TESTIMONY OF
JOSEPH P. BORG

Director, Alabama Securities Commission

before the

COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE
AND GOVERNMENT SPONSORED ENTERPRISES

United States House of Representatives

March 7, 2012

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

Thank you for the invitation and opportunity to participate in your hearing focusing on the Securities Investor Protection Act (SIPA) and the Securities Investor Protection Corporation (SIPC). I am Joseph Borg, Director of the Alabama Securities Commission and today I appear in my capacity as Director of the Alabama Securities Commission (ASC). While I served as a member of the SIPC Modernization Task Force, I am not a spokesperson for the Task Force or for SIPC.

As the state securities regulator for the State of Alabama, our office has administrative, civil and criminal authority under the Alabama Securities Act, and, specifically, with respect to investor fraud. ASC investigates Ponzi and pyramid schemes, illegal blind pools, fraudulent private placement offerings under Regulation D and other scams which have led to numerous enforcement cases and criminal prosecutions.

The majority of U.S. households now invest in capital markets in one form or another, whether through direct equity investments, retirement plans, mutual funds or similar investment vehicles (up from 1 in 18 in 1978—the year of the last significant amendments to SIPA). These investments by "Main Street" investors have become the primary method by which Americans save for their future, accumulate wealth and plan for a secure retirement. Financial fraud therefore has a profound impact and threatens the future of a great number of working families.

Beginning June 10, 2010, the SIPC Modernization Task Force conducted a series of meetings (including industry and government agencies) and telephone discussions, as well as document reviews and research, which resulted in the Task Force presenting its "Report and Recommendations of the SIPC Modernization Task Force" to the SIPC Board of Directors in late fall of 2011.

As I previously testified[1] in hearings held by this Committee on September 23, 2010, the Task Force focused on 12 main areas:

1. Adequacy of the SIPC Fund
2. Audit Responsibilities
3. Avoidance Actions
4. Corporate Governance
5. Customer Definition
6. Customer Name Securities
7. Customer Property
8. Direct Payment
9. Fictitious Securities
10. International Relations
11. Investor Education
12. Levels of Protection

The published "Report and Recommendations" covers 15 recommendations encompassing the 12 general areas mentioned above. As a member of Subgroup #1,[2] I shall discuss the recommendations primarily examined by our subgroup, namely Recommendations 1 through 4, 14 and 15.

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[1] Testimony of Joseph Borg before the Committee on Financial Services Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises, United States House of Representatives, September 23, 2010. [Copy attached as Appendix "A"].

[2] The Task force was split into two subgroups with specific areas of review.

RECOMMENDATION NO.1: INCREASE MAXIMUM PROTECTION T0 $1.3 MILLION and INDEX THE LEVEL OF PROTECTION TO INFLATION

I strongly supported an increase in the levels of protection and I stand by my previous testimony before this committee:

> "...It is my belief that the level of protection with regard to the SIPC Fund should be increased from $500 thousand to $1 million. It is clear that in today's society, Americans are heavily invested in the markets and that a large portion of their retirement savings consist of securities investments in addition to savings in banks. Further, the $1 million level of protection would match SIPC's Canadian counterpart, the Canadian Investor Protection Fund (CIPF), which is currently at the $1 million (CAN). Secondly, I believe that the levels of protection should be indexed to inflation. Part of the public's concern with SIPC is the lack of adjustments over the years to the levels of protection, and indexing to inflation would allow some measure of increased protection going forward."[3]

The recommendation of $1.3 million reflects my original opinion of an increase to $1 million plus an adjustment for indexing to inflation in recognition that Americans increasingly look to the markets and investments to secure their long term future goals. Congress has recognized the importance of "Main Street" investors in our markets and has consistently introduced legislation to further encourage small investors to continue investing in start-up companies, existing small businesses, and our markets. If we continue to encourage investments, we must recognize that the standards of the 1970s and 1980s can no longer apply in today's economic environment. The days of realizing the American dream of a secure future by saving only in a bank account or a certificate of deposit are long gone, especially with current rates generally below 40 basis points.

During the deliberations of the Task Force and after discussions with various government agencies, it became clear that concerns existed with regard to this recommendation; specifically, diverging from the historical relationship between FDIC and SIPC protection levels. Part of the

[3] Testimony of Joseph Borg before the Committee on Financial Services Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises**,** United States House of Representatives, September 23, 2010.

concerns are evident in recent SIPC matters and can be traced in part to a lack of understanding of the differences of FDIC and SIPC coverage. This public perception stems partly from the historical notion of maintaining parity. **The insurance of FDIC to bank accounts and the coverage (non insurance) of SIPC to securities is fundamentally different both in statutory application and practical application** under existing law.

RECOMMENDATION NO. 2: ELIMINATE THE DISTINCTION IN THE LEVELS OF PROTECTION FOR CASH AND SECURITIES

The distinction of cash vs. securities in brokerage accounts is meaningless in today's markets. For example, money market accounts were relatively small in 1978—certainly not the $2.7 trillion[4] now held by investors. In addition, brokerage cash 'sweeps' into money markets or bank accounts overnight with the result that substantial investor cash is routinely held in brokerage accounts (which funds deserve the full amount of SIPC protection). Further, this distinction has caused inconsistent court decisions, investor confusion and in some cases loss of customer funds[5]. This was an issue I discussed in my previous testimony before this Committee on September 23, 2010:

> "…A major issue is the treatment of claims based on a securities position which never actually existed. The Task Force is aware of the conflicts between decisions from the Second and Sixth Circuit Courts of Appeals in this area. I believe that the problem which stems from SIPA's distinction between cash and securities (currently $250,000.00 cash limit) could be eliminated by ending the disparate protection between claims for cash and claims for securities. For example, a person selling their securities portfolio and receiving a check in excess of the maximum SIPC advance for cash claim where the brokerage firm failed before the check was cashed, would be limited to the cash limitation. Therefore the current law may, in some cases, result in unintended and inequitable results. I would also note that the Canadian Investor Protection Fund (CIPF) eliminated a distinction between claims for cash and claims for securities in 1998. In a

[4] Presentation of Investment Company Institute ("ICI") to the SIPC Task Force.
[5] See examples set forth in the Task Force recommendations.

> discussion with SIPC staff, it appears that a change in favor of eliminating the cash vs. securities distinction would not alter the risk models used by SIPC…."[6]

Again, as with the increase of protection in RECOMMENDATION NO. 1, there was significant discussion of the concerns by banking authorities that the SIPC will offer greater protection against cash losses than the FDIC. The artificial "connection" between FDIC and SIPC levels of protection is meaningless in today's economic society and maintaining 'parity' does not benefit investors. Rather than trying to maintain the lowest level of parity, we should allow the realities of today's markets to determine the actual and appropriate need for the benefit of all investors.

RECOMMENDATION NO. 3 PROTECT PARTICIPANTS IN PENSION FUNDS ON A PASS-THROUGH BASIS

Many Americans have their retirement accounts as part of a 'fund' or 'plan'. These investors should be able to avail themselves of SIPC protection and not be discriminated against because their generally small accounts are part of an overall defined benefit, defined contribution or deferred profit sharing plan. This recommendation comports with the trust and fiduciary provision under the Employee Retirement Income Security Act of 1974 ("ERISA").

My testimony at this Committee's September 23, 2010 hearing included the following:

> "….The Task Force has had initial discussions with regard to indirect investors. It is my opinion that certain retirement plans are appropriate for customer eligibility. I am unsure with respect to the hedge fund arena due to the nature of hedge fund investing, including lack of transparency, lack of oversight and higher risk strategies. However, this matter is on the agenda for further discussion with the Task Force. The Task Force is also aware that certain pension plans and employee benefit plans have been covered by FDIC and NCUA on a pass-through basis since 1978. The limitation is that each beneficiary could only receive the "present vested and ascertainable interest of each beneficiary". Issues concerning deferred compensation plans and non-bank covered pension funds are issues for Task Force discussion. It appears to me that pension plans and employee benefit plans

[6] Testimony of Joseph Borg before the Committee on Financial Services Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises, United States House of Representatives, September 23, 2010.

> matching those covered by FDIA and FCUA would be appropriate for protection under SIPA."[7]

The Task Force recognizes that SIPC staff will need to review and implement specific mechanisms and procedures (claim filing, documentation, etc). SIPC accounting may also need to determine if the SIPC Fund target should be adjusted. The Task Force asked the SIPC staff if the costs would have been material based on a historical review. In response, SIPC staff advised that had this recommendation been previously implemented, the effect on the SIPC Fund would not have been material.

RECOMMENDATION NO.4 AMEND THE MINIMUM ASSESSMENT TO THE GREATER OF 1) $1,000.00; OR 2) THE AMOUNT SET BY SIPC BYLAW NOT TO EXCEED 0.02% OF THE MEMBER'S GROSS REVENUES FROM THE SECURITIES BUSINESS.

SIPC staff reported to the Task Force that 25% of the SIPC membership paid a flat $150.00 based on net operating revenues. After Dodd-Frank, based on 0.02% of gross revenues, many of the same members would pay less than $150.00, and in some cases, $0. If members are utilizing SIPC in marketing materials and benefitting from the SIPC program, they should pay a minimum amount. Similarly, considering the size of the industry and the touting of SIPC coverage in advertising, a reasonable minimum assessment should be required. While I personally thought $1,000.00 was low, the general consensus was that $1,000.00 would be a reasonable amount in the current environment.

Another area discussed by the Task Force involved whether Mutual Fund Dealers and Assessments on Mutual Fund Revenues should be included. Representatives from the mutual fund industry appeared and made a case that there is no significant history of losses to investors

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[7] Testimony of Joseph Borg before the Committee on Financial Services Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises**,** United States House of Representatives, September 23, 2010.

on mutual funds and that structural differences between retail broker dealers and mutual fund distribution do not warrant such assessments. I did not agree with the majority of the Task Force not to assess mutual fund revenues on the theory that the mutual fund industry utilizes the SIPC logo, touts the SIPC coverage and billions of dollars of mutual fund shares are held in street name.[8] However, the fact that there is a history of minimal losses was persuasive to the majority of the Task Force. Further, SIPA §78ddd (c)(3)(C) currently exempts "…revenues received by a broker or dealer in connection with distribution of shares of a registered open end investment company... ."

RECOMMENDATION NO 14 INTERNATIONAL RELATIONS: SIPC TO ASSIST IN THE CREATION OF AN INTERNATIONAL ASSOCIATION

In today's "global" economy, geographical boundaries have little meaning. The cross-border effects of a failure of a multi-national business (Lehman, MF Global) have local, national and international implications. While the financial sectors have transcended political and geographical boundaries, the mechanisms for resolution when a major failure occurs are still rooted in the laws of the respective national jurisdiction. This 'sorting out' of laws, rules, regulations and procedures incurs substantial expenditure of time and resources. The creation of an international forum specifically dedicated to resolution of a failed entity should be seriously considered. The Task Force recognized that an international association will take time to develop, but beginning with a forum for discussion of international securities investor protection initiatives may provide the basis for future dispute resolution. In past years, I have served as the States' representative through NASAA[9] to the International Organization of Securities Commissions ("IOSCO") and between 2004 to 2009 as a U.S. Delegate in an expert capacity to

[8] Members of ICI manage assets of $12.33 trillion with 90 million shareholders according to ICI.

the United Nations Committee on International Trade and Law (UNCITRAL). That experience convinced me that the establishment of direct contacts and combining efforts specifically targeted to develop methods for coordination of a cost effective, transparent and efficient claims process would be a substantial benefit to investors. The Task Force recommendation encourages SIPC to continue its Memorandum of Understanding Program but to now elevate this program to a new level in taking the lead in the development of an International Association of like entities.

RECOMMENDATION NO 15 SIPC TO CONTINUE INVESTOR EDUCATION EFFORTS

As one of the Task Force members who participated in both of the SIPC public forums and answered telephone questions from the public, it was painfully evident that many investors consider FDIC and SIPC to be virtually identical, that is, insurance against theft, loss and fraud. I stand by my testimony at this Committee's September 23, 2010 hearing:

> "…It is clear that there is a general public misconception that SIPC is some type of insurance, akin to FDIC insurance for banks. It is also clear in SIPC's application of the law that SIPA was not intended to be insurance for fraud, but only for replacing cash, as well as securities missing from customer accounts not connected to the actual value of investment into the securities purchased or believed to have been purchased, and not based on a risk of loss fundamental. If Congressional intent is to change SIPC into FDIC type insurance-based protection, then the parameters of the level of funding would change. The misconception has been historically exacerbated by references to FDIC as a comparison and by the broker-dealer community who tout the SIPC protection levels. Education initiatives to correct the misconception have proven to be inadequate. Therefore, I would suggest that to seriously educate investors with an understanding as to what levels of protection are available and the true nature of SIPC protection, a constant and systemic notification (education) effort will be required. I would suggest that every brokerage account statement that is sent to investors include a page or a section that clearly underscores what SIPC is and is not. I would also suggest that it include examples which change every quarter so that the public can see what to expect or not to expect from SIPC. The fact of the matter is that television advertisements, public presentations and newspaper reports are one-shot efforts that will not overturn a history of belief and

[9] NASAA (International Securities Administrators Association) is a voluntary association whose membership consists of 67 state, provincial and territorial securities administrators in the 50 states, the District of Columbia, Puerto Rico, the U.S. Virgin Islands, Canada, and Mexico.

> expectation. I would also not recommend an insert into the account statements as they have a tendency to be discarded, instead, every account statement would have a portion of a page dedicated to SIPC coverage. It may take several years of constant message delivery to reverse the current tide of misconception. This is not to say that elimination of other types of investor education is desirable. However, for true education, the repetitive nature of account statement receipt should assist in disseminating correct information of the purpose and role of SIPC. I am also aware that SIPC does not have the power or authority to require this type of account statement inclusion and the matter would have to be implemented through the SEC and FINRA…."

The Task Force considered the recommendations above but were unable to determine the costs to the industry and the potential effectiveness of these efforts. The issue is left with the SIPC Board for further study. The Task force did, however, unanimously recommend that a dedicated investor education employee be hired to enhance existing efforts and develop new initiatives.

<u>VIEWS ON PENDING LEGISLATION:</u>

The Committee's invitation further requested any views on pending legislation, specifically the following:

H.R. 757 "EQUITABLE TREATMENT OF INVESTORS ACT"

H.R. 1987 "PONZI SCHEME INVESTOR PROTECTION ACT OF 2011"

H.R. 4002 "IMPROVING SIPC ACT OF 2012"

<u>H.R. 757</u>

When a fraud occurs, the purpose of the fraudster is simple….deprive honest people of their funds to benefit the crook….. In essence, stealing with paper and pen (now computers and technology) rather than at gunpoint or through a burglary. In a perfect world we would want anyone so injured to get back what they lost. The question is then, what should they get back? Is it what they put in, that is, the actual investment that was stolen and distributed as 'profits' to other victims (less the amount taken by the crook) or what was promised, that is, the representations or promises of <u>potential</u> profit?[10] Our office has been faced with numerous ponzi, pyramid and other scams that affect our citizens. The Alabama Securities Commission currently has 48 defendants awaiting trial for various forms of securities fraud. So far in this past year we have convicted 16 individuals for fraud upon our investors. The problem is always the same—limited assets to distribute. While the intent of HR 757 is noble, it is not equitable and therefore confers an unequal benefit to some victims over other victims, all of whom are innocent and all of whom relied on the con artist. The investor rule then becomes: be the first in on a ponzi scheme, always take out your profit to guarantee the money can't be touched and save all your account statements. The goal is to be an early investor at the expense of later investors.

In one case[11] prosecuted by my office, fictitious account statements were issued indicating substantial profits from options trading. In fact, what trading did occur consistently lost money. What little assets remained were proportionately distributed based on the actual cash invested. Had our office distributed assets based on the account statements, and not considered the payouts already received, the vast majority of the later investors would have received nothing.

In a Ponzi scheme, early investors may receive distributions in excess of their initial investment but their ever increasing account statements show substantial amounts the victims <u>believe</u> to be in existence. With a limited amount of assets to distribute, we must treat every investor equitably by first attempting to make everyone whole on their initial investment (amount invested—amount received=actual cash lost). Rarely is there ever enough money to

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[10] For example, in *Alabama Securities Commission vs. Greater Ministries International Church* the promise was "Double your money in 17 months". Over 20,000 victims invested with losses of over $500 million. Account statements were sent quarterly for nine (9) years. Likewise, *In the matter of MN Partners*, the promise of a $300.00 investment that would return $1,800 as month for life tax free after 5 years, resulted in over 18,000 victim investor accounts.

[11] *ASC v. Wealth Builders International* and *Networker 2000*.

accomplish this task. In my 18 years of experience only once were we able to return 100 cents on the dollar of actual investments (not promised returns). Unless there is an endless supply of funds to pay 'promised' returns, it becomes difficult if not impossible from assets available to cover all promises or expectations without a 'bailout' from someone else, whether it be the federal government or increased costs to the industry (with costs passed on to other investors).

The fundamental problem with the 'last statement' approach is that when thievery is involved the statements will match the fraudulent representations made (historical or otherwise) regardless of reasonableness, market conditions or reality. Fraudulent representations of "double your money" or 20% returns and statements to match are commonplace.

While H.R. 757 attempts to fix a terrible problem for many, it creates a problem for many others. I concur with a suggestion made by Prof. John Coffee at the September 23, 2010 Committee hearing in his discussion of "Net Winners" and "New Losers" in a ponzi scheme on a possible compromise solution:

> "…..One can certainly understand the desire to protect the smaller Net Winner, who withdrew only a small amount in excess of his or her cash investment in the Ponzi scheme. Most likely, the SIPC trustee would not sue the smaller Net Winners, but a *de minimus* exception could be created, instructing a SIPC trustee not to bring suit against persons whose withdrawals exceeded their investment by a given amount (say, $500,000). This would give peace of mind to many, but it would not impede the trustee in his pursuit of the larger Net Winners……
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> Another more limited exemption may also be justified. It can be argued that early investors in a Ponzi scheme should be given credit for the imputed interest on their investments, and such amounts should not be regarded as "fictitious profits." To illustrate, assume that two investors both invest $1 million in a Ponzi scheme, and both withdraw $2 million. But Investor A invested his $1 million ten years ago, while Investor B invested his $1 million only last year. Thus, Investor A made a profit of $1 million (the $2 million withdrawn minus a $1 million initial investment) over ten years (or a 10% annual rate of return), while Investor B made the same $1 million profit in one year (or a 100% rate of return).
>
> These two investors look very different once we recognize the time value of money. From such a perspective, Investor A's real rate of return was only 10% per annum. In this light, Congress could immunize some minimum annual rate of return from the concept of "fictitious profits." This could be done either in the Bankruptcy Code or (less desirably) in SIPA. Thus, Section 8A(f)[12] could instead

[12] Prof. Coffee's reference is to H.R. 5032 (2011), now H.R. 1987 (2012).

> instruct the SIPC trustee not to seek to the recovery of profits from any investor in a Ponzi scheme without first subtracting a credit against these profits equal to a defined interest rate (say, 10%) times the principal amount invested each year. On this basis, Investor A would not have received "fictitious profits," while Investor B would have. For the sake of simplicity, I am not considering the compounding of interest in this hypothetical.
>
> This distinction rests on a real economic difference between these two investors, subtracting a credit against these profits equal to a defined interest rate (say, 10%) times the principal amount invested each year. On this basis, Investor A would not have received "fictitious profits," while Investor B would have."[13]

Perhaps HR 757 should be revisited and drafters may wish to consider revisions reflecting a basis as described by Prof Coffee in order to maintain equitable balance among the victims of a ponzi scheme.

<u>HR 1987:</u>

To the extent that HR 1987 contains similar concepts as HR 757, the same commentary would apply. HR 1987 also seeks to limit the trustee of a Ponzi scheme on recovery of funds from investors who have received funds from later investors (clawback). The net effect is subordinating the claims of later investors, the 'net losers' under Prof. Coffee's terminology, to the interests of the 'net winners'. Reducing the pool of assets injures the later investors to a greater degree. When faced with a ponzi scheme situation, all the assets, including the transfers stolen from later investors and given to earlier investors should be pooled to benefit all investors without preferential treatment. <u>There are no real 'profits' in a ponzi scheme and payments to earlier investors are proceeds of a crime unbeknownst to both the earlier and later investors</u>. All victims are equal, and unlike George Orwell's <u>Animal Farm</u>, some victims should not be more equal than other victims[14].

[13] Testimony of Prof John Coffee Before the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises of the Committee on Financial Services, United States House of Representatives September 23, 2010.

I note that HR 1987 Section 8 (A) (h) would apply the law retroactively with a threshold of $1,000,000,000. Our experience in prosecuting these schemes confirms that even a small ponzi scheme can wipe out investors life savings and destroy the hopes and dreams of entire families. Such a threshold is artificial and is not fair to all investors. Only those investors in 'large' frauds get the benefit of the law and smaller frauds essentially don't count. The devastating effect on families occurs regardless of the size of the scheme. If Congress is considering retroactive application, why not retroactively apply the law to all ponzi schemes affecting all American investors, perhaps retroactive to March of 2000[15]?

With regard to 'indirect investors', while the Task Force discussed the concept of coverage for indirect investors, the Task Force chose to limit the discussion to similarities in existing law (see discussion of RECOMMENDATION NO 3 above). Considering the large body of law on limitations on claims against third parties (such as limitations on class actions and recent decisions not allowing derivative claims, etc.) and considering that investors who dealt with 'feeder' funds placed reliance in the feeder funds and not the brokerage entity, pass through liability to SIPC may not be appropriate. The 'feeder fund' is the client of the failed entity. The investors in the 'feeder fund' have claims against that 'feeder fund' for any violation of duty of care, failure of due diligence, etc. However, one provision of H.R. 1987 proposes a maximum amount for indirect ponzi scheme investors which may have merit <u>prospectively</u> if fully researched and developed. Coverage for "indirect investors" is feasible if clear rules are in place including transfer of potential claims similar to subrogation on insurance, up front disclosures by feeder funds to the brokerage entity of its clients, disclosure by the feeder fund to its investors of the pass through coupled with transparency as to fees charged for the service, and clear disclosure as to what actual services the feeder fund is doing for its fee.

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[14] Orwell, George, <u>Animal Farm</u> (1945) " … all animals are equal but some animals are more equal than others …"

HR 4002

This Bill is specifically directed to the unfortunate situation created by the massive Stanford fraud. The matter is in litigation and will apparently be decided by the courts. Depending on a final court decision, the one-time payments being proposed may be correct, may be subject to recapture or may be determined to be inappropriately paid.

The pending issue is whether SIPC has the statutory power to reimburse the investors/victims in the alleged Stanford Ponzi scheme since it appears they did not lose money in a failed brokerage firm. Investors lost as they purchased CDs from an offshore "bank" instead of an FDIC insured institution[16]. The bank issuing the CDs was chartered, domiciled, regulated and audited in Antigua. Investors purchased the CDs for the interest rates being paid which were substantially higher than rates paid by U.S. regulated banks.

The potential result of the pending action may have wide ranging effects. If in fact a foreign (non - U.S. regulated) bank can sell CDs (or similar products) through a brokerage then it makes sense for anyone contemplating the purchase of a CD to find an offshore bank (through a brokerage) paying substantially higher than any U.S. Bank, therefore knowing that **if** a loss occurs by fraud they will be covered by SIPC at a possibly higher rate than currently offered by the FDIC. In such a case, why would anyone invest in a U. S. bank CD at substantially lower interest rates for the same or a lesser guarantee of coverage? At this point SIPC becomes the virtual equivalent of FDIC coverage for <u>non</u> U.S. regulated banks. If Congress has not yet sought the opinion of the federal and state banking regulators on this issue, I suggest that such a request be made.

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[15] Beginning of the first major crash of the century, commonly referred to as the "tech wreck".

[16] Based on information available, including comments by SIPC and its Trustee, it does not appear that investors placed funds in the Stanford brokerage unit <u>and</u> that the brokerage failed to purchase the Certificates of Deposit. If the brokerage unit had failed to transfer funds to the bank's accounts either in the U.S. or directly to Antigua for the CD purchase then clearly, SIPC coverage would be in effect.

Let me be clear, as a state securities regulator, I always look for ways to have investor losses covered when legally possible. If the current litigation between the U.S. Securities and Exchange Commission and SIPC determines that coverage is available for a foreign bank CD fraud, then we should expect that all similar cases of securities fraud should also be covered, not just foreign bank CDs. For example, the Alabama Securities Commission has investigated the matter of Mallory Investments[17], a defunct registered broker-dealer who sold millions of dollars of fraudulent Regulation D 506 private placement offerings to investors. Similar frauds exist through brokerages and investors in those cases should be covered as well if the decision in SEC vs. SIPC requires coverage in a situation even more remotely removed from a brokerage than the private placement offerings.[18]

At this time, it appears that the more prudent course would be to allow the judicial system to finalize the issue so Congress can consider the result and act accordingly to support, modify or overturn the Court's action through appropriate legislation.

Improvements to SIPA and SIPC can and should be made but must be made for the benefit of all investors equally.

Thank you for the honor to once again submit testimony on these critical issues.

[17] To date, ASC has criminally convicted 5 individuals from California connected with the Mallory fraud. Other cases such as DBSI, MedCap and others may also become eligible for coverage.

[18] During the period 1996-1999, the Alabama Securities Commission was the lead state investigating the micro-cap frauds of the time, including such firms as Stratton Oakmont, Duke & Co., Biltmore Securities, etc. (Testimony of Joseph Borg, "Fraud in the Micro-Cap Markets and Penny Stock Fraud", before the Permanent Subcommittee on Investigations of the Committee on Governmental Affairs, United States Senate, September 22, 1997). We proffered the idea that the SEC, SIPC and Congress consider the issue of SIPC coverage for brokerage fraud in the micro-cap area. The idea was rejected.

APPENDIX A to Testimony of Joseph P. Borg before the Committee on Financial Services Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises (March 7, 2012)

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

I am Joseph Borg, Director of the Alabama Securities Commission and I welcome the opportunity to participate in your hearing focusing on the Securities Investor Protection Act (SIPA) and the Securities Investor Protection Corporation (SIPC). Today I appear as a member of the SIPC Modernization Task Force and in my capacity as Director of the Alabama Securities Commission (ASC). Our office has administrative, civil and criminal authority under the Alabama Securities Act and specifically with respect to investor fraud, ASC investigates Ponzi and pyramid schemes, illegal blind pools, fraudulent private placement offerings under Regulation D and other scams which have led to numerous enforcement cases and criminal prosecutions in this arena.

With about 55% of US households now investing in our capital markets, up from 1 in 18 in 1978 (the year of the last significant amendments to SIPA), financial fraud has a profound impact on a great number of working families.

With regard to SIPC, I was invited to participate on its Modernization Task Force in late May of 2010. Since that time, we have had a series of telephone conferences, three in-person meetings discussing various issues related to SIPA and SIPC, as well as dedicated website access to exchange information and ideas. I would like to take a few minutes and advise you of my position with regard to certain "modernization" issues which I have either proffered or have supported. These views do not necessarily reflect those of SIPC or of the Task Force. The Task Force discussions are concentrating on twelve particular areas as follows:

1. Adequacy of the SIPC Fund,
2. Audit Responsibilities,
3. Avoidance Actions,
4. Corporate Governance,
5. Customer Definition,
6. Customer Name Securities,
7. Customer Property,
8. Direct Payment,
9. Fictitious Securities,
10. International Relations,
11. Investor Education, and
12. Levels of Protection.

In order to move the process along in an efficient manner, the Task Force has been subdivided into two groups. Later, the subgroups will join together for discussions on the various subjects for final recommendations. I would like to take a moment to commend the SIPC staff for prompt responses to my specific requests for information, data, reports and source materials in order for the Task Force to become adequately informed in certain areas. My particular areas of concern are as follows:

1. Levels of Protection. It is my belief that the level of protection with regard to the SIPC Fund should be increased from $500 thousand to $1 million. It is clear that in today's society, Americans are heavily invested in the markets and that a large portion of their retirement savings consist of securities investments in addition to savings in banks. Further, the $1 million level of protection would match SIPC's Canadian counterpart, the Canadian Investor Protection Fund (CIPF), which is currently at the $1 million (CAN). Secondly, I believe that the levels of protection should be indexed to inflation. Part of the public's concern with SIPC is the lack of adjustments over the years to the levels of protection, and indexing to inflation would allow some measure of increased protection going forward.
2. Fictitious Securities. A major issue is the treatment of claims based on a securities position which never actually existed. The Task Force is aware of the conflicts between decisions from the Second[1] and Sixth Circuit Courts of Appeals[2] in this area. I believe that the problem which stems from SIPA's distinction between cash and securities (currently $250,000.00 cash limit) could be eliminated by ending the disparate protection between claims for cash and claims for securities.[3] For example, a person selling their securities portfolio and receiving a check in excess of the maximum SIPC advance for cash claim where the brokerage firm failed before the

[1] *In Re: New Times Securities Services, Inc.*, 371 F.3rd 68 (2nd Cir. 2004)
[2] *Plumbers & Steamfitters Local No. 490 Severance and Retirement Fund v. Appleton (In Re: First Ohio Securities Co.,* No. 93-3313, 1994 US App. LEXIS 31347) (6th Cir. Nov. 1, 1994)
[3] If Subsection (a)(1) of SIPA § 78fff-3 is deleted, the disparity would no longer exist.

check was cashed, would be limited to the cash limitation.[4] Therefore the current law may, in some cases, result in unintended and inequitable results. I would also note that the Canadian Investor Protection Fund (CIPF) eliminated a distinction between claims for cash and claims for securities in 1998. In a discussion with SIPC staff, it appears that a change in favor of eliminating the cash vs. securities distinction would not alter the risk models used by SIPC[5].

With respect to increasing the limit to $1 million and eliminating the cash vs. securities distinction, the banking industry and/or banking regulators could be expected to oppose such a change as there has been an apparent historical progression of matching levels of FDIC protection to SIPC limits even though the operation of FDIC insurance is completely different to the operation of SIPC as a securities replacement vehicle. Certainly discussions with the Securities & Exchange Commission (SEC), Treasury, Federal Reserve Board and views of the industry (SIFMA) and other authorities would be appropriate.

3. <u>Increase the Line of Credit from Treasury</u>. Considering the explosive growth of the markets and investor participation therein since the enactment of SIPA and the expected continuation of growth in the securities markets, a change in coverage to $1 million cash or securities and indexed to inflation may require an increase in the line of credit from Treasury. The Task Force has requested the staff of SIPC to review the effect of protections at the $1 million level. It is my personal feeling that a line of credit of $5 billion matched with reserves of $5 billion would be appropriate going forward. At the current level of assessments, it will take a number of years to reach those levels. However, I believe those levels to be realistic and planning for them should begin now.

4. <u>Assessments</u>. Prior to enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), assessments by SIPC had a floor of $150.00 with a maximum of .25% of revenues. The SIPC staff has also informed the Task Force that there are some SIPC members under the new Dodd-Frank Act who now pay zero assessments.[6] It is my belief, as well as other members of the Task

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[4] Investors do not routinely accumulate cash with a broker and an investor's position is only "caught" in a cash position when the brokerage firm fails.

[5] It is my understanding that the sufficiency of the SIPC Fund Analysis is premised upon paying each claim up to the maximum limit for securities.

[6] Due to deductions for expenses, etc., in some cases, certain broker-dealers, based on net operating revenues, now pay zero due to elimination of any floor for assessments.

Force, that there should be a minimum assessment of some amount. I believe that minimum amount should be at least $1,000.00 and preferably in the range of $2,000.00 to $2,500.00. Based on information from the SIPC staff, SIPC receives about 80% of the assessment revenue from the larger firms and at current levels it will take approximately 5 years for the fund to reach the current target of $2.5 billion. I was surprised to learn that in computing assessments that revenues on mutual funds are not included. I am of the opinion that since all investors benefit from SIPC protection, that revenues on mutual funds should be included for assessment purposes as well.

Regardless of the target level that the Task Force recommends or what target level of funding for SIPC is finally adopted, any time that a target level is reached, there should be another determination of whether assessments are adequate based on the current level of investors assets in the market and whether new targets should then be considered. Also, it appears to me that the current arrangement with the Treasury for a line of credit, which is a term loan, should actually be a revolving loan in order to ensure continuity and flexibility in the ability of SIPC to protect investors where and when needed.

5. Investor Education Efforts. It is clear that there is a general public misconception that SIPC is some type of insurance, akin to FDIC insurance for banks. It is also clear in SIPC's application of the law that SIPA was not intended to be insurance for fraud, but only for replacing cash, as well as securities missing from customer accounts not connected to the actual value of investment into the securities purchased or believed to have been purchased, and not based on a risk of loss fundamental. If Congressional intent is to change SIPC into FDIC type insurance-based protection, then the parameters of the level of funding would change. The misconception has been historically exacerbated by references to FDIC as a comparison and by the broker-dealer community who tout the SIPC protection levels. Education initiatives to correct the misconception have proven to be inadequate. Therefore, I would suggest that to seriously educate investors with an understanding as to what levels of protection are available and the true nature of SIPC protection, a constant and systemic notification (education) effort will be required. I would suggest that every brokerage account statement that is sent to investors include a page or a section that clearly underscores what SIPC is and is not. I would also suggest that it include

examples which change every quarter so that the public can see what to expect or not to expect from SIPC. The fact of the matter is that television advertisements, public presentations and newspaper reports are one-shot efforts that will not overturn a history of belief and expectation. I would also not recommend an insert into the account statements as they have a tendency to be discarded, instead, every account statement would have a portion of a page dedicated to SIPC coverage. It may take several years of constant message delivery to reverse the current tide of misconception. This is not to say that elimination of other types of investor education is desirable. However, for true education, the repetitive nature of account statement receipt should assist in disseminating correct information of the purpose and role of SIPC. I am also aware that SIPC does not have the power or authority to require this type of account statement inclusion and the matter would have to be implemented through the SEC and FINRA.

<u>Response to Issues Presented in the Subcommittee's Invitation of September 16, 2010</u>:

In the September 16, 2010 invitation to appear before this Subcommittee, there were certain issues that the panelists were invited to address. I will respond to them in the order presented.

1. <u>Whether the SIPC board should include a representative of the Securities & Exchange Commission (SEC) and what, if any, other modifications to the government structure may be appropriate</u>. It is my understanding that SIPC reports to the SEC by way of required records and reports, as well as the filing of an audited annual report, and that SIPC must obtain SEC approval for changes to its operational rules and bylaws. Although I see little harm in having an SEC representative on the SIPC board, caution should be exercised. It appears that since SIPC, in essence, reports to the SEC, an SEC representative could possibly exercise undue influence over the board in its recommendations or positions which may, in some instances, become a conflict of interest. It appears that the question of an SEC representative should be addressed to an expert on corporate governance for a determination of possible conflicts in this area. In any case, an SEC representative should continue to attend each SIPC board meeting as an observer or adviser, which I am advised is currently done.

2. Whether the statutory minimum balance of the SIPC Fund should be adjusted in light of the recent increase in the target balance, and if so, explain how it should be adjusted. As I mentioned earlier, I believe the balance in the fund should be adjusted substantially upwards given the effect that a major case may have on SIPC's reserves. According to the SIPC staff, the former $1 billion balance has historically proved adequate to meet the requirements of SIPC cases, however, it is my belief that in light of the growth of the securities industry, plans should be made for a larger target and that is why I have recommended a target of $10 billion, composed of $5 billion in reserves and $5 billion revolving line of credit. I have no mathematical formula for this opinion. However, by increasing the coverage amount to $1 million, essentially a doubling of the current $500,000.00 limit, and looking at the possibility of the potential impact of future fraud cases, it appears prudent to be prepared so that assessments over time will be realistic and that the balance of the fund is also increased over time.
3. Whether any trustee appointed by SIPC should also be subject to bankruptcy court approval and whether trustees appointed in civil liquidations have been as efficient and effective as those appointed under similarly sized non-SIPC liquidations. It is my understanding that the bankruptcy court appoints the trustees in SIPC cases and that there must be a designation that the trustees are "disinterested parties". The Task Force has asked for further information from the SIPC staff on the history of trustee appointments and details on liquidations. This information will be studied as discussions continue.
4. Whether the standard to file a SIPC claim is too low and whether it results in frivolous claims that slow down the liquidation proceedings or otherwise creates an expectation on behalf of the customers that their claim is bona fide. I think it can be reasonably assumed that when people file claims with regard to any type of action, they believe they are entitled to some recompense. From that point of view there is a possibility that filing a SIPC claim creates an expectation, however, limiting a potential claim may cause greater harm in that the claimant who fails to file a timely claim but was eligible will be barred from recovery. From a public policy point of view it appears that encouraging investors to file a claim when they think they have a claim is preferable than trying to eliminate claims on the front end and then discovering that some with viable claims have

not filed. Since this is a fine line, I would err on the side of encouraging anyone who believes they have a claim to make the appropriate filing. Although this may result in an increase in time and perhaps costs, covering the universe of potential claimants is preferable to inadvertently leaving someone eligible out of the claims process. We are advised by staff that they have no historical indication that there have been a large number of frivolous claims in SIPA proceedings. Understanding that the *Madoff* situation may be unique, the *Madoff* matter may be an exception to the general rule.

5. Whether SIPA's direct payment procedures result in an efficient and effective way to return customer property and whether and how such criteria ought to be modified. In discussions with the SIPC staff and reviewing SIPC's direct payment procedures, it is my opinion that the direct payment procedures appear to be efficient and effective in returning customer property.[7] I have suggested to the Task Force that the direct payment amount threshold should be increased[8] to utilize the efficiency of the direct payment procedures. The Task Force is currently discussing what that proper amount should be and I have recommended that the Task Force consider $2 million as the appropriate amount.
6. Whether the statutory definition of a customer eligible for SIPC coverage remains relevant given indirect investing increases via retirement plans and hedge funds. The Task Force has had initial discussions with regard to indirect investors. It is my opinion that certain retirement plans are appropriate for customer eligibility. I am unsure with respect to the hedge fund arena due to the nature of hedge fund investing, including lack of transparency, lack of oversight and higher risk strategies. However, this matter is on the agenda for further discussion with the Task Force. The Task Force is also aware that certain pension plans and employee benefit plans have been covered by FDIC and NCUA on a pass-through basis since 1978.[9] The limitation is that each beneficiary could only receive the "present vested and ascertainable interest of each beneficiary". Issues concerning deferred compensation plans and non-bank covered pension

[7] SIPC records indicate that the direct payment procedure has been used in 35 of the 204 proceedings since 1978.
[8] Current law authorizes use of out-of-court direct payment procedure where aggregate claims are less than $250,000.00 [15 U.S.C. '78fff-(4)(a)].

funds are issues for Task Force discussion. It appears to me that pension plans and employee benefit plans matching those covered by FDIA and FCUA would be appropriate for protection under SIPA.

7. Whether and how SIPA's definition of customer property should be amended in light of the changing nature of customer arrangement with their broker-dealer, including account balances tied to client commission agreements and innovative investment vehicles such as security based swaps and to-be-announced security transactions. There is a substantial difference between individual retail investors and large institutional investors (including large sophisticated investors) who have interrelated and complex agreements with brokerage firms. Clearly the original intent of SIPA in 1970 was protection of the retail market and it appears that the complex relationship investment arrangements implicit in the question were not contemplated at the time. While this area deserves study, truly sophisticated investors, especially institutional investors, are in most cases a different type of investor and therefore it may be appropriate for these non Main Street large investors to be subject to a different standard than traditional SIPA protected investors.

8. Whether and how SIPA's definition of "net equity" should be revised to address situations whereby a customer statement from their broker-dealer does not agree with the broker-dealer's books and records and the extent to which customers should be entitled to rely on a statement they have received. Historically, customers net equity has been determined by the securities position shown on the customer's account statements. And again, historically, the account statements would show accurately the transactions that occurred, but the securities were then missing. In most cases, where statements are received the securities positions that had been purchased at the customer's instructions are accurate and those securities are expected to be in their accounts. It is a different matter, however, when securities positions are fictitiously created, as in the *Madoff* case. The Madoff customers expected that the money given to Madoff would be placed in legitimate trading circles. Concocting account statements with 20/20 hindsight is more akin to the type of Ponzi and pyramid schemes

[9] Allowing for each beneficiary of a pension, profit sharing plan (401(d) of IRS Code) or individual retirement account (408(a) of IRS Code) – FDIA amended in 1991 to allow for 457 plans (deferred

generally seen by state regulators in which no SIPC member is involved. The vast majority of these cases which occur on an alarmingly frequent basis cause the same monumental damage to individual investors as any *Madoff* or *Stanford* case. These situations have generally been handled through the cash-in cash-out method of calculating equity. In the 15 years my office has been handling cases involving Ponzi, pyramids and other schemes outside the SIPC arena, most cases only return pennies on the dollar with the assets marshaled through a receivership and distributed based on a cash-in cash-out basis. Where there are inflated account statements, they do not reflect actual cash in but a promise of expectation computed retroactively or completely fabricated. Where there are insufficient assets to pay all parties, the most fair determination has been to compute all cash in, all distributions out, resulting in the net loss, then determining the pro rata basis for payments of whatever assets have been marshaled. This is significantly different than a customer who directs a broker to buy a specific security, the trade is paid for and the broker sends a false confirmation. In a non-SIPC covered fraud, this would be of no effect since there is no coverage for said transaction. However, under SIPA, the customer's net equity would be the market value of the security the broker should have purchased that the customer actually paid for and the broker-dealer lied about having purchased. SIPC would then obtain the security in the marketplace or credit the customer with the actual market value as of the appropriate filing date. Utilizing the last inflated account statement would give a preference to earlier investors while disenfranchising later investors. It should be noted that the time-value of the funds is not considered in the non-SIPA cases generally handled by the states. Most Ponzi schemes do not last for decades, are relatively short in time and therefore the time value interest differential is generally not significant. It is my understanding that the SEC has taken a position with regard to the *Madoff* case that the calculations could include a factor with regard to time value or time equivalent (constant dollars)[10]. It would appear that each case would have to be reviewed for a determination based on the amount of investments and the <u>time</u> that the fraud was ongoing. I would respectfully suggest, based on our

compensation plans) and certain non-profits.

history of cases and prosecutions involving Ponzi schemes, that generally the cash-in cash-out is the most equitable method in most cases. However, cases involving a situation of long-standing ongoing fraud could consider a cash-in cash-out and a factor of time value or time equivalent conversion, *except* that each investor's claim should be measured from a date certain, whereupon an inflation factor would be applied. This type of time value of money approach appears to require a statutory change to SIPA as this variable treatment is not recognized under current law.

Judging from the complexity and duration of certain current Ponzi schemes, some flexibility in the SIPA rules and SIPC administration is due to be considered and should be reviewed by the Task Force.

9. Whether the requirement for SIPC to pay interest on customer named securities and customer property not distributed within 60-days of filing the SIPA Liquidation Application is an effective way to ensure that customer claims are properly satisfied. In discussions with the SIPC staff, it appears that the issue of substantial delays rarely arises. We are advised that the typical liquidation involves a transfer to a solvent brokerage. However, provisions requiring SIPC to pay interest on property not distributed within 60-days may not be much of a motivating factor to encourage customer claims to be paid promptly and, further, could add to the complexity of the payment calculation. Questions may arise as to when the 60-days begin to run, or, if claimant waits until the end of the six month period to file a claim. Also, it appears that, in general, interest is not paid on bankruptcy claims. For these reasons, I believe a provision for the payment of interest would not effectively ensure claims are satisfied more efficiently. On the other hand, one issue to be considered is that under state law if an improper sale of securities has occurred or where a recission is ordered by the state securities regulator, each state may apply a statutory rate of interest. For example, in Alabama, a recission of a transaction order or a buy-back includes a 6% interest factor. Other states will have varying amounts of statutory interest. Whether this has any practical value in a SIPC claims situation has not yet been discussed by the Task Force.

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[10] U.S. House Committee on Financial Services, Subcommittee on Capital Markets – Testimony of Mr. Michael Conley, Deputy Solicitor, U.S. SEC, December 9, 2009.

10. Whether the avoidance powers granted to a trustee in a SIPA liquidation should differ from US Bankruptcy Code. The US Bankruptcy Code has been a primary vehicle with regard to determining avoidance powers and setting precedents. I see no reason to create a separate system for SIPA liquidations that differ from the US Bankruptcy Code. Not only will a different system cause confusion, but considering there is a national system in place under the US Bankruptcy Code, uniformity with respect to avoidance powers would be preferable. At the present time, the Task Force has this matter under consideration and after further discussion I believe a recommendation will be made.
11. Whether the mechanics for informing investors about the existence of and protections afforded by SIPC should be altered. The issue with regard to investor education and the existence and levels of protection afforded by SIPC was discussed earlier and I would refer the Subcommittee back to Page 4 of this paper.
12. Whether the private sector could provide primary coverage in the event that SIPA was modified to eliminate and replace SIPC's coverage with a requirement for broker-dealers to obtain private coverage comparable to the coverage currently provided by SIPC and whether excess SIPC coverage by the private sector is appropriate. For all practical purposes, a meaningful broker blanket bond does not exist with respect to fraud claims. A number of brokers have minimal capital requirements to begin with. Problems will exist as to whether or not the broker who has placed itself in financial jeopardy would continue the blanket bond and whether the damage, already done to investors, would have any real recompense. Without a central entity, such as SIPC, the "coverage" is only as good as the insurance company behind the blanket bond, assuming that it remains in effect and generally, in the business community, fraud claims are either not covered or vigorously defended. I do not believe this would be a practical approach and in the current environment, private insurers are generally not interested in selling this type of coverage. If available, the cost could be prohibitive to most brokers thereby reducing the competitive nature of the industry. This is not an area that I have studied in any great detail and would leave to others more qualified to comment, however replacing SIPC which a private sector insurer does not appear workable or desirable.

13. Whether the capital adequacy rules for broker-dealers are sufficient to prevent significant customer losses. In my experience as a state regulator, the capital rules are generally insufficient to cover losses. This is an area for SEC and FINRA to utilize their experience to consider the capital rules in light of today's environment and issue a report and recommendation. In a situation where fraud exists or other obligations such as an award in arbitration that has not been paid, there is generally insufficient capital to cover those customer losses.[11]
14. Whether investment advisers should be scoped into and subject to assessments under SIPA or a similar protection regime. In general, investment advisers do not hold customer assets, as the assets and the transactions involving those assets are held at a broker-dealer who would be a SIPC member. In light of the current switch of a significant portion of the investment adviser population from SEC to state level, the question by the Subcommittee has prompted my office to undertake a review of the activities of those investment advisers, between $25 million and $100 million, to determine the differences in their operations with respect to the investment advisers we have historically regulated (those under $25 million). I expect to share the results of my staff's examination with the Task Force. Until such time of the determination as to whether or not this is a significant issue, I am reserving an opinion.

International Relations.

In addition to the above discussion, I have been requested by the Task Force to look at SIPC's involvement in international relations. For a number of years I have been honored to represent NASAA[12] at the International Organization of Securities Commissions (IOSCO) and the Council of Securities Regulators of the Americas (COSRA). From 2004 through 2009 I served as a U.S. Delegate as an expert on securities fraud to the United Nations Committee on International Trade and Law (UNCITRAL). In reviewing SIPC's activities, it is apparent that SIPC has taken a more active role in international affairs as broker-dealers increasingly have overseas affiliates or subsidiaries, and, as demonstrated by the failure of Lehman Bros., these overseas affiliates and subsidiaries can have world-wide implications. The questions being asked by the Task Force include:

[11] Please also see related discussion in Item 12 above.
[12] NASAA (International Securities Administrators Association) is a voluntary association whose membership consists of 67 state, provincial and territorial securities administrators in the 50 states, the District of Columbia, Puerto Rico, the U.S. Virgin Islands, Canada, and Mexico.

1. “Does SIPA adequately protect customers in the event of the insolvency of a member which is a multi-national corporation?”
2. “How can membership in an international association of investor protection agencies be used effectively?”
3. “What lessons can be learned from the liquidation of Lehman Bros., Inc.?”

SIPC’s records show that it has entered into Memoranda of Understanding with a number of foreign regulators, including the Financial Services Compensation Board (United Kingdom), Canadian Investor Protection Fund, Securities and Futures Investor Protection Center (Taiwan), Korea Deposit Insurance Corporation, China Securities Investor Protection Fund Company, Ltd., and Egyptian Investor Protection Fund. Recently SIPC has joined IOSCO as an auxiliary member. The SEC is the primary member of IOSCO for the United States, followed by the North American Securities Administrators Association (NASAA) as an affiliate member, FINRA as an affiliate member, and SIPC as an auxiliary member beginning in 2009. Current discussions are underway concerning creation of a new organization to deal exclusively with investor protection in the context of cross-border financial intermediary collapse. It is therefore appropriate for SIPC to enter discussions with the Secretary General of IOSCO concerning a new international association of investor protection entities. There appears to be preliminary interest from the IOSCO Secretariat in the creation of this entity under the auspices of IOSCO. Such an international cooperation mechanism could formulate and develop policies as:

1. Formal rules on cross-border protection issues,
2. Create a dispute resolution mechanism with a team of experts available,
3. Develop a platform for exchange of information, and
4. Establish cooperative principles.

Work towards development of an international forum has already begun through the efforts of Mr. Chen Gongyan, Chairman of the China Securities Investor Protection Fund Corporation and a member of the Task Force. Discussions with SIPC to build an international cooperation mechanism were brought about primarily due to the *Lehman Bros*. case and Chairman Gongyan has indicated his willingness to co-sponsor an international forum together with SIPC and the Canadian Investor Protection Fund. Communications with the IOSCO Secretary General are underway to organize an open forum to discuss the issues and determine protocols for creation of such an international organization. Work in this arena is extremely preliminary and is subject to a number of factors, including relevant application of law to cross-border investor protection, varying laws involving bankruptcy, development of an information sharing platform and transparency with regard to the rules of compensation and protection to ensure that investors within the country and abroad have a fair chance to submit an application for compensation and access to relevant information.

I thank you again for the invitation and opportunity to appear before you today.

(cwdocs/2010 house subcommittee testimony/2010 testimony borg.14)