A. The Enforcement Staff Initially Reacted Enthusiastically to the Referral and Opened a MUI

The immediate reaction from the Enforcement staff to the Stanford referral was very positive. On April 8, 2005, ENF Asst Dir 1 e-mailed Preuitt and Prescott:

> [T]his memo is terrific. Very nicely done.
>
> Moreover, I agree with the preliminary legal conclusions in the memo, including the deduction that this almost certainly has to be fraudulent.
>
> I would like to get together with both of you and talk in greater depth about possible courses of action. From a tactical standpoint, the international dimension concerns me because it limits our investigative powers. The [broker-dealer] is domestic, of course, but I'm concerned that taking action only against the domestic [broker-dealer] will have a limited long-term effect on the whole apparently-criminal organization, most of which is overseas. Moreover, the immediate impact on U.S. investors of an action against the domestic [broker-dealer] might not be favorable.

Exhibit 114.

Preuitt immediately responded to ENF Asst Dir 1 observations about the "international dimension" as follows:

> The problem is very interesting. We agree with many of your concerns. Its a difficult choice. It seems too difficult to go after the foreign entity so nothing happens or it seems too limiting to go after the US [broker-dealer] when we know the whole thing must be a fraud. *As a result, we've just sat around for ten years fussing about what is going on at this firm/bank.*

Id. (emphasis added).

Although ENF Asst Dir 1 was very interested in the case, he did not have a staff attorney available, so on April 12, 2005 ENF Asst Dir 1 forwarded the referral to Jeffrey Cohen and ENF Asst Dir 2

ENF Asst Dir 2 the other two Assistant Directors in FWDO Enforcement, with the following explanation:

> I've reviewed this and spoken to Victoria and Julie, and I believe this case is worth pursuing. Victoria's memo ... does a good job of laying out the apparent violations. If, after reviewing it, you find yourself wondering why I thought the case was worth pursuing, let me know. I don't think that will be your reaction, but I'm happy to share my impression of this if it would be helpful. ... One of the obvious logistical and jurisdictional problems with this case is the location of the issuer in Antigua.[62]

April 12, 2005 E-mail from ENF Asst Dir 1 to Jeffrey Cohen, attached as Exhibit 115. One day later, Cohen forwarded ENF Asst Dir 1 e-mail to ENF BC 3 a branch chief in Cohen's group, and asked, "[W]hat's ENF Staff Atty 5] handling? Does she have time for this one?" *Id.*

On April 14, 2005, ENF BC 3 e-mailed Prescott:

> Your memo was fantastic. Will be very helpful going forward. ENF Staff Atty 5 and I are opening MUI with hope of bringing case quickly (possibly [Temporary Restraining Order]). May need some help from you and [other members of the Examination staff] to make it happen.[64]

April 14, 2005 E-mail from ENF BC 3 to Victoria Prescott, attached as Exhibit 116. On April 15, 2005, Cohen responded to ENF Asst Dir 1 April 12, 2005 e-mail, "We've opened a MUI in ENF Staff Atty 5 name." April 15, 2005 E-mail from Jeffrey Cohen to ENF Asst Dir 1 ENF Asst Dir 1 attached as Exhibit 117 at 2. Later the same day, Cohen e-mailed ENF Asst Dir 1 that the Stanford matter "look[ed] promising." *Id.* at 1.

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[62] ENF Asst Dir 1 testified that it was "almost impossible ... if you're telling people you've got a CD and it's safe like a bank CD ... I don't know how anybody can generate returns in double digits while still offering that kind of security. I mean, all of this is implausible." ENF Asst Dir 1 Testimony Tr. at 29.

[63] At that time, ENF Staff Atty 5 was a FWDO Enforcement staff attorney.

[64] ENF BC 3 explained his initial reaction to the memorandum as follows:

> [T]here was the thought that this could have been a Ponzi scheme and that if, essentially, we could get kind of bank records that would reflect, you know, the money basically going in and then not being used for legitimate investment purposes but being used to kind of pay back prior investors, that, you know, we'd be able to bring a case quickly.

ENF BC 3 Testimony Tr. at 20 ENF BC 3 testified that he had hoped to bring a case quickly because it seemed as though the matter was an ongoing fraud and he wanted to stop it as quickly as possible. *Id.* at 20-21.

Early in the investigation, the Enforcement staff contacted OIA to assist them in getting records from SIB in Antigua. ENF BC 3 Testimony Tr. at 24. In May 2005, the Enforcement staff sent questionnaires to U.S. and foreign investors in an attempt to identify clear misrepresentations by Stanford to investors. June 3, 2005 E-mail from ENF BC 3 to Jeffrey Cohen, attached as Exhibit 118; *see also* ENF BC 3 Testimony Tr. at

Charles Rawl, a financial advisor at SGC from 2005 through 2007 who raised concerns about Stanford with the SEC in 2008, told the OIG in an interview that the investor questionnaires led to "significant concerns" by investors in the CDs. Rawl and Tidwell Interview Tr. at 6-10. Mark Tidwell, another financial advisor at SGC from 2004 through 2007, who later raised concerns about Stanford with the SEC, told the OIG that his phone "lit up like a Christmas tree" with client concerns after the questionnaires were sent out. *Id.* at 8.

DPP. WP, PII

ENF BC 3 Testimony at 36. Of course, as ENF BC 3 and ENF Staff Atty 5 acknowledged, until a Ponzi scheme begins to collapse, its victims are unsuspecting and not in a position to provide the SEC staff with evidence of the ongoing Ponzi scheme ENF BC 3 testified, "[U]nlike a lot of Ponzi schemes that have collapsed when you've got investors calling you and ... they can't get their money out or there's clear misrepresentations ... here ... we just didn't have that." *Id.* at 34. ENF BC 3 further explained that while a Ponzi scheme is ongoing, it is difficult to get investors to complain about it because they are still getting paid. *Id.* at 35. ENF Staff Atty 5 testified that it was generally hard to bring a Ponzi scheme case before the Ponzi started to unravel because:

> [Y]ou don't have any witnesses, you don't have anybody complaining about anything going wrong, everybody is happy, so they are not particularly cooperative. In fact, they are usually against us when we go in and talk to them, as was the case with a lot of the investors in Stanford. They were against us even meddling.

ENF Staff Atty 5 Testimony Tr. at 18-19.

As demonstrated below, after the Stanford investors failed to deliver any evidence that the Enforcement staff believed would have allowed them to bring a case against Stanford, the staff attempted to close the matter and refer it to the NASD.

B. By June 2005, the Enforcement Staff Had Decided to Refer the Matter to the NASD, Apparently as a Precursor to Closing the Matter.

BD Exam BC 2 testified that at a meeting with Cohen and others shortly after the referral, Cohen was "not real excited" about the Stanford matter, and that Cohen expressed DPP, WP DPP, WP [65] BD Exam BC 2 Testimony Tr. at 24-25. By June 2005, two months after opening the MUI, Enforcement's interest in the matter had waned.[66] On June 14, 2005, Sen Cnsl, an attorney PII who was assisting the Enforcement staff with the Stanford matter, asked ENF Staff Atty 5 for a "pithy email ... explaining to [the Antiguan regulator] why our case is compelling." *See* June 14, 2005 E-mail from Sen Cnsl to ENF Staff Atty 5, attached as Exhibit 124, at 2. ENF Staff Atty 5 forwarded Sen Cnsl e-mail to ENF BC 3 with the sarcastic comment, "Uhhh--yeah....we'll send a persuasive e-mail setting out why our case is so compelling..." *Id.* at 1 (ellipses in original). ENF BC 3 responded jokingly, "Apparently he hasn't seen your closing memo." *Id.*

At June 21, 2005 quarterly regulators meeting, Cohen expressed pessimism about the viability of the SEC's investigation. *See* Minutes of June 21, 2005 Regulatory Coordination Meeting, attached as Exhibit 125. Attendees at the meeting included Degenhardt, Cohen, Prescott, Preuitt and a representative from NASD. *Id.* at 5. The minutes of that meeting memorialized Cohen's remarks as follows:

> Stanford – Jeff [Cohen] not optimistic about viable enforcement referral disclosure very cleverly crafted - impeccable for most part investors well off, enjoying returns -no concrete evidence of Ponzi

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[65] There is some indication that Cohen might have spoken to Barasch about Stanford a few days after Barasch left the SEC and approximately one week after Cohen opened the MUI. As discussed above in footnote 63, Barasch's last day at the Commission was April 14, 2005. On Friday, April 22, 2005, a social function was held in Barasch's honor. *See* April 24, 2005 E-mail from Jeffrey Cohen to Harold Degenhardt, *et al.*, attached as Exhibit 119. At 6:35 p.m. on Sunday, April 24, 2005, Cohen e-mailed several SEC employees the remarks he had written for Barasch's party. *Id.* Four hours later, at 10:34 p.m. on Sunday April 24, 2005, Cohen e-mailed ENF BC 2 "Must discuss this case with both of you ASAP—critical." April 24, 2005 E-mail from Jeffrey Cohen to ENF BC 3, attached as Exhibit 120.

[66] On April 19, 2005, the SEC received from the Department of Labor's Occupational Safety & Health Administration (OSHA) a copy of a Sarbanes-Oxley whistleblower complaint from an individual alleging that he was terminated in reprisal for reporting illegal financial activities. *See* SEC Complaint/Tip/Referral database printout, Control Number 13639, attached as Exhibit 121. On June 21, 2005 ENF Asst Dir 1 e-mailed Degenhardt about the FWDO's receipt of this whistleblower complaint, stating, "In rare cases, the referrals contain information that does justify follow-up, and this one appears to be an example of that. Stanford Group is a very problematic broker-dealer that has been the subject of enforcement investigations." June 21, 2005 E-mail from ENF Asst Dir 1 to Harold Degenhardt, attached as Exhibit 122. ENF Asst Dir 1 then sent an e-mail to ENF BC 2 about the whistleblower complaint, stating, "This whistle blower [sic] may provide some valuable inside info on the firm that otherwise would be hard to get." June 21, 2005 E-mail from ENF Asst Dir 1 to ENF BC 3, attached as Exhibit 123. ENF BC 3 testified that he did not recall talking to this complainant. ENF BC 3 Testimony Tr. at 45-46.

> Trying to reach out to some foreign investors for more information.
>
> Calls it a CD when it's more like a hedge fund. Telling foreign investors there is no risk but American investors are being told there is complete risk. Moneys are being held in Stanford's Antigua Bank. The fee is not disclosed to foreigners and to US they are not told fees are reoccurring.
> ...

Id. at 1-2.

A July 8, 2005 e-mail from Sen Cnsl to ENF BC 3 discussed "[o]ptions to obtain [Stanford] bank documents." July 8, 2005 E-mail from Sen Cnsl to ENF BC 3 attached as Exhibit 126. Sen Cnsl summarized these options as follows:

> 1. MLAT[67] (Requires criminal interest, even soft interest, to make this request);[68]
>
> 2. Ask [the IRS attaché to Antigua] to lean on Leroy King;[69] and
>
> 3. Ask for the documents voluntarily from Stanford.

Id. at 2.

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[67] The SEC's intranet describes Mutual Legal Assistance in Criminal Matters Treaties ("MLATs") as follows:

> ... MLATs are designed for the exchange of information in criminal matters and are administered by the US Department of Justice ... Despite the fact that MLATs are primarily arrangements to facilitate cross-border criminal investigations and prosecutions, the SEC may be able to use this mechanism in certain cases. ... US criminal interest in the matter may be required.... Notwithstanding the slowness of the process ..., MLATs may be an effective mechanism to obtain assistance ..."

See "Obtaining Documents And Testimony From Abroad," attached as Exhibit 127, at 3.

[68] ENF Staff Atty 5 testified that the staff drafted a MLAT request but it required "criminal interest, and ... [t]he criminal authorities [the U.S. Department of Justice] wouldn't step up." ENF Staff Atty 5 Testimony Tr. at 44-45. Consequently ENF Staff Atty 6 testified that a MLAT request was not sent while she worked on the Stanford matter [in 2005 and 2006]. *Id.*

[69] Leroy King was the Administrator and Chief Executive Officer of the Antigua Financial Services Regulatory Commission. As discussed below, King has been indicted for criminal obstruction of the SEC's Stanford investigation.

Sen Cnsl e-mail prompted ENF BC 3 to e-mail Prescott:

> I feel strongly that we need to make voluntary request for docs from bank. If we don't and close case, and later Stanford implodes, we will look like fools if we didn't even request the relevant documents. As for MLAT, we probably should discuss further. Talked to FBI agent in Houston who was aware of Standford [sic].[70] DPP, WP DPP, WP As for having [the IRS attaché to Antigua] lean on Leroy King, can't hurt.

Id. at 1.

In June 2005,[71] Degenhardt directed Prescott to refer the matter to the NASD. *See* Prescott Interview Tr. at 31-32. The decision to refer the matter to the NASD apparently was made within days of a meeting attended by, Degenhardt, Cohen and a NASD representative, during which Cohen expressed that he was "not optimistic about [a] viable enforcement referral."[72]

According to Prescott, Degenhardt did not give her "much in the way of explanation" for why he wanted the matter referred to the NASD. *Id.*; *see also* Prescott

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[70] ENF BC 3 testified that he could not recall any discussions with the FBI regarding Stanford in 2005. ENF BC 3 Testimony Tr. at 52.

[71] A June 29, 2005 draft of the NASD referral letter is attached as Exhibit 128. The final referral letter that was sent to the NASD on July 21, 2005, is attached as Exhibit 129. The letter included essentially the same information contained in the 2005 Enforcement Referral. The letter noted, "SGC's admitted inability to get information from SIB about the investments underlying the CDs suggests that SGC may be violating NASD Rule 2310 (Suitability)." Exhibit 129 at 2.

According to a September 2009 FINRA report released on October 2, 2009, the NASD conducted a routine examination of Stanford sometime in 2005. *See* Report of the 2009 Special Review Committee on FINRA's Examination Program in Light of the Stanford and Madoff Schemes ("FINRA Report"), attached as Exhibit 130, at 18. The lead examiner on FINRA's 2005 Stanford examination gave "special attention to the CD issue [because of] ... substantial concerns in the Dallas office regarding the Stanford firm and the CD program in particular. *Id.* at 20. The lead examiner and his manager "decided that it made sense to take a broad look and 'see what we reel in.'" *Id.*

ENF Staff Atty 1 the former SEC Enforcement staff attorney who had worked on the SEC's 1998 MUI concerning Stanford, worked at FINRA PII and "joined the discussion on the CD issue" while the FINRA examiners prepared for their Stanford exam. *Id.*; ENF Staff Atty 1 Tr. at 33. "From the moment she became involved in discussions regarding the CD aspect of the 2005 Stanford cycle exam, ENF Staff Atty 1 reportedly expressed the view that the Stanford CDs were *not* 'securities' regulated under the federal securities laws, and were therefore outside of FINRA's jurisdiction." Exhibit 120 at 20 (emphasis in original).

[72] *See* Exhibit 125. The meeting where Cohen made his pessimistic comments about the Stanford investigation occurred on June 21, 2005. *Id.* By June 29, 2005, Prescott had drafted the referral letter. *See* Exhibit 128.

Testimony Tr. at 68 ("[T]he case was being referred to the NASD because we were instructed to do so, and my recollection is that came from Hal Degenhardt....").

Prescott testified that she had been "unhappy" about the decision to refer the Stanford matter to the NASD. Prescott Testimony Tr. at 68. Prescott "felt like that it was unlikely that the NASD would be able to be able to create the same kind of result that we could here at the Commission." *Id.* She "wanted to see [the SEC] work the case." *Id.* at 68-69.

Prescott's "impression and understanding was that we were referring it to the NASD because we would not be working it." *Id.* at 69. Prescott explained that Degenhardt's "intent was probably to [shut down the investigation]. But in the meantime we kept arguing and lobbying for it here, Julie [Preuitt] taking the lead, and I was assisting her with that. Julie [Preuitt] is pretty relentless when she decides something needs to happen. And so she was continuing to lobby and talk to people." Prescott Interview Tr. at 33.

Preuitt also told the OIG that the NASD referral had been made because Enforcement was "trying to get rid of it." Preuitt Interview Tr. at 9. As discussed in Section XII, the OIG investigation found that Enforcement was reluctant to take these types of cases for a variety of reasons, including: the difficulties in obtaining approval from the SEC staff in Washington, DC to pursue novel investigations; the pressure in the FWDO to bring a lot of cases; the preference for "quick hit" cases as a result of that pressure; and the fact that Stanford was not a "quick hit" case. Preuitt testified that referring the matter to the NASD was "ludicrous," and "after the referral was made I just pretended like it had never happened." January 26, 2010 Preuitt Testimony Tr. at 44.

By mid-August 2005, the Enforcement staff had apparently conveyed to [Sen Cnsl] their intention to close the matter because Stanford was refusing to voluntarily produce documents. In an August 17, 2005 e-mail from [Sen Cnsl] to [ENF Staff Atty 5] discussing OIA's comments regarding a draft request for documents, [Sen Cnsl]

> As this letter may mark the end of your investigation, I think it makes sense that we think long and hard about the type of letter we wish to send.

August 17, 2005 E-mail from [Sen Cnsl] to [ENF Staff Atty 5], attached as Exhibit 131.

In late August 2005, the Enforcement staff sent SIB a voluntary request for documents. *See* September 1, 2005 E-mail from [ENF BC 3] to Jeffrey Cohen, attached as Exhibit 132. However, requesting voluntary document production from Stanford was a completely futile exercise. [Sen Cnsl] noted in his August 17, 2005 e-mail, the ineffectiveness of sending Stanford "a letter that relies on the good will of the recipient." Exhibit 131.

Moreover, the Enforcement staff sent SIB this "standard" request six days *after* SIB's attorney "made it clear that SIB would not be producing documents on a voluntary basis." *See* August 23, 2005 E-mail from [redacted] to [redacted], attached as Exhibit 133. The Enforcement staff sent the request even though it recognized that its efforts to obtain the requested documents voluntarily were "moot[]." *Id.*

The reason behind the staff's document request to Stanford was apparent in a July 10, 2005 e-mail from [redacted] to Victoria Prescott as follows:

> I feel strongly that we need to make voluntary request for docs from bank. If we don't and close case, and later Stanford implodes, we will look like fools if we didn't even request the relevant documents.

Exhibit 126.

It is not clear why the Enforcement staff would have expected Stanford to produce documents evidencing that it was operating a Ponzi scheme. In this instance, the staff knew that the request was futile, but decided to send it anyway so as not to later appear foolish. As discussed below, their decision to close the matter was overruled by new senior management in the FWDO.

C. In September 2005, the Enforcement Staff Decided to Close the Stanford Investigation, But the Examination Staff Fought to Keep the Matter Open

In the fall of 2005, the FWDO Enforcement staff considered closing its Stanford investigation after it had reached an impasse due to Stanford's lack of cooperation and the staff's lack of access to SIB's records in Antigua. [redacted] described this impasse in a September 1, 2005 e-mail to Cohen and [redacted]

> Antigua will not compel bank to produce docs. After much time talking with OIA, we finally received green light to issue volun[t]ary doc request to bank, care of the bank's attorney. Letter issued last week [redacted] spoke with attorney for bank, who stated bank would not be producing docs. ...
>
> [redacted]

September 1, 2005 E-mail from to [ENF BC 3] to Jeffrey Cohen, attached as Exhibit 132. Cohen responded, "Close the case." *Id.*

However, the examination staff, Preuitt in particular, fought to keep the Enforcement investigation open. On September 21, 2005, at 9:46 a.m., [ENF Staff Atty 5] e-mailed Cohen the following:

> On Stanford, this morning I heard that people from [the Examination staff] met with [James] Clarkson [the newly appointed Acting Director of the FWDO[74]] yesterday about it. A little annoying, eh? Do you know anything about that? I'll tell you what I know when I see you.[75]

September 21, 2005 E-mail from [ENF Staff Atty 5] to Jeffrey Cohen, attached as Exhibit 136. At virtually the same time that [ENF Staff Atty 5] sent her e-mail to Cohen, Preuitt e-mailed the examination staff's "report on Stanford" to Clarkson [ENF BC 3] and [ENF Staff Atty 5] *et al. See* September 21, 2005 E-mail from Julie Preuitt to James Clarkson, attached as Exhibit 137. Approximately one hour later, at 10:41 a.m., Cohen e-mailed [ENF BC 3] regarding Preuitt's e-mail to Clarkson, "Please call me about this." *Id.* At 11:35 a.m., Cohen responded to [ENF Staff Atty 5] e-mail telling him "that people from [the Examination staff] met with Clarkson yesterday about [Stanford]" as follows:

> Who from [the Examination staff]? How did you hear it? Where's [ENF BC 3]?

Exhibit 136. Four minutes later, after receiving no response from [ENF Staff Atty 5] to his questions, Cohen e-mailed [ENF Staff Atty 5]:

> Please respond (I'm not reaching [ENF BC 3]). Who from [the Examination staff]...and are you talking about our office or DC?

Id. (ellipse in original).

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[73] Cohen testified that he decided to close the Stanford matter "out of deference to [ENF BC 3] recommendation." Cohen Testimony Tr. at 52-53. [ENF BC 3] disputed this assertion, stating his belief that Cohen decided to close the case because he felt that it was appropriate to do so, not because Cohen was deferring to [ENF BC 3] recommendation. [ENF BC 3] Testimony Tr. at 79-80.

[74] Degenhardt's departure from the SEC was announced on August 15, 2005. *See* SEC Press Release 2005-116 (Aug. 15, 2005), attached as Exhibit 134. On August 31, 2005, James Clarkson was named as the Acting Director of the FWDO. *See* SEC Press Release 2005-123 (Aug. 31, 2005), attached as Exhibit 135.

[75] The e-mail exchange indicates that Cohen was out of the office which is supported by the fact that he responded from his blackberry. *See* Exhibit 136.

ENF Staff Atty 5 replied:

> ...Julie [Preuitt] said they talked to Clarkson and expressed their frustration with the fact that enforcement didn't want to bring a case ....

Id.

However, Preuitt's efforts did not change Cohen's decision to close the case. On October 24, 2005, ENF Staff Atty 5 e-mailed Prescott and Preuitt:

> FYI, we have decided to recommend closing the Stanford investigation. We're preparing the closing memo. I'll keep you posted.

October 24, 2005 E-mail from ENF Staff Atty 5 to Victoria Prescott, attached as Exhibit 138 at 2.[76] Twenty minutes after receiving this message, Preuitt forwarded it to Katherine Addleman, FWDO Associate District Director for Enforcement,[77] copying Cohen and ENF Staff Atty and asked, "Can we discuss before closing?" *Id.* Preuitt testified that she also "went to Kit [Addleman] telling her how much we needed not to close this and that angered [Cohen]." January 26, 2010 Preuitt Testimony Tr. at 56.

Cohen responded to Preuitt's e-mail, copying Addleman and ENF Staff Atty 5

> Since our last meeting in ENF Staff Atty 5 office last week ENF Staff Atty 5 and I met to discuss with the legal intern ... the fruits of her research. DPP, WP, LE DPP, WP, LE

Exhibit 138.

According to an October 26, 2005 e-mail exchange between ENF BC 8 and ENF Staff Atty 5 the Examination staff advocated for continuing the investigation and the rcement staff continued advocating that the matter be closed. ENF Staff Atty 5 described the status of the matter as follows:

> Well, Stanford is kind of a goat screw. Long story short, Jeff [Cohen] told me to kill it, Julie [Preuitt] was upset, started an e-mail battle, long talks with Julie, fight b/w Julie and Jeff (Julie won), now I'm researching and doing all kinds of stuff on it, but still am finding DPP, WP

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[76] Prescott testified that she was "unhappy" when she received ENF Staff Atty 5 e-mail that said Enforcement was closing the Stanford investigation. Prescott Testimony Tr. at 74.

[77] Addleman replaced Barasch as the FWDO Associate District Director for Enforcement on August 23, 2005. *See* SEC Press Release 2005-120 (Aug. 23, 2005), attached as Exhibit 123. Addleman was FWDO Associate District Director for Enforcement until 2007. Addleman Testimony Tr. at 9.

> DPP, WP but having to run down every possible scenario. It's not so much fun. That's about all.[78]

October 26, 2005 E-mail from ENF Staff Atty 5 to ENF BC 3 attached as Exhibit 141. ENF BC 3 responded, "On Stanford, agree with Jeff [Cohen]. If no offering fraud, not worth pursuing." *Id.* ENF Staff Atty 5 replied, "I totally do agree with Jeff. Julie is just really passionate about this and is fighting hard, going to Kit [Addleman], etc. and so we have to do all this stuff. It's frustrating!" *Id.*

On October 27, 2005, Clarkson e-mailed Preuitt:

> I advised Jeff [Cohen] that I understood that the exam staff and the folks in enforcement were wrestling with how to deal with the Sandford [sic] matter. I requested that he prepare for me a brief memo setting out the reasons why enforcement feels that the case can't be made.
> I would like you to do the same from an exam staff perspective. ... When I return to the FWDO on November

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[78] It appears that until November 2005, the Enforcement staff spent more time and energy trying to close the Stanford matter than they spent investigating it. On October 27, 2005, Wright e-mailed Clarkson regarding his concerns about Cohen's interactions with the examination staff in connection with Stanford. *See* October 27, 2005 E-mail from Hugh Wright to James Clarkson, attached as Exhibit 140. Specifically, Wright tried to "clarify the situation as it relates to Julie [Preuitt], Victoria [Prescott], and maybe ENF Staff Atty 5 ENF Staff Atty 5" *Id.* at 1. Wright explained:

> Basically, Julie is scared of Jeff's reactions to anything that crosses him. ... According to Julie, Victoria is also very concerned PP PP PP ... Whether resolving the issues about the Stanford case will alleviate the situation is questionable. ... If the decision is made to close Stanford, that is certainly up to Kit and the enforcement staff. ... The point that I am trying to make clear is that at least one member of the staff, and maybe more, are personally concerned PP PP

Id. at 2.

The staff tension may have been exacerbated by the fact that Cohen had been Degenhardt's choice to replace Barasch, but on August 23, 2005, Addleman was named as Barasch's successor instead. *See* Exhibit 139; Addleman Testimony Tr. at 55-56. Addleman had worked in the FWDO office as a branch chief at one point. *See* Exhibit 139. She was serving as an Assistant Regional Director for Enforcement in the SEC's Denver Regional Office when she was promoted to Associate District Director for Enforcement in FWDO. *Id.* Addleman testified that Cohen had been "unhappy with my appointment to that position over him." Addleman Testimony Tr. at 19-20.

> 7th, Kit [Addleman] and I will plan to sit down with you and Jeff and resolve this matter one way or the other.

October 27, 2005 E-mail from James Clarkson to Julie Preuitt, attached as Exhibit 142 at 1-2.

In response to Clarkson's request, Preuitt prepared a November 7, 2005 memorandum for Clarkson and Addleman that summarized the Examination staff's concerns about Stanford. *See* November 7, 2005 Memorandum from Hugh Wright to James Clarkson (the "Preuitt Memorandum"), attached as Exhibit 143. In addition to discussing the significant circumstantial evidence that the SIB CDs were a Ponzi scheme, the Preuitt Memorandum noted:

> Stanford is expanding rapidly. From what records we can obtain it has increased its assets by approximately 50% over the last 18 to 24 months. Per our discussions with current and former Stanford Group personnel, Stanford Bank has been in a consistent state of growth over the past ten years and the pressure to increase the amount of sales has increased over the last two or three years. Accordingly, Stanford Bank has not had to undergo any period when withdrawals have exceeded deposits. Such pressure to increase sales is frequently associated with fraudulent schemes.

Id. at 2. The Preuitt Memorandum closed with a recommendation that the Enforcement staff obtain a formal order of investigation as follows:

> In light of the earmarks of fraud noted above, it is troubling to imagine the Commission failing to resolve its concerns regarding the legitimacy of the product offered because the relevant parties either refuse to or cannot provide the requested, necessary information to confirm or dispel those concerns. Just as troubling, is to imagine the Commission to continue allowing a U.S. registered broker-dealer to offer a product about which it does not have the necessary information to make a reasonable basis for a recommendation.

Id. at 2.

The Preuitt Memorandum convinced senior management to overrule Cohen and continue the investigation. This decision ultimately ended the feuding between the examiners and the Enforcement staff that had consumed most of the time spent on the matter to that point.

D. In November 2005, the Head of the FWDO Enforcement Group Overruled Her Staff's Objections to Continuing the Stanford Investigation and Decided to Seek a Formal Order in Furtherance of That Investigation

In response to Clarkson's request for a memorandum setting forth Enforcement's perspective regarding the Stanford investigation, Cohen prepared an eleven-page memorandum (the "Cohen Memorandum") that discussed the status of the investigation, the difficulties confronting the staff, and Cohen's view of the options going forward. *See* November 14, 2005 Memorandum from Jeffrey Cohen to James Clarkson, attached as Exhibit 144. Cohen addressed the Examination staff's recommendation for a formal order as follows:

DPP, WP [redacted]

Id. at 1-2.

Cohen recommended that, if the Stanford investigation continued, it should focus on DPP, WP causes of action. *Id.* at 11. After discussing the DPP, WP [redacted] DPP, WP Cohen made the following recommendation:

DPP, WP [redacted]

DPP, WP

Id.[80]

Addleman testified that she recalled that at this time there was a "disagreement" between the Examination staff and the Enforcement staff about the Stanford investigation. Addleman Testimony Tr. at 12. She recalled that the Enforcement staff "was having a difficult time getting their arms around whether it was a fraud." *Id.* She testified that the issue was framed as, "[D]oes it make sense to do a case that[] ... appeared at that time to be all that the SEC could prove would be a registration violation, does it make sense for us to use scarce resources for that case versus something else[?]" *Id.* at 14.

Addleman met with the staff to discuss the disagreement. January 26, 2010 Preuitt Testimony Tr. at 62. Before she met with the staff, Addleman was aware that there had been other examinations of Stanford prior to the 2004 Examination. Addleman Testimony Tr. at 14. However, she was not aware that the examination staff had concluded as far back as 1997 that Stanford was a potential Ponzi scheme. *Id.*

Addleman recalled that during the meeting, the staff discussed the possibility of filing an action against Stanford alleging violations of the federal securities laws unrelated to a Ponzi scheme as a way to overcome Stanford's refusal to provide documents necessary to prove the SIB CDs were a Ponzi scheme. *Id.* at 14-15. Specifically, Addleman recalled a discussion about "whether it made sense to bring a Section 5 [unregistered securities] case and try and address in a court setting as opposed to a Commission investigation getting behind those documents." *Id.* at 15-16. Addleman testified that Cohen had "the strongest view" on the issue. *Id.* at 16. Despite Cohen presenting a DPP, WP charge as an option in the Cohen Memorandum, Addleman characterized Cohen's view on bringing a DPP, WP DPP, WP

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[79] Addleman explained that the reason for the DPP, WP in the Cohen Memorandum which DPP, WP ... DPP, WP DPP, WP was that Addleman had been "pretty direct ... that we were going to continue to do what we could to obtain information" about Stanford. Addleman Testimony Tr. at 26. *See also*, Prescott Testimony Tr. at 78 ("The memorandum itself seems DPP, WP but the context in which this memorandum was created came out of the decision to close it. So I viewed this as, okay, if we're not going to close it, here is my best judgment as to how we might be able to proceed.")

[80] Preuitt testified that working with Cohen was "extraordinarily difficult," in part because "he only wanted to bring cases that were slam dunk, easy cases." January 26, 2010 Preuitt Testimony Tr. at 42. Preuitt elaborated, "He wanted to have all of his cases so they were narrowed down to something so small and so bulletproof that you could be exempt from any sort of possible criticism that it would tend to gut your case." *Id.*

DPP, WP [redacted] Exhibit 144; Addleman Testimony

At the meeting, Addleman decided to "keep the case open and to seek a formal order." Prescott Interview Tr. at 34. Although Cohen proposed limiting the investigation to DPP, WP [redacted] Addleman decided to continue the investigation of whether Stanford was operating a Ponzi scheme. *See* Addleman Testimony Tr. at 24-26. Addleman made this decision because of "the possibility of a Ponzi scheme and a pretty significantly-sized one." *Id.* at 26. She added, "although there are some hurdles, we needed to move the investigation forward and if possible get into court." *Id.* Addleman testified that after the meeting, the Enforcement staff "did move [the investigation] forward and ... did look for avenues to try and determine the best way to get evidence [of a Ponzi scheme]." *Id.* at 25-26.

The staff obtained a formal order of investigation on October 26, 2006 – two years after the Examination staff began their examination of SGC in order to refer the matter to Enforcement.[81] As discussed above, the staff's conduct of the Stanford investigation from this point forward was the subject of a previously-issued OIG Report. That OIG Report did not substantiate the allegation that the SEC had made no effort to investigate Stanford after obtaining the formal order until Madoff's Ponzi scheme collapsed in mid-December 2008. The OIG also found that after April 2008, when the FWDO staff referred Stanford to DOJ, the FWDO effectively halted its Stanford investigation at the request of DOJ so it could pursue its criminal case. However, the OIG investigation also found that "[i]mmediately after the revelations of the Madoff Ponzi scheme became public in December 2008, the Stanford investigation became more

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[81] After Addleman decided to seek a formal order, it took the FWDO staff approximately seven months to prepare a formal order action memorandum because, according to Addle ohen "worked very, very hard to get it perfect." Addleman Testimony Tr. at 51. On April 25, 2006, ENF Staff Atty 5 received comments to a draft of the formal order action memorandum from Cohen and ENF BC 1, a branch chief who had replaced ENF BC 2 on the Stanford investigation. *See* April 25, 2006 E-mail from ENF BC 1 to ENF Staff Atty 5, ENF Staff Atty 5, attached as Exhibit 145. One comment to the draft action memorandum was:

> We need right here a thorough discussion of what FWDO [Enforcement and Examination staff] have been doing with this matter since the referral – we'll stick with the 3/05 referral date rather than what I understand to be the exam date in 10/04. List everything, including document gathering, meetings, research, whatever. We're going to get nailed for the passage of time unless we have a good explanation here. Be creative.

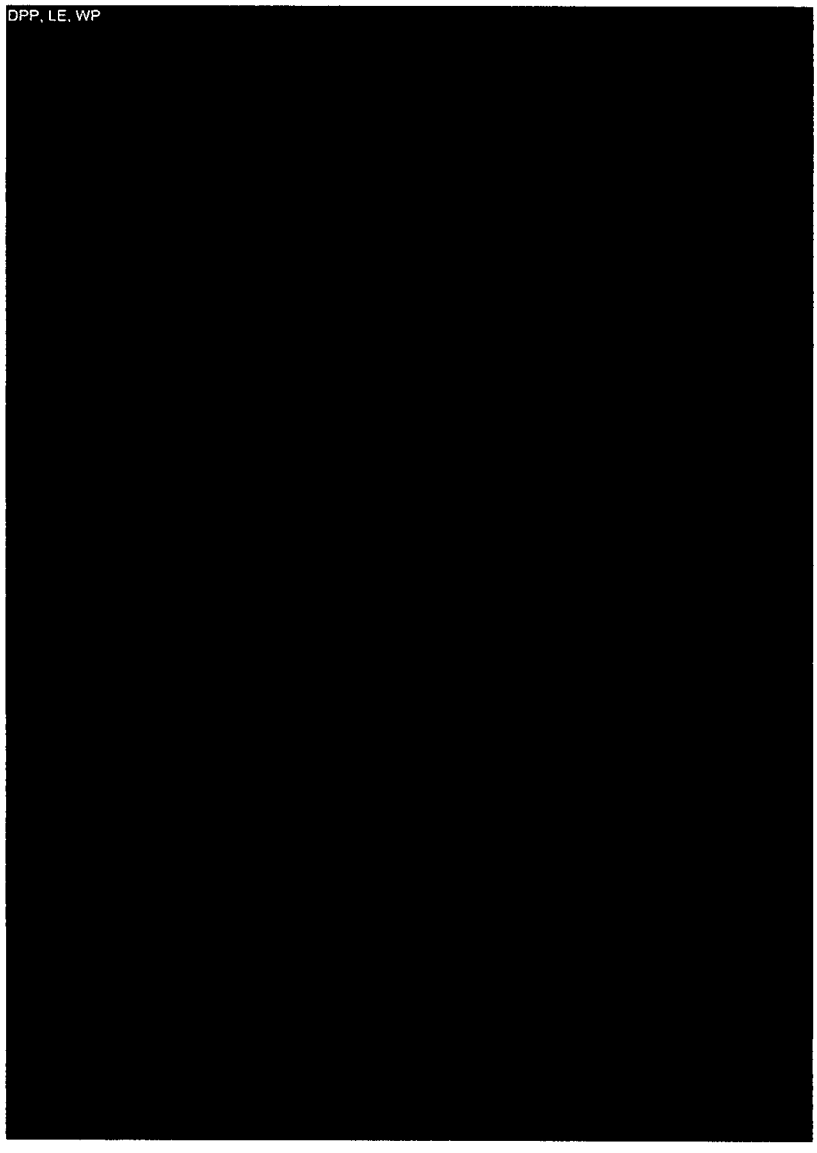
Id. at 4, note 1.

A draft of the formal order action memorandum was circulated by the FWDO for review and comment to various SEC offices and divisions in Washington, DC, on June 13, 2006. *See* June 13, 2006 E-mail from Jeffrey Cohen to "Enforcement Action Memos," attached as Exhibit 146. FWDO responded to comments received from OCIE, the Office of General Counsel and the Divisions of Investment Management, Market Regulation, and Corporation Finance. *See* August 21, 2006 E-mail from ENF Staff Atty 5 to ENF Atty 2 and ENF Asst Ch Cnsl attached as Exhibit 147. Four months after the draft was circulated, the request for the formal order was presented to the Commission and approved. *See* October 11, 2006 Action Memorandum Seeking Formal Order Authority, attached as Exhibit 148.

urgent for the FWRO," and the SEC moved forward with its Stanford investigation. Report of Investigation, Case No. OIG-516, entitled "Investigation of Fort Worth Regional Office's Conduct of the Stanford Investigation" at 10.

VIII. THE ENFORCEMENT STAFF REJECTED THE POSSIBILITY OF FILING AN "EMERGENCY ACTION" AGAINST SIB BASED ON CIRCUMSTANTIAL EVIDENCE THAT IT WAS OPERATING A PONZI SCHEME

In November 2005, the Enforcement staff considered recommending that the Commission file an "emergency action" against SIB expressly alleging that the CDs were a Ponzi scheme based solely on the circumstantial evidence available to the staff. *See* Exhibit 144. The Cohen Memorandum presented this option as follows:



DPP, LE, WP

Id. at 2-3 (footnotes omitted).

The Cohen Memorandum stated that bringing such an action DPP, LE, WP

DPP, LE, WP

Id. at 4. *See also* Cohen Testimony Tr. at 50

The Cohen Memorandum acknowledged that there were two primary categories of circumstantial evidence that would have supported an allegation by the Commission that the SIB CDs were a Ponzi scheme – DPP, LE, WP

DPP, LE, WP

DPP, LE, WP

Id. at 3-4 (footnotes omitted) (emphasis in original).

Cohen believed that the DPP, LE, WP that the CDs were a Ponzi scheme and the DPP, LE, WP meant that an action by the Commission would have been a DPP, WP

DPP, WP

DPP, WP

Id. at 4 (footnotes omitted) (emphasis in original). Cohen also noted that if the Commission filed an action, DPP, WP DPP, WP *Id.*

Cohen testified that he met with Addleman, Clarkson and Stephen Korotash, then a FWRO trial attorney, and that those three individuals decided against filing an emergency action DPP, WP DPP, WP Cohen Testimony Tr. 65-68. Cohen testified that he was not "entirely comfortable with that decision" and that he "thought it was a mistake at the time we met." *Id.* at 68, 78.[82]

In April 2006, the Enforcement staff apparently considered presenting to the Commission the issue of whether it should file an emergency action. *See* Exhibit 145. A draft of the formal order action memorandum that was circulated in April 2006 discussed three "special issues" as follows:

> This matter raises three special issues: (1) AC, DPP, WP AC, DPP, WP (2) whether further investigation is warranted to determine whether the CD program is a Ponzi scheme; and (3)

[82] However, as discussed above, approximately six weeks before the meeting, Cohen had instructed ENF BC to "[c]lose the case" and Addleman overruled Cohen after an appeal by Preuitt. *See* Exhibit 132.

AC, DPP, WP

Id. at 7.

After including verbatim an excerpt from AC, DPP, WP the draft action memorandum concluded, AC, DPP, WP AC, DPP, WP

Id. at 9. As the draft action memorandum noted, during the five months since the November 2005 meeting, AC, DPP, WP AC, DPP, WP *Id.* at 8, note 10.

However, the draft formal order action memorandum that the FWDO submitted to Washington, DC, for review and comment on June 13, 2006 ("June Draft Action Memorandum"), omitted the discussion of filing an "emergency action" as a "special issue." *See* Exhibit 146. The June Draft Action Memorandum described the special issues as follows:

AC, DPP, WP

Id. at 5. The June Draft Action Memorandum did state, AC, DPP, WP AC, DPP, WP AC, DPP, WP *Id.* at 6.

Ultimately, the SEC did rely, in part, on circumstantial evidence in filing an action against Stanford on February 16, 2009.[84] The following chart compares some of the circumstantial evidence included in the SEC's 2009 Complaint with similar statements from the prior examinations and referrals.

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[83] The discussion of the "special issues" and the statement AC, DPP, WP AC, DPP, WP AC, DPP, WP in the June Draft Action Memorandum, were AC, DPP, WP AC, DPP, WP *See* Exhibit 148.

[84] The Complaint filed by the SEC in 2009 also relied on "additional evidence in 2008 that was not available earlier." *See* Prescott Testimony Tr. at 60. *See also* Report of Investigation, Case No. OIG-516, entitled "Investigation of Fort Worth Regional Office's Conduct of the Stanford Investigation."

SEC ALLEGATIONS IN 2009	EVIDENCE FROM PRIOR EXAMS
SIB claims that its "diversified portfolio of investments" lost only 1.3% in 2008, a time during which the S&P 500 lost 39% and the Dow Jones STOXX Europe 500 Fund lost 41%. Exhibit 1 at ¶ 3 (emphasis added). *See also, id.* at ¶ 29 For almost fifteen years, SIB represented that it has experienced consistently high returns on its investment of deposits (ranging from 11.5% in 2005 to 16.5% in 1993) ... Since 1994, SIB claims that it has never failed to hit targeted investment returns in excess of 10%. ... SIB's historical returns are improbable, if not impossible. After reviewing SIB's returns on investment over ten years, a performance reporting consultant hired by Stanford characterized SIB's performance as "not possible - almost statistically impossible." Further, in 1995 and 1996, SIB reported identical returns of 15.71%, a remarkable achievement considering the bank's "diversified investment portfolio." Exhibit 149 at 7-8.	[F]rom 2000 through 2002, SIB reported earnings on investments of between approximately 12.4% and 13.3%. This return seems remarkable when you consider that during this same time frame SIB supposedly invested at least 40% of its customers' assets into the global equity market. Ten of 12 global equity market indices were down substantially during the same time frame. The indices we reviewed were down by an average of 11.05% in 2000, 15.22% in 2001 and 25.87% in 2002. It is equally unlikely that the portion of the portfolio invested into debt instruments (approximately 60%) could make up the expected losses in the equity portion of the portfolio. **For example, in 2002, when the global indices were down 25%, the debt portion of the portfolio would have to generate an approximately 40% return for SIB to generate the 12.4% overall return it claimed in 2002.** Exhibit 101 at 5 (emphasis added).
SIB's extraordinary returns have also enabled the bank to pay disproportionately large commissions to SGC for the sale of SIB CDs. SGC receives a 3% fee from SIB on sales of CDs by SGC advisers. ... SGC promoted this generous commission structure in its effort to recruit established financial advisers to the firm. **The commission structure also provided a powerful incentive for SGC financial advisers to aggressively sell CDs to United States investors**, and aggressively expanded its number of financial advisers in the United States. Exhibit 149 at 9 (emphasis added).	**Moreover, the Staff is equally suspicious of SIB's *recurring annual 3%* trailer. We are unaware of any legitimate, short-term, low or no-risk investments that will pay a 3% concession every year an investor keeps his funds invested in any product.** Exhibit 101 at 5 (emphasis added).

In addition to the foregoing, Enforcement's decision not to bring a case in 2005 may have also been influenced by the following factors, discussed in Section XII: (1) the staff bureaucracy in Washington, DC, discouraged pursuing "novel" cases; (2) the pressure for "stats" resulted in an emphasis on pursuing "slam-dunk" cases; and (3) the "feeling that the Commission was ... more receptive to clear-cut cases." *See* January 26, 2010 Preuitt Testimony Tr. at 72-74; Addleman Testimony Tr. at 27.

IX. THE ENFORCEMENT STAFF REJECTED THE POSSIBILITY OF FILING AN ACTION AGAINST SGC'S BROKER-DEALER FOR VARIOUS VIOLATIONS OF THE FEDERAL SECURITIES LAWS

As discussed above, the Examination staff and the Enforcement staff had a fundamental disagreement for eight years regarding whether Stanford should be investigated. However, they did agree that Stanford was probably operating a Ponzi scheme. Cohen acknowledged that agreement and explained the staff's divergent views on the issue of whether an investigation was warranted as follows:

> Everybody, everybody believed that this was probably a Ponzi scheme. We weren't entirely sure because there was no actual evidence of an imploding scheme. But the examination people were very clear. They said, "We're convinced this is a Ponzi scheme." ... [A]nd nobody in the enforcement division disagreed with them. They just said we've got to have proof.

Cohen Testimony Tr. at 24-25.[85]

On this point, Cohen and Preuitt agreed with each other. Preuitt testified that no one in FWDO ever said, "I think you're wrong. It doesn't look to be a Ponzi scheme to me. It doesn't look to be a fraud." January 26, 2010 Preuitt Testimony Tr. at 70. Instead, "[t]he response was this is indicia of fraud. You can't take that into court, indicia of fraud, you must be able to prove it." *Id.* Wright also testified that "[i]t was obvious for years that [Stanford] was a Ponzi scheme." Wright Testimony Tr. at 51.

In a November 7, 2005 memorandum to Addleman and Clarkson, Wright and Preuitt expressed their view about the situation as follows:

> In light of the earmarks of fraud noted above, it is troubling to imagine the Commission failing to resolve its concerns regarding the legitimacy of the product offered because the

[85] ENF Staff Atty 5 testified that when she became involved in the Stanford investigation, it was generally thought that the CD returns were too good to be true and it was pretty clear that there was some fraud or Ponzi scheme going on but it was a question of how to attack it. ENF Staff Atty 5 Testimony Tr. at 32-33.

> relevant parties either refuse to or cannot provide the requested, necessary information to confirm or dispel those concerns. Just as troubling, is to imagine the Commission to continue allowing a U.S. registered broker-dealer to offer a product about which it does not have the necessary information to make a reasonable basis for a recommendation.

Exhibit 143 at 2-3.

The Examination staff advocated that the Enforcement investigation focus on SGC and that the SEC pursue any viable legal theories to support an action against SGC. As Preuitt explained:

> [M]y suggestion -- we had so many different theories. Instead of going after the big thing which we may not be able to get to in Antigua, why can't you do something about the broker-dealer? We have a US-registered broker-dealer selling something that we don't know what it is. And, you know, why can't we be a little bit -- you know, pursue all our legal theories related to that and at least stop them from selling it?

Preuitt Interview Tr. at 19.

Similarly, IA Examiner 1 described how he had envisioned Enforcement pursuing an action against SGC as follows:

> My thought at the time was -- is that we've got SEC-registered entities selling an investment. ... My idea ... was ... that the enforcement staff would ... send out a voluntary request for information from the registered entities, we want information about what's happening to the money offshore, and probably they would not provide it. At that point, you get a formal order.
>
> Then you subpoena the information from those regulated entities. They say, we don't have it, we can't get it. At that point, now you can file a public subpoena enforcement action in a federal court and lay out all of your suspicions about those CDs for the entire world to know. It would be about two weeks after that you found out whether there was a Ponzi [scheme] or not.

IA Examiner 1 Testimony Tr. at 57.

IA Examiner 1 attributed the fact that the Enforcement staff never pursued that course of action to the following:

> [I]t seemed that there was a preoccupation with the fact we're dealing with an Antigua bank, and I was always saying forget the bank. We've got a [broker-dealer] and an [investment adviser]. Focus on them.

Id. at 58.

Addleman agreed that filing an action against Stanford alleging violations of the federal securities laws unrelated to a Ponzi scheme would have been one way to overcome Stanford's refusal to provide documents that the staff needed to prove the SIB CDs were a Ponzi scheme. Addleman Testimony Tr. at 14-16. In fact, as discussed above, she decided in November 2005 to continue the investigation because of "the possibility of a Ponzi scheme and a pretty significantly-sized one." *Id.* at 26.

The potential violations that the Examination staff advocated that Enforcement pursue included:

- Section 10(b) of the Exchange Act and Rule 10b-5: In 1997, and again in 2005, the Examination staff argued that SGC was making misrepresentations regarding the safety of the CDs. The Examination staff noted the consistently high returns on the SIB CDs, and observed, "Based on the amount of interest rate and referral fees paid, SIB's statements indicating these products to be safe appear to be misrepresentations. ... SIB must be investing in products with higher risks than are indicated in its brochures and other written advertisements." Exhibit 49 at 2-3. The 2005 Enforcement Referral noted that the CD sales brochures provided by SGC included representations of a "guaranteed" interest rate and claimed that the CD "provide[d] a secure way" to participate in the growth of equity markets. Exhibit 101 at 5-6. The 2005 Enforcement referral stated that "[u]se of the terms CD, 'interest,' 'secure' and 'guaranteed' are misleading and suggest a degree of safety that is not inherent in the product being offered." *Id.* at 6.

- Rule 17a-4 of the Exchange Act: In 1997, the Examination staff referred SGC for possible violations of Rule 17a-4 of the Exchange Act for failing to maintain books and records. Exhibit 49 at 4. The Examination staff found that SGC recommended the SIB CDs to clients without maintaining any records pertaining to the client's financial information or investment objectives, or any records such as order tickets or confirmations relating to the CD purchase by the client. *Id.*

- NASD Rule 2310 (Suitability): In 2005, the Examination staff encouraged the Enforcement staff to consider bringing a suitability case against SGC. On April 18, 2005, Prescott e-mailed Cohen the following:

> In one of our conversations--either this morning or last Friday--I mentioned the possibility of taking a somewhat novel approach and naming Stanford for violating the NASD Rule pertaining to suitability, which seems easier to prove than our standard 10b-5 approach. Specifically, NASD Rule 2310 "Recommendations to Customers (Suitability)" provides that
>
> > "In recommending to a customer the purchase, sale or exchange of any security, a member shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs."
>
> It is hard to see how Stanford the broker-dealer can, on the one hand, claim that it does not know any details about the "CDs," and on the other hand, make a determination that these are suitable investments.
>
> Exchange Act Section 21, dealing with investigations and actions, is helpful with respect to charging violations of NASD rules. Specifically, Section 21(d)(1) and Section 21(f). I think we can make a strong argument that it is in the public interest and for the protection of investors to charge Stanford with violations of NASD Rule 2310.

April 18, 2005 E-mail from Victoria Prescott to Jeffrey Cohen *et al.*, attached as Exhibit 150.[86]

[86] Cohen testified that the SEC could not bring an action to enforce NASD rules, such as the suitability rule. Cohen Testimony Tr. at 91. In fact, the SEC can enforce NASD's rules, as Prescott's e-mail explained, if to do so "is in the public interest and for the protection of investors." Exhibit 150; *see also* ENF BC 3 Testimony Tr. at 22.

- Section 5 of the Securities Act: In 2002, and again in 2005, the Examination staff referred SGC for a potential unregistered offering of securities. Exhibit 70 at 1, 15; Exhibit 101 at 3-4. In 2002, the Examination staff argued that SGC was generally soliciting investors for the SIB CDs in violation of its Regulation D exemption. Exhibit 70 at 11-12. The 2005 Enforcement Referral stated:

> [I]t appears that SIB is relying upon Regulation D Rule 506 to exempt its CD offerings from registration. Rule 506 requires SIB to comply with the prohibitions against a general solicitation and the limitations upon unaccredited investors. The Staff has not found evidence of sales by SGC to non-accredited investors who are U.S. citizens. It does appear that SGC sold CDs to more than 35 unaccredited foreign investors. In fact, it appears that SGC made no attempt to limit sales to accredited foreign investors.

Exhibit 101 at 3.

- Exchange Act Rule 10b-10: In 2005, the Examination staff referred potential violations of Rule 10b-10 by SGC. The 2005 Enforcement Referral stated that the rule required SGC to disclose the source and amount of remuneration it received in connection with its referred customers' purchase of the SIB CDs. Exhibit 101 at 6. The 2005 Enforcement Referral observed that the SIB brochure given to foreign investors did not contain any information regarding the 3% trailer fee paid to SGC by SIB. *Id.*

- Section 7(d) of the Investment Company Act of 1940 ("Investment Company Act"): In 2005, the Examination staff also referred potential violations of Section 7(d) of the Investment Company Act by SIB. *Id.* at 4. The referral noted that, "Although banks are ordinarily excluded from the registration requirements of the Investment Company Act, SIB's own disclosure documents suggest that it fails to meet the definition of a foreign bank ..." *Id.*

Furthermore, Cohen recommended in November 2005, that the Stanford investigation be DPP, LE, WP [redacted] DPP, LE, WP However, in 2006, the Enforcement staff circulated a draft formal order action memorandum that DPP, LE, WP [redacted] DPP, LE, WP. *See* Exhibit 146. As part of the formal order action memorandum review process in 2006, the SEC's Division of Corporation Finance DPP, LE, WP [redacted] DPP, LE, WP DPP, LE, WP [redacted] *See* Exhibit 147 at 3.

However, in 2005, the Enforcement staff decided that attacking Stanford's Ponzi scheme indirectly by filing an action at that time against SGC for any of the above-listed violations would not be worthwhile. ENF Staff Atty 5 Testimony Tr. at 33-34. ENF Staff Atty 5 explained the Enforcement staff's rationale for that decision in the following exchange:

> Q: ... [W]as there any thought to trying to find any hook to bring a case against Stanford even if you didn't necessarily have all of your ducks in a row so you could kind of start the process of stopping the fraud?
> A: Yeah. ... We talked to market reg. We talked to IM. We talked to – I mean, I feel like a lot of heads looked at it, and ... the aim was what can we do, what can we really do to get this when we don't have what we would normally need to bring [a Ponzi scheme case] -- typically when we bring a Ponzi scheme case, we would have bank records or we would know that the money was being misappropriated.
>
> Here we had this kind of legitimate looking operation with a lawyer [Thomas Sjoblom[87]] that used to be with the SEC and he's making these representations to us, and there was just so much that we didn't have. So what kind of case could we bring? I know we talked about maybe a 10b-10 case or some kind of a sales practice case and thought it's going to be really lame. Like we looked at the remedies on some of these things, and the one in particular -- I don't remember the provision or what it was, but it was like a FINRA violation, and it just seemed like so small potatoes, who cares. So there was sort of a weighing of if we're going to get this, we should get it and not be wasting our time with a sales practice case.

Id.

As noted earlier, the initial Complaint filed by the SEC on February 17, 2009, did not include allegations that Stanford was operating a Ponzi scheme. However, it did attack the Ponzi scheme indirectly by asserting other claims including a claim that SGC and SIB violated Section 7(d) of the Investment Company Act. Exhibit 149 at ¶¶ 128-

[87] Stanford was represented by Thomas Sjoblom, a partner at Proskauer Rose LLP, in connection with the SEC's investigation. Sjoblom was an "assistant chief litigation counsel in the SEC's enforcement division for 12 years before going into private practice." *See* Amir Efrati, *The Stanford Affair: Another Bad Day for Proskauer*, The Wall Street Journal Law Blog, August 27, 2009, attached as Exhibit 151.

131. The SEC's Complaint alleged that SIB was an unregistered investment company that offered or sold securities it had issued, and that SGC acted as an underwriter for SIB. *Id.* The public revelation that the SEC failed to uncover the Madoff Ponzi scheme changed the Enforcement staff's view of the risks and benefits of filing an action against Stanford without direct evidence that he was operating a Ponzi scheme.

X. THE ENFORCEMENT STAFF DID NOT CONSIDER FILING AN ACTION UNDER THE INVESTMENT ADVISERS ACT THAT COULD HAVE POTENTIALLY SHUT DOWN SGC'S SALES OF THE SIB CDs

[redacted] testified that there were very significant obstacles that hampered any effort by the SEC to gather direct evidence that SIB was operating a Ponzi scheme: "[G]etting the bank records was ... an important piece of the puzzle, and to the extent we were unable to get those bank records either from the bank or from the regulator because it was a foreign bank, that it was going to make a case very difficult." [redacted] Testimony Tr. at 56. [redacted] testified that without being able to get the SIB bank records, it was "probably impossible to bring a Ponzi scheme case or extremely difficult to bring that kind of case without having some documentation about ... where the money was going." *Id.* at 57. Moreover, the FWDO Enforcement staff believed that they would have faced opposition from the staff in Washington, DC had they recommended bringing any action predicated on the argument that [redacted] and would certainly have had to successfully litigate that issue had they brought such an action.

The Examination staff advocated that the SEC attack the Ponzi scheme indirectly by filing an action against SGC for violations of various securities laws, including selling unregistered securities and making inadequate disclosures to foreign investors regarding the referral fees SIB paid SGC. However, the Enforcement staff felt that bringing an action against SGC for those violations would have been "lame." *See* [redacted] Testimony Tr. at 34. In addition, the legal remedies for those violations would have fallen short of stopping the CD sales. The remedies available for the violations that the staff considered were "small potatoes." *Id.* Consequently, the Enforcement staff believed that if they could not bring a case for "offering fraud, [the Stanford investigation was] not worth pursuing." Exhibit 141.

However, the greatest obstacle to the SEC's efforts to investigate its suspicions that the SIB CDs were a Ponzi scheme, *i.e.*, the complete lack of information produced by SGC regarding the SIB portfolio that supposedly generated the CDs returns, also presented the SEC with an opportunity to bring a significant "offering fraud" action against SGC for violation of Section 206. Simply, the filing of such an action against SGC could have potentially given investors and prospective investors notice that the SEC considered SGC's sales of the CDs to be fraudulent. As a practical matter, many of Stanford's victims would not have purchased the CDs with such notice. Moreover, had the SEC successfully prosecuted such an action against SGC, SGC could have been permanently enjoined and barred from selling the CDs as an investment adviser.

A. The Issue of Whether the Stanford CDs Were Securities Was Irrelevant to an Action Against SGC For Violations of the Anti-Fraud Provisions of the Investment Advisers Act

All of the possible causes of action considered by the FDWO Enforcement staff in 2005 required that the SEC establish that the SIB CDs were securities. The Cohen Memorandum's discussion of a possible emergency action included the following assertion, DPP, WP [redacted] DPP, WP Exhibit 144 at 4. Cohen then noted:

> DPP, LE, WP [redacted]

Id. at 4, n. 11 (emphasis in original).

ENF Staff Atty 5 confirmed that there was a long period of time during which the Stanford matter was analyzed and discussed. ENF Staff Atty Testimony Tr. at 37. ENF Staff Atty 5 described these discussions as follows:

> [A] lot of the discussion [before requesting and obtaining the formal order in October 2006] was on DPP, WP [redacted] DPP, WP like how -- you know, is this going to be -- DPP, WP [redacted] What if we get to this point and DPP, WP [redacted] So we lose on something like that. And there was definitely, you know, a feeling that DPP, WP [redacted] DPP, WP [redacted]

Id.

In the context of the Enforcement staff's request for a formal order in the Stanford matter, the SEC's Office of General Counsel commented:

> AC, DPP, LE, WP [redacted]

AC, DPP, LE, WP [redacted]

October 24, 2006 Memorandum to the Commission from the SEC's Office of General Counsel, attached as Exhibit 152, at 2-3.

More recently, in response to a question from Mark Adler, Deputy Chief Litigation Counsel in the SEC's Enforcement Division, about whether the SEC could have filed an action against SGC earlier, Kimberly Garber, Associate District Administrator for Examinations in FWDO, explained that the SEC had been unable to take action against SGC because DPP, WP [redacted] DPP, WP

May 6, 2009 E-mail from Kimberly Garber to Mark Adler, attached as Exhibit 153. Specifically, Garber stated:

> There may be legal theories as to how we could have stopped them from doing business in the US, and we considered a number of approaches along the way, however DPP, WP [redacted]

Id.

As the SEC stated in its brief filed in support of its February 16, 2009 action against Stanford, fraud claims brought under Section 206 of the Investment Advisers Act do not require that the fraud involve a security. *See* Exhibit 149 at 26. The SEC expressly argued:

> Through their deceitful and fraudulent conduct in selling the CDs and SAS, Defendants violated the antifraud provisions of the Investment Advisers Act. *This is true, even if the Court, for the sake of argument, determines that the defendants' fraud was not in connection with the offer, sale or purchase of securities for purposes of Section 17(a) of the Securities Act or Section 10(b) of the Exchange Act.*

Id. (emphasis added). The SEC further argued in its brief:

> Section 206 establishes federal fiduciary standards to govern the conduct of investment advisers. The fiduciary duties of investment advisers to their clients include ... the duty to employ reasonable care to avoid misleading clients.

> An adviser has "an affirmative obligation to employ reasonable care to avoid misleading [his or her] clients."

Id. at 27 (citations omitted).[88]

Had the FWDO Enforcement staff considered pursuing a fraud case against Stanford under Section 206, the perceived obstacles to filing an action could have been eliminated.

B. The Enforcement Staff Did Not Consider Filing a Section 206 Case or Conducting a Section 206 Investigation

1. The 2005 Referral Did Not Mention Section 206

The 2005 Enforcement Referral did not discuss any potential violations of the Investment Advisers Act, including Section 206. *See* Exhibit 101. In fact, it did not even mention that SGC was a registered investment adviser. *Id.* It did not contain any reference to the previous examinations, including the 1998 and 2002 investment adviser examinations, which would have necessarily included the information that SGC was a registered investment adviser. *Id.*

Prescott explained that she did not reference the prior examinations because she thought the 2004 Examination gave Enforcement enough information to act upon. Prescott Testimony Tr. at 14.[89] Although the 2005 Enforcement Referral did not specifically discuss Section 206 of the Investment Advisers Act, it did state:

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[88] A former FWDO Examination branch chief who asked not to be identified testified that, generally:

> Once the attorneys figured out that Section 206 of the Advisers Act, antifraud provision, does not contain the word "security," man, you can make a lot of hay out of 206 (1) and (2). We'd make them look good bringing in a case and just charging 206(1) and (2). You don't even have to have a security involved.

Unidentified Former FWDO Examination Branch Chief Testimony Tr. at 58.

[89] Prescott testified that, while drafting her 2005 referral memorandum, she became aware that there had been previous examinations, but she did not review them because she felt there was enough information in the 2004 examination report to support a referral. Prescott Testimony Tr. at 13-14. However, she testified that until 2009, she was unaware of the 1998 Stanford MUI, which was referenced in both the 1998 and 2002 investment adviser examination reports. *Id.* at 12; Exhibit 70 at 2; Exhibit 55 at 1. Wright testified that Prescott's position in the Examination group was Senior Special Counsel to the B-D examiners, and, thus, she would not have interacted with the investment adviser examiners. Wright Testimony Tr. at 41, 59-60. As discussed below, the failure to include information from the 1998 and 2002 investment adviser examinations in the 2005 Enforcement Referral made by the B-D Examination staff may have had significant consequences for the conduct of the Enforcement investigation.

As further evidence of the self-imposed wall between the two examination groups, Staff Acct 1 the examiner on the 1997 B-D Examination of SGC, testified that no one from the Investment Advisor examination group contacted him in connection with the 1998 or 2002 exams Staff Acct 1 Testimony Tr. at 28, 38-39. Staff Acct 1 testified that the Investment Advisor and B-D Examination groups "just kind of never talked to each

(Footnote continued on next page.)

> SGC claims that it keeps no records regarding the portfolios into which SIB places investor funds and that it can not get this information from SIB. Indeed, SGC has related to the Staff that SIB claims it cannot divulge the specifics of how it has used customers' deposits, based (variously) upon the bank secrecy laws of Antigua and SIB's own internal "Chinese Wall" policies with SGC.

Exhibit 101 at 2 (footnotes omitted).

2. Neither Cohen's nor Preuitt's November 2005 Memorandum Discussed a Section 206 Violation

Similar to the 2005 Enforcement Referral, the Preuitt and Cohen Memoranda did not discuss a potential Section 206 claim, nor did they reference the fact that SGC was a registered investment adviser. Cohen's memorandum did state:

DPP, LE, WP

Exhibit 144 at 6. Cohen then discussed SGC's DPP, LE, WP DPP, LE, WP and concluded that the SEC would DPP, LE, WP DPP, LE, WP. *Id.* at 7. According to the Cohen Memorandum:

DPP, LE, WP

DPP, LE, WP

Id. at 39; IA Examiner 1 testified that, in connection with the 1998 SGC examination that he conducted, he gained some familiarity with the 1997 B-D Examination, "but not a great deal." IA Examiner 1 Testimony Tr. at 15-16.

DPP, LE, WP

Id. at 6-7 (emphasis in original).

Cohen concluded that it was DPP, WP AC, DPP, WP regarding the SIB CDs:

DPP, LE, WP

Id. at 8-9.[90]

3. When the FWDO Staff Met With Addleman, She Was Unaware That SGC Was an Investment Adviser

Addleman testified that she was "unaware" that the Investment Adviser Examination staff had done an examination of SGC in Houston in 1998 and 2002. Addleman Testimony Tr. at 40. In fact, Addleman testified that she was not aware that SGC was a registered investment adviser when the staff briefed her on the matter in November 2005. *Id.* at 34-35. Addleman only learned that SGC had been a registered investment adviser during her OIG testimony. *Id.* at 40-41. Her reaction to that information was striking, as evidenced by the following exchange:

> Q: [T]he fact is ... that Stanford was a dual registrant, a broker-dealer and an investment adviser. You didn't know that, correct?
>
> A: As I sit here, it's a surprise.

[90] IA Examiner 2 testified that, in his experience, the Enforcement attorneys in FWDO were not "very familiar with the Investment Advisors Act." IA Examiner 2 Testimony Tr. at 77.

> ...
>
> Q: I take it ... that you were unaware that the Investment Adviser exam staff had done an exam of Stanford Group Company in Houston in 1998 and 2002. ....
>
> A: I was not aware of that.
>
> ...
>
> Q: ... And I assume that you were unaware that the 2002 exam had resulted in a referral to enforcement to bring, among other things, a [Section] 206 case. ...
>
> A: I didn't know that, no.

Id.

Because the Enforcement staff was not familiar with any of the findings of the investment adviser examinations, bringing a Section 206 case against SGC for its admitted failure to conduct any due diligence regarding Stanford's investment portfolio was never considered. As discussed below, that option would have been "a potentially straightforward way to have attempted to approach [the Ponzi scheme]." *Id.* at 45-46.

C. The Enforcement Staff Could Have Filed a Section 206 Case With the Potential For Shutting Down SGC's Sales of the SIB CDs and/or Discovering Evidence of the Ponzi Scheme

As discussed above, the 2002 Examination Report discussed SGC's failure to conduct any due diligence regarding the SIB CDs. [IA Examiner 2] testified about that failure as follows:

> [F]or all of [SGC's] investment advisory clients they were [a] fiduciary and whenever they refer that client to some other investment product, whether it's a security or not, they were supposed to do some due diligence into doing that. So we asked them: Give us the due diligence file for this offshore bank. We want to see [] everything you looked at before you made this recommendation to refer these clients over. The only thing we got if I remember right was just the file with the financial statements and maybe a couple other things in there. So [IA Examiner 1] and I took the position that that wasn't enough.

[IA Examiner 2] Testimony Tr. at 48-49.

[IA Examiner 1] explained SGC's failure to conduct the required due diligence as follows:

> Q: [SGC] needed to know what SIB's portfolio was that supported the CD rates, right?
>
> A: Right. I mean, they did that with all of their managers in the Schedule A in the wrap program. They were constantly reviewing to make sure these managers were complying with their investment mandates, staying within their universe and all those things. They didn't do any of that with Stanford International.

IA Examiner 1 Testimony Tr. at 113.

Had the SEC successfully prosecuted an injunctive action against SGC for violations of Section 206, an anti-fraud provision, it could have completely stopped the sales of the SIB CDs through the SGC investment adviser. Moreover, as a practical matter it could have significantly impacted the sales of the CDs through the SGC broker-dealer. As Prescott described in the 2005 Enforcement Referral:

> Certainly, the ability to sell through a U.S. based broker-dealer gives SIB an *imprimatur* of legitimacy to foreign investors. It is quite possible that action by the Commission against SGC for its role in the CD offering could cause the entire scheme to collapse.

Exhibit 101 at 6 (emphasis in original). ENF BC 3 acknowledged that a case against SGC that would have stopped its sales of the SIB CDs would have been worth bringing in 2005. ENF BC 3 Testimony Tr. at 71-72.[91]

As noted above, Addleman was not aware that SGC was a registered investment adviser until her OIG testimony. During that testimony, Addleman testified regarding the missed opportunity to have filed a Section 206 action against SGC, in the following exchange:

> Q: ... [The examiners' Section] 206 argument was focused on the fact that the Investment Adviser in

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[91] Basagoitia had stated in her November 18, 2004 e-mail to Exam Sr Cnsl

> Most Clients open accounts because they believe the B-D's clearing agreement with Bear Stearns provides them with account protection. They also believe in the soundness of US laws. Should the Bank not have US representation, clients would not invest as they do at the Bank.

Exhibit 106.

> Houston would not provide them any information about ... what [SIB] was investing the proceeds in to generate these returns. And, in fact, affirmatively represented that they had no such information, alternatively saying that there was a prohibition in Antiguan bank secrecy laws that prevented SGC from getting that information and then secondly ... claiming there was a Chinese wall between the entities. And so the theory that they proposed in essence was that ... the investment adviser did not have enough due diligence to satisfy its fiduciary duty to its clients under either [Sections] 206(1) [or] 206(2). ... [D]o you have an opinion on the viability of that case?
>
> A: As I sit here, I have a bit of a pit in my stomach, because I wish I had known that. ... Adviser cases are always easier than broker-dealer cases because of the heightened fiduciary duty standard. And it always does give an alternative way to look at facts. If I knew that and I overlooked it, I apologize. If I didn't know it, I'm a little frustrated but.
>
> Q: But if you had known that at that time, would that have been a very good avenue to bring a case against Stanford under Section 206 of the Advisers Act?
>
> A: Well, I don't want to overstate it, but it would have been an alternative theory that has some potential, yeah.

Addleman Testimony Tr. at 40-43.

The OIG then asked Addleman to review the 2002 Examination Report. *See Id.* at 43-44. After reviewing that report, Addleman testified in the following exchange:

> Q: ... [D]o you have a sense of the viability or the potential for bringing a Section 206 case in order to get into court and if nothing else shut down the sale of the CDs by the Investment Adviser entity until they had adequate due diligence and perhaps through the civil discovery process ... obtain the evidence of a Ponzi scheme. Do you have an opinion about that?
>
> A: I do. I think that the issue when you're dealing with an adviser versus a broker-dealer here gives the ability to sort of add on that due diligence component .... [W]hen you put it in the fiduciary realm and you have, for

> example, the chart in here that shows the difference between what the U.S. CDs were paying and this purportedly Antiguan CD, there's reason to raise a red flag that would require additional fiduciary duties upon an adviser that wouldn't or might not be there with respect to a broker. *So, yes, I see that as a potentially straightforward way to have attempted to approach it.*[92]

Id. at 45-46 (emphasis added).

XI. HAD THE SEC FILED AN ACTION EARLIER, SIGNIFICANT INVESTOR LOSSES COULD POTENTIALLY HAVE BEEN AVOIDED

The 1998 Examination Report estimated that "SGC brokerage and advisory clients may have invested as much as $250 million in the CDs." Exhibit 55 at 1. The 2002 Examination Report stated, "SIB's financial statements for the year ended December 31, 2001, discussed in more detail below, indicated total 'certificates of deposit' of $1.1 billion." Exhibit 70 at 10. The 2002 Examination Report estimated that $640 million of those outstanding CDs were attributable to SGC. *Id.* at 2. The 2004 Examination Report indicated that SIB had $1.5 billion of outstanding CDs, of which $227 million were held by U.S. citizens. Exhibit 98 at 4.

The growth in sales of the fraudulent CDs continued to increase at an alarming rate after the 2004 Examination. The SEC's brief filed in support of its February 16, 2009 action against Stanford described that growth as follows:

> SIB sold more than $1 billion in CDs per year between 2005 and 2007, including sales to U.S. investors. The bank's deposits increased from $3.8 billion in 2005, to $5 billion in 2006, and $6.7 billion in 2007. SIB markets CDs to investors in the United States exclusively through SGC advisers pursuant to a Regulation D private placement. In connection with the private placement, SIB filed a Form D with the Commission.

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[92] In contrast to Addleman, Cohen testified that a Section 206 claim would have been just as difficult to bring as a Section 10b-5 claim. Cohen Testimony Tr. at 80-86. However, it should be noted: (1) a Section 206 claim would not have posed the jurisdictional question of whether the SIB CDs were securities; (2) SGC's lack of due diligence regarding its sales of the SIB CDs would have more easily supported a Section 206 fiduciary-based claim than a claim that those sales violated the NASD suitability rule; and (3) Section 206(2) has a lower scienter standard in which only a showing of negligence is necessary for a successful action. *See* Exhibit 149 at 26-27.

Memorandum of Law in Support of Motion for Ex Parte Temporary Restraining Order, Preliminary Injunction and Other Emergency Relief ("SEC Brief"), filed on February 17, 2009, attached as Exhibit 149 at 7. In its Complaint filed on February 16, 2009, the SEC alleged that "SIB, acting through a network of SGC financial advisors, has sold approximately $8 billion of self-styled 'certificates of deposits' ..." Exhibit 1 at ¶ 2.

A Stanford Victims Coalition survey indicated that losses could have potentially been minimized for a significant percentage of investors had the investors been aware of an investigation or examination of Stanford in 1997, when SEC examiners first raised concerns about the fund.[93] Nearly a third of the Stanford investors who responded to the survey indicated that they invested with Stanford prior to 2005. *See* Exhibit 154 at 1. Approximately 95% of the 211 responding Stanford investors stated that knowledge of an SEC inquiry would have affected their decision to invest. *See id.* at 4. One Stanford victim, who invested the money that she "saved through several years of business, nights working late and skipping vacations [she] could have taken with [her] family," said that had she "known that Stanford Group was ever under investigation by the SEC, [she] would not have bought at all." *See* February 2010 Inspector General Survey Response Excerpts, attached as Exhibit 155 at 1; February 2010 Stanford Victims Coalition Survey Response Excerpts, attached as Exhibit 156 at 1.[94] Two other investors said that an SEC investigation "would have been a very large red flag" and they "would have transferred out of that bank immediately." Exhibit 156 at 2.

Indeed, over 99 percent of the surveyed investors had no knowledge of the SEC's inquiry at the time they first invested. Exhibit 154 at 3. One Stanford investor stated, "[I] [h]ad no knowledge of any prior SEC complaints or inquiries. I researched on [the] internet and could find no registered complaints against Stanford. Obviously, [I] would not have invested with Stanford if there was any sign of trouble." Exhibit 155 at 2.

The action taken by SEC Enforcement as part of its investigation in June 2005 in sending a questionnaire out to Stanford investors in an attempt to identify clear misrepresentations by Stanford, as discussed in Section VII.A of this report, raised significant concerns among the investors. Rawl and Tidwell Interview Tr. at 8. Mark Tidwell, a vice president and financial adviser at Stanford from 2004 through 2007 who later contacted the SEC with concerns about Stanford, said that his phone "lit up like a Christmas tree the morning [the questionnaire] went out." *Id.* This flurry of phone calls from his clients led Tidwell to believe that had the SEC sent clients questionnaires prior to 2005, it would have "absolutely" raised red flags with clients, and made them more

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[93] In February 2010, at the request of the OIG, the Stanford Victims Coalition, an organization of Stanford investors, sent a survey to investors in the SIB CDs. The Stanford Victims Coalition received 211 responses to its survey. *See* February 2010 Inspector General Survey Summary, attached as Exhibit 154. Respondents to the survey certified that all answers provided were correct to the best of their knowledge.

[94] The Stanford Victims Coalition conducted its own survey of Stanford investors in February 2010.

hesitant to invest in Stanford at earlier dates. *See id.* at 7, 8. Rawl also testified that the 2005 SEC investor questionnaire led to "significant concerns" by investors in the CDs. *See id.* at 7.

However, even after investors received the questionnaire about Stanford in June 2005, many continued to invest because financial advisers told them that the fund had been given "a clean bill of health" by the SEC. Exhibit 155 at 3. Advisers told their investors that the inquiry was "routine," a result of a "disgruntled employee," and that "the investigation was complete and fined SGC a very small amount for some 'sloppy accounting'...." *Id.* at 29, 37. In fact, financial advisers used the fact that the SEC had previously examined Stanford to reassure investors about the fund's safety. One investor said that her broker told her that "regulators came constantly" and everything at Stanford was "perfect." Stanford Victim Interview Memorandum, attached as Exhibit 157. Investors were told that the SEC regulated Stanford and Stanford had "always passed with flying colors." Exhibit 155 at 4. Ironically, this gave investors "comfort knowing that [Stanford was] being watched." *Id.* at 5. Tidwell noted that he was told "there was never an issue with any regulatory body," that there may have been some regulatory "grumbling here or there, but all those matters were closed" and that anything that a governmental agency had looked into was "fine," and there was "nothing ongoing." Rawl and Tidwell Interview Tr. at 10-12.

Tidwell stated that it gave him comfort when he was told by Stanford management that nothing was found by any regulatory inquiries, and that his understanding that regulatory entities looked into Stanford and found nothing was an "endorsement." *Id.* at 12-13. Stanford officials were able to persuasively represent that Stanford had been given a "clean bill of health" by the SEC because, in fact, Stanford had been examined on multiple occasions and only been issued routine deficiency letters; deficiencies that they purportedly remedied. The 1997, 1998, 2002 and 2004 SEC examinations of SGC all resulted in deficiency letters sent from the FWDO examiners to SGC. SGC responded to each of these deficiency letters in a manner that would allow them to claim that they had responded to and addressed the SEC's concerns. *See, e.g.,* October 17, 1997 Letter from Lena Stinson to Staff Acct 1 ("[T]he deficiencies have been noted and your recommendations implemented."), attached as Exhibit 158.

Some even increased their investments due to confidence in the SEC's audits. One investor stated, "[I]n late 2008 I increased my CD investment by 150% due to the confidence in the SEC audit ... and the approval of the SEC." Exhibit 155 at 2.[95]

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[95] Ironically, Enforcement branch chief ENF BC 3 testified that he was concerned that if the SEC brought a technical violation against SGC, that could do more harm than good in the sense that SGC would publicize that the SEC has been investigating them and all that was wrong was a minor issue. ENF BC 3 Testimony Tr. at 70.

One investor reported that her husband contacted the SEC to inquire about Stanford's stability. *See* Stanford Victim Interview Memorandum. This investor said that SEC representative stated the fund was "very solid," "the most solid group in Texas." *Id.* She said that the SEC confirmed that Stanford was a "prestigious" fund that had been "functioning well for 18 years." *Id.*

In addition, investors reported that they relied on favorable remarks concerning Stanford by Federal government leaders, including a 2008 commendation from President George W. Bush, in making their decision to invest in Stanford. *See* February 20, 2008 letter from George W. Bush, attached as Exhibit 159. For example, one investor stated: "[T]here was nothing but praise by our congressmen, senators, and our own President Bush [as to] how wonderful [t]his company and man was and the safest sound company." Exhibit 155 at 6. Another investor stated that "SGC had an impec[c]able record and had received many awards and commendations[,] one even from President Bush commending Allen Stanford for his exemplary conduct in the business community." *Id.* at 7.

XII. THE SEC ENFORCEMENT STAFF'S FAILURE TO BRING AN ACTION AGAINST STANFORD EARLIER WAS DUE, IN PART, TO THE STAFF'S PERCEPTION THAT THE CASE WAS DIFFICULT, NOVEL, AND NOT THE TYPE OF CASE FAVORED BY THE COMMISSION

A. Senior Enforcement Management Emphasized the Need For "Stats"

Degenhardt told the OIG that he "absolutely felt that it was important to convey to the Commission the number of cases that his office brought." Degenhardt Interview Memorandum at 2. He said the regional offices were "heavily judged" by the number of cases they brought when he first came to the SEC. *Id.* Degenhardt stated that after 1997, the FWDO brought more cases than any other regional office on a per-capita basis. *Id.* He said the FWDO, the third-smallest regional office, was always in the "top three" for overall number of cases brought from 1997 through 2005, and in 2001, the FWDO brought the highest number of cases of any regional or district office. *Id.* He emphasized that this was a "source of great pride" for himself, Spencer Barasch as the head of Enforcement in the FWDO, and the FWDO as a whole. *Id.*

Degenhardt described himself as having been "very outspoken" while he was at the SEC, but felt he was "bullet proof" because of the high number of cases that the FWDO brought and, as a result, the Commission "could not get rid of him." *Id.* at 4. Degenhardt said he would often "fight with the bureaucrats in DC" and would tell the staff, "You are my shield, because of the high numbers of cases you are bringing, so if you like me working here, keep bringing a lot of cases." *Id.*

According to Degenhardt, Barasch was even more concerned about "stats" than Degenhardt was, stating that "it was very important to Barasch that the FWDO bring a high number of cases." *Id.* at 4. Degenhardt stated that the FWDO's high number of cases "was a feather in Barasch's cap." *Id.*

Barasch told the OIG:

> [E]very regional and district office was very motivated to bring as many cases as possible, because that's --you were judged by the number of cases you brought and then the quality of the cases you brought. And it was both. And the number of cases was extremely important. ...

Barasch Interview Tr. at 28. Like Degenhardt, Barasch told the OIG that there was one year in which the FWDO brought more cases than any other regional or district SEC office. Barasch Interview Tr. at 28-29.

Cohen also acknowledged the primacy of "stats" as follows:

> Everybody was mindful of stats. ... Stats were recorded internally by the SEC in Washington. ... I think when I was assistant director, there was a lot of pressure to bring a lot of cases. I think that was one of the metrics that was very important to the home office and to the regions.

Cohen Testimony Tr. at 105. Cohen testified that the pressure to bring a lot of cases came from Barasch and Degenhardt, and that Barasch and Degenhardt would compare the FWDO's stats with those of other offices. *Id.* at 108-109. Cohen testified that the FWDO was "very proud" of its productivity. *Id.* at 109 ENF BC 3 also testified that he understood that there was pressure on regional offices to show that they had brought "X" number of cases per year in order to show that they were productive. ENF BC 3 Testimony Tr. at 75-76 ENF BC 3 also testified that the FWDO was well-known for bringing a lot of cases and that its reputation for doing so was a source of pride within the office. *Id.* at 78.

Wright observed that after he left FWDO's Enforcement group, "Barasch [put] a lot more pressure on people to produce numbers." Wright Testimony Tr. at 18. Wright testified that the pressure to produce numbers also came from Degenhardt, stating:

> [Degenhardt] came from a big law firm, and he quickly decided the way to impress people was to come up with lots of numbers. And Spence, of course, was part of that.

Id. at 18-19. Wright testified that Barasch "was pretty upfront" with the Enforcement staff about the pressure to produce numbers and communicated to the Enforcement staff, "I want numbers. I want these things done quick." *Id.* at 21-22.

Wright also observed a change in emphasis when Addleman replaced Barasch as Associate District Director for Enforcement. Wright Testimony Tr. at 49-50. Wright testified that Addleman was not so enamored with the numbers like Barasch and

Degenhardt were and that Addleman "was much more concerned about the kind of cases you're bringing and why you're bringing cases." *Id.*

Addleman acknowledged that before she became the Associate District Director for Enforcement, "there was some internal pressure within the Fort Worth office to generate numbers ... of cases." Addleman Testimony Tr. at 27. By contrast, she agreed that while obviously it's important to have numbers, it's also important to have substantial cases, and even cases that are complicated or difficult or that may involve some work to get through the Commission. *Id.* Addleman described this "culture shift" as follows:

> My emphasis was less on numbers than the [Degenhardt and Barasch] administration ... where people were of the belief that the numbers were the only thing that mattered ... And there needed to be some, in my opinion, reality brought back to what the enforcement program is supposed to be. ... So, yes, I think there's definitely a culture shift and Jeff [Cohen] had a little trouble with some of that I will admit. ... He had some tougher cases. I won't say that he only had easy things, but in a way that he could sort of charge ahead on the things that he knew were going to be fruitful and give rise to a number as opposed to a case that didn't have that degree of certainty, if you will, would be a factor in his analysis.

Id. at 28-29.

Walter Ricciardi, former Deputy Director of Enforcement from 2005 through 2008, was quoted in the April 16, 2009 Bloomberg article, *Stanford Coaxed $5 Billion as SEC Weighed Powers*, as follows:

> SEC enforcement offices were evaluated on the number of cases, or "stats," they brought in, rather than on the seriousness or difficulty of action, said Walter Ricciardi, the agency's deputy chief of enforcement from 2005 through 2008, in a speech April 1 in New York. "So if you brought an Enron, that's one," Ricciardi said. "If you brought a WorldCom, that's two." Delisting 135 defunct companies in a week for failing to file annual reports gave an enforcer 135 cases to count, he said. "Maybe certain investigations would have gotten put in the right place and in the right posture" with a different evaluation system, he said.

Alison Fitzgerald and Michael Forsythe, *Stanford Coaxed $5 Billion as SEC Weighed Powers*, Bloomberg, April 16, 2009, attached as Exhibit 160 at 4. *See also* Judith Burns, *SEC's Near-Record Enforcement Results Raise Questions*, Dow Jones, October 9, 2008, attached as Exhibit 161.

B. The Pressure For "Stats" May Have Discouraged the Staff From Pursuing Difficult Cases

Wright testified that the pressure for numbers incentivized the Enforcement staff to focus on easier cases, the "quick hits." Wright Testimony Tr. at 18. According to Wright, as a result of the "pressure on people to produce numbers[,] ... anything that didn't appear ... likely ... to produce a number in a very short period of time got pretty short shrift." *Id.* at 18.[96] A former FWDO Examination branch chief, who asked not to be identified, agreed that the FWDO Enforcement staff "were concerned about the number of cases that they were making and that perhaps if it wasn't a slam-dunk case, they might not want to take it because they wanted to make sure they had enough numbers because that's what they felt the Commission wanted them to do." Unidentified Former FWDO Examination Branch Chief Testimony Tr. at 86-87.

BD Examiner 1 testified that "examiners will refer great cases to Enforcement, and they just sit there ... for a variety of reasons." BD Examiner 1 Testimony Tr. at 54. BD Examiner 1 testified that one reason that great cases "sit" in Enforcement is that the Enforcement staff takes the approach that, "Yes, there may be some fraud here, but it is not a slam dunk, [and] we are not going to try to go to court if it is not a slam dunk." *Id.* Similarly IA Examiner 2 testified that he "got the sense that [the Enforcement staff] did not want to lose any cases. So if there was a high risk of losing a case, there was a reluctance for them to take it." IA Examiner 2 Testimony Tr. at 77.

Addleman acknowledged that when she became the Associate District Director for Enforcement in the FWDO, there was a feeling that the Commission was possibly more receptive to clear-cut cases, in which you have clear victims already losing money,

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[96] Wright recalled one case that he had assigned to Prescott when Barasch was her branch chief that he later learned Barasch had instructed her not to work on because it was not going to be a quick hit. Wright Testimony Tr. at 22-24. Ironically, that case bore many similarities to the Stanford matter. *Id.* Wright testified that the matter "involved insurance, and while presumably they were selling insurance, it was really a Ponzi scheme." *Id.* at 23. Wright believes that Barasch told Prescott not to work on it DPP, WP DPP, WP

But, as Wright explained, "the case got transferred [to another SEC office]. ... [T]hey did a little research and came up with the idea that what they were selling was not an insurance contract but really a security. ... [A]nd it became one of these [cases] where you rush to the courthouse to get a temporary injunction and restraining order and all the rest." *Id.* at 23. Wright reflected on the parallels between that case and Stanford, stating, "Again, you get back to the number aspect, you know. If you got a problem with determining whether or not something is a security, just like in Stanford, then it's going to be harder to do. It's not going to be a quick hit. You're not going to get a number quicker." *Id.* at 24.

and that if they were going to bring a case, they should bring a case that is more clear-cut and has potential victims, so it's easier to get through the Commission and generate their numbers. Addleman Testimony Tr. at 27. Similarly, Preuitt testified:

> [Stanford] was also a very difficult case. It was going to use a lot of resources, and that was unappealing.
>
> And very much during the Cox administration, there was concern that the Commission wasn't going to take anything unless it was just nailed down and perfect and beautiful and that you might receive a lot of negative feedback unless you had a case like that. And people wanted to avoid that sort of negative response. ...

December 14, 2009 Preuitt Testimony Tr. at 55-56.

As discussed below, at some point, FWDO management was instructed to focus less on Ponzi scheme cases. However, as Preuitt explained, the FWDO was willing to bring Ponzi scheme cases if they were *easy* cases:

> [T]o be fair, the Fort Worth office has been one of the most aggressive offices in terms of Ponzi schemes.
>
> ... But most of those are really quite easy to prove, and you can get into court quickly. And we were just very aggressive on doing those.
>
> So during Hal and Spence's tenure, we did many Ponzi schemes; but they were small in comparison. They were much -- you know, very easily proven. Once they start to break and you can get some bank records, I mean, in comparison, the difficulty of those cases is, you know – it doesn't compare.

Id. at 56-57.

Wright testified that Stanford "was not going to be a quick hit. It was going to be a dogfight." Wright Testimony Tr. at 18. Accordingly, Wright explained that Stanford was not considered as high priority of a case as easier cases. *Id.* at 18-19. Similarly, Preuitt told the OIG that Cohen did not want to pursue the investigation "[b]ecause it was going to be hard to prove...." Preuitt Interview Tr. at 18-19. Preuitt testified that Cohen only wanted to bring cases that were slam dunk, easy cases. January 26, 2010 Preuitt Testimony Tr. at 42.

Preuitt testified that no one in Enforcement ever disagreed with her conclusion that Stanford was probably a fraud. December 14, 2009 Preuitt Testimony Tr. at 45. According to Preuitt, Enforcement's unwillingness to investigate Stanford "was always about ... barriers. ... [Stanford] was seen [by Enforcement] as a fantastically difficult case, and I couldn't convince them to do it." *Id.* at 45-46.[97]

The Enforcement staff perceived the Stanford case was difficult, in part, because there was no evidence that the Ponzi scheme was collapsing. The Cohen Memorandum included the following observation:

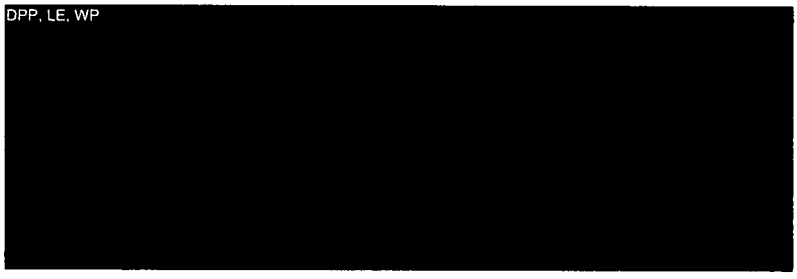

Exhibit 144 at 3-4 (emphasis in original).[98]

On October 25, 2004, while the 2004 examination was ongoing, Wright forwarded to Preuitt an e-mail chain from early-June 2003 that discussed Enforcement staff's view at that time that a Stanford investigation was too difficult to undertake. October 25, 2004 E-mail from Hugh Wright to Julie Preuitt, attached as Exhibit 162.

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[97] Degenhardt and Barasch vigorously denied that the FWDO was averse to difficult investigations during their tenure. Degenhardt told the OIG that, in addition to doing "kick in the door and grab" cases, the FWDO had worked on complex cases. Degenhardt Interview Memorandum at 2. He added that he felt the FWDO "worked very hard in his tenure on all types of cases (including big cases)...." *Id.* at 6. Barasch told the OIG that he had brought several cases against broker-dealers and investment advisers. Barasch Interview Tr. at 30-35. Barasch also stated that he was instructed to "focus[] on working what would be deemed to be good core cases for the Commission." *Id.* at 13.

[98] ENF Staff Atty 5 testified that she believed it was difficult to bring a Ponzi scheme case before the scheme began to unravel because "you don't have anybody complaining about anything going wrong, everybody is happy, so they are not particularly cooperative[ENF Staff Atty 5] Testimony Tr. at 18-19. The belief that the SEC could not act against a suspected Ponzi scheme was shared by the staff in the SEC's failed Bernard Madoff investigation. Doria Bachenheimer, the Assistant Director responsible for a 2005-2006 investigation of Madoff that was closed without any action, testified in the OIG's investigation of that matter that she viewed circumstantial evidence that Madoff was running a Ponzi scheme as only "theories," stating, "[the red flags of a Ponzi scheme that were presented to the Enforcement staff] weren't evidence. You know, it wasn't something we could take and bring a lawsuit with." *See* the OIG's September 30, 2009 Report of Investigation, Case No. 509, entitled "Investigation of Failure of the SEC to Uncover Bernard Madoff's Ponzi Scheme," at 247. Bachenheimer further explained her view that "[i]t's very challenging to develop evidence [about a Ponzi scheme] until the thing actually falls apart." *Id.*

Preuitt responded:

> I love this stuff. We all are confident that there is illegal activity but no easy way to prove.[99] Before I retire the Commission will be trying to explain why it did nothing. Until it falls apart all we can do is flag it every few years.

October 25, 2004 E-mail from Julie Preuitt to Hugh Wright, attached as Exhibit 162.

But Preuitt and IA Examiner 1 testified that after the revelation that the SEC failed to uncover the Bernard Madoff Ponzi scheme, the staff's view about recommending an Enforcement action without clear evidence that it was a Ponzi scheme changed. IA Examiner 1 explained the change as follows:

> I have a general recollection that our office, after the Madoff situation, said, hey, is there anything that we have any concern about that we haven't done something about, and I believe Stanford was one of them. ...
>
> And, so, we decided we need to pick this up and run with it and see if we can do something because, you know, *the game has changed. The risk of losing is a whole lot less now. We -- we're going to be punished more for not doing something than for doing something and ending up being unsuccessful or whatever.* That was my general feeling, that we couldn't let that sleep anymore.

IA Examiner 1 Testimony Tr. at 136 (emphasis added). Similarly, Preuitt testified:

> Well, clearly when Madoff broke, that changed everything. People felt like now ... maybe ... the Commission will not turn us down if we bring to them, you know, an imperfect case where we don't have all of the documents.

December 14, 2009 Preuitt Testimony Tr. at 87-88. The OIG found in its earlier report regarding the Stanford investigation as follows, "Immediately after the revelations of the Madoff Ponzi scheme became public in December 2008, the Stanford investigation became more urgent for the FW[D]O and, after ascertaining that the DOJ investigation was in its preliminary phase, the FW[D]O staff asked DOJ if it could move forward with the Stanford investigation." Report of Investigation, Case No. OIG-516, entitled

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[99] IA Examiner 1 testified that Stanford was "a subject of common discussion in the office." IA Examiner 1 Testimony Tr. at 122.

"Investigation of Fort Worth Regional Office's Conduct of the Stanford Investigation" at 10.

C. Ponzi Scheme Cases Were Disfavored by Senior Enforcement Officials

Degenhardt told the OIG that Enforcement Director Richard Walker was critical that the FWDO was bringing too many Temporary Restraining Order (TRO), Ponzi, and prime bank cases, which Walker referred to as "kick in the door and grab" cases or "mainstream" cases. Degenhardt Interview Memorandum at 2. According to Degenhardt, Walker told him that the FWDO needed to bring more Wall Street types of cases, like accounting fraud cases. *Id.* Degenhardt recalled a meeting with Walker in which Walker said, "[G]ive the Ponzi scheme-type cases to the states." *Id.* at 4. Degenhardt said that he replied, "[T]he states are not capable of doing these cases," to which Walker reiterated, "[G]ive them to the states." *Id.*

Barasch told the OIG that when he was hired to be the director of Enforcement for the FWDO, senior management in the Enforcement Division in Washington, DC, as well as in the Denver Regional Office (which supervised the FWDO at that time), told him to clean up the FWDO's inventory and repeatedly told him that the FWDO's emphasis should be on accounting fraud cases. Barasch Interview Tr. at 12-14. Barasch told the OIG that the pressure to focus on accounting fraud cases exponentially increased after Enron filed for bankruptcy on December 2, 2001, and revelations of massive accounting fraud followed. Barasch Interview Tr. at 24.

Barasch further told the OIG that he was told that the FWDO was spending way too much of its resources on Ponzi-scheme kinds of cases, and that those resources would be better deployed on accounting fraud cases. Barasch Interview Tr. at 34.[100] Barasch specifically recalled that in November 2000, after the FWDO brought several Ponzi scheme cases, he was told by a senior official in the Enforcement Division (whom Barasch declined to name): "Spence, you know you got to spend your resources and time on financial fraud. What are you bringing these cases for[?]" Barasch Interview Tr. at 31-33.

Preuitt also testified that the FWDO "actually received a great deal of pushback from all of the Ponzi schemes that we were doing." December 14, 2009 Preuitt Testimony Tr. at 57. Preuitt explained her view that "the Commission is very interested in a fraud of the day. And [Stanford] wasn't ever the fraud of the day." *Id.* at 55.

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[100] In the context of another Ponzi scheme matter investigated by the FWDO, NYRO Counsel, a PII Counsel in the SEC's New York office, e-mailed a FWDO attorney on January 14, 2004, "[O]f course [the SEC] should get out of the business of burning resources to chase Ponzi schemes ...." E-mail dated January 14, 2004 from NYRO Counsel at Exhibit 163.

According to Preuitt, Ponzi scheme cases "became the fraud of the day after Madoff." *Id.* at 56.

D. The SEC Bureaucracy May Have Discouraged the Staff From Pursuing Novel Legal Cases

Degenhardt told the OIG that the arduous process of getting the SEC staff's approval in Washington, DC to recommend an Enforcement action to the Commission was a factor in deciding which investigations to pursue. Degenhardt Interview Memorandum at 5. Degenhardt recalled one matter in late-2000 in which the FWDO staff invested a lot of time in an investigation involving DPP, WP DPP, WP and felt strongly that the matter warranted an Enforcement action. *Id.* at 5-6; February 11, 2001 E-mail from Harold Degenhardt to Annette Nazareth and Robert Colby, attached as Exhibit 164. However, staff in the Division of Market Regulation took the position that DPP, WP and consequently prevented the FWDO staff from bringing the matter to the Commission's attention. *Id.*

Barasch also recalled the FWDO's unsuccessful efforts to convince the staff in Washington, DC, to recommend an Enforcement action DPP, WP. Barasch Interview Tr. at 37-39. Barasch said his experience in that matter was a factor in his view that the Stanford matter was not worth investigating. *Id.* at 39. According to a former FWDO Examination branch chief, the Enforcement staff in Washington, DC – specifically the staff in the Branch of Regional Office Assistance ("BROA")[101] – would not have let an Enforcement recommendation on Stanford go to the Commission because of its novel characteristics. Unidentified Former FWDO Examination Branch Chief Testimony Tr. at 79-80. He described the process of trying to get Enforcement recommendations to the Commission through BROA as "very frustrating." *Id.* at 80.

Wright testified that "[o]ver a period of time when I was here, [the bureaucracy] got a lot worse. ... [Y]ou've got so many layers between what you do in Fort Worth before it ever gets to the Commission. It's got to go through what was called BROA at that time. I don't know what it's called now. And you have a lot of people second-guessing everything, and so, you know, what we thought were good reasons weren't necessarily accepted by anybody else." Wright Testimony Tr. at 13-14.

Addleman testified that the process of obtaining a formal order in the Stanford matter, in particular, involved a "ridiculous" amount of review by various staff in DC, stating:

> As I recall, it took a longer period than was appropriate, in my opinion, to get the formal order done, both in terms of getting the written product out the door and then getting it

[101] BROA has been renamed the Office of Chief Counsel.

> through the Commission. I mean, it was something ridiculous like two months of review in DC before it got on a Commission calendar, those kinds of things. So there were a lot of time delays that are, I suppose, different points in my career more frustrating than others and this might have been one of those points where I was frustrated.

Addleman Testimony Tr. at 33. ENF Staff Atty 5 also recalled that the process of getting the staff's request for a formal order before the Commission took a particularly long time because of jurisdictional issues and comments and pushback from other offices within the SEC. ENF Staff Atty 5 Testimony Tr. at 47-48.

Preuitt testified that she believed that the desire of the Enforcement staff to avoid difficult cases was partly due to the realities of dealing with the Commission's bureaucracy. Preuitt described the challenges posed by that bureaucracy in the following exchange:

> A: [T]he gauntlet, even before you get to the part of the Commission, is nightmarish, to get through market reg, to get through IM, to get through general counsel. ... And it's just like hitting your head against the wall repeatedly over and over and over. ...
>
> Q: So is it your impression that in general ... the harder cases, more challenging cases are going to be difficult to get through the bureaucratic process in Washington?
>
> A: A nightmare. Difficult is an understatement. It is a horrific miserable process. ...
>
> ...
>
> A: [N]ot only do [the Enforcement staff] have to worry about criticism if [a case] finally gets to the Commission .... First [the Enforcement staff] have to deal with a year or two of nightmarish difficulties, so it really was no small thing for [the Examination staff] to ask them to try to bring this on a more novel case. Did I think it was worth it?
> Did I think that the senior people then should have supported and helped that process and protected their staff in some way from the misery to make it happen, I did. But I don't want to give the impression I thought this was easy to do and they could just go do it and they

> were stubborn. Nobody wanted to face the people in Washington. They didn't and for good reason.

January 26, 2010 Preuitt Testimony Tr. at 72-74.

As discussed above, for seven years the SEC Enforcement staff did not open an investigation into Stanford although every member of the staff that had examined Stanford believed the CDs were a Ponzi scheme. That failure was due in part to repeated decisions by Barasch to quash the matter. Immediately after he left the SEC, an investigation of Stanford was opened. While that investigation proceeded haltingly, beset by feuding among the staff that at times consumed more of the staff's time and energy than the actual investigation, as discussed below, Barasch repeatedly attempted to represent Stanford in connection with the investigation he had blocked for seven years.

XIII. AFTER LEAVING THE SEC, BARASCH SOUGHT TO REPRESENT STANFORD IN CONNECTION WITH THE SEC INVESTIGATION ON THREE SEPARATE OCCASIONS AND DID REPRESENT STANFORD FOR A LIMITED PERIOD OF TIME

A. In June 2005, Two Months After Leaving the SEC, Barasch Sought to Represent Stanford and Was Advised He Could Not Do So

Barasch left the SEC on April 14, 2005, and joined the law firm of Andrews Kurth, LLP later that month. *See* March 9, 2005 Andrews Kurth press release, attached as Exhibit 165. On June 1, 2005, Jane Bates, SGC's Chief Compliance Officer, asked an Investment Adviser consultant who was working with SGC for an attorney recommendation as follows:

> Would you give me names of some very good attorneys you would recommend that we might want to hire if necessary for this SEC inquiry[?] SEC Enforcement is involved and I want to be prepared. This is informal now, but that could change.

June 1, 2005 E-mail from Jane Bates to Stanford Empl 6 attached as Exhibit 166. On June 2, 2005, the consultant responded and recommended Barasch specifically because of his FWDO experience, saying,

> . . . [R]ight off the bat my instinct would say to call [Barasch] because of his specific experience in dealing with the FWDO enforcement staff.

June 2, 2005 E-mail from Stanford Empl 6 to Jane Bates, attached as Exhibit 166.

On June 6, 2005, Bates e-mailed Yolanda Suarez, Stanford Financial Group ("SFG") Chief of Staff, and Mauricio Alvarado, SFG General Counsel, as follows:

> ... I talked to our [investment adviser] consultant who used to be a Branch Chief at OCIE in DC and asked him if he knew any individuals who knew the SEC Enforcement staff in Fort Worth. He gave me the name of the following individual [Barasch] who recently left the SEC and is at Andrews Kurth in Dallas.

June 6, 2005 E-mail from Jane Bates to Yolanda Suarez, attached as Exhibit 167 at 2. Suarez immediately e-mailed Alvarado, "Lets [sic] talk to him." June 6, 2005 E-mail from Yolanda Suarez to Mauricio Alvarado, attached as Exhibit 167.

On or about June 11, 2005, Stanford Empl 1, a SFG compliance employee, forwarded the recommendation of Barasch to Robert Allen Stanford. *See* E-mail from Stanford Empl 1 to Robert Allen Stanford, attached as Exhibit 168. Stanford replied, "This guy looks good and probably knows everyone at the Fort Worth office. Good job Stanford Empl 1 June 11, 2005 E-mail from Robert Allen Stanford to Stanford Empl 1 attached as Exhibit 168.

By June 17, 2005, Alvarado had contacted Barasch, presumably about representing Stanford. *See* June 17, 2005 E-mail from Spencer Barasch to Mauricio Alvarado, attached as Exhibit 169. On June 20, 2005, Barasch e-mailed Richard Connor, Assistant Ethics Counsel in the SEC's Office of General Counsel, as follows:

> Hope all is well in this time of incredible change at the SEC. I never believed that my departure would trigger so many others to abandon ship...
>
> I have been approached about representing an investment complex called Stanford Financial Group, of Houston, Texas, in connection with (what appears to be) a preliminary inquiry by the Fort Worth office. The assigned attorneys are (I think) ENF Staff Atty 5 and ENF BC 3.
>
> *I am not aware of any conflicts* and I do not remember any matters pending on Stanford while I was at the [C]ommission. Would you please confirm this with the Fort Worth staff?[102]

[102] Connor testified that he did not recall Barasch at any point telling him that in 1998, Barasch had participated in a decision to close an inquiry regarding Stanford; in 2002, Barasch had participated in a decision to refer a complaint about Stanford to the Texas State Securities Board; and in 2003, Barasch had participated in a decision not to investigate Stanford after reviewing a complaint that Stanford was engaged in a massive Ponzi scheme. Connor Testimony Tr. at 14-15. Barasch stated that he did not mention the

(Footnote continued on next page.)

June 20, 2005 E-mail from Spencer Barasch to Richard Connor, attached as Exhibit 170 (emphasis added).

Although Barasch claimed not to remember any matters pending on Stanford while he was at the SEC, the OIG investigation found, as discussed more fully above, that Barasch had played a significant role in the FWDO's inquiries and examinations of the possibility of Stanford engaging in a Ponzi scheme or similar fraud, including: (1) in 1998, deciding to close an inquiry regarding Stanford, *see* Section II.C; (2) in 2002, deciding to forward the Complainant 1 letter to the TSSB and not respond to the letter or investigate the issues it raised, *see* Section IV.E; (3) in 2002, deciding not to act on the Examination staff's referral of Stanford for investigation, *see* Sections IV.H and I; (4) in 2003, participating in a decision not to investigate Stanford after receiving the Confidential Source letter comparing Stanford's operations to the PII fraud, *see* Section V; and (5) in 2003, participating in a decision not to investigate Stanford after receiving the letter from an anonymous insider alleging that Stanford was engaged in a "massive Ponzi scheme," *see* Section V.B.

Federal conflict-of-interest laws impose on former government employees a lifetime ban on making a communication to or appearance before an employee of a federal agency or court in connection with a particular matter (A) in which the United States is a party or has a direct and substantial interest, (B) in which the former employee was personally and substantially involved as a government employee, and (C) which involved a specific party or parties at the time of the participation. *See* 18 U.S.C § 207(a)(1); *see also* 17 C.F.R. § 200.735-8(a)(1). Under federal ethics regulations, "[t]he same particular matter may continue in another form or in part," and "[i]n determining whether two particular matters involving specific parties are the same, all relevant factors should be considered, including the extent to which the matters involve the same basic facts, the same or related parties, related issues, the same confidential information, and the amount of time elapsed." 5 C.F.R. § 2641.201(h)(5). Moreover, "[a] particular matter may involve specific parties prior to any formal action or filings by the agency or other parties." 5 C.F.R. § 2641.201(h)(4).[103]

1998 inquiry or the 2002 matter to Connor when they spoke in 2006 because he "just didn't remember anything" about these events. Barasch Interview Tr. at 60. Connor agreed that this conduct would be pretty substantial involvement in a variety of Stanford-related matters over time, and that when an individual is seeking ethics advice to represent a particular company before the Commission, that individual should inform the Ethics Office of the roles he played previously while at the Commission. Connor Testimony Tr. at 15.

[103] One of the examples provided in 5 C.F.R. 2641.201 makes clear that a government employee can be found to have participated in a particular matter even if the employee left the agency before charges were filed. Example 1 to paragraph (h)(4) of the regulation provides as follows: "A Government employee participated in internal agency deliberations concerning the merits of taking enforcement action against a company for certain trade practices. He has participated in a particular matter involving specific parties and may not represent another person in connection with the ensuing administrative or judicial proceedings against the company."

Given that all of the instances listed above involved essentially the same parties and the same underlying issue, *i.e.*, whether Stanford was engaging in a Ponzi scheme or a similar fraud, in our view, Barasch had personal and substantial involvement over a period of time in the Stanford Ponzi scheme matter that, under the applicable criminal statute, precluded him from communicating to or appearing before the SEC regarding Stanford. In fact, Connor agreed that Barasch's earlier involvement in the 1998 inquiry, the 2002 complaint referral and the 2003 Ponzi-scheme complaint, would have barred Barasch from representing Stanford in the 2005 SEC investigation. Connor Testimony Tr. at 13-14.

In response to Barasch's request to confirm that he had no conflicts, Connor contacted ENF Staff Atty 5 on June 20, 2005. *See* June 20, 2005 E-mail from Richard Connor to Spencer Barasch, attached as Exhibit 170. After Connor contacted ENF Staff Atty 5 ENF BC 3 e-mailed several members of the FWDO regarding "Stanford Group Company" and asked:

> Spence is looking to become engaged on the above referenced matter. The matter was referred to Enforcement by [the Examination staff] via a memo dated March 14, 2005. The memo was from Victoria, to Spence. Does anyone know if Spence received the memo before his departure? Did he read it? Did anyone have any discussions with him about the matter? I'll let the Ethics Office know.

June 20, 2005 E-mail from ENF BC 3 to Harold Degenhardt, *et al.*, attached as Exhibit 171.

On June 20, 2005, Prescott responded to ENF BC 3 e-mail:

> I had no discussions with Spence individually, but he was present (along with Hal, Julie, ENF Asst Dir 1 and Cohen) at a regulatory summit meeting in Austin earlier this spring at which the general facts of the case were presented. I did not give Spence a copy of the memo. Although it was prepared for him, Julie and ENF Asst Dir 1 had been discussing the case, and it is my understanding that Julie forwarded the memo directly to ENF Asst Dir 1 I do not know whether ENF Asst Dir 1 discussed it with Spence or not, or whether Julie sent the memo to anyone but ENF Asst Dir 1

June 20, 2005 E-mail from Victoria Prescott to ENF BC 3 attached as Exhibit 171.

On June 20, 2005, Degenhardt responded to [ENF BC 3] e-mail:

> This is really no different from the prior matter.[104]
>
> A memorandum was sent to Spence while here. Whether he says that he received it, or not, is irrelevant. He cannot represent them. Please pass this to Ethics folks, though I would be amazed, if they had not reached this conclusion independently.

June 20, 2005 E-mail from Harold Degenhardt to [ENF BC 3], attached as Exhibit 172.

On June 20, 2005, Cohen responded to Degenhardt's e-mail:

> I didn't discuss Stanford with Spence. Anyway, I agree with your assessment Hal; even if Spence doesn't recall reading it, as preoccupied as he was at the time, it may have simply slipped his memory. And optically, it would look very bad.

June 20, 2005 E-mail from Jeffrey Cohen to Harold Degenhardt, attached as Exhibit 172.

Connor then determined, based on the information he received from the Fort Worth staff, including Prescott, that Barasch could not represent Stanford on the basis of his attendance at a meeting with regulators in the district at which complaints about a Ponzi scheme at Stanford were discussed. Connor Testimony Tr. at 16-18. Connor stated, ". . . [U]pon learning more information from the staff in Fort Worth, we made the determination that Spence Barasch had participated in the Stanford matter and that he could not participate in these post-employment activities." *Id.* at 16.[105]

On June 20, 2005, at 7:14 p.m., Alvarado e-mailed Robert Allen Stanford and Suarez about the news that Barasch could not represent Stanford:

> As you know, per your instructions, I was in the process of retaining the legal services of Spencer Barasch, the former

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[104] When interviewed by the OIG, Degenhardt did not recall this e-mail, but noted that Barasch would have been prevented from working on any Stanford matter that his group had worked on. Degenhardt Interview Memorandum at 6.

[105] Connor explained that Barasch's actions in attending a meeting at which it was discussed whether Stanford was a Ponzi scheme "would constitute participation, and that matter, whether it had been assigned a particular number or not, would be considered a continuation of . . . whatever the Fort Worth number that was assigned to it that ultimately became the Enforcement investigation. So it would be the issues, the parties are all the same, and so that initial participation would continue right on up until a formal investigation was opened and a Fort Worth number was assigned to it." Connor Testimony Tr. at 20.

> head of enforcement of the Dallas SEC office, currently with Andrews and Kurth. However, he called me today to inform me that he was unable to assist us in the referenced matter as he was conflicted out. It appears that he did not receive the okay from the office of the General Counsel of the SEC, as the matter started before he left the SEC. He left the SEC six weeks ago. Thus, we are not able to retain his services. Thanks.

June 20, 2005 E-mail from Mauricio Alvarado to Robert Allen Stanford, attached as Exhibit 173. On July 2, 2005, Robert Allen Stanford reacted strongly to the news, stating, "This is bs and I want to know why the SEC would /could conflict him out." July 2, 2005 E-mail from Robert Allen Stanford to Mauricio Alvarado, attached as Exhibit 173.

We note that apart from Barasch's involvement in Stanford matters while he was at the FWDO, at the time Barasch sought to represent Stanford in June 2005, he was prohibited by the federal conflict-of interest statutes from communicating to or appearing before the SEC on *any* matter until April 13, 2006, one year after his departure.[106] During his OIG interview, Barasch stated that he did not recall having contacted the SEC in 2005 about representing Stanford, but did acknowledge he was subject to the one-year ban. Barasch Interview Tr. at 53-54. In fact, when the OIG first asked Barasch about his effort to represent Stanford in 2005, his immediate response was as follows:

> 2005 I had my one-year ban. Okay. I had a one-year ethical ban, because I was an SES or [Senior Officer], or whatever they're called. So I couldn't practice before the Commission for a year.

Id. at 53.

[106] 18 U.S.C. § 207(c)(1) prohibits certain senior government officials from "knowingly mak[ing], with the intent to influence, any communication to or appearance before any officer or employee of the department or agency in which such person served within 1 year before" termination from senior service, if that communication or appearance is made "on behalf of any other person (except the United States), in connection with any matter on which such person seeks official action by any officer of employee of such department or agency . . . ." *See also* 5 C.F.R. § 2641.204; 17 C.F.R. § 200.735-8(a)(4). This one-year ban is not in any way limited to matters in which the former employee participated as a government employee; rather, it is "a one year across the board" prohibition on appearing before the individual's former agency. Connor Testimony Tr. at 36-37. Connor confirmed that Barasch was subject to the one-year ban. *Id.* at 37.

B. In September 2006, Stanford Retained Barasch to Represent it in Connection With the SEC's Investigation of Stanford, and Barasch Performed Legal Work on Behalf of Stanford

Approximately one year after the SEC's Ethics Office determined that Barasch's conflicts, not the one-year ban, prevented him from representing Stanford in connection with the SEC investigation, Stanford retained Barasch to do just that. On September 29, 2006, Robert Allen Stanford e-mailed Alvarado and James Davis, SIB's Chief Financial Officer, the following:

> The former sec [D]allas lawyer we spoke about in [S]t [C]roix. Get him on board asap.

September 29, 2006 E-mail from Robert Allen Stanford to Mauricio Alvarado, attached as Exhibit 174. Alvarado responded to Robert Allen Stanford approximately one hour later:

> I have already spoken to Spencer Barasch. I have scheduled a meeting for next Tuesday in Miami in the afternoon. For your information, Spencer is a partner at Andrews Kurth and was previously the Associate Director in the SEC's Fort Worth office where he headed up the agency's enforcement program in the Southwest.

September 29, 2006 E-mail from Mauricio Alvardo to Robert Allen Stanford, attached as Exhibit 174.

Also on September 29, 2006, Barasch e-mailed Alvarado:

> Thanks for the call this morning – I look forward to the opportunity to be of service to Stanford going forward.
>
> I will await instructions about where and when to meet in Miami on [T]uesday. . . .

September 29, 2006 E-mail from Spencer Barasch to Mauricio Alvarado, attached as Exhibit 175. On Monday, October 2, 2006, Alvarado notified Robert Allen Stanford and Davis, "Fyi. I will be meeting with Spencer Barasch, former SEChead [sic] of enforcement tomorrow at 3:00 PM at our offices in Miami (21st floor conference room)." October 2, 2006 E-mail from Mauricio Alvarado to James Davis and Robert Allen Stanford, attached as Exhibit 175.

On October 3, 2006, Barasch met with Alvarado in Stanford's Miami office. *See* Andrews Kurth billing records, attached as Exhibit 176; Barasch Interview Tr. at 52-53, 55-57. Barasch told the OIG that, after sitting in the lobby of the Miami office for "over

an hour," he met with Alvarado "for 15 minutes, and all [Alvarado] did was hand[] [him] a stack of Stanford promotional documents . . . ." Barasch Interview Tr. at 56. Barasch billed 4.5 hours for the meeting and preparation for the meeting which, according to his billing records, did not include time related to travel or review of publicly available company information to prepare on the day before for the meeting. *See* Exhibit 176.

On October 4, 2006, the day after the meeting in Miami, Barasch followed up with Alvarado by e-mail as follows:

> I enjoyed finally meeting you yesterday. Some follow-up thoughts/questions?
>
> (1) Any more news from the SEC or from Antigua? Did you actually make the trip to Antigua this morning?
>
> (2) How is the progress on the response to the NASD? . . .

October 4, 2006 E-mail from Spencer Barasch to Mauricio Alvarado, attached as Exhibit 177.

Alvarado responded to Barasch's e-mail, stating:

> Likewise, I am very glad that we finally met. Responding to your questions, we have not heard anything else from the SEC today. We are nonetheless, working on the draft response to the NASD. . . .
>
> As soon as I get back to Houston [from Antigua], I will give you a call to discuss further, and plan a strategy to follow.
>
> I am glad that you are now part of our team. I look forward to our working together.

October 5, 2006 E-mail from Mauricio Alvarado to Spencer Barasch, attached as Exhibit 177. Barasch billed 6.5 hours to Stanford on October 4, 2006, for return travel from Miami and "review [of] documentation received from company about SEC and NASD inquiries." Exhibit 176.

On October 12, 2006, Barasch billed Stanford 0.7 hours for, *inter alia*, a "[t]elephone conference with Mauricio Alvarado regarding status of SEC and NASD matters." *Id.* On October 12, 2006, Alvarado e-mailed Barasch and Thomas Sjoblom, a

partner at Proskauer Rose LLP who represented Stanford on the SEC's investigation, the following regarding the "NASD CD Inquiry," as follows:

> Spence/Tom,
>
> Per our conversation, I am attaching for your review our proposed response to the latest NASD letter dated September 27, 2006. Please review it and send me your comments, if any, by the end of the day tomorrow. . . .

October 12, 2006 E-mail from Mauricio Alvarado to Spencer Barasch and Thomas Sjoblom, attached as Exhibit 178.

Barasch responded to Alvarado's request for comments the next day, October 13, 2006, stating:

> As much as I would like to offer you some brilliant suggestions, and show off my wisdom, I have nothing of substance to add. I think the content of the response, and its tone, are excellent.
>
> I suspect that the NASD will just go through the motions to satisfy the SEC.

October 13, 2006 E-mail from Spencer Barasch to Mauricio Alvarado, attached as Exhibit 179. Alvarado forwarded Barasch's comments to Robert Allen Stanford on October 13, 2006, with the introduction, "FYI. This is the feedback from the former SEC person in Fort Worth in relation to our proposed draft letter to the NASD." October 13, 2006 E-mail from Mauricio Alvarado to Robert Allen Stanford, attached as Exhibit 180.

In his SEC interview, Barasch told the OIG that Alvarado had asked him to review a draft letter to the NASD, but that he had only "looked at it for two minutes." Barasch Interview Tr. at 59. Barasch stated that he wrote him back and said "something like . . . , 'Hey, as much as I'd like to tell you I have pearls of wisdom, I have nothing to add.'" *Id.* Barasch said that his two-minute review of the draft letter "was the extent of [his] involvement with Stanford." *Id.* at 59-60.[107]

On October 16, 2006, Barasch e-mailed Bernerd Young, SGC's Chief Compliance Officer, stating, "Get back to me on dates for Antigua – if not too far out,

[107] In fact, as demonstrated in this section of the report, the OIG found evidence that, in addition to reviewing the draft letter to the NASD, Barasch had met with Stanford General Counsel Alvarado, reviewed documentation received from the company, and participated in conference calls with Alvarado, and in connection with this work billed a total of approximately 12 hours to Stanford.

week of November 13th would be great." October 16, 2006 E-mail from Spencer Barasch to Bernerd Young, attached as Exhibit 181. In response, Young e-mailed a Stanford employee the same day as follows:

> I was speaking to Mauricio [Alvarado] at the Jean Gilstrap awards Friday night and he would like me to bring our outside counsel, Spencer Barasch to visit the Bank. Mauricio would like this done in the next few months if possible. Please send me your availability through the end of the year, I will coordinate with Mr. Barasch and then coordinate with your staff.

October 16, 2006 E-mail from Bernerd Young to Juan Rodriguez-Tolentino, attached as Exhibit 182. Four days later, on October 20, 2006, Young e-mailed another Stanford employee to arrange for Barasch's visit as follows:

> As you can see below, I have been requested by Mauricio Alvarado to bring our securities outside counsel to view your fine facilities. On Tuesday, Mauricio again requested (in Mr. Stanford's presence no less) that this meeting be accomplished ASAP.
>
> If you or Juan can provide me with a couple of available dates, I will run it by Mr. Barasch and let you know.
>
> If you are not the right person, I apologize, and please point me in the right direction.

October 20, 2006 E-mail from Bernerd Young to Stanford Empl 7, attached as Exhibit 183.

On October 26, 2006, the Commission issued a formal order of investigation in the Stanford matter. Exhibit 148. On November 20, 2006, the SEC staff had a conference call with Sjoblom. *See* November 21, 2006 E-mail from Spencer Barasch to Mauricio Alvarado, attached as Exhibit 184. The next day, November 21, 2006, at 11:07 a.m., Stanford counsel Sjoblom sent Alvarado an e-mail with the subject "Spencer Barasch." November 21, 2006 E-mail from Thomas Sjoblom to Mauricio Alvarado, attached as Exhibit 185. Sjoblom's e-mail stated:

> . . . [D]o you have Spencer's phone number and name of his law firm. I am sending the letter to the SEC requesting formal order. So that I get the formal order, I need to also tell them that I will accept service, but will not be back until late next week. So, don't send subpoenas until then.

Id. Approximately one hour later, at 12:20 p.m., Alvarado sent Sjoblom the requested contact information for Barasch. November 21, 2006 E-mail from Mauricio Alvarado to Thomas Sjoblom, attached as Exhibit 185.

An e-mail sent later that day, at 2:57 p.m., from Barasch to Alvarado suggests that Barasch and Sjoblom may have discussed the SEC investigation after Sjoblom received Barasch's contact information. In that e-mail, Barasch stated:

> Would you ask Tom [Sjoblom] if he recalls who the other SEC person was that called him yesterday? *[M]ay be somebody I know well and can call for info.*

Exhibit 184 (emphasis added). Alvarado responded a few minutes later, "He told me that the call was from ENF Staff Atty 5 and the new Chief." November 21, 2006 E-mail from Mauricio Alvarado to Spencer Barasch, attached as Exhibit 184. Barasch replied, "'New chief' could mean a number of people -- if he has the name, it would help. [I]f not, no big deal." Exhibit 184. Alvarado then asked Sjoblom, "What are the names of the SEC folks who called you yesterday?" November 21, 2006 E-mail from Mauricio Alvarado to Thomas Sjoblom, attached as Exhibit 186. Alvarado e-mailed Barasch, "He did not get the name." November 21, 2006 E-mail from Mauricio Alvarado to Spencer Barasch, attached as Exhibit 184.[108]

On or about November 27, 2006, Barasch spoke with Cohen about Stanford. *See* November 27, 2006 E-mail from Spencer Barasch to Jeffrey Cohen, attached as Exhibit 187. Barasch told the OIG that he had called and talked to ENF Staff Atty 5 or left a voice-mail for ENF Staff Atty 5 and Cohen called him back. Barasch Interview Tr. at 64. Barasch said he knew he "talked to [Cohen.]" *Id.* Barasch stated that Cohen asked him during the conversation, "Spence, can you work on this?" *Id.* According to Barasch, Cohen told him, ". . . I'm not sure you're able to work on this[,]" and Barasch replied, "I'm already talking to Rick Connor about it." *Id.* Cohen testified that Barasch may have called him, but that he did not remember any "specifics" of the conversation, although he said he thought that he remembered talking to Barasch "about the prospects of his getting involved in the case . . . ." Cohen Testimony Tr. at 111-112.[109]

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[108] Barasch's Stanford billing records do not have an entry for November 21, 2006. *See* Exhibit 176. The last date in November 2006 that Barasch billed time to the Stanford account was November 13, 2006. *Id.* On November 13, 2006, Barasch billed Stanford 0.3 hours for a "[t]elephone conference with Mauricio Alvarado regarding status of SEC and NASD inquiries." *Id.*

[109] If Barasch did, in fact, discuss the substance of the SEC's investigation of Stanford in the telephone call with Cohen, Barasch could have made a communication to his former agency with intent to influence in violation of 18 U.S.C. § 207(a)(1). Under 5 C.F.R. 2641.201(d), "[a] former employee makes a communication when he imparts or transmits information of any kind, including facts, opinions, ideas, questions or direction, to an employee of the United States, whether orally, in written correspondence, by electronic media, or by any other means." A communication "is made with the intent to influence when made for the purpose of... (ii) Affecting government action in connection with an issue or aspect of a

(Footnote continued on next page.)

C. In Late November 2006, After He Had Already Performed Legal Work on Stanford's Behalf, Barasch For the Second Time Sought SEC Approval to Represent Stanford and Was Again Told He Could Not Do So

On November 27, 2006, Barasch belatedly sought permission from the SEC's Ethics Office to represent Stanford. *See* November 27, 2006 E-mail from Spencer Barasch to Jeffrey Cohen, copying Richard Connor, attached as Exhibit 187. On November 27, 2006, Barasch e-mailed Cohen the following:

> Jeff –
>
> FYI, I just talked to Rick Connor in the GCs office and shared with him our conversation about Stanford -- I am sure he will be following up with you soon.

Id.[110] Also on November 27, 2006, Preuitt e-mailed ENF Staff Atty 5:

> March 22nd 2005 -- the last summit meeting that Spence attended. It was in Austin and Victoria made a presentation regarding Stanford. I cannot find my notes, but I would swear in court that he was in attendance at that meeting and that Victoria discussed Stanford. He was familiar enough with the issue that he was negative on the case and the idea that we would ever be able to do anything about Stanford during the meeting. Victoria will be back tomorrow and she may have notes regarding the specifics of what she discussed regarding Stanford. Spence was very aware of the firm and its activities, but some of that may have been from our earlier attempt to get enforcement to take action against the firm in either 1997 or 1998. I will look to see if Spence was e-mailed the Stanford report and referral memo. I'm not certain he ever saw that because it was given to ENF Asst Dir 1 to discuss with us.[111]

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matter which involves an appreciable element of actual or potential dispute or controversy." 5 C.F.R. § 2641.201(e). However, we found no specific evidence that such a violation occurred.

[110] As discussed above, Barasch had already been denied permission from the SEC's Ethics Office to represent Stanford in the SEC investigation in June 2005.

[111] Five minutes after sending this e-mail, Preuitt forwarded to ENF Staff Atty 5 her April 5, 2005 e-mail to ENF Asst Dir 1 with the referral memorandum and stated:

> The e-mail below suggests strongly that Spence had not looked at the memo. I really don't think that he did.

(Footnote continued on next page.)

November 27, 2006 E-mail from Julie Preuitt to [ENF Staff Atty 5], attached as Exhibit 189.[112]

On December 13, 2006, Prescott e-mailed Connor and copied Preuitt the following:

> I have been out of the office, and this morning received your voice mail inquiry about the location of the meeting in which Stanford was discussed as a possible enforcement matter. My recollection is that this was at one of the meetings among regulators in our district that occurs quarterly, and that this particular meeting was in Austin, Texas.

December 13, 2006 E-mail from Victoria Prescott to Richard Connor, attached as Exhibit 190. Preuitt responded to Prescott, stating:

> I gave him the same information yesterday. Spence had told them that he didn't recall the meeting and wanted to know where it was held.

December 13, 2006 E-mail from Julie Preuitt to Victoria Prescott, attached as Exhibit 191.

Sometime after Connor was reminded by Preuitt and Prescott about Barasch's prior involvement in the Stanford matter, Connor called Barasch and told him that he could not represent Stanford on the SEC investigation and made reference to Barasch's attendance at Prescott's presentation during the March 2005 meeting of regulators. Barasch Interview Tr. at 58; *see also* Connor Testimony Tr. at 16. Barasch told the OIG that he asked Connor to reconsider as follows:

> . . . [S]o I said, "Rick, if that's the sole basis for me to hav[e] a conflict on this, I have to tell you, one I don't remember it. Two, the discussions at these meetings, these roundtables, are so superficial, and at such a high level, you

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I don't know that discussions at a meeting about a situation he was already familiar with would preclude him or not.

November 27, 2006 E-mail from Julie Preuitt to [ENF Staff Atty 5] attached as Exhibit 188.

[112] Preuitt testified that the SEC Ethics Office requested information about how much involvement Barasch had with SEC investigations of Stanford while he was with the SEC, and she "specifically referred them to . . . a summit meeting with the other regulators in the district," at which they discussed Stanford at length. Preuitt December 14, 2009 Testimony Tr. at 77-78.

> know, I can't imagine that anything of any significance there would have been [discussed]." I said, "Would you please reconsider[?]" I needed the work. But I wanted it to be ethical work.

Barasch Interview Tr. at 58-59. Barasch stated that Connor called him back again and told him that he could not represent Stanford on the SEC investigation, and that Barasch then called Alvarado and relayed that decision. *Id.* at 59-60.

Barasch further told the OIG that when Connor informed him that he was prohibited from working on the Stanford investigation, Barasch "had done absolutely nothing to that point," and that Alvarado had not yet asked him to do anything. *Id.* at 59. Barasch told the OIG that, as discussed above, what he described as a two-minute review of a draft letter to the NASD "was the extent of [his] involvement with Stanford." *Id.* at 59-60.[113] As shown above, by the time he contacted Connor on November 27, 2006, Barasch had already met with Stanford's General Counsel, participated in telephone conferences with him and reviewed pertinent documentation, resulting in billings to Stanford of approximately 12 hours. *See* Exhibit 176.

It appears to the OIG that Barasch's representation of Stanford may have violated the District of Columbia and Texas Bar rules of professional conduct.[114] As discussed above, the DC Bar's Rules of Professional Conduct state that "[a] lawyer shall not accept other employment in connection with a matter which is the same as, *or substantially related to*, a matter in which the lawyer participated personally and substantially as a public officer or employee." District of Columbia Rule of Professional Conduct 1.11 (emphasis added). *See* Exhibit 48.[115] The Texas Disciplinary Rules of Professional Conduct state that "a lawyer shall not represent a private client in connection with a matter in which the lawyer participated personally and substantially as a public officer or

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[113] Barasch told the OIG that Alvarado had set up a phone call with Sjoblom and him "to talk about the case, "but he was in Dubai on a case and couldn't make the call." Barasch Interview Tr. at 59. So, according to Barasch, they "never had the call." *Id.* Sjoblom sent an e-mail to Barasch and Alvarado on December 6, 2006, containing dialing instructions for a conference call. December 6, 2006 E-mail from Thomas Sjoblom to Spencer Barasch and Mauricio Alvarado, attached as Exhibit 192. Barasch replied, "What day? I am in [D]ubai through [F]riday," and Alvarez responded, "Please call me when you come back." *Id.*

[114] Barasch is admitted to practice law in both the District of Columbia and the State of Texas. *See* Barasch biography, attached as Exhibit 193.

[115] The inquiry under Rule 1.11 "is a practical one asking whether the two matters substantially overlap." *In re Sofaer*, 728 A.2d 625, 628 (D.C. 1999)(footnote omitted). The D.C. Court of Appeals noted as follows regarding the language of Rule 1.11: "By announcing an approach that deems transactions substantially related if the former government attorney may have had access to any information that could be useful – not just legally relevant – in the later transaction . . . we have broadened the scope of the substantially related test for revolving door purposes." *Brown v. District of Columbia Board of Zoning Adjustment*, 486 A.2d 37 (D.C. 1984)(quotations and parenthetical omitted).

employee, unless the appropriate government agency consents after consultation." *See* Exhibit 47.[116] Accordingly, the OIG is referring this Report of Investigation to the Commission's Ethics Counsel for referral to the Office of Bar Counsel for the District of Columbia and the Chief Disciplinary Counsel for the State Bar of Texas.

D. Immediately After the SEC Sued Stanford on February 17, 2009, Barasch Again Sought to Represent Stanford, This Time in the Litigation

Despite having had significant responsibility for delaying the initiation of an SEC investigation into Stanford's Ponzi scheme for seven years and having been advised by the SEC's Ethics Office on two separate occasions that he could not represent Stanford in connection with the SEC's investigation, on the very day that the SEC filed its action against Stanford, Barasch contacted the SEC's Ethics Office a third time in an effort to represent Stanford.

On February 17, 2009, Barasch sent an e-mail to Connor, stating:

> I hope this e-mail finds you well and that you are surviving all the turmoil on Wall Street.
>
> I have a conflict related question [f]or you, where time is of the essence. It involves the Stanford matter filed by the Fort Worth office today that has been all over the news.
>
> Would you please call me the first chance you get: if I am not in my office you can try my cell anytime, ...

February 17, 2009 E-mail from Spencer Barasch to Richard Connor, attached as Exhibit 194.

Connor stated that he could not recall another occasion on which a former SEC employee contacted his office on three separate occasions trying to represent a client in the same matter. Connor Testimony Tr. at 27.

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[116] In contrast to the Texas and District of Columbia rules of professional conduct, with the exception of the one-year ban, federal conflicts-of-interest statutes do not *per se* prohibit a former SEC employee from representing a party in connection with a matter in which he or she participated while employed at the SEC. Instead, the federal statutes impose a narrower ban on former government employees against knowingly make a communication or appearance before an officer or employee of a federal agency or court on behalf of another person in connection with a particular matter (A) in which the United States is a party or has a direct and substantial interest, (B) in which the person participated personally and substantially as an officer or employee, and (C) which involved a specific party or parties at the time of the participation. 18 U.S.C. § 207(a)(1). "Behind-the-scenes assistance" is not prohibited, "provided that the assistance does not involve a communication to or an appearance before an employee of the United States." 5 C.F.R. § 2641.201(d)(3).

Connor testified:

> [I]t struck me as unusual that [Barasch] would be coming back for a matter that obviously he would have known that he had been told he couldn't participate in the matter . . . on two [previous] occasions.

Id. at 44-45.

Barasch described the circumstances of his third request to represent Stanford as follows:

> 2009 the whole thing[] blows up. Every lawyer in Texas and beyond is going to get rich over this case. Okay? And I hated being on the sidelines. And I was contacted right and left by people [to] represent them.

Barasch Interview Tr. at 61.[117]

On February 19, 2009, Prescott e-mailed Connor, "I tried to return your call last evening, but missed you. Since then, I found an old e-mail that I think pertains to the question being raised. I will forward it to you." *See* February 19, 2009 E-mail from Victoria Prescott to Richard Connor, attached as Exhibit 195. Prescott then forwarded to Connor the e-mail she had sent him on December 13, 2006, in connection with the last time Barasch had sought clearance to represent Stanford. February 19, 2009 E-mail from Victoria Prescott to Richard Connor, attached as Exhibit 196. Connor replied to Prescott, "Thanks for your help. This is all we need for now." February 19, 2009 E-mail from Richard Connor to Victoria Prescott, attached as Exhibit 196

Connor testified that ". . . Barasch was upset with [the Ethics Office's] decision [that he could not represent Stanford]. . . . He . . . strongly argued that the matter currently in 2009 was new and was different and unrelated to the matter that had occurred before he left." Connor Testimony Tr. at 27. In a February 23, 2009 e-mail to Connor, Barasch disagreed with the SEC's position that he could not represent Stanford in the SEC litigation because of his past involvement in the SEC matter. *See* February 23, 2009 E-mail from Spencer Barasch to Richard Connor, attached as Exhibit 197. Barasch cited statements in the press by Stephen Korotash, Associate Regional Director of the FWDO Enforcement group, that "[t]he current S.E.C. charges stem from an inquiry opened in

[117] Barasch explained that "this [was] four years after he left the Commission" and he did not think "this would be a matter that would still be lingering..." Barasch Interview Tr. at 61.

October 2006 after a routine examination of Stanford Group"[118] in support of his argument as follows:

> Please review the information noted below, and then I would like to talk with you as soon as reasonably possible. With all due respect to the persons with whom you are dealing in the FWDO, I don't think they have their facts and information correct. I left the Commission on April 15, 2005, more than one year before the SEC's Associate Director in charge of "this matter" has publicly acknowledged that "this matter" arose. (although irrelevant here, I reiterate that to the extent that there was a "prior matter," I had no involvement in it, either).
>
> Rick, the Commission seems to be taking a different position on the date of "this matter" with me than it appears to be taking publicly. Maybe I am missing something, but it seems pretty self-evident to me that there is no conflict in this matter. I have copied my firm's General Counsel, who is in agreement with me.

Id.

In his OIG interview, Barasch described the basis for his belief at the time that the SEC action must have been unrelated to any matters that he had been involved with while at the SEC, as follows:

> . . . I said, "Hey, Rick. This is a new matter. I'd like to work on it. I don't know how or what, yet, but I'm getting lots and lots of calls." . . . And then somewhere right about that time, right then the staff is getting slammed in Fort Worth for, you know, why did it take so long. And the question was when did this thing start. When did this matter start, and Steven Korotash . . . [was] quoted in the "Journal" and the "Times." "This matter didn't start until 2006." There's a quote. . . . So I send [the articles] to Rick, and I go, "Hey, here's my proof, and this is a new matter. It's right there." Steve [Korotash] says, "This

[118] *See* Clifford Krauss, Phillip L. Zweig and Julie Creswell, *Texas Firm Accused of $8 Billion Fraud*, The New York Times, February 17, 2009, attached as Exhibit 198. Barasch also cited a Wall Street Journal article in support of his argument that he did not have a conflict representing Stanford in the SEC litigation. *See* Glenn R. Simpson, Dionne Searcey and Kara Scannell, *Madoff Case Led SEC to Intensify Stanford Probe*, Wall Street Journal, February 19, 2009, attached as Exhibit 199.

> matter started in '06." That was a year after I left. So the way I see it, I could work on it.

Barasch Interview Tr. at 61-62. Barasch told the OIG that Connor called him and responded:

> . . . I don't remember the words he used, but it was something along the lines that Steven misspoke. . . . And that the matter really did go back before that . . . . So what was left out there in the press was '06, but he was telling me it was something earlier, and I wasn't going to argue with him. I didn't want to embarrass his staff or Steve, or anything, so I just absolutely dropped it.

Id. at 62-63.[119]

Subsequently, on March 9, 2009, Barasch e-mailed Connor as follows:

> Based on our last conversation on this issue, it is my understanding that the Commission's position is that I have a conflict and should not participate in "the SEC matter" in which I allegedly participated back in 2005. To the extent that my firm participates in "that SEC matter," I will be walled off .... I am writing to let you know that I am intending to participate, on behalf of one or more former Stanford employees (who, by the way, joined Stanford after 2005), in different matters, specifically private litigation and/or regulatory inquiries by a State securities regulator. Please advise asap if you believe that this presents any issues.

March 9, 2009 E-mail from Spencer Barasch to Richard Connor, attached as Exhibit 200.

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[119] Connor disagreed with Barasch's position that the matter began in 2006, testifying as to his perspective as follows:

> [T]he matter did not start in 2006, and I don't know exactly what the basis was for [Korotash] to say that it did. But from our perspective, from the ethics perspective, the matter had clearly started long before that. It had started back when Mr. Barasch was here, and it was a continuation of the same matter. It was a matter involving, among other things, a Ponzi scheme by Stanford, and that . . . matter had started much earlier and had continued as the same matter right up to the time we were talking.

Connor Testimony Tr. at 26.

Connor responded:

> Your participation in the other Stanford matters does not violate the post-employment laws. Your prohibition applies only to appearing before or communicating with the federal government in connection with the same matter that you participated in while at the SEC.

March 10, 2009 E-mail from Richard Connor to Spencer Barasch, attached as Exhibit 200.

CONCLUSION

The OIG investigation found that the SEC's Fort Worth office was aware since 1997 that Robert Allen Stanford was likely operating a Ponzi scheme, having come to that conclusion a mere two years after SGC, Stanford's investment adviser, registered with the SEC in 1995. We found that over the next eight years, the SEC's Fort Worth Examination group conducted four examinations of Stanford's operations, finding in each examination that its sale of CDs through SIB could not have been "legitimate," and that it was "highly unlikely" that the returns Stanford claimed to generate could have been achieved with its purported conservative investment approach. While the Fort Worth Examination group made multiple efforts after each examination to convince Enforcement to open and conduct an investigation of Stanford, no meaningful effort was made by Enforcement to investigate the potential fraud, or to bring an action to attempt to stop it, until late 2005.

Moreover, the OIG investigation found that even at that time, Enforcement missed an opportunity to bring an action against SGC for its admitted failure to conduct any due diligence regarding Stanford's investment portfolio, which could have potentially completely stopped the sales of the SIB CDs through the SGC investment adviser, and provided investors and prospective investors notice that the SEC considered SGC's sales of the CDs to be fraudulent. The OIG investigation found that this particular type of action was not considered, partially because the new head of Enforcement in Fort Worth was not apprised of the findings in the investment advisers' examinations in 1998 and 2002, or even that SGC had registered as an investment adviser, a fact she learned for the first time in the course of this OIG investigation in January 2010.

The OIG did not find that the reluctance on the part of the SEC's Fort Worth Enforcement group to investigate or recommend an action against Stanford was related to any improper professional, social or financial relationship on the part of any former or current SEC employee. We found evidence, however, that SEC-wide institutional influence within Enforcement did factor into the repeated decisions not to undertake a full and thorough investigation of Stanford, notwithstanding staff awareness that the potential fraud was growing. We found that senior Fort Worth officials perceived that

they were being judged on the numbers of cases they brought, so-called "stats," and communicated to the Enforcement staff that novel or complex cases were disfavored. As a result, cases like Stanford, which were not considered "quick-hit" or "slam-dunk" cases, were not encouraged.

The OIG's findings during this investigation raise significant concerns about how decisions were made within the SEC's Division of Enforcement with regard to the Stanford matter. We are providing this Report of Investigation ("ROI") to the Chairman of the SEC with the recommendation that the Chairman carefully review its findings and share with Enforcement management the portions of this ROI that relate to the performance failures by those employees who still work at the SEC, so that appropriate action (which may include performance-based action, if applicable) is taken, on an employee-by-employee basis, to ensure that future decisions about when to open an investigation and when to recommend that the Commission take action are made in a more appropriate manner.

The OIG is also recommending that the Chairman and the Director of Enforcement give consideration to promulgating and/or clarifying procedures with regard to:

(1) the consideration of the potential harm to investors if no action is taken as a factor when deciding whether to bring an enforcement action, including consideration of whether this factor, in certain situations, outweighs other factors such as litigation risk;

(2) the significance of bringing cases that are difficult, but important to the protection of investors, in evaluating the performance of an Enforcement staff member or a regional office;

(3) the significance of the presence or absence of United States investors in determining whether to open an investigation or bring an enforcement action that otherwise meets jurisdictional requirements;

(4) coordination between the Enforcement and OCIE on investigations, particularly those investigations initiated by a referral to the Enforcement by OCIE;

(5) the factors determining when referral of a matter to state securities regulators, in lieu of an SEC investigation, is appropriate;

(6) training of Enforcement staff to strengthen their understanding of the laws governing broker-dealers and investment advisers; and

(7) emphasizing the need to coordinate with the Office of International Affairs and the Division of Risk, Strategy, and Financial Innovation, as appropriate, early

in the course of investigations in which relevant documents, individuals, or entities are located abroad.

The OIG investigation also found that the former head of Enforcement in Fort Worth, Spencer Barasch, who played a significant role in multiple decisions over the years that quashed the investigations of Stanford, sought to represent Stanford on three separate occasions after he left the Commission, and in fact represented Stanford briefly in 2006 before he was informed by the SEC Ethics Office that it was improper to do so. Because the OIG found that Barasch's representation of Stanford appeared to violate state bar rules that prohibit a former government employee from working on matters in which that individual participated as a government employee, we are referring this Report of Investigation to the Commission's Ethics Counsel for referral to the Bar Counsel offices in the two states in which he is admitted to practice law.

Submitted: [redacted] Date: [redacted]

Concur: [redacted] Date: [redacted]

Approved: H. David Kotz Date: 3·31·10