



Highlights of [GAO-12-414](#), a report to congressional requesters

## Why GAO Did This Study

With the collapse of Bernard L. Madoff Investment Securities, LLC—a broker-dealer and investment advisory firm with thousands of clients—Bernard Madoff admitted to reporting \$57.2 billion in fictitious customer holdings. The Securities Investor Protection Corporation (SIPC), which oversees a fund providing up to \$500,000 of protection to qualifying individual customers of failed securities firms, selected a trustee to liquidate the Madoff firm and recover assets for its investors. The method the Trustee is using to determine how much a customer filing a claim could be eligible to recover—an amount known as “net equity”—has been the subject of dispute and litigation. This report discusses (1) how the Trustee and trustee’s counsel were selected, (2) why the method for valuing customer claims was chosen, (3) costs of the liquidation, and (4) disclosures the Trustee has made about its progress. GAO examined the Securities Investor Protection Act; court filings and decisions; and SIPC, Securities and Exchange Commission (SEC), and Trustee reports and records. GAO analyzed cost filings and interviewed SIPC, SEC, and SEC Inspector General officials, and the Trustee and his counsel.

## What GAO Recommends

SEC should advise SIPC to (1) document its procedures for identifying candidates for trustee or trustee’s counsel, and in so doing, to assess whether additional outreach efforts should be incorporated, and (2) document a process and criteria for appointment of a trustee and trustee’s counsel. SEC and SIPC concurred with our recommendations.

View [GAO-12-414](#). For more information, contact A. Nicole Clowers at (202) 512-8678 or [clowersa@gao.gov](mailto:clowersa@gao.gov).

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# SECURITIES INVESTOR PROTECTION CORPORATION

## Interim Report on the Madoff Liquidation Proceeding

## What GAO Found

The Securities Investor Protection Corporation (SIPC) generally followed its past practices in selecting the trustee for the Madoff liquidation. SIPC maintains a file of trustee candidates from across the country, but given the anticipated complexities of the case, officials said the field of potential qualified trustees was limited. SIPC has sole discretion to appoint trustees and, wanting to act quickly, SIPC senior management considered four trustee candidates. After three of the four candidates were eliminated for reasons including having a conflict of interest or ongoing work on a large financial firm failure, SIPC selected Irving H. Picard, who has considerable securities and trustee experience. However, SIPC has not documented a formal outreach procedure for identifying candidates for trustee and trustee’s counsel, or documented its procedures and criteria for selecting persons for particular cases, as internal control standards recommend. Having such documented procedures could allow SIPC to better assess whether it has identified an optimal pool of candidates, and to enhance the transparency of its selection decisions.

A key goal of broker-dealer liquidations is to provide customers with the securities or cash they had in their accounts. However, because the Trustee determined that amounts shown on Madoff customers’ statements reflected years of fictitious investments and profits, he chose to determine customers’ net equity using the “net investment method” (NIM), which values customer claims based on amounts invested, less amounts withdrawn. SIPC senior management and officials of the Securities and Exchange Commission (SEC)—which oversees SIPC—initially agreed on the appropriateness of NIM. Over the course of 2009, however, SEC officials continued to consider alternative approaches for reimbursing customers. Although some customers have challenged the Trustee’s use of NIM, two courts have held that the Trustee’s approach is consistent with the law and with past cases, with both courts indicating that using the values shown on customers’ final statements would effectively sanction the Madoff fraud and produce “absurd” results. In November 2009, SEC commissioners voted to support the use of NIM, but with an adjustment for inflation, in an approach known as the “constant dollar” method. However, after an SEC official’s conflict of interest was made public in February 2011, the SEC Chairman directed SEC staff to review whether the commission should revote on the constant dollar approach. The matter is currently pending.

As of October 2011, costs of the Madoff liquidation reached more than \$450 million, and the Trustee estimates the total costs will exceed \$1 billion by 2014. Legal costs, which include costs for the Trustee and the trustee’s counsel, are the largest category. While the estimated total cost for the Madoff liquidation is double the total for all completed SIPC cases to date, the Trustee, SIPC, and SEC note that the costs reflect the unprecedented size, duration, and complexity of the Madoff fraud. SIPC senior management also said the liquidation costs are justified, as litigation the trustee has pursued has produced \$8.7 billion in recoveries for customers to date. Through various reports, court filings, and a website, the Trustee has disclosed information about the status of the liquidation. SIPC senior management, SEC officials, and the U.S. Bankruptcy Court have concluded that the Trustee’s disclosures sufficiently address the requirements for disclosure under the Bankruptcy Code and the Securities Investor Protection Act.