Although the SEC refused to disclose Madoff's identity as the broker-dealer servicing the accounts for Avelino and Bienes, Madoff's identity was disclosed two weeks later in a December 16, 1992 article in the WSJ:

> Who was the broker with the Midas touch? The SEC, which last month went to court to shut down the operation, won't say. . . . But the mystery broker turns out to be none other than Bernard L. Madoff – a highly successful and controversial figure on Wall Street, but until now not known as an ace money manager.

See Exh. 2.

Of course, we now know, as a result of Madoff's March 12, 2009 plea, that he started his Ponzi scheme in "at least as early as the 1980's and that he never bought stocks for his customers.[1] Yet, SEC official Kuperberg had announced to the world that there was "nothing to indicate fraud" on the part of Madoff. On what basis did Kuperberg make that statement? If the SEC had simply demanded that Madoff produce the documentary evidence of its money management for Avelino and Bienes in 1992, the SEC would have discovered that Madoff never bought securities for his clients and his Ponzi scheme would have been exposed and terminated at that time.

SIPC has violated its statutory obligations

The devastation caused by the Madoff Ponzi scheme could easily have stripped 200,000 people of their lives' savings. The full demographics of Madoff's victims are unknown. Irving Picard, the SIPC Trustee, can certainly provide to you the number of active accounts Madoff had as of December 11, 2008. However, those accounts consisted of (a) direct investors; (b) investors through partnerships or LLC's formed by groups of family members or friends who, alone, could not meet Madoff's minimum

[1] In the allocution that Mr. Madoff read in court on March 12, 2009, he stated that the Ponzi scheme began in the early '90's. However, in response to a question from Judge Chin, Mr. Madoff acknowledged that the government's Information was accurate. The Information alleged that the Ponzi scheme began "at least as early as the 1980's."

investment requirements; (c) investors through feeder funds, including IRA's, 401-K's, and pension funds of which hundreds or thousands of company employees could have been beneficiaries; (d) investors through feeder funds which drew on foreign investment funds and foreign banks; and (e) charities, universities, and foundations, some of which lost their entire endowment.

(a) SIPC has failed to promptly pay customers' claims

The most immediate need for the SEC's intervention is the utter failure of SIPC and its trustee, Irving Picard, to provide immediate payment of SIPC insurance to the Madoff investors. Many of these investors are elderly people who were entirely dependent upon their Madoff investments for their daily expenses. When that funding was cut off in December 2008, these people had literally no ability to buy food or pay for shelter. Many have been forced into nursing homes; many have been forced to try to sell their homes at fire-sale prices, simply so that they do not have to go on welfare.

Despite the catastrophic consequences for so many innocent Americans and despite the fact that SIPC is statutorily mandated to "promptly satisfy all obligations of the member to each of its customers," 15 U.S.C. Section 78fff-4(c), so far as I know **SIPC has, to date, paid SIPC insurance to only 15 investors** – despite the fact that thousands of investors have filed claims.

(b) SIPC has deliberately mis-interpreted "net equity"

SIPC insurance is $500,000 per account for securities and $100,000 per account for cash – amounts that have not been changed since 1978 despite the fact that the cost of living has tripled in that period. SIPC has charged broker-dealers a mere $150 per year for SIPC insurance. Thus, firms like Goldman Sachs have paid $150 per year for the privilege of printing on every trade confirmation that the customer's account is insured by $500,000 of SIPC insurance.

Given the paltry fee that SIPC has charged brokers and dealers for this insurance coverage, SIPC does not have sufficient funds to honor its contractual obligations to the Madoff victims. **Therefore, SIPC has decided to construe its insurance obligation in such a way as to deprive the vast majority of Madoff investors of any coverage.**

SIPC has done this by creating an entirely new – and insupportable – definition of "net equity." The SIPA trustee is required to "satisfy net equity claims of customers" of the failed broker-dealer. 15 U.S.C. Section 78fff(a)(1)(A)-(B). According to Mr. Picard, a Madoff customer's "net equity" is determined by taking the total amount the customer has invested in Madoff and reducing that sum by the total amount the customer has withdrawn from Madoff while entirely ignoring the appreciation in the customer's account over the 20-25 years the customer may have had his Madoff account.

Mr. Picard's convenient definition is directly contrary to SIPA which requires that the customer's "net equity" be determined by taking the balance in the customer's account as of the customer's last statement and reducing it by any funds owed by the customer to the broker. See 15 U.S.C. Section 78lll(11). *See also, In re New Times Securities Services, Inc.*, 371 F. 3d 68, 72 (2d Cir. 2004)("Each customer's "net equity" is "the dollar amount of the account or accounts of a customer, to be determined by calculating the sum which would have been owed by the debtor to such customer if the debtor had liquidated, by sale or purchase on the filing date, all securities positions of such customer" corrected for "any indebtedness of such customer to the debtor on the filing date.").

SIPC's position is directly contradicted by a statement that SIPC's general counsel, Josephine Wang, gave to the press on December 16, 2008 wherein Ms. Wang acknowledged that a Madoff customer is entitled to the securities in his account:

> Based on a conversation with the SIPC general counsel, Josephine Wang, if clients were presented statements and had reason to believe that the securities were in fact owned, the SIPC will be required to buy these securities in the open market to make the customer whole up to $500K each. So if Madoff client number 1234 was given a statement showing

> that they owned 1000 GOOG shares, even if a transaction never took place, the SIPC has to buy and replace the 1000 GOOG shares.

See Exh. 3.

If SIPC had acted in accordance with its general counsel's statement that SIPC would replace the shares in each Madoff customers' account as of November 2008 up to $500,000, every Madoff customer would have received securities worth $500,000 or a check for $500,000. That has not occurred because of Mr. Picard's inventive definition of "net equity."

SIPC's position is also directly contrary to the position it took in the 2002 Ponzi scheme case, New Times Securities Services, Inc., where SIPC elected to provide investors with substitute securities. There, SIPC recognized its obligation to allow "that portion of the mutual fund investors' claims that represent shares of such mutual funds purchased by them **through dividend reinvestment.**" See Exh. 4 hereto at 7, fn. 5; emphasis added. **Thus, the trustee in that case paid SIPC insurance based on the customers' final statements, which included dividend reinvestment, and thereby fulfilled the customers' legitimate expectations.**

SIPC's position is also inconsistent with the Internal Revenue Code and with Rev. Proc. 2009-20, recently issued by IRS Commissioner Shulman, which expressly recognizes the income earned by investors on their Madoff investments and the billions of dollars of taxes that Madoff investors paid to the Internal Revenue Service on phantom income over the last 20-30 years.

The practical effect of SIPC's self-serving interpretation of "net equity" is that SIPC will not pay any money to thousands of people who invested with Madoff in the 1980's and 1990's, whose accounts appreciated substantially and who, after retirement, drew out funds annually to pay taxes on their "phantom" income (at short term capital gains rates), to support themselves, and to satisfy the mandatory withdrawal obligations of their IRA's.

By ignoring the statute's mandate to credit customers with the appreciated balances in their accounts, SIPC does not have to assess its members for any additional funds to compensate Madoff investors in accordance with SIPA's requirements. At the same time, of course, **SIPC is destroying the legitimate expectations of Madoff's customers that the balances shown on their monthly statements represented their assets.** [2]

Surely, this is not the time in our history for SIPC to add to America's disgrace by further enriching Wall Street at the expense of Main Street. Surely, there is no more essential means of re-building the world's confidence in the American securities markets than by recognizing a customer's **legitimate expectation** that the balance on his monthly statement belongs to him.

(c) The SEC has the responsibility to challenge SIPC's interpretation

The Supreme Court held that SIPA invests the SEC with plenary authority to supervise SIPC. *Securities Investor Protection Corporation v. Barbour,* 421 U.S. 412, 417 (1975). As noted by the Second Circuit in the *New Times* case, Congress clearly intended for the SEC to provide "substantial oversight" over the "conduct of the affairs of SIPC." SEC. H.R. Rep. NO. 91-1613, at 11-12 (1970), reprinted in 1970 U.S.C.C.A.N. 5254, 5265. Indeed, the House Committee on Interstate and Foreign Commerce indicated that it "not only directs, but expects the Commission to use oversight in a vigorous, but fair, manner." *Id.* at 5266.

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[2] *See, e.g.,* SIPC's Series 500 Rules, 17 C.F.R. 300.500, which provide for the classification of claims in accordance with the "legitimate expectations" of a customer based upon the written transaction confirmations sent by the broker-dealer to the customer. *See also,* 53 F.R. 10368, 1988 WL 263894, Rules of the Securities Investor Protection Corporation (March 31, 1988)(Commission order approving SIPC's Series 500 Rules, agreeing with SIPC that rules will give full effect to the Congressional intent to "satisfy the customers' legitimate expectations."(quoting S. Rep. No. 905-763 at 2.95th Cong. 2d Sess. (April 25, 1978).

In the *New Times Securities* case, the Second Circuit asked the SEC to submit an *amicus* brief with respect to SIPC's position that customers of a broker who operated a Ponzi scheme and, like Madoff, never purchased securities, were entitled to only $100,000 of SIPC insurance (instead of $500,000) since they had no securities in their accounts. The customers whose claims were the subject of the appeal had received trade confirmations indicating the purchase of investments in non-existent mutual funds. **Nevertheless, the SEC took a position adverse to SIPC and agreed with the customers that they were entitled to $500,000 of SIPC insurance because they legitimately expected that they owned securities, regardless of the fact that the broker had never purchased the securities.**

However, the SEC agreed with SIPC that, unlike the *New Times* customers whose trade confirmations indicated the purchase of investments in real securities (whose claims SIPC honored at the amount shown on their last statements), with respect to customers who held non-existent securities in their accounts, the amount of their customer claims should exclude any appreciated amounts. The rationale for this holding was that a customer that purportedly owned non-existent securities could not have legitimately expected any appreciation since the customer could not have verified any appreciated amount. The Second Circuit noted:

> As the SEC indicated in its brief, basing customer recoveries on "fictitious amounts in the firm's books and records would allow customers to recover arbitrary amounts that necessarily have no relation to reality . . . [and] leaves the SIPC fund unacceptably exposed."

371 F. 3d 68, 88 (2d Cir. 2004).

Of course, in Madoff, all of the customer confirmations indicated the ownership of securities in Fortune 100 corporations and customers could easily check the purchase and sale prices of these securities. Thus, the balances shown on customer statements bore a direct relationship to the appreciation in their accounts through the purchase and sale of

known securities. **For this reason, the Madoff investors are entitled under SIPA to customer claims in the amount shown as their balance as of November 2008.** [3]

SIPC and Trustee Picard have taken the position that no Madoff investor who has taken more money out than he has put in (over the course of 20-30 years) is entitled to any SIPC coverage, no matter how much his November 2008 statement indicated his assets in Madoff were. Thus, SIPC is refusing to pay insurance to a huge number of long-time Madoff investors whose November 2008 balances showed millions of dollars in assets. **Given the extreme devastation that Madoff victims are suffering, I ask that you intercede with SIPC to assure that SIPC honors customer claims immediately.** It would only extend the calamity for innocent investors to have to wait years for this issue to be resolved in their favor through the court system.

SIPC insurance should be increased to $1.6 million

In 1970, Senator Edward S. Muskie proclaimed, in urging the prompt enactment of SIPA: "after this bill is enacted, no American will lose his savings through a brokerage firm bankruptcy."[4] SIPC insurance was fixed in 1978 at $500,000 and has never been adjusted for the enormous cost of living increase in the past 30 years. If the insurance were adjusted in accordance with the increase in the cost of living, investors would be entitled to $1.6 million of SIPC insurance. It is in our national interest for this adjustment to be made, effective so as to increase the insurance for Madoff investors.

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[3] In the *New Times* SIPC proceeding, 900 claims were filed of which 726 customers had confirmations showing real securities that were never purchased and 174 customers had confirmations showing fictitious securities that were never purchased. SIPC honored the 726 customers' claims, crediting those customers with the appreciation shown in their accounts. It was only the customers whose confirmations showed fictitious securities whose claims were limited to the amounts they had invested.
[4] Federal Broker Dealer Ins. Corp.: Hearing on S2388, 3988 and 3989 before the Subcommittee on Securities of the Senate Com. on Banking and Currency, 95th Congress Cog. 10(1970) at 147.

Brokers and dealers are in the best position to police illegal securities operations. It is absolutely preposterous that Goldman Sachs has paid a mere $150 a year for SIPC insurance. If Wall Street firms were responsible for the losses of Ponzi scheme victims, they would diligently police their industry and protect investors. As a matter of public policy, this would be a crucial step in restoring confidence in the SEC and in the American securities markets.

The SEC should advocate an amendment to the Bankruptcy Code to prohibit clawbacks from innocent investors

Trustee Picard has announced that he intends to "claw back" pursuant to the avoidance provisions of the Bankruptcy Code payments of income that were made by Madoff to investors over the past six years. Investors withdrew income from their accounts at Madoff to support themselves and their families, to pay short-term capital gains taxes on their Madoff income, and to take the mandatory withdrawals from their IRA accounts.

It is totally inconsistent with the purposes and provisions of SIPA to sue innocent investors who received payments from Madoff out of their accounts. I therefore respectfully request that you put the SEC's recommendation behind an amendment to the Bankruptcy Code, which would provide as follows:

> Notwithstanding the provisions of Sections 544, 547 and 548 of this title, no action shall be brought by a SIPC trustee against any customer of an SEC-regulated broker-dealer seeking the recovery of assets in that customer's account, absent a showing that the customer participated in some illegal transaction with the broker-dealer.

SIPA supersedes the Bankruptcy Code where the provisions of the Code are inconsistent with SIPA. 15 U.S.C. § 78fff(b). The underlying purpose of SIPA is to satisfy the "legitimate expectations" of customers of an SEC-regulated broker-dealer. Such a customer has a legitimate expectation that the balance shown on his brokerage