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### REPORT OF INVESTIGATION

## UNITED STATES SECURITIES AND EXCHANGE COMMISSION OFFICE OF INSPECTOR GENERAL

Case No. OIG-526

Investigation of the SEC's Response to Concerns Regarding Robert Allen Stanford's Alleged Ponzi Scheme

Appendix, Volume I

March 31, 2010

# EXHIBIT 1

### IN THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF TEXAS DALLAS DIVISION

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

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COMPLAINT

STANFORD INTERNATIONAL BANK, LTD., STANFORD GROUP COMPANY, STANFORD CAPITAL MANAGEMENT, LLC, R. ALLEN STANFORD, JAMES M. DAVIS, and LAURA PENDERGEST-HOLT

Defendants.

Plaintiff Securities and Exchange Commission alleges:

#### SUMMARY

- 1. The Commission seeks emergency relief to halt a massive, ongoing fraud orchestrated by R. Allen Stanford and James M. Davis and executed through companies they control, including Stanford International Bank, Ltd. ("SIB") and its affiliated Houston-based investment advisers, Stanford Group Company ("SGC") and Stanford Capital Management ("SCM"). Laura Pendergest-Holt, the chief investment officer of a Stanford affiliate, was indispensable to this scheme by helping to preserve the appearance of safety fabricated by Stanford and by training others to mislead investors. For example, she trained training SIB's senior investment officer to provide false information to investors.
- 2. Through this fraudulent scheme, SIB, acting through a network of SGC financial advisors, has sold approximately \$8 billion of self-styled "certificates of deposits" by promising high return rates that exceed those available through true certificates of deposits offered by traditional banks.

- 3. SIB claims that its unique investment strategy has allowed it to achieve double-digit returns on its investments over the past 15 years, allowing it offer high yields to CD purchasers. Indeed, 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%.
- 4. Perhaps even more strange, SIB reports identical returns in 1995 and 1996 of exactly 15.71%. As Pendergest-Holt SIB investment committee member and the chief investment officer of Stanford Group Financial (a Stanford affiliate) admits, it is simply "improbable" that SIB could have managed a "global diversified" portfolio of investments in a way that returned identical results in consecutive years. A performance reporting consultant hired by SGC, when asked about these "improbable" returns, responded simply that it is "impossible" to achieve identical results on a diversified investment portfolio in consecutive years. Yet, SIB continues to promote its CDs using these improbable returns.
- 5. These improbable results are made even more suspicious by the fact that, contrary to assurances provided to investors, at most only two people Stanford and Davis know the details concerning the bulk of SIB's investment portfolio. And SIB goes to great lengths to prevent any true independent examination of those portfolios. For example, its long-standing auditor is reportedly retained based on a "relationship of trust" between the head of the auditing firm and Stanford.
- 6. Importantly, contrary to recent public statements by SIB, Stanford and Davis (and through them SGC) have wholly-failed to cooperate with the Commission's efforts to account for the \$8 billion of investor funds purportedly held by SIB. In short, approximately 90% of

SIB's claimed investment portfolio resides in a "black box" shielded from any independent oversight.

- 7. In fact, far from "cooperating" with the Commission's enforcement investigation (which Stanford has reportedly tried to characterize as only involving routine examinations), SGC appears to have used press reports speculating about the Commission's investigation as way to further mislead investors, falsely telling at least one customer during the week of February 9, 2009, that his multi-million dollar SIB CD could not be redeemed because "the SEC had frozen the account for two months." At least one other customer who recently inquired about redeeming a multi-million dollar CD claims that he was informed that, contrary to representations made at the time of purchase that the CD could be redeemed early upon payment of a penalty, R. Allen Stanford had ordered a two-month moratorium on CD redemptions.
- 8. This secrecy and recent misrepresentations are made even more suspicious by extensive and fundamental misrepresentations SIB and its advisors have made to CD purchasers in order to lull them into thinking their investment is safe. SIB and its advisers have misrepresented to CD purchasers that their deposits are safe because the bank: (i) re-invests client funds primarily in "liquid" financial instruments (the "portfolio"); (ii) monitors the portfolio through a team of 20-plus analysts; and (iii) is subject to yearly audits by Antiguan regulators. Recently, as the market absorbed the news of Bernard Madoff's massive Ponzi scheme, SIB has attempted to calm its own investors by claiming the bank has no "direct or indirect" exposure to Madoff's scheme.
- 9. These assurances are false. Contrary to these representations, SIB's investment portfolio was not invested in liquid financial instruments or allocated in the manner described in its promotional material and public reports. Instead, a substantial portion of the bank's portfolio was

placed in illiquid investments, such as real estate and private equity. Further, the vast majority SIB's multi-billion dollar investment portfolio was not monitored by a team of analysts, but rather by two people – Allen Stanford and James Davis. And contrary to SIB's representations, the Antiguan regulator responsible for oversight of the bank's portfolio, the Financial Services Regulatory Commission, does not audit SIB's portfolio or verify the assets SIB claims in its financial statements. Perhaps most alarming is that SIB has exposure to losses from the Madoff fraud scheme despite the bank's public assurances to the contrary.

- 10. SGC has failed to disclose material facts to its advisory clients. Alarmingly, recent weeks have seen an increasing amount of liquidation activity by SIB and attempts to wire money out of its investment portfolio. The Commission has received information indicating that in just the last two weeks, SIB has sought to remove over \$178 million from its accounts. And, a major clearing firm after unsuccessfully attempting to find information about SIB's financial condition and because it could not obtain adequate transparency into SIB's financials—has recently informed SGC that it would no longer process wires from SGC accounts at the clearing firm to SIB for the purchase of SIB issued CDs, even if they were accompanied by customer letters of authorization.
- 11. Stanford's fraudulent conduct is not limited to the sale of CDs. Since 2005, SGC advisers have sold more than \$1 billion of a proprietary mutual fund wrap program, called Stanford Allocation Strategy ("SAS"), by using materially false and misleading historical performance data. The false data has helped SGC grow the SAS program from less than \$10 million in around 2004 to over \$1.2 billion, generating fees for SGC (and ultimately Stanford) in excess of \$25 million. And the fraudulent SAS performance was used to recruit registered financial advisers with significant

books of business, who were then heavily incentivized to re-allocate their clients' assets to SIB's CD program.

- 12. Moreover, SIB and Stanford Group Company have violated Section 7(d) of the Investment Company Act of 1940 by failing to register with the Commission in order to sell SIB's CDs. Had they complied with this registration requirement, the Commission would have been able to examine each of those entities concerning SIB's CD investment portfolio.
- 13. By engaging in the conduct described in this Complaint, defendants Stanford, Davis, Pendergest-Holt, SIB, SGC, and Stanford Capital, directly or indirectly, singly or in concert, have engaged, and unless enjoined and restrained, will again engage in transactions acts, practices, and courses of business that constitute violations of Section 17(a) of the Securities Act of 1933 ("Securities Act") [15 U.S.C. §§ 77e(a), 77e(c) and 77q(a)], and Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") [15 U.S.C. § 78j(b)], and Exchange Act Rule 10b-5 [17 C.F.R. § 240.10b-5] or, in the alternative, have aided and abetted such violations. In addition, through their conduct described herein, Stanford, SGC, and Stanford Capital have violated Section 206(1) and (2) of the Investment Advisers Act of 1940 ("Adviser's Act") [15 U.S.C. §§ 80b-6(1) and 80b-6(2)] and Davis and Pendergest-Holt have aided and abetted such violations. Finally, through their actions, SIB and SGC have violated Section 7(d) of the Investment Company Act of 1940 ("ICA") [15 U.S.C. § 80a-7(d)].
- 14. The Commission, in the interest of protecting the public from any further unscrupulous and illegal activity, brings this action against the defendants, seeking temporary, preliminary and permanent injunctive relief, disgorgement of all illicit profits and benefits defendants have received plus accrued prejudgment interest and a civil monetary penalty. The Commission also seeks an asset freeze, an accounting and other incidental relief, as well as the

appointment of a receiver to take possession and control of defendants' assets for the protection of defendants' victims.

### JURISDICTION AND VENUE

- 15. The investments offered and sold by the defendants are "securities" under Section 2(1) of the Securities Act [15 U.S.C. § 77b], Section 3(a)(10) of the Exchange Act [15 U.S.C. § 78c], Section 2(36) of the Investment Company Act [15 U.S.C. § 80a-2(36)], and Section 202(18) of the Advisers Act [15 U.S.C. § 80b-2(18)].
- 16. Plaintiff Commission brings this action under the authority conferred upon it by Section 20(b) of the Securities Act [15 U.S.C. § 77t(b)], Section 21(d) of the Exchange Act [15 U.S.C. § 78u(d)], Section 41(d) of the Investment Company Act [15 U.S.C. § 80a-41(d)], and Section 209(d) of the Advisers Act [15 U.S.C. § 80b-9(d)] to temporarily, preliminarily, and permanently enjoin Defendants from future violations of the federal securities laws.
- 17. This Court has jurisdiction over this action, and venue is proper, under Section 22(a) of the Securities Act [15 U.S.C. § 77v(a)], Section 27 of the Exchange Act [15 U.S.C. § 78aa], Section 43 of the Investment Company Act [15 U.S.C. § 80a-43], and Section 214 of the Advisers Act [15 U.S.C. § 80b-14].
- 18. Defendants have, directly or indirectly, made use of the means or instruments of transportation and communication, and the means or instrumentalities of interstate commerce, or of the mails, in connection with the transactions, acts, practices, and courses of business alleged herein. Certain of the transactions, acts, practices, and courses of business occurred in the Northern District of Texas.

#### **DEFENDANTS**

- 19. Stanford International Bank, Ltd. purports to be private international bank domiciled in St. John's, Antigua, West Indies. SIB claims to serve 30,000 clients in 131 countries and holds \$7.2 billion in assets under management. SIB's Annual Report for 2007 states that SIB has 50,000 clients. SIB's multi-billion portfolio of investments is purportedly monitored by the SFG's chief financial officer in Memphis, Tennessee. Unlike a commercial bank, SIB does not loan money. SIB sells the CD to U.S. investors through SGC, its affiliated investment adviser.
- 20. Stanford Group Company, a Houston-based corporation, is registered with the Commission as a broker-dealer and investment adviser. It has 29 offices located throughout the U.S. SGC's principal business consists of sales of SIB-issued securities, marketed as certificates of deposit. SGC is a wholly owned subsidiary of Stanford Group Holdings, Inc., which in turn is owned by R. Allen Stanford ("Stanford").
- 21. Stanford Capital Management, a registered investment adviser, took over the management of the SAS program (formerly Mutual Fund Partners) from SGC in early 2007.
  Stanford Group Company markets the SAS program through SCM.
- 22. R. Allen Stanford, a U.S. citizen, is the Chairman of the Board and sole shareholder of SIB and the sole director of SGC's parent company. Stanford refused to appear and give testimony in the investigation.
- 23. James M. Davis, a U.S. citizen and resident of Baldwin, Mississippi and who offices in Memphis, Tennessee and Tupelo, Mississippi, is a director and chief financial officer of SFG and SIB. Davis refused to appear and give testimony in this investigation.

24. Laura Pendergest-Holt, is the Chief Investment Officer of SIB and its affiliate

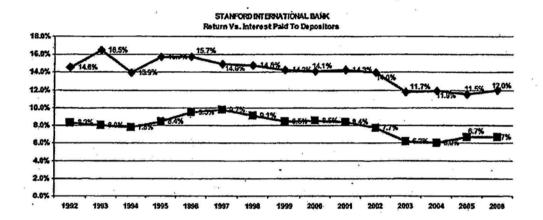
Stanford Financial Group. She supervises a group of analysts in Memphis, Tupelo, and St. Croix
who "oversee" performance of SIB's Tier II assets.

### STATEMENT OF FACTS AND ALLEGATIONS RELEVANT TO ALL CAUSES OF ACTION

### A. The Stanford International Bank

- 25. Allen Stanford has created a complex web of affiliated companies that exist and operate under the brand Stanford Financial Group ("SFG"). SFG is described as a privately-held group of companies that has in excess of \$50 billion "under advisement."
- 26. SIB, one of SFG's affiliates, is a private, offshore bank that purports to have an independent Board of Directors, an Investment Committee, a Chief Investment Officer and a team of research analysts. While SIB may be domiciled in Antigua, a small group of SFG employees who maintain offices in Memphis, Tennessee, and Tupelo, Mississippi, purportedly monitor the assets.
- 27. As of November 28, 2008, SIB reported \$8.5 billion in total assets. SIB's primary product is the CD. SIB aggregates customer deposits, and then re-invests those funds in a "globally diversified portfolio" of assets. SIB claims its investment portfolio is approximately \$8.4 billion. 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 had approximately \$3.8 billion in CD sales to 35,000 customers in 2005. By the end of 2007, SIB sold \$6.7 billion of CDs to 50,000 customers.

28. 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):



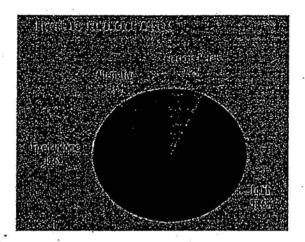
- 29. In fact, since 1994, SIB has never failed to hit targeted investment returns in excess of 10%. And, SIB claims that its "diversified portfolio of investments" lost only \$110 million or 1.3% in 2008. During the same time period, the S&P 500 lost 39% and the Dow Jones STOXX Europe 500 Fund lost 41%.
- 30. As performance reporting consultant hired by SGC testified in the Commission's investigation, SIB's historical returns are improbable, if not impossible. In 1995 and 1996, SIB reported identical returns of 15.71%, a remarkable achievement considering the bank's "diversified investment portfolio." According to defendant Pendergest-Holt the chief investment officer of SIB-affiliate SFG—it is "improbable" that SIB could have managed a "global diversified" portfolio of investments so that it returned identical results in consecutive years. SGC's performance reporting consultant was more emphatic, saying that it is "impossible" to achieve identical results on a diversified investment portfolio in consecutive years. SIB continues to promote its CDs using these improbable, if not impossible, returns.

- 31. SIB's consistently high returns of investment have enabled the bank to pay a consistently and significantly higher rate on its CD than conventional banks. For example, SIB offered 7.45% as of June 1, 2005, and 7.878% as of March 20, 2006, for a fixed rate CD based on an investment of \$100,000. On November 28, 2008, SIB-quoted 5.375% on a 3 year CD, while comparable U.S. Banks' CDs paid under 3.2%. And recently, SIB quoted rates of over 10% on five year CDs.
- 32. SIB's extraordinary returns have enabled the bank to pay disproportionately large commissions to SGC for the sale of SIB CDs. In 2007, SIB paid to SGC and affiliates \$291.7 million in management fees and commissions from CD sales, up from \$211 million in 2006 and \$161 million in 2005.
- 33. SIB markets CDs to investors in the United States exclusively through SGC advisers pursuant to a claimed Regulation D offering, filing a Form D with the SEC. Regulation D permits under certain circumstances the sale of unregistered securities (the CDs) to accredited investors in the United States. SGC receives 3% based on the aggregate sales of CDs by SGC advisers. Financial advisers also receive a 1% commission upon the sale of the CDs, and are eligible to receive as much as a 1% trailing commission throughout the term of the CD.
- 34. 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.
- 35. SIB purportedly manages the investment portfolio from Memphis and Tupelo. SIB's investment portfolio, at least internally, is segregated into 3 tiers: (a) cash and cash equivalents ("Tier 1"), (b) investments with "outside portfolio managers (25+)" that are

monitored by the Analysts ("Tier 2"), and (c) unknown assets under the apparent control of Stanford and Davis ("Tier 3"). As of December 2008, Tier 1 represented approximately 9% (\$800 million) of the Bank's portfolio. Tier 2, prior to the Bank's decision to liquidate \$250 million of investments in late 2008, represented 10% of the portfolio. And Tier 3 represented 81% of the Bank's investment portfolio. This division into tiers is not generally disclosed to actual or potential investors.

### B. SIB's Fraudulent Sale of CDs

- 1. SIB Misrepresented that Its Investment Portfolio is Invested Primarily in "Liquid" Financial Instruments.
- 36. In selling the CD, SIB touted the liquidity of its investment portfolio. For example, in its CD brochure, SIB emphasizes the importance of the liquidity, stating, under the heading "Depositor Security," that the bank focuses on "maintaining the highest degree of liquidity as a protective factor for our depositors" and that the bank's assets are "invested in a well-diversified portfolio of highly marketable securities issued by stable governments, strong multinational companies and major international banks." Likewise, the bank trained SGC advisers that "liquidity/marketability of SIB's invested assets" was the "most important factor to provide security to SIB clients." Davis and Pendergest-Holt were aware, or were reckless in not knowing, of these representations.
- 37. In its 2007 annual report, which was signed and approved by Stanford and Davis, SIB represented that its portfolio was allocated in the following manner: 58.6% "equity," 18.6% fixed income, 7.2% precious metals and 15.6% alternative investments. These allocations were depicted in a pie chart, which was approved by Davis. The bank's annual reports for 2005 and 2006 make similar representations about the allocation of the bank's portfolio. Davis and Stanford knew or were reckless in not knowing of these representations.



- 38. SIB's investment portfolio is not, however, invested in a "well-diversified portfolio of highly marketable securities issued by stable governments, strong multinational companies and major international banks." Instead, Tier 3 (i.e., approximately 90%) consisted primarily of illiquid investments namely private equity and real estate. Indeed, it SIB's portfolio included at least 23% private equity. The bank never disclosed in its financial statements its exposure to private equity and real estate investments. Stanford, Davis and Pendergest-Holt were aware, or were reckless in not knowing, that SIB's investments were not allocated as advertised by SIB's investment objectives or as detailed in SIB's financial statements.
- 39. Further, on December 15, 2008, Pendergest-Holt met with her team of analysts following SIB's decision to liquidate more than 30% of its Tier 2 investments (approximately \$250 million). During the meeting, at least one analyst expressed concern about the amount of liquidations in Tier 2, asking why it was necessary to liquidate Tier 2, rather than Tier 3 assets, to increase SIB's liquidity. Pendergest-Holt told the analyst that Tier 3 was primarily invested in private equity and real estate and Tier 2 was more liquid than Tier 3. Pendergest-Holt also stated that Tier 3 "always had real estate investments in it." Pendergest's statements contradicts

what she had previously stated to SIB's senior investment adviser, knowing, or reckless in not knowing, that the senior investment advisor would provide this misrepresentation to investors.

- 2. SIB Misrepresented that Its Multi-Billion Dollar Investment Portfolio is Monitored By a Team of Analysts
- 40. Prior to making their investment decision, prospective investors routinely asked how SIB safeguarded and monitored its assets. In fact, investors frequently inquired whether Allen Stanford could "run off with the [investor's] money." In response to this question, at least during 2006 and much of 2007, the bank's senior investment officer as instructed by Pendergest-Holt told investors that SIB had sufficient controls and safeguards in place to protect assets.
- 41. In particular, the SIO was trained by Ms. Pendergest-Holt to tell investors that the bank's multi-billion portfolio was "monitored" by the analyst team in Memphis. In communicating with investors, the SIO followed Pendergest's instructions, misrepresenting that a team of 20-plus analysts monitored the bank's investment portfolio. In so doing, the SIO never disclosed to investors that the analyst only monitor approximately 10% of SIB's money. In fact, Pendergest-Holt trained the SIO "not to divulge too much" about oversight of the Bank's portfolio because that information "wouldn't leave an investor with a lot of confidence."

  Likewise, Davis instructed him to "steer" potential CD investors away from information about SIB's portfolio. As a result, both Davis and Pendergest-Holt knew, or were reckless in not knowing, of these fraudulent misstatements.
- 42. Contrary to the representation that responsibility for SIB's multi-billion portfolio was "spread out" among 20-plus people, only Stanford and Davis know the whereabouts of the vast majority of the bank's multi-billion investment portfolio. Pendergest-Holt and her team of analysts claim that they have never been privy to Tier 1 or Tier 3 investments. In fact, the SIO

was repeatedly denied access to the Bank's records relating to Tier 3, even though he was responsible, as the Bank's Senior Investment Officer, for "closing" deals with large investors, "overseeing the Bank's investment portfolio" and "ensuring that the investment side is compliant with the various banking regulatory authorities." In fact, in preparing the Bank's period reports (quarterly newsletters, month reports, mid-year reports and annual reports, Pendergest and the Analyst send to Davis the performance results for Tier 2 investments. And Davis calculates the investment returns for the aggregated portfolio of assets.

- 3. SIB Misrepresented that its Investment Portfolio is Overseen by a Regulatory Authority in Antigua that Conducts a Yearly Audit of the Fund's Financial Statements.
- 43. SIB told investors that their deposits were safe because the Antiguan regulator responsible for oversight of the Bank's investment portfolio, the Financial Services Regulatory Commission (the "FSRC"), audited its financial statements. But, contrary to the Bank's representations to investors, the FSRC does not verify the assets SIB claims in its financial statements. Instead, SIB's accountant, C.A.S. Hewlett & Co., a small local accounting firm in Antigua is responsible for auditing the multi-billion dollar SIB's investment portfolio. The Commission attempted several times to contact Hewlett by telephone. No one ever answered the phone.
  - SIB Misrepresented that Its Investment Portfolio is Without "Direct or Indirect" Exposure to Fraud Perpetrated by Bernard Madoff.
- 44. In a December 2008 Monthly Report, the bank told investors that their money was safe because SIB "had no direct or indirect exposure to any of [Bernard] Madoff's investments." But, contrary to this statement, at least \$400,000 in Tier 2 was invested in Meridian, a New York-based hedge fund that used Tremont Partners as its asset manager. Tremont invested approximately 6-8% of the SIB assets they indirectly managed with Madoff's investment firm.

- 45. Pendergest, Davis and Stanford knew about this exposure to loss relating to the Meridian investment. On December 15, 2008, an Analyst informed Pendergast, Davis and Stanford in a weekly report that his "rough estimate is a loss of \$400k . . . based on the indirect exposure" to Madoff.
  - 5. Market Concerns About SIB's Lack of Transparency
- 46. On or about December 12, 2008, Pershing, citing suspicions about the bank's investment returns and its inability to get from the Bank "a reasonable level of transparency" into its investment portfolio informed SGC that it would no longer process wire transfers from SGC to SIB for the purchase of the CD. Since the spring of 2008, Pershing tried unsuccessfully to get an independent report regarding SIB's financials condition. On November 28, 2008, SGC's President, Danny Bogar, informed Pershing that "obtaining the independent report was not a priority." Between 2006 and December 12, 2008, Pershing sent to SIB 1,635 wire transfers, totaling approximately \$517 million, from approximately 1,199 customer accounts.
  - D. From at least 2004, SCM misrepresented SAS performance results.
- 47. From 2004 through 2009, SCM induced clients, including non-accredited, retail investors, to invest in excess of \$1 billion in its SAS program by touting its track record of "historical performance." SCM highlighted the purported SAS track record in thousands of client presentation books ("pitch books").
- 48. For example, the following chart from a 2006 pitch book presented clients with the false impression that SAS accounts, from 2000 through 2005, outperformed the S&P 500 by an average of approximately 13 percentage points:

	2005	2004	2003	2002	2001	2000				
SAS Growth	12.09%	16.15%	32.84%	-3.33%	4.32%	18.04%				
S&P 500	4.91%	10.88%	28.68%	-22_10%	-11.88%	-9.11%				

SCM used these impressive, but fictitious, performance results to grow the SAS program from less than \$10 million in assets in 2004 to over \$1 billion in 2008.

- 49. SGC also used the SAS track record to recruit financial advisers away from legitimate advisory firms who had significant books of business. After arriving at Stanford, the newly-hired financial advisors were encouraged and highly incentivized to put their clients' assets in the SIB CD.
- 50. The SAS performance results used in the pitch books from 2005 through 2009 were fictional and/or inflated. Specifically, SCM misrepresented that SAS performance results, for 1999 through 2004, reflected "historical performance" when, in fact, those results were fictional, or "back-tested", numbers that do not reflect results of actual trading. Instead, SCM, with the benefit of hindsight, picked mutual funds that performed extremely well during years 1999 through 2004, and presented the back-tested performance of those top-performing funds to potential clients as if they were actual returns earned by the SAS program.
- Similarly, SCM used "actual" model SAS performance results for years 2005
   through 2006 that were inflated by as much as 4%.
- 52. SCM told investors that SAS has positive returns for periods in which actual SAS clients lost substantial amounts. For example, in 2000, actual SAS client returns ranged from negative 7.5% to positive 1.1%. In 2001, actual SAS client returns ranged from negative 10.7%

to negative 2.1%. And, in 2002, actual SAS client returns ranged from negative 26.6% to negative 8.7%. These return figures are all gross of SCM advisory fees ranging from 1.5% to 2.75%. Thus, Stanford's claims of substantial market out performance were blatantly false. (e.g., a claimed return of 18.04% in 2000, when actual SAS investors lost as much as 7.5%).

- 53. SGC/SCM's management knew that the advertised SAS performance results were misleading and inflated. From the beginning, SCM management knew that the pre-2005 track record was purely hypothetical, bearing no relationship to actual trading. And, as early as November 2006, SCM investment advisers began to question why their actual clients were not receiving the returns advertised in pitch books.
- 54. In response to these questions, SGC/SCM hired an outside performance reporting expert, to review certain of its SAS performance results. In late 2006 and early 2007, the expert informed SCM that its performance results for the twelve months ended September 30, 2006 were inflated by as much as 3.4 percentage points. Moreover, the expert informed SCM managers that the inflated performance results included unexplained "bad math" that consistently inflated the SAS performance results over actual client performance. Finally, in March 2008, the expert informed SCM managers that the SAS performance results for 2005 were also inflated by as much as 3.25 percentage points.
- 55. Despite their knowledge of the inflated SAS returns, SGC/SCM management continued using the pre-2005 track record and never asked Riordan to audit the pre-2005 performance. In fact, in 2008 pitch books, SCM presented the back-tested pre-2005 performance data under the heading "Historical Performance" and "Manager Performance" along side the audited 2005 through 2008 figures. According to SCM's outside consultant, it was "[grossly misleading]" to present audited performance figures along side back-tested figures.

56. Finally, SGC/SCM compounded the deceptive nature of the SAS track record by blending the back-tested performance with audited composite performance to create annualized 5 and 7 year performance figures that bore no relation to actual SAS client performance. A sample of this misleading disclosure used in 2008 and 2009 follows:

			Galenda As of	r Year F March 2						
	YTD	2007	2008	2005	2004	2003	2002	2001	2000	1990
SAS Growth	-7.60%	12.40%	14,68%	3.82%	1615%	3286%	-333%	4325,	13.01%	22.55N
S&P 500	-9.48%	5.45%	5.79%	491%	\$183%	28.59%	-22.10%	-11,96%	-9.17%	21.04%
	_L	(not an	Annual musized	zed Re	tums than 1	year)	L	L		L
	YII		1 year		year	5 year	FS.	7 years		ance repton
SAS Growth	-7,44	176	0.80%	9.	36%	15.3	1%	11.03%	12	.30%
S&P 500	-2.44	-9.44%		5.	85%	11.33	1%.	3.70%	2	45%

57. Other than the fees paid by SIB to SGC for the sale of the CD, SAS was the second most significant source of revenue for the firm. In 2007 and 2008, approximately \$25 million in fees from the marketing of the SAS program.

### CAUSES OF ACTION

### FIRST CLAIM AS TO ALL DEFENDANTS

### Violations of Section 10(b) of the Exchange Act and Rule 10-5

- 58. Plaintiff Commission repeats and realleges paragraphs 1 through 57 of this Complaint and incorporated herein by reference as if set forth verbatim.
- 59. Defendants, directly or indirectly, singly or in concert with others, in connection with the purchase and sale of securities, by use of the means and instrumentalities of interstate

commerce and by use of the mails have: (a) employed devices, schemes and artifices to defraud;
(b) made untrue statements of material facts and omitted to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; and (c) engaged in acts, practices and courses of business which operate as a fraud and deceit upon purchasers, prospective purchasers and other persons.

- 60. As a part of and in furtherance of their scheme, defendants, directly and indirectly, prepared, disseminated or used contracts, written offering documents, promotional materials, investor and other correspondence, and oral presentations, which contained untrue statements of material facts and misrepresentations of material facts, and which omitted to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.
- Defendants made the referenced misrepresentations and omissions knowingly or grossly recklessly disregarding the truth.
- 62. For these reasons, Defendants have violated and, unless enjoined, will continue to violate Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and Exchange Act Rule 10b-5 [17 C.F.R. § 240.10b-5].

### SECOND CLAIM AS TO STANFORD, DAVIS, AND PENDERGEST-HOLT

### Aiding and Abetting Violations of Exchange Act Section 10(b) and Rule 10b-5

- 63. Plaintiff Commission repeats and realleges paragraphs 1 through 57 of this Complaint and incorporated herein by reference as if set forth verbatim.
- 64. If Stanford, Davis, and Pendergest-Holt did not violate Exchange Act Section 10(b) and Rule 10b-5, in the alternative, Stanford, Davis, and Pendergest-Holt, in the manner set forth above, knowingly or with severe recklessness provided substantial assistance in connection

with the violations of Exchange Act Section 10(b) [15 U.S.C. § 78j(b)] and Rule 10b-5 [17 C.F.R. § 240.10b-5] alleged herein.

65. For these reasons, Stanford, Davis, and Pendergest-Holt aided and abetted and, unless enjoined, will continue to aid and abet violations of Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and Rule 10b-5 [17 C.F.R. § 240.10b-5].

### THIRD CLAIM AS TO ALL DEFENDANTS

### Violations of Section 17(a) of the Securities Act

- 66. Plaintiff Commission repeats and realleges paragraphs 1 through 57 of this Complaint and incorporated herein by reference as if set forth verbatim.
- 67. Defendants, directly or indirectly, singly or in concert with others, in the offer and sale of securities, by use of the means and instruments of transportation and communication in interstate commerce and by use of the mails, have: (a) employed devices, schemes or artifices to defraud; (b) obtained money or property by means of untrue statements of material fact or omissions to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; and (c) engaged in transactions, practices or courses of business which operate or would operate as a fraud or deceit.
- 68. As part of and in furtherance of this scheme, defendants, directly and indirectly, prepared, disseminated or used contracts, written offering documents, promotional materials, investor and other correspondence, and oral presentations, which contained untrue statements of material fact and which omitted to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.
- Defendants made the referenced misrepresentations and omissions knowingly or grossly recklessly disregarding the truth.

70. For these reasons, Defendants have violated, and unless enjoined, will continue to violate Section 17(a) of the Securities Act [15 U.S.C. § 77q(a)].

### FOURTH CLAIM AS TO STANFORD, SGC, AND STANFORD CAPITAL

### Violations of Sections 206(1) and 206(2) of the Advisers Act

- 71. Plaintiff Commission repeats and realleges paragraphs 1 through 57 of this Complaint and incorporated herein by reference as if set forth verbatim.
- 72. Stanford, SGC, and Stanford Capital, directly or indirectly, singly or in concert, knowingly or recklessly, through the use of the mails or any means or instrumentality of interstate commerce, while acting as investment advisers within the meaning of Section 202(11) of the Advisers Act [15 U.S.C. § 80b-2(11)]: (a) have employed, are employing, or are about to employ devices, schemes, and artifices to defraud any client or prospective client; or (b) have engaged, are engaging, or are about to engage in acts, practices, or courses of business which operates as a fraud or deceit upon any client or prospective client.
- 73. For these reasons, Stanford, SGC, and Stanford Capital have violated, and unless enjoined, will continue to violate Sections 206(1) and 206(2) of the Advisers Act [15 U.S.C. §§ 80b-6(1) and 80b-6(2)].

### FIFTH CLAIM AS TO STANFORD, DAVIS, AND PENDERGEST-HOLT

### Aiding and Abetting Violations of Sections 206(1) and 206(2) of the Advisers Act

- 74. Plaintiff Commission repeats and realleges paragraphs 1 through 57 of this Complaint and incorporated herein by reference as if set forth verbatim.
- 75. Based on the conduct alleged herein, Stanford, Davis, and Pendergest-Holt, in the manner set forth above, knowingly or with severe recklessness provided substantial assistance in

connection with the violations of Advisers Act Sections 206(1) and 206(2) [15 U.S.C. §§ 80b-6(1) and 80b-6(2)] alleged herein.

76. For these reasons, Stanford, Davis, and Pendergest-Holt aided and abetted and, unless enjoined, will continue to aid and abet violations of Sections 206(1) and 206(2) of the Advisers Act [15 U.S.C. §§ 80b-6(1) and 80b-6(2)].

### SIXTH CLAIM AS TO SIB AND SGC

#### Violations of Section 7(d) of the Investment Company Act

- 77. Plaintiff Commission repeats and realleges paragraphs 1 through 57 of this Complaint and incorporated herein by reference as if set forth verbatim.
- 78. SIB, an investment company not organized or otherwise created under the laws of the United States or of a State, directly or indirectly, singly or in concert with others, made use of the mails or any means or instrumentality of interstate commerce, directly or indirectly, to offer for sale, sell, or deliver after sale, in connection with a public offering, securities of which SIB was the issuer, without obtaining an order from the Commission permitting it to register as an investment company organized or otherwise created under the laws of a foreign country and to make a public offering of its securities by use of the mails and means or instrumentalities of interstate commerce.
- 79. SGC, directly or indirectly, singly or in concert with others, acted as an underwriter for SIB, an investment company not organized or otherwise created under the laws of the United States or of a State that made use of the mails or any means or instrumentality of interstate commerce, directly or indirectly, to offer for sale, sell, or deliver after sale, in connection with a public offering, securities of which SIB was the issuer, without obtaining an order from the Commission permitting it to register as an investment company organized or

otherwise created under the laws of a foreign country and to make a public offering of its securities by use of the mails and means or instrumentalities of interstate commerce.

80. For these reasons, SIB and SGC have violated, and unless enjoined, will continue to violate Section 7(d) of the Investment Company Act [15 U.S.C. § 80a-7(d)].

### RELIEF REQUESTED

Plaintiff Commission respectfully requests that this Court:

I.

Temporarily, preliminarily, and permanently enjoin: (a) Defendants from violating, or aiding and abetting violations of, Section 10(b) and Rule 10b-5 of the Exchange Act; (b)

Defendants from violating Section 17(a) of the Securities Act; (c) Stanford, Davis, Pendergest-Holt, SGC, and Stanford Capital from violating, or aiding and abetting violations of, Sections 206(1) and 206(2) of the Advisers Act; and (d) SIB and SCG from violating Section 7(d) of the Investment Company Act.

II.

Enter an Order immediately freezing the assets of Defendants and directing that all financial or depository institutions comply with the Court's Order. Furthermore, order that Defendants immediately repatriate any funds held at any bank or other financial institution not subject to the jurisdiction of the Court, and that they direct the deposit of such funds in identified accounts in the United States, pending conclusion of this matter.

III.

Order that Defendants shall file with the Court and serve upon Plaintiff Commission and the Court, within 10 days of the issuance of this order or three days prior to a hearing on the Commission's motion for a preliminary injunction, whichever comes first, an accounting, under

oath, detailing all of their assets and all funds or other assets received from investors and from one another.

#### IV.

Order that Defendants be restrained and enjoined from destroying, removing, mutilating, altering, concealing, or disposing of, in any manner, any of their books and records or documents relating to the matters set forth in the Complaint, or the books and records and such documents of any entities under their control, until further order of the Court.

#### V.

Order the appointment of a temporary receiver for Defendants, for the benefit of investors, to marshal, conserve, protect, and hold funds and assets obtained by the defendants and their agents, co-conspirators, and others involved in this scheme, wherever such assets may be found, or, with the approval of the Court, dispose of any wasting asset in accordance with the application and proposed order provided herewith.

### VI.

Order that the parties may commence discovery immediately, and that notice periods be shortened to permit the parties to require production of documents, and the taking of depositions on 72 hours' notice.

### VII.

Order Defendants to disgorge an amount equal to the funds and benefits they obtained illegally as a result of the violations alleged herein, plus prejudgment interest on that amount.

#### VIII.

Order civil penalties against Defendants pursuant to Section 20(d) of the Securities Act [15 U.S.C. § 77t(d)], Section 21(d) of the Exchange Act [15 U.S.C. § 78u(d)], Section 41(e) of

the Investment Company Act [15 U.S.C. § 80a-41(e)], and Section 209(e) of the Advisers Act [15 U.S.C. § 80b-9(e)] for their securities law violations.

IX.

Order that Stanford, Davis, and Pendergest-Holt immediately surrender their passports to the Clerk of this Court, to hold until further order of this Court.

· X.

Order such further relief as this Court may deem just and proper.

For the Commission, by its attorneys:

February 16, 2009

Respectfully submitted,

STEPHEN J. KOROTASH

Oklahoma Bar No. 5102

J. KEVIN EDMUNDSON

Texas Bar No. 24044020

DAVID B. REECE

Texas Bar No. 24002810

MICHAEL D. KING

Texas Bar No. 24032634

D. THOMAS KELTNER

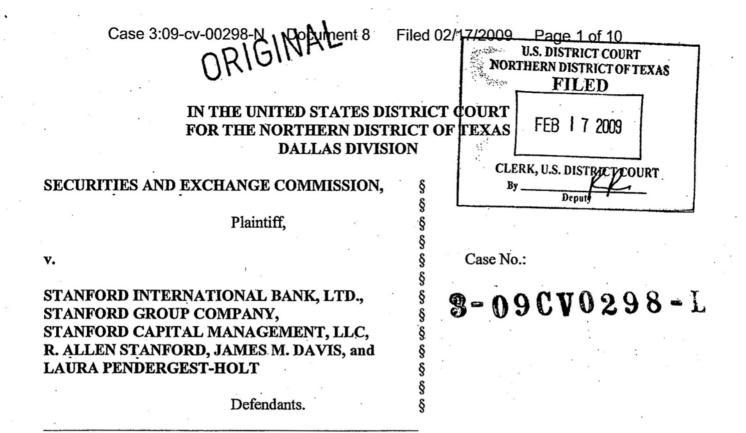
Texas Bar No. 24007474

U.S. Securities and Exchange Commission Burnett Plaza, Suite 1900 801 Cherry Street, Unit #18 Fort Worth, TX 76102-6882

(817) 978-6476 (dbr)

(817) 978-4927 (fax)

## EXHIBIT 2



## TEMPORARY RESTRAINING ORDER, ORDER FREEZING ASSETS, ORDER REQUIRING AN ACCOUNTING, ORDER REQUIRING PRESERVATION OF DOCUMENTS, AND ORDER AUTHORIZING EXPEDITED DISCOVERY

This matter came before me, the undersigned United States District Judge, this 16th day of February 2009, on the application of Plaintiff Securities and Exchange Commission ("Commission") for the issuance of a temporary restraining order against Defendants Stanford International Bank, Ltd. ("SIB"), Stanford Group Company ("SGC"), Stanford Capital Management, LLC ("SCM"), R. Allen Stanford ("Stanford"), James M. Davis ("Davis"), and Laura Pendergest-Holt ("Pendergest-Holt") (collectively, "Defendants"), and orders freezing assets, requiring an accounting, prohibiting the destruction of documents, pulling the passports of Stanford, Davis, and Pendergest-Holt, authorizing expedited discovery, and alternative service of process and notice. On the basis of the papers filed by the Commission, and argument of Commission counsel, the Court finds as follows:

 This Court has jurisdiction over the subject matter of this action and over the Defendants.

- The Commission is a proper party to bring this action seeking the relief sought in its Complaint.
  - 3. Venue is appropriate in the Northern District of Texas.
- 4. There is good cause to believe that Defendants have engaged in, and are engaging in, acts and practices which did, do, and will constitute violations of Section 17(a) of the Securities Act of 1933 ("Securities Act") [15 U.S.C. § 77q(a)], Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") [15 U.S.C. §78j(b)], Exchange Act Rule 10b-5 [17 C.F.R. § 240.10b-5], Sections 206(1) and 206(2) of the Investment Advisers Act of 1940 ("Advisers Act") [15 U.S.C. §§ 80b-6(1), (2)], and Section 7(d) of the Investment Company Act of 1940 ("Investment Company Act") [15 U.S.C. § 80a-7(d)].
- 5. There is good cause to believe that Defendants will continue to engage in the acts and practices constituting the violations set forth in paragraph 4 unless restrained and enjoined by an order of this Court.
- 6. There is good cause to believe that Defendants used improper means to obtain investor funds and assets. There is also good cause to believe that Defendants will dissipate assets and that some assets are located abroad.
- 7. An accounting is appropriate to determine the disposition of investor funds and to ascertain the total assets that should continue to be frozen.
- It is necessary to preserve and maintain the business records of Defendants from destruction.
  - 9. This proceeding is one in which the Commission seeks a preliminary injunction.

- 10. The timing restrictions of Fed. R. Civ. P. 26(d) and (f), 30(a)(2)(C) and 34 do not apply to this proceeding in light of the Commission's requested relief and its demonstration of good cause.
- Expedited discovery is appropriate to permit a prompt and fair hearing on the Commission's Motion for Preliminary Injunction.
- 12. There is good cause to believe that Stanford, Davis, and Pendergest-Holt may seek to leave the United States in order to avoid responsibility for the fraudulent acts alleged herein.

#### IT IS THEREFORE ORDERED THAT:

- A. Defendants, their officers, directors, agents, servants, employees, attorneys, and all other persons in active concert or participation with them, are restrained and enjoined from violating Section 17(a) of the Securities Act [15 U.S.C. § 77q(a)], directly or indirectly, in the offer or sale of any security by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, by:
  - (1) employing any device, scheme, or artifice to defraud; or
  - (2) obtaining money or property by means of any untrue statement of material fact or any omission to state a material fact necessary in order to make the statement(s) made, in the light of the circumstances under which they were made, not misleading; or
  - (3) engaging in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser;
- B. Defendants, their officers, directors, agents, servants, employees, attorneys, and all other persons in active concert or participation with them, are restrained and enjoined

from violating Section 10(b) of the Exchange Act or Rule 10b-5 [15 U.S.C. § 78j(b) and 17 C.F.R. §240.10b-5], directly or indirectly, in connection with the purchase or sale of any security, by making use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange:

- to use or employ any manipulative or deceptive device or contrivance in contravention of the rules and regulations promulgated by the Commission;
- (2) to employ any device, scheme, or artifice to defraud;
- (3) to make any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; or
- (4) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person;
- C. Stanford, Davis, Pendergest-Holt, SGC, SCM, their officers, directors, agents, servants, employees, attorneys, and all other persons in active concert or participation with them, are restrained and enjoined from violating Sections 206(1) and 206(2) of the Advisers Act [15 U.S.C. §§80b-6(1), (2)], directly or indirectly, by use of the mails or any means or instrumentality of interstate commerce, by:
  - employing any device, scheme, or artifice to defraud any client or prospective client; or
  - (2) engaging in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client;

- D. SIB, SGC, their officers, directors, agents, servants, employees, attorneys, and all other persons in active concert or participation with them, are restrained and enjoined from violating Section 7(d) of the Investment Company Act [15 U.S.C. §80a-7(d)], directly or indirectly, by use of the mails or any means or instrumentality of interstate commerce, by:
  - (1) acting as an investment company, not organized or otherwise created under the laws of the United States or of a State, and offering for sale, selling, or delivering after sale, in connection with a public offering, any security of which such company is the issuer; or
  - (2) acting as a depositor of, trustee of, or underwriter for such a company; unless
  - (3) the Commission, upon application by the investment company not organized or otherwise created under the laws of the United States or of a State, issues a conditional or unconditional order permitting such company to register and to make a public offering of its securities by use of the mails and means or instrumentalities of interstate commerce.
- 5. Defendants, their officers, directors, agents, servants, employees, attorneys, and all other persons in active concert or participation with them, who receive actual notice of this Order by personal service or otherwise, and each of them, are hereby restrained and enjoined from, directly or indirectly, making any payment or expenditure of funds belonging to or in the possession, custody, or control of Defendants, or effecting any sale, gift, hypothecation, or other disposition of any asset belonging to or in the possession, custody, or control of Defendants, pending a showing to this Court that Defendants have sufficient funds or assets to satisfy all claims

arising out of the violations alleged in the Commission's Complaint or the posting of a bond or surety sufficient to assure payment of any such claim. This provision shall continue in full force and effect until further ordered by this Court and shall not expire.

- 6. All banks, savings and loan associations, savings banks, trust companies, securities broker-dealers, commodities dealers, investment companies, other financial or depository institutions, and investment companies that hold one or more accounts in the name, on behalf or for the benefit of Defendants are hereby restrained and enjoined, in regard to any such account, from engaging in any transaction in securities (except liquidating transactions necessary to comply with a court order) or any disbursement of funds or securities pending further order of this Court. This provision shall continue in full force and effect until further order by this Court and shall not expire.
- 7. All other individuals, corporations, partnerships, limited liability companies, and other artificial entities are hereby restrained and enjoined from disbursing any funds, securities, or other property obtained from Defendants without adequate consideration. This provision shall continue in full force and effect until further order by this Court and shall not expire.
- 8. Defendants are hereby required to make an interim accounting, under oath, within ten days of the issuance of this order or three days prior to any hearing on the Commission's Motion for Preliminary Injunction, whichever is sooner: (1) detailing all monies and other benefits which each received, directly or indirectly, as a result of the activities alleged in the Complaint (including the date on which the monies or other benefit was received and the name, address, and telephone number of the person paying the money or providing the benefit); (2) listing all current assets wherever they may be located and by whomever they are being held (including the name and address of the holder and the amount or value of the holdings); and (3)

listing all accounts with any financial or brokerage institution maintained in the name of, on behalf of, or for the benefit of, Defendants (including the name and address of the account holder and the account number) and the amount held in each account at any point during the period from January 1, 2000 through the date of the accounting. This provision shall continue in full force and effect until further order by this Court and shall not expire.

- 9. Defendants, their officers, directors, agents, servants, employees, attorneys, and all other persons in active concert or participation with them, including any bank, securities broker-dealer, or any financial or depositary institution, who receives actual notice of this Order by personal service or otherwise, and each of them, are hereby restrained and enjoined from destroying, removing, mutilating, altering, concealing, or disposing of, in any manner, any books and records owned by, or pertaining to, the financial transactions and assets of Defendants or any entities under their control. This provision shall continue in full force and effect until further order by this Court and shall not expire.
- 10. The United States Marshal in any judicial district in which Defendants do business or may be found, or in which any Receivership Asset may be located, is authorized and directed to make service of process at the request of the Commission.
- 11. The Commission is authorized to serve process on, and give notice of these proceedings and the relief granted herein to, Defendants by U.S. Mail, e-mail, facsimile, or any other means authorized by the Federal Rules of Civil Procedure.
  - 12. Expedited discovery may take place consistent with the following:
    - A. Any party may notice and conduct depositions upon oral examination and may request and obtain production of documents or other things for inspection and copying from parties prior to the expiration of thirty days

- after service of a summons and the Plaintiff Commission's Complaint upon Defendants.
- B. All parties shall comply with the provisions of Fed. R. Civ. P. 45 regarding issuance and service of subpoenas, unless the person designated to provide testimony or to produce documents and things agrees to provide the testimony or to produce the documents or things without the issuance of a subpoena or to do so at a place other than one at which testimony or production can be compelled.
- C. Any party may notice and conduct depositions upon oral examination subject to minimum notice of seventy-two (72) hours.
- D. All parties shall produce for inspection and copying all documents and things that are requested within seventy-two (72) hours of service of a written request for those documents and things.
- E. All parties shall serve written responses to written interrogatories within seventy-two (72) hours after service of the interrogatories.
- 13. All parties shall serve written responses to any other party's request for discovery and the interim accountings to be provided by Defendants by delivery to the Plaintiff Commission address as follows:

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Fort Worth Regional Office
Attention: David Reece
Burnett Plaza, Suite 1900
801 Cherry Street, Unit #18
Fort Worth, TX 76102-6882
Facsimile: (817) 978-4927

and by delivery to other parties at such address(es) as may be designated by them in writing. Such delivery shall be made by the most expeditious means available, including e-mail and facsimile.

- 14. Stanford, Davis, and Pendergest-Holt shall surrender their passports, pending the determination of the Commission's request for a preliminary injunction, and are barred from traveling outside the United States.
- 15. Defendants, their directors, officers, agents, servants, employees, attorneys, depositories, banks, and those persons in active concert or participation with anyone or more of them, and each of them, shall:
  - (a) take such steps as are necessary to repatriate to the territory of the United States all funds and assets of investors described in the Commission's Complaint in this action which are held by them, or are under their direct or indirect control, jointly or singly, and deposit such funds into the Registry of the United States District Court, Northern District of Texas; and
  - (b) provide the Commission and the Court a written description of the funds and assets so repatriated.
- 16. Defendants shall serve, by the most expeditious means possible, including e-mail and facsimile, any papers in opposition to the Commission's Motion for Preliminary Injunction and for other relief no later than 72 hours before any scheduled hearing on the Motion for Preliminary Injunction. The Commission shall serve any reply at least 24 hours before any hearing on the Motion for Preliminary Injunction by the most expeditious means available, including facsimile.

17. Unless extended by agreement of the parties, the portion of this order that $\theta$
constitutes a temporary restraining order shall expire at $\underline{5}$ o'clock $\underline{\rho}$ .m. on the $\underline{2}$ day of
March 2009 or at such later date as may be ordered by this Court. All other provisions of
this order shall remain in full force and effect until specifically modified by further order of this
Court. Unless the Court rules upon the Commission's Motion for Preliminary Injunction
pursuant to Fed. R. Civ. P. 43(e), adjudication of the Commission's Motion for Preliminary
Injunction shall take place at the United States Courthouse, Northern District of Tem Dallas,
Texas, on the 1d day of Murch, 2009, at 10 o'clock a.m. 1100 Commerce Street Dallas Texas 75242 (Earl Cabell Bldg).
Dallas Texas 75242 (Earl Cabell Bldg).
EXECUTED AND ENTERED at 11:40 o'clock a.m. CST this 16th day of February

UNITED STATES DISTRICT JUDGE

2009.

# EXHIBIT 3

#### IN THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF TEXAS DALLAS DIVISION

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

Case No.:

.

STANFORD INTERNATIONAL BANK, LTD., STANFORD GROUP COMPANY, STANFORD CAPITAL MANAGEMENT, LLC, R. ALLEN STANFORD, JAMES M. DAVIS, and LAURA PENDERGEST-HOLT

Defendants.

### ORDER APPOINTING RECEIVER

This matter came before me, the undersigned United States District Judge, on the motion of Plaintiff Securities and Exchange Commission ("Commission") for the appointment of a Receiver for Defendants Stanford International Bank, Ltd., Stanford Group Company, Stanford Capital Management, LLC, Robert Allen Stanford, James M. Davis, and Laura Pendergest-Holt ("Defendants"). It appears that this Order Appointing Receiver is both necessary and appropriate in order to prevent waste and dissipation of the assets of Defendants to the detriment of the investors.

#### IT IS THEREFORE ORDERED that:

1. This Court assumes exclusive jurisdiction and takes possession of the assets, monies, securities, properties, real and personal, tangible and intangible, of whatever kind and description, wherever located, and the legally recognized privileges (with regard to the entities), of the Defendants and all entities they own or control ("Receivership Assets"), and the books and records, client lists, account statements, financial and accounting documents, computers,

SEC v. Stanford International Bank, Ltd., et al.

computer hard drives, computer disks, internet exchange servers telephones, personal digital devices and other informational resources of or in possession of the Defendants, or issued by Defendants and in possession of any agent or employee of the Defendants ("Receivership Records").

- 2. Ralph S. Janvey of Dallas, Texas, is hereby appointed Receiver for the Receivership Assets and Receivership Records (collectively, "Receivership Estate"), with the full power of an equity receiver under common law as well as such powers as are enumerated herein as of the date of this Order. The Receiver shall not be required to post a bond unless directed by the Court but is hereby ordered to well and faithfully perform the duties of his office: to timely account for all monies, securities, and other properties which may come into his hands; and to abide by and perform all duties set forth in this Order. Except for an act of willful malfeasance or gross negligence, the Receiver shall not be liable for any loss or damage incurred by the Receivership Estate, or any of Defendants, the Defendants' clients or associates, or their subsidiaries or affiliates, their officers, directors, agents, and employees, or by any of Defendants' creditors or equity holders because of any act performed or not performed by him or his agents or assigns in connection with the discharge of his duties and responsibilities hereunder.
- 3. The duties of the Receiver shall be specifically limited to matters relating to the Receivership Estate and unsettled claims thereof remaining in the possession of the Receiver as of the date of this Order. Nothing in this Order shall be construed to require further investigation of Receivership Estate assets heretofore liquidated and/or distributed or claims of the Receivership Estate settled prior to issuance of this Order. However, this paragraph shall not be

construed to limit the powers of the Receiver in any regard with respect to transactions that may have occurred prior to the date of this Order.

- 4. Until the expiration date of this Order or further Order of this Court, Receiver is authorized to immediately take and have complete and exclusive control, possession, and custody of the Receivership Estate and to any assets traceable to assets owned by the Receivership Estate.
- 5. As of the date of entry of this Order, the Receiver is specifically directed and authorized to perform the following duties:
  - (a) Maintain full control of the Receivership Estate with the power to retain or remove, as the Receiver deems necessary or advisable, any officer, director, independent contractor, employee, or agent of the Receivership Estate;
  - (b) Collect, marshal, and take custody, control, and possession of all the funds, accounts, mail, and other assets of, or in the possession or under the control of, the Receivership Estate, or assets traceable to assets owned or controlled by the Receivership Estate, wherever situated, the income and profit therefrom and all sums of money now or hereafter due or owing to the Receivership Estate with full power to collect, receive, and take possession of, without limitation, all goods, chattel, rights, credits, monies, effects, lands, leases, books and records, work papers, records of account, including computer maintained information, contracts, financial records, monies on hand in banks and other financial initiations, and other papers and documents of other individuals, partnerships, or corporations whose interests are now held by or under the direction, possession, custody, or control of the Receivership Estate;

- (c) Institute such actions or proceedings to impose a constructive trust, obtain possession, and/or recover judgment with respect to persons or entities who received assets or records traceable to the Receivership Estate. All such actions shall be filed in this Court;
- (d) Obtain, by presentation of this Order, documents, books, records, accounts, deposits, testimony, or other information within the custody or control of any person or entity sufficient to identify accounts, properties, liabilities, causes of action, or employees of the Receivership Estate. The attendance of a person or entity for examination and/or production of documents may be compelled in a manner provided in Rule 45, Fed. R. Civ. P., or as provided under the laws of any foreign country where such documents, books, records, accounts, deposits, or testimony may be located;
- (e) Without breaching the peace and, if necessary, with the assistance of local peace officers or United States marshals to enter and secure any premises, wherever located or situated, in order to take possession, custody, or control of, or to identify the location or existence of, Receivership Estate assets or records;
- disbursements as the Receiver deems advisable or proper for the marshaling, maintenance, or preservation of the Receivership Estate. Receiver is further authorized to contract and negotiate with any claimants against the Receivership Estate (including, without limitation, creditors) for the purpose of compromising or settling any claim. To this purpose, in those instances in which Receivership Estate assets serve as collateral to secured creditors, the Receiver has the authority to surrender such assets to secured creditors, conditional upon the waiver of any deficiency of collateral;

- (g) Perform all acts necessary to conserve, hold, manage, and preserve the value of the Receivership Estate, in order to prevent any irreparable loss, damage, and injury to the Estate;
- (h) Enter into such agreements in connection with the administration of the Receivership Estate, including, but not limited to, the employment of such managers, agents, custodians, consultants, investigators, attorneys, and accountants as Receiver judges necessary to perform the duties set forth in this Order and to compensate them from the Receivership Assets;
- (i) Institute, prosecute, compromise, adjust, intervene in, or become party to such actions or proceedings in state, federal, or foreign courts that the Receiver deems necessary and advisable to preserve the value of the Receivership Estate, or that the Receiver deems necessary and advisable to carry out the Receiver's mandate under this Order and likewise to defend, compromise, or adjust or otherwise dispose of any or all actions or proceedings instituted against the Receivership Estate that the Receiver deems necessary and advisable to carry out the Receiver's mandate under this Order;
  - (j) Preserve the Receivership Estate and minimize expenses in furtherance of maximum and timely disbursement thereof to claimants;
- (k) Promptly provide the United States Securities and Exchange Commission and other governmental agencies with all information and documentation they may seek in connection with its regulatory or investigatory activities;
- Prepare and submit periodic reports to this Court and to the parties as directed by this Court; and

- (m) File with this Court requests for approval of reasonable fees to be paid to the Receiver and any person or entity retained by him and interim and final accountings for any reasonable expenses incurred and paid pursuant to order of this Court.
- 6. Upon the request of the Receiver, the United States Marshal's Office is hereby ordered to assist the Receiver in carrying out his duties to take possession, custody, or control of, or identify the location of, any Receivership Estate assets or records.
- 7. Creditors and all other persons are hereby restrained and enjoined from the following actions, except in this Court, unless this Court, consistent with general equitable principals and in accordance with its ancillary equitable jurisdiction in this matter, orders that such actions may be conducted in another forum or jurisdiction:
  - (a) The commencement or continuation, including the issuance or employment of process, of any judicial, administrative, or other proceeding against the Receiver, any of the defendants, the Receivership Estate, or any agent, officer, or employee related to the Receivership Estate, arising from the subject matter of this civil action; or
  - (b) The enforcement, against the Receiver, or any of the defendants, of any judgment that would attach to or encumber the Receivership Estate that was obtained before the commencement of this proceeding.
- 8. Creditors and all other persons are hereby restrained and enjoined, without prior approval of the Court, from:
  - (a) Any act to obtain possession of the Receivership Estate assets;
  - (b) Any act to create, perfect, or enforce any lien against the property of the Receiver, or the Receivership Estate;

- (c) Any act to collect, assess, or recover a claim against the Receiver or that would attach to or encumber the Receivership Estate; or
- (d) The set off of any debt owed by the Receivership Estate or secured by the Receivership Estate assets based on any claim against the Receiver or the Receivership Estate.
- 9. Defendants, their respective officers, agents, and employees and all persons in active concert or participation with them who receive notice of this Order by personal service or otherwise, including, but not limited to, any financial institution, broker-dealer, investment adviser, private equity fund or investment banking firm, and each of them, are hereby ordered, restrained, and enjoined from, directly or indirectly, making any payment or expenditure of any Receivership Estate assets that are owned by Defendants or in the actual or constructive possession of any entity directly or indirectly owned or controlled or under common control with the Receivership Estate, or effecting any sale, gift, hypothecation, assignment, transfer, conveyance, encumbrance, disbursement, dissipation, or concealment of such assets. A copy of this Order may be served on any bank, savings and loan, broker-dealer, or any other financial or depository institution to restrain and enjoin any such institution from disbursing any of the Receivership Estate assets. Upon presentment of this Order, all persons, including financial institutions, shall provide account balance information, transaction histories, all account records and any other Receivership Records to the Receiver or his agents, in the same manner as they would be provided were the Receiver the signatory on the account.
- 10. Defendants, and their respective agents, officers, and employees and all persons in active concert or participation with them are hereby enjoined from doing any act or thing whatsoever to interfere with the Receiver's taking control, possession, or management of the

Receivership Estate or to in any way interfere with the Receiver or to harass or interfere with the duties of the Receiver or to interfere in any manner with the exclusive jurisdiction of this Court over the Receivership Estate, including the filing or prosecuting any actions or proceedings which involve the Receiver or which affect the Receivership Assets or Receivership Records, specifically including any proceeding initiated pursuant to the United States Bankruptcy Code, except with the permission of this Court. Any actions so authorized to determine disputes relating to Receivership Assets and Receivership Records shall be filed in this Court.

- 11. Defendants, their respective officers, agents, and employees and all persons in active concert or participation with them who receive actual notice of this Order by personal service or otherwise, including any financial institution, broker-dealer, investment adviser, private equity fund or investment banking firm, and each of them shall:
  - (a) To the extent they have possession, custody, or control of same, provide immediate access to and control and possession of the Receivership Estate assets and records, including securities, monies, and property of any kind, real and personal, including all keys, passwords, entry codes, and all monies deposited in any bank deposited to the credit of the Defendants, wherever situated, and the original of all books, records, documents, accounts, computer printouts, disks, and the like of Defendants to Receiver or his duly authorized agents;
  - (b) Cooperate with the Receiver and his duly authorized agents by promptly and honestly responding to all requests for information regarding Receivership Assets and Records and by promptly acknowledging to third parties the Receiver's authority to act on behalf of the Receivership Estate and by providing such authorizations, signatures, releases, attestations, and access as the Receiver or his duly authorized agents may reasonably request;

- (c) Provide the Commission with a prompt, full accounting of all Receivership Estate assets and documents outside the territory of the United States which are held either: (1) by them, (2) for their benefit, or (3) under their control;
- (d) Transfer to the territory of the United States all Receivership Estate assets and records in foreign countries held either: (1) by them, (2) for their benefit, or (3) under their control; and
- (e) Hold and retain all such repatriated Receivership Estate assets and documents and prevent any transfer, disposition, or dissipation whatsoever of any such assets or documents, until such time as they may be transferred into the possession of the Receiver.
- 12. Any financial institution, broker-dealer, investment adviser, private equity fund or investment banking firm or person that holds, controls, or maintains accounts or assets of or on behalf of any Defendant, or has held, controlled, or maintained any account or asset of or on behalf of any defendant or relief defendant since January 1, 1990, shall:
  - (a) Hold and retain within its control and prohibit the withdrawal, removal, assignment, transfer, pledge, hypothecation, encumbrance, disbursement, dissipation, conversion, sale, gift, or other disposal of any of the assets, funds, or other property held by or on behalf of any defendant or relief defendant in any account maintained in the name of or for the benefit of any defendant or relief defendant in whole or in part except:
    - (i) as directed by further order of this Court, or
    - (ii) as directed in writing by the Receiver or his agents;
  - (b) Deny access to any safe deposit boxes that are subject to access by any Defendant; and

- (c) The Commission and Receiver may obtain, by presentation of this Order, documents, books, records, accounts, deposits, or other information within the custody or control of any person or entity sufficient to identify accounts, properties, liabilities, causes of action, or employees of the Receivership Estate. The attendance of a person or entity for examination and/or production of documents may be compelled in a manner provided in Rule 45, Fed. R. Civ. P., or as provided under the laws of any foreign country where such documents, books, records, accounts, deposits, or testimony may be located;
- 13. The Defendants, their officers, agents, and employees and all persons in active concert or participation with them and other persons who have notice of this Order by personal service or otherwise, are hereby restrained and enjoined from destroying, mutilating, concealing, altering, transferring, or otherwise disposing of, in any manner, directly or indirectly, any contracts, accounting data, correspondence, advertisements, computer tapes, disks or other computerized records, books, written or printed records, handwritten notes, telephone logs, telephone scripts, receipt books, ledgers, personal and business canceled checks and check registers, bank statements, appointment books, copies of federal, state, or local business or personal income or property tax returns, and other documents or records of any kind that relate in any way to the Receivership Estate or are relevant to this action.
- 14. The Receiver is hereby authorized to make appropriate notification to the United States Postal Service to forward delivery of any mail addressed to the Defendants, or any company or entity under the direction and control of the Defendants, to himself. Further, the Receiver is hereby authorized to open and inspect all such mail to determine the location or identity of assets or the existence and amount of claims.

15. Nothing in this Order shall prohibit any federal or state law enforcement or regulatory authority from commencing or prosecuting an action against the Defendants, their agents, officers, or employees.

So Ordered and signed, this 16 day of February 2009.

NITED STATES DISTRICT JUDGE

## EXHIBIT 4

#### IN THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF TEXAS DALLAS DIVISION

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SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

FIRST AMENDED COMPLAINT

Case No.: 3:09-cv-0298-N

v.

STANFORD INTERNATIONAL BANK, LTD., STANFORD GROUP COMPANY, STANFORD CAPITAL MANAGEMENT, LLC, R. ALLEN STANFORD, JAMES M. DAVIS, and LAURA PENDERGEST-HOLT,

Defendants,

and

STANFORD FINANCIAL GROUP, and THE STANFORD FINANCIAL GROUP BLDG INC.,

Relief Defendants.

,

Plaintiff Securities and Exchange Commission alleges:

#### **SUMMARY**

- 1. For at least a decade, R. Allen Stanford and James M. Davis, through companies they control, including Stanford International Bank, Ltd. ("SIB") and its affiliated Houston-based investment advisers, Stanford Group Company ("SGC") and Stanford Capital Management ("SCM"), executed a massive Ponzi scheme. In carrying out the scheme, Stanford and Davis misappropriated billions of dollars of investor funds and falsified SIB's financial statements in an effort to conceal their fraudulent conduct.
- 2. Laura Pendergest-Holt, the chief investment officer of Stanford Financial Group ("SFG") and a member of SIB's investment committee, facilitated the fraudulent scheme by

misrepresenting to investors that she managed SIB's multi-billion investment portfolio of assets and employed a sizeable team of analysts to monitor the portfolio.

- 3. By year-end 2008, SIB had sold approximately \$8 billion of self-styled "certificates of deposits" (the "CD") by touting: (i) the bank's safety and security; (ii) consistent, double-digit returns on the bank's investment portfolio; and (iii) high return rates on the CD that greatly exceeded those offered by commercial banks in the United States.
- 4. Contrary to SIB's public statements, Stanford and Davis, by February 2009, had misappropriated at least \$1.6 billion of investor money through bogus personal loans to Stanford and "invested" an undetermined amount of investor funds in speculative, unprofitable private businesses controlled by Stanford.
- 5. In an effort to conceal their fraudulent conduct and maintain the flow of investor money into SIB's coffers, Stanford and Davis fabricated the performance of the bank's investment portfolio. Each month, Stanford and Davis decided on a pre-determined return on investment for SIB's portfolio. Using this pre-determined number, SIB's internal accountants reverse-engineered the bank's financial statements to report investment income that the bank did not actually earn. SIB's financial statements, which were approved and signed by Stanford and Davis, bore no relationship to the actual performance of the bank's investment portfolio.
- 6. In addition to sales of the CD, SGC and SCM advisers, since 2004, have sold more than \$1 billion of a proprietary mutual fund wrap program, called Stanford Allocation Strategy ("SAS"), using materially false and misleading historical performance data. The false data enabled SGC/SCM to grow the SAS program from less than \$10 million in 2004 to over \$1.2 billion in 2009 and generate fees for SGC/SCM (and ultimately Stanford) in excess of \$25 million. The fraudulent SAS performance results were also used to recruit registered financial advisers with significant

books of business, who were then heavily incentivized to re-allocate their clients' assets to SIB's CD program.

7. By engaging in the conduct described in this Complaint, Defendants directly or indirectly, singly or in concert, have engaged, and unless enjoined and restrained, will again engage in transactions acts, practices, and courses of business that constitute violations of Section 17(a) of the Securities Act of 1933 ("Securities Act") [15 U.S.C. §§ 77q(a)], and Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") [15 U.S.C. § 78j(b)], and Exchange Act Rule 10b-5 [17 C.F.R. § 240.10b-5] or, in the alternative, have aided and abetted such violations. In addition, through their conduct described herein, Stanford, SGC, and SCM have violated Section 206(1) and (2) of the Investment Advisers Act of 1940 ("Adviser's Act") [15 U.S.C. §§ 80b-6(1) and 80b-6(2)] and Davis and Pendergest-Holt have aided and abetted such violations. Finally, through their actions, SIB and SGC have violated Section 7(d) of the Investment Company Act of 1940 ("Investment Company Act") [15 U.S.C. § 80a-7(d)].

#### JURISDICTION AND VENUE

- 8. The investments offered and sold by the Defendants are "securities" under Section 2(1) of the Securities Act [15 U.S.C. § 77b], Section 3(a)(10) of the Exchange Act [15 U.S.C. § 78c], Section 2(36) of the Investment Company Act [15 U.S.C. § 80a-2(36)], and Section 202(18) of the Advisers Act [15 U.S.C. § 80b-2(18)].
- 9. Plaintiff Commission brings this action under the authority conferred upon it by Section 20(b) of the Securities Act [15 U.S.C. § 77t(b)], Section 21(d) of the Exchange Act [15 U.S.C. § 78u(d)], Section 41(d) of the Investment Company Act [15 U.S.C. § 80a-41(d)], and Section 209(d) of the Advisers Act [15 U.S.C. § 80b-9(d)] to temporarily, preliminarily, and permanently enjoin Defendants from future violations of the federal securities laws.

- 10. This Court has jurisdiction over this action, and venue is proper, under Section 22(a) of the Securities Act [15 U.S.C. § 77v(a)], Section 27 of the Exchange Act [15 U.S.C. § 78aa], Section 43 of the Investment Company Act [15 U.S.C. § 80a-43], and Section 214 of the Advisers Act [15 U.S.C. § 80b-14].
- 11. Defendants have, directly or indirectly, made use of the means or instruments of transportation and communication, and the means or instrumentalities of interstate commerce, or of the mails, in connection with the transactions, acts, practices, and courses of business alleged herein. Certain of the transactions, acts, practices, and courses of business occurred in the Northern District of Texas.

#### **DEFENDANTS**

- 12. Stanford International Bank, Ltd. purports to be a private international bank domiciled in St. John's, Antigua, West Indies. SIB claims to serve 50,000 clients in over 100 countries, with assets under management of approximately \$8 billion. Unlike a commercial bank, SIB claims that it does not loan money. SIB sells the CD to U.S. investors through SGC, its affiliated investment adviser.
- 13. Stanford Group Company, a Houston-based corporation, is registered with the Commission as a broker-dealer and investment adviser. It has 29 offices located throughout the United States. SGC's principal business consists of sales of SIB-issued securities, marketed as certificates of deposit. SGC is a wholly owned subsidiary of Stanford Group Holdings, Inc., which in turn is owned by R. Allen Stanford.
- 14. Stanford Capital Management, a registered investment adviser, took over the management of the SAS program (formerly Mutual Fund Partners) from SGC in early 2007. SCM markets the SAS program through SGC.

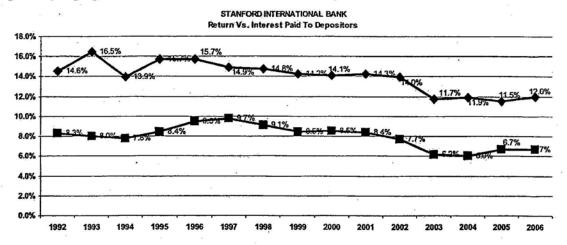
- 15. R. Allen Stanford, a citizen of the U.S. and Antigua, West Indies, is the chairman of the board and sole shareholder of SIB and the sole director of SGC's parent company. During the Commission's investigation, Stanford refused to produce documents and information accounting for the bank's multi-billion dollar investment portfolio.
- 16. James M. Davis, a U.S. citizen and resident of Baldwyn, Mississippi, is a director and chief financial officer of SFG and SIB. Davis maintains offices in Memphis, Tennessee, and Tupelo, Mississippi. During the Commission's investigation, Davis refused to provide documents and information accounting for the bank's multi-billion dollar investment portfolio.
- 17. Laura Pendergest-Holt, is the chief investment officer of SFG and a resident of Baldwyn, Mississippi. She was appointed to SIB's investment committee on December 7, 2005. She supervises a group of analysts who "monitor" the performance of a small portion of SIB's portfolio.

#### STATEMENT OF FACTS

#### Stanford International Bank

- 18. Stanford controls a web of private affiliated companies that operate under the name Stanford Financial Group. Stanford is the sole owner of SFG.
- 19. SIB, one of SFG's affiliates, is a private, offshore bank located in Antigua. SIB purports to have an independent board of directors, an investment committee, a chief investment officer and teams of global portfolio advisers and analysts.
- 20. The vast majority of the bank's assets are managed exclusively by Stanford and Davis. Stanford and Davis surrounded themselves with a close-knit circle of family, friends and confidents. Accordingly, SIB, and in turn Stanford and Davis, had no independent oversight over SIB's assets.

- 21. As of November 28, 2008, SIB reported approximately \$8 billion in total assets. SIB aggregated customer deposits, and then purportedly re-invested those funds in a "globally diversified portfolio" of assets.
- 22. SIB sold more than \$1 billion in CDs per year between 2005 and 2008, including sales to U.S. investors.
- 23. SIB marketed the CD 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 several Forms D with the Commission.
- 24. As indicated by the following chart from SIB's training materials, for almost fifteen years, SIB claimed that it has earned consistently high returns on its investment of deposits (ranging from 11.5% in 2005 to 16.5% in 1993):



- 25. SIB sold the CD using these purported returns on investment.
- 26. SIB's purportedly high returns on investment allegedly enabled the bank to pay significantly higher rates on the CD than those offered by U.S. banks. For example, SIB offered 7.45% as of June 1, 2005, and 7.878% as of March 20, 2006, for a fixed rate CD based on an

investment of \$100,000. On November 28, 2008, SIB quoted 5.375% on a 3-year flex CD, while comparable U.S. bank CDs paid under 3.2%.

- 27. SIB paid disproportionately large commissions to SGC for the sale of CDs. SGC received a 3% trailing fee from SIB on sales of CDs by SGC advisers. SGC advisers received a 1% commission upon the sale of the CDs, and were eligible to receive as much as a 1% trailing commission throughout the term of the CD.
- 28. SGC used this generous commission structure 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 investors.
- 29. In 2007, SIB paid SGC and its affiliates more than \$291 million in management fees and CD sales, up from \$211 million in 2006.
- 30. SIB segregated its investment portfolio into three tiers: (i) cash and cash equivalents ("Tier 1"); (ii) investments with "outside portfolio managers (25+)" that were monitored by the SFG analysts ("Tier 2"); and (iii) unknown assets managed by Stanford and Davis ("Tier 3"). As of December 2008, Tier 1 represented approximately 9% (\$800 million) of SIB's portfolio. Tier 2, prior to the bank's decision to liquidate \$250 million of investments in late 2008, represented approximately 10% of the portfolio. And Tier 3 represented approximately 80% of SIB's investment portfolio.

#### SIB's Fraudulent Sale of CDs

Stanford and Davis Misappropriated Investor Funds and Fabricated SIB's Financial Statements

31. In selling the CD to investors, SIB touted, among other things, the CD's safety and SIB's consistent, double-digit returns on its investment portfolio.

- 32. In its brochure, SIB told investors, under the heading "Depositor Security," that its investment philosophy is "anchored in time-proven conservative criteria, promoting stability in [the bank's] certificate of deposit." SIB also emphasized that its "prudent approach and methodology translate into deposit security for our customers."
  - 33. Stanford, Davis and Pendergest-Holt approved the use of the brochure.
- 34. Contrary to SIB's representations in the brochure about depositor security, SIB made, with Davis's knowledge, at least \$1.6 billion in undocumented "loans" to Stanford. These undocumented loans were never disclosed in SIB's financial statements or other communications with investors.
- 35. In an effort to conceal their fraud and ensure that investors continued to purchase the CD, Stanford and Davis fabricated the performance of SIB's investment portfolio.
- 36. In SIB's Annual Reports, SIB told investors that the bank earned from its "diversified" investments approximately \$642 million in 2007, and \$479 million in 2006.
- 37. SIB's financial statements, including its investment income, are fictional. In calculating SIB's investment income, Stanford and Davis provided to SIB's internal accountants a pre-determined return on investment for the bank's portfolio. Using this pre-determined number, SIB's accountants reverse-engineered the bank's financial statements to reflect investment income that SIB did not actually earn.
- 38. Between February 2 and February 6, 2009, Stanford and Davis admitted, during a meeting with a core group of senior employees (including Pendergest-Holt) in Miami, Florida, that they had misappropriated investor funds and falsified SIB's financial statements.
- 39. Incredibly, four days after the Miami meetings, Pendergest-Holt made a two-hour presentation to the Commission's staff and subsequently testified under oath regarding the

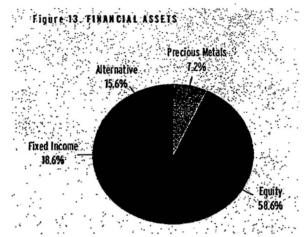
whereabouts of SIB's multi-billion dollar investment portfolio. During her presentation and testimony, Pendergest-Holt denied any knowledge concerning the status of the vast majority of the bank's assets and failed to disclose that Stanford and Davis had misappropriated investor funds.

#### SIB Misrepresented That It Received a Capital Infusion

- 40. In its December 2008 Monthly Report, SIB told investors that the bank had received a capital infusion of \$541 million on November 28, 2008.
- 41. This representation was false. SIB did not receive a capital infusion of \$541 million. Instead, Stanford contributed to SIB equity interests in two pieces of real estate that the bank already owned. The real estate was valued at approximately \$88.5 million when acquired.
- 42. By virtue of their positions on SIB's board of directors and investment committee, Stanford and Davis knew that: (i) Stanford did not make a \$541 million capital infusion into SIB; (ii) SIB, not Stanford, owned the real estate; and (iii) the real estates value was approximately \$88.5 million, not \$541 million.
- 43. Stanford, Davis and Pendergest-Holt approved the December 2008 Monthly Report.

#### Stanford and Davis Misrepresented the Liquidity of SIB's Investments

44. In its 2006 and 2007 Annual Reports, SIB told investors that the bank's assets were invested in a "well-balanced global portfolio of marketable financial instruments, namely U.S. and international securities and fiduciary placements." More specifically, as shown below, SIB represented that its 2007 portfolio allocation was 58.6% equity, 18.6% fixed income, 7.2% precious metals and 15.6% alternative investments:



- 45. In its CD brochures, SIB emphasized the importance of investing in "marketable" securities, saying that "maintaining the highest degree of liquidity" was a "protective factor for our depositors."
- 46. Consistent with its Annual Reports and brochures, SIB trained SGC financial advisers, in February 2008, that "liquidity/marketability of SIB's invested assets" was the "most important factor to provide security to SIB clients."
- 47. Stanford and Davis approved and/or signed the Annual Reports, brochure and training materials.
- 48. Contrary to SIB's representations regarding the liquidity of its portfolio, SIB did not invest in a "well-diversified portfolio of highly marketable securities." Instead, significant portions of the bank's portfolio were misappropriated by Stanford used by him to acquire private equity and real estate. In fact, at year-end 2008, the largest segments of the bank's portfolio were: (i) undocumented "loans" to Stanford; (ii) private equity; and (iii) over-valued real estate.

SIB Trained Financial Advisers to Misrepresent that Its Multi-Billion Dollar Investment Portfolio was Managed by a Global Network of Portfolio Advisers, Monitored By a Team of Analysts and Audited by Regulators

- 49. Prior to making investment decisions, prospective investors routinely asked how SIB safeguarded and monitored its assets. Investors frequently inquired whether Stanford could "run off with the money."
- 50. In response to this question, at least during 2006 and much of 2007, Pendergest-Holt trained SIB's senior investment officer ("SIO") to tell investors that the bank's multi-billion dollar portfolio was managed by a "global network of portfolio managers" and "monitored" by a team of SFG analysts in Memphis, Tennessee. In communicating with investors, the SIO followed Pendergest-Holt's instructions, telling investors that SIB's investment portfolio was managed by a global network of money managers and monitored by a team of 20-plus analysts.
- 51. Neither Pendergest-Holt nor the SIO disclosed to investors that the "global network" of money managers and the team of analysts did not manage any of SIB's investments and only monitored approximately 10% of SIB's portfolio. In fact, Pendergest-Holt trained the SIO "not to divulge too much" about the oversight of SIB's portfolio because that information "wouldn't leave an investor with a lot of confidence." Likewise, Davis instructed the SIO to "steer" potential CD investors away from information about SIB's portfolio.
- 52. In addition, the SIO, at Pendergest-Holt's direction, told investors that their deposits were safe because the Antiguan regulator responsible for oversight of the bank's investment portfolio, the Financial Services Regulatory Commission (the "FSRC"), audited its financial statements.
- 53. Contrary to SIB's representations to investors, the FSRC did not audit or verify the assets SIB claimed in its financial statements. Instead, SIB's accountant, C.A.S. Hewlett &

Co., a small local accounting firm in Antigua was responsible for auditing SIB's multi-billion dollar investment portfolio.

#### Stanford, Davis and Pendergest-Holt Lied to Financial Advisers

- 54. On January 10, 2009, Stanford, Davis and Pendergest-Holt spoke to SIB's Top Performer's Club in Miami, Florida.
- 55. During the meeting, Davis stated that SIB was "stronger" than at any time in history. Stanford, Davis and Pendergest-Holt represented that SIB was secure and built on a strong foundation, and that its financial condition was shored up by capital infusions.
- 56. But Davis failed to disclose that he had been informed only days earlier by the head of SIB's treasury that, despite their best efforts to liquidate tier two assets, SIB's cash position had fallen from the June 30, 2008 reported balance of \$779 million to less than \$28 million.
- 57. Stanford and Davis failed to disclose to the attendees that: (i) they had invested SIB funds in a manner inconsistent with offering documents and its own financial statements and (ii) the November 28, 2008 capital infusion was a fiction.
- 58. During her speech, Pendergest-Holt, after being introduced as SFG's chief investment officer and a "member of the investment committee of the bank," answered questions about SIB's investment portfolio. In so doing, she failed to disclose to attendees that she and her team of analysts did not manage SIB's investment portfolio and only monitored approximately 10% of the bank's investments.
- 59. Significantly, Stanford, Davis and Pendergest-Holt also failed to disclose that on or about December 12, 2008, Pershing, citing suspicions about SIB's investment returns and its inability to get from the bank "a reasonable level of transparency" into its investment portfolio.

informed SGC that it would no longer process wire transfers from SGC to SIB for the purchase of the CD.

60. Stanford, Davis and Pendergest knew that SGC advisers would use the information provided to them during the Top Performer's Club meeting to sell the CD.

### SIB Misrepresented That It Had No Exposure to Losses From Madoff-related Investments

- 61. In the December 2008 Monthly Report, SIB told CD investors that the bank "had no direct or indirect exposure to any of [Bernard] Madoff's investments."
- 62. Contrary to this statement, Stanford, Davis and Pendergest-Holt knew, prior to the release of the Monthly Report, that SIB had exposure to losses from investments with Madoff.
- 63. On December 12, 2008 and again on December 18, 2008, Pendergest received emails from Meridian Capital Partners, a hedge fund with which SIB had invested, detailing SIB's exposure to Madoff-related losses.
- 64. On December 15, 2008, an SFG-affiliated employee notified Pendergest-Holt and Davis that SIB had exposure to Madoff-related losses in two additional funds through which SIB had invested. That same day, Davis, Pendergest-Holt and others consulted with Stanford regarding the bank's exposure to Madoff-related losses.
  - 65. Stanford, Davis and Pendergest-Holt never corrected this misrepresentation.

#### SGC and SCM's Fraudulent Mutual Fund Sales

- 66. From 2004 through 2009, SGC and SCM induced clients, including non-accredited, retail investors, to invest in SAS, a proprietary mutual fund wrap program, by touting a fraudulent track record of "historical performance."
- 67. SGC/SCM highlighted the purported SAS track record in thousands of client presentation books ("pitch books"). For example, the following chart from a 2006 pitch book

presented clients with the false impression that SAS accounts, from 2000 through 2005, outperformed the S&P 500 by an average of approximately 13 percentage points:

		(Calendar)	ear Reium www		The Russian	
	2005	2004	2003	2002	2001	2000
SAS Growth	12.09%	16.15%	32.84%	-3.33%	4.32%	18.04%
S&P 500	4.91%	10.88%	28.68%	-22.10%	-11.88%	-9.11%

- 68. SGC/SCM used these performance results to grow the SAS program to over \$1 billion in 2008.
- 69. SGC/SCM also used the SAS track record to recruit financial advisers with significant books of business away from competitors. After arriving at Stanford, the newly-hired financial advisers were incentivized to put their clients' assets in the CD.
- 70. Other than the fees paid by SIB to SGC/SCM for CD sales, SAS was the most significant source of revenue for SGC/SCM. In 2007 and 2008, SGC/SCM received approximately \$25 million in fees from the marketing of SAS.
- 71. The SAS performance results used in the 2005 through 2009 pitch books were fictional and/or inflated. SGC/SCM misrepresented that SAS performance results, for 1999 through 2004, reflected "historical performance" when, in fact, those results were fictional, or "back-tested," numbers that did not reflect the results of actual trading.
- 72. SGC/SCM, with the benefit of hindsight, picked mutual funds that performed extremely well from 1999 through 2004, and presented the performance of those top-performing funds to potential clients as if they were actual returns earned by the SAS program.

- 73. SGC/SCM also used "actual" model SAS performance results for 2005 and 2006 that were inflated by as much as 4 percentage points.
- 74. SGC/SCM told investors that SAS had positive returns for periods in which actual SAS clients lost substantial amounts. In 2000, actual SAS client returns ranged from negative 7.5% to positive 1.1%. In 2001, actual SAS client returns ranged from negative 10.7% to negative 2.1%. And, in 2002, actual SAS client returns ranged from negative 26.6% to negative 8.7%.
- 75. SGC/SCM's management knew that the advertised SAS performance results were misleading and inflated. And they also knew that the pre-2005 track record was purely hypothetical.
- 76. As early as November 2006, SGC/SCM investment advisers began to question why their clients were not receiving the returns advertised in the pitch books. In response to these questions, SGC/SCM hired an outside performance reporting expert to review the SAS performance results.
- 77. In late 2006 and early 2007, the expert informed SGC/SCM that its performance results for the twelve months ended September 30, 2006 were inflated by as much as 3.4 percentage points. Moreover, the expert informed SGC/SCM managers that the inflated performance results included unexplained "bad math" that consistently inflated the purported SAS performance results over actual client performance. Finally, in March 2008, the expert informed SGC/SCM managers that the SAS performance results for 2005 were also inflated by as much as 3.25 percentage points.
- 78. Despite its knowledge of the inflated SAS returns, SGC/SCM management continued using the pre-2005 track record and never asked the performance expert to audit the

pre-2005 performance. In fact, in 2008 pitch books, SGC/SCM presented the back-tested pre-2005 performance data under the heading "Historical Performance" and "Manager Performance" alongside the audited 2005 through 2008 figures. SGC/SCM's outside consultant testified that it was "misleading" to present audited performance figures alongside back-tested figures.

79. Finally, as indicated the chart below, SGC/SCM blended the back-tested performance with audited composite performance to create annualized 5 and 7 year performance figures that bore no relation to actual SAS client performance:

•			As of	March 2						-
	YTD.	2007	2006	2005	2004	2003	2002	2001	2000	1999
SAS Growth	-7 <i>A4%</i>	1240%	84.66%	8.82%	16.15%	32.84%	-3.33%	432%	18.04%	22.59%
S&P 500	-9.44%	5.49%	15.79%	491%	10.68%	29.63%	-22.10%	-11.88%	-9.11%	21.049
		(not an	Annual nualzed	zed Re if less	turns than 1	vear)		_		
	YTT		1 year	3	years	5 yea	rs	7 years		eption Since

	YTD	1yaar	3 years	5 years	7 years	Inception
SAS Growth	-7.44%	0.80%	9.38%	15.31%	11.03%	12.30%
S&P 500	-9.44%	-5.08%	5.85%	11.32%	3.70%	2.45%

80. As evidence by its use of fictional and/or inflated performance results in the pitch books, SGC/SCM knowingly misled investors in connection with the sale of SAS.

#### **CAUSES OF ACTION**

### FIRST CLAIM AS TO ALL DEFENDANTS Violations of Section 10(b) of the Exchange Act and Rule 10b-5

81. Plaintiff Commission repeats and realleges paragraphs 1 through 80 above.

- 82. Defendants, directly or indirectly, singly or in concert with others, in connection with the purchase and sale of securities, by use of the means and instrumentalities of interstate commerce and by use of the mails have: (i) employed devices, schemes and artifices to defraud; (ii) made untrue statements of material facts and omitted to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; and (iii) engaged in acts, practices and courses of business which operate as a fraud and deceit upon purchasers, prospective purchasers and other persons.
- 83. As a part of and in furtherance of their scheme, Defendants, directly and indirectly, prepared, disseminated or used contracts, written offering documents, financial statements, promotional materials, investor and other correspondence, and oral presentations, which contained untrue statements of material facts and misrepresentations of material facts, and which omitted to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.
- 84. Defendants made the referenced misrepresentations and omissions knowingly or grossly recklessly disregarding the truth.
- 85. For these reasons, Defendants have violated and, unless enjoined, will continue to violate Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and Exchange Act Rule 10b-5 [17 C.F.R. § 240.10b-5].

### SECOND CLAIM AS TO STANFORD, DAVIS, AND PENDERGEST-HOLT Aiding and Abetting Violations of Exchange Act Section 10(b) and Rule 10b-5

- 86. Plaintiff Commission repeats and realleges paragraphs 1 through 80 above.
- 87. If Stanford, Davis, and Pendergest-Holt did not violate Exchange Act Section 10(b) and Rule 10b-5, in the alternative, Stanford, Davis, and Pendergest-Holt, in the manner set

forth above, knowingly or with severe recklessness provided substantial assistance in connection with the violations of Exchange Act Section 10(b) [15 U.S.C. § 78j(b)] and Rule 10b-5 [17 C.F.R. § 240.10b-5] alleged herein.

88. For these reasons, Stanford, Davis, and Pendergest-Holt aided and abetted and, unless enjoined, will continue to aid and abet violations of Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and Rule 10b-5 [17 C.F.R. § 240.10b-5].

### THIRD CLAIM AS TO ALL DEFENDANTS Violations of Section 17(a) of the Securities Act

- 89. Plaintiff Commission repeats and realleges paragraphs 1 through 80 above.
- 90. Defendants, directly or indirectly, singly or in concert with others, in the offer and sale of securities, by use of the means and instruments of transportation and communication in interstate commerce and by use of the mails, have: (i) employed devices, schemes or artifices to defraud; (ii) obtained money or property by means of untrue statements of material fact or omissions to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; and (iii) engaged in transactions, practices or courses of business which operate or would operate as a fraud or deceit.
- 91. As part of and in furtherance of this scheme, Defendants, directly and indirectly, prepared, disseminated or used contracts, written offering documents, promotional materials, investor and other correspondence, and oral presentations, which contained untrue statements of material fact and which omitted to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.
- 92. Defendants made the referenced misrepresentations and omissions knowingly or grossly recklessly disregarding the truth.

93. For these reasons, Defendants have violated, and unless enjoined, will continue to violate Section 17(a) of the Securities Act [15 U.S.C. § 77q(a)].

### FOURTH CLAIM AS TO STANFORD, SGC, AND STANFORD CAPITAL Violations of Sections 206(1) and 206(2) of the Advisers Act

- 94. Plaintiff Commission repeats and realleges paragraphs 1 through 80 above.
- 95. Stanford, SGC and SCM, directly or indirectly, singly or in concert with others, knowingly or recklessly, through the use of the mails or any means or instrumentality of interstate commerce, while acting as investment advisers within the meaning of Section 202(11) of the Advisers Act [15 U.S.C. § 80b-2(11)]: (i) have employed, are employing, or are about to employ devices, schemes, and artifices to defraud any client or prospective client; or (ii) have engaged, are engaging, or are about to engage in acts, practices, or courses of business which operates as a fraud or deceit upon any client or prospective client.
- 96. For these reasons, Stanford, SGC and SCM have violated, and unless enjoined, will continue to violate Sections 206(1) and 206(2) of the Advisers Act [15 U.S.C. §§ 80b-6(1) and 80b-6(2)].

### FIFTH CLAIM AS TO STANFORD, DAVIS, AND PENDERGEST-HOLT Aiding and Abetting Violations of Sections 206(1) and 206(2) of the Advisers Act

- 97. Plaintiff Commission repeats and realleges paragraphs 1 through 80 above.
- 98. Based on the conduct alleged herein, Stanford, Davis, and Pendergest-Holt, in the manner set forth above, knowingly or with severe recklessness provided substantial assistance in connection with the violations of Advisers Act Sections 206(1) and 206(2) [15 U.S.C. §§ 80b-6(1) and 80b-6(2)] alleged herein.

99. For these reasons, Stanford, Davis, and Pendergest-Holt aided and abetted and, unless enjoined, will continue to aid and abet violations of Sections 206(1) and 206(2) of the Advisers Act [15 U.S.C. §§ 80b-6(1) and 80b-6(2)].

### SIXTH CLAIM AS TO SIB AND SGC Violations of Section 7(d) of the Investment Company Act

- 100. Plaintiff Commission repeats and realleges paragraphs 1 through 80 above.
- 101. SIB, an investment company not organized or otherwise created under the laws of the United States or of a State, directly or indirectly, singly or in concert with others, made use of the mails or any means or instrumentality of interstate commerce, directly or indirectly, to offer for sale, sell, or deliver after sale, in connection with a public offering, securities of which SIB was the issuer, without obtaining an order from the Commission permitting it to register as an investment company organized or otherwise created under the laws of a foreign country and to make a public offering of its securities by use of the mails and means or instrumentalities of interstate commerce.
- 102. SGC, directly or indirectly, singly or in concert with others, acted as an underwriter for SIB, an investment company not organized or otherwise created under the laws of the United States or of a State that made use of the mails or any means or instrumentality of interstate commerce, directly or indirectly, to offer for sale, sell, or deliver after sale, in connection with a public offering, securities of which SIB was the issuer, without obtaining an order from the Commission permitting it to register as an investment company organized or otherwise created under the laws of a foreign country and to make a public offering of its securities by use of the mails and means or instrumentalities of interstate commerce.

103. For these reasons, SIB and SGC have violated, and unless enjoined, will continue to violate Section 7(d) of the Investment Company Act [15 U.S.C. § 80a-7(d)].

#### RELIEF REQUESTED

Plaintiff Commission respectfully requests that the Court:

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Temporarily, preliminarily and permanently enjoin: (i) Defendants from violating, or aiding and abetting violations of, Section 10(b) and Rule 10b-5 of the Exchange Act; (ii) Defendants from violating Section 17(a) of the Securities Act; (iii) Stanford, Davis, Pendergest-Holt, SGC, and SCM from violating, or aiding and abetting violations of, Sections 206(1) and 206(2) of the Advisers Act; and (iv) SIB and SCG from violating Section 7(d) of the Investment Company Act.

II.

Enter an Order immediately freezing the assets of Defendants and directing that all financial or depository institutions comply with the Court's Order. Furthermore, order that Defendants immediately repatriate any funds held at any bank or other financial institution not subject to the jurisdiction of the Court, and that they direct the deposit of such funds in identified accounts in the United States, pending conclusion of this matter.

Ш.

Order that Defendants shall file with the Court, and serve upon Plaintiff Commission and the Court, within 10 days of the issuance of this Order or three days prior to a hearing on the Commission's motion for a preliminary injunction, whichever comes first, an accounting, under oath, detailing all of their assets and all funds or other assets received from investors and from one another.

### IV.

Order that Defendants be restrained and enjoined from destroying, removing, mutilating, altering, concealing, or disposing of, in any manner, any of their books and records or documents relating to the matters set forth in the Complaint, or the books and records and such documents of any entities under their control, until further order of the Court.

#### V.

Order the appointment of a temporary receiver for Defendants, for the benefit of investors, to marshal, conserve, protect, and hold funds and assets obtained by the Defendants and their agents, co-conspirators, and others involved in this scheme, wherever such assets may be found, or, with the approval of the Court, dispose of any wasting asset in accordance with the application and proposed Order provided herewith.

### VI.

Order that the parties may commence discovery immediately, and that notice periods be shortened to permit the parties to require production of documents, and the taking of depositions on 72 hours' notice.

### VII.

Order Defendants to disgorge an amount equal to the funds and benefits they obtained illegally as a result of the violations alleged herein, plus prejudgment interest on that amount.

## VIII.

Order civil penalties against Defendants pursuant to Section 20(d) of the Securities Act [15 U.S.C. § 77t(d)], Section 21(d) of the Exchange Act [15 U.S.C. § 78u(d)], Section 41(e) of the Investment Company Act [15 U.S.C. § 80a-41(e)], and Section 209(e) of the Advisers Act [15 U.S.C. § 80b-9(e)] for their securities law violations.

IX.

Order that Stanford, Davis, and Pendergest-Holt immediately surrender their passports to the Clerk of this Court, to hold until further order of this Court.

X.

Order such further relief as this Court may deem just and proper.

Respectfully submitted,

S/David B. Reece
STEPHEN J. KOROTASH
Oklahoma Bar No. 5102
J. KEVIN EDMUNDSON
Texas Bar No. 24044020
DAVID B. REECE
Texas Bar No. 24002810
MICHAEL D. KING
Texas Bar No. 24032634
D. THOMAS KELTNER
Texas Bar No. 24007474
JASON ROSE
Texas Bar No. 24007946

U.S. Securities and Exchange Commission Burnett Plaza, Suite 1900 801 Cherry Street, Unit #18 Fort Worth, TX 76102-6882 (817) 978-6476 (dbr) (817) 978-4927 (fax)

# EXHIBIT 5

THE UNITED STATES SECURITIES AND EXCHANGE COMMISSION

In the Matter of: )

) File No. OIG-526

OIG-526

WITNESS: Witness No. 1

COPY

PAGES:

1 through 95

PLACE:

Securities & Exchange Commission

801 Cherry Street

Burnett Plaza, Suite 1900

Fort Worth, Texas 76102

DATE:

Monday, December 14, 2009

The above-entitled matter came on for hearing, pursuant to notice, at 10:50 a.m.

Diversified Reporting Services, Inc. (202) 467-9200

- 1 Q Okay. And do you remember how you first heard
- 2 about that in August of '97?
- 3 A Yes. I had taken it upon myself, and I became the
- 4 branch chief to become familiar with all of the registrants
- 5 in the area. And so this was going to be really a two-fold
- 6 process that was -- I thought was going to be very helpful
- 7 for selecting examinations and becoming familiar.
- 8 And one of those is -- and policy to review all of
- 9 the annual audits as they came in. One, you got to know what
- 10 the firm was like; and, two, you identified problems that --
- in their annual audits, a wealth of information that would
- 12 target -- would make them a good target for examinations.
- So Stanford -- I think their fiscal year-end is in
- 14 June, or at least it used to be. Anyway, it came in -- I was
- 15 reviewing the audit and became very concerned in terms it had
- 16 only been open for two years; and the firm had gone from very
- 17 little revenue to an incredible amount of revenue in a very
- 18 short time period, which is very unusual.
- 19 MR. (b)(6), (b)(7)c : I'm sorry, which audit were you
- 20 reviewing?
- 21 THE WITNESS: This is -- there is an annual audit
- 22 that's reviewed to be filed, and I can't remember the form
- 23 name.
- 24 MR. Okay.
- 25 THE WITNESS: X5A. I don't know.

- But all broker-dealers have to file an annual
- 2 audit, and we get a copy of every one of these in the office.
- 3 So in reviewing that, I noticed that it was very odd to have
- 4 the revenues go like that.
- 5 Secondly, in CD's -- I mean, CD's typically --
- 6 people get \$10 for selling a CD. I had seen a few jumbo CD's
- 7 where people had gotten \$50. But usually when a
- 8 broker-dealer sells a CD, it's a come-on to get people in the
- 9 door. And they try to then steer them to some other product
- 10 either in addition to or instead of the CD. So all of those
- 11 revenues from CD's was extraordinary, so I scheduled an exam.
- 12 BY MR. KOTZ:
- 13 Q Uh-huh. So did you suspect that these matters that
- 14 you found which were unusual or extraordinary could be
- 15 related to fraud?
- 16 A Yes.
- 17 Q Okay. So was this a cause examination?
- 18 A I'm not sure that we -- I mean, I have to look at
- 19 it. I'm not sure if it was cause because usually if I found
- 20 a reason to do an exam, I would also then look to see if
- 21 there was a potential oversight of FINRA or NASD at the time
- 22 because you would need to do so many of those. So you would
- 23 try to -- even if I had a cause reason, try to also do an
- 24 oversight of FINRA'S activities.
- THE WITNESS: You're looking like there's something

- 1 nonsensical about my answer.
- 2 MR. Oh, me? Oh, I wouldn't take my
- 3 expression to mean anything. No, no, I'm just thinking in
- 4 general.
- 5 THE WITNESS: Well, I may not be explaining enough
- 6 about the background. That's why I wanted to make sure of
- 7 it.
- 8 MR. Yeah, not at all. Not at all.
- 9 THE WITNESS: Yeah.
- 10 BY MR. KOTZ:
- 11 Q They call it a surveillance exam.
- 12 A Oh.
- 13 Q Is that --
- 14 A Well, then surveillance -- when I did a
- 15 surveillance, that means that there was no oversight. I
- 16 didn't know if it was fraud or not. Usually at that time, if
- 17 it were fraud -- if we called it cause, I'd have a specific
- 18 complaint.
- 19 Q Uh-huh.
- 20 A This, I didn't have a complaint. I didn't have any
- 21 information like that. It just looked, for lack of a better
- 22 word, "hinky." It looked like that there was a problem, so I
- 23 called it a surveillance.
- Q Okay. But, I mean, it was clear it was not kind of
- 25 a routine exam. It was an exam that you initiated because

- 1 you were concerned about possible fraud?
- 2 A Yes.
- 3 Q Okay. Okay.
- A Very undefined and indistinct, but there was
- 5 something unusual here that we needed to look at.
- 6 Q Okay. Now, were you aware at the time that there
- 7 had been a Texas State Securities Board examination --
- 8 A No.
- 9 Q -- as well? Okay. Did you learn that later?
- 10 A Actually, I learned that last week.
- 11 Q Okay. And so in the end, it was your decision to
- 12 initiate this examination?
- 13 A Yes.
- Q Okay. And did you have to run that by anybody?
- 15 A No.
- 16 Q Okay. And how did you decide -- or did you decide
- 17 who would be conducting the examination?
- 18 A I am the one that decided who was going to go, and
- 19 this is where it becomes uncomfortable; but I had the most
- 20 \* confidence in for the examiners. He probably was
- 21 also available, and that helped; but he was a very good
- 22 examiner.
- Q Okay. And was it based on his experience that you
- 24 had the most confidence in him or his general work?
- 25 A Well, experience is helpful. But many people have

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a lot of experience, but they don't necessarily have very
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- 2 good judgment. And had excellent judgment.
- 3 Q Okay. Great.
- 4 MR. So why did that make you
- 5 uncomfortable? I guess, it seems --
- 6 THE WITNESS: Because I don't want to be impugning
- 7 the other examiners. That's not something I'm anxious to
- 8 see.
- 9 MR. KOTZ: Okay. Well, let's focus just on the
- 10 fact that you wanted Okay. We're going to show you
- 11 a copy of the exam report and then ask you some questions
- 12 about it.
- 13 I'll mark this as Exhibit 2. This is -- it says on
- 14 the top, "Stanford Group Company, 5056 Westheimer, Suite
- 15 605." And it's a four page document, marked as Exhibit 2.
- 16 (Exhibit Number 2 was marked
- for identification.)
- 18 BY MR. KOTZ:
- 19 Q Do you recognize this document?
- 20 A Yes, I do.
- 21 Q Okay. And is it the exam report for the exam we
- 22 were just discussing?
- 23 A Yes, it is.
- Q Okay. Who drafted this report?
- 25 A (b)(6), (b)(7)c

- Q Okay. Did you review it?
- 2 A Yes.
- 3 Q Okay. You signed off on it?
- 4 A Yes.
- 5 Q And what about Mary Lou Felsman? Did she look at
- 6 it at all? Did she play a role?
- 7 A She would also look at the examinations. I would
- 8 review it and sign off on it and give it to Mary Lou. And
- 9 sometimes she had comments, and sometimes not.
- 10 Q Okay. You don't remember what happened in this
- 11 case?
- 12 A No, I don't.
- Q Okay. Do you remember if you and had any
- 14 differences of opinion or substantial comments or --
- 15 A No. His judgment was wonderful. I remember
- 16 looking at the documents because this was very serious, and I
- 17 wanted to feel very comfortable with what -- what we were
- 18 alleging in here. So we did definitely spend time reviewing
- 19 the documents that he used to come to these conclusions so
- 20 that we could prepare to discuss it with Mary Lou.
- Q Okay. And did anybody in the SEC Washington's
- 22 office, would they get a copy or look at this report?
- 23 A They would when it was completed. We would send
- 24 them a copy.
- Q Okay. Do you know who in Washington might have

- sales practices," what exactly does that mean?
- 2 A Well, that can be very broad. It can be really
- 3 anything besides looking at the financials, essentially.
- 4 Much of that would involve looking at the activity and
- 5 customer accounts, the supervision of the activity in those
- 6 accounts, the type of products that were being sold, the
- 7 appropriateness of those products.
- 8 Q Okay. Was the Stanford Group Company cooperative
- 9 in connection with his examination?
- 10 A I don't specifically recall except for from reading
- 11 the report. You know, we didn't feel like we could get any
- 12 information regarding the actual bank.
- 13 Q And how come you felt that way?
- 14 A The specifics as to why I felt that way, I --
- 15 Q Okay.
- 16 A -- I don't recall. I remember feeling that way,
- 17 but I don't remember why.
- 18 Q Okay. Were there any specific documents or
- 19 information that you were trying to get in the examination
- 20 that they were unable to get or that was refused?
- 21 A Is that mentioned in the report? I don't
- 22 specifically recall that.
- 23 **Q Okay.**
- A Oh, well, we did want more information, I believe,
- 25 regarding the -- the money, the addition to capital. And I'm

- 1 sure you'll have discussion with , and he could
- 2 probably -- he was down there talking with them. So he
- 3 reme- -- may remember the specifics, but we were really
- 4 concerned about this. And we didn't feel like we could get
- 5 the information regarding the origins of those funds.
- 6 Q Okay. And why were you unable to get that
- 7 information? The company wouldn't give it to you?
- 8 A I don't recall the specifics. I assume that's why
- 9 but --
- 10 Q Okay. Let me ask you some questions about the
- 11 specifics of this report --
- 12 A Okay.
- 13 Q -- Exhibit 2. So under "Findings, Possible
- 14 Misrepresentations, Rule 10b-5," it talks about the fact that
- 15 SIB pays a recurring annual 3.75 percent referral fee to
- 16 Stanford Group. And then there is a footnote that says
- 17 "During 1996, the referral fee was 5 percent."
- And then the last line of Page 2 of Exhibit 2, it
- 19 says "SIB pays out in interest and referral fees between 11
- 20 percent and 13.5 percent annually."
- 21 Do you know for how long a period that this was
- 22 going on where they were paying out on these CD's between 11
- 23 percent and 13.75 percent annually?
- 24 A I don't recall. I do know the firm started a
- 25 business in 1995, so I assumed it was related from 1995 on

- 1 because --
- 2 Q Okay.
- 3 A -- that was my focus.
- Q Okay. And it says in this report, again, on Page 2
- of Exhibit 2, "SIB promotes its products as being safe and
- 6 secure." And then it references the brochure which talks
- 7 about investment-grade bonds, ensure safety of assets,
- 8 traditional safeguards, a conservative approach.
- 9 And then it says here, "Based on the amount of
- 10 interest rate and referral fees paid, SIB's statements
- 11 indicating these products to be safe appear to be
- 12 misrepresentations."
- 13 So was the conclusion of this examination that SIB
- 14 could not be paying out fees between 11 percent and 13.75
- 15 percent annually using such safe and secure investments?
- 16 A That's correct.
- 2 And so did you or contemplate the
- 18 responsibility that SIB was not actually investing these
- 19 monies in these CD's but perhaps was engaged in some sort of
- 20 Ponzi scheme or other fraud?
- 21 A That's correct.
- 22 Q Okay. I mean, we -- do you have a sense at the
- 23 time of how unusual it was to have a CD with 11 percent to
- 24 13.75 percent of returns?
- 25 A I don't recall what returns were at 1997, but I do

- 1 recall thinking this was absolutely ludicrous.
- Q Okay. And why -- why do you say it was ludicrous?
- 3 A Because legitimate CD's do not pay that much over
- 4 market.
- 5 Q Okay.
- A And the legitimate CD's do not also pay continuing
- 7 ongoing referral fees and certainly not ones of this size and
- 8 volume. It was, in my mind, impossible that this was a CD.
- 9 Q Okay.
- 10 MR. Do you know what the market return
- 11 rate was at the point of comparison around that time?
- 12 THE WITNESS: No.
- 13 BY MR. KOTZ:
- 14 Q But you understood that these CD's that were paying
- 15 out between 11 percent and 13.75 percent was significantly
- 16 above market at that time?
- 17 A Yes. Well, this is interest and referral fees
- 18 together --
- 19 Q Right.
- 20 A -- meaning it would have to pay 11. Yes, I -- I
- 21 understood that to be, as I said, ludicrous, fantastical,
- 22 impossible.
- Q Right. And isn't it the case that if they were
- 24 paying the customers between 11 percent and 13.75 percent,
- 25 they must have been generating more than that for them to

- 1 make money, right, so in fact that returns were at least a
- 2 few percent above 11 and 7 -- 13.75?
- 3 A Well, the interest rate -- again, when we use the
- 4 11 to 13.75, that's the interest rate plus referral fee to
- 5 the broker, correct. And then the bank itself would have to
- 6 make even more. You know, what are they -- I don't know what
- 7 a spread is for a bank; but if it was just even one percent,
- 8 now you're looking nearly 15 percent annually on a
- 9 conservative investment, which is -- I can't think of enough
- 10 words to describe how --
- 11 Q It's -- would you say it's impossible?
- 12 A Yeah.
- 13 Q And then there's another item if you look on Page 3
- 14 of Exhibit 2, it says "Item of interest, Addition to Capital.
- 15 During 1996, Stanford made a cash contribution of \$19 million
- 16 to Stanford Group. We are concerned that the cash
- 17 contribution may have came from funds invested by customers
- 18 at SIB."
- 19 This fact that there was this very large cash
- 20 contribution and that the cash contribution may have come
- 21 from funds invested by customers, was that a red flag, as
- 22 well?
- 23 A Yes. I assumed he was possibly stealing from
- 24 investors.
- Q Okay. And that -- would that be a -- an attribute

- 1 of Enforcement to investigate this company for possible fraud
- 2 based on what you found in the examination?
- 3 A That's correct.
- 4 Q And that fraud would potentially include a Ponzi
- 5 scheme, but it wouldn't necessarily be limited to a Ponzi
- 6 scheme?
- 7 A That's correct.
- Q Okay. Let me show you another document.
- 9 MR. KOTZ: I'm going to mark it as Exhibit 3.
- 10 (Exhibit Number 3 was marked
- 11 for identification.)
- 12 BY MR. KOTZ:
- 13 Q This is an Office of Compliance Inspection and
- 14 Examinations Super Tracking and Reporting Systems, STARS.
- 15 And it's a five page document. Do you recognize this
- 16 document, Exhibit 3?
- 17 A I have seen a document like this before.
- 18 Q Okay. Do you know what it is? It looks like some
- 19 kind of printout.
- 20 A Yes, just a printout giving some basic information
- 21 regarding particulars on the examination.
- Q Okay. So what is the STARS system?
- 23 A It's just a system where we keep track of exams
- 24 that we started, when they were closed, a disposition, you
- 25 know, various different statistics that would want to keep

- 1 regarding each examination.
- Q Okay. It looks like there's a -- just a mistake
- 3 there on the front page where it says "Afghanistan"?
- A Yeah, there were -- there was a while where there
- 5 was a -- some kind of glitch in it. And if you -- and it
- 6 would just stick in Afghanistan. We had a number at the time
- 7 that did that. It was --
- 8 Q But it was --
- 9 A -- fantastical. We didn't -- we live in Texas. We
- 10 had no idea that we had be seated to Afghanistan.
- 11 Q Okay. So that was just a mistake; is that right?
- 12 A Yes.
- Q Okay. All right. If you look at the last page,
- 14 Page 5 of this document, the STARS printout, Exhibit 3, it
- 15 says "Violations Description, possible misrepresentation,
- 16 possible Ponzi scheme." Do you see that?
- 17 A Yeah.
- 18 Q Do you know who would have put that in? Would that
- 19 have been you or (b)(6), (b)(7)c ?
- 20 A It probably wouldn't have been . I don't --
- 21 I don't remember.
- 22 Q Okay. And it might have been you?
- 23 A It might have been me.
- Q Okay. A question for you, if you look at the exam
- 25 report, which we marked as Exhibit 2, it talks about possible

- 1 A In discussions with Enforcement, they seemed to
- 2 believe that that was a concern and maybe limited our
- 3 interests.
- 4 Q Why was that?
- 5 A It was never clear to me.
- 6 Q So in your view, if there is a company of which the
- 7 SEC has jurisdiction, then they are engaged in fraud of
- 8 people outside the United States, that would still be
- 9 something that the SEC should look at?
- 10 A Absolutely. I -- I don't -- people may have tried
- 11 to explain it to me; but at the end, I -- I couldn't
- 12 understand, why would it matter; we have a U.S. broker-dealer
- 13 engaged in fraud.
- 14 Q We want to stop him from ripping everybody off,
- 15 even if they're not only ripping U.S. citizens, right?
- 16 A Absolutely.
- 17 Q Okay. And do you remember who -- who did you have
- 18 those conversations with?
- 19 A No. And that's why I've been crazy the last week
- 20 trying to remember the conversations. I do -- and I
- 21 explained to [D](C), (D)(7)C , I go in and out. And so my
- 22 memory  $--^{(b)(6), (b)(7)c}$ , and this was sort
- 23 of one of the first big projects I worked on when I came back
- 24 after Not an excuse, but there's some things
- 25 I don't remember very well.

- 1 examination? We can give you the names of a couple of people
- 2 who worked on the investigation if that would help.
- 3 A I know that the people that worked on the
- 4 investigation, and I -- it's like this blankness in my mind.
- 5 I remember when it was closed and that discussion. I
- 6 remember multiple discussions with Mary Lou regarding the
- 7 fraud and the impossibility; but I don't recall talking about
- 8 this with (b)(6), (b)(7)c or (b)(6), (b)(7)c
- 9 Q Okay. Let me ask you this. How quickly after the
- 10 exam ended was the matter referred; do you remember?
- 11 A It was referred immediately, but you'll see that
- 12 they didn't open anything for a long time. Mary Lou actually
- 13 retired in January of 1998. And I was a very young branch
- 14 chief that had virtually no experience managing people and
- going through (b)(6),(b)(7)c , and I remember being very
- 16 scared that I was left alone to try to make this happen.
- 17 Q Okay.
- 18 A And after she left, I obviously kept pushing. I
- 19 just can't recall because it took a long time to get anybody
- 20 to open something. Was it March of '98 before they even
- 21 opened it?
- 22 Q I believe it was May. Let me ask you this. You
- 23 said it was referred immediately. So the examination start
- 24 date was August 25th, 1997. The letter that was sent out
- 25 with the deficiencies was September 25th, 1997. So when you

- 1 say immediately, during what time frame do you think it was
- 2 referred?
- 3 A Either at or before September 25th.
- Q Okay. And so how does it work when you refer
- 5 something? What do you do, make a phone call, send a memo,
- 6 send an e-mail?
- 7 A I live through many different administrations here
- 8 in terms of how that's handled. I have --
- 9 Q How was it handled then in 1997?
- 10 A Yeah. You call the head of Enforcement and send
- 11 them over a report, go down there and talk to them about it,
- 12 sell it. If you can find an attorney that seemed interested,
- 13 that was usually the best way, to go get an attorney excited
- 14 about the case. And then you could go present it to the head
- of Enforcement; and not only do we have this great case, we
- 16 have an attorney that wants to work it.
- 17 Q Uh-huh. And so do you remember about how it worked
- 18 with respect to the referral that took place either on or
- 19 before September 25th, 1997 of the Stanford exam findings?
- 20 A No.
- 21 Q Okay.
- 22 A I can tell you what I learned.
- 23 **Q** Okay.
- 24 A I learned about the process. This is my first one
- 25 after I became branch chief, and I learned that you can't

- 1 just send it over and periodically check or ask. I learned
- 2 you have to be a tiger.
- 3 Q Okay. But at that time frame, you at least
- 4 remember that you sent it over and periodically --
- .5 A They --
  - 6 Q -- asked about it?
  - 7 A They -- they had it. And I know that I was more
- 8 aggressive than periodically asking about it. I just -- I
- 9 mean, I do remember talking to ; but I -- I
- 10 don't remember if it was about this case. I -- I just don't
- 11 have memory. I'm sorry.
- 12 Q That's okay. Do you remember what the reaction was
- 13 from the Enforcement folks? Initially you said you had to
- 14 kind of -- you were pushing it. So what was their -- what
- 15 was their pushback?
- 16 A Well, I remember the concerns being that they were
- 17 non-U.S. citizens. I remember -- I can't even tell you if I
- 18 remember them being concerned about it being a CD and them
- 19 calling it a CD. I don't recall that. The most significant
- 20 thing I remember at the time was it was a non-U.S. citizen.
- 21 Q And so that was the reason that some folks in the
- 22 Enforcement gave for not wanting to conduct an investigation
- 23 of the Stanford findings?
- 24 A Yes.
- 25 Q Okay.

- 1 A Mary Lou Felsman has excellent memory at this time,
- 2 so she'll be a lot more helpful with you --
- 3 Q Okay.
- 4 A -- on this.
- 5 Q Do you remember if there was any discussions about
- 6 the possibility that this was a Ponzi scheme with the folks
- 7 in Enforcement at that time?
- A I don't recall the specifics. We all thought it
- 9 was a fraud. It didn't matter if it was a Ponzi scheme, was
- 10 it a money laundering scheme.
- 11 Q Now --
- 12 A It was a scheme.
- 13 Q All right.
- 14 A And there was just no question in our minds it was
- a scheme, and there was nobody that we ever didn't express
- 16 our opinion like that to. Just the specifics, I --
- 17 Q And do you remember if anyone in Enforcement ever
- 18 expressed to you that they didn't think it was a fraud? Or
- 19 was it these -- these other considerations, like it didn't
- 20 affect U.S. citizens?
- 21 A It was always about other barriers. I don't recall
- 22 anybody saying it wasn't a fraud. Maybe -- I thought maybe I
- 23 was overly aggressive sometimes in my thought about it being
- 24 a fraud. Of course, that, I dismissed. But it was more
- 25 related to barriers. This was a -- seen as a fantastically

- 1 difficult case, and I couldn't convince them to do it.
- 2 Q But then at some point, a matter under inquiry was
- 3 . opened; isn't that right?
- 4 A Yeah.
- 5 Q So at some point, you did convince them to do it?
- A No. I convinced them to open a matter under
- 7 inquiry, which is not the same thing as launching. At least
- 8 I got -- that's the beginning phase.
- 9 Q Okay. So how were you -- do you know how you were
- 10 able to convince them to open this matter under inquiry?
- 11 A I'm sure I was a pain in the ass.
- 12 Q Okay. And so that on -- so our records show the
- 13 matter of inquiry was opened on May 18th, 1998. So that was
- 14 several months after the referral; is that right?
- 15 A Yes.
- 16 Q Okay. There was an e-mail that I wanted to show
- 17 you, as well. I'll mark the e-mail.
- 18 A There also was chaos in Enforcement at that time,
- 19 which didn't help.
- 20 Q What kind of chaos?
- 21 A Mary Lou Felsman, when she retired, they decided to
- 22 put Hugh -- eventually they decided to put Hugh Wright into
- 23 that position, and he had been the head of Enforcement. So
- 24 he was leaving Enforcement and kind of caught in the worlds
- 25 between.

- And then Spence Barasch came in eventually to head

  Enforcement, so it was just personnel change at the higher
- 3 level. And Spence is, you know, very different than Hugh.
- Q So there was some sort of an absence of leadership
- 5 at that point in time in Enforcement?
- A Well, sort of lame duck leadership. How's that?
- 7 Q Okay. And that you think may have contributed to
- 8 the difficulty you were having in -- in getting Enforcement
- 9 to move on this matter?
- 10 A Yes.
- 11 Q Okay. All right. Let me show you this document.
- MR. KOTZ: We're going to mark it as Exhibit 6.
- 13 It's an e-mail.
- 14 (Exhibit Number 6 was marked
- for identification.)
- 16 BY MR. KOTZ:
- 17 Q It says "Author: Date, 5/18/98; 11:22 a.m."
- 18 I think it refers to b(6), (b)(7)c to Hugh Wright. Do you know
- 19 who is?
- 20 A Yes.
- 21 Q What was his position at that time; do you know?
- 22 A He was an examiner. He was a staff accountant.
- Q Okay. And Hugh Wright during this time period was
- 24 the head of Enforcement or he had taken Mary Lou's job?
- 25 A In May? I don't know. And even if he had taken

- 1 Mary Lou's job, he may have still been very involved in
- 2 Enforcement.
- Q Okay. In this e-mail, it says -- it talks about a
- 4 referral from U.S. Customs Department regarding possibly
- 5 money laundering and wanting information regarding our BD
- 6 examination of Stanford. It's actually spelled Stamford, but
- 7 I assume means Stanford. "I orally provided him info from
- 8 our report and deficiency letter."
- 9 What I guess we were curious about is, the referral
- 10 was made in September of 1997. Nothing happened for a long
- 11 time period. And then the day that this e-mail coincided
- 12 with the date that the MUI was opened. Do you know if
- 13 there's any relationship?
- 14 A It's very easy to open a MUI. We couldn't get them
- 15 to open a MUI, and maybe that's why I don't recall a lot of
- 16 discussion.
- 17 Q So you think that maybe this referral from the U.S.
- 18 Customs Department was what convinced Enforcement to finally
- 19 open a MUI?
- 20 A Yeah.
- 21 Q Okay. Do you remember anything about a referral
- 22 from the Customs Department?
- 23 A No.
- 24 Q Okay.
- 25 A This could be why I was fuzzy about stuff.

- 1 examination?
- 2 A This was a long time ago.
- 3 Q Okay.
- A Again, this is talking about specific people; and
- 5 this makes me very uncomfortable. But [0](0), (0)(7)c was not
- 6 particularly enamored with the examination process or -- that
- 7 was my impression. This was not an attorney I would have
- 8 steered it to because she was not one that was easily
- 9 approachable or particularly enthralled.
- 10 Q Okay. Were you aware of Enforcement seeking
- 11 documents from Stanford in connection with the inquiry?
- 12 A I believe we gave them the work papers. I don't
- 13 remember handing it to them, but that was a --
- 14 Q And do you remember them -- Enforcement actually
- 15 requesting documents from Stanford as part of this inquiry?
- 16 A I don't recall anything except what's on the
- 17 records that I've looked at most recently regarding what they
- 18 did with the MUI.
- 19 Q Okay. And at a certain point in time, the MUI was
- 20 closed; is that right?
- 21 A I remember that vividly.
- Q Okay. And when was that?
- 23 A It was August of '98.
- 24 Q Okay. And do you know who made the decision to
- 25 close the MUI?

- 1 A I was invited down to Spence Barasch's office, and
- 2 so I -- that's why I know I had to be involved because they
- 3 felt like they had to tell me personally because they didn't
- 4 expect a very happy response.
- 5 Q And so what were you told in September of '98 --
- 6 A He went --
- 7 Q -- or August of '98? Excuse me. August of '98.
- 8 Sorry.
- 9 A He just went through some problems with the case;
- 10 but mostly what I remember is just sitting there in shock and
- 11 disbelief and this incredible feeling of failure and great
- 12 disappointment because I didn't know if I was limited in
- 13 terms of I didn't understand the Enforcement world or maybe I
- 14 was on a different reality than they were.
- 15 Q What were the reasons that Spence Barasch gave at
- 16 that time; do you remember?
- 17 A That's what I am telling you. I was just like
- 18 going in and getting a very bad doctor's information. They
- 19 give you all sorts of detail, and somebody's writing it down.
- 20 It's --
- 21 Q So was it clear to you at that point in August of
- 22 1998 that it wasn't that Enforcement had looked into it and
- 23 determined there was no fraud, right? It was simply that
- 24 they weren't going to conduct a full-blown investigation of
- 25 the fraud?

- 1 A That's correct.
- 2 MR. Was there anyone else from the exam
- 3 program that was at that meeting that you were --
- THE WITNESS: No. It was just me and Spence.
- 5 MR. So no other individuals at all, just
- 6 the two of you?
- 7 THE WITNESS: Just me and Spence.
- 8 MR. : Okay.
- 9 BY MR. KOTZ:
- 10 Q So do you know why Enforcement didn't conduct a
- 11 full-blown investigation of these concerns that the exam
- 12 report had come up with regarding fraud?
- 13 A It was never clear to me. The reasons that were
- 14 given, just -- the only one I could remember was, you know,
- 15 that foreign citizens didn't make any sense. And, of course,
- 16 later we've done multiple cases out of this office that
- 17 involved mostly marked foreign citizens.
- 18 At some point in time it came up, you know, about
- 19 CD's not being a security. That also had a great difficulty
- 20 for me because it clearly wasn't really a CD. It wasn't
- 21 really a bank. These were just words they were using to
- 22 throw up dust and why they were stopping us from moving
- 23 forward.
- 24 It wasn't clear to me at all as to why it was
- 25 closed. I was never satisfied. I think what you're

- 1 referring to is earlier this year when I was at -- on a
- 2 social event with Spence Barasch, I asked him why because it
- 3 was all very fuzzy to me. And he just thought a moment and
- 4 said that Wayne Secore had told him there was nothing there.
- 5 Q And who was Wayne Secore at that time?
- A Well, when we had the conversation, I couldn't
- 7 figure out what Wayne Secore had to do with it, other than
- 8 they were friends. And Wayne Secore at one time had been the
- 9 head of the office. It was incomprehensible. I couldn't
- 10 figure out his connection, so I asked around and found out
- 11 that Wayne Secore was the -- was representing Stanford.
- 12 Q So Wayne Secore at one point was the head of the
- 13 Fort Worth office of the SEC?
- 14 A That's right.
- 15 Q And then subsequent to that went to the private
- 16 sector and represented Stanford?
- 17 A That's right.
- 18 Q And so Spence Barasch told you that the reason why
- 19 the MUI was closed in 1998 was because Wayne Secore who
- 20 Spence Barasch knew from when he was in the Fort Worth office
- 21 but who was then representing Stanford had told him there was
- 22 nothing there?
- 23 A That's correct.
- Q Was there anybody else in that conversation with
- 25 you and Spence Barasch?

- 1 A I don't think so. I think it was after dinner or
- 2 just getting ready for dinner. And, you know, and
- 3 were around. Were they around at the moment when
- 4 we had that conversation, I -- I couldn't tell you.
- I know I asked about it later. It may
- 6 have been another trip to New Orleans because I was so upset.
- 7 I didn't know how serious Spence was in his answer. It was
- 8 very upsetting. It probably was maybe just a little
- 9 thumbnail sketch he thought I would be happy with. I don't
- 10 know.
- 11 Q So when was the trip to New Orleans and this
- 12 conversation with Spence Barasch?
- 13 A It was -- I forgot to go back and look at the
- 14 dates. We went -- I think it was during the first week of
- 15 August, but it could have been the last few days of July of
- 16 this year.
- 17 Q Okay.
- 18 A I want to make it clear, I wasn't traveling like --
- 19 there were many other people there. I'm not dating Spence
- 20 Barasch.
- 21 Q Okay. I wasn't thinking that, but that's good to
- 22 have on the record.
- 23 A I wasn't meeting him out of town.
- 24 Q So -- but where were you? You were out at you said
- 25 a social event?

- 1 A We were -- I believe it was Becks or Besh's
- 2 Steakhouse in Harrah's Casino in New Orleans.
- 3 Q Okay. Let me ask you this. Do you believe that at
- 4 that time or generally based on your knowledge of how the
- 5 Enforcement Division in Fort Worth did their work that there
- 6 was a reluctance to take on a matter that might be
- 7 complicated?
- 8 A Spence Barasch was brand-new, and I didn't have any
- 9 predetermined notions about what he would or wouldn't do.
- 10 And I was brand-new as a supervisor. All those perceptions
- 11 came -- any perceptions that I had about that would come
- 12 later.
- 13 Q So what perceptions did come -- came later that may
- 14 have precipitated the decision back then that you, you know,
- 15 learned later on after you worked here for longer?
- 16 A I don't know if it was as much the case in '97, but
- 17 the Commission is very interested in a fraud of the day. And
- 18 this wasn't ever the fraud of the day. This was also a very
- 19 difficult case. It was going to use a lot of resources, and
- 20 that was unappealing.
- 21 And very much during the Cox administration, there
- 22 was concern that the Commission wasn't going to take anything
- 23 unless it was just nailed down and perfect and beautiful and
- 24 that you might receive a lot of negative feedback unless you
- 25 had a case like that. And people wanted to avoid that sort

- of negative response so --
- 2 Q So you said it wasn't the fraud of the day. You
- 3 mean Ponzi schemes or those types of fraud cases?
- A Well, a classic recent fraud of the day was
- 5 back- -- backdating options. So then suddenly you all run
- 6 around. You drop everything. You do as many backdating
- 7 options cases as possible.
- When we were working on Stanford, the -- one of the
- 9 fraud of the day was market timing, late trading. And so
- 10 everyone is to use our resources to do that, and you just --
- 11 chasing headlines.
- 12 Q So is it fair to say that during your time in
- 13 commission there have been various points in time where there
- 14 were particular matters that it seemed like you -- there was
- 15 an encouragement in the agency to look for; and this
- 16 particular type of fraud that you found as a potential in the
- 17 '97 exam was never one of those particularly -- areas of
- 18 fraud that were focused on?
- 19 A This became fraud of the day after Madoff.
- 20 Q But prior to Madoff, this particular type of fraud
- 21 that was potentially found in the '97 Stanford exam was never
- 22 the fraud of the day?
- 23 A It was never the fraud of the day of the
- 24 Commission. Our -- to be fair, the Fort Worth office has
- 25 been one of the most aggressive offices in terms of Ponzi

- 1 schemes. And there's -- and so there's some irony there.
- 2 And we actually received a great deal of pushback
- 3 from all of the Ponzi schemes that we were doing. But most
- 4 of those are really quite easy to prove, and you can get into
- 5 court quickly. And we were just very aggressive on doing
- 6 those.
- 7 So during Hal and Spence's tenure, we did many
- 8 Ponzi schemes; but they were small in comparison. They were
- 9 much -- you know, very easily proven. Once they start to
- 10 break and you can get some bank records, I mean, in
- 11 comparison, the difficulty of those cases is, you know -- it
- 12 doesn't compare.
- 13 Q Okay. Was it your understanding that Spence
- 14 Barasch made the decision not to go forward with the '98
- 15 investigation of Stanford Group based on the '97 examination?
- 16 A That was my understanding because he called me to
- 17 his office to give me that information.
- 18 MR. : Do you know if Hal Degenhardt weighed
- 19 in at all in that decision?
- 20 THE WITNESS: I have no idea. I don't recall. He
- 21 very well may have. I -- I don't know.
- 22 BY MR. KOTZ:
- 23 Q But is it fair to say as of the date that you were
- 24 informed that the MUI had been closed and there was not going
- 25 to be a full investigation of the findings from the '97

- 1 very involved in both sides.
- 2 Q And so what was it you -- what was your
- 3 understanding of what the IA branch was looking at exactly?
- 4 A That wasn't very clear to me just because it was
- 5 pretty much all broker-dealer stuff, and so I was unaware
- 6 that it was very significant in any IA. And I think that's
- 7 kind of what the report showed.
- I mean, I think they found similar problems, but it
- 9 was much smaller in scope. had a great
- 10 background in terms of being involved in what they used to
- 11 call small issues. And he had an issue where -- problems,
- 12 and so I think his report concentrated on --
- 13 Q Do you know if the IA exam got to the issue of how
- 14 Stanford was able to achieve these returns, which you said
- 15 were extraordinary or impossible?
- 16 A No. I just know the scuttlebutt was that we all
- 17 knew that it was a fraud and -- so we could go down there and
- 18 again demonstrate that it's a fraud and that there's a --
- 19 probably a fraud because we couldn't get -- we didn't have
- 20 all of the records.
- 21 Q So was it your understanding that the IA examiners
- 22 who looked at Stanford after your group did also believed
- 23 there may have been a fraud?
- 24 A That was my understanding, yes.
- Q Okay. I'm going to show you another document.

- 1 Q Uh-huh.
- A And so whether or not, you know, registered reps or
- 3 whether or not a firm can sell an unregistered offshore hedge
- 4 fund -- you know, maybe -- maybe you can. I don't know the
- 5 answer to that.
- 6 Q Okay. But one last question. And just generally,
- 7 your -- based on your understanding of the several different
- 8 bases that the SEC is asserting jurisdiction in the current
- 9 matter against Stanford, were those bases available to the
- 10 SEC to assert had they -- in a '98 investigation and action,
- 11 had they pursued your referral? Did something change between
- 12 '98 and 2009 that made these arguments that they're making in
- 13 2009 viable and they wouldn't have been viable in 1998?
- 14 A Well, they had two real positive things happen to
- 15 them that made it possible to bring it in 2009. One is they
- 16 did finally get more information from the insider, which made
- 17 it easier to go directly to the fraud instead of going after
- 18 the broker-dealer. They always --
- 19 Q I'm not talking about like evidentiary, you know,
- 20 developments. I'm just talking about legal theories. Were
- 21 the legal theories available in '98, or was there something
- 22 that happened that made these theories available only in
- 23 2009, not in 1998, that you're aware of?
- 24 A Well, clearly when Madoff broke, that changed
- 25 everything. People felt like now, you know, maybe the courts

- 1 will take us seriously and that the Commission will not turn
- 2 us down if we bring to them, you know, an imperfect case
- 3 where we don't have all of the documents.
- 4 So there came with that this sort of feeling of
- 5 maybe we really can do Stanford now whereas before they
- 6 didn't have that feeling.
- 7 The due diligence theory, I don't know if we
- 8 discussed it in '97. It would have been the same then as it
- 9 is now. There's just lots and lots of case law regarding the
- 10 due diligence theory,
- 11 They certainly had that option in '97.
- 12 Q Okay. One last question, just wrapping up. With
- 13 respect to the conversation you had with Mr. Barasch in New
- 14 Orleans, I believe you pinned it to late July or August of
- 15 this year. And then if I understand your testimony
- 16 correctly, you said that you subsequently talked to
- 17 about the conversation you had with Mr. Barasch.
- 18 Can you give me a little sense of timing and the
- 19 circumstances of your conversations with
- 20 A We probably discussed it several times. He's very
- 21 anxious about discussing anything related to Stanford. He
- 22 doesn't want to know. He wants to be far away from it.
- I believe we talked on another trip, a business
- 24 trip we were on in New Orleans. And we were at the same
- 25 steakhouse, and it was brought up. And I had discussion with

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then. And he really didn't want to talk about it, but
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- 2 we were there at the same steakhouse where we had dinner with
- 3 Spence. So I -- I brought it back up to him because it was
- 4 very upsetting to me and --
- 5 Q And the topic was not just the topic of Stanford
- 6 but the comment that Mr. Barasch had made about closing the
- 7 MUI because of representation by Wayne Secore?
- 8 A That's right.
- 9 Q Okay. This -- this time you were at -- that same
- 10 restaurant that you brought it up again with  $^{^{(b)(6),\,(b)(7)c}}$  , do
- 11 you have an approximate time, date?
- 12 A We took testimony in -- I think it's called Houma.
- 13 And we stayed overnight in New Orleans at the Harrah's.
- 14 Probably October.
- 15 MR. : All right. That's all I have.
- 16 MR. I just have one follow-up.
- 17 EXAMINATION
- 18 BY MR. (b)(0), (b)(7)c
- 19 Q When you were discussing the personnel changes in
- 20 Fort Worth in 1998, you mentioned Spence Barasch replacing
- 21 Hugh Wright as the head of Enforcement, and you described him
- 22 as very different than you. In what sense was he very
- 23 different?
- 24 A He was just much more aggressive.
- 25 Q Who's he?

# EXHIBIT 6

### UNITED STATES SECURITIES AND EXCHANGE COMMISSION

In the Matter of:

) File No. OIG-526

OIG-526

COPY

WITNESS: Number 12

PAGES: 1 through 92

PLACE: Securities and Exchange Commission

801 Cherry Street

Burnett Plaza, Suite 1900

Fort Worth, Texas

DATE: Tuesday, January 26, 2010

The above-entitled matter came on for hearing, pursuant to notice, at  $1:00\ \mathrm{p.m.}$ 

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Page 2
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- 1 worried about for some time and we were having -- I was
- 2 having a planning meeting with Mr. Hugh Wright regarding what
- 3 the schedule would look like for the 2005 fiscal year and he
- 4 expressed -- he thought it was very important that we do
- 5 Stanford Financial Group in the upcoming year.
- 6 Q Did he say why he thought that was important?
- 7 A I don't recall if he said why. We both knew why.
- 8 I was very anxious about doing it because I didn't think that
- 9 anything had changed so that we would necessarily be more
- 10 effective than the past in terms of being able to get a case
- 11 done, so we had a discussion to that effect and Mr. Wright
- 12 was adamant that it was the right thing to do and we needed
- 13 to go do it.
- 14 And not that I disagreed with him, but he was sort
- 15 of asking me to go to battle, I guess, in some way and it was
- 16 going to take a lot of energy and resources and so we talked
- 17 a lot about that and decided that the -- you know, the -- the
- 18 affected investors needed to be served and so this was how we
- 19 needed to do it.
- 20 Q Okay. And so when you say "battle," you mean a
- 21 battle with the enforcement division to get them to begin an
- 22 investigation out of the information that you had already
- 23 learned about Stanford in addition to what you find in the
- 24 2004 exam?
- 25 A I meant it in that way. It was a two-pronged

- 1 battle.
- 2 Q Okay.
- 3 A Because Mr. Stanford had a very well set-up fraud
- 4 and it was going to be very challenging to break that down
- 5 and also with enforcement and what could I bring to the table
- 6 or how could we bring it to the table so we could get action
- 7 on a referral.
- 8 MR. KOTZ: All right. Let me show you another
- 9 document. This is an e-mail dated 9/29/2004 from (b)(6), (b)(7)c
- 10 (b)(6), (b)(7)c to (b)(6), (b)(7)c and (b)(6), (b)(7)c I'm going to mark
- 11 this as Exhibit 2.
- 12 (SEC Exhibit No. 2 was marked for
- 13 identification.)
- 14 BY MR. KOTZ:
- 15 Q Your name is not on this e-mail, but there's a
- reference here from someone named (b)(6), (b)(7)c to
- 17 saying, I did a search on the Stanford Group because we were
- 18 tracking down referrals from OC to enforcement to see whether
- 19 they had been followed up on. Here's the information that I
- 20 found. And then it references the previous -- a previous
- 21 referral, both a referral in December of 2002 and an earlier
- 22 referral in 1998. Do you see that?
- 23 A Uh-huh.
- Q Okay. So do you remember that at a certain point
- 25 in time they were tracking down referrals to see what

Okay. And so what was your role in the 2004 exam? 1 I was not in the field, but it was very involved 2 from selecting the staff that were going to participate, 3 helping them develop the areas of focus. 4 And so which --5 Untold amounts of meetings. I helped them put 6 together the outline of the report and the outline of the 7 draft memo, very deeply involved in the details. 8 9 Okay. And so who did you choose to conduct the examination? 10 I chose the two people that I thought had the most 11 experience and were likely the most capable examiners on 12 staff and that was He had just come over here 13 or it might have been at the time and he had 14 from maybe b(7)c years experience there, including being a 15 supervisor. And I selected , who had also 16 . And he had been with the SEC recently come over from 17 previous to coming to our office and he had also 18 and been a supervisor at (b)(6), (b)(7)c, extraordinarily capable staff. 19 Okay. And then what was (b)(6), (b)(7)c 20 role? 21 She was the Branch Chief and --22 Α She was not as involved as 23 . Q and 24 Α She was not as involved. Although she was her 25 supervisor, --

And I had tremendous confidence in and I 2 wanted it steered towards him. The info that we had received was, you know, really give it to the trio and that they would handle it and I sort of went around that and steered it to | | | 5 BY MR. KOTZ: Okay. And around this time, was there this regulatory summit in Austin? 8 Yes. 9 10 Can you tell me what happened in Austin with respect to the Stanford matter? 11 A I had asked Victoria to give a summary of our case 12 to present to the other regulatory agencies that were there. 13 Hal Degenhardt, I believe, was there and I know Spence 14 . Barasch was there. I don't recall if Jeff Cohen was there or 15 not. He may have been there at that one. 16 Victoria made her presentation. Spence was 17 dismissive of it, didn't think there was anything there. I'm 18 19 pretty confident that Hal was there and kind of echoed that. 20 It was very disheartening. Did Barasch specifically say why he didn't think 21 Q there was anything there? What was his basis for that? 22 I think he mentioned something about 23 24

Okay. And so what were the other regulatory

25

e i i i i vecessitatoj se es

- 1 A Yes.
- Q Okay. This was the first effort in that arena that
- 3 you're aware of to talk to Office of International Affairs
- 4 about Stanford?
- 5 A I don't know if enforcement had previously or at
- 6 any other point in time, I don't know. I know that we made a
- 7 decision that we were going to go ahead and start with like
- 8 the preliminary steps of an investigation and not end it
- 9 where an examination typically did. And Victoria had a lot
- 10 of experience in this and she thought it was one of the
- 11 places to go and basically start the investigation.
- 12 Q Okay. So you weren't aware of any contacts between
- 13 the Fort Worth office and OIA prior to April 2005 about
- 14 Stanford?
- 15 A None that I can recall.
- 16 Q Okay. And you don't recall Office of International
- 17 Affairs responding by saying, Oh, you know, we heard about the second second
- 18 this already. We've already talked to folks about Stanford.
- 19 I mean, did they give you the impression that this was
- 20 something that had come up before?
- 21 A No. This -- my understanding this was all quite
- 22 novel.
- 23 Q Okay.
- 24 MR. And back in 1998 and 2002 was that
- 25 ever given as one of the reasons why it would be difficult to

```
1
               Not necessarily.
           Q
               Jeff Cohen was
  2
  3
  4
  5
  6
               He wanted to have all of his cases so they were
  7
     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.
10
11
          Q
               And so in effect he only wanted to bring cases that
     were slam dunk, easy cases?
12
13
          A
               Yes.
               MR. KOTZ: Let me show you another document. We're
14
     going to mark this as Exhibit 11. This is an e-mail from
15
     Jeffrey Cohen to you 06/24/05, 11:13 a.m. Exhibit 11.
16
17
                               (SEC Exhibit No. 11 was marked for
                               identification.)
18
               BY MR. KOTZ:
19
20
               And this references in this e-mail string, it
21
     references a communication with someone at NASD,
          , a conference call to discuss Stanford Group that took
22
23
     place in June of 2005. Do you remember what that was about?
24
     What the conference call or any communications with NASD was
25
     about at that time?
```

- 1 A I don't recall specifically. I think Jeff was very
- 2 hopeful that we could get the NASD to do the case instead of
- 3 us.
- 4 Q And so if there was a case that, say, wasn't a slam
- 5 dunk, easy case that could not be subject to any criticism,
- 6 was Jeff Cohen interested in having somebody else do it other
- 7 than SEC?
- 8 A Anybody, anywhere but him.
- 9 MR. : And what could the NASD have done that
- 10 the SEC could not have done at this point concerning Stanford
- 11 in the Summer of '05?
- 12 THE WITNESS: I think the real optimistic hope, and
- 13 there is some validity to this, is that under the rule about
- 14 knowing your customer or under the rule about is it just and
- 15 equitable principles of trade, something like that, that your
- 16 standard would be less than the standard to prove fraud and,
- 17 therefore, perhaps they could do a case with less evidence or
- 18 less show of egregiousness than it would take to do a fraud
- 19 case.
- 20 BY MR. KOTZ:
- 21 Q Did the NASD ever bring a case, to your knowledge?
- 22 A They brought a couple de minimis cases. I'm sure
- 23 one of the next things you'll bring up is our referral to the
- 24 NASD.
- 25 MR. I mean, how did this reaching out to

- 1 NASD start? Was that -- we've gone from May, when it's an
- 2 SEC matter to June. Do you know whose idea it was to involve
- 3 NASD or who first reached out to NASD?
- 4 THE WITNESS: I don't recall who in enforcement
- 5 asked. I believe Hugh Wright, because I believe Hugh Wright
- 6 asked me or he asked me through Victoria, I don't remember,
- 7 that this should be referred over to NASD.
- 8 So I complied and suggested it to over
- 9 at NASD, but I felt that the idea was ludicrous and, quite
- 10 frankly, after the referral was made I just pretended like it
- 11 had never happened.
- 12 BY MR. KOTZ:
- 13 Q So we're going to mark now as Exhibit 12 the June
- 14 29th, 2005 letter to and just to confirm this
- 15 is the referral you're referring to.
- 16 (SEC Exhibit No. 12 was marked for
- 17 identification.)
- 18 MR. : Or a draft thereof.
- 19 THE WITNESS: Yes.
- 20 BY MR. KOTZ:
- 21 Q Okay. Let me show you another document. This is
- 22 dated 07/12/05, 10:11 a.m. from Victoria Prescott to you,
- 23 (b)(6), (b)(7)c and (c)(6), (b)(7)c I'm going to mark this as Exhibit
- 24 13.
- 25 (SEC Exhibit No. 13 was marked for

- 1 questionnaires?
- 2 A We did receive responses and my recall was that the
- 3 responses were generally that people were happy.
- Q Did any investors express any concern that they
- 5 were getting this questionnaire, that perhaps the SEC was ( 3)
- 6 looking at this matter?
- 7 A I don't recall that.
- 8 Q Okay. So with respect to this e-mail dated -- this
- 9 e-mail string from 10-24-2005, you were informed by
- 10 that the decision was made to close the Stanford
- 11 investigation. And is it correct that it was your
- 12 understanding that Jeffrey Cohen made that decision?
- A Yes. I immediately called and she told me
- 14 that that's what Jeff wanted to do.
- 15 Q And how did you react?
- 16 A I reacted in a very negative fashion.
- 17 Q Okay. And you didn't want to let that just end the
- 18 thing; is that right?
- 19 A Yes. I went into gear to protect the case. I
- 20 wasn't going to accept that, so I immediately went to Kit
- 21 Addleman, and I think that's actually when I got the
- call, that's -- from Jeff, because I went to Kit
- 23 telling her how much we needed not to close this and that
- 24 angered him because she told him about that. I also believe
- 25 I went to Jim Clarkson.

- 1 those conversations with Kit in a way that Jeff would have
- 2 known about or been a part of before he wrote this memo?
- 3 THE WITNESS: Yes, because when he decided to close
- 4 it, I went to Kit and I believe to Jim Clarkson. I know I
- 5 went to Jim Clarkson. And Kit told Jeff about me going to
- 6 him and that's when he got very angry at me and called me
- 7 with the call about not to go around him to Kit.
- 8 He had been trying to -- my impression was to limit
- 9 the information to Kit and control that flow of information.
- 10 And so by going around him, Jim and Kit were exposed to, you
- 11 know, more info on the case.
- 12 Kit and Jim also hadn't been here for very long, so
- 13 we hadn't had a lot of discussion, but I knew that she had
- 14 told Jeff because he was angry with me about me having told
- 15 Kit.
- 16 BY MR. KOTZ:
- 17 Q And in some fashion it was conveyed by Kit to Jeff
- 18 that you agreed -- that Kit agreed with you and was going to
- 19 authorize an investigation?
- 20 A Well, Kit was interested enough to at least have a
- 21 meeting where we would present both our sides.
- 22 Q Right.
- 23 A And I don't know if Kit had expressed to him that
- 24 she agreed with me or that -- my impression was that Jeff
- 25 just didn't think that he would be able to carry the day at

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1 are the chances of that, but --
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- 2 MR. Did anyone ever disagree with those
- 3 red flags? We see no evidence that anyone, you know, sort of
- 4 took on the predicate, if you will, of your referral and
- 5 said, No, I don't think these red flags add up to evidence
- 6 that there's a ponzi scheme or a fraud?
- 7 THE WITNESS: No.
- 8 MR. Did anyone in this office ever say,
- 9 No, I think you're wrong. It doesn't look to be a ponzi
- 10 scheme to me. It doesn't look to be a fraud?
- 11 THE WITNESS: Never. No. The response was this is
- 12 indicia of fraud. You can't take that into court, indicia of
- 13 fraud, you must be able to prove it, so we came up with the
- 14 alternative, right, we probably can't ever hit it dead-on,
- 15 because we don't know if any court will agree with us, we
- 16 don't know if we can get the Commission to agree, we could
- 17 try -- so if we don't feel like we can go to court, because
- 18 you have to, you know, tell the judge that you have the
- 19 evidence to do so, so we presented other theories to
- 20 enforcement so that they could try to do it directly.
- 21 So we couldn't convince them to do it directly, so
- 22 it became our goal then to find ways to do it indirectly so
- 23 we can get to the same spot.
- 24 MR. (b)(6), (b)(7)c : So is it fair to say that everyone in
- 25 this office, even on the enforcement side that you dealt

- 1 with, had ever looked at this, concurred with the predicate
- 2 that there was high probability here that this was a ponzi
- 3 scheme or some type of a fraud?
- 4 THE WITNESS: Yeah.
- 5 MR. And is it fair to say then the only
- 6 difference of opinion was between sort of the staff that felt
- 7 like, well, that inevitably leads to the conclusion that we
- 8 have to try to do something and the staff that was more
- 9 focused on the difficulties or the possibility of getting
- 10 embarrassed if an attempt to do something failed?
- 11 THE WITNESS: Yes.
- 12 BY MR. KOTZ:
- 13 Q Let me ask you this, because this is something that
- 14 has come up in other investigations that we've conducted.
- 15 I'm trying to understand the mindset that has been
- 16 represented to be the case in numerous investigations that we
- 17 did -- that we've done involving enforcement attorneys of
- 18 this idea of they're only going to take a case if it's a slam
- 19 dunk case.
- Now, there have been different theories about why
- 21 that mindset occurs and one of them has been that in some
- 22 ways if you're an enforcement attorney, you're hurt worse by
- 23 criticism from the Commission or losing a case than if you
- 24 don't -- you know, and that's worse and that's a reason why
- 25 you might not want to try a hard case because you -- you will

- 1 be praised and/or be promoted by bringing cases even if
- 2 they're not hard cases, but you would be more adversely
- 3 affected if you tried to bring a hard case and you were
- 4 criticized. Do you know if that's the case?
- 5 A That's certainly one theory. Working in regulation
- 6 cases I have found that those that will take regulation cases
- 7 on a routine basis, that I consider those attorneys to be
- 8 heros and deserve a lot of pats on the back, because the
- 9 gauntlet, even before you get to the part of the Commission,
- 10 is nightmarish, to get through market reg, to get through IM,
- 11 to get through general counsel. And anything with a reg
- 12 related notion has -- IM and trading markets can be
- 13 extraordinary difficult to get anything through. And it's
- 14 just like hitting your head against the wall repeatedly over
- 15 and over and over and you may put years into it and some
- 16 dimwit, excuse the language, in Washington will prevent your
- 17 case from happening.
- 18 I've had cases here that I had somebody in
- 19 Washington kill. I just simply waited until they moved to
- 20 another position. I went out, did a similar exam, came up
- 21 with a same fraud, and guess what, that person wasn't there
- 22 to kill it and, you know what, now it's a case.
- 23 Q So is it your impression that in general the easier
- 24 cases -- the harder cases, more challenging cases are going
- 25 to be difficult to get through the bureaucratic process in

#### 1 Washington?

- 2 A A nightmare. Difficult is an understatement. It is
- 3 a horrific miserable process and you have to really know your
- 4 p's and q's, which many don't related to regulated entities.
- 5 It's not their area.
- 6 MR. Does that difficulty include the
- 7 enforcement staff in Washington that you have to get your
- 8 matters through? You mentioned IM and market reg.
- 9 THE WITNESS: They're very challenging, because I
- 10 know that that's much more challenging when you do a reg
- 11 case, because that's my frame of reference --
- $MR.^{(0)(6),(6)(7)6}$ : Okay.
- 13 THE WITNESS: -- obviously the cases I've dealt
- 14 with.
- 15 And dealing with market reg and IM is very
- 16 challenging. And I've seen ones where they do comments six
- 17 months later that come back and they want to do comments
- 18 again because there was a case that came out somewhere and
- 19 now suddenly they have whole new thoughts on it. And now you
- 20 think you're all ready to bring the case and they just
- 21 suddenly announce to you they have more comments that
- 22 completely change the flavor again of the case.
- 23 It's a horrific negative process. It's very, very
- 24 challenging for enforcement to go through and they need to be
- 25 able to continuously to go back to regulation, to answer the

- 1 questions and to deal with it.
- And sometimes we just can't even understand where
- 3 the people in these other offices are coming from. And they
- 4 get narrowed down to just a couple of liaisons that sometimes
- 5. are just completely off-base and you let this amazing power
- 6 in the hands of a few people that you have to try to deal
- 7 with to try to get your case done.
- 8 So not only do they have to worry about criticism
- 9 if it finally gets to the Commission, if they don't like it.
- 10 First they have to deal with a year or two of nightmarish
- 11 difficulties, so it really was no small thing for us to ask
- 12 them to try to bring this on a more novel case.
- 13 Did I think it was worth it? Did I think that the
- 14 senior people then should have supported and helped that
- 15 process and protected their staff in some way from the misery
- 16 to make it happen, I did. But I don't want to give the
- 17 impression I thought this was easy to do and they could just
- 18 go do it and they were stubborn. Nobody wanted to face the
- 19 people in Washington. They didn't and for good reason.
- 20 BY MR. KOTZ:
- 21 Q So it's your view that the bureaucratic
- 22 infrastructure in Washington creates incentives for
- 23 enforcement folks in regional offices like Fort Worth to
- 24 bring the easier cases?
- 25 A To bring the easier cases or the cases du jour, the

## EXHIBIT 7

### UNITED STATES SECURITIES AND EXCHANGE COMMISSION

In the Matter of: )

) File No. OIG-526

OIG-526

COPY

WITNESS: Witness No. 2

PAGES: 1 through 61

PLACE: Securities & Exchange Commission

~2001 Ross Avenue

Dallas, Texas 75201

DATE: Monday, December 14, 2009

The above-entitled matter came on for hearing, pursuant to notice, at 3:45 p.m.

Diversified Reporting Services, Inc. (202) 467-9200

```
Stanford?
 1
 2
          Α
               That's correct.
               Okay. Now, prior to working on that matter, were
 3
          Q
     you aware that the SEC conducted an examination of the
 4
     Stanford Group Company in 1997?
 5
               As I sit here today, I -- I just don't have a
 6
          Α
     recollection of that one way or the other.
 7
               Okay. Let me show you a document. I'm going to
 8
     show you -- we're going to mark it as Exhibit 2.
 9
10
                                    (Exhibit No. 2 was marked for
                                    identification.)
11
               And this is a four page document. It says on the
12
13
     top Stanford Group Company, 5056 Westheimer, Suite 605. It
     is an examination report, so I want to show you this and ask
14
     you -- maybe this refreshes your recollection.
15
16
          Α
               Okay.
               MR. KOTZ: Here you go.
17
               MR. WOLK:
                          Thanks.
18
19
               BY MR. KOTZ:
20
               So if you could, just take a minute or two to maybe
     look through it. And then I'll ask you a couple of questions
21
     about it.
22
               Okay.
23
24
               Okay. Do you think you've ever --
               (Handing.)
25
          Α
```

- 1 Q You can keep it. Do you think you've ever seen
- 2 this document before, Exhibit 2?
- 3 A I don't have a recollection of seeing this document
- 4 before. I don't -- I don't know one way or the other. I
- 5 just don't have a recollection.
- 6 Q Sure. What about some of the issues that were
- 7 referenced in this document? The findings of the
- 8 examination, possible misrepresentations, do those -- are
- 9 those familiar at all?
- 10 A In that time frame, no, I don't recall them. I --
- 11 what I recall about this -- well, to answer your question,
- 12 no.
- 13 O Okay.
- MR. WOLK: When you say "time frame," what do you
- 15 mean? Because I don't think -- I don't -- unless I'm
- 16 misunderstanding --
- 17 THE WITNESS: Well, he --
- 18 MR. WOLK: -- it doesn't have a date on it.
- 19 THE WITNESS: Mr. Kotz represented that it was --
- 20 this was from 2000 -- I mean -- I'm sorry -- 1997. And it
- 21 referenced it in --
- MR. KOTZ: Page 2, it says the FWDO conducted a
- 23 surveillance examination of Stanford Group in August 1997.
- 24 The report doesn't have a date, but that reference is to when
- 25 the field work was.

- THE WITNESS: Okay. So when I said time frame,
- 2 that's what I mean, the 1997 time frame.
- 3 BY MR. KOTZ:
- Q Okay. You were about to say "what I do recall
- 5 about it" --
- 6 A What I recall about it was that allegations -- I
- 7 recall there being allegations of money laundering, drug
- 8 trafficking, and just other -- the allegations of that
- 9 nature, that they -- the firm may be involved with some South
- 10 American drug traffickers, those types of things.
- 11 Q Okay. The enforcement matter that you said you
- 12 were assigned to, do you remember what precipitated it? Do
- 13 you remember if it was precipitated by an examination?
- 14 A I don't. I don't recall.
- 15 Q Okay. Let me show you another document. This is a
- 16 printout of a STARS system. It says on it Office of
- 17 Compliance, Inspections, and Examinations. And it's a five
- 18 page document. I'm going to mark it as Exhibit 3.
- 19 (Exhibit No. 3 was marked for
- 20 identification.)
- 21 And this document just references information about
- 22 this examination that took place in August of 1997. If you
- 23 take a look at the last page of the document, Page 5, you see
- 24 where it says "violations description" --
- 25 A Yes.

- Q -- "possible misrepresentation, possible Ponzi
- 2 scheme"?
- 3 A Yes, I see that.
- Q Okay. And we've had testimony that in August 1997,
- 5 the SEC examination broker-dealer program conducted an
- 6 examination and referred to the enforcement division
- 7 investigation of possible misrepresentations and possible
- 8 Ponzi scheme which they found out about by doing an
- 9 examination.
- 10 Do you know if that was what maybe precipitated
- 11 your -- or do you think it was something else?
- 12 A I just -- I just don't recall one way or the other.
- 13 And oftentimes, investigations, I guess, have multiple
- 14 sources. So I just -- I just don't recall.
- 15 Q Okay. Do you understand that the matter that you
- 16 were working on in 1998 that related to Stanford -- did you
- 17 understand that at least part of your investigation was to
- 18 look at Stanford for fraud?
- 19 A What I have a recollection of is that -- as I
- 20 indicated earlier, is that it involved allegations that I
- 21 described earlier, the money laundering, drug trafficking.
- 22 That's what I recall. So if there were more -- if there was
- 23 something more, I just don't recall that at this time.
- Q Do you recall anything about someone alleging
- 25 during that time period, 1998, that Stanford was engaged in a

- 1 Ponzi scheme and that this information came from the
- 2 examination?
- 3 A I do not. I spent a lot of time thinking about
- 4 this matter. And I -- what I recall -- that is what I
- 5 recall, just about the money laundering, the drug
- 6 trafficking.
- 7 Q Our records show that a matter under inquiry was
- 8 opened in May of 1998. The examination concluded in August
- 9 of 1997. Do you have any idea why there was a --
- 10 MR. WOLK: No, you said -- I'm not sure I
- 11 understand. I don't mean to be problematic. I thought you
- 12 said that the MUI was opened in ninety -- May of '97 --
- 13 MR. KOTZ: 1998.
- 14 MR. WOLK: -- and that the -- it had concluded in
- 15 '97.
- MR. KOTZ: No.
- 17 MR. WOLK: Or -- or the examination concluded in
- 18 '97.
- 19 MR. KOTZ: Right.
- 20 MR. WOLK: Okay. Sorry.
- 21 BY MR. KOTZ:
- 22 Q So I guess the question is, do you have any idea
- 23 why there was that -- there was a long lag period between
- 24 when -- there has been testimony that the matter was referred
- 25 to enforcement and when a matter under inquiry was opened.

- A No, I have no knowledge of that. I mean it was the
- 2 routine practice to open -- once it was assigned to a staff
- 3 lawyer, to open a MUI, a matter under inquiry.
- 4 COURT REPORTER: I'm sorry. "A matter" --
- 5 THE WITNESS: Matter under inquiry.
- 6 MR. KOTZ: It's all caps, MUI.
- 7 BY MR. KOTZ:
- Q All right. Let me show you another document. This
- 9 is a letter dated May 27, 1998, from you to | |
- 10 Stanford Group Company. And we will mark this as Exhibit 4.
- 11 A Okay. Okay.
- 12 (Exhibit No. 4 was marked for
- 13 identification.)
- 14 Q Okay. Do you remember this document?
- 15 A I don't remember this document, but I believe that
- 16 to be my signature on Page 4 of the document.
- 17 Q Do you believe that this document related to the
- 18 Stanford inquiry matter?
- 19 A Yes.
- 20 Q Okay. And so what is this document?
- 21 A An information or document request.
- Q Okay. Do you have any recollection of what
- 23 specifically you were looking into as part of this inquiry
- 24 involving Stanford?
- 25 A To the best of my recollection, there were

- 1 allegations, as I've indicated, of the money laundering, drug
- 2 trafficking. And we were just trying to get a better sense
- 3 and better understanding of this firm because as I look at
- 4 this document, it's -- it was one of our typical documents
- 5 that we would send out. I mean it's not really focused in
- 6 one particular area. They were asking for just about every
- 7 document at the firm.
- 8 And so it was really an effort to gain a better
- 9 understanding of the firm, its business operations, and who
- 10 is involved is the way I interpret the -- the document.
- 11 Q I'm just a little bit curious. Money laundering
- 12 and drug trafficking, would that be something normally the
- 13 SEC would be investigating?
- 14 A In my career at the SEC, there were not -- I had
- 15 not worked in another matter involving money laundering or
- 16 drug trafficking; but I think the -- to the best of my
- 17 recollection, if an SEC registered broker-dealer was engaged
- 18 in money laundering, then that would be something that the
- 19 SEC would want to know and want to -- to look at. So that
- 20 was my understanding.
- 21 Q What about drug trafficking? Would the SEC
- 22 investigate drug trafficking?
- 23 A Well, no. I mean I don't know how I'd go about
- 24 investigating drug trafficking. I mean I think we would look
- 25 to seek to understand the -- the firm's business operations,

- 1 look at their books and records and, you know, see if -- if
- 2 we could see any unusual activity there; but I don't think
- 3 that the SEC would investigate drug trafficking. I don't
- 4 know how it would go about --
- 5 Q Just to be clear -- and because obviously, it was
- 6 some time ago.
- 7 A Right.
- 8 Q So we have testimony that this examination was
- 9 done, they were concerned that Stanford was operating a Ponzi
- 10 scheme or engaged in some other fraud --
- 11 A Right.
- 12 Q -- that Julie Preuitt referred it to enforcement
- 13 and had conversations with you about the case, that she made
- 14 efforts to convince enforcement to investigate it, but that
- 15 it didn't -- I mean from what we heard, it didn't have
- 16 anything to do with money laundering or drug trafficking.
- 17 Is it that all you remember is the money laundering
- 18 and drug trafficking part, or do you think that perhaps that
- 19 was the entirety of what you were looking at?
- 20 A That's all I remember. And I don't remember having
- 21 conversations directly with Julie Preuitt. So I guess to
- 22 understand -- to understand your question, are you saying she
- 23 had conversations directly with me, --
- 24 Q Right.
- 25 A -- regarding trying to convince me to open a case

- 1 on it?
- 2 Q Right.
- 3 A Okay. Well, that would be inconsistent with the
- 4 way the -- the process worked at -- during that time.
- 5 Q How is that?
- 6 A Because I was a staff attorney. The -- by this
- 7 time, I don't remember what Julie's role was and if she was a
- 8 branch chief. I don't know if she was branch chief at that
- 9 time.
- 10 Q Right. I think she was.
- 11 A But the bran -- the enforcement -- I'm sorry --
- 12 regulation management did not make personal appeals to
- 13 individual staff attorneys to open cases. There was a
- 14 management structure and hierarchy there that would have
- 15 dealt with this matter in terms of assessing whether or not
- 16 it was something to open or to close. So that -- that is not
- 17 at all how the process worked.
- 18 Q Okay. Just for you to understand what was said,
- 19 Julie testified that in order to get enforcement to take a
- 20 matter, it was helpful to get an enforcement attorney who was
- 21 interested in the case; and you are more likely to get
- 22 enforcement to open something if you had an attorney who was
- 23 interested; so you go to the attorney, try to get the
- 24 attorney interested; and then you would go to enforcement and
- 25 say "I have somebody that wants to work on" --

- 1 A Okay. That's not -- that's not my recollection.
- Q Okay. But forgetting about the conversation with
- 3 Julie part, do you think that it may have -- the matter that
- 4 was opened involving Stanford may have been a result of this
- 5 examination and dealt with issues of fraud, but you don't
- 6 remember that part of it?
- 7 A My testimony is I don't recall. I -- I remember
- 8 the -- the drug trafficking and the money laundering issue,
- 9 and that could be just what I remember so --
- 10 Q Okay.
- 11 A I -- it's just my recollection, so it could include
- 12 other things. I just don't recall.
- 13 MR. WOLK: Have you told him when the money
- 14 laundering and drug trafficking came to your attention, those
- 15 issues?
- 16 THE WITNESS: Well, that there -- that there were a
- 17 series of regulatory tips, as I understood it, that had come
- 18 in that made those allegations.
- 19 And I recall attending a meeting in Houston, Texas,
- 20 with several other law enforcement agencies and organizations
- 21 where we all sat around the table and discussed the various
- 22 information and facts that the various organizations had.
- 23 And what I remember from that, the key issue was
- 24 the money laundering and drug trafficking. And if I recall,
- 25 some of the participants at the meeting were the -- the U.S.

- 1 Attorney's Office, the Postal Inspector, the Secret Service,
- 2 and maybe even a representative from the DEA and possibly the
- 3 IRS but --
- 4 BY MR. KOTZ:
- 5 Q Do you know where these regulatory tips came from?
- 6 A I do not.
- 7 Q Okay. So you think they weren't from an individual
- 8 or someone outside the government? They were something
- 9 inside the government?
- 10 A No, I think they were coming from the outside; but
- 11 I don't think any -- I don't -- I don't know -- I shouldn't
- 12 say "I don't think." I don't know if we ever knew the
- 13 source.
- 14 Q So there was an anonymous tip?
- 15 A There were tips. There were numerous tips.
- 16 Q Numerous anonymous tips. During that time frame in
- 17 1998?
- 18 A To the best of my recollection, yes.
- 19 Q And they came into the SEC?
- 20 A I don't recall how I gained knowledge of the tips.
- 21 I don't know if it was when the case was assigned to me,
- 22 if -- if I was told at that time or if the -- you know,
- 23 through my attendance at that meeting; but I learned somehow
- 24 that there were these tips.
- 25 Q And the tips were related to money laundering and

- 1 drug trafficking?
- 2 A That's what I recall.
- 3 Q Okay. Okay. Let me show you another document.
- 4 And this is dated June 19, 1998. This is a letter from Jack
- 5 Ballard of Ogden, Gibson, White & Broocks to you. And it's a
- 6 four page document we're going to mark as Exhibit 5.
- 7 (Exhibit No. 5 was marked for
- 8
   identification.)
- 9 Just for the record, this Exhibit No. 5 is a June
- 10 10, 1998, document from Jack Ballard to you.
- 11 A Okay.
- 12 Q So do you have any recollection of this document?
- 13 A I do not.
- 14 Q Does it look like it was a response to the previous
- 15 document, May 27, 1998, with regard to the request for
- 16 documents?
- 17 A Well, yes, based on the first sentence in the
- 18 letter.
- 19 Q Okay. Do you recall whether Stanford was
- 20 responsive with respect to the documents that you had asked
- 21 for in the May 27, 1998, letter?
- 22 A I have no recollection of receiving this letter. I
- 23 have no recollection of the -- the documents that were
- 24 actually received. Just reading through this, it appears
- 25 that the firm provided some documents; but then in others --

- 1 Q Do you have any idea why it would be informal, not
- 2 under oath?
- 3 A I don't. The only thing I can think of is that we
- 4 did not have a -- we did not have subpoena authority because
- 5 this was still a MUI. We didn't have a formal order.
- 6 Q So is it fair to say that in the MUI stage, there
- 7 is a request for documents and a request to have somebody
- 8 come in; while in the formal order stage, there would be more
- 9 of a demand?
- 10 A Subpoena. Right. A subpoena.
- 11 Q In this same letter from Jack Ballard, he asks that
- 12 you consider limiting your review of the files to 300, 400
- 13 new customers. Do you remember anything about Stanford's
- 14 counsel asking that you limit inquiry?
- 15 A No, I have no specific recollection of the
- 16 investigative steps.
- 17 Q Do you remember Hal Degenhardt?
- 18 A Yes.
- 19 Q Harold Degenhardt. Was he involved at all -- do
- 20 you know -- in this matter? If you notice, he talks about --
- 21 it says "please let me know at your earliest convenience when
- 22 a personal meeting with you and Mr. Degenhardt can be
- 23 scheduled."
- A As I indicated earlier, it was -- Hal was very
- 25 active in the cases. And as a staff attorney, everything

- 1 that I would have been doing would have been going through my
- 2 branch chief, through the head of enforcement, and through
- 3 Hal just because he was a very, very involved director.
- 4 So to answer your question, it doesn't surprise me
- 5 that he would be copied and people would request a meeting
- 6 that he would be involved in.
- 7 Q So it was common on the enforcement cases that you
- 8 worked on that the meetings you had with the folks you were
- 9 interviewing, Mr. Degenhardt sat in on?
- 10 A I definitely recall him participating in
- 11 meetings -- not testimony. And I'm not talking specifically
- 12 about Stanford. I'm just talking generally.
- 13 So whether or not he actually sat in on this, the
- 14 informal interviews, if they were held, I don't know; but he
- 15 was -- he was very involved. So it would not -- it doesn't
- 16 surprise me that someone would request him to appear at a
- 17 meeting. Now, whether or not he actually did, I have no
- 18 idea.
- 19 Q Okay. Do you recall in July of 1998 -- so this
- 20 would have been shortly after the MUI was opened, before it
- 21 was closed -- there was a second examination of Stanford,
- 22 this time not by the broker-dealer group of
- 23 but the investment adviser group?
- 24 A No.
- 25 Q And you don't remember the folks on the investment

- 1 adviser side, (b)(6), (b)(7)c (b)(6), (b)(7)c , (b)(6), (b)(7)c
- 2 referring further information to you or to (b)(6), (b)(7)c about
- found in his examination for use in your enforcement
- 5 inquiry?
- 6 A I don't recall.
- 7 Q Do you remember anything about the fact that two
- 8 compliance officers for Stanford had left the firm within a
- 9 very short time period and examiners felt that that was a red
- 10 flag?
- 11 A No, no, I have no recollection one way or the
- 12 other.
- 13 Q Other than that one meeting that you described, do
- 14 you remember any other communications with other federal
- 15 regulatory agencies about these allegations of money
- 16 laundering and drug trafficking against Stanford?
- 17 A I -- I don't have a specific recollection, but I --
- 18 I -- there could have been others. There could have been
- 19 other communications as follow-up to that or as preludes to
- 20 that meeting.
- 21 Q All right. But if there was an allegation of drug
- 22 trafficking, for example, that was being looked at, wouldn't
- 23 you think there was another entity other than the SEC that
- 24 was involved?
- 25 A Well, as I indicated, at that meeting, I believe

- 1 that the DEA was there. I believe that the Secret Service
- 2 was there. I believe the Postal Inspector was there. The
- 3 U.S. Attorney's Office was there. So I knew that there were
- 4 others involved.
- 5 Q Do you know what, if anything, they did in terms of
- 6 these allegations?
- 7 A No, I do not.
- Q Do you know if you were ever informed what they
- 9 did?
- 10 A I don't know that I was ever informed, but my
- 11 general recollection is that I don't know of any cases that
- 12 were brought.
- 13 Q Do you know who made the decision to close the 1998
- 14 Stanford MUI?
- 15 A I don't have specific recollection regarding the
- 16 Stanford MUI and matter; but it would have been -- the
- 17 typical process would be that the head of the enforcement,
- 18 the branch chief, the staff lawyer, and in many instances Hal
- 19 would all be involved in that decision.
- 20 Q Okay. So the ultimate decision to close a MUI
- 21 would not have been made by you or, say, a staff attorney?
- 22 A No.
- 23 Q Okay. It would have gone through several levels?
- 24 A Absolutely.
- Q Okay. Let me show you another document. This may

- 1 shed some light on things. This is an e-mail from someone
- 2 named (b)(7)c to Wright dated 5/18/98. It's a one page document,
- 3 and we're going to mark it as Exhibit 7.
- 4 (Exhibit No. 7 was marked for
- 5 identification.)
- Do you know who was?
- 7 A He was an ex -- an examiner.
- 8 Q And Hugh Wright?
- 9 A Hugh was the former head of enforcement. And if
- 10 he -- if Spence was there, then he was over working in the
- 11 regulation as the administrator.
- 12 Q Okay. In this e-mail, it says "I received a note
- 13 from " -- I don't know if I pronounced that
- 14 right -- "to contact (b)(6), (b)(7)c re a BD exam. (b)(6), (b)(7)c
- 15 enforcement, Washington D.C., explained he received a
- 16 referral from U.S. customs department regarding possible
- 17 money laundering and wanted information regarding our BD
- 18 examination of Stanford Group. I orally provided him info
- 19 from report and deficiency letter."
- 20 Do you think that might have been part of what you
- 21 were discussing earlier, that there was a referral from the
- 22 U.S. Customs Department, as well?
- 23 A It could have been. I -- I -- I don't know. I
- 24 just -- my memory is that there were several agencies.
- 25 Customs could have been at that meeting. Those are just some

- of the names of agencies that I remembered, and I remembered
- 2 money laundering as an allegation.
- 3 Q Okay. Do you remember at any point in time the
- 4 Texas State Security Board having any involvement in the
- 5 Stanford matter?
- A I don't believe they were at that meeting that I
- 7 attended; but I don't -- we routinely would do things -- you
- 8 know, parallel type investigations. So while I don't have a
- 9 specific recollection, it would not surprise me if they were.
- 10 Q And did you do any other work related to Stanford
- 11 while at the SEC before you left the SEC other than the MUI
- 12 that we discussed?
- 13 A To the best of my recollection, that was the only
- 14 matter that I worked in involving Stanford.
- Q Okay. And then when you went to the book , you
- 16 began working on another Stanford matter?
- 17 A In 1995 -- I'm sorry -- 2005, I worked on a matter
- 18 involving Stanford.
- 19 Q Okay. I'm not going to get into a lot of details
- 20 about that.
- 21 A Okay.
- 22 Q But that matter you worked on regarding Stanford in
- 23 2005, did that relate to possible fraud or a Ponzi scheme?
- 24 A Yes.
- Q Okay. So at that time, when you got the

- 1 conversations with him.
- 2 O What about with

Do you remember any

3 conversations you had with

about the Stanford MUI

- 4 in '98?
- 5 A No, but I definitely would have -- I mean the --
- 6 the branch chiefs worked very closely with the -- with the
- 7 staff lawyers. And so she would have been involved in, you
- 8 know, every step of what I was doing. And we would have been
- 9 talking to Spencer and most likely Hal, too.
- 10 Q But you would have had more conversations with
- 11 , you think, about the Stanford matter than with
- 12 Spencer?
- 13 A You know, I don't -- I don't know because it's --
- 14 if -- if they -- they being Spence and Hal, who were kind of
- 15 the senior management in the enforcement area during this
- 16 time period, the 1998 time period -- and if there was
- 17 something that they were interested in, they could be -- you
- 18 know, they could be very proactive.
- 19 I mean I know that sometimes the branch chiefs used
- 20 to get frustrated but -- feeling like Spence and Hal would go
- 21 over their heads to, you know, get involved and stuff. So --
- 22 so I don't -- you know, I don't know how many conversations I
- had with Spence versus (5)(6), (6)(7)C
- Q Were there times where a lawyer for the subject of
- 25 an investigation or the target of investigation would contact

- 1 someone above either the staff attorney or branch chief level
- 2 like Spence or Hal and get them involved in the case?
- 3 A That was very common.
- 4 Q And did some staff attorneys or branch chiefs
- 5 sometimes feel like they were being undercut when that would
- 6 happen?
- 7 A You know, I think that the answer to that -- and I
- 8 can only speak for myself -- it was -- it was frustrating'
- 9 sometimes; but it happened.
- 10 Q What was frustrating about it?
- 11 A Just that -- the feeling that -- and this is not in
- 12 respect to a specific case, but it happened to me several
- 13 times while I worked there -- but just that, you know, I'm
- 14 working on this case; and this person is really trying to
- 15 undermine me; but, you know, it was a frequent occurrence,
- 16 just the way it was, and --
- 17 Q So when you say this person would try to undermine
- 18 you, you mean counsel for the person you were against in the
- 19 case?
- 20 A Correct.
- 21 Q And the counsel would be at least somewhat
- 22 successful in that if they brought in people who were above
- 23 you?
- 24 A You know, it wasn't the matter -- I mean because
- 25 I -- because it was a frequent occurrence, I don't -- and I

- 1 don't think the managers even minded getting those calls. I
- 2 mean I think it was just a frequent occurrence.
- 3 And, you know, it wasn't -- like in my cases, I
- 4 mean everyone was always kept well informed as to what was
- 5 going on. So I don't think it was a surprise to -- to
- 6 anyone; but, you know, it was just -- it was just
- 7 frustrating. You're dealing with somebody.
- 8 You're -- things seem to be going fine. And then,
- 9 you know, Spence walks in your office or Hal walks in "I just
- 10 got a call from this person." And it wasn't -- you know, my
- 11 recollections of when it happened to me, it wasn't situations
- 12 where they were necessarily complaining about something
- 13 you've done. It was just they wanted to talk to someone more
- 14 important than you were.
- 15 Q And then you had to explain what was going on in
- 16 the case, your position, to Hal or Spence in order to get --
- 17 A Well, it depends on the circumstances. I mean
- 18 there were times where lawyers just felt like "I don't want
- 19 to deal with the staff attorney. You guys don't have any
- 20 power. You don't have any authority. You know, I want to
- 21 deal with someone who can make decisions."
- 22 So in those instances, as I said, it wasn't always
- 23 like the staff attorney is doing something they don't like.
- 24 It was "just you don't have enough power. You don't have
- 25 enough clout."

- 1 And then there would be times where if they felt
- 2 like, you know, you were making unreasonable demands or
- 3 requests or time frames or things of that nature. So in
- 4 those instances, yes, I would have to explain this is why I'm
- 5 not giving an extension or this is why -- you know, whatever
- 6 the issue was.
- 7 Q And in those cases, the motivation of the outside
- 8 lawyer would be to try to get a better deal by getting
- 9 somebody else involved than the deal they were getting from
- 10 the staff attorney?
- 11 A They -- I mean in those instances and specifically
- 12 those instances where they are complaining about something
- 13 that the staff lawyer is doing, they are -- they were trying
- 14 to right whatever the thing -- the thing they perceived to be
- 15 wrong.
- 16 Q Right. But in doing so, they would be getting
- 17 something out of it? You would -- they would try to convince
- 18 your higher-ups to have something that wasn't as strict as
- 19 what you were requesting in that case?
- 20 A Well, you know, one thing that comes to mind that
- 21 was a frequent issue was the timing of production of things
- 22 or the scope of production. And so I do recall instances
- 23 where, you know, lawyers went to Spence or Hal trying to
- 24 either get additional time or that type of thing.
- 25 Q And so were they successful in getting additional

- 1 time or a smaller scope when they would go to Hal or Spence?
- 2 A You know, I just don't -- I don't recall. I mean
- 3 I -- I think it depended on the -- the issue, whether or not
- 4 there had been extensions previously. It was just, I think,
- 5 case-by-case.
- 6 Q So when you were working on a matter as a staff
- 7 attorney, you knew that the person you're dealing with on the
- 8 outside could go above you at any time?
- 9 A Right. And it happened often.
- 10 Q Okay.
- 11 MR. : A couple of questions.
- 12 MR. KOTZ: Okay. is going to ask a
- 13 couple of questions.
- 14 EXAMINATION
- 15 BY MR.
- 16 Q Just in kind of the vein Mr. Kotz left off. One of
- 17 the exhibits he showed you earlier was an exhibit from Mr.
- 18 Ballard. It was a letter from Mr. Ballard to you. And among
- 19 other things, it requested a meeting with Mr. Degenhardt. Do
- 20 you recall if such a meeting occurred.
- 21 A No, I do not recall.
- 22 Q You don't recall that you participated in a meeting
- 23 in an office with Mr. Ballard or Mr. Secore?
- 24 A No. And to be honest with you, I don't even recall
- 25 who Mr. Ballard was. I recall Mr. Secore because he's

- 1 someone that I have continued to deal with; but Mr. Ballard,
- 2 I don't even recall who he is.
- 3 Q Do you recall ever hearing that Mr. Secore had
- talked to Mr. Degenhardt or Mr. Barasch about the matter, the
- 5 Stanford MUI?
- A No, I don't recall other than, you know, just what
- 7 I read in the letter.
- 8 Q Did you -- and I'm apologize if you've already gone
- 9 over this. But I'm trying to get sort of a sense in my own
- 10 mind of how much work was done during the course of the MUI
- 11 before it was closed. You know, a very long document request
- 12 was sent out. But in addition to that, was there anyone that
- 13 the staff interviewed or --
- 14 A You know, based on the -- the letters there, it
- 15 appears that we made requests for informal interviews. And I
- 16 have no recollection as to whether or not they actually
- 17 happened, but it appears that they were requested if they
- 18 send that letter.
- 19 Q Okay. Would there have been any records that would
- 20 have been maintained if there were such interviews conducted
- 21 in their -- in the SEC's NRSI system, for example?
- 22 A I'm sorry. The what system?
- 23 Q The NRSI system. I'm just trying to ascertain
- 24 whether there's any way that we could determine today whether
- 25 anything has been done, an entry has been made in the NRSI

## EXHIBIT 8

## UNITED STATES SECURITIES AND EXCHANGE COMMISSION

In the Matter of:

) File No. OIG-526

OIG-526

WITNESS: Witness No. 3

COPY

PAGES: 1 through 38

PLACE:

Securities & Exchange Commission

801 Cherry Street

Burnett Plaza, Suite 1900

Fort Worth, Texas 76102

DATE:

Tuesday, December 15, 2009

The above-entitled matter came on for hearing, pursuant to notice, at 9:06 a.m.

Diversified Reporting Services, Inc.

(202) 467-9200

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Page 2
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      APPEARANCES:
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      On behalf of the Securities and Exchange Commission:
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- 1 A Yeah. I'm thinking '78, uh-huh. Probably '78. And
- 2 then in January of 1981 I became the Assistant Regional
- 3 Administrator for Regulation.
- 4 Q Okay.
- 5 A And I held that position from '81 to '83. I left
- 6 from '83 to '86 and I was regional counsel for the NASD.
- 7 Q Oh.
- 8 A And then I came back in '86 -- I was gone three
- 9 years almost exactly and then I retired -- and I held that --
- 10 I came back as assistant for regulations the same job I had
- 11 before and I retired in that position in -- well, at the end
- 12 of 1997. I think my official departure date was like January
- 13 the 2nd, '98, something like that.
- 14 Q What were your duties in the time period 1986 to
- 15 1998 as Assistant Regional Administrator for Regulation?
- 16 A Okay. Well, I was a general supervisor for all the
- 17 regulatory activities in the office. That included examiners
- 18 in the broker-dealer section, Investment Advisor section,
- 19 Investment Company section. I also oversaw the consumer
- 20 affairs person. And I think when I came back we still did
- 21 have a full disclosure branch. We did at that time. Later
- 22 that was eliminated, but that was also under my supervision.
- 23 Q So how many people total were under your
- 24 supervision?
- 25 A I think at the time I retired, I'm just going to

- 1 Q Maybe with
- 2 A That could be. I would have talked -- I know I
- 3 talked to Julie, and if there was another examiner involved,
- 4 I would have spoken to him, also.
- 5 Q Do you remember what you talked to Julie about with
- 6 respect to the exam?
- 7 A Well, I looked at the documents and she refers in
- 8 here to this brochure.
- 9 Q Right.
- 10 A And I do remember that brochure. And, yeah, I
- 11 talked to them about -- well, the things that were obvious
- 12 and that she is speaking here that she's concerned about is
- 13 they -- one of the things is -- well, she doesn't really say
- 14 this in here, but the interest that those CDs were paying and
- 15 those -- they called it the Flex account. I had forgotten --
- 16 I don't remember about that particularly, but I do remember
- 17 they were offering these CDs offered by this offshore bank
- 18 that was affiliated with Mr. Stanford.
- 19 Q Right.
- 20 A He was involved in it. Maybe he owned it. I don't
- 21 -- I don't remember specifically about that.
- 22 Q Sure.
- 23 A But I do remember that the -- the thing that
- 24 aroused my suspicion and that I think I remember, this is
- 25 what I recall, is that the interest that they were

- 1 purportedly paying on these CDs was significantly higher than
- 2 what you could get on a CD in the United States. And as far
- 3 as I know -- I mean, I wasn't an expert on foreign
- 4 investments, but I was generally aware of the financial
- 5 situation around the world at that time. And whatever it was
- 6 he was offering was far above what anybody else offered, so
- 7 that was, you know, kind of a red flag.
- 8 Q Okay. And also the fact that in the brochure in
- 9 the products they used they talked about how they were
- 10 investing in, you know, investment-grade bonds, --
- 11 A Exactly.
- 12 Q -- safe, conservative approach.
- 13 A Exactly.
- 14 Q So did you come to the conclusion at that time that
- 15 it didn't seem possible that these kinds of returns could be
- 16 achieved using that conservative approach?
- 17 A I felt it was highly unlikely.
- 18 Q Okay. And so let me show you another document.
- 19 This is a STARS printout, Super Tracking and Reporting
- 20 System. If you remember the STARS system back in the day.
- 21 (SEC Exhibit No. 3 was marked for
- 22 identification.)
- 23 THE WITNESS: I don't remember it.
- 24 BY MR. KOTZ:
- 25 Q I'm going to mark this as Exhibit 3, and it's a

- 1 several-page document -- five-page document that's a
- 2 printout. It says on the top Office of Compliance Inspection
- 3 and Examination Super Tracking and Reporting System.
- 4 A Okay.
- 5 Q You see on this document it has the examination
- 6 information, exam start date, entity name, field work start
- 7 date, the lead examiner, 00,00,00,00,00,00
- 8 A It says field work start date not known.
- 9 Q Right. Field work end date 8-29-1997.
- 10 A '97. Okay.
- 11 Q Last exam inspection date 9-25-1997.
- 12 A Uh-huh.
- 13 Q And then if you turn to page five, the last page of
- 14 this document, it says violations description, possible
- 15 misrepresentations, possible ponzi scheme.
- 16 A Uh-huh. Yes. I see that.
- 17 Q So do you recall that that was -- that there were
- 18 those concerns arising from this examination of possible
- 19 misrepresentations and possible ponzi scheme?
- 20 A Absolutely. I do remember that very well.
- 21 Q And so do you recall that because of those concerns
- 22 that came up in the examination, there was a referral made to
- 23 enforcement?
- 24 A Yes.
- Q Okay. Do you know how that referral was made? I

- 1 A And whatever -- he did do that and whatever he
- 2 found was not significant, so I don't remember specific, but
- 3 I'm sure -- but I do remember talking to . I know he
- 4 went down there, so I feel quite confident that I did talk to
- 5 Hugh Wright about it because that was what we always did.
- 6 Q And you also remember that you thought that this
- 7 was a matter relating to Stanford that should be investigated
- 8 by the enforcement --
- 9 A I thought there were a lot of red flags.
- 10 Q Okay. And do you know what enforcement did?
- 11 A No.
- 12 Q Okay.
- 13 A But I retired, you know, shortly -- this says that
- 14 they did that examination in July and I retired at the end of
- 15 the year. To the best of my recollection, nothing had been
- 16 done as of the time I retired.
- 17 Q Okay. And do you recall any frustration on the
- 18 part of you or Julie that enforcement wasn't moving quicker
- 19 to take action with regard to the Stanford matter?
- 20 A Well, it's been a long time, but this is what I
- 21 remember.
- 22 Q Okay.
- 23 A This is what I think I remember.
- 24 Q Okay.
- 25 A There was a -- I thought -- it's my recollection

- 1 there was a major jurisdictional issue, because while Mr.
- 2 Stanford was -- may have been in Houston, Texas dreaming up
- 3 this idea, it's my recollection that, to the best of our
- 4 knowledge, the securities that we were concerned about were
- 5 issued by a foreign entity. They were being sold outside of
- 6 the United States. And the person -- the investors that were
- 7 buying them were foreign citizens not residing in the United
- 8 States, so I remember that -- you know, we had a problem --
- 9 or that's what I think I remember.
- 10 Q Okay.
- 11 A That there was a difficulty about it because there
- 12 was a jurisdictional issue, whether we had jurisdiction over
- 13 it.
- 14 Q Okay.
- 15 A And I think, if I remember from way back, there was
- 16 some kind of case that said the SEC didn't have jurisdiction
- 17 over those things. And in any event, I don't think that the
- 18 Commission itself was interested in entertaining cases not
- 19 involving United States citizens.
- 20 Q Okay.
- 21 A Especially when the scheme was being executed
- 22 beyond our shores.
- 23 Q And is it your recollection that that was kind of
- 24 the perspective of the enforcement division?
- 25 A I think so and I'm not -- and I kind of understood

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1 A Well, all that -- I've been gone 12 years. And
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- 2 during that period of time I probably have seen or talked to
- 3 Julie Preuitt perhaps six times. And every time I talk to
- 4 her I'd say, Whatever happened to Stanford? Because my
- 5 parting words to her upon retirement was keep your eye on
- 6 these people because this looks like a ponzi scheme to me and
- 7 some day it's going to blow up.
- 8 Q Really? You said that to Julie --
- 9 A Yes.
- 10 Q -- Preuitt --
- 11 A Yes.
- 12 Q -- right before you retired?
- 13 A Yes. And every time I talked to her -- you can ask
- 14 her, I'd always say, Whatever became of Stanford?
- 15 Q Huh. And so how did you feel when you learned in
- 16 2009 that --
- 17 A When I picked up --
- 18 Q -- it was an eight billion dollar ponzi scheme?
- 19 A -- the Wall Street Journal and there it was I
- 20 called her up on the phone and I said, You finally got him.
- 21 Finally blew up.
- 22 Q Wow. Although wouldn't you say that if it had been
- 23 investigated and/or stopped in 1997, it would have saved a
- 24 lot of money then when it was finally caught in 2009?
- 25 A Well, obviously.

- 1 Q Okay. Do you remember anything at that time about
- 2 other concerns about Stanford relating to money laundering or
- 3 drug trafficking?
- 4 A That sounds kind of familiar. I think we might
- 5 have speculated about that, because of just, you know, the
- 6 business as a whole, the way he was conducting his business
- 7 and where was he getting all of this money and he was -- I do
- 8 remember this -- or this is my recollection, that he was
- 9 primarily selling these -- I don't -- I see in this -- let me
- 10 start over.
- 11 Before I read this exam report again today, it was
- 12 my recollection that his customers or we believed his
- 13 customers to be exclusively outside of the United States and
- 14 non-American citizens. When I'm reading the exam report it
- 15 sounds like they were soliciting people within the United
- 16 States, because we're talking about the books and records and
- 17 -- well, it actually said in the exam report how many
- 18 accounts they had and -- maybe 2,500 and 1,200 of which were
- 19 foreign accounts. I believe those were the numbers. And I
- 20 didn't -- yeah. Firm has approximately 2,000 customer
- 21 accounts of which apparently 1,200 were foreign.
- I thought -- what I thought before I came in today
- 23 my recollection was that virtually all of their customers
- 24 were outside the United States. And what the business that
- 25 the broker-dealer was doing, which seems to be confirmed by

- 1 the report, was just a regular broker-dealer business. They
- 2 were just, you know, dealing in OTC exchange -- I don't know
- 3 what kind of securities but nothing exotic.
- 4 Q Right.
- 5 A And I don't know where I was going on this, but
- 6 just to emphasize that we thought most of all of this
- 7 activity was going on outside the United States and they were
- 8 focusing on customers in Mex -- I don't remember Mexico
- 9 specifically but south of the United States, the western
- 10 hemisphere south of the United States, and that they didn't
- 11 really -- and that bothered me.
- 12 Back to the money laundering thing. Now I know
- 13 where I was going on that. Why I was concerned about that,
- 14 because at that time -- well, and even today, as we know,
- 15 there's a lot of drug and narcotics trafficking through South
- 16 America --
- 17 Q Right.
- 18 A -- and Central America and so forth and we know
- 19 that a lot of that money is laundered. And so I was just
- 20 looking at his business as a whole merely speculating,
- 21 absolutely no evidence, --
- 22 Q Right.
- 23 A -- just thinking, --
- 24 Q Right.
- 25 A -- that this was a good opportunity, a good way to

- 1 launder money.
- 2 Q Right.
- 3 A I didn't know if he was doing it or not.
- 4 Q Okay. I see.
- 5 A But I was just -- I had thoughts in my mind about
- 6 that.
- 7 Q Okay. And did you hear of anyone else coming --
- 8 any other tips that came from the outside about that or do
- 9 you think that was just based on your speculation of what
- 10 they found in the exam?
- 11 A I don't know.
- 12 Q One matter that was in the exam report related to
- 13 the fact that there was a 19 million dollar cash contribution
- 14 made --
- 15 A Uh-huh.
- 16 Q -- by Stanford.
- 17 A Uh-huh.
- 18 Q And that the general counsel stated that the cash
- 19 contribution came from personal funds and not from the above
- 20 loans, but then the report concludes, seems at least
- 21 questionable whether Stanford had access to 19 million
- 22 dollars in personal funds. Do you remember that being also
- 23 kind of a red flag that there was this huge cash
- 24 contribution?
- 25 A One of several, yes, absolutely.

```
1 And when I came back one of the very first cases I
```

- 2 worked on was an investment company case and Spence Barasch
- 3 was a new lawyer in the office and he was assigned to it.
- 4 And so maybe he wasn't -- maybe -- you know, Wayne might have
- 5 hired him. I don't know.
- 6 Q Okay.
- 7 A But right at the end of his --
- 8 Q Okay.
- 9 A And other than their relationship, that I don't
- 10 know.
- 11 Q Okay. Were you aware -- and this might have
- 12 occurred after you left, but were you aware that the
- 13 Investment Advisor, Investment Company examinations group did
- 14 an examination of Stanford in early 1998?
- 15 A No. I would have been gone by then.
- Q Okay. What was your assessment of

17 ability as an examiner?

- 18 A I thought he was very competent.
- 19 Q Okay. And what about Julie Preuitt as a Branch
- 20 Chief?
- 21 A Excellent.
- Q What about the folks who did the ICIA exam,

23

- A Oh, He knows everything there is to know
- 25 about the Investment Adviser's Act and Investment Company

## EXHIBIT 9

COPY

## UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WITNESS: Witness No. 4

PAGES: 1 through 47

PLACE: Securities & Exchange Commission

801 Cherry Street

Burnett Plaza, Suite 1900

Fort Worth, Texas 76102

DATE: Tuesday, December 15, 2009

The above-entitled matter came on for hearing, pursuant to notice, at 10:11 a.m.

Diversified Reporting Services, Inc. (202) 467-9200

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Page 8
 1
          Q
               Okay. What year was that?
          Α
               1985.
 2
 3
               Where did you get that degree?
                         . Actually '84. I'm sorry. I started
 4
 5
     employment in '85.
 6
               Okay. And did you work for the SEC right after
 7
     graduation?
               No. I went to the
 9
               Okay. How long did you work for the
10
          Q
11
          A
               Seven years.
               Okay. So that was from approximately 19 --
12
          Q
               '85 to '92.
13
          Α
               To 1992. What did you do for the
14
          Q
15
               I was an examiner.
16
               Okay. What kind of examinations did you work on?
17
               Broker-dealer, same function I do now -- well,
     before I moved over to IA, but.
18
               Okay. And so in 1992 did you join the SEC?
19
20
               Yes. September.
          A
21
               September 1992. What was your first position at
     the SEC?
22
23
          Α
               Examiner. I don't know my exact title, but
     function was examiner.
24
              It might have been staff accountant?
25
          Q
```

- 1 A I don't think we had staff accountant at that time.
- 2 I was probably compliance examiner.
- 3 Q Okay. And so how long did you serve as a
- 4 compliance examiner?
- 5 A The function I'm still doing. The title -- I'm not
- 6 exactly sure when we went to staff accountant, but it was
- 7 like a couple years later.
- 8 Q Okay.
- 9 A I mean -- yeah, staff accountant.
- 10 Q So sometime in the mid-1990's?
- 11 A Yes. Whenever they allowed us that promotion.
- 12 Q Okay. And so from then on till today you're a
- 13 staff accountant with the SEC?
- 14 A Yes.
- 15 Q Now, in the 1997 time period, do you remember who
- 16 your supervisor was?
- 17 A I believe it was Julie Preuitt.
- 18 Q And she was the Branch Chief?
- 19 A Yes.
- 20 Q Okay. Prior to conducting an exam in August of
- 21 1997, had you ever conducted an exam that related to
- 22 broker-dealers for involvement in possible ponzi schemes?
- 23 A Not to my knowledge, no.
- 24 Q Okay. When did you first learn of the existence of
- 25 Allen Stanford, the Stanford Group Company or Stanford

- 1 A -- side of it.
- 2 Q Right.
- 3 A And I know it talks about some people I talked
- 4 with. I never talked to Mr. Stanford at all.
- 5 Q Okay.
- A I don't even know if I ever saw him. And as far as
- 7 being responsive, my best recollection, yes.
- 8 Q Okay. All right. Let me ask you about some
- 9 specifics in the findings. The finding possible
- 10 misrepresentations Rule 10b-5.
- 11 A Uh-huh.
- 12 Q It talks about the fact that SIB promoted its
- 13 products as being safe and secure, referenced
- 14 investment-grade bonds, safety of assets, conservative
- 15 approach, yet it paid out in interest and referral fees on a
- 16 CD 11 to 13.75 percent. Is that a concern?
- 17 A The 11 -- are you talking about the last sentence
- 18 there?
- 19 Q Yeah.
- 20 A That 11 to 13 and three quarters was an overall --
- 21 that would include what they paid to the reps. --
- 22 Q Right.
- 23 A -- plus what they were paying out for the CDs.
- In my mind, yes, that was a concern, because what
- 25 they represented to me was that this bank would take these

- 1 funds and were investing in safe, liquid securities. Well, I
- 2 don't know where you can find something that's safe and
- 3 liquid that's going to pay 11 to almost 14 percent.
- 4 Q Right.
- 5 A It just doesn't exist.
- 6 Q Right.
- 7 A And what they explained to me was that they were --
- 8 they were investing in foreign-type securities, maybe, you
- 9 know, Mexican bonds or some foreign -- the government-type
- 10 issuances or maybe even corporations, but that's the way they
- 11 represented it to me. And a lot of this language here, and I
- 12 sure wish we had the work papers, came from the brochure that
- 13 they were providing to the clients.
- 14 Q Okay. They were very fancy glossy brochures?
- 15 A Oh, yeah. And they were just a little bit bigger
- 16 than 11 and a half papers. Yeah. They were slick.
- 17 Q So is it fair to say you didn't believe that they
- 18 were able to achieve these kinds of returns with the types of
- 19 investments that they were claiming?
- 20 A I had my doubts, yes.
- 21 Q Okay. And then if you could look at page three of
- 22 this document, Exhibit 2, the exam report. There's a
- 23 reference to cash contribution of 19 million dollars.
- 24 A Uh-huh.
- Q What was your concern about that?

- 1 A Well, just what it says, I didn't -- I didn't know
- 2 Mr. Stanford, but it just baffled me that someone has 19
- 3 million dollars cash sitting on-hand to -- to loan out.
- 4 Q Right. And the fact that the general counsel
- 5 stated that the cash contribution came from personal loans,
- 6 that didn't seem to be evidenced anywhere?
- 7 A No. And I'm trying to remember where I got this.
- 8 I believe it was from either -- either the bank brochures
- 9 that we had or -- it was probably from the bank brochures.
- 10 I'm not exactly sure where it came from.
- 11 Q Okay. But the general counsel couldn't demonstrate
- 12 that it came from personal funds, not to your satisfaction.
- 13 A They didn't -- no.
- 14 Q Okay. And then the maintenance of books and
- 15 records issue, if you see in that paragraph it talks about
- 16 the fact that the RR is recommending a particular product of
- 17 SIB's and therefore should have a basis for making that
- 18 recommendation.
- 19 A Uh-huh.
- Q What was the issue there?
- 21 A Well, if you're going to recommend a particular
- 22 investment, you need to know that that investment is suitable
- 23 for that client.
- 24 Q Right.
- 25 A And in this instance, they weren't -- they didn't

- 1 have that, I guess, new account information that we would
- 2 require, name, address, financial background.
- 3 Q So during the examination was anybody able ever to
- 4 explain to you what investments were being used specifically
- 5 that could achieve these returns?
- 6 A Other than the foreign bonds and whatnot. I mean,
- 7 that's --
- 8 Q That's all they told you, it was in foreign bonds?
- 9 A Right. It was other than U.S. and it was -- yeah,
- 10 either corporate or government-issued bonds, securities.
- 11 Q So the people who were selling the CDs or trying to
- 12 convince people to buy the CDs weren't able to articulate
- 13 exactly how these returns were being achieved?
- 14 A Right. It was probably Mr. Stinson is who I talked
- 15 to.
- 16 Q Okay.
- 17 A Or Lena, Mrs. Stinson, --
- 18 Q Okay.
- 19 A -- and that's the explanation I got. Well,
- 20 actually that's the books and records.
- The FlexCD, that information, when I asked how --
- 22 what investments were being invested in with the money,
- 23 that's what they told me. But it was all on the SIB -- the
- 24 bank side. And since we didn't have jurisdiction --
- 25 Q Right.

- 1 A -- I didn't have access to that side of the
- 2 business.
- 3 Q Okay. But it's fair to say that there were
- 4 significant red flags that came out of your examination of
- 5 Stanford in 1997?
- 6 A Yes. I mean, the 10b-5 is very significant.
- 7 Q Let me show you another document and that is a
- 8 printout from the STARS system. Do you remember --
- 9 A Yeah.
- 10 Q -- the STARS system?
- 11 A I don't have -- I don't put that information in the
- 12 system.
- 13 Q Okay. But still maybe it can help.
- 14 A It's accessible. And I don't know that I even --
- 15 at that point I don't think I even had access to it. I do
- 16 now.
- 17 BY MR. KOTZ:
- 18 Q Let me show you the document. We're going to mark
- 19 it as Exhibit 3, Office of Compliance Inspection and
- 20 Examination Super Tracking and Reporting System and it's a
- 21 five-page document.
- 22 A It's a mouthful, isn't it?
- 23 (SEC Exhibit No. 3 was marked for
- 24 identification.)
- 25 BY MR. KOTZ:

- 1 Q So you see it talks about the date of the exam,
- 2 lists you as lead examiner, but you don't think you would
- 3 have been the one to put this information in the system?
- 4 A No.
- 5 Q Okay. Do you know who would have been?
- 6 A It could have been Julie. I'm not sure.
- 7 Q Okay. If we could turn to the last page of this
- 8 document, page five.
- 9 A (Witness complied).
- 10 Q See under violations description it says possible
- 11 misrepresentations, possible ponzi scheme?
- 12 A Uh-huh.
- 13 Q So is it fair to say that that was accurate in
- 14 terms of the possible concerns that you had arising out of
- 15 the 1997 examination of Stanford?
- 16 A I don't recall talking about ponzi scheme. Most of
- 17 my concerns was with the misrepresentations that they were
- 18 obtaining investment funds on misinformation to the investor.
- 19 They were saying that their deposits were being invested in
- 20 the liquid, safe investment and that there was no -- based on
- 21 this there was -- the likelihood of them losing their money
- 22 was small.
- Q Okay. But was there kind of an overall concern of
- 24 possible fraud, maybe not specifically a ponzi scheme, but
- 25 overall concern that there might have been fraud going on?

- 1 Q But as far as the examination record, that would
- 2 close the matter, the deficiency response?
- 3 A Yes.
- 4 Q All right. Do you remember at any time you or
- 5 Julie trying to encourage enforcement with respect to this
- 6 investigation of the findings you made?
- 7 A I don't recall like sitting down with someone and
- 8 saying you need to take this. I don't recall that, but I --
- 9 I do know that I wanted them to. I thought this was
- 10 something that was absurd and someone needed to look at it.
- I know that because it was a foreign offshore,
- 12 didn't -- and that was another thing when I looked at the
- 13 exam, one of the concerns was were there U.S. investors
- 14 involved in this.
- 15 Q Right.
- 16 A And part of my sampling I tried -- I looked at
- 17 accounts to see if there were any U.S. investors that had
- 18 invested at SIB and I didn't note any. And so based on that
- 19 and the fact that it was represented to us that everything is
- 20 foreign investors, and since, you know, we kind deal with
- 21 U.S. investors, it was -- that's kind of more also why we
- 22 gave it to enforcement to see if they could handle it.
- 23 But my understanding was because it primarily was
- 24 foreign investors that's probably why it didn't proceed as
- 25 much as it should have.

- 1 Q You were aware, were you, that a MUI, a matter
- 2 under inquiry, was eventually opened in April of 1998?
- 3 A I may have been.
- 4 Q Okay. But were you aware that enforcement was
- 5 looking at this matter?
- 6 A Yes.
- 7 Q Okay.
- 8 A Yeah.
- 9 Q And you're aware that eventually they didn't do a
- 10 full-blown investigation?
- 11 A I'm sure I was. It was -- you know, it was kind of
- 12 a disappointment, but it was explained that since it was
- 13 foreign investors and offshore entity that, you know, we
- 14 didn't have -- my understanding was we didn't have a lot of
- 15 jurisdiction.
- 16 Q So that was the reason that was given to you as to
- 17 why enforcement didn't do a full-blown investigation?
- 18 A That was my understanding. I don't know if they
- 19 actually verbalized it or, you know, gave me a letter, but
- 20 that was my understanding.
- Q Okay. And that was, you think, from Julie or did
- 22 you talk to the enforcement people yourself?
- 23 A Oh, I don't know if I talked with anybody directly.
- 24 It was probably just kind of filtered down.
- Q Okay. Do you remember anything about other

- 1 allegations about Stanford relating to money laundering or
- 2 drug trafficking?
- 3 A No. I don't recall -- that wasn't a focus. I
- 4 mean, that was kind of -- I don't know if hearsay is the
- 5 right word, but it was just something, man, all this money,
- 6 something's got to be going on wrong, but I didn't know
- 7 anything.
- 8 Q Okay. And do you know if the enforcement division
- 9 was looking into that issue, that possible --
- 10 A No. To my knowledge, no. I mean, my understanding
- 11 of him, you know, Mexia, which is just south of here, that's
- 12 where his family is from. And so that's kind of -- he had
- 13 Texas ties.
- 14 Q Who is that? Stanford?
- 15 A Yeah.
- Q Do you remember anything about (b)(6), (b)(7)c going
- 17 down to Mexia and checking out where the operation took
- 18 place?
- 19 A I don't recall that. I know he lives -- he has a
- 20 farm down there, so.
- Q Okay. What about Spence Barasch? Did you work
- 22 with him at all?
- A He was an attorney. I don't know what level he
- 24 was, but, yes.
- 25 Q Do you know if he was involved in the decision on

- 1 Stanford?
- A He could have been.
- 3 Q Okay. Did Julie Preuitt ever express to you
- 4 frustration that she felt like the enforcement group wasn't
- 5 taking this matter on as significant --
- A I'm sure we both discussed the fact that we were
- 7 frustrated that it wasn't going forward.
- Q Okay. Was there at that point in time sometimes
- 9 some tension between the examination group and the
- 10 enforcement group in terms of when matters would be referred
- 11 from examinations?
- 12 A I never was. Management might have been.
- 13 Q Okay.
- 14 A I didn't.
- 15 Q But there were times where folks in the examination
- 16 group felt that the enforcement attorneys weren't focused as
- 17 much as they could have been on some of these referrals?
- 18 A I'm sure there were times, sure, but I didn't dwell
- 19 on it.
- Q Okay. Were you aware that in July 1998 the
- 21 Investment Company, Investment Advisor examination group went
- 22 in again on Stanford?
- 23 A At the time, no. I do now.
- Q Okay. And are you aware now that they -- that they
- 25 found some of the same concerns that you had found?

- information, answer questions about the broker-dealer, but
- 2 this SIB, they don't know anything about?
- 3 A Yes. Yeah. They -- you know, that was -- that was
- 4 Allen's deal. And I do know that --
- 5 Q I'm sorry. You said that was?
- 6 A Allen, Allen Stanford.
- 7 Q Oh, Allen Stanford.
- 8 A That was his bailiwick, but I do recall -- and I
- 9 don't know where the information came from but -- probably
- 10 from them, that he did have a bank once before at another
- 11 island and hurricane came through and knocked it out and so
- 12 that's why he moved his -- the bank to Antigua. Is that
- 13 where it is now?
- 14 Q Right.
- 15 A So I got that bit of history.
- 16 Q But to the extent you asked questions about SIB,
- 17 the response would be --
- 18 A They -- they were open, you know, as far as it's a
- 19 bank over there and they do these deposits and they have
- 20 these FlexCDs and we -- we refer clients -- I call them
- 21 clients, they wouldn't, but, you know, we refer the foreign
- 22 investors to them with an application and once it's over
- 23 there, we're out of the -- we're out of the picture, so.
- Q Do you remember an issue where there was a
- 25 recurring annual referral fee? In other words, this was a

- 1 referral fee and then the next year they got the fee again
- 2 and the next year again.
- 3 A Uh-huh.
- 4 0 Is that odd?
- 5 A To me it was and that's why I -- you know, the
- 6 whole thing just didn't smell right to me, so.
- 7 Q I mean, had you ever heard of a situation where you
- 8 could refer a CD for -- customers for a CD and every year
- 9 they --
- 10 A As long as the money stayed in the bank was my
- 11 understanding. As long as the client funds were at the bank
- 12 and a CD they were getting a referral fee. You know, like
- 13 mutual funds do the same thing with their trailers, but it's
- 14 not that high.
- 15 Q Right.
- 16 A They have smaller trailers.
- 17 Q Right. And if the SIB was paying out in interest
- 18 and referral fees between 11 and 13.75 percent, there must
- 19 have been a portion that they were making in addition to
- 20 that, right?
- 21 A Yeah. Well, yeah. You wouldn't want to be doing
- 22 this for free.
- 23 Q So that would be at least a couple or one or two
- 24 points at least higher than 11 to 13.75 percent. So really
- 25 with these very conservative investments they were making

- 1 upwards of close to 15 percent?
- 2 A You could say that and this was my concern as well.
- 3 Q Right.
- A And this three and -- or three and three quarter,
- 5 the recurring referral, I'm sure that the broker-dealer kept
- 6 part of that --
- 7 Q Right.
- 8 A -- and paid out the rest to the rep. who brought
- 9 the client to the bank.
- 10 MR. How far back were those rates going as
- 11 far as the rate's return that you got the information for?
- 12 THE WITNESS: How far back?
- 13 MR. : In time from -- was this going on --
- 14 were those the rates of the return for two or three years or
- 15 just for the -- that current year?
- 16 THE WITNESS: It was that current year. And if I
- 17 had the brochure I could -- we could answer the question a
- 18 little better. I do have a footnote that the referral fee
- 19 prior to me being there was as high as five percent, so that
- 20 was even a little crazier, --
- 21 BY MR. KOTZ:
- 22 Q Right.
- 23 A -- if you will.
- Q Were you aware at the time generally of what CDs in
- 25 the market were giving?

- 1 A I can't recall, but...
- Q But have you ever heard of a CD that's making that
- 3 kind of --
- A Oh, yeah. I was -- I was surprised. And you know
- 5 they kept saying, well, you know, this is foreign and, you
- 6 know, the foreign markets, and I didn't follow foreign
- 7 markets, you know, they have better returns and that was
- 8 their explanation.
- 9 Q Right. But I mean if everybody could get 15
- 10 percent return consistently with foreign markets, then --
- 11 A I agree --
- 12 Q -- we'd all be rich.
- 13 A -- with you. Why are they investing in the U.S.,
- 14 exactly, yeah.
- 15 Q Okay. So you didn't really believe that this could
- 16 be possible?
- 17 A I didn't buy into it, no.
- 18 Q Okay. And that was an opinion that was also shared
- 19 by Julie?
- 20 A Yes.
- 21 Q And by Mary Lou as well?
- 22 A I can't speak to her mind, but I can't -- she
- 23 agreed with it because, you know, she okayed the report.
- Q Right. And do you know if a copy of your report
- 25 was sent to enforcement as part of the referral?

- 1 A I don't know if it was, but that was the procedure
- 2 at the time.
- 3 Q Okay.
- 4 MR. KOTZ: Okay. Why don't we take a minute, take
- 5 a break. I think we're almost done. I just want to confer a
- 6 little bit.
- 7 THE WITNESS: I gotcha.
- 8 MR. KOTZ: So we'll go off the record.
- 9 (A brief recess was taken.)
- 10 BY MR. KOTZ:
- 11 Q All right. We just have a couple more things.
- 12 Nothing too much. We'll go back on the record.
- 13 There was another examination that occurred in 2002
- 14 that also related to Stanford. Were you aware of that one?
- 15 A Probably -- sure. I mean --
- 16 Q At the time?
- 17 A At the time, I'm sure I knew it happened.
- 18 Q Okay. Did you ever have a conversation with the
- 19 folks who did that exam, or
- 20 A Oh, it was an IAIC exam?
- 21 Q Yes.
- 22 A Oh, no. I thought you meant BD. No. I wouldn't
- 23 have known that, because -- I mean, now we have three floors.
- 24 At the time I think we only had two and we were all separate.
- Q Okay. So if IAIC did an exam, even if it was of

- the same entity, you wouldn't necessarily be involved in it?
- 2 A I wouldn't be involved. They may have, you know,
- 3 pulled our report. Chances are back then they didn't
- 4 because, you know, we were -- that's BD and that's IA, we
- 5 just kind of never talked to each other. That's kind of --
- 6 now it's all kind of intermingled.
- 7 Q Right.
- 8 A But, you know, they may have pulled our report and
- 9 looked at it just to get -- glean information, because I know
- 10 that just reading this one, you know, they offered IA
- 11 products, so, you know, they may have looked at it. They may
- 12 even -- what we do is when we go in and do an exam, we look
- 13 at prior exams and look at work papers and reports and kind
- 14 of glean what they were doing then and see if they're still
- 15 doing it now, if they fixed any deficiencies. And I know
- 16 that the IAIC side would do that with their own area.
- 17 Q But not necessarily with the BD area?
- 18 A They could have. I don't know if they did or not.
- 19 Q But nobody came to you in either '98 or 2002 and
- 20 said we're looking at the same entity that you looked at.
- 21 Can I ask you some questions or talk to you about Stanford?
- 22 A To my recollection, no. But that wouldn't be -- I
- 23 mean, they could have and I would have -- I would have talked
- 24 to them, but I don't recall.
- Q Okay. Do you remember anything about other

- 1 BY MR. KOTZ:
- 2 Q And so in 2009, when the SEC brought an action
- 3 against Stanford and it came out he was running a ponzi
- 4 scheme, you weren't surprised?
- 5 A I wasn't surprised that he finally got caught. I
- 6 didn't realize it was a ponzi scheme. I personally just
- 7 thought, you know, he had this bank over there and he was
- 8 just fraudulently obtaining the funds and I didn't think that
- 9 he had the wherewithal to make these returns.
- 10 Q Okay. But you weren't surprised in 2009 when it
- 11 came out that he was engaged in some kind of fraud?
- 12 A No.
- 13 Q And do you kind of wish now that maybe --
- 14 A Oh, yeah.
- 15 Q -- enforcement had gone forward and opened a full
- 16 investigation back in 1997?
- 17 A I wish then that they had but my understanding was
- 18 that because it was all foreign, offshore investors and the
- 19 bank was offshore, that we didn't have jurisdiction. That
- 20 was my understanding.
- 21 Q Okay.
- 22 A Yes. I, at the time, sure, I was gung-ho and
- 23 wanted enforcement to take action.
- 24 Q Okay.
- 25 MR. KOTZ: All right. I think that's all we have.

# EXHIBIT 10

COPY

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

In the Matter of:

) File No. OIG-526

OIG-526

WITNESS: Witness No. 5

PAGES: 1 through 39

PLACE: Law Offices of

DATE: Tuesday, December 15, 2009

The above-entitled matter came on for hearing, pursuant to notice, at 12:47 p.m.

Diversified Reporting Services, Inc.

(202) 467-9200

- 1 conservative investment-grade bonds and securities. And the
- 2 examiners felt that it was not possible for those returns to
- 3 be achieved using the method of investments that Stanford
- 4 stated they were using. Do you remember that as an issue in
- 5 the inquiry that enforcement did of Stanford at that time?
- 6 A What I remember is that -- well, no. I don't --
- 7 what I do remember is I do recall that there was some sense
- 8 that the return was -- was, you know, sort of over-market,
- 9 and so the suspicion was that it was fraudulent, because it
- 10 wasn't realistic, but that really is all I remember.
- 11 Q Okay. And that was what the enforcement division
- 12 was looking at in their inquiry of Stanford in 1998?
- 13 A I suppose that was. And, again, what I remember is
- 14 because there was a foreign aspect to it and there wasn't
- 15 access to the foreign records, that there wasn't sufficient
- 16 information to establish what representations were made or
- 17 what method was used for achieving the return.
- 18 Q Okay. So do you remember whether enforcement made
- 19 efforts to gain that information from this foreign entity?
- 20 A I don't remember if the enforcement staff sought
- 21 assistance from the Office of International Affairs. Their
- 22 ability at that time to help, especially in, you know, a tax
- 23 haven was very, very limited, if at all, so I don't remember
- 24 if that was sought.
- 25 I -- I do think -- so if you're asking broadly what

## EXHIBIT 11

### UNITED STATES SECURITIES AND EXCHANGE COMMISSION

SUBJECT: TELEPHONE INTERVIEW OF CONFIDENTIAL WITNESS

PAGES: 1 through 17

PLACE: Securities and Exchange Commission

100 F Street, N.E.

Washington, D.C. 20549



AUDIO TRANSCRIPTION

Diversified Reporting Services, Inc. (202) 467-9200

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Page 2
 1
     APPEARANCES:
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     On behalf of the Securities and Exchange Commission:
 3
          H. DAVID KOTZ, ESQ., Inspector General
          (b)(6), (b)(7)c
 6
 7
          Securities and Exchange Commission
 8
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          100 F Street, N.E
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          Washington, D.C. 20549
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           (202) 551-6037
12
13
     On behalf of the Witness:
14
                        Pro Se
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to (b)(7)c memorandum from Hugh Wright (phonetic) by 1 2 (phonetic), examination liaison. Here's a copy of the report. 3 Α Okay. 5 So if you look at the second page it references you as an examiner along with (phonetic). 6 was more senior than you, is that right? Yeah, I was more like a follower and he was the 8 lead examiner. But you did work on the Stanford exam, right? 10 0 Yes. 11 Now if you could turn to the next page. You see 12 the exam actually talks about another exam that the 13 14. broker/dealer unit had done. Do you remember that Julie Preuitt and the broker/dealer folks had done an exam prior to 15 your exam? 16 Oh gosh. I remember Julie Preuitt. I now her name 17 18 and I know she worked for the broker/dealer unit. 19 don't remember --20 Do you remember what you were looking for at Stanford, what you were concerned about? Would it be CDs? 21 Α Yeah. 22 23 Stanford was selling these CDs? Q

Yeah, we were looking at some CDs.

And was there a concern that the CDs were getting

24

25

Α

Q

- 1 very high interest rates?
- 2 A Yeah. But that's the only, yeah. But I don't know
- 3 the other reasons why we went there besides CDs.
- 4 Q Okay. Do you remember if Julie Preuitt's group did
- 5 an examination?
- 6 A No I do not remember Julie Preuitt did an
- 7 examination just so you know that. I want to clear that up
- 8 for the record. I do not remember that.
- 9 Q Okay. Do you remember an examination being done
- 10 prior to your examination?
- 11 A Honestly, I can't recall that. I don't remember
- 12 that.
- 13 Q All right. Do you remember when you did the exam
- 14 that you looked at these CDs; one of the missions was the
- 15 CDs?
- 16 A Mm-hmm.
- 17 Q Yes?
- 18 A Yeah. I think we looked at CDs but I don't know
- 19 that we looked at other stuff besides CDs. I'm not sure.
- 20 Q Okay. And were there concerns that the CDs were
- 21 giving these very, very high interest rates, which were
- 22 higher than regular bank CDs at that time?
- 23 A I'm so sorry. It has been a long time ago.
- 24 Q Do you remember Stanford not providing you with
- 25 information that you were asking for? If you could look at

- 1 A It could be. It could be. But there are some
- 2 exams that felt like that, not just Stanford. So I don't
- 3 want to single out Stanford like that. You know, if I think
- 4 back there could be others that there are some; that could
- 5 be. But I just don't remember, but minor things.
- 6 Q You don't remember anything specifically about the
- 7 CDs that Stanford that selling? They were in Antigua?
- A I just remember like CDs that just gave out very
- 9 high rates. I remember that aspect.
- 10 Q Do you remember if you ever figured how he was able
- 11 to give such a high rate?
- 12 A I don't remember.
- 13 Q Is that something that as an examiner you could do,
- 14 is to try to analyze?
- 15 A Yeah, yeah.
- 16 Q To see how it was that such a high rate would be
- 17 given? Is that something that an examiner can do?
- 18 A Yes.
- 19 Q Yes?
- 20 A Yeah, we can ask that information. But I don't
- 21 remember what our results were. I don't remember how did we
- 22 find out or what was the answer. I don't remember that.
- 23 Q Was a good examiner?
- 24 A I think so.
- 25 Q Yeah? Was he well respected in the office?

## EXHIBIT 12

#### UNITED STATES SECURITIES AND EXCHANGE COMMISSION

In the Matter of: )

) File No. OIG-526

OIG-526

COPY

WITNESS: Witness No. 6

PAGES: 1 through 142

PLACE: Securities & Exchange Commission

801 Cherry Street

Burnett Plaza, Suite 1900

Fort Worth, Texas

DATE: / Monday, January 11, 2010

The above-entitled matter came on for hearing, pursuant to notice, at 11:32 a.m.

Diversified Reporting Services, Inc.

(202) 467-9200

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Page 2
 1
     APPEARANCES:
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     On behalf of the Securities & Exchange Commission:
 3
           H. DAVID KOTZ, Inspector General
 4
 5
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           (b)(6), (b)(7)c
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12
     On behalf of the Witness:
13
                                PRO SE
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- A Shortly before the first exam back in '97, I
- 2 believe, sort of in preparation for conducting that first
- 3 exam.
- 4 Q So this is the exam -- and I'll show you documents
- 5 -- that was done by the broker-dealer group. Is that what
- 6 you're talking about, or you're talking about the exam by the
- 7 investment adviser group?
- 8 A I'm talking about the exam by the investment
- 9 adviser group.
- 10 Q Right. Okay.
- 11 A Now, I was familiar with the broker-dealer exam
- 12 generally through discussions, but my real familiarity with
- 13 Stanford started with -- when I started to prepare for my
- 14 exam.
- 15 Q Right. Do you know what triggered the
- 16 broker-dealer exam that was -- occurred before your exam?
- 17 A I don't recall. Maybe I could review the report,
- 18 but I don't recall it.
- 19 Q Okay. Were you aware at any point of a referral
- 20 from the Texas State Security Board to the SEC in the 1990s
- 21 about Stanford?
- 22 A No, not -- not sitting here today, I don't recall.
- Q Okay. And, so, in connection with the exam you
- 24 did, did you gain some familiarity with what the
- 25 broker-dealer side did in their exam?

- 1 A Some, yes, but not a great deal.
- 2 Q Did you ever speak with Julie Preuitt about the
- 3 exam, the broker dealer exam?
- A I don't recall, but I -- I just don't recall.
- Q Okay. What about with (b)(6), (b)(7)c ? Do you
- 6 recall speaking with b)(6),(6),(7)c about that exam?
- 7 A I don't recall.
- 8 Q' What about Mary Lou Feldman?
- 9 A About the broker-dealer exam?
- 10 Q Right.
- 11 A I don't recall.
- 12 Q Okay. Let me show you a document. This is the
- 13 examination report, and we're going to mark this document as
- 14 Exhibit 2.
- 15 (SEC Exhibit No. 2 was marked for
- 16 identification.)
- 17 MR. KOTZ: It is a four-page document -- let me
- 18 see. It's a four-page document. It says on the top Stanford
- 19 Group Company, 5056 Westheimer, Executive Summary and
- 20 Comments, and we're going to mark it as Exhibit 2.
- 21 BY MR. KOTZ:
- 22 Q If you could take a look at this document and tell
- 23 me if you recognize it.
- 24 A I don't recognize it. I don't remember seeing it.
- Q Okay. Do you think, though, that when you were

- 1 preparing to do your exam, you would have read the
- 2 examination report from the BD exam or not necessarily?
- 3 A I'm not a hundred percent sure that the BD exam
- 4 report had been completed at the time I began my IA exam. I
- 5 don't specifically recall, but I would -- believe I would
- 6 have at least have had discussions with the broker-dealer
- 7 examiners about what they were doing.
- 8 Q Okay.
- 9 A I can't recall any specific discussion.
- 10 Q Okay. And do you think that irrespective of
- 11 whether the broker-dealer exam report came out before or
- 12 during your IA exam, do you think you would have read the
- 13 broker-dealer report or not necessarily?
- 14 A Back at that time, I can't say with a hundred
- 15 percent certainty that I would have looked at it or read it.
- 16 I was aware of it. I was aware of what they were finding,
- 17 and I was focusing on what was the adviser doing with respect
- 18 to those CD sales.
- 19 Q Okay. All right. Let me show you another
- 20 document. We're going to mark this one as Exhibit 3. It's a
- 21 STARS printout, Office of Compliance, Inspection and
- 22 Examinations STARS printout, and it is five pages. It says on
- 23 the top, Office of Compliance, Inspection and Examination,
- 24 Super Tracking and Reporting System, STARS. We're going to
- 25 mark it as Exhibit 3.

(SEC Exhibit No. 3 was marked for 1 identification.) 2 BY MR. KOTZ: 3 Do you recognize this, the STARS system? I recognize the STARS system, yes. 5 Okay. And what is the STARS system? It is a system that is designed to track the 7 8 progress and ultimate disposition of examinations. Okay. So if the investment adviser side was going 9 to do an examination, would they look at the STARS system to 10 11 see if another examination had been done? Could, yes. 12 Α Okay. So if you could turn to Page 5 of this 13 14 document, Exhibit 3. If you could see on Page 5 it lists the 15 violations description. Right. 16 Do you see where it says, "Possible 17 misrepresentations. Possible Ponzi scheme"? 18 Yes, sir. 19 20 So was it your understanding at the time that the broker-dealer exam had determined in their examination that 21 there was possible misrepresentations and a possible Ponzi 22 scheme on the part of Allen Stanford when you were working on 23 your exam in 1998? 24 Definitely. 25 A

- 1 Q Okay. What else do you remember about what you
- 2 understood the broker-dealer folks to have learned in their
- 3 examination?
- A Well, what I understood was -- is that they were
- 5 concerned that there wasn't a lot of information about what
- 6 the offshore bank was doing with the money that was being
- 7 raised through the sale of the CDs.
- 8 Q Okay. If we can go back to Exhibit 2 for a second,
- 9 which is the broker-dealer exam report, I want to ask about a
- 10 couple of things in this respect. If you could, turn to Page
- 11 2 of that report, Exhibit 2.
- 12 In the section noting "Findings, possible
- 13 misrepresentations, Rule 10b-5 -- that's that little b -- it
- 14 says in the second full paragraph, "SIB promotes its products
- 15 as being safe and secure. A brochure regarding the products
- 16 offered through SIB states that" -- et cetera -- "funds from
- 17 these accounts are invested in investment-grade bonds. The
- 18 brochure indicates a high level of safety for customer
- 19 deposits," and then it gives several representations of that
- 20 safety.
- 21 If you could see in the first paragraph, it talks
- 22 about how SIB pays a recurring annual 3.75 percent referral
- 23 fee to Stanford Group, and it notes in the third full
- 24 paragraph, under Findings, "SIB pays out in interest and
- 25 referral fees between 11 percent and 13.75 percent annually."

- 1 It also states in the second paragraph, "Based on the amount
- 2 of interest rate and referral fees paid, SIB statements
- 3 indicating these products to be safe appear to be
- 4 misrepresentations." Do you see that?
- 5 A Where was that last part you read?
- 6 Q That's the second full paragraph and the last
- 7 sentence.
- 8 A Okay. What was your question?
- 9 Q So was it your understanding that the broker-dealer
- 10 group had concerns about the fact that these CDs had
- 11 relatively high interest rates and yet were being promoted as
- 12 being very safe and secure, and so they had concerns about
- 13 how Stanford was able to achieve these returns with such
- 14 allegedly safe investments?
- 15 A Yes.
- Q Okay. Did that -- was that something that you also
- 17 shared in terms of your concern about how this was possible?
- 18 A Yes.
- 19 Q Okay. And, so, was that part of the concern about
- 20 it being a Ponzi scheme, that it didn't seem -- it didn't
- 21 seem possible that you could get those returns with where seems.
- 22 investment-grade bonds and securities, particularly since
- 23 those returns were significantly higher than other banks were
- 24 giving for CDs at the time?
- 25 A I don't know whether my analysis went that far --

- 1 Q Okay.
- 2 A -- except just to say extremely high interest
- 3 rates, extremely generous compensation, the firm is extremely
- 4 dependent upon that compensation to conduct its day-to-day
- 5 operations. It just smells bad.
- 6 Q Okay. Then if you look on Page 3 of this document,
- 7 the exam report, there's a reference to a cash contribution
- 8 that Stanford made of \$19 million. And if you could see at
- 9 -- the last sentence of the paragraph that's labeled Item of
- 10 Interest, Addition to Capital, it says, "The general counsel"
- 11 stated that the cash contribution came from personal funds
- 12 and not from the above loans. However, it seems at least
- 13 questionable whether Stanford had access to \$19 million in the
- 14 personal funds." Did you understand also that to be a
- 15 concern? Did that seem odd to you?
- 16 A I don't recall much about that.
- 17 Q Okay. Okay. What about in the next paragraph,
- 18 which is entitled Maintenance of Books and Records, and it
- 19 says, about three-quarters of the way down, "It appears that
- 20 the RR is recommending a particular product of SIB's and, and
- 21 therefore, should have a basis for making that
- 22 recommendation"?
- 23 Do you remember anything about a concern that there
- 24 were recommendations being made to folks to buy these CDs?
- 25 There was a referral fee, but then they were claiming that

- 1 they didn't know anything about how these CDs were being
- 2 invested?
- 3 A At what point are you asking about?
- 4 Q Okay. Well, we'll talk right now prior to the
- 5 exam.
- A Prior to the exam, I didn't know a lot about
- 7 precisely how they referred to their referrals.
- 8 Q Okay.
- 9 A I just knew their client ended up investing in the
- 10 CDs, they were suspicious, and we needed to find out what's
- 11 happened.
- 12 Q Okay. Okay. So would you say that -- that your
- 13 investment adviser exam kind of came out of what the
- 14 broker-dealer side had learned in their exam?
- 15 A My thought at the time was that my adviser exam was
- 16 to supplement the broker-dealer exam from the adviser side
- 17 because it was our understanding that the adviser had to owe
- 18 a greater duty to investors than the broker-dealer. So it
- 19 was, in my mind, an easier claim of some fraud or some
- 20 misrepresentation or undisclosed conflict on the adviser side
- 21 than it was on the broker-dealer side.
- Q Okay. Now, were you aware that there was a
- 23 referral made by the broker-dealer folks after their
- 24 examination to enforcement?
- 25 A Yes, I was. It's in my exam report. I was aware

- 1 that there was a matter under inquiry.
- 2 Q And do you remember whether you were aware of that
- 3 prior to when you started the exam or during the exam?
- A I don't recall. It was right around that time.
- 5 Q Okay. But it was clear that before you completed
- 6 the examination, the investment adviser exam, you were aware
- 7 of this referral?
- 8 A Oh, yes.
- 9 Q Are you aware of what enforcement did in connection
- 10 with the referral?
- 11 A Back in 1998?
- 12 Q Did they -- do you know whether they investigated
- 13 Stanford? Did they take any steps that you can recall?
- 14 A I remember, I believe, talking with an enforcement
- 15 attorney, (b)(6), (b)(7)c .
- 16 Q Okay.
- 17 A And as far as I knew, she was the one that was the
- 18 staff attorney assigned to look into it.
- 19 Q Right.
- 20 A And I -- I'm sure I discussed things with her, but
- 21 I can't recall too much of the detail of that.
- 22 Q Do you remember if, in your discussions with Ms.
- or others in enforcement -- did you have the
- 24 understanding that the enforcement division was investigating
- 25 Stanford for a Ponzi scheme?

- 1 A I presumed it was for a Ponzi scheme because that
- 2 was everybody's concern, that they can't make this work. So
- 3 I don't know if anybody ever said we're investigating a Ponzi
- 4 scheme, but that was clearly what I understood they were
- 5 doing.
- 6 Q Okay. But do you remember any particular steps
- 7 that enforcement took in connection with this investigation?
- 8 A No. I can't recall any at this point.
- 9 Q Okay. But did you get the sense that it was a --
- 10 kind of a vibrant investigation, they were doing lots of
- 11 things and, you know, gathering lots of materials and coming
- 12 to conclusions?
- 13 A I presumed they were conducting an inquiry the way
- 14 they would any other inquiry --
- 15 Q Okay.
- 16 A -- that they would first seek voluntary production
- 17 of whatever information they wanted to get from the entities
- 18 involved, and if they didn't get that cooperation, then they
- 19 would go to the next step to get a formal order and all that.
- 20 So that's just the general way everything should go.
- 21 Q Do you know if, in the Stanford case, they got a
- 22 formal order?
- 23 A As far as I can recall, they never -- they did not
- 24 get a formal order as a result of that 1997, '98 matter under
- 25 inquiry.

- 1 Q Do you have any idea why not?
- 2 A Do I have any idea? It was my understanding that
- 3 they saw, number one, they didn't have any clear evidence of
- 4 a fraud simply because they didn't have enough information
- 5 about what was going on at the offshore bank. Number two,
- 6 they had questions about the jurisdiction and about their
- 7 ability to successfully subpoena information from that
- 8 offshore bank. Those are the two big things that come to my
- 9 mind.
- 10 Q Because there's a lot of things that happened over
- 11 a long period of time, do you remember that specifically in
- 12 connection with the referral in 1998, or is that general
- 13 understanding of how enforcement viewed the Stanford case
- 14 over a longer period of time?
- 15 A That was my impression of how they viewed it from
- 16 almost the beginning, that that was -- those were the two big
- 17 issues that they were trying to overcome.
- 18 Q Okay.
- 19 BY MR.
- 20 Q And when you say a question of jurisdiction, I just
- 21 want to make sure, what were you referring to?
- 22 A With respect to the international bank, the issuer.
- 23 They were focused on the issuer.
- 24 BY MR. KOTZ:
- Q Okay. Our records show that the broker-dealer

- 1 of the CDs and what's happening with the money.
- Q Okay. So do you think it's possible that
- 3 enforcement was actually focused in a different area at that
- 4 time?
- 5 A It's possible. I -- I don't know. That would be
- 6 speculation for me to say that. I don't know.
- 7 Q Okay.
- 8 BY MR.
- 9 Q Was there any coordination efforts between your
- 10 group and enforcement in the sense of looking to see what
- 11 documents enforcement had requested to see whether it's
- 12 something that you were also interested in even looking at?
- 13 A I didn't do that. My exam was done. I did the
- 14 exam report. I understood enforcement was looking at it. I
- 15 just thought enforcement will go out and get whatever
- 16 additional information they need.
- 17 Because one of the things was -- is that we had an
- 18 offshore bank. I had an adviser saying we don't have much
- 19 information about it. So I didn't have really any access to
- 20 a lot of the information I thought enforcement would need,
- 21 and it was enforcement that was going to have to go get it.
- 22 BY MR. KOTZ:
- 23 Q Okay. I wanted to see if I could get a little bit
- 24 of general kind of information on the difference between the
- 25 broker-dealer group and the investment adviser group. Okay?

- 1 portfolio management." What does that mean?
- 2 A Okay. That -- that's not referring to the
- 3 portfolio of the Antiguan bank.
- 4 Q Okay.
- 5 A That's referring to the portfolios that were
- 6 actually managed by the investment adviser for the clients of
- 7 Stanford Group Company, the adviser. They had real advisory
- 8 clients.
- 9 Q Okay. Okay. And then it states, the next
- 10 paragraph, "The examination revealed at least 17 SGC advisory
- 11 client accounts have also invested in an as-yet undetermined
- 12 amount in the CDs." How did you make that determination that
- 13 there were at least 17 client accounts?
- 14 A Well, we asked the compliance personnel at Stanford
- 15 have any advisory clients invested in these CDs, and their
- 16 first answer was we don't know. And I said, well, how can
- 17 you not know. They said, well, we just refer them over to
- 18 the bank, and we don't know whether they end up buying a CD
- 19 or not.
- 20 And, so, I said, well, I need to know. And, so,
- 21 during the course of the exam, maybe even after the
- 22 completion of the fieldwork, they eventually got back to me
- 23 and gave me a list, I believe, of names that included 17
- 24 names.
- Q Okay. Did you find that suspicious that they say

CHARLES A. ..

- 1 they didn't know?
- 2 A I sure did.
- Q Okay. It says in the next sentence, "It was also
- 4 represented to the examiners that these clients are non-U.S.
- 5 citizens." What do you mean by represented to the examiners?
- A By the compliance staff when they told us, you know
- 7 -- because the obvious question was are these U.S. investors
- 8 or are these investors who are not U.S. residents.
- 9 Q Okay. Were there any attempts made to learn
- 10 whether the clients were U.S. citizens, other than asking
- 11 Stanford?
- 12 A Not by myself.
- 13 Q Okay.
- 14 A At the time we did the report, I presumed that was
- 15 something enforcement was going to be following up on.
- 16 Q Okay. Do you know if -- do you know if enforcement
- 17 ever followed up on that?
- 18 A I don't.
- 19 Q Okay. So it was certainly possible that the
- 20 compliance person from Stanford would be lying, right?
- 21 A I always presume they can be lying, right.
- 22 Q And certainly if the SEC is coming in to examine
- 23 them, it would be in their interest to say they don't have
- 24 any clients who are U.S. citizens, right?
- 25 A Exactly.

- 1 concerns and obtain more information on that?
- 2 A I'm sorry. Rephrase your question.
- 3 Q Did the enforcement adviser group, in their
- 4 examination --
- 5 A Hold on. Enforcement -- investment adviser?
- 6 Q I'm sorry. I'm sorry. Yes. Did the investment
- 7 adviser investment company examination that you conducted,
- 8 did it take any steps to follow up on what the broker-dealer
- 9 exam report had found regarding the CDs?
- 10 A We asked for all due diligence information that the
- 11 adviser or the Stanford Group Company possessed concerning
- 12 the CDs, whatever they had as to how the money was being
- 13 invested, performance returns of the portfolio, whatever they
- 14 had, and as I recall, they produced very, very little. They
- 15 claimed, we don't have access to that information.
- It may have been the most that I got was some sort
- 17 of fairly dated annual report or financial report of a bank
- 18 that gave very top level information.
- 19 Q Okay. So you had requested this information but
- 20 didn't really receive anything that was helpful?
- 21 A No, not really. And they claimed we don't have it,
- 22 we can't get it.
- Q Okay. Did you believe that representation that
- 24 they don't have it and they can't get it?
- 25 A In some ways, I did. In some ways, I didn't. On

- 1 the one hand, if it was really a planned scheme, then I could
- 2 believe that the folks carrying out the financial fraud would
- 3 not want to give that information to the folks in the United
- 4 States selling it. So at least they could claim some
- 5 plausible deniability.
- 6 BY MR. (b)(6), (b)(7)c
- 7 Q Essentially, local blindness?
- 8 A Correct. So in that way, I might believe it. And
- 9 the second thing is -- is I was seeing one of the recurring
- 10 themes on the exam was Mr. Stanford is a very dictatorial
- 11 person. So it sort of fit his persona that he would keep
- 12 crucial information pretty tight to his chest, so --
- 13 BY MR. KOTZ:
- 14 Q How would one go about recommending to clients, and
- 15 obtaining a fee for that, of a particular -- to invest in a
- 16 particular investment vehicle if he didn't know anything
- 17 about how the vehicle was achieving its returns? How would
- 18 -- how would you sell the vehicle?
- 19 A Well, the question is how would you sell it
- 20 consistent -- in the case of an adviser, consistent with your
- 21 fiduciary duty to your clients.
- 22 Q Right. But, I mean, even beyond that, if you're
- 23 going to try to convince somebody to invest in something and
- 24 they ask you, oh, okay, well, what is it invested in, and you
- 25 say I don't have any idea, who would ever invest in it?

- A Exactly. And that's what -- that's what I said. I
- 2 said I can't believe -- of course, first of all, they backed
- 3 off and said we're not recommending this. We're just -- if
- 4 they look like somebody who might want to invest in a CD, we
- 5 refer them over to a bank employee. Okay?
- 6 Q And they get a fee?
- 7 A And they get a fee. So I didn't buy that.
- 8 Q Okay.
- 9 A . Okay. So my conclusion was, as I have asked you,
- 10 give me everything you've got about that investment, and they
- 11 gave me virtually nothing, certainly nothing in my mind that
- 12 would be a reasonable basis for making a recommendation of an
- 13 investment.
- 14 So that's why -- I think if you see the letter I
- 15 sent to Stanford as a result of this report, I put in there
- 16 206 language about it doesn't look like you've got enough
- 17 information to fulfill your fiduciary duty in making this
- 18 recommendation. The first thing I told them is -- is I'm not
- 19 buying your, oh, we're just referring them over. You're
- 20 recommending them.
- 21 And, so, that was all I could do, was say, hey, you
- 22 don't have enough information, and you are -- you are risking
- 23 violating your fiduciary duty. And that would have -- in my
- 24 mind, have been one of the theories to bring a case against
- 25 the adviser by enforcement that that was such a -- a glaring

- 1 absence of basis for a recommendation that it amounted to
- 2 deceit or fraud upon the client.
- 3 Q And, so, is it fair to say that there were
- 4 suspicions before you began your examination and those
- 5 suspicions were even greater after you did your examination?
- A I don't know if I'd say they were greater. They
- 7 were pretty high to begin with.
- 8 Q Okay.
- 9 A But --
- 10 Q But there was nothing that Stanford provided that
- 11 allayed your concerns?
- 12 A No.
- 13 Q All right. Let me ask you about a footnote on this
- 14 Page 4 of the exam report. It says, "It was first
- 15 represented to the examiners that no records were kept by SGC
- 16 in relation to the client investments in the CDs. However,
- 17 SGC later represented that such records do exist and is
- 18 compiling a list as requested."
- 19 Does that seem to you like a pretty big red flag,
- 20 that they would say something and then you kind of caught
- 21 them in a lie?
- 22 A That was one in many red flags. I found it
- 23 incredible that they wouldn't know who they had referred, at
- 24 a minimum, over to the bank. They should know that.
- 25 But this is referring to records of the actual

Do you remember, in what form was that brought to 1 2 enforcement's attention? Sending them a copy of our exam report probably. 3 Okay. Who would you have sent that copy of your exam report to? Would that have been I hate to say definitely who it would have been. I Α .6 wish I had the -- the transmittal information, but it would be speculation for me to say I sent it to (b)(6), (b)(7)c . 8 9 would be reasonable. Right. But you're pretty confident that you sent a 10 copy of this July 16, '98 exam report to someone in 11 enforcement who was working on the referral --12 A Yes. 13 -- in the Stanford matter? 14 A · Yes. 15 Okay. Do you remember if you had any conversations 16 with them saying here's what I found, I'm sending you the 17 exam report, if you have any questions, come talk to me? 18 Not specifically. Like I say, I remember some 19 discussions with (b)(6), (b)(7)c 20 21 But do you think that was after you finished the Q exam or before? 22 After. 23 A Okay. So you remember some discussions with 24 And do you remember whether you talked about what 25

- 1 Q Okay. So is it fair to say that even after
- 2 Stanford responded to your deficiency letter, you still were
- 3 suspicious about their operations?
- 4 A Definitely.
- 5 Q Okay. So do you feel like they satisfactorily
- 6 provided you a response to the deficiency letter?
- 7 A They provided a response, but it wasn't adequate to
- 8 allay my concerns about what they were doing, and, basically,
- 9 I would have considered this to show enforcement that
- 10 Stanford is continuing to ignore our concerns.
- 11 Q Okay. Was there any thought to kind of reopening
- 12 the exam or going back and asking for more information after
- 13 you received a nonsatisfactory response?
- 14 A I'm sure there would have been, but either the
- 15 enforcement inquiry was ongoing or enforcement had decided to
- 16 close it. Either way, it generally was not fruitful to get
- 17 into a letter-writing campaign with the registrant.
- 18 Q Okay.
- 19 A You know, it kind of makes you look weak.
- 20 **Q** Okay.
- 21 A So my idea was -- is that the only response to this
- 22 type of response to the deficiency letter was to begin an
- 23 enforcement inquiry in this particular situation.
- 24 Q Now, had there not been an already ongoing
- 25 enforcement inquiry, is it fair to say that you would have

- 1 referred what you found in your investment advisory exam to
- 2 enforcement?
- 3 A Definitely.
- 4 Q Okay. Was there any discussion about consulting
- 5 the SEC's Office of International Affairs to get assistance
- 6 since this was a matter that was partially taking place in the same of the s
- 7 Antigua?
- 8 A If that happened, it would have happened by
  - 9 enforcement. They have a whole lot more dealings with OIA
- 10 than the examiner.
- 11 Q Okay. Do you remember if that was ever brought up?
- 12 A I don't remember. I don't remember.
- Q Okay. Well, let me ask you this question. And you
- 14 were a former enforcement lawyer, and so you have some
- 15 background in this.
- But putting aside the issue of jurisdiction
- 17 relating to Antigua, just simply based on the information
- 18 that you were aware of as of this time period, 1998, would
- 19 there have been -- would there have been a possibility of
- 20 bringing an action against Stanford in any way based on what
- 21 you found? We talked about the hook previously.
- 22 A Well, this gets into an enforcement strategy, which
- 23 is not my area. I only was an enforcement attorney for a
- 24 year and a half.
- 25 **Q** Okay.

- 1 A It's kind of like staying at the Holiday Inn
- 2 Express.
- 3 Q A little bit better than that.
- 4 A My thought at the time was -- is that we've got
- 5 SEC-registered entities selling an investment. We may not
- 6 have much pull on the ish-worthy investments, but the
- 7 registered entities, we certainly have more than enough
- 8 interest and jurisdiction to regulate what they are doing.
- 9 So at that point, it just became an issue of how
- 10 much risk was enforcement willing to take to bring an action
- or even start an investigation and run the risk of losing.
- 12 My idea, as it sort of germinated over time, was -- is that
- 13 the enforcement staff would just do the standard thing, send
- 14 out a voluntary request for information from the registered
- 15 entities, we want information about what's happening to the
- 16 money offshore, and probably they would not provide it. At
- 17 that point, you get a formal order.
- 18 Then you subpoena the information from those
- 19 regulated entities. They say, we don't have it, we can't get
- 20 it. At that point, now you can file a public subpoena
- 21 enforcement action in a federal court and lay out all of your
- 22 suspicions about those CDs for the entire world to know. It
- 23 would be about two weeks after that you found out whether
- 24 there was a Ponzi or not.
- Q And is it fair to say that that, that you just

and the state of the state of

- described, could have happened in 1998?
- 2 A It could have. And like I say, you know, we're
- 3 going back into time, different circumstances. You know,
- 4 it's a subjective determination by the people in charge in
- 5 enforcement.
- 6 Q Right. But isn't it fair to say that it could have
- 7 happened in 1998, and if it did happen in 1998, knowing now-
- 8 what we know, that would have saved tremendous amounts of
- 9 folks from investing in Stanford's Ponzi scheme?
- 10 A It's possible, yes, if it -- if it had been done.
- 11 Q Okay. And there was nothing -- there was no
- 12 impediment, that you're aware of, in 1998 from taking that
- 13 approach? There was nothing new that occurred later that you
- 14 could then -- that then made it possible to take that
- 15 approach, correct?
- 16 A Not that I'm aware of. I mean, in my mind, it
- 17 seemed that there was a preoccupation with the fact we're
- 18 dealing with an Antigua bank, and I was always saying forget
- 19 the bank. We've got a BD and an IA. Focus on them.
- 20 Q Right. Now, were you aware that the enforcement
- 21 division eventually closed the 1998 Stanford matter under the
- 22 inquiry?
- 23 A I was aware of it.
- 24 Q Okay. Were you aware of it at the time? In other
- 25 words, did they come to you and say, you know, you did all of

- 1 this work on the exam, we appreciate your help,
- 2 unfortunately, we're going to close it?
- 3 A No.
- 4 Q How come?
- 5 A I don't know. It just wasn't done.
- 6 Q Isn't that a little odd? I mean, you had kind of
- 7 put some of your own time and effort into it, and you
- 8 wouldn't even be notified, sorry, nothing came of it for this
  - 9 reason, you know, we tried.
- 10 A I can't say for certain I wasn't notified. I mean,
- 11 that's a long time ago.
- 12 Q Okay.
- 13 A I know I became aware of it. You know, I had had
- 14 discussions. Everybody knew, that needed to know, what my
- 15 viewpoint was, so --
- 16 Q So were you disappointed when you heard that
- 17 enforcement had closed the matter under inquiry?
- 18 A I was concerned because, you know, we still had the
- 19 same concerns that this thing is going to continue to grow
- 20 and we're not really comfortable that it's a legitimate
- 21 operation.
- 22 Q Okay. So at that time period when enforcement
- 23 closed the matter under inquiry, you were still concerned
- 24 that Stanford was operating a Ponzi scheme, is that right, or
- 25 another fraud?

- 1 A I would prefer to say a fraud. I don't --
- 2 Q Okay.
- 3 A Going -- saying a Ponzi scheme is a very specific
- 4 thing.
- 5 Q Right.
- A I thought in my mind, in the best-case scenario,
- 7 Mr. Stanford was using the money at the bank to -- to fund
- 8 what I understood to be his passion, which was real estate
- 9 development. So I suspected he was using that money to
- 10 bankroll some of his deals. Was that a Ponzi, no. But could
- 11 it be a fraud, yes.
- 12 Q Okay. So it's fair to say that as of 1998, when
- 13 the enforcement division closed the matter under inquiry,
- 14 that you were still concerned that Stanford was operating
- 15 some kind of fraud?
- 16 A Correct.
- 17 Q Okay. Do you know who Wayne Secor is?
- 18 A Yes, I do.
- 19 Q Okay. He used to work at the SEC?
- 20 A Yes, he did.
- 21 Q Okay. Did you know that he ever -- if he ever
- 22 represented Stanford?
- 23 A Sitting here today, no, I can't recall that.
- 24 Q Did you ever hear that the reason that the
- 25 enforcement matter under inquiry was closed was that Wayne

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1 BY MR. KOTZ:
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- Q Okay. Well, we'll -- and then there's a reference
- 3 here to a complaint letter from a Mexican resident concerning
- 4 SGC's apparent sales of CDs to her 75-year-old mother in
- 5 Mexico. Do you remember that complaint letter?
- 6 A Oh, yes.
- 7 Q What do you remember about that?
- 8 A Well, it was written by her daughter, I believe,
- 9 who was an accountant of some sort, who apparently had
- 10 learned from her mother that she had invested in the CDs and
- 11 had concerns, after looking at the materials, about what --
- 12 the safety of this investment. In a nutshell, I -- I think
- 13 that was the --
- 14 Q And what were your -- what was your reaction to
- 15 that complaint?
- 16 A My reaction was we need to talk to that lady.
- 17 Q Okay. Did you talk to that lady?
- 18 A No, I didn't.
- 19 Q How come?
- 20 A Well, what I started to do was draft a reply letter
- 21 to the -- the -- I believe the daughter --
- 22 Q Right.
- 23 A -- saying thank you for your complaint or your
- 24 information -- I don't know that she really wanted to call it
- 25 a complaint -- seeking additional information, contact

- 1 information, that we would really be interested in talking to
- 2 her about what happened. But as far as I know, that letter
- 3 never went out, and I think we'll develop that as we go along
- 4 here.
- 5 Q Okay.
- A But that was my initial response, we need to get in
- 7 touch with this lady and here's how I propose to do it, let's
- 8 send this letter.
- 9 Q Okay. And, so, is it fair to say that you felt
- 10 that her complaint might have been valid, that there might
- 11 have been something to her complaint?
- 12 A Well, I was almost certain there was something to
- 13 her complaint.
- 14 Q Okay. Okay. All right. We'll get to that with
- 15 some documents, but let me continue with this report. If you
- 16 look at Page 7, Footnote 2, one thing I didn't ask you about
- 17 before, it references that "SGC receives a three percentage
- 18 annual trail commission from SIB for convincing clients to
- 19 invest in SIB's CDs." By the way, what's a trail commission?
- 20 A That refers to a -- a percentage compensation based
- 21 on assets placed with an issuer in the past. It's kind of an a
- 22 like a 12b-1 fee. They're compensating the seller, in
- 23 essence, for having made the original sale plus keeping that
- 24 money in place, because obviously the CDs mature. They can
- 25 walk away. So the reps presumably are doing something to

pyrod make

- 1 maintain those CDs, to get the people to roll over, reinvest,
- 2 put more money in, whatever.
- 3 Q Okay.
- 4 A So that's kind of a continuing --
- 5 Q Right.
- 6 A -- compensation.
- 7 Q Right. And, so, they got this three percent fee
- 8 every year?
- 9 A Yes.
- 10 Q Okay. And was that particularly unusual, that here
- 11 you have a situation where they sort of feign not to really
- 12 be doing much, and yet not only did they get this initial
- 13 fee, even though they don't have any idea what the
- 14 investments were, they're continuing to get the fee every
- 15 year? Was that a big red flag?
- 16 A That was a big red flag.
- 17 Q All right. Let's turn to Page 10, Referrals to
- 18 Affiliated Bank for Certificate of Deposits. "A review of
- 19 SGC's due diligence files for the SIB certificates of deposit
- 20 revealed that SGC had little more than the most recent SIB
- 21 financial statements and the private offering memorandum and
- 22 subscription documents." Did you find that to be odd?
- 23 A Yes. Well, not odd. I -- I considered it to be
- 24 extremely lacking.
- Q Okay. So "There was no indication that anyone at

- 1 So case law talked about when can a CD be a
- 2 security, and one of the things is are they subject to
- 3 regulation. And if not, maybe they are a security, so --
- 4 Q Okay. Let me ask you this question about the --
- 5 this particular issue. Does the question of whether there
- 6 were -- there were U.S. investors, does that matter in terms
- 7 of the SEC's ability to bring an action?
- 8 A No, but it does factor into their priorities.
- 9 Q Okay. In terms of resources within the office of
- 10 enforcement?
- 11 A I believe so, yes.
- 12 Q But, I mean, as a matter -- strictly speaking, as a
- 13 matter of law, the -- if there's an entity that is engaging
- 14 in fraud and they're only defrauding foreigners, the SEC has
- 15 the same jurisdiction to bring an action against them as if
- 16 they were defrauding the United States investors, right?
- 17 A Yes, and, in fact, we have done that in our office
- 18 before. So it's not something that hasn't been done.
- In my view, whenever you have activities of a
- 20 registered broker or a registered adviser under the
- 21 regulation of the SEC, anything they do that's not right
- 22 could cause damage to the U.S. financial reputation and
- 23 system, whatever.
- 24 Q And, so, when was that done? Do you remember the
- 25 case?

- 1 handwriting, and it says 12/13/02. Is that your handwriting
- 2 by any chance?
- 3 A Yes, it is.
- Q Okay. Could you read it for me?
- 5 A "Complaint letter sent to TSSB on 12/10/02."
- 6 Q What does it say on top of that?
- 7 A "Telephone conference with (b)(6), (b)(7)c ."
- 8 Q Who's (b)(6), (b)(7)c ?
- 9 A (b)(6), (b)(7)c was the person who was basically in
- 10 charge of all of the tracking systems in enforcement. She was
- 11 sort of in charge of making sure all the data got inputted
- 12 into the system, like this system here, reflected in the
- 13 printout.
- 14 BY MR. (b)(b), (b)(r)c
- 15 Q Is she in D.C. or Fort Worth?
- 16 A In Fort Worth. She just retired a couple of years
- 17 ago. I'm trying to remember how this -- well, I'll let you
- 18 ask the questions.
- 19 BY MR. KOTZ:
- 20 Q How come it was referred to TSSB?
- 21 A I don't know.
- 22 Q Did you participate in that decision to refer it to
- 23 TSSB?
- 24 A No.
- Q Who did make that decision?

with this draft response to the lady in Mexico. It should at

least get the ball rolling on responding. Let us know what

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you want us to do."

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sends it to
               And then
 1
 2
      "Would you look this over for any comments or additions that
     you may have?" And says, "I want to spend more time
 3
 4
     with this. It may make sense after we look at everything.
 5
     The letter should come from the enforcement attorney." What
 6
                      role in this?
     was
               I believe he was a branch chief in enforcement.
 7
               Why was he looking at this? Why was he involved in
 8
 9
     this?
               At this time, I believe that an enforcement
10
     attorney in our office, (b)(6), (b)(7)c , was looking into the
11
     Stanford, and I think ____
                                    was in
12
                                                         branch.
     That's my -- that's my best recollection.
13
14
               So this is at the same time that it was referred to
15
     TSSB. Before it was referred, they were looking at it, or
     how did that work? Do you remember?
16
               As far as I know, we had received a complaint just
17
18
     as we were doing this exam, and I thought, oh, this is great,
     we've got actually somebody complaining. And I said, here's
19
     a letter to send to the person.
20
21
               And, so,
                                   was in charge of responding to
22
     consumer complaints. And, so, that's why I sent it to her.
     Here's a letter we can send. Or at least I sent it to Hugh
23
24
     to look over it and make sure I was not too far off base.
                                  was aware that (b)(7); was looking
              And I guess
25
```

	rage 100
1	identification.)
2	BY MR. KOTZ:
3	Q This is a reference to communications with the
4	Federal Reserve. Do you remember a point in time trying to
5	have having communications with the Federal Reserve,
.6	contacting the representative at the Federal Reserve?
7	A Yes.
.8	Q What was that all about?
.9	A Well, we had the issue of we have CDs being sold
10	that for all intents and purposes appears to be banking
11	activity. We thought the banking regulators might have some
12	say in this and might have a regulatory hook to use against
13	Stanford. So I had decided, I think or someone decided to
14	contact the Federal Reserve and find out what they thought
15	about this.
16	Q And did you have any luck with the Federal Reserve?
17	A After a long time of effort, we finally did talk
18	with some people who were familiar with Stanford.
19	Q And what did they tell you?
20	(b)(7)a, (b)(5) (b)(7)a, (b)(5)
21	(O)(1) d. (O)(O)
22	
23	
24	
25	

- 1 -- or wasn't going to open any kind of review themselves?
- 2 A Yes. This was a shot out of the blue because I had
- 3 sent him the draft of my response letter to the Mexican lady
- 4 and was waiting to get some comment, get it cleared to get it
- 5 going. And then I received this email saying, it's
- 6 already been referred to the Texas State Securities Board.
- 7 Q Okay. And you understood that to mean that it's
- 8 not just the letter but the entire -- the entire exam
- 9 referral?
- 10 A Well, I took it to mean only the complaint.
- 11 Q Okay.
- 12 A Because I still had control over the exam report
- 13 and what its findings would be and what its recommendation
- 14 would be. That didn't depend upon the lady in Mexico.
- 15 Q So did you understand it to still be an open issue
- 16 under consideration by enforcement at this point?
- 17 A Based on his statement that "When you are finished
- 18 with your report, however, I would like to read it. At that
- 19 time, I will reevaluate our interest in the matter."
- 20 Q Okay.
- 21 A So I didn't give up.
- 22 BY MR. KOTZ:
- 23 Q And, in fact, let me just shoot a little bit
- 24 further to this email dated 6/4/2003, which is a significant
- 25 time many months later, and these conversations are still

- 1 diligence with the Stanford International Bank because they
- 2 still couldn't tell me -- they didn't provide records of
- 3 exactly what they're buying and selling, what actual
- 4 investment activity is generated in these returns. And, so,
- 5 all they're doing is quoting me performance information that
- 6 may or may not be accurate or supported by actual financial
- 7 and viable operations, so --
- 8 BY MR. (b)(6), (b)(7)c
- 9 Q They needed to know what SIB's portfolio was that
- 10 supported the CD rates, right?
- 11 A Right. I mean, they did that with all of their
- 12 managers in the Schedule A in the wrap program. They were
- 13 constantly reviewing to make sure these managers were
- 14 complying with their investment mandates, staying within
- 15 their universe and all those things. They didn't do any of
- 16 that with Stanford International.
- 17 BY MR. KOTZ:
- 18 Q Okay. All right. And, then, if we go to the March
- 19 13, 2003 response to that letter, which we're going to mark
- 20 as Exhibit 22, from Stanford to --
- 21 (SEC Exhibit No. 22 was marked for
- 22 identification.)
- 23 BY MR. KOTZ:
- 24 Q -- you can see their response on Page 4 is, "We do
- 25 exercise proactive due diligence with respect to Stanford

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identification.)
 1
                BY MR. KOTZ:
                Here it says, "(b)(6), (b)(7)c,
                                        (b)(6), (b)(7)c and (b)(6), (b)(7)c all agree with
 3
     your assessment that there's something sinister about the tracks
 4
 .5
      Stanford black eagle. Isn't it swell they are expanding
      their operations? I guess they need more and new money for
. 6
     their bank." This is from (b)(7)c to you. Who are
 7
     and (b)(7)c
 8
 9
           A
                                                               and.
10
           is
11
          Q
                And who are those people?
                                is now a branch chief in investment
12
                           was a former member of my branch and a
13
     advisers.
     former branch chief in the exam program. And (b)(6), (b)(7)c
14
15
     currently an assistant director in the exam program.
16
          Q
                How did they all know about what was going on with
     Stanford?
17
                This was a subject of common discussion in the
18
     office.
19
20
          Q
                Okay. So what does it mean that they agree with
21
     your assessment there's something sinister about the Stanford
22
     black eagle?
23
                That may have been relating to some -- I don't
     remember using those terms. It may be that they're just
24
25
     coming up with a cute way to refer to Stanford --
```

- 1 A I have a general recollection that our office,
- 2 after the Madoff situation, said, hey, is there anything that
- 3 we have any concern about that we haven't done something
- 4 about, and I believe Stanford was one of them. I don't
- 5 remember the others.
- And, so, we decided we need to pick this up and run
- 7 with it and see if we can do something because, you know, the
- 8 game has changed. The risk of losing is a whole lot less
- 9 now. We -- we're going to be punished more for not doing
- 10 something than for doing something and ending up being
- 11 unsuccessful or whatever. That was my general feeling, that
- 12 we couldn't let that sleep anymore.
- 13 Q So looking back now, with the benefit of hindsight,
- 14 do you wish that that kind of decision might have been made
- 15 ten years earlier?
- 16 A Sure. Hindsight is 20/20.
- 17 Q But was there any different facts that were
- 18 uncovered? Were there any different circumstances that
- 19 occurred other than -- you know, relating to Stanford --
- 20 other than the Madoff situation, which is unrelated to see that
- 21 Stanford -- that changed, that was different in 2009 rather
- 22 than in 1998 that enforcement then could bring the action?
- 23 A You mean in 2009?
- 24 Q Yes.
- 25 A One thing that was different was -- is that

## EXHIBIT 13

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

In the Matter of:

) File No. OIG-526

OIG-526

WITNESS: Witness No. 8

PAGES: 1 through 32

PLACE: Law Office of (b)(6), (b)

(b)(6), (b)(7)c

DATE: Monday, January 11, 2010

The above-entitled matter came on for hearing, pursuant to notice, at 3:19 p.m.

Diversified Reporting Services, Inc. (202) 467-9200

```
Page 2
 1
     APPEARANCES:
 2 .
     On behalf of the Securities & Exchange Commission:
 3
           H. DAVID KOTZ, Inspector General
 4
 5
 6
           (b)(6), (b)(7)c
 7
           Securities & Exchange Commission
 8
           100 F Street, N.E.
 9
           Washington, D.C. 20549
10
            (202) 551-6037
11
12
     On behalf of the Witness:
13
                               PRO SE
14
15
16
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21
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23
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25
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- 1 certainly gives me the impression that I may have read the -2 the Stanford exam report.
- 3 Q Okay.
- 4 BY MR.
- 5 Q Who was your assistant director at --
- 6 A This surprises me --
- 7 Q Oh, I'm sorry.
- 8 A Go ahead.
- 9 Q Who was your assistant director at that point?
- 10 A Oh, that would have been
- 11 Q Okay.
- 12 A Yeah.
- 13 BY MR. KOTZ:
- 14 Q Now, from what we understand, the matter was
- 15 eventually referred to the Texas State Securities Board?
- 16 · A Uh-huh.
- 17 Q Does that ring any bells?
- 18 A No.
- 19 Q Okay. So do you remember at any point in time
- 20 looking into seeing whether there might be a case to be
- 21 brought against Stanford?
- 22 A You know, I remember having a discussion or
- 23 possibly two with b)(6),(b)(7)c about it. I couldn't tell
- 24 you the content of that. I mean --
- 25 **Q** Okay.

## EXHIBIT 14

## UNITED STATES SECURITIES AND EXCHANGE COMMISSION

In the Matter of: )

) File No. OIG-526

COPY

OIG-526 .

WITNESS: Witness No. 7

PAGES: 1 through 31

PLACE: Securities & Exchange Commission

801 Cherry Street

Burnett Plaza, Suite 1900

Fort Worth, Texas

DATE: Monday, January 11, 2010

The above-entitled matter came on for hearing, pursuant to notice, at 2:43 p.m.

Diversified Reporting Services, Inc.

(202) 467-9200

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Page 2
     APPEARANCES:
 1
 2
     On behalf of the Securities & Exchange Commission:
 3
           H. DAVID KOTZ, Inspector General
 4
         (b)(6), (b)(7)c
 5
 6
 7
           Securities & Exchange Commission
 8
           100 F Street, N.E.
 9
           Washington, D.C. 20549
10
           (202) 551-6037
11
12
     On behalf of the Witness:
13
                              PRO SE
14
15
16
17
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19
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21
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23
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25
```

- 1 in that conversation?
- 2 A I don't. I don't. I know Wayne.
- 3 Q You do know Wayne?
- 4 A (Nodding.)
- 5 Q Do you know that he represented Stanford?
- 6 A I did not know that.
- 7 Q Okay. Let me just give you the testimony we'll
- 8 give -- we were given and just see if it refreshes your
- 9 recollection.
- 10 A Okay.
- 11 Q A discussion between you and Julie Preuitt
- 12 regarding Stanford on a business trip to New Orleans, and the
- 13 discussion was that Mr. Barasch had -- was the one who made
- 14 the decision to close the matter under inquiry in the
- 15 Stanford matter because of representation made by Wayne
- 16 Secor, who at the time was representing Stanford, that there
- 17 wasn't any fraud there. Does that ring a bell at all?
- 18 A It does not.
- 19 Q Okay. So you were only in New Orleans once, is
- 20 that right, over the last year, or more than once? We have
- 21 reports of a trip in July, late July, early August, and
- 22 another trip in October. Do you remember which was the one
- 23 you went to?
- 24 A I do not. I know we drove there, and I want to --
- 25 I don't recall when it was.

- 1 Q But you were only there once?
- 2 A Right.
- 3 Q Okay. And at the time you were there, the dinner
- 4 you had was both with Julie and Spence Barasch?
- 5 A And (b)(6), (b)(7)c
- 6 Q And . You weren't there a second time
- 7 where you had a dinner with Julie Preuitt at the same place
- 8 that you previously had dinner with Spence Barasch?
- 9 A Oh, I might have. Hold on. I know I've eaten
- 10 there twice because there's a specific restaurant in New
- 11 Orleans -- oh, well, there -- there was a second time that we
- 12 went and took testimony --
- 13 Q Okay.
- 14 A -- in -- in a commission matter.
- 15 Q Okay. Was Julie Preuitt there?
- 16 A Yeah. It was just Julie and I on that one.
- 17 Q Okay. So from what we understand is there was a
- 18 dinner at the steak house at one point in time with Spence
- 19 Barasch?
- 20 A Correct.
- 21 Q Then you and Julie went back to that same steak
- 22 house. I guess it was good, the same steak house that you
- 23 went to with Spence Barasch. And because it was the same
- 24 steak house that you went to with Spence Barasch, Julie
- 25 raised Spence Barasch's name, because I guess he came up

- 1 since you were there with him, and then had this conversation
- 2 with you.
- 3 A I honestly don't recall a conversation.
- 4 Q But do you think that the conversation didn't
- 5 happen, or you just don't recall it?
- A Either one. I mean, I just don't recall ever
- 7 having a discussion with her alone about Spence Barasch and
  - 8 Stanford.
- 9 Q Okay. Do you recall when you had this dinner with
- 10 Julie, the second dinner, what you guys talked about?
- 11 A No idea.
- 12 Q And you don't recall during that dinner talking
- 13 about Stanford at all?
- 14 A I don't recall.
- 15 Q Okay.
- 16 BY MR.
- 17 Q Or Wayne Secor at all?
- 18 A No.
- 19 BY MR.
- 20 Q When was this dinner that you were there on
- 21 testimony?
- 22 A It would have been -- and I can find out because we
- 23 -- I mean, we took testimony at a little town outside of New:
- 24 Orleans so we'd have a record of the transcript, of when it
- 25 occurred.

- 1 Q Three or four months ago at most?
- 2 A Yeah. It was very recent.
- 3 BY MR. KOTZ:
- Q Do you have any idea why Julie would say that you
- 5 had this conversation -- it has not been that long ago -- and
- 6 you wouldn't remember it?
- 7. A Not really, other than we had finished testimony
- 8 and it had been a long day. So I -- I just do not recall any
- 9 -- any -- any discussions about Stanford.
- 10 Q Okay. Are you aware of any role that Spence
- 11 Barasch played in the Stanford investigations?
- 12 A I am not.
- 13 Q Okay. Would you have associated Spence Barasch
- 14 with Stanford?
- 15 A Frankly, no.
- 16 Q Are you aware of Julie's concern about Spence
- 17 Barasch? Has she ever indicated to you any concerns about
- 18 Spence Barasch?
- 19 A Yes.
- 20 Q What kind of concerns?
- 21 A Well, Julie -- Julie's view of Spence was that he
- 22 was someone that she would never want to get on his bad side.
- 23 Q How come?
- 24 A It was her view that Spence was pretty ruthless
- 25 with people.

# EXHIBIT 15

### UNITED STATES SECURITIES AND EXCHANGE COMMISSION

In the Matter of: )

) File No. OIG-526

COPY

OIG-526

WITNESS: Number 10

PAGES: 1 through 41

PLACE: Securities and Exchange Commission

801 Cherry Street

Burnett Plaza, Suite 1900

Fort Worth, Texas

DATE: Tuesday, January 12, 2010

The above-entitled matter came on for hearing, pursuant to notice, at 10:04 a.m.

Diversified Reporting Services, Inc. (202) 467-9200

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Page 2
     APPEARANCES:
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     On behalf of the Securities and Exchange Commission:
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     On behalf of the Witness:
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                                PRO SE
15
16
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- 1 A I think it was about four years before I became a
- 2 branch chief. I'd have to go back and look; but I think in
- 3 about 2001, I became a branch chief.
- Q Okay. What were your duties as a staff attorney?
- 5 A Investigating cases, usually fraud cases, involving
- 6 a variety of different things, from prime bank schemes to
- 7 broker-dealer fraud to accounting cases.
- 8 Q And that was in the Division of Enforcement?
- 9 A Yes.
- 10 Q Okay. Who was your supervisor when you were a
- 11 staff attorney?
- 12 A The first one was . And then I'm
- 13 wondering if there was another one after that. She was the
- 14 direct supervisor. Hugh Wright was the head of enforcement
- 15 here at first, and then Spence Barasch became the head of
- 16 enforcement here.
- 17 Q Okay.
- 18 A As a staff attorney, that's all I remember. I
- 19 don't know if I actually had another -- b)(6), (b)(7)c might have
- 20 left at some point right before I became a branch chief, but
- 21 I don't think I had a substitute branch chief at that point.
- 22 Q Okay. And how long have you served as a branch
- 23 chief?
- 24 A Since around 2001.
- Q Okay. What are your duties as a branch chief?

```
I'm sure I did, if I said I did, but I don't
 1
      remember anything specific about it. And I'm sure I talked
 2
                        about it, too. I just don't --
 3
                Okay.
           Q
                Looking at it now, I -- I don't recollect reading
           Α
 5
     it, but I don't have a doubt, based on my e-mail, that I must
 6
 7
     have received it.
                Okay. And then what about the complaint? It looks
     like it's comparing it to (b)(6). (b)(7)c
 9
                                           . Were you familiar with
10
          Α
               Right.
11
12
          Q
                -- the
                                   case?
               Yes. I was in on the
                                                  case.
13
          A
               What was the (b)(6), (b)(7)
                                         case?
14
                That was similar.
                                   It was a
15
                                                         -based
          Α
16
     investment complex that had an IA and a BD.
     representing -- I'm trying to remember this, because this was
17
18
     one of the first ones when I was in here -- well, about 2000,
     maybe '99 -- basically, representing, you know, safe, secure
19
20
     investments to what were primarily, I believe,
21
     foreign clients; although I believe there were some
     U.S.-based clients. And I know we shut them down. I came in
22
23
     at the end of that investigation to help -- when we filed the
24
     case, the receiver took over -- help kind of garner
     everything at the offices there in
25
```

- 1 Q So it was a fraud?
- 2 A It was a fraud.
- 3 Q Was it a Ponzi scheme?
- A I think, ultimately, it was at least partially a
- 5 Ponzi scheme. I think there were, obviously, new-investor
- 6 funds used to pay the old investors their interest, and
- 7 perhaps principal, as well.
- 8 Q Okay. So what do you remember about looking into
- 9 this matter? It looks like you were given a copy of a
- 10 complaint that compares it to --
- 11 A Uh-huh.
- 12 Q -- a fraud --
- 13 A Right.
- 14 Q -- potential Ponzi scheme, and you were given a
- 15 copy of an exam report. You had some conversations with
- , who did the exam.
- 17 A Uh-huh.
- 18 Q What do you remember about looking into this
- 19 matter?
- 20 A I remember talking about it with -- with Jeff Cohen
- 21 and Spence Barasch. And the issues that we came up with that
- 22 were difficult ones -- I mean, I think we recognized,
- 23 obviously, what was being represented on these CDs that were
- 24 being offered by Stanford looked suspicious, just because of
- 25 the -- I think the consistently high returns that were being

- 1 put together with the claim that it was safe and secure.
- 2 But the issues we ran across were, A, this was a CD
- 3 from a bank in Antiqua. And I believe there was a case -- I
- 4 think it was a Marine Bank case -- that basically held that
- 5 CDs issued by banks here in the United States, at least, were
- 6 not securities regulated by the SEC. So we were trying to
- 7 overcome that issue.
- 8 The second issue was that the offerings, as far as
- 9 I knew -- and I think I mention it in the e-mail -- were not
- 10 made from Houston, but rather, the Houston folks were
- 11 referring clients to Bank of Antigua folks, supposedly, in
- 12 Antigua. So the sale of that was being made actually out of
- 13 Antigua to primarily, if not completely, offshore citizens.
- 14 So that was an issue, whether we -- the SEC would cover that.
- 15 And then the third issue was the records, should we
- 16 try to get them, were probably -- or likely in Antigua.
- 17 Q Right.
- 18 A Therefore, you know, what's the likelihood that we
- 19 could -- we could end up getting enough to -- to make a case?
- 20 Q Right. So do you remember if -- you know, who made
- 21 the decision to not go forward with this, or how did it work?
- 22 A I mean, it was made above my level. Whether it was
- 23 Spence, or Spence and Jeff together, or even Hal Degenhardt,
- 24 who was the head of the office, I don't know.
- 25 Q Uh-huh.

- 1 A All I know is that we presented the issues that
- 2 were recognized by Jeff and Spence; and rather than spend a
- 3 lot of resources on something that could end up being
- 4 something that we could not bring, the decision was made to
- 5 -- to not go forward at that time, or at least to -- to not
- 6 spend the significant resources and -- and wait and see if
- 7 something else would come up. Because, don't forget, this
- 8 complaint on Exhibit 2, I believe, was anonymous, which made
- 9 it a little more difficult to prove whether what they're
- 10 saying is -- is true.
- 11 Q Okay.
- 12 A I've found, in my experience, that anonymous
- 13 complaints are really difficult to -- to make use out of
- 14 because you don't have anyone to talk to to ask follow-up
- 15 questions.
- 16 Q Were you aware at that time that there had been a
- 17 previous complaint from a woman in Mexico? Are you aware of
- 18 that, in addition to that complaint?
- 19 A I don't recall anything other than the
- 20 information and the anonymous complaint. I don't recall
- 21 that.
- Q Okay. Let me ask you a question about Exhibit 4 --
- 23 A Okay.
- 24 Q -- which is the exam report.
- 25 A Uh-huh.

# EXHIBIT 16

#### UNITED STATES SECURITIES AND EXCHANGE COMMISSION

In the Matter of: )

) File No. OIG-526

OIG-526

COPY

WITNESS: Number 11

PAGES: 1 through 95

PLACE: Securities and Exchange Commission

801 Cherry Street

Burnett Plaza, Suite 1900

Fort Worth, Texas

DATE: Tuesday, January 12, 2010

The above-entitled matter came on for hearing, pursuant to notice, at 11:12 a.m.

Diversified Reporting Services, Inc.

(202) 467-9200

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Page 2
     APPEARANCES:
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     On behalf of the Witness:
14
15.
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```
Does she have the ability to do deductive
 1
 2
      reasoning?
                              What do you think?
  3
                MR.
                BY MR. KOTZ:
 5
                I don't know. Was she not one of your strongest
 6
      examiners?
                No. And we've had some strong ones.
 7
           Α
                         But
 8
           Q
                Uh-huh.
                                      was strong?
 9
                Oh, heck, yeah.
                                          has probably got the most
      experience and knows more about whatever --
10
11
                Right.
                -- goes on in the -- the securities industry.
12
                So the fact that (b)(6), (b)(7)c
                                             and/or
13
     or whoever else worked on he enforcement MUI, didn't contact
14
15
             , from what we can see, does that indicate to you that
16
     there probably wasn't a lot going on, or else they would have
     at least sought the assistance of (b)(6), (b)(7)c
17
                                                , who did the exam?
18
          A
                And he says he didn't have any contact with them?
19
                No.
          Q ·
20
                That's unusual. It's crazy. It makes -- it's
          Α
21
     nonsensical, because -- unless to come back and say that
     they've given us a plausible story.
22
               Why would you say it's unusual or nonsensical?
23
24
               Well, you go to the people that's been there.
25
               Right.
          Q
```

```
1 into and examiners had done an exam contemporaneously, would
```

- 2 they -- would they come to them, if they were interested in
- 3 pursuing it, to kind of pick their brains or --
- 4 THE WITNESS: More than likely, it would be a
- 5 formal order. If it was something we referred to them, they
- 6 -- they got a formal order, and we would pursue it to --
- 7 generally, the best we could and support enforcement in
- 8 anything that they did.
- 10 back to your --
- 11 THE WITNESS: But I don't remember --
- 12 MR. O(0), (0)(7): -- to your statement about -- that --
- 13 that it was kind of non- -- just generally, would be
- 14 nonsensical for them to not talk to him. What we understand
- 15 happened in this case is that they opened the MUI and -- and
- 16 (b)(6), (b)(7)c was, you know, doing a -- an exam and did a pretty
- 17 detailed report, yet the people that were working on the MUI
- 18 never came to him and talked to him about it. Is that --
- 19 THE WITNESS: That doesn't make any sense.
- 20 MR. And do you say that because if they
- 21 had been interested in pursuing that MUI, they -- the way
- 22 things worked around here, they would have come and talked --
- 23 THE WITNESS: How quickly did they close it?
- 24 BY MR. KOTZ:
- 25 Q A few months.

```
Page 46
 1
          Q
 2
 3
                            a good examiner?
          Q
                          He's got an interesting background. He
 4
               You bet.
 5
     came up as a
 6
          Q
               Uh-huh.
                                               and then went to --
               -- and then a
 7
     got an accounting -- took the CPA exam and passed the CPA
 8
            And then next thing I knew, he was knocking on the
 9
     door and wanting a job.
10
11
               Right. And now he's at
               Yes.
12
13
               We're actually going to see him tomorrow in New
     Orleans.
14
               Oh, I bet he's interested in that.
15
          Α
16
          Q
               Yeah, I think he will be.
               I hope you enjoy New Orleans. I've never been --
17
     even though I was with the Commission this long, I've never
18
     been to New Orleans.
19
20
               And so do you remember both --
                                                            also
     feeling like there was a concern about Stanford's operations
21
22
     and --
23
          A
               I don't know -- can I --
24
          Q
               Sure.
               The best I recall, yes, we had concerns -- major
          Α
25
```

- 1 concerns. Without looking at this, there were major
- 2 concerns. I thought, you know, the amount of income that
- 3 Stanford Group Company was receiving was humongous.
- Q Okay. Do you want to take a look at the report?
- 5 A Well, you can see one thing. We spent a heck of a
- 6 lot more hours on it with two people that knew what they were
- 7 doing. Jane Bates was the chief compliance officer,
- 8 according to the report, and she was a very weak compliance
- 9 officer.
- 10 Q What do you mean by "weak compliance officer"?
- 11 A Best I recall, we invited her up after this exam to
- 12 -- to talk to us. And I dealt with Jane at VALIC, Variable
- 13 Annuity Life Insurance Company, down in Houston. She was the
- 14 chief compliance officer -- or worked for VALIC, which is a
- 15 wholly owned subsidiary of American General Life Insurance
- 16 Company, which is now part of AIG. And her experience in
- 17 variable annuities in an investment company complex did not
- 18 go over well, as far as I was concerned, as an adviser. I
- 19 looked at it more as a flunky to do whatever Stanford or his
- 20 -- the powers that be at Stanford wanted her to do.
- 21 Q Oh, I see. If you look at --
- 22 A Oh, my God. This is back where we had to do these
- 23 -- what did they call it?
- 24 MR. Are you talking about the SR-CEM?
- 25 Yeah, that's what I thought you were talking about.

```
1 Q You do not?
```

- 2 A I -- I don't.
- 3 Q How come?
- 4 . A I --
- 5 Q I mean, a receiver was appointed immediately after
- 6 the SEC brought its complaint.
- 7 A Correct.
- Q Okay. Couldn't a receiver have been appointed in
- 9 1998 or 1997?
- 10 A I don't know that you could get it through the
- 11 Commission.
- 12 Q How come?
- A Well, the way it's designed now -- then, it's where
- 14 you've got -- I don't know what you call it now. BROA? Is
- 15 BROA still around?
- 16 MR. That's become the Office of Chief
- 17 Counsel. It's the same organization, just a different name,
- 18 OCC. I mentioned (b)(6), (b)(7)c -- (b)(6), (b)(7)c that we talked about
- 19 earlier --
- THE WITNESS: Uh-huh.
- 21 MR. (b)(6), (b)(7)c : -- he came from the group that is now
- 22 -- was formerly BROA.
- THE WITNESS: Okay.
- 24 A But, you know, usually, it was always "Mr. No"s.
- 25 No, you can't do it. No, you can't. No, you can't. Your

- 1 stuff doesn't --
- BY MR. KOTZ:
- 3 Q Who was saying "no, you can't"?
- 4 A Washington.
- 5 Q And what were they saying -- no, you can't do what?
- A Well, there were certain types of cases the
- 7 Commission, you know, wanted to see. And they were at the
- 8 table and were able to determine whatever, and if it didn't.
- 9 fit with -- if you've got a round hole and putting a square
- 10 peg in it, they didn't want, you know, to let it go through.
- 11 Q And was Stan- --
- 12 A It was very frustrating.
- 13 Q Was Stanford a round-hole-type case?
- 14 A I think so. I think it was a square peg going in a
- 15 round hole and didn't know what to do with it.
- 16 Q So you think there was concern that the Commission
- 17 wouldn't approve of a request to go forward with the Stanford
- 18 investigation at that time?
- 19 A Well, you'd have to talk -- yeah. And if they --
- 20 if they did, it still, I think -- he was blowing smoke with
- 21 the -- with the attorneys that he had and his supposed
- 22 position. I think there's an investigation going on right
- 23 now about the congresspeople that were -- the members of
- 24 Congress that were wined and dined in Antiqua.
- 25 Q Right, Let me show you another --

```
1
                     could have done.
 2
          Α
               Well, give him a star. Make him an assistant.
               All right. I'm just trying to get your take on it.
               No, there's no question. He's been -- he's been,
 5
     you know, left out.
 6
               What do you mean, "he's been left out"?
               Of promotions, as far as I'm concerned.
                                                         I mean, I
 7
 8
     hired nearly every -- nearly all of these examiners that were
 9
     here.
                                            has been left out of
10
               How come -- how come
11
     promotions?
               I don't know.
12
               THE WITNESS: Go off the record.
13
               MR. KOTZ: We can go off the record.
14
               (A brief recess was taken.)
15
16
               BY MR. KOTZ:
17
               Okay. We're wrapping up. I just wanted to -- to
18
     ask you something that we discussed while we were off the
     record. You talked about the fact that at that time,
19
20
     enforcement and other groups within the Fort Worth office
21
     were concerned about the number of cases that they were
22
     making and that perhaps if it wasn't a slam-dunk case, they
23
     might not want to take it because they wanted to make sure
24
     they had enough numbers because that's what they felt the
25
     Commission wanted them to do. Is that right?
```

- 1 A That's correct.
- Q Okay. And so, perhaps, that might have gone into
- 3 the thinking in the Stanford matter, that this was a case
- 4 that had some -- some difficulties, and so they were not
- 5 necessarily apt to take on the tough cases because there was
- a concern within the Commission, as a whole, about making
- 7 sure that they have enough numbers of cases.
- 8 A And that --
- 9 Q Is that right?
- 10 A And that goes forward from the standpoint of why
- 11 enforcement took Enron away from us.
- 12 Q But is that -- is that correct, what I just said?
- 13 A Yeah. From the exam program -- and we started out
- 14 each year -- you know, at the end of the year with writing
- 15 this glowing report about yourself and how you walk on water,
- and then OC -- you know, |b|(b), |b|(f)|c| and |b|(b), |b|(f)|c| , et
- 17 cetera, and b)(6),(b)(7)c , and whatever, would get together and
- 18 -- with the managers and try to determine what are our goals
- 19 and objectives for the next year. Because, apparently,
- 20 Congress is real interested in goals and objectives --
- 21 Q Right.
- 22 A -- and did you meet them and did you do this and
- 23 did you do whatever, rather than, you know, did you do your
- 24 job.
- 25 Q Right. So there was pressure from Washington, on

## EXHIBIT 17

### UNITED STATES SECURITIES AND EXCHANGE COMMISSION

In the Matter of:

) File No. OIG-526

OIG-526

)

WITNESS: Number 11

COPY

PAGES:

1 through 128

PLACE:



DATE:

Wednesday, January 13, 2010

The above-entitled matter came on for hearing, pursuant to notice, at 10:15 a.m.

Diversified Reporting Services, Inc.

(202) 467-9200

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Page 2
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     APPEARANCES:
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14.
                           PRO SE
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```

- 1 And at that time, was one level up.
- Q Okay. And how about when you were in (b)(6), (b)(7)c
- 3 who'd you report to?
- 4 A (b)(6), (b)(7)c was my branch chief.
- 5 Q And did you go right to then from the SEC in
- 6 2007?
- 7 A Yes, sir.
- 8 Q And what's your title today?
- 9 A Principal examiner, I think.
- 10 Q And what do you do now?
- 11 A Basically the same sort of job, except I go out to
- 12 broker dealers instead of investment advisors just make sure
- 13 that they're following all the rules they're supposed to
- 14 follow with the 34 Act and all of our rules, as well.
- 15 Q And in your time with the SEC, did you -- putting
- 16 aside Stanford for a moment, did you ever look at any other
- 17 matters that seem like they could possibly be Ponzi schemes?
- 18 A Not that I can recall.
- 19 Q And when did you first learn of the existence of
- 20 either Robert Allen Stanford or the Stanford Group Company or
- 21 Stanford International Bank?
- 22 A I think the first time I heard of Stanford was
- 23 sometime late in 2002. gave us a great deal of
- 24 leeway in scheduling our own exams and I pulled up the
- 25 schedule and sorted the schedule for a Houston exam. I like

- 1 to go to Houston and a lot of other examiners weren't
- 2 particularly fond of Houston.
- 3 And I just picked out Stanford at random. I was
- 4 just looking for a medium to small size investment advisor.
- 5 And I think I picked out three files in total for a two-week
- 6 trip to Houston, and Stanford was one of them.
- 7 BY MR. (b)(6), (b)(7)c
- 8 Q Is this list the five-year plan?
- 9 A Yes, sir. I think biron and Hugh would break out the
- 10 five-year plan into annual pieces so, we would go into, share
- 11 a drive, and there could be about a hundred exams or so. And
- 12 [b)(6), (b)(7)c usually assigned out cause exams and investment company
- 13 exams but investment advisory exams, as long as we were being
- 14 productive, and, you know, he gives a great deal of leeway in
- 15 where we went and which exams.
- 16 BY MR. (6)(6)(6)(7)(6)
- 17 Q And so was the 2002 exam a cause exam, then?
- 18 A I don't believe so. I think it was just routine.
- 19 Q And at the time that you were preparing for the
- 20 exam, were you aware that the -- of the SEC conducting any
- 21 prior exams of the Stanford Group?
- 22 A Right when I picked the files, there was one other
- 23 examiner that I knew, like, going to Houston and we worked
- 24 together a lot and that was block in the state of the
- 25 was planning a two-week trip to Houston and that I picked

- 1 three files.
- 2 He asked me which three, and I can't remember the
- 3 other two. But one of them was Stanford. Right when I
- 4 mentioned Stanford, he kind of had an odd look on his face
- 5 and I asked him, "What's wrong with Stanford?" And he
- 6 explained to me that he had been there in 1999, and that he
- 7 had strongly suspected that the affiliated bank of the
- 8 investment advisor had problems.
- 9 BY MR. (b)(6), (b)(7)c
- 10 Q Do you have a sense of what kind of problems, was
- 11 it a sort of quality issue?
- 12 A Yeah, I asked him what type of problems, you know,
- 13 what was the deal, and -- I can't remember whether he
- 14 actually came out and said Ponzi scheme or fraud but he made
- 15 it clear that the bank was taking in deposits and he
- 16 suspected that, whenever there was a redemption, they were
- 17 just taking that money out of -- new money from new
- 18 investors. So like I said, I can't remember if he used the
- 19 word "fraud" or "Ponzi scheme," but he made it clear that
- 20 that's what he suspected.
- 21 BY MR. (b)(6), (b)(7)c
- 22 Q And apart from the prior IA exam that
- 23 participated in, in 2002, do you have an understanding
- 24 that there were any other exams that the SEC conducted of
- 25 Stanford Group?

- 1 happened at the State of Texas, so I don't know whether the
- 2 information he had came from when he was at the State of
- 3 Texas or the SEC.
- 4 BY MR.
- 5 Q Do you know who in the Fort Worth office conducted
- 6 the inquiry on the enforcement side in 1998 for Stanford?
- 7 A No.
- 8 Q And have you ever spoken to about the
- 9 Stanford Group at all?
- 10 A I remember . I want to say she left the
- 11 Commission sometime in 2000, late 2000, not long after I got
- 12 there. I remember -- I'm sorry, might have been after that.
- 13 So -- but I don't ever recall speaking about Stanford with
- 14 her.
- 15 Q How about , have you ever spoken to
- 16 (b)(6), (b)(7)c about Stanford?
- 17 A I believe she may have been in some of the meetings
- 18 after the exam. But I'm not certain about that. I do
- 19 remember several meetings with enforcement, from the time
- and I got back from the field, to the time I left for
- 21 (b)(6),(b)(7)c . I can't recall exactly which attorneys were there.
- 22 I do remember that there were no high-level attorneys there,
- 23 there were branch chiefs and staff attorneys. I don't
- 24 remember any meetings with, like, Hal or Spence, but like I
- 25 said, I just can't remember which attorneys were there, at

- 1 A No.
- 2 Q And I guess, turning back to page three, the part
- 3 that says referral fees, towards the bottom of the page,
- 4 discusses the referral fees that the Stanford Group got from
- 5 Stanford International Bank. Did you look at this issue at
- 6 all in your 2002 exam?
- 7 A We looked at how the rates that the bank was paying
- 8 and with that, the rates that they were also paying to the
- 9 reps, so if you were a rep of Stanford and you sold a CD, you
- 10 would look at how much money -- how much commission you got.
- 11 And I just remember when you looked at just the CDs, the
- 12 rates weren't that much higher than a regular bank, but when
- 13 you looked at what they were paying to the reps, and added
- 14 them together, it just seemed very unlikely that the bank was
- 15 able to invest that money in something that earned more than
- 16 that. So I guess that whole part of it was, you know, the
- 17 main basis of our concern.
- 18 Q And so did you find either the referral fees or the
- 19 commissions to be unusually high?
- 20 A When you added them together, they were unusually
- 21 high and then just being on site, seemed -- seeing the
- 22 building they were in, the furnishings that were there, the
- 23 way people were dressed, it was a lot of overhead to cover,
- 24 as well. And when you take the CD rates, the commissions,
- 25 the overhead and added them together, like I said, it just

- seemed very unlikely that they could invest in anything
- 2 legitimate to earn a return to cover all those expenses.
- 3 Q And turning -- the same topic, turning to the next
- 4 page, on top of page four, it starts and says that the exam
- 5 reviewed at least 17 SEC advisory client accounts that also
- 6 invested in CDs, which represented to the examiners that
- 7 these clients are non-U.S. citizens. Did you have any
- 8 understanding in 2002 as to whether there was any U.S.
- 9 investors referred by SGC to invest in the SIV CDs?
- 10 A I remember and I had to ask several times
- 11 for basically a list of all the investment advisory clients,
- 12 who did refer to the bank to purchase a CD. We eventually
- 13 got that list, I can't remember how many were on it. It
- 14 wasn't many. It was probably less than 20. I do remember
- 15 people from Baton Rouge, or at least one person in Baton
- 16 Rouge, and it seemed like others in the United States, it was
- 17 represented to us that most of the other investors, the
- 18 nonadvisory client investors, were foreign nationals, people
- 19 from other countries.
- 20 Q And so -- yeah, just following up on that last
- 21 part, to make sure I understood that, was Stanford Group
- 22 representing that most of the investors that -- that they,
- 23 that is the Stanford Group, referred, were non-U.S.
- 24 residents?
- 25 A I don't know if I remember them saying that, so

I'm not certain about that. 1 BY MR. As far as the risk labeling which is right below. 3 4 that, it's got a 1-H for risk level on this cover page, what does that mean? 5 If I remember right, that's high. We would set 6 A that at the end of the exam. As far as what the examiners 7 thought, after completing that SR-CEM module, we would take 8 that into consideration and assign each firm a risk rating. BY MR. 10 What was it about Stanford, do you recall, that 11 to assign it a high risk rating? 12 caused you and The international bank, I'm sure, was a big factor. 13 Generally speaking, a lot of dual firms would be rated high 14 anyhow, because they're operating as a broker dealer in a 15 bank especially if the advisory clients are customers of that 16 broker dealer. Just be a lot higher risk than your regular 17 investment advisor. 18 19 And, again, just so the record's clear, when you say the international bank, I mean, what issue about the war we 20 international bank was something that caused them to be the last 21 Right, our suspicions the international bank was a Α 22 Ponzi scheme. 23 24 Q Okay.

25

BY MR.

```
but I do know we asked a lot of questions and I'm sure that
  1
      they knew that we were concerned about the bank.
  2
  3
           Q
                And is there anyone else that you remember talking
      to in this trip about the Stanford International Bank CDs?
 .4
           Α
                At the firm?
  5
  6
                Yeah.
                Oh, maybe there was one other compliance person,
           Α
      his name is b(7)c, we may have spoken to b(7)c. That's about all.
. . 8
                               Is that (b)(7)c ?
                MR.
 9
                BY MR.
10
11
12
                Yes.
                How about after you got back from Houston, what
13
           Q
      work did you do, if anything, further, for the exam? I
1.4
15
      guess, in general, for starters?
                I guess, as far as field work, I can't remember how
16
     much field work we had to complete when we got back.
17
     remember a lot of meetings with (b)(6), (b)(7)c
18
                                                  and Hugh Wright,
     about the firm.
19
                BY MR.
20
                Was that typical, you come back after exam, have
21
22
     those kind of meetings?
                It was typical on our first day back that b(0)(7)c
23
                                                                would
     come in and brief us on the firm. If it was a very simple,
24
```

straightforward firm, that might take an hour or two,

25

- something that's complicated, might take a whole lot more
- 2 time than that. I think it's safe to say, that before we
- 3 even went out in the firm, that bird knew that we had
- 4 concerns, and he had concerns as well. So our conversations
- 5 just sort of picked up from where we left off when we left.
- 6 BY MR. (b)(6), (b)(7)c
- 7 Q And so what did you discuss, then, sort of to
- 8 follow up, once you got back with Mr. (b)(6), (b)(7)c and Mr. Wright?
- 9 A I can't remember exactly the discussions, but, like
- 10 I say, I think it's safe to say that (b)(7)c was very much aware
- 11 of how concerned we were and that the likelihood that this
- 12 international bank was legitimate, which was slim. We told
- 13 them about the interest rates and, you know, the exam, in
- 14 general. Yeah, I can't remember exactly what else we
- 15 discussed.
- 16 Q Maybe if we could hit some of the points in the
- 17 report itself. And the executive summary, on page two, in
- 18 the second paragraph, it -- it discusses the area of concern,
- 19 the prior examination of all registrants, referral of
- 20 customers to affiliated offshore bank, etc., it says, "In the
- 21 end it was determined this there was insufficient information
- 22 to support an enforcement action." This is -- I think
- 23 referring to the 1998 time period. Do you know where you --
- 24 either you or Mr. had the basis to write that that was
- 25 -- that was the determination that was made back then, that

- 1 there was insufficient information to support enforcement
- 2 action?
- 3 A Since wrote this report, it was pretty
- 4 customary for whoever led the exam, at least on paper, to
- 5 write the sections of executive summary background exams. So
- 6 I think it's probably pretty safe to say that wrote
- 7 this. I don't know whether he was just going off of what he
- 8 knew and remembered before or whether he had some document he
- 9 was looking at when he wrote that.
- 10 Q And it may be actually easier to start on page one,
- just before that, the summary violations and maybe go through
- 12 each one. And so the first section that was violated was
- 13 Section 206 and then Rule 206 3-2. So what was the issue
- 14 there?
- 15 A We had found that they had some problems with
- 16 principal transactions or agency cross transactions, I
- 17 couldn't remember which. And that is just with the investment
- 18 advisory clients. The main -- I guess the more significant
- 19 write-up in this was the second part, that when we were at
- 20 the firm -- back up. As -- for all of their investment
- 21 advisory clients they were fiduciary and whenever they refer
- 22 that client to some other investment product, whether it's a
- 23 security or not, they were supposed to do some due diligence.
- 24 into doing that. So we asked them: Give us the due
- 25 diligence file for this offshore bank. We want to see that

- 1 everything you looked at before you made this recommendation
- 2 to refer these clients over. The only thing we got if I
- 3 remember right was just the file with the financial
- 4 statements and maybe a couple other things in there. So
- and I took the position that that wasn't enough.
- 6 Like, they -- just because it's an affiliate did not relieve
- 7 them of having to do some due diligence of making sure that
- 8 what they were referring their clients to wasn't a fraud.
- 9 And we felt like they -- you know, having a set of financial
- 10 statements that was put together by an accounting firm that
- 11 we had never heard of or auditing firm we had never heard of,
- 12 we just didn't feel like that was enough due diligence, so
- 13 that's why that violation.
- 14 Q Okay.
- 15 BY MR.  $^{(b)(6), (b)(7)c}$ :
- 16 Q I think this is ringing a bell, but maybe this is
- 17 from my discussion with . Did you and discuss
- 18 or do you just recall the fact that with respect to the due
- 19 diligence the firm had done on true independent third parties.
- 20 like I think it was in the context of their mutual fund rep
- 21 fee program, they had done a lot more due diligence with
- 22 respect to those entities than they had with respect to their
- 23 own affiliate? Is that --
- A It's safe to say we probably looked into whatever
- 25 due diligence they did for those mutual fund programs.

- 1 there were U.S. investors in -- in the SIB CDs in the
- 2 Stanford Group?
- 3 A I don't think it came about until we were there.
- 4 We asked them, as I said, a number of times for all the
- 5 investors that were advisory clients who were invested in the
- 6 bank. Eventually we got that list, and the only reason why I
- 7 remember one was, at least one investor was a U.S. investor
- 8 because I recognize the name of b(6), (b)(7)c in Baton Rouge,
- 9 who's the office for a
- 10 number of years and I recognize the name from being from
- 11 Baton Rouge. I think that's probably the first time, wherein
- 12 you can be certain that some investors, at least some were
- 13 Americans.
- 14 Q And where did you see that list or that --
- 15 A I can't remember if we were at the firm or whether
- 16 they sent it afterwards. But I just remember looking at the
- 17 name, and right away I recognized name.
- 18 Q And did you understand that could be inconsistent
- 19 at all with anything that SEC had said in the past about U.S.
- 20 investors or did -- do you remember him
- 21 knowing anything about that?
- 22 A I remember and the firm saying that the
- 23 vast majority of the investors were not Americans, but I
- 24 think I'd always understood that there were probably at least
- 25 a few American customers.

- Q And was that relevant at all to your exam, whether
- 2 there were U.S. investors or how many there were?
- 3 A As for me, I don't think it mattered either way,
- 4 you know. We were there to protect investors, whether they
- 5 were Americans or not.
- 6 BY MR. (b)(6), (b)(7)c
- 7 Q Well, what was your sense on whether or not -- this
- 8 is kind of jumping ahead a topic, although we're going there,
- 9 but we've heard references from various people that it -- it
- 10 was or it may have been a factor on the enforcement side. I
- 11 mean, do you have any sense, just generally speaking, of
- 12 whether or not -- whether U.S. investors were involved? Was
- 13 it a factor that enforcement considered, whether or not to
- 14 take a referral from the exam side?
- 15 A Everything I heard was secondhand. I don't think I
- 16 heard anything from somebody in enforcement --
- 17 Q Okay.
- 18 A -- mentioning, you know, that most of these people
- 19 are not Americans, why should we spend time on that? I mean,
- 20 like I said, everything I heard was secondhand.
- 21 Q Did you hear that secondhand here on this matter?
- 22 A Yes.
- 23 Q Do you remember it from or your friend?
- 24 A I can't remember who it was from. I think there
- 25 was just discussion amongst regulation that -- that may be a

- 1 factor in why they didn't pursue it.
- Q Okay. And can you give us a time frame? Was that
- 3 -- again, I'm jumping ahead in terms of the fact that there
- 4 was a referral here. But was that kind of --
- 5 A That would have been after --
- 6 Q -- at the time the decision was made by enforcement
- 7 not to pursue it or a year or two later or --
- 8 A I think it was not long after we got back, I just
- 9 remember people bringing up, you know, they believed that may
- 10 be a factor, and whether they would take it and afterwards,
- 11 they didn't take it.
- 12 Q Okay.
- 13 BY MR.
- 14 Q And at the bottom of page ten, that paragraph that
- 15 runs into the next page, it discusses some of the offered
- 16 rates of return. I was hoping if you had any understanding
- 17 the paragraph ends, it says the guaranteed rate on an index
- 18 LCD is 3.90 percent, and maturity is at 3.5 years. What does
- 19 it mean to have a guaranteed rate? Were all the rates a West Fr
- 20 guaranteed, to a degree? Or was there guarantees associated
- 21 with these returns, versus either past performance or we hope
- 22 we can get you this return?
- 23 A I can't remember them advertising that the rates
- 24 were guaranteed. Yeah, so I don't know if I could say one
- 25 way or another. I'm sure if they did advertise that they were

drafting a Okay. Do you recall 1 Q 2 response at all? No, I sure don't. 3 Okay. 4 Q 5 A You mean a response to the complainant? Q Yes. A I don't know if he did or not. 7 8 Okay. Q BY MR. (b)(6), (b)(7) 9 10 What do you think about the substance of that Q 11 lady's concerns? It looked like she had the same sort of concerns we 12 had, about the higher rate of interest and I think the one 13 14 thing that sticks out that I remember was her pointing out that there were a lot of investors from Mexico at the bank, 15 and that she wanted us to look into it. But, yeah, I 16 understand the concerns she had. 17 I gather you would say they were legitimate 18 19 concerns? 20 Α I think so. 21 Similar or the same as you and Q concerns? 22 Yes. A 23 BY MR. 24 Q And as far as those concerns over the rates of the 25 return, we've been talking about that?

- 1 paragraph, it talks about SIB promotes its products as being
- 2 safe and secure, a brochure regarding the products offered
- 3 through SIB, including the flexi E account, states that funds
- 4 from these accounts are invested in investment grade bonds,
- 5 securities and Euro dollar and foreign currency deposits.
- 6 The brochure indicates a high level of safety for customer
- 7 deposits. Do you recall seeing similar statements about the
- 8 safety of the products in any -- either SGC commercial
- 9 documents or SIB commercial documents?
- 10 A No, I sure don't.
- 11 Q Okay. Again, let me know if I'm characterizing
- 12 this correctly, but it sounds like what you were saying
- 13 earlier, that there wasn't a lot of specificity as to --
- 14 given by SEC as to what the Stanford Bank investments
- 15 actually were for the CDs; is that right?
- 16 A That's correct. I remember in the private
- 17 placement memorandum, they didn't really say what the money
- 18 was being invested in.

(b)(5), (b)(7)a

20

21

22 So I think it's mentioned here in

- 23 the report, but that's as far as it went.
- 24 Q And did it make sense to you that Stanford Group
- 25 Company could be earning -- seems like a substantial amount

- of revenue for these referrals in that Stanford Bank CDs,
- 2 that it will be able to persuade all these people to invest,
- 3 without having any understanding as to what the product was,
- 4 in the sense that -- how can you get a customer excited about
- 5 something you can't explain what it is, even?
- A It's been my experience that, when you offer a
- 7 commission that high to a rep, they'll find some way to make
- 8 it attractive to the customer. Take equity indexed
- 9 annuities, for example, if you ask me personally, it's a
- 10 horrible product, it's got fees through the roof but they
- offer these huge commissions and the reps will find some spin
- 12 or some way to convince investors that this is a great
- 13 investment. They sell themselves when you pay that much in
- 14 commissions, that's just what I've seen, I guess.
- 15 Q Yeah, yeah.
- 16 MR. That's an -- I agree with what he
- 17 says.
- 18 BY MR. (b)(6), (b)(7)c
- 19 Q I think that -- would you agree with this, that the
- 20 high referral fee was indicative of a possible fraud in two
- 21 respects. One is just what we've talked about a lot today,
- 22 is how you make a safe investment to support that, and the
- 23 interest that you're paying?
- 24 A Right.
- 25 Q But two, it's indicative of a strong incentive

- 1 that's being put on the reps to sell that product. Is that
- 2 also somewhat of a red flag when a company is incentivizing
- 3 or steering its reps to recommend one product over others for
- 4 its clients?
- 5 A Yes, that's correct. That's a typical thing that
- 6 we look for in any investment advisory exam. Typically
- 7 investment advisors have different programs for their
- 8 clients. If there was one program where the advisor or the
- 9 employee made more money for referring that customer over to
- 10 -- they would always raise red flags and conflicts of
- 11 interest, and whether everything was properly disclosed.
- 12 Q Could it also be a red flag for something more, you
- 13 know, serious, like a fraud?
- 14 A Yes. Could be.
- 15 Q You also mention -- I'm sorry,
- 16 MR. No, you're fine.
- 17 BY MR. (b)(6), (b)(7)c
- 18 Q You mentioned something -- I want to make sure I
- 19 understood it correctly. You mentioned something about the
- 20 Section 5 issue that I have never thought of before. I think
- 21 what I understand you said was that the issue of information
- 22 about what the bank's portfolio was in, let me just -- that
- 23 issue, the information about what it was in, was relevant,
- 24 both to a Section 206 case, okay, in the sense that the reps
- 25 needed to do some due diligence to make sure they were

- 1 action letter somewhere. And like I said, I just couldn't
- 2 find it.
- 3 Q Okay.
- 4 (A brief recess was taken.)
- 5 BY MR. (6)(6), (6)(7)c
- 6 Q All right. Back on the record. Go back to Exhibit
- 7 8 and page 15, at the end, it says, last paragraph, "Each are
- 8 considering the possible unregistered public offering of the
- 9 CDs has been referred to Fort Worth district office's
- 10 enforcement division, which has decided to refer the matter
- 11 to the Texas State Securities Board." Now, why did you refer
- 12 the issue concerning the possible unregistered public
- 13 offering to enforcement?
- 14 A We -- as far as I was concerned, we referred the
- 15 whole thing over to enforcement and to be honest with you, I
- 16 didn't care which one of these issues they wanted to take
- 17 with and run, you know, we just wanted some action against
- 18 the firm to try to shut them down. I remembered hearing
- 19 later on, through, I think  $or^{(b)(6), (b)(7)c}$  or  $or^{(b)(7)c}$ , that they had
- 20 decided to refer it to the State of Texas and if my memory's
- 21 right, that Spence had made that call.
- 22 BY MR. (b)(6), (b)(7)c
- 23 Q You had mentioned earlier, after you guys came back
- 24 from the field, there were a series of meetings, you,
- 25 (b)(6), (b)(7)c and Hugh. Was that one of the topics of those

- 1 Q I mean, was it their sense they were too hard or
- 2 they didn't have any expertise or --
- 3 A I think it was a combination of two things. First
- 4 of all, I got the sense that they did not want to lose any
- 5 cases. So if there was a high risk of losing a case, there
- 6 was a reluctance for them to take it. Secondly, out of all
- 7 the enforcement attorneys there, there just seemed to be not
- 8 many who were very familiar with the Investment Advisors Act,
- 9 even fewer familiar with the Investment Company Act, and I
- 10 suppose that probably had something to do with the reluctance
- 11 to take cases.
- 12 Q Did you ever experience -- express that -- that
- 13 frustration on that topic?
- 14 A To Hugh Wright?
- 15 Q Yeah, Hugh Wright, I'm sorry.
- 16 A I don't ever remember Hugh being frustrated by
- 17 anything. He was the most even-keeled person I've ever met.
- 18 I don't think I ever remember him being upset, angry,
- 19 anything like that. He was just very level, to describe it.
- 20 Q Okay. And so how was the referral -- apart from
- 21 it's in the written report, but how more informally was the
- 22 referral actually made? Who reached out to who and how did
- 23 that play?
- 24 A Once we spoke with Hugh and made a decision, we
- 25 would write up the report, sometimes we'd meet with

- 1 open up a MUI or not, based on that e-mail.
- 2 Q That's right.
- 3 A I don't know if I could ever remember, or if I even
- 4 ever knew if they opened a MUI from our exam. And just
- 5 because they had referred it to Texas, in my mind, didn't
- 6 automatically mean that we weren't going to consider -- still
- 7 look at it.
- 8 Q Uh-huh.
- 9 BY MR. (b)(6), (b)(7)c
- 10 Q We being the enforcement side?
- 11 A We being the commission side, the Fort Worth
- 12 office.
- 13 Q Yeah, okay.
- 14 BY MR. (6)(7)(6)
- 15 Q You didn't take that necessarily to preclude them
- 16 from opening, just because they had referred it to Texas
- 17 State --
- 18 A That's the way I had hoped anyways. I didn't know
- 19 for sure one way or another, but I'd hoped that they didn't
- 20 just push this off on Texas without -- and just close the
- 21 file and never look at it again.
- 22 Q And to your understanding, what -- what could Texas
- 23 -- what interest would -- I guess, what would be the value of
- 24 Texas pursuing this versus the SEC? What would they be able
- 25 to do that you guys couldn't?

- 1 A That I never did understand. I don't know -- I
- 2 suppose the State of Texas may have some restrictions with,
- 3 like, the Freedom of Information Act, but, you know, I think
- 4 it's safe to say I was pretty confused, or -- just wasn't
- 5 expecting a referral to the State of Texas.
- 6 Q Did anyone ever try to offer an explanation, that
- 7 you recall, as to why they referred it to Texas?
- 8 A Not to me.
- 9 Or even indirectly that you heard secondhand?
- 10 A Heard a lot of things secondhand. Second- and
- 11 third-hand, about resources and things like that, about
- 12 jurisdictional problems. I remember one of the attorneys
- 13 telling me, I can't remember which one, about this case they
- 14 had back in the '90s, I think it was Dominion, that it wasn't
- 15 a Ponzi scheme, but it was a bad firm that just sucked up an
- 16 enormous amount of resources and enforcement, they just never
- 17 could get the place shut down. And I had just heard stories
- 18 that that was one reason why it was referred to Texas.
- 19 Q And who told you that, if you can remember?
- 20 A I can't remember.
- 21 Q Okay.
- 22 A It was one of the attorneys in one of those
- 23 meetings that we had, but I can't remember.
- 24 MR. I'm sorry if you guys already
- 25 covered this.

- 1 A Yes.
- 2 Q And that in a nutshell is what we're trying to
- 3 establish, if something like that happened.
- 4 A Uh-huh.
- 5 Q But it's unfair to ask you to opine too much on an
- 6 e-mail that you're not even on, much less that you didn't
- 7 write. I'm sorry, go on.
- 8 BY MR.
- 9 Over on Exhibit 15, though, I wanted to just the --
- 10 the e-mail from to you. It's discussing the
- 11 issue of trying to get the names and addresses of the
- 12 investors in the CDs. The only thing I wanted to ask about
- 13 is that first paragraph from (b)(6), (b)(7)c to you at the top, it
- 14 says, "On the one hand, I don't want to limit our request.
- 15 On the other hand, if we aren't going to investigate the
- 16 thing, I don't see that it matters." Do you see that?
- 17 A Yes.
- 18 Q What do you think he meant by that? What was your
- 19 understanding?
- 20 A That if Spence had already decided to refer this to
- 21 the State of Texas, that our hands were tied in that, and the
- 22 only thing to do was to move on to other exams.
- 23 Q At some point, is it not a productive exercise to
- 24 have the examiners push for these documents if, in the end,
- 25 Enforcement's not going to investigate the matter?

- 1 A That's correct.
- 2 Q And were you frustrated at all by the decision not
- 3 to open a MUI in 2002?
- A Well, I didn't know for sure if they had opened one
- 5 or not, but, yes, I was disappointed, frustrated.
- 6 Q You never learned for sure whether or not they had
- 7 pursued an investigation around that time?
- 8 A I knew for sure that they had referred it to the
- 9 State. I didn't know for certain, I guess, what was going on
- 10 behind the scenes. I didn't know if Hal or Spence was on the
- 11 phone with the FBI or the DEA or postal inspectors or someone
- 12 else. I just knew that from our perspective, that the exam
- 13 was pretty much over with, and that's all we could do, and,
- 14 yes, it was frustrating.
- 15. Q And getting back to our conversation just a few
- 16 minutes ago, I mean, you looked at the dates of this, that
- 17 exchange that we were talking about between and
- , is December 16th. And, you know, your report's not
- 19 even finished then, it's anticipating that. And on December
- 20 19th, this exchange with you and bi60, bi(7)c , I mean, certainly
- 21 indicates that, understanding that enforcement had
- 22 decided not to investigate it, even before the report was
- 23 finalized?
- 24 MS. : Is that Exhibit 15?
- 25 MR. Yeah.

- THE WITNESS: I think that's pretty much what I
- 2 had gathered from (b)(6), (b)(7)c , that they weren't going to
- 3 proceed. But, like I said, I just didn't know for sure
- 4 whether Hal had spoken with the commissioners, or like I
- 5 said, some outside agency, you could hopefully do something
- 6 to further investigate it. I mean, as an examiner, my hands
- 7 were tied, that I can't work under cover, you know, I can't
- 8 -- I can only ask for books and records and refer the
- 9 things that I have.
- 10 BY MR.
- 11 Q You can't moonlight and do your investigation on
- 12 your own time?
- 13 A That's correct.
- 14 Q I understand that. I'm just struck that, you know,
- 15 as you said, Spence would get, would be cc'd on reports,
- 16 particularly and they would be sent to him if there was
- 17 referral. But the report wasn't done. So this chain of
- 18 e-mails makes it pretty clear that a decision had been made
- 19 to refer the Stanford matter to the Texas State Board before
- 20 Spence ever saw the exam, before he could have even seen an
- 21 exam report, laying out your guys' concerns?
- 22 A I think so. We could look at the date of the exam
- 23 report, but, yes, because in the exam report --
- 24 MR. : It's the 19th.
- 25 THE WITNESS: And we put --

```
BY MR.
 1
               You note that it's already been referred. Right?
 2
          Q
               That's correct.
 3
               And as you pointed out earlier, you're pretty
 5
     confident, based on standard operating procedure, that your
     report was never provided to the Texas State Securities
 6
 7
     Board.
               I think that would have been unusual to -- for any
 8
     outside agency or anyone to receive one of our reports.
10
               So presumably the decision, the decision -- if I'm
11
     -- looks like -- I just want to see if you agree with this or
     if I'm missing something, it looks like the decision to refer
12
     the matter to Stanford was made without the benefit of your
13
14
     report having been finished yet. And it was referred to an
     entity for investigation, and that entity also, presumably,
15
     never had the benefit of your report. And -- is that
16
17
     correct?
18
                     That's correct. As I said, I'm sure we sat
     in meetings and they had a good idea of what was going to be
19
     in the report.
20
21
               Those being enforcement folks?
          Q
               Yes.
22
          A
23
          Q
               But not Spence Parish?
```

I'm not sure what the enforcement folks were

24

25

Α

telling.

- 1 need to get in touch with the people in Antigua. She
- 2 definitely wanted to give the impression that they did not
- 3 have those documents onsite, and that they had very little to
- 4 do with that offshore bank.
- 5 Q And you had already asked for the due diligence
- 6 files and they gave you next to nothing, except for. I think
- 7 you said just the basic financial statements; is that right?
- 8 A I think there were a couple of other things in
- 9 there, but the basic things were the financial statements.
- 10 Q So it didn't have quarterly information about
- 11 portfolio allocation or anything like that?
- 12 A No. Not that I remember.
- 13 Q Was that suspicious or a red flag that all of a
- 14 sudden they claimed to have this information when they didn't
- 15 have it before?
- 16 A Yes.
- 17 Q And was that -- earlier, I think -- misstating it,
- 18 you said when you spoke with -- it was either Jane or the
- 19 investment officer, that they said that primarily the bank
- 20 investments were, for the CDs were commercial loans. Right?
- 21 A That's what she had originally told me. I remember
- 22 speaking with after we received those financial
- 23 statements. If I remember right, there was nothing in the
- 24 financial statements. They gave me an impression that they
- 25 had much, if anything, invested in commercial lines. So we

- 1 chain, I had, I guess, four questions or questions about four
- 2 things. First one, going through the information that the
- 3 COO -- or CCO, now says constitutes their due diligence, if
- 4 you look -- it's a sentence that begins, "Jane also says," if
- 5 you get there. It's about halfway or a little more than
- 6 halfway through the last big paragraph. You see that?
- 7 A Yes.
- 8 Q And you comment on them concluding their due
- 9 diligence files, "I believe this to be a mistake by Jane and
- 10 others at Stanford, this response should come in handy when
- 11 the bank collapses and everyone there plays dumb," so I
- 12 gather from that, that you foresaw the possibility of the
- 13 bank collapsing?
- 14 A I think I had said before, I mean, if I had given
- 15 it a percentage figure, in my mind, what I thought -- I
- 16 thought it was about a 95 percent chance that it was going to
- 17 collapse.
- 18 Q It was going to collapse. And that was because --
- 19 I mean, your thought that it was going to collapse was
- 20 because you thought it was going to be a Ponzi scheme.
- 21 Right?
- 22 A Right. There comes a point where the fund just
- 23 gets too big and they can't get enough investors in, if the
- 24 market turns south or some reason why people start pulling
- 25 money out, they'll run out of money to pay everyone.

```
I believe so. I mean, I just don't ever remember
 1
      getting a file big enough to account for the size of this
 2
     bank and the amount of deposits that they claim to have.
 3
                Did you ever get a satisfactory response, and a
 5
     full list of investors?
                Not that I ever remember.
 6
          Α
                               (SEC Exhibit No. 19 was marked for
                               identification.)
               BY MR.
               I'm showing you what's been marked Exhibit 19, a
10
     series of e-mails, the top one is May 23rd, 2003, 7:11 a.m.
11
     e-mail from yourself to (b)(6). (b)(7)c
12
13
               BY MR.
               We've just got a couple of questions about this.
14
     So you need to look at it. The first one is to sort of
15
     figure out ' DC's involvement at this point, and this person
16
17
                      Because there's a reference to having
18
     realized that OCIE should have been contacted before the fed
19
     was, the Federal Reserve. Do you remember anything about
20
     that?
               I remember at some point OCIE coming down and
          A
21
     saying we shouldn't be calling people outside of the SEC
22
     about any firm, without checking with them first, that they
23
     had set up some sort of contact people with various federal
24
25
     agencies that we should go through.
```

## EXHIBIT 18

## UNITED STATES SECURITIES AND EXCHANGE COMMISSION

In the Matter of:

) File No. OIG-526

COPY

OIG-526

WITNESS: Number 15

PAGES: 1 through 88

PLACE: Securities and Exchange Commission

801 Cherry Street

Burnett Plaza, Suite 1900

Fort Worth, Texas

DATE: Wednesday, January 27, 2010

The above-entitled matter came on for hearing, pursuant to notice, at 8:00 a.m.

Diversified Reporting Services, Inc.

(202) 467-9200

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Page 2
     APPEARANCES:
 1
 2
     On behalf of the Securities and Exchange Commission:
 3
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 4
 5
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12
13
     On behalf of the Witness:
14
          VICTORIA F. PRESCOTT, PRO SE
15
16
17
18
19
20
21
22
23
24
25
```

- beginning of an investigation?
- 2 A You're talking about in the previous?
- 3 Q Yeah. So you get down there in 2004, and you're
- 4 working on a referral to enforcement. So you're aware that
- 5 something had happened before. Were you aware of, you know,
- 6 anything specifically they had done? Because if you're
- 7 working on a referral now and they had gone down a certain
- 8 road and that road didn't lead anywhere, that might be
- 9 relevant in terms of what you're referring now.
- 10 A When I got down there and began looking at
- 11 examiners who were actually doing the examination -- and the
- 12 field work, I think, had already taken place. I was looking
- 13 at reports that they gave me. And looking at the report, I
- 14 felt like there was enough information there to make a
- 15 referral based on this given exam. So while I knew that
- 16 there had been previous examinations, I didn't try to draw
- 17 them into my written referral. If you don't have a copy of
- 18 the written referral, I can go get you one.
- 19 Q We do.
- 20 A There may have been a footnote in there. I haven't
- 21 looked at it in a while. I don't know if that answers your
- 22 question.
- 23 Q Sure. So you weren't focused on the old exam. But
- 24 what about what, if anything, enforcement had done in the
- 25 past? Were you aware of anything enforcement had done in the

- 1 they still had small issues work or took different positions.
- 2 So billion had that background, and I would sometimes go pick his
- 3 brain.
- 4 BY MR. KOTZ:
- 5 Q And so one of the things that Leyla Basagoitia said
- 6 to you was she thought that Stanford was running a Ponzi
- 7 scheme? I guess you wrote here, "She thinks it is like a
- 8 Ponzi scheme," on Exhibit 5.
- 9 A I'm sure if that's what I -- I'm not sure where
- 10 you're looking right now.
- 11 Q It says, per (b)(7)c
- 12 A Yes, okay. "She thinks it is like a Ponzi scheme."
- 13 I don't know if those were her words. They could have been.
- 14 Leyla is very emotive, very excitable. Her English,
- 15 particularly when she got excited, was -- her English was
- 16 good, but she had a very thick accent. So when I wrote that
- 17 down, she could have said the word Ponzi scheme or I may have
- 18 been trying to create my own notes of what she said. But I
- 19 suspect that's probably her words.
- 20 Q Okay. So did she provide some useful information
- 21 about Stanford?
- 22 A The most useful information that she gave was
- 23 giving me name, and I think there was another
- 24 fellow named . I followed up and called all the people
- 25 whose names she gave me, and I found them more helpful. They

- 1 were -- they had a broader understanding, and Leyla had made
- 2 up her mind that this was -- that Stanford was a problem, but
- 3 she couldn't really relate evidence. I don't think she had
- 4 any. She had her conclusion, and her approach to it was sort
- 5 of ipso facto that it must be, and I could never get details
- 6 from her that I would consider really useful from an
- 7 evidentiary standpoint.
- But she did give me these other names, and I called
- 9 them and got additional information from them. I tried to
- 10 follow up on the things that Leyla brought up. And I also
- 11 connected -- you know, gave this information to enforcement
- and set up a telephone call with of the
- 13 enforcement staff to kind of facilitate the transfer of
- 14 information. I sent my notes as well.
- 15 Q And when was that telephone call? Was that around
- 16 the time period you spoke to Leyla, or was that sometime
- 17 later?
- 18 A The call with the enforcement folks?
- 19 Q Yeah.
- 20 A That would have been sometime in 2005. I could get
- 21 the date for you.
- 22 Q Let me show you a document. That might help you
- 23 quantify the particular date. This looks like the date that
- 24 you sent the actual notes of the interviews that you did.
- 25 Why don't we mark as Exhibit 7 an e-mail you sent

(6), (b)(7)c

```
, a copy to Julie Preuitt and
                                                            on June
 1
 2
     21, 2005, as Exhibit 7.
                               (SEC Exhibit No. 7 was marked for
 3
                               identification.)
                             This would have been one of the ones,
               THE WITNESS:
     but this is not necessarily the date that we had the
     telephone call.
 7.
 8
          Q
               Okay.
               And I can get that for you. I just don't know it
 9
     off the top of my head. I think the date of the phone call
10
                   would have been after this date.
11
     with
                      Who was on the call from enforcement?
          Q
               Okav.
12
13
          Α
                               and I and originally Jeff Cohen
     wanted to attend it. So it was scheduled. But the call was
14
     actually handled by me making the introductions and sitting
15
     in while
                       visited with
16
17
          Q
               So was Jeff Cohen on the call?
18
          Α
               No.
19
               So originally he was supposed to be on the call,
    but in the end he wasn't?
20
               That's right.
21
          A
               Was there any specific reason?
22
          Q
               I was not told.
23 .
          A
24
               Okay.
          Q
               I did see a follow-on e-mail where he asked about
25
          A
```

- 1 it and said she was going to get with him and give
- 2 him the details. I presume that they did so.
- 3 Q Okay. And so judging from this e-mail dated June
- 4 21, it looks like you spoke to Leyla twice, twice,
- 5 and Mr. once?
- A Actually, I think I spoke to Leyla three times. I
- 7 think there was probably a third conversation.
- 8 Q And the information that these folks gave you, were
- 9 they consistent with each other?
- 10 A Leyla and (b)(7)c and (c)(6), (b)(7)c ?
- 11 Q Yes.
- 12 A I don't recall anything coming to mind that was
- 13 inconsistent. None of them had, you know, evidence. They
- 14 were people from whom you could get a better idea of what --
- 15 how things were handled from the perspective of someone
- 16 inside the firm. It was a starting point. It was not --
- 17 Q Right. But I mean, you wouldn't necessarily expect
- 18 witnesses to come forward with all the evidence. I mean,
- 19 that's what the SEC's job is to do is to develop evidence,
- 20 right?
- 21 A It's a starting point.
- Q Okay. So, I mean, it's helpful in an
- 23 investigation, wouldn't you say, to have insiders providing
- 24 information to you, and then the SEC's job is to develop
- 25 evidence from that?

- 1 invested.
- Q Okay. I guess in a previous conversation that you
- 3 had with my colleagues, you mentioned something about getting
- 4 pushback from Spence Barasch with regard to the Stanford
- 5 matter. Can you tell me about that?
- A That would have been later after we had made the
- 7 referral, after the document that is attached to Exhibit 8
- 8 had been finalized -- well, actually, technically wasn't
- 9 finalized. We can go into that in a minute. But it had been
- 10 sent to enforcement sometime in April. Then subsequent to
- 11 the time it was actually sent to enforcement, we had -- as a
- 12 regulation division, we had quarterly or so meetings with
- 13 other regulators in our region to try to discuss regulatory
- 14 issues and share information. This would have probably been
- 15 the first one I had ever attended. But Julie indicated to me
- 16 that she called upon people to share information about what
- 17 they had been working on. This is what I had been working
- 18 on. She asked me to present to the group a little sketch of
- 19 what we had been working on, and so I did.
- 20 Spence was present at that meeting, and so was Hal
- 21 Degenhardt. And after I made the presentation -- and this, I
- 22 believe, was in Austin at the Securities Board of Texas. As
- 23 we were standing in the meeting area after the meeting had
- 24 sort of adjourned, they came up to me and indicated that this
- 25 was not something that -- it seems like they said that they

- 1 had already looked at it and made a decision that it wasn't
- 2 going to be worked, something to that effect.
- 3 Q When you say they, you mean Spence Barasch?
- A I think they came to me and said something like
- 5 that, we've already looked at this and it's not going to be
- 6 worked, and it was Spence and Hal together. So I didn't -- I
- 7 was a little nonplussed, and I didn't --
- 8 Q Do you remember a separate conversation that you
- 9 had with Spence Barasch as well after that?
- 10 A No. If you have something to refresh my memory --
- 11 Q We understand, I guess, that, you know, that Spence
- 12 and Hal came up to you, and I guess Julie was there as well,
- 13 and made this comment that you just indicated but that there
- 14 may have been a separate conversation that you had with
- 15 Spence, just the two of you, about the Stanford case. Do you
- 16 remember that?
- 17 A I don't. If you can provide some additional
- 18 detail. I'd be kind of surprised if I had forgotten it. It's
- 19 not beyond the pale of possibility, if you refresh my memory.
- 20 MR. Prior to that interaction with Spence
- 21 Barasch and Hal Degenhardt, did you have any understanding as
- 22 to whether Hal Degenhardt had any opinion as to whether to
- 23 pursue the Stanford matter in enforcement?
- 24 THE WITNESS: The only thing that -- and I don't
- 25 think it would have been specific as to Hal or Spence. It

- 1 was those general conversations that I had had with Hugh
- Wright when he first said we were going to do this referral
- 3 in writing because there had been previous referrals. There
- 4 wasn't a great deal of factual flushing out of what had gone
- 5 on in the past. I took the referral and went forward with
- 6 it.
- 7 MR. Did you have any concern as to whether
- 8 the referral would be accepted in light of the comments that
- 9 the head of the office said at that point?
- 10 THE WITNESS: I think that's probably a fair
- 11 statement. I don't -- you know, I think we were all
- 12 concerned and felt like we needed to do a good job presenting
- 13 it to them. I mean, you know, from where I sat, I really
- 14 didn't know how the matter had been presented in the past.
- A lot of times referrals, when I was in enforcement
- 16 and I received a regulation referral, what I would get would
- 17 be a regulation examination report, which is full of a lot of
- 18 information that is totally extraneous to the referral. And
- 19 then somewhere in the report, there will be -- and not only
- 20 always in one place -- the bits that you need.
- 21 I found it challenging to, as an enforcement
- 22 attorney, to sort out what is really useful from an
- 23 enforcement standpoint and what is more the normal kinds of
- 24 things that regulation has to monitor. And a lot of times
- 25 during that period, the referrals were made orally. They

- 1 would take the exam report up, and then they would just come
- 2 talk to you.
- 3 I personally -- I receive information better
- 4 visually in writing where I have time to think and reflect on
- 5 it than I do having an oral conversation where the content
- 6 may be, you know, bounced back and forth and it just may not
- 7 be organized in a way that I can really receive it. So when
- 8 I took this, I realized that there had been previous
- 9 referrals, and my thought -- and I was asked to do a written
- 10 referral -- was, let's put something in writing that is going
- 11 to be something that will look more like what an enforcement
- 12 attorney would expect to see as they begin to work a case.
- 13 So that's what I tried to do.
- 14 MR. Getting back to your meeting with the
- 15 other regulators and the conversation with Degenhardt and
- 16 Barasch afterwards, I think part of the reason that us on
- 17 this side thought it sounded like a different conversation
- 18 than what we had heard before from different accounts was,
- 19 I'm guessing, may have been because of the tone that you had
- 20 described. Can you give us a tone or flavor? The accounts
- 21 we've heard of that conversation was it was more than just a
- 22 respectful FYI, by the way we looked at this before, we're
- 23 not going to do it, that Barasch was a little more animated
- 24 and disrespectful in his comments.
- 25 THE WITNESS: He was -- it was a very short

- 1 conversation. They said we're not going to work this.
- 2 BY MR. KOTZ:
- 3 Q Do you remember who said it? Was it Barasch or
- 4 Degenhardt?
- 5 A No, I don't, but they were both there together.
- 6 There was no sense of anything but unison in their opinion on
- 7 it. And I'm sorry, the rest of your question is was he
- 8 animated?
- 9 MR. Just the flavor. The sense I had
- 10 before, I thought, from talking to you is you felt like you
- 11 had been chided for even bringing it up at the meeting?
- 12 THE WITNESS: I got the impression that bringing it
- 13 up as a full-scale referral -- and, of course, I didn't
- 14 realize that -- I didn't have a real appreciation for what
- 15 they had looked into historically. So knowing what I know
- 16 now, I can see where it probably -- having that presented to
- 17 a whole group of regulators and FINRA personnel when they had
- 18 already looked at it and made a decision --
- 19 BY MR. KOTZ:
- 20 Q You say knowing what I know now. Do you know --
- 21 A Because of getting the documents for Adler, I saw
- 22 some e-mails as we gathered those.
- 23 Q That there was a sort of a comprehensive look?
- 24 A Don't indicate that. Just that there were other --
- 25 there were other -- that Spence and/or Hal had other looks at

- 1 previous Stanford complaints.
- Q Okay. Because we've been investigating this for
- 3 some time, talked to every person who was even involved, and
- 4 we have not found any specific thing that was ever done prior
- 5 to this in terms of investigations of Stanford.
- 6 A I'm not saying it was investigated. I'm saying
- 7 they had looked at the facts and formed some opinions on it.
- 8 I was coming there first out of the box in my new position
- 9 presenting something, and I think I did a pretty good job of
- 10 presenting it as a possible Ponzi scheme or possible money
- 11 laundering scheme. I don't think they had any clue that I
- 12 was going to make that presentation. So here a presentation
- 13 had been made in a mixed group of regulators. Okay. That's
- 14 one part of how I wanted to respond.
- 15 The other thing in terms of his animation, there
- 16 was some tensions in enforcement before I left enforcement,
- 17 and that's one of the reasons why I was interested in taking
- 18 the job in regulation. So by this point in time, my
- 19 relationship with Spence was professional. It was cordial.
- 20 It was not warm. And Spence could be -- Spence could be very
- 21 personable, and he could be very authoritative. So I would
- 22 say that this was not one of his personable encounters.
- 23 He was communicating to me in a very emphatic way
- 24 that a decision apparently had already been made. I was
- 25 sitting there thinking, you know, wondering what I had just

- 1 walked into in terms of having made a presentation to a group
- 2 of our colleagues that were outside the commission, thinking
- 3 that that was actually a bit awkward. So I don't know. If
- 4 you have -- I hope that answers your question. Please feel
- 5 free to follow up.
- 6 MR. I think so. I think I get the
- 7 general sense that you did feel -- what I thought I basically
- 8 heard you say was, yes, his tone was authoritative.
- 9 THE WITNESS: Yes.
- 10 MR. It was somewhat dismissive, and maybe
- 11 chided isn't an appropriate term. And you're just saying now
- 12 knowing what you know, you kind of see what was going on in
- 13 his mind of, hey, we've already heard the same stuff, this is
- 14 old news, we decided not to do anything with it, we don't
- 15 want to hear any more about it?
- 16 THE WITNESS: Yes. And I just made a big
- 17 presentation. I felt --
- 18 MR. I think you told me before something
- 19 to the effect of you sort of felt like the wind went out of
- 20 your sails, like what the heck have I been working on and
- 21 have I been wasting my time all these months or something
- 22 like that. Is that fair to say?
- 23 THE WITNESS: Well, that, too. I wanted to see the
- 24 case worked. I've clearly been an advocate for working the
- 25 case, but I just was not expecting that. And then to have it

```
an e-mail dated 4/19/2005, 11:23 a.m. This is from you to
 1
 2
                  with a copy to Julie Preuitt and
 3
                 and we're going to mark it as Exhibit 12.
                               (SEC Exhibit No. 12 was marked for
                               identification.)
 5
                THE WITNESS:
                              Okay.
 6
                BY MR. KOTZ:
                There's a reference in here to our relationship
 8
     with the Southern District of Texas has been problematic?
 9
                Yes.
10
          Α
               Do you know what that's referring to?
11
                Something happened between them and Spence and
1.2
13
     others in his chain of authority, and I never knew, but I
     heard some disparaging comments. I wish I could remember
14
     more of the detail. I had the impression that the southern
15
     district had done something that -- I probably knew a little
16
17
     bit about it at the time, and it struck me as being
     problematic in our relationship.
18
               So there were disparaging comments from who about
19
          Q
20
     who?
               I think they were going both directions.
21
     some tension between enforcement, people in control of
22
     enforcement here and people in control of the Houston
23
     district -- U.S. Attorney's Office.
24
25
               Okay. And there's also a reference to, "also let
          Q
```

- 1 me know when you want to contact the Office of Economic
- 2 Analysis."
- 3 A Yes.
- 4 Q Do you remember contacting the Office of Economic
- 5 Analysis?
- 6 A Yes.
- 7 Q And did you gain any information from them that was
- 8 helpful?
- 9 A Not much. I made the contact, and I probably have
- 10 some notes or an e-mail or something downstairs which would
- 11 give me the name of the person I talked to. I can tell you
- 12 it was a man. And I was interested in trying -- well, I
- 13 believe what I was interested in doing was trying to get a
- 14 way of converting our intuitive concerns about the rates of
- 15 return in light of what the markets were doing to something
- 16 that could be used as evidence. I was hoping that the Office
- 17 of Economic Analysis could do some number crunching to help
- 18 us with that.
- My recollection is -- and (b)(6), (b)(7)c is copied on
- 20 this. This would have been during the time period that 6070c
- 21 was the branch chief on the case. I made the initial
- 22 contact, and  $\frac{b(7)c}{b(7)c}$  was going to continue with the contact.
- 23 Q And you said your recollection was -- did you get
- 24 anything from economic analysis to help with the numbers?
- 25 A I didn't get anything, but I had -- and I don't

- 1 think that it was -- I think it was -- my impression was it
- 2 was probably problematic whether or not they could do the
- 3 kind of analysis that really would turn into evidence, but we
- 4 were trying and that was going to continue to follow up
- 5 on that.
- 6 Q But you don't know if b)(7)c ever got anything from
- 7 the Office of Economic Analysis?
- 8 A No, I do not. But I will tell you I would be a
- 9 little surprised if they were able to do the kind of analysis
- 10 that would be -- that we would have really liked to have had.
- 11 We were trying.
- 12 Q Why would you say that, you would be surprised if
- 13 they were able to do it?
- 14 A I think it's very hard when you have as many
- 15 variables, when you don't know what Stanford is investing in,
- 16 to be able to say that it is impossible to generate this
- 17 particular return. I don't think many people are going to be
- 18 able to do that when there are so many components of the
- 19 information that Stanford wouldn't give us, that we didn't
- 20 have. So we were trying hard, but I realized it was going to
- 21 be difficult.
- 22 Q Okay. But are you aware in 2009 that the SEC filed
- 23 a complaint containing information about the impossibility or
- 24 improbability of Stanford's returns?
- 25 A Yes.

```
THE WITNESS: I believe that's 8.
```

- 2 MR. Color Chart Page 5 of that
- 3 document, and your Paren 3.
- 4 THE WITNESS: Yes.
- 5 MR. Where you're citing generally the
- 6 returns that he's claiming in years that the indices were
- 7 down and what that would mean for the other portion of the
- 8 portfolio, that's in essence the same information that's in
- 9 the complaint, different years, but that kind of, if you
- 10 will, circumstantial evidence of improbability or
- 11 impossibility.
- 12 My question to you is if OEA had done any kind of
- 13 analysis, maybe a macroanalysis, and said, yeah, we might not
- 14 be able to say that it's absolutely impossible but we agree
- 15 with you it seems highly improbable or seems suspicious,
- 16 would that have been helpful for the staff down here to know
- 17 that they were onto something?
- 18 THE WITNESS: I think it would have been helpful.
- 19 Since you called attention to Paragraph 3, which is on Page 5
- 20 of Exhibit 8, let me tell you a little bit about how this
- 21 information was derived. We sat downstairs in reg and were
- 22 talking about this kind of idea. I was trying to turn our
- 23 concerns and our intuitions into something closer to
- 24 evidence. I asked the reg staff, look at these indices and
- 25 let's do some number crunching. How close can we get? And

```
1 they tried very, very hard, and that's what this is based on.
```

- 2 MR. : And Footnote 11 also talks about the
- 3 number crunching or the effort to do some number crunching.
- 4 It's on the same page, Page 5.

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5 (6)(5), (b)(7)a

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15 BY MR. KOTZ:

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Q You said they were apprehensive. Who was apprehensive? Julie Preuitt?

I'd say was one of the people I was No. 18 These are people who work with numbers, and working with. 19 they work with precision. This is not -- the kind of 20 analysis we were doing was, by definition, extremely 21 22 imprecise. So there was this chasm that we were going to 23 have to bridge. I reached out to -- I did it with the people 24 downstairs to try to begin priming the pump, if you will, for enforcement referral. I reached out to OEA in hopes that 25

- 1 they might be able to take it a little further.
- 2 MR. And that's my question. Don't you
- 3 think they would have been able, should have been able, to
- 4 take it a little further, even if they couldn't come up with,
- 5 you know, absolute metaphysical certainty? I mean, isn't
- 6 that their job to provide this kind of quantitative analysis
- 7 to help the enforcement staff?
- 8 THE WITNESS: I reached out to them in hope that
- 9 they would help me. I have to tell you I don't know if I
- 10 understand all the things they do well enough to give you a
- 11 black and white opinion on it. I was certainly reaching out
- 12 to a number of different divisions trying to get help.
- 13 MR. You knew enough to know that they
- 14 might be able to provide help?
- 15 THE WITNESS: Yes.
- 16 MR. And the help you were looking for was
- 17 kind of taking the quantitative analysis that you asked



- to do a step further?
- THE WITNESS: A step further, yes.
- 20 MR. And to your knowledge, no one on the
- 21 investigation or you ever got any analysis or help from OEA
- 22 on that issue?
- THE WITNESS: Well, I know that was going
- 24 to continue the discussion. And what they may have told him,
- 25 I mean, they may have been able to tell him it was

- 1 impossible. I don't know. I was out of the communication by
- 2 that point. I just don't know.
- MR.  $^{(b)(6), (b)(7)c}$ : Was  $^{(b)(6), (b)(7)c}$  the name of the person
- 4 you contacted?
- 5 THE WITNESS: I think that is. I think that's
- 6 right.
- 7 BY MR. KOTZ:
- Q All right. I want to show you another document,
- 9 mark it as Exhibit 13.
- 10 (SEC Exhibit No. 13 was marked for
- 11 identification.)
- 12 BY MR. KOTZ:
- 13 Q It's a memo from you dated 3/14/2005. I just
- 14 wanted to know, was this the final version eventually of the
- 15 Stanford report that we saw in draft previously?
- 16 A Probably.
- 17 Q Okay.
- 18 A Because of the way this got referred electronically
- 19 -- usually I sign them and PDF them so that I can keep track
- 20 of exactly which one is the final version and exactly who I
- 21 sent it to and on what date, because this one was e-mailed by
- 22 Julie instead of by me. I can go back to the e-mail and
- 23 probably print the attachment from the e-mail and compare it
- 24 to Exhibit 13 and then tell you for sure. There were a lot
- 25 of drafts of this thing.

- A Well, let me give two brief answers, and then you
- 2 can follow up as you prefer. The answer to the big question
- 3 is that the case was being referred to the NASD because we
- 4 were instructed to do so, and my recollection is that came
- 5 from Hal Degenhardt. The more narrow question is why this
- 6 letter was written to the NASD is because (b)(6),(b)(7)c , after
- 7 we had a telephone conference about the referral, asked me to
- 8 write a letter.
- 9 Q Okay. And do you know why Hal Degenhardt
- 10 determined that it should be referred to the NASD?
- 11 A He didn't elaborate.
- 12 Q Do you know if that was his decision?
- 13 A Well, he was the office head.
- 14 Q So ultimately --
- 15 A I presumed it was.
- 16 Q Okay. And what was your feeling about the decision
- 17 made to refer to the NASD?
- 18 A I was unhappy about that.
- 19 Q How come?
- 20 A Because I felt like that it was unlikely that the
- 21 NASD would be able to be able to create the same kind of
- 22 result that we could here at the commission.
- Q Why was that?
- 24 A Partly because our remedies are different. Our
- 25 jurisdiction is a little different. I wanted -- you know, I

- 1 wanted to see us work the case, frankly.
- 2 Q So you believed that the SEC was in a better
- 3 position to make headway in the Stanford investigation than
- 4 the NASD?
- 5 A In most respects, yes. There's some things that
- 6 the NASD has greater -- you know, different types of leverage
- 7 through their membership. You know, if a member refuses to
- 8 cooperate with the NASD, the NASD can expel them from
- 9 membership. That's a little bit different leverage that what
- 10 we would have by issuing subpoenas and going through subpoena
- 11 enforcement and perhaps litigating the merits of the case in
- 12 subpoena enforcement proceeding. So there's nuanced
- 13 distinctions, but ultimately I wanted to see the commission
- 14 work it.
- 15 MR. Did you have any concern that the
- 16 referral from the SEC to NASD would impact the commission's
- 17 own investigation of Stanford?
- 18 A Well, we've worked cases with other regulators
- 19 jointly before, and so there's a lot of different ways that
- 20 this could happen. Obviously if this is going on on multiple.
- 21 fronts, there needs to be coordination, which I would expect
- 22 enforcement to do. At this particular juncture, my
- 23 impression and understanding was that we were referring it to
- 24 the NASD because we would not be working it.
- 25 MR. : And how did you get that impression?

- 1 something that suggested that. It may have been like an
- 2 e-mail. I don't remember that it was anything that was
- 3 particularly detailed. It was like a letter or an e-mail or
- 4 something. I'm sure it could be found again.
- MR. KOTZ: Do you have anything, (b)(6):
- 6 MR. Just two quick questions. When you
- 7 went downstairs, as you say, from enforcement to regulation,
- 8 it sounds like that Stanford for Hugh Wright was a big
- 9 priority, immediately that was a big priority for him to make
- 10 a referral on. Can you give us a sense of what kind of
- 11 priority Stanford was for the regulation people when you went
- 12 down there?
- 13 A Well, I think it was a very high priority. I mean,
- 14 obviously it was my first matter to work on, and so it had my
- 15 full attention. I didn't have a lot of competing things
- 16 other than what I was finishing up from enforcement during
- 17 that time period. Everyone wanted to see the case worked.
- 18 MR. (b)(6), (b)(7)c : And then somewhat of a, you know, off
- 19 the beaten path question. You mentioned much earlier in your
- 20 testimony (b)(6), (b)(7)c
- 21 A Yes.
- 22 MR. Do you know where he is today?
- 23 A Someone indicated to me in a passing conversation
- 24 in the hallway yesterday that he's on trial right now in
- 25 Virginia or something like that as some of the -- I think he

## EXHIBIT 19

## UNITED STATES SECURITIES AND EXCHANGE COMMISSION

In the Matter of: )

) File No. OIG-526

COPY

OIG-526

WITNESS: Number 16

PAGES: 1 through 42

PLACE: Securities and Exchange Commission

801 Cherry Street

Burnett Plaza, Suite 1900

Fort Worth, Texas

DATE: Wednesday, January 27, 2010

The above-entitled matter came on for hearing, pursuant to notice, at 11:37 a.m.

Diversified Reporting Services, Inc.

(202) 467-9200

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Page 2
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- 1 this kind of thing.
- 2 Q Right.
- 3 A Namely that it was too good to be true and they
- 4 couldn't possibly have been making this much money and so on
- 5 and so forth. It sounds -- this analysis sounds kind of
- 6 familiar to me, but I think really it sounds familiar to me
- 7 from reading the paper or things like it in the paper.
- 8 Q But this type of analysis where the reported
- 9 earnings of between 12.4 and 13.3 percent, but then when you
- 10 look at the indices it's substantially down, that would give
- 11 rise to suspicion that they are either not trading or
- 12 somehow engaged in a fraud, wouldn't it?
- 13 A Absolutely. I mean, it's almost impossible. It's
- 14 almost impossible for them to be, No. 1 -- I mean, even aside
- 15 from, you know, what the indices are doing -- I guess you can
- 16 always argue that you beat the market, but if you're telling
- 17 people you've got a CD and it's safe like a bank CD, you
- 18 know, I mean, I don't know how anybody can generate returns
- 19 in double digits while still offering that kind of security.
- 20 I mean, all of this is implausible.
- 21 Q Right. Let me ask you this question. If you had a
- 22 situation where you believe that there may be a fraud going
- 23 on, potentially a Ponzi scheme, but there are sort of
- 24 logistical, even perhaps jurisdictional, issues as there were
- 25 in Stanford, would one approach be to try to bring an action