Securities Investor Protection Corporation

Gary Shorter
Specialist in Financial Economics

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Summary

The Securities Investor Protection Corporation (SIPC) is a nonprofit, quasi-public, quasi-industry, nongovernmental corporation that was established in 1970 through the Securities Investor Protection Act (SIPA), which amended the Securities and Exchange Act of 1934. Overseen by the Securities and Exchange Commission (SEC), SIPC reimburses customers of failed SIPC member broker-dealers for remaining losses beyond the recovered assets that are returned to them by a court-appointed trustee who presides over the firm's liquidation. With the broad goal of helping to maintain investor confidence in the securities markets, SIPC has historically provided valid customer claims up to $500,000 per customer, of which up to $100,000 can be in claims for cash, and the rest in claims for securities. Signed into law on July 21, 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act expands SIPC protection available for cash claims up to $250,000 out of the total maximum per customer claims of $500,000.

The SIPC funds that are used for such customer claims derive from the SIPC Fund. The fund's assets come largely from annual assessments on SIPC broker-dealer members, at a rate that has been periodically adjusted by SIPC. From 1997 to 2009, SIPC charged a flat rate of $150 per member. In the event that the SIPC Fund became insufficient for carrying out SIPA's mission, SIPC had the authority to borrow up to $1 billion from the U.S. Treasury.

Following large liquidations at firms like Lehman Brothers and Bernard Madoff's operation, Investment Securities LLC, the SIPC Fund fell to $1 billion in 2009, a recent historical low. In response, SIPC decided to provide for a SIPC fund level target of $2.5 billion, and increased annual member assessments to 0.25% of each member's net operating revenue. The Dodd-Frank Act increases the amount that SIPC could borrow from the Treasury Department to $2.5 billion and imposes a minimum assessment on SIPC members of 0.02% of the gross revenues from the securities business of each SIPC member. Arguing that the present system effectively subsidizes and thus encourages potentially high-risk firms, some observers have urged SIPC to shift to a risk-based pricing system for member assessments. Others, however, question the cost-benefit calculus of risk-based pricing.

The Madoff case drew the public's attention to a number of public policy concerns. One involves the use by the trustee in the Madoff case of a "cash-in-minus-cash-withdrawn" approach to calculating the value of a customer's account. By contrast, many of Madoff's victims advocate a calculation based on the "last-statement method," which relies on the value of a customer's account according to their last statement. In March 2010, a bankruptcy judge from the United States Bankruptcy Court for the Southern District of New York ruled in support of the Madoff trustee, a ruling that received SEC support. A second issue involves the large number of Madoff's investors who were indirect investors, investors invested through third party investment vehicles like pension funds and mutual funds. According to SIPC officials, SIPA limits each of their protections to a prorated portion of the up to $500,000 in cash and securities that the vehicle that they were invested in would receive from SIPC. Many of the indirect investors, however, say that being the recipients of such a diluted, prorated form of distribution is unfair. H.R. 5032 (Ackerman) would require SIPC to provide up to $100,000 worth of protection to indirect investors in Ponzi schemes, and it would retroactively apply to the Madoff liquidation. Other pending legislation that involves SIPC include S. 3166 (Schumer), S. 3258 (Reed), H.R. 1159 (Meeks), H.R. 1389 (Ackerman), and H.R. 2798 (Arcuri). In 2010, SIPC formed a Modernization Task Force, whose mission is to conduct a major review of the corporation and then report to the SIPC board. This report will be updated as events dictate.

Contents

Contacts

Background

The Securities Investor Protection Corporation (SIPC) is a nonprofit, nongovernmental corporation. When securities firms become incapable of performing their custodial obligations for customers, SIPC is responsible for ensuring that customers recover cash and securities that they have entrusted to SIPC's 5,000 member firms.

The late 1960s saw a marked rise in securities trading volume, exposing major inadequacies in the systems that processed securities trades and provided centralized clearing. Bottlenecks and paralysis plagued the processing of trades, and there were significant accounting and reporting abuses. The subsequent stock market decline pushed many securities firms into financial difficulties and many firms merged, failed, or ceased operating. Some firms used customer property for their own trading, while others experienced procedural breakdowns in the management of customer accounts, resulting in customer losses of millions of dollars. In 1970, to avoid a recurrence of these events and accompanying negative consequences for investor confidence in the securities markets, Congress amended the Securities Exchange Act of 1934 by adding the Securities Investor Protection Act of 1970 (SIPA),[1] and significantly changed it via the Securities Investor Protection Act Amendments of 1978.[2] The Securities and Exchange Commission (SEC) has oversight over the resulting SIPC and its bylaws. SIPA gives the SEC authority to review, disapprove, and even impose SIPC bylaws and rules.

The SIPC is not a government agency and is not a regulatory authority. It is a nonprofit, membership corporation, funded by securities broker-dealers. SIPC has a seven-member public board of directors. The Secretary of the Treasury and the Federal Reserve Board each appoint one, and the President appoints the remaining five, subject to Senate confirmation. Of the President's appointees, three must be from the securities industry and two must represent the general public. The latter become SIPC's chairman and vice chairman.

Under SIPA, any entity that is registered as a broker-dealer with the SEC under the Securities Exchange Act of 1934 or who is a member of a national securities exchange must be a SIPC member. Also under SIPA, members are required to pay an annual assessment to SIPC.

This report provides an overview of various issues related to SIPC, including policy issues that have been highlighted by the Madoff fraud, SIPC reforms in the Dodd-Frank Wall Street Reform and Consumer Protection Act, and pending legislation involving SIPC.

SIPC's Basic Functions

With a mandate to help maintain investor confidence in the securities markets, SIPC provides protection to customers for securities and cash left with failed securities firms. It protects customer assets (registered securities and cash) against losses of up to $500,000 at the time of a firm's collapse, of which up to $100,000 may be cash. Non-cash assets that are covered include registered stocks, bonds, notes, and mutual funds. Through SIPA, Congress designed SIPC to recover remaining assets, which are registered in "street name" (the normal convention in which a

[1] P.L. 91-598, 84 Stat. 1636.

[2] P.L. 95-283, 92 Stat. 249.

security is held in the name of a broker on behalf of a customer) at the failed firms and to allocate them in a prorated fashion to the firms' customers.[3] Subject to the statutory limits, SIPC then pays out of the SIPC fund the remaining amounts of accepted customer claims.

Typically, customer claims evolve through the following process: First, the SEC or a self-regulatory organization like the New York Stock Exchange, or the Financial Industry Regulatory Authority (FINRA, the principal securities broker-dealer regulator) alerts SIPC when a SIPC member is in serious financial difficulty. The SIPC normally responds by filing an administrative petition in a federal court to liquidate the firm. The court usually appoints a SIPC-recommended trustee, although the SIPC will sometimes be the trustee when liabilities are limited and a collapse affects fewer than 500 customers. After liquidation proceedings are moved to a U.S. bankruptcy court, the trustee notifies the firm's customers and attempts to sell or transfer customer accounts to viable SIPC members. If the firm's customers are unable to fully recover missing funds or securities from the firm, they may file claims, which SIPC and the trustee either accept or reject. To the extent that failed firms are unable to fully meet accepted customer claims, SIPC advances fund to up to the statutory amounts identified above. SIPC does not directly compensate for losses in commodities, precious metals, derivatives, investment contracts, limited partnerships, or any other "securities" that are not registered.

For example, suppose a SIPC-member firm fails and goes through the liquidation procedure. Suppose that the failed firm has an aggregate total of $5 billion in accepted claims, and that SIPC has been able to recover $4.5 billion, or 90% of those claims, through the firm's assets. This means that 90% of each former client's accepted claim will be covered through assets that have been recovered from the firm. Now suppose that there is a former customer, Client A, who has an accepted claim for $5 million against the firm. In this SIPC customer proceeding, Client A would receive 90% of the $5 million claim, or $4.5 million, from assets recovered from the firm, and $500,000 from SIPC itself, making the client whole. If, however, the claim was $6 million, Client A would receive 90% of that, or $5.4 million from the recovered funds and $500,000 from SIPC, leaving the client with $100,000 in losses.

The SIPC Fund and Member Assessments

The SIPC funds that are used to make advances for customer claims and to supplement the recovered assets to satisfy customer claims derive from what is known as the SIPC Fund, sometimes known as the SIPC reserves. The fund is also used to cover the administrative expenses of liquidation proceedings.

The fund's assets come from interest on investments in U.S. government securities and an annual assessment on SIPC-member firms. Historically, the assessment rate has been periodically adjusted by SIPC's board with the SEC's approval.

In the event that the SIPC reserves have become or threaten to become insufficient for carrying out SIPA's mission, SIPC has the authority to indirectly borrow up to $1 billion from the U.S. Treasury. Formally, the SEC would borrow the funds from the Treasury and then would relend them to SIPC. Until recently, SIPC also had access to a $1 billion line of credit with a consortium

[3] In the much less common instances in which a security is registered or about to be registered in an investor's name, all of the securities will be returned to that investor.

of banks. During the 1970s, 1980s, and 1990s, SIPC members were subject to changing rates. The annual rates, which are the same for all members, fluctuated as SIPC's board has reportedly attempted to meet declines in the fund's balance with rises in the assessment rate so that years with high expenditures would be followed by higher assessments.[4] Members have alternately been levied an annual percentage of their revenues (which was as low as 0.065% during periods of the 1990s) or have been assessed flat fees, such as between 1997 and 2009, when each member paid a flat annual rate of $150, the statutory minimum.

The fund's target level was initially established in 1970 by SIPA at $150 million. Through the years, due to inflation, changes in the securities markets and securities industry, and rising levels of perceived monetary risk to SIPC, the corporation's board set the fund level well above the original $150 million. For example, in 1991, the board adopted a policy to increase the fund to $1 billion by 1997, a level that was reached in 1996.

Between 1996 and 2001, the size of the SIPC Fund ranged between $1.0 and $1.2 billion. From 2002 to 2006, the fund hovered in the $1.2 billion to the $1.4 billion range. In 2007, it was roughly $1.45 billion. In 2008, the fund peaked at $1.7 billion, then fell to slightly more than $1 billion in 2009.

By 2009, after the massive bankruptcies and liquidations of Lehman Brothers and Madoff's firm,[5] the consortium of banks that provided SIPC with a line of credit informed the SIPC that the credit line was not being renewed. Subsequently, SIPC's board decided on a $2.5 billion target for the SIPC Fund (more than double the existing $1 billion). In addition, the board decided that SIPC also needed to boost its line of contingency credit from the Treasury Department from $1 billion to $2.5 billion, a change that required a legislative act. In 2009, with the SEC's approval, the SIPC amended its bylaws to incorporate a $2.5 billion target for its fund.[6] To reach the significantly higher target level, SIPC also increased its member assessments from a flat $150 annual rate for all members to a rate that is now 0.25% of each member's net operating revenue.[7]

One major criticism of SIPC's approach to funding the SIPC fund through its current membership assessment protocol is that it does not price the assessments on a risk-adjusted basis in which

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[4] U. S. General Accounting Office, *Securities Investor Protection Update on Matters Related to the Securities Investor Protection Corporation*, GAO-03-811, July 2003.

[5] On December 11, 2008, the SEC sued Bernard L. Madoff and his firm, Bernard Madoff Investment Securities, LLC, for securities and investment advisory fraud in connection with an alleged Ponzi scheme that allegedly resulted in substantial losses to investors in the United States and other countries. Underscoring the magnitude of the Madoff liquidation and its potentially significant implications for the viability of the SIPC Fund was an observation by Stephen P. Harbeck, then SIPC's president and chief executive officer: In December 2009, Mr. Harbeck indicated that the value of accepted claims from Madoff's clients had reached $4.6 billion with about $560 million of that coming from the SIPC Fund. Statement of Proposed Testimony of Stephen P. Harbeck, SIPC president and chief executive officer, before the United States House of Representatives Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises, Committee on Financial Services, December 9, 2009.

[6] Securities Investor Protection Corporation Modernization Task Force, *Adequacy of the SIPC Fund*, SIPC, June 2010, available at http://www.sipcmodernization.org/Topics/summary/Adequacy%20of%20Fund%20FINAL.pdf. In an extreme emergency, where the SIPC Fund is depleted to $100 million, under SIPA, not less than half of 1% of a member's gross revenues can be charged. The absolute maximum member assessment is 1% of a member's gross revenues.

[7] After the assessment increase, some larger broker-dealers firms claimed that they will be paying millions of dollars in SIPC assessments. Some smaller broker-dealers reportedly have expressed resentment that they were effectively "paying for Bernard Madoff." For example, see Dan Jamieson, "B-Ds Reel from Higher SIPC Fees," *Investment News*, August 9, 2009, available at http://www.investmentnews.com/article/20090809/REG/308099981.

members would be assessed in accordance with their perceived risk to SIPC. The practical concern is that the current system may result in SIPC effectively subsidizing and thus encouraging high-risk member broker-dealers.[8]

Proposals to address this perceived problem include (1) giving SIPC a regulatory watchdog role with respect to members' safety and soundness, which would likely require a major rewriting of SIPA, and involve a bigger SIPC with a larger budget; and (2) requiring that SIPA be amended to require SIPC-member fees be risk-adjusted so that the members who are seen to pose the greater risks would be assessed accordingly, which would likely require an expanded SIPC and could raise questions over the accuracy with which broker-dealer firm risks can be assessed.[9]

The notion of a risk-based pricing system was criticized in a 2003 report done for SIPC by Fitch Risk Management, the credit rating agency. The report argued that adopting a tiered fee schedule based on a member's perceived risk would pose two major problems: (1) to gauge fee levels for its members, SIPC would have to evaluate their creditworthiness, which could be a very costly exercise that lacks any clear benefits; and (2) firms deemed to pose particular risks might experience significant stress as a result of the assessment, possibly contributing to their failure.[10]

Policy Issues Highlighted by the Madoff Case

On December 11, 2008, the SEC sued Bernard L. Madoff and his firm, Bernard Madoff Investment Securities, LLC, for securities and investment advisory fraud in connection with an alleged Ponzi scheme that it alleged had resulted in substantial losses to investors in the United States and other countries.[11] The Madoff fraud case has generated interest in several controversial policy issues involving SIPC, including the following:

- **Net Equity.** SIPC officials, and the court appointed Madoff trustee, have indicated that SIPA provides protection based on an investor's actual net investment, or net equity, which should represent the difference between an investor's invested cash minus the cash that was withdrawn from an account.[12] A number of Madoff's investors objected to this

[8] In 2003, SIPC hired a risk manager responsible for giving SIPC's board and senior management an ongoing analysis of risk factors and exposures to the SIPC Fund.

[9] For example, see Testimony of Professor John C. Coffee, Jr. before the United States Senate Committee on Banking, Housing and Urban Affairs, *The Madoff Investment Securities Fraud: Regulatory And Oversight Concerns and The Need for Reform*, January 27, 2009.

[10] "Review of SIPC Risk Profile and Practices: The MJK Clearing Event, the Securities Lending Exposure, Risk Management Practices and Capital Requirements," *Fitch Risk Management*, January 31, 2003, available at http://www.sipc.org/pdf/SIPC_fitch.pdf.

[11] SEC, "SEC Charges Bernard L. Madoff for Multi-Billion Dollar Ponzi Scheme," press release, December 11, 2010, available at http://www.sec.gov/news/press/2008/2008-293.htm.

[12] The Internal Revenue Service has provided a safe harbor for taxpayers to enable them to deduct losses from fraudulent investment schemes as "theft losses." Up to 95% of qualified losses from a fraudulent investment arrangement, calculated through detailed definitions and formulas, can be deducted if certain requirements and circumstances are satisfied. Investors who unknowingly invested in a Ponzi scheme, such as the Madoff investment fund, through an intermediary fund or investment advisor cannot deduct losses under the safe harbor. However, the intermediary investment fund may itself qualify to claim theft losses under the safe harbor. The new procedure also provides guidance for taxpayers choosing not to use the safe harbor, but who plan to deduct investment fraud losses under the theft loss provisions of Section 165 of the Internal Revenue Code. Rev. Proc. 2009-20, 2009-14 I.R.B. (March 17, 2009). Available at http://www.irs.gov/irb/2009-14_IRB/ar11.html.

approach, saying that the trustee should use the "last statement method" and simply look at the value of their portfolio on their last statement to calculate their net equity because that last statement shows significant earnings on their initial cash investments. On March 1, 2010, a bankruptcy judge from the United States Bankruptcy Court for the Southern District of New York ruled on this issue by approving the trustee's net investment method of determining customer claims. In doing so, the court rejected the Madoff investors' contention that customer claims must be allowed in the amounts shown on final customer statements.[13] The decision has been criticized by various investors and Members of Congress, including Representative Paul Kanjorski, chairman of the House Financial Services Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises.[14] Siding with the trustee and SIPC, officials at the SEC, which filed a brief in support of the cash in/cash out method, argued that the Madoff customer account statements "showed the results of securities transactions selected by Madoff and 'executed' at prices calibrated after the fact to produce predetermined favorable returns, returns that were possible only because they were entirely divorced from the uncertainty and risk of actual market trading."[15]

- **Indirect Investors.** SIPA does not cover indirect investors. Known as "no account claimants," these investors invested money with Madoff's operation through investment vehicles that included family partnerships, pension plans, 401(k) plans, hedge funds, and other broker/dealers. Reports indicate that North Americans who invested with Madoff did so largely as indirect investors via money managers, feeder funds, and other hedge funds.[16] SIPA defines a customer to be an entity who has direct investments with a failed broker-dealer, which means that many indirect investors are not eligible for the $500,000 SIPC protection. They are only eligible for a diluted, prorated portion of the $500,000 protection that would be paid to the direct investor with an account with the failed firm. As a consequence, many indirect investors have criticized the restrictions on indirect

[13] This is taken from the Madoff trustee's website, which is located at http://www.madofftrustee.com/. The case is *Bernard L. Madoff Investment No. 08-017890 (BRL) and the Securities Investor Protection Corporation v. Bernard L. Madoff Investment Securities LLC*, which is available at http://www.madofftrustee.com/documents/ Net_Equity_Decision_3-1-10.pdf. In August 2010, attorneys for 700 Madoff investors asked the United States Court of Appeals in New York to reverse the March ruling, asserting that the judge erred in his opinion. Bloomberg, "Madoff Judge Erred in SIPC Ruling, Court Told," *InvestmentNews*, August 10, 2010, at http://www.investmentnews.com/ article/20100810/FREE/100819992.

[14] Chairman Kanjorski stated: "Unfortunately, SIPC has denied the claims of customers based on statement balances provided to them by their brokers, yet SIPC expects customers to use those very same statements to report unauthorized trading in their accounts. This paradox results in a customer's statement being meaningless whenever it could harm SIPC, but not when it harms the customer." Kanjorski Announces September Hearing to Assess Limitations of the Securities Investor Protection Act, press release from Rep. Paul Kanjorski's office, July 30, 2010, at http://financialservices.house.gov/press/PRArticle.aspx?NewsID=1346.

[15] In his December 9, 2009, statement before the House Financial Services Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises, SEC Deputy Solicitor Michael Conley previewed the SEC's position that net equity for SIPC claims in the Madoff bankruptcy should be measured on a cash-in/cash-out basis, adjusted for the time value of money. "Statement Before the House Financial Services Capital Markets, Insurance, and Government Sponsored Enterprises Subcommittee by Michael A. Conley, Deputy Solicitor of the SEC," December 9, 2009, at http://www.sec.gov/news/testimony/2009/ts120909mac.htm.

[16] Raphael Minder, and Diana Henriques, "Overseas Madoff Investors Settle With Banks," *New York Times*, May 24, 2010.

investors as unfair.[17] H.R. 5032 (Ackerman) would require SIPC to provide up to $100,000 worth of insurance coverage to indirect investors in so-called Ponzi schemes.

- **Clawbacks.** Under bankruptcy law, court-appointed bankruptcy trustees are entitled to claw back, or recover payments that were made out of a corrupt fund before the scheme was discovered and then return them to the bankruptcy estate for distribution of the scheme's victims. Accordingly, the court-appointed trustee in the Madoff case has been attempting to claw back funds from such investors, many of whom reportedly withdrew all of their funds from the operation years before Mr. Madoff's arrest.[18] This policy has been criticized by investors and by some Members of Congress. Under H.R. 5032 (Ackerman), SIPC would be prohibited from clawing back any money from victims unless the bilked investor was proven in bankruptcy court to be complicit or negligent in their participation in a Ponzi scheme. It would also apply retroactively to trustees appointed to liquidate assets in discovered Ponzi schemes with total investments in excess of $1 billion, including the Madoff case.[19] In December 2009, Representative Paul Kanjorski, chairman of the House Financial Service Committee's Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises, reportedly expressed concerns that restrictions on the clawbacks would result in the unfair treatment of the later Madoff investors, while also noting that clawing back money that charitable organizations have already spent could be "especially devastating."[20] In support of the status quo, John Coffee, Jr., a Columbia University law professor and a frequent panelist at congressional hearings, has spoken of the longstanding principle that investors who are aided or allowed by a fraudulent manager to redeem their investments should not be allowed to benefit from their association with such a fraudulent entity.[21]

The Stanford Case

In February 2009, the SEC charged Robert Allen Stanford and three of his companies for orchestrating a fraudulent, multi-billion dollar investment scheme centering on an $8 billion certificate of deposit (CD) program. Among Mr. Stanford's companies were the Antiguan-based Stanford International Bank (SIB) and the Stanford Group Company (SGC), an investment

[17] For example, see "Testimony of Peter J. Leveton, Co-Chairman of the Agile Funds Investor Committee, before the House Financial Service Committee's Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises Hearing," December 9, 2009, at http://www.house.gov/apps/list/hearing/financialsvcs_dem/leveton.pdf.

[18] Beth Hawkins, "Efforts to Recover Lost Funds from Ponzi Schemes Introduce New Legal Term to Public: Clawback," *Minnesota Post*, July 26, 2010, at http://www.minnpost.com/stories/2010/07/26/19933/efforts_to_recover_lost_funds_from_ponzi_schemes_introduce_new_legal_term_to_public_clawback.

[19] According to press reports, Rep. Gary Ackerman, the bill's sponsor, indicated that many of his New York constituents who were Madoff investors have been gouged by the clawback provision. Marcy Gordon, "Lawmakers Blast SIPC, Madoff Bankruptcy Trustee," *Associated Press*, December 9, 2009.

[20] Ibid.

[21] "Testimony of John C. Coffee, Jr. before the House Financial Services Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises hearing, Additional Reforms to the Securities Investor Protection Act," December 9, 2009. Professor Coffee did, however, suggest that possible reforms should redefine the criteria by which a clawback would be permitted from "whether the investor/creditor believed the 'assets in its account belonged to it' to whether it 'knew, or recklessly disregarded, facts indicating that the debtor was approaching insolvency."

adviser. The CDs were issued by SIB and marketed by SGC to investors worldwide, including to many Americans.[22]

SIPC officials have indicated that under SIPA, SIPC is obligated to repay up to certain amounts of accepted customer claims from failed broker-dealers when their securities are missing from the firm's accounts. However, according to the officials, the protection does not extend to investors who physically received their CDs, as they say was the case with the holders of the Stanford CDs.[23] The officials also noted that if fraudulent securities are issued by an SIPC non-member like the Antigua-based SIB, no SIPC coverage exists.[24] Finally, they observed that when securities are rendered worthless by fraudulent conduct, as was alleged in the Stanford case, SIPC provides no protection for loss of value.[25]

Many holders of the now virtually worthless Stanford CDs criticized as unfair SIPC's determination that they were not eligible for its protections. Several Stanford victims joined forces with Madoff's victims to lobby Members of Congress for legislation aimed at improving SIPC's treatment of victims like them.[26]

The SIPC perspective that SIPA only authorizes it to cover the physical loss or theft of a security by a broker-dealer member, not a security's loss in value, has been a continual source of controversy. Some observers note that the entrance of many relatively unsophisticated investors into the securities markets appears to have led to increased brokerage fraud, which they say argues for broadening SIPC's mandate to include loss of value due to fraud.

The SIPC Modernization Task Force

In mid-2010, noting that the "last significant amendments to the Securities Investor Protection Act … were in 1980," SIPC formed a Modernization Task Force whose mission is to conduct a major review of the corporation.[27] The task force will be chaired by SIPC's chairman and its vice chairman and will include representatives from the securities industry, investors, government regulators, and academia. Its specific duties will be to propose to the SIPC board "such statutory amendments, as may be necessary, useful, or appropriate, given the passage of time, changes in the securities industry, and judicial precedents construing SIPA."[28] The board is then supposed to review the task force's findings, conclusions, reports, and proposals with an eye toward possible legislative changes and other potential reforms to SIPC.

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[22] SEC, "SEC Charges R. Allen Stanford, Stanford International Bank for Multi-Billion Dollar Investment Scheme," press release, February 17, 2009, at http://www.sec.gov/news/press/2009/2009-26.htm.

[23] "Statement of Proposed Testimony of Stephen P. Harbeck, SIPC president and chief executive officer before the House Financial Services Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises," December 9, 2009.

[24] Ibid.

[25] Ibid.

[26] Robert Schmidt and Jesse Westbrook "Madoff Victims Join Stanford Investors to Lobby for Payback," *Bloomberg*, March 10, 2010, at http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aQMvceptRuSA.

[27] The task force website is available at http://www.sipcmodernization.org/.

[28] Ibid. In a press release, Chairman Kanjorski referred to a March 4, 2010, letter to SIPC supporting the establishment of the task force, which the release reported was initiated by SIPC after "coming under intense scrutiny at a December [2009] hearing of the Capital Markets Subcommittee." Available at http://kanjorski.house.gov/index.php?option=com_content&task=view&id=1731&Itemid=1.

Major areas of concern for the task force include (1) the adequacy of the SIPC Fund, (2) no account claimants, (3) investor education,[29] (4) clawbacks and recovery issues,(5) the level of SIPC protection, (6) net equity, and (7) excess SIPC insurance.[30]

Dodd-Frank Wall Street Reform and Consumer Protection Act

The Dodd-Frank Wall Street Reform and Consumer Protection Act (P.L. 111-203, 124 Stat. 1376) was signed into law on July 21, 2010. The comprehensive financial regulatory reform law contains several provisions that amend SIPA and apply to all SIPA liquidations filed on or after July 22, 2010. The provisions are as follows:

- **Changes in the Minimum Assessment Amount.** Section 929V amends the minimum assessment amount for SIPC-member firms. The highest amount that SIPC can impose as a minimum assessment is changed from $150 per annum to 0.02% of the gross revenues from the securities business of SIPC member.
- **Increases in the Line of Credit Available from the Treasury Department.** Section 929C increases the amount of money that SIPC can borrow from the Treasury Department (through the SEC) from $1 billion to $2.5 billion.
- **Increase in the Standard Maximum Cash Advance Amount for Each Customer.** Section 929H increases the amount of SIPC protection available for claims for cash from $100,000 to $250,000. Section 929H also provides that the amount of protection for cash claims may be indexed to inflation in accordance with the terms of the statute and with the approval of SIPC's board.
- **Criminalization of Misrepresentation of SIPC Membership and Increase in Fines for Other Crimes Under SIPA.** Section 929V criminalizes the misrepresentation of SIPC membership by making such misrepresentation punishable by a fine of $250,000 or imprisonment for not more than five years. The maximum fine for other prohibited acts under SIPA is increased from $50,000 to $250,000.

[29] One traditional area of focus with respect to SIPC and investor education has been apprising investors of the differences between SIPC insurance and the FDIC insurance for depository institutions.

[30] As mentioned above, SIPC advances are limited to $500,000 per customer, of which up to $100,000 may be a claim for cash. Because of these limits, many large brokerage firms also purchase "excess SIPC" insurance products, which insure their customers for any losses in customer property above and beyond the distributions they would receive in a liquidation proceeding, including advances from SIPC. The number of claims for excess SIPC insurance have been very limited. Although the Lehman Brothers bankruptcy generated some excess SIPC insurance liability claims, only one other brokerage firm failure has produced another claim. Going forward, in a report to the SIPC board on excess insurance, a task force report posed three policy options and their likely implications: (1) stay with the current policy; (2) raise the limits of protection provided by SIPC, which would decrease claims for excess insurance, thus either making excess insurance cheaper, more profitable for insurance companies, or both; and (3) eliminate the current distinctions between cash and securities claims, a change that would eliminate some of the demand for excess insurance. The report is available at http://www.sipcmodernization.org/Topics/summary/05-04-10%20Excess%20SIPC%20Ins.FINAL.pdf. Many of the reports that the task force is generating for the SIPC board are available at http://www.sipcmodernization.org/about_mtf.cfm.

- **Provision of SIPC Protection to Customers with Futures Contracts.** Section 983 amends the definition of a SIPC protected customer to include those with futures and options on futures in portfolio margin accounts.

Pending Legislation

Several pending bills also involve SIPC. Among them are the following:

S. 3166 (Schumer). The bill would amend the Internal Revenue Code to allow (1) a special tax deduction for qualified fraudulent investment losses held in an individual retirement account (IRA), (2) a six-year carryback of net operating losses that are qualified fraudulent investment losses, (3) withdrawals from tax-exempt retirement plans for a 10-year period without penalty to replace qualified fraudulent investment losses, (4) catch-up contributions to retirement plans to compensate for fraudulent investment losses, and (5) an extension of the limitation period for filing refund claims for overpayments of tax in connection with gifts and bequests of an interest in an investment for which there is a qualified fraudulent investment loss.

S. 3258 (Reed). The bill would amend SIPA to (1) remove the distinction between claims for cash and claims for securities, and (2) prohibit any SIPC member who has customers from entering into an insolvency, receivership, or bankruptcy proceeding without prior SIPC consent.

H.R. 1159 (Meeks). The bill would amend the Internal Revenue Code to (1) allow an enhanced tax deduction for losses sustained from a fraudulent Ponzi-type scheme, (2) extend the carryback period for net operating losses attributable to such schemes, (3) waive certain limitations on the charitable tax deduction for contributions to charities with losses from fraudulent Ponzi-type schemes, and (4) restore the gift tax unified credit for gifts of an interest in a fraudulent Ponzi-type scheme.

H.R. 1389 (Ackerman) The bill would amend the Internal Revenue Code to allow a refundable tax credit for taxes paid on earnings (1) from an investment that the taxpayer did not know, and reasonably should not have known, was fraudulent; (2) that were reinvested in such investment; and (3) that remained so reinvested until the fraud was discovered. These tax credits would apply to frauds that were discovered in 2008, the year that the Madoff fraud was officially revealed.

H.R. 2798 (Arcuri). The bill would amend SIPA to (1) increase from $100,000 to $250,000 (with inflation adjustments), the amount of an investor's net equity claim insured by SIPC; (2) increase the line of credit from the Treasury Department available to SIPC; (3) increase the minimum annual assessment levied on SIPC members from $150 to $1,000; (4) permit SIPC to appoint itself or one of its employees as a liquidation trustee if there appear to be fewer than 5,000 customers of a broker-dealer member that is facing liquidation; and (5) prohibit SIPC advances to the insiders of failed or failing broker-dealers.

H.R. 5032 (Ackerman). The bill would amend SIPA to (1) require that SIPC provide up to $100,000 worth of protection to indirect investors in Ponzi schemes (a fraudulent investment operation that is managed in a manner that provides investors with actual or purported returns that largely derive from investments made by other investors rather than from profits); (2) require that within 30 days after the discovery of a Ponzi scheme in which total customer investments exceeded $1 billion, SIPC would have to submit to the House Financial Services Committee, the Senate Banking Committee, and the Secretary of the Treasury, its expected timeline for the consideration of claims. In the event that SIPC fails to meet the deadline, the Secretary of the Treasury would be permitted to direct SIPC to pay the claims with interest; and (3) restrict the ability of SIPC to "clawback" funds from victims of Ponzi schemes unless the bilked investor was proven to be complicit or negligent in their participation in the scheme in bankruptcy court. This would apply retroactively to trustees appointed to liquidate assets in previously discovered Ponzi schemes with customer investments totaling more than $1 billion, which includes the Madoff liquidation.

Author Contact Information

Gary Shorter
Specialist in Financial Economics
gshorter@crs.loc.gov, 7-7772