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TESTIMONY

RECONSIDERING THE SIPC

J.W. VERRET
Assistant Professor of Law, George Mason School of Law
Senior Scholar, Mercatus Center at George Mason University

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Subcommittee on Securities, Insurance, and Investment
Hearing: Oversight of the Securities Investor Protection Corporation

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Chairman Crapo, Ranking Member Warner, and members of the Subcommittee, I appreciate the opportunity to testify today on your subcommittee's oversight of the Securities Investor Protection Corporation.

My name is J.W. Verret. I am an assistant professor of law at George Mason University Law School, where I teach corporate, securities, and banking law. I serve as a senior scholar at the Mercatus Center at George Mason University and until recently I was chief economist and senior counsel at the House Committee on Financial Services.

The explosive growth in federally backed loan and guaranty programs has been an appropriate focus of congressional oversight in recent years. The Office of Management and Budget (OMB) estimates the federal government supports over $3 trillion in loans and guarantees. Those loans and guarantees are often shrouded by indirect government support and unreasonable assumptions in government accounting practices.[1]

I submit that the Securities Investor Protection Corporation's (SIPC) provision of securities custody insurance should be an appropriate part of that conversation. Government officials appoint SIPC directors and SIPC enjoys access to a $2.5 billion line of credit with the Department of the Treasury. Some may argue that statutory language that "SIPC shall—not be an agency or establishment of the United States Government" suggests otherwise.[2] We all recall how similar statutory language governing the government-sponsored enterprises proved meaningless when those companies were placed in federal conservatorship.

1. See, e.g., Federal Accounting Standards Advisory Board, "Memorandum: Public Hearing on *Reporting Entity*," August 20, 2013, http://www.fasab.gov/pdffiles/tab-a2_august-2013.pdf.
2. Securities Investor Protection Act of 1970, 15 U.S.C. § 78ccc.

The ideas presented in this document do not represent official positions of the Mercatus Center or George Mason University.

Today I will argue that privatization of SIPC is the best solution to protect American taxpayers. I will identify unexplored solutions for victims of Ponzi schemes. Though I argue privatization is the first best solution, I am glad to constructively engage in this subcommittee's discussion about additional SIPC reforms.

REFORMING THE GOVERNMENT MONOPOLY

Most broker-dealers and members of national exchanges are required by statute to be members of SIPC, and SIPC is funded by assessments on its membership. SIPC thereby enjoys a statutory monopoly over the provision of securities custody insurance beneath the ceiling of its coverage.

Some of my fellow panelists may argue that SIPC serves an important role as a specialized liquidator of broker-dealers. Assuming that argument is true, it remains a tall leap of logic to further contend that a government monopoly in the provision of securities custody insurance is thereby warranted.

SIPC's board is currently composed of private sector and government members. I submit that privatization of SIPC's insurance function is the first best solution to the problems presented by the current structure of the SIPC. We might begin by lowering the ceiling of coverage.

I find it hard to accept that a market failure necessitates a government monopoly in this space. In fact, there are underwriters at Lloyd's that sell "excess of SIPC" coverage for the portion of this market not crowded out by SIPC.[3]

In the absence of full privatization, the public-private composition of SIPC's board should not be viewed as a second best option. It would be better to officially recognize SIPC for the government entity that it is, remove the private-sector board members, establish a similar level of congressional accountability for SIPC to that required of other government agencies, and impose a term limit on its CEO.

THE PROBLEM OF PONZI SCHEME VICTIMS

The controversy and subsequent litigation between the SEC and SIPC with respect to the Allen Stanford Ponzi scheme, and issues with respect to Bernie Madoff victim claims, also suggest that a warning label should be provided as part of the legend describing SIPC coverage. This label would warn customers, "SIPC coverage only applies under limited circumstances, and SIPC reserves the right to deny claims despite reasonable expectations of coverage." SIPC won the Stanford litigation as a result of regrettable stipulations of fact by the SEC. In the related Madoff litigation, SIPC utilized an aggressive valuation methodology from among a range of methods used in prior cases.

My impression of both cases was that they were close calls that might have come out either way. It is nevertheless also clear to me that SIPC's aggressive litigation position was designed to minimize claims to a fund that was unprepared for those claims, which suggests a clear conflict of interest for the receivers hired by SIPC and for SIPC itself.

I am not here today to re-litigate those cases or to endorse legislation that might ultimately result in new assessments by SIPC. I sympathize with the victims, and I recognize they have been subjected to unusually aggressive legal posturing by SIPC, but I worry about action that might only further entrench SIPC's insurance monopoly.

I would suggest instead that this subcommittee consider whether undistributed funds in the SEC's Fair Funds program or in the Consumer Financial Protection Bureau's settlement awards would better serve the purpose of making these victims whole.

I thank you for the opportunity to testify, and I look forward to answering your questions.

3. TIAA-CREF, "SIPC and Excess of SIPC Asset Protection Guide," 2015, https://www.tiaa-cref.org/public/pdf/forms/SIPC_Reference_Guide_FINAL.pdf.