Statement of
United States Senator David Vitter
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of the House Financial Services Committee
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Thank you, Chairman Garrett and Ranking Member Waters and members of the Capital Markets and Government Sponsored Enterprises Subcommittee, for inviting me to testify here today. Congress has given the Securities Investor Protection Corporation (SIPC) incredible responsibility for protecting investors, and for that reason, it's vitally important and appropriate that we point the spotlight at SIPC to understand the ways that it is and is not working.

If there is one common cause between Stanford and Madoff investors, it's the way SIPC fought investors every step of the way and has absolutely refused to protect the victims of fraud. For three years the Stanford victims have been fighting just to have their day in court – and unfortunately, it's SIPC that they have to fight.

I fear we are in a situation where, if SIPC were a true financial regulator, we would call it regulatory capture. The actions of SIPC are dictated by the member companies rather than by the law. SIPC is functioning more like a trade association and advocate than a quasi-regulator.

I first became involved in the Stanford case because it has affected thousands of victims in the United States, and many of them live in Louisiana. Allen Stanford was adept at preying upon the savings of retired oil and gas workers in Louisiana in particular. Many of the victims have told me their entire savings has been lost because of the Stanford fraud, and that they have been forced to sell their home and re-enter the work force.

I want to be absolutely clear. I don't believe there is any need to change to the Securities Investor Protection Act in order to provide coverage for the Stanford victims. These victims are entitled to coverage under the law as it is currently written.

In the actual criminal case against Allen Stanford, he is accused of stealing customer funds. Instead of purchasing Stanford International Bank (SIB) "certificates of deposit" (CDs), the Stanford Group Company (SGC) which was a SIPC member, acquired control of its customers' funds and the funds were stolen by Allen Stanford. The Securities Exchange Commission (SEC) and courts have taken the position in litigation related to the receivership of Stanford's estate, that the Stanford companies operated as a Ponzi scheme and, "a Ponzi scheme is, as a matter of law insolvent from its inception." And, just yesterday, a jury convicted Allen Stanford on 13 of 14 counts related to this case.

In *Old Naples Securities, Inc.* the U.S. Court of Appeals for the 11th Circuit held that customers of an introducing broker-dealer who thought they were purchasing bonds through the broker-dealer were "customers" of an introducing broker-dealer within the meaning of SIPA and entitled to coverage under the statute. The court held 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." Rather, the issue was one of "actual

receipt, acquisition or possession of the property of a claimant by the brokerage firm under liquidation."

Previously, the SEC has argued that "a customer's legitimate expectations" ought to be protected "regardless of the fact that the securities were fictitious." It is impossible for an insolvent entity issue legitimate securities. In *re New Times Securities Services, Inc.,* the owner sold fictitious mutual funds, as well as bona fide mutual funds to investors via a register broker dealer that was a SIPC member and a non-broker-dealer entity.

Forensic accounting, which was done by the court appointed receiver, shows that the SIB CDs were not purchased by SGC for its customers, and therefore they are not worthless securities with zero value as argued by SIPC. Instead, these CDs are fictitious. The SGC customer funds were never transferred to the Antiguan bank and there was never any money standing behind the CDs.

On June 5, 2011, the SEC Commission voted on a determination that SIPC should provide coverage for the Stanford victims. In the analysis of the case provided by the SEC to SIPC, the SEC explains that on the specific facts of this case, investors with brokerage accounts at SGC who purchased the CDs through the broker-dealer qualified for protected "customer" status under SIPA.

In reaching its determination, the SEC cited the conclusions in the report of the court appointed-receiver for SGC, who noted that the many companies controlled and directly or indirectly owned by Stanford "were operated in a highly interconnected fashion, with a core objective of selling" the CDs. Among other things, the receiver also noted that "[c]orporate separateness was not respected within the Stanford empire… Money was transferred from entity to entity as needed, irrespective of legitimate business need. Ultimately, all of the fund transfers supported the Ponzi scheme in one way or another, or benefited Allen Stanford personally."

A SIPA liquidation proceeding would allow investors with accounts at the SGC to file claims with a trustee selected by SIPC. The trustee would decide whether the investors have "customer" claims that are protected by the statute, and an investor who disagreed with the trustee's determination could seek court review.

However, the ultimate roadblock to the victim's day in court is SIPC.

During the eight months since the SEC made its determination instructing to provide protection to the Stanford victims, SIPC has tried every conceivable idea to drag out making a final determination.

After the SEC's determination, SIPC ran up $200,000 of charges in June and July of last summer in reviewing the court appointed receiver's documents – a cost that will be ultimately be paid for with the money set aside for the victims. When asked about these charges, SIPC claimed that it was in order to do research into a settlement offer to the victims. However, an official settlement offer never materialized.

During the time between the SEC's determination and the SEC ultimately filing an application with the DC Circuit Court to compel a SIPA liquidation, I had many calls and meetings with Orlan Johnson, then Chairman of SIPC and his staff, including Stephen Harbeck. Concerns were raised by both Mr. Johnson and his staff on a reoccurring basis, as far back as our first meeting on this issue, about the cost to the SIPC fund of covering Stanford victims and how SIPC member companies would react to the need for SIPC to increase its assessments. I stressed in our discussions that I believe the only focus should be on providing the victims with swift resolution under the law in a manner that takes into account the complex nature of the fraud and uses the forensic accounting that had already been undertaken.

In these meetings and on these calls, it seemed to me, that SIPC was more interested in the cost of the resolution and protecting its Wall Street member companies than it was in doing their duty, doing the right thing, and immediately initiating a formal liquidation proceeding in the Stanford matter as ordered by the SEC. In fact, I was told that SIPC felt they would be sued no matter what they ultimately decided to do. SIPC was certain they would either be sued by the SEC or sued by their member companies

During the course of these meetings and phone calls it also became obvious that SIPC hired lawyers to defend itself from the SEC while still negotiating a settlement offer, and SIPC has shown every indication it will continue to litigate this matter in court.

Currently, SIPC is fighting the SEC in court trying to avoid being compelled to file a protective order which would ultimately allow individual victims to get a judicial review of the merits of their claims against SIPC. While this judicial review is certainly part of the SIPA process, it was intended to be more of a summary proceeding, and I think everyone would be surprised at some of SIPC's tactics they are willing to use in order to avoid compensating the victims.

In a filing on February 16th, despite the fact that SIPC has run up a charge of $200,000 dollars with the court-appointed receiver, SIPC asked the judge to allow a discovery of documents related to who the customers were, the certificates of deposit and the corporate structure of the Stanford Companies. In addition, on Monday of this week, SIPC asked the judge for approval to review all of emails and documents of the SEC's legislative affairs team in a fishing expedition in an attempt to find a past instance where a staffer at the SEC might have said something that disagreed with what the SEC ultimately voted on months or years later.

The SIPA statute is 41 years old, and SIPC has never challenged the authority of the SEC in court the way it is now. SIPC has decided to test the SEC's authority to compel SIPC to protect investors. If SIPC persists on this pat, SIPC will undermine the faith investors have in markets and in SIPC coverage itself. Although I hope SIPC will see the error of their logic, I realize that ship has already sailed. I will continue to work on behalf of Stanford victims and all of Louisiana victims of securities fraud.

Chairman Garrett, I want to close by once again commending you on this timely hearing. I hope that my testimony shows that though no additional legislative action is needed to provide SIPC coverage for the Stanford victims, they are facing what amounts to regulatory capture and are in a desperate search for ways to hold SIPC accountable. Hearings like this one are a very

important step in that process. I encourage you to bring them back before this committee on a regular basis to answer for their actions.

I hope at some point to hear Mr. Harbeck and Ms. Bowen tell the victims why they feel comfortable running up a $200,000 tab at the expense who have lost everything.

Thank you again Chairman Garrett, Ranking Member Waters and Members of the Subcommittee for the opportunity to speak on behalf of the victims.