't we take some responsibility now, in trying to make the people who were impacted by our incompetence and by our malfeasance, by creating a fund to make them somewhat whole? And what would prevent the SEC from doing that?

Mr. CONLEY. Thank you, Congresswoman. I can respond in two ways. Creating the fund that you talk about is certainly something that Congress could do, if it determined that was the appropriate thing to do here; certainly you could do that.

With respect to the failures that you have identified, that is something which the Commission has recognized, and takes extremely seriously. And since Chairman Schapiro has come to the Commission, in fact, there have been numerous reforms that have been put in place that are directly responsive to what you identified, and which the Inspector General's report identified as very serious failings at the Commission.

And among the things that have changed that, on a going-forward basis, to make sure that something like this will not happen again, is that hundreds of employees have been trained to be certified fraud examiners. There is the requirement now—in all examinations—of third-party verification of customer assets that are held by the investment advisor or broker-dealer. And we also have

been hiring more people with particularized expertise that will make the examination teams much more effective. And we are working to deploy more people to the front lines, more investigators who will be there, and be able to root out this fraud in an effective way.

So, all that has happened. And there are even greater reforms coming down the road. Next week, for example, the Commission will be voting on rules designed particularly to address the situation of investment advisors with custody of customer assets. Those rules would encourage investment advisors not to have custody of customer assets, and instead, to place them with third parties, to prevent the exact kind of misconduct that occurred here.

Ms. SPEIER. My time has expired, Mr. Chairman, but I certainly think that we need to appreciate that going forward doesn't fix those who have been injured by government's inaction, and that we should really reflect on what we can do to make whole some of these people.

Chairman KANJORSKI. I just have a couple of questions. I think you are absolutely correct, Ms. Speier, and we are going to work toward that end, I hope, as a committee.

But I notice you are talking about increasing the premiums in the future. Why have you not thought about making a back assessment? You are really punishing the people who are going to come into the business who may not even have been in the business when Madoff was around.

Why should we not put the assessment on the people who were in the business when it happened? And with the law professor, Professor Coffee, indicating that would put an incentive on the dealers to be working more in conjunction with the SEC and with your organization, to see that this does not happen, because there would be a payment that they would have to make, why—in order to accomplish an assessment instead of a future increase in premiums, would you need legislation to do that?

Mr. HARBECK. Yes, we would, Mr. Chairman.

Chairman KANJORSKI. Would you prepare that request, so you get it to the committee, and we can look at it?

The second request I have of you is not totally unrelated to this hearing. But I have spent a number of days meeting with legal representatives of about 1,300 claimants who are in 23 countries around the world. And they tell me that, under present conditions, to handle the claims that are out there, because they are under all the various laws of the 23 nations involved, that it is going to take something like 30 years to resolve these claims.

I was going through the roughly $100 million a year of the trustee's fees. Are you prepared to pay out $3 billion over the next 30 years to the trustee, so he can be around to settle these claims? And, quite frankly, I think it is going to end up that his fees are going to be a lot larger than the claims.

Now, what I am saying to you is, what are you doing, in terms of establishing some sort of method of arbitration for international settlement of claims? And why should that not be before the Congress? And should that recommendation not be coming from your organization?

You know what you face. You know what your problems are. You know that we are going to be doing more international business, and not less. These frauds will continue to occur in the future. Why do we not have a simplified way of getting the issue before an arbitration board or somebody on a relatively uniform basis, instead of just spending these inordinate fees for trustees?

I am not against lawyers; I am one myself. But, that is a big one. I do not think there is any member of this panel who would assume for a million-and-a-half a week—maybe they would leave the Congress and take that trusteeship. I am being facetious. Naturally, we would never do that.

But seriously, can you make recommendations to the committee as to what should be done to facilitate international claims of this sort that will occur in the future—

Mr. HARBECK. The—

Chairman KANJORSKI. —are existent now that we can act on?

Mr. HARBECK. Yes. The one thing that we have done prospectively on an international basis is to enter into memorandums of understanding with our foreign counterparts to SIPC, in case a brokerage firm fails with a footprint in more than one jurisdiction. We have those agreements with Canada, the United Kingdom, China, Korea, and Taiwan. We seek to expand that.

What you have suggested is far more complex, but I would be certainly willing to discuss it with any international expert that we can find.

Chairman KANJORSKI. This is not a one-time deal. We are going to have these transactions, we are going to have these occurrences. Let us not end up paying fees to trustees and lawyers that take money away from the basic account that could be paid to the claimants. That is going to happen in this case, and it is going to be a tragedy.

Let me give Mr. Ackerman one question, and then Ms. Speier.

Mr. ACKERMAN. Yes, I just wanted to follow up on the first question that the chairman just asked. Your response was that you're a creature of legislation.

Under legislation under which you act, you have a line of credit of $1 billion, as I understand, which can be accessed if the fund is depleted—and there is still a lot of money in the fund.

If you did—and therefore can—act by resolution, why can't you generously and liberally pay out to the greatest number of people promptly, as the statute requires, whatever money is in there, access your line of credit, and at least have $1 billion. You don't have to wait for all this legislative process to take place.

You know, everybody working on this, and who are working hard and are entitled to whatever money they are entitled to earn on being trustees, and whatever, all this money every week, they expect to be paid promptly.

If the people who are victims were paid promptly a couple of months ago, some of them could have ridden the 40 percent rise, because they're all investors—or at least were; they're investors without money, some of them—could have gotten 40 percent in the market right now. I mean, everybody is losing and double losing and triple losing here, because of the delay.

Can you spin that out, and request it by resolution, or whatever?

Mr. HARBECK. No. And the reason is the only people we can protect are those people who fit within the statutory definitions. And we believe that people who—

Mr. ACKERMAN. Which of your interpretations of that statutory definition?

Mr. HARBECK. The same cases that have uniformly, since 1973, held that with respect to fraudulent statements that are backdated, all of the cases uniformly—including the New Times case—hold that those claims are not customer claims, and that the fraudulent documents should be ignored.

Mr. ACKERMAN. His testimony didn't say that.

Chairman KANJORSKI. Okay, thank you. Ms. Speier, do you have any further questions? We re down to less than 5 minutes now for the vote.

Ms. SPEIER. Okay, I will be very brief. Mr. Harbeck, I would like for you to come back to the committee with a proposal of providing an insurance product that really is going to reflect the kind of investing done by average American investors today, who do most of their investing through funds, and who do not have the sophistication to know whether or not the actual stocks they have purchased are indeed being purchased. That is where the SEC comes to play.

But I—we need a different product. The product that exists just doesn't meet the needs of the American people.

And then, if you could, just provide to us what does one quarter of one percent of revenue actually generate?

Mr. HARBECK. This year—and again, because it fluctuates with the brokerage firm—

Ms. SPEIER. Yes.

Mr. HARBECK. —revenues, I believe it's $480 million.

Ms. SPEIER. $480 million. And you came up with one fourth of one percent on your own. It could have been a half a percent, or it could have been—

Chairman KANJORSKI. May I suggest that this calculation be made and supplied to Ms. Speier, so we can get this wound up and get our members over to vote?

The Chair notes that some members may have additional questions for this panel which they may wish to submit in writing. Without objection, the record will remain open for 30 days for members to submit written questions to today's participants, and to place their responses in the record.

I thank you gentlemen for participating. We appreciate it. And may I just make the request, I think of all the members present here right now, let's have a little better interaction between your respective organizations and the committee, to get to the bottom of the substantive questions that have to be answered.

Thank you very much for participating in today's hearing. The panel is dismissed, and this meeting is adjourned.

[Whereupon, at 2:55 p.m., the hearing was adjourned.]

A P P E N D I X

December 9, 2009

OPENING STATEMENT OF
CHAIRMAN PAUL E. KANJORSKI

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE, AND GOVERNMENT SPONSORED ENTERPRISES

HEARING ON ADDITIONAL REFORMS TO THE SECURITIES INVESTOR PROTECTION ACT

DECEMBER 9, 2009

Good morning. One year ago this week, Federal authorities arrested Mr. Bernard Madoff for perpetrating the largest Ponzi scheme in U.S. history. It is therefore appropriate for us to meet today for the third time to examine this massive securities fraud. As my colleagues know, I have sought to use this $65 billion deception as a case study to guide our work in reshaping and reforming our financial services regulatory system.

Last month, our Committee passed H.R. 3817, the Investor Protection Act, and we have now rolled this important securities reform bill into H.R. 4173, the Wall Street Reform and Consumer Protection Act, which the House will begin to consider today. Both bills contain a number of provisions that directly respond to Mr. Madoff's substantial swindle.

The repeated failures of the U.S. Securities and Exchange Commission -- despite having received several leads from a number of sources -- to detect the Madoff fraud allowed the hoax to continue for more than a decade. A lack of effective coordination, sufficient funding, and staff expertise each contributed to this unfortunate regulatory breakdown.

In response, our bills double the authorized funding for the Commission over 5 years to ensure that the agency has the resources it needs to hire staff with appropriate expertise and to get its job done. The bills also provide for an expeditious, independent, and comprehensive review of the entire securities regulatory structure by a high-caliber entity with experience in organizational change. This study will identify specific reforms and improvements that the Commission and the other entities that oversee our securities markets must put in place to ensure superior investor protection going forward.

The Madoff episode also revealed the need to elevate the importance of whistleblowers like Mr. Markopolos -- who made repeated entreaties to the Commission regarding Mr. Madoff's con -- by establishing incentives so that more of them will come forward. Our regulatory reform package therefore includes a bounty program to help identify wrongdoing in our securities markets and reward individuals whose tips lead to successful enforcement actions. With a bounty program, we will effectively have more cops on the beat.

In studying the Madoff case, we have additionally learned that the Public Company Accounting Oversight Board lacked the powers it needed to examine and take action against the auditors of broker-dealers. Our legislation closes this loophole so

schemers like Madoff will no longer be able to rely on inept or corrupt accounting firms to rubber stamp their criminal activities.

Through our investor protection reforms, we have further sought to strengthen the Securities Investor Protection Act, the law that helps investors to recover funds when a broker or dealer fails. We have increased the resources available to the Securities Investor Protection Corporation to fund liquidations, boosted the level of cash coverage an investor is entitled to, and raised penalties on brokerages for violations of the law. We have also broadened the eligible types of investments covered. We can, however, do more to reform this law.

Today, we will continue to move this process forward as we examine the ongoing efforts of the Securities Investor Protection Corporation to mitigate the sizable losses suffered by Mr. Madoff's victims, as well as the casualties of the $8 billion Stanford Financial fraud. We will also explore the intended and unintended consequences of several proposed changes to the Securities Investor Protection Act that aim to address problems that some Madoff and Stanford Financial victims -- including retirees, pension funds, charities and others -- have encountered.

While each of these amendments seeks to fix a perceived deficiency in the law, each proposal would also benefit from a robust debate in order to identify potential problems and possible refinements. Some, for example, have advocated that the Securities Investor Protection Corporation should not claw back the profits taken by early investors who unwittingly partook in a Ponzi scheme. I have concerns that such a plan, if implemented, would treat later investors unfairly. That said, clawing back profits already used by charities could prove especially devastating. As such, we must walk a fine line in determining how to proceed, if at all.

In closing, I would like to extend my appreciation to my colleagues from New York, Mr. Ackerman and Mr. Maffei, as well as Mr. Ellison of Minnesota, Mr. Klein of Florida, and Mr. Perlmutter of Colorado who have helped to select today's witnesses and advance discussions on reforming the Securities Investor Protection Act. Together, I hope that we can learn more from these terrible events and figure out how we can further improve our regulatory system.

Congressman Joe Baca
Capital Markets Subcommittee: December 9, 2009 – Opening Statement

I want to start off by thanking Chairman Kanjorski and Ranking Member Garrett for holding this hearing today. I also want to thank the witnesses for being here and offering their insight on these issues.

Last fall, one of the greatest frauds in our nation's history was uncovered. Because of it, thousands of Americans' financial future was put in jeopardy. What's worse is that the SEC, the government watchdog that is charged with preventing these kinds of frauds, seemed to be asleep at the switch for some time.

But simply laying blame does nothing to solve the problem or restore Americans' faith in the SEC. Nor does it restore the estimated $64.8 billion that was stolen from Americans.

Recently this committee has reviewed a number of proposals that will work toward preventing this fraud from happening again. While we cannot guarantee that there will not be any more bad actors like Madoff, we can work to guarantee that a fraud will not slip through the cracks like this one did. Additionally, we can work to ensure that all innocent parties are made whole.

A number of my colleagues have introduced proposals that would work toward fixing the restrictions that preventing the recovery of these stolen funds. I look forward to hearing from the witnesses and my colleagues regarding these proposals and how we can expand the recovery efforts and work to ensure recovery for all victims. I want to thank the Chair and Ranking member for their leadership on this issue and I yield back.

Testimony of Helen Davis Chaitman, Esq. Before the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises House Financial Services Committee December 9, 2009

Chairman Kanjorski and distinguished Representatives, I thank you for this opportunity to testify today. In the past year, I have become an avid student of the Securities Investor Protection Act ("SIPA") and painfully knowledgeable about the deficiencies in the performance of the Securities Investor Protection Corporation ("SIPC") under the Act.

I am an attorney practicing law in New York and New Jersey. On the evening of December 11, 2008, I learned that I had lost my life savings in Bernard L. Madoff Investment Securities, LLC. When I recovered from my shock and devastation, I realized that I was one of the lucky ones, because I am still practicing law and able to support myself. I devoted the next six months of my life to working, on an entirely *pro bono* basis, for the hundreds of destitute Madoff victims who were in their 70's, 80's and 90's and who had lost their sole means of support.

At the present time, I represent over 200 families of Madoff investors. In addition, entirely on a *pro bono* basis, I have sought both tax and SIPA relief for Madoff investors who, unlike me, no longer have the capacity to work and who, unlike me, are subject to clawback. In the past few months, I have met with many of you and with your aides and I thank you, on behalf of all my clients, for the time and attention you have given to the issues I have raised.

My clients are typically people who had invested in Madoff for 15 – 20 years; who had worked hard during the productive years of their lives; sold their businesses;

invested the proceeds in Madoff; and retired on the income they derived from their Madoff investments. Some of my clients had served with distinction in the Second World War and in the Korean War. Most of my clients were generous with philanthropies and with their children. These are Americans of whom we should all be very proud. They are living at the most fragile time of their lives. Many of them are dealing with cancer and other life-threatening illnesses. They should not have to wake up every day terrified that they will now lose the meager funds they have left. Yet, that is the way they are living.

On December 11, 2008, they were hit with a financial tsunami from which they can never recover. I know that this Subcommittee has focused on the failure of the SEC to uncover Madoff's fraud and that is not the subject of my comments. However, it is one thing for my clients to have suffered as victims of a crime. It is quite another for them to be further devastated by the failure of SIPC to comply with the mandates of a federal statute. As a result of the improper conduct of SIPC, my clients have been devastated by two additional financial tsunamis after December 11, 2008 and it is on these that I want to focus my comments today.

Tsunami 2: SIPC's Failure to Honor its Insurance Obligations to Investors

The second tsunami that devastated Madoff investors was the failure of SIPC to honor its statutory obligation to replace securities in their accounts up to $500,000.

Congress enacted SIPA in 1970 in order to instill confidence in the capital markets by establishing SIPC which would function, like the FDIC, but would be

funded by the brokerage industry.[1] I cannot imagine that there was more of a need to instill public confidence in the capital markets in 1970 than there is today. In light of SIPC's status as a quasi-governmental insurance company, SIPC's default on its obligations to the Madoff customers is destructive not only to the customers but to the compelling national interest in stabilizing the capital markets, in the same way that a default by the FDIC would be devastating to the national economy.

In 1978, the amount of SIPC insurance was fixed at $500,000 for securities and $100,000 for cash and those amounts have not been increased since 1978, despite the significant increase in the cost of living since then.[2] Many of my clients would be fully compensated if SIPC fulfilled its statutory obligations. For other clients, while the $500,000 would not have made them whole, it would have allowed them to support themselves on an interim basis and saved them the tragedy of disposing of houses at liquidation values in a tremendously distressed market.

The legislative history of SIPA makes clear that Congress' intent was to protect a customer's "legitimate expectations," based on his brokerage statements and to replace securities even if the broker stole the customer's money and never purchased the securities. For example, Congressman Robert Eckhardt commented when SIPA was amended in 1978:

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[1] "The intention of SIPC, like the FDIC, is to minimize losses to and to maintain public confidence in the institutions the public deals with." S. Rep. 91-1218, at 9, *reprinted in* Federal Securities Laws Legislative History 1933-1982, Vol. IV, at 4641. According to the FDIC's website, "It is the FDIC's goal to make deposit insurance payments within two business day[s] of the failure of the insured institution." http://www.fdic.gov/consumers/banking/facts/payment.html.

[2] The purpose of SIPC was to "maintain and administer an insurance fund which would provide coverage against customer losses. . . resulting from broker-dealer firms' insolvency." S.Rep. No. 91-1218, p. 1 (1970). The Senate described SIPC as "an insurance plan for the industry," and one of several "federally sponsored insurance programs." *Id.* at 4 - 5, 7 - 9

> One of the greatest shortcomings of the procedure under the 1970 Act, to be remedied by [the 1978 amendments] is the failure to meet legitimate customer expectations of receiving what was in their account at the time of their broker's insolvency.
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> * * *
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> A customer generally expects to receive what he believes is in his account at the time the stockbroker ceases business. But because securities may have been lost, improperly hypothecated, misappropriated, never purchased, or even stolen, this is not always possible. Accordingly, [when this is not possible, customers] will receive cash based on the market value as of the filing date.

H.R. Rep. 95-746 at 21.

SIPC's Series 500 Rules, 17 C.F.R. 300.500, enacted pursuant to SIPA, provide for the classification of claims in accordance with the "legitimate expectations" of a customer based upon the written transaction confirmations sent by the broker-dealer to the customer.

Up until the Madoff case, both SIPC and the SEC acknowledged that an investor who invested in an SEC-regulated broker who operated a Ponzi scheme is entitled to replacement securities up to $500,000, even where the broker never purchased the securities and even though the securities, on paper, might have tripled in value. The controlling factor is the "legitimate expectations" of the customer; not whether the broker was a crook. In fact, in the *New Times* case, a long-running Ponzi scheme in which the broker never purchased the securities indicated on the customers' statements, Stephen Harbeck, the President of SIPC, assured the bankruptcy court that SIPC would replace securities in investors' accounts, even where the securities had

tripled in value, despite the fact that no securities had ever been purchased for the investors. [3]

Consistent with Harbeck's representation to the bankruptcy court, in the Second Circuit both SIPC and the SEC assured the Court of Appeals in *New Times* that SIPC would replace securities in a customer's account so long as the customer's statements reflected the purchase of securities. SIPC wrote in its Second Circuit brief:

> Reasonable and legitimate claimant expectations on the filing date are controlling even where inconsistent with transaction reality. Thus, for example, **where a claimant orders a securities purchase and receives a written confirmation statement reflecting that purchase, the claimant generally has a reasonable expectation that he or she holds the securities identified in the confirmation and therefore generally is entitled to recover those securities (within the limits imposed by SIPA), even where the purchase never actually occurred and the debtor instead converted the cash deposited by the claimant to fund that purchase** . . . [T]his emphasis on reasonable and legitimate claimant expectations frequently yields much greater 'customer' protection than would be the case if transaction reality, not claimant expectations, were controlling, as this Court's earlier opinion in this liquidation well illustrates.

Br. of Appellant SIPC at 23-24 (citing *New Times*)(emphasis added).

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[3] HARBECK: . . . if you file within sixty days, you'll get the securities, without question. Whether – if they triple in value, you'll get the securities . . . Even if they're not there.

COURT: Even if they're not there.

HARBECK: Correct.

COURT: In other words, if the money was diverted, converted –

HARBECK: And the securities were never purchased.

COURT: Okay.

HARBECK: **And if those positions triple we will gladly give the people their securities positions.**

Tr. at 37-39, *In re New Times Securities Services, Inc.*, No 00-8178 (B.E.D.N.Y. 7/28/00) (emphasis added).

In an *amicus curiae* brief in the *New Times* case, the SEC wrote:

> Our view [is] that when possible, SIPA should be interpreted consistently with a customer's legitimate expectations based on confirmations and account statements. [4]

The Second Circuit's two decisions in *New Times* are directly controlling in the Madoff case because the precise issue of how to treat customers, like the Madoff investors, was approved by the Court, with the agreement of the SEC and SIPC.

As late as December 16, 2008 – five days after Madoff's confession, SIPC's general counsel, Josephine Wang, assured the public, through a statement to the press, that a Madoff customer is entitled to the securities in his account:

> Based on a conversation with the SIPC general counsel, Josephine Wang, if clients were presented statements and had reason to believe that the securities were in fact owned, the SIPC will be required to buy these securities in the open market to make the customer whole up to $500K each. So if Madoff client number 1234 was given a statement showing they owned 1000 GOOG shares, even if a transaction never took place, the SIPC has to buy and replace the 1000 GOOG shares.

December 16, 2008 Insiders' Blog, www.occ.treas.gov/ftp/alert/2008-37.html.

Yet, shortly thereafter, SIPC decided to violate the clear mandates of SIPA and its own representations to investors for 38 years by reneging on its insurance obligation to the victims of Madoff's fraud.

Without legal authority, Picard has invented his own definition of "net equity"

SIPA mandates that a customer's claim in a SIPA liquidation be fixed at the customer's "net equity." SIPA defines "net equity" as the value of the securities positions in the customer's account as of the SIPA filing date, less any amount the customer owes the debtor.

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[4] Br. of the SEC, Amicus Curiae, In Partial Support of the Position of Appellants and In Partial Support of the Position of Appellees at 13, *New Times I* (No. 02-6166).

> The term 'net equity' means the dollar amount of the account or accounts of a customer, to be determined by –
>
> (A) calculating the sum which would have been owed by the debtor to such customer if the debtor had liquidated, by sale or purchase on the filing date, all securities positions of such customer . . .; minus
>
> (B) any indebtedness of such customer to the debtor on the filing date . . .

15 U.S.C. § 78*lll*(11).

SIPA specifically prohibits SIPC from changing the definition of "net equity." 15 U.S.C. § 78ccc(b)(4)(A). The Second Circuit has recognized that:

> Each customer's "net equity" is "the dollar amount of the account or accounts of a customer, to be determined by calculating the sum which would have been owed by the debtor to such customer if the debtor had liquidated, by sale or purchase on the filing date, all securities positions of such customer" [corrected for] any indebtedness of such customer to the debtor on the filing date.

In re New Times Securities Services, Inc., 371 F. 3d 68, 72 (2d Cir. 2004). [5]

In derogation of his obligations to carry out the provisions of SIPA, the trustee chosen by SIPC in the Madoff case, Irving Picard, has invented his own definition of "net equity." Picard has asserted that he has a right to recognize investors' claims only for the amount of their net investment, disregarding all earnings in their accounts. By this procedure, Picard would reduce the total Madoff claims from $64.8 billion to approximately $21 billion and he would reduce the number of customers entitled to SIPC insurance from approximately 4,904 account holders to 2,335 account holders.

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[5] *See also,In re Adler Coleman Clearing Corp.*, 247 B.R. 51, 62 N. 2 (B.S.D.N.Y. 1999)("'Net equity' is calculated as the difference between what the debtor owes the customer and what the customer owes the debtor on the date the SIPA proceeding is filed.").

The 2,569 account holders whose claims are thereby eliminated include a significant multiple of 2,569 people because many accounts include the life savings of several elderly, long-term Madoff investors whose families pooled their savings in order to meet Madoff's minimum investment amount. Many of my clients had family accounts in which parents and their siblings, children and grandchildren pooled their funds. Under SIPA's definition of "customer," each of these family members is entitled to SIPC insurance, although Picard and SIPC have denied coverage to all of them.[6]

Harbeck has offered the following justification for inventing a new definition of "net equity." He says:

> Using the final statements created by Mr. Madoff as the sole criteria [sic] for what a claimant is owed perpetuates the Ponzi Scheme. It allows the thief . . . Mr. Madoff . . . to determine who receives a larger proportion of the assets collected by the Trustee.

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[6] 15 U.S.C. § 78lll(2)("The term "customer" includes . . . any person who has deposited cash with the debtor for the purpose of purchasing securities."). *Rosenman Family, LLC v. Picard,* 401 B.R. 629, 635 (B.S.D.N.Y. 2009)("the mere act of entrusting . . . cash to the debtor for the purpose of effecting securities transactions . . . triggers customer status. . ."); *SEC v. Ambassador Church Financial Devel. Group, Inc.,* 679 F. 2d 608, 614 (6th Cir. 1982); *In re Primeline Sec. Corp.,* 295 F. 3d 1100, 1107 (10th Cir. 2002)("SIPA does . . . protect claimants who try to attempt to invest through their brokerage firm but are defrauded by dishonest brokers . . . If a claimant intended to have the brokerage purchase securities on the claimant's behalf and reasonably followed the broker's instructions regarding payment, the claimant is a 'customer' under SIPA even if the brokerage or its agents misappropriate the funds"); *Miller v. DeQuine (In re Stratton Oakmont, Inc.),* 2003 WL 22698876 at *3 (S.D.N.Y. Nov. 14, 2003)("Stratton Oakmont's conversion of Claimants' property makes the customers within the meaning of SIPA.").

Clearly, if Congress had intended to limit customers to account holders the definition of customer could have been six words: "A "customer" is an account holder." Instead, Congress' definition of "customer" is 20 lines long and is further clarified in 15 U.S.C. § 78fff-3(a) to make clear that customers of a bank or broker or dealer that invests in Madoff are all customers under SIPA ("no advance shall be made by SIPC to the trustee to pay or otherwise satisfy any net equity claim of any customer who is a broker or dealer or bank, other than to the extent that it shall be established . . . that the net equity claim of such broker or dealer or bank against the debtor arose out of transactions for customers of such broker or dealer or bank . . . , **in which event each such customer of such broker or dealer or bank shall be deemed a separate customer** of the debtor")(emphasis added).

Harbeck's statement is a rationalization of what appears to be SIPC's goal, *i.e.,* to save money for the brokerage community at the expense of innocent investors who relied upon the assurance of SIPC insurance to invest their funds in Wall Street.

After almost 12 full months of his tenure, Picard has identified only two Madoff investors who **might not** have had a "legitimate expectation" that the trade confirmations and account statements they received were accurate. Picard has sued two Madoff customers, Stanley Chais and Jeffry Picower who, Picard has alleged, took out of Madoff $7.2 billion more than they invested. Picard has further alleged that these two investors received returns in their accounts of 100% – 900% and that Madoff back-dated $100 million losses in their accounts. Assuming these allegations are true, Chais and Picower were Madoff's co-conspirators and certainly could not have had a "legitimate expectation" that their accounts were genuine.

However, the fact that two people may have been Madoff's co-conspirators does not justify SIPC's depriving thousands of totally innocent investors of their statutory maximum payment of $500,000 in SIPC insurance. My clients received monthly statements from Madoff in the past several years indicating returns on their Madoff investment in the range of 9 – 11% per year, all taxable at the highest rate as short term capital gains. My clients had entered into standard brokerage agreements with Madoff, a licensed SEC-regulated broker-dealer, pursuant to which they received on a monthly basis trade confirmations for every securities transaction in the Account which accurately set forth the names and prices of securities indicating the purchase and sale of Fortune 100 company stocks and the purchase of US Treasury securities.

There is no basis to claim that my clients did not have a "legitimate expectation" that the assets reflected on the account statements sent to them by Madoff belonged to them.

Moreover, as indicated by the legislative history, the focus of SIPA is not on the state of mind of a broker who turns out to be a crook; it is on the legitimate expectations of customers who relied on the promise of SIPC insurance as reflected on every statement they received from their broker. Only by that focus can confidence be instilled in the capital markets.

SIPC's Motivation for Violating the Law

There is only one reason why SIPC has violated the clear mandates of SIPA. SIPC's and Picard's conduct saves Wall Street about $1.5 billion in SIPC insurance. Clearly, from the perspective of the Wall Street firms, they have already realized the economic benefit of SIPA because hundreds of billions of dollars of American's savings were poured into street name securities held by Wall Street because of the promise of SIPC insurance.[7] And, for 38 years, Wall Street was able to profit handsomely from those street name securities, without sharing any of those profits with the owners of the securities. SEC regulations allow brokerage firms to treat street name securities as their own property. They can lease them out; they can sell them and buy them back; they can borrow against them for their own corporate purposes. [8] The only protection for the investors is SIPC insurance.

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[7] *See An Investor's Guide to the Alternatives of Holding Physical Certificates,* published by the Securities Industry and Financial Market Association, available at http://www.sifma.org/services/publications/pdf/PhysCertGuide2alternatives.pdf (stating that the Securities Industry and Financial Market Association "strongly supports and encourages [street name] type of ownership".

[8] *See, e.g.,* 17 C.F.R. 240.8c-1; 17 C.F.R. 15c-1.

Congress pointed out to SIPC that its failure to appropriately assess the Wall Street firms for SIPC insurance left SIPC incapable of handling a major liquidation. Despite warnings from the GAO and from the House Financial Services Committee, [9] SIPC persisted during the entire period from 1996 – 2008 to charge a mere $150 per year to each firm for hundreds of billions of dollars of SIPC insurance. Thus, Goldman Sachs paid $150 per year for the privilege of printing on tens of billions of dollars of trade confirmations that the customers' accounts were insured up to $500,000 by SIPC.

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[9] For example, the GAO wrote in April 2003:

> the SIPC fund was at risk in the case of failure of one or more of the large securities firms. SEC found that even if SIPC were to triple the fund in size, a very large liquidation could deplete the fund. Therefore, SEC suggested that SIPC examine alternative strategies for dealing with the costs of such a large liquidation. SIPC management agreed to bring this issue to the attention of the Board of Directors, who evaluates the adequacy of the fund on a regular basis.

July 2003 United States Accounting Office Report to Congressional Requesters, "Securities Investor Protection: Update on Matters Related to the Securities Investor Protection Corporation."

In their August 11, 2003 letter, Reps. Frank, Kanjorski and Dingell declared that they were "deeply troubled by th[e] state of affairs" at SIPC outlined the GAO Report. Specifically, the SEC had found in an examination of SIPC that:

> (1) some statements in SIPC's brochure and Web site might overstate the extent of SIPC coverage and mislead investors; (2) there was insufficient guidance for SIPC personnel and trustees to follow when determining whether claimants have established valid unauthorized trading claims, one. . principle source of investor complaints; (3) SIPC had inadequate controls over the fees awarded to trustees and their counsel for services rendered and their expenses; (4) SIPC lacks a retention policy for records generated in liquidations where SIPC appoints an outside trustee; and (5) the SIPC fund was at risk in the case of failure of one or more of the large securities firms.

Reps. Frank, Kanjorski and Dingell stated that this situation was "totally unacceptable and [they] urge[d] SIPC to fix these shortcomings, which [they] consider[ed] to be significant, with all deliberate speed before a major problem occurs." Now, the "major problem," foreseen by the SEC has come to pass in this case, and SIPC's failure to remedy its shortcomings has resulted in SIPC's fund being inadequate.

If we accept Picard's position that SIPC is only liable to replace securities up to $500,000 **per account**, there were 4,904 active Madoff accounts on December 11, 2008 on which SIPC had an exposure of approximately $2.5 billion. As we know, SIPC did not have assets of $2.5 billion on December 11, 2008. It only had assets of $1.7 billion. SIPC had two choices following December 11, 2008:

(a) SIPC could have complied with the law and borrowed up to $2 billion on its lines of credit with the SEC and the Treasury so that it would have the funds necessary to replace securities in each customer's account up to $500,000. Or

(b) SIPC could default on its obligations to Madoff's customers, thereby causing untold tragedy to innocent investors whose lives had already been devastated by the SEC's failure to close Madoff down in 1992.

This second choice is virtually unthinkable because it is such a flagrant violation of the express provisions of SIPA. And yet this is what SIPC did. SIPC announced – for the first time in its history – that, even if a customer's statements reflected the purchase of real securities, SIPC only insured the "net investment" of each customer.

By this device, the Trustee reduced the number of Madoff customers eligible for SIPC insurance from 4,904 to 2,335 account holders, leaving 2,569 account holders without the SIPC insurance to which they are absolutely entitled. And as to the 2,335 account holders who are indisputably entitled to SIPC insurance, SIPC has inexcusably delayed payment to these investors. In fact, it is now one year since Madoff was put into liquidation and the Trustee was appointed. And after one year, SIPC has only allowed 1,637 of the 2,335 account holder claims that SIPC admits are valid.

This is hardly the prompt replacement of securities that Congress mandated in SIPA or the prompt replacement of securities of which Stephen Harbeck bragged in a February 26, 2003 News Release available on SIPC's website:

> The Park South case is a textbook illustration of why Congress created SIPC to protect investors at troubled brokerage firms. While misuse of customer cash and securities is uncommon, it is important for investors to know that SIPC is here as a safety net when they need us in those situations. SIPC's mission also was met here in terms of making sure that more than 2,000 Park South investors were not further victimized by having their assets tied up for months or longer in a bankrupt brokerage firm.[10]

I want to be very clear on something: SIPC and Picard have absolutely no legal authority for the position they are taking in the Madoff case. There is not a single case involving a SIPA liquidation in the 39 years of SIPC's history in which a court held that SIPC could utilize its net investment calculation against investors whose statements reflected the purchase of real securities. Instead, SIPC and Picard are relying on decisions of some courts in non-SIPA Ponzi scheme cases where the courts, unrestricted by a comprehensive statutory scheme like SIPA, have held that the equitable way to distribute the debtor's assets is to limit each investor to his net investment.

However, I must tell you that, in a recent decision in the Southern District of New York, **with the SEC's support**, the claims of investors in a non-SEC regulated firm which operated a Ponzi scheme were fixed at the investors' net investment **plus undistributed earnings.** In *SEC v. Byers*, 2009 WL 2185491 (S.D.N.Y. July 23, 2009), the Court's only consideration in approving the plan of distribution was whether the plan was "fair and reasonable" because it was not a SIPA liquidation. 2009 WL

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[10] http://www.sipc.org/media/release26feb03.cfm; emphasis added.

2185491, at *6. Yet, with the SEC's support, the *Byers* Court approved a formula wherein each investor's claim would be fixed at his investment plus any re-invested earnings. *Id.* at *4. Pursuant to this formula, an investor's claim would include any distribution that the investor chose to "roll over" into his account, even though such "distribution" never existed and did not correlate to an out of pocket loss. *Id.*

The *Byers* formula is equivalent to an investor's tax basis. In the Madoff case, an investor's tax basis would be the amount shown on his December 31, 2007 Madoff statement, adjusted for any investments or withdrawals that took place in 2008. Indeed, the Internal Revenue Service has recognized Madoff customers' claims as the amount of their tax basis. See Rev. Proc. 2009-20. The *Byers* formula is also similar to the method required under SIPA of fixing a claim in the amount of the investors' last statement, since the Customers' November 30, 2008 statement would reflect investments and withdrawals since the December 31, 2007 statement.

For some reason, the SEC advocated that result in a non-SIPA liquidation but it has refused to require SIPC to comply with the law in this case where, admittedly, the SEC bears 100% responsibility for the investors' losses.

The effect of SIPC's failure to comply with the statute has been absolutely devastating to my clients. If SIPC had promptly replaced securities in their accounts, they would have benefited from the remarkable appreciation in the stock market in the past seven months. Moreover, they would not have been forced to sell their homes in a depressed market, realizing a small percentage of the market value of their homes just a few years earlier.

Unfortunately, this case has become a classic struggle between Wall Street, represented by SIPC, and Main Street, represented by the destitute investors. And most unfortunately of all, in this battle the SEC has protected the interests of Wall Street over the innocent investors in Madoff.

Congress granted the SEC plenary jurisdiction over SIPC. SIPA imposes upon the SEC the obligation to enforce SIPA when SIPC violates the statute. Yet, the SEC has done nothing to require SIPC to fulfill its statutory obligations to investors and, instead, has sat by and watched the victims of the SEC's incompetence be devastated by SIPC's violation of its statutory obligations.

The SEC's conduct is particularly incomprehensible in view of the fact that SIPC could simply have utilized a portion of its $2 billion lines of credit to satisfy in full its obligations. SIPC needed only approximately $1.5 billion in addition to its own assets to fulfill this obligation. This is a mere 1% of the projected Wall Street bonuses in the year that the financial services industry brought the global economy to its knees. That 1% would hardly be noticed by Wall Street. But the entire world is watching as Wall Street cheats innocent investors of their promised insurance and the SEC is standing by, allowing it to happen.

Like all investors who deal with SEC-regulated broker/dealers, the Madoff investors understood that they had SIPC insurance. Indeed, every trade confirmation they received from Madoff indicated that Madoff's customers were insured by SIPC. Both SIPC's own writings, and the representations of brokers even to this day, assured customers that their accounts were insured up to $500,000, even where the broker was dishonest and never purchased the securities reflected on the customer's statements.

How can any American have confidence in the capital markets when the SEC won't even fulfill its statutory obligation to compel SIPC to comply with the law?

Tsunami 2: The clawback

I told you there were three tsunamis: the first was the loss of the Madoff investment. The second was the denial of SIPC insurance. But the third is the most devastating of all and it is truly a wonder that many of my clients are able to function at all under the stress caused by this last tsunami.

Let me take a minute to explain how Picard is using his new definition of "net equity" so that you can understand the clawback issue. Because of Madoff's unique place in the investment community over a period of almost 50 years, many of my clients are third generation Madoff investors. Let's just take one hypothetical example which is illustrative of the situation faced by many of my clients:

Assume that my grandfather – and again, this is just a hypothetical -- put $500,000 into Madoff in 1970. The account appreciated in value, as would any investment in the stock market. My grandfather died in 2003, at which time the account had a balance of $3 million. At that point, $1.5 million was taken out of the account to pay estate taxes. I then inherited the account, with a balance of $1.5 million which grew, by 2008, to 2.5 million. According to Picard, I would not be entitled to SIPC insurance because only $500,000 was invested in the account (the original investment by my grandfather in 1970) and $1.5 million was withdrawn from the account (to pay the estate taxes for my grandfather's estate and my mother's estate). Therefore, Picard would say, there was no net investment and no entitlement to SIPC insurance.

But it is much worse than that. Picard is demanding that people like me, in the above hypothetical, pay back to the bankruptcy estate all funds withdrawn within the past six years up to the amount of the negative net investment. So, in the hypothetical I have given you, my grandfather invested $500,000; $1.5 million was taken out to pay estate taxes; therefore the negative net investment in the account is $1 million. Picard is demanding that all that money be paid back.

Picard has been sending out letters to people in their 70's, 80's and 90's, who have already lost everything but their houses and their tax refunds, and he is demanding that they pay him back. In fact, Picard has already sued several elderly, virtually destitute investors who are fighting to hold onto the proceeds of the houses they were forced to sell after December 11, 2008 and the tax refunds they received from the Internal Revenue Service in 2009. These are the only funds they have left to cover all of their expenses for the rest of their lives. And now Picard is demanding that they turn over all of these funds to him.[11]

And for what purpose? Who would want to benefit from the recovery of these funds? This is blood money. I must tell you that I personally would benefit financially from the recovery of clawbacks but I am adamantly opposed to them. I never took any

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[11] Although Picard is demanding payment of all withdrawals within six years of December 11, 2008, to the extent of each investor's negative net investment, there is substantial question as to whether Picard would have a right, under bankruptcy law, to claw back six years since 11 U.S.C. Section 546(e) limits a trustee to a two year statute of limitations when seeking to void a transfer by a broker in connection with a securities contract. This section provides as follows:

> Notwithstanding sections 544, 545, 547, 548(a)(1)(B), and 548(b) of this title, **the trustee may not avoid a transfer . . . that is a transfer made by . . . a stockbroker [or] financial institution, . . . in connection with a securities contract,** as defined in section 741(7) . . . that is made before the commencement of the case, except under section 548(a)(1)(A) of this title. (Emphasis added.)

Section 741(7) defines a securities contract to be all-encompassing and it certainly covers the transactions here.

money out of my Madoff account and, if Picard recovered billions of dollars in clawbacks it would increase my distribution from the bankruptcy estate. However, I am opposed to clawbacks against innocent investors because I understand and support the Congressional intent to instill confidence in the capital markets by honoring the legitimate expectations of customers as reflected on their account statements. I represent many investors who are not subject to clawback who, similarly, are opposed to what Picard is doing.

Clearly, if a customer is entitled to rely upon the brokerage statements he receives from an SEC-regulated broker/dealer, then he cannot be required to disgorge funds he withdrew from his account.

It is one thing for investors to have been victimized by a criminal like Madoff. However, it is entirely another thing for investors to be victimized by SIPC and by the SEC's failure to enforce the law against SIPC. This is something that Congress cannot permit to continue. While I am confident that the Second Circuit will enforce the law against SIPC, it could take three years for the Second Circuit to rule and, in the meantime, the lives of thousands of innocent people are being destroyed, along with global investor confidence in our capital markets.

It is for this reason that I have proposed a clarifying amendment of SIPA to reinforce Congress' original intent to respect the legitimate expectations of customers who relied upon the trade confirmations and monthly account statements they received from their SEC-regulated brokers. No investor who had a legitimate expectation that his statements were accurate should be subject to a clawback suit, either a preference claim or a fraudulent conveyance claim. That still leaves plenty of room to sue the

Jeffry Picowers of the world because they could not have had a legitimate expectation that their statements were accurate.

The Need to Put Some Teeth in "Promptly"

There is one last issue that I would like to address. And that is the SIPA mandate that SIPC "promptly" replace securities in a customer's account. Congress made absolutely clear its intention to minimize the devastation to customers of an insolvent broker/dealer through prompt payment of SIPC insurance.

> GENERAL PROVISIONS OF A LIQUIDATION PROCEEDING
>
> **(a) PURPOSES**
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> The purposes of a liquidation proceeding under this chapter shall be—
>
> (1) **as promptly as possible** after the appointment of a trustee in such liquidation proceeding, and in accordance with the provisions of this chapter—
>
> (A) to deliver customer name securities to or on behalf of the customers of the debtor entitled thereto as provided in §78fff-2(c)(2) of this title; and
>
> (B) to distribute customer property and (in advance thereof or concurrently therewith) otherwise satisfy net equity claims of customers to the extent provided in this section.
>
> **PAYMENT TO CUSTOMERS.-SIPC shall promptly satisfy all obligations of the member to each of its customers relating to, or net equity claims** based upon, securities or cash by the delivery of securities or the effecting of payments to such customer (subject to the provisions of section8 (d) and section **9** (a)) insofar as such obligations are ascertainable from the books and records of the member or are otherwise established to the satisfaction of SIPC.

15 U.S.C. §78fff-2(c)(2); emphasis added. *See also,* 15 U.S.C. § 78fff-3(a).

Congress intended for the trustee to promptly pay customer claims based upon the debtor's books and records, without the filing of proofs of claim:

> **[SIPA] establishes procedures** for prompt orderly liquidation of SIPC members when required and **for making prompt distributions and payments on account of customers' claims without need for formal proofs of claim.**
>
> * * *
>
> The committee also believes that **it is in the interest of customers of a debtor that securities held for their account be distributed to them as rapidly as possible in order to minimize the period during which they are unable to trade and consequently are at the risk of market fluctuations.**
>
> * * *
>
> **Because of the difficulties involved in filing proofs of claim . . ., the bill provides in general for the trustee to make payments and deliveries based upon the books and records of the debtor or when otherwise established to his satisfaction, without requiring customers to file proofs of claim.**[12]

While SIPC has never asserted that it could replace investors' securities within 48 hours, it has set a standard of doing so within two to three months. In *SIPC v. SJ Salmon & Co.,* No. 72 Civ. 560 (S.D.N.Y. 1972), 1500 out of 2000 claims had been

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[12] (S. Rep. 91-1218, at 10, 11, 12 (1970), *reprinted in* Federal Securities Laws Legislative History 1933-1982, Vol. IV, at 4642, 4643, 4644 (1983)). Thus, as the Sixth Circuit explained in *Bell & Beckwith v. McGraw,* 937 F. 2d 1104, 1106-1107 (6th Cir. 1991):

> Implementing this statutory scheme is complicated by the congressional requirement that SIPC make prompt payments to customers. These payments take the form of advances which are used to satisfy customer claims:
>
> > SIPC would advance to the trustee such sums from the SIPC fund as would be necessary to provide for prompt payment of claims of customers of the debtor, but only to the extent of [$500,000] for each customer. This significant provision will make it possible for public customers to receive promptly that to which they are entitled without the delay entailed in waiting for the liquidation proceeding to be completed. In addition, and subject to the limitation of [$500,000, of which not more than $100,000 may be in satisfaction of a claim based on cash], public customers of the broker-dealer would receive back 100 percent of that to which they are entitled.
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> House Report at 5262; 15 U.S.C. Sec. 78fff-3. SIPC makes such advances prior to a determination of each customer's ratable share of or distribution from the customer property fund.

paid within a few months. [13] As recently as November 2007, Harbeck stated:

> The fastest that an investor could conceivably get back in control of one's account is one week" but he added that "In most situations, it takes two to three months." The article further stated that "the process can stretch out even longer if the brokerage firm kept shoddy records.[14]

In the Madoff case, there is no evidence that the records were shoddy. On the contrary, Picard has been able to precisely reconstruct investors' net investment going back into the 1980's. Yet, Picard paid virtually no claims for the first five months of the case. Even after 12 months, he has paid only approximately 2/3 of the claims that he has considered valid, using his improper definition of "net equity." One must recognize, here, that Picard and his law firm are being compensated at the rate of approximately $1 million per week. It is certainly to their advantage to keep this stream of income flowing for five to ten years. However, nothing could be more destructive to the national crisis in confidence on our capital markets.

One must also recognize that SIPC's history, unfortunately, has been to delay

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[13] The court wrote:

> This action was instituted early this year and the trustee is proceeding with all due speed in his investigation and orderly liquidation of the business of the defendant. Approximately 2,000 claims have been filed; securities and cash have been returned to some 1,500 customers as either specifically identifiable property or as payment of the portion of "net equities" in the single and separate fund representing free credit balances. This clearly indicates that the trustee is proceeding as swiftly as the circumstances of the case permit and negates any suggestion that he is guilty of unnecessary delay or dilatory tactics in the performance of his duties.

[14] www.kiplinger.com/printstory.php?pid=12842

and try to defeat customer claims.[15] While the statute mandates prompt payment, it

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[15] Members of Congress repeatedly complained that SIPC was acting adversely to the interests of the customers it was charged with protecting. The GAO Report issued in 2001 found that there were "significant deficiencies" in SIPC, and Rep. Dingell told the New York Times that "SIPC's mission is to promote confidence in securities markets by facilitating the prompt return of missing customer cash and/or securities held at a failed firm. However, the large number of claims denied in several recent high-profile SIPC liquidation proceedings has raised concern that SIPC policies may unduly limit the actual protection afforded consumers."

Representative Kanjorski was also quoted in the New York Times article as stating that:

> According to the GAO, both the SIPC and the SEC have fallen short in their duty to make sure that investors are informed on the actions they need to take to protect their interests. Both Congress and the administration must address these concerns and deficiencies promptly, especially as more Americans than ever – roughly 50 percent – are invested in the stock market.

Id..

Representative Dingell was so agitated by SIPC's policies that he sent a letter to the Acting Chairmen of the SEC and SIPC on June 20, 2001 regarding SIPC's deficiencies in the wake of the GAO report, and posted the letter to the Committee on Energy and Commerce's website. Rep. Dingell wrote that:

> the large number of claims denied in several recent high-profile SIPC liquidation proceedings have raised concerns that SIPC policies and practices may unduly limit the actual protection afforded customers. Critics argue that SIPC's main goal has been to protect its industry-supplied fund rather than to protect customers as contemplated by SIPC.[15]

Two years later, the July 2003 United States Accounting Office Report also caused consternation in Congress. In their August 11, 2003 letter, Reps. Frank, Kanjorski and Dingell declared that they were "deeply troubled by the state of affairs" at SIPC outlined in the GAO Report.[15] The letter stated that the Congressmen "cannot overstate the importance of the SIPC program in the ongoing effort to restore and maintain investor confidence" and criticized SIPC's failure to cure the deficiencies outlined in the GAO Report.[15]

Reps. Frank, Kanjorski and Dingell stated that this situation was "totally unacceptable and [they] urge[d] SIPC to fix these shortcomings, which [they] consider[ed] to be significant, with all deliberate speed before a major problem occurs."

The Congressmen "strongly agree[d]" with the statement in the GAO Report that:

> Disclosure has an important role in securities market regulation, and the Securities Investor Protection Corporation (SIPC) has a responsibility to inform investors of actions they can take to protect their investments and help ensure that investors are afforded the full protections allowable under the Securities Investor Protection Act of 1970 (SIPA).

Id.

does not provide for interest if SIPC delays inordinately in paying claims. The statute should require SIPC, if it delays in paying customer claims, to give the customer the choice of either having $500,000 of securities replaced in his account, valued as of the date of the liquidation, or paying $500,000 with a rate of interest, such as 7%, which has some real teeth to it. The last 39 years have taught us that, without this protection, SIPC will continue to victimize investors.[16]

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[16] Despite Congressional warnings, SIPC has appointed mere "puppets" to act as trustees in SIPA proceedings. *In re First State Securities Corp.*, 39 B.R. 26 (B.S.D. Fla. 1984). These puppets have advanced frivolous arguments to delay and defeat customer claims. For example, Irving Picard, as SIPC Trustee, was chastised by one court for advancing a totally frivolous argument in his attempt to defeat a valid customer claim, after he had tried to threaten and intimidate the customer. In *In re Investors Center, Inc.*, 129 B.R. 339 (B.E.D.N.Y. 1991), Picard was faced with customer claims for cash where the customers had received confirmations from the broker that their securities had been sold. After the sale, the securities became worthless and SIPC wanted to simply replace the worthless securities rather than pay the cash that was reflected on the account statements. The court held that "Under [SIPC's] rules, each of the objecting *claimants*, because of the receipt of written confirmation of a sale prior to the filing of SIPC's application to liquidate Investors Center, has a claim for cash and not for securities and the Trustee's determination otherwise is incorrect." The court wrote:

> Except that the Trustee appears to urge this most seriously, the Court would deem the contention too frivolous to even consider.

In rejecting Picard's argument, the court cited 17 C.F.R. 501(a)(1), (2) and stated "The Rules are as binding on the Trustee and on SIPC as they are on the public. The Trustee is not free to ignore them or rewrite them." *Id.* at 348. Despite this inauspicious conduct, SIPC chose Picard as the trustee in the Madoff case.

See also, In *In re Investors Security Corp.*, 6 B.R. 415 (B. W.D.Pa. 1980), SIPC and the trustee argued that two accounts, one held by an investor individually and one held jointly by the investor and his wife, should be treated as belonging to one "customer," thus making the investor and his wife entitled only to the statutory minimum, rather than twice the statutory minimum. The court found that the two accounts were held by two separate customers, and ordered a judgment against the trustee in the statutory minimum at that time. However, SIPC had successfully delayed for nearly five years from the date the claims were filed.

In a later proceeding in the same case, *In re Investors Security Corp.*, 30 B.R. 214 (B. W.D.Pa. 1983), SIPC and the trustee filed a motion for reconsideration and to alter judgments after the court entered a judgment finding that two investors were "customers" within the meaning of SIPC. After reviewing all of the "expanded record, counsel's motions and their brief in support thereof," the court remained "firmly convinced that the [investors] fall squarely within the definition of 'customer' as set forth in the SIPA statute, and are therefore entitled to its protection." However, SIPC obtained a delay of nearly eight months between the court's first decision in favor of the investors and its second decision, reiterating its findings in favor of the investors.

In *SIPC v. Ambassador Church Finance/Development Group, Inc.*, 788 F.2d 1208 (6th Cir. 1986), SIPC litigated for over 7 1/2 years the question of whether investors were "customers" under SIPA, a question that the Sixth Circuit decided in favor of the investors.

In this case, SIPC has delayed payment to customers while the stock market has increased approximately 40%. SIPC claims that it was impractical to replace securities, as required by the statute. However, even if it would have been impractical to replace the securities in the 4,904 accounts within 60 days, it certainly would not have been impractical to do so over a 12-month period. In fact, even after eliminating more than half of the customer claims, Picard has still not paid 1/3 of the account holders to whom he acknowledges he owes money. And this is a 12-month period in which Picard and his law firm have earned fees of $1 million per week.

The $52 million that Picard will be paid for his first year could have satisfied SIPC's obligation to 104 Madoff victims.

I thank you very much, on behalf of my clients, for giving me this opportunity to address you.

Helen Davis Chaitman

In *In re C.J. Wright & Co., Inc.*, 162 B.R. 597 (B. M.D. Fla. 1993), claimants objected to the trustee's determination that they were not customers. The claimants had deposited money with the debtor in the belief that the debtor was purchasing CD's with such funds. The trustee argued that the funds were loans because CD's were never purchased with the funds. The court found that the claimants did not intend to loan funds to the debtor, but entrusted the monies with the debtor for the purposes of purchasing securities (the CD's). Thus, the court ruled claimants were customers within the meaning of SIPA and had claims for cash. Yet, through litigation, SIPC delayed paying such customers for over one year. Harbeck acted as counsel for SIPC in the matter.

In *In re Primeline Securities Corp*, 295 F.3d 1100 (10th Cir. 2002), SIPC delayed payment of customer claims for four years. The bankruptcy court had ruled that claimants (and others) were entitled to payments, but the trustee and SIPC had filed an appeal. The district court found that the claimants were not entitled to payments and were not "customers." The Court of Appeals reversed and remanded the district court order denying customer status to claimants with respect to funds each claimant sought to invest in debentures. The protective order was entered in 1998, but the 10th Circuit decision was not entered until 2002. Harbeck was on the brief for SIPC and the trustee.

Testimony of Professor John C. Coffee, Jr.

Adolf A. Berle Professor of Law
Columbia University Law School

Before the Subcommittee on Capital Markets, Insurance, and
Government Sponsored Enterprises of the Committee on Financial Services,
United States House of Representatives
December 9, 2009

"ADDITIONAL REFORMS TO THE SECURITIES INVESTOR PROTECTION ACT"

"You only find out who's swimming naked when the tide goes out."

Warren Buffett
(Annual Letter to Berkshire
Hathaway shareholders)

Chairman Kanjorski, Ranking Member Garrett, and Fellow Congressmen:

I am pleased and honored to be invited to testify here today. I will limit my testimony to Title V ("Securities Investor Protection Act Amendments") of the proposed Investor Protection Act of 2009 and certain amendments that have been proposed thereto. We are now at the first anniversary of Mr. Madoff's arrest, and, disappointingly, very little has been done to prevent future Madoffs. But future Madoffs are predictable. Annual losses from Ponzi schemes in the U.S. appear to regularly exceed $1 billion, and, prior to Mr. Madoff, the record year was 2002 when losses exceeded $9.6 billion.[1] That level of loss justifies more serious reforms than have yet been adopted by the SEC.

The proposed legislation takes some important steps in the appropriate direction, but more should be done. In terms of the legislation before this Committee, I see three principal issues:

(1) Beneficial Interests and the Definition of Customer Under the SIPA. Should the Securities Investor Protection Act ("SIPA") be amended so that it covers persons who are beneficial holders in collective investment entities, in particular "participants" in pension funds? This is costly, and thus careful line drawing is necessary. I will make some modest suggestions toward this end.

(2) Clawbacks by the SIPC's Trustee. Should investors who redeemed some or all of their investment in a "Ponzi scheme," or other fraud, prior to the brokerage firm's collapse continue to be subject to existing fraudulent conveyance doctrines under the Bankruptcy Code? Those doctrines permit the trustee appointed by the Securities Investor Protection Corporation ("SIPC") to recover certain transfers and redemptions and restore

[1] See Statement of Tamar Frankel, Professor of Law, Boston University Law School before the House Financial Services Committee, January 5, 2009, at p. 2.

them to the general fund in which all creditors share. Ultimately, this is a zero-sum game between the redeeming and the non-redeeming creditors, but I would suggest that the special status of charitable organizations be recognized.

(3) Subsidizing High-Risk Brokerage Firms. Today, SIPC does not truly distinguish between the brokerage firms that it insures in terms of their relative risk. Inevitably, the failure to charge riskier firms higher assessments causes lower risk firms to subsidize higher-risk firms. In turn, this creates a moral hazard problem because the higher risk firm has less incentive to take precautions or implement internal controls than it would if it were not so subsidized. Economically, this is a perverse system. The proposed legislation takes a desirable and overdue first step towards a risk-adjusted insurance system.

I. SIPA's Definition of "Customer"

The protections and insurance afforded by SIPA extend only to "customers" of a registered securities brokerage firm. Thus, if Mr. Madoff had conducted his fraud without having formed a registered broker-dealer firm, his customers would have been entirely unprotected. Still, SIPA defines the term customer somewhat narrowly, as:

> "[A]ny person . . . who has a claim on account of securities received, acquired, or held by the debtor in the ordinary course of its business as a broker or dealer from or for the accounts of such person for safekeeping, with a view to sale, to cover consummated sales, pursuant to purchases, as collateral security or for purposes of effecting transfer. The term 'customer' includes any person who has a claim against the debtor arising out of sales or conversions of such securities, and any person who has deposited cash with the debtor for the purposes of purchasing securities. . . ."[2]

Although no case has definitively so held, this language does not appear to reach beneficial holders, such as the shareholders of a mutual fund, pensioners in a pension

[2] See Section 16(2) of SIPA, 15 U.S.C. § 78lll(2).

fund, or investor in other collective investment vehicles (for example, hedge funds). Certainly, that is how the SIPC has long read this provision.

Nonetheless, the Madoff debacle has shown that this limitation may deny meaningful compensation to some of the most seriously injured victims of a Ponzi scheme. A good hypothetical illustration is supplied if we assume a small medical practice, organized as a corporation, in which some ten doctors are associated and which employs some additional twenty staffers – i.e., nurses, secretaries, technicians, etc. Assume further that this small organization has a defined contribution pension fund, with total assets of $10 million, of which $5 million were entrusted to Madoff (and lost). Under the prevailing interpretation of SIPA, they will receive only a single advance of $500,000 under Section 9 of SIPA (15 U.S.C. 78fff-3) (and, at present, only $100,000 with respect to a claim for cash). If, instead, legislation were to give each pensioner a right to be deemed a separate customer, the full $5 million loss could be recovered from SIPC (as each individual pensioner's loss would be entitled to up to a $500,000 advance).

In my judgment, it would be feasible to craft a definition of "customer" under SIPA that treated the participants in small pension plans as individual customers and thus entitled them to individual SIPC advance of up to $500,000 (or $250,000 in the case of claims for cash, as SIPA would be revised by proposed Section 503). But there are at least three major problems in doing this that need to be candidly faced and require delicate line drawing. In addition, there are some technical problems in expressing this goal in legislative language so that the legislation is neither overinclusive nor underinclusive.

The major problems include:

1. Exhausting SIPC's Resources. Today, a large pension fund may have assets in excess of $200 billion dollars (CalPERS, the nation's largest public pension fund, had $250 billion in assets as of 2007, and there are even larger private pension funds). Assume that such a fund may have over 20,000 participants in its pension plan and that its losses to a Madoff could be in the vicinity of several billion dollars. At this point, SIPC could become liable for billions to a single pension fund. Frankly, SIPC could not afford such a loss to a single customer. Under the proposed legislation, SIPC's borrowing authority from the Treasury is proposed to be increased to $2.5 billion, and the broker-dealer industry could not easily afford the assessments that such a multi-billion dollar liability would require it to bear. Although my example of a single pension fund sustaining a several billion dollar loss may seem unrealistic, it is easily imaginable that several dozen pension funds could have accounts with a future Madoff, giving rise to an aggregate recoverable loss from SIPC of over $1 billion. The point then is that insurance is costly and realistic limits must be placed on how broadly we define eligible "customers" for purposes of SIPC.

2. Moral Hazard. A second major problem is moral hazard. If institutional investors (such as pension funds) were fully insured against the risk of Madoff-like frauds, they would have reduced incentive to monitor. Knowing that SIPC would pick up any losses, they might even rush to invest with financial managers who promised impossibly high returns (as most Ponzi scheme operators do). The counter-productive result of such reform might be more frauds and less monitoring.

3. Pension Plans Versus Other Collective Investment Entities. A third problem is to explain coherently why pension funds deserve such special treatment, while mutual

funds, hedge funds and other collective investment vehicles do not. Certainly, some investors who were placed into Madoff's firm by a feeder fund or another investment adviser (who did not open separate accounts for them) may understandably feel that they have been equally victimized. Why then should pension funds alone be specially treated?

A plausible answer to this question is that pensioners, at least in smaller pension plans, tend to suffer a more concentrated loss. Effectively, they may lose most or all of their retirement assets. In contrast, investors in mutual funds are usually more diversified, and hedge fund investors generally must have significant independent assets just to be eligible to invest in the hedge fund. Extending SIPA to cover the investors in hedge funds might look to many as "Socialism for the Rich." That is not the case for pension funds, which account for most of the retirement savings of many (if not most) Americans. An additional factor is that smaller pension funds frequently lack the in-house capacity to monitor.

But if these twin considerations – a more concentrated loss and a lesser ability to monitor – justify treating participants in pension plans differently from other beneficial holders, a number of technical problems remain. First of all, it would be overinclusive to treat all pension plans alike. Pension plans subdivide into basically two categories: (1) defined benefit plans, and (2) defined contribution plans. In the case of the former, the corporate employer agrees to pay a defined benefit (say, 50% of the final year salary for the covered pensioner) for life. Thus, if the pension plan suffers a loss because of fraud, it is the corporate employer who bears the primary burden of this loss, because it remains liable on its future pension obligations. In this setting, it makes little sense to deem each participant in the pension plan a "customer" for purposes of the SIPA, because they do

not suffer any individualized loss. Even if the defined benefit plan were likely to become insolvent, this is a risk that ERISA's own insurance system was designed to handle.

In contrast, in the case of a defined contribution plan, specific amounts are paid by the employer (and often by the employee also) into the employee's individual account. The gain (or loss) on this account belongs to the employee/pensioner. In this context, the loss on a Ponzi scheme investment by the pension fund falls on the pensioner, and this is the context in which the term "customer" under the SIPA might be liberalized to include such persons.

How should this concept be best implemented? The simplest approach would be to amend the definition of "customer" in Section 16(2) of SIPA (15 U.S.C § 78lll(2)). Section 509 of the Investor Protection Act of 2009 already proposes some other changes to this Section, but I would propose to revise the second sentence of Section 16(2) to read as follows:[3]

> "The term 'customer' includes (i) any person who has a defined contribution account as a participant in a pension plan (as the terms "pension plan" and "participant" are defined in Sections 3(2) and 3(7) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. § 1002(2)), where that pension plan is a customer of the debtor and has total assets of less than $[#] million, and (ii) any person who has deposited cash with the debtor for the purposes of purchasing securities, but does not include – . . . ."

The blank that remains to be inserted in the above definition would be whatever number is used as the breakpoint between large and small pension plans. Conceivably, it could be as high as $100 million; alternatively, the definition of a "smaller" pension plan could be framed in terms of the number of participants in the plan. This alternative faces a problem because the pension plan of an investment bank might be included, even

[3] The first sentence of Section 16(2) is quoted in the text supra at footnote 1.

though its assets were high, because few were covered. Hence, both tests (assets and participants) probably should be combined.

The term "pension plan" in the ERISA statute covers public pension plans and union plans, as well as private employer plans. The above language does, however, exclude persons who only have interests in defined benefit plans or "employee welfare benefit plans" on the rationale that the interests involved in such plans do not rise to the same level of concentrated economic injury. If the term "participant" is used, one should be aware that some case law indicates that persons who are "independent contractors" are not ERISA participants. See Barnhart v. New York Life Ins. Co., 141 F.3d 1310 (9th Cir. 1998). Also, plans involving professional or business groups might not be covered. See Nichols v. Southeast Health Plan, 859 F. Supp. 553, 559 (S.D. Ala. 1993). I doubt that this limitation has much significance, however, in this area.

Once pensioners were so recognized under SIPA's definition of "customer," they become entitled under Section 9(a) of SIPA to an advance by SIPC to the trustee of up to $500,000. To avoid ambiguity, it would also be desirable to revise similarly Section 9(11) of SIPA (15 U.S.C. § 78lll(11)) to indicate that the "net equity" of a participant in a pension plan would be such person's proportionate share of the pension plan's net equity.

II. The Fraudulent Conveyance Problem

The Madoff Ponzi scheme was unique in the speed with which it collapsed. More typically, there is an indefinite period of time during which rumors circulate, the evidence of irregularity mounts, the sponsors assure investors that all is well, but many investors still redeem. Sometimes, those closest to the crooked sponsor are among these early redeemers who thereby escape the bulk of the losses. The collapse of the Bayou Fund

exemplifies this pattern. It collapsed in 2005, and its remaining, non-redeeming investors bore a $250 million loss. The trustee filed fraudulent conveyance actions against the numerous investors who redeemed in the period before the collapse, relying primarily on Section 548 of the Bankruptcy Code. Section 548(a)(1)(A) addresses actual fraudulent transfers,[4] while Section 548(a)(1)(B) deals with constructively fraudulent transfers.[5] In these cases, the "good faith" defense specified in Section 548(c) becomes critical; it provides that:

> ". . . [a] transferee or obligee of such a transfer or obligation that takes for value and in good faith has a lien on or may retain any interest transferred or may enforce any obligation incurred as the case may be, to the extent that such transferee or obligee gave value to the debtor in exchange for such transfer or obligation."

Because exactly this same pattern of actions by the trustee is beginning to play out in the Madoff affair, the initial decision in the Bayou case has special relevance. See In re Bayou Group LLC, 396 B.R. 810 (Bankr. S.D.N.Y. 2008). There, the Bankruptcy Court construed the "good faith" defense narrowly, relying upon a line of earlier authority

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[4] §548(a)(1)(A) of the Bankruptcy Code provides as follows:

> "(a)(1) The trustee may avoid any transfer (including any transfer to or for the benefit of an insider under an employment contract) of an interest of the debtor in property, or any obligation (including any obligation to or for the benefit of an insider under an employment contract) incurred by the debtor, that was made or incurred on or within two years before the date of the filing of the petition, if the debtor voluntarily or involuntarily—
> (A) made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation was incurred, indebted[.]"

[5] §548(a)(1)(B) provides in pertinent part that the trustee can avoid a transfer "if the debtor voluntarily or involuntarily":

> "(B)(i) received less than a reasonably equivalent value in exchange for such transfer or obligation; and
> (ii)(I) was insolvent on the date that such transfer was made or such obligation was incurred or became insolvent as a result of such transfer or obligation;
> (II) was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital;
> (III) intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured[.]"

requiring the "good faith" reliance be that of an "objective" or "reasonable person." The Court wrote:

> "The Bankruptcy Code does not define "good faith" as used in section 548(c). Moreover, the legislative history related to section 548(c) never defines, and scarcely addresses, good faith. Nevertheless, federal courts have reached a consensus that "good faith" as used in section 548(c) must be determined according to an "objective" or "reasonable person" standard, and not on the subjective knowledge or belief of the transferee. Under this objective standard, subjective assertions of good faith are of no moment. Instead, courts look to what the transferee objectively knew or should have known in questions of good faith, rather than examining what the transferee actually knew from a subjective standpoint. Accordingly, a transferee cannot be found to have taken a transfer in good faith if the circumstances would place a reasonable person on inquiry of a debtor's fraudulent purpose, and a *diligent* inquiry would have discovered the fraudulent purpose." In re Bayou, 396 B.R. at 844.

Although the decision is on appeal (and I will not attempt to predict the ultimate outcome), its message for those who received redemptions of their Madoff accounts is clear: the more that they had a basis for discomfort or concern about Madoff, the more that they are at risk and may have to return the amounts so received to be pooled and shared among all creditors.

This prospect has provoked outrage and shock from many of the persons so sued, who point out that they did suffered significant losses, which may yet be compounded significantly by the trustee's actions. Some have called for legislative changes to protect them. Thus, it has been proposed that Section 6 of SIPA (15 U.S.C. § 78fff) be amended by adding the following new Section (f):

> "(f) Notwithstanding any other provision of this Act, no action under sections 544, 547, or 549 of title 11, United States Code, may be brought against a customer of a registered broker or dealer to recover funds received representing either principal or income on the customer's account absent proof that the customer did not have a legitimate expectation that the assets in his account belonged to him."

Such a provision would largely override the existing law on fraudulent conveyances. Because it appears to use a subjective test (although even this assessment is arguable), it would require the trustee to prove not simply that the transferee knew that the debtor was likely insolvent, but that the transferee did not honestly expect that "the assets in his account belonged to him." What this means is obscure. Any investor may sincerely (and perhaps "legitimately") expect that any funds reported in his account belong to him, even if he knew that the debtor was in serious trouble. Under this proposed standard, it is possible that only a co-conspirator in the fraud would be subject to the trustee's ability to rescind the transfer as a fraudulent conveyance.

Is this result wrong? Why should those investors who redeem be required to give back the funds that they received where it cannot be shown that they are implicated in the fraud? Here, the first principle underlying fraudulent conveyance law is simple: the crook should not be able to choose his victims. Like case should be treated alike, and the crook should not be able to select who bears the loss. If a person in Madoff's position knows that the "gig is up" and detection is inevitable, he may still want to help his friends and minimize their losses, at the expense of the other victims. The latter's injuries will be aggravated by these 12th hour redemptions. In a number of recent Ponzi schemes, some of the late redemptions have been by persons having long-standing relationships with the Ponzi scheme operator (and that is particularly true in the Madoff case). But these general suspicions and even a demonstration that a reasonable person would have realized that the debtor was in trouble will not justify rescinding the language under the above proposed legislative revision.

In this light, are there any reasonable compromises between the "objective" standard of existing fraudulent conveyance law and the proposed "no legitimate expectation" standard? Two different general approaches seem feasible. One could seek to frame an intermediate standard. Or, one could to define special classes of investors who should be exempt from fraudulent conveyances in most instances. For example, a persuasive case can be made that tax-exempt charitable organizations should be exempted from fraudulent conveyance law, because it interferes excessively with both their legitimate plans and those of their beneficiaries. Indeed, Congress has long recognized the special status of charitable and religious organizations in § 548(b) of the Bankruptcy Code, which exempts charitable contributions under most circumstances from fraudulent conveyance law. See 11 U.S.C. § 548(b) (exempting charitable contributions that are less than 15% of gross annual income of the debtor from fraudulent conveyance doctrine). Unfortunately, this provision does not apply in the case of the typical Ponzi scheme because the transfers at issue are not charitable contributions, but rather attempts by the charitable organization to redeem some or all of its account with the debtor. In this light, Section 548(b) could be easily expanded to include redemptions or withdrawals from its account.

An intermediate standard might be achieved if the focus were shifted from whether the investor/creditor believed the "assets in its account belonged to it" to whether it "knew, or recklessly disregarded, facts indicating that the debtor was approaching insolvency" at the time of its redemption or transfer. This "knowing or reckless" standard is more exacting than the simple negligence standard that Section 548(c) now uses, but it

does not require the creditor to be a virtual co-conspirator before the transfer can be rescinded by the trustee.

The trustee's goal is to treat all creditors equally by placing all the debtors' assets in the same pot for equitable distribution. That is not a goal that Congress should lightly reject or undercut by encouraging the recipients of 12th hour transfers to "take the money and run." Still, charitable organizations (with an exclusion for those established by the crook and/or his relatives) are a special case.

III. Should SIPC Insurance Premiums Be Risk-Adjusted?

SIPC is a unique insurer in that the premiums it charges are both (a) trivial and (b) relatively uniform. For a long time, these assessments were only $150 per year. With this proposed legislation, SIPC's assessments from the industry will increase (modestly), but they still are not risk adjusted to any meaningful degree.

When all insureds pay the same premium, either the risks are equal or low-risk insureds are subsidizing high-risk insureds. Because the risks posed by different broker-dealers are clearly not equal, this means that low-risk broker-dealers have long been subsidizing high-risk broker-dealers. In turn, it follows that higher-risk broker-dealers have less incentive to adopt protective measures or safeguards because they can escape paying the higher cost for SIPC insurance that their riskier behavior should necessitate.

The Bernard Madoff debacle illustrates this failure by SIPC. Mr. Madoff used his own brokerage firm as the custodian for his investment adviser clients.[6] Such a "self-custodian" cancels the purpose of the custodian requirement, because no one can serve as

[6] Under Rule 206(4)-2 ("Custody of Funds or Securities of Clients By Investment Advisers") (17 C.F.R. § 275.206(4)-2), adopted under the Investment Advisers Act of 1940, an investment adviser must maintain client funds or securities with a "qualified custodian." However, this term – "qualified custodian" – is defined by Rule 206(4)-2(c)(3) to include any registered broker-dealer. Thus, Madoff's brokerage firm could serve as custodian to his investment adviser clients.

his own watchdog. Thus, Mr. Madoff could clear his own trades, and hence no alarm bells went off when he did not trade. This incestuous system also allowed him to recycle the investments made by new investors to earlier investors – which is the very definition of how a Ponzi scheme works. This is precisely why investment companies are required by Section 17(f) of the Investment Company Act to use an independent custodian.[7]

Although it is regrettable that the SEC permits self-custodians to persist,[8] that is not SIPC's fault. Rather, the immediately relevant point is that any brokerage firm serving as custodian for an affiliated investment adviser is riskier and should pay a higher assessment. Madoff proved this. SIPC has long resisted any proposals to assess its fees on a risk-adjusted basis,[9] and the industry will not be happy with this proposal. Although I recognize that SIPC is not well positioned to assess the level of risk posed by different broker dealers (in part, this reflects the fact that it does not operate like an insurance company), it can respond to gross and obvious differences in risk. The use of a "self-custodian" is such an obvious difference. At present, it is estimated that there are some 370 investment advisers that use affiliated broker-dealers as their custodians.[10] With a modest effort, SIPC could identify them and charge a higher assessment. This would also shine some sunlight on an undesirable practice.

To this end, the SIPA should be amended to require greater use of risk criteria. Section 511 ("Risk-Based Premiums") of the Investor Protection Act of 2009 takes an important first step in this regard by adding at the end of Section 4(c) of SIPA, 15 U.S.C.

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[7] See 15 U.S.C. § 80a-17(f)(1).

[8] The SEC made, and then backed off of, proposals for surprise audits in the case of such self-custodians. See Sara Hansard, "SEC Wilts on Surprise Adviser Audits; Investment Division Relents After Field Input," Investment News, November 23, 2009 at p. 0001.

[9] This proposal is not new and does not originate with this witness. See Thomas W. Joo, Who Watches the Watchers?: The Securities Investor Protection Act, Investor Confidence and the Subsidization of Failure, 72 S. Calif. L. Rev. 1071 (1999).

[10] See Hansard, supra note 8.

§ 78ddd(c), a new subparagraph 4 ("(4) Risk-Based Assessment System"). I would propose that this Section 4(a) be amplified so that subparagraph 4(B)(i) ("Risk-Based Assessment System Defined") would read at its end, as follows:

> "(IV) the existence of factors, such as the number of investment advisory or discretionary accounts or the failure to use an independent custodian for such accounts, that may increase the prospect of fraud or misappropriation; and
> (V) any other factors SIPC determines are relevant to assessing such probability;"

The simple truth cannot be ignored: a brokerage firm with many advisory or discretionary accounts is more subject to the risk of fraud, and those without an independent custodian (now, a relatively small number) are inviting disaster because there is no meaningful watchdog.

CONCLUSION

Some will argue that only criminal convictions and stern sentences can stop Ponzi schemes. Justified as the use of the criminal law is, most Ponzi schemes do not start as the work of evil con men, but are rather the product of desperation. Just as the gambler at the race track may bet the rent money on the last race, hoping to make up losses on earlier races, so may an investment adviser use proceeds from new investors to pay earlier ones. He hopes this is only a temporary deviation, but quickly it becomes a large scale fraud. To stop this, we need not simply tougher law enforcement, but also preventive controls. Ultimately, an ounce of prevention can be worth a pound of indictments. SIPC can play a desirable role in this process if it begins to think about prevention as well as compensation.

STATEMENT
OF
MICHAEL A. CONLEY
DEPUTY SOLICITOR
SECURITIES AND EXCHANGE COMMISSION
BEFORE THE
CAPITAL MARKETS, INSURANCE, AND GOVERNMENT
SPONSORED ENTERPRISES SUBCOMMITTEE
UNITED STATES HOUSE OF REPRESENTATIVES

December 9, 2009

Introduction

Chairman Kanjorski, Ranking Member Garrett, and members of the Subcommittee, thank you for the opportunity to appear before you today on behalf of the Securities and Exchange Commission to discuss the Securities Investor Protection Act of 1970 (SIPA), and specifically the Commission's views regarding the liquidation of Bernard L. Madoff Investment Securities LLC being conducted by the Securities Investor Protection Corporation (SIPC). My name is Michael Conley, and I am the SEC's Deputy Solicitor.

Before I discuss the legal issues that are the focus of my testimony, I want to make clear that the Commissioners and staff of the SEC are keenly aware of the devastating losses that Madoff's fraud has caused to the thousands of investors who entrusted him with their money. We know that many—if not most—of Madoff's victims have had their lives up-ended. At the SEC, Chairman Schapiro has urged all of us to learn from the experience and reform the way we operate. Already, we are revitalizing our Enforcement Division, revamping the way we handle tips and complaints, seeking whistleblower authority, creating a new division to focus on risk, expanding training, seeking adequate and reliable funding, and hiring more personnel with skill sets critical to addressing new challenges that face investors and the capital markets. In response to the Madoff matter, we proposed rules to better protect clients of investment advisors from

theft and abuse by assuring clients that their accounts contain the funds that their investment advisers and account statements say they contain.

With regard to issues concerning the Madoff liquidation, I can assure you that the Commission and its staff have been and remain committed to ensuring that Madoff investors' interests are protected in the ongoing liquidation proceeding. Claims for losses suffered by the Madoff investors are determined under SIPA, but the statute does not provide a clear answer to some key questions related to claims by Madoff account holders. In particular, the statute does not expressly address how to calculate the "net equity" in a customer's account when a broker-dealer has engaged in the sort of fraudulent scheme Madoff perpetrated here. The answer to that question is essential to determining the proper value of the Madoff customers' claims. The bankruptcy court will soon hear arguments on the competing theories of valuing customer claims that have been advanced by claimants and the SIPC Trustee. My testimony describes the structure of SIPA in protecting brokerage customers, the existing case law, the competing theories of claim valuation in the Madoff case, and the views of the Commission regarding the appropriate way to measure "net equity" on the facts of this case.

The Commission appreciates the real world consequences of the bankruptcy court's decision on how customers' claims should be valued. The recommendation the Commission will make to that court is based on what the Commission believes is the best reading of SIPA and the decisions that have interpreted that statute. The Commission is cognizant of the fact that the total pool of customer money available to distribute to claimants is limited. Unfortunately, we know that there will not be enough money in that pool to compensate all the victims for their losses. As such, the customer money allocated to one Madoff victim will affect the money that is

available to compensate other victims. The bankruptcy court's task—and the Commission's goal in making its recommendation—is to arrive at the fairest way, consistent with the law, of dividing that limited pool of money.

The Securities Investor Protection Act

Congress enacted SIPA in 1970 after serious and persistent financial problems in the securities industry led to a number of brokerage firm bankruptcies that resulted in substantial losses by those firms' customers. The statute was designed to protect brokerage customers when a firm fails and cash and securities are missing from customers' accounts. Congress wanted to ensure that when brokerage firms fail, customers could quickly obtain the cash and securities that should be in their brokerage accounts or receive some measure of compensation if those assets were missing. By establishing those protections, Congress sought to avoid the inevitable weakening of confidence in the U.S. securities markets that would occur if customers were afraid to entrust their funds and securities to broker-dealers.

Through SIPA, Congress created SIPC, which is a membership corporation made up of securities broker-dealers registered with the SEC. Generally, SIPA requires the SEC, the Financial Industry Regulatory Authority, and other industry self-regulatory organizations to inform SIPC when a brokerage firm is approaching financial difficulty. If SIPC then determines that the brokerage firm has failed or is in danger of failing to meet its obligations to customers, SIPC may then bring a customer protection proceeding for the purpose of returning to the firm's customers the cash and securities that are owed by the firm to its customers even if those securities are missing. SIPC designates a Trustee and counsel, who are appointed by a federal

district court judge, and then the matter is referred to the appropriate bankruptcy court to oversee the firm's liquidation.

As part of that proceeding, the failed brokerage's customers have claims for net equity based upon securities and cash shown on the books and records of the brokerage firm or otherwise established to the satisfaction of the Trustee. After the Trustee determines a customer's net equity claim, the Trustee satisfies the claim with a *pro rata* distribution from customer property. The term customer property includes all of the cash and securities that the broker-dealer received or acquired from customers or for customers' accounts, and the proceeds of any property transferred by the brokerage firm (including property unlawfully converted). The Trustee attempts to recover as much missing property as possible, which can include bringing preference and fraudulent transfer actions.

If the amount of securities and cash in the fund of customer property is inadequate to satisfy customers' net equity claims, the Trustee makes payments from the SIPC Fund of up to $500,000 per customer to cover claims for missing securities and cash—with coverage for missing cash limited to $100,000. The SIPC Fund, which currently has assets of approximately $1.2 billion, is funded through assessments on SIPC's member firms. If the Fund is insufficient to satisfy customer claims, SIPC may request a loan from the SEC. The SEC, in turn, is authorized under SIPA to issues notes or other obligations to the Secretary of the Treasury, up to $1 billion, to obtain the money to loan to SIPC. Typically, customers first receive payments from the SIPC Fund, and thereafter receive payments from the fund of customer property as assets are recovered over the course of the SIPA proceeding. In the case of Madoff, customer property,

even after it is supplemented by payments from the SIPC Fund, will not be sufficient to satisfy customers' net equity in full.

Congress amended SIPA in 1978 to require that, where possible, trustees satisfy claims for securities that are missing from customer accounts with actual securities, rather than paying their value as of the date the SIPC proceeding was filed. Both the Senate and House reports on the 1978 amendments make clear that SIPA's protection extends to securities that are not in the account because the broker never purchased them, even though the customer ordered the purchase and the trade was confirmed by the broker.

Although it is clear that SIPA does not cover losses by customers who are fraudulently induced to purchase or sell securities, SIPA *does* protect against fraudulent conduct when it involves the conversion of funds that customers intended to be used for securities purchases.

Case Law

In the case *In re New Times Securities Services, Inc.*, 371 F.3d 68 (2d Cir. 2004), the Second Circuit addressed a question Congress did not consider when it enacted SIPA: to what extent does SIPA apply when a brokerage fails after taking customer funds based on a promise to invest in specified securities that turn out to be fictitious? The case involved a Ponzi scheme in which customers were solicited to invest in money market funds. Several of the funds (Vanguard and Putnam) were real funds, but another group of funds (the New Age funds) did not exist and were simply fabricated by the promoter. In all cases, the money was never invested, but converted by the firm's principal, Charles Goren, for his own use.

The Second Circuit agreed with SIPC that the net equity of the New Times customers who were told that their money would be invested in the Vanguard and Putnam funds (and whose account statements falsely showed that such purchases had been made) should be calculated differently under SIPA than the net equity of the customers who were told their money was being invested in the fictitious New Age funds. The investors who gave Goren money to purchase Vanguard and Putnam money market funds were in the same position as any customer whose broker simply fails to make an investment that has been confirmed by the broker-dealer. Under settled law, those customers' net equity reflected the market value of the Vanguard and Putnam securities that had been paid for and were shown on their account statements but, in fact, had never been purchased.

But the Court concluded that the customers who were solicited to invest in the non-existent New Age funds were in a different position. Because those securities were fictitious and could never have been acquired, the Court held that basing net equity on the fabricated returns shown on customer account statements would be inconsistent with SIPA. Instead, the Court concluded that those customers' net equity should be calculated based on their initial cash investment—which served as a "proxy" for the securities the customers believed they were purchasing.

The Madoff case

The Madoff liquidation does not fall neatly within the situations expressly addressed by SIPA or dealt with in cases interpreting the statute. The Madoff case involves a variation of the fictitious investment scenario addressed in *New Times* and raises a new question: how does SIPA

apply when customers' brokerage statements show non-existent positions in real securities that the broker concocted *after the fact* to support pre-determined fictional investment returns? Although Madoff claimed to have developed a so-called "split-strike conversion strategy," the strategy was in fact a complete fraud.

Madoff instructed his key lieutenant, Frank DiPascali, to generate credible annual returns for the strategy of between 10 and 17 percent. DiPascali implemented the strategy by periodically selecting—after the fact—weighted baskets of stocks in the S&P 100 index and booking fictitious trades in these stocks to achieve Madoff's targeted returns. With the benefit of hindsight, DiPascali picked advantageous historical prices, with purchases often near the lows and sales near the highs, to create the appearance of a profit.

A computer allocated the fictitious trades to individual Madoff customer accounts and generated separate trade confirmations and account statements for each account based on its *pro rata* share of the purported trading. None of the transactions shown on the customers' account had been requested by the customer, and none of the transactions actually occurred. Instead, Madoff was operating a classic Ponzi scheme in which the invested funds of newer investors were converted and used to pay fictitious returns to older investors to keep the scheme from being discovered.

Methods for Valuing Customer Claims

Two primary approaches have been proposed for establishing the value of claims by Madoff customers. The first is known as the "final account statement method." Under this method, it is argued that the net equity in customer accounts should be based upon the securities

positions shown on the final account statements customers received before the Madoff firm was placed in liquidation. Because customers rely on the information in their account statements to keep track of their investments, proponents of this method contend that these documents reflect their "legitimate expectations" of what was in customer accounts when the Madoff firm failed.

The second principal approach to resolving customer claims is the "cash-in/cash-out" method. Proponents of this method contend that because the account statements show fictitious transactions and returns that are part of an overall fraudulent scheme, the securities positions shown on those statements are not a legitimate basis for determining the customers' net equity. Instead, they argue that net equity must be determined by crediting the amount of cash the customer deposited in the account, and subtracting any amounts withdrawn from the account.

Madoff's firm was placed in a SIPA liquidation proceeding in early December 2008. The Trustee informed Madoff's customers at the official meeting of creditors on February 20, 2009, that claims would be based on the cash customers had invested less the cash they had withdrawn —the cash-in/cash-out method. Many customers have filed objections to the Trustee's determinations. Most of those customers contend that their net equity should be based upon the securities positions shown on their final account statements. The bankruptcy court currently is in the process of resolving the dispute between the Trustee and the objecting claimants over which of the two methods should be used.

There is no dispute that the Madoff customer claims are to be treated as claims for securities for purposes of the SIPA limits and thus are eligible for up to $500,000 from the SIPC Fund. The critical question is how to calculate the customers' net equity. The answer is not immediately apparent, as the facts here differ from the typical SIPC case in which courts have

concluded that customers' net equity can be determined by the securities positions shown on the customers' account statements.

That was the situation with the *New Times* customers who directed the broker to invest in the Vanguard and Putnam funds. The broker had committed to buy specific existing securities, and customers paid for those purchases. The broker did not buy those securities, though he sent out confirmations and account statements that purported to show the purchase of those securities. There, the customers' net equity was based on the value, as of the date the SIPA proceeding was filed, of the securities shown on their account statements. Those statements accurately reflected the securities positions that the customers had instructed the broker to purchase and expected to be in their accounts. By contrast, the account statements and confirmations Madoff sent to customers reflected fabricated securities positions, based on hindsight, that were designed to facilitate his fraudulent scheme. Most Madoff customers expected that he would invest their money through legitimate trading in real securities. Instead, through no fault of those customers, Madoff opted out of the market in favor of a wholly fictitious series of transactions with pre-determined outcomes.

The situation also is not exactly like that of the customers in *New Times* who were solicited to invest in the non-existent New Age funds. There, the court concluded that the customers' net equity could not be based on the fictitious amounts shown on their account statements because basing recovery on the transactions in non-existent securities reflected on those statements would allow customers to recover amounts that had no relation to reality. In this case, by contrast, the securities on the account statements Madoff sent to customers were real securities.

The question the bankruptcy court will have to resolve is whether the Madoff brokerage customers are more like the *New Times* customers who directed the broker to purchase securities that actually existed (which would support the final account statement approach to calculating net equity) *or* more like the *New Times* customers who directed the broker to invest their money in securities that turned out to be non-existent (which would support the cash-in/cash-out method of calculating net equity).

The SEC's Recommendation

The Madoff case raises difficult issues. Based on an analysis of SIPA, its legislative history, and cases that have applied it, the Commission is recommending to the bankruptcy court that customer claims should be determined through the cash-in/cash-out method advocated by the Trustee and SIPC—with an additional adjustment to ensure that the investors' claims in this long-running scheme are valued most accurately and fairly.

The Commission is basing its recommendation on the conclusion that the claims of the Madoff investors cannot be valued based on the balance shown on their final account statements. Although this approach would allow most Madoff account holders to receive payments on their claims, those payments would be based on account balances reflecting amounts that Madoff himself concocted that bear no relation to reality. The account statements Madoff sent to the customers showed the results of a Ponzi scheme designed as an investment program, with positions selected *after the fact* to produce pre-determined results. Neither SIPA nor any of the cases interpreting that statute can be read to support an approach that would value claims based on the fictitious investment returns of such a scheme.

Madoff essentially promised customers that he would pick "winning" stocks for them, did not tell them which stocks he would purchase, waited to see which stocks did well, and then falsely reported that he selected stocks that met their investment expectations. The account statements that Madoff sent to his customers were illegitimate tallies of a fraudulent scheme and provide no basis for calculating those customers' net equity. Therefore, the Commission has concluded that the most reasonable way to measure the value of the Madoff customers' net equity is to look to the money those customers invested with Madoff as a proxy for the *unspecified* investments in securities (the split-strike conversion strategy) Madoff told them he would make for their accounts.

The Commission's recommendation resembles what would likely be the outcome in a private suit by a customer challenging the distribution of assets on the same facts. Although the customer could establish that the broker had committed fraud, and could recover her initial investment (less withdrawals), she would not be able to recover as damages the amounts shown on the final account statements because they were based on fraudulent backdating of trades through hindsight. The fraud did not cause the customer to lose actual proceeds that were (or could have been) the product of legitimate trading. The same principles are relevant in calculating the Madoff customers' net equity under SIPA. In this case, the only reliably determinable transactions are the cash deposits and withdrawals those customers made to and from their brokerage accounts.

By contrast, where a customer directs a broker to buy a specific security, the customer pays for that security, and the broker does not buy the security but sends a false confirmation of the transaction to the customer, the customer presumably could obtain a judgment in a private

action requiring the broker either to purchase the missing security for the customer's account or to pay the customer the current market value of the security. On the same facts, a customer's net equity under SIPA would likewise reflect the market value of the security the broker committed to buy, the customer paid for, and the broker-dealer falsely confirmed having purchased. In such a situation, the Trustee would either go into the market and buy the security for the customer's account or credit the customer with the market value of the security as of the filing date.

In addition, it is important to note that basing customers' net equity on the fictitious balances on their final account statements would do nothing to increase the fund of customer property—it would simply reallocate it. It is clear that there will not be enough money in the fund of customer property to pay out the $65 billion that Madoff falsely reported was in customer accounts when the firm failed. The Trustee has estimated that he may be able to recover as much as $8 billion to distribute to claimants. Using the final account statement approach would have the effect of favoring early investors—many of whom withdrew all or more than the principal they invested with Madoff—over later investors—some of whom withdrew little or none of what they invested and will not receive a distribution equal even to their principal.

While the final account statement approach favors earlier customers at the expense of later customers, the SEC is also sensitive to the corresponding fairness concerns under the cash-in/cash-out method. That method of calculating net equity favors later customers at the expense of earlier customers by treating a dollar invested in 1987 as having the same value as a dollar invested in 2007. To illustrate this concern, assume that one claimant invested $100 in the Madoff firm in 1987, a second claimant invested $100 in 2007, and neither withdrew any funds from their accounts. Under the cash-in/cash-out approach advocated by SIPC and the Trustee,

the net equity of both claimants would be $100. But because, in basic economic terms, $100 in 1987 dollars is worth $183 in 2007 dollars (http://data.bls.gov/cgi-bin/cpicalc.pl.), the claimant who invested $100 in Madoff's firm 21 years before the firm collapsed has suffered a much more substantial real-world loss than a claimant who invested $100 only one year before the collapse.

In the SEC's view, to achieve a fair and economically accurate allocation among Madoff customers who invested and withdrew funds in different historical periods, it is appropriate to convert the dollars invested into "time-equivalent" or constant dollars. This constant-dollar approach is rooted in the classic economic concept of the time value of money and will result in greater fairness across different generations of Madoff investors—in effect, treating early investors and later investors alike in terms of the real economic value of their investments.

The issue of calculating net equity in constant dollars has not arisen before in SIPA cases, probably because many Ponzi-type schemes are of relatively short duration, and the inequity among those who invested at different points in time is less striking. But the Madoff fraud—which lasted for 20-plus years—puts this issue into stark relief. In light of the silence of SIPA regarding the payment of interest and of a Court of Appeals decision[1] suggesting, in a distinct factual circumstance, that interest may not be applied to customer claims under SIPA, the Commission considered whether calculating net equity in constant dollars would be inconsistent with that case. Under the facts of this case, the Commission believes that the use of constant dollars can be distinguished from the payment of interest discussed in that Sixth Circuit case and

[1] *SIPC v. Ambassador Church Fin./Dev. Group*, 788 F.2d 1208 (6th Cir. 1986) (holding that customers of a failed brokerage could not obtain post-judgment interest for the 7 ½-year period during which SIPC delayed in paying their claims because SIPA's definition of "net equity" does not expressly provide for interest).

that the best reading of SIPA and the cases interpreting it is that net equity here should be calculated in constant dollars.

It also is the Commission's view that the constant-dollar method will have limited application to the calculation of net equity in other liquidations under SIPA. In a SIPA liquidation, a claimant's net equity is determined by calculating the net value on the filing date of the securities positions and cash shown on the books and records of the broker-dealer. Where the claimant's account statement and the books and records of the broker-dealer are consistent, there is no need to adjust that net equity value for inflation, because it is determined in current dollars as of the filing date. Calculating net equity in constant dollars should be necessary only where (1) the customer has a claim for securities, and (2) the claimant's account statement does not match the books and records of the broker-dealer either because (a) the securities are fictitious, or (b) the securities positions were the product of a fraudulent scheme. In calculating the customer's net equity under these circumstances, as in *New Times*, the money that the customer gave the firm to purchase securities serves as a proxy for the securities positions that were not and—critically—could not legitimately have been purchased. When the customer's net equity is calculated using cash as a proxy for securities positions, it is appropriate to calculate net equity in constant dollars.

Conclusion

The Madoff case poses difficult questions regarding the appropriate method for calculating the value of customers' claims in the absence of clear direction from either the statute or existing case law. The Commission's recommendation to the bankruptcy court is based on a

determination that calculating the net equity of Madoff customer accounts using a constant-dollar, cash-in/cash-out method is most consistent with the purposes of the statute and provides the greatest degree of fairness.

I thank you again for the opportunity to appear before you today. I would be pleased to answer any questions you may have.

Statement of Joel H. Green
Vice President – Legal Affairs & General Counsel
Upsher-Smith Laboratories, Inc.

Committee on Financial Services
Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises

December 9, 2009

Chairman and Members of the Subcommittee:

Thank you for the opportunity to address your Committee. My name is Joel Green and I am Vice President – Legal Affairs & General Counsel of Upsher-Smith Laboratories, Inc., Maple Grove, Minnesota.

I am here today in support of legislation that will protect the employees of Upsher-Smith Laboratories and working people throughout America, whose retirement security is imperiled by the Madoff fraud.

I urge you to support the Investor Protection Act of 2009 to expand SIPC protection to cover the losses of individual participants in pension plans, profit sharing plans, and other qualified retirement plans.

Some background is in order:

Upsher-Smith Laboratories is a family-owned pharmaceutical company based in Maple Grove, Minnesota. We were formed in 1919, and have approximately 550 employees, approximately 435 located in the Twin Cities, 65 in Denver and the rest around the country.

We established a profit sharing retirement plan for our employees in 1974, and beginning in 1995, plan assets were invested with Bernard L. Madoff Investment Securities LLC, a registered broker-dealer based in New York.

Over the next twelve years, the Company contributed over $8,000,000 to the plan for the benefit of our employees and invested these funds with Madoff. We believed these funds were invested by Madoff, a broker-dealer regulated by the SEC, in a diversified pool of high grade securities and treasury investments. The monthly reports we received from Madoff confirmed this investment structure, and the returns obtained were consistent, if unspectacular. We believed the investment was safe and prudent.

On December 11, 2008, Bernard Madoff, president and founder of Bernard L. Madoff Investment Securities LLC, was arrested and charged with engaging in a massive Ponzi scheme involving thousands of investors who invested billions of dollars for decades.

The fact that Madoff will spend the rest of his life in prison provides little comfort to our current and former employees or to the other victims of his fraud. Any recovery from the bankruptcy estate will likely yield only pennies on the dollar, and even then, will take years to resolve.

The principle source of recovery for our employees, as participants in our profit sharing plan, is SIPC.

We have filed a timely claim with SIPC on behalf of the plan and also on behalf of our 615 plan participants. Yet under the position adopted by the President of SIPC, only the plan is considered a "customer" for SIPC purposes, and only one recovery is available to the plan, despite the fact that over 600 of our current and former employees, and countless other pension plan participants throughout the country, have suffered real losses due to the Madoff fraud.

The legislation proposed by Congressman Ellison (and others) would protect these employees and their retirement security, and that of countless working men and women throughout America who rely on their retirement benefits for a secure and dignified retirement.

Congress created SIPC to protect the investments of a broad range of average Americans. Today, a vast percentage of the wealth of average working men and women is held in their retirement plans. The importance of these funds is heightened when our economy is struggling, homes are declining in value and being foreclosed, and jobs are lost or at risk.

Congress created ERISA to protect the retirement assets of working people. Under the rules imposed by ERISA, plan assets must be held in trust in the name of the plan trustee, and not in the names of individual plan participants.

When the public policies of both SIPC – to protect the interests of ordinary investors – and ERISA – to protect the retirement interests of ordinary working men and women – are considered together, a compelling argument exists that the only way to fairly accomplish these objectives is to expand SIPC coverage for pension plans to provide meaningful relief for the losses incurred by individual plan participants. Without such expanded coverage, the retirement security of these working people is lost.

Congress has already adopted a protection for average citizens who participate in retirement plans with respect to the plan's investment in FDIC-insured deposits. Even though the deposit is held in the name of the trustee of the plan, as with all plan assets, the FDIC rules provide that the interest of each participant is insured up to $250,000. The Congressional policy decision embodied in ERISA was to protect the retirement benefits of working men and women. The same policy decision should apply to protection of the retirement benefits of working men and women in pension plan investments in federally-regulated broker-dealers through SIPC

coverage. Two lower courts reached this very conclusion in the case of Morgan v. Kennedy, only to be overruled by an appellate court.

We believe that the appellate decision is bad law, bad public policy and should be reversed by the legislation proposed by Congressman Ellison and others. Congress intended SIPC to protect the investments of average American investors. For most average American workers, their primary investments are held in their retirement plans. Unless SIPC covers these workers' investments in their retirement accounts, it fails to protect the investments of the average American worker, as Congress intended.

We have been asked whether it is possible to afford such SIPC protection to cover the losses of individual participants of pension plans invested with Madoff, and not also extend such protection to individual investors of "feeder funds" who invested with Madoff. We believe the answer is "yes." ERISA prevents individual plan participants from investing their retirement accounts directly in their own names – all assets are titled with the plan trustee. The situation differs for individual investors in feeder funds. Those individuals are not prevented from investing directly in their own names, nor is their investment governed by a public policy of encouraging worker retirement savings. For these reasons, expanding SIPC coverage to cover the losses of individual plan participants would not require also expanding SIPC coverage to individual investors of feeder funds.

This proposed legislation would protect the retirement savings for average working men and women. We have worked with three other Minnesota companies whose retirement plans also suffered loss because of the Madoff fraud. Collectively, our companies have 735 participants who lost over $19,000,000 in company contributions due to Madoff – real cash contributions, excluding the illusory profits reported by Madoff. Of these 735 participants, over 640 had account balances of less than $50,000. These plans cover the average worker and do not focus on highly paid executives. A modest retirement benefit which is critical to the retirement security of these working men and women would fall well below the SIPC ceiling for coverage that would apply under this legislation.

We believe that our employees are representative of pension plan participants throughout the country who have been hurt by Madoff and who will benefit by the proposed legislation that will expand SIPC coverage to them.

We believe the Department of Labor can assist the Committee in identifying the number of plans and participants who were hurt by Madoff and who would be helped by this legislation. We have visited with companies throughout the country whose plans and employees have been hurt by Madoff. The DOL has extensive data in this matter that will assist the Committee in determining the scope of the loss and the cost of correction.

On behalf of our 615 current and former affected employees, we urge the passage of this bill, and thank you very much for your time and attention to this very important legislation.

Statement of Proposed Testimony
of
Stephen P. Harbeck
President and Chief Executive Officer
Securities Investor Protection Corporation
Before the
United States House of Representatives
Subcommittee on Capital Markets, Insurance, and
Government Sponsored Enterprises
Committee on Financial Services

December 9, 2009

Chairman Kanjorski, Ranking Member Garrett, and Members of the Subcommittee, thank you for the opportunity to appear before you today to discuss the work of the Securities Investor Protection Corporation or "SIPC" and possible improvements to the Securities Investor Protection Act or "SIPA."[1] My name is Stephen P. Harbeck and I am the President and Chief Executive Officer of SIPC. I have worked at SIPC for 34 years and have served in my current position since 2003.

SIPC is a non-profit membership corporation that was created under SIPA in 1970. With some narrow exceptions, every registered securities broker or dealer is a member of SIPC. Membership in SIPC is not voluntary; it is automatic upon registration as a broker or dealer. By statute, SIPC is not a government agency or establishment. Its policies are set by its seven-member Board of Directors, five of whom are appointed by the President of the United States and confirmed by the Senate. Three of the five Directors are selected from the securities industry and two are non-industry Directors. The remaining two Directors, respectively, are representatives of the United States Treasury and the Federal Reserve.

A central goal of SIPC is to protect customers of failed securities brokerage firms that are members of SIPC and that are in liquidation under SIPA. A firm is placed in liquidation upon an application by SIPC in federal District Court. In this regard, SIPC works closely with the United States Securities and Exchange Commission and securities self-regulatory organizations. Because SIPC has no investigatory or regulatory authority, these entities must notify SIPC when a broker-dealer is in financial trouble and unable to meet its obligations to customers. Once a District Court places a firm in SIPA liquidation and appoints a trustee to administer the liquidation, the case is removed to Bankruptcy Court where the matter proceeds like a bankruptcy case but with special customer protection features.

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 its purposes, SIPC may borrow against a $1 billion line of credit

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[1] 15 U.S.C. §78aaa et seq.

from the United States Treasury. In its nearly 40-year history, SIPC has never drawn upon the credit line.

Every customer is protected by SIPC up to $500,000 against lost or missing cash and securities deposited with the broker or dealer for the customer's account. Of the $500,000, up to $100,000 may be used to satisfy a claim for cash only. SIPC advances also may be used to pay the expenses of administering the liquidation proceeding where the debtor's general estate is insufficient.

To date, SIPC has overseen the administration of 322 customer protection proceedings which have involved the distribution, through 2008, of roughly $160 billion of assets for customers. Of the $160 billion, approximately $159.6 billion has come from debtors' estates and $323 million from the SIPC Fund.

Lehman Brothers Inc.

A little over 11-months ago, I appeared before this Committee and reported on two of SIPC's largest and most complex cases to date. I am pleased to report substantial progress in both of those proceedings.

In the early days of the Lehman Brothers Inc. proceeding, the Trustee in that case, with oversight by SIPC, established the framework that would allow him to transfer, in very short order, approximately $92 billion in customer assets for the benefit of more than 110,000 former Lehman customers. Since that time, the Trustee has addressed the resolution of accounts that were not part of the transfer. This resolution, through a "claims process," has involved the submission and review of approximately 12,700 claims, over 8,000 of which have been determined by the Trustee. Many of these claims involve the reconciliation of securities positions, claims related to accounts with a foreign affiliate or related entity, or claims for which there is no SIPC protection because they are subordinated or involve transactions that are not "securities" under SIPA.

In addition to resolving claims, the Trustee continues to pursue the recovery of assets for the benefit of customers and to investigate the Debtor and its activities in order to identify further sources of recovery. The Trustee also continues to coordinate and to discuss issues of common concern with Lehman's parent company and foreign affiliates located throughout Western Europe, Asia, the Middle East, and the Cayman Islands. The Trustee reports that as of November 11, 2009, he has approximately $18.7 billion in assets under his control.

Bernard L. Madoff Investment Securities LLC

In less than one year, the Trustee for the Bernard L. Madoff Investment Securities LLC proceeding also has made significant progress in this large and complex proceeding. Much attention has been paid to the claims process and to resolving claims as promptly as possible under challenging circumstances. Over 16,000 claims have been filed in the case. I am told that before the end of this week, determination letters with respect to more than 11,500 claims will have been issued by the Trustee. These 11,500 claims represent more than 71% of all claims filed.

The value of allowed claims in the case is $4.6 billion and will be satisfied partly with funds provided by SIPC that total more than $559 million. This is more than the amount that has been advanced by SIPC in all of its 322 customer protection proceedings. With respect to claims, the Trustee has implemented a Hardship Program to accelerate the review and satisfaction of claims of victims suffering from the worst financial circumstances. A central issue relating to claims determination, namely, the calculation of the customer's net equity, is currently before the Bankruptcy Court in the case.

Much work also is being done on the recovery of assets for the benefit of customers. The Trustee has brought 14 lawsuits seeking to recapture more than $14.8 billion from various feeder funds, Madoff friends and families and related parties. To date, the Trustee has collected more than $1.1 billion for the benefit of customers. The Trustee believes that a number of the pending law suits will add substantially to the amount already recovered.

In answer to a question posed by the Subcommittee, the total Trustee fees paid in the case for services from December 2008 through September 2009 is $1,275,867. It must be emphasized that none of the fees will reduce the amounts available for customers. All administrative expense advances in the Madoff case, including fees, are paid with SIPC funds.

I would add that, like Lehman, the Madoff case has vast international implications. In this regard, the Trustee continues to investigate, and to seek to recover assets, in no fewer than eleven different foreign jurisdictions.

Legislative Measures

More than 625,000 claims have been satisfied under SIPA since SIPC's inception in 1970 through 2008. SIPC has proposed various legislative measures aimed at enhancing, even further, customer protection and ensuring the adequacy of the SIPC Fund. Among other things, SIPC has proposed that the limit of protection for cash claims be increased from $100,000 to $250,000 and adjusted periodically for inflation. It has recommended that the line of credit from the United States Treasury, which has not been adjusted since the enactment of SIPA in 1970, be increased. It also has proposed an increase to the maximum "minimum assessment" paid to SIPC by member broker-dealers. As of November 30, 2009, the balance of the SIPC fund was $1,188,000,000. At an assessment rate of 1/4 of 1%, SIPC anticipates revenues totaling $480 million for 2010. SIPC's borrowing from the Treasury, if any, cannot be forecast at this time. Recently, SIPC's Board of Directors authorized a change to its Bylaws that would increase the size of the target balance of the SIPC Fund from $1 billion to $2.5 billion.

The Subcommittee has asked that I address various proposals for improving SIPA. To the extent not already discussed above, SIPC's views on the proposals are as follow:

- Extending SIPA coverage to individual investors in ERISA plans up to $500,000 per investor.

Only "customers," as defined in SIPA, are eligible for protection. In the case of pension plans or "trusts," SIPA provides, and the case law supports, that there is only one customer and that customer is the trust or plan itself. There is no protection for individual participants in the plan. The proposal to extend protection to the participants is an important one, but one that warrants study by SIPC and consideration by its Board before a position can be taken by SIPC. Protecting individual participants has substantial implications for other customers in a liquidation because all customers share, pro rata, in any fund of customer property. The increased protection also has implications for the SIPC Fund. There has been no risk management analysis of the consequences for either SIPC or the line of credit with the Treasury. Among other questions raised under the proposal are the cost to the SIPC Fund; the necessary changes to the assessment basis; the consequences of treatment of the individual participant as a "customer" with respect to "clawbacks" or avoidance actions and the individual's submission to the jurisdiction of the bankruptcy court; the justifications for limiting the expanded protection to only one group of claimants with pooled assets; whether the expanded protection would cause a plan's administrators to be less vigilant or exercise less due diligence in reliance upon the SIPC protection.

The above are just some of the issues needing consideration. SIPC welcomes the opportunity to work with Congress in studying this proposal.

- Prohibiting any recovery of principal or interest from an investor without proof that the investor did not have a legitimate expectation that the assets belonged to him or her.

I urge the Subcommittee to reject this proposal in the strongest possible terms. If this proposal were currently in place in the Madoff liquidation, it would cost the victims in that case literally billions of dollars. The Madoff Trustee has used the avoiding powers granted to him by SIPA and the Bankruptcy Code judiciously. He has not sued small investors. He has urged any Madoff customer who has received more money than he placed with Mr. Madoff to open discussions with him. He has instituted preference and fraudulent transfer proceedings against large investors who received disproportionate returns. But the weapons in the Trustee's arsenal include the fact that all he must prove is the disparate return, without any issue of "legitimate expectation."

The only situation in the Madoff case where small investors have been sued were three instances where the claimants ignored the claims filing procedure that has been in place for 39 years and initiated a lawsuit against the trustee. The Trustee was compelled to assert mandatory counterclaims. In short, the proposal addresses a problem which has not arisen , and would do extensive damage to the very people it seeks to help.

- Requiring SIPC to make SIPC advances based on the customer's statement balance up to $500,000 per customer within 60 days of a customer filing a claim.

  SIPC supports the prompt determination and satisfaction of customer claims and every effort is made toward that end. For example, in the Madoff case, claims are being satisfied promptly with advances from SIPC even if the claimant has objected to some portion of the determination of his claim. Thus, if the claimant deposited $500,000 with the brokerage but is claiming $2.5 million based on his last fictitious account statement, the claimant is being paid $500,000 by the Trustee pending resolution of the dispute.

  The determination of claims, however, should not be based solely on account statements. Under SIPA, a broker's obligation to a customer must be verifiable from the debtor's books and records or otherwise established to the satisfaction of the trustee. To give blind adherence to account statements may be to endorse fictitious profits, backdated trades or other fabrications by a wrongdoing broker-dealer.

  As to the timing of SIPC advances, SIPC can only advance funds to satisfy a claim once the trustee has determined that the claim is valid. A 60 day limit for determining a claim is impractical and ignores the realities of a liquidation. To correctly determine claims, a trustee must be able to compare them against the debtor's books and records, and to assure himself that records are reliable. In many instances, however, the records may be in poor condition or incomplete. The records may not be immediately available because they have been seized by regulatory or criminal enforcement authorities. In those instances, the trustee's use or access to the records may be limited and require coordination with other authorities. There may be a very substantial number of claims or highly complex claims that require more time to be researched and determined. There may be questions of fact presented by a claim or incomplete information submitted by the claimant. This will require the claimant to supplement his claim with additional information which may take time. These are just some of the considerations that argue against a set time limit and in favor of a more flexible standard.

- Extending SIPA coverage to investors who purchased securities through a SIPC member broker or dealer, but whose securities were eventually transferred to an affiliate entity, such as Stanford Financial Group ("Stanford").

  SIPA protects customers against the loss of cash and securities custodied by or for them with the broker. Once the customer's property has been delivered off of the broker's books and records, with the client's consent, it is unclear why the brokerage would continue to be responsible.

  With respect to the facts in Stanford, it is SIPC's understanding that a related entity,

Stanford International Bank, Ltd., an Antiguan entity not regulated by any U. S. authority, issued certificates of deposit ("CDs") directly to investors, most of whom took possession of the CDs or had them held for them at a different firm. The investors suffered a loss when the CDs lost or had no market value.

SIPC opposes any proposal to extend protection to investors against the loss in value of their securities, including those issued by an offshore entity beyond the reach of U. S. regulators and whether the loss is market loss or the result of fraud. Such protection would change substantially the mandate of SIPA, create an incentive to commit fraud, require a massive increase to the size of the SIPC Fund, and be an undue burden on SIPC members and their customers.

- Requiring any of the proposals above be applied retroactively for liquidations occurring after December 1, 2008.

  Enacting and making retroactive any of the above proposals would be fundamentally unfair to SIPC, its members, their customers, and potentially the American taxpayer. The adequacy of the SIPC Fund is a matter that is consistently considered and evaluated by SIPC. The size of the Fund is based upon SIPC's obligations under the law as the law exists. To impose suddenly additional obligations upon SIPC that have not previously existed, would require an unplanned and potentially massive infusion of money into the Fund and trigger a host of real problems. The availability of SIPC funding for known obligations in existing SIPA liquidations, and the availability of monies for future SIPA liquidations, would be compromised. SIPC's budget would be jeopardized. Members of SIPC who would have factored the SIPC assessment into their planned budget, would be required to find funding for an unexpected and sizeable liability. The use of taxpayer money would be a reality.

  SIPC submits that favoring one group of investors retroactively has consequences that when weighed against the benefits, simply cannot be justified. Any change in SIPA protection should have prospective effect only, and should be made only after considered deliberation on the need for and the consequences of such change, and the ability of the SIPC Fund to sustain it.

Thank you for the opportunity to express SIPC's views. I welcome any questions that the Committee has.

I would like to first thank Chairman Kanjorski, Ranking Member Garrett and the Representatives that consist of the Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises.

My name is Gregory Lancette. I am currently the Business Manager of Plumbers and Steamfitters Local 267 in Syracuse, NY. I also serve as Chairman of Local 267's Jointly Administered Multi-Employer Trust Funds. I have served in these capacities since 2005. Local 267 is a chartered local union of the United Association of Plumbers, Steamfitters, Sprinklerfitters and HVAC Service Technicians of the United States and Canada. I am here today on behalf of not only my 1,115 pension participants and their families, but I also stand here today as President of the Central and Northern New York building and Construction Trades Council representing nearly 16,000 pensioners and their families from other unions in Central New York.

I would like to discuss the direct relationship between S.I.P.C and Bernard Madoff's Ponzi scheme.

Plumbers and Steamfitters Local 267, at the time of Madoff's arrest, had a market value approximately 34 million dollars invested with Madoff's direct brokerage. Also, Local 267 had 6.5 million dollars invested with Beacon and Associates. Beacon is a fund consisting of a "basket of investments", which was comprised of up to 40% of total assets invested in Madoff.

Under the current formula of SIPC Reimbursement, Local 267 will receive $500,000 for the Madoff direct account. The reimbursement for the Beacon account will only be $900, due to the fact that the amount of Local 267's portion consisted of only 1.8% of Beacon's total assets. To summarize, Local 267's pension lost almost 37 million dollars and is expected to recover $500,900 from S.I.P.C.

I must take a moment to reiterate that the only reason I am here today is the fact that we had money invested with Bernard Madoff. Mr. Madoff has stolen billions of dollars and the S.E.C failed to recognize this criminal behavior, even after several investigations. Representatives Maffei and Ellison have introduced an Amendment that I believe will be a significant step in the right direction addressing pension funds that were victimized by this criminal act.

The proposed Amendment consists of:

- Extending SIDA coverage to individual investors n ERISA plans up to $500,000 per investor;
- Prohibiting any claw back of principal or interest from an investor without proof that the investor did not have a legitimate expectation that the assets belonged to him or her; and
- Requiring the Securities Investment Protection Corporation (SIPC) to make advances based on the customers statement balance up to $500,000 per customer within 60 days of a customer filing a claim

The reasoning behind the proposed amendment regarding S.I.P.C treating each pensioner as an individual investor is that pension funds would be made closer to whole to compare what is currently being paid back to pension plans in Central New York. Currently, if all 30 funds receive the $500,000

benefit, a total of 15 million dollars will be paid to these funds, compared to nearly 350 million dollars in losses.

To further illustrate: Local 267's pension loss was nearly 37 million dollars. That equates to approximately $33,183 per participant. I can state with certainty that allowing individual pensioners to be considered as individual investors, would severely lessen the burden of being victimized by Bernard Madoff's actions

The portion of the Amendment that would require SIPC to reimburse within 60 days would benefit all plans in many ways. This would be accomplished by either returning assets to invest, or to pay benefit to retired members.

Numerous pension and health funds that were affected by the acts of Bernard Madoff are facing insolvency. The Securities Exchange Commission was not able to identify the fraud that took place in a timely manner; which resulted in much more significant losses as the criminal act progressed.

The Pension Protection Act of 2006 requires pension funds to amortize debt in a 15 year period. I would ask for consideration of relaxation of the PPA, allowing a pension plan to amortize the Madoff related losses at a 30 year rate would help ensure stability. The plans could recover naturally, instead of the Plans solvency being jeopardized, which may result in the plan being turned over to the Pension Benefit Guarantee Corp.

In summary:

I strongly urge consideration for multiple investor groups or participants in multi employer ERISA plans to be considered as individual investors, and that SIPC be funded to operate and reimburse in this manner. I also strongly urge that pension plans be given a thirty or forty year amortization period based on the current market value at the time of Madoff's arrest.

Thank you for your time and consideration.

Testimony of Jeannene Langford

107 Spring Grove Ave.
San Rafael, CA 94901

December 6, 2009

The Honorable House Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises

Thank you for holding these hearings and looking into the SEC's complicity with Bernard L. Madoff Investments. My name is Jeannene Langford and I live in San Rafael California. As one of the more than 16,000 victims of the Bernard L. Madoff ponzi scheme, I am grateful to have the opportunity to come here today to present how this financially devastating scandal destroyed my quality of life. It has shattered my trust in my government's ability to serve and protect us. My hope is that Congress will choose to recognize and protect ALL indirect investors such as myself who were victimized by this scandal. We need your help NOW.

I have worked for 30 years starting as a Visual Designer and now work as an Art and Design Consultant in the Stationery and Craft industries. The past 17 have been as a single parent working to provide for my daughter and myself. The training I've pursued to advance as a professional designer and artist along with the commitment to raising my daughter have been my priorities. In areas where I have little expertise, I recognized the necessity to rely on hiring a specialist. Personal investment was one of those areas but I knew there were systems such as the SEC in place to protect me. I looked to Investment groups, read books on investing and talked with friends in order to educate myself. From my research, there was no reason to believe that this investment was not a viable place to put the majority of my life savings. Looking back I had no way of knowing the partnership where I placed my money was invested with Madoff.

The money I had invested with Madoff represented 30 years of my life savings. This was my retirement, a down payment for a house, investment for the business I was starting, and it was money for my daughter's education. In short it was the foundation for my future. I do not have another 30 years to earn this money again. If the SEC had done its job I would have my savings and I would not be looking at working the rest of my life just to get by.

I was shocked when I found out my money was gone, but I was even more shocked and outraged to find out that the very governing body that sanctioned this business did not protect me. I need help in understanding how the SEC could ignore expert testimony, be lax in its investigations, be influenced by the aura of Madoff, and not carry out its duties.

I find it both tragic and ironic that the interpretation of the language by the SIPC leaves out indirect investors who in many cases are the people most in need of protection; hard working people like myself who were not wealthy and who are now struggling to keep up because their lifetime of hard earned savings, or their pension has been stolen. These are the very investors for whom the SIPC insurance protection is most important.

Congress needs to take action to restore confidence for all future investors. I understand a simple change to the definition of the word "customer" in the SIPA to include indirect investors would ensure that the SIPC symbol would protect both indirect and direct investors in the financial markets and begin to restore a sense of trust. If nothing is changed, the current situation would be similar to having a catastrophic landslide, and the government came in to assist those on one side of the street but not the other. As I sit here today in this chamber I cannot believe this is the intent of this Committee, or of Congress.

I am here today asking this Committee to take action to help all Madoff victims, especially the indirect investors who have found themselves to be victims of this fraud.

Though I appreciate extending the SIPC coverage through the Maffei/Ellison amendment to investors in ERISA plans, this does not go far enough. All of us who invested through family partnerships, trusts, hedge funds, feeder funds, and pension plans that did not place their funds directly, are victims of this crime. All of us who invested are also victims of the SEC's inability to find the fraud. Unlike the "direct investors," who stand to recover up to $500,000 from the SIPC, we as "Indirect Investors" at the present time are ineligible for the same SIPC relief. We all are victims of the same crime and we all need to be granted equal protection.

On the SEC's website under "What We Do" reads "The mission of the U.S. Securities and Exchange Commission is to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation." I urge you to rectify this current disparity of protection by carrying out the mission you set forth.

Sincerely,

Jeannene Langford

Testimony by Peter J. Leveton
Co-Chairman of the Agile Funds Investor Committee
Before the House Financial Services Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises, December 9, 2009

"Additional Reforms to the Securities Investor Protection Act"

Introduction

Chairman Kanjorski, Ranking Member Garrett and Members of the Committee.

My name is Peter J. Leveton. I live in Lakewood, Colorado, a Denver suburb in Congressman Ed Perlmutter's 7th District. I am a Co-Chairman of the Agile Group, LLC ("Agile") Investor Committee. Agile is a Boulder, CO based hedge fund manager that was forced to suspend redemptions and has been in liquidation since the fourth quarter of 2008. The Investor Committee is an ad hoc entity formed in December 2008 to maximize the recovery of Agile's investor assets. My fellow Investor Committee members and I serve as unpaid volunteers.

Thank you for giving me the opportunity to testify about and propose solutions for:

1. The current inability of "indirect" investors to be recognized by the Securities Investor Protection Corporation ("SIPC") as "customers".

2. The current inability of all Ponzi scheme victims to receive Federal income tax relief for the loss of their Individual Retirement Accounts ("IRAs"), 401(k)s. Charitable Remainder Trusts ("CRTs"), variable annuities and any other tax deferred retirement accounts (collectively "Tax-Deferred Retirement Accounts").

3. The proposed Securities Investor Protection Act ("SIPA) amendment for investors in ERISA plans.

4. The proposed SIPA amendment prohibiting clawbacks.

5. A SIPA amendment or other action requiring SIPC to make advances based on a customer's statement balance within 60 days of a customer filing a claim.

I am testifying on behalf of Agile's 205 "indirect" investors; several hundred Ponzi Victims Coalition members from more than 20 states; and, by extension, Bernard L. Madoff Investment Securities, LLC ("BLMIS" or "Madoff"). Indirect investors who filed more than 11,000 SIPC claims on or before the bar date of July 2, 2009.

Please see Exhibit I for information about Agile's investment history, its investments with hedge funds that invested with BLMIS and personal letters from 55 Agile investors to the Senate Finance Committee immediately prior to that Committee's March 17, 2009 hearing titled "Tax Issues Related to Ponzi Schemes".

In addition to commenting on items 3, 4 and 5 above, as requested in the official invitation, my goal is to accomplish two significant objectives for the benefit of all Indirect investors:

1. Clarify SIPA's definition of Customer consistent with Congress's 1970 intent to provide a "safety net" for all investors who placed their money with US brokerage firms that later turned out to be engaged in fraudulent activities or otherwise failed.

As SIPA is currently interpreted by SIPC and BLMIS Trustee Irving H. Picard, "direct" investors stand to recoup up to $500,000 from SIPC for each of their BLMIS accounts, while Indirect investors will receive zero.

When SIPA was enacted in 1970 it was clearly Congress' intent to protect all investors from losing 100% of their investment in fraudulent investment schemes run by brokerages supervised by the Securities and Exchange Commission ("SEC"). It was clearly not Congress' intent to discriminate between Indirect and Direct investors.

We propose that Congress clarify SIPA's definition of Customer and require SIPC to provide equal financial relief for all Indirect and Direct investor victims whose funds were stolen by BLMIS and other Ponzi schemes operating under the regulatory authority of the SEC and exposed after December 31, 2007.

2. Provide Federal income tax relief for all Ponzi scheme investor victims whose Tax-Deferred Retirement Accounts were stolen by BLMIS and other Ponzi scheme operators exposed after December 31, 2007

Indirect Investor Profile

Indirect investors are not definable as a homogeneous group. Indirect investors are Americans from all walks of life, including farmers, doctors, lawyers, teachers, engineers, entrepreneurs, business owners, corporate executives, and others who have worked hard our entire lives. We have typically saved diligently, helped create jobs, played by the rules, contributed to charities and, we thought, invested wisely for our retirement and to provide some remainder for our children and charities, including medical research foundations, educational institutions and other not-for-profit organizations recognized under IRC S 501 (c) (3).

Many of us are your constituents. Many of us had no disposable income, financial investments or savings, except what we accumulated over the course of our working lives and invested in Tax-Deferred Retirement Accounts, hedge funds and feeder funds, much of which then found its way from our "trusted" fund managers to BLMIS.

Many of us are now devastated, financially and psychologically. 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 60s, 70s and 80s, are attempting to reenter the work force, sometimes in menial jobs, to obtain money for food and shelter, and some of us have had to beg for support from our siblings and children.

It is fundamentally unfair, and was categorically not Congress' intent in passing SIPA, that Indirect investors would go overnight from a well planned retirement to financial ruin; while the Direct investors, who knowingly invested with Bernard L. Madoff and BLMIS, would receive up to $500,000 for each of their accounts.

There is only one significant distinction between Direct and Indirect investor victims:

- Direct investors intentionally placed their money with BLMIS without going through an intermediary, knew they were investing with Bernard L Madoff, and they or their financial advisors had ample opportunity to carry out extensive due diligence.

- Indirect investors invested via trusted advisors in hedge funds, pension funds, and feeder funds, which subsequently invested with BLMIS. A majority of Indirect investors had never heard of Bernard L. Madoff before learning that he had stolen our money.

In addition to hedge and feeder fund investors, Madoff and other Indirect Ponzi scheme victims' money came from family partnerships, corporate pension plans, physician pension and profit sharing plans, community/township plans, and similar investment vehicles, and the many charitable organizations that are recipients of CRTs. Because the contributors to these investment vehicles are also Indirect investors, they, like the victims who invested in hedge funds and feeder funds, are precluded from SIPC relief because they are not currently defined as Customers.

All Indirect investors lost their money to the same fraud and suffered the same devastating effects as the Direct investors. All Indirect investors should be entitled to the same financial relief as the Direct investors.

Eliminate Discrimination Against Indirect Investors

Until recently Congress seems to have focused primarily on the approximately 4,900 Direct investor Madoff victims who submitted SIPC claims on or before the Trustee's bar date of July 2, 2009. Substantially overlooked have been the Indirect investors who submitted more than 11,000 SIPC claims on or before July 2, 2009.

Per the Trustee's web site, as of December 3, 2009, SIPC had processed 3,062 Direct investor claims, allowed 1,641 of them and advanced approximately $559 million to the Direct investors (an average of about $341,000 per claim). Over the same period, to our knowledge, not one Indirect claim has even been processed. Without a change in the definition of Customer, these Indirect claims will never be processed and certainly not paid.

If Congress does not act to correct this inequity, Direct investors will continue to receive up to $500,000 SIPC advances for each of their allowed BLMIS claims, plus perhaps additional monies from the sale of Madoff's material assets, and Indirect investors, who lost their money to the same fraud and suffered the same financial devastation, will receive nothing.

It defies logic and basic fundamental American fairness to somehow believe that when passing SIPA and creating SIPC Congress' intent was to put Indirect investors at a decided disadvantage to Direct investors. But that is exactly the result of the current interpretation.

SIPA was passed and implemented in 1970 as an amendment to the Securities Exchange Act of 1934. In urging its prompt passage, Senator Edward S. Muskie proclaimed on the Senate floor: "...after this bill is enacted, no American will lose his savings through a brokerage firm bankruptcy."

It is apparent that Senator Muskie's and Congress' intent was for SIPA to protect all Americans from losing their savings through the failure or fraud of their brokerage firm.

He did not say that only those investors who invested directly with an apparently-successful money manager would receive SIPC relief if things went wrong, but, instead, that **all Americans** would receive such relief.

In 1970, hedge funds and feeder funds, to the extent they existed at all, were unavailable to most individual investors. Since then, even though these investment products are now available to the majority of investors, SIPA's language has not been clarified to clearly extend coverage to individual investors whose money was entrusted to fund managers. As a result, SIPC and BLMIS Trustee Irving H. Picard have felt free to construct their own definition and, contrary to congressional intent, have concluded that Indirect investors are not Customers and are, therefore, not eligible to receive SIPC advances.

To exclude Indirect investors would be, we believe, contrary to congressional intent.

Why should Congress pass legislation requiring SIPC to treat all BLMIS investors equally?

- The distinction between Indirect and Direct investors is form over substance, contrary to congressional intent, and clear discrimination against Indirect investors. Unless Congress intervenes to correct this inequity, Indirect investors will not benefit from the SIPC safety net and receive no relief for their losses to the Madoff and other Ponzi schemes in firms regulated by the SEC. We believe it is time to correct this injustice and only Congress can do so.

- A major reason for the magnitude of the Madoff Ponzi is the collective failure, negligence, ineptitude and incompetence of the Securities and Exchange Commission ("SEC"), the Financial Industry Regulator Authority ("FINRA"), the IRS, and SIPC.

  The SEC's failures are clearly documented in the August 31, 2009 Investigation of Failure of the SEC to Uncover Bernard Madoff's Ponzi Scheme report prepared by SEC Inspector General David Kotz. According to press reports the failures have also been confirmed by Bernard L. Madoff's own comments of recent months. This Subcommittee and the full House Financial Services Committee have received extensive testimony and discussed these failures at great length so I don't feel the need to go over them again.

  However, had the SEC and other regulatory agencies, adequately carried out their responsibilities, not been satisfied with the incomplete results of multiple superficial investigations, and not provided BLMIS and Bernard L. Madoff himself with one clean bill of health after another, the gigantic Madoff Ponzi scheme would have been stopped years ago; and the amount of money stolen and lives ruined would have been substantially less than the carnage that has taken place this past year.

- The IRS approved BLMIS as one of only about 250 non-bank custodians for IRAs and pension funds, and did so in the midst of Harry Markopolos' repeated warnings to the SEC that Madoff was running a Ponzi scheme. This approval was another vote of confidence in Bernard L. Madoff and BLMIS.

- If Congress and the SEC do not accept at least partial responsibility for these travesties, do not act to restore parity between Indirect and Direct investors, and do not carry out the provisions of

SIPA as intended by Congress (thereby allowing the BLMIS Trustee and SIPC to "make up the rules" as they go along), it is entirely possible that both domestic and foreign investors will lose significant confidence in the US securities markets and will look elsewhere to invest.

Why should Congress provide tax relief to investors for Ponzi scheme losses in their Tax-Deferred Accounts?

- Congress created tax-deferred retirement vehicles to encourage all Americans to put their money in safe, growing investments for their retirement. This long term strategy was extremely successful in attracting investment capital. Unfortunately such accounts constituted a significant portion of monies stolen by Madoff and the other Ponzi operators and because this type of loss was not anticipated, the tax laws did not provide for relief in such circumstances.

- Market losses exceeding an investor's tax basis in Tax-Deferred Retirement Accounts are clearly not deductible under current Federal income tax regulations and we are not proposing that they be deductible. However, losses attributable to Ponzi schemes are not market losses and are brought about by the unusual circumstances discussed elsewhere in this testimony.

  We believe that Congress should act to provide tax relief for such losses. This is particularly true in the case of BLMIS where the SEC and IRS essentially issued "official seals of approval".
  - The SEC, in December 1992 when the Wall Street Journal quoted one of the Commissions' senior officials as saying that a recent Madoff investigation found "nothing to indicate fraud". Although this statement was made years ago, it has been extensively referenced and relied upon by investors and fund managers as an indication that Madoff had been vetted.

  - The IRS, in July 2004 when it named BLMIS as a non-bank custodian of IRA and pension plan accounts.

  CRT Ponzi losses are particularly damaging because they adversely affect both the donors and recipients. Such losses deprive the donors of a regular source of retirement income and deprive the recipient charities, such as educational institutions, hospitals, churches, foundations and other charitable organizations, and not-for-profit entities of money they counted on to fund their respective missions.

Other Important Considerations

- It has been suggested that Indirect investors may actually be better off than Direct investors because we can sue our hedge and feeder funds. This suggestion is simplistic, misleading and not practical. Many of the hedge and feeder funds are bankrupt, and have retained expensive, high-powered attorneys to defend whatever might be left. Most Indirect investors, on the other hand, cannot afford expensive, high-powered attorneys, and we have nothing left. Even if this course of action were feasible and ultimately successful, such litigation would likely take many years and investor assets would be substantially depleted during the interim.

- Much has been made of the sale of Madoff's material assets and the several million dollars raised by these sales. Some reporters have stated that the proceeds will go to "Madoff's victims." However, unless the definition of Customer clearly includes Indirect investors, any proceeds that

may be left after the lawyers deduct their fees, will only be divided among the Direct investors, and, once again, Indirects will be looking at zero.

- Recent media attention and Senator Charles E. Schumer's comments have underscored the Senate's amendment to HR 3548, the Unemployment Extension Act. The amendment allows Indirect investors to carry back Ponzi theft losses consistent with the provisions of IRS Rule 2009-9 and Procedure 2009-20 allowed for the Direct investors. While this amendment is appreciated and will indeed be beneficial to some Indirect Investors, it is of little or no assistance to many smaller and retired Indirect Investors and the fact it was needed at all underscores the degree to which Indirects have been overlooked.

Proposed Congressional Intervention

Because of the collective failure, negligence, ineffectiveness and ineptitude of the SEC, FINRA, SIPC and IRS, we propose that Congress enact legislation to:

1. Amend SIPA and require SIPC to treat Indirect and Direct investors equally for BLMIS and all other Ponzi schemes in brokerages under the regulatory authority of the SEC and exposed after December31, 2007; and

2. Provide Federal income tax or other relief for Tax-Deferred Retirement Accounts lost to the BLMIS and all other Ponzi schemes exposed after December 31, 2007.

To carry out these recommendations we propose that Congress do the following:

1. Amend SIPA to clearly provide that all Indirect investors receive parity and be treated equally with Direct investors in BLMIS and all other Ponzi schemes under the regulatory authority of the SEC after December 31, 2007.

There are many precedents for amending Federal and state laws to clarify the intent of the legislative sponsors. In this instance, the SIPA amendment would simply provide that those who suffered indirectly, for example as customers of customers, are equally entitled to protection under the law as those who suffered directly. An analogy would be the many "indirect purchaser" statutes and amendments enacted under antitrust consumer laws.

An equitable approach to accomplish this objective would be to amend the definition of Customer, SIPA Section 15 U.S.C. 78lll (2), to read:

"...The term 'customer' of the debtor means any person investing directly or indirectly through one or more parties who has a claim against the debtor arising out of sales or conversions of such securities".

"The effective date of this subsection shall apply to claims made after December 31, 2007".

2) Enact legislation that either modifies the Federal tax code or provides alternative means for all victims of Ponzi schemes exposed after December 31, 2007 to recover a reasonable portion of their Tax-Deferred Retirement Accounts.

Tax law modification is an extremely complex issue and we are not proposing specific solutions at this time. However, unless there are modifications to the Federal income tax code or Congress creates other approaches to provide some relief for the loss of Tax-Deferred Retirement Accounts, the unprecedented magnitude of the 2008 Ponzi revelations will leave many honest investors with zero relief for their stolen Tax-Deferred Retirement Accounts.

To address this problem, we propose that the Capital Markets Subcommittee initiate discussions with the House Ways and Means Committee and the appropriate Senate Committee to study and analyze the issues and recommend fair and equitable solutions.

Proposed SIPA amendment for investors in ERISA plans (Maffei/Ellison) Amendment.

The concepts promoted in this amendment are certainly commendable. However, it unfortunately and arbitrarily excludes many Indirect Madoff and other Ponzi scheme victims. The amendment only addresses relief for ERISA plan Indirect investors and once again discriminates against the many thousands of other Indirect investors, including those in self-funded retirement plans such as IRAs, 401ks, variable annuities and other Tax-Deferred Retirement Plans.

Why should Congress protect investors in ERISA pension plans while ignoring innocent investors in the other self-funded Tax Deferred Retirement Plans?

If this amendment is passed without including all Indirect investors, thousands of Indirect investors will still be left with no relief whatsoever, and will once again be victimized by the system: first by Madoff, then by SIPC, and then by Congress.

We Indirect investors are seeking an Act of Congress that will end the discrimination against certain classes of investors, not perpetuate it.

Please do not pass the Maffei/Ellison Amendment unless it is amended to include all Indirect investors as discussed elsewhere in this testimony.

Proposed SIPA Amendment Prohibiting Clawbacks

We endorse an amendment which prohibits clawbacks from investors who withdrew their money in good faith and can substantiate their claim that they did not know and had no reason to believe that BLMIS, or other Ponzi Schemes were fraudulent operations.

SIPA amendment or other action requiring SIPC to make advances based on a customer's statement balance within 60 days of a customer filing a claim.

Obviously advance of the statement balance is a very complex matter (including whether or not the investor knew or should have known they were investing in a Ponzi scheme) with likely unintended consequences whichever way it is decided. Primarily because of the regulator failures discussed elsewhere in this testimony, we would apply the same test as with clawbacks. That is, investors who withdrew their money in good faith and can substantiate their claim that they did not know and had no reason to believe that BLMIS, or other Ponzi Schemes, were fraudulent operations, we believe they should receive credit for their statement balance closest to the date the Ponzi scheme was exposed.

With regard to payment within 60 days of a claim being filed, we would need to know far more about the processing logistics before stating an opinion. However, regardless of what period is determined to be reasonable for payment, we suggest that processing parameters and guidelines be established and that SIPC be held accountable for meeting such parameters and guidelines

Conclusion

In closing, I suggest that "this could have happened to you", as it did to the thousands of honest and innocent investors who have been living in fear and deprivation for the past year, and whose lives will be permanently ruined without your help.

It is clear that only "Acts of Congress" will rectify the injustices discussed in this testimony. If left unmitigated and not corrected by Congress, we believe these financial problems of epic proportion will erode future investor confidence in the entire US investment system.

We look to you and your colleagues as our only hope to:

(1) carry out Congress' original intent to protect all investors when it enacted SIPA, and

(2) allow us to recover a portion of our Tax-Deferred Retirement Account losses because of monies stolen by Bernard L. Madoff and other unscrupulous Ponzi operators.

Thank you again for the opportunity to testify about these matters which are so important to the thousands of investors who have been financially devastated by the BLMIS and other Ponzi schemes.

I would be pleased to answer any questions you may have.

Sincerely,

Peter J. Leveton
Co-Chairman
Agile Funds Investor Committee
303-981-8783
Pete3489@aol.com

Attachments:

Exhibit I: Proposed SIPA curative amendment for equitable treatment of Indirect and Direct Investors

Exhibit II: Agile Background Information and Personal Letters

Exhibit III: Leveton resume

Exhibit I

Peter J. Leveton Testimony Before the House Financial Services Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises, December 9, 2009

"Additional Reforms to the Securities Investor Protection Act"

Curative Legislation to Provide Equal Relief for All Investors by Amending the 1970 Securities Investor Protection Act ("SIPA") Definition of Customer

This proposed amendment defines "customer" to clearly allow "indirect" investors to receive SIPC safety net protection on equal footing with "direct" investors. Indirect investors include those in hedge funds, feeder funds, pension plans, trusts, family partnerships and similar investment vehicles ("Indirect Investment Vehicles").

- Direct investors placed their money with a particular brokerage firm without going through an intermediary and knew they were investing with that firm.
- Indirect investors invested in Indirect Investment Vehicles which subsequently invested with a brokerage firm.

Amendment Justification

Updating SIPA

- SIPA was passed by Congress in 1970 as part of the Securities Exchange Act of 1934. Since its inception investment opportunities have expanded dramatically and become available to a much wider range of investor. The proposed amendment will clarify the definition of "customer" and clearly provide equality and parity for Indirect and Direct investors.

- In 1970, Senator Edmund S. Muskie proclaimed, in urging the prompt enactment of SIPA: "...after this bill is enacted, no American will lose his savings through a brokerage firm bankruptcy." (Federal Broker Dealer Ins. Corporation: Hearing on S2388, 3988 and 3989 before the Subcommittee on Securities of the Senate Com. on Banking and Currency, 95th Congress Cog. 10(1970) at 147.).

- If SIPA is not amended, thousands of Americans -- the indirect investors -- will have lost their savings and retirement accounts through a brokerage firm bankruptcy, with no safety net as was Congress' intent when SIPA was passed and SIPC created.

Restoring Trust

- The failure of the SEC to provide oversight to the industry it was created to regulate, in spite of many warnings and red flags, has received widespread media attention. The August 31, 2009 Investigation of Failure of the SEC to Uncover Bernard Madoff's Ponzi Scheme report prepared by SEC Inspector General David Kotz admitted that the government was a major cause of Madoff's success and of the enormous harm which has befallen thousands of direct and indirect investors. Judge Chin, in his sentencing of Bernard Madoff on June 29th, cited the need to restore confidence and public trust in investments. In his own words he said, "...But more is at stake than money, as we have

heard. The victims put their trust in Mr. Madoff. That trust was broken in a way that has left many-victims as well as others-doubting our financial institutions, our financial system, our government's ability to regulate and protect, and sadly, even themselves."

- The loss of trust felt by those victimized by the Madoff fraud is not limited to Madoff victims. There has been a general outcry to the investing community that "This could happen to you." The proposed amendment will help to restore confidence for all investors that the SIPC symbol will protect them in the event of brokerage fraud or financial failure.

PROPOSED CURATIVE LEGISLATION:

The intent of the SIPA was clearly to protect all investors, not to exclude investors who placed their money with Indirect Investment Vehicles. The following amendment will effectuate this change:

> The definition of CUSTOMER – Section 16 (2) of the Securities Investor Protection Act (15 U.S.C. 78111) is amended by inserting "directly or indirectly through one or more parties," after "The term 'customer" of a debtor means any person (including any person with whom the debtor deals as principal or agent) who has a claim".
>
> "Effective Date – The provisions of this Subsection shall take effect with respect to claims made after December 31, 2007."

EXHIBIT II

Testimony by Peter J. Leveton Before the House Financial Services Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises, December 9, 2009

"Additional Reforms to the Securities Investor Protection Act"

Agile Group, LLC Background Information

Agile and its predecessor companies have managed investor money since the 1980s and operated as a "fund of funds" hedge fund manager since 2002. On September 30, 2008, Agile funds under management totaled approximately $475 million ($175 million equity and $300 million debt) invested in about 50 underlying hedge funds.

Agile's Bernard L. Madoff Investment Securities, LLC investments were through Rye Select Broad Market Prime Fund, LP ("Rye"). Rye's General Partner is Tremont Partners, Inc. ("Tremont"). Tremont's parent is Tremont Group Holdings, Inc., a wholly owned subsidiary of Oppenheimer Acquisition Corporation, itself a wholly owned subsidiary of Mass Mutual Holding Company, which is a wholly-owned subsidiary of Massachusetts Mutual Life Insurance Company.

Agile suspended redemptions and has been in liquidation since the fourth quarter of 2008.

Investor Letters

Attached are 55 letters sent from typical Agile investors to the Senate Finance Committee immediately prior to that Committee's March 17, 2009 hearing "Tax Issues Related to Ponzi Schemes".

Exhibit III

Testimony by Peter J. Leveton Before the House Financial Services Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises, December 9, 2009

"Additional Reforms to the Securities Investor Protection Act"

Experience and Affiliations

Currently retired and serving as an unpaid Co-Chairman of the Boulder, CO, Agile Funds, LLC ("Agile") Investor Committee. Agile is a "fund of Funds" hedge fund that suspended redemptions and has been in liquidation since the fourth quarter of 2008. The Committee is an ad hoc committee organized in December 2008 to assist Agile investors to maximize recovery of their Agile investments.

No prior experience in the securities industry.

More than 29 years experience as the CEO and CFO of public (NYSE, NASDAQ and OTCBB) and private companies, and 4 years experience as the Managing Director and Partner of an investment banking firm. Industry experience includes healthcare/medical devices, chemical manufacturing/mining and real estate development with company revenues between $1 million and $350 million. Functional emphasis on business development, team building, raising and deploying capital, mergers and acquisitions, deal analysis, structuring and negotiating, developing and achieving strategic and operating plans, and transitioning undercapitalized and struggling companies into highly successful, profitable and sought after enterprises. More than 18 years experience as an executive director of two public and five private companies.

Education

Willamette University, Salem Oregon, BA 1959

New York University Graduate School of Business (the Stern School), MBA 1964

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February 22, 2010

The Honorable Paul E. Kanjorski, Chairman
Subcommittee on Capital Markets, Insurance,
and Government Sponsored Enterprises
United States House of Representatives
2188 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Kanjorski:

Introduction

At the December 9, 2009 hearing before the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises, the members of the Subcommittee, including yourself, requested information and possible legislative proposals on a number of issues. SIPC's legislative counsel has also been in touch with the Subcommittee staff to refine and round out those information requests. This letter will begin SIPC's response to the Subcommittee.

I should note that SIPC has already proposed a number of substantive amendments for the Subcommittee's consideration, several of which were included in H.R. 4173. In addition, subsequent to the December 9 Hearing, I discussed with President Obama's nominees for Chairman and Vice-Chair of SIPC an action plan for the first full fledged review of the Securities Investor Protection Act ("SIPA") since the mid-1970s. Those nominees, Orlan Johnson and Sharon Bowen, were confirmed by the Senate on February 11. SIPC is forming a Task Force to take a comprehensive review of the entire SIPA statute, and to propose any relevant amendments, beyond those SIPC has presently proffered. I anticipate that the Task Force will go beyond the items raised by the Subcommittee on December 9.

Issues Raised By The Subcommittee

1. Retroactive Assessments

You raised the issue of retroactive assessments. As you explained, this would give members of SIPC an incentive to report to regulators any irregularity which might give rise to a brokerage firm failure. As explained below, we believe this is already the case.

First, if there were a regime that implemented retroactive assessments, it would be impossible to assess SIPC members that have left the industry, and collect additional assessments. Typically, those entities have gone out of business.

Second, SIPC members that were in existence at the time of a "Madoff-like" situation, and which remain SIPC members after such an event, are precisely the SIPC members that are assessed to pay for such a failure, by means of increased assessments to reconstitute the depleted SIPC Fund. And while it would be possible to assess those members based upon the respective net operating revenues previously earned by those members during the time of an ongoing "Madoff-like" situation, a backward-looking assessment rate does not take into account the effect of such assessments on the current financial condition of any particular member. In contrast, a change in the assessment, applied prospectively, allows the member to budget accordingly. The current assessment, initiated as a result of SIPC's expenditures in the Madoff proceeding, has clearly made SIPC members aware of the fact that they...and no one else... will pay for Madoff's fraud, and the failure to detect it. Even were it necessary for SIPC to borrow against its line of credit with the United States Treasury, SIPC members, and no one else, will repay those borrowings. The incentive for a SIPC member firm to report illegal or suspicious conduct is identical in both cases. Legislation providing a "safe harbor" for such reports, that is, protection against lawsuits arising from such reports to a regulatory authority, may be advisable.

2. International Coordination and Arbitration

You have requested comment and possible legislative proposals to speed the process of international dispute resolution in the context of a multinational brokerage insolvency.

The difficulty with a legislative solution is this: Even if Congress were to enact a mandatory arbitral forum for such dispute resolution, there would be no way

to compel a foreign counterparty to comply. Similar, if not identical legislation, would be required in every jurisdiction relevant to any particular dispute.[1] In a significant international dispute, any number of jurisdictions could be involved. Passage of a law by Congress could not force a recalcitrant foreign counterparty to agree to be bound by it, especially if the law of that counterparty's jurisdiction offers that party a different legal outcome.

SIPC proffers two alternative solutions, both of which are relatively recent developments and are being implemented now. Further, a relatively recent chapter of the Bankruptcy Code warrants possible amendment to include reference to brokerage firm failures.

A.
Bilateral Memoranda of Understanding Between SIPC and SIPC's International Counterparts

SIPC has in fact anticipated the need for an international vehicle to solve the problems you have identified. Currently, SIPC has executed a Memorandum of Understanding with each of the following entities:

- The Financial Compensation Scheme in the United Kingdom
- The Canadian Investor Protection Fund
- The China Securities Investor Protection Fund Corporation
- The Securities and Futures Investor Protection Fund in Taiwan
- The Korea Deposit Insurance Corporation
- The Egyptian Investor Protection Fund.

SIPC shares information with each of these entities, attends international forums to understand the nature and limits of the operation of those counterparts, and

[1] I met with Gaytri Kachroo, an attorney in Boston, and a major advocate for such an arbitral forum, to discuss this issue at some length. Also present was my Canadian counterpart, Rozanne Reszel, the President of the Canadian Investor Protection Fund, and SIPC's General Counsel, Josephine Wang.

cooperates where possible with those entities.[2] SIPC affirmatively intends to seek out additional opportunities for similar bilateral agreements.

Where possible, the typical MoU agreement contains a provision whereby the parties specifically agree to cooperate in the event of a cross border brokerage firm failure that has consequences in both jurisdictions, particularly with respect to claims. (See, for example, the MoU between SIPC and the Canadian Investor Protection Fund, attached as Exhibit 1.)

In addition to the Bilateral MoUs, SIPC became an auxiliary member of the International Organization of Securities Commissions in 2009. This will further facilitate international cooperation, and I hope, international dispute resolution.

B.
Cross-Border Insolvency Protocols

Specific situations require specific solutions. The insolvency of Lehman Brothers Holdings, Inc., its subsidiary Lehman Brothers Inc., which was a SIPC member, and other related corporate affiliates, is the largest bankruptcy proceeding in history. The Lehman corporate empire spanned the globe. In order to deal with insolvency proceedings in multiple jurisdictions in an efficient and economical way, the parties developed a "Cross-Border Insolvency Protocol For The Lehman Brothers Group Of Companies." This document is attached as Exhibit 2. I have also attached as Exhibit 3 a Report of the Official Representatives and Other Participating Affiliates Pursuant To The Cross-Border Insolvency Protocol which demonstrates the enormity of the undertaking. I believe that the Cross-Border Insolvency Protocol may serve as a model for dealing with international cooperation and dispute resolution.

---

[2] As a part of this program of international cooperation and coordination, I addressed an international forum in Beijing on the problems encountered as a result of the failures of Bear Stearns, Lehman Brothers, and Bernard L. Madoff LLC in November 2009.

C.
Chapter 15 of The Bankruptcy Code:
Ancillary and Other Cross-Border Cases

Enacted in 2005, Chapter 15 of The Bankruptcy Code is an adaptation of the Model Law on Cross-Border Insolvency promulgated by The United Nations Commission on International Trade Law ("UNCITRAL"). I would note that Chapter 15 is specifically not applicable in a proceeding under the Securities Investor Protection Act ("SIPA"). See 15 U.S.C. section 1501(c)(3). There is no legislative history which explains this exclusion. I intend to discuss with counsel for Lehman Brothers Holdings, Inc., and the Trustee for Lehman Brothers Inc., the issue of whether the continued exclusion of SIPA liquidations from the provisions of Chapter 15 makes sense in light of the Lehman experience. SIPC is open to the prospect of changing that provision of the Bankruptcy Code if it will expedite dispute resolution. I will report to the Subcommittee their conclusions.

3. Representative Speier's Request For Proposed Legislation For Updated Protection That Reflects Contemporary Investment Practices

In the Madoff case, a number of defined benefit pension plans were decimated by Mr. Madoff's depredations. As I stated in my testimony on December 9, SIPC will examine whether a change in the SIPA statute, to protect individual pensioners, is feasible. Currently, only the pension plan which has an account at the brokerage, and not individual participants in the plan, is protected by SIPC. While the FDIC has such protections, doing so with respect to a pension plan's securities holdings at a SIPC member firm presents far greater logistical problems. It is also necessary to study this issue from a risk management perspective. I am confident the Task Force, mentioned above, will address this issue. I will report to the Subcommittee on the results of those studies.

4. Representative Speier's Request for Information on SIPC Assessments

From SIPC member 2009 assessments, SIPC anticipates receiving approximately $360 million. SIPC currently anticipates receiving $480 million for 2010 assessments. SIPC will continue the current level of assessments until the SIPC Fund reaches $2.5 billion. Based upon projected expenditures, particularly in the Madoff liquidation proceeding, and projected assessment revenue in the future, SIPC should reach the new Fund target by 2015.

Congresswoman Speier also asked for an estimate of the current SIPC Fund balance if SIPC had not reduced assessments to a flat fee from 1990 to 2008. The following calculations are based on data provided by the SEC and employ the definitions for 'net operating revenue' derived from SIPC and FINRA. Data for 2009 is not yet available.

There are some data limitations which provide a possible upward bias to the results. Definitional changes in brokerage firm financial reporting line items over the years may have biased the data, but probably not to a significant degree. Consequently, total revenues and net operating revenues are likely overstated somewhat, though the degree of overstatement is unknown. The numbers are thus most likely an upper bound on the theoretical SIPC Fund balance if member assessments had been at ¼ of 1% of total revenue and net operating revenue, respectively, during the period.

The calculations show that, at a ¼ of 1% assessment rate based on total revenue, the SIPC Fund might have grown to $11.3 billion by the end of 2008, an increase of $9.6 billion over the funds actual balance at that date of $1.7 billion. If based on net operating revenue, the fund might have reached $8.5 billion, an increase of $6.8 billion.

Representative Speier has asked how SIPC determined to use .25% of SIPC member net operating revenues as the basis for assessments. A history of SIPC's assessments provides context for the answer. SIPC has continuously worked to assure that the SIPC Fund is adequate to protect the investing public.

A.
Statutory Assessment Requirements

When the SIPA statute was enacted in 1970, Congress set a minimum target for the SIPC Fund at $150 million. See 15 U.S.C. section 78ddd(d). That subsection requires assessments of ½ of 1 percent of gross revenues until the Fund first reached $150 million and at any time the Fund balance is below $100 million. At any time the Fund is below $150 million, the statute requires an assessment of 1/4 of 1 percent of gross revenues. Thus, the statute gives SIPC some guidance as to the appropriate levels of assessments.

B.
SIPC's Continuous Review of Capital Adequacy

Given the passage of time, SIPC did not rely on the targets set as a minimum in 1970. Historically, SIPC's Board periodically reviewed the capital adequacy of SIPC on a continuous basis. A summary of the more important milestones in that continuous review follows.

i. Special Study of the SIPC Fund and Funding Requirements, October 8, 1990, Deloitte & Touche

This study concluded:

> [T]he SIPC Fund and funding structure is adequate to fund maximum projected losses and intermediate cash flows. In closing, however, we note that the cash requirements to fund the liquidation of a very major firm could temporarily deplete the SIPC Fund almost entirely. Thus, while the current SIPC Fund and funding would appear to be adequate to manage a major failure or failures, we believe that our projections establish a framework for the Securities Investor Protection Corporation Board to utilize in evaluating whether, as a policy matter, such depletion could be allowed.

At year end, 1990, the SIPC Fund balance was $581,716,987.

ii. Report and Recommendation of the SIPC Task Force on Assessments, 1991

The Board established this Task Force and instructed the group that the Board wished to increase the SIPC Fund to $1,000,000,000. In arriving at that amount, an increase of more than 40% of the Fund balance, the Board simply felt that the statutory targets were too low, given inflation and other market factors, and that a $1,000,000,000 Fund would promote investor confidence. The purpose of the Task Force was to determine how best to reach that goal. The Task Force addressed the fact that the SIPC Fund is "currently in a very strong position."[3] Report, page 2.

After determining that fact, the Task Force recommended that the Board institute a growth goal of 8% per year until the SIPC Fund reached $1,000,000,000.

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[3] At year end 1991, the SIPC Fund stood at $652,623,120.

While the Board accepted the principles of the Task Force Report, the Board determined to increase the SIPC Fund at the more aggressive rate of 10% per year.

iii. GAO Report: Securities Investor Protection - "The Regulatory Framework Has Minimized SIPC's Losses", 1992

Congressmen Donald W. Reigle, Jr., and John Dingell requested that the General Accounting Office review "the operations and solvency" of SIPC. The gist of the Report, at page 5:

> SIPC Has Addressed Its Funding Needs
>
> There is no scientific basis for determining what SIPC's level of funding should be because the greatest risk the fund faces – a breakdown of the effectiveness of the net capital and customer protection rules – cannot be foreseen. However, given the growing complexity and riskiness of securities markets, GAO believes that SIPC officials have acted responsibly in adopting a financial plan that would increase fund reserves to $1 billion by 1997. While GAO cannot conclude that this level of funding will be adequate, $1 billion should be more than sufficient to deal with cases of fraud at smaller firms, and it probably can finance the liquidation of one of the largest securities firms. The $1 billion fund may not, however, be sufficient to finance worst-case situations such as massive fraud at a major firm or the unlikely simultaneous failures of several of the largest broker-dealers. Periodic SIPC and SEC assessments must account for factors such as the size of the largest broker-dealer and any signs that regulatory enforcement of the net capital or customer protection rules has deteriorated. (See pp. 40-46; emphasis supplied.)

The SIPC Fund reached the $1,000,000,000 mark by 1996, ahead of the Board's schedule.

iv. William M. Mercer/Peat Marwick: Report On The Adequacy Of The SIPC Fund, 1998

Using "Ruin Theory," this Report states, at page 1-2:

> We find that the probability of a large demand on the SIPC Fund appears smaller today than in the past. For a liquidation proceeding

> to cause a substantial demand on the Fund, one of the largest firms in the brokerage industry must fail and a significant amount of customer assets must be missing. Liquidation proceedings of relatively large brokerage firms have historically required SIPC's assistance for only a small percentage of distributions to customers and administrative costs. The largest brokerage firms' bond ratings continue to be high in quality, indicating that it is unlikely that a large firm will become insolvent in the near future. Our application of Ruin Theory shows that, based on historical proceedings data, the probability of exhausting the Fund in the future is extremely remote. Sensitivity testing of scenarios suggests that the state-of-the-world where a reasonably possible demand on the SIPC Fund could deplete the Fund in a few years would have to be dramatically different from what we observe today.
>
> Therefore, we find the current level of the Fund, as adjusted for its expected inflow from proceedings and operating expenses, to be sufficient for the foreseeable future. However, if for any reason the soundness of securities markets were to deteriorate significantly, our predictions regarding the safety of the SIPC Fund would cease to apply.

Other aspects of the report of interest include the Extrapolation of Historical SIPC Experience to Large Firms, which includes a Scatter Plot and Regression Analysis (Report, p. 51-56), and a discussion of Alternatives to Increasing the Size of the SIPC Fund (Report, p. 72). The Report specifically notes (p. 54) that there is "one in 250 chances that the failure of a firm with $1 trillion in customer assets would create a positive claim on the SIPC Fund." (Emphasis supplied.)

The Mercer/Peat Marwick Report also states (p. 67) that "one time out of 40,000, the current level of the fund plus expected earnings (at 5.5% per annum) would not be sufficient to meet all claims in the next 5 years. For a 25 year period, the current Fund size and expected earnings should not be sufficient one time out of 1,650." (Emphasis supplied.)

v. SIPC Internal Analysis, 1998

Subsequent to the Mercer/Peat Marwick Report, Joseph F. Marino, then SIPC's Vice President-Finance and Operations, assembled a variety of prior memoranda on the subject of liquidity needs at the outset of a large liquidation. Mr.

Marino concluded that SIPC funds could be advanced to a trustee to free securities subject to margin loans from the Debtor's margin lender, so as to be able to transfer the securities positions to an acquiring broker. The acquiring firm would then use the securities as collateral with its margin lender, and reestablish both the long securities position and the margin debt in each customer's account. The acquiring firm would then repay the trustee – who could then repeat the process, and use the same funds once again.

Using this "recycling" method would alleviate the short term liquidity needs at the start of a proceeding without the necessity of a larger SIPC Fund.

vi. Fitch Risk Management Study, 2003

After the collapse of MJK Clearing, Inc. in Minneapolis in September 2001, SIPC chartered a study of that case and an analysis of the losses incurred. On January 31, 2003, Fitch Risk Management issued its Review of SIPC Risk Profile and Practices: the MJK Clearing Event, the Securities Lending Exposure, Risk Management Practices and Capital Requirements. That Review used a Risk Qualification Methodology to find that the SIPC Fund "is sufficient at a 99% confidence interval . . . we believe that the total claims paying abilities are adequate to withstand an extremely severe stress case." The review concluded that "the adequacy of the SIPC fund remains sufficient," and "that a loss in excess of $500 million is expected . . . once in 100 years." (Review, p. 51).

vii. Other Developments

SIPC added a Risk Manager to its staff in August 2003. The Risk Manager's role is to provide SIPC's Board and senior management with a continuing analysis of risk factors and exposures to the SIPC Fund. In addition, the SEC approved an amendment to SIPC's Assessment Bylaw. The 2003 amendment to the Bylaws allowed SIPC to initiate immediately a change in the assessment rate, once the Board of Directors determines a change is appropriate, rather than wait until November of that year.

The wisdom of enacting the 2003 Bylaw amendment was demonstrated when the Madoff fraud was uncovered. SIPC immediately reinstituted revenue based assessments.

Finally, as a direct result of the Lehman Brothers and Madoff liquidations, SIPC submitted a proposed Bylaw change to the SEC in September, 2009, to raise

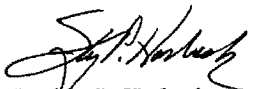
the target amount of the SIPC Fund to $2.5 billion. That Bylaw is now in effect. SIPC will now continue to collect assessments based upon 1/4 of one percent of net operating revenues of SIPC members, at least until the new target is reached. The determination as to what rate to use for assessments was made after extensive analysis by SIPC's Risk Manager, who presented alternative projections to the Board prior to the adoption of the present rate in the Bylaws.

In an extreme emergency, where the SIPC Fund was depleted to $100 million, the SIPA statutory rates of "not less than ½ of 1 percentum of gross revenues" would control. The absolute maximum assessment is set forth in 15 U.S.C. section 78ddd(c)(3)(B) and is one percent of a member's gross revenues.

Conclusion

I look forward to working with you and the Subcommittee to make SIPA a stronger vehicle for investor protection. Please let me know if you have any comments or questions.

Very truly yours,



Stephen P. Harbeck
President

SPH:ved

Enclosures

MEMORANDUM OF UNDERSTANDING

Between:

(1) THE CANADIAN INVESTOR PROTECTION FUND ("CIPF")
whose office is at 79 Wellington Street West, Suite 610, P.O. Box 75, Toronto, Ontario M5K 1E7;

(2) THE SECURITIES INVESTOR PROTECTION CORPORATION ("SIPC")
whose office is at 805 Fifteenth Street, NW, Ste. 800, Washington, DC 20005, USA

INTRODUCTION

1. CIPF is a non-profit, membership corporation created pursuant to Part II of the Canada Corporations Act, R.S.C. 1970, c. C-32. CIPF's primary purpose is to provide protection to customers of members firms of its self-regulatory organizations who have suffered financial loss as a result of the insolvency of such member firm.

2. SIPC is a nonprofit, membership corporation created by the Securities Investor Protection Act of 1970 ("SIPA"). SIPA is codifed at Title 15, United States Code, Sections 78aaa-lll. SIPC's purpose is to afford certain protections against losses to customers resulting from a broker-dealer failure, thereby promoting investor confidence in the securities markets.

3. This Memorandum of Understanding (the "MoU") is intended to create a cooperative relationship between and amongst CIPF and SIPC in the context of a cross-border liquidation of member firms.

4. CIPF and SIPC recognize the potential for cross-border insolvencies of member firms and the prospect of cross border claims from investors. The parties accept the responsibility of cooperating with each other to ensure that investors receive compensation promptly.

5. CIPF and SIPC desire to provide one another the fullest mutual assistance possible, subject to their available resources, to facilitate the performance of functions with which each investor protection program is entrusted within their respective jurisdictions to secure confidence with their laws and regulations.

6. The parties recognize that the investor compensation programs operated by the parties differ in both the scope of protection afforded to investors and the financial benefits afforded to investors under each program.

EXHIBIT 1

7. CIPF and SIPC have agreed to base their cooperation in the field of investor compensation on the principles and procedures provided for in this MoU. The implementation of the memorandum will allow for more efficient and economic handling of claims and related issues, and it will therefore be in the interest of investors, those who fund or contribute to the cost of compensation, and financial services regulators.

A. OBJECTIVES

8. The objectives of this MoU are to facilitate and encourage good relations between CIPF and SIPC including:

(a) the exchange of information on a regular basis regarding the nature, role and experience of each ("communication");

(b) cooperation when dealing with claims for compensation that involve cross-border issues of member firms ("cooperation");

(c) representation with proper authorization, formally or informally, of one investor compensation program by the other in dealings with third parties (including investors, insolvency practitioners and governmental agencies) ("representation").

B. LEGAL IMPLICATIONS

9. This MoU is not legally binding on the parties. Nothing in this MoU applies to override or challenge any laws or obligations to which either CIPF or SIPC are subject. In identifying these objectives, each party recognizes that the other's compliance with these objectives is subject to those limits.

10. The home country investor compensation program has the primary responsibility for compensating investors with respect to member firms operating in both the home and host country. CIPF and SIPC agree that the host country's investor compensation program shall, as far as legally and practically possible, respond to requests from the home country concerning the practicalities of dealing with claims and making payments to investors under the terms specifically settled by CIPF and SIPC in each case.

11. CIPF and SIPC agree that more detailed rules and procedures for cooperation between them must be worked out regarding specific member firms, with consideration given to the size of the firm, any corporate affiliates or branch offices, the number of investors and the amounts of compensation to be paid. All such issues shall be resolved as quickly as possible by negotiation between CIPF and SIPC.

C. COMMUNICATION

12. Each investor compensation program will notify the other as soon as possible of:

(a) the initiation of a proceeding to implement an investor compensation program with respect to any member firm or clearing firm that has connections to the host country and notify over time, the other investor protection program regarding developments in such a proceeding;

(b) any material changes (for example, to structure or funding) likely to affect international investors;

(c) any changes in the legal aspects for that investor compensation program. In the case of material changes in the investor compensation program, a revised overview of the investor compensation program following the changes shall also be supplied;

(d) a significant change in market or business conditions; and

(e) any circumstance that makes it necessary to amend or extend this MoU.

13. At least every 12 months CIPF and SIPC will send each other a report of its activities for that period. Each investor compensation program is free to decide the length and format of its report, but the content should include:

(a) contact details and any change of personnel;

(b) if known, a list of all member firms with branches or operations in the country of the other investor compensation program which are in liquidation under the auspices of the home country investor protection program;

(c) where available, a list of branches or operations of member firms of the other investor compensation program who are members of its own investor compensation program;

(d) an overview of claims experience and the funding position, and

(e) the annual report.

14. CIPF and SIPC will also be required to supply particulars of its investor compensation program as soon as possible upon request to the other program.

D. COOPERATION

15. Upon one investor compensation program becoming aware of an insolvent member firm which is also a member of the other investor compensation program or against whom claims for compensation might be made from investors based in the country of the other investor compensation program, that first investor compensation program will notify the other of the firm's identity and other relevant details as soon as permissible.

16. The investor compensation program in the host country shall, at the request of the investor compensation program in the home country, assist, as far as legally and practically possible, in providing all the information required by the home country for the purpose of assessing and paying compensation to investors with claims arising in the host country, for example by:

(a) providing details of the identity and whereabouts of investors and/or claimants;

(b) directing investors/claimants to the appropriate investor compensation program; and

(c) distributing information with respect to the relevant investor compensation programs and contact information.

As far as possible CIPF and SIPC shall work together in drafting and compiling the information to be sent to investors/claimants, in accordance with any legal requirements applicable to the respective investor compensation program.

17. At the request of either investor compensation program, the other will provide or assist in arranging such practical assistance or advice as may be required to deal with investors' claims including:

(a) legal, insolvency and accounting advice;

(b) translation services;

(c) expert opinions (for example, on conduct of business rules);

(d) the wording and dispatch of application forms, requests for information and offers of compensation; and

(e) methods of payment to investors.

18. Paragraphs 16 and 17 apply regardless of whether or not the insolvent member firm is also a member of the investor compensation program in the host country, in order to continue an effort of cooperation.

E. CLAIMS AGAINST FIRMS WHICH ARE MEMBERS OF BOTH INVESTOR COMPENSATION PROGRAMS

19. The home country investor compensation program of the member firm will lead the handling of investors' claims for compensation and will determine claims first (including paying compensation if appropriate). In some circumstances, for example in a SIPA liquidation, the process of compensating customers/creditors may take years as the trustee recovers assets and makes multiple distributions over time. If, therefore, an investor's claim may not be finalized for an extended period of time, then CIPF and SIPC will agree how to progress with respect to the investor's claim.

20. When the home country investor compensation program has concluded its procedure with respect to an investor who also has a claim against a branch of the member firm in the host country, the investor compensation program in the home country shall send a copy of the determination and details of any distribution, with supporting documents, to the investor compensation program in the host country. However, this applies only when the home country investor compensation program or the investor is of the opinion that the host country investor compensation program is, or may be, obliged to pay supplementary compensation. The investor compensation program in the host country shall then deal with the case and pay any further compensation due to the investor. The investor compensation program in the host country shall inform the investor compensation program in the home country of the outcome of the procedure, with a copy of the decision and supporting documents.

21. Each investor compensation program will apply its own rules, procedures and laws when: (a) initiating an investor protection program; (b) dealing with claims for compensation; (c) notifying investors of the initiation of an investor compensation program for a member firm; and (d) when obtaining information about claims, all without prejudice to the right of the host country to impose its objective and generally applied rules on participating member firms.

F. REPRESENTATION

22. If requested by one investor compensation program, the other will use its reasonable effort to deal with third parties in its own jurisdiction on that first investor compensation program's behalf, for example in:

(a) requesting and storing files or other information on a member firm or an insolvency practitioner;

(b) compiling and submitting any reports or notices required in that jurisdiction, including claims to an insolvency practitioner; and

(c) attending meetings with investors, creditors meetings and meetings with regulators and insolvency practitioners.

Where practicable, CIPF and SIPC will cooperate as to the making and pursuit of claims by either investor compensation program to recover the cost of compensation either from a member firm itself or any third party.

G. MISCELLANEOUS

23. CIPF and SIPC recognize this MoU may need to be adjusted in the light of experience and agree to review its terms from time to time.

24. Any dispute over the meaning of any term used in this Memorandum of Understanding will be solved in each case by agreement between CIPF and SIPC.

February 16, 2005

Signed for and on behalf of the Canadian Investor Protection Fund

by.....
Name: Rozanne E. Reszel
Title: President and CEO

by.....Barbara Love.....
Name: Barbara D. Love
Title: Vice-President and Secretary

Signed for and on behalf of the Securities Investor Protection Corporation

by.....
Name: Stephen P. Harbeck
Title: President

GLOSSARY

"home country": the country in which the member firm has its principal place of business and is authorized or regulated for that business;

"host country": the country in which a member firm's overseas or foreign branch or subsidiary is located;

"insolvent": the financial (or commercial) state of a member firm in which the firm may be or has been determined by the competent authority (including in Canada a securities regulatory authority) to be unable to meet its obligations arising out of investors' claims and has no early prospect of being able to do so, or where a judicial authority has made a ruling for reasons directly related to a member firm's financial circumstances which has the effect of suspending investors' ability to make claims against it. Since brokerage firms in the US may file for insolvency outside of a SIPA liquidation, see e.g., 11 U.S.C. Sect. 741, the "insolvent" or "insolvent firms" in this MoU with respect to SIPC, refers to member firms that are in a SIPA liquidation proceeding. In Canada, "insolvent" or "insolvent firms" in this MoU with respect to CIPF refer to member firms in respect of which CIPF is, or may reasonably be expected to be, required to provide customers protection for losses suffered. Additionally, in the US and Canada a firm may be insolvent and file no proceeding at all;

"member firm": an investment firm against whom investors may have claims which are compensated by the investor compensation program;

"investor compensation program": the programs operated by CIPF or SIPC;

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CROSS-BORDER INSOLVENCY PROTOCOL FOR THE LEHMAN BROTHERS GROUP OF COMPANIES

This cross-border insolvency protocol (the "Protocol") establishes a framework for the conduct of the Proceedings (as such term is defined herein) concerning Lehman Brothers Holdings Inc. ("LBHI") and its affiliated debtors worldwide that are parties hereto (collectively, the "Debtors" and, collectively with their non-debtor affiliates, "Lehman") and the management of the estates of the Debtors pursuant to those Proceedings.

Background[1]

A. The Proceedings

Commencing on September 15, 2008 and periodically thereafter (as applicable, the "Commencement Dates"), the Debtors commenced (or in some cases, had initiated against them) plenary insolvency, administration, liquidation, rehabilitation, receivership, or like proceedings ("Plenary Proceedings") in different jurisdictions (the "Plenary Fora") and before different courts and governmental, regulatory, or administrative bodies (the "Tribunals"), as well as proceedings that are secondary or ancillary to a Plenary Proceeding ("Limited Proceedings," and together with the Plenary Proceedings, the "Proceedings") in jurisdictions other than the Plenary Fora (together with the Plenary Fora, the "Fora" and each a "Forum").

In certain of these Proceedings, the Debtors remain authorized to operate their businesses and manage their properties as "Debtors in Possession," while in others, liquidators, administrators, trustees, custodians, supervisors or curators have been appointed to manage the Debtors' affairs and represent their insolvency estates (collectively, with Debtors in Possession, the "Official Representatives"). Furthermore, in certain of these Proceedings, one or more statutory committee of creditors or equity holders has or have been appointed (the "Committees").

B. Lehman's Global Business

Lehman was a truly global group of companies. Prior to the events leading up to these Proceedings, Lehman was the fourth largest investment bank in the United States, and one of the largest financial services firms in the world. For more than 150 years, Lehman was a leader in the global financial markets by serving the financial needs of corporations, governmental units, institutional clients and individuals worldwide. Its headquarters in New York and regional headquarters in London and Tokyo were complemented by a network of offices in North America, Europe, the Middle East, Latin America and the Asia Pacific region.

To manage their businesses efficiently, Lehman utilized a centralized cash management system to collect and transfer the funds generated by its operations and disburse those funds to satisfy the obligations required to operate their businesses. The cash management

[1] Factual statements contained in this Background are for informational purposes only and shall not be deemed admissions by, or binding on, any party hereto.

system facilitated Lehman's cash monitoring, forecasting, and reporting, subject to the regulatory requirements of various jurisdictions. Furthermore, prior to the commencement of the Proceedings, LBHI and its direct and indirect subsidiaries continuously worked together and shared information in unison. This information was spread across 2,700 different software applications and dispersed throughout ledger accounts in its subsidiaries across the globe.

C. The Need for a Protocol

Given the integrated and global nature of Lehman's businesses, many of the Debtors' assets and activities are spread across different jurisdictions, and require administration in and are subject to the laws of more than one Forum. The efficient administration of each of the Debtors' individual Proceedings would benefit from cooperation among the Official Representatives. In addition, cooperation and communication among Tribunals, where possible, would enable effective case management and consistency of judgments.

Accordingly, this Protocol is designed to facilitate the coordination of the Proceedings, and to enable the Tribunals and Official Representatives to co-operate in the administration of their respective Debtors' estates in the interest of all of the Debtors' creditors.

Terms

1. Purpose and Aims

1.1. The parties acknowledge that this Protocol represents a statement of intentions and guidelines designed to minimize the costs and maximize recoveries for all creditors of the Proceedings, by promoting the sharing of relevant information among the parties and the international coordination of related activities in the Proceedings, while respecting the separate interests of creditors and other interested parties to each Proceeding (which shall be subject at all times to the local laws of the jurisdiction applicable to each Official Representative), and the independence, sovereignty, and authority of each Tribunal.

1.2. In recognition of the substantive differences among the Proceedings in each jurisdiction, this Protocol shall not be legally enforceable nor impose on Official Representatives any duties or obligations, including (but not limited to) any obligations (i) that may be inconsistent with or that may conflict with the duties or obligations to which the Official Representative is subject under applicable law, or (ii) that are not in the interests of the Debtor's estate represented by the Official Representative and/or its creditors. Furthermore, nothing in this Protocol should be interpreted in any way so as to interfere with (i) the proper discharge of any duty, obligation or function of an Official Representative, or (ii) the exercise of statutory or other powers otherwise available to an Official Representative under applicable law.

1.3. Official Representatives should coordinate with each other and cooperate in all aspects of the Proceedings, subject in appropriate cases to bilateral protocols and protocols for communication among Official Representatives, Tribunals and Committees, that may be executed in furtherance of this Protocol. In doing so, the Official Representatives acknowledge and agree that the parties shall deal in good faith with each other in the interests of maximizing recovery for all of the Debtors' creditors.

1.4. The aims of this Protocol are:

1.4.1. **Coordination** – To promote international cooperation and the coordination of activities in the Proceedings; and to provide for the orderly, effective, efficient, and timely administration of the various Proceedings in order to reduce their cost and maximize recovery for creditors.

1.4.2. **Communication** – To promote communication among Official Representatives and Committees; and to provide, wherever possible, for direct communication among Tribunals.

1.4.3. **Information and Data Sharing** – To provide for the sharing of relevant information and data among Official Representatives in order to promote effective, efficient, and fair administrations, and to avoid duplication of effort and activities by the parties.

1.4.4. **Asset Preservation** – To identify, preserve, and maximize the value of the Debtors' worldwide assets for the collective benefit of all creditors and other interested parties.

1.4.5. **Claims Reconciliation** – To coordinate an efficient and transparent claims process; and in particular, to provide for a consistent and measured approach to the calculation and adjudication of intercompany claims that avoids unnecessary intercompany litigation.

1.4.6. **Maximize Recoveries** – To cooperate in marshalling the assets of the Debtors in order to maximize recovery for all of the Debtors' creditors.

1.4.7. **Comity** – To maintain the independent jurisdiction, sovereignty, and authority of all Tribunals.

1.5. Notwithstanding the multilateral nature of this Protocol, nothing herein shall restrict Official Representatives from dealing with other Official Representatives on a bilateral basis on matters that concern only their respective Debtors, provided that Official Representatives should keep each other generally informed of any bilateral protocols with other parties hereto, to the extent that such bilateral protocols address similar aims as this Protocol.

2. **Notice**

2.1. Official Representatives should provide adequate notice by email to the parties hereto, as well as to any Committees established in the Proceedings, of relevant matters in which those parties have an interest.

2.2. Where appropriate, each Official Representative should provide adequate notice by email as far in advance as possible of any matters in which other Official

Representatives have a material interest and that may require preparation and/or travel by such Official Representatives, such as any creditors' or shareholders' meetings, statutory deadlines, administrative deadlines, or hearings before a Tribunal.

3. **Rights of Official Representatives and Creditors to Appear**

3.1. Subject to the laws of each Forum, Official Representatives shall have the right to appear in all of the Proceedings, whether before a Tribunal or in statutory meetings convened pursuant to applicable law. If required and available in a particular Forum, an exequatur or similar proceeding may be utilized to implement recognition of the Official Representative.

3.2. Official Representatives shall not, by virtue of their being a party to this Protocol, be deemed to have submitted to jurisdiction in any Forum, nor shall appearing in a Forum, whether in person or pursuant to Section 3.3, subject an Official Representative to jurisdiction for any purpose other than the matter with respect to which the appearance is made, except, (i) to the extent otherwise set forth herein to the contrary, and (ii) to the extent that an Official Representative otherwise submits to the jurisdiction of a Forum.

3.3. To the extent that an Official Representative is entitled to appear in the Proceedings under applicable law but cannot be present before the Tribunal or Committee(s) (or similar body, as the case may be) either in person or through counsel, the parties hereto shall consent to the Official Representative's communication of any observations to such Tribunal or Committee(s) prior to any order (or similar action) being made, provided that such communication is made in writing and copies of such communication are non-confidential and delivered to all interested parties or filed on the Tribunal's public records.

4. **Communication and Access to Data and Information Among Official Representatives**

4.1. Official Representatives should keep each other generally informed when appropriate of any relevant information and material developments in matters involving the Debtors and their Proceedings, and should consent wherever possible to the sharing of information among Official Representatives, which consent should not be unreasonably withheld.

4.2. Official Representatives should share information regarding the Debtors, and their assets and liabilities, which each may lawfully share with the other; provided, however, that with respect to work product or other privileged information, Official Representatives may, but are not obliged, to share such information with each other, subject to all privileges under the applicable rules of evidence or applicable law, and provided that sharing work product or privileged information shall not be deemed a waiver of any attorney-client privilege or work product protections under the applicable rules of evidence or applicable law.

4.3. To facilitate access to information, Official Representatives should make available to each other, upon request, any information that is publicly available in their respective Fora; and may, where permitted under applicable laws, share non-public information

with other Official Representatives, subject to appropriate confidentiality arrangements and all privileges under the applicable rules of evidence.

4.4. Official Representatives agree that each shall not (and shall direct their respective agents and representatives not to) provide any non-public information received from the other to any third party, unless such information is (i) agreed to by the other party, (ii) required by applicable law, or (iii) required by order of any Tribunal.

4.5. The approval of this Protocol by a Tribunal (by entry of an order or otherwise) shall constitute the recognition by such Tribunal and the Official Representative in that Tribunal's Proceeding that communications among Official Representatives and their respective professionals, employees, agents, and representatives are subject to, and do not waive any attorney-client, work-product, legal, professional, or other privileges recognized under any applicable law; provided, however, that approval of this Protocol by a Tribunal shall not result in the parties hereto, other than the Official Representative in that Proceeding, becoming subject to the jurisdiction and laws of that Tribunal and Forum.

4.6. Each Official Representative should cooperate in the gathering and sharing of certain data and share analysis of certain transactions by:

4.6.1. sharing, via free, read-only access, all relevant information and data that it has the right to disclose and for which it is not required to make payment relating to (i) material interest holders of an asset, (ii) restitution of assets, and (iii) relevant information that assists such other Official Representative to fulfill its duties, except where (x) litigation has commenced (or is contemplated), or (y) statutory or regulatory requirements prohibit disclosure;

4.6.2. if an Official Representative is in possession of the books, records, correspondence and other materials or documents that belong to another Debtor, providing the Official Representative of such other Debtor's estate such books, records, correspondence and other materials or documents;

4.6.3. coordinating in good faith the investigations of pre-filing activities with any other Official Representative with an interest in such activities, so long as the interests of the Official Representatives coordinating such investigations do not diverge; and

4.6.4. liaising with any other Official Representatives on matters (i) in which such other Official Representatives have a significant mutual interest, so long as their interests do not diverge and (ii) relating to a significant strategy to exit from a Proceeding in which such other Official Representatives have an interest.

4.7. Any sharing of information and data shall not include or give an Official Representative a right of automatic access to (i) documents relating to a Debtor's post-filing

transactions, or (ii) working papers, summaries, or other work product drafted by an Official Representative, and any professionals retained in the course of a Proceeding.

5. Communication Among Tribunals

5.1. The Guidelines Applicable to Court-to-Court Communication in Cross-Border Cases (the "Guidelines") attached as Schedule "A" hereto, shall, where applicable to the relevant Proceeding and where recognized by the Tribunal of the relevant Proceeding, be incorporated by reference and form part of this Protocol subject to formal adoption of the Guidelines in whatever form by each Tribunal, in whole or in part and with or without modifications (if any). Where there is any discrepancy between the Protocol and the Guidelines, this Protocol shall prevail.

6. Communication Among Committees

6.1. To the extent permitted and approved by the respective Committee, non-public information available to the Committee in any Forum may, if relevant to a matter in which another Debtor has an interest, be shared with the Committees of such Debtor, subject to appropriate confidentiality arrangements and all privileges under the applicable rules of evidence or applicable law.

7. Asset Preservation

7.1. Each Tribunal should administer the assets subject to its jurisdiction.

7.2. If, in the course of a Proceeding, an Official Representative learns or believes that another Debtor could have a material interest in a particular asset whose value and/or recovery is at risk, such Official Representative may notify the Official Representative of the Debtor whose estate includes such asset and, where practicable and consistent with the duties of such Official Representative under applicable laws, the Official Representative of the Debtor whose estate includes such asset should consult with the Official Representative of the Debtor that may have such material interest prior to: (i) the sale, abandonment, or any disposition of such asset; (ii) the termination, suspension, or other transition of any employees managing such asset; or (iii) the commencement of any judicial, or non-judicial, proceeding affecting such asset.

7.3. In the event that (a) an Official Representative claims to have a legal or beneficial interest in property which is transferred to, or received by another Debtor, or (b) an Official Representative determines that the estate for which it is responsible has improperly received or is improperly holding property transferred from or owned by another estate, such Official Representatives should cooperate in:

7.3.1. Assessing the ownership of such transferred property and provide all relevant information, to the extent not otherwise restricted, allowing each Official Representative to ascertain ownership of the property; and

7.3.2. Where ownership of the property has been established and subject to applicable laws: (i) returning the property to the Official

Representative of the Debtor establishing its right to such property; and (ii) refraining (to the extent an Official Representative may do so and subject to applicable laws) from transferring or co-mingling property once another Official Representative establishes ownership of such transferred property.

7.4. Official Representatives should, to the extent permitted under applicable law and where appropriate, cooperate to maximize the realizable value of assets for which multiple Debtors have an interest. Official Representatives also recognize that in certain cases such as where a Debtor (the "Funding Estate") has an existing interest in an asset which forms part of another Debtor's estate (the "Funded Estate"), the Official Representative of the Funding Estate may wish to provide funding towards the asset held by the Funded Estate in order to preserve and maximize its realizable value. In such event, the Official Representative of the Funded Estate may, subject to applicable laws, allow such funding to be provided on mutually acceptable bilateral terms

7.5. Should the Funded Estate, after appropriate consultation with the Funding Estate and after obtaining any necessary approval in an applicable Proceeding, (i) dispose of the asset after receiving funds from the Funding Estate, and (ii) receive proceeds in respect of such disposition, then the Funding Estate shall receive a fair allocation of share of such proceeds.

7.6. Where applicable, compliance with sections 7.2 through 7.6 by Official Representatives is subject to approval from their respective Tribunals or Committees, as the case may be under local law.

8. Claims

8.1. Where there are two or more Proceedings pending as to the same Debtor, those being one or more Plenary Proceeding and/or one or more Limited Proceedings, a claim should be filed only in the Proceeding(s) designated by the Official Representative of such Debtor (provided that certain Official Representatives may be required to make such designation in accordance with applicable law).

8.2. Without prejudice to secured claims or rights *in rem*, and subject to applicable law, Official Representatives should adjust distributions so that a creditor who has received payment with respect to its claim in one Proceeding may not receive a payment for the same claim in any other Proceeding as to the same Debtor, so long as the payment to the other creditors of the same class is proportionately less than the payment the creditor has already received in respect of that claim.

8.3. Consistent with section 8.2 above, if any claims against one or more Debtors (a "Direct Claim") is subject to a guarantee issued by another Debtor (a "Guarantee"), the Official Representatives shall seek to adjust distributions on the allowed Direct Claim and allowed Guarantee claim so that distributions on the Direct Claim and distributions on the Guarantee do not exceed in the aggregate the amount of the Direct Claim or the Guarantee, whichever is highest. Subject to the preceding sentence, distributions on a Direct Claim shall not

reduce the amount of any claim asserted under a corresponding Guarantee, and distributions under a Guarantee shall not reduce the amount of any corresponding Direct Claim.

8.4. Official Representatives should, where possible and subject to the applicable laws of the relevant forum, endeavor to coordinate notice procedures and establish the same deadlines for the filing of claims in their respective Proceedings, and in all other matters regarding the filing, reviewing and objecting to claims.

9. Special Procedures for Intercompany Claims

9.1. The Official Representatives agree that in order to provide for the efficient and timely administration of these Proceedings, and to reduce their cost and maximize recovery for creditors, resources and time should not be spent reviewing historical intercompany accounting records to resolve claims asserted in their respective Proceedings by other Official Representatives on the basis of (i) the allocation of overhead or expense from one Debtor to another Debtor, (ii) the flow of funds from one Debtor to another Debtor, (iii) the incurrence of a liability by one Debtor on behalf of another Debtor, or (iv) a transaction between Debtors (collectively, "Intercompany Claims"); but that rather, it is in the best interests of the Debtors' creditors for Official Representatives to agree to a common set of financial accounting records that form the basis of Intercompany Claims, and that those financial records shall be *prima facie* valid unless there are elements of proof suggesting that a transaction was recorded in error, or that no such transaction ever occurred or is inconsistent with the inter-company accounting records of the relevant Debtor(s).

9.2. Subject to the other provisions of this section 9, the Official Representatives shall endeavor to negotiate in good faith to attempt to reach a consensual resolution of any differences in their accounting of Intercompany Claims. Only to the extent that Official Representatives certify that they are unable to consensually resolve in good faith any differences in their accounting of Intercompany Claims, the Official Representatives shall resort to adjudication by the Tribunal holding jurisdiction over such claims.

9.3. The Official Representatives shall establish a committee (the "Procedures Committee"), whose members shall be jointly appointed by the Official Representatives and, where required, the Committees, and confirmed by the Tribunals (where applicable) overseeing each Proceeding, to consensually resolve, in accordance with section 9.1 above and in good faith, any differences in the accounting of Intercompany Claims.

9.4. The Procedures Committee shall propose the (i) procedures, (ii) accounting methodologies, and (iii) elements of proof that it intends to use in its calculation and consensual resolution of Intercompany Claims (the "Accounting Procedures"). Furthermore, if two or more Debtors were counterparties to a derivative contract in which the contractual obligations are referenced to one or more underlying assets or indices of asset values and subject to movements in the financial markets (such as contracts for the purchase, sale, or loan of securities; forward contracts; repurchase agreements; or swap agreements; and in some cases, multiple such agreements governed by a master agreement) (the "Intercompany Derivative Contracts"), and if an Intercompany Derivative Contract has been rejected, terminated, liquidated, or accelerated by any of the Debtor counterparties thereto, any damages (the

"Intercompany Derivatives Claims") that arise shall be measured and fixed by the Procedures Committee, pursuant to a methodology to be agreed upon by the members of the Procedures Committee (the "Derivatives Methodology").

9.5. As soon as is practicable after the Procedures Committee has agreed upon its Accounting Procedures and Derivatives Methodology, the Official Representatives shall, to the extent required under applicable law, seek approval from their respective Tribunals or Committees (where required) for the use of the Accounting Procedures and Derivatives Methodology in their respective Proceedings in the resolution of Intercompany Claims either as a general rule or on a case by case basis.

9.6. The Official Representatives should cooperate to submit the findings of the Procedures Committee (the "Procedures Committee Findings"), in a form substantially similar to each other, for approval by their respective Tribunals or Committees to the extent required by applicable law.

9.7. To the extent that creditors, Committees, or other interested parties object to (i) the application of the Accounting Methodology, or (ii) the application of the Derivatives Methodology, or (iii) any of the Procedures Committee Findings, all Official Representatives should coordinate a response to such objections.

10. Submission of Winding-Up Plan, Plan of Reorganization or Liquidation, or Deed of Company Arrangement

10.1. Where applicable and permitted under the law of the Forum in a Proceeding, Official Representatives should endeavor to submit a winding-up plan, plan of reorganization or liquidation, or deed of company arrangement (a "Plan") in their respective Proceedings, or to amend a Plan once submitted (to the extent permitted by applicable law) so that each Official Representative's Plan is consistent with Plans filed by other Official Representatives, provided that nothing herein shall require an Official Representative to agree (or shall be deemed to be an agreement), and shall not constitute a waiver of such Official Representative's right to object, to the Plan of another Official Representative.

10.2. Official Representatives should endeavor to coordinate all procedures in connection with their Plans to the extent permitted by applicable law, including, without limitation, all solicitation proceedings relating to their plans.

10.3. No provision of this Protocol contemplates that any Official Representative is required to delay filing, prosecuting or consummating a Plan with respect to the estate administered by such Official Representative.

11. **Comity**

11.1. The parties hereto agree that each Tribunal is an independent, sovereign Tribunal, entitled to preserve its independent jurisdiction and authority with respect to matters before it and the conduct of the Official Representatives.

11.2. Each Tribunal shall have sole jurisdiction and power over the conduct of the Proceeding in that forum; the appointment of the Official Representatives and their professionals, their retention, tenure in office, and compensation; and the hearing and determination of matters arising in that forum.

11.3. Nothing in this Protocol is intended to interfere with the exercise of jurisdiction by each of the Tribunals in the Proceedings, or to interfere with the natural rules or ethical principles by which an Official Representative is bound according to applicable national law and professional rules.

12. **Amendment**

12.1. This Protocol may not be waived, amended, or modified orally or in any other way or manner (including, without limitation, pursuant to a Plan) except by a writing signed by a party to be bound and, where applicable, approved by the Tribunal with jurisdiction over that party. Notice of any proposed amendment to this Protocol shall be provided via email by the party or parties hereto proposing such to all Official Representatives, and their respective Committees.

12.2. Additional parties may be added to this Protocol at any time after the effective date of this Protocol by means of an amendment pursuant to section 12.1.

13. **Adherence**

13.1. Notwithstanding the provisions of section 12, nothing in this Protocol shall preclude Official Representatives who are not parties hereto from adhering to the terms of this Protocol.

14. **Execution and Application**

14.1. This Protocol shall inure to the benefit of the parties hereto and their respective successors, assigns, representatives, heirs, executors, administrators, trustee, receivers, custodians, or curators, as the case may be, to the extent permitted under applicable law. Nothing herein shall create a right for any entity that is not a party to the Protocol, and a party hereto shall not be bound by this Protocol in its dealings with any entity that is not a party hereto.

14.2. Any request for the entry of an order which is contrary to the provisions of this Protocol must be made on notice to all Official Representatives and their respective Committees by the proponent of the order.

14.3. This Protocol may be signed in any number of counterparts, each of which shall be deemed an original and all of which together shall be deemed to be one and the same

instrument, and may be signed by facsimile signature, which shall be deemed to constitute an original signature.

14.4. A Tribunal having jurisdiction over an Official Representative shall retain jurisdiction over such Official Representative for the purpose of approving any amendments or modifications thereto in accordance with applicable laws; provided, however, in no event shall this or any other provision in this Protocol be deemed to create any liability on the part of an Official Representative for any reason.

14.5. Each Official Representative shall exercise good faith efforts to take such actions and execute such documents as may be necessary and appropriate to implement and effectuate this Protocol.

14.6. This Protocol shall be deemed effective with respect to each Official Representative and the estate administered thereby upon execution by all Official Representatives whose signature blocks appear below, and its approval by the Tribunal with jurisdiction over such estates or the relevant Committee (or similar body), where such approval is required under applicable law.

14.7. This Protocol shall remain in effect with respect to any Official Representative who is a party hereto and the estate administered thereby until the earlier of (i) the conclusion of that Official Representative's Proceeding as respectively defined by applicable law; or (ii) where applicable, and after providing notice to the parties hereto, entry of an order (or similar action) terminating this Protocol by the Tribunal having jurisdiction over such Proceeding, or approval of such termination by the relevant Committee(s) (or similar body) where such approval is required under applicable law, upon a determination by such Tribunal or Committee(s) that the Protocol has achieved all of its objectives as to that Official Representative's Proceeding.

[*signature pages follow*]

EXECUTION COPY

IN WITNESS WHEREOF, the parties hereto have caused this Protocol to be executed either individually or by their respective attorneys or representatives hereunto authorized.

Dated: As of May 12, 2009

LEHMAN BROTHERS HOLDINGS INC.,
on its own behalf and on behalf of its affiliates that are debtors in cases pending under chapter 11 of Title 11 of the United States Code.

By: _____
Name: Daniel Ehrmann
Title: Vice President

_____

Rutger Shimmelpenninck in his capacity as bankruptcy trustee ("curator") for **LEHMAN BROTHERS TREASURY CO. B.V.**

_____

Dr. Michael C. Frege in his capacity as insolvency administraton ("Insolvenzverwalter") of **LEHMAN BROTHERS BANKHAUS AG (IN INSOLVENZ)**

EXECUTION COPY

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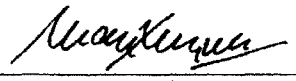
EXECUTION COPY



Chay Fook Yuen for himself, Yap Cheng Ghee and Tay Puay Cheng, as Joint and Several Liquidators, without personal liability, of and for and on behalf of **LEHMAN BROTHERS INVESTMENTS PTE. LTD. (IN CREDITORS' VOLUNTARY LIQUIDATION)**

Chay Fook Yuen for himself, Yap Cheng Ghee and Tay Puay Cheng, as Joint and Several Liquidators, without personal liability, of and for and on behalf of **LEHMAN BROTHERS FINANCE ASIA PTE. LTD. (IN CREDITORS' VOLUNTARY LIQUIDATION)**

Chay Fook Yuen for himself, Yap Cheng Ghee and Tay Puay Cheng, as Joint and Several Liquidators, without personal liability, of and for and on behalf of **LEHMAN BROTHERS COMMODITIES PTE. LTD. (IN CREDITORS' VOLUNTARY LIQUIDATION)**

Chay Fook Yuen for himself, Yap Cheng Ghee and Tay Puay Cheng, as Joint and Several Liquidators, without personal liability, of and for and on behalf of **LEHMAN BROTHERS PACIFIC HOLDINGS PTE. LTD. (IN CREDITORS' VOLUNTARY LIQUIDATION)**

Chay Fook Yuen for himself, Yap Cheng Ghee and Tay Puay Cheng, as Joint and Several Liquidators, without personal liability, of and for and on behalf of **SAIL INVESTOR PTE. LTD. (IN CREDITORS' VOLUNTARY LIQUIDATION)**

EXECUTION COPY

Chay Fook Yuen for himself, Yap Cheng Ghee and Tay Puay Cheng, as Joint and Several Liquidators, without personal liability, of and for and on behalf of **LEHMAN BROTHERS ASIA PACIFIC (SINGAPORE) PTE. LTD. (IN CREDITORS' VOLUNTARY LIQUIDATION)**

Executed for and on behalf of **LEHMAN BROTHERS AUSTRALIA GRANICA PTY LIMITED** (Administrators Appointed) by **Neil Singleton**, as one of the joint and several administrators

Executed for and on behalf of **LEHMAN BROTHERS REAL ESTATE AUSTRALIA COMMERCIAL PTY LIMITED** (Administrators Appointed) by **Neil Singleton**, as joint and several administrators

Executed for and on behalf of **LEHMAN BROTHERS AUSTRALIA REAL ESTATE HOLDINGS PTY LIMITED** (Administrators Appointed) by **Neil Singleton**, as joint and several administrators

EXECUTION COPY

Chay Fook Yuen for himself, Yap Cheng Ghee and Tay Puay Cheng, as Joint and Several Liquidators, without personal liability, of and for and on behalf of **LEHMAN BROTHERS ASIA PACIFIC HOLDINGS PTE. LTD. (IN CREDITORS' VOLUNTARY LIQUIDATION)**

Executed for and on behalf of **LEHMAN BROTHERS AUSTRALIA GRANICA PTY LIMITED** (Administrators Appointed) by **Neil Singleton**, as one of the joint and several administrators

Executed for and on behalf of **LEHMAN BROTHERS REAL ESTATE AUSTRALIA COMMERCIAL PTY LIMITED** (Administrators Appointed) by **Neil Singleton**, as joint and several administrators

Executed for and on behalf of **LEHMAN BROTHERS AUSTRALIA REAL ESTATE HOLDINGS PTY LIMITED** (Administrators Appointed) by **Neil Singleton**, as joint and several administrators

EXECUTION COPY

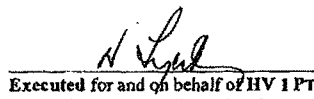
Executed for and on behalf of **LEHMAN BROTHERS AUSTRALIA FINANCE PTY LIMITED** (Administrators Appointed) by **Neil Singleton**, as joint and several administrators

Executed for and on behalf of **LEHMAN BROTHERS AUSTRALIA HOLDINGS PTY LIMITED** (Administrators Appointed) by **Neil Singleton**, as one of the joint and several administrators

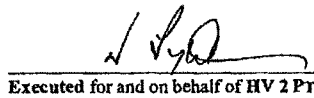
Executed for and on behalf of **LEHMAN BROTHERS AUSTRALIA LIMITED** (Administrators Appointed) by **Neil Singleton**, as one of the joint and several administrators

Executed for and on behalf of **LBHV 1 PTY LIMITED** (Administrators Appointed) by **Neil Singleton**, as one of the joint and several administrators

EXECUTION COPY



Executed for and on behalf of **HV 1 PTY LIMITED** (Administrators Appointed) by **Neil Singleton**, as one of the joint and several administrators



Executed for and on behalf of **HV 2 PTY LIMITED** (Administrators Appointed) by **Neil Singleton**, as one of the joint and several administrators

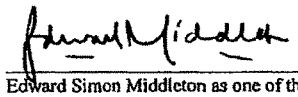
Edward Simon Middleton as one of the Joint and Several Liquidators, without personal liability, of and for and on behalf of **LEHMAN BROTHERS ASIA HOLDINGS LIMITED (In Liquidation)**

Edward Simon Middleton as one of the Joint and Several Liquidators, without personal liability, of and for and on behalf of **LEHMAN BROTHERS ASIA LIMITED (In Liquidation)**

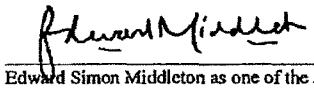
EXECUTION COPY

Executed for and on behalf of **HV 1 PTY LIMITED** (Administrators Appointed) by **Neil Singleton**, as one of the joint and several administrators

Executed for and on behalf of **HV 2 PTY LIMITED** (Administrators Appointed) by **Neil Singleton**, as one of the joint and several administrators

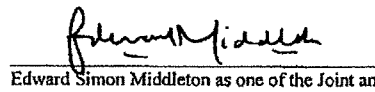


Edward Simon Middleton as one of the Joint and Several Liquidators, without personal liability, of and for and on behalf of **LEHMAN BROTHERS ASIA HOLDINGS LIMITED (In Liquidation)**

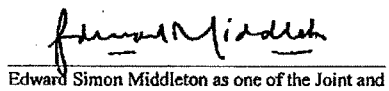


Edward Simon Middleton as one of the Joint and Several Liquidators, without personal liability, of and for and on behalf of **LEHMAN BROTHERS ASIA LIMITED (In Liquidation)**

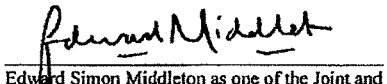
EXECUTION COPY



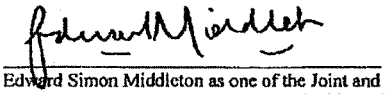
Edward Simon Middleton as one of the Joint and Several Liquidators, without personal liability, of and for and on behalf of **LEHMAN BROTHERS FUTURES ASIA LIMITED (In Liquidation)**



Edward Simon Middleton as one of the Joint and Several Liquidators, without personal liability, of and for and on behalf of **LEHMAN BROTHERS SECURITIES ASIA LIMITED (In Liquidation)**

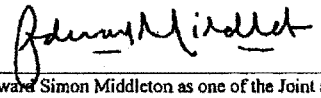


Edward Simon Middleton as one of the Joint and Several Liquidators, without personal liability, of and for and on behalf of **LBQ HONG KONG FUNDING LIMITED (In Liquidation)**

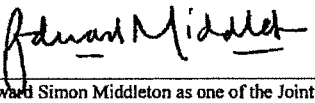


Edward Simon Middleton as one of the Joint and Several Liquidators, without personal liability, of and for and on behalf of **LEHMAN BROTHERS NOMINEES (H.K.) LIMITED (In Liquidation)**

EXECUTION COPY



Edward Simon Middleton as one of the Joint and Several Liquidators, without personal liability, of and for and on behalf of **LEHMAN BROTHERS ASIA CAPITAL COMPANY (In Liquidation)**



Edward Simon Middleton as one of the Joint and Several Liquidators, without personal liability, of and for and on behalf of **LEHMAN BROTHERS COMMERCIAL CORPORATION ASIA LIMITED (In Liquidation)**

Schedule A

Guidelines

A copy of the Guidelines is attached to the Motion as Exhibit C.

EXHIBIT C

Guidelines

THE AMERICAN LAW INSTITUTE

in association with

THE INTERNATIONAL INSOLVENCY INSTITUTE

Guidelines Applicable to Court-to-Court Communications in Cross-Border Cases

As Adopted and Promulgated in Transnational Insolvency: Principles of Cooperation Among the NAFTA Countries

BY

THE AMERICAN LAW INSTITUTE
At Washington, D.C., May, 2000

And as Adopted by

THE INTERNATIONAL INSOLVENCY INSTITUTE
At New York, June, 2001

The American Law Institute
4025 Chestnut Street
Philadelphia, Pennsylvania 19104-3099
Telephone: (215) 243-1600
Telecopier: (215) 243-1636
E-mail: ali@ali.org
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The International Insolvency Institute
Scotia Plaza, Suite 2100
40 King Street West
Toronto, Ontario M5H 3C2
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Telecopier: (416) 360-8877
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Website: http://www.iiiglobal.org

FOREWORD

In May of 2000 The American Law Institute gave its final approval to the work of the ALI's Transnational Insolvency Project. This consisted of the four volumes eventually published, after a period of delay required by the need to take into account a newly enacted Mexican Bankruptcy Code, in 2003 under the title of *Transnational Insolvency: Cooperation Among the NAFTA Countries*. These volumes included both the first phase of the project, separate Statements of the bankruptcy laws of Canada, Mexico, and the United States, and the project's culminating phase, a volume comprising *Principles of Cooperation Among the NAFTA Countries*. All reflected the joint input of teams of Reporters and Advisers from each of the three NAFTA countries and a fully transnational perspective. Published by Juris Publishing, Inc., they can be ordered on the ALI website (www.ali.org).

A byproduct of our work on the Principles volume, these *Guidelines Applicable to Court-to-Court Communications in Cross-Border Cases* appeared originally as Appendix B of that volume and were approved by the ALI in 2000 along with the rest of the volume. But the *Guidelines* have played a vital and influential role apart from the *Principles*, having been widely translated and distributed, cited and applied by courts, and independently approved by both the International Insolvency Institute and the Insolvency Institute of Canada. Although they were initially developed in the context of a project arrived at improving cooperation among bankruptcy courts within the NAFTA countries, their acceptance by the III, whose members include leaders of the insolvency bar from more than 40 countries, suggests a pertinence and applicability that extends far beyond the ambit of NAFTA. Indeed, there appears to be no reason to restrict the *Guidelines* to insolvency cases; they should prove useful whenever sensible and coherent standards for cooperation among courts involved in overlapping litigation are called for. See, e.g., American Law Institute, International Jurisdiction and Judgments Project §12(c) (Tentative Draft, 2003).

The American Law Institute expresses its gratitude to the International Insolvency Institute for its continuing efforts to publicize the *Guidelines* and to make them more widely known to judges and lawyers around the world; to III Chair E. Bruce Leonard of Toronto, who as Canadian Co-Reporter for the Transnational Insolvency Project was the principal drafter of the Guidelines in English and has been primarily responsible for arranging and overseeing their translation into the various other languages in which they now appear; and to the translators themselves, whose work will make the *Guidelines* much more universally accessible. We hope that this greater availability, in these new English and bilingual editions, will help to foster better communication, and thus better understanding, among the diverse courts and legal systems throughout our increasingly globalized world.

LANCE LIEBMAN
Director
The American Law Institute

January 30, 2004

International Insolvency Institute

Introduction

The International Insolvency Institute, a world-wide association of leading insolvency professionals, judges, academics and regulators, is pleased to recommend the adoption and the application in cross-border and multinational cases of The American Law Institute's *Guidelines for Court-to-Court Communications in Cross-Border Cases*. The *Guidelines* were reviewed and studied by a Committee of the III and were unanimously approved by its membership at the III's Annual General Meeting and Conference in New York in June 2001.

Since their approval by the III, the *Guidelines* have been applied in several cross-border cases with considerable success in achieving the coordination that is so necessary to preserve values for all of the creditors that are involved in international cases. The III recommends without qualification that insolvency professionals and judges adopt the *Guidelines* at the earliest possible stage of a cross-border case so that they will be in place whenever there is a need for the courts involved to communicate with each other, e.g., wherever the actions of one court could impact on issues that are before the other court.

Although the *Guidelines* were developed in an insolvency context, it has been noted by litigation professionals and judges that the *Guidelines* would be equally valuable and constructive in any international case where two or more courts are involved. In fact, in multijurisdictional litigation, the positive effect of the *Guidelines* would be even greater in cases where several courts are involved. It is important to appreciate that the *Guidelines* require that all domestic practices and procedures be complied with and that the *Guidelines* do not alter or affect the substantive rights of the parties or give any advantage to any party over any other party.

The International Insolvency Institute expresses appreciation to its members who have arranged for the translation of the *Guidelines* into French, German, Italian, Korean, Japanese, Chinese, Portuguese, Russian and Swedish and extends its appreciation to The American Law Institute for the translation into Spanish. The III also expresses its appreciation to The American Law Institute, the American College of Bankruptcy, and the Ontario Superior Court of Justice Commercial List Committee for their kind and generous financial support in enabling the publication and dissemination of the *Guidelines* in bilingual versions in major countries around the world.

Readers who become aware of cases in which the *Guidelines* have been applied are highly encouraged to provide the details of those cases to the III (fax: 416-360-8877; email: *info@iiiglobal.org*.) so that everyone can benefit from the experience and positive

results that flow from the adoption and application of the *Guidelines*. The continuing progress of the *Guidelines* and the cases in which the *Guidelines* have been applied will be maintained on the III 's website at *www.iiiglobal.org*.

The III and all of its members are very pleased to have been a part of the development and success of the *Guidelines* and commend The American Law Institute for its vision in developing the *Guidelines* and in supporting their worldwide circulation to insolvency professionals, judges, academics, and regulators. The use of the *Guidelines* in international cases will change international insolvencies and reorganizations for the better forever and the insolvency community owes a considerable debt to The American Law Institute for the inspiration and vision that has made this possible.

E. Bruce Leonard
Chairman
The International Insolvency Institute

Toronto, Ontario
March, 2004

Judicial Preface

We believe that the advantages of co-operation and co-ordination between Courts is clearly advantageous to all of the stakeholders who are involved in insolvency and reorganization cases that extend beyond the boundaries of one country. The benefit of communications between Courts in international proceedings has been recognized by the United Nations through the *Model Law on Cross-Border Insolvency* developed by the United Nations Commission on International Trade Law and approved by the General Assembly of the United Nations in 1997. The advantages of communications have also been recognized in the European Union Regulation on Insolvency Proceedings which became effective for the Member States of the European Union in 2002.

The *Guidelines for Court-to-Court Communications in Cross-Border Cases* were developed in the American Law Institute's Transnational Insolvency Project involving the NAFTA countries of Mexico, the United States and Canada. The *Guidelines* have been approved by the membership of the ALI and by the International Insolvency Institute whose membership covers over 40 countries from around the world. We appreciate that every country is unique and distinctive and that every country has its own proud legal traditions and concepts. The *Guidelines* are not intended to alter or change the domestic rules or procedures that are applicable in any country and are not intended to affect or curtail the substantive rights of any party in proceedings before the Courts. The *Guidelines* are intended to encourage and facilitate co-operation in international cases while observing all applicable rules and procedures of the Courts that are respectively involved.

The *Guidelines* may be modified to meet either the procedural law of the jurisdiction in question or the particular circumstances in individual cases so as to achieve the greatest level of co-operation possible between the Courts in dealing with a multinational insolvency or liquidation. The *Guidelines*, however, are not restricted to insolvency cases and may be of assistance in dealing with non-insolvency cases that involve more than one country. Several of us have already used the *Guidelines* in cross-border cases and would encourage stakeholders and counsel in international cases to consider the advantages that could be achieved in their cases from the application and implementation of the *Guidelines*.

Mr. Justice David Baragwanath
High Court of New Zealand
Auckland, New Zealand

Chief Justice Donald I. Brenner
Supreme Court of British Columbia
Vancouver

Hon. Sidney B. Brooks
United States Bankruptcy Court
District of Colorado
Denver

Hon. Charles G. Case, II
United States Bankruptcy Court
District of Arizona
Phoenix

Mr. Justice Miodrag Dordević
Supreme Court of Slovenia
Ljubljana

Hon. James L. Garrity, Jr.
United States Bankruptcy Court
Southern District of New York (Ret'd)
Shearman & Sterling
New York

Mr. Justice Paul R. Heath
High Court of New Zealand
Auckland, New Zealand

Chief Judge Burton R. Lifland
United States Bankruptcy Appellate
Panel for the Second Circuit
New York

Hon. George Paine II
United States Bankruptcy Court
District of Tennessee
Nashville

Mr. Justice Adolfo A.N. Rouillon
Court of Appeal
Rosario, Argentina

Mr. Justice Wisit Wisitsora – At
Business Reorganization Office
Government of Thailand
Bangkok

Mr. Justice J.M. Farley
Ontario Superior Court of Justice
Toronto

Hon. Allan L. Gropper
Southern District of New York
United States Bankruptcy Court
New York

Hon. Hyungdu Kim
Supreme Court of Korea
Seoul

Mr. Justice Gavin Lightman
Royal Courts of Justice
London

Hon. Chiyong Rim
District Court
Western District of Seoul
Seoul, Korea

Hon. Shinjiro Takagi
Supreme Court of Japan (Ret'd)
Industrial Revitalization Corporation of Japan
Tokyo

Mr. Justice R.H. Zulman
Supreme Court of Appeal of South Africa
Parklands

Guidelines
Applicable to Court-to-Court Communications
in Cross-Border Cases

Introduction:

One of the most essential elements of cooperation in cross-border cases is communication among the administrating authorities of the countries involved. Because of the importance of the courts in insolvency and reorganization proceedings, it is even more essential that the supervising courts be able to coordinate their activities to assure the maximum available benefit for the stakeholders of financially troubled enterprises.

These Guidelines are intended to enhance coordination and harmonization of insolvency proceedings that involve more than one country through communications among the jurisdictions involved. Communications by judges directly with judges or administrators in a foreign country, however, raise issues of credibility and proper procedures. The context alone is likely to create concern in litigants unless the process is transparent and clearly fair. Thus, communication among courts in cross-border cases is both more important and more sensitive than in domestic cases. These Guidelines encourage such communications while channeling them through transparent procedures. The Guidelines are meant to permit rapid cooperation in a developing insolvency case while ensuring due process to all concerned.

A Court intending to employ the Guidelines — in whole or part, with or without modifications — should adopt them formally before applying them. A Court may wish to make its adoption of the Guidelines contingent upon, or temporary until, their adoption by other courts concerned in the matter. The adopting Court may want to make adoption or continuance conditional upon adoption of the Guidelines by the other Court in a substantially similar form, to ensure that judges, counsel, and parties are not subject to different standards of conduct.

The Guidelines should be adopted following such notice to the parties and counsel as would be given under local procedures with regard to any important procedural decision under similar circumstances. If communication with other courts is urgently needed, the local procedures, including notice requirements, that are used in urgent or emergency situations should be employed, including, if appropriate, an initial period of effectiveness, followed by further

consideration of the Guidelines at a later time. Questions about the parties entitled to such notice (for example, all parties or representative parties or representative counsel) and the nature of the court's consideration of any objections (for example, with or without a hearing) are governed by the Rules of Procedure in each jurisdiction and are not addressed in the Guidelines.

The Guidelines are not meant to be static, but are meant to be adapted and modified to fit the circumstances of individual cases and to change and evolve as the international insolvency community gains experience from working with them. They are to apply only in a manner that is consistent with local procedures and local ethical requirements. They do not address the details of notice and procedure that depend upon the law and practice in each jurisdiction. However, the Guidelines represent approaches that are likely to be highly useful in achieving efficient and just resolutions of cross-border insolvency issues. Their use, with such modifications and under such circumstances as may be appropriate in a particular case, is therefore recommended.

Guideline 1

Except in circumstances of urgency, prior to a communication with another Court, the Court should be satisfied that such a communication is consistent with all applicable Rules of Procedure in its country. Where a Court intends to apply these Guidelines (in whole or in part and with or without modifications), the Guidelines to be employed should, wherever possible, be formally adopted before they are applied. Coordination of Guidelines between courts is desirable and officials of both courts may communicate in accordance with Guideline 8(d) with regard to the application and implementation of the Guidelines.

Guideline 2

A Court may communicate with another Court in connection with matters relating to proceedings before it for the purposes of coordinating and harmonizing proceedings before it with those in the other jurisdiction.

Guideline 3

A Court may communicate with an Insolvency Administrator in another jurisdiction or an authorized Representative of the Court in that jurisdiction in connection with the coordination and harmonization of the proceedings before it with the proceedings in the other jurisdiction.

Guideline 4

A Court may permit a duly authorized Insolvency Administrator to communicate with a foreign Court directly, subject to the approval of the foreign Court, or through an Insolvency Administrator in the other jurisdiction or through an authorized Representative of the foreign Court on such terms as the Court considers appropriate.

Guideline 5

A Court may receive communications from a foreign Court or from an authorized Representative of the foreign Court or from a foreign Insolvency Administrator and should respond directly if the communication is from a foreign Court (subject to Guideline 7 in the case of two-way communications) and may respond directly or through an authorized Representative of the Court or through a duly authorized Insolvency Administrator if the communication is from a foreign Insolvency Administrator, subject to local rules concerning ex parte communications.

Guideline 6

Communications from a Court to another Court may take place by or through the Court:

(a) Sending or transmitting copies of formal orders, judgments, opinions, reasons for decision, endorsements, transcripts of proceedings, or other documents directly to the other Court and providing advance notice to counsel for affected parties in such manner as the Court considers appropriate;

(b) Directing counsel or a foreign or domestic Insolvency Administrator to transmit or deliver copies of documents, pleadings, affidavits, factums, briefs, or other documents that are filed or to be filed with the Court to the other Court in such fashion as may be appropriate and providing advance notice to counsel for affected parties in such manner as the Court considers appropriate;

(c) Participating in two-way communications with the other Court by telephone or video conference call or other electronic means, in which case Guideline 7 should apply.

Guideline 7

In the event of communications between the Courts in accordance with Guidelines 2 and 5 by means of telephone or video conference call or other electronic means, unless otherwise directed by either of the two Courts:

(a) Counsel for all affected parties should be entitled to participate in person during the communication and advance notice of the communication should be given to all parties in accordance with the Rules of Procedure applicable in each Court;

(b) The communication between the Courts should be recorded and may be transcribed. A written transcript may be prepared from a recording of the communication which, with the approval of both Courts, should be treated as an official transcript of the communication;

(c) Copies of any recording of the communication, of any transcript of the communication prepared pursuant to any Direction of either Court, and of any official transcript prepared from a recording should be filed as part of the record in the proceedings and made available to counsel for all parties in both Courts subject to such Directions as to confidentiality as the Courts may consider appropriate; and

(d) The time and place for communications between the Courts should be to the satisfaction of both Courts. Personnel other than Judges in each Court may communicate fully with each other to establish appropriate arrangements for the communication without the necessity for participation by counsel unless otherwise ordered by either of the Courts.

Guideline 8

In the event of communications between the Court and an authorized Representative of the foreign Court or a foreign Insolvency Administrator in accordance with Guidelines 3 and 5 by means of telephone or video conference call or other electronic means, unless otherwise directed by the Court:

(a) Counsel for all affected parties should be entitled to participate in person during the communication and advance notice of the

communication should be given to all parties in accordance with the Rules of Procedure applicable in each Court;

(b) The communication should be recorded and may be transcribed. A written transcript may be prepared from a recording of the communication which, with the approval of the Court, can be treated as an official transcript of the communication;

(c) Copies of any recording of the communication, of any transcript of the communication prepared pursuant to any Direction of the Court, and of any official transcript prepared from a recording should be filed as part of the record in the proceedings and made available to the other Court and to counsel for all parties in both Courts subject to such Directions as to confidentiality as the Court may consider appropriate; and

(d) The time and place for the communication should be to the satisfaction of the Court. Personnel of the Court other than Judges may communicate fully with the authorized Representative of the foreign Court or the foreign Insolvency Administrator to establish appropriate arrangements for the communication without the necessity for participation by counsel unless otherwise ordered by the Court.

Guideline 9

A Court may conduct a joint hearing with another Court. In connection with any such joint hearing, the following should apply, unless otherwise ordered or unless otherwise provided in any previously approved Protocol applicable to such joint hearing:

(a) Each Court should be able to simultaneously hear the proceedings in the other Court.

(b) Evidentiary or written materials filed or to be filed in one Court should, in accordance with the Directions of that Court, be transmitted to the other Court or made available electronically in a publicly accessible system in advance of the hearing. Transmittal of such material to the other Court or its public availability in an electronic system should not subject the party filing the material in one Court to the jurisdiction of the other Court.

(c) Submissions or applications by the representative of any party should be made only to the Court in which the representative making the submissions is appearing unless the representative is specifically given permission by the other Court to make submissions to it.

(d) Subject to Guideline 7(b), the Court should be entitled to communicate with the other Court in advance of a joint hearing, with or without counsel being present, to establish Guidelines for the orderly making of submissions and rendering of decisions by the Courts, and to coordinate and resolve any procedural, administrative, or preliminary matters relating to the joint hearing.

(e) Subject to Guideline 7(b), the Court, subsequent to the joint hearing, should be entitled to communicate with the other Court, with or without counsel present, for the purpose of determining whether coordinated orders could be made by both Courts and to coordinate and resolve any procedural or nonsubstantive matters relating to the joint hearing.

Guideline 10

The Court should, except upon proper objection on valid grounds and then only to the extent of such objection, recognize and accept as authentic the provisions of statutes, statutory or administrative regulations, and rules of court of general application applicable to the proceedings in the other jurisdiction without the need for further proof or exemplification thereof.

Guideline 11

The Court should, except upon proper objection on valid grounds and then only to the extent of such objection, accept that Orders made in the proceedings in the other jurisdiction were duly and properly made or entered on or about their respective dates and accept that such Orders require no further proof or exemplification for purposes of the proceedings before it, subject to all such proper reservations as in the opinion of the Court are appropriate regarding proceedings by way of appeal or review that are actually pending in respect of any such Orders.

Guideline 12

The Court may coordinate proceedings before it with proceedings in another jurisdiction by establishing a Service List that may include parties that are entitled to receive notice of proceedings before the Court in the other jurisdiction ("Non-Resident Parties"). All notices, applications, motions, and other materials served for purposes of the proceedings before the Court may be ordered to also be provided to or served on the Non-Resident Parties by making such materials available electronically in a publicly accessible system or by facsimile transmission, certified or registered mail or delivery by courier, or in such other manner as may be directed by the Court in accordance with the procedures applicable in the Court.

Guideline 13

The Court may issue an Order or issue Directions permitting the foreign Insolvency Administrator or a representative of creditors in the proceedings in the other jurisdiction or an authorized Representative of the Court in the other jurisdiction to appear and be heard by the Court without thereby becoming subject to the jurisdiction of the Court.

Guideline 14

The Court may direct that any stay of proceedings affecting the parties before it shall, subject to further order of the Court, not apply to applications or motions brought by such parties before the other Court or that relief be granted to permit such parties to bring such applications or motions before the other Court on such terms and conditions as it considers appropriate. Court-to-Court communications in accordance with Guidelines 6 and 7 hereof may take place if an application or motion brought before the Court affects or might affect issues or proceedings in the Court in the other jurisdiction.

Guideline 15

A Court may communicate with a Court in another jurisdiction or with an authorized Representative of such Court in the manner prescribed by these Guidelines for purposes of coordinating and harmonizing proceedings before it with proceedings in the other jurisdiction regardless of the form of the proceedings before it or before the other Court wherever there is commonality among the issues and/or the parties in the proceedings. The Court should, absent

compelling reasons to the contrary, so communicate with the Court in the other jurisdiction where the interests of justice so require.

Guideline 16

Directions issued by the Court under these Guidelines are subject to such amendments, modifications, and extensions as may be considered appropriate by the Court for the purposes described above and to reflect the changes and developments from time to time in the proceedings before it and before the other Court. Any Directions may be supplemented, modified, and restated from time to time and such modifications, amendments, and restatements should become effective upon being accepted by both Courts. If either Court intends to supplement, change, or abrogate Directions issued under these Guidelines in the absence of joint approval by both Courts, the Court should give the other Courts involved reasonable notice of its intention to do so.

Guideline 17

Arrangements contemplated under these Guidelines do not constitute a compromise or waiver by the Court of any powers, responsibilities, or authority and do not constitute a substantive determination of any matter in controversy before the Court or before the other Court nor a waiver by any of the parties of any of their substantive rights and claims or a diminution of the effect of any of the Orders made by the Court or the other Court.

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The *Guidelines for Court-to-Court Communications in Cross-Border Cases* were developed by The American Law Institute during and as part of its *Transnational Insolvency Project* and the use of the *Guidelines* in cross-border cases is specifically permitted and encouraged.

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The text of the *Guidelines Court-to-Court Communications in Cross-Border Cases* is available in English and several other languages including Chinese, French, German, Italian, Japanese, Korean, Portuguese, Russian, Spanish and Swedish on the website of the International Insolvency Institute at http://www.iiiglobal.org/international/guidelines.html.

Insert A

This translation has been made, published and distributed with the authorization of The American Law Institute. The American Law Institute and the International Insolvency Institute express their appreciation to _____ [Please insert name of translator] for creating and providing this translation.

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Attorneys for Debtors
and Debtors in Possession

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re	:	**Chapter 11 Case No.**
LEHMAN BROTHERS HOLDINGS INC., *et al.*,	:	**08-13555 (JMP)**
Debtors.	:	**(Jointly Administered)**

NOTICE OF REPORT OF ACTIVITIES THROUGH JANUARY 15, 2010 OF THE OFFICIAL REPRESENTATIVES AND OTHER PARTICIPATING AFFILIATES PURSUANT TO THE CROSS-BORDER INSOLVENCY PROTOCOL

PLEASE TAKE NOTICE that on February 2, 2010, Lehman Brothers Holdings Inc. and its affiliated debtors filed the annexed Report of Activities Through January 15, 2010 of The Official Representatives And Other Participating Affiliates Pursuant To The Cross-Border Insolvency Protocol for The Lehman Brothers Group of Companies.

Dated: February 2, 2010
New York, New York

/s/ Richard P. Krasnow
Richard P. Krasnow
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EXHIBIT 3

OFFICIAL REPRESENTATIVES AND OTHER PARTICIPATING AFFILIATES PURSUANT TO THE CROSS-BORDER INSOLVENCY PROTOCOL FOR THE LEHMAN BROTHERS GROUP OF COMPANIES

REPORT OF ACTIVITIES through January 15, 2010

Introduction

On September 15, 2008, Lehman Brothers Holdings Inc. ("LBHI"), the parent entity of the Lehman Brothers group ("Lehman"), filed a chapter 11 petition with the U.S. Bankruptcy Court.

Prior to this date, Lehman was the fourth-largest U.S. investment bank, with 900+ operating entities located in 40+ countries and more than $600B in assets. LBHI managed substantially all of the material cash resources of the Lehman Brothers group centrally, and the inability of LBHI to settle obligations of its worldwide Affiliates led to insolvency proceedings for many of the Lehman affiliates (the "Affiliates") in the days and weeks subsequent to September 15.

As a result, entities which were once part of the Lehman consolidated group were immediately separated by numerous insolvency proceedings in various jurisdictions. Today there are 80+ proceedings in progress under the purview of 16 Official Representatives (the "Official Representatives").

The fragmentation of the Lehman group posed a litany of complicated issues and practical barriers to the eventual emergence or unwinding of those Affiliates. These hurdles - to name but a few - include:

- Assets and activities of Affiliates spread across jurisdictional borders.
- Complex agreements which commonly pertain to multiple Affiliates.
- Intercompany funding arrangements arising from Lehman's cash management system which gave rise to tens of billions of dollars in intercompany positions.
- Over 322,000 intercompany derivative and foreign exchange trade legs open at September 12, 2008 (the last trading date prior to the chapter 11 filing of LBHI).
- Securities lending positions between Affiliates approaching $300 billion in gross value.
- Various forms of asserted guarantees by LBHI in respect of the activities of Affiliates.

Due to the presence of these issues, Official Representatives of many of the Affiliates recognized the necessity for international cooperation. To further this, the Cross-Border Insolvency Protocol for the Lehman Brothers Group of Companies (the "Protocol") was developed. The Protocol is a non-binding agreement, the stated aim of which is to minimize costs and maximize fair recoveries for all creditors through information sharing, by coordination of activities and by a commitment to finding consensual, negotiated solutions wherever possible, in order to keep to a minimum the need to involve courts or other dispute resolution forms. This commitment informs all of the activities of Signatories and Participating Affiliates (defined below).

To date, 10 Official Representatives have signed the Protocol (the "Signatories," listed on Schedule A hereto) representing Affiliates in Australia, the Netherlands, the Netherlands Antilles, Hong Kong, Germany, Luxembourg, Singapore, Switzerland, and the United States. In addition to the Signatories, Official Representatives in Japan and Bermuda, (the "Participating Affililates" and, together with the Signatories, the "Signatories and Participating Affiliates") have participated in a series of activities and meetings designed to advance the objectives set forth in the Protocol. This report highlights the accomplishments to date of the Signatories and Participating Affiliates, as well as the ongoing activities and next steps.

Report of Activities

I. First Protocol Meeting

The Signatories and Participating Affiliates gathered for the first time as a group on July 16-17, 2009, in London. Rutger Schimmelpenninck (representing Lehman Brothers Treasury in the Netherlands) and Eddie Middleton (representing Lehman Brothers Asia Holdings and subsidiaries in Hong Kong) were appointed co-Chairmen of this First Protocol Meeting. Each of the 12 Official Representatives in attendance provided the group with a brief Case Update of their respective proceedings, and then participated in discussion around a number of topics.

The main points of emphasis in the First Protocol Meeting were:

- **Global Close:** The Official Representatives recognized that the resolution of intercompany claims is crucial for the administration of their respective proceedings, but that to attempt to reconcile their intercompany claims with the procedural and evidentiary rigors of court proceedings under a multiplicity of local insolvency laws and rules of evidence was likely to be a protracted and expensive labor that could take many years to complete. Accordingly, the objective of the First Protocol Meeting was primarily to discuss how the Official Representatives might agree to intercompany balances through a streamlined, consistent, coordinated, and transparent process that significantly reduces administrative expenses and minimizes the potential for costly litigation.

  The September 14, 2008 Global Close Balance Sheet is considered to be the critical starting point for achieving this goal, particularly with respect to general intercompany funding positions (i.e. the "non-trading" balances). Subsequent to LBHI filing a chapter 11 petition and many of the other Affiliates entering into insolvency proceedings in their respective jurisdictions, a globally-coordinated effort was undertaken to perform a consolidated close of the Lehman Brothers group as of September 14, 2008 (the "Global Close"). In the period from November 2008 – January 2009, the Global Close was executed by a team comprised of Lehman professionals from LBHI and Lehman Brothers International (Europe) ("LBIE"), as well as former Lehman professionals working for Barclays or Nomura. The Global Close is considered a critical source of information, as it represents the last consolidated set of books and records of the Lehman Group prior to LBHI filing for bankruptcy. Beginning with the First Protocol Meeting, the importance and usefulness of the Global Close for the purpose of agreeing intercompany balances has been stressed amongst the Signatories and Participating Affiliates.

  In accordance with the information sharing provisions in the Protocol, LBHI distributed the September 14, 2008 Global Close Balance Sheet information for their respective entities to the Signatories and Participating Affiliates. Further, a draft "White Paper" describing the background and mechanics of the Global Close was provided to Signatories and Participating Affiliates, and presented at the First Protocol Meeting.

- **Trading positions:** The Affiliates engaged in heavy trading activity with each other, including derivatives, foreign exchange trades, and financing trades (repos, stock lending, etc.). A significant point of emphasis in the First Protocol Meeting was for Affiliates to focus their attention toward the efforts of: (i) reconciling populations of intercompany trades; and (ii) agreeing to termination dates. Only once those two exercises have been completed (an effort which is

ongoing) can the Affiliates then move on to the effort of valuing the trading positions. To that end, the Signatories and Participating Affiliates agreed to a milestone date by which they would have the steps of population reconciliation and agreement of termination dates finalized.

The meeting concluded with the Signatories and Participating Affiliates agreeing to take up various key topics in the Procedures Committee (see following).

II. Procedures Committee

One of the clauses of the Protocol states that the Official Representatives shall establish a committee (the "Procedures Committee") to "consensually resolve in good faith any differences in the accounting of Intercompany Claims to be filed in their respective Proceedings".

Following the First Protocol Meeting, each of the 12 Signatories and Participating Affiliates appointed a representative (or representatives) to the Procedures Committee. Ron Geraghty and Steve Nietupski (both of LBHI) assumed the role of co-Chairmen of the Procedures Committee.

The Procedures Committee met for the first time (via conference call) on August 5, 2009. Subsequent calls took place on August 24, September 9, September 30, October 28, November 11, December 2, and December 16.

The key goal of the inclusion of the Procedures Committee as an element of the Protocol was to provide a forum that facilitated open communication and continued involvement from all of the Affiliates. The Procedures Committee has been a success to date in that regard. Topics addressed on the various calls have included:

- Ongoing updates regarding the reconciliation of trading populations. The Procedures Committee has determined that notices served terminating ISDA contracts should, in principle, be regarded as the appropriate date for recognizing trade termination dates (barring consensual agreement between the parties of an alternative).
- Continued discussion around the topic of appropriate termination dates under derivatives contracts.
- Promotion of the usage of the Global Close Balance Sheets as a key means toward reconciling non-trading balances in the most efficient manner.
- Exploration of a common approach toward an issue having to do with the release of certain Affiliates' assets held in custody by other Affiliates.
- Issues and strategies around data sharing amongst Affiliates.
- Providing guidance to Affiliates in regard to claims filing requirements in certain jurisdictions.
- Agendas for future in-person meetings such as the Global Close Seminar and Second Protocol Meeting (see descriptions of these meetings later).
- Ongoing discussions around settlement of intercompany trading and non-trading balances.

Procedures Committee calls will continue to occur approximately every two weeks.

III. Global Close Seminar

In response to inquiries from the other Official Representatives as to the robustness and reliability of the Global Close, LBHI hosted a Global Close Seminar (the "Seminar") on September 23-24, 2009.

The content of Global Close Seminar was developed and presented by a highly-experienced group of Lehman professionals, now working in the LBHI estate, with years of hands-on familiarity with the Lehman financial systems and organization. The Seminar was attended by all of the Signatories and Participating Affiliates with the exception of Lehman Brothers Bankhaus. The agenda for the Seminar included:

- Overview on the Global Close itself – why it was done, who was involved, and how it was executed.
- Presentation of the Information Technology environment used in the Global close, given by Barclays professionals who implemented the IT platform.
- A series of presentations around historical controls in place at Lehman that were leveraged to execute an effective close of books at September 14, 2008.
- Description and demonstrations of the various systems that drove intercompany balances.
- An opportunity for each Official Representative to work in a one-on-one workshop setting with experienced Lehman Brothers Legal Entity Controllers.

All of the attendees to the Global Close Seminar expressed their gratitude to LBHI for organizing this event. Universal feedback was that the Seminar was useful, and advanced the objective of being able to rely on the Global Close as the appropriate starting point for reconciling intercompany balances.

IV. Second Protocol Meeting

The Signatories and Participating Affiliates, gathered again on October 15-16, 2009 in Amsterdam. Rutger Schimmelpenninck and Eddie Middleton once again served as co-Chairmen of this Second Protocol Meeting.

Each of the Official Representatives were again given the opportunity to provide a brief Case Update of the proceedings in their respective jurisdictions. Following the Case Updates, the meeting agenda turned to the following topics:

- **Global Close update:** In light of the various efforts (the Global Close Seminar, the Global Close White Paper, sharing of September 14, 2008 Balance Sheet information) that had been undertaken by LBHI to shed light on the Global Close, each Official Representative was asked if they now had a greater level of comfort around the notion of utilizing the Global Close for the purpose of reconciling intercompany balances. A resolution was agreed to that the Global Close shall be used to determine non-trading intercompany balances, subject to: (i) further analysis of material breaks; and (ii) approvals, where required, of

creditors' committees and/or Tribunals, as defined in the Protocol[1].

- **Intercompany Settlement Guidelines:** A document was presented by LBHI that set forth its proposed approach for settling intercompany trading and non-trading balances with each of the Affiliates. LBHI requested feedback from the other Official Representatives, and proposed integrating this feedback into a revised set of Guidelines that all Official Representatives could use as a common framework for commencing bilateral settlement discussions with each other, with the Procedures Committee continuing to serve as a forum for general oversight and discussion.

- **Update on reconciliation of Trading positions:** Since the First Protocol Meeting, the Signatories and Participating Affiliates had undertaken a concerted effort to reconcile trading populations and agree termination dates. The update provided at the Second Protocol Meeting was that, as of October 9, 2009, 27% of derivative trade legs had been agreed and reconciled, and 25% of ISDAs had been mutually agreed to have been terminated. This was considered to be a disappointing result at the time; however, further progress has been made since the Second Protocol Meeting. It was agreed at the Second Protocol Meeting that the group would work toward having trade populations reconciled by December 31, 2009.

  During the Second Protocol Meeting, some further discussion was held in respect of alternative approaches toward agreement of termination dates for derivatives. Various options were discussed, and ultimately, it was determined that the ISDA Termination Date was the technically correct and legally sound approach.

Further to the above, a series of topics relating to interactions with LBIE were discussed (refer to following section "Interaction with LBIE").

It was determined that the Third Protocol Meeting would take place in January 2010.

V. Third Protocol Meeting

The Signatories and Participating Affiliates gathered for a third time on January 12-13 in New York. Rutger Schimmelpenninck and Eddie Middleton once again chaired this Third Protocol Meeting.

Each of the Official Representatives provided Case Updates of significant developments in their respective proceedings since the Second Protocol Meeting. Following the Case Updates, the agenda covered the following topics:

- **Data Sharing:** Representatives from LBHI discussed the efforts that had gone on since the chapter 11 filing to preserve Lehman Brothers data. LBHI has preserved access to 754 applications which were in use at Lehman prior to the bankruptcy, as well as terabytes of user-created data such as emails, archived hard

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[1] Lehman Re Ltd., as one of the Participating Affiliates, has reserved the right to negotiate and/or agree with relevant counterparties in respect of the nature of balances (i.e. trading or non-trading). The LBI Trustee is performing an ongoing analysis and therefore could not agree to the resolution at this time.

Japan commented that they continue to discuss positively, with internal and supervisor approval required.

copy files, instant messaging, etc. Several of the Affiliates have submitted requests to LBHI regarding sharing of this data. To that end, LBHI discussed the legal framework in which data could be circulated among the Signatories and Participating Affiliates, and the potential limitations to data sharing.

- **LBHI Claims Update:** LBHI representatives provided the group with a high-level update on the magnitude and types of claims which have been submitted in the chapter 11 cases, as well as the resources LBHI has devoted to analyzing such claims. The importance of Affiliate cooperation in respect of intercompany claims was further emphasized.

- **Non-trading Update:** The Signatories and Participating Affiliates discussed progress made to date in respect of agreeing non-trading balances. The Signatories and Participating Affiliates confirmed the resolution of the Second Protocol Meeting regarding the Global Close, with further positive statements made regarding the usage of the Global Close figures as the appropriate starting point for non-trading reconciliation.[2] LBHI updated the group on ongoing discussions taking place with various Affiliates, including LBIE and other entities in Administration in the UK.

- **Trading Update:** An update was provided on the process of settling intercompany trading balances. Substantial progress has been made in the area of reconciling trade populations, with 97% of the derivative population within LBHI's control facing Affiliates under the control of other Official Representatives now having been reconciled. Further, termination dates have been agreed for 72% of the master agreements governing the derivative trades between entities under LBHI control facing Affiliates under the control of other Official Representatives.

- The Third Protocol Meeting was supplemented by two seminars organized by LBHI (i) on best practices in regard to derivatives unwind strategies, for interested Affiliates with street-side derivatives trades, and (ii) for sharing common issues and strategies regarding structured products, for those Affiliates who issued structured notes, warrants, certificates, etc.

VI. Interaction with LBIE

The Joint Administrators of LBIE[3] have not signed the Protocol and did not attend the First, Second, or Third Protocol Meetings. The Joint Administrators have also not participated in the Procedures Committee, but instead have proposed an alternative approach to the multi-lateral discussions held by the Signatories and Participating Affiliates in the form of a bilateral Memorandum of Understanding (the "MoU"). At a meeting in London on July 16, 2009, LBIE presented to attending Signatories and Participating Affiliates its role in the Global Close process and a draft version of its MoU.

The Signatories and Participating Affiliates have entered into bilateral agreements with LBIE, they have also taken a common

[2] See footnote 1.

[3] The stance to not sign the Protocol also pertains to the other UK entities in Administration and/or under the purview of the Joint Administrators.

approach in facing LBIE on certain topics. For example, for reasons of data privacy and confidentiality, LBIE has been unable to share any information which is commingled with that of another Affiliate or third party. A letter is being prepared which states that, in respect of all Affiliates who choose to sign the letter, those Affiliates will not object to LBIE sharing data with an Affiliate which contains commingled data of another Affiliate. The hope is that this will facilitate the flow of necessary information from LBIE.

LBIE will continue to have the opportunity to sign the Protocol, attend future Protocol Meetings, participate in the Procedures Committee, receive conclusion minutes of the Protocol Meetings, etc.

VII. Ongoing Workstreams and Upcoming Activities

The group of Signatories and participating Affiliates continues to press forward with the various issues facing the International proceedings of the Lehman Brothers companies. Some highlights of ongoing work and future activities include:

- The process of agreeing intercompany derivatives trades began in November 2008, and continues with frequent meetings and information sharing between Affiliates. As of January 2010, over 90% of intercompany derivative trades have been reconciled, with a goal of completing the remaining 3% by February 28, 2010.

- LBHI has proposed to Affiliates that the LBHI platform, with appropriate oversight from Affiliate counterparties, be used for valuing Affiliates' derivatives and structured notes (where relevant).

- The Intercompany Settlement Guidelines are in the process of being updated to reflect comments received from Affiliates following their initial presentation at the Second Protocol Meeting. While most of the steps pertaining to trading balances (derivatives, financings) between Affiliates have been underway for some time, the process for agreeing non-trading intercompany balances is largely still ahead. Affiliates must undertake to address this now, with similar process and reporting as that in the derivatives reconciliation process to be implemented.

- The Procedures Committee continues to meet approximately every two weeks, with broad participation and a full agenda of topics present on every call.

- The Fourth Protocol Meeting is scheduled for April 21-23, 2010, in Hong Kong. The Signatories and Participating Affiliates have committed to holding such Protocol Meetings on a quarterly basis going forward.

Dated: January 15, 2010
New York, New York

Edward S. Middleton, co-chair

Rutger J. Schimmelpenninck, co-chair

Schedule A

Signatories	
Signatory	Entities
Rutger Schimmelpenninck, in his capacity as bankruptcy trustee ("curator") for Lehman Brothers Treasury Co. B.V.	• Lehman Brothers Treasury Co. B.V.
Edward Simon Middleton as one of the Joint and Several Liquidators, without personal liability, of and for and on behalf of the Lehman Hong Kong Group; and as Joint Official Liquidator of Lehman Brothers Equity Finance (Cayman) Limited (In Official Liquidation)	• Lehman Brothers Asia Holdings Limited (In Liquidation) • Lehman Brothers Asia Limited (In Liquidation) • Lehman Brothers Futures Asia Limited (In Liquidation) • Lehman Brothers Securities Asia Limited (In Liquidation) • LBQ Hong Kong Funding Limited (In Liquidation) • Lehman Brothers Nominees (H.K.) Limited (In Liquidation) • Lehman Brothers Asia Capital Company (In Liquidation) • Lehman Brothers Commercial Corporation Asia Limited (In Liquidation) • Lehman Brothers Equity Finance (Cayman) Limited (In Official Liquidation)
Chay Fook Yuen for himself, Yap Cheng Ghee and Tay Puay Cheng, as Joint and Several Liquidators, without personal liability, of and for and on behalf of the Lehman Singapore Group	• Lehman Brothers Investments Pte. Ltd. (In Creditors' Voluntary Liquidation) • Lehman Brothers Finance Asia Pte. Ltd. (In Creditors' Voluntary Liquidation) • Lehman Brothers Commodities Pte. Ltd. (In Creditors' Voluntary Liquidation) • Lehman Brothers Pacific Holdings Pte. Ltd. (In Creditors' Voluntary Liquidation) • Sail Investors Pte. Ltd. (In Creditors' Voluntary Liquidation) • Lehman Brothers Asia Pacific Holdings Pte. Ltd. (In Creditors' Voluntary Liquidation)
Lehman Brothers Holdings Inc., on its own behalf and on behalf of its affiliates that are debtors in cases pending under chapter 11 of Title 11 of the United States Code	Lehman Brothers Holdings Inc. LB 745 LLC PAMI Statler Arms LLC Lehman Brothers Commodity Services Inc. Lehman Brothers Special Financing Inc. Lehman Brothers OTC Derivatives Inc. Lehman Brothers Derivative Products Inc. Lehman Commercial Paper Inc. Lehman Brothers Commercial Corporation Lehman Brothers Financial Products Inc. Lehman Scottish Finance L.P. CES Aviation LLC CES Aviation V LLC CES Aviation IX LLC East Dover Limited Luxembourg Residential Properties Loan Finance S.a.r.l. BNC Mortgage LLC Structured Asset Securities Corporation LB Rose Ranch LLC LB 2080 Kalakaua Owners LLC Merit LLC LB Somerset LLC LB Preferred Somerset LLC
Dr. Michael C. Frege in his capacity as insolvency administration ("Insolvenzverwalter") of Lehman Brothers Bankhaus AG (in Insolvenz)	• Lehman Brothers Bankhaus AG (in Insolvenz)

Neil Singleton, as one of the joint and several administrators of the Lehman Australia Group	• Lehman Brothers Australia Granica Pty Limited (Subject to Deed of Company Arrangement), • Lehman Brothers Real Estate Australia Commercial Pty Limited (Subject to Deed of Company Arrangement), • Lehman Brothers Australia Real Estate Holdings Pty Limited (Subject to Deed of Company Arrangement), • Lehman Brothers Australia Finance Pty Limited (Subject to Deed of Company Arrangement), • Lehman Brothers Australia Holdings Pty Limited (Subject to Deed of Company Arrangement), • Lehman Brothers Australia Limited (In Liquidation), • LBHV 1 Pty Limited (Subject to Deed of Company Arrangement), • HV 1 Pty Limited (DOCA), • HV 2 Pty Limited (DOCA)
James W. Giddens, as Trustee for the Liquidation of Lehman Brothers Inc. under the Securities Investor Protection Act.	• Lehman Brothers Inc.
Mr. Michiel R.B. Gorsira in his capacity of Court appointed receiver ("curator") of Lehman Brothers Securities N.V.	• Lehman Brothers Securities N.V.
PricewaterhouseCoopers Ltd., Zurich, Christiana Suhr-Brunner and Pascal Portmann, appointed bankruptcy administrators of Lehman Brothers Finance S.A. in liquidation.	• Lehman Brothers Finance AG (in liquidation), a/k/a Lehman Brothers Finance SA (in liquidation)
Maître Jacques Delvaux and Maître Laurent Fisch, court appointed bankruptcy receivers of Lehman Brothers (Luxembourg) Equity Finance S.A., and court appointed Joint Liquidators of Lehman Brothers (Luxembourg) S.A.	• Lehman Brothers (Luxembourg) Equity Finance S.A. (en faillite) • Lehman Brothers (Luxembourg) S.A. (in liquidation)

Statement of Robert J. Jerome

I have been in the Financial Services Industry for 38 years. I have also been an investor. The integrity of the Financial Services Industry and the Banking Industry rests on their ability to provide the client with an accurate and presumed verifiable accounting of their positions and balances on an ongoing basis. This integrity is further enhanced by the presence of the SIPC Logo. The very name itself, Securities Investor Protection Corporation, is in part responsible for instilling investor confidence, one benefit being that the Industry was able to migrate from a Certificate based platform to a Book Entry system where clients are matched electronically to their holdings, all of which are reported on their Client Statements.

In addition to the Account Statement, clients are also notified whenever there is account activity on their behalf by a Trade Confirmation. These records of trade activity are also captured on the Monthly Statement and are the core of the Financial Institution's reporting to clients of changes in their accounts. Taken in its entirety, it is why clients are willing to leave their assets on deposit with a Financial Institution.

For approximately 15 years, my in-laws maintained first a joint, and then two separate Trust Accounts with Bernard L. Madoff Investment Securities, LLC ("Madoff"). During those years, they received hundreds, if not thousands, of trade confirmations detailing activity in their accounts. They also received an uninterrupted flow of monthly statements, recapturing both the previously mentioned trade activity as well as a summary of their positions and total equity as of the statement close date. This continued right up to November 30, 2008. During this time they made withdrawals based solely on the reliance that there was sufficient capital remaining in their account to continue to sustain the

investment activity that had historically occurred in these accounts. Additionally, they paid in to the Internal Revenue Service hundreds of thousands, if not over $1 million, in taxes on short term gains from realized profits in their accounts.

This brings me to the present reality. Their final statement from Madoff showed a combined equity in excess of $4 million. Under normal circumstances, they could expect a combined $ 1 million from the SIPC coverage on their two separate Trust Accounts.

However, they are now living under the uncertainty that they could see nothing. Madoff Trustee, Irving Picard, has taken the stance that, given the circumstances of the fraud, Madoff customers are entitled to SIPC payments only for their net investment up to $500,000. I would be the first to admit that I do not know every line and clause of the Securities Investor Protection Act, but in 38 years of experience I have never heard of this. And I am reasonably certain that, if this were so, it should be easily identified in SIPC's guidelines and in the disclosures made by every SEC-regulated broker/dealer. I have seen no evidence of such disclosures to investors. Moreover, it would also be reasonable to expect that this would have come up at sometime in the past.

In short, it gives the impression that SIPC protects the Financial Services Industry rather than the customers of the Financial Services Industry. This is completely mis-guided and, in my opinion, irresponsible. Let me explain my position: Netting of withdrawals against deposits gives the impression that clients knew they were pulling a fast one and now they have been caught. SIPC and the government regulatory agencies are completely shifting the blame from the guilty to the innocent parties. The guilty parties start, of course, with Madoff and his associates. However, the regulatory failures here are beyond comprehension. Year after year Madoff received a clean bill of health from the Securities

and Exchange Commission on his operations. Based on this alone it would appear that Mr. Picard is aiming his legal arsenal at the wrong enemy. He is punishing the victims instead of the perpetrators.

The last point I would make is this: if in fact it has been determined that no trades ever occurred, that there were no dollars actually invested for profit or loss, that everything that appeared on confirmations and statements was fictitious and that 1099 reporting was pure fantasy, then it would seem that every client who paid taxes every year on gains that never occurred should be entitled to have those monies returned, irrespective of how far back in time it occurred. These taxes were paid with real dollars from real accounts belonging to real people. If indeed no trades ever occurred, then the IRS has an obligation beyond the five years already acknowledged to refund monies that, in light of events, they were never entitled to in the first place. Fair is fair: customers should not be denied at every turn (i.e. SIPC and the IRS). In the Notice of Trustee's Determination of Claim dated October 19, 2009 denying my in-laws of any restitution from SIPC, Trustee Irving H. Picard states "As noted, no securities were ever purchased by BLMIS for your account. Any and all profits reported to you by BLMIS on account statements were fictitious." If this is indeed the case, then any taxes paid to the IRS over the course of my in-laws association with BLMIS were by definition paid in error.

I offer for your consideration that Irving and Annette Jungreis, my in-laws, are both first generation children of Eastern European immigrants born as proud citizens of the United States. With the outbreak of World War II, my father-in-law was drafted in the United States Army and served in the European Theater. For his service he was decorated with the Bronze Star for bravery in his role as a medic bringing aid to wounded soldiers on

the battlefields. After the war he married my mother-in-law, and, starting with very little, my father-in-law built a modestly successful business. They have two children; my wife and her older sister. Upon liquidating his business to retire, my in-laws invested everything they had with BLMIS. Their living expenses were exclusively drawn from the appreciation of their investments. They are now both into their eighties and suffer from a variety of medical issues, all of which have been exacerbated by their present emotional stress. Their fear of not having sufficient funds to provide for their lives is all consuming.

In closing, customers such as my in-laws rely on their government to protect them from circumstances like this as a last resort. They rely on a trademark such as the SIPC logo and they rely on the oversight of agencies and bodies who, purportedly, exist to protect them from financial harm. It is not their fault that these systems broke down and failed in every aspect. Moreover, it goes against every fiber that they are told that the rules and regulations they trusted just don't apply in this case because it is different. In every sense of the word, they are victims of an unprecedented financial disaster and should be able to rely on whatever resources were designed to protect them. SIPC is one of those resources.

October 26, 2009

Robert F. Jerome
25A Bearwoods Road
Park Ridge, New Jersey 07645

Lenore Schupak
December 8, 2009

Dear Congressman Garrett:

Thank you for participating in the Subcommittee on Capital Markets hearing on Dec. 9, 2009. Kindly enter my letter for the record in support of two proposed Amendments to SIPA to speed the process for paying out SIPC claims, and to preclude clawbacks from innocent investors.

BACKGROUND

I am a Madoff victim. My elderly parents, brother, sister and I each had direct accounts with Bernard L. Madoff Investment Securities, Inc., LLC (BLMIS) and we have all suffered devastating financial losses.

We each routinely received written trade confirmations, monthly statements and year end 1099's from BLMIS. We relied on the information in those statements as did the IRS. We thought we had invested in a conservative, well diversified portfolio composed of about 35 blue chip companies, with a highly credentialed Wall Street expert. On December 11, 2008 we learned differently.

It is a year since we learned that our savings had been stolen; we have not received any payment from SIPC and have no idea when we might receive it. Any tax refund, which is gratefully appreciated, will be woefully short of the taxes we paid over the years on Madoff's phantom income. These monies will not make us whole, but are essential for our basic necessities.

SLOW PAYOUT BY TRUSTEE AND SIPC

We relied upon SIPC, FINRA and the SEC to properly do their jobs and protect investors as Congress and the SIPA law had intended. As is well documented, by the SEC, these agencies did not protect innocent investors. Now, when the SIPC has an opportunity to fulfill its obligations, it has fallen short.

The Trustee and SIPC have invented a new way of defining the provisions of SIPA and invented a cash in/cash out methodology which is not consistent with SIPA law. Not only is this methodology denying payments to innocent victims, it is creating busy work with all the forensic accounting that is being performed to support the cash in/cash out formula, thus creating a log jam for processing claims and generating unnecessary billable hours for the law firms and accounting firms involved. It has been well over a month since the Trustee and SIPC announced that they identified the "net loser" claims, yet to date payments have not been made to all the innocent "net loser" victims. What is taking so long?

On November 20, 2009 the Trustee filed a Notice of Hearing on Second Application for Interim Compensation ("Notice"). The Trustee and Baker &Hostetler LLP (B&H) have requested a "reduction in the amount of hold back applied to their fees from 20% to 15%". They have also requested that the 15% be applied retroactively to December 2008, effectively producing a 5% bonus to the Trustee and B&H. In light of the slow speed that claims are being processed,

perhaps a more appropriate holdback would be 25%, not 15%. Why should their payments be accelerated at this time?

Also, in the November 20th Notice, it indicates that Alix Partners, the forensic accounting and consulting firm hired by the Trustee, was listed as submitting its final invoice for services ending February 28, 2009. If the February 2008 date is correct as published in the Notice, it raises the question of why the SIPC payouts have been performed in such a long protracted timeframe when the forensic work was completed in February. For the record, the February 28, 2009 date published in the Notice should be confirmed, or there should be an explanation as to why the payouts are delayed even though the forensic accounting had been completed in February.

SIPA intended its customers to be paid-out promptly, and surely this should be enforced. As an incentive to comply with the law in a timely manner, SIPC should be compelled to pay interest if claims are not processed promptly.

NO CLAWBACK OF INNOCENT INVESTORS

Although I am not subject to clawback under the Trustee's methodology (and theoretically I would benefit from clawbacks that add to the estate funds to which I would receive a pro-rata share), I oppose clawback from innocent victims. Indeed, any clawback should be from the SEC which allowed this fraud to continue for so many years, even though they had ample opportunity, resources and warnings to stop Madoff.

Ms. Helen Chaitman of Phillips Nizer LLP has proposed two amendments to SIPA which are intended to cure two very serious issues dealing with clawback and the slow rate at which claims are being processed. I support these proposed amendments and urge you to support them and make them law. These are a necessary step to help restore confidence in the capital markets.

Thank you for your consideration and due diligence in this very important matter.

Sincerely,
Lenore Schupak
53 Norfolk Street
Bergenfield, NJ 07621

STATEMENTS SUBMITTED

BY

MADOFF VICTIMS

AND

TWO EXPERTS

TO

THE HOUSE SUBCOMMITTEE ON CAPITAL MARKETS

Washington D.C.

December 9, 2009

Submission on Behalf of Madoff Victims

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Statement of Norma Hill

I am a 69-year-old widow. I am responsible for the partial support of a retarded stepson, a promise that I made to my deceased husband. I learned on December 11, 2008 that Bernard Madoff was a thief and that my life savings - left to me by my husband and added to over twenty years of my own earnings - had been lost. My account with Bernard L. Madoff Investment Securities, LLC ("Madoff ") had a balance on November 30, 2008 of $2,400,000. This account was opened as an IRA account, with FISERV as the custodian.

Over the years I have taken withdrawals from the account in order to fund my living expenses because, once I retired, the account was my sole source of income. Naturally, I have paid income taxes on the money withdrawn. Since that income was cut off, I have tried to sell my home because I can no longer afford to maintain it. Unfortunately, the real estate market is very depressed in my area and I have not been able to sell my house.

Moreover, once I sell it, I am deeply concerned that Irving Picard, the SIPC trustee appointed in the Madoff liquidation, will sue me on a "clawback" theory and take away the proceeds of my home in view of the fact that I took out more from my IRA than I had invested in it. If I am sued by Mr. Picard I will be left destitute and homeless.

I became an American citizen many years ago. I stood in a court room, put my hand over my heart and pledged allegiance to this great country. I walked out of the court room and felt a sense of pride that I was now a citizen of this great nation. It is hard to believe that the law in the United States can make a person liable to repay money that she has withdrawn from her own IRA savings account.

Statement of Norma Hill

Mr. Picard, in my view, represents the monstrous greed of Wall Street. Clearly Mr.Picard is suing innocent investors only so that he can enrich SIPC - the entity representative of all SEC-regulated broker/dealers - at the investors' expense. I ask the members of Congress to stand up to Wall Street on behalf of the average American who works his entire life and saves money for his retirement. Please clarify that clawback litigation against customers of an SEC-regulated broker/dealer is impermissible where the customer had a "legitimate expectation" that his statements were accurate. Surely, this was the intent of the Securities Investor Protection Act.

How can any American have confidence in our capital markets if we can be sued for taking money out of our own IRA accounts?

October 22, 2009

Norma Hill
9 Wampus Close
Armonk, New York 10504

Statement of Calvin Berkowitz

I am an 80 year-old veteran of the Korean War, in which I suffered injuries for which I receive a service-connected disability pension. My wife is a Holocaust survivor. We live in Brooklyn, New York. Before I retired, I was self-employed in the jewelry business.

My wife and I began investing in Avelino & Bienes approximately 30 years ago. In 1992, the SEC closed Avelino & Bienes because it was an unregistered mutual fund. It was disclosed at the time that Bernard Madoff handled the investments for Avelino & Bienes. According to information published in the Wall Street Journal at the time, the SEC investigated Madoff and found no evidence of fraud. As a result, we took all of our money and put it directly into Bernard L. Madoff Investment Securities, LLC ("Madoff").

One of my sons had a friend who was a forensic accountant with the SEC. I asked the SEC accountant about Madoff and he told me that Madoff was "whistle clean." I did not use a computer but every month of my Madoff investment I would hand-write out a detailed statement of the activity in our Madoff account. I submitted that statement with our tax returns to the IRS and to New York State. Thus the government was made aware of these purported trades and collected tax on them.

In August 2008, I was diagnosed with central nervous system lymphoma, brain cancer. When the Madoff bubble burst on Dec 11, I could not initially comprehend what had happened. My wife and I each had an account with Madoff: a direct account and an IRA account. The November 30, 2008 balance in each account was approximately $1. 5 million. In addition, I had an IRA account with Madoff which had a balance, as of November 30, 2008, of approximately $2.5 million. All of that money was lost.

We have always lived very simple lives. We still live in the house we bought in 1972 in Midwood, Brooklyn. We have no mortgage on our home and have conserved our money so that

Statement of Calvin Berkowitz

we could donate large amounts to charity. In memory of our son, Zvi, who died at a young age, we endowed a program to help at-risk girls from poor families in Israel. We sponsored the tuition of dozens of children in local schools and provided for the hungry in Brooklyn and in Israel. Of course, a substantial portion of our money was paid to the Internal Revenue Service in taxes on the short term capital gains appreciation in our Madoff account which was taxed at a very high rate.

Because of our Madoff investment, I retired at the age of 62 and we never took out long term care insurance. We felt confident that we had more than enough money to provide for ourselves in our old age.

Under the formula that Mr. Picard is using, we took out approximately $950,000 more than we invested in each of our direct accounts. Thus, we are each subject to a clawback of approximately $950,000 . In addition, being self-employed, I had no company pension and had to save for my retirement in a self-directed IRA with Madoff that had approximately 2.5 million in it. Thus, from what I thought would be my retirement income I might now be subject to clawback of over $200,000. I live in daily fear of this clawback because it would force us out of our home and take away from us the little money we have, including the tax refund we have recently received, based on the five-year carry back of our theft loss.

Every trade confirmation we received from Madoff indicated that we had SIPC insurance. Yet, now when we need the money, SIPC is not paying us at all and instead, is claiming that we owe them money. In my view, SIPC is behaving illegally and yet no one is interceding to enforce SIPA against SIPC. Mr. Picard's threat of clawback is adding insult to injury. This will create a virtual blood bath among Madoff victims, for no reason other than to enrich SIPC at our expense. I understand that SIPC is not a government entity but, surely,

Statement of Calvin Berkowitz

Congress has the power to prevent SIPC from further destroying our lives and the lives of others who invested their life savings in Madoff.

Calvin Berkowitz
1226 East 22nd Street
Brooklyn, New York 11210

Statement of Leonard Forrest

On Dec. 13th of this year, I will be 81 years old. Exactly one year prior, Dec 13, 2008, two days after Bernard Madoff turned himself in, and on my 80th birthday, I put my two heavily-mortgaged homes on the market and hoped, against all odds, for quick sales.

All of my money and my wife's money, except for a very small cash balance, was invested in Bernard L. Madoff Investment Securities ("Madoff"). Hearing the news on Dec. 11, 2008, we knew that our cash would not last very long after paying our monthly fixed expenses. We were forced to sell our homes and most of our possessions very quickly at prices significantly below market value in order to survive. After satisfying the large mortgages, we used whatever residual funds we had to purchase a small home in a modest community.

The physical and emotional toll on both of us has been enormous. Afflicted with heart disease, I was not in good health prior to this event. Now I suddenly had to uproot and move. I had to do this while under constant stress about my health and about the fact that we were suddenly without funds. My wife had the horrible fear that I would not make it. Now we have the fear of clawback. This continual stress has taken a terrible toll. Now I can add stress related, chronic, debilitating back and chest pains, chronic sleep problems, and the loss of 30 of my 155 pounds to the rest of my health problems.

I have worked hard my entire life. I began working when I was nine years old. I am a W. W. II U.S. Navy Veteran and served my country proudly. I ran my own successful electrical supply business for 37 years, giving many employees the opportunity to support their families and become productive community members. Until retirement due to heart disease in 1993, I contributed to Social Security for 56

consecutive years. I have worked hard and honorably, supported myself and my family, and contributed to charities regularly. That all changed on Dec. 11, 2008.

Prior to investing directly with Madoff, I had indirect Madoff accounts with Avellino and Bienes: a regular account and an IRA. In 1992 the SEC shut them down. With the assurance of the SEC that no fraud was found at Madoff, I transferred my investments to two direct Madoff accounts, a regular account and an IRA. All the proceeds from the sale of my business and the entire proceeds of my defined benefit pension were invested with Madoff. In 1992 my wife opened a direct account with Madoff. She also rolled over her IRA into an indirect, Madoff feeder fund. The total of our last statements (November 30, 2008) of our three direct investments was $14,444,000. My IRA account had $8,945,261. My regular account had $1,795,999. My wife's account had $3,702,740. The indirect feeder fund IRA had a balance of $260,515.

Although I was accepted in Mr. Picard's Hardship Program, according to his definition of net equity, we will receive no SIPC funds. We made withdrawals over the years from accounts that we had every reason to believe were legitimate. We did not live lavishly, considering the balances that we thought we had. We paid income taxes on phantom income every year since 1992 and the money to pay those taxes was withdrawn from our accounts. According to Mr. Picard's accounting, those withdrawals contributed to our negative net equity.

My IRA account's net equity was directly affected **by required minimum IRA distributions which were based on phony account balances**. Since we did not live a lavish lifestyle and did not need the full IRA required minimum distribution, we reinvested the money in my regular account, used those funds to pay the taxes on the IRA

withdrawals and whatever was left over is now gone with everything else. The total of my IRA deposits was $1,369,012. The total of my **required minimum withdrawals** was $2,043,667.

My regular Madoff account had deposits of $2,330,131 according to my calculation and withdrawals of $2,095,250 according to Mr. Picard. He did not give me credit for a full transfer of deposits plus profits from a prior joint account that I had had with my wife. This regular account was used to pay the majority of our living expenses, our taxes including the taxes on my required minimum IRA withdrawals, our mortgages, and all other expenses that we had every reason to believe we were able to afford. The total of my withdrawals was $3,908,750.

My wife's account had deposits that totaled $2,599,923 according to our accounting, but only $1,930,816 according to Mr. Picard. She did not get credit from Mr. Picard for a good portion of those deposited funds. As with my account, Mr. Picard did not give credit for a full transfer of deposits plus profits from the prior joint account that she had with me. He also did not give her credit for most of her inheritance from other Madoff accounts. This is significant because, when my mother-in-law died in 2002, the **estate taxes were paid based on the value of her assets in her Madoff accounts. The statements which were used to determine those values are now deemed to be phony.** The taxes were paid using the funds in the Madoff accounts. Once the estate was settled, the estate attorney directed Madoff to make deposit transfers into my wife's account for her share of the inheritance. According to Picard, my wife will receive credit for just a fraction of her inheritance deposits, partly because **of the withdrawal of funds to pay for estate taxes which were all based on phony statements as well as the withdrawals**

for the payment of income taxes on phantom profits over the years. These withdrawals to make required government payments affected my wife's net equity. According to Mr. Picard, my wife's withdrawals of $2,423,109 exceed her deposits.

Mr. Picard has sent us only one determination letter, but has sent us accounting tables for each of our accounts. They are all negative. Mr. Picard has not informed us as to whether or not we will be sued for clawback. We can only speculate and we live in abject fear.

This whole "Madoff" event has caused and continues to cause both my wife and myself constant crippling anxiety. Should we now be faced with clawback, we would have to give up our new home and move again. We don't know where. We would be unable to support ourselves.

Were Mr. Picard to pursue us for clawback, he would be penalizing us for something we had no control over. We, the victims, would be treated like the criminals. We believed the SEC when they said they found no fraud at Madoff and we thought we had a legitimate conservative investment. We had a reasonable expectation that we had plenty of funds to withdraw from our accounts and that there would be a significant balance left over for our peace of mind and security in our final years. We withdrew what we needed to live on and to pay taxes on phantom income and required IRA distributions, and we withdrew the required minimum IRA distributions based on phony statements. We were given almost no credit for deposits that were transfers from other accounts that were deemed to lack "net equity" in Picard's definition. Those accounts, however, were reduced by withdrawals to pay estate taxes that were based on phony statements and income taxes on phantom profits. The government has been enriched over the years by

Statement of Leonard Forrest

this fraud and, partly because of this enrichment, we are now being deprived of SIPC insurance and also subject to clawback litigation. We were assured by the SEC and believed we were insured by the SIPC and could never have dreamed of either the fraud or the interpretation of net equity that Mr. Picard has put forth.

We cannot believe that our government would let this happen to us. There is no justification.

October 22, 2009

Leonard Forrest
2100 SW Keating Drive
Port St. Lucie, Florida 34987

Statement of Michael Stein

My name is Michael Stein. I am an 84-year old retired business man who has devoted much of my life to philanthropic and community service. I write this statement to address the inhuman attempt of Irving Picard, Madoff Trustee, to cause further grief to many people like myself who have already been victimized by Bernard Madoff.

Picard, for his purposes and that of SPIC, has invented his own definition of "net equity", not supported by law, and he has created two classifications of victims which he erroneously calls "winners" and "losers."

What Picard calls "net equity' is really "net investment"...that is the difference between money invested and the money withdrawn from that investment for whatever reason. He allows no consideration for taxes paid on supposed income, the value of money honestly invested, the legitimate expectations of the investor, or the fact that we had every reason to believe that the money in our Madoff account was our money to do with as we wished.

As for "winners" and "losers," all Madoff investors are losers who have experienced a life changing event. The difference is that different people employed different investment strategies...all of them legitimate. . Those Picard calls "losers" decided, for their own reasons, to leave their money in and watch it grow. They could have withdrawn funds at any time, but decided not to. That was their choice!

Others, whom Picard calls "winners" had a different strategy and/or needs. They withdrew funds to pay taxes, to support philanthropic activities which were based on expectation of Madoff income, for living and medical expenses and/or for diversification, all appropriate uses for money they believed was their money.

Statement of Michael Stein

In my case, all the money I took out of my Madoff account over and above the amount I invested went to taxes and charities, alone. If Picard is successful in clawing back that money, (the ugliness of that word "clawback" gives me the chills), I would not have it, and I would have to sell my homesteaded home to survive....a sorry end to a life devoted to public service and philanthropy.

With that in mind, I urge you to prevent the use of clawbacks by the Trustee except in cases where there is evidence of complicity or knowledge of Madoff's fraudulent activities.

I know a great many victims, both "winners" and "losers" and it is clear that their anger is not directed at each other but rather at Madoff for cheating them, at the SEC for failing to protect them through its consistent pattern of negligence, at SIPC for its refusal to cover their losses as required by law, and at the IRS for allowing only five years refund of taxes paid on fictitious income when, in fact, many victims paid taxes on fictitious income for many more than five years and the government has that money to which it is not entitled.

All Madoff victims, regardless of how Picard classifies them, look to our elected representatives in Congress to redress these miscarriages of justice.

You can do that by protecting us from "clawback...a word whose ugly and threatening sound adds anguish to injury.

You can do that by ordering the SEC to instruct SIPC to honor claims as the law prescribes.

You can do that by recognizing that we are in this mess largely through the failure of one government agency, the SEC, to protect us, and you can help assuage that disaster

Statement of Michael Stein

by ordering another government agency, the IRS, to give us back the money they have no right to keep by refunding all taxes paid on fictitious income from the beginning.

I ask you to do these things because it is right and by so doing to justify our faith in Congress as the protector of the American people and the American tradition of fair dealing.

I thank you for your attention and for your earnest consideration of the arguments and information I have presented.

For those who want to know more about me I am adding below a list of my activities on behalf of the community and the many philanthropies for which I have worked and contributed.

Mike Stein's Community and Philanthropic activities:

1. I am the longest serving trustee of the Long Island Jewish Medical Center where I served as Vice Chairman prior to the merger which produced the North Shore/ LIJ Health system where I was awarded a Life Trusteeship in recognition of my many years (46) of service.
2. I was co founder, president, chairman, and now chairman emeritus of the Washington Institute for Near East Policy. I'm sure those of you who are involved with Middle East policy are familiar with this Institute which provides scholarly research, analysis, policy ideas, and often people for our government.
3. I serve on the Board of Regents of the Hebrew University of Jerusalem where I have been awarded an honorary fellowship.

Statement of Michael Stein

4. I am a (founding) trustee of the Morse Geriatric Center in West Palm Beach and of the Kramer Senior Resource Center.
5. I serve on the Executive Committee of the Palm Beach Civic Association and co-chair its Health Care Committee. Previously, I served on the Town of Palm Beach's Medical Care Commission.
6. I am a board member and Secretary Treasurer of the Palm Beach Police Foundation.
7. I was the founding President of the Gustave Hartman YM-YWHA in Queens, N. Y. and a VP of the Associated Y's of greater N. Y.
8. I chaired the Palm Beach Board of the Florida Philharmonic Orchestra.
9. I was a trustee of the Children's Medical Fund which worked with Long Island Jewish Medical Center towards the building of the Schneider Children's Hospital and I chaired the Committee that planned that Hospital.
10. I was a trustee of Temple Beth El of Great Neck where my wife founded the school.
11. I was treasurer of the Village of Kings Point when I lived in that community.

As you can see, my plate has been rather full, not counting the fact that I have coronary artery disease and spinal stenosis, my wife has Parkinson's, and my daughter has Multiple Sclerosis. This keeps us very busy with medical issues and research, including two bio-medical laboratories I have invested in with no immediate prospect of return.

Statement of Michael Stein

For many years, I relied on Madoff income to support these activities. Now that income is gone, and the prospect of clawback destroys even more, not only for me, but for others who will feel the ripple effect of disappearing support for many worthy and necessary causes.

Michael Stein
227 Via Tortuga
Palm Beach, Florida 33480

29 Winding Lane
Upper Brookville, New York 11545

Statement of Donald Benjamin

I am a 76-year old cancer victim with homes in Florida and New York. I worked my way through college by working as a charter boat captain and a commercial fisherman. After graduating from law school, I practiced labor law in Brooklyn, Long Island and New York. During the 1970's, I served as a director of Mutual Discovery, a large mutual fund. At the same time, I owned and operated five different General Motors car dealerships in Brooklyn, Queens and Smithtown. One of the dealerships was the largest Chevrolet dealer in New York; another was the largest Pontiac dealership in New York. I sold the five dealerships to General Motors in 1996. I invested most of the after-tax proceeds of my five dealerships in Bernard L. Madoff Investment Securities, LLC ("Madoff").

In 2008, I was diagnosed with life-threatening neck cancer and given ten months to live. At that point, the focus of my life became dealing with my illness and the pain I have been in every day of my life since my surgery. However, since December 11, 2008, my life has had a new focus. That was the day that Bernard Madoff confessed and I realized that I had lost approximately $13.5 million of my wife's and my net worth. Now, I worry more about being able to support myself and my wife than I do about my health.

My wife had two Madoff accounts in which she had a total of approximately $3.6 million as of November 30, 2008. I also had two Madoff accounts: In one, my IRA account, I had a November 30, 2008 balance of $4,116,000. However, Irving Picard, the SIPC trustee, did not pay me the full $500,000 in SIPC insurance on this account because I had taken mandatory withdrawals from this account and, over the years, I had withdrawn a total of $1,455,045 and invested a total of $1,684,009.39. Thus, according

to Mr. Picard, I was only entitled to SIPC insurance in the amount of $228,964.39, the excess of my deposits over my withdrawals. Mr. Picard took this position despite the fact that the November 30, 2008 balance on the account was $4,116,000 and despite the fact that I had paid taxes on every dollar withdrawn from the account. A copy of Mr. Picard's determination letter to me is annexed as Exhibit A.

The other account I had with Madoff had a balance, as of November 30, 2008, of $5,807,135. According to Mr. Picard's analysis, I had deposited a total of $3,490,000 into this account from January 4, 1993 through November 30, 2008; and I had withdrawn from the account during that period a total of $4,560,000. Thus, according to Mr. Picard, who disregarded all appreciation in the account, I was not entitled to any SIPC insurance on this account despite the fact that I paid taxes every year on that appreciation. In fact, according to Mr. Picard, he has a right to claw back from me the $1,070,000 that I withdrew from the account over the years, in excess of the amounts I invested. See Mr. Picard's determination letter with respect to this account annexed as Exhibit B.

Not a day goes by that my mind is not racked with anxiety about a clawback suit against me. Aside from my own health issues, I am deeply concerned about providing for my wife. The loss of our Madoff investments has been devastating. I am in the process of trying to sell our apartment in Florida and taking other steps to reduce our living expenses. Living with the threat of a suit from Mr. Picard causes me and my wife daily and continuing anguish. If Mr. Picard succeeds in his suit against me, he will leave me with insufficient assets to support myself and my wife.

I had a long and successful professional and business career. I contributed a great deal to this country and I would have hoped that the country would have respected my

contribution and honored me – at least to the extent of providing me timely protection of its laws. Yet, I have watched Mr. Picard abuse his position by extracting settlements from destitute Madoff investors that will enrich the SIPC at the investors' expense. I have watched Mr. Picard violate the mandates of the Securities Investor Protection Act by ignoring the "legitimate expectations" of honest, law abiding citizens whose only mistake was to believe that the Securities and Exchange Commission would act to protect investors against the greed of Wall Street.

Donald Benjamin
152 Darters Lane
Manhasset, New York 11030

EXHIBIT A

BERNARD L. MADOFF INVESTMENT SECURITIES LLC

In Liquidation

DECEMBER 11, 2008[1]

NOTICE OF TRUSTEE'S DETERMINATION OF CLAIM

June 9, 2009

NTC & CO. FBO Donald A. Benjamin
152 Darters Lane
Manhasset, New York 11030-4024

Dear NTC & CO. FBO Donald A. Benjamin:

PLEASE READ THIS NOTICE CAREFULLY.

The liquidation of the business of BERNARD L. MADOFF INVESTMENT SECURITIES LLC ("BLMIS") is being conducted by Irving H. Picard, Trustee under the Securities Investor Protection Act, 15 U.S.C. § 78aaa et seq. ("SIPA"), pursuant to an order entered on December 15, 2008 by the United States District Court for the Southern District of New York.

The Trustee has made the following determination regarding your claim on BLMIS Account No. 1CM402 designated as Claim Number 000980:

Your claim for securities is **DENIED**. No securities were ever purchased for your account.

Your claim is **ALLOWED** for $228,964.39, which is the amount of money you deposited with BLMIS for the purchase of securities, less subsequent withdrawals, as outlined in Table 1.

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1 Section 78*lll*(7)(B) of SIPA states that the filing date is "the date on which an application for a protective decree is filed under 78eee(a)(3)," except where the debtor is the subject of a proceeding pending before a United States court "in which a receiver, trustee, or liquidator for such debtor has been appointed and such proceeding was commenced before the date on which such application was filed, the term 'filing date' means the date on which such proceeding was commenced." Section 78*lll*(7)(B). Thus, even though the Application for a protective decree was filed on December 15, 2008, the Filing Date in this action is on December 11, 2008.

DATE	AMOUNT
6/24/96	$800,000.00
2/23/98	$35.00
3/4/98	$200,000.00
6/1/00	$199,907.00
6/6/00	$35.00
6/20/00	$58.00
5/16/01	$300,000.00
12/27/01	$35.00
12/17/02	$39.93
1/12/05	$15.13
2/21/06	$45.17
1/16/08	$164.74
7/8/08	$183,674.42
Total deposits:	$1,684,009.39

DATE	AMOUNT
12/24/01	$300,000.00
12/24/02	$400,000.00
12/10/04	$140,000.00
12/23/05	$140,035.00
11/27/06	$300,010.00
12/7/07	$175,000.00
Total withdrawals:	$1,455,045.00
Total deposits less withdrawals:	**$228,964.39**

Your **ALLOWED CLAIM** of $228,964.39 will be satisfied in the following manner:

The enclosed **RELEASE AND ASSIGNMENT** must be executed, notarized and returned in the envelope provided herewith. You also should provide the name of the custodian for your IRA. Upon receipt of the executed and notarized **RELEASE AND ASSIGNMENT**, and designation of your IRA custodian the Trustee will fully satisfy your **ALLOWED CLAIM** by sending you a check in the amount of $228,964.39, with the funds being advanced by Securities Investor Protection Corporation pursuant to section 78fff-3(a)(1) of SIPA.

PLEASE TAKE NOTICE: If you disagree with this determination and desire a hearing before Bankruptcy Judge Burton R. Lifland, you **MUST** file your written opposition, setting forth the grounds for your disagreement, referencing Bankruptcy Case No. 08-1789 (BRL) and attaching copies of any documents in support of your position, with the United States Bankruptcy Court and the Trustee within **THIRTY DAYS** after June 9, 2009, the date on which the Trustee mailed this

notice.

PLEASE TAKE FURTHER NOTICE: If you do not properly and timely file a written opposition, the Trustee's determination with respect to your claim will be deemed confirmed by the Court and binding on you.

PLEASE TAKE FURTHER NOTICE: If you properly and timely file a written opposition, a hearing date for this controversy will be obtained by the Trustee and you will be notified of that hearing date. Your failure to appear personally or through counsel at such hearing will result in the Trustee's determination with respect to your claim being confirmed by the Court and binding on you.

PLEASE TAKE FURTHER NOTICE: You must mail your opposition, if any, in accordance with the above procedure, to each of the following addresses:

Clerk of the United States Bankruptcy Court for
the Southern District of New York
One Bowling Green
New York, New York 10004

and

Irving H. Picard, Trustee
c/o Baker & Hostetler LLP
45 Rockefeller Plaza
New York, New York 10011

Irving H. Picard

Trustee for the Liquidation of the Business of
Bernard L. Madoff Investment Securities LLC

300014494

EXHIBIT B

BERNARD L. MADOFF INVESTMENT SECURITIES LLC

In Liquidation

DECEMBER 11, 2008[1]

NOTICE OF TRUSTEE'S DETERMINATION OF CLAIM

August 28, 2009

Donald A. Benjamin
152 Darters Lane
Manhasset, NY 11030

Dear Mr. Benjamin:

PLEASE READ THIS NOTICE CAREFULLY.

The liquidation of the business of BERNARD L. MADOFF INVESTMENT SECURITIES LLC ("BLMIS") is being conducted by Irving H. Picard, Trustee under the Securities Investor Protection Act, 15 U.S.C. § 78aaa et seq. ("SIPA"), pursuant to an order entered on December 15, 2008 by the United States District Court for the Southern District of New York.

The Trustee has made the following determination regarding your claims on BLMIS Account No. 1CM006 designated as Claim Number 141, Claim Number 100119 and Claim Number 100134 (the latter two of which are duplicative of Claim Number 141) and are combined ("Combined Claim") for purposes of this determination. This letter shall serve as the Trustee's determination with respect to the Combined Claim:

Your Combined Claim for securities is **DENIED**. No securities were ever purchased for your account.

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1 Section 78lll(7)(B) of SIPA states that the filing date is "the date on which an application for a protective decree is filed under 78eee(a)(3)," except where the debtor is the subject of a proceeding pending before a United States court "in which a receiver, trustee, or liquidator for such debtor has been appointed and such proceeding was commenced before the date on which such application was filed, the term 'filing date' means the date on which such proceeding was commenced." Section 78lll(7)(B). Thus, even though the Application for a protective decree was filed on December 15, 2008, the Filing Date in this action is on December 11, 2008.

Further, based on the Trustee's analysis, the amount of money you withdrew from your account at BLMIS (total of $4,560,000.00), as more fully set forth in Table 1 annexed hereto and made a part hereof, is greater than the amount that was deposited with BLMIS for the purchase of securities (total of $3,490,000.00). As noted, no securities were ever purchased by BLMIS for your account. Any and all profits reported to you by BLMIS on account statements were fictitious.

Since there were no profits to use either to purchase securities or to pay you any money beyond the amount that was deposited into your BLMIS account, the amount of money you received in excess of the deposits in your account ($1,070,000.00) was taken from other customers and given to you. Accordingly, because you have withdrawn more than was deposited into your account, you do not have a positive "net equity" in your account and you are not entitled to an allowed claim in the BLMIS liquidation proceeding. Therefore, your claim is **DENIED** in its entirety.

DATE	TRANSACTION DESCRIPTION	AMOUNT	ADJUSTED AMOUNT
1/4/1993	CHECK	$100,000.00	$100,000.00
4/1/1993	CHECK	$50,000.00	$50,000.00
8/12/1994	CHECK	$50,000.00	$50,000.00
12/14/1994	CHECK	$95,000.00	$95,000.00
1/13/1995	CHECK	$150,000.00	$150,000.00
8/31/1995	Check	$75,000.00	$75,000.00
1/11/1996	CHECK	$740,000.00	$740,000.00
4/16/1996	CHECK	$400,000.00	$400,000.00
11/20/1997	CHECK	$300,000.00	$300,000.00
6/16/1998	CHECK	$250,000.00	$250,000.00
11/16/1998	CHECK	$300,000.00	$300,000.00
8/20/1999	CHECK	$80,000.00	$80,000.00
12/30/2005	TRANS FROM 1CM78330	$2,484.93	$0.00
2/15/2006	TRANS FROM 1CM78330	$437.21	$0.00
1/4/2007	CHECK	$900,000.00	$900,000.00
Total Deposits		$3,492,922.14	$3,490,000.00

DATE	TRANSACTION DESCRIPTION	AMOUNT	ADJUSTED AMOUNT
10/18/1996	CHECK	($150,000.00)	($150,000.00)
1/2/1997	CHECK	($100,000.00)	($100,000.00)
4/1/1997	CHECK	($100,000.00)	($100,000.00)
7/1/1997	CHECK	($100,000.00)	($100,000.00)
6/2/1999	CHECK	($50,000.00)	($50,000.00)
10/20/1999	CHECK	($85,000.00)	($85,000.00)
12/7/1999	CHECK	($50,000.00)	($50,000.00)
5/25/2000	CHECK	($100,000.00)	($100,000.00)

7/18/2000	CHECK	($30,000.00)	($30,000.00)
8/18/2000	CHECK	($75,000.00)	($75,000.00)
10/18/2000	CHECK	($40,000.00)	($40,000.00)
12/27/2000	CHECK	($250,000.00)	($250,000.00)
10/22/2001	CHECK	($25,000.00)	($25,000.00)
10/23/2001	CHECK	($25,000.00)	($25,000.00)
6/4/2002	CHECK	($250,000.00)	($250,000.00)
4/11/2003	CHECK	($300,000.00)	($300,000.00)
10/10/2003	CHECK	($100,000.00)	($100,000.00)
12/4/2003	CHECK WIRE	($750,000.00)	($750,000.00)
4/27/2004	CHECK	($70,000.00)	($70,000.00)
8/3/2004	CHECK	($60,000.00)	($60,000.00)
10/14/2004	CHECK	($25,000.00)	($25,000.00)
12/13/2004	CHECK WIRE	($500,000.00)	($500,000.00)
12/19/2005	CHECK WIRE	($500,000.00)	($500,000.00)
8/24/2006	CHECK	($100,000.00)	($100,000.00)
7/11/2007	CHECK	($250,000.00)	($250,000.00)
3/12/2008	CHECK WIRE	($300,000.00)	($300,000.00)
6/3/2008	CHECK	($75,000.00)	($75,000.00)
10/14/2008	CHECK	($100,000.00)	($100,000.00)
Total Withdrawals:		($4,560,000.00)	($4,560,000.00)
Total deposits less withdrawals:		($1,067,077.86)	($1,070,000.00)

As reflected in Table 1, certain of the transfers into or out of your account have been adjusted. As part of the Trustee's analysis of accounts, the Trustee has assessed accounts based on a money in/money out analysis (i.e., has the investor deposited more or less than he or she withdrew from BLMIS). This analysis allows the Trustee to determine which part of an account's balance is originally invested principal and which part is fictitious gains that were fabricated by BLMIS. A customer's allowed claim is based on the amount of principal in the customer's account.

When ever a customer requested a transfer from one account to another, the Trustee analyzed whether the transferor account had principal in the account at the time of the transfer. The available principal in the account was transferred to and credited in the transferee account. Thus, the reason that the adjusted amount of transferred deposits in Table 1 is less than the purported transfer amount is that the transferor account did not have sufficient principal available to effectuate the full transfer. The difference between the purported transfer amount and the adjusted transfer amount is the amount of fictitious gain that was transferred to or from your account. Under the money in/money out analysis, the Trustee does not give credit for fictitious gains in settling your allowed claim.

Should a final and unappealable court order determine that the Trustee is incorrect in his interpretation of "net equity" and its corresponding application to the determination of customer claims, the Trustee will be bound by that order and will apply it retroactively to all previously

determined customer claims in accordance with the Court's order. Nothing in this Notice of Trustee's Determination of Claim shall be construed as a waiver of any rights or claims held by you in having your customer claim re-determined in accordance with any such Court order.

Nothing in this Notice of Trustee's Determination of Claim shall be construed as a waiver of any rights or claims held by the Trustee against you.

PLEASE TAKE NOTICE: If you disagree with this determination and desire a hearing before Bankruptcy Judge Burton R. Lifland, you **MUST** file your written opposition, setting forth the grounds for your disagreement, referencing Bankruptcy Case No. 08-1789 (BRL) and attaching copies of any documents in support of your position, with the United States Bankruptcy Court and the Trustee within **THIRTY DAYS** after August 28, 2009, the date on which the Trustee mailed this notice.

PLEASE TAKE FURTHER NOTICE: If you do not properly and timely file a written opposition, the Trustee's determination with respect to your claim will be deemed confirmed by the Court and binding on you.

PLEASE TAKE FURTHER NOTICE: If you properly and timely file a written opposition, a hearing date for this controversy will be obtained by the Trustee and you will be notified of that hearing date. Your failure to appear personally or through counsel at such hearing will result in the Trustee's determination with respect to your claim being confirmed by the Court and binding on you.

PLEASE TAKE FURTHER NOTICE: You must mail your opposition, if any, in accordance with the above procedure, to each of the following addresses:

Clerk of the United States Bankruptcy Court for
the Southern District of New York
One Bowling Green
New York, New York 10004

and

Irving H. Picard, Trustee
c/o Baker & Hostetler LLP
45 Rockefeller Plaza
New York, New York 10011

Irving H. Picard

Irving H. Picard

Trustee for the Liquidation of the Business of
Bernard L. Madoff Investment Securities LLC

cc: Helen Davis Chaitman, Esq.
Phillips Nizer LLP
666 Fifth Avenue
New York, New York 10103-0084

Statement of Maureen Ebel

I am a widow, a retired nurse, and a resident of West Chester, Pennsylvania. I lost all of my family savings – over $7 million -- in Bernard L. Madoff Investment Securities, LLC ("Madoff"). Following December 11, 2008, I radically changed my life style: I took on numerous jobs in order to cover my expenses (including working as a maid); I sold a residence in Wellington, Florida; I sold various items of personal property such as jewelry and rugs; and I took on a full-time position as an office manager.

I am one of the lucky Madoff investors because I received full SIPC insurance for my two accounts, but only after and because a lawyer sued Madoff Trustee Irving Picard on my behalf on a *pro bono* basis. Mr. Picard, the Madoff Trustee, had refused to pay me what I was entitled to – until my attorney sued him.

Although I withdrew funds from my Madoff accounts to fund my living expenses, my charitable contributions, and my taxes, I withdrew far less than I had invested. Thus, on Mr. Picard's theory of "net investment" rather than "net equity" as defined in the Securities Investor Protection Act ("SIPA"), I am a direct beneficiary of Mr. Picard's intended "clawbacks" of innocent investors.

Although I would benefit financially from such clawbacks, I am adamantly opposed to them. Based on my understanding of SIPA, clawbacks are anathema to the Congressional mandate to honor the legitimate expectations of customers of an SEC-regulated broker/dealer. Moreover, while I would certainly like to recover the money I lost, I do not want to take money from honest Americans whose only mistake was assuming that Madoff was honest.

Unfortunately, the overwhelming greed of Wall Street has denigrated the basic human values for which America's culture used to be so admirable. We used to be a

Statement of Maureen Ebel

country in which people's legal rights were respected. Now, based on the conduct of Mr. Picard and SIPC, it is clear that we are a country in which money controls. SIPA was enacted to instill confidence in the capital markets by insuring customer accounts up to $500,000 and by honoring the "legitimate expectations" of customers. Now, Wall Street has decided it doesn't want to foot the bill for the Madoff insurance, even though it has enjoyed the economic benefits of Americans' trust that SIPA would be followed.

Under SIPA, as I read it, any customer who was defrauded by Madoff should be entitled to keep whatever they withdrew from their accounts and paid taxes on. It is bizarre to me that Congress would allow SIPC to "claw back" from innocent investors, simply to enhance Wall Street's subrogation rights. I ask you not to let this happen. There has to be a point at which Congress stands up for Main Street, despite the wealth and power of Wall Street.

October 24, 2009

Maureen Ebel
506 Hansen Drive
West Chester, Pennsylvania 19830

Statement of Sarah Fisk

I am a resident of Berkeley, California. I have no children, but contribute to the support of other family members, one disabled. I hold a PhD in Psychology and have my own business, a consulting practice in Organization Development. Since I am on my own, with no inheritance, I have been diligently saving for my retirement since I finished paying for my education. I don't consider myself wealthy, but I have no debt and I was hoping not to be a burden to anyone in my old age regardless of whether I marry again.

In 2007, I became discouraged with my financial advisor and the volatility of the stock market. On the advice of a friend, I invested $100,000 into a limited partnership called MOT Family Investors. I was told that MOT had a trading strategy that had been successful since the 1970's in producing positive returns that were not as high as some mutual funds but were steady over the long term. This same friend told me that many funds and many people (including lots of my friends who subsequently added their recommendations) were invested in this same strategy. He said it had been investigated by the SEC and was "on the up-and-up". In fact, he told me that when he heard of the SEC's investigation back then, he had moved all his extended family's assets (close to a billion dollars altogether) out of this investment, and then, when the SEC found nothing wrong, he had moved all their money back in.

This was a major deciding factor for me in choosing to move my money into MOT since I felt that, if the SEC had investigated this system and found it legitimate, I was safe in putting my money into it. At this time, I had not heard of Bernard L. Madoff, and I thought my friends were recommending a certain strategy, not an investment guru. I understand that I had this wrong.

Statement of Sarah Fisk

In the spring of 2008, having watched my 401(k) portfolio continue to do poorly and the MOT Family Investments fund achieve small but positive gains, I rolled the whole 401(k) into an IRA with a company called FISERV so I could move $100,000 of my retirement into MOT and at the same time put another $115,000 of my retirement funds into a new fund, called Lakeview Investment LP. I thought it would be wise to diversify by not having all of my retirement funds in MOT. I did not know that Lakeview and MOT were both feeder funds into Madoff Investments.

During the same time, 2007-2008, my siblings and I sold my mother's home and I invested my share of those proceeds (approximately $200,000) into MOT as well. Consequently, in December 2008, I had a total of $544,425.53 invested in three accounts through two separate limited partnership/feeder funds. After December 11, 2008, I learned that all of this money had been invested with Bernard L. Madoff who had stolen it. Many of my friends were also defrauded and are experiencing extremely difficult circumstances as a result.

Presently, as an independent consultant I have seen a precipitous drop in client referrals and bookings. I expect my income in 2009 will be about half of 2008. My expenses, including health insurance, will stay the same. I don't own a home so I don't have that to lose. I still consider myself lucky because I am paying my rent.

Given the current state of the economy, I do not see how I could re-earn what I had before this theft. I worry about having enough to take care of myself in my old age. I have given up hope of taking care of my disabled brother, or helping my nieces and nephew.

Statement of Sarah Fisk

Although I would stand to benefit from any clawback litigation brought by Irving Picard, I am adamantly opposed to such litigation. It is one thing for Mr. Picard to sue alleged co-conspirators who were earning extraordinary returns (400-900%/year) on their accounts and taking out billions of dollars. However, Mr. Picard has identified only two such investors. For the thousands of others, we were all innocent victims of Madoff's thievery and the SEC's failure to uncover his fraud.

As I understand the Securities Investor Protection Act, its purpose is to instill confidence in the capital markets by honoring the "legitimate expectations" of customers of SEC-regulated broker/dealers, based upon the statements they received from their brokers. It is inconsistent with that Congressional policy to claw back from people who had every right to take money out of their accounts to fund their expenses.

Sarah Fisk, PhD
2908 Benvenue Avenue
Berkley, California 94705

Statement of Larry Doyle

As my attached resume reflects, I am a Wall Street veteran. Having left Wall Street after 23 years, I now manage my own website, Sense on Cents, and host my own radio show. The primary area of focus of my work is transparency and integrity in the markets and our economy. Rest assured, I am not writing for my former colleagues on Wall Street but rather that large percentage of our population who are feeling increasingly disenfranchised at this time. To that end, in my opinion, one of the most egregious examples of Wall Street's abuse of its power is the situation involving investors in Bernard L. Madoff Investment Securities, LLC ("Madoff").

The Securities Investor Protection Corporation ("SIPC") deliberately under-funded its insurance fund – charging a token $150 per year to each investment firm for hundreds of billions of dollars of insurance for the entire boom year period from 1996 - 2008. As a result of the promise of SIPC insurance, Americans have allowed Wall Street to hold their life savings in street name since 1970. Over the 38 years since the Securities Investor Protection Act ("SIPA") was enacted, Wall Street has profited handsomely by the ownership of street name securities. Firms were able to lend out the street name securities, borrow against them, and sell and buy them back for a profit. That profit was not shared with the actual owners of those shares. The only benefit to the owners was that they had SIPC insurance on their securities, up to $500,000.

Or so they thought. Now, because Wall Street does not want to foot the bill for the SIPC insurance on the Madoff loss, SIPC has decided that it doesn't insure the customer's last statement – as clearly required under SIPA. Instead, it only insures the customer's net investment. This is an outrage. If I have Chubb insurance on my home for $10 million, and I have a total loss, do you think I would tolerate it if, after a total loss, Chubb said to me: "We're only going to pay you $800,000 because that's what you paid for your house in 1972." That would be an outrage; and SIPC's treatment of the Madoff investors is a similar outrage.

Statement of Larry Doyle

Every customer of an SEC-regulated broker/dealer is assured in writing that his account is insured up to $500,000 by SIPC. No broker has ever informed a customer that the SIPC insurance is only up to $500,000 based upon the customer's net investment, exclusive of all appreciation. Thus, at the present time, every broker is defrauding its customers by failing to reveal the true nature of SIPC insurance. For example, after Madoff confessed, CitiGroup Global Markets, Inc. ("CGMI") sent out a letter to all of its customers containing the following statement:

> CGMI is a member of the Securities Investor Protection Corporation (SIPC), a federally mandated U.S. nonprofit corporation that protects investors if a broker-dealer becomes insolvent. When a brokerage firm that is a member of SIPC fails, SIPC's role is to ensure that investors get back what belongs to them. If, when SIPC and the trustee examine the client accounts at a failed broker-dealer, there is a shortfall in the amount of securities or cash owed clients due to record-keeping errors or fraud, the affected clients are protected by SIPC coverage.
>
> Each client with missing securities or cash will be reimbursed by SIPC up to a maximum of $500,000, or which $100,000 may be cash. SIPC does not cover market losses, and it does not cover certain types of investments such as commodity futures contracts and fixed-annuity contracts.

See Exh. 2 hereto.

The Madoff Coalition for Investor Protection wrote letters to some of the major financial institutions, including CitiGroup, apprising them that they are misleading their customers. The institutions have responded not at all or arrogantly. See, for example, the letter to Goldman Sachs, and Goldman Sachs' response, annexed hereto as Exh. 3.

The applicable provisions of SIPA

Pursuant to SIPA, the Madoff Trustee (the "Trustee") is obligated to "satisfy net equity claims of customers." 15 U.S.C. § 78fff(a)(1)(A)-(B). SIPA defines "net equity" as the value of the securities positions in the customer's account as of the SIPA filing date, less any amount the

customer owes the broker (the "debtor"). This is the statutory balance of each customer's account.

> The term "net equity" means the dollar amount of the account or accounts of a customer, to be determined by –
>
> (A) calculating the sum which would have been owed by the debtor to such customer if the debtor had liquidated, by sale or purchase on the filing date, all securities positions of such customer . . .; minus
> (B) any indebtedness of such customer to the debtor on the filing date. . .

15 U.S.C. §78lll(11).

Congress specifically prohibited SIPC from changing any definitions contained in § 78lll, which section includes the definition of "net equity." As stated in SIPA:

> SIPC shall have the power. . . to adopt, amend and repeal, by its Board of Directors, such rules as may be necessary or appropriate to carry out the purposes of this chapter, including rules relating to . . .the definition of terms in this chapter, **other than those terms for which a definition is provided in section 78lll of this title. .**

15 U.S.C. § 78ccc(b)(4)(A) (emphasis added).

In a May 2001 Report, the United States General Accounting Office, wrote:

> SIPC's statutory mission is to promote confidence in securities markets by allowing for the prompt return of missing customer cash and/or securities held at a failed firm. **SIPC fulfills its mission** by initiating liquidation proceedings where appropriate and transferring customer accounts to another securities firm or returning the cash or securities to the customer **by restoring to the customer accounts the customer's "net equity." SIPA defines net equity as the value of cash or securities in a customer's account as of the filing date, less any money owed to the firm by the customer, plus any indebtedness the customer has paid back** with the trustee's approval within 60 days after notice of the liquidation proceeding was published.

GAO Report to the Ranking Minority Member, Energy and Commerce Committee, House of Representatives entitled "Securities Investor Protection: Steps Needed to Better Disclose SIPC Policies to Investors," (the "GAO Report") at 15; emphasis added).

Statement of Larry Doyle

In addition, SIPA mandates that SIPC satisfy customer claims "promptly following the initiation of a liquidation proceeding." 15 U.S.C. § 78fff-3(a) and 4(c). As stated in the legislative history of SIPA:

> The intention of SIPC, like the FDIC, is to minimize losses to and to maintain public confidence in the institutions the public deals with.

S. Rep. 91-1218, at 9, *reprinted in* Federal Securities Laws Legislative History 1933-1982, Vol. IV, at 4641.

According to the FDIC's website, "It is the FDIC's goal to make deposit insurance payments within two business day[s] of the failure of the insured institution." http://www.fdic.gov/consumers/banking/facts/payment.html. Yet in the Madoff liquidation, more than eight months after the institution of the liquidation proceeding, the Trustee had allowed only 747 claims out of at least 15,400 claims filed, and not all 747 claims have been paid.

Because SIPC has no power to change the statutory definition of "net equity," the Directors have no power to allow the Trustee to do so. Yet, SIPC has allowed the Trustee to ignore the statutory definition of "net equity" and invent his own definition whereby a customer's claim is limited to the customer's net investment over the life of the account, even where the account was opened 35 years ago. Thus, a customer who opened an account in 1970 with $100,000, which account had a balance on November 30, 2008 of $2.3 million, is not entitled to any SIPC insurance if, at some point in the past 38 years, the customer withdrew more than $100,000 from his account.

Aside from the fact that the Trustee's definition of "net equity" is *ultra vires*, it is totally destructive to Congress' purpose in enacting SIPA, as evidenced not only by the plain language of the statute but by its legislative history. *See, e.g.*, H.R. Rep. No. 91-1613, at 3-4

(1970)("[SIPA] will reinforce the confidence that investors have in the U.S. securities markets."). *See also In re New Times Securities Services, Inc.*, 371 F.3d 68, 87 (2d Cir. 2004)("[T]he [SIPA] drafters' emphasis was on promoting investor confidence in the securities markets and protecting broker-dealer customers."); *Appleton v. First Nat'l Bank of Ohio*, 62 F.3d 791, 794 (6th Cir. 1995) ("'Congress enacted [SIPA] to . . . restore investor confidence in the capital markets[ ] and upgrade the financial responsibility requirements for registered brokers and dealers.")(citations omitted). SIPA attempted to do this initially by satisfying customers' "net equity" claims for securities with actual securities only if the debtor held securities of the appropriate class and kind to satisfy customers' claims, while otherwise customers would receive the cash equivalent of the value of their securities on the filing date. SIPA § 6(c)(2)(B)-(D), Pub. L. No. 91-598, 84 Stat. 1636, 1648-50 (1970); H.R. Rep. No. 95-746 (39-41)(statement of SIPC Chairman Hugh F. Owens).

When SIPA was amended in 1978, the goal was to fix "[o]ne of the greatest shortcomings of the procedure under the 1970 Act, to be remedied by [the 1978 amendments], *[i.e.]*, . . . **the failure to meet legitimate customer expectations of receiving what was in their account at the time of their broker's insolvency**." D 922 Cong. Rec. H. 36326 (daily ed. Nov. 1, 1977)(statement of Rep. Robert C. Eckhardt)(emphasis added). See also Hearing on H.R. 8064 Before the Subcomm. on Consumer Protection and Finance of the H. Comm. On Interstate and Foreign Commerce, 94th Cong. 63 (1975)("The basic framework of the 1970 Act in regard to satisfaction of customers' claims should be modified to better meet the legitimate expectations of customers.") (report to the SIPC Board of Directors by the Special Task Force to consider possible amendments to SIPA); Hearing on H.R. 8331 before the Subcomm. on Consumer Protection and Finance of the H. Comm. on Interstate and Foreign Commerce, 95th Cong. 81

(1977) ("The proposed [1978] amendments carry out the Task Force recommendations and are designed to make the Act more responsive to the reasonable expectations of investors.") (statement of SIPC Chairman Hugh F. Owens); Hearing on H.R. 8064 Before the Subcomm. on Consumer Protection and Finance of the H. Comm. on Interstate and Foreign Commerce, 94th Cong. 161-162 ("[T]he principal purpose of these amendments is to meet more nearly the reasonable expectations of brokerage firm customers.")(statement of SEC Commissioner Philip A. Loomis, Jr.).

A customer's reasonable expectations were that their actual securities, as shown on their statements, would be returned to them "in the form they existed on the filing date." H.R. Rep. No. 95-746, at 21. Thus, SIPA was amended to state that "[t]he trustee shall, to the extent that securities can be purchased in a fair and orderly market, purchase securities as necessary for the delivery of securities to customers in satisfaction of their claims for net equities. . ." 15 U.S.C. § 78fff-2(d); SIPA § 8(d), Pub. L. No. 95-283, 92 Stat. 249, 263 (1978).

Here, the legitimate expectations of the Madoff customers were contained in the account statements and trade confirmations they received. They expected that their accounts held the securities reflected therein. The fact that Madoff was dishonest and operated a Ponzi scheme for over 15 years is irrelevant to this process. Indeed, it is precisely because Madoff was dishonest that it is essential that SIPC honor its statutory obligation to promptly replace securities in the customers' accounts up to $500,000 based upon their last statements. Indeed, Congress **specifically contemplated** that "securities positions" reflected in a customer's statements could include securities that were never actually purchased, as was the case here. The Senate and House Reports on the 1978 amendments to SIPA show that SIPA was intended to cover securities that the broker-dealer did not actually purchase:

> Under present law, because securities belonging to customers may have been lost, improperly hypothecated, misappropriated, **never purchased** or even stolen, it is not always possible to provide to customers that which they expect to receive, that is, securities which they maintained in their brokerage account. . . By seeking to make customer accounts whole and returning them to customers in the form they existed on the filing date, the amendments. . . would satisfy the customers' legitimate expectations. . . .

S. Rep. No. 95-763, at 2 (1978) (emphasis added).

> A customer generally expects to receive what he believes is in his account at the time the stockbroker ceases business. But because securities may have been lost, improperly hypothecated, misappropriated, **never purchased**, or even stolen, this is not always possible. Accordingly, [when this is not possible, customers] will receive cash based on the market value as of the filing date.

H.R. Rep. No. 95-746 at 21 (emphasis added).

There is absolutely no support for the Directors' and Trustee's "cash in minus cash out" theory in either SIPA or its legislative history. Nor is there any authority for a SIPC trustee to invent his own statutory definition of "net equity" to suit his own concept of what is equitable in a particular case.

It is inconsistent with SIPA to claw back from customers

As set forth above, the purpose of SIPA is to honor the legitimate expectations of customers and, thereby, instill confidence in the capital markets. That purpose cannot be fulfilled if customers of an SEC-regulated broker/dealer can be required to pay back money they withdrew from their own accounts. In my view, it is devastating to the average American's confidence in the capital markets for SIPC to reneg on its insurance obligations to innocent customers of an SEC-regulated broker/dealer.

However, what would be absolutely destructive of the capital markets would be to allow a SIPC trustee to both reneg on SIPC's insurance obligations and also sue innocent customers for money they withdrew and paid taxes on. Hence, I urge Congress to amend SIPA to clarify that

Statement of Larry Doyle

clawback litigation against innocent customers is absolutely prohibited. This could be handled by simply adding to SIPA section 15 U.S.C. Section 78fff(b) the following:

> Notwithstanding any other provision of this title, no action under Sections 544, 547 or 548 shall be brought against a customer of an SEC-regulated broker/dealer to recover funds received representing either principal or income on the customer's account absent proof that the customer did not have a legitimate expectation that the assets in his account belonged to him.

October 22, 2009

Larry Doyle
128 Byram Shore Road
Greenwich, Connecticut 06830

EXHIBIT 1

128 Byram Shore Road Greenwich, CT 06830 (203) 531-6611 (h); (203) 233-8715 (c) LWDoyle128@aol.com

Lawrence W. Doyle

Professional

February 2006 -present

Manage my own affairs and do not for profit work

April 2000 – February 2006
JP Morgan Chase: Managing Director – National Sales Manager Securitized Products

- Producing manager, April 2000 – January 2004
- Hired 40+ salespeople directly
- Grew sales revenue from 0 to 250mm +
- Instituted coverage of approximately 350 accounts
- Extensive client interaction, mentoring and public speaking
- Integrated SPG business with Banking/Origination, FIG Banking, Liquid Markets, Chase Home Finance, Structured Credit
- Series 7, 9, 10, 24, 63

August 1998 – April 2000
Bank of America: Managing Director

- Senior MBS sales professional

December 1996 – May 1998
Union Bank of Switzerland: Managing Director – Senior MBS Trader

- Recruited/hired 15 professionals across trading, sales and research
- Instituted real time risk management system across entire MBS trading
- Chairman, PSA Mortgage Trading Practices Committee

January 1990 – December 1996
Bear Stearns & Company: Senior Managing Director – Senior MBS Pass-Thru Trader

- Promoted to Senior MD in 1993
- Traded all 30yr and seasoned MBS pass-thrus
- Average annual revenues of $20mm +

August 1983 – January 1990
First Boston Corporation: MBS pass-thru trader

Education

June 1983
College of the Holy Cross Worcester, MA B.A. Economics

- Cum Laude graduate, Phi Beta Kappa, Fulbright Scholar Nominee

January – May 1982
Institute of European Studies, Freiburg, West Germany

- Esmark Foundation Scholarship, sole recipient based on academic merit

Personal

- Married for 21 years, 4 children (ages 20, 18, 16, 10)
- Actively involved in church and community activities
- Interests revolve around family, sports, and Holy Cross

Exhibit 1

- Launched CT chapter of Fellowship of Christian Athletes, January 2008
- Chairman, Holy Cross Leadership Council of New York

EXHIBIT 2

Citi Personal Wealth Management is a business of Citigroup Inc.

On January 13, 2009, Citi and Morgan Stanley announced a new joint venture between Smith Barney and Morgan Stanley, creating a wealth management firm to be named Morgan Stanley Smith Barney. While the Smith Barney name will become part of the joint venture as a result of this transaction, Citigroup Global Markets Inc. ("CGMI"), your current broker/dealer, will remain with Citi and continue to service your account. Citi will create a new business called Citi Personal Wealth Management, which will offer investment and advisory services through CGMI. You will start to see the name **"Citi Personal Wealth Management"** appear on many of the documents you receive from CGMI, including monthly account statements, confirmations and other correspondence.

The introduction of the **"Citi Personal Wealth Management"** name, however, will not take place all at once and you will still see "Citi Smith Barney" or references that "Smith Barney is a division of Citigroup Global Markets Inc." after the close of the joint venture transaction in some or all of the following: signage in Citibank branches, on-line, Citibank ATMs and in certain documentation. During the months following the close, CGMI will be replacing "Citi Smith Barney" with Citi Personal Wealth Management in these locations.

The important thing to keep in mind is that Citi Personal Wealth Management, a business of Citigroup Inc., and Morgan Stanley Smith Barney are separate businesses and each is responsible for its own obligations. In those instances where you continue to see the "Citi Smith Barney" name, you should remember that your account and your Financial Advisor are associated with Citi Personal Wealth Management.

A New Insurance Agency

A new insurance agency has been created by Citi to work with Citi Personal Wealth Management clients. Following the close of the transaction of the joint venture, your insurance needs will begin to be handled by Citigroup Life Agency LLC ("CLA"). If you currently have insurance products such as annuities or variable life policies, CLA will eventually replace your current life insurance agency, SBHU Life Agency, Inc. You do not need to do anything in order for this change to occur. Your Financial Advisor, as an agent of CLA, will be able to service any existing insurance products.

You will not be charged different fees or higher rates as the result of CLA becoming your new agency, and all your existing policies and annuities will remain in effect.

Same Level of Account Protection

Since CGMI will remain your broker/dealer, your accounts will have the same protection as they did before the introduction of Citi Personal Wealth Management.

- **Securities are Segregated.** CGMI is required by law to keep client securities—such as stocks and bonds that are fully paid for, or excess-margin securities—separate from the firm's securities. This means that these segregated client securities are not available to the general creditors of CGMI or of our parent company, Citigroup, in the event of insolvency.

In the unlikely event of insolvency, if a shortfall exists between what was required to be segregated and what actually was, Citi Personal Wealth Management clients are further protected by the following types of insurance:

- **SIPC Protection.** CGMI is a member of the Securities Investor Protection Corporation (SIPC), a federally mandated U.S. nonprofit corporation that protects investors if a broker-dealer becomes insolvent. When a brokerage firm that is a member of SIPC fails, **SIPC's role is to ensure that investors get back what belongs to them.** If, when SIPC and the trustee examine the client accounts at a failed broker-dealer, there is a shortfall in the amount of securities or cash owed clients due to record-keeping errors or fraud, the affected clients are protected by SIPC coverage.

Each client with missing securities or cash will be reimbursed by SIPC up to a maximum of $500,000, of which $100,000 may be cash. SIPC does not cover market losses, and it does not cover certain types of investments such as commodity futures contracts and fixed-annuity contracts.

- **Additional Protection.** Citigroup Inc. has purchased, at no cost to you, a supplementary insurance policy. In the unlikely event that client assets are not fully recovered and SIPC protection limits have been paid, this additional policy becomes available and provides protection above the SIPC limits subject to an aggregate loss limit for all clients of $1 billion including, for Citi Personal Wealth Management, up to $1.9 million per client for the cash portion of any remaining shortfall.

If a client maintains more than one account at the firm in separate capacities (individual, joint, trust), each account would be protected by SIPC and the supplementary protection up to the client and aggregate limits mentioned above.

Exhibit 2

EXHIBIT 3

MADOFF COALITION FOR INVESTOR PROTECTION

17200 W. Bell Rd. Site 2489
Surprise, Az 85374
631.676.1030
madoffcoalition@gmail.com

September 24, 2009

Mr. Lloyd C. Blankfein
Chairman of the Board & CEO
Goldman Sachs
85 Broad Street
17th Floor
New York, NY 10004

Dear Mr. Blankfein:

We write on behalf of the Madoff Coalition for Investor Protection to inform you that you are inadvertently perpetrating a fraud on your securities customers which must be corrected immediately.

As a member of the Securities Investor Protection Corporation ("SIPC"), you are authorized to notify customers that their accounts are protected by SIPC up to $500,000. According to SIPC's bylaws, the Official Explanatory Statement that members of SIPC are authorized to use is either

> Member of SIPC, which protects securities customers of its members up to $500,000 (including $100,000 for claims for cash). Explanatory brochure available upon request or at www.sipc.org;
> or
> Member of SIPC. Securities in your account protected up to $500,000. For details, please see www.sipc.org.

The above disclosures are consistent with SIPC's conduct for the first 38 years of its existence. However, the above disclosures are now false based upon the conduct of SIPC and its chosen trustee, Irving H. Picard, in the case of Bernard L. Madoff Investment Securities, LLC ("Madoff"), filed on December 15, 2008 in the United States District Court for the Southern District of New York. In the Madoff case, SIPC and Picard have taken the position that Madoff customer accounts were not insured by SIPC up to $500,000 per account. Instead, they have taken the position that SIPC only insures the net investment in each account. Thus, a customer who opened an account with Madoff in 1970 with $100,000 which appreciated to $1,800,000 as of November 30, 2008, is not

entitled to any SIPC insurance if, during the course of the 38 years of the account's existence, the customer withdrew more than $100,000 from the account.

In view of SIPC's position in the Madoff case, it is essential that you immediately change your notification to customers of SIPC insurance to explain that each customer's account is only insured for the customer's net investment over the life of the account. You might also advise customers that they should transfer their accounts from one institution to another every few years so that, if your firm is liquidated by SIPC, the customer's uninsured appreciation will be minimized. We would suggest a notification along the following lines:

> **Please be advised that your account is insured up to $500,000 by SIPC. However, this insurance covers only your net investment and does not include any appreciation in the account. Therefore, if the insurance is of importance to you, in order to protect your investment, you should transfer your account from one institution to another whenever there is significant appreciation in the account. SIPC will insure your account with a new institution for the amount of your investment with that institution. However, again, SIPC will not insure any appreciation in the account with that institution.**

SIPC's position in the Madoff case is laid out in court filings and in determination letters that Picard has sent to customers. A copy of such a letter is enclosed for illustration purposes.

Yours sincerely,
Ronnie Sue Ambrosino
Coordinator
Madoff Coalition for Investor Protection

cc: Commissioner Mary Schapiro
Senator Christopher Dodd
Representative Barney Frank
Secretary of the Treasury Timothy Geithner

The Goldman Sachs Group, Inc. | One New York Plaza | New York, New York 10004
Tel: 212-902-4762 | Fax: 212-492-3966

Gregory K. Palm
Executive Vice President
and General Counsel

October 12, 2009

Ronnie Sue Ambrosino
Coordinator
Madoff Coalition for Investor Protection
17200 W. Bell Rd.
Suite 2489
Surprise, AZ 85374

Dear Ms. Ambrosino:

Thank you for your letter of September 24, 2009 to Lloyd C. Blankfein. We appreciate your bringing the issue of SIPC coverage to our attention and your views with respect thereto.

Very truly yours,

Gregory K. Palm

cc: Rachel Ascher

Statement of Robert J. Jerome

I have been in the Financial Services Industry for 38 years. I have also been an investor. The integrity of the Financial Services Industry and the Banking Industry rests on their ability to provide the client with an accurate and presumed verifiable accounting of their positions and balances on an ongoing basis. This integrity is further enhanced by the presence of the SIPC Logo. The very name itself, Securities Investor Protection Corporation, is in part responsible for instilling investor confidence, one benefit being that the Industry was able to migrate from a Certificate based platform to a Book Entry system where clients are matched electronically to their holdings, all of which are reported on their Client Statements.

In addition to the Monthly Statement, clients are also notified whenever there is account activity on their behalf by a Trade Confirmation. These records of trade activity are also captured on the Monthly Statement and are the core of the Financial Institution's reporting to clients of changes in their accounts. Taken in its entirety, it is why clients are willing to leave their assets on deposit with a Financial Institution.

For approximately 15 years, my in-laws maintained first a joint, and then two separate Trust Accounts with Bernard L. Madoff Investment Securities, LLC ("Madoff"). During those years, they received hundreds, if not thousands, of trade confirmations detailing activity in their accounts. They also received an uninterrupted flow of monthly statements, recapturing both the previously mentioned trade activity as well as a summary of their positions and total equity as of the statement close date. This continued right up to November 30, 2008. During this time they made withdrawals based solely on the reliance that there was sufficient capital remaining in their account to continue to sustain the investment activity that had historically occurred in these accounts. Additionally, they paid in to the Internal Revenue Service hundreds of thousands, if not over $1 million, in taxes on short term gains from realized profits in their accounts.

Statement of Robert J. Jerome

This brings me to the present reality. Their final statement from Madoff showed a combined equity in excess of $4 million. Under normal circumstances, they could expect a combined $ 1 million from the SIPC coverage on their two separate Trust Accounts.

However, they are now living under the uncertainty that they could see nothing. Madoff Trustee, Irving Picard, has taken the stance that, given the circumstances of the fraud, Madoff customers are entitled to SIPC payments only for their net investment up to $500,000. I would be the first to admit that I do not know every line and clause of the Securities Investor Protection Act, but in 38 years of experience I have never heard of this. And I am reasonably certain that, if this were so, it should be easily identified in SIPC's guidelines and in the disclosures made by every SEC-regulated broker/dealer. I have seen no evidence of such disclosures to investors. Moreover, it would also be reasonable to expect that this would have come up at sometime in the past.

In short, it gives the impression that SIPC protects the Financial Services Industry rather than the customers of the Financial Services Industry. This is completely mis-guided and, in my opinion, irresponsible. Let me explain my position: Netting of withdrawals against deposits gives the impression that clients knew they were pulling a fast one and now they have been caught. SIPC and the government regulatory agencies are completely shifting the blame from the guilty to the innocent parties. The guilty parties start, of course, with Madoff and his associates. However, the regulatory failures here are beyond comprehension. Year after year Madoff received a clean bill of health from the Securities and Exchange Commission on his operations. Based on this alone it would appear that Mr. Picard is aiming his legal arsenal at the wrong enemy. He is punishing the victims instead of the perpetrators.

Statement of Robert J. Jerome

The last point I would make is this: if in fact it has been determined that no trades ever occurred, that there were no dollars actually invested for profit or loss, that everything that appeared on confirmations and statements was fictitious and that 1099 reporting was pure fantasy, then it would seem that every client who paid taxes every year on gains that never occurred should be entitled to have those monies returned, irrespective of how far back in time it occurred. These taxes were paid with real dollars from real accounts belonging to real people. If indeed no trades ever occurred, then the IRS has an obligation beyond the five years already acknowledged to refund monies that, in light of events, they were never entitled to in the first place. Fair is fair: customers should not be denied at every turn (i.e. SIPC and the IRS). In the Notice of Trustee's Determination of Claim dated October 19, 2009 denying my in-laws of any restitution from SIPC, Trustee Irving H. Picard states "As noted, no securities were ever purchased by BLMIS for your account. Any and all profits reported to you by BLMIS on account statements were fictitious." If this is indeed the case, then any taxes paid to the IRS over the course of my in-law's association with BLMIS were by definition paid in error.

I offer for your consideration that Irving and Annette Jungreis, my in-laws, are both first generation children of Eastern European immigrants born as proud citizens of the United States. With the outbreak of World War II, my father-in-law was drafted into the United States Army and served in the European Theater. For his service he was decorated with the Bronze Star for bravery in his role as a medic bringing aid to wounded soldiers on the battlefields. After the war he married my mother-in-law, and, starting with very little, my father-in-law built a modestly successful business. They have two children; my wife and her older sister. Upon liquidating his business to retire, my in-laws invested everything they had with BLMIS. Their living expenses were exclusively drawn from the appreciation of their investments. They are now both into their

Statement of Robert J. Jerome

eighties and suffer from a variety of medical issues, all of which have been exacerbated by their present emotional stress. Their fear of not having sufficient funds to provide for their lives is all consuming.

In closing, customers such as my in-laws rely on their government to protect them from circumstances like this as a last resort. They rely on a trademark such as the SIPC logo and they rely on the oversight of agencies and bodies who, purportedly, exist to protect them from financial harm. It is not their fault that these systems broke down and failed in every aspect. Moreover, it goes against every fiber that they are told that the rules and regulations they trusted just don't apply in this case because it is different. In every sense of the word, they are victims of an unprecedented financial disaster and should be able to rely on whatever resources were designed to protect them. SIPC is one of those resources.

October 26, 2009

Robert F. Jerome
25A Bearwoods Road
Park Ridge, New Jersey 07645

8308 Waterline Drive Apt. 102
Boynton Beach, FL 33472
December 4, 2009

I am writing this letter to indicate my objection to the formula used by Irving Picard, Trustee for the Bernard Madoff bankruptcy case, in determining net equity for the victims of the Madoff Ponzi scheme. Mr. Picard's formula of cash-in minus cash-out is not the intention of the SIPA Act, which aimed to ensure protection for defrauded customers of broker/dealers. Precedents to the Madoff case based net equity on the client's last statement, rather than Mr. Picard's method. As one of many Madoff victims, I am dismayed that defrauded investors continue to be denied their appropriate due from SIPC.

Another problem created by Mr. Picard has to do with clawbacks. It is my belief that innocent victims should not be subjected to clawbacks, as is Mr. Picard's intention. Monies taken out of accounts, with the legitimate expectations that it was indeed the victims' money to take, should not be subject to clawbacks.

Additionally, I believe that it is incorrect for the IRS to have benefited by years of taxes paid on fraudulent income, and to keep those monies.

Please try to help the thousands of people affected by this terrible situation, many of whom are in their "golden years" and have been devastated by having their savings and IRA's wiped out. Thank you for any aid you can give to repair the damages done to us. We truly appreciate any efforts that Mr. Klein can offer, on our behalf, to alleviate the disaster that has ruined so many lives.

Yours truly,
Beryl H. Stevens