

Mark E. Maddox²
Thomas A. Hargett¹
Steven B. Caruso³
Thomas K. Caldwell⁵
Barbara Quinn Smith⁴
T. John Kirk¹

80 Broad Street
Fifth Floor
New York, NY 10004
212.837.7908
212.837.7998 fax

www.investorprotection.com

Indianapolis	Cleveland
10100 Lantern Road	9853 Johnnycake Ridge Rd.
Suite 150	Suite 302
Fishers, IN 46037	Mentor, OH 44060
317.598.2040	440.354.4010
317.598.2050 fax	440.848.8175 fax

Testimony Before the
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Subcommittee on Capital Markets, Insurance and Government-Sponsored Enterprises

“Assessing the Limitations of the Securities Investor Protection Act”

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By

Steven B. Caruso

Maddox Hargett & Caruso, P.C.

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

I am Steven B. Caruso, the resident partner in the New York City office of Maddox Hargett & Caruso, P.C., a law firm whose practice is almost exclusively devoted to the representation of public investors in connection with their disputes with the securities industry. I am a past President and a current member of the Board of Directors of the Public Investors Arbitration Bar Association (“PIABA”), which is the largest national association of attorneys whose individual law practices focus on the representation and protection of public investors in securities arbitration proceedings, and I am also a current public member of the National Arbitration and Mediation Committee (“NAMC”) of the Financial Industry Regulatory Authority, Inc. (“FINRA”), which is the advisory group that provides recommendations on the rules, regulations and procedures governing securities arbitrations, mediations and dispute resolution activities.

I am honored to be able to have the opportunity to share with you my thoughts and perspectives on the Securities Investor Protection Act (“SIPA”) and the Securities Investors Protection Corporation (“SIPC”), from the point of view of both my professional experiences as an investor advocate and, of equal importance, as a member of the SIPC Modernization Task Force (“SIPC Task Force”).

Historical Overview of SIPA & SIPC

When the United States Congress enacted SIPA in 1970, and created the SIPC, its stated purpose was to promote investor confidence in the nation’s securities markets through the extension of certain protections against certain losses to customers resulting from the financial difficulties and/or failures of their broker-dealer firms.

SIPC is a nonprofit membership corporation whose members are, with certain limited statutory exceptions, all persons registered as brokers or dealers under Section 15(b) of the Securities Exchange Act of 1934 and all persons who are members of a national securities exchange. As of December 31, 2009, it is reported that there were 4,956 members of SIPC.

Since the inception of SIPC in 1970 through the end of 2009, it has been reported that SIPC had commenced 322 customer protection proceedings, in accordance with the requirements that are set forth in SIPA, and, during that same period of time, it is estimated that SIPC has distributed cash and securities to an estimated 625,100 customers of those failed brokerage firms in the approximate aggregate amount of \$108.5 billion.

The monetary resources that are required to protect and reimburse customers of failed broker-dealers are derived from three (3) primary sources – the assets in the possession of the trustee for the estate of the failed broker-dealer, assessments that are collected from SIPC members and interest that is earned on SIPC’s investment in United States government securities (collectively the “SIPC Fund”). As a supplement to the SIPC Fund, the United States Securities & Exchange Commission (“SEC”) has the authority to lend SIPC up to \$1 billion which it, in turn, would borrow directly from the United States Treasury.

Creation of the SIPC Modernization Task Force

In view of recent events that have publicized SIPC and its role in the protection of investors, as well as the fact that the last significant amendments to SIPA had been effectuated in 1978, based on discussions that I understand had been originally

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held before this Subcommittee last year, SIPC announced on June 17, 2010, that it had created the SIPC Modernization Task Force (“SIPC Task Force”).

The stated mission statement of the SIPC Task Force is to undertake a comprehensive review of both SIPA and SIPC’s operations and policies, and to propose reforms to the Board of Directors of SIPC and other interested parties, with respect to statutory amendments and other operational and/or procedural refinements, as may be appropriate, given the passage of time since the original enactment of SIPA, changes that we have all experienced in the securities industry and judicial precedents and/or interpretations thereof.

The twelve (12) members of the SIPC Task Force include representatives of the securities industry, investor advocates, government regulators and academia, from across the nation, as well as one international member.

I believe that the objective of the SIPC Task Force is clear and unequivocal – to modernize SIPA and SIPC so as to ensure that its role in the protection of investors and the promotion of investor confidence in the nation’s securities markets remains viable.

Among the topics being considered for review by the SIPC Task Force are SIPC’s corporate governance, adequacy of existing SIPC protection, the ongoing viability of the SIPC Fund, inherent limitations on investor protection, investor education, the misnomer of what has commonly been referred to as excess SIPC “insurance” and the relationship of all of these initiatives in the context of the international arena.

It is notable that, in connection with the efforts that are being undertaken by the SIPC Task Force, an interactive website has been established (www.SIPCModernization.org) through which the general public is being given the opportunity to provide comments and recommendations to SIPC and each of the members of the SIPC Task Force. It is also anticipated that, in the course of the review that is being undertaken by the SIPC Task Force, several public forums will be held through which investors and other interested parties will have the opportunity to provide comments, thoughts and suggestions on the process that is being undertaken. In fact, on September 14, 2010, the first national public forum was held and the members of the SIPC Task Force will be reviewing the comments and suggestions that were received as we continue to move through the process.

It is anticipated that the SIPC Task Force will present its findings, conclusions and proposals for reform in a written report, or possibly a series of written reports, that will be submitted to the SIPC Board of Directors later this year which will then review those

findings, conclusions and proposals with a view towards legislative changes and other potential operational improvements. Of equal importance, it is anticipated that the reports of the SIPC Task Force, and all related documentation, will be made publicly available.

Focus on Specific Topics

In my role, as a member of the SIPC Task Force, and based on my own personal experience with SIPA and SIPC, as an attorney who has provided representation to numerous investors in SIPC proceedings, it is my personal belief that there are a number of topics that are and should remain the subject of specific focus by both the SIPC Task Force and the members of this Subcommittee.

These topics include, but are not necessarily limited to, the following:

1. Whether the distinction in SIPA, between a customer claim for cash and a customer claim for securities, remains a viable distinction not only in the context of the securities industry today, but of equal if not greater importance, in the context of ensuring that customers understand the nature of the protections that are provided by SIPC when their broker-dealer firms encounter financial difficulties and/or fail;
2. Whether the limitation on the maximum amount of protection that is provided by SIPC in a SIPA proceeding, which is currently \$500,000 per customer, should be increased to a level that more adequately reflects the economic realities of the securities industry today and the amount of investable assets that investors entrust to their financial advisors;
3. Whether the protection that is provided by SIPC in a SIPA proceeding should be extended to additional classes of investors who, based on SIPA and numerous judicial interpretations of both the SIPA statute and SIPC Rules, may not currently receive any SIPC protection because the investors do not have a “direct” customer relationship with the failed brokerage entity – these additional classes of investors would include, for example, investors in hedge funds and other similar types of indirect alternative investments, investors who entrust their assets to investment advisors, individual beneficiaries of defined benefit pension plans and individual beneficiaries of defined contribution plans;
4. Whether the educational materials and related information that are available to investors in connection with the protection that is provided by SIPC and, of equal if not greater importance, the protection that is not provided by SIPC, should be enhanced so as

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to minimize any misimpressions and/or misunderstandings that may exist in the investment community;

5. Whether the legislation that has been proposed and is currently pending before Congress, which was intended to address some of the more egregious victimizations of investors in the Bernie Madoff and Allen Stanford Ponzi scheme debacles, represents an economically viable, equitable and efficient solution for investors;

6. Whether customers of a failed broker-dealer should have a potential means of recovery for unpaid arbitration awards, whether through the protection that is provided by SIPC, a SIPA proceeding or otherwise, that are procured through an arbitration proceeding against a failed broker-dealer and/or its former agents; and

7. Whether the minimum balance of the SIPC Fund, which was recently increased to a target of \$2.5 billion, with a corresponding recommendation to similarly increase the U.S. Treasury credit line to an additional \$2.5 billion, will be adequate to address both SIPC's statutory responsibilities and the promotion of investor confidence in our nation's securities markets in the coming years.

Conclusion

Thank you for providing me with the opportunity, as a member of the SIPC Task Force, to share with you my thoughts and perspectives on both SIPA and SIPC.

I would be happy to entertain any questions that the members of the Subcommittee may have.