

**Statement
of
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President and CEO
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before the
Committee on Financial Services
U. S. House of Representatives**

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Chairman Frank, Ranking Member Bachus, and Members of the Committee, thank you for the opportunity to appear before you today to discuss the work of the Securities Investor Protection Corporation, known as SIPC. My name is Stephen Harbeck and I have been the President and CEO of SIPC for the past six years. I have worked at SIPC for 33 years and was General Counsel prior to my appointment as President and CEO.

SIPC was created under the Securities Investor Protection Act of 1970 ("SIPA") to provide specific financial protection to customers of failed securities broker-dealers. Although created under a federal statute, SIPC is not a government entity. It is a membership corporation, the members of which are, with very limited exceptions, all entities registered with the Securities and Exchange Commission ("SEC") as securities broker-dealers. Membership is not voluntary; it is required by law.

As a fundamental part of its statutory mandate, SIPC administers the SIPC Fund from which advances are made to satisfy claims of customers. The Fund is supported by assessments on SIPC member firms and its assets currently total \$1.6 billion. In addition, SIPC maintains a commercial line of credit with an international consortium of banks, and, by statute, has a \$1 billion line of credit with the United States Treasury.

SIPC has no authority to examine or investigate member firms. Those are the functions of the SEC and the Financial Industry Regulatory Authority which is a self-regulatory organization ("SRO") of the securities industry. When either of those entities or any other SRO informs SIPC that the customers of a brokerage firm are in need of the protections of SIPA, SIPC may initiate a customer protection proceeding to return to customers the contents of their securities accounts within specified limits. The proceedings are a specialized form of bankruptcy. A trustee and counsel are designated by SIPC, and appointed by the United States District Court, subject to a hearing on disinterestedness. The case is then referred to the appropriate Bankruptcy Court for all purposes.

To the extent securities or cash is missing from customer accounts, SIPC may use its funds, within limits, to restore customer accounts to the appropriate account balances. SIPC may advance up to \$500,000 per customer on account of missing securities, of which up to \$100,000 may be based upon a claim for cash. SIPC does not protect customers against market loss in an account. It is also important to note that customer property is never used to pay any of the administration expenses, such as fees of accountants, lawyers or even the trustee in a SIPA proceeding.

Through 2007, SIPC liquidated 317 brokerage firms, and returned over \$15.7 billion in cash or securities to customers. Of that sum, SIPC used \$322 million from the SIPC Fund to restore missing cash or securities. To date, SIPC has never used any government funds or borrowed under its commercial line of credit.

This year has been very different from anything in our past history. In addition to three smaller cases, SIPC has faced in recent months two unprecedented events: the initiation of liquidation proceedings for Lehman Brothers Inc. in September 2008, and the liquidation of Bernard L. Madoff Investment Securities LLC, in December. Both of those cases present significant challenges, but the two cases are very different.

Lehman Brothers Inc.

The Lehman Brothers Inc. ("LBI") liquidation was preceded by the Chapter 11 filing of Lehman Brothers Holdings Inc. on September 15, 2008. The Holding Company owned the SIPC member brokerage firm, LBI, which in turn held securities customer accounts. In order to facilitate the sale of brokerage assets, SIPC initiated a customer protection proceeding on Friday, September 19. On application by SIPC to the United States District Court for the Southern District of New York, LBI was placed in SIPA liquidation, James W. Giddens was appointed as trustee, and the law firm of Hughes Hubbard & Reed LLP was appointed as his counsel. That day, upon removal of the proceeding by the District Court, the United States Bankruptcy Court for the Southern District of New York held an extended hearing and approved the sale of assets of LBI to Barclays Bank.

Over the following weekend, the trustee for LBI transferred customer account positions, which contained \$142 billion in customer assets, to two broker-dealers, one of which was the brokerage arm of Barclays. As a result, many of the customers of the defunct firm were able to exercise control over their respective portfolios in a seamless way. While much remains to be done in every aspect of the LBI matter, the initial stages have proceeded very well.

Bernard L. Madoff Investment Securities LLC

The failure of Lehman Brothers Inc. was linked to the complex, systemic failure of the subprime mortgage situation. The failure of Bernard L. Madoff Investment Securities LLC, a registered securities broker-dealer and SIPC member, involved a very different problem: the theft of customer assets on an unprecedented scale. The firm was placed in a SIPA liquidation proceeding on December 15, 2008, after the principal of the firm, Bernard Madoff, confessed to having stolen customer property over a period of many years. Irving H. Picard was appointed as trustee, and the law firm of Baker & Hostetler LLP was appointed as his counsel.

Unlike the LBI case, where customer records were accurate, it became apparent very early in the Madoff case that the customer statements Mr. Madoff had been sending to investors

bore little or no relation to reality. The records sent to customers were inaccurate when compared to the inventory of securities actually held by the brokerage firm. For that reason, it was not possible to transfer all or part of any customer's account to another, solvent brokerage firm. Instead, pursuant to SIPA, Mr. Picard sought and received authority from the Bankruptcy Court for the Southern District of New York to publish a notice to customers and creditors, and to mail claim forms to them, as required by law, no later than January 9, 2009. I am pleased to report that the notice of the initiation of the case was published on January 2, 2009, and claim forms have been mailed to more than 8,000 investors at their addresses as they appeared on the Madoff firm's records within the last twelve months.

The trustee has requested information from each customer as to the sums given to the Madoff brokerage firm, and sums withdrawn from the firm, to assist in the analysis of what each customer is owed. There are some situations, particularly where the investors have not made withdrawals, where it will be relatively easy to determine exactly how much a claimant put into the scheme. In other situations, the extended time period of the deception, coupled with numerous deposits with or withdrawal of assets from the brokerage over time, may make that reconstruction very difficult. SIPC and the trustee are committed to using all available resources to resolve these issues quickly.

Mr. Madoff apparently has stated that he stole \$50 billion. Even though this sum may include the annual "profits" he reported to investors in his fraudulent scheme, this defalcation is on a different order of magnitude than seen in any SIPA liquidation that has preceded it. Until customer claims are received and processed and further accounting and related work accomplished, SIPC will not know the extent of the demand on its resources. We can predict that the demand will be in excess of any previous case. Of course, the maximum amount under SIPA that SIPC can advance to any one claimant is \$500,000 (including the \$100,000 cash limit), even if the valid amount of the claim is much higher. The extent of recovery by customers beyond the amounts advanced by SIPC will depend upon the amount of customer property that the trustee is able to recover. Most recently, the trustee obtained a court order authorizing the release of \$29 million of debtor assets to him. In addition, the trustee has identified over \$830 million in liquid assets of the defunct brokerage firm that may be subject to recovery. Finally, the trustee has in place a team of highly trained attorneys, forensic accountants, and computer specialists, to assist him in locating and recovering assets. The trustee and SIPC will be aggressive in their pursuit of such recoveries.

The failure of the Madoff firm has broad potential consequences for securities regulation, as well as possible effects on SIPC. Depending on the potential cost of customer claims, SIPC will determine whether to adjust the target balance of the SIPC Fund. The amount of SIPC's \$1 billion line of credit with the Treasury has not changed since the passage of SIPA in 1970, and this may merit review as well. Other matters affecting SIPC may also be appropriate for review as a result of the Madoff case. As this case moves forward and we have a clearer picture of the facts and their implications, SIPC will maintain a dialogue with Congress about any issues that may give rise to the need for changes to SIPA.

I would be pleased to answer any questions from the Committee.