



Testimony November 22, 2013

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Network for Investor Action and Protection

Subcommittee on Capital Markets and Government Sponsored Enterprises

Chairman Garrett, Ranking Member Maloney and Members of the Subcommittee, my name is Ron Stein, and I am the President of the Network for Investor Action and Protection (“NIAP”) -- a national not for profit organization comprised of small investors dedicated to improving our Nation’s investor protection regime. I am also a Registered Investment Advisor, Certified Financial Planner, and a member of the financial services community in good standing. Over 1000 members of our organization were victims of the Madoff fraud.

I am honored to speak to you today, nearly five years after the collapse of the Madoff brokerage firm, to give voice to the small and mostly middle-class investors who were devastated by this fraud and who, despite reasonable expectations, received little or no protection from the SIPC and the SIPC-appointed Trustee. What I have to say has been said by many others in front of this Committee in the past. Perhaps more, I’m here on behalf of millions of small investors who have *not* been victimized, who depend on Congress, the regulatory apparatus and the industry for the protections of their life savings should similar financial disaster befall them.

Where do we stand? Thousands of lives upended, with another thousand being sued; story after dismal story of family horrors – depression, premature deaths, suicide, loss of medical care, life savings obliterated. Gruesome stories. Devastating stories.

This was not what Congress intended when it first passed SIPA legislation in 1970, amidst the turmoil of hundreds of brokerage insolvencies, a devastating paper crunch crisis, recession, massive theft fraud, and yes, Ponzi schemes. The creation of SIPC, the insurance-like entity, was the cornerstone of that legislation, and an essential step to providing confidence and trust to investors as Congress was ushering them away from the certainty of their physical securities to the new, more manageable world of the investment statement.

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On signing the SIPA legislation that created SIPC in December 1970, President Nixon said:

Richard Nixon: I AM SIGNING today the Securities Investor Protection Act of 1970. This legislation establishes the Securities Investor Protection Corporation (SIPC), a private nonprofit corporation, which will insure the securities and cash left with brokerage firms by investors against loss from financial difficulties or failure of such firms.

I urged the formation of a corporation to afford protection to small investors

Just as the Federal Deposit Insurance Corporation protects the user of banking services from the danger of bank failure, so will the Securities Investor Protection Corporation protect the user of investment services from the danger of brokerage firm failure.

This act protects the customer, not the broker, since only the customer is paid in the event of firm failure. It does not cover the equity risk that is always present in stock market investment, but it will assure the investor that the solvency of the individual firm with which he deals will not be cause for concern. It protects the small investor, not the large investor, since there is a limit on reimbursable losses. And it assures that the widow, the retired couple, the small investor who have invested their life savings in securities will not suffer loss because of an operating failure in the mechanisms of the marketplace.

SIPC was a central leg in the investor protection stool. It was the protector of last resort should all other regulatory components fail, as they have here.

SIPC's obligation and the commitment Congress made to the public in passing SIPA law filtered down to the investor customer. Every financial professional, every broker, every brokerage firm, has extended to every client the promise of SIPC protection. From JP Morgan Chase, Citigroup, Goldman, Merrill, to BLMIS and Stanford, every customer was informed that they were/are protected to the SIPC limit based on their account statements should their broker fail. This was part of every broker's securities training. No asterisks. No exceptions. And no reference to what fine print may have been recently, discreetly inserted in certain SIPC materials. Significantly upon these promises, the financial services industry was able to gain the trust of the American public and explode in size.

How do these promises and Congress' intentions comport with the facts of the Madoff insolvency?

FACT: the majority of investors in the regulated broker-dealer will not receive a penny of the SIPC advance guaranteed by Congress under the SIPA statute as a result of a methodology which minimizes SIPC's outlays, and more still have seen their SIPC payments markedly reduced.

FACT: after having their protections stripped away by the Trustee, over 1000 investors, acknowledged as being innocent, are being vigorously sued, like thieves and criminals, many having already lost everything.

FACT: institutions and professional investors are receiving over 80% of the recoveries of customer property (over \$9 billion has been recovered) – many of these entities that the Trustee himself has indicated should have or could have known about the fraud.

FACT: in addition to saving SIPC over \$1 billion by the Trustee's own calculations, the Trustee and his associated consultants have similarly been enriched by almost \$1 billion, funds which could have gone instead to those devastated and to desperately needed education to help reduce the likelihood of future fraud.

There is no rational way to conceive that this result – where over half the investor victims are left unprotected, and 1000 sued – is the outcome that Congress would have preferred were it sitting here today. Indeed, *this is precisely what Congress would have dreaded and was seeking to prevent*. Clearly, in no way would the American public have supported SIPA law in 1970 if this was seen as a possible outcome.

The excruciating absurdity of SIPC's handling of this debacle, and the Stanford one, after failure upon failure of the regulatory powers to quickly identify and dismantle these frauds before they reached these magnitudes makes this situation all the more surreal and horrifying.

The implications, however, are potentially devastating to all investors and the financial markets. SIPC and the Trustee have effectively destroyed for all investors the sanctity of their investment statements – the one and only item every investor has to demonstrate their ownership of a security. By their actions, they have said that the Trustee can choose to void from any protection any of the interest or growth of their investment at a broker-dealer. That the Trustee, at his whim, can deduct funds withdrawn to pay necessary living expenses in retirement, for taxes, or medical costs from any amounts ordinarily eligible for protection. Or worse, sue, without consequence, a retiree for innocently withdrawing funds from their accounts for the mere purposes of "living".

Instead of enhancing safety and protection, encouraging saving for retirement in registered broker-dealers, SIPC, in complete defiance of Congressional intent has said that when it suits their purposes, “investor be damned”. In this new SIPC-world, what investor in their right mind might could possibly trust that SIPC would be there to protect them, or worse, not sue them? What are the public policy implications of investors seeing their protection reduced during their non-working retirement years just when they’re drawing on their life’s savings, ironically when they are least capable of reinventing themselves and re-enter the workforce should disaster strike.

In this new SIPC world, every investor who is living on investment income might be well-advised to participate in an extreme version of musical chairs by pulling their assets from their existing brokerage firm where their SIPC “net equity” protection may have been reduced by any withdrawals, and move them to another firm where their new “net equity” will be reset to the amount they are depositing at the new firm.

Speaking as a financial professional for 27 years, I’m troubled and deeply embarrassed that the NASD-FINRA and SEC failed on so many occasions to identify this fraud and others. I’m embarrassed and saddened that investment professionals in firms in my industry who had reason to believe that a fraud was taking place, chose instead to keep quiet and the industry has failed to make a well-publicized statement about the moral responsibility we each have to speaking up.

But I am especially troubled, and infuriated -- as are many of my fellow financial practitioners -- that SIPC has refused to honor their very purpose: to protect investors, and instead done everything in their power to circumvent those responsibilities. Indeed, they refused to go to Congress preemptively regarding this issue (nor over New Times, Old Naples and other cases with similar issues over the years), asserted the falsehood that SIPC advances would reduce payments to other investors, and audaciously trumpeted ludicrous scenarios through the halls of Congress to cloak their behaviors. They have thumbed their noses at Congress and the American public. Unfortunately, SIPC seems to have a history of doing whatever they can to thwart investors when there is sufficient vagary in the SIPA law or rules to do so and like bullies, done so with relative impunity. Finally, under the spotlight, the dangers their actions pose to our financial system by undermining investor protection, and the opaque culture from which these attitudes evolve may become more visible for Congress and policy-makers to observe

Fortunately, the solution to this horror is simple and here before us. HR 3482 – The Restoring Main Street Investor Protection Act of 2013 -- is an important step to restoring the most basic protections intended by Congress in 1970 and in subsequent

legislation. It affirms the validity and certainty of the investment statement much as a bank customer's statement would. It prevents the clawback of innocent investors in a failed brokerage. It prevents a Trustee from becoming a go-to profit machine operating under SIPC's will. It insists that the SEC does, in fact, have the plenary authority over SIPC it is supposed to have.

This bill's assurances should be welcome news for all investors. But no assurances can be readily embraced without keeping to past promises. It can't return all the funds stolen, but in providing relief for victims of Madoff, Stanford, McGinn-Smith and other brokerage failures, this legislation makes evident Congress' intention of enhancing protections for all brokerage customers, putting Main Street first, and rebuilding confidence in the financial markets. I would hope the investment professionals and the financial services industry would see the benefit of standing with their customers in supporting this legislation, that the SIPC insurance protection they purchase for their clients is meaningful, and not worthless paper.

We don't know when the next great fraud or failure will take place, and we should undertake every reasonable measure to minimize that likelihood. There is much more to do, and I would be pleased to help the Committee with those at another time. The first step, however, is passing HR3482, and sticking to the promise we make every day to millions of small investors who depend on their brokerage firm, investment advisors, and investor protection regime for their life's savings.

My deepest thanks to you, Mr. Chairman, for your willingness to have me testify and your leadership regarding this extremely important work; and my sincere thanks as well to all your colleagues – including Congresswoman Maloney, and all the other sponsors of this legislation – who are undertaking to improve protections for all investors at this most basic, yet critical level.

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