A LEGISLATIVE PROPOSAL TO AMEND THE SECURITIES INVESTOR PROTECTION ACT

HEARING

BEFORE THE

SUBCOMMITTEE ON CAPITAL MARKETS AND GOVERNMENT SPONSORED ENTERPRISES

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

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A LEGISLATIVE PROPOSAL TO AMEND THE SECURITIES INVESTOR PROTECTION ACT

Thursday, November 21, 2013

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

The subcommittee met, pursuant to notice, at 9:30 a.m., in room 2128, Rayburn House Office Building, Hon. Scott Garrett [chairman of the subcommittee] presiding.

Members present: Representatives Garrett, Hurt, Neugebauer, Huizenga, Mulvaney, Hultgren, Ross; Maloney, Sherman, Perlmutter, Scott, Peters, Watt, and Carney.

Chairman GARRETT. Good morning, everyone. The Subcommittee on Capital Markets and Government Sponsored Enterprises will come to order.

Today's hearing is entitled, "A Legislative Proposal to Amend the Securities Investor Protection Act." I thank all the members of the panel.

And before we turn to the panel, we will begin with opening statements. I recognize myself for 10 minutes.

Today's hearing is to further examine legislation introduced by myself and also by Ranking Member Maloney, H.R. 3482, the Restoring Main Street Investor Protection and Confidence Act.

I want to begin by directly recognizing and commending the esteemed gentlelady from New York, my colleague, for all of her hard work and dedication to this bill and to this issue as well. It has been an honor, and it has been a privilege to work closely with her on this very important issue. I also do want to thank the panelists for coming, especially our two victims who have felt the full brunt of the two largest financial frauds in our Nation's history.

I also want to specifically thank all of my fellow members of the committee, and the broader Congress as well, who have formally cosponsored this legislation that we are discussing today. I think right now we are at about one quarter of the committee on the bill. I hope that number continues to rise as Members learn more about this important subject.

I also want to express my sincere thanks to Senators David Vitter and Chuck Schumer for introducing companion legislation in the U.S. Senate. Hopefully, now, with this bicameral support, it will aid us in coming to a more expedited resolution to this problem.

Now, I want to make it absolutely clear that I am not advocating for this legislation because I am trying to score any political points. I am supporting this legislation because I have studied the law, reviewed past precedent, and analyzed the original congressional intent. And it is very clear to me that SIPC and the trustees are not applying the law as intended by Congress, and they are not adhering to their own past precedent, which has been affirmed by the courts. So the purpose of this legislation today is to reaffirm the original intent of the law and to correct the misapplication of the law by SIPC and the trustees.

It is not some retroactive change of the law. It is a reaffirmation of it. SIPC now argues that it is nothing like FDIC insurance. Yet years ago, President Nixon's original signing statement of SIPA stated, "Just as the Federal Deposit Insurance Corporation protects the users of banking services from the danger of bank failures, so will the Securities Investor Protection Corporation protect the users of investment services from the danger of brokerage firm failure."

In case that was not convincing enough, I also found this quote from Senator Edmund Muskie during the Senate deliberations of SIPA legislation. He said, "Mr. President, since 1934, the United States has insured bank deposits under the FDIC and the Federal Savings and Loan Corporation. These insurance programs protect bank depositors from loss of their savings because of bank failures. And the existence of this deposit insurance has become a source of confidence in the soundness of our savings institutions. S. 2348, the Securities Investor Protection Act of 1970, would accomplish a similar purpose for security investors by protecting them from losses because of the failure of their brokers."

If that wasn't enough, Senator Harrison Williams from New Jersey, then the chairman of the Senate Securities Subcommittee, stated the legislation "would establish a Federal brokers-dealers insurance corporation. Granted, it is not the FDIC, but the FBDIC is pretty darn close to it."

I have a 2009 email from from Mr. Harbeck to congressional staff, where in it, he directly compared SIPC to FDIC. I would like to later insert that in the record.

In Mr. Hammerman's testimony, he suggested SIPC was never intended to cover frauds, and said the legislation was "to introduce a new public policy for SIPA and SIPC, namely insuring investors against the risk of loss due to securities fraud."

Yet when going over the reason for the legislation, Senator Muskie specifically said, "There remain some very basic problems within certain parts of the securities industry. There are problems of obsolete management techniques, careless business practices, inadequate self-regulation, and occasional fraudulent activities. All of these account for some part of the industry's financial difficulties today."

To add further clarification to this topic, the head of the New York Stock Exchange, Robert Haack, wrote to the SEC at the time to provide their analysis of the potential loss to new SIPC funds. The letter states, "I should make it clear, however, that no one can, in our opinion, make a realistic or useful evaluation of the potential dollar exposure to SIPC because there is no known way to measure the liability which might be faced in the event of a broker-dealer failure. The fraud of Allied Crude Vegetable Oil against Ira Haupt, for example, caused the loss of $27 million, which in no way could be anticipated in advance."

In 1992, GAO conducted a report on the operations of the program and said, "Within the last 6 years, 26 of the 39 SIPC liquidations have involved failures due to fraud." They also stated in the report, "In essence, SIPC is a backup line of protection to be called upon generally in the event of fraud or breakdown of other regulatory protections."

With all that, I struggle to see how we are putting a new public policy objective of fraud protection on SIPC when the record is this long and this clear that protecting investors from fraud was a core function of the original statute and has been applied that way throughout its existence.

Again, turning to Mr. Harbeck's testimony, he suggests that following a final account statement to determine a customer's net equity somehow legitimizes a Ponzi scheme. SIPC argued for, and the Second Circuit Court agreed, to support using the exact same methodology in the New York Times securitization Ponzi scheme resolution in 2004. That New York Times case is very similar, almost identical, to the Madoff case. You see, time and time again, SIPC changes the rules and its story after the fact when it suits its own purposes.

The clear truth and the long and exhaustive record makes it clear that SIPC is an insurance program set up by Congress to protect investors and to ensure the appropriate functioning of our Nation's securities markets, especially in the case of fraud. So, regardless of your views about the original appropriateness of programs like these, it is a current duty as elected Representatives to ensure the law is followed and administered as originally intended by Congress, and that investors receive the protection they are promised. The legislation before us is designed to improve protections of securities investors, particularly the regular retail investor lacking professional expertise in the market. It is the direct outgrowth of a stunning regulatory failure to detect and promptly respond to massive frauds and failures of SEC registered broker-dealers, as in the Madoff and Stanford cases, or now in the McGinn Smith case, which destroyed the principal savings of over 12,000 investors. The devastation of these losses has been compounded by the failure of SIPC to fulfill its obligation as intended by Congress back in 1970.

So the provisions are commonsense reform in the bill, specifically to do these things: one, remove the inconsistences in the application of SIPC coverage, which have led to greater confusion; two, to assure the SIPC protective benefits goes to innocent customers; three, limit the exposure of taxpayers by establishing new accountability measures for SIPC's borrowing authority; four, avoid overtechnical legal interpretation at odds with SIPA's remedial objectives and the original spirit and intent of the law; five, improve the fiduciary character of SIPA's liquidations; six, strengthen SEC's plenary oversight of SIPA; and finally, direct the SEC and FINRA to give high priority to inspection procedures which verify and validate the accuracy and authenticity of information provided by broker-dealers to their customers.

All of these proposed amendments seek to assure that SIPA is administered with constant attention to the perspective and the reasonable expectations of the broker-dealer customers, those whose confidence's marked participation SIPA is intended to engender and maintain. Now, a point too often overlooked is that SIPA, while using many of the established practices of the Bankruptcy Code, is unconditionally an amendment to the Federal securities law meant to strengthen the efficient operation of the capital markets by maintaining the confidence of the retail user. It is the backbone of the system. Accordingly, the bill seeks for the future administration of SIPA to clarify that securities law primarily shall have the operative recognition.

Now, Mr. Harbeck, your written statement this morning further emboldened me in my determination to put SIPC back on the right course in carrying out SIPA's grand objective of deploying its resources to help the financially devastated, innocent and unsophisticated victims of broker-dealers in bankruptcy, including fraud, such as those who are with us this morning, rather than lawyering up to see how narrowly it can interpret the law's remedial objectives. It is basically your complete confidence in SIPC performing as the 1970 Congress intended that troubles me.

I don't doubt for a second that you believe with genuine conviction that SIPC actions are absolutely correct, not only with SIPA's letter, but the spirit of the law. And I don't question your integrity for a moment. But I am deeply disturbed by your satisfaction with SIPC's performance in these massive fraud cases, which have thankfully captured the attention of Congress now with profound concern. Our bill seeks to reaffirm the original intent of Congress in the enactment of SIPA, to make reforms in its administration for the future and, above all else, to change the culture of SIPC to one that seeks to fulfill and not hinder SIPA's remedial purposes.

I will close by saying I am thankful to a lot of people today. I said so at the beginning of my statement. But with all the victims and their families still reeling from these frauds, I must say that this is not a thankful day. But I will be thankful once SIPC is reformed and the original intent of Congress is reaffirmed.

With that, I conclude, and I now turn to the cosponsor of this legislation, the gentlelady from New York.

Mrs. MALONEY. Thank you very much, Mr. Chairman, not only for holding this hearing, but for your tireless work on this really important bill. We, unfortunately, share the same situation of representing many people who were hurt by these Ponzi schemes. And I know how hard that you focused on trying to help them.

And I welcome all of our panelists, particularly our two victims, who will help put a human face on what we are arguing about today and debating today. Unfortunately, when Bernie Madoff and Allen Stanford's massive Ponzi schemes came crashing down, they exposed several key flaws in the Securities Investor Protection Corporation and how it operates. Our bill attempts to fix these flaws and would reaffirm the primary purpose of the Securities Investor Protection Act, which is to protect customers of broker-dealers and to maintain investor confidence in our securities markets.

SIPC is supposed to maintain this confidence by winding down failed broker-dealers in a fair and equitable manner, which above all means protecting innocent customers' assets. Unfortunately, in the Madoff case, SIPC and the trustees have pursued a highly aggressive strategy that in my opinion has unfairly punished some of my constituents who are innocent customers, and has almost certainly reduced investor confidence in our securities markets.

In some cases, former Madoff customers who had withdrawn their money many, many years before the firm's failure learned for the first time that their money was being clawed back only when the trustees filed a lawsuit against them. This is hardly the way to promote confidence in the securities market. And our bill would put a stop to these tactics.

Now, SIPC has argued that these clawbacks are allowed under the Federal Bankruptcy Code. But it is important to remember that Congress enacted the Securities Investor Protection Act in the 1970s because the Bankruptcy Code was not very useful for winding down broker-dealers. Congress recognized that broker-dealers, like commercial banks, are fundamentally different from regular, nonfinancial companies. And just as commercial banks are liquidated by the FDIC, broker-dealers need to be liquidated by SIPC.

It is important to recognize that broker-dealers are different because they are heavily regulated by the SEC, which examines their books and records to make sure that customer money is actually there, makes routine on-site inspections, and requires annual audits of the broker-dealer. It is this seal of approval from the government that customers rely on, and which allows investors to place their confidence in the country's securities markets. They can have confidence in our securities markets because they have confidence in the SEC. Also, because they have confidence that if their broker-dealer fails, they will be protected by SIPC and treated fairly.

The account statements are also good enough for the government to rely on. After all, these customers pay taxes to the IRS on the profits that they see on their account statements. Now, SIPC says that they can claim a tax deduction on this IRS payment in the case of a clawback, but most of these people are retired and don't have the income to have a tax deduction. In addition, customers make all of their financial decisions based on the financial statements that they receive from their brokers, which tell them how much money is in their account. For SIPC and the trustee to come in years later, in some cases 10, 20, 30 years later and say, sorry, you actually can't rely on these financial statements that the government has essentially been signing off on for years, they are wrong. SIPC should not be able to claw back money that innocent customers had withdrawn years ago. Our bill would prevent these unfair clawbacks of money that innocent customers had long ago withdrawn. It would, however, still allow clawbacks in cases where an investor actually knew about the fraud when they withdrew their money. That is the way it should be. Innocent people should be protected, while customers who knew about the fraud do not receive the benefit of government protection.

The time has now come to reform SIPC. And I believe that our bill is a good starting point toward a lively debate on this issue. I thank the chairman and all of our participants, my colleagues, for being here today. And I thank particularly the chairman's, I would say inspiring, leadership on this. He has been very dedicated in working on this issue for a long time.

And I yield to Mr. Sherman for 2 minutes.

Mr. SHERMAN. I want to thank the Chair and the ranking member for these hearings. They have studied this issue, and know far more about it than many of us on the subcommittee. There seems to be a general agreement that the limits on SIPC insurance should be clear and should be prospective. And the payout from any insurance company needs to be limited by the limit of the insurance rather than limited only by our empathy for the insured beneficiary. The FDIC faces many of the same issues because the limit is per customer, in effect, or per depositor. If Three Brothers Moving and Storage Company has a $750,000 deposit at a bank, they only have $250,000 of FDIC insurance. If three brothers each open up a quarter million dollar account at the same bank, those three brothers collectively have $750,000. The account name matters. The entity that is making the investment matters. And whether it be a partnership, a trust, or a corporation, we cannot allow General Motors to have $100 million of FDIC insurance just because General Motors has millions of shareholders.

We have cases in progress now, and I think they ought to be decided based on what the law was at the relevant time. And I would count on judicial and quasi-judicial entities to make that determination without a lot of help from Congress. But that doesn't mean that there won't be future Madoffs, and future Lehman Brothers, and future circumstances for which we can't do a much better job in providing. And I look forward to learning more here, even though I will have to leave early because I have another hearing. Thank you.

Mrs. MALONEY. I now yield 1 minute to Mr. Perlmutter.

Mr. PERLMUTTER. I thank the ranking member. And I thank the chairman for bringing this bill forward. I do think that there are some fundamental questions that we can't forget. The old saying is that bad facts make for bad law. And we have to watch out that we don't do something here that is a problem. Because trying to address a Ponzi scheme, which is a sham, a phony deal from the very outset, and the numbers are not real, and there is sympathy for the people who are drawn into the fraud, obviously. But does the taxpayer in Montana who has nothing do with the folks who were defrauded in Boulder, Colorado, is it their responsibility to cover the fraud? Madoff and Stanford bilked thousands of people of a lot of money. And it was all a house of cards. And somebody who gets into the fraud early gets to benefit from it against the people who got in late. And so, these are very different circumstances.

I appreciate the panelists today and their testimony. I appreciate the sponsors for bringing this. But we have to watch this whole area very closely.

With that, I yield back.

Mrs. MALONEY. I thank the gentleman, and I yield back the balance of my time.

Chairman GARRETT. The gentlelady yields back. The gentlelady's side went over a little bit.

Because one of our Members may not be here later, I ask unanimous consent to yield 30 seconds to Mr. Mulvaney, without objection.

Mr. MULVANEY. I appreciate that, and I thank the chairman and the ranking member.

And I thank the panelists for being here today.

In the event I am not able to return, I did want to go on record on one important thing that affects SIPC. It is a little outside of the topic today, but is still very important. I am not sure if folks are aware that SIPC, along with groups like the Tobacco Trust Fund, FDA user fee accounts, the Public Company Audit Oversight Board, the Financial Accounting Standings Board, all of those groups had specific user fee funds sequestered. I think it was an unintended consequence of the sequester. The sequester was designed to limit the use of general account funds, not user-fee funds. What we have is groups that are counting on user fees to operate their various institutions that have been sequestered. All the more reason not to have voted for the sequester in the first place.

But in any event, I want to tell SIPC that I am sympathetic, and tell the other groups that I am sympathetic. And as we try and figure out a way to work out various fixes to the sequester, I hope we focus attention on the fact that user fees were unintentionally sequestered as well, and I think that is wrong. Thank you, Mr. Chairman.

Chairman GARRETT. I thank the gentleman.

With the time for opening statements now expired, we will turn to statements from the panel. And again, I wish to say thank you to all of the members of the panel who are here today for this very important topic. We will run down the aisle as we do. Your complete written statements have been made a part of the record. We will now yield to you 5 minutes for a summary of your statements.

Many of you have never been here before. There are lights in front of you to indicate how much time you have. It will be green when you start. It will turn yellow when you have one minute left. And it will turn red when you are supposed to have concluded. I also ask each one of you when you do speak, because I am a little hard of hearing up here sometimes, to make sure your microphone is turned on, and that your microphone is pulled close to you, like Mr. Hammerman is doing right now, good, because it doesn't pick up from a far distance.

So with that being said, we will start with the president of SIPC, Mr. Harbeck. Good morning. You are recognized for 5 minutes.

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

Mr. HARBECK. Good morning, Chairman Garrett, Ranking Member Maloney, and members of the panel. My name is Steve Harbeck. I am the president of SIPC. I have been with SIPC for 38 years, the last 10 of which as president.

I will dispense with discussing most of the major activities of SIPC since the start of the financial crisis because they are listed in my written statement. However, I do want to point out one important point, and that is at no point in the financial crisis was it more important to improve investor confidence than in September of 2008 and the failure of Lehman Brothers. SIPC stepped in to liquidate the brokerage entity in Lehman Brothers and, with the trustee in place, transferred 110,000 customer accounts with $92 billion in them within 10 days. I believe that was absolutely critical to investor confidence in what was clearly the most dangerous period of our time since the Depression.

We are here today to talk about a specific bill and more specifically the performance of SIPC in the Madoff case. I appreciate particularly Congressman Perlmutter, who has a bankruptcy background, indicating how difficult these decisions were. But it is SIPC's belief that to do the greatest good for the greatest number, consistent with the law, we have done so. And that we have done so consistently with prior precedent.

What I would like to do is take you through something that would occur under the bill if it were passed. And let's go to the Madoff case in particular. If the FBI and the Securities and Exchange Commission and SIPC had arrived in Mr. Madoff's office 2 days later than we did, there were $175 million worth of checks on Mr. Madoff's desk that would have gone to innocent customers of his choosing. But that would have only left under $200 million for the trustee to distribute.

And further, under the bill, if you strip it from the avoiding powers that are specifically given under the existing statute, specifically given to a trustee, instead of having the $9 billion that he now has to distribute, he would have less than $200 million. That is an unintended consequence of the activities that this bill would sponsor.

I realize how difficult it is for the victims. But the fact remains that this is a zero-sum game. And if one credits Ponzi scheme profits that were generated solely in the mind of Mr. Madoff, and if those profits stand on equal footing with the net amounts that people have not received back, that means that dollar for dollar, people who receive those amounts as profits—those profits would be taken directly from people who did not receive their own money back. That is bad policy and bad law. It is not the law and never has been.

In any instance, the first of which was in 1973 in the S.J. Salmon case, and again in the Adler, Coleman case, and yes, even in the cases mentioned by the chairman today, the fact is that at no time have fictional profits ever been recognized under the Securities Investor Protection Act. That is the policy, the consistent policy that was also applied in the Madoff case.

What we have here is the trustee acting, again, to do the greatest good for the greatest number consistent with the law. I would like to turn to Ranking Member Maloney's mention of the fact that the trustee has initiated lawsuits. As soon as he initiated those lawsuits, he also initiated what he called a hardship program. Because all a person who has been sued has to show under the scenario that you correctly laid out, that they had used the money over time, the trustee did not know that, but if those facts were brought to his attention, the lawsuit was summarily dropped. Some people have been ill-advised, in my view, by their counsel not to enter the hardship program. I believe that people who can demonstrate the sort of hardship that you rightly empathize with will have those lawsuits dismissed.

But make no mistake, the current statute does allow what are called the avoiding powers. And the entire purpose behind those avoiding powers is to do equity. The bill strips those away. I would be pleased to answer your questions.

[The prepared statement of Mr. Harbeck can be found on page 50 of the appendix.]

Chairman GARRETT. Thank you.

Mr. Hammerman is now recognized for 5 minutes.

STATEMENT OF IRA D. HAMMERMAN, EXECUTIVE VICE PRESIDENT AND GENERAL COUNSEL, SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION (SIFMA)

Mr. HAMMERMAN. Chairman Garrett, Ranking Member Maloney, and members of the subcommittee, I would like to express my deepest sympathy for the victims of the Madoff and Stanford schemes. I have family and friends whose financial lives were adversely impacted on December 11, 2008. And I know from personal interactions the havoc caused to individuals, retirees, and wonderful charities by Madoff and the feeder funds that never even disclosed they were investing in Madoff. So I understand and in fact applaud the tenacity being expressed by Chairman Garrett and Ranking Member Maloney as they seek to help their constituents and the investing public at large. I also commend you for recognizing more generally the need to consider changes to SIPA in order to better protect investors and increase investor confidence in the financial markets.

I served on the 2012 task force that undertook a comprehensive review of SIPA. And I agree, there are proposals for reform that warrant consideration. Any reform proposal should be made with an analysis of their costs to SIPC, the members of SIPC, and the investing public. This is particularly important with respect to the proposed legislation, which would materially expand SIPC's mandate to provide insurance against the risk of loss due to securities fraud and fictitious profits.

Congress enacted SIPA in 1970 in response to the paperwork crisis of the 1960s, a time when stock certificates routinely went missing, trade processing errors were common, and there were multiple failures of brokerage firms. Congress created SIPC to protect the custody function that broker-dealers perform. And while it is certainly within the prerogatives of Congress these 44 years later to expand SIPA's scope to provide insurance against losses due to securities fraud and fictitious profits, we believe the costs would be extraordinarily high.

The SIPC Modernization Task Force recommended changes that would increase the protection available to customers in at least 3 important ways: increase the cap on advances from $500,000 to $1.3 million; eliminate the lower cap of $250,000 applicable to customer claims for cash versus securities; and make individuals eligible for advances with respect to shares of their pension plans account. These types of changes would appropriately expand SIPA, while continuing to reflect its core purpose of protecting investors against the loss of cash or securities in the event the brokerage firm holding their property becomes insolvent.

The proposed legislation provides that the assets of a customer would be determined on the basis of the last account statement, with customer property in liquidation allocated accordingly. We have significant concerns with this approach since customer account statements in situations involving fraud reflect fictitious transactions and do not truly represent customers' positions. The property held by a Ponzi scheme is simply the pooled investments of all the victims of the scheme less the amounts already misappropriated, and making distributions based on anything other than the victims' net investments would be fundamentally unfair.

The net investment method has been used with respect to fraudulent schemes as far back as the 1920s. It has been applied by several trustees and courts in SIPA liquidations, and we believe it should be used to determine net equity for purposes of allocating customer property in situations involving fraud.

The proposed legislation would also add to the customer definition any person whose assets were misappropriated by an affiliate of a brokerage firm, whether or not the firm had custody, possession, or control of such assets. Expanding SIPA in this manner could ultimately result in significant increases in the costs borne by investors, and in some cases result in investors losing access to the financial markets altogether.

Regarding the effective date, we question whether application of the draft bill to active liquidation proceedings is even feasible. For example, in liquidations in which distributions have already commenced, it is unclear whether customers would be required to return assets to the trustee so that the trustee could redetermine claims and allocations. At a minimum, retroactive application of the proposed bill would significantly slow down the current SIPA proceedings.

Finally, it is a very unfortunate fact of life that fraud exists and that crooks will continue to use the financial system to find victims because, to quote notorious bank robber Willie Sutton, that is where the money is. Criminals who steal investors' hard-earned money and life savings should be prosecuted and put in jail, but using fraudulent account statements to insure all of us against the risk of fraud is quite another undertaking, and its ramifications for businesses and investors should be carefully analyzed and debated, lest we inadvertently let the criminals decide which victims recover what amounts.

Thank you for allowing me the opportunity to testify. I would be pleased to answer your questions.

[The prepared statement of Mr. Hammerman can be found on page 39 of the appendix.]

Chairman GARRETT. Thank you.

Our next witness is making her way up here, I believe. Take your time.

Welcome.

And just to recap, since I know you just came in, please make sure your microphone is on. You will be recognized for 5 minutes. The little lights in front of you are green, yellow, and red, for that purpose. Your full written statement will be made a part of the record, and we therefore ask all the witnesses to give a summary during their 5-minute presentation. So you are now welcome and recognized for 5 minutes.

STATEMENT OF ANGELA SHAW KOGUTT, DIRECTOR AND FOUNDER, THE STANFORD VICTIMS COALITION

Ms. KOGUTT. Thank you, Chairman Garrett. My name is Angela Shaw Kogutt, and I am the director and founder of the Stanford Victims Coalition, a nonprofit advocacy group for the victims of the Stanford Financial Group Ponzi scheme.

Chairman Garrett, Ranking Member Maloney, thank you for holding this hearing today to discuss a much-needed amendment to the Securities Investor Protection Act of 1970. I applaud you both for your leadership in introducing the Restoring Main Street Investor Protection and Confidence Act, which has given hope to thousands of financially devastated investor victims across the country who feel they have been unfairly denied the protection of which the SEC has determined they are entitled. I also thank the distinguished members of the subcommittee who have already joined H.R. 3482, and I ask those of you here today to consider this important legislation.

I want to point out right away that I am not the typical face of the Stanford victims. I am a second generation victim. Most of the victims are senior citizens, and for the past almost 5 years now, I have spent a majority of my life serving as their advocate, hoping to help them recover some of their losses. I have done this because I am younger than they are and because they deserve it.

Like thousands of other Stanford victims, my life was forever changed by the events of February 17, 2009. As we watched the news and feared the worst in the immediate aftermath of Madoff's confession, we eventually realized that Allen Stanford had stolen what two generations of my family worked 4 generations to build. And he did it through Stanford Group Company, a registered broker-dealer and member of SIPC.

The SEC had known for more than a decade that Stanford was operating a Ponzi scheme. While Madoff had outsmarted the SEC, Stanford hadn't. And the SEC knew for 12 years that he was using the U.S. broker-dealer to steal customer funds intended to purchase CDs from Stanford International Bank. In that timeframe, the Stanford Ponzi scheme grew by $5 billion, including the investments of every single U.S. citizen who invested in the CDs.

My father-in-law is an 87-year-old World War II veteran and a first-generation American who, again, like so many Stanford victims, was able to live the American dream, only to have it snatched away practically overnight. In 1965, he started a manufacturing business with a few thousand dollars borrowed from family members. He and my mother-in-law put in long hours for several years, and eventually all three of their sons, including my husband, joined the business. The family worked together for more than 3 decades to build the business to more than 300 employees and close to $20 million a year in revenue. At that point, the business had outgrown the family, and they made the decision to sell at just the right time, before the economic collapse of 2008.

As soon as the sale of the business closed, our lawyer who handled the transactions suggested we invest with a brokerage firm that specialized in managing large accounts. She then recommended what she called a boutique brokerage firm, Stanford Group Company, which specialized in high-wealth clients. The family had never heard of Stanford but agreed to a meeting. Other firms were also considered, but Stanford really stood out because of their enthusiasm, professionalism, their very high public profile, the top notch credentials of their advisers, and what we misinterpreted as genuine and sincere interest in our investment goals.

What we didn't know is that financial advisers at Stanford Group Company were hooked on what they internally called bank crack in the highly lucrative commissions and bonuses they received for selling the CDs from Stanford International Bank. Also, little did we know that none of the financial advisers at Stanford Group Company knew what assets were held, if any, in Stanford International Bank's investment portfolio.

How someone who has a fiduciary duty to their clients could recommend putting any of their funds in an investment vehicle for which they didn't even know the underlying investments seems extremely questionable, but that was also an inside secret that Stanford paid them enough to overlook.

Ultimately, a substantial portion of the proceeds of the sale of my family's business was invested with two Stanford Group Company financial advisers. At the first meeting, the family explained that they were very conservative and risk-averse. One of the advisers, Bill Leighton, was an estate planning lawyer. The other, Patrick Cruickshank, was a certified financial planner, and NFL, NBA, and NHL-approved financial adviser and Series 7 license holder. They told us their safest, most conservative investment was their exclusive signature product, the Stanford International Bank CDs for accredited investors. We learned at the meeting that the entire Stanford financial group of companies, which included Stanford Group Company, Stanford International Bank, Stanford Trust Company, and more than 100 other Stanford entities all owned by Allen Stanford was headquartered and operated out of Houston, Texas, and regulated by the SEC and numerous State regulators, as the SEC had 33 offices across the country and more than 250 financial advisers who are still working in the business today with no record on their FINRA broker check.

We were also told that the bank's portfolio was managed by a team of money managers in Memphis, Tennessee, with a company called Stanford Capital Management, which was also regulated by the SEC. We were told that the international CDs were better than investing in a U.S. bank CD because the international CDs were securities, and they were backed by SIPC, which was up to $500,000, and the FDIC at the time was only $100,000. Many Stanford victims made their decision to make that investment because of the securities product versus the bank product.

It is now almost 5 years later and SIPC has continued to deny protection of Stanford Group Company customers by saying we received the securities we purchased through SGC, which simply is not true. Our money was stolen. How could we have gotten a security when the owner of the broker-dealer stole our funds? Allen

Stanford is serving a 110-year jail sentence for stealing our money right here in the United States, not for committing an Antiguan bank fraud, which has not even been alleged in the country of Antigua.

In November 2009, the Stanford Victims Coalition formally asked the SEC to review the SIPC's determination about SGC customers' right to protection under SIPA. After more than a year of the SVC suffering the burden of proof and producing hundreds of SGC customer documents at a time to the SEC only to have the target moved each time and more documents requested, it appeared the SEC was obviously avoiding making a determination. The SVC's members then asked our political leaders to urge the SEC to make a determination. More than 50 Members of the House and Senate signed on to a letter asking the SEC to give the SVC an answer. Still, no answer, only repeated promises that a vote would happen soon, which I have now learned in SEC language could be months or even years, given the way they have handled the Stanford case.

Finally, when it appeared this game would go on forever, while Stanford victims were losing their homes and going without life necessities, Senator David Vitter blocked the nomination of an incoming SEC Commissioner until Stanford victims were given an answer. This was not a political play. Senator Vitter never told the SEC how to vote. He just asked them to give the investors an answer, to just take a fair vote and give us an answer. The vote was taken, and as the SVC and our counsel had hoped, the SEC determined that SGC customers were entitled to protection under SIPA because the SIB CDs were fictitious securities, and SGC customer funds intended to purchase the CDs were either acquired by Stanford Group Company to pay the broker-dealer's expenses or were outright stolen by Allen Stanford.

Chairman GARRETT. I am going to ask you—

Ms. KOGUTT. In closing, I would just like to say one more thing. There are thousands of investors who truly are living in poverty right now. This summer, an article came out in the Baton Rouge newspaper that a food bank was going under, mainly because of the devastation caused by the losses in Baton Rouge of the victims of the Stanford financial fraud. They are living on donations from charity.

Chairman GARRETT. Thank you.

Ms. KOGUTT. Thank you for holding this hearing and for allowing me to speak for the victims.

[The prepared statement of Ms. Kogutt can be found on page 67 of the appendix.]

Chairman GARRETT. Thank you.

Mr. Stein, you are now recognized.

STATEMENT OF RON STEIN, PRESIDENT, THE NETWORK FOR INVESTOR ACTION AND PROTECTION (NIAP)

Mr. STEIN. Thank you, Chairman Garrett, Ranking Member Maloney, and members of the subcommittee. My name is Ron Stein. I am the president of the Network for Investor Action and Protection, a national not-for-profit organization dedicated to improving our Nation's investor protection system. I am also a registered investment adviser, a certified financial planner, and a member of the financial services industry in good standing.

Over 1,000 members of our organization were victims of the Madoff fraud. I am honored to speak to you today, as others have done before me, to give voice to the mostly middle-class investors who were devastated by this fraud, and who are being stripped of protections from SIPC and the SIPC-appointed trustee.

Perhaps more, I am here on behalf of small investors, millions of small investors who have not yet been victimized, who depend on Congress, the regulatory apparatus, and the industry for the protection of their life savings should similar financial disaster befall them.

So where do we stand today, 5 years after, regarding the Madoff fraud? Frankly, thousands of lives upended with another thousand being sued, story after dismal story of family horrors, depression, premature deaths, suicide, loss of medical care, life savings obliterated, gruesome and devastating stories.

This is not what Congress intended when it first passed SIPA law in 1970 amidst the turmoil of hundreds of brokerage insolvencies, recession, massive theft, fraud, and, yes, Ponzi schemes. The creation of SIPC, the insurance-like entity, was the cornerstone of that legislation and an essential step to providing certainty, confidence, and trust to investors as Congress was ushering them away from the certainty of their physical securities to the new, more manageable world of the investment statement. It goes way beyond a custody function; it goes to ensuring confidence in the investment markets themselves.

Now, Congressman Garrett quoted President Nixon and several others. I would just like to include one additional excerpt from the original Nixon testimony on signing SIPA legislation in 1970. He said pertaining to the SIPA law, “It protects the small investor, not the large investor, since there is a limit on reimbursable losses. And it assures that the widow, the retired couple, the small investor who has invested their life savings in securities will not suffer loss because of an operational failure.”

I would like to point out that neither Nixon nor anyone else at that time ever said that profits weren’t going to be protected, or mentioned the words “fictitious profits” as an exception to this protection. That is revisionist history.

Following the passage of this legislation in 1970, every brokerage firm trumpeted SIPC protection to its customers, and every customer was informed that they are/were protected to the SIPC limit based on their account statement values should their broker fail. This was part of every broker’s security training, every one. I know. There were no asterisks. There were no exceptions. There was no hint of being sued. And it was upon these promises that the financial services industry was able to gain the trust of the American public and explode in size.

Now, how do those promises and Congress’ intentions comport with the realities today?

Fact: The majority of Madoff investors will not receive a penny of the SIPC advance guaranteed by Congress under SIPA statute as a result of the net investment methodology the trustee has chosen to use.

Fact: Over 1,000 investors acknowledged as being innocent by the trustee are being vigorously sued like thieves and criminals, many having already lost everything.

Fact: Institutions and professional investors are receiving over 80 percent of the recoveries of customer property. Many of these entities that the trustee himself has indicated should have or could have known about the fraud.

Fact: In addition to saving SIPC over $1 billion by the trustee's own calculations, the trustee and his associated consultants have similarly been enriched by almost $1 billion, and that number could grow, and those are funds which could have gone to those who have been devastated and go to needed education to prevent further frauds of this nature.

There is simply no rational way to conceive that this is the outcome that Congress would have preferred were it sitting here today. Indeed, this is precisely what Congress would have sought to avoid, and clearly in no way would the American public have supported a SIPA law in 1970 if this was seen as a possible outcome.

The implications of this would be disastrous and could be disastrous to all investors today. What investor in their right mind could possibly trust that SIPC would be there or, worse, not sue them for withdrawing funds from their own accounts? What retirees would want to see their protections reduced just when they are drawing on their life savings? Once investors realized their protections don't exist, consider the impact on the financial services industry as investors withdraw and move funds from one firm to another.

Let me be clear. I am deeply, deeply troubled as a financial practitioner about the failures of the regulatory entities that were charged with the responsibility to protect or unmask this fraud at a much earlier level. But I am also deeply distressed that members of my own industry, when they had the knowledge or the thought or the concern about a fraud, chose not to come forward. I hope that will change as we go forward.

But I am truly infuriated at SIPC's lack of response in a human way to help protect the investors they were charged with protecting, and that they have thumbed their noses at Congress, refused to go to Congress when they could have to ask for guidance in this issue and instead taken it on their own to create the situation we are in today.

H.R. 3482, the Restoring Main Street Investor Protection and Confidence Act is an important step to restoring the most basic protections that investors need at this time. I want to thank Congressman Garrett for showing tremendous leadership in this, for Congresswoman Maloney and the rest of the committee in sharing support, and I truly hope the industry will stand with us in supporting this very important legislation. Thank you very much.

[The prepared statement of Mr. Stein can be found on page 151 of the appendix.]

Chairman GARRETT. Thank you.

Ms. Shean, welcome, and you are recognized for 5 minutes.

STATEMENT OF SUZANNE SHEAN, A CUSTOMER OF STANFORD INTERNATIONAL BANK

Ms. SHEAN. Thank you. I would like to thank Chairman Scott Garrett and Ranking Member Carolyn Maloney for holding this hearing today and allowing me to speak about my experience as a victim of the Stanford Financial Group Ponzi scheme. I would also like to thank you from the bottom of my heart for giving victims like me hope for recovering our stolen retirement savings by introducing H.R. 3482. Thank you also to all the subcommittee members here who have already joined this desperately needed bill.

My name is Suzanne Shean, and I am 64 years of age. I live in Carriere, Mississippi. Allen Stanford and the SIPC member broker-dealer Stanford Group Company took more than my life savings of a quarter million dollars invested just 18 months before the SEC took the Stanford group of companies into receivership. He took from me what money can't buy. He took my husband's life, my soul mate, my daughter's daddy, my grandchildren's granddad, and the life we had together.

When the news of the Stanford scandal broke, I had just had surgery and was undergoing radiation treatments for breast cancer. My sweet husband Michael sheltered me from the news for months during my treatments and recovery. Michael had also had cancer, colon cancer, and underwent surgery in March of 2008. The doctors were able to remove it all, and they said he did not need radiation or chemo or any kind of other treatment, but being a victim of a Ponzi scheme is like cancer itself. The stress eats away at you. For some, that happens slowly. For Michael, it only took 6 months.

His cancer returned with a vengeance and quickly spread throughout his body. The burden of losing our life savings was just too much for him, especially when he carried that burden alone for so long to protect me while I was sick.

He died on April 29, 2011, at the age of 66 years old.

Before Michael died, he worried so much about me and my future alone without our savings. My greatest hope was that he would be comforted with the knowledge that SIPC would make things right for us before he died. That didn't happen.

I only saw my husband cry 3 times in our 43 years of marriage. Tears of joy at the birth of our daughter in 1969, tears of helplessness when neighbors had to help me pick him up after he fell a few weeks before he died, and tears of anguish when he asked me to forgive him. He had liquidated our IRA stock market portfolios to invest in safer IRA CDs with Stanford International Bank, with the Stanford Group Company. He was inconsolable, but it was not his fault. The safety net created to protect investors like us had failed to do so.

During our whole lives together, Michael and I worked so hard to put money away so we could retire one day and enjoy our golden years. For him to die thinking that was all in vain is an abomination of the very soul of our society.

Discovering that the SEC knew Stanford Group Company was involved in a Ponzi scheme for more than a decade before we invested with them added insult to injury. The double whammy of SIPC announcing it had absolved itself from protecting us was just inconceivable.

I am now forced to work two jobs to keep my home. As a working widow under 66 years of age, I am not entitled to my husband's Social Security checks because my salary is over $17,000 a year. I should be enjoying my grandchildren and the fruits of my labor for these past 64 years. Instead, retirement is not an option now that our entire IRA is gone.

What will happen to me when I can no longer work? The 1 percent recovered by the Stanford receiver after almost 5 years will just about cover one house note and my trip here today.

Michael and I were very conservative investors, and we entrusted Stanford Group Company, a registered broker-dealer and SIPC member, to invest our IRA funds safely. We were told because we had an IRA that Stanford Trust in Louisiana would hold custody of our investments, and we felt comfortable with this investment because every aspect was being managed in the United States and regulated by government.

But what we didn't know did hurt us. We had no idea that Stanford Trust Company was created by SGC as a way to tap into a whole new source of money to feed the Ponzi scheme. Hundreds of millions of dollars of innocent investors' IRA funds were lost. The Stanford Trust Company was a subsidiary company of SGC and was created as a State-regulated entity solely to evade oversight by the Federal Government. The Louisiana Attorney General's Office later explained that SGC employees operated the trust company and even served as its board of directors. In short, SGC held custody of our CDs, and our savings never left the United States and never went to purchase securities of any kind.

We were shocked when we found out that SIPC announced we didn't qualify for protection because we weren't customers of SGC because it supposedly didn't hold custody of the fictitious Stanford International Bank CDs. But we had a customer contract with SGC, and our account numbers begin with STSGC. What SIPC was telling us seemed like hyper-technical legalese designed solely to avoid covering our losses, despite other similar SIPC cases in which investors were protected. SIPC was behaving as if it was a private insurance company with government immunity, and they have gotten away with it so far at the expense of thousands of victims just like me.

Here we are, innocent investors, who used a SIPC member broker to purchase securities that come to find out didn't even exist, and SIPC is treating us as their enemy. The CDs were an imaginary investment vehicle designed to take money from Stanford's right hand, Stanford Group Company, and steal it with its left hand, Stanford International Bank. In short, we have been victimized again and again, first by the SEC for not stopping Stanford Group Company when they were aware of misappropriations of customer funds and other fraudulent activities, and then by Allen Stanford himself, who stole our money, and then a third time by SIPC because they have told us Allen Stanford stole our money the wrong way.

Chairman GARRETT. Ms. Shean, I would ask you to come to a conclusion.

Ms. SHEAN. Okay. I beg you to please close the loopholes in the law that SIPC has manipulated in order to protect it. It means Michael—I will never have Michael back, but I know his soul will rest in peace if he knew I was taken care of. That would mean the world to me. I am a survivor. Yesterday was my 5th year anniversary of being cancer free. Please don't take hope away from me. Thank you for your time and your attention. It has been my honor to share my story with you today.

[The prepared statement of Ms. Shean can be found on page 125 of the appendix.]

Chairman GARRETT. Thank you, Ms. Shean.

And finally, Mr. Friedman is recognized for 5 minutes.

STATEMENT OF NEIL FRIEDMAN, A CUSTOMER OF BERNARD L. MADOFF INVESTMENT SECURITIES

Mr. FRIEDMAN. Thank you, Mr. Chairman, and members of the subcommittee, for the opportunity to be here and to tell my story. My greatest loss is something that SIPC would never cover, the loss of my wife after 53 years of marriage. I am 79 years old. I am a veteran of Korea, and I am left with two wonderful children and four grandchildren. My daughter has MS. My children relied upon me and my account—although it was not large, because I by no means was considered rich—to take care of them if they needed it. I put in—let me go back to my story on how I got involved, if I may, with Madoff.

A friend of mine in 1962 had a daughter the age of my son who played in a playground together. Their father was Bernie Madoff's CPA, Jerry Horowitz, and Jerry and I were strictly friends until I went into my own business, which was subsequently in the middle of the 1960s, when I opened a life insurance agency, and he became my CPA. Jerry had been investing with Madoff well before the 1980s, and so I felt that his due diligence, with the SEC as a backup and SIPC as a last resort would take care that if we lost everything, we would at least recover something. I put in my pension plan assets. I even sold Madoff in the early 1980s a retirement program and had free access to his office at 1 Wall Street, walked around, knew all the employees, and was never aware of anything that was not honorable.

I am a graduate of NYU. I graduated as an accountant, hated that as a profession, and ended up in the insurance business, which was more personable. I grew moderately, I marketed with 16 different life insurance companies across the United States, actually specializing in impaired risks as well as competitive products. And I was able to amass, I guess, well, the balance was about $2 million in my retirement program, which my employees had the option of not partaking in, thank God, and my personal savings.

I am now living on Social Security, with a little money in the bank, which primarily was the result of refunds from Internal Revenue for the taxes I paid in my, was forced to pay mandatory at 70 and a half to withdraw moneys. In essence, that is my story. I got a part-time job, maybe 1 day a week or 2 or whatever they needed me, and I really have no source of income other than Social Security, which is $1,400 a month. I had to put my house in a reverse mortgage just so I could stay there. I would not live with my children. And I thank you all for this.

[The prepared statement of Mr. Friedman can be found on page 36 of the appendix.]

Chairman GARRETT. I thank you for your testimony, and I thank everyone for the testimony, and so we will go to questioning now. I guess I will begin with Mr. Harbeck. Would you agree that when SIPA was passed in 1970, the creation of the SIPC fund capitalized by industry assessments was the feature given the most attention in the Floor discussion in the House and the Senate?

Mr. HARBECK. I am not sure I understand.

Chairman GARRETT. In other words, the establishment of the fund, the focus was in large part in setting up a fund because it provided liquidations at broker-dealer firms with another source of relief coming from the assessments.

Mr. HARBECK. That was absolutely one of the major components of the bill, yes, sir.

Chairman GARRETT. Right. So, by doing that, you are going beyond conventional bankruptcy to try to do what, to mitigate losses, correct?

Mr. HARBECK. That is correct.

Chairman GARRETT. And so in providing for the supplemental relief to customers of failed broker-dealers, is it correct to say that the overarching congressional purpose was to restore and maintain the confidence of investors, particularly nonprofessional investors, in their continued participation in capital markets for the benefit of the economy?

Mr. HARBECK. That is also correct.

Chairman GARRETT. Right. So, a couple of points taken from that.

Mr. Stein, what was the number you gave as far as where the distribution is at this point as far as between regular just retail investors versus institutional investors?

Mr. STEIN. Over 80 percent.

Mr. HARBECK. I would love to address that, if I may.

Mr. STEIN. Over 80 percent of the funds in terms of dollar amount will be going to institutional investors based upon the recovery numbers that the trustee and SIPC have provided.

Chairman GARRETT. And is it true—overall, have the majority of people who have been taken advantage of in the Madoff situation received compensation payments or have the majority not received payments?

Mr. STEIN. The majority have—first of all, talking about direct investors, if we added indirect investors, the number of those who have received relief is fractional, but the majority of investors have not received any SIPC protection whatsoever, and significant numbers of those who have received protection have had those protections, those amounts reduced significantly because of the net investment method adopted by the trustee.

Chairman GARRETT. And I should probably take this moment just to be clear here that we are talking about two, I don't want to call it pots of money here, but two avenues of money of relief, right? One is advances, correct me if I am wrong on any of this, the advances which basically comes from the industry-generated fees, right? And the other is the recaptured or recovered money when the trustee goes out and re-collects, collects the money from the bad actors in this; is that correct?

Mr. STEIN. Yes.

Chairman GARRETT. Right. So there are two pots of money here. And in the legislation before us, essentially we are talking about making sure that—we are really not making any changes with regard to the recovered money? I will go to Mr. Stein for that.

Mr. STEIN. The trustee is given a significant range of opportunity to apply what methodology he feels is most appropriate regarding the recoveries of customer property, but regarding SIPC advances themselves, this legislation is making clear that the trustee does not have the right to change the intent of SIPA law to suit the purposes of the SIPA fund or any other rationalization he can come up with to do so.

Chairman GARRETT. Right. Mr. Hammerman, I do sincerely appreciate your opening comment with regard to your concern for the victims and also for your statements and your association to try to work with us on this legislation, I do appreciate that. One comment that you did make, though—you did say this point, you said that fraud is a fact of life, and you said something that has been with us always, words to that effect you said. Ponzi schemes, I guess, have been with us always. You didn't say that, but I guess that means that you would agree with that in one way, shape or form or another, right?

So if that is the case, then back in 1970 when they created this law, and they created the fund, created the whole—and the focus was on the SIPC fund, they must have known at that point in time that Ponzi schemes existed, but I didn't see anything in the original law, and I certainly didn't see anything in the Senate discussions on this where they created a Ponzi exemption. When did that come about?

Mr. HAMMERMAN. Mr. Chairman, there is no Ponzi exemption, as you explain. The way I understand it is the way it would work is if you as a customer gave, let's say, $100,000 to a brokerage firm with the expectation that the brokerage firm would buy securities for you—

Chairman GARRETT. Right.

Mr. HAMMERMAN. —in the account, and then that brokerage firm turns out to be a Ponzi scheme, for example, then you would be covered for that $100,000 of cash that you gave for the purpose of buying securities, full stop.

What would not be covered is, let's say you gave that $100,000 and the monthly statement—

Chairman GARRETT. But that was—I know where you are going to go with this, but that was not said in the original law. Isn't that just a creation of later court cases?

Mr. HAMMERMAN. That is not my understanding, but I am not an expert in SIPC and the court cases.

Chairman GARRETT. Okay. And I am going to be mindful of the time because we are coming up on votes, so—I have a whole series of other questions, but I will return probably in a second round to the gentlelady from New York.

Mrs. MALONEY. Thank you, Mr. Chairman.

And I thank all the panelists, and I think the basic question is, what does SIPC insure? And going forward, what should it insure in the future? How do we make that clear to investors? Because we heard from victims that in the case of Stanford, they weren't insured in anything.

Is that correct, Ms. Kogutt? SIPC did not insure or give any paybacks at all to the Stanford victims, right?

Ms. KOGUTT. None whatsoever.

Mrs. MALONEY. None whatsoever.

Ms. KOGUTT. We actually haven't even been able to file claims because there is no liquidation, so we have had no right of a judicial review of if our claims are valid or not.

Mrs. MALONEY. So this is a tremendous problem going forward, and in terms of Madoff, were payments done in Madoff or not from SIPC?

Mr. STEIN. Yes. Approximately half of the Madoff direct customers received SIPC compensation.

Mrs. MALONEY. What, $500,000 for securities, or what compensation did they get?

Mr. STEIN. Up to $500,000. The average payment is a little less than that. But for those who were fortunate enough, and I say that very carefully, when they were fortunate enough not to have needed to pull funds out of their plan to live on, they were able to receive SIPC compensation, and that gets to the fundamental problem, and the public policy debacle that SIPC and the trustee are representing here.

Witness, as Exhibit A, what Mr. Friedman has experienced. Here is a man who has put his whole life savings into a retirement plan. He retires with the intention of being able to live off that savings, and because he has withdrawn money to live off those savings, precisely as Congress would have wanted him to do, precisely as he needed to do, he is being tortured because those funds are being denied him. Any penny he has taken out in his retirement has been deducted from the amount of money that he has put in. So basically anybody who is utilizing a retirement experience, who has been withdrawing funds for the cost of living over any period of time, has probably exceeded even the amount of money that they have contributed over their lifetime to their savings. We are actually having—we are actually reducing protections for those people precisely for whom we should be going out of our way to improve protections, and that is an unfortunate consequence.

Mrs. MALONEY. Also they are saying if it is a Ponzi scheme, you are not covered. Obviously, they didn't know it was a Ponzi scheme; the government didn't know it was a Ponzi scheme. And so, I think a crucial issue, and I guess I want to ask Mr. Hammerman, what does SIPC cover now, and if you could get it back to us in writing, and what do you think it should cover in the future? And obviously, the situation of Stanford, of where no determination and an outrageous Ponzi scheme, I would like to know from Mrs. Kogutt in writing where you say the SEC knew about this Ponzi scheme for 12 years, if anyone knew about it and didn't report it or stop it, that is a criminal offense. So, that is a whole other subject. We are looking at the SIPC moneys now. So who do you think—what does it cover now, and what should it cover? And if you could answer some of the salient issues that the victims raised to you today.

Mr. HAMMERMAN. Ranking Member Maloney, as I tried to explain in answering the chairman's question, I believe today, SIPC would cover an investor who put in, let's say, $100,000 with a brokerage firm with the expectation that the brokerage firm was going to purchase securities, and if that brokerage firm turned out to be a Ponzi scheme, that amount of money would be covered and advanced by SIPC.

When you asked about what it should cover going forward, I think that raises an entirely appropriate—

Mrs. MALONEY. Mr. Hammerman, that is not what she testified to. That is not with the Stanford people. They bought securities. They bought CDs that apparently the SEC and other people knew about, and then they are told that is not applicable.

Mr. HAMMERMAN. Ranking Member Maloney, I do not profess to be an expert or extremely familiar with every underlying fact with Stanford. From my limited understanding, the investors invested in CDs issued by an Antiguan bank. Now, they may have—that is my understanding of what happened, and what foreign—

Mrs. MALONEY. At the very least, going forward, it should be clear—

Mr. HAMMERMAN. No, going forward—

Mrs. MALONEY. —any CD from a foreign bank, that nothing from a foreign bank is covered because they can't even get it resolved in the foreign bank, they won't even acknowledge that there was a problem. So the main thing is investors have to know what they are getting, and they were totally misled. They thought it was insured, that they would have this protection, and going forward, we made a mistake, it is in a foreign bank, you are not covered. So, I think we have to be clear at the very least going forward that people know what their situation is.

Mr. HAMMERMAN. I agree. I am sorry, Mr. Chairman?

I was just going to say I agree on a going-forward basis that we need to be clear, and there is a public policy issue about insuring against all sorts of financial fraud. The FBI estimates $40 billion of financial fraud a year. They also estimate $1 billion to $3 billion in micro cap securities fraud, and the question is, what are we going to be—

Chairman GARRETT. Thank you. I know there is—but I want to get to the gentleman from Virginia.

Mr. HURT. Thank you, Mr. Chairman.

I want to first of all thank the chairman for holding this hearing.

And I want to thank each of you for being here. This is sort of rare in Washington, it seems to me, where you have folks who are not necessarily represented by moneyed interests here testifying before your Congress, a Congress that you own, about how to improve a law that clearly has been implemented in a way that is less than perfect. So I want to, as a former prosecutor who has dealt with people who have been the victim of theft, outright theft, thank you for joining us today. I thank the chairman for spearheading an effort to try to improve the way this works.

I guess I would like to begin with Mr. Harbeck, who it sounds like you have been with SIPC for 38 years total. Mr. Stein in his opening statement and in his written testimony indicated, and the chairman alluded to this, indicated that as a fact that institutions and professional investors were receiving over 80 percent of the recoveries in the Madoff case. Over $9 billion has been recovered, and that is a striking—I think that is a striking fact as stated.

Mr. Harbeck, I would like to know if you think that is—first, do you agree with that, and second, if that is true, do you think that is consistent with what the intent of this law was as passed?

Mr. HARBECK. Let's connect the dots. Thank you for the opportunity to do so.

Mr. HURT. Yes, but please be—

Mr. HARBECK. The answer, sir, is that if an institution such as a pension fund has a claim with Mr. Madoff, and the pension fund has a thousand indirect victims of Mr. Madoff, by paying that institution, one gets the money to the indirects. That is precisely how the system works. The pension fund had the contract with Mr. Madoff. If it had a $10 million pension fund with Mr. Madoff—

Mr. HURT. Okay.

Mr. HARBECK. They have already gotten 4.2 back.

Mr. HURT. Do you believe that has been applied fairly, and is that the way the law is intended to work?

Mr. HARBECK. Yes, sir.

Mr. HURT. Mr. Stein, do you have a response to that?

Mr. STEIN. I think the first response is that it doesn't take into consideration the fact that you have 1,000-plus victims who have been denied any SIPC protection whatsoever, so let's just start there, that whether or not funds are going to a pension fund is immaterial to the moneys that SIPC should be advancing to those small, middle-income investors who invested directly with a regulated registered broker-dealer, as Congress and the financial service industry intended.

Getting to the issue of a pension fund, a very small percentage of the total dollars that have been distributed to the institutional investors are going to pension funds, which is not to say that pension funds shouldn't receive their distribution, but Mr. Harbeck uses an example of an entity that is receiving a benefit. And in using that particular example, he misleads the committee as to the most, what constitutes the majority of the entities that are receiving the funds. And the fact of the matter is that the kinds of funds, the kinds of institutions the trustee himself has alleged could have known and should have known about this fraud were the ones that are receiving most of these funds, and the fact of the matter is that over a thousand innocent victims are being sued.

Mr. HURT. Okay. I hope I have time for one more question. Again to Mr. Harbeck, a second fact that is stated in Mr. Stein's testimony is the fact that in addition to saving SIPC over a billion dollars by the trustee's own calculations, the trustee and his associated consultants have similarly been enriched by almost $1 billion, funds which could have gone instead to the devastated and desperately needed, those who desperately needed it. Is that true? Would you agree with that as a fact? And, again, do you believe that is consistent with the intent of Congress, and is that fair?

Mr. HARBECK. The billion dollars in administrative expenses in the Madoff case went to compile the $9 billion fund that the trustee has been able to recover.

Mr. HURT. So you think that is fair?

Mr. HARBECK. I think that is an extraordinary return, yes, sir.

Mr. HURT. Mr. Stein?

Mr. STEIN. That is kind of patently absurd on its face because $7.2 billion or approximately was immediately recovered by the Department of Justice. Early in the trustee's proceedings, long before the number had reached $100 million, another 2.2 was negotiated with another estate. So the amount of money the trustee has actually utilized to effectively recover funds has been an enormous amount. If you look at the investment quality of the return on investment for the trustee for the majority of that $1 billion in expenditures, a relatively small amount of money has been recovered from the large institutional investors.

Mr. HURT. Okay. Thank you. My time has expired.

Chairman GARRETT. Thank you.

The gentleman from Colorado.

Mr. PERLMUTTER. And I, again, want to thank the Chair and the ranking member for tackling what is a very difficult and unsatisfying problem because no matter how you push the balloon, somebody gets hurt, because this is all a sham, and everybody has been robbed from the beginning to the end. Now the way I look at it is, there are three pots of money—we talked about two. There really are three pots of money. And I am sorry, ma'am, you are Ms. Kogutt? How do you say it?

Ms. KOGUTT. "Kogutt."

Mr. PERLMUTTER. "Kogutt," pardon me. There really are three pots of money: You have the insurance fund, and how big are we going to make that insurance fund so that we can cover people who have been lost, and how many tiers down? Is it the direct investor, is it the second direct, indirect investor, third? Then, you have the recovery that goes on among the people who have been defrauded.

So, Ms. Shean, you get, your husband gets in at the end of Stanford, okay? You are helping the guys who got in earlier into the fraud than your poor husband and you. You are in 18 months before they close it down, but there were people in 3 years, 4 years, 5 years; they are the ones getting interest payments off of your money. So, that is the second.

Then, you are trying to figure out how do we resolve it so that everybody is treated equally, the early guys get paid, but the late guys don't get paid? They are hurt?

And then there is the third pot of money, which, Ms. Kogutt, you reminded me of, is those people who got you into the deal, okay? Whether it was the lawyers or the accountants or the advisers or some other company, and then there are all those lawsuits about—

Ms. KOGUTT. Actually, there are no lawsuits.

Mr. PERLMUTTER. There certainly are in the Madoff side.

Ms. KOGUTT. There should be.

Mr. PERLMUTTER. I don't know about on the Stanford side, but there certainly are on the Madoff side.

Ms. KOGUTT. There should be on the Stanford. There is a litigation stay that has been in place since February 2009.

Mr. PERLMUTTER. Here is the question, and I appreciate the ranking member and the chairman for tackling this. Do we try to even it out? Is equity—everybody was robbed, so everybody is going to be treated equally, or do the first people get to make out better than the guys who put their money in at the end? That is a policy question. For me, I think the equality, everybody being treated equally is appropriate.

You then have the lawsuits against the advisers, and then you have the question of how big should we have this insurance fund? And will the broker-dealers or the taxpayers add to that insurance fund? Because the losses from Madoff and the losses from Stanford are so huge, they swamp the fund. It is just gone. It is bankrupt because we haven't made it that big because we hadn't seen those kinds of losses before. And in my previous life as a lawyer, I represented victims of Ponzi schemes. I represented trustees trying to collect money for the victims of Ponzi schemes. These are horrible situations because everybody is—and I want to use a crass term, but I am not going to since I am on the microphone—robbed, and I don't know that there is a good answer.

Ms. Shean, please?

Ms. SHEAN. One of the things that confuses me is that we invested in Stanford Trust Company.

Mr. PERLMUTTER. It is all phony.

Ms. SHEAN. But Stanford was a member of SIPC.

Mr. PERLMUTTER. Absolutely, I agree.

Ms. SHEAN. As an investor, when I purchase an IRA government-approved account, or I should say my husband did, and my statements come from Baton Rouge, Louisiana; there is no mention of Antigua. I have—

Mr. PERLMUTTER. I know, but it is snake oil. It is not real. That is the problem. And when you told—when you brought up that the SEC knew 12 years in advance, okay, that is horrible. And I don't know how we want to try to compensate you for that. That is terrible.

Ms. SHEAN. So since Stanford was a member of SIPC, what is SIPC covering?

Mr. PERLMUTTER. There ought to be something from the insurance fund available to you, and I don't know why you are not getting some recovery, but there were so many people making a claim against that fund, it is gone.

Ms. SHEAN. So they were accepting money from a brokerage firm that was being run illegally?

Mr. PERLMUTTER. Correct.

Ms. KOGUTT. Can I comment on that?

Mr. PERLMUTTER. Sure.

Ms. KOGUTT. Part of the provisions of SIPA, 78eee(a)(1), if the SEC or any self-regulatory organization is aware of facts which lead it to believe that any broker or dealer subject to its regulation is in or is approaching financial difficulty, it shall immediately notify SIPC. However, in 1997, the SEC had an item of interest in their very first exam—

Mr. PERLMUTTER. That is a troubling fact, and I am not sure what the heck to do with that, because you don't have to have a claim against the United States, I am not sure you could do it, but I feel like you have a claim—

Ms. KOGUTT. There have been lawsuits against the SEC. The one that has moved forward the most is the one that has alleged the SEC's violation of SIPA for this particular role because the broker-dealer had a negative 1,400 percent loss year after year, so they are at a negative operating loss, and it grew every single year.

Mr. PERLMUTTER. And, look—

Ms. KOGUTT. Why didn't SIPC know that?

Mr. PERLMUTTER. Your testimony is very compelling, but my time has expired.

Chairman GARRETT. The gentleman's time has expired.

Mr. PERLMUTTER. I appreciate you all coming here and sharing with us. This is a tough deal, and I appreciate them tackling it. I am not sure they have the right answer.

Chairman GARRETT. I appreciate that the gentleman's time has expired. I also appreciate the fact that the gentleman indicated that Ms. Shean probably should receive something from the SIPC fund.

I now recognize Mr. Hultgren.

Mr. HULTGREN. Thank you, Mr. Chairman.

I, too, thank you all for being here today. I know this is a very difficult thing.

I would like to focus my questions for on, Mr. Harbeck, if that is all right, just for me to help understand a little bit more of some of the challenges here. Focusing on the SIPC Modernization Task Force report, I know one of the recommendations is to eliminate the distinction between claims for cash and claims for securities during the resolution of a failed broker-dealer. First, I wondered if you can explain why this distinction between cash and securities claims may have existed before and, second, why SIPC feels the distinction is no longer appropriate or necessary?

Mr. HARBECK. First of all, that is not SIPC's position; it is the task force's position. And SIPC will be responding to the task force on or before its next February board meeting. What the original distinction tied the amount of cash directly to the amount of cash available for the FDIC, and rose with that dollar number. But in point of fact, sometimes cash gets literally caught in the form of a check going to someone when they didn't really want to leave cash with the brokerage firm, it just happened to be caught as cash as the brokerage firm failed. The task force looked at that and said it might be appropriate to simply abolish the difference.

Mr. HULTGREN. I wonder if you could explain how fictitious securities are categorized in this process. And as you talk about that, are claims for fictitious securities considered cash claims or security claims? I understand there has been some confusion over that in the courts, and I wonder what SIPC's position is on that?

Mr. HARBECK. There is a split in the circuits on this. The Sixth Circuit has taken the position that the only conceivable way to measure cash legitimately deposited for the purpose of purchasing a security which does not ever exist would be protected as a claim for cash.

The Second Circuit has taken a different view, and protected it as a claim for securities. But one important thing with respect to any claim for securities is that SIPC, under no circumstances and in no case, was ever intended to guarantee the underlying value of a security. SIPC was designed to get you your security back. If it went up, excellent. If it went down, that is the way the marketplace works. Under no circumstances, regardless of why a security moves up or down in value, does SIPC protect the underlying value. It simply returns the security to you.

Mr. HULTGREN. I know another recommendation from the SIPC Modernization Task Force report is to increase the maximum level of protection from $1.3 million and index it to inflation. If the distinction between cash and security claims is eliminated, effectively eliminating any cash maximum, and the level of protection is raised to $1.3 million, this means that all cash up to $1.3 million would be SIPC-covered. That is over 5 times the level of FDIC coverage. Is that desirable? And how might that affect cash holdings in deposit accounts and brokerage accounts?

Mr. HARBECK. I think there may be unintended consequences to the task force's recommendation. And I am sure that the SIPC board will be actively debating that and has begun that debate already.

Mr. HULTGREN. And that response will be in the next few months?

Mr. HARBECK. It is my understanding that the board intends to reply to the task force on or before its February board meeting in 2014.

Mr. HULTGREN. One last thing. Appreciating that one of the fundamental principles guiding SIPC is to certainly protect small investors, I wonder how raising the maximum coverage level would affect small brokers. Surely you would think this would raise broker-dealer assessments.

Mr. HARBECK. The fact of the matter is that what we will do when we reach the target of $2.5 billion, which matches the Federal line of credit that we have against the United States Treasury, I am confident that the board will assess whether at that particular point in time—our current assets are $1.9 billion—whether a target of $2.5 billion is appropriate or whether it should be increased. I think we will take a hard look at where we stand and where our obligations are and what our legal obligations are as to whether the assessments should be raised, lowered, or stay the same.

Mr. HULTGREN. Thank you all. My time has almost expired.

I yield back. Mr. Chairman, thank you so much.

Chairman GARRETT. Thank you. The gentleman yields back.

Mr. Carney is recognized.

Mr. CARNEY. Thank you, Mr. Chairman.

I would like to thank you and the ranking member for having this hearing today, and particularly for your tenacity on behalf of your constituents. Knowing how important our constituents are, I have great sympathy and appreciation for the work that you are doing. I appreciate in particular the victims who have come here today.

For me, I think our role is at some level to establish what the facts are and to try to come up with the best public policy, not just for these two terrible cases, the Stanford case and the Madoff swindle, but also going forward for everything else. So I am going to try to I think address most of my questions to Mr. Harbeck and Mr. Hammerman.

First, I want to have some more discussion about the treatment of institutional investors versus retail investors. Mr. Stein, I think, said that 80 percent of the institutional investors were protected, and obviously, a lot of retail investors were not getting assistance.

Mr. Harbeck, you mentioned the situation with pension funds.

Mr. Stein seemed to take some exception to that.

What is it? Is that the full explanation, or what other institutional investors might we be talking about here?

Mr. HARBECK. The statute makes no distinction between a corporate investor, a large investor, or a small investor. The measurement is how much and, in the Madoff case, how much net did that investor put in.

Mr. CARNEY. So is it the case that the institutional corporate investors put in more money than the retail investors? Is that part of the explanation?

Mr. HARBECK. Whatever the net amount in was for any individual, whether it is a corporation, a hedge fund, or anything else.

Mr. CARNEY. So it would be your view that in fact SIPC is not treating institutional investors any differently than retail investors in terms of the methodology that you are using.

Mr. HARBECK. The methodology is the same for all.

Mr. CARNEY. So should we look at that methodology if the effect is to maybe, this is my word, favor institutional investors over retail investors? Or is there something in the methodology that gives preference to institutional investors?

Mr. HARBECK. It gives no preference to institutional investors. It gives preference, on a pro rata basis, to a larger contributor to the fund.

Mr. CARNEY. Which at some level is fair, right?

Mr. HARBECK. Especially when you consider that the institutional investor, whether it is a hedge fund which has partners, or whether it is a pension fund which has pension participants, if that institutional investor is an innocent institutional investor, it will get a proportional share.

One thing that I take strenuous exception to is the fact that any institution that should have known about this or is alleged to have known about this has not shared, nor will it.

Mr. CARNEY. Quickly, Mr. Stein, you are jumping out of your chair to get a point in here. Please feel free. My time is running out, but go ahead.

Mr. STEIN. I get back to the words that Mr. Garrett stated initially when he was referring to the opening comments that President Nixon made. This legislation and the statute was intended—its very purpose was to protect the small investor. I don't know how many times that point has to be reiterated for it to sink in to SIPC's conceptual thinking. But that is the essential point. It is understood that professional investors and institutions have the resources and the recourse to be able to protect themselves and their investors.

Mr. CARNEY. Fair enough. So should the methodology then slant towards the retail investor?

Mr. STEIN. I think it is a legitimate question to pose going forward. But I interpreting the law as it is written now, I think first of all it is from a public policy point of view, it is essentially we protect the smaller investor and the middle-class investor, as it was intended in the law.

Mr. CARNEY. That makes a lot of sense to me. There is something to be said for that. But does the kind of the fundamental part of the bill going from a calculation of actual net investment to last statement method, does that do that?

Mr. STEIN. Actually, the bill that Congressman Garrett has written gives the trustee the ability to determine what is in the best interests when it comes to the recovery of customer property, that second pool of money that Congressman Perlmutter was referring to. So those moneys that are recovered—we are talking about everybody getting their $500,000—the pool of money that is recovered, the trustee now has the ability to look to the SIPA legislation and say, what is the most equitable way to distribute this money? Do we give most of it to the small investor? Do we give most of it to the large investor? How are we going to split it?

Mr. CARNEY. That seems to me to be a fundamental question.

My time has run out. I may have additional time at some point. But I appreciate everybody coming in. Again, thank you to the chairman and the ranking member for your tenacity on this issue.

Chairman GARRETT. Thank you. And we are going to stay for 5 more minutes and then go to vote, or 10 more minutes, to go a second round, without objection.

So, Mr. Hammerman and Mr. Harbeck, you have heard the testimony or the statements by Ms. Shean and Mr. Friedman as to how Mr. Shean invested and how Mr. Friedman invested. Can you tell the committee, and I guess all the American public who is watching them as just regular investors going forward, can you tell us what exactly did they do as regular investors that was wrong in their process of making their investments?

Mr. HARBECK. Chairman Garrett, these victims did nothing wrong, nor has anyone ever said that they did.

Chairman GARRETT. Okay.

Mr. Hammerman, as far as the clients or the institutions in your association, would you say on their behalf that either one of them did something wrong as far as their selection?

Mr. Friedman told how he went out and knew about it, actually went to the company and went through it, which is sort of amazing. That, to me, is due diligence. Do you think they did anything wrong?

Mr. HAMMERMAN. Absolutely not, Mr. Chairman. These are victims of terrible financial crimes.

Chairman GARRETT. So if America is watching right now, and they put themselves in the shoes of Ms. Shean and Mr. Friedman, and that those two people did absolutely everything right, and looking, they went in and they saw the SIPC logo there, Mr. Harbeck, and they saw that there was a guarantee that SIPC would protect them, and now America realizes there is no protection, as you were saying before, both of you were saying before, for fraud or these Ponzi schemes, what is the answer then for other Americans?

Mr. Hammerman, should there be an addendum, or Mr. Harbeck, should there be an addendum on the SIPC logo that when they go into Mr. Hammerman's, any of the firms in his association, should there be a bold statement saying that you are protected by SIPC; however, if there is fraud by this firm or if there is a Ponzi scheme by this firm, you will not be protected? I am willing to do that. Are you?

Mr. HARBECK. Chairman Garrett, SIPC has given $800 million—

Chairman GARRETT. Answer the question.

Mr. HARBECK. I am. $800 million to the victims of a Ponzi scheme.

Chairman GARRETT. But you are not to this one.

Mr. HARBECK. Yes, sir, $800 million.

Chairman GARRETT. Not to Ms. Shean, you haven't. Not to Mr. Friedman, you haven't.

Mr. HARBECK. No. We have not started a liquidation proceeding for Stanford because the courts have upheld the position that it is inappropriate to start such a case.

Chairman GARRETT. Ms. Kogutt?

Ms. KOGUTT. That is under appeal right now with the D.C. Circuit Court.

Chairman GARRETT. So, in the Madoff situation, then, are you willing to say that if they had invested in Madoff, as opposed to in Mr. Stanford's case, you are saying in this case, you are willing now to have SIPC advances being made so that they can be guaranteed that those payments will be made?

Mr. HARBECK. SIPC advanced $800 million to the victims of the Madoff Ponzi scheme.

Chairman GARRETT. In the case where they are in similar situations, where they have withdrawn more than they have invested in the fund?

Mr. HARBECK. If you wish to put an addendum saying SIPC does not permit the payment of fraudulent, fictional profits, we would be in agreement. Because the courts have consistently—

Chairman GARRETT. How about this situation, then? Say I put $1,000 into one of Mr. Hammerman's firms or clients a few years ago, and I have been taking out, like Mr. Friedman says, I took out enough just to pay my taxes, I took out just to pay my medical bills and so on. So after so many years, I have taken out my $1,000. But my statement says I still have a thousand or more, right? Under your understanding, how much would I get from advances?

Mr. HARBECK. If the entire—if the entire scheme is a Ponzi scheme—

Chairman GARRETT. Right.

Mr. HARBECK. —then the answer is—

Chairman GARRETT. Zero, right?

Mr. HARBECK. The answer is zero. And the reason the answer is zero, sir, is because it would take money away from people who did not get their own money.

Chairman GARRETT. Wait. The time is mine. So what you are advising to do, what I have to do and what they should do in the future, everyone watching this should do in the future, is when you go to a broker-dealer and you make an investment, you should keep track every day that you take money out of that broker-dealer—every day you take out money to make a tax payment, every day you take your money out to make a payment for your insurance or your health care—keep track so that you say, as soon as I get to that limit, in my case my hypothetical, I took out my $1,000 original investment, you are telling me at that point my coverage with SIPC ended, so you know what I would do as a prudent investor? I would close my account with that dealer, and I would walk across the street to another dealer, and at that point, it resets. Is that true that it would reset when I walk across the street?

Mr. HARBECK. I think what you—

Chairman GARRETT. Answer that question, please. Would it reset?

Mr. HARBECK. I am trying to answer it, sir.

Chairman GARRETT. Yes or no?

Mr. HARBECK. The answer to your question is that if you did that, you would be protected. But it is not necessary. And it is not necessary because—

Chairman GARRETT. Tell me how else I would be protected for that thousand dollars.

Mr. HARBECK. The answer is, in the history of SIPC—

Chairman GARRETT. No, tell me how I should be protected.

Mr. HARBECK. You should be protected by the regulatory system, you should be protected by the auditors of the firm.

Chairman GARRETT. Okay. So you have been there for 38 years. You know you are not protected that way. So how am I going to be protected?

Mr. HARBECK. I believe that one of the things that has come out of the financial crisis is heightened review by the PCAOB of auditors of—

Chairman GARRETT. So, we don't need SIPC any more because my protection is not from SIPC at that point; it is from the SEC and the other agencies. Is that what you are telling me?

Mr. HARBECK. Certainly, that is the first line of defense against fraud, yes.

Chairman GARRETT. That is. But I thought SIPC was my second line, my final line. You are telling me SIPC is not going to be there for me.

I think that is one of the takeaways from today is that first, you are willing to change the SIPC logo to say that there is a caveat and that your members will now have a caveat or statement, and that should be indicated to them on a regular basis—I think that is significant that we are going to have to do that. And second, your takeaway is that to be a prudent investor, as Ms. Shean and Mr. Friedman should be going forward, is that you should roll your money every so often from one broker-dealer to another broker-dealer as soon as you have come to that capstone, because my only reliance is on the regulators, and we know how good regulators are, and we know, you have just stated, that SIPC will not be there to protect me. I think that is a significant takeaway from this hearing. Ms. Kogutt?

Ms. KOGUTT. That is assuming that the Ponzi scheme has gone on long enough for all of the investors to have withdrawn anything.

In my case, we invested 9 months before the collapse of the Stanford Ponzi scheme.

But I want to point out that SIPC's Web site right now says that SIPC helps individuals whose money, stocks, and other securities are stolen by a broker-dealer or put at risk when a broker fails for other reasons.

But Mr. Harbeck has said SIPC doesn't cover fraud. How do you steal a customer's funds without defrauding them? Isn't that burglary? There has to be some level of fraud to steal money.

Chairman GARRETT. Yes. This issue is so frustrating on so many levels.

Mr. Harbeck, you indicated you have been there for 37 years. Can you tell me, prior to this collapse, what was the insurance rate that you charged the member firms during that period of time?

Mr. HARBECK. It has varied dramatically over that 38-year period.

Chairman GARRETT. Okay. Just prior to the crisis in—

Mr. HARBECK. Just prior to the crisis, when we had $1.6 billion, we felt that was enough. And there was a token assessment of $150 per firm.

Chairman GARRETT. $150.

Ms. KOGUTT. Stanford paid $1,750 for their protection for their—

Chairman GARRETT. So Goldman Sachs in New York, what were they paying?

Mr. HARBECK. At the time, they were paying $150 a year. Once we turned the assessment spigot back on, they paid tens of millions of dollars.

Chairman GARRETT. Right. Just coincidentally, I am in the market right now to buy a used truck. It costs $1,500. So I called up the insurance agent last night and said, how much does it cost me to insure this truck that I bought for $1,500? They said, it is going to cost you $1,000 a year to insure that truck. If I have homeowners' insurance, it is going to cost me about $1,000 on my house. If you go to a Sears and you go and you buy a large TV or something like that, when you leave, they try to sell you one of these insurance policies, which will cost you $200 or $300. Goldman Sachs was paying $150 for basically—for coverage. That doesn't seem irresponsible to you?

Mr. HARBECK. I will refer to my written statement, where I have gone through SIPC's financial condition, Chairman Garrett. And we are currently in a stronger position than we were in 2008.

Chairman GARRETT. Right. But you were not in a strong enough position in 2008 not to have to make these draconian, what appears to be draconian increases, sudden increases, which I can understand completely when I meet with Mr. Hammerman, some of your smaller members, and they are saying, hey, I budgeted, or I planned, and this is my operating budget, my budget for this much. And all of a sudden, wham, I am going to be hit this much. I can understand that. If your guys—I am sorry, if your members had known back in 1980, it was this much; in 1990, it was this much; and in 2000, it is this much, as a business owner, you could probably have planned for that and made for appropriate adjustments in your operation, and I can understand that completely. But to go from next to nothing, less than it costs to buy insurance on a TV at Sears, to go to what some of your members, Mr. Hammerman, are going to right now, you can tell us, is this significant to them, the changes? The increases that some of your members are going to have to—

Mr. HAMMERMAN. It sounds like, from Mr. Harbeck's testimony, that it is multiples of millions of dollars.

Chairman GARRETT. Right. And I can understand that is probably unconscionable to your members' situation, and that they just can't adapt to it.

That is why, Mr. Harbeck, when you say you have been there for years and you have seen this ramping up to this, and the preparation wasn't made, it goes back to my opening questions. What did they do wrong? Nothing. What did the regulators do wrong? A lot. What did SIPC do wrong? Apparently not a significant amount with regard to preparing the fund and being in preparation for cases like this.

Ms. Shean?

Ms. SHEAN. Nothing.

Chairman GARRETT. The committee will stand in recess. Mr. Stein, do you—

Mr. STEIN. Yes, Chairman Garrett, I just wanted to thank you very much. I think you have hit a lot of the key points. I think there are two things that I would just ask for consideration here.

I think we are finally getting a chance to shine a light on the culture of SIPC. I think it has been largely opaque for probably the 38 years that Mr. Harbeck has been there. I think the transparency is essential. I think we are getting to see some of the warts, but I think we need to dig deeper. I think we need to truly see whether SIPC is in fact even worthwhile. Is bad insurance better than no insurance at all?

The second point, more of an overarching issue, is getting back to what the concept was in setting up basic issues of certainty for the banking industry and the financial services industry, and that means that when people see a bank deposit statement or a bank statement or an investment statement, there has to be a certain level of certainty in order for those markets to operate with the kind of confidence and trust that allows this economy to prosper.

Once we start chipping away and nuancing at those very, very fundamental assumptions, we are threatening great damage to our financial and banking systems.

If we applied the same characteristics that Mr. Harbeck and Mr. Hammerman have just been speaking about to the banking industry, to bank statements, to bank depositors, imagine the horrific result that would take place.

I have to encourage the committee to consider, again, in all these decisions what the impacts are going to be to the financial industry and the importance of creating certainty and confidence in the markets, particularly now after what we have gone through collectively in this country.

Chairman GARRETT. Thank you.

Without objection, and it doesn't look like I am going to have any objections, I am going to put into the record: a statement from the Financial Services Institute; the GAO report of 1992; and an email of May 21, 2009, from Mr. Harbeck relative to the matters that we somewhat touched upon during the course of this hearing.

We are in votes, and I know that the other Members will be leaving town. So I want to take this opportunity to thank each and every one of the witnesses who have come here today. I appreciate your concern for this issue, and I very much appreciate the testimony. We look forward to any input that any of you have on suggestions as we move forward on this legislation.

The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

And with that, this hearing is adjourned.

[Whereupon, at 11:24 a.m., the hearing was adjourned.]

A P P E N D I X

November 21, 2013

Mr. Neil Friedman
2438 Carriage Place
Palm City, FL 34990

Honorable Chairman Garrett
Subcommittee on Capital Markets and Government Sponsored Enterprises
House of Representatives

November 18, 2013

Thank you, Mr. Chairman and the Committee for giving me an opportunity to tell you my story as a victim of the Madoff fraud. Just to give you some background, I am 79, my wife, who I love and miss dearly, passed away in January 2012. I have two children, Rena who lives in New York, and Alan, who lives in California, and I'm fortunate to also have four grandchildren. My daughter Rena struggles with MS. Like the vast majority of the Madoff victims, I was not rich. I worked hard to make a living, save for a modest retirement, and then the Madoff tragedy took away our life savings.

I graduated from New York University many years ago with a Bachelor of Science, and majored in Accounting. I began my career as an accountant, and over time moved to Connecticut General, trained as a life insurance brokerage representative servicing property and casualty agents, and built up a number of agencies. I then moved on to Beneficial National, another insurance company, set up my own agency and helped many clients over the years. Over time, my business evolved to include pension and retirement planning services. At age 65, having built up enough savings, I retired and moved to Florida with my lovely wife.

So it happens, when I was living in Far Rockaway in the 1960s, I had a personal friend who was a neighbor and a CPA, Jerome Horowitz. He became my business accountant, and much later, when I was in the pension and retirement plan business, he introduced me to Madoff to assist with setting up a pension plan. This was in the 80's.

At this time Madoff's firm was at 1 Wall Street, NYC, and I was granted access to all the employees of his firm. Although the plan was implemented for the benefit of his employee they were very disappointed because the investment was restricted to high quality bonds, and not stocks. This plan was ultimately discontinued, but my relationship with Bernard Madoff, and his staff was friendly. With Jerry's success in his investment with Madoff, I expressed interest in opening an account. Bernard Madoff's minimum new account was in excess of $500,000 (if my memory serves me correctly) but he made an exception for me that he would accept whatever I could afford. It should be noted that my accounts were opened during the 80's. Assured by Jerry, that if all else fails we have protection up to $500,000 per account from SIPC.

I was very aware of Madoff's high level of credibility in the industry. Even though I didn't see myself as an expert in the securities industry, my CPA told me that Madoff was being considered for a government position. I also knew from social circles that he was considered in the very highest regard, and was honorable. I was told that the SEC, when they visited him, were "interviewing for job positions", they were so taken with his business and reputation.

When I set up my 401k retirement plan for my own business, like many people who thought they were investing in a properly overseen firm investing in very conservative securities, I put all my retirement assets into this account. I also had a personal account, into which I put my other savings, my son's wedding funds, college funds for the grandchildren, and funds to help my daughter to cover her very high medical expenses and medications when needed.

We lived very modestly. Over the years, however, I withdrew funds to cover taxes, some living expenses, and took the required minimum distributions from the retirement plan.

Now comes December 8, 2008, with Madoff being arrested, and I was wiped out personally and in my retirement plan.

When the news broke, I called Jerry Horowitz only to find him in a state of shock. His one comforting comment was that SIPC provided security for up to $500,000.

Since them, I was declared by the SIPC Trustee to be a "net winner", primarily because of the IRS mandate that required that I withdraw, starting at 70 ½ an amount calculated by use of a mortality table times the balance of funds in the Profit Sharing (401K).

Now I would like to call to your attention the effects that our loss of all our money had in our life. With the prospect of losing our home, a friend took over our mortgage and waived charging us interest until we sold our house or our death; however, his need for repayment caused me to enter into a reverse mortgage and repay all the money (this occurred after my wife's death).

Existing on only our Social Security, we had to monitor everything. No longer were we able to visit our children & grandchildren, carefully spending for food, budgeting for insurance, house repairs, and supplemental health & drug insurance. I'm sure I omitted a number of other important things.

My daughter with multiple sclerosis is now on social security disability. As you can imagine, her stress levels have increased tremendously, which is very bad for her condition.

With the loss of everything and the denial by SIPC of our right of benefit, my wife could no longer smile, stop worrying, and, apparently, find any reason to continue living. She was deeply depressed. During the month of December 2011, she had a fatal accident, and died in January 2012.

In the year 2000 I weighed in at 232 pounds, I now weigh 150.

I applied to Publix for a job, and was deemed too qualified.

My time is now spent as a volunteer at Hospice and visiting with Military Veterans under Hospice Care, and presenting them with a Veteran Appreciation Certificate which states "We pay special tribute to their military service to America and for advancing the universal hop of freedom and liberty to all". In addition to aforementioned Certificate, we present them with a lapel pin - a US Flag & another Flag with the words "Honored Veteran".

I'm also trying to put my photographic skills to good use, making postcards, trying to raise a little extra cash so I can visit my children. Without my wife, I am now very much alone.

I think that the actions of the Madoff Trustee & President of SIPC in changing the 1970 SIPA Law, for their own benefit, was beyond their legal authority. Nothing can give me back all that I worked so hard for and lost, but being denied the insurance protection that SIPC had promised has made our life so much harder. I'm pushing on, but years after this tragedy, it really saddens me that no one in Congress had yet been able to stop SIPC's illegal actions and force SIPC to do the right thing.

Mr. Chairman, I thank you for your time and everything you're trying to do to help me and my fellow victims who by themselves could never counter the power of SIPC and the SIPC Trustee.

Sincerely,

Neil Friedman

TESTIMONY OF IRA D. HAMMERMAN,
EXECUTIVE VICE PRESIDENT AND GENERAL COUNSEL,
SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION

BEFORE THE
U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON FINANCIAL SERVICES
CAPITAL MARKETS AND GOVERNMENT SPONSORED
ENTERPRISES SUBCOMMITTEE

HEARING ON A LEGISLATIVE PROPOSAL
TO AMEND THE SECURITIES INVESTOR PROTECTION ACT

NOVEMBER 21, 2013

I. Introduction

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

My name is Ira Hammerman, and I am Executive Vice President and General Counsel of the Securities Industry and Financial Markets Association ("SIFMA").[1] Thank you for allowing me the opportunity to testify today.

I would like to begin by expressing my deepest sympathy for the victims of the Madoff and Stanford schemes. I have family and friends whose financial lives were forever adversely impacted on December 11, 2008 and for whom life "post-Madoff" is a tremendous burden. I know from up close and personal interactions the havoc caused to individuals, retirees and wonderful charities by Madoff and the feeder funds that never even disclosed they were investing with Madoff.

So I understand, and in fact applaud, the tenacity being expressed by Chairman Garrett and Ranking Member Maloney as they seek to help their constituents and the investing public at large. I also commend Chairman Garrett and Ranking Member Maloney for recognizing more generally the need to consider changes to the Securities Investor Protection Act ("SIPA") in order to better protect investors and increase investor

[1] SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to develop policies and practices that strengthen financial markets and encourage capital availability, job creation and economic growth while building trust and confidence in the financial industry. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association.

confidence in the financial markets. I served on the 2012 task force that undertook a comprehensive review of SIPA and the operations and policies of the Securities Investor Protection Corporation ("SIPC"), and I agree there are proposals for reform that warrant consideration. I am sure you are familiar with the recommendations made by the SIPC Modernization Task Force (the "Task Force") to SIPC's Board of Directors, and I will address some of the recommendations in my remarks as well.

However, while I supported the recommendations of the Task Force, I noted at the time that they were made without any analysis of their cost to SIPC, the members of SIPC or, ultimately, the investing public. This concern is even more pressing with respect to the proposed legislation. The draft bill would not make tweaks or adjustments to the law that's been on the books nearly 44 years, but rather would introduce a new public policy objective for SIPA and SIPC – namely, insuring investors against the risk of loss due to securities fraud. It is certainly within the prerogative of Congress to enact a bill that would represent such a tremendous departure from the legislative intent and historical practice of SIPA and would materially expand SIPC's mandate, but we believe the costs would be extraordinarily high.

We have some specific concerns about the proposed bill that I'd like to share with you today. More importantly, we urge Congress to consider the far-reaching impact of the proposed bill, and to consider whether the costs of the expanded protection that is proposed would be justified by the anticipated increase in investor confidence. We believe an analysis of the costs will be critical to ensure that well-intentioned investor protection and modernization measures do not inadvertently undercut SIPC's overall effectiveness in protecting investors.

II. Background of SIPC

To provide context for my remarks, I believe it is important that we consider the background and purpose of SIPA and the creation of SIPC. Following a period of great expansion in the 1960s, the period from 1967 to 1970 was one of crisis for the securities industry and the investing public. First, there was a so-called paperwork crisis, in which brokerage firms failed to upgrade their back-office infrastructures and adequately staff their trade processing and record-keeping functions to accommodate the significant increases in trading volume. As a result, errors became common, with firms losing securities or otherwise failing to complete trades and deliver cash and securities. In addition, instances of misconduct, such as thefts of securities, increased.

Second, the securities industry experienced a business contraction from 1969 to 1970 that, coupled with financial losses related to the paperwork crisis, led to the failure or instability of a significant number of brokerage firms. The cash and securities that customers had on deposit with failed brokerage firms were missing or tied up in lengthy bankruptcy proceedings, and investor confidence was eroding.

Congress responded in 1970 by enacting SIPA, an act with the stated goal of "provid[ing] greater protection for customers of registered brokers and dealers and members of national securities exchanges." Securities Investor Protection Act of 1970, Pub. L. 91-598, 84 Stat. 1636 (codified at 15 U.S.C. §§ 78aaa et seq.). Congress's intent was to prevent the failure of additional brokerage firms, restore investor confidence in our markets, and upgrade the financial responsibility requirements for registered brokers. *SIPC v. Barbour*, 421 U.S. 412, 415 (1975). In particular, SIPA was designed to create a new form of liquidation proceeding in order to complete the open transactions of otherwise solvent firms with firms that have failed and to provide for the efficient return of customer property. *Id.*

III. Task Force and SIFMA Recommendations for SIPC Modernization

The SIPC Modernization Task Force recommended a number of important pro-investor changes, including changes that would expand and increase the protection available to brokerage firm customers in three important ways. As you know, when a brokerage firm is liquidated and the customer property marshaled by the trustee is inadequate to return to customers all of the funds and securities they entrusted to the custody of the firm, SIPC makes advances to customers from its own funds. Since 1980, these advances have been capped at $500,000 per customer. The Task Force recommended increasing the maximum advance amount from $500,000 to $1.3 million to reflect inflation since 1980. The Task Force also recommended eliminating the current distinction under SIPA between claims for cash, which are capped at $250,000 per customer, and claims for securities. Finally, the Task Force recommended a limited "pass-through" of SIPC protection to make individual pension plan participants eligible for SIPC advances with respect to their shares of the plan's account at a failed broker.

In addition to these recommendations, SIFMA proposed at the time, and still believes, that consistency between the customer protection rule (Rule 15c3-3) of the Securities and Exchange Commission (the "SEC") and SIPA would benefit investors. The customer protection rule requires each broker to maintain possession or control of its customer's fully paid and excess margin securities and deposit into a reserve account an amount generally equal to its net monetary obligations to customers or in respect of customer securities positions. However, a broker's proprietary account is not treated as a customer account for purposes of the customer protection rule, while a broker's net equity claim based on its proprietary account is eligible to share in the pro rata distribution of customer property in a SIPC liquidation. As a result, there may be net equity claims entitled to share in the pro rata distribution of customer property for which no assets were set aside. A similar difference exists in the treatment of the firm's principal officers and directors, who are non-customers under the customer protection rule but eligible for customer status under SIPA. Until SIPA and the customer protection rule are harmonized, even a failed broker-dealer that has complied with its regulatory obligations will not have sufficient customer property to fully satisfy the net equity claims of its customers under SIPA.

SIFMA also believes that separating customer accounts into classes would benefit individual investors. Maintaining a single class of customers – encompassing cash account customers, margin account customers, portfolio margin customers and securities-based swap customers – may unfairly impose risks of the newer and more complex types of accounts and transactions (*i.e.*, portfolio margin and securities-based swaps) on the customers who have simpler accounts (*i.e.*, cash accounts). Accordingly, SIFMA recommends that consideration be given to dividing customers into separate account classes, tailoring customer protection rules to each account class in a way that provides for a separate pool of customer property for each class, and, in a liquidation proceeding, distributing the customer property for each account class solely to members of that class based on net equity in that class.

With the caveat I noted at the outset that the cost of any changes to SIPA must be carefully considered, we continue to believe that the recommendations of the Task Force and the additional changes recommended by SIFMA appropriately reflect SIPA's purpose of promoting investor confidence in the financial markets by protecting investors against the loss of cash or securities in the event the brokerage firm holding their property becomes insolvent.

IV. Net Equity Based on Last Statement and Allocation of Customer Property

The proposed legislation would amend SIPA to provide that, in determining net equity, the assets of a customer reported to that customer as held by a failed brokerage firm would be determined based on the information contained in the last statement issued by the brokerage firm to the customer and any additional written confirmations after the last statement date. However, if the net value of the customer's assets on the firm's books and records is greater than the net value as determined using the customer's last statement, the proposed legislation would provide that the customer's net equity would be determined using the firm's books and records instead of the customer's last statement. Customer property in liquidation would be allocated based on customers' net equities as determined pursuant to these provisions, unless the trustee determined that another allocation would be necessary to reach a fair and reasonable result.

It is unclear how these provisions would operate in a situation involving fraud by the failed brokerage firm. For example, when a broker-dealer is operated as a Ponzi scheme, the customer account statements will themselves be fraudulent, as it is the essence of a Ponzi scheme that the perpetrator report false profits to investors, and therefore the account statements will not truly represent positions in the firm's customer accounts.

Instead of relying on fraudulent account statements to determine the net equity of the customers of Bernard L. Madoff Investment Securities LLC ("Madoff"), the trustee appointed by SIPC to liquidate Madoff used the "net investment" method. Under that method, fraudulent customer account statements are disregarded and a customer's net equity is determined solely by reference to the amount of money the customer entrusted to the Ponzi scheme operator and the amount of money the customer received from the Ponzi scheme. The customer's net equity is his net investment in the fraudulent scheme – in other words, the excess (if any) of the amount entrusted over the amount received. This method has been used with respect to fraudulent schemes outside of the SIPA context as far back as the 1920s, and has been applied by several trustees and courts in SIPA liquidations, including the Madoff liquidation.

In upholding the use of the net investment method in connection with the Madoff liquidation, the U.S. Court of Appeals for the Second Circuit explained that, "notwithstanding the [Madoff] customer statements, there were no securities purchased and there were no proceeds from the money entrusted to Madoff for the purpose of making investments." *In re Bernard L. Madoff Inv. Sec. LLC*, 654 F.3d 229, 240 (2d Cir. 2011). As a result, any "[c]alculations based on made-up values of fictional securities would be 'unworkable' and would create 'potential absurdities.'" *Id.* at 241 (quoting *In re New Times Sec. Servs., Inc.*, 371 F.3d 68, 88 (2d Cir. 2004)). Moreover, changes to a firm's books and records after the last statement date may reflect fictitious transactions in anticipation of the generation of the next month's customer statements. In such a situation, basing net equity calculations on the firm's latest fraudulent entries in its books and records – as the proposed legislation would do for any customer for whom this resulted in a higher net value – would allow "the whim of the defrauder" to "control[] the process that is supposed to unwind the fraud." *Id.*

When a failed brokerage firm is operated as a Ponzi scheme, SIFMA believes that, as a matter of fundamental fairness, the net investment method should be used to determine net equity for purposes of allocating customer property held by the failed firm.

The property held by a Ponzi scheme and used to make distributions to the "investors" in the scheme is simply the pooled investments of all victims of the scheme (less amounts misappropriated by the Ponzi scheme operator), and making distributions based on anything other than the victims' net investments would be fundamentally unfair.

We thus respectfully recommend that the proposed provisions relating to net equity and alternate allocation methodologies be replaced with a provision that specifically provides for the use of the net investment method in situations involving fraudulent account statements and brokerage books and records.

V. Definition of Customer Status

The proposed legislation would add to the definition of the term "customer" under SIPA: (a) any person whose cash or securities were misappropriated by the brokerage firm (or by any person who controls, is controlled by, or is under common control with the firm, if such person was operating through the firm), regardless of whether the firm held or otherwise had custody, possession or control of such cash or securities, and (b) any person whom the SEC, in its discretion and without court approval, deems to be a customer of the firm. SIFMA disagrees with both of these proposed amendments to the "customer" definition.

A. Persons With Assets Misappropriated by Brokerage Affiliates

Expanding the definition of the term "customer" under SIPA, as proposed, to include any person whose cash or securities were misappropriated by an affiliate of a brokerage firm operating through the firm would be inconsistent with SIPA's legislative history and purpose and contrary to public policy.

It is clear from SIPA's legislative history that Congress intended SIPA to remedy a specific problem: "provid[ing] financial relief to the customers of failing broker-dealers with whom they had left cash or securities on deposit" who "found their cash and securities" "tied up in lengthy bankruptcy proceedings." *Barbour*, 421 U.S. at 413, 415. Since its enactment in 1970, SIPA has been understood to protect an investor from the risk that he will be unable to regain his property from his brokerage firm in the event of the firm's insolvency, and customers have been expected to have, at the time of the firm's insolvency, cash or securities on deposit or otherwise entrusted with the brokerage.

The decisions in *In re Old Naples Securities, Inc.*, 223 F.3d 1296 (11th Cir. 2000), and *In re Primeline Securities Corp.*, 295 F.3d 1100 (10th Cir. 2002), apply this history and practice to the situation of an investor giving money to an agent of a brokerage firm who then stole the investor's funds instead of purchasing the securities that the investor believed he was purchasing with the funds entrusted to the firm via the agent. In those cases, the investors were deemed to be customers because they thought their assets were entrusted with the brokerage. *Cf. In re Bernard L. Madoff Inv. Sec. LLC*, 708 F.3d 422, 428 (2d Cir. 2013) (no "customer" status when the investors "could not reasonably have thought" that their funds were deposited with the broker).

SIPA was never intended to provide broad protection to investors against the risk of fraud or investments that turn out to be worthless – situations in which damage would have occurred to the investor even if the brokerage firm had remained solvent. The proposed expansion of the term "customer" to include any person whose assets were misappropriated by an affiliate of a brokerage firm would extend SIPA well beyond its core purpose and would have significant public policy implications. Such an expansion would have financial costs that could exceed the available SIPC funds and could have a detrimental impact on the viability of SIPC and firms across the brokerage industry. This could ultimately result in significant increases in the costs borne by investors (and, in some cases, result in investors losing access to the financial markets altogether).

<u>B. Persons Deemed to Be Customers by the SEC</u>

SIFMA also disagrees with the proposed expansion of the "customer" definition to include any person whom the SEC, in its discretion and without court approval, deems to be a customer of the failed brokerage firm. SIFMA believes that the authority to interpret SIPA and its definition of who is a customer should remain vested with the courts. Additionally, SIFMA believes the SEC may not be able to deem persons to be customers under SIPA without first providing notice and an opportunity for public comment.

VI. SEC Authority to Require SIPC Action

SIFMA disagrees with the proposal that the SEC be permitted, without court approval, to require SIPC to discharge its obligations under SIPA in the event of SIPC's refusal to act. Giving the SEC the authority to require SIPC to commence a liquidation proceeding would effectively replace the judgment of SIPC's board of directors – which includes among its members a representative of the Department of the Treasury, a representative of the Federal Reserve Board, three representatives of different aspects of the securities industry, and two members of the general public – with that of the SEC.

In drafting SIPA, Congress considered and rejected this alternative,[2] and SIPA's apportionment of responsibility reflects Congressional judgment at the time of enactment of SIPA that it should be SIPC's independent board of directors – not the SEC – that makes the decision whether a liquidation proceeding should commence.

This legislative judgment is supported by substantial policy considerations. In leaving the determination of whether a SIPA liquidation is required to SIPC, an entity with its own source of funding, Congress successfully insulated this decision from political pressure. The neutrality of the decision is especially important when private actors bear the cost of the liquidation decision. By contrast, allowing the SEC to substitute its judgment for that of SIPC would leave the decision subject to political interference – a situation best avoided.

VII. Inspection of SIPC Members

With respect to the proposed provision requiring the SEC to carry out periodic inspections of SIPC members, we note that SIPC's members are broker-dealers registered with the SEC and members of the Financial Industry Regulatory Authority, Inc. ("FINRA"), and thus are subject to inspections and examinations by the SEC and FINRA. While we believe broker-dealers are heavily supervised under the current regulatory regime, the proposed inspection provision brings to mind the interesting question that has been discussed in other contexts regarding registered investment advisers ("RIAs"), which are not members of FINRA and are infrequently examined by the SEC. RIAs also provide information to customers, and entities in many cases seek dual registration as both brokers and RIAs. In fact, both the Madoff and Stanford cases involved broker-dealers that were also RIAs.

VIII. Effective Date

The proposed legislation provides that its provisions would become effective with respect to any liquidation proceeding under SIPA that was in progress as of the date of enactment. This would significantly slow down the liquidation proceedings that are currently in progress and is simply not feasible.

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[2] An early version of SIPA contemplated the SEC Commissioners themselves serving as SIPC's board of directors with the power to determine when a SIPA liquidation should be commenced. *Cf.* S. 2348, 91st Cong. §3(b) (1969), with 15 U.S.C. § 78eee(a)(3)(A). Congress ultimately rejected this alternative at the SEC's urging. *See* Hearings on S. 2348, S. 3988, and S. 3989 Before the Subcomm. on Securities of the Comm. on Banking and Currency of the United States Senate, 91st Cong. 17 (1970) (statement of Hamer H. Budge, Chairman of the SEC) (explaining that the Commissioners should not serve as SIPC's board members because of potential conflicts posed between the roles of a SIPC board member and an SEC Commissioner).

Once SIPC determines that a member firm has failed or is in danger of failing to meet its obligations to customers, SIPC may file an application for a protective decree in a court of competent jurisdiction. The insolvent firm may consent to issuance of the protective decree or may contest it, in which case the court holds a hearing on the application. The court also appoints a trustee for the liquidation of the firm's business and attorneys for the trustee, and holds a hearing on their disinterestedness at which customers, creditors and stockholders of the insolvent firm may file objections.

The trustee will publish notice of the liquidation describing the proceedings and the procedure for claims and specifying the time period during which investors may assert their claims. The trustee will also mail notice to the insolvent firm's customers and creditors. The trustee will investigate the conduct, property, liabilities and financial condition of the insolvent firm, determine the allowable customer claims, marshal assets of the firm, and determine how to allocate customer property. Once the court has approved the trustee's determination of customer property and amount and timing of distributions, the trustee distributes assets to customers.

According to SIPC's website, there are currently seven active liquidation cases in which the six-month claims filing period is closed.[3] These include the Lehman Brothers Inc. liquidation, in which the trustee is in the process of completing 100 percent distributions on allowed securities customer claims, and the MF Global Inc. liquidation, in which the trustee's allocation motion has recently been approved. In addition, SIPC's website indicates that there is currently one active liquidation case with an open filing period, in which the claim form has already been distributed to customers.[4] It is unclear how the provisions of the proposed legislation would apply to these liquidations. Among other things, with respect to the proceedings in which distributions have already commenced, it is unclear whether customers would be required to return assets to the trustee so that the trustee could re-determine claims and allocation under the proposed legislation. The net effect would be to significantly slow down the progress of the proceedings that are currently active, if it were even feasible to apply the legislation retroactively.

IX. Conclusion

SIFMA supports the goals evident from the title of the proposed legislation – to restore Main Street investor protection and confidence – and, through our membership on the SIPC Modernization Task Force, have participated in reviewing SIPC's operations and policies and proposing reforms to modernize SIPA and SIPC. We

[3] http://sipc.org/Cases/CasesClosed.aspx (accessed Nov. 19, 2013).
[4] http://sipc.org/Cases/CasesOpen.aspx (accessed Nov. 19, 2013).

remain supportive of these goals, but strongly caution against the enactment of legislation that would result in an unprecedented expansion of SIPC's coverage without careful consideration of the effects of that expansion.

Losses from securities and commodities frauds in the United States, which include, among others, market manipulation, Ponzi and pyramid schemes, and broker embezzlement, total in the tens of billions of dollars each year.[5] Market manipulation schemes alone have been estimated to generate $6 billion in losses each year.[6]

These estimated losses vastly exceed the amounts available in SIPC's reserve fund, which amounted to $1.6 billion as of December 31, 2012,[7] and SIPC would be unable to continue operating for long if its purpose were expanded to provide compensation for investors with losses from securities fraud. Even if SIPC were to borrow in the public debt markets at reasonable terms, as is contemplated in the proposed legislation, or to tap its $2.5 billion line of credit with the federal government, SIPC would be unable to provide the necessary liquidity if SIPA were expanded to make SIPC the insurer against the risk of loss due to securities fraud.

It is unfortunate that financial frauds like the Madoff and Stanford schemes exist and will continue. Crooks will continue to use the financial system to find victims because, to quote notorious bank robber Willie Sutton, "that's where the money is." Criminals who steal investors' assets through fraudulent securities activities should be prosecuted and put in jail, and recoveries for victims of these frauds should be sought through the applicable criminal and civil forfeiture statutes. In addition, victims can seek to obtain recoveries by bringing claims under the Securities Act of 1933 or the Securities Exchange Act of 1934 – additional avenues Congress envisioned defrauded investors would take to recoup their investments.[8]

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[5] *See, e.g.*, FBI Financial Crimes Report to the Public, Fiscal Year 2006, available at http://www.fbi.gov/stats-services/publications/fcs_report2006 (accessed Nov. 19, 2013) (estimating losses of $40 billion per year from securities and commodities fraud). *See also* http://sipc.org/Who/NotFDIC.aspx (accessed Nov. 19, 2013) (stating that the Federal Trade Commission, Federal Bureau of Investigation, state securities regulators and other experts have estimated that investment fraud in the United States ranges from $10 billion to $40 billion per year).

[6] FBI Financial Crimes Report to the Public, Fiscal Year 2006, *supra*. *See also* http://sipc.org/Who/NotFDIC.aspx, *supra* (estimating investor losses from microcap stock fraud at $1 billion to $3 billion annually).

[7] 2012 Annual Report at 8, available at http://sipc.org/Portals/0/PDF/2012AnnualReport.pdf (accessed Nov. 19, 2013).

[8] "The Securities Act of 1933 requires that investors have adequate information to exercise sound judgment concerning the securities they purchase; and the Securities [] Exchange Act of 1934 insures that they will not be victimized by fraudulent, manipulative, or deceptive selling schemes. But neither statute prevents the investor from losing his entire investment if his broker fails because of operational and, ultimately, financial difficulties." See S. Rep. No. 91-1218, at 3 (1970). It was this gap that SIPA and SIPC were designed to fill.

But insuring all of us against the risk of fraud is quite another undertaking. As noted earlier, SIPC would be unable to provide the necessary liquidity if SIPA were amended so that it effectively provided such insurance. This expanded scope of coverage would cause SIPC's assessments on its member firms to increase astronomically. The cost to brokerage firms would likely be quite high, and could cause brokers to go out of business. Moreover, the cost would ultimately be passed on to customers and could negatively impact their financial returns and access to the financial markets. If such an insurance system is what Congress now desires to achieve, the anticipated costs and benefits should be carefully considered, and the ramifications for businesses and investors should be carefully analyzed and debated. While it may be meritorious to limit risk for investors, it will certainly not be free or without other consequences.

SIFMA looks forward to continuing to work with the Subcommittee on addressing these very important issues.

Thank you again for allowing me the opportunity to testify. I would be pleased to answer your questions.

Statement

Of

Stephen P. Harbeck

President and Chief Executive Officer

To The

House Financial Services Committee

Subcommittee on Capital Markets & Government Sponsored Enterprises

November 21, 2013

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

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

Lehman Brothers, Inc.

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

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

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

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

Bernard L. Madoff Investment Securities LLC

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

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

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

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

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

MF Global Inc.

A bit of perspective is useful in a discussion of the MF Global case. This is the eighth largest bankruptcy in history. $1.6 billion that should have been set aside for commodities claimants was not properly segregated. The Commodity Futures Trading Commission has no analog to SIPC to protect commodities customers. Because securities customers were at risk, SIPC was contacted by the SEC before dawn on October 31, 2011, a mere two years ago, and initiated a proceeding that same day. The case has not been without controversy. SIPC was criticized by some for appointing as trustee James Giddens, who also served as the trustee in the Lehman Brothers SIPA proceeding. There were international impediments to recovery of funds. Yet, Bankruptcy Judge Martin Glenn recently stated that "At the outset of the case, nobody thought that customers would recover everything they lost."

The results to date:

All securities customers were satisfied early in the proceeding.

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

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

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

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

In short, the process worked, and worked well.

SIPC's Financial Condition

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

New Cases

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

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

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

- The bill requires SIPC to accept as accurate a financial statement known to be intentionally fraudulent. Under the bill, SIPC must accept whatever statement a thief issues to his customers.

- The bill not only legitimizes Ponzi Schemes, it guarantees that the phony profits of a Scheme are backed by federal taxpayer funds.

- The bill makes Ponzi Schemes a better investment than legitimate securities markets.

- The bill's limitations on the "avoidance powers" in a SIPA case result in demonstrably inequitable distributions of "customer property." For example, had Mr. Madoff's fraud been detected and closed a mere two days later, the $175,000,000 in checks on his desk would have gone to arbitrarily favored clients at the direct expense of similarly situated other clients. This was more than half of the liquid assets the firm had when it failed. Further, as the United States Court of Appeals for the Second Circuit correctly noted, "any dollar paid to reimburse a fictitious profit is a dollar no longer available to pay claims for money actually invested."

- Attached is a graphic presentation demonstrating the inequitable consequences of eliminating the avoidance powers.

- The bill provides a complex mechanism for ignoring a fraudulent final account statement in the interest of equity. In reality, this is an invitation to extended litigation by various claimants with disparate, conflicting and competing interests in a finite corpus of customer property. This will delay return of customer property to injured claimants on a timely basis.

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

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

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

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

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

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

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

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

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

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

742099

SIPC

EQUITABLE TREATMENT OF INVESTORS

H.R. ___________

An Analysis of the "Restoring Main Street Investor Protection and Confidence Act"

Prepared for the House Financial Services Committee

Capital Markets Subcommittee

Stephen P. Harbeck

President and CEO

The Securities Investor Protection Corporation

November 21, 2013

SIPC

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

SIPC

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

SIPC

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

One customer receives:

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

The other two customers receive:

- Far less than their original investment.

SIPC

The Facts

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

SIPC

WHAT DOES EACH CUSTOMER RECEIVE?

SIPC

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

Results Under Current Law

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

SIPC

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

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

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

SIPC

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

SIPC

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

Results Under Current Law

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

SIPC

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

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

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

SIPC

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TESTIMONY OF ANGELA SHAW KOGUTT
DIRECTOR AND FOUNDER
STANFORD VICTIMS COALITION

HOUSE FINANCIAL SERVICES SUBCOMMITTEE ON CAPITAL MARKETS AND GOVERNMENT SPONSORED ENTERPRISES

NOVEMBER 21, 2013

Good morning. My name is Angela Shaw Kogutt, and I am the Director and Founder of the Stanford Victims Coalition, a nonprofit advocacy group for the victims of the Stanford Financial Group Ponzi scheme.

Chairman Garret and Ranking Member Maloney, thank you for holding this hearing today to discuss a much-needed amendment to the Securities Investor Protection Act of 1970 (SIPA). I applaud you both for your leadership in introducing H.R. 3482, the "Restoring Main Street Investor Protection and Confidence Act," which has given hope to thousands of financially devastated investor victims across the country who feel they've been unfairly denied the protection of which the SEC has determined they are entitled. Also, thank you to the distinguished Subcommittee Members who have already joined H.R. 3482, and to those of you here today to consider this important legislation.

I want to point out right away that I am not the typical face of Stanford victims. I am a second-generation victim. Most of the victims are senior citizens, and for the past almost five years now, I have spent a majority of my life serving as their advocate, hoping to help recover some of their losses. I've done this because I am younger than they are, and because they deserve it.

Like thousands of other Stanford victims, my life was forever changed by the events of February 17, 2009. As we watched the news and feared the worst in the immediate aftermath of Madoff's confession, we eventually realized that Allen Stanford had stolen what two generations of my family worked four decades to build—and he did it through Stanford Group Company (SGC), a registered broker dealer and member of the Securities Investor Protection Corporation (SIPC) the SEC had known for more than a decade was operating a Ponzi scheme. While Madoff had outsmarted the SEC, Stanford hadn't, and the SEC *knew* for 12 years that he was using his U.S. broker dealer to steal customer funds intended to purchase CDs from Stanford International Bank (SIB). In that time frame, the Stanford Ponzi scheme grew by more than $5 billion.

My father-in-law is an 87-year-old World War II veteran and first-generation American who, again like so many Stanford victims, was able to live the "American Dream," only to have it snatched away practically overnight. In 1965, he started a manufacturing business with a few thousand dollars borrowed from family members. He and my mother-in-law put in long hours for several years, and eventually all three of their sons—including my husband—joined the business. The family worked together for more than three decades to build the business to more than 300 employees and close to $20 million a year in revenue. At that point, the business had outgrown the family, and they made the decision to sell it at just the right time—before the economic collapse in 2008.

As soon as the sale of the business closed, the lawyer who handled the transaction advised us to invest it with a brokerage firm that specialized in managing large accounts. She then recommended what she called a "boutique" brokerage firm, Stanford Group

Company, which specialized in high wealth clients. The family had never heard of Stanford, but agreed to have a meeting, which she arranged. But the family didn't just go with her recommendation outright. Other firms were also considered, but Stanford really stood out because of their enthusiasm, their professionalism, their high public profile, the top-notch credentials of their advisors, and what we misinterpreted as genuine and sincere interest in our investment goals. What we didn't know is that the Financial Advisors at Stanford Group Company were hooked on what they internally called "Bank Crack"—the highly lucrative commissions and bonuses they received for selling certificates of deposit from Stanford International Bank in Antigua. Also, little did we know, none of the Financial Advisors at Stanford Group Company knew what assets were held (if any) in Stanford International Bank's investment portfolio. How someone who has a fiduciary duty to their clients could recommend putting any of their funds in an investment vehicle for which they didn't even know what the underlying investments were seems extremely questionable, but that was also an inside secret that Stanford paid them enough to overlook.

Ultimately, a substantial portion of the proceeds from the sale of the family's business was entrusted to two Stanford Group Company Financial Advisors, Patrick Cruickshank and Bill Leighton. At the very first meeting with Bill and Patrick, the family explained they were very conservative and risk averse. Bill, an estate planning lawyer, and Patrick, a Certified Financial Planner and NFL, NBA, and NHL approved Financial Advisor with a Series 7 license, told us their safest, most conservative investment was their exclusive, signature product—the Stanford International Bank CD program for Accredited Investors.

We learned at that meeting that the entire Stanford Financial Group of Companies, which included Stanford Group Company, Stanford International Bank, Stanford Trust Company, and more than 100 other Stanford entities all owned by Allen Stanford--was headquartered and operated out of Houston, Texas, and regulated by the SEC and numerous state securities regulators as SGC had 33 offices across the country.

When the family expressed concern about the "international" aspect of the investment, we were told that Allen Stanford, a Texan like us, managed all of his company's operations from the U.S., and that even the bank's portfolio was managed by Stanford Capital Management (SCM) in Memphis, Tennessee. SCM, which was also regulated by the SEC, purportedly had a team of expert money managers overseeing the purported $8 billion SIB bank portfolio. SCM was also regulated by the SEC, so the international CDs started sounding more like domestic securities and not like a risky investment. The best part about the international bank CDs, we were told, was that the Stanford International Bank CDs were securities backed by SIPC and even Excess SIPC so our entire investment would be insured "dollar for dollar," whereas a U.S. bank CD would only be protected by FDIC for $100K. The interest rate was only 1.6% higher than a U.S. bank CD so this security CD thing sounded pretty safe—especially since it was all regulated by the SEC. Plus, the "dollar for dollar" protection meant a lot to us.

But, as conservative as our family is, we didn't just buy the Stanford hype right away, although it was impressive—glossy brochures, beautiful annual reports, slick personalized presentations—all prominently emblazoned with "SIPC Member." We hired an attorney to conduct due diligence on Allen Stanford and the Stanford Financial Group of Companies. Her report stated she found no red flags—only a handful of disgruntled employee lawsuits that had been dismissed.

Now that our lawyer had given us the go ahead, three separate family members signed Customer Agreements with Stanford Group Company and opened SGC brokerage accounts for the very purpose of purchasing the CDs. Pershing served as the custodian for SGC customer's investments, and SGC had the authority to buy and sell securities in our account. We were instructed by SGC on how to fund the brokerage accounts in order for SGC to effectuate the transaction to purchase the SIB CDs. On January 31, 2008, three members of the family invested a totally of $4.5 million. And just like that, the "American Dream" was gone, and the thieves proudly displayed the SIPC logo everywhere we looked—because they were required to.

In the aftermath of the collapse of the Stanford Financial Group, SIPC immediately, and admittedly without seeing any documents except the SEC's complaint against Stanford, et al, made an adamant public announcement that Stanford victims did not qualify for protection under the Securities Investor Protection Act (SIPA).

Almost five years later and SIPC has continued denying protection to Stanford Group Company customers by saying we received the securities we purchased through SGC, which simply isn't true. Our money was stolen. How could we have gotten any security when the owner of the broker dealer stole our funds? Allen Stanford is serving a

110-year jail sentence for stealing our money right here in the US—not for committing an Antiguan bank fraud (which has not been alleged in Antigua).

In November 2009, the Stanford Victims Coalition formally asked the SEC to review SIPC's determination about SGC customers' right to protection under SIPA. After more than a year of the SVC suffering the burden of proof and producing hundreds of SGC customer documents at a time, only to have the target moved and more documents requested, it appeared the SEC was obviously avoiding making a determination. The SVC's members then asked our political leaders to urge the SEC to make a determination. More than 50 Members of the House and Senate signed on to a letter asking the SEC to give the SVC an answer. Still, no answer—only repeated promises that a vote would happen "soon," which I've now learned in SEC language could be months or even years given the way they've handled the Stanford case. Finally, when it appeared this game would go on forever while Stanford victims were losing their homes and going without life necessities, Senator Vitter blocked the nomination of an incoming SEC Commissioner until Stanford victims were given an answer. Senator Vitter never told the SEC how to vote—just to take a fair vote and give the victims an answer. The vote was taken, and as the SVC and counsel had hoped, the SEC determined that SGC customers WERE entitled to protection under SIPA because the SIB CDs were fictitious securities, and the SGC customer funds intended to purchase the CDs were either acquired by Stanford Group Company to pay the broker dealer's expenses, or were outright stolen by Allen Stanford (*see attached affidavit of Karyl Van Tassell*).

Of course SIPC refused to comply with the SEC's recommendation to initiate a liquidation of SGC in order to pay net equity claims for SGC customers, and the SEC took the unprecedented action to initiate an Enforcement Action against SIPC by asking for a court order to compel SIPC to discharge its obligation under SIPA.

The animosity Stanford victims have seen from SIPC is truly astonishing. SIPC President Stephen Harbeck even told a Senate staffer he would resign if SIPC had to pay claims to Stanford victims. What kind of investor protection regime is led with that kind of mentality? Certainly not one looking out for investors who entrust their savings to a SIPC member firm.

Stanford victims did not simply make a bad investment in a worthless security. We didn't even make an investment. We tried, but our money was intercepted before any security could be purchased.

Stanford Group Company customers wired funds to their Pershing accounts, wrote checks they handed to their SGC advisor, or rolled their IRA over directly to Stanford Group Company. NONE of those funds went to Stanford International Bank in Antigua. They went to Allen Stanford's or to the SGC Financial Advisors pockets. No CDs were purchased. No CDs even existed.

What Allen Stanford and the Stanford Financial Group did can only accurately be described as an act of **financial terrorism**. Now SIPC has apparently become an accomplice as it has gone out of its way to avoid applying the case law in similar SIPC cases in which the owner of a SIPC-member broker dealer used an affiliate entity to launder customer funds in order to steal them.

SIPC has grossly mislead Congress and the Courts about the REAL facts of this case, and even convinced the SEC to agree to stipulations in the District Court that were absolutely false (see *attached email exchange with SEC Chief Litigator Matt Martens*).

I can say in all sincerity and honesty that Stanford's victims are good, hardworking and law-abiding people. They are the kind of people you want as neighbors, friends and family. They are middle-class people who were targeted because they had a nest egg. They are war veterans, retired teachers, nurses, small business owners, refinery workers—the kind of small investors SIPA was enacted to protect

We did *not* simply lose our investments with the Stanford Financial Group; our investments were *stolen*. SIPC may not protect fraud, but it is supposed to protect theft.

No one could imagine the harrowing stories I've heard from Stanford victims all over the world. They range from not having money to bury family members to not being able to afford life-saving medical treatments. I've watched as so many have died impoverished. I have received letters from victims on their death beds pleading with me to help their surviving relatives recover their inheritances. I've received phone calls from sobbing strangers in foreign countries explaining their hardships in broken English. Countless victims have been, and are suicidal. Some have even taken their own lives.

The impact of this crime is immeasurable, and it is truly a human tragedy as well as a financial one. Allen Stanford thrived on cheating the system while preying on the middle class, and our financial regulatory structure let him do it. They knew what he was doing.

FINRA knew Stanford Group Company was in financial difficulty, and SIPC was either not notified or just didn't act.

Chairman Garrett, Ranking Member Malony and the honorable members of the subcommittee, thank you for hearing me today. I urge you to pull the reigns in on SIPC. It is not above the federal government, yet it is spending its fund litigating against its federal oversight authority. The SIPC fund was created by Congress to be used to protect investors, not cost our taxpayers an untold amount of money by engaging in time consuming litigation while innocent, elderly investors who entrusted their funds to a SIPC member are left out here with no safety net and SIPC is acting as our adversary rather than our advocate.

Thank you for your time and your attention.

EXHIBITS

STANFORD FINANCIAL GROUP PONZI SCHEME
FACT SHEET

STANFORD GROUP COMPANY: BACKGROUND

- Stanford Group Company (SGC) was an SEC-registered broker dealer and SIPC member. SGC had more than 30 offices throughout the US with more than 250 FINRA-Registered Representatives.
- Stanford International Bank was an offshore bank registered in Antigua.
- SGC's Registered Reps sold approximately $2 billion worth of fictitious Stanford International Bank (SIB) CDs to 5,000 US investors in 46 states.
- Both SGC and SIB were wholly owned by Allen Stanford, and operated under the umbrella brand of The Stanford Financial Group of Companies, headquarted in Houston, Texas.
- The SIB CDs were sold to US citizens as securities disclosed to the SEC under a Regulation D exemption, which was filed annually with SEC. Although Regulation D requires buyers to be "accredited investors," many SGC clients who were sold the fictitious CDs did not meet the accreditation requirements. Neither the SEC, nor FINRA have taken enforcement action against the SGC Reps who violated this critical requirement under the Regulation D exemption.
- SGC Reps targeted middle-class, retirement-age investors to invest their brokerage account holdings, including IRAs and pension plans, in the SIB CDs.
- For most SGC customers, their SIB CD investments represented their entire life savings. Approximately 80% had account balances less than $500K.
- SGC customer funds intended to purchase the CDs were *never sent to SIB*. Funds were laundered through (primarily US) banks, and used to pay earlier investors, SGC's expenses and support Allen Stanford's lavish lifestyle.
- SGC was financially dependent on referral fees for selling the SIB CDs, and additional shareholder capital contributed by Allen Stanford in the form of "loans" from SIB. Both the fees and the additional capital—both disclosed on SGC's monthly financial statements filed with FINRA—came from the stolen SIB CD funds.
- The SEC's examination of SGC in 1998 specifically noted millions of dollars in SGC capital contributions came from misappropriated SIB CD funds belonging to SGC's customers.
- Stanford Trust Company (STC) in Baton Rouge, La., also wholly owned by Allen Stanford, held custody of approximately $400 million of SGC customers' IRAs that were invested in the SIB CDs. STC was a subsidiary of SGC—as disclosed in audits filed annually with the SEC. STC's operations were governed by a Board of Directors that included SGC employees.
- Most of the SGC customers who purchased SIB CDs used their brokerage accounts (held for SGC by a third party custodial firm) to fund the CD transactions. Others wrote checks made out to SGC, Stanford Trust Company, SIB or just "Stanford."
- The CDs were sold by SGC Registered Reps along with other securities, and ALL products were sold as SIPC-insured investments.
- In November 2009, the Stanford Victims Coalition (SVC) formally asked the SEC to review SIPC's determination that SGC customers met the statutory requirements for compensation up

to $500K under the Securities Investor Protection Act (SIPA).

- From December 2009-May 2011, the SVC provided the SEC with thousands of SGC customer documents in order to prove their right to protection under SIPA.
- In June 2010, by a vote of the Commissioners, the SEC determined that SGC should be liquidated under SIPA, and authorized the SEC Division of Enforcement to seek a court order to compel SIPC if its Board of Directors refused to comply.
- In November 2011, SIPC took the unprecedented action to defy the SEC's plenary authority over SIPC by refusing to commence a SIPA liquidation of SGC. SIPC launched a PR campaign against protecting SGC customers, and hired two outside law firms to defend its actions.
- In December 2011, the SEC filed an application with the District Court in Washington, D.C. seeking an order to compel SIPC to discharge its obligations under SIPA by initiating a liquidation of SGC.
- In the District Court proceedings, the SEC agreed with SIPC on 8 stipulations—at least half of which were factually incorrect.
- In July 2012, the D.C. District Court, citing the erroneous stipulations, denied the SEC's application.
- In August 2012, more than 50 Members of Congress asked the SEC to appeal the District Court's decision, which the SEC agreed to.
- As of June 2013, the SEC vs. SIPC appeal is fully briefed and pending oral arguments in the Circuit Court for the District of Columbia.

STANFORD GROUP COMPANY'S REGULATORY HISTORY

- Stanford Group Company (SGC) registered with the SEC in 1996 as both a broker dealer and an investment advisor.
- In its first exam of SGC in 1997, the SEC suspected a Ponzi scheme, and opened a Matter Under Inquiry (MUI), which was closed 30 days later after Stanford did not voluntarily submit the requested documentation. No further action was taken despite direct knowledge of SGC customer funds in jeopardy of being misappropriated or stolen.
- Three more SEC exams were completed between 1998 and 2004. Each concluded that Stanford was in violation of numerous securities laws, and that the SIB CDs were likely fraudulent. The size of the fraud, in each instance, was bigger than the SEC's entire budget. No action was taken.
- A formal SEC investigation was finally opened in 2005. The investigation took 4 years, during which SIB CD sales doubled. More than 85% of all SIB CD sales to US investors occurred from 2007 through 2009 when the SEC filed a civil lawsuit that took all Stanford entities into Receivership on Feb. 16, 2009.
- The SEC blames the 4-year investigation delay on Stanford's lack of cooperation and Antigua's bank secrecy laws.
- None of the exams or the multi-year investigation of SGC were made public. The SEC had every reason and resource to stop the Stanford Ponzi scheme, but chose not to for 12 years. The longer the SEC took to act, the more legitimacy the SIB CDs had.
- SGC's financial statements filed with the SEC and FINRA showed SGC's dependence on

revenue from selling SIB bank CDs and large cash contributions from Allen Stanford, which were directly traced to loans from SIB. SGC showed an operating loss every year of its existence. Without SIB, SGC was insolvent. No protective action was taken.

- Dozens of SGC employees came forward to FINRA alleging fraudulent practices at SGC. FINRA arbitration favored SGC in every instance.
- In 2007, FINRA fined SGC $20,000 for failing to maintain minimum net capital requirements, and $10,000 for allegations of distributing "misleading, unfair and unbalanced information" about the SIB CDs.
- In 2008, FINRA fined SGC $30,000 failing to adequately disclose its research methods used to report securities valuations.
- Stanford was under investigation by numerous US government agencies for more than 20 years. The DEA, FBI, US Attorney's Office, IRS Criminal Division, US Customs and the Federal Reserve all notified the SEC that Stanford was under investigation starting in 1999.
- In 1999, the US Treasury issued an advisory to all banks in the US warning them to scrutinize transactions to/from Antigua because of Stanford's role as the head of the regulator that oversaw his own bank. The advisory, lifted in 2011, was only the second of its kind against an entire nation.
- In 2001, the US Treasury entered into an information sharing agreement with the government of Antigua. The agreement gave Treasury access to information from any financial institution operating in Antigua if there was a suspected financial crime. During their 4-year investigation, the SEC never asked Treasury to help get information about SIB's assets.
- In 2001, the State of Texas entered into an information sharing agreement with the government of Antigua and Barbuda. The agreement allowed for the Texas Banking Department to examine the books and records of a financial institution in Antigua with offices in Texas. During their 4-year investigation, the SEC never asked the Texas Banking Department to help get information about SIB's assets.
- Leroy King, Director of Antigua's Financial Services Regulatory Authority (FSRC), was indicted in June 2009 for obstruction of the SEC's investigation of Stanford. However, starting in 2001, the US State Department provided the FSRC with all of its technology equipment. During their 4-year investigation of Stanford, the SEC never asked for the State Department's assistance with the uncooperative regulator in Antigua. King has not been extradited to the US to face charges.
- In February 2009, Antiguan government official Dr. Errol Cort was sued in the District Court in Dallas, Texas, for the return of more than $1 million fraudulently transferred to him in $25K monthly payments from Stanford. As Antigua's Minister of Finance from 2004-2009, Dr. Cort had full authority over and responsibility for the FSRC. Dr. Cort now serves as Antigua's Minister of National Security and heads up the Caribbean's security initiative partnership with the US—despite his obvious role in the Stanford Ponzi scheme.
- In February 2009, the Stanford Financial Group (SFG) entities were taken into Receivership after the SEC alleged the companies were in engaged in a "massive, ongoing fraud."
- In June 2009, seven former SFG employees were indicted for their involvement in the Stanford Ponzi scheme.
- In August 2009, former SFG Chief Financial Officer James Davis pleaded guilty to facilitating a Ponzi scheme with Allen Stanford. He was sentenced to 5 years in prison.
- In February 2012, Allen Stanford was found guilty by a jury of his peers in Houston, Texas. He

was sentenced to 110 years in prison.

- In September 2012, former SFG Chief Investment Officer Laura Pendergest Holt pleaded guilty to obstructing the SEC's investigation of Stanford in exchange for 20 other felony charges being dropped. She was sentenced to 3 years in prison.
- In February 2013, two former SFG accounting employees were found guilty by a jury of their peers in Houston, Texas. They were each sentenced to 20 years in prison.
- In May 2013, the District Court in Dallas, Texas, ruled in favor of the SEC in its civil lawsuit against Stanford, and order to disgorge $6.7 billion.
- After more than 4 years with no recovery of their losses, in June 2013, the District Court in Dallas approved the Receiver's request for a distribution of one cent on the dollar to Stanford's victims—for a total of $55 million. The expenses for the Receivership have exceeded $110 million.

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STANFORD VICTIMS COALITION

LEGAL PRECEDENTS FOR SIPC COVERAGE FOR SGC CUSTOMERS

The two primary reasons the SEC and SIPC have given to explain why Stanford Group Company (SGC) has not been put in liquidation under the Securities Investor Protection Act (SIPA) are:

1. SGC was an introducing broker dealer, which did not hold custody of customer funds or securities; and
2. SIPC does not cover securities that are worthless or have declined in value.

1. INTRODUCING BROKER DEALER AND CUSTODY STATUS

Many of SIPC's members are introducing broker dealers and SIPC has compensated customers of introducing broker dealers numerous times. Introducing broker dealers are SIPC members, in part, so that customers are protected if the broker dealer steals its customers' funds. The SEC and the DOJ have accused Allen Stanford of stealing customer funds.

SGC customers deposited funds with SGC (typically through its clearinghouse, Pershing LLC) with the legitimate expectation that the funds would be used to purchase Stanford International Bank (SIB) CDs. **Instead of purchasing SIB CDs, SGC acquired control of its customers' funds and the funds were stolen—*not* by SIB, but by SGC, the SIPC member.** (see attached for almost identical SIPC cases).

Additionally, the SVC has provided the SEC with numerous examples of customer documents indicating that many SGC customers did not receive their CDs and that the CDs were held at SGC. At least some SGC customers received CD statements from SGC with the words "Member FINRA/SIPC." The legitimate customer expectation for SGC clients is the CDs were purchased by SGC and were in SGC's custody protected by SIPC.

Investors in the US purchased SIB CDs *only* via SGC. Each SGC customer entered into an "Account Application and Agreement," which contains language indicating that customers were entering into an Agreement with SGC, member of NASD/FINRA and SIPC. **SGC customers had no legitimate reason to believe in any circumstance they were not SGC customers and protected by SIPC in the event the CDs were stolen or entirely fictitious.**

SGC customers' IRAs converted to the SIB CDs were held in the custody of Stanford Trust Company (STC) in Baton Rouge, LA. STC's Board Members were SGC employees who conducted STC's custodial functions.

The Stanford Receiver and SEC Enforcement have said SGC could not have survived financially without the sales of the CDs because the SIB CD referral fees accounted for a majority of SGC's revenues. According to the forensic accountant's declaration, these referral fees came directly from embezzled customer deposits.

SGC registered representatives who marketed and sold CDs to customers received forgivable loans as part of their compensation package. Additionally, SGC's registered representatives received commissions on CD sales, Performance Appreciation Rights Plan and bonus payments based on CD sales. According to the forensic accountant's declaration, the "loans" and other payments were made from embezzled SIB CD funds.

SGC received substantial capital contributions from Allen Stanford. The forensic accounting declaration states these contributions came directly from embezzled customer deposits.

2. WORTHLESS SECURITIES/ "FICTITIOUS SECURITIES"

SGC customers who purchased CDs are NOT seeking recovery for securities that are now worthless or that have lost value. **The SIB CDs that were not purchased by SGC for its customers are not worthless securities, they are entirely *fictitious*. Fictitious securities have been covered by SIPC in previous cases.**

The SEC and the DOJ have not accused Allen Stanford of simply *misappropriating* customer funds; the SEC and DOJ have accused Allen Stanford of *stealing* customers' funds that were intended to purchase SIB CDs. The SIB CDs were never real securities, serving as nothing more than as a vehicle to feed the Ponzi scheme. **According to the forensic accountant's declaration, SGC customer funds intended to purchase SIB CDs did not go to SIB.**

LEGAL PRECEDENTS THAT FAVOR SIPC COMPENSATION OF STANFORD GROUP COMPANY CUSTOMERS

There are two Court of Appeals cases that are strongly analogous to the facts in the Stanford case. In both cases, the Court ruled in favor of the investors over SIPC.

I. Customer Status for Introducing Broker-Dealer Clients

The fact that Stanford Group Company (SGC) was an introducing broker-dealer should not preclude coverage of SGC's customers under the Securities Investor Protection Act of 1970 (SIPA). SGC customers are in the same position as customers in *In re Old Naples Securities, Inc.* The United States Court of Appeals for the Eleventh Circuit held in *Old Naples* that customers of an introducing broker-dealer who thought they were purchasing bonds through the broker-dealer were "customers" of the broker-dealer within the meaning of SIPA and entitled to coverage under the statute.[1] Old Naples Securities, Inc. ("Old Naples") was an SEC-registered introducing broker-dealer, i.e., it did not clear and carry its customers securities accounts. Old Naples' owner, James Zimmerman, perpetrated a Ponzi scheme through the introducing broker-dealer. The customers believed that Zimmerman used their payments to purchase bonds in their names, but amounts received from some customers were used to make payments of fictitious interest to other customers who also thought that they had purchased bonds or to Zimmerman for his personal use.[2] The customers made payment for the bonds to a non-broker-dealer entity that Zimmerman also owned.[3] The fictitious interest paid to some customers was deposited into the customers' accounts at Old Naples' clearing firm.[4] Zimmerman ultimately could not sustain the Ponzi scheme, Old Naples collapsed, and SIPC initiated a liquidation of the broker-dealer under SIPA.[5]

On appeal to the Eleventh Circuit, SIPC and the trustee argued that the claimants were not customers for SIPA purposes because (1) the funds used to pay Zimmerman to purchase the bonds were wired to his non-broker-dealer entity, not to Old Naples; (2) the investments were not securities; and (3) the investments were poorly documented and paid such high rates of return that they could not be viewed as having been sold within Old Naples' "ordinary course of business."[6]

The Eleventh Circuit affirmed the district court order allowing the claims of Old Naples' customers in the SIPA proceeding.[7] First, the court affirmed the bankruptcy court's determination that the customers' had deposited cash with the debtor broker-dealer. The court reasoned that whether a claimant deposited cash with the debtor *"does not ... depend simply on to whom the claimant handed her cash or made her check payable, or even where the funds were initially deposited."*[8] Rather, the issue was one of "*'actual receipt, acquisition or possession of the property of a claimant by the brokerage firm under liquidation.'*"[9] Specifically, the court concluded that the bankruptcy court's determination that the claimants had no reason to know that they were not dealing with Old Naples was not in error.[10] Moreover, the court determined that Old Naples acquired control over the claimants' funds because the funds were used by, or at least for (through Zimmerman), Old Naples.[11] Zimmerman used the claimants' funds to pay Old

[1] *Old Naples*, 223 F.3d at 1303.
[2] *Id.* at 1301.
[3] *Id.*
[4] *Id.* at 1300.
[5] *Id.*
[6] *Id.* at 1302.
[7] *Id.* at 1305.
[8] *Id.* at 1302.
[9] *Id.* quoting *SEC v. Kenneth Bove & Co.*, 378 F. Supp. 697, 700 (S.D.N.Y. 1974).
[10] *Id.* at 1303.
[11] *Id.*

Naples' expenses. *"[T]he funds of the individual claimants in this cased were used by the owner of Old Naples Securities for the benefit of Old Naples Securities*."[12]

II. Claims for Worthless Securities vs. Fictitious Securities

Of course SIPA does not cover losses to customers due to changes in the market, or loss of value of securities. The losses of SGC customers are not due to loss in value of the Stanford International Bank (SIB) CDs. Customer funds were never used to purchase legitimate securities – customer funds were used to feed the Stanford Ponzi scheme. The SEC has taken the position in litigation related to the Stanford Receivership that an entity that operates as a Ponzi scheme "*is, as a matter of law, insolvent from its inception*."[13] An insolvent entity cannot issue legitimate securities, however, SGC customers' funds did not even go to SIB. The SIB CDs that were not purchased by SGC for its customers are not worthless securities, they are entirely *fictitious*. In the past, the Commission has argued that "*a customer's legitimate expectations," ought to be protected "regardless of the fact that that the securities were fictitious.*"[14]

SGC's customers are in the same position as the customers who were the subject of *In re New Times Securities Services, Inc*. In *New Times*, William Goren sold fictitious mutual fund shares, as well as shares of bona fide mutual funds, to investors via two entities, one a register broker-dealer that was a SIPC member, and the other a non-broker-dealer entity.[15] The mutual funds in which investors thought they were investing never existed.[16] Although the investors received confirmations and account statements indicating that their payments had been invested in mutual funds, Goren had stolen their money.[17]

The SIPA trustee took the position that *New Times* investors in fictitious securities had claims for cash subject to the $100,000 SIPA limit on cash advances. *New Times* investors whose cash Goren stole, but who were misled into believing that he had purchased existing mutual fund shares were treated as having claims for securities.[18]

The Second Circuit held that the *New Times* investors who purchased fictitious securities had "claims for securities." In doing so, the court gave deference to the position of the Commission over that of SIPC. The Commission in *New Times* took the position that the purchasers of the fictitious securities had claims for securities because they received confirmations and account statement from the insolvent broker-dealer and the customers' legitimate expectations, i.e., that they had purchased securities, should be satisfied.[19]

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[12] *Id*. at 1303, n. 16.
[13] In a brief the SEC filed in one of the Stanford Receivership cases in the Fifth Circuit Court of Appeals, the Commission argued that a Ponzi scheme is insolvent from its inception, and quoted *Warfield v. Byron*, 436 F.3d 551, 558 (5th Cir. 2006) (citation omitted). Br. of the SEC, *Amicus Curiae*, In Support of Appellees at 14 , *Janvey v. Gaines, et al.*, 09-10761 (5th Cir. Oct. 8, 2009).
[14] In re *New Times Securities Services, Inc.*, 371 F.3d 68, 76 (2nd Cir. 2004).
[15] *New Times*, 371 F.3d at 71.
[16] *Id*. at 74.
[17] *Id*.
[18] *Id*.
[19] *Id*. at 76, 87.

STANFORD VICTIMS COALITION

SEEKING JUSTICE FOR INTERNATIONAL FRAUD

September 14, 2010

Mr. Stephen Harbeck
President and CEO
Securities Investor Protection Corporation
805 15th Street, Suite 800
Washington, D.C., 20005

Dear Mr. Harbeck,

I was very surprised to see this statement from you in Kathy Kristof's *Los Angeles Times* column on Sunday:

> *"The investors in Stanford Financial Group are holding the certificates of deposit in a bank in Antigua in their hands. We do not protect fraudulent projections of value. We ensure that investors receive the securities that they bought, and they have them."*

With all due respect, you are clearly misinformed about the details in this case. Your statement is simply inaccurate and it is very difficult to understand how after 18 months of ongoing discussions between my organization, the Stanford Victims Coalition (SVC), and SEC and SIPC officials regarding the various aspects of the legal arguments we've outlined and documented that you can continue to blatantly ignore the facts and rely instead on false assumptions to defend SIPC's position in the Stanford case.

While it is possible some Stanford investors MAY have gotten a piece of paper saying they purchased a CD at Stanford International Bank (but no different than the pieces of paper Madoff investors received), this is not the case for MOST Stanford International Bank CD investors who purchased the securities from a registered representative of Stanford Group Company (SGC), an SEC-registered broker dealer and SIPC member. **The Stanford International Bank CD certificates were, in most cases, in the physical custody of Stanford Group Company and thousands of SGC customers DO NOT hold their securities in their hands.**

SGC customers literally did NOT get the securities they purchased, nor do those investors even have a piece of paper saying they received their securities. In my own personal example, I am MISSING SECURITIES totaling $1.3 million, yet I cannot file a SIPC claim.

As the SVC, along with dozens of members of Congress, have said, Stanford Group Company customers should be extended the same protection as Madoff customers, and be treated with the same application of the Securities Investor Protection Act Madoff's customers have been fortunate enough to have received. The fact some Madoff investors do not believe they have been provided adequate coverage seems to be given more attention than the fact Stanford Group Company's customers can't even file claims to receive equal treatment.

It is a devastating reality Stanford victims face each day knowing that being a Madoff victim is a much better situation to be in than being a Stanford victim. Both groups of investors were customers of a SIPC-member broker dealer whose owner has been accused of carrying out a Ponzi scheme and stealing customer funds. Both Madoff Securities and Stanford Group Company represented to customers to have purchased securities for their customers. There are approximately 5,000 investors in each case, yet Madoff investors' losses are up to $60 billion and SGC customers lost less than $2 billion. Basic math tells you the Stanford investors are much smaller investors and for most SGC customers, their losses represent 30-40 years of retirement savings that were entrusted to a SIPC-member company to invest. Additionally, SIPC protection would make most SGC victims whole.

Like most Americans who utilize the services of SIPC's members and rely on their expertise and the protection of the SEC and SIPC, these are not savvy investors who understand the difference between an *"introducing broker dealer"* and a "custodial *broker dealer."* All that was represented to investors on everything from business cards and signage to promotional footballs and water bottles (and everything in between) was *"SIPC Member."* There were NO disclaimers. Those came only AFTER our funds were stolen by a broker dealer. The question of who held custody of securities that never existed is not at all a fair way to determine coverage. The fact SGC DID hold physical custody of a substantial number of customers' securities has been glossed over entirely, and I'm sure your response will be something along the lines of "SIPC can return those securities to you, but they have no value. SIPC does not cover loss of value or worthless securities." Mr. Harbeck, the CDs have no value because the owner of the broker dealer stole the funds, not because we purchased securities that did not retain their value, or even securities that never had value. **Our funds were STOLEN and there were no securities**, as the SEC Director of Enforcement has stated. The SEC has even cited case law in the receivership proceeding saying "A Ponzi scheme is insolvent from inception." **How could an insolvent criminal enterprise issue securities?**

The SEC and the DOJ have accused the owner of a SIPC-member of stealing customer funds. The SEC has determined the CDs were in fact securities. **Customer funds intended to purchase Stanford International Bank CDs never made it to Stanford International Bank,** and according to forensic accounting reports, were instead laundered through a series of Stanford Financial Group controlled bank accounts in the U.S. to ultimately pay out redemptions to earlier investors and pay for the expenses of the broker dealer. **This is a very straightforward case and the SEC and SIPC have made it very complicated by taking a hyper-technical interpretation of the SIPA statute and overlooking the basic facts of our case**, which is truly no different than that of Madoff investors. A SIPC-member sold us securities that did not exist. That same SIPC member provided its customers with statements displaying the "Member SIPC" logo on them. The legitimate customer expectation is that the CDs are covered by SIPC.

Adding insult to injury, and protecting the SEC and SIPC rather than investors, we have no private right of action when it comes to disagreements about SIPC coverage and whether or not claims can be filed. It is simply up to the SEC and SIPC to enforce the law and if an investor disagrees – too bad, there's no right to an opinion review by an objective third party. The only judge we get are your organization and the SEC, and **the fact there are previous cases in which SIPC has extended coverage to investors in similar situations seems to be irrelevant.** It is painfully clear the legal documents provided to your office at the expense of tens of thousands of dollars paid for by the defrauded investors have not even been reviewed or considered and it is simply astonishing our right to SIPC has never been given serious consideration. **Instead, false assumptions are determining the future of 5,000 middle-class American investors who were not protected before a SIPC member stole their savings and most certainly are not getting fair treatment in the aftermath of that crime.**

At a time when it is more important than ever for investors to be reassured of their protection when it comes to investing their hard-earned life savings, the Securities Investor **PROTECTION** Corporation, should be acting as an ADVOCATE for investors rather than as an ADVERSARY. Not even realizing the most fundamental of facts in our case is definitely not in the realm of advocating for our protection. In fact, SIPC seems to have gone out of its way to take an adversarial - and at times condescending - approach in denying coverage for SGC customers. My hope is that the much needed SIPA reform measures will create an organization like SIPC that truly protects investors rather than itself and the industry it represents. **No victims should ever have to go through what Stanford victims have had to endure in this case.**

I would be more than happy to discuss this matter with you personally and look forward to your response.

Sincerely,

Angela Shaw

Angela Shaw
Director and Founder
Stanford Victims Coalition

Cc: Securities & Exchange Commission Chairman Mary Schapiro
SEC Division of Markets & Trading
House Financial Services Committee
Senate Banking Committee
Government Accountability Office

STANFORD VICTIMS COALITION

December 2, 2011

Ira Hammerman, Esq.
General Counsel
Securities Industry and Financial Markets Association
1101 New York Ave NW # 800
Washington D.C., DC 20005-4279

Re: SIFMA's August 2011 Memo to the SIPC Board of Directors

Mr. Hammerman,

As the Director and Founder of the Stanford Victims Coalition, a member of the District Court-appointed Stanford Investors Committee, and more generally as an investor, I am astounded by the Securities Industry and Financial Markets Association's (SIFMA) oppositional response to the Securities and Exchange Commission's (SEC) recommendation to the Securities Investor Protection Corporation (SIPC) to liquidate Stanford Group Company (SGC) and satisfy customer claims for net investments in Stanford International Bank (SIB) certificates of deposit.

Your August 17, 2011 memo to the SIPC Board of Directors clearly demonstrates SIFMA's inherent conflict of interest in protecting the industry it represents over the investing public. Apart from the complete *misinformation* used as the basis of SIFMA's recommendation the SIPC Board "reject" the SEC's analysis regarding the status of SGC customers under the Securities Investor Protection Act (SIPA), SIFMA fails to acknowledge any "legitimate expectations" of the investors who relied on the SIPC logo and the "professionals" in the industry SIFMA represents.[1]

While SIFMA publicly claims to support fostering "an environment of trust and confidence in the financial markets," your memo exposes SIFMA's true intention—to prevent an increase in fee assessments on SIPC member companies. In essence, SIFMA opposes *real* investor protection, and would rather give investors the *false* sense of confidence conveyed by the use of the SIPC logo.

Simply put, when an investor who is sold securities by a Registered Representative of a SIPC Member (like SGC) cannot rely on SIPC to uphold its statutory requirements under the SIPA, *any* use of the SIPC logo is misleading and the only confidence an investor might have is false confidence. SIFMA should be ashamed of its lobbying position to perpetuate investor deception.

[1] In *New Times Securities*, the Second Circuit gave deference to the SEC's position that a customer's "legitimate expectations," based on written confirmations of transactions, ought to be protected

Your memo makes numerous references to the SEC's "unprecedentedly broad" interpretation of SIPA's "narrow mandate" and "limited purpose," but the reality is the SIPA has always protected customers whose funds were stolen by a SIPC member. It is only in the aftermath of regulatory failure to protect investors from insolvent broker dealers like Madoff and SGC that SIFMA and SIPC have decided to defend a much more "limited" perspective of the SIPA.

I would like to address some of the specific points made in your memo, and the position SIFMA has taken that protecting SGC customers contravenes "public policy" and the legislative intent of SIPA.

SIFMA does not have oversight authority over SIPC

Congress did not give SIFMA legislative authority over SIPC; Congress granted that power to the SEC. It is not SIFMA's position to interpret the statute and make recommendations to SIPC. Congress put SIPC's direction in the hands of a publicly chosen board of directors—not SIPC's and SIFMA's member firms.

It is manifestly contrary to the public policy of the United States for a private, self-interested organization to undermine the government's legislative authority or intervene in their administration of a law. SIPA was enacted to protect customers of registered broker dealers, and more than 100 members of Congress have weighed in on this issue over the past 33 months—all seeking for their constituents the mandated protections SIPA was created to provide.

SIFMA's erroneous analysis of the SEC's recommendation

SIFMA's memo states, "Crucially, unlike the situation in the cases relied upon in the SEC Analysis, including the liquidation of Bernard L. Madoff Investment Securities LLC, the purchasers of SIBL CDs actually purchased the very security they sought to acquire." That statement could not be more inaccurate.

The SIB CDs did not exist as anything more than a vehicle to steal customer funds. By all definitions, the SIB CDs were never legitimate securities, and customer funds never went to SIB in Antigua.[2] SGC customers had the legitimate expectation they were purchasing actual securities and instead, as the SEC and DOJ have alleged, their funds were stolen in a Ponzi scheme. SGC management, including Chief Financial Officer James Davis, were fully aware of the misappropriation of customer funds and that the CDs were entirely

[2] The February 15, 2011 Declaration of Karyl Van Tassel, forensic accountant for the Stanford Receiver, states customer's funds intended to purchase the SIB CDs were misappropriated to pay: *(i)* previous customers; *(ii)* the expenses of SGC, including the salaries and commissions of its registered representatives; and *(iii)* Allen Stanford, the sole owner of SGC. According to Van Tassel, a majority of SGC's revenue came from the SIB CD funds acquired by the broker dealer after its registered reps sold the securities.

fictitious, yet enticed its Registered Representatives to sell the SIB CDs in order to fund SGC's operations and pay previous customers.[3]

The SEC has alleged in its civil suit against Stanford, et al, the Stanford Financial Group of Companies operated a "massive Ponzi scheme." Additionally, the SEC has taken the position in litigation related to the Stanford Receivership that an entity that operates as a Ponzi scheme "is, as a matter of law, insolvent from its inception."[4] An insolvent entity cannot issue real securities and the SIPA has previously been used to protect investors "regardless of the fact that that the securities were fictitious."[5]

SGC customers do not have "ordinary losses"

There is nothing "ordinary" about SGC customers' losses. SGC was an insolvent broker dealer and SIPC member that misappropriated customers' funds for more than a decade. SGC sold its customers fictitious securities, then acquired its customers' funds to pay for commissions and bonuses for the Registered Representatives who sold the CDs; SGC's marketing and advertising; professional endorsements for SGC; and generally all of the expenses of the SIPC member.[6]

In *Old Naples Securities*, the court reasoned that whether a claimant deposited cash with the debtor "does not ... depend simply on to whom the claimant handed her cash or made her check payable, or even where the funds were initially deposited."[7] Rather, the issue was one of "'actual receipt, acquisition or possession of the property of a claimant by the brokerage firm under liquidation.'"[8]

SGC customers did not simply make a bad investment; a SIPC member stole our funds. We understand that SIPC was not created to protect investors from worthless securities or securities that decline in value; however, the SIB CDs have no value because the funds were stolen in a Ponzi scheme.

The SIB CDs did not exist and cannot be replaced. When missing securities cannot be replaced by SIPC, a customer is entitled to compensation of their net equity investments.

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[3] Stanford Group Company's Chief Financial Officer James Davis pleaded guilty to criminal charges in August 2009.

[4] In a brief the SEC filed in one of the Stanford Receivership cases in the Fifth Circuit Court of Appeals, the Commission argued that a Ponzi scheme is insolvent from its inception, and quoted *Warfield v. Byron*, 436 F.3d 551, 558 (5th Cir. 2006) (citation omitted). Br. of the SEC, *Amicus Curiae*, In Support of Appellees at 14, *Janvey v. Gaines, et al.*, 09-10761 (5th Cir. Oct. 8, 2009).

[5] In re *New Times Securities Services, Inc.*, 371 F.3d 68, 76 (2nd Cir. 2004)

[6] The Feb. 15, 2011 Declaration of Karyl Van Tassel, forensic accountant for the Stanford Receiver, states SGC customers' funds intended to purchase the SIB CDs were misappropriated to pay: *(i)* previous customers; *(ii)* the expenses of SGC, including the salaries and commissions of its registered representatives; and *(iii)* SGC's owner, Allen Stanford. According to Van Tassell, a majority of SGC's revenue came from the SIB CD funds.

[7] *Id.* at 1302.

[8] *Id.* quoting *SEC v. Kenneth Bove & Co.*, 378 F. Supp. 697, 700 (S.D.N.Y. 1974).

<u>SGC customers did not bypass the brokerage</u>

SIFMA's memo states, "However, there are also facts that provide strong arguments against extending the *Old Naples Securities* precedent to the SIBL CD investors. Most significantly, unlike the customers in *Old Naples Securities* and *Primeline Securities*, investors in SIBL CDs sent their funds directly to the issuer of the securities they intended to purchase.....These investors transferred funds to SIBL for the purchase of SIBL CDs, and SIBL CDs were in fact purchased with those funds."

This is absolutely false. SGC directed ***all*** transfers to SIB accounts.

Most, if not all, of the SGC customers who purchased SIB CDs conducted traditional brokerage business with SGC through its third-party clearing firm, Pershing LLC.[9] The CDs were typically transacted through the customer's SGC brokerage account at Pershing. Some SGC customers rolled over IRAs from other accounts, and distribution checks were made out to Stanford Group Company or Stanford Trust Company, a Louisiana trust company managed by a Board of Directors comprised of SGC employees. Other customers wrote checks directly to Stanford Group Company, Stanford, or Stanford International Bank; however, customers did ***not*** send those checks directly to SIB. The checks were taken by SGC representatives, deposited in U.S. bank accounts and the funds never left the U.S.[10]

Customer checks made out to SIB were initially deposited into an account in the name of SIB, but then transferred to an account in the name of the Stanford Financial Group ("SFG"), the parent company for all Stanford entities—including SIB and SGC.[11] Once in the SFG accounts, the funds were then dispersed to the various Stanford entities as needed—including, primarily, SGC.[12]

SGC customers did not interface with SIB staff in any way, shape or form. If an SGC customer contacted SIB, they were instructed to contact their SGC Representative. If a customer wanted to renew or redeem their CDs, it was handled by the SGC Registered Representative, and redemption funds were typically directed back into the customers brokerage account held at Pershing. If a customer wanted change their address with SIB, SGC reps also handled all of the paperwork. For all intents and purposes, we were customers of SGC and had no interaction whatsoever with SIB.

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[9] Pershing is a defendant in a class-action lawsuit for its role in transferring more than $500 million from SGC brokerage accounts to Toronto Dominion Bank to purportedly fund SIB CDs. On Dec. 12, 2008, the day Madoff confessed to operating a Ponzi scheme, Pershing told SGC it could no longer wire funds to purchase SIB CDs until SIB could produce an independent audit. Pershing Chairman Richard Brueckner currently serves on SIFMA's Board of Directors.

[10] SGC did not send customer checks to SIB. SIB in Antigua did not accept or hold customer funds. It did not have a vault, or even a safe. If checks did arrive at SIB in Antigua, they were sent to Houston for the SFG accounting staff to deposit in U.S. bank accounts.

[11] All of the bank accounts were controlled by SGC CFO James Davis and/or Allen Stanford, SGC Chairman.

[12] Declaration of Karyl Van Tassel

SIPC membership should be limited

SGC customers in 46 states across the country relied on the assurances represented by the SIPC logo, as well as the fiduciary duties of some of the most experienced advisors in the industry. Many of those advisors are *currently* members of SIPC and SIFMA and they will be greatly affected by the outcome of this case as their customers face significant losses that will be arbitrated by FINRA or litigated in court.

If SIPA's scope is so limited that it does not protect customers of introducing broker dealers whose funds are stolen, then those firms should not be members of SIPC. Anything else is pure misrepresentation to investors.

Sincerely,

Angela Shaw

Angela Shaw
Director and Founder
Stanford Victims Coalition

Cc: SEC Chairman Mary Schapiro
SEC Commissioner Luis Aguilar
SEC Commissioner Daniel Gallagher
SEC Commissioner Troy Paredes
SEC Commission Elisse Walter
SIPC Chairman Orlan Johnson
SIPC Board of Directors
SIPC Modernization Task Force

Enclosure: Declaration of Karyl Van Tassel

Q And then very shortly thereafter, the Ponzi scheme collapsed?

A When [redacted] got in there and found some records, that makes a lot of difference.

Q Right. So do you think kind of looking back that if perhaps some of the investigative steps that were taken in the late 2000s were taken years earlier and then a complaint brought significantly earlier, that that might have acted to uncover the Ponzi scheme before it grew to the point it grew?

A Oh, I'm sure if we had been able -- I don't know about investigative steps. It's always been -- you know, for years I said the only way you're going to get this done is to get subpoena power and subpoena the records. If we go into court and they fight a subpoena and we lose, well, we've done everything we can do. But we ought to do that.

Q If that effort had been done instead of in 2006, in 1996, it would have saved a lot of the growth of the Ponzi scheme?

A I would think so. It was obvious for years that it was a Ponzi scheme. You never knew where the money was going. Nobody knew where the money was going. The only person that knew where the money was going was Allen Stanford or people that were in cahoots with him.

[redacted]: I want to be clear on your reference to getting subpoena power and what it is you were advocating

Excerpt from 2002 SEC Exam Report Stanford Group Company

Findings were not disclosed to the public.

An additional $5 billion went to Stanford International Bank, including 95% of all US Investment.

OCIE assigned SGC an "adviser ranking" of "182". Based upon the results of this examination, the FWDO has assigned a "risk rating" of "1," the highest risk rating possible, primarily due to SGC's sales of the CDs.

IN THE UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF TEXAS

DALLAS DIVISION

IN RE: STANFORD INTERNATIONAL BANK, LTD

Debtor in a Foreign Proceeding.

Civil Action No. 3:09-CV-0721-N

EXCERPTS FROM ORDER ISSUED BY JUDGE DAVID GODBEY ON JULY 30, 2012

The Receiver contends that because SIB was but one of many entities in Stanford's elaborate Ponzi scheme, the Court's COMI analysis should center on the aggregated Stanford Entities.

As the SEC expands, **SIB was window dressing**, part of an effort to mask from United States regulatory scrutiny the massive securities fraud Stanford and others orchestrated from the United States. **The law does not give effect to legal trappings that are designed for a fraudulent purpose, and, therefore, Stanford's operations should be viewed in their entirety.**

It is axiomatic that a corporation is a legal entity existing separate and apart from the persons composing it and entities related to it. **However, courts equally accept that they should disregard the corporate form where that form was the means to a subversive end**.

Indeed, it would be irrational to hold that a parent and a subsidiary have been refused for purposes of in personam jurisdiction, but remain separate for purposes of subject matter jurisdiction.

... **it would defy logic and run afoul of equity to treat a fictitious corporation as a real entity...**

Proliferating corporate fictions...would also protect sinister characters such as Ponzi schemers who may target offshore jurisdictions to run their fraudulent empires. Thus, **the Court holds that corporate disregard doctrines apply...**

Not aggregating the entities, in this instance, would perpetuate an injustice.

However, **the Court is fairly certain that Chapter 15 is also meant to apply to real entities and not fictitious entities. It would be absurd to implement a law that**

would encourage U.S. courts to cooperate with foreign proceedings directed at fanciful organizations. The Court will not engage in semantics that obfuscate the purpose of the statute.

First, the Court takes judicial notice that on March 6, 2012, a jury in Houston, Texas convicted Stanford of four counts of wire fraud, one count of conspiracy to commit wire and mail fraud, five counts of mail fraud, one count of conspiracy to obstruct an SEC proceeding, one count of obstruction of an SEC proceeding, and one count of conspiracy to commit money laundering, all related to his Ponzi scheme.

The evidence demonstrates that SIB was nothing like a typical commercial bank.

Further, this Court has previously recognized that Stanford and his affiliates operated as one and there is substantial evidence in the record in this action to support that finding.

("The evidence further demonstrates that the Ponzi scheme was comprised of over 100 interrelated entities whose primary, if not exclusive, source of funding was derived from SIB CDs . . . .")

SIB had been insolvent since at least 1999 and remained in business by operating as a Ponzi scheme.

SIB relied on the proceeds from the sale of new CDs to make purported interest and principal payments to existing CD investors.

Stanford was the sole owner, directly or indirectly, of more than 130 separate Stanford Entities, including SIB, in more than 14 countries. The Stanford Entities comprised a single financial services network referred to as SFG.

Funds from the Stanford Entities, consisting primarily of CD proceeds almost exclusively comprised Stanford's reported income from at least 1999 onward.

Stanford controlled the Stanford Entities with substantial assistance from James Davis, Chief Financial Officer ("CFO") of Stanford Financial Group Company ("SFGC") and SIB, and Laura Pendergest-Holt, Chief Investment Officer ("CIO") of SFGC.

The evidence demonstrates that Stanford, Davis, and Pendergest-Holt provided misinformation regarding SIB's investment strategy, earnings, and safety to financial advisors at various Stanford Entities, who then used it to induce customers to purchase CDs.

...in many instances Stanford and others doctored SIB's paperwork to look reassuringly like the paperwork of a real financial institution, **the reality is that SIB did not observe corporate formalities in all respects.**

For example, the SIB CD proceeds did more than just keep the bank afloat. Stanford Entities and Stanford himself received large disbursements of the proceeds.

Joint Liquidators Marcus Wide: "**As our investigations have continued and we've tracked the flow of funds and we've looked at how money was removed from control of the depositor, if you like, it became clear to me that the funds were being stripped out of SIB, partly through those contracts that were spoken about earlier and partly by simply removing them, putting them into other Stanford entities and then onwards for the benefit of either Mr. Stanford or other persons unknown...**From our view**, it looked like the bank's money was being stolen rather than the bank was running a Ponzi itself**...."

"the evidence demonstrates that employees of other Stanford Entities largely ran SIB, as its employees had no authority to make any significant managerial decisions and no access to SIB's records..".

To put it shortly:

(1) as a Ponzi scheme, all assets and liabilities are difficult to segregate and ascertain,

(2) the absence of consolidated financial statements matters not because Stanford and/or his associates doctored the financial statements,

(3) it makes economic sense to consolidate the entities,

(4) commingling of funds among the Stanford Entities was the norm,

(5) Stanford directly or indirectly owned all subsidiary as department or division of parent; directors or officers of subsidiary do not act in interests of subsidiary, but take directions from parent; formal legal requirements of the subsidiary as a separate and independent corporation are not observed; the transfer of assets without formal observance of corporate formalities;" and noting the different substantive consolidation tests).

(6) SIB "loaned" Stanford $1.8 billion without a guaranty,

(7) Stanford and his associates transferred assets among the Stanford Entities in disregard of corporate formalities...

On balance, **the evidence overwhelmingly supports substantive consolidation were it to apply.**

Courts have found the requisite level of entwinement where "the debtor corporations were operated as a single unit with little or no attention paid to the formalities usually observed in independent corporations, . . . the officers and directors of all, so far as ascertainable, were substantially the same and acted as figureheads for [the owner], . . . funds were shifted back and forth between the corporations in an extremely complex pattern and in effect pooled together, loans were made back and forth, borrowings made by some to pay obligations of others, freights due some pledged or used to pay liabilities and expenses of others, and withdrawals and payments made from and to corporate accounts by [the owner] personally not sufficiently recorded on the books." **This is clearly analogous to the facts here.**

The Receiver has shown that Stanford operated the entire network of Stanford Entities as an integrated unit in order to perpetrate a massive worldwide fraud.

Each Stanford Entity either participated in the scheme, derived benefit from the scheme, or lent the appearance of legitimacy to the entirety of Stanford's fraudulent enterprise. To ignore these findings would elevate form over substance – thereby legitimizing the corporate structure that Stanford utilized to perpetrate his fraud and running afoul of Fifth Circuit precedent cautioning courts to look beyond the surface.

Thus, because SIB did not observe corporate formalities and because all the Stanford entities were "operated as one for purposes of perpetrating a fraud on investors," the Court pierces SIB's corporate veil and aggregates the Stanford Entities.

...Congress cannot have intended to grant formal recognition to letterbox companies merely because the schemers were adept at pulling the wool over investors, creditors, and regulators' eyes. Surely, it is against U.S. public policy to reward such gamesmanship and manipulation.

Most of the Stanford Entities' revenue came from selling CDs. **CD sales largely bypassed Antigua, as depositors wishing to deposit funds were usually introduced to SIB through their financial advisors, who maintained primary if not sole contact with the depositor**...

U.S. investors exclusively purchased CDs through broker-dealers in the United States at SGC. All financial advisors, regardless of location, would send client applications and requisite paperwork to Antigua, and SIB would then deposit the funds into U.S., Canadian, and English banks....

Those who wished to pay via check **provided checks to their financial advisors** at a non- Antiguan location. Financial advisors would send the checks to SIB in Antigua, and, after endorsing them, SIB would send the checks to Houston, Texas for deposit in Canada or the United Kingdom. **After deposit, Davis would then disburse the funds among the Stanford Entities.**

In reality, broker-dealers in the United States generated substantially more CD sales, by dollar amount, than broker dealers in any other country, and no other country approached the magnitude of the United States as a generator of CD sales. (JL Dickson stating that he couldn't disagree with Van Tassel's testimony that **financial advisors at SGC in United States were responsible for 42-48% of SIB CD sales in 2007 and 2008**).

According to the Receiver, U.S. residents hold more CDs, in terms of number and dollar amount, than the residents of any other country in the world, including Antigua. (the United States comprised 7,072 clients, which accounted for 25.26% of clients, and $2,660,676,142 in deposit amount, which accounted for 37% of dollar amounts).

Stanford employees managed and directed the CD enterprise from the United States with no meaningful input from Antigua. Although SIB, the issuing bank, was chartered and registered in Antigua, Stanford and Davis controlled it – with assistance from Pendergest-Holt – from various places within the United States. And **Davis facilitated several millions of dollars in transfers of CD proceeds among the Stanford Entities**.

SIB employees were paid with funds administered from Houston. CFO Davis and President Rodriguez-Tolentino were paid by other Stanford Entities in the United States investment accounts.

Stanford and his associates in the United States generated and maintained SIB's financial information. Stanford, Davis, Pendergest-Holt, and other U.S. residents disseminated false information regarding SIB's financial strength, profitability, capitalization, investment strategy, investment allocation, value of its investment portfolio, and other matters to financial advisors around the world for use in inducing potential investors to purchase CDs.

Additionally, extensive SIB client records exist in the United States, and records regarding SIB's investments and cash balances were kept outside of Antigua, predominantly generated (i.e., fancifully created) and maintained in the United States by Stanford and Davis.

All of these assets were purportedly directed and managed from the United States. And, as stated above, Stanford and his associates doctored most, if not all, of the numbers.

SIB employees performed limited administrative, bookkeeping, and operating functions in Antigua, these functions were heavily dependent upon Stanford's global human resources, accounting, and information technology ("IT") groups

Stanford Entity employees in the United States wrote SIB's purported internal audit reports. .

As for SIB, Stanford Entity employees in the United States fulfilled most of its core operational needs.

Stanford and his associates similarly managed and controlled other Stanford Entities from the United States.

SGC solicited or intended to solicit CD purchasers in all fifty U.S. states, and it made regulatory filings with state securities regulatory agencies in the United States.

Even the Antiguan government stated that Stanford ran SIB from Houston, Texas – referring to Antigua as a mere transit point.

Most CD purchasers never saw or interacted with Antiguan employees...
<u>Investors instead dealt only with their financial advisors</u>

These financial advisors were essentially the face of the Stanford enterprise to investors, providing CD applications, CD investment managing, and Stanford

brokerage accounts. The financial advisors disseminated reports prepared by Stanford, Davis, Pendergest-Holt, and others, which portrayed a global group of companies under the name SFG, headquartered in the United States. SIB's marketing materials, in fact, advertised that it was able to pay higher interest, in part, because of "synergies" and cost savings that resulted from it being part of SFG and because of a globally diversified investment strategy.

In summary:

(1) SIB, the Bank of Antigua, and STCL were only nominally headquartered in Antigua, and SIB's major activities, CD sales and investment of funds, took place outside of Antigua; a substantial number of the other aggregated Stanford Entities were headquartered outside of Antigua;

(2) Stanford, Davis, Pendergest-Holt, and others who actually managed the Stanford Entities did so largely from the United States;

(3) Stanford Entities and banks outside of Antigua primarily held the Stanford Entities' primary assets;

(4) the vast majority of the Stanford Entities' investor-victims and creditors reside outside of Antigua;

(5) although the Court does not here decide that U.S. law applies to all disputes, this Court is the jurisdictional locus of the entire Stanford Entities enterprise and estate, see Receivership Order; and

(6) the Stanford Entities' nerve center (center of direction, control, and coordination) is in the United States.

STANFORD INTERNATIONAL BANK
STATISTICS FOR STANFORD GROUP COMPANY CUSTOMERS

21,434 customers held $7.2 billion in Stanford International Bank CDs

- **7,814 Stanford Group Company customers held $3.5 billion in SIB CDs**
  6,143 with CD balances at or below $500K
  1,671 with CD balances over $500K

- 13,620 non-Stanford Group Company customers held $3.7 billion in SIB CDs
  11,904 with CD balances at or below $500K
  1,716 with CD balances over $500K

Type of SIB CD Holder	Number of Customers	Total CD Balance	Percentage of SGC Customers	Recovery Rate for SIPC
SGC – All	7,814	$3.5 billion		
SCG Below $500K	6,143	$956.6	79%	100%
SGC Above $500K	1,671	$2.5 billion	21%	Not Known

STANFORD GROUP COMPANY CUSTOMER DATA

7,814 SGC customers held $3.5 billion in SIB CDs
37 % of all SIB CD holders by number of SIB depositors, or 49% by deposit volume

6,143 of these customers have CD balances at or below $500K with an aggregate total of **$956.6 million.**
-79% of SGC customers made whole from SIPC

1,671 SGC customers with CD balances of **$2.5 billion** had individual balances in excess of $500K.
-Capping the loss of each of these customers at $500K would result in potential SIPC coverage of **$835.5 million**.
-Losses for this group of investors is over $1.66 billion

Total SIPC coverage for SGC Customers would be $1.8 billion ($835 mil. + $956.6 mil.)

STANFORD GROUP COMPANY
5056 Westheimer, Suite 605
Tel. No. (713) 964-8300
Houston, Texas 77056

File No. 8-48611 CRD No. 39285
Examination No. 06-D-97-037

EXECUTIVE SUMMARY

Rule 17a-4Failure to maintain books and records.

Rule 10b-5 Possible misrepresentation and misapplication of customer funds.

COMMENTS

Stanford Group Company ("Stanford Group"), a member of the NASD Regulation, Inc., has been registered with the Commission since September 1995. The firm is also a registered investment advisor (File no. 801-50374). Stanford Group is owned by Allen Stanford ("Stanford") who also owns several affiliated companies. Two such companies include Stanford International Bank ("SIB"), an offshore bank located in St. John's, Antigua, West Indies, and Stanford Financial Group ("SFG") headquartered in Houston, Texas. Stanford is not involved in the day to day operations of the firm and is not registered as a principal. [redacted] is the firm's president and one of six registered principals of the firm.

Stanford Group operates pursuant to the (k)(2)(ii) exemption to Rule 15c3-3 and is required to maintain net capital of $250,000. As of July 31, 1997, the firm had net capital of $9,011,027 with excess net capital of $8,761,027. Aggregate indebtedness totaled $532,485.

Stanford Group conducts a general securities business through a fully disclosed clearing arrangement with Bear Stearns Securities Corp. The firm also offers two money management programs to its clients.[1] The firm has generated $6,101,346 in revenues from January 1, 1997 through July 31, 1997. The three primary sources of revenue include referral fees from SIB (68%), advisory fees (8%) and gains on investments (4%). The firm has five branch offices and 66 employees, of which 25 are registered representatives. The firm has approximately 2,000 (1,200 foreign) customer accounts and writes approximately 250 tickets each month.

[1]The Master Fund Program ("MFP") offers discretionary managed accounts for those clients invested in mutual funds the Master Manager Program ("MMP") offers discretionary managed accounts by outside third-party managers.

EXAMINATION

The FWDO conducted a surveillance examination of Stanford Group in August 1997. Four and one half staff days were spent in the field. Three staff days were spent on the review of sales practices.

We conducted an entrant interview with [redacted] chief executive officer, and [redacted], operations manager. We furnished them with the FOIA and Privacy Act Notices. The signed receipt of acknowledgement is included in the work papers.

FINDINGS

Possible Misrepresentations - Rule 10b-5

As noted earlier, Stanford Group is affiliated through common ownership with SIB, an offshore investment bank. Stanford Group has a written agreement with SIB wherein Stanford Group refers its foreign customers to SIB. SIB pays a recurring annual 3.75% referral fee to Stanford Group on all deposits referred to SIB.[2] SIB offers several types of products including the FlexCD Account which makes up 96% of all cash deposits at SIB. The FlexCD Account requires a minimum balance of $10,000, has maturities and annual interest rates ranging from 1 month at 7.25% to 36 months at 10%, and withdrawals of up to 25% of the principal amount are allowed without penalties with a five day advance notice. As of July 31, 1997, Stanford Group was due referral fees of $958,424 which is based on customer deposits at SIB of $306,695,545 (75% of all deposits at SIB).

SIB promotes its products as being safe and secure. A brochure regarding the products offered through SIB, including the FlexCD Account, states that "[F]unds from these accounts are invested in investment-grade bonds, securities and Eurodollar and foreign currency deposits." The brochure indicates a high level of safety for customer deposits. For example: "banking services which ensure safety of assets, privacy, liquidity and high yields", "...protects its clients' money with traditional safeguards", "placing deposits only with banks which have met Stanford's rigorous credit criteria", "depository insolvency bond", "bankers' blanket bond", and "portfolio managers follow a conservative approach". Based on the amount of interest rate and referral fees paid, SIB's statements indicating these products to be safe appear to be misrepresentations.

SIB pays out in interest and referral fees between 11% and 13.75% annually. To consistently pay these returns, SIB must be

[2] During 1996, the referral fee was 5%.

investing in products with higher risks than are indicated in its brochures and other written advertisements.

Because SIB is a foreign entity, we were unable to gain access to SIB's records.

Item of Interest - Addition to Capital

During 1996, Stanford made a cash contribution of $19,000,000 to Stanford Group. We are concerned that the cash contribution may have come from funds invested by customers at SIB. We noted that SIB had loaned Stanford $13,582,579. In addition, we noted that SFG had borrowed $5,447,204 from SIB for a total receivable at SIB of $19,029,783 directly and indirectly from Stanford. We contacted the general counsel for the Stanford companies regarding our concerns. The general counsel stated that the cash contribution came from personal funds and not from the above loans; however, it seems at least questionable whether Stanford has access to $19,000,000 in personal funds.

Maintenance of Books and Records - Rule 17a-4

Stanford Group failed to maintain books and records as they relate to the offer and sale of SIB products. Lena Stinson ("Stinson"), senior vice president and administrative officer, stated that the firm only refers clients to SIB and receives a referral fee. Stinson stated that the client is the customer of SIB and not Stanford Group. From our discussions with Stinson, the RR informs the client of the SIB products (usually the FlexCD) and prepares an application which is sent to SIB for their approval. Once approved, the client sends the funds directly to SIB who then confirms the deposit. Stinson stated that once the application is sent, the RR is no longer involved (other than receiving a referral fee) and all paperwork is maintained by SIB. It appears that the RR is recommending a particular product of SIB's and therefore should have a basis for making that recommendation (i.e., a new account form containing, among other things, financial information and investment objectives). In addition, since the RR is recommending the purchase of a product, an order ticket, confirmation, and purchase and sales blotter should be maintained.

OTHER ITEMS REVIEWED

Customer Account Review

We reviewed the activity in 35 customer accounts for suitability, churning, and profit and loss. Our review noted no discrepancies.

Chinese Wall Procedures

We examined the adequacy of the firm's Chinese Wall and overall supervisory procedures to prevent and detect insider trading by accounts of the firm, employees and customers. The firm's procedures appear to be reasonably designed to prevent such misuse given the nature of the firm's business.

Currency and Foreign Transactions

Prior to our examination, we accessed the IRS CTR database and found no reports on file for the firm. Our on-site review of the firm's bank statements, bank reconciliations, deposit slips and checks received and delivered blotter from February 1997 through July 1997 disclosed no currency transactions. We found no foreign accounts involving the receipt/delivery of securities or currency from/to foreign locations.

RECOMMENDATION

We will send a deficiency letter to the firm citing their failure to maintain adequate books and records.

We will provide a copy of our report to the FWDO Division of Enforcement for their review and disposition.

March 21, 2011

Mr. Ira Hammerman
General Counsel
Securities Industry and Financial Markets Association
1101 New York Ave NW # 800
Washington D.C., DC 20005-4279

Mr. Hammerman,

I am the Director and Founder of the Stanford Victims Coalition ("SVC"), an advocacy group representing the 20,000 victims of the Stanford Financial Group ("SFG") Ponzi scheme. I also serve as one of seven members on the District Court-appointed Stanford Investors Committee.

I would like to bring to your attention to some critical misinformation about the circumstances related to the customers of Stanford Group Company ("SGC") and their status for protection under the Securities Investor Protection Act ("SIPA"). This misinformation has been widely perpetuated by the Securities Investor Protection Corporation ("SIPC") and the SEC.

Your testimony before the House Financial Services Committee last fall indicated the facts in the Stanford case were not fully disclosed to you. SGC customers did not incur losses ***on*** their investments, but rather losses ***of*** their investments. As the SEC has argued in its civil suit against Stanford, et al, the Stanford International Bank ("SIB") certificates of deposit were never legitimate securities and were merely a vehicle to steal investor funds. Historically, the Commission has argued that "a customer's legitimate expectations," ought to be protected "regardless of the fact that that the securities were fictitious." (*In re New Times Securities Services, Inc., 371 F.3d 68, 76 (2nd Cir. 2004)).*

As you know, SIPC has come under great scrutiny in the aftermath of the Madoff and Stanford Ponzi schemes, and investor confidence has suffered tremendously. As a result, SIPC has shifted into self-preservation mode rather than advocating for the investors whose savings were stolen by SIPC members. As a member of the SIPC Modernization Task Force as well as the General Counsel for the Securities Industry and Financial Markets Association ("SIFMA"), your knowledge of investors' legitimate expectations when dealing with a SIPC member is of the utmost importance. I hope you will objectively consider the information presented here.

Background

SFG was an international criminal enterprise made up of more than 130 commonly owned and controlled companies that included SGC, a dual-registered Broker Dealer and Investment Advisor based in Houston, Texas, and Stanford International Bank ("SIB"), an offshore bank in Antigua. In February 2009, the SEC filed a civil lawsuit alleging Allen Stanford, as the owner of the SFG companies, and James Davis, as the Chief Financial Officer for the SFG companies, along with other SFG employees (but no SIB employees), facilitated a $7.2 billion Ponzi scheme.

Approximately 7,800 of the 20,000 investors affected by the SFG Ponzi scheme were SGC customers. Most, if not all, of these customers conducted traditional brokerage business with SGC through its third-party clearing firm, Pershing LLC. In the ordinary course of business, SGC Registered Representatives marketed and sold approximately $3.5 billion in fictitious SIB certificates of deposit (of $7.2 billion total). The CDs were sold as fully disclosed under a Regulation D SEC filing and were typically transacted through the customer's SGC brokerage account at Pershing. The brokerage funds allocated to the SIB CDs constituted a majority, if not all, of the SGC customers' savings, and the assurances offered by the SIPC logo were used as a sales tactic to create a false sense of confidence in the CDs. In fact, many of the SGC Registered Representatives convinced their clients the SIB CDs offered greater protection than an FDIC-backed bank CD because FDIC insurance only protected up to $100,000 in deposits in a US bank CD (the limit at the time), but SIPC covered up to $500,000 of the SIB CD securities. It is important to note the former SGC Representatives have not been accused by the SEC or FINRA of misrepresentation of this assurance, which was made in marketing materials, in written communications between SGC Representatives and their clients and generally in all interaction the investor had with SGC (the SIPC logo appeared on everything from promotional pens, water bottles, signage, customer documents, etc.)

FTI consulting, the forensic accounting firm chosen by the SEC to work with the Stanford Receiver, has reported that SGC's customer funds intended to purchase the SIB CDs did not go to SIB to purchase the securities.
As outlined in the attached declaration of senior FTI partner Karyl Van Tassel, SGC customer's funds intended to purchase the CD securities were misappropriated to (i) pay previous customers; (ii) Allen Stanford's lavish lifestyle; (iii) the expenses of SGC, including the exorbitant compensation of Registered Representatives who sold the fictitious securities as well as referral fees to the broker dealer, which constituted a majority of SGC's revenue.

By all definitions, the SIB CDs were never legitimate and served as nothing more than as a vehicle to lure customers to feed the Ponzi scheme. SGC customers had the legitimate expectation they were purchasing actual securities and instead, as the SEC and DOJ have alleged, their funds were stolen in a Ponzi scheme. In denying protection under the SIPA, SIPC has taken the position that SGC customers purchased securities that declined in value or were worthless. Completely contradicting that argument, the SEC has taken the position in litigation related to the Stanford receivership that an entity that operates as a Ponzi scheme "is, as a matter of law, insolvent from its inception." An insolvent entity cannot issue real securities and as such, the SIB CDs are not simply worthless securities, they are entirely fictitious. The SIPA has been used to protect customers of introducing broker dealers who were sold fictitious securities in previous cases. I'm sure you will agree that if customers of introducing broker dealers are not truly protected by SIPC in situations like the SGC customers find themselves in, those broker dealers should not be members of SIPC as the false confidence the SIPC logo provides investors is nothing short of misleading.

Similar to the points made in your Congressional testimony, the SEC has pointed out two of the risks facing customers of broker dealers: "the risk that the security purchased will be a bad investment and the risk that the broker-dealer will not execute the order, convert the customer's funds and become insolvent, leaving the customer with no cash or securities. SIPA was intended to protect customers against the latter risk, not the former, which is borne by the investor." *(Br. of the SEC, Amicus Curiae, In Partial Support of Appellants in re: New Times Securities, Inc., 02-6166 (2nd Cir. June 20, 2003)).* SGC customers who were sold SIB CDs fall into the latter category and SIPC would make almost 80% of these investors whole.

The SVC's Request for a Liquidation of SGC Under SIPA

In November 2009, the SVC formally asked the SEC to order a liquidation of SGC under SIPA (see attached) and has provided hundreds of customer documents to the SEC Division of Trading and Markets over the last 16 months. The SEC has yet to make a determination regarding this request, which more than 100 members of Congress have supported (see attached). In a meeting convened last week by Senate Banking Committee Ranking Member Richard Shelby, SEC Chairman Mary Schapiro committed to making a formal decision on this matter within a few weeks.

Investor confidence and investor protection are two very important goals of SIPA and SIFMA and I'm sure you'll agree that when an investor cannot rely on SIPC protection when their funds are stolen by a SIPC member, any confidence an investor may have is false confidence. I hope this information changes the opinion you expressed in your Congressional testimony, as well as SIFMA's lobbying position. Many of SIPC's and SIFMA's current members are greatly affected by the outcome of this case as their customers face significant losses that will arbitrated by FINRA or litigated in court.

Please feel free to contact me if you would like any additional information. I would be more than happy to discuss this matter with you, or any other member of the SIPC Modernization Task Force as the Stanford case is not nearly as simple as it has been written off to be and the manner in which investors were victimized in this crime should be considered in any legislative recommendations related to investor protection.

Sincerely,

Angela Shaw
Director and Founder
Stanford Victims Coalition

972-672-1512

cc: SIPC Board
SIPC Modernization Task Force Members

Hear the victims tell their stories at
www.stanfordvictimscoalition.blogspot.com.

STANFORD FINANCIAL GROUP
REGULATORY NEGLIGENCE TIMELINE

1982-1987
Allen Stanford files for business and personal bankruptcy in Texas. The Court discharges him from $13.6 million in obligations.[1]

Allen Stanford opens Guardian International Bank Ltd. in Montserrat. Stanford also opens Guardian International Investment Services[2], an investment firm in Miami that targets Latin American customers and offers a certificate of deposit product yielding 10.75%, doubling the then current rate of return.[3]

1989-1991
The Texas Department of Banking warns Stanford about operating a foreign bank representative office in Texas "*without authority under either state or federal laws*." The U.S. Treasury Office of International Banking and the Office of the Comptroller of the Currency are copied on the warning letter to Stanford.[4]

As a result of investigations by banking regulators in Texas, Florida and California[5], the U.S. Treasury's Office of the Comptroller of the Currency issues a Banking Circular regarding Stanford's unauthorized banking activities in the United States.

The Texas Department of Banking orders Guardian International Bank Ltd. to immediately cease its Texas operations or "*the Texas Attorney General will be requested to promptly file charges against the bank, its board of directors and its management for apparent willful and continuing violations of the Texas Banking Code*."[6]

The Police Department in Mexia, Texas investigates Stanford for allegations of drug trafficking.

The FBI opens an extensive investigation along with the UK's Scotland Yard to uncover Stanford's money laundering activities. FBI agent Ross Gaffney, who headed the U.S. task force set up to investigate the suspicious explosion of offshore banks in Montserrat, said, "We had hard intelligence about what he was doing and we began to develop it."[7]

Due to investigation reports from the FBI and Scotland Yard, the government of Montserrat decides that Stanford no longer meets bank ownership requirements on their island and the license for Guardian International Bank is revoked.[8]

Stanford purchases a commercial bank charter for the Bank of Antigua and relocates his offshore banking headquarters to Antigua. Stanford International Bank (SIB) is chartered as an offshore bank

[1] Unites States Bankruptcy Court Dockets Numbers 6-82-00061 and 00263
[2] Florida Department of State Registration Number J83381, July 20, 1987
[3] *BusinessWeek*, Feb. 24, 2009, "Did Court Ruling Prolong Stanford Probe?"
[4] Letter from Texas Banking Department, Dec. 19, 1990
[5] United States Treasury, Office of the Comptroller of the Currency BC 171
[6] Letter from Texas Banking Department, Jan. 8, 1991
[7] *The Independent*, Feb. 22, 2009, "Secret World of Allen Stanford."
[8] Government of Montserrat, Letter from Financial Secretary John George, November 1990

under the laws of Antigua and Barbuda.[9]

1992-1996

Stanford Group Company (SGC) is incorporated in the state of Texas. SGC registers with the SEC as both a broker dealer and an investment advisor and begins operations in Houston, Texas, and Baton Rouge, Louisiana.[10]

The Texas State Securities Board conducts its first examination of SGC. The case is referred to the SEC.

Stanford is accused of money laundering. Case is settled out of court.[11]

Faced with international scrutiny for its extensive money laundering activities, Allen Stanford and the government of Antigua and Barbuda propose the Money Laundering Prevention Act of 1996. Stanford is represented by Dr. Errol Cort, an Antiguan lawyer, and the Miami-based law firm, Greenberg Traurig. [12]

1997-1998

The SEC Fort Worth Regional Office (FWRO) conducts its first broker dealer examination of SGC and concludes "possible Ponzi." The exam report includes an "Item of Interest" that questions a $19 million cash contribution to SGC from Allen Stanford while SIB loaned $13.5 million to Allen Stanford and $5.5 million to the Stanford Financial Group (SFG, the parent company of all Stanford entities) – for a total of $19 million directly and indirectly from SIB loans. The exam report states that 68% of SGC's revenue comes from referral fees for SIB CD sales (in addition to the cash contributions from Allen Stanford directly). The exam findings are referred to SEC Enforcement, which opens a Matter Under Inquiry (MUI). The MUI is closed 3 months later after Stanford did not *voluntarily* provide documents requested by the SEC in its deficiency letter sent in response to the 1997 broker dealer exam.[13]

The Fort Worth SEC conducts an investment advisor examination of SGC. The findings are similar to the 1997 broker dealer exam, and the exam findings are reported to SEC Enforcement.[14]

With the help of Dr. Errol Cort as local counsel in Antigua and Greenberg Traurig in the U.S., Stanford and the government of Antigua and Barbuda create a task force to rewrite Antigua's offshore banking laws. The task force is funded by Allen Stanford, and includes former U.S. Customs investigator Patrick O'Brien; former U.S. Attorney's Office lawyers working for Greenberg Traurig; 3 BDO Seidman partners; and Tom Cash, a representative of Kroll & Associates and the former head of the DEA's operations in Florida and the Caribbean.

Under the new offshore banking regulations written by the Stanford-funded task force, the International Financial Services Regulatory Authority (IFSRA) is established as the government of Antigua and Barbuda's offshore banking regulator. Allen Stanford is appointed as president of

[9] *BusinessWeek*, Feb. 24, 2009, "Did Court Ruling Prolong Stanford Probe?"
[10] Securities and Exchange Commission File Numbers 8-48611 and 801-50374
[11] *Latin American Herald Tribune*, Feb. 27, 2009, "The Sir Allen Stanford Story"
[12] Government of Antigua and Barbuda, Money Laundering Prevention Act of 1996
[13] Securities and Exchange Commission Office of the Inspector General Report on Investigation 526, March 31, 2010
[14] Ibid

IFSRA, and, as a result, is responsible for regulating his own bank.[15]

The FBI, U.S. Attorney's Office, DEA, IRS Criminal Division and Customs Services each individually request the SEC's records on Stanford. The requests cite ongoing investigations into criminal activity[16]

In a letter to the U.S. Ambassador to Barbados, Allen Stanford's counsel at Greenberg Traurig states that he has been investigated by numerous U.S. agencies over the years, and none had found evidence of wrongdoing.[17]

Stanford becomes largest private employer in Antigua.

The State of Florida Department of Banking and Finance approves establishment of Stanford Fiduciary Investor Services (SFIS), a Trust Representative Office (TRO) for Antigua-based Stanford Trust Company LTD. SFIS markets and sells SIB CDs to foreign investors through the Miami-based, state-regulated entity.[18]

1999

Stanford's legal counsel, Dr. Errol Cort, becomes the government of Antigua and Barbuda's Attorney General.[19]

In only the second warning of its kind, the U.S. Treasury's Financial Crimes Enforcement Network (FINCEN) issues an advisory to U.S. banks to scrutinize all financial transactions routed into or out of Antigua for evidence of money laundering. The warning is a result of the U.S. government's concern about Allen Stanford's role in Antigua as the head of the IFSRA, the regulatory body overseeing Stanford International Bank. The warning states: "*The operation of Antigua' offshore financial sector has been a concern of regulators and enforcement officials in the United States, the United Kingdom, and other nations for some time.*[20]

In a letter to Antiguan Prime Minister Lester Bird, U.S. Treasury Undersecretary for Enforcement James E. Johnson, writes, "*It is clear that the Government of Antigua and Barbuda has, in effect, turned away from its partnership with the United States Government in combating money laundering and other financial crimes.*"[21]

The U.S. State Department places Antigua on its money laundering watch list. Jonathan Winer, then-head of the State Department's Bureau for International Narcotics and Law Enforcement Affairs, says Antigua is "one of the most attractive financial centers in the Caribbean for money launderers." In a Senate testimony, Winer said, "Antigua has long been one of the worst regulated offshore centers in the world."

Retired DEA agent Mike Vigil, who was then the Chief of International Operations in the Caribbean, said island banks "have always been a focal point for laundering illicit drug proceeds and Antigua has always a primary center of money laundering operations for many significant drug traffickers."[22]

[15] Government of Antigua and Barbuda, International Business Corporations Act
[16] Securities and Exchange Commission Office of the Inspector General Report on Investigation 526, March 31, 2010
[17] *New York Times*, Feb. 20, 2009 "Fraud Case Shakes a Billionaire's Caribbean Realm."
[18] Memorandum of Agreement, State of Florida and Stanford Trust Company LTD, December 14, 1998
[19] Government of Antigua and Barbuda website
[20] United States Department of Treasury Financial Crimes Enforcement Network Advisory, April 1999.
[21] *Wall Street Journal*, April 27, 1999, "US Antigua Dual on Money Laundering - High Flying Houston Financial is Caught in the Middle."
[22] *New York Times*, Feb. 20, 2009 "Fraud Case Shakes a Billionaire's Caribbean Realm."

Texas securities regulators find evidence of money laundering involving Stanford. The case is referred to the FBI and the SEC, because it involves offshore banks, where Texas has no jurisdiction. Texas securities commissioner Denise Voigt-Crawford later tells the state legislative committee: "Why it took 10 years for the feds to move on it, I cannot answer." She added: "We worked with the FBI and the SEC and basically gave them the case. We told them what we'd seen and they were going to run with it."[23]

After evidence surfaces that former Mexican drug lord, Amado Carillo Fuentes, had used SIB to hide or launder money, Stanford voluntarily makes out a cashier's check for $3.1 million, and gives it to the U.S. DEA. No further investigation is pursued by the DEA.[24]

Year	Total SIB Deposits
1990-1999	$676 Mil.

2001

Stanford files an SEC regulation D disclosure for selling Stanford International Bank certificates of deposit to U.S. citizens through Stanford Group Company.[25]

The U.S. Treasury enters into an information sharing agreement with the government of Antigua and Barbuda that "*will provide for the exchange of information on tax matters between the United States and Antigua and Barbuda.*" The agreement is signed by Treasury Secretary Paul O'Neill and Antiguan Prime Minister Lester Bird.[26]

The first Stanford employee comes forward to FINRA (then NASD) alleging Stanford Group Company is engaged in fraudulent business practices in violation of the Securities Acts of 1933 and 1934. Arbitration claim is resolved in favor of Stanford.[27]

After previous run-ins with the Texas Department of Banking, the state of Texas initiates a partnership with the government of Antigua and Barbuda to provide "*coordinated comprehensive supervision.*" According to Texas Banking Commissioner Randall S. James, the partnership "*represents a landmark in cooperation between financial institution supervisory authorities of the state of Texas and a foreign government. It underscores that seamless supervision of both Texas State-chartered financial institutions with offices in other countries and foreign institutions with offices in Texas can be achieved.*" The agreement, which is signed by Antiguan Prime Minister Lester Bird and then Texas Secretary of State Henry Cuellar, specifies the state of Texas can examine a financial institution in Antigua's jurisdiction..[28]

Year	Total SIB Deposits	SIB Growth
2000-2001	$1.198 Bil.	$677 Mil.

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[23] *Houston Chronicle*, Feb. 20, 2009 "Past Probe Sought to Tie Stanford to Drugs"
[24] *New York Times*, Feb. 20, 2009 "Fraud Case Shakes a Billionaire's Caribbean Realm."
[25] Securities and Exchange Commission IDEA database.
[26] United States Department of Treasury, "Agreement Between the Government of the United States of America and the Government of Antigua and Barbuda for the Exchange of Information," Dec. 6, 2001
[27] FINRA Case #01-00680
[28] Texas Department of Banking, July 2001

2002
An accountant in Mexico sends the SEC a letter pointing out numerous red flags regarding the Stanford International Bank certificates of deposit, including inexplicable high rates of return, a lack of detailed information about the performance of the CDs and the fact a small, Antiguan firm handles Stanford International Bank's audits. The letter ends with a plea that the SEC "make sure that many investors do not get cheated. These investors are simple people of Mexico and maybe many other places and have their faith in the United States financial system."[29]

The Fort Worth SEC opens its third examination of Stanford Group Company. The exam report cites SGC's misrepresentation of the safety of SIB CDs and the lack of sufficient documentation to conduct adequate due diligence to verify/validate the substantial returns SIB claimed. The exam report is referred to Enforcement, but no investigation is opened.[30]

A second Stanford employee comes forward in case with FINRA (then NASD) alleging fraudulent business practices in violation of the Securities Acts of 1933 and 1934. Arbitration claim is resolved in favor of Stanford.[31]

2003
The SEC receives a whistleblower report from a Stanford insider saying:

> **"STANFORD FINANCIAL IS THE SUBJECT OF A LINGERING CORPORATE FRAUD SCANDAL PERPETUATED AS A MASSIVE PONZI SCHEME THAT WILL DESTROY THE LIFE SAVINGS OF MANY, DAMAGE THE REPUTATION OF ALL ASSOCIATED PARTIES, RIDICULE SECURITIES AND BANKING AUTHORITIES, AND SHAME THE UNITED STATES OF AMERICA."**

The insider claims the fraud has gone on for 17 years and that no legitimate audit has questioned why CDs were invested in "primarily in high risk securities," which are "not congruent with the nature of safe CD investments promised to clients." The alert says the CDs are marketed and sold as safe, but in reality, investor proceeds are being directed into speculative investments like stocks, options, futures, currencies, real estate and unsecured loans. The report goes on to say, "Overlooking these issues and not thoroughly investigating them is becoming an accomplice to any wrongdoing."[32]

A North Carolina attorney contacts Congressman Bob Etheridge about allegations of Stanford's violations of the Foreign Corrupt Practices Act and "widespread reports that certain Antigua government officials are soliciting and accepting large sums of money in bribery payments from a Texas businessman named R. Allen Stanford in order to allow Mr. Stanford to obtain and retain business in Antigua on behalf of Stanford Financial Group of Houston, Texas." Twelve other Congressmen are copied on the letter.[33]

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[29] Complaint to Securities and Exchange Commission, October 28, 2002.
[30] Securities and Exchange Commission Office of the Inspector General Report on Investigation 526, March 31, 2010
[31] FINRA Case #01-00687
[32] Complaint to Securities and Exchange Commission, September 1, 2003
[33] Letter to US Congressman Bob Etheridge, December 10, 2003

Ten more Stanford employees file individual cases with FINRA (then NASD) alleging wrongful dismissal and fraudulent business practices in violation of the Securities Acts of 1933 and 1934. Arbitration claims are resolved in favor of Stanford.[34]

Key whistleblower Leyla Basagoitia (now Wydler) comes forward to SEC and FINRA (then NASD) with details of an alleged Ponzi scheme to defraud clients. Defendant refused to sell CD products and was fired from Stanford's Houston office. Wrongful dismissal suit filed against Stanford and case is eventually settled in FINRA arbitration with no warning to investors.[35]

Year	Total SIB Deposits	SIB Growth
2002-2003	$2.225 Bil.	$1.027 Bil.

2004

North Carolina Congressman Bob Etheridge contacts U.S. Attorney General John Ashcroft about "specific concerns" of Stanford's alleged violations of the Foreign Corrupt Practices Act.[36]

U.S. Assistant Attorney General Christopher Wray contacts North Carolina attorney and Congressman Etheridge saying the Department of Justice "will take appropriate investigative steps" regarding allegations of Stanford's violation of the Foreign Corrupt Practices Act.[37]

Four more Stanford employees file individual cases with FINRA (then NASD) alleging fraudulent business practices in violation of the Securities Acts of 1933 and 1934. Arbitration claims are resolved in favor of Stanford.[38]

Year	Total SIB Deposits	SIB Growth
2004	$3.086 Bil.	$861 Mil.

2005

Two investors file a lawsuit in a Florida District Court accusing Stanford of aiding and abetting Ponzi scheme.[39]

The SEC conducts its fourth exam of Stanford Group Company and a referral is made to Enforcement, which opens an "informal inquiry" and conducts a survey of SGC clients who purchased SIB CDs. A questionnaire is sent on May 26, asking for responses by June 8 – indicating a sense of urgency. The 4-page questionnaire asks for detailed information about the investors' SGC financial advisor and the marketing and sales of the SIB CDs. Among many other questions, investors are asked if were told the CDs had insurance and if they recorded any conversations they had with their advisor.[40]

Five more Stanford employees file individual FINRA (then NASD) complaints alleging wrongful dismissal and fraudulent business practices in violation of the Securities Acts of 1933 and 1934.

[34] FINRA Arbitration & Mediation Database
[35] FINRA Case #03-02025
[36] Congressman Bob Etheridge letter to US Attorney General John Aschcroft, February 10, 2004
[37] US Department of Justice letter, September 9, 2004
[38] FINRA Arbitration & Mediation Database
[39] US District Court, Southern District Florida, Miami Division, Docket # 1:05CV22911
[40] Securities and Exchange Commission Stanford Investor Questionnaire, May 26, 2005

Arbitration claims are resolved in favor of Stanford.[41]

Year	Total SIB Deposits	SIB Growth
2005	$4.059 Bil.	$973 Mil.

2006

SEC Enforcement staff in Fort Worth opens a formal investigation of SGC and asks the broker dealer to voluntarily submit SIB CD investor files.[42]

A lawsuit alleging a Ponzi scheme is filed by former employee Lawrence J. De Maria under the Florida Private Whistleblower Act. De Maria alleges Stanford is "operating a Ponzi scheme or pyramid scheme" by using money from the offshore bank "to finance its growing brokerage business." The suit also alleges that Stanford is paying off Antiguan regulators and US government officials to keep money laundering legislation from being passed. [43] The complaint is referred to the SEC by OSHA.[44]

Four more Stanford employees file FINRA (then NASD) complaints alleging wrongful dismissal and fraudulent business practices in violation of the Securities Acts of 1933 and 1934. Arbitration claims are resolved in favor of Stanford.[45]

Year	Total SIB Deposits	SIB Growth
2006	$5.336 Bil.	$1.277 Bil.

2007

SGC employees in good standing, Mark Tidwell and Charles Rawl, resign and file a lawsuit alleging SGC requires employees to engage in "illegal and unethical methods to market and sell its financial products to the public." The lawsuit also accuses SGC of falsifying returns, lying to investors and destroying critical documents for an ongoing SEC inquiry. The suit outlines glaring violations of U.S. laws and regulations.[46]

FINRA fines Stanford Group Company $20,000 for failure to maintain minimum net capital requirements.[47]

FINRA fines Stanford Group Company $10,000 for allegations of distributing "misleading, unfair and unbalanced information" about its Stanford International Bank Certificates of Deposit.[48]

Four more Stanford employees file FINRA complaints alleging wrongful dismissal and fraudulent business practices in violation of the Securities Acts of 1933 and 1934. Arbitration claims are

[41] FINRA Arbitration & Mediation Database
[42] Securities and Exchange Commission Office of Inspector General Report on Investigation, July 2009
[43] Miami Dade County Circuit Court, Miami, FL
[44] Securities and Exchange Commission intake source control #4156, referred to Miami office
[45] FINRA Arbitration & Mediation Database
[46] US District Court, Harris County, Texas, Cause Number 2008-05203
[47] FINRA Regulatory Event Docket Number E062005005301
[48] FINRA Regulatory Event Docket Number 2005002203701

resolved in favor of Stanford.[49]

Year	Total SIB Deposits	SIB Growth
2007	$7.058 Bil.	$1.722Bil.

2008

In January 2008, international clearinghouse Pershing, LLC becomes worried of Stanford's business operations. Pershing continues to wire CD funds from the U.S. to international financial institutions until December 12, 2008, the same day Bernard Madoff confesses to operating a $50+ billion Ponzi scheme. Pershing alerts SGC that it will no longer wire SGC brokerage account customer funds to another Stanford entity in order to purchase Stanford International Bank CDs because Pershing cannot verify SIB is not involved in fraud of some nature. Pershing wired $517 million in 1,635 transfers from 1,200 US accounts from 2006-2008.[50]

FINRA fines Stanford Group Company $30,000 for allegations of failing to adequately disclose its research methods used to report certain securities valuations.[51]

Former executives Tidwell and Rawl file appeal of 2007 FINRA arbitration, which ruled in favor of Stanford Group Company. The appeal outlines specifics illegal marketing and sales tactics involving Stanford International Bank CDs. The plaintiffs allege SGC Financial Advisors were prohibited from filing mandatory security forms for clients transferring IRA accounts to SIB CDs and notifying clients of the civil and criminal penalties associated with the failure to do so.[52]

Due to evidence uncovered in Tidwell and Rawl case, the SEC's Fort Worth Regional Office refocuses Enforcement personnel on the Stanford investigation opened in 2005.[53]

U.S. President George W. Bush endorses the Stanford Financial Group on White House stationery. The letter, which is sent to all SIB clients, states, "*To protect their future well-being and that of their families, it is important for individuals to give careful thought to strengthening their financial security. By providing investment and wealth management services, companies like yours are helping more Americans build a solid foundation for the future.*"[54]

Four more Stanford employees file FINRA complaints alleging wrongful dismissal and fraudulent business practices in violation of the Securities Acts of 1933 and 1934. Arbitration claims are resolved in favor of Stanford.[55]

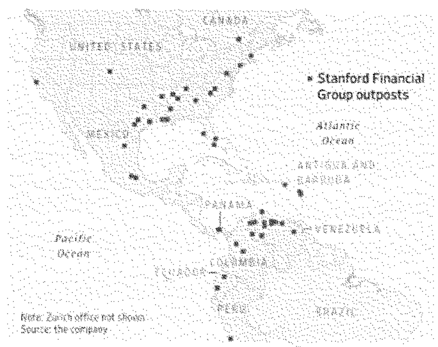
Stanford International Bank's December 2008 newsletter tells investors the bank had "no direct or indirect exposure" to Madoff investments, securitized or the subprime mortgage meltdown and that is in position to "well exceed Basel II capital requirements as we continue to grow in to 2009."[56] Later,

[49] FINRA Arbitration & Mediation Database
[50] *Times of London*, Feb. 23, 2009, "Pershing Assisted SEC Ahead of Stanford Fraud Charge."
[51] FINRA Regulatory Event Docket Number 2007007168001
[52] US Fourteenth Court of Appeals, Houston, Texas, Case#14-08-00408-CV
[53] Stephen Korotash, SEC Associate Regional Director of Enforcement, Fort Worth, Texas
[54] Stanford News, February 2008
[55] FINRA Arbitration & Mediation Database
[56] Stanford International Bank-Antigua Investor Newsletter, December 2008

the SEC reports SIB has been exposed to Madoff losses.[57] Newsletter also says the bank provides insurance coverage through Lloyd's, Bankers Blanket Bond, Directors and Officers Liability, Professional Liability (errors and omissions) and Excess FDIC. Stanford International Bank is reported to be "strong, safe and fiscally sound."[58]

Year	Total SIB Deposits	SIB Growth
2008	$8.5 Bil.	$1.442 Bil.

2009
The Stanford Financial Group of Companies has over 125 entities with offices in more than 100 locations globally, primarily in the southeastern U.S. and Latin America.



In the wake of widespread criticism of the SEC's failure to catch Bernard Madoff's $50 billion Ponzi scheme, SEC files civil charges against Stanford group of companies and its top three executives, alleging "massive ongoing fraud" involving Stanford International Bank certificates of deposit. Thousands of customer brokerage accounts held at Pershing for customers of Stanford Group Company are frozen, leaving investors without access to non-SIB funds.[59]

The SEC files a civil lawsuit against Allen Stanford, et al, and asks the Northern District Court of Texas to appoint Ralph Janvey as Receiver for all Stanford entities. The Court's order states that all Stanford-owned assets around the globe are subject to an asset freeze. However, international assets are compromised when local governments in Antigua, Venezuela and Panama seize banks in their countries and assume all assets – obliterating hundreds of millions of dollars in Stanford investor assets. The U.S. government does nothing to work with the foreign governments to protect foreign

[57] Securities and Exchange Commission Complaint to US District Court, Northern District of Texas, Dallas Division, Complaint #LR20901, Feb. 16, 2009.
[58] Stanford International Bank-Antigua Investor Newsletter, December 2008
[59] Securities and Exchange Commission Complaint to US District Court, Northern District of Texas, Dallas Division, Complaint #LR20901, Feb. 16, 2009.

assets belonging to Stanford investors.[60]

The government of Antigua and Barbuda does not acknowledge the U.S. Court's authority over Stanford International Bank-Antigua and appoints UK-based Vantis PLC as receiver.[61] Dual receiverships result in a multi-year international turf war fighting for control of Stanford's foreign assets.

U.S. Congressman Dennis Kucinich, Chairman of the Subcommittee for Domestic Policy Reform, publicly asks SEC Chairman Mary Schapiro to disclose documents related to SEC "stand down" order.[62]

U.S. Receiver Janvey closes over 30 Stanford Group offices throughout the U.S., eliminating approximately 1,000 jobs.

Former Stanford Group Company Financial Advisors retain FINRA licenses and resume employment at other U.S. brokerage firms. FINRA records for individual brokers do not disclose any involvement of selling alleged fraudulent securities used to carry out a $7 billion Ponzi scheme.[63]

The IRS files a motion in the Northern District Court of Texas seeking Receivership assets to pay Allen Stanford's personal income tax debt of $227 million.[64]

SEC Inspector General H. David Kotz publishes an audit report stating the agency has "not complied with the requirements of the Regulation D exemptions," or does not "*substantively review the more than 20,000 Form D filings that it receives annually, which in 2008, identified total estimated offerings of $609 billion dollars*." The report identifies several instances of "*misuse, non-compliance, and illegal acts regarding the Regulation D exemptions*."[65]

Receiver Ralph Janvey files for professional fees and expenses in excess of $40 million for the first 3 months of the Receivership.

Receiver Ralph Janvey attempts to clawback $925 million from investors who received principal or interest for SIB CD investments.

Stanford Group Company brokerage account customers are denied coverage under the Securities Investor Protection Act (SIPA) despite a legal precedent for coverage of fictitious securities in other similar cases. In denying coverage, Securities Investor Protection Corporation (SIPC) president says the SIB CDs were not fictitious securities.[66]

Year	Investor Losses
2009	**$7.2 Bil.**

[60] Bloomberg, Feb. 17, 2009, "Stanford Bank's Clients in Latin American Seek Funds."
[61] Financial Services Regulatory Commission, Government of Antigua and Barbuda, Claim #ANUHCV20009/0110, Feb. 26, 2009.
[62] US Congressman Dennis Kucinich, www.kucinich.house.gov.
[63] FINRA BrokerCheck.
[64] US District Court, Northern District of Texas, Dallas Division, March 13, 2009, Case #3:09-cv-00298-N.
[65] Securities and Exchange Commission Office of Inspector General Audit Report, March 31, 2009.
[66] *Houston Chronicle*, Feb. 27, 2011, "Forensic Accountant Gives Stanford Investors Sliver of Hope."

2010

The SEC Office of the Inspector General (OIG) releases a report on investigation revealing that the SEC knew for 12 years that Stanford was operating a fraud before the SEC took any action.[67]

Forty-five Members of the 111th Congress write to SEC Chairman Mary Schapiro addressing the OIG report findings and questioning the SEC's interpretation of the Securities Investor Protection Act (SIPA) that would provide up to $500K of SGC customers' losses through the Securities Investor Protection Corporation (SIPC). The letter points out, "*The SEC's primary function is to protect investors, and it would appear that the SEC Enforcement Director and other staff members at the SEC's Fort Worth office committed impermissible acts of discretion that needlessly prolonged the extend and severity of the fraud....It would seem illogical and contrary to the spirit of SIPA to tell SGC customers their funds were stolen by the owner of the broker dealer, yet the manner in which the theft occurred precludes the customers from receiving their due relief.*"[68]

Approximately 6,000 hours are billed against the Stanford estate for work done for the U.S. government's prosecution of Allen Stanford, et al.

Dozens of former Stanford Group Company Financial Advisors who misrepresented the safety of Stanford International Bank CDs continue to work in the securities industry without any disclosure to future investors. Additionally, the former compliance officer, accounting personnel and attorneys for various Stanford entities heavily involved in the fraud remain free of any civil or criminal actions.

2011

Allen Stanford is deemed incompetent to stand trial indefinitely and is ordered to a rehabilitation facility for treatment for an addiction to prescription anxiety medication he has been given only since he was incarcerated.[69]

More than 60 members of the 112th Congress write to SEC Chairman Mary Schapiro urging the Commission to order SIPC to provide compensation for up to $500K in losses for SGC customers. The letter states, "*It has been more than two years since thousands of Americans lost their savings in the Stanford Ponzi scheme....These Americans relied on the SEC to uphold its federal mandate to protect investors and the SEC failed in the regard.*"[70]

By a vote of the Commissioners, the SEC determines that Stanford Group Company customers are entitled to protection under the Securities Investor Protection Act (SIPA). The SEC asks the Securities Investor Protection Corporation (SIPC) to initiate a liquidation proceeding of Stanford Group Company.

SIPC refuses to comply with the SEC's directive, and the SEC files an unprecedented Enforcement Action against SIPC for failure to comply with the SIPA.

2012

The District Court for the District of Columbia denies the SEC's request for a court order to force SIPC to discharge its obligations under SIPA. The SEC appeals the District Court's decision.

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[67] Securities and Exchange Commission Office of the Inspector General Report on Investigation 526, March 31, 2010

[68] Congressional letter to SEC Chairman Mary Schapiro, May 6, 2010

[69] Order for Psychiatric Evaluation, United States of America v. Robert Allen Stanford, US District Court, Southern District of Texas, Houston Division, Case #H-09-342, Jan. 26, 2011.

[70] Congressional letter to SEC Chairman Mary Schapiro, March 16, 2011

2013
The SEC appeals the District Court's decision siding with SIPC.

The Stanford Receiver makes the first distribution to Stanford victims: one penny on the dollar for a total of $55 million. The Receiver spent $115 million to recover $55 million for the victims.

FAILURE TO ACT

The Securities Investor Protection Act of 1970 *Section 78eee(a)(1)*:

"If the [SEC] or any self-regulatory organization is aware of facts which lead it to believe that any broker or dealer subject to its regulation is in or is approaching financial difficulty, ***it shall immediately notify SIPC****."*

Why wasn't SIPC ever notified of Stanford Group Company's financial difficulty?

As an SEC-registered broker dealer, Stanford Group Company (SGC) was required to file monthly financial reports with the SEC. The purpose of filing the monthly financial statements is to demonstrate a brokerage firm's financial stability so that investor funds are not at risk of being misappropriated.

There are numerous examples of SGC's financial difficulty from its inception. If the required financial reports filed with the SEC were even superficially reviewed, the substantial cash infusions of millions of dollars from Allen Stanford; the firm's dependence on referral fees from an affiliate entity not subject to any U.S. regulation; and millions of dollars in intra-company loans should have indicated significant fraudulent activity– including misappropriation of customer funds. **Because of the SEC's failure to follow its mandate under the Securities Investor Protection Act 78*eee(a)(1)*, the Stanford Financial Group Ponzi scheme grew by $7 billion from 1996 to 2009.**

A very blatant example of SGC customers' funds being misappropriated was cited as an "Item of Interest" in the SEC's 1997 examination report, which questioned a $19 million cash contribution to SGC from Allen Stanford in 1996 while Stanford International Bank (SIB) in that same year loaned $13.5 million to Allen Stanford and $5.5 million to the Stanford Financial Group—for a total of $19 million coming directly and indirectly to SGC from SIB customer funds. Since SGC's customers were being sold the SIB CDs, the misappropriated funds were indistinguishable from belonging to SGC or SIB customers.

Item of Interest - Addition to Capital

During 1996, Stanford made a cash contribution of $19,000,000 to Stanford Group. We are concerned that the cash contribution may have come from funds invested by customers at SIB. We noted that SIB had loaned Stanford $13,582,579. In addition, we noted that SFG had borrowed $5,447,204 from SIB for a total receivable at SIB of $19,029,783 directly and indirectly from Stanford. We contacted the general counsel for the Stanford companies regarding our concerns. The general counsel stated that the cash contribution came from personal funds and not from the above loans; however, it seems at least questionable whether Stanford has access to $19,000,000 in personal funds.

The same 1998 SEC exam report states that 68% of SGC's revenue was from referral fees for SIB CD sales (on top of the $19 million cash contribution).

In addition to regular, growing cash contributions from Allen Stanford and referral fees from SIB CD sales, SGC financials filed with the SEC reported a mounting operating loss that clearly indicated the broker dealer was in dire financial difficulty without the revenue from the sale of the fictitious SIB CDs. As the SEC itself alleged in its civil complaint against Stanford, SGC could not have stood on its own without the SIB CD funds, which were used to prop up the broker dealer and further its expansion in the US rather than to purchase securities.

If the SEC had upheld its SIPA mandate in 1998, the theft of SGC customer's funds would have been limited to $210 million from foreign investors. Instead, SGC was allowed to continue selling SIB CDs, and even expanded its offering to US investors starting in 2001 (through a Regulation D disclosure). More than 6,000 US citizens lost approximately $2.2 billion because the very government they funded with their tax dollars did not follow the law.

Even More Reason to Scrutinize SGC's Financial Statements

SGC's financial reports from 1997 through 2009 are even more disturbing considering the context of what was occurring in the SEC's Enforcement Division to inexplicably overlook the Examination team's repeated concerns about SGC starting with its first examination in 1997. It wasn't until 7 years after that first exam – and three subsequent exams coming to the same conclusion – that Enforcement even opened an investigation of SGC. During the 4-year investigation that eventually led to the SEC's civil suit, SGC's financial difficulty became more and more apparent.

The monthly financial statements filed with the SEC after a formal investigation was opened reported even more cash contributions from Allen Stanford, more loans from affiliate entities, increased referral fees from SIB, and mounting annual operating losses. **Stanford was exactly the kind of situation SIPA was enacted to prevent and SGC all but sent a monthly notice to the SEC saying it was stealing customer funds.**

According to a forensic accounting report filed in the U.S. District Court by the Stanford Receiver, customer funds for new SIB CD purchases went directly to fund CD redemptions for other SIB customers. The report also revealed that customer funds intended to purchase SIB CDs didn't go to SIB—making it impossible for the securities to have been purchased.

According to SGC insiders, in 2007 and 2008, there was increasing internal pressure to bring in more SIB CD sales and discourage redemptions. During this time frame, SGC senior executives were visiting each of the broker dealer's 30+ offices throughout the US encouraging more CD sales by offering lucrative bonuses and lavish incentives like trips and expensive cars. Because of this increased "push" by SGC to US investors—along with the misrepresentation that SIB was "safer than a US bank," and "insured dollar for dollar"—SIB CD purchases by US citizens grew at a record rate in 2007 and 2008.

Instead of adhering to the SIPA and notifying SIPC that a broker dealer's customer funds were in jeopardy as SGC's financials indicated an increasingly dire financial situation, the SEC did nothing during this critical 2007-2008 time frame except take 2 more years to complete an investigation that should have taken place a full decade before the influx of US investment in the SIB CDs.

A broker dealer in severe financial difficulty combined with the SEC's suspicion that Stanford was operating a Ponzi scheme should have clearly indicated some effort to protect investors was required under SIPA so that even remedial action by SIPC could be taken. By not alerting SIPC to protect vulnerable investors, the SEC, in its oversight of a registered broker dealer, violated the SIPA.

Summary of Mounting Net Operating Debt at Stanford Group Company 2001-2007

Accumulated Deficit December 31, 2001: $10,129,621

Accumulated Deficit December 31, 2002: $7,839,161

Accumulated Deficit December 31, 2003: $3,484,858

Accumulated Deficit December 31, 2004: $5,950,128

Accumulated Deficit December 31, 2005: $29,400,804* (494% increase over previous year – also the year the SEC opened a formal investigation that led to the February 2009 civil suit)

Accumulated Deficit December 31, 2006: $49,910,101(170% increase over prior year and **830% increase** over year investigation opened)

Accumulated Deficit December 31, 2007: $77,294,204 (157% increase over prior year and **1,300% increase** over year investigation opened)

Item of Interest - Addition to Capital

During 1996, Stanford made a cash contribution of $19,000,000 to Stanford Group. We are concerned that the cash contribution may have come from funds invested by customers at SIB. We noted that SIB had loaned Stanford $13,582,579. In addition, we noted that SFG had borrowed $5,447,204 from SIB for a total receivable at SIB of $19,029,783 directly and indirectly from Stanford. We contacted the general counsel for the Stanford companies regarding our concerns. The general counsel stated that the cash contribution came from personal funds and not from the above loans; however, it seems at least questionable whether Stanford has access to $19,000,000 in personal funds.

Q: Did special rules apply in the context of US customers purchasing these types of CDs?

A: Yes. Clients who were U.S. residents had to qualify as "accredited investors," which is a reference in Rule 501(a) of Regulation D of the Securities Act of 1933, and had to be referred to the bank through Stanford Group Company brokerage only, with the financial advisor being a registered broker. In addition to other requirements in the case of such investors, the minimum deposits as to all CDs was $50,000. Additionally, such investors could not deposit funds either in Premium or Performance accounts and could not use the Express Account to maintain balances or any of the other services offered for such accounts except that Express Accounts could be utilized to facilitate immediate transfers to and from CDs.

TESTIMONY OF SUZANNE SHEAN

HOUSE FINANCIAL SERVICES SUBCOMMITTEE ON CAPITAL MARKETS AND GOVERNMENT SPONSORED ENTERPRISES HEARING:

"A LEGISLATIVE PROPOSAL TO AMEND THE SECURITIES INVESTOR PROTECTION ACT"

NOVEMBER 21, 2013

I would like to thank Chairman Scott Garrett and Ranking Member Carolyn Maloney for holding this hearing today and allowing me to speak about my experience as a victim of the Stanford Financial Group Ponzi scheme. I would also like to thank you from the bottom of my heart for giving victims like me hope for recovering our stolen retirement savings by introducing "The Restoring Main Street Investor Protection and Confidence Act." Thank you also to all of the subcommittee members here who have already joined this desperately needed bill.

My name is Suzanne Shean, and I am 64 years of age. I live in Carriere, Mississippi. Allen Stanford and the SIPC-member broker dealer Stanford Group Company took more than my life savings of $250,000 invested just 18 months before the SEC took the Stanford Group of Companies into Receivership in February 2009. He took from me what money can't buy. He took my husband's life, my soul mate, my daughter's "Daddy," my grandchildren's "Grandad," and the life we had together.

When the news of the Stanford scandal broke, I had just had surgery and was undergoing radiation treatments for breast cancer. My sweet husband, Michael, sheltered me from the news for months until I was better.

Michael had also had cancer—colon cancer—and underwent surgery in March 2008. The doctor said they were able to remove all of the cancer and there was no need for chemo or radiation.

But being a victim of a Ponzi scheme is like cancer itself. The stress eats away at you. For some, that happens slowly. For Michael, it only took about six months.

His cancer returned with a vengeance and quickly spread throughout his body. The burden of losing our life savings was too much for him, especially when he carried that burden alone for so long to protect me while I was sick. He died on April 29, 2011, at the age of 66.

Before Michael died, he worried so much about me and my future alone without our savings. My greatest hope was that he would be comforted with the knowledge that SIPC would make things right for us before he died. That didn't happen, and that devastation still weighs heavily on my heart.

I only saw my husband cry three times in our 43 years together—tears of joy at the birth of our daughter in 1969; tears of helplessness when neighbors had to help me pick him up after he fell a few weeks before he died; and tears of anguish when he asked me to forgive him for liquidating our IRA stock market portfolios to invest in "safer" IRA CDs from Stanford International Bank with Stanford Group Company (SGC.) He was inconsolable, but it was not HIS fault the safety net created to protect investors like us had failed to do so.

Our whole lives together, Michael and I worked so hard to put money away so we could retire one day, and enjoy our "Golden Years." For him to die thinking that it was all in vain is an abomination of the very soul of our society.

We were U.S. taxpayers, and we trusted the government to do its part to keep our money safe. Discovering that the SEC ***knew*** Stanford Group Company was involved in a Ponzi scheme for more than a decade ***before*** we invested with them added insult to injury. The double-whammy of SIPC announcing it had absolved itself of protecting us was just inconceivable.

I am now forced to work two jobs to keep my home. As a working widow under 66 years of age, I am not entitled to my husband's Social Security checks because my salary exceeds $17,000 a year. I should be enjoying my grandchildren and the fruits of my labor from these past 64 years. Instead, retirement is not an option now that that our entire IRA is gone. What will happen to me when I can no longer work? The one percent recovered by the Stanford Receiver after almost five years will just about cover a house note and my trip here to DC.... but that is another scandal we aren't here to discuss today...

Michael and I were very conservative investors, and we entrusted Stanford Group Company, or "SGC," a registered broker dealer and SIPC member, to invest our IRA funds safely. The Stanford International Bank CDs were sold by SGC as "Reg. D Securities" and were supposed to only be offered to "accredited investors." Like so many other Stanford victims, we did not meet the "accredited investor" criteria—but we didn't know anything about these requirements at the time. Nonetheless, our IRA was rolled over to Stanford Trust Company in Baton Rouge, Louisiana, in order for SGC to "purchase" the Stanford International Bank CDs they told were the "safest investment possible" for our IRAs. We were told because we had an IRA, that Stanford Trust in Louisiana would hold custody of our investments. We felt comfortable with this investment because every aspect it was being managed in the U.S. and regulated by our government.

But what we didn't know DID hurt us. We had no idea that Stanford Trust Company was created by SGC as a way to tap into a whole new source of money to feed the Ponzi scheme—hundreds of millions of dollars of innocent investors' IRA funds. The Stanford Trust Company was a subsidiary company of the brokerage firm, and was created as a state-regulated entity solely to evade oversight by the federal government. The Louisiana Attorney General's office later explained that SGC employees operated the Trust Company, and even served as its Board of Directors (*see attached affidavit of Scott Bailey*). In short, SGC held custody of our CDs, and our savings *never* left the U.S., and never went to purchase securities of any kind.

We were shocked when we found out that SIPC announced we didn't qualify for protection because we weren't "customers" of SGC because it supposedly didn't hold custody of the fictitious Stanford International Bank CDs. But we had a customer contract with SGC, not Stanford International Bank in Antigua. We didn't send our money to Antigua like SIPC has told Congress, the Courts and the public. We also never dealt with a single employee of Stanford International Bank. We received monthly statements from Stanford Trust Company, operated and governed by SGC employees in Baton Rouge, Louisiana, and our account numbers, ST**SGC**-40917 and ST**SGC**-40912 even indicated we were SGC customers. The custodian of our IRAs was—for all intents and purposes—Stanford Group Company.

What SIPC was telling us seemed like hyper-technical legalese designed solely to avoid covering our losses despite other similar SIPC cases in which investors *were* protected. SIPC has behaved as if it is a private insurance company with government immunity—and they've gotten away with it so far—at the expense of thousands of victims just like me.

When the SEC Commissioners finally voted to overturn SIPC's position about our status as "customers," SIPC launched an all-out war against us with an anti-Stanford victim PR campaign, labeling us as "foreign bank clients" as if we had sought out a tax haven to hide our IRAs. They even launched a new website called The Stanford Antiguan Bank Fraud, loaded with misleading information and the words "foreign," "offshore," and "Antigua" multiple times on every page--somewhat like the SIPC logo was slapped on everything in SGC's offices and the all of Stanford's marketing materials. It was so surreal to see this entity created by Congress to protect investors going to such extreme lengths to invalidate the SEC's analysis as they prepared for a protracted legal battle that has lasted more than two years now. The expense of their litigation against the SEC has probably cost SIPC millions of dollars when those funds should be going to protect investors—not fight the federal government.

Here we are--innocent investors who used a SIPC-member broker to purchase securities that, come to find out, didn't even exist, and SIPC is treating us as their enemy! The CDs were an imaginary investment vehicle designed to take money from Stanford's right hand—Stanford Group Company—and steal it with his left—Stanford International Bank. In short, we have been victimized again—first by the SEC for not stopping Stanford Group Company when they were aware of misappropriation of customer funds and other fraudulent activity; then by Allen Stanford himself, who stole our savings; and then a third time by SIPC—because they have told us Allen Stanford stole our money "the wrong way."

Chairman Garrett, Ranking Member Maloney and the honorable members of the subcommittee, I beg you to please close these loopholes in the law that SIPC has manipulated in order to protect its member firms rather than investors. People like me desperately need the provisions of H.R. 3482 to protect us so we can have our lives back. I will never be able to have my Michael back, but I know his soul would rest in peace if he knew I was taken care of. That means the world to me, and I want that for him as much as I do for myself.

Thank you for your time and your attention. It has been my honor to share my story here today.

EXHIBITS

AFFIDAVIT OF SCOTT BAILEY
STATE OF LOUISIANA
OFFICE OF THE ATTORNEY GENERAL

1. Stanford Trust Company (STC) was a Louisiana chartered financial institution which offered trust services to the customers of Stanford Group Company (SGC), a SEC-registered broker dealer. Both SGC and STC were subsidiaries of Stanford Group Holdings, Inc., which was wholly-owned by R. Allen Stanford.

2. Stanford Group Company has reported in its financial audits filed with the SEC that Stanford Trust Company was a wholly-owned subsidiary of SGC, a registered broker dealer and member of the National Association of Securities Dealers (NASD) and the Securities Investor Protection Corporation (SIPC).

3. The Board of Directors for Stanford Trust Company was comprised of employees of Stanford Group Company who supervised – and had a financial interest in – the sale of Stanford International Bank CDs. One SGC executive served in two capacities – as a Financial Advisor for SGC and as the Certified Public Accountant for STC.

4. As members of the Stanford Trust Company Board of Directors, Stanford Group Company employees directed the operations of STC. Interviews with former SGC and STC employees clearly establish the protective walls that should have been in place to separate the functions of STC from the potential conflicts of interest of SGC did not exist. When the need arose, SGC employees would use the STC fax machines to avoid the scrutiny of regulatory compliance in accomplishing transactions that may have been prohibited or disclose conflicts of interest.

5. Stanford Trust Company's primary function for Stanford Group Company was to serve as the custodian for Individual Retirement Accounts (IRAs) for SGC customers who purchased Stanford International Bank (SIB) Certificates of Deposit.

6. Most, if not all, Stanford Group Company customers in the United States who purchased Stanford International Bank CDs with their IRA funds had their IRAs in the custody of Stanford Trust Company.

7. When the Stanford Financial Group of Companies collapsed in February 2009, Stanford Trust Company had custody of approximately $400 million of Stanford International Bank CDs held in IRAs owned by Stanford Group Company customers.

8. Stanford Group Company customers deposited funds directly with Stanford Trust Company for the purchase of Stanford International Bank CDs. This was done in a variety of ways depending on the customer's situation. Some SGC customers rolled over existing IRA funds directly to STC. Others wrote checks directly to SGC, STC, or even to STC's bank, Hancock Bank, to purchase SIB CDs to be held in their IRA accounts. Similarly, wire transactions were directed to STC's account at Hancock Bank for the purchase of SIB CDs.

9. Stanford Trust Company held physical custody of Stanford International Bank CDs, in the form of the paper certificate, at STC for Stanford Group Company customers.

10. Stanford Group Company customers who held Stanford International Bank CDs in custody at Stanford Trust Company received statements from STC reflecting their SIB CD balance. These customers routinely did not receive statements from SIB.

11. Stanford Trust Company account numbers started with "STSGC" indicating at a minimum that the IRA accounts were still Stanford Group Company accounts and STC was simply performing an administrative function at SGC's direction.

12. Stanford Group Company customers with funds held in IRAs at Stanford Trust Company maintained their relationships with their SGC Financial Advisors as the primary point of contact for all of their SGC investments, including their Stanford International Bank CDs.

13. Stanford Group Company Financial Advisors (FAs) continued to oversee their customers' accounts at Stanford Trust Company. If funds were to be added or withdrawn, SGC FAs facilitated those transactions.

14. Some Stanford Group Company customers with IRA funds held at Stanford Trust Company were unaware Stanford International Bank was an offshore bank chartered and regulated in Antigua, and believed that they were purchasing CDs from a subsidiary of Stanford Group Company that was operated in, regulated by, and insured by the U.S. government.

15. At least some of Stanford Group Company customers with IRA funds allocated to the Stanford International Bank CD's were not Accredited Investors as defined by the Securities and Exchange Commission and required for the solicitation and purchase of Regulation D securities like the SIB CDs.

16. Virtually all Stanford Group Company customers were told the Stanford International Bank CD's were covered by SIPC insurance.

17. The lack of protective fire walls and conflicts of interest between Stanford Group Company and Stanford Trust Company is most evident in the complete lack of portfolio diversification. Most Stanford Group Company customers were advised by their SGC Financial Advisor to allocate a disproportionate majority of their retirement funds to the Stanford International Bank CDs, and in some cases the Financial Advisors made disproportionate purchases of Stanford International Bank CD's in trust accounts without the knowledge of the account holder.

18. A review of Stanford Group Company and Stanford Trust Company records in the possession of the court appointed receiver indicated a significant number if not most of the SGC customer records for Stanford International Bank CD holders are missing. A further review revealed that some Louisiana SGC customer files related to the purchase of SIB CD's were found in boxes next to a shredder ready to be destroyed with other miscellaneous items and trash. Absent any explanation, missing SGC customer documents along with SIC CD records obviously ready to be shredded are a strong indication that someone was taking steps to destroy records and evidence that may be used in civil or criminal proceedings.

Signature: Scott Bailey

Printed Name: Scott Bailey

Date: 7-20-2010

Sworn and subscribed before me this 20th day of July 2010 A.D.

Notary Public: Adam L. Ortego
ADAM L. ORTEGO Notary No. 30131

My Commission Expires: at my death

SUZANNE T SHEAN

NOTICE OF DETERMINATION EXHIBIT

CLAIM NUMBER(S)	CLAIM TYPE(S)	CLAIMANT(S)	TOTAL CLAIMED AMOUNT	ALLOWED CLAIM AMOUNT	REASON(S) FOR DISALLOWANCE	PAYEE(S)	PAYMENT MAILING ADDRESS
STANFORD-[redacted]	CD	SUZANNE T SHEAN	$73,146.00	$64,019.01	PURSUANT TO RECORDS AVAILABLE TO THE RECEIVERSHIP, THE NET LOSS FOR THE PAYEE(S) EQUALS THE ALLOWED CLAIM AMOUNT, RATHER THAN THE TOTAL CLAIMED AMOUNT.	SUZANNE T SHEAN	[redacted]

133

STANFORD TRUST COMPANY
445 North Blvd, Suite 820
Baton Rouge, LA 70802

Account Summary

Statement of Value and Activity

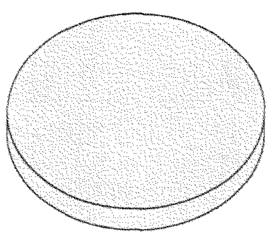
January 1, 2009 - March 31, 2009

Market Value Reconciliation

	This Period	*1/1/09 to 3/31/09*
Beginning Market Value	**$73,236.97**	**$73,236.97**
Additions	$0.00	$0.00
Distributions	$0.00	$0.00
Fees/Expenses/Taxes	$0.00	$0.00
Income	$0.00	$0.00
Capital Gain Distributions	$0.00	$0.00
Non Cash Asset Changes	$0.00	$0.00
Asset Transfers	$0.00	$0.00
Change in Market Value	-$73,146.70	-$73,146.70
Ending Market Value	**$90.27**	**$90.27**

Asset Allocation Summary

Investment Objective: Self Directed

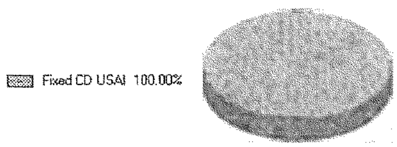


	Asset Class	*Balance*
100%	Cash & Equivalents	$90.27
100%	**Total Assets Value**	**$90.27**

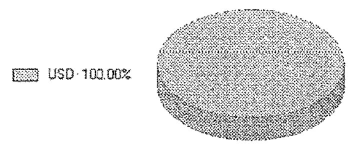
STC CUSTODIAN FBO SUZANNE F SHEAN IRA

Statement as of
December 31, 2008

Deposit Allocation



Deposit Currency



Summary	
Loans	0.00
Total Deposits	73,146.70

Accounts Included in this Statement

Account No.	Principal Balance	Interest Balance	Ending Balance	Interest This Period	Interest This Year	Maturity Date
US DOLLAR						
[redacted]	0.00	0.00	0.00	0.00	0.00	
	64,019.01	9,127.69	73,146.70	504.51	5,739.45	May 15, 2012
Acct. Total	64,019.01	9,127.69	73,146.70	504.51	5,739.45	

Total Combined Account Balances Expressed in US Dollars

	64,019.01	9,127.69	73,146.70	504.51	5,739.45

Percentages and Summary are expressed in United States Dollars (USD).
Percentages less than 0.75% of overall total are not displayed in the charts.

Accounts Details

Express Account Currency: USD Rate: 0.000%

Account No: [redacted]

Value Date	Description	Transaction Amt	Principal	Interest	Balance
Dec 1, 2008	BEGINNING BALANCE	0.00	0.00	0.00	0.00
Dec 31, 2008	INTEREST EARNED	0.00	0.00	0.00	0.00
Dec 31, 2008	ENDING BALANCE	0.00	0.00	0.00	0.00

Fixed CD USAI Currency: USD Rate: 8.150% Term: 60 Month(s)

Account No: [redacted]

Value Date	Description	Transaction Amt	Principal	Interest	Balance
Dec 1, 2008	BEGINNING BALANCE	0.00	64,019.01	8,623.18	72,642.19
Dec 31, 2008	INTEREST EARNED	0.00	0.00	504.51	73,146.70
Dec 31, 2008	ENDING BALANCE	0.00	64,019.01	9,127.69	73,146.70

2007 IRA CONTRIBUTION INFORMATION - FORM 5498

OMB No. 1545-0747

[ ] CORRECTED (If Checked)

TRUSTEE'S OR ISSUER'S name, street address, city, state, and ZIP code
STANFORD TRUST COMPANY
445 NORTH BOULEVARD STE. 820
BATON ROUGE, LA 70802

Account Number
STSGC[redacted]

TRUSTEE'S OR ISSUER'S Federal identification number: [redacted]

PARTICIPANT'S name, street address, city, state, and ZIP

SUZANNE T. SHEAN
[redacted]

PARTICIPANT'S Social Security #
[redacted]

COPY B

FOR PARTICIPANT.

1	IRA contributions (other than amounts in boxes 2-4, and 8-10)						
2	Rollover contributions						
3	Roth IRA conversion amount						
4	Recharacterized contributions						
5	Fair market value of account						67,495.98
6	Life insurance cost included in box 1						
7	Check for IRA	X		SEP			
	SIMPLE			Roth IRA			
8	SEP contributions						
9	SIMPLE contributions						
10	Roth IRA contributions						
11	Check if RMD for 2008						

THIS INFORMATION IS BEING FURNISHED

TO THE INTERNAL REVENUE SERVICE.

JSA
7F9043 2.000

TEP92824_730_4377 3 of 6

2007 IRA CONTRIBUTION INFORMATION - FORM 5498

OMB No. 1545-0747

[ ] CORRECTED (If Checked)

TRUSTEE'S OR ISSUER'S name, street address, city, state, and ZIP code
STANFORD TRUST COMPANY
445 NORTH BOULEVARD STE. 820
BATON ROUGE, LA 70802

Account Number
STSGC[redacted]

TRUSTEE'S OR ISSUER'S Federal identification number: [redacted]

PARTICIPANT'S name, street address, city, state, and ZIP

SUZANNE T. SHEAN
[redacted]

PARTICIPANT'S Social Security #
[redacted]

COPY C

FOR TRUSTEE OR ISSUER.

1	IRA contributions (other than amounts in boxes 2-4, and 8-10)						
2	Rollover contributions						
3	Roth IRA conversion amount						
4	Recharacterized contributions						
5	Fair market value of account						67,495.98
6	Life insurance cost included in box 1						
7	Check for	IRA	X	SEP			
		SIMPLE		Roth IRA			
8	SEP contributions						
9	SIMPLE contributions						
10	Roth IRA contributions						
11	Check if RMD for 2008						

STANFORD TRUST COMPANY
445 North Blvd. 8th Fl. - East
Baton Rouge, LA 70802

Statement of Value and Activity

April 1, 2007 - June 30, 2007

Suzanne T. Shean IRA
Account # STSGC[redacted]

0100468 01 MB 0.350 A T 2 0 0183 39426-7738 245 B10

Suzanne T. Shean
[redacted]

For Questions Contact:
John Buzzell
(225) 381-0550

For Your Information

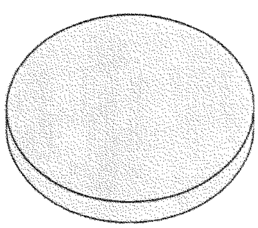
Your Statement of Value and Activity has been designed to keep you up-to-date on the activity in your account.
It provides you with an easy-to-read summary of your account balance and history of your transactions during the past time period.

Your Activity Summary

	This Period	***Year to Date***
Beginning Market Value	$0.00	$0.00
Additions	64,019.01	64,019.01
Distributions	0.00	0.00
Income	36.33	36.33
Fees	0.00	0.00
Non-Cash Asset Changes	0.00	0.00
Change in Market Value	675.31	675.31
Ending Market Value	$64,730.65	$64,730.65

Your Portfolio Allocation

Your account is currently allocated among the investments specified on the right. Percentages may not be exact due to rounding.



	Investment	***Market Value***
100%	Cash and Equivalents	$64,730.65
100%	Stanford Intl Bk CD 8.150% 5/15/12	64,694.32
0%	Prime Obligation Fund	36.33
100%	Total Portfolio Value	$64,730.65

For an explanation of terms used, please refer to the "About Your Investor Account Statement" section.

Statement Period: April 1, 2007 to June 30, 2007

The Value of Your Portfolio Investments

Investment	*Shares*	*Share Price ($)*	*Market Value*
Cash and Equivalents 100%			$64,730.65
Stanford Intl Bk CD 8.150% 5/15/12	100.000	64,694.32	64,694.32
Prime Obligation Fund	36.330	1.00	36.33
Total Portfolio			$64,730.65

Your Portfolio Activity Detail

Date	*Activity Description*	*Shares*	*Share Price ($)*	*Cash Amount*
04/27/07	Sold Prime Obligation Fund	1.000	1.000	$1.00
04/27/07	Purchased Prime Obligation Fund	1.000	1.000	-1.00
05/11/07	Received IRA Transfer			64,019.01
05/11/07	Purchased Prime Obligation Fund	64,019.010	1.000	-64,019.01
05/15/07	Sold Prime Obligation Fund	64,019.010	1.000	64,019.01
05/16/07	Purchased Stanford Intl Bk CD 8.150% 5/15/12	100.000	64,019.010	-64,019.01
06/01/07	Received Dividend Prime Obligation Fund Dividend from 5/11/07 to 5/15/07			36.33
06/04/07	Purchased Prime Obligation Fund	36.330	1.000	-36.33

smith barney

May 11, 2007

1310N21500182701 423-417

*** SUZANNE T. SHEAN
CGM IRA CUSTODIAN
[redacted]

MICHAEL I FLYNN
Financial Advisor
504-585-3914
www.smithbarney.com

ACCOUNT NUMBER [redacted]

IMPORTANT NOTICE | FUNDS MONEY TRANSFER CONFIRMATION

PLEASE RETAIN FOR YOUR RECORDS.

As you have instructed, we have completed a Federal Fund Money Transfer in the amount of $64,019.01

To: HANCOCK BANK OF LOUISIANA

For the benefit of: [redacted] STANFORD TRUST COMPANY CLIENT DDA

For the further benefit of: STSGC [redacted] STANFORD TRUST CO. C F FBO

The transfer agent has confirmed that this transfer was executed as a Federal Funds transaction with paid ref number [redacted]

This transfer was made from your Smith Barney account referenced above.

If any of the above information is not in accordance with your instructions, or any of the information is incorrect, please contact your Branch Manager immediately at 504-585-3900.

We appreciate your business.

909 POYDRAS ST. • STE 1600 LL&E TOWER • NEW ORLEANS, LA 70112

MICHAEL C SHEAN

NOTICE OF DETERMINATION EXHIBIT

CLAIM NUMBER(S)	CLAIM TYPE(S)	CLAIMANT(S)	TOTAL CLAIMED AMOUNT	ALLOWED CLAIM AMOUNT	REASON(S) FOR DISALLOWANCE	PAYEE(S)	PAYMENT MAILING ADDRESS
STANFORD-1011449-1	CD	MICHAEL C SHEAN	$144,728.00	$127,093.00	PURSUANT TO RECORDS AVAILABLE TO THE RECEIVERSHIP, THE NET LOSS FOR THE PAYEE(S) EQUALS THE ALLOWED CLAIM AMOUNT, RATHER THAN THE TOTAL CLAIMED AMOUNT.	MICHAEL C SHEAN	[redacted]

STANFORD TRUST COMPANY
445 North Blvd, Suite 820
Baton Rouge, LA 70802

Account Summary

Statement of Value and Activity

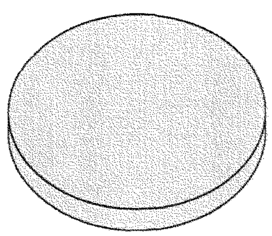
January 1, 2009 - March 31, 2009

Market Value Reconciliation

	This Period	*1/1/09 to 3/31/09*
Beginning Market Value	**$145,139.86**	**$145,139.86**
Additions	$0.00	$0.00
Distributions	$0.00	$0.00
Fees/Expenses/Taxes	$0.00	$0.00
Income	$0.10	$0.10
Capital Gain Distributions	$0.00	$0.00
Non Cash Asset Changes	$0.00	$0.00
Asset Transfers	$0.00	$0.00
Change in Market Value	-$144,728.23	-$144,728.23
Ending Market Value	**$411.73**	**$411.73**

Asset Allocation Summary

Investment Objective: Self Directed

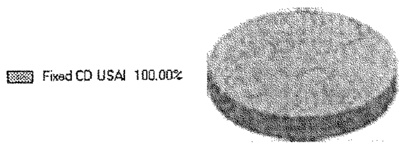


	Asset Class	*Balance*
100%	Cash & Equivalents	$411.73
100%	**Total Assets Value**	**$411.73**

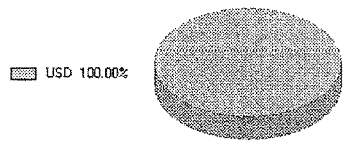
STC CUSTODIAN FBO MICHAEL C SHEAN IRA

Statement as of
December 31, 2008

Deposit Allocation



Deposit Currency



Summary	
Loans	0.00
Total Deposits	144,728.23

Accounts Included in this Statement

Account No.	Principal Balance	Interest Balance	Ending Balance	Interest This Period	Interest This Year	Maturity Date
US DOLLAR						
[redacted]	0.00	0.00	0.00	0.00	0.00	
	127,093.00	17,635.23	144,728.23	998.22	11,356.04	May 30, 2012
Acct. Total	127,093.00	17,635.23	144,728.23	998.22	11,356.04	

Total Combined Account Balances Expressed in US Dollars

	Principal Balance	Interest Balance	Ending Balance	Interest This Period	Interest This Year	
	127,093.00	17,635.23	144,728.23	998.22	11,356.04	

Percentages and Summary are expressed in United States Dollars (USD).
Percentages less than 0.75% of overall total are not displayed in the charts.

Accounts Details

Express Account Currency: USD Rate: 0.000%

Account No: [redacted]

Value Date	Description	Transaction Amt	Principal	Interest	Balance
Dec 1, 2008	BEGINNING BALANCE	0.00	0.00	0.00	0.00
Dec 31, 2008	INTEREST EARNED	0.00	0.00	0.00	0.00
Dec 31, 2008	ENDING BALANCE	0.00	0.00	0.00	0.00

Fixed CD USAI Currency: USD Rate: 8.150% Term: 60 Month(s)

Account No: [redacted]

Value Date	Description	Transaction Amt	Principal	Interest	Balance
Dec 1, 2008	BEGINNING BALANCE	0.00	127,093.00	16,637.01	143,730.01
Dec 31, 2008	INTEREST EARNED	0.00	0.00	998.22	144,728.23
Dec 31, 2008	ENDING BALANCE	0.00	127,093.00	17,635.23	144,728.23

2007 IRA CONTRIBUTION INFORMATION - FORM 5498

OMB No. 1545-0747

[ ] CORRECTED (If Checked)

TRUSTEE'S OR ISSUER'S name, street address, city, state, and ZIP code
STANFORD TRUST COMPANY
445 NORTH BOULEVARD STE. 820
BATON ROUGE, LA 70802

Account Number
STSGC[redacted]

TRUSTEE'S OR ISSUER'S Federal identification number: [redacted]

PARTICIPANT'S name, street address, city, state, and ZIP

MICHAEL C. SHEAN
[redacted]

PARTICIPANT'S Social Security #
[redacted]

COPY B

FOR PARTICIPANT.

1	IRA contributions (other than amounts in boxes 2-4, and 8-10)					
2	Rollover contributions					
3	Roth IRA conversion amount					
4	Recharacterized contributions					
5	Fair market value of account					133,776.90
6	Life insurance cost included in box 1					
7	Check for IRA	X	SEP			
	SIMPLE		Roth IRA			
8	SEP contributions					
9	SIMPLE contributions					
10	Roth IRA contributions					
11	Check if RMD for 2008					

THIS INFORMATION IS BEING FURNISHED

TO THE INTERNAL REVENUE SERVICE.

2007 IRA CONTRIBUTION INFORMATION - FORM 5498

OMB No. 1545-0747

[ ] CORRECTED (If Checked)

TRUSTEE'S OR ISSUER'S name, street address, city, state, and ZIP code
STANFORD TRUST COMPANY
445 NORTH BOULEVARD STE. 820
BATON ROUGE, LA 70802

Account Number
STSGC[redacted]

TRUSTEE'S OR ISSUER'S Federal identification number: [redacted]

PARTICIPANT'S name, street address, city, state, and ZIP

MICHAEL C. SHEAN
[redacted]

PARTICIPANT'S Social Security #
[redacted]

COPY C

FOR TRUSTEE OR ISSUER.

1	IRA contributions (other than amounts in boxes 2-4, and 8-10)					
2	Rollover contributions					
3	Roth IRA conversion amount					
4	Recharacterized contributions					
5	Fair market value of account					133,776.90
6	Life insurance cost included in box 1					
7	Check for IRA	X	SEP			
	SIMPLE		Roth IRA			
8	SEP contributions					
9	SIMPLE contributions					
10	Roth IRA contributions					
11	Check if RMD for 2008					

JSA
7F9043 2.000

TEP92624_721_4325 5 of 6

STANFORD TRUST COMPANY
445 North Blvd. 8th Fl. - East
Baton Rouge, LA 70802

Statement of Value and Activity

April 1, 2007 - June 30, 2007

Michael C. Shean IRA
Account # STSGC[redacted]

0100467 01 MB 0.360 A T 2 0 0183 39425-7738 245 B10

Michael C. Shean
[redacted]

For Questions Contact:
John Buzzell
(225) 381-0550

For Your Information

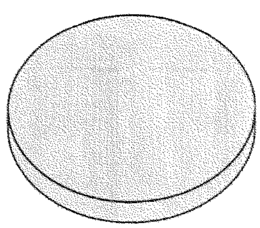
Your Statement of Value and Activity has been designed to keep you up-to-date on the activity in your account.
It provides you with an easy-to-read summary of your account balance and history of your transactions during the past time period.

Your Activity Summary

	This Period	***Year to Date***
Beginning Market Value	$0.00	$0.00
Additions	127,093.00	127,093.00
Distributions	0.00	0.00
Income	343.16	343.16
Fees	0.00	0.00
Non-Cash Asset Changes	0.00	0.00
Change in Market Value	911.25	911.25
Ending Market Value	$128,347.41	$128,347.41

Your Portfolio Allocation

Your account is currently allocated among the investments specified on the right. Percentages may not be exact due to rounding.



	Investment	***Market Value***
100%	**Cash and Equivalents**	**$128,347.41**
100%	Stanford Intl Bk CD 8.150% 5/30/12	128,004.25
0%	Prime Obligation Fund	343.16
100%	Total Portfolio Value	$128,347.41

For an explanation of terms used, please refer to the "About Your Investor Account Statement" section.

984 -0100467

smith barney

May 11, 2007

131DN21500182801 423-417

*** MICHAEL C. SHEAN
CGM IRA CUSTODIAN
[redacted]

MICHAEL I FLYNN
Financial Advisor
504-585-3914
www.smithbarney.com

ACCOUNT NUMBER [redacted]

IMPORTANT NOTICE	FUNDS MONEY TRANSFER CONFIRMATION

PLEASE RETAIN FOR YOUR RECORDS.

As you have instructed, we have completed a Federal Fund Money Transfer in the amount of $127,093.00

To: HANCOCK BANK OF LOUISIANA

For the benefit of: [redacted] STANFORD TRUST CO. CLIENT DDA

For the further benefit of: STSGC [redacted] STANFORD TRUST CO. C F FBO

The transfer agent has confirmed that this transfer was executed as a Federal Funds transaction with paid ref number [redacted]

This transfer was made from your Smith Barney account referenced above.

If any of the above information is not in accordance with your instructions, or any of the information is incorrect, please contact your Branch Manager immediately at 504-585-3900.

We appreciate your business.

STANFORD | Stanford Group Company
MEMBER FINRA/SIPC

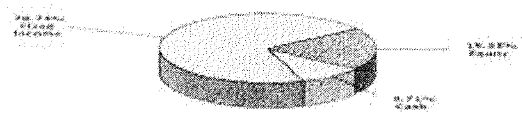
[redacted]

Premiere Wealth Management Services

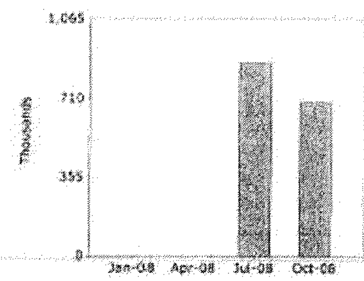
October 2008

Doug Shaw
713-964-5264
dshaw@stanfordeagle.com

Asset Allocation Summary



Consolidated Portfolio Value



Total Value
$692,179.17

Accounts Summary

Account	Type	Abbreviated Title		This Period		Last Period
NIL-010653	SAS	CAJ FAMILY PARTNERSHIP SAS GROWTH	$	220,332.29	$	338,120.98
NMY-015818	MAP	CAJ FAMILY PARTNERSHIP	$	201.86	$	201.67
SIBL		ASHTON T. AND SALLY MATTHEWS/CAJ FAMI	$	461,644.02	$	459,305.55
		Total Portfolio	$	692,179.17	$	797,628.20

NIAP

Network for Investor Action and Protection

Testimony November 22, 2013
Ron Stein, CFP
Network for Investor Action and Protection
Subcommittee on Capital Markets and Government Sponsored Enterprises

Chairman Garrett, Ranking Member Maloney and Members of the Subcommittee, my name is Ron Stein, and I am the President of the Network for Investor Action and Protection ("NIAP") -- a national not for profit organization comprised of small investors dedicated to improving our Nation's investor protection regime. I am also a Registered Investment Advisor, Certified Financial Planner, and a member of the financial services community in good standing. Over 1000 members of our organization were victims of the Madoff fraud.

I am honored to speak to you today, nearly five years after the collapse of the Madoff brokerage firm, to give voice to the small and mostly middle-class investors who were devastated by this fraud and who, despite reasonable expectations, received little or no protection from the SIPC and the SIPC-appointed Trustee. What I have to say has been said by many others in front of this Committee in the past. Perhaps more, I'm here on behalf of millions of small investors who have *not* been victimized, who depend on Congress, the regulatory apparatus and the industry for the protections of their life savings should similar financial disaster befall them.

Where do we stand? Thousands of lives upended, with another thousand being sued; story after dismal story of family horrors – depression, premature deaths, suicide, loss of medical care, life savings obliterated. Gruesome stories. Devastating stories.

This was not what Congress intended when it first passed SIPA legislation in 1970, amidst the turmoil of hundreds of brokerage insolvencies, a devastating paper crunch crisis, recession, massive theft fraud, and yes, Ponzi schemes. The creation of SIPC, the insurance-like entity, was the cornerstone of that legislation, and an essential step to providing confidence and trust to investors as Congress was ushering them away from the certainty of their physical securities to the new, more manageable world of the investment statement.

On signing the SIPA legislation that created SIPC in December 1970, President Nixon said:

Richard Nixon: I AM SIGNING today the Securities Investor Protection Act of 1970. This legislation establishes the Securities Investor Protection Corporation (SIPC), a private nonprofit corporation, which will ***insure*** *the securities and cash left with brokerage firms by investors against loss from financial difficulties or failure of such firms.*

I urged the formation of a corporation to afford protection to small investors

Just as the Federal Deposit Insurance Corporation protects the user of banking services from the danger of bank failure, so will the Securities Investor Protection Corporation protect the user of investment services from the danger of brokerage firm failure.

This act protects the customer, not the broker, since only the customer is paid in the event of firm failure. It does not cover the equity risk that is always present in stock market investment, but it will assure the investor that the solvency of the individual firm with which he deals will not be cause for concern. It protects the small investor, not the large investor, since there is a limit on reimbursable losses. And it assures that the widow, the retired couple, the small investor who have invested their life savings in securities will not suffer loss because of an operating failure in the mechanisms of the marketplace.

SIPC was a central leg in the investor protection stool. It was the protector of last resort should all other regulatory components fail, as they have here.

SIPC's obligation and the commitment Congress made to the public in passing SIPA law filtered down to the investor customer. Every financial professional, every broker, every brokerage firm, has extended to every client the promise of SIPC protection. From JP Morgan Chase, Citigroup, Goldman, Merrill, to BLMIS and Stanford, every customer was informed that they were/are protected to the SIPC limit based on their account statements should their broker fail. This was part of every broker's securities training. No asterisks. No exceptions. And no reference to what fine print may have been recently, discreetly inserted in certain SIPC materials. Significantly upon these promises, the financial services industry was able to gain the trust of the American public and explode in size.

How do these promises and Congress' intentions comport with the facts of the Madoff insolvency?

FACT: the majority of investors in the regulated broker-dealer will not receive a penny of the SIPC advance guaranteed by Congress under the SIPA statute as a result of a methodology which minimizes SIPC's outlays, and more still have seen their SIPC payments markedly reduced.

FACT: after having their protections stripped away by the Trustee, over 1000 investors, acknowledged as being innocent, are being vigorously sued, like thieves and criminals, many having already lost everything.

FACT: institutions and professional investors are receiving over 80% of the recoveries of customer property (over $9 billion has been recovered) – many of these entities that the Trustee himself has indicated should have or could have known about the fraud.

FACT: in addition to saving SIPC over $1 billion by the Trustee's own calculations, the Trustee and his associated consultants have similarly been enriched by almost $1 billion, funds which could have gone instead to those devastated and to desperately needed education to help reduce the likelihood of future fraud.

There is no rational way to conceive that this result – where over half the investor victims are left unprotected, and 1000 sued – is the outcome that Congress would have preferred were it sitting here today. Indeed, *this is precisely what Congress would have dreaded and was seeking to prevent*. Clearly, in no way would the American public have supported SIPA law in 1970 if this was seen as a possible outcome.

The excruciating absurdity of SIPC's handling of this debacle, and the Stanford one, after failure upon failure of the regulatory powers to quickly identify and dismantle these frauds before they reached these magnitudes makes this situation all the more surreal and horrifying.

The implications, however, are potentially devastating to all investors and the financial markets. SIPC and the Trustee have effectively destroyed for all investors the sanctity of their investment statements – the one and only item every investor has to demonstrate their ownership of a security. By their actions, they have said that the Trustee can choose to void from any protection any of the interest or growth of their investment at a broker-dealer. That the Trustee, at his whim, can deduct funds withdrawn to pay necessary living expenses in retirement, for taxes, or medical costs from any amounts ordinarily eligible for protection. Or worse, sue, without consequence, a retiree for innocently withdrawing funds from their accounts for the mere purposes of "living".

Instead of enhancing safety and protection, encouraging saving for retirement in registered broker-dealers, SIPC, in complete defiance of Congressional intent has said that when it suits their purposes, "investor be damned". In this new SIPC-world, what investor in their right mind might could possibly trust that SIPC would be there to protect them, or worse, not sue them? What are the public policy implications of investors seeing their protection reduced during their non-working retirement years just when they're drawing on their life's savings, ironically when they are least capable of reinventing themselves and re-enter the workforce should disaster strike.

In this new SIPC world, every investor who is living on investment income might be well-advised to participate in an extreme version of musical chairs by pulling their assets from their existing brokerage firm where their SIPC "net equity" protection may have been reduced by any withdrawals, and move them to another firm where their new "net equity" will be reset to the amount they are depositing at the new firm.

Speaking as a financial professional for 27 years, I'm troubled and deeply embarrassed that the NASD-FINRA and SEC failed on so many occasions to identify this fraud and others. I'm embarrassed and saddened that investment professionals in firms in my industry who had reason to believe that a fraud was taking place, chose instead to keep quiet and the industry has failed to make a well-publicized statement about the moral responsibility we each have to speaking up.

But I am especially troubled, and infuriated -- as are many of my fellow financial practitioners -- that SIPC has refused to honor their very purpose: to protect investors, and instead done everything in their power to circumvent those responsibilities. Indeed, they refused to go to Congress preemptively regarding this issue (nor over New Times, Old Naples and other cases with similar issues over the years), asserted the falsehood that SIPC advances would reduce payments to other investors, and audaciously trumpeted ludicrous scenarios through the halls of Congress to cloak their behaviors. They have thumbed their noses at Congress and the American public. Unfortunately, SIPC seems to have a history of doing whatever they can to thwart investors when there is sufficient vagary in the SIPA law or rules to do so and like bullies, done so with relative impunity. Finally, under the spotlight, the dangers their actions pose to our financial system by undermining investor protection, and the opaque culture from which these attitudes evolve may become more visible for Congress and policy-makers to observe

Fortunately, the solution to this horror is simple and here before us. HR 3482 – The Restoring Main Street Investor Protection Act of 2013 -- is an important step to restoring the most basic protections intended by Congress in 1970 and in subsequent legislation. It affirms the validity and certainty of the investment statement much as a bank customer's statement would. It prevents the clawback of innocent investors in a failed brokerage. It prevents a Trustee from becoming a go-to profit machine operating under SIPC's will. It insists that the SEC does, in fact, have the plenary authority over SIPC it is supposed to have.

This bill's assurances should be welcome news for all investors. But no assurances can be readily embraced without keeping to past promises. It can't return all the funds stolen, but in providing relief for victims of Madoff, Stanford, McGinn-Smith and other brokerage failures, this legislation makes evident Congress' intention of enhancing protections for all brokerage customers, putting Main Street first, and rebuilding confidence in the financial markets. I would hope the investment professionals and the financial services industry would see the benefit of standing with their customers in supporting this legislation, that the SIPC insurance protection they purchase for their clients is meaningful, and not worthless paper.

We don't know when the next great fraud or failure will take place, and we should undertake every reasonable measure to minimize that likelihood. There is much more to do, and I would be pleased to help the Committee with those at another time. The first step, however, is passing HR3482, and sticking to the promise we make every day to millions of small investors who depend on their brokerage firm, investment advisors, and investor protection regime for their life's savings.

My deepest thanks to you, Mr. Chairman, for your willingness to have me testify and your leadership regarding this extremely important work; and my sincere thanks as well to all your colleagues – including Congresswoman Maloney, and all the other sponsors of this legislation – who are undertaking to improve protections for all investors at this most basic, yet critical level.

Ron Stein, CFP
President
Network for Investor Action and Protection

FINANCIAL SERVICES INSTITUTE

VOICE OF INDEPENDENT FINANCIAL SERVICES FIRMS AND INDEPENDENT FINANCIAL ADVISORS

STATEMENT FOR THE RECORD

On

The U.S. House Committee on Financial Services,
Subcommittee on Capital Markets and Government Sponsored Enterprises

"A Legislative Proposal to Amend the Securities Investor Protection Act"

November 21, 2013

FINANCIAL SERVICES INSTITUTE — VOICE OF INDEPENDENT FINANCIAL SERVICES FIRMS AND INDEPENDENT FINANCIAL ADVISORS

Statement of the Financial Services Institute
To the Subcommittee on Capital Markets and Government Sponsored Enterprises
For Oversight Hearing on
A Legislative Proposal to Amend the Securities Investor Protection Act

Summary
The Financial Services Institute (FSI) has been advocating for Main Street American investors, along with the independent financial services firms and financial advisors that serve them, for nearly a decade and has the utmost sympathy for the victims of the Madoff and Stanford Ponzi schemes. Any criminal who takes advantage of investors deserves retribution, and the victims deserve restitution.

We oppose the Restoring Main Street Investor Protection and Confidence Act (H.R. 3482) because of the detrimental unintended consequences hard-working Americans may face as a result of this legislation. The costs incurred by financial services firms as a result of this legislation will ultimately be passed down to innocent Main Street investors, making saving for retirement, paying for their children's education, and taking care of aging parents even more difficult. The proposed legislation would expand SIPC's role beyond what was initially intended and would result in a disproportional negative impact on Independent Broker-Dealer firms and their employees who had no part of either of these Ponzi schemes.

While we cannot support the bill in its current form, we look forward to working with Congress as it takes up the important issue of SIPC reform.

Introduction
The Financial Services Institute (FSI) was founded in 2004 with a clear vision and mission: to ensure that all individuals have access to competent and affordable financial advice, products and services delivered by a growing network of independent financial advisors and independent financial services firms. FSI's members comprise independent broker-dealers (IBDs) and their independent contractor registered representatives. FSI has over 100 broker-dealer member firms with more than 138,000 affiliated registered representatives who serve more than 14 million American households. FSI also has more than 35,000 independent financial adviser members.

We are very sympathetic to the victims of the Madoff and Stanford Ponzi scheme. However, we oppose the Restoring Main Street Investor Protection and Confidence Act (H.R. 3482) because, in its effort to compensate the victims of these crimes, it creates negative unintended consequences for the owners, employees, and financial advisors of the IBDs we represent, which will in turn impact Main Street investors.

FSI's members provide affordable financial services to Main Street, middle-class Americans and their ability to do so is threatened by the bill's effort to expand the Securities Investor Protection

Act (SIPA) to cover the victims of recent and future Ponzi schemes. Since its enactment in 1970, SIPA has been understood to protect investors against the loss of their funds and most types of securities in the event of the failure of their broker-dealer. It was not intended and has not been understood to provide protection against the fraudulent creation and marketing of securities.[1]

All registered broker-dealer firms are required by SIPA to be members of SIPC and each SIPC member firm is required to contribute SIPC assessments in an amount that is a function of two variables: (i) the level of the broker-dealer's net operating revenues, and (ii) the total payments that SIPC has been required to make to all investors nationwide whose property was lost due to the failure of their broker-dealer.

As SIPA has been applied for decades, the assessments levied on registered broker-dealer members of SIPC were bearable, and the system worked well, providing limited relief to the customers of bankrupt brokers. However, in recent years, the negative financial and investing climate has exacerbated the drain on SIPC's resources and, consequently, SIPC assessments on all registered broker-dealers, including FSI's member firms, have grown substantially. In its current form, H.R. 3482 would compound these challenges by introducing a revolutionary expansion of SIPA, driving up SIPC assessments that would have a devastating impact on independent broker-dealers and financial advisors and have detrimental unintended consequences for Main Street investors.

SIPC Coverage Was Never Intended to Pay Customers Fraudulent Returns

SIPA was passed in 1970 to address concerns with the substantial contraction that hit the securities industry in 1969 to1970. Following a great expansion during the 1960's, the contraction led to brokerage firms engaging in voluntary liquidations, mergers, receiverships, and bankruptcies. Sometimes the cash and securities that customers had deposited with these firms would be tied up in lengthy bankruptcy hearings, and Congress sought to address mounting customer losses and the erosion of investor confidence. SIPA created a new form of liquidation proceeding for brokerage firms that would quickly return customer property and address situations where a solvent firm had an open transaction with a firm that had failed.[2]

The proposed legislation expands SIPC's role in the financial system beyond its intended purpose, its capabilities and its appropriate role, particularly given the power and responsibilities of other agencies such as the SEC. The SEC's civil enforcement authority is aimed at punishing wrong-doers and making investors whole while SIPC's role is to provide short-term stability in the event of the failure of a broker-dealer. To use the SIPC fund to pay investors fraudulent returns is to broaden it beyond its original regulatory scope, which was to insure investment assets were available in the event a firm failed. SIPC and the SIPC fund were intended to provide investors the assurance

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[1] SIPC's website reflects the societal understanding that its function does not include providing general protection against investment fraud:

> "Insurance" for investment fraud does not exist in the U.S. The Federal Trade Commission, Federal Bureau of Investigation, state securities regulators and other experts have estimated that investment fraud in the U.S. ranges from $10-$40 billion a year...With a reserve of slightly more than $1 billion, SIPC could not keep its doors open for long if its purpose was to compensate all victims in the event of loss due to investment fraud.

http://www.sipc.org/Who/NotFDIC.aspx (last accessed November 18, 2013). The current version of H.R. 3482 would put SIPC on track to do exactly that.

2 See http://www.uscourts.gov/FederalCourts/Bankruptcy/BankruptcyBasics/SIPA.aspx.

that the failure of a firm would have a limited impact on the value of their investments. Additionally, the SIPC fund allowed many smaller broker-dealers to enter the business, as customers did not need to become an expert on the financial risks to the broker-dealer firm and could instead focus on making prudent and informed investment decisions.

The legislation as proposed would have numerous detrimental unintended consequences. First and foremost, Section 2(a) provides that a customer's net equity would be determined using the last account statement received by the customer. This would expand SIPC coverage beyond the actual investment of principal to cover sham investment returns. This could incentivize fraudsters who know their Ponzi scheme is unraveling to create final statements reflecting returns that maximize SIPC coverage. Furthermore, the fraud exceptions contained in the proposed legislation eliminate coverage for victims who knew of the fraud. This exception would have the unintended consequence of discouraging customers who are receiving unrealistic returns from questioning the validity of the investment so as to remain unaware of the fraud, thus preserving their SIPC coverage.

<u>IBDs were not Part of the Problem and are Disproportionately Impacted by Increased Assessments</u>

It is clear that independent broker-dealer (IBD) firms were not part of the problems that created the most recent financial crisis. In fact, neither Madoff nor Stanford were registered with IBD firms. Yet, these same firms are disproportionately bearing the burden of the failures that resulted in the crisis through the imposition of significant and unanticipated increases in SIPC assessments. The failure of Lehman Brothers and others have placed an enormous burden on IBD firms. Prior to 2009, SIPC assessments were at the very minimum, $150 per year. In fact, this had been the practice for so long that our members had developed a reasonable expectation that the cost would remain at that level for the foreseeable future.

Since 2009, SIPC assessments have increased exponentially and without warning causing a significant blow to IBDs, making already difficult economic circumstances even more challenging. We include below three examples to illustrate the level of assessments borne by a typical small, mid-size and large independent broker-dealer from 2008 through 2012.

- A small FSI member firm located in the Southeastern United States, with approximately $27.3 million in revenues in 2012, had the following SIPC assessments from 2008 to 2012:
    - 2008 - $150
    - 2009 – $12,050 – an increase of 7,933.3% from the prior year
    - 2010 - $22,417 – an increase of 86% from the prior year
    - 2011 - $34,891 – an increase of 55.7% from the prior year
    - 2012 - $38,488 - an increase of 10.3% from the prior year
- A mid-size FSI member firm in located in the Southeastern United States, with revenues of $98.9 million in 2012, had the following SIPC assessments from 2008 to 2012:
    - 2008 - $150
    - 2009 - $63,615 – an increase of 42,310% from the prior year
    - 2010 - $98,295 – an increase of 54.5% from the prior year
    - 2011 - $113,366 – an increase of 15.3% from the prior year
    - 2012 - $118,831 – an increase of 4.8% from the prior year
- A large FSI member firm in the Northeastern United States with approximately $711 million in revenue in 2011, had the following SIPC assessments from 2008 to 2011:
    - 2008 - $150

- 2009 - $486,714 – an increase of 324,376% from the prior year
- 2010 - $795,174 – an increase of 63.4% from the prior year
- 2011 - $835,763 – an increase of 5.1% from the prior year
- 2012 - $995,606 – an increase of 19% from the prior year

Profit margins for IBD firms are low, at least in part, because the vast majority of these firms' revenues are in the form of commission and fee payments which pass through the broker-dealer to the financial advisor in compensation for the advice, products and services the financial advisor provides to investors. From 2006 to 2012, the average annual profit margin for IBD firms was 2.0%. SIPC assessments are likely to remain high for the foreseeable future, especially with recent developments involving a court battle between the SEC and SIPC to determine coverage for victims of the Stanford Ponzi scheme and the failure of MF Global currently progressing through SIPC liquidation.

These assessments are having a disparate impact on small IBD firms which do not have the resources to absorb the large and unexpected increase in fees. Furthermore, many IBD firms operate as dual registrants conducting both investment advisory and securities brokerage operations under a single corporate entity. Small firms are organized in this manner to reduce costs and simplify their business operations, which allows them to service Main Street investors. This structure results in additional complications due to the fact that when investment advisory services are segregated into a separate corporate entity they are excluded from SIPC assessments, but are included when they occur under the same corporate entity as the brokerage services. IBD firms should not be penalized simply for choosing a more efficient business structure that helps lower their costs.

Another reason IBD firms are shouldering a disproportionate share of the burden is that IBD firms present a significantly lower risk of causing SIPC payouts because they operate as introducing brokers. As such, they are prohibited from obtaining custody of investor funds and securities, and therefore receive no cash or securities from investors other than for transmittal purposes. Instead, checks are made payable directly to the product sponsor and accounts are held, and securities transactions are processed, through clearing firms. The risk to investors is significantly less in this model and, thus, the risk of an adverse event requiring SIPC liquidation is also lower.

In addition, the vast majority of IBD firms do not sell proprietary securities or insurance products. Those IBD firms who do engage in proprietary product sales are usually subsidiaries of large, heavily regulated insurance companies and typically do not offer their financial advisors preferential compensation for the sale of those products. Proprietary products are often the vehicle through which those who perpetrate financial fraud, like R. Allen Stanford, gain access to investor funds. Even if SIPC were interpreted to cover losses due to the Stanford fraud, the structure of the typical IBD firm lowers the risk of these types of SIPC payouts.

Effects of Increased SIPC Assessments on Main Street Investors

The results of excessively high SIPC assessments will continue to be predictable – the failure of small IBD firms. In 2008, there were more than 5,000 broker-dealer firms. In 2013 that number has fallen to fewer than 4,200, with approximately 175 broker-dealer firms failing in 2009 alone, the first year of the increased assessments.

The most significant impact that the loss of IBD firms will have is decreased access to financial advice, services and products for Main Street investors seeking to save for retirement and their children's education. Small IBD firms and the independent financial advisers associated with them typically provide financial services and products to middle-class investors that are not served by larger firms. These investors need access to quality financial advice, products and service every bit as much as wealthier investors. However, many of these investors are unable to access these products and services through large wire house firms, which often find servicing smaller accounts unprofitable. Without the small IBD firms and their associated independent financial advisors providing local access to financial advice, less affluent investors will be left to their own devices to achieve their financial goals.

In addition to the impact on access to affordable advice for Main Street investors, the failure of small IBD firms will have a significant impact on innovation within the securities industry. Smaller IBD firms are a significant source of industry innovation. With profit margins generally very slim, small IBD firms have incentives to consistently develop new methods of efficiently and effectively meeting their regulatory obligations, while at the same time providing the financial advice and services that Main Street Americans need and demand. These innovations often are adopted by others in the industry and become industry best practices. The excessively high SIPC assessments will lead to not only failures of small IBD firms, but also to reduced investment in new resources and innovation – including the hiring and training of new employees, acquisition of new equipment, and development of software – among remaining IBD firms.

The Restoring Main Street Investor Protection and Confidence Act would further exacerbate these problems by insuring the continuation of heightened SIPC assessments for years to come. In addition, the bill introduces a moral hazard into the SIPC system by creating perverse incentives for investors to take risks on schemes that sound too good to be true.

A Better Approach

FSI believes that true SIPC modernization is necessary. However, SIPC will not be improved by expanding coverage to the victims of fraud. SIPC modernization requires a system that provides speedy recovery in a smooth and orderly process to securities investors whose broker-dealer has failed. This process should emphasize returning funds to investors, rather than unjustly enriching trustees and attorneys. In order to be equitable, such a system should impose the greatest cost for maintaining the system on those that present the greatest risk. This system must also provide broker-dealers with greater predictability so that they can budget appropriately for the costs. The system must avoid imposing a disproportionate impact on IBD or other small firms. Finally, clear and consistent application of SIPA, enhanced investor disclosures concerning the role of SIPC and even a name change, intended to avoid subconscious associations with FDIC insurance, would help alleviate investor confusion concerning the fund's purpose. FSI stands ready to work with Congress to develop a SIPC reform bill that achieves these important goals.

We thank the Subcommittee for holding this hearing and for the work it is doing to address these issues. Please contact David T. Bellaire, Esq., FSI's General Counsel & Director of Government Affairs at 202 803-6061 or david.bellaire@financialservices.org if you would like more information on the Financial Services Institute and our position on this important issue.

Background on FSI and the Independent Broker-Dealer Community

The IBD community has been an important and active part of the lives of American investors for more than 30 years. The IBD business model focuses on comprehensive financial planning services and unbiased investment advice. IBD firms also share a number of other similar business characteristics. They generally clear their securities business on a fully disclosed basis; primarily engage in the sale of packaged products, such as mutual funds and variable insurance products; take a comprehensive approach to their clients' financial goals and objectives; and provide investment advisory services through either affiliated registered investment adviser firms or such firms owned by their registered representatives. Due to their unique business model, IBDs and their affiliated financial advisors are especially well positioned to provide middle-class Americans with the financial advice, products, and services necessary to achieve their financial goals and objectives.

In the U.S., approximately 201,000 financial advisors – or 64% percent of all practicing registered representatives – operate as self-employed independent contractors, rather than employees of their affiliated broker-dealer firm.[3] These financial advisors provide comprehensive and affordable financial services that help millions of individuals, families, small businesses, associations, organizations, and retirement plans with financial education, planning, implementation, and investment monitoring. Clients of independent financial advisors are typically "main street America" – it is, in fact, almost part of the "charter" of the independent channel. The core market for advisors affiliated with IBDs is clients who have tens and hundreds of thousands, as opposed to millions, of dollars to invest. Independent financial advisors are entrepreneurial business owners who typically have strong ties, visibility, and individual name recognition within their communities and client base. Most of their new clients come through referrals from existing clients or other centers of influence.[4] Independent financial advisors get to know their clients personally and provide them investment advice in face-to-face meetings. Due to their close ties to the communities in which they operate their small businesses, we believe these financial advisors have a strong incentive to make the achievement of their clients' investment objectives their primary goal.

FSI is the advocacy organization for IBDs and independent financial advisors. Member firms formed FSI to improve their compliance efforts and promote the IBD business model. FSI is committed to preserving the valuable role that IBDs and independent advisors play in helping Americans plan for and achieve their financial goals. Our mission is to insure our members operate in a regulatory environment that is fair and balanced. FSI's advocacy efforts on behalf of our members include industry surveys, research, and outreach to legislators, regulators, and policymakers. We also provide our members with an appropriate forum to share best practices in an effort to improve their compliance, operations, and marketing efforts.

[3] Cerulli Associates at http://www.cerulli.com/.

[4] These "centers of influence" may include lawyers, accountants, human resources managers, or other trusted advisors.

United States General Accounting Office

GAO

Report to Congressional Requesters

September 1992

SECURITIES INVESTOR PROTECTION

The Regulatory Framework Has Minimized SIPC's Losses

GAO/GGD-92-109

GAO United States
General Accounting Office
Washington, D.C. 20548

General Government Division

B-248152

September 28, 1992

The Honorable Donald W. Riegle, Jr.
Chairman, Committee on Banking,
Housing, and Urban Affairs
United States Senate

The Honorable John D. Dingell
Chairman, Subcommittee on Oversight
and Investigations
Committee on Energy and Commerce
House of Representatives

This report responds to your requests that we review the operations and solvency of the Securities Investor Protection Corporation (SIPC). It discusses how the regulators' success in protecting customers depends upon the quality of regulatory oversight of the securities industry. We also provide recommendations to improve Securities and Exchange Commission (SEC) and SIPC disclosures to customers and SEC's oversight of SIPC's operations.

We will send copies of this report to the Chairman, SIPC; the Chairman, SEC; appropriate congressional committees and subcommittees; and other interested parties. We will also make copies available to others upon request.

This report was prepared under the direction of Craig A. Simmons, Director, Financial Institutions and Markets Issues, who may be reached on (202) 275-8678 if there are any questions concerning the contents of this report. Other major contributors to this report are listed in appendix IV.

Richard L. Fogel
Assistant Comptroller General

Executive Summary

Purpose

Congress created the Securities Investor Protection Corporation (SIPC) in 1970 after a large number of customers lost money when they were unable to obtain possession of their cash and securities from failed broker-dealers. SIPC was established to promote public confidence in the nation's securities markets by guaranteeing the return of property to small investors if securities firms fail or go out of business. SIPC is a member-financed, private nonprofit corporation with statutory authority to borrow up to $1 billion from the U.S. Treasury.

This report responds to requests by the Senate Banking Committee and the House Energy and Commerce Subcommittee on Oversight and Investigations that GAO report on several issues, including (1) the exposure and adequacy of the SIPC fund, (2) the effectiveness of SIPC's liquidation oversight efforts, and (3) the disclosure of SIPC protections to customers.

Background

The law that created SIPC also required the Securities and Exchange Commission (SEC) to strengthen customer protection and increase investor confidence in the securities markets by increasing the financial responsibility of broker-dealers. Pursuant to this mandate, SEC developed a framework for customer protection based on two key rules: (1) the customer protection rule and (2) the net capital rule. These rules respectively require broker-dealers that carry customer accounts to (1) keep customer cash and securities separate from those of the company itself and (2) maintain sufficient liquid assets to protect customer interests if the firm ceases doing business. In essence, SIPC is a back-up line of protection to be called upon generally in the event of fraud or breakdown of the other regulatory protections.

Except for certain specialized broker-dealers, all securities broker-dealers registered with SEC are required to be members of SIPC. Other types of financial firms that are involved in the purchase or sale of securities products, such as open-end investment companies and certain types of investment advisory firms, are not permitted to be SIPC members. As of December 31, 1991, SIPC had 8,153 members. Of this number, only 954 are authorized to receive and hold customer property. The rest either trade exclusively for their own accounts or act as agents in the purchase or sale of securities to the public. SEC and SIPC officials estimate that over $1 trillion of customer property is held by SIPC members.

SIPC is not designed to keep securities firms from failing or, as in the case of deposit insurance for banks, to shield customers from changes in the market value of their investment. Rather, SIPC has the limited purpose of ensuring that when securities firms fail or otherwise go out of business, customers will receive the cash and securities they own up to the SIPC limits of $500,000 per customer, of which $100,000 may be used to satisfy claims for cash. Thus, the risks to the taxpayer inherent in SIPC are less than those associated with the deposit insurance system.

SEC and self-regulatory organizations, such as the New York Stock Exchange, are responsible for enforcing the net capital and customer protection rules. However, if a firm is in danger of failing and customer accounts are at risk, SIPC may initiate liquidation proceedings. SEC and industry participants do not expect that SIPC's back-up role in liquidating firms should be needed very often, which both reduces SIPC's exposure to loss and minimizes potential adverse market impacts. SIPC liquidation proceedings can be quite complex, and it can take weeks or longer before customers receive the bulk of their property.

In the 20 years since its inception, SIPC has been called on to liquidate 228 firms, most of which have involved fewer than 1,000 customers. The revenues available to the SIPC fund have been sufficient to meet all liquidation and administrative expenses, which totaled $236 million. As of December 31, 1991, the accrued balance of the fund stood at $653 million, the highest level ever. After conducting a review of its funding needs, SIPC adopted a policy to increase its reserves to $1 billion by 1997. SIPC and SEC officials believe that reserves of this level, augmented by bank lines of credit of $1 billion and also by a $1 billion line of credit at the U.S. Treasury, will be more than sufficient to fulfill its back-up role in protecting against the loss of customer property.

Results in Brief

The regulatory framework within which SIPC operates has thus far been successful in protecting customers while at the same time limiting SIPC's losses. However, complacency regarding SIPC's continuing ability to be successful is not warranted because securities markets have grown more complex and the SIPC liquidation of a large firm could be very disruptive to the financial system. The central conclusion of this report—that SIPC's funding requirements and market stability depend on the quality of regulatory oversight of the industry—underscores the need for SEC and self-regulatory organizations to be diligent in their oversight of the industry and their enforcement of the net capital and customer protection rules.

No objective basis exists for setting the right level for SIPC reserves, but GAO believes that efforts to plan for the SIPC fund's future needs by increasing SIPC's reserves represent a responsible approach to dealing with the fund's potential exposure. However, in view of the industry's dynamic nature, SIPC and SEC must make periodic assessments of the fund to adjust funding plans to changing SIPC needs. In particular, measures to strengthen the fund must be taken immediately if there is evidence that the customer protection and net capital rules are losing effectiveness.

While SIPC generally has received favorable comments from securities regulators and industry officials on its handling of past liquidations, it could do more to prepare for the potential liquidation of a large firm. SIPC's readiness to respond quickly by having the information and automated systems necessary to carry out a liquidation is important for the timely settlement of customer claims. The impact upon public confidence in the securities markets may be important in the liquidation of a large firm with thousands of customers.

SIPC and SEC could provide the public with more complete information about the nature of SIPC coverage. Certain SEC-registered firms that are not SIPC members, including some investment advisers, may act as intermediaries in the purchase and sale of securities to the public and have temporary access to customer funds. These firms are not required to disclose the fact that they are not SIPC members, even though their customers are subject to the risks of loss and misappropriation of their funds and securities. Better disclosure is needed so that customers can make informed investment decisions.

GAO's Analysis

Strong Enforcement Is the Key to Continued Success in Protecting Customers

To date, SIPC's role in providing back-up protection for customers' cash and securities has worked well. The securities industry has faced many difficult challenges since SIPC's inception, such as major volatility in the stock markets and numerous broker-dealer failures (including two of the largest securities firms within the past 3 years). Since 1971, more than 20,000 broker-dealers have failed or ceased operations, but SIPC has initiated liquidation proceedings for only 228—about 1 percent—of these firms. (See p. 22.)

Most firms involved in SIPC liquidations failed due to fraudulent activities. Within the last 5 years, 26 of 39 SIPC liquidations have involved failures due to fraud by firms that were acting as intermediaries between customers and firms authorized to hold customer accounts. Most firms that cease operations do not require a SIPC liquidation because they do not carry customer accounts, customer accounts are fully protected, or they and/or the regulators have made alternative arrangements to protect the customer accounts. (See pp. 29-31.)

In the future, SIPC losses can remain modest if SEC and self-regulatory organizations continue to successfully oversee the securities industry. But complacency is not warranted, and securities markets could be significantly disrupted if the enforcement of the net capital and customer protection rules proved insufficient to prevent a SIPC liquidation of a large securities firm. In that instance, customers of the firm could experience delays in obtaining access to their funds. In addition, the development of new products and the increasing risks associated with the activities of many of the larger securities firms pose special challenges to the regulators. (See pp. 36-39.)

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.)

Improve SIPC Preparation for Liquidating a Large Firm

SIPC liquidations may involve delays and can expose customers to declines in the market value of their securities. To minimize delays, in the early 1980s a SIPC task force and SEC recommended that SIPC prepare for potential liquidations of large firms. However, SIPC continues to make only limited preparations for the potential liquidations of large troubled firms. SIPC believes it is unlikely it will ever be called on to liquidate a large firm and cites its record of success as demonstrating its ability to liquidate any firm. (See pp. 54-57.)

GAO has no reason to question the way SIPC has conducted liquidations. However, those liquidations have all been of relatively small firms. GAO is concerned that lack of preparation and planning may limit SIPC's ability to ensure the prompt return of customer property in the event it was called on to liquidate a large, complex firm. SIPC could have been better prepared to conduct the liquidation of a large firm that could have become a liquidation in 1989. In addition, SIPC has not analyzed automation options and may be limited in its ability to ensure that the trustee of a major liquidation would be able to acquire a timely and cost-effective automation system. Working with SEC, SIPC should improve its capabilities in these areas. (See pp. 57-61.)

Improve Disclosure to Customers

SIPC-member broker-dealers are required to display a SIPC symbol to notify their customers that they are SIPC members. They are also encouraged to provide customers with a brochure that explains SIPC protection. GAO believes that this brochure could be modified to clarify areas of confusion that have been raised by customers—for example, that customers of firms that fail or go out of business have only 6 months to file a claim. (See pp. 65-67.)

However, the greatest opportunity for customer confusion arises from SEC-registered firms that act as intermediaries in the purchase and sale of securities products to customers. These firms include some SIPC-exempt broker-dealers and certain types of investment advisory firms. These firms may have temporary access to customer property but are not required to disclose that they are not SIPC members. Some customers have purchased securities from nonmember intermediaries that were affiliated or associated with SIPC firms and were not protected by SIPC when the intermediary firm failed. Customers of these intermediary firms risk loss of their property by fraud and mismanagement. GAO believes that customers should receive information on the SIPC status of SEC-registered intermediary firms that have access to customer funds and securities so that they can make informed investment decisions. (See pp. 67-72.)

Recommendations

The chairmen of SIPC and SEC should periodically review the adequacy of SIPC's funding arrangements (see p. 53). The chairmen should also work with self-regulatory organizations to improve SIPC's access to the information and automated systems necessary to carry out a liquidation of a large firm on as timely a basis as possible. In addition, the SEC Chairman should periodically review SIPC operations to ensure that SIPC liquidations are timely and cost effective (see p. 62).

Finally, the chairmen of SIPC and SEC, within their respective jurisdictions, should review and, as necessary, improve disclosure information and regulations to ensure that customers are adequately informed about the SIPC status of SEC-registered financial firms that serve as intermediaries in customer purchases of securities and have access to customer property (see p. 72).

Agency Comments

SEC and SIPC provided written comments on a draft of this report (see apps. II and III). SEC and SIPC agreed with GAO's assessment of the condition of the SIPC fund and with GAO's recommendation for periodic evaluation of the fund's adequacy. SEC also agreed with GAO's recommendations to improve its oversight of SIPC's operations and to consider some expansion of SEC disclosure regulations. SIPC agreed with GAO's recommendation to improve SIPC disclosures to customers. SEC and SIPC did not believe that problems exist in obtaining information or acquiring automated liquidation systems, but they agreed to review their policies and consider GAO's recommendations in these areas.

Russell, Chris

From: Stephen P. Harbeck <sharbeck@sipc.org>
Sent: Thursday, May 21, 2009 11:31 AM
To: Dean_Shahinian@banking.senate.gov; Hester_Peirce@banking.senate.gov; Kara_Stein@reed.senate.gov; William_Henderson@bunning.senate.gov; Roberson, Peter; Edgar, Kevin; Harper, Todd; Russell, Chris; sylvis.stanojev@mail.house.gov
Cc: Josephine Wang; Collins, John
Subject: Proposed Amendments to the Securities Investor Protection Act

Ladies and Gentlemen:

On May 8, 2009, I forwarded suggested amendments to the Securities Investor Protection Act ("SIPA") to your attention. Prominent among those suggested amendments is a provision which would reestablish parity of cash protection for brokerage firm customers with the protection afforded to bank depositors by the Federal Deposit Insurance Corporation ("FDIC").

I understand that the Helping Families Save Their Homes Act has extended FDIC protection of bank deposits of up to $250,000 until 2013.

I respectfully request that customers of SIPC member brokerage firms be given the same level of protection available to bank depositors, and urge the immediate consideration of the suggested amendments to SIPA.

Should you have any questions, please feel free to contact me at sharbeck@sipc.org, or Josephine Wang, SIPC's General Counsel, at jwang@sipc.org, or at the telephone number below.

Very truly yours,

Stephen P. Harbeck

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ANSWERS OF STEPHEN P. HARBECK, PRESIDENT, SECURITIES INVESTOR PROTECTION CORPORATION ("SIPC"), TO QUESTIONS FOR THE RECORD BY THE HONORABLE RANDY HULTGREN, IN CONNECTION WITH THE NOVEMBER 21, 2013, OVERSIGHT HEARING OF SIPC, BEFORE THE HOUSE COMMITTEE ON FINANCIAL SERVICES

This is in response to the additional questions submitted on December 4, 2013 by Representative Randy Hultgren to Stephen P. Harbeck, President of the Securities Investor Protection Corporation, for the record of the November 21, 2013 SIPC Oversight Hearing.

Background Information

Representative Hultgren's questions involve amendments to Securities and Exchange Commission ("SEC" or "Commission") Rule 17a-5(d)(6), 17 C.F.R. §240.17a-5(d)(6) (Broker-Dealer Reports, Exchange Act Release No. 34-70073, 78 Fed. Reg. 51910 (Aug. 21, 2013)). Before its amendment in 2013, Rule 17a-5(d)(6) required the annual audit report prepared for a broker-dealer by an independent public accountant to be filed with the SEC, and a copy of the report to be provided to each self-regulatory organization ("SRO") of which the broker-dealer was a member. As amended, the Rule requires SIPC member broker-dealers to file copies of their annual reports with SIPC.

For more than sixty years, under SEC Rule 17a-5, the Commission has required securities broker-dealers to report on their financial condition and to have the reports audited by independent certified or public accountants. The accountant's representations as to the audit ensure the safeguarding of customers' securities and over the years, have provided the Commission and SROs with an early warning that the assets of customers may be at risk due to the financial condition of a brokerage firm.

In 1970, the protection of customers was strengthened by Congress's enactment of the Securities Investor Protection Act ("SIPA"). In addition to providing for a specialized form of liquidation proceeding, SIPA required the SEC to identify and eliminate unsafe and unsound practices of broker-dealers. From the latter requirement, there followed two measures to upgrade broker-dealers' financial responsibility requirements: (1) a tightening of the Commission's net capital requirements; and (2) the adoption by the Commission of a customer reserve requirement.

The certified audit of a broker-dealer ensures, as a primary purpose, compliance with these upgraded financial responsibility requirements. The audit report includes detailed information regarding net capital and customer reserve compliance. Under SIPA, the Commission and the SROs must notify SIPC of any member broker-dealer's failure to comply with the requirements. A failure to comply by a member may be grounds for a liquidation. Thus, the Commission's requirements serve to minimize the misuse or loss of customer assets and reduce the likelihood of the liquidation of a firm under SIPA -- an outcome that the Supreme Court has stated should be a "last resort."

Questions and Answers

1. *Regarding the Securities and Exchange Commission's (SEC) final rule (Release No. 34-70073; File No. S7-23-11) adopted in July, has the Securities Investor Protection Corporation's (SIPC) ability to assess the financial health of a broker dealer been restricted by having to request the annual report from the SEC? Under the new rule, how will the annual reports received directly from broker dealers by SIPC be reviewed?*

SIPC is not a government agency and it has no authority to investigate or to regulate its member broker-dealers. Whether customer assets are properly segregated by broker-dealers is monitored by the Commission and the SROs of which the broker-dealer is a member. The annual audited financial report prepared by an independent public accountant helps to ensure that broker-dealers meet the financial responsibility requirements established by the Commission for safeguarding customer assets. A proper audit report enables early detection that a firm is in financial trouble and customer assets are at risk. SIPC funds and, ultimately, taxpayer funds which may be drawn upon should the SIPC Fund become inadequate, would be compromised if a liquidation proceeding becomes necessary because an auditor has failed to perform properly his functions. Filing a copy of the audit report with SIPC offers an extra layer of protection for investors and a safety net for SIPC and the U. S. taxpayer against otherwise avoidable expenditures of their funds.

SIPC will review an audit report to determine whether the independent public accountant has concluded that its report was unqualified, qualified, or adverse. In the event of a qualified or adverse audit report, SIPC will notify the Commission and the appropriate SRO, and request investigation of the broker-dealer if an investigation has not already been initiated.

2. *What steps has the SIPC made to process and evaluate the annual reports of member broker-dealers that will be delivered to the SIPC when the new rule takes effect? Has the SIPC had to redirect resources? Will there be demands for additional resources?*

Upon receipt of an audit report, SIPC's membership staff will log receipt of the audit report into SIPC's database. The report will be provided to SIPC's operations staff, who will review each audit report to determine whether the report was unqualified, qualified, or adverse. Any qualified or adverse audit report will be reported to SIPC's Vice President-Finance, and SIPC's Vice President-Operations. In the event of a qualified or adverse audit report, SIPC's Vice President-Finance will notify the Commission and the appropriate SRO, and request investigation of the broker-dealer if an investigation has not already been initiated.

SIPC has not had to redirect any resources as a result of the rule amendment, and does not anticipate any demands for additional resources.

3. *If the SIPC is concerned with the financial health of a member, what powers does the SIPC have to further investigate the member firm?*

SIPC is not a regulatory organization, and it does not have the power to investigate its member broker-dealers. Rather, pursuant to provisions of SIPA, SIPC relies upon the Commission and the SROs to investigate the firms, and, where appropriate, to notify SIPC if a firm is in or is approaching financial difficulty.

4. *Has the SIPC historically monitored individual firm fitness? What corrective powers does SIPC have to improve the financial health of a member?*

SIPC is not a regulatory organization, and it does not monitor the financial fitness of its member firms. Should SIPC nevertheless become aware that a firm may be in financial trouble, it refers the matter to the appropriate regulatory or self-regulatory authority for investigation.

5. *Did the SIPC ask the SEC for expanded lawsuit ability? Why did the SIPC not approach Congress requesting expanded authority? Did the SIPC or the SEC determine that the SEC had the authority to expand the SIPC's ability to sue through regulation? May we have a copy of that determination?*

Negligence or other misconduct by the independent public accountant in the performance of the audit and in the preparation of the audit report facilitates and deepens the loss suffered by investors at the hand of unscrupulous broker-dealers. SIPC ultimately bears the cost of such negligence, and in fewer than a dozen cases over more than forty years, has had to sue to recover its losses. SIPC has the power to bring such actions pursuant to 15 U.S.C. section 78ccc(b)(1) and, thus, has not asked Congress for any expanded statutory authority.

Prior to amendment of the Rule, SIPC relied, based upon the filing of the audit reports with the Commission and SROs, on the information contained in the reports. In spite of that reliance, some, but not all, courts held such reliance to be insufficient for standing purposes. This enabled independent public accountants to avoid, merely on procedural grounds, any liability for grossly negligent conduct in performing the audit requirements. The amended Rule clarifies, rather than expands, SIPC's reliance on the work performed by the auditor.

The Commission's authority to amend the Rule is set forth in Exchange Act Release No. 34-70073. *See* Broker-Dealer Reports, 78 Fed. Reg. 51910, 51988 (Aug. 21, 2013). SIPC does not know whether the requested "determination" exists but if it does, SIPC does not have a copy.

6. *Did the SIPC or the SEC perform a cost-benefit analysis on the impact of these expanded authorities? May we have a copy of that analysis?*

SIPC did not perform a cost-benefit analysis. The Commission estimated, as part of its rulemaking process, that compliance by a broker-dealer with the amendment would require the cost of time necessary to copy and mail the report, and the cost of postage. The Commission further estimated that based on its experience, the preparation of a copy of the report and mailing to SIPC would be performed by a Financial Reporting Manager at an annual cost of $154.50. Finally, the Commission estimated that the broker-dealer would incur annual postage costs of $12.05. *See* Broker-Dealer Reports, 78 Fed. Reg. 51910, 51978 n. 819 (Aug. 21, 2013).

7. *Since the member assessment was raised in 2009, the SIPC has required broker-dealers to submit supplemental reports. What evidence led the SIPC to conclude that such information was inadequate to assess the financial health of broker-dealers? What additional information is provided in these reports? What is the additional cost of these supplemental reports for broker-dealers?*

When the SIPC assessment is other than a minimum assessment under SIPA, a broker-dealer must include with the audit report a supplemental report that is covered by the opinion of an independent public accountant on the status of the broker-dealer's membership in SIPC. *See* 17 C.F.R. 240.17a-5(e)(4). This requirement was instituted in 1972, by amendment to SEC Rule 17a-5, to ensure that member broker-dealers correctly calculate their SIPC assessment. The assessment represents a percentage of gross revenues minus various deductions. *See* Report of Securities Investor Protection Corporation Assessments, 37 Fed. Reg. 18909 (Sept. 16, 1972); *see also* Broker-Dealer Reports, 78 Fed. Reg. 51910, 51,927 (Aug. 21, 2013) (general discussion of the history of SEC Rule 17a-5(e)(4)). The need for the 1972 amendment grew out of discrepancies identified between information supplied to SIPC and information supplied to the SEC on which calculation of assessments was based. *See* Report of Securities Investor Protection Corporation Assessments, 37 Fed. Reg. 18909 (Sept. 16, 1972).

The supplemental report is unrelated to the recent amendment to Rule 17a-5(d)(6). The supplemental report regarding the SIPC assessment does not provide information regarding the financial health of a broker-dealer. It merely provides information covering the SIPC annual general assessment reconciliation, or exclusion from membership.

SIPC does not have information regarding the cost of preparing the supplemental report.

8. *Does the SIPC's demand for more information through supplemental reports reflect on the comprehensiveness of the annual reports that the SIPC and SEC have previously required? How?*

As indicated above, the supplemental report regarding the SIPC assessment does not provide information regarding the financial health of a broker-dealer. It merely provides information covering the SIPC annual general assessment reconciliation, or exclusion from membership. It includes an opinion of the independent public accountant on the status of the broker-dealer's membership in SIPC.

The 2013 amendment to Rule 17a-5(d)(6) simply requires that SIPC be an added recipient of the annual audit report that a broker-dealer already files with the Commission and its SRO(s). There is no additional information required to be produced by a broker-dealer.

9. *If the new rule makes it easier for the SIPC to sue for administrative expenses, please identify the different categories of administrative expense. Are there typical or average outlays for these different categories when administering a failed broker-dealer?*

SIPA liquidation proceedings typically are required because of the misappropriation of investors' securities and cash. Negligence or other misconduct by the independent public accountant in performing the audit requirements and failing properly to detect and warn of a broker-dealer's violations of financial responsibility rules could permit an unscrupulous broker-dealer to continue a scheme to misappropriate customer's securities and funds, and exacerbate the harm suffered by investors.

SIPC ultimately bears the cost of such negligence when it advances funds, in accordance with SIPA, to pay claims of customers who have suffered losses. SIPC advances for losses to customers typically range from about $2 million to $10 million, though occasionally can be much more significant.

10. *Under what circumstances would the SIPC seek reimbursement from accounting firms?*

Were an independent public accountant to be negligent or engage in misconduct in the performance of the audit requirements of a broker-dealer, SIPC could be adversely affected by having to expend funds to protect investors. Since the enactment of SIPA more than forty years ago, 328 broker-dealers have been the subject of SIPA liquidation proceedings for the protection of investors. In those 328 proceedings, SIPC has sued public accountants to recover losses in fewer than a dozen cases.

11. *Does the SIPC expect that filing annual reports with the SIPC will raise costs for accounting firms or broker-dealers? Will these costs be internalized or passed through to their clients?*

The amendment to Rule 17a-5(d)(6) merely provides that SIPC is to be an added recipient of the annual audit report that a broker-dealer must file with the Commission and its SRO(s). There is no additional information required to be produced by a broker-dealer, or the independent public accountant. The Commission estimates that compliance by a broker-dealer with the amendment would require the cost of time necessary to copy and mail the report, and the cost of postage. As previously noted, the Commission estimates that based on its experience, the preparation of a copy of the report, and mailing to SIPC, would be performed by a Financial Reporting Manager at an annual cost of $154.50. The Commission further estimates that the broker-dealer would incur annual postage costs of $12.05. SIPC does not know how the added costs would be absorbed, but if providing to SIPC a copy of the annual report causes accountants to be more careful in their audits, that is a salutary consequence for investors.

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