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## **REPORT OF INVESTIGATION**

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

**Case No. OIG-516**

#### **Investigation of Fort Worth Regional Office's Conduct of the Stanford Investigation**

##### **Introduction and Background**

The Office of Inspector General ("OIG") recently received several complaints regarding the Securities and Exchange Commission's (SEC's) investigation of, and action against, Robert Allen Stanford and his companies (collectively, hereinafter, referred to as "Stanford"). These complaints generally faulted the SEC for not acting sooner and more aggressively to discover and shut down Stanford's alleged Ponzi scheme. Specifically, the complaints charged that the SEC staff had not diligently pursued its investigation of Stanford until the Madoff Ponzi scheme collapsed in December 2008. The complaints also criticized the SEC for "standing down" from its investigation at some point in response to a request from another federal law enforcement entity. The latter criticism appears to have been based on news reports that the SEC investigation of Stanford had been delayed by such a request.

On February 17, 2009, the SEC filed an action in the U.S. District Court for the Northern District of Texas alleging that Stanford and his co-defendants orchestrated a \$8 billion fraud based on false promises of guaranteed returns related to certificates of deposit ("CDs") issued by the Antigua-based Stanford International Bank ("SIB").<sup>1</sup> The SEC's Complaint alleged that SIB sold approximately \$8 billion of CDs to investors by promising improbable and unsubstantiated high interest rates.<sup>2</sup> Pursuant to the SEC's request for emergency relief, the Court immediately issued a temporary restraining order, froze the defendants' assets, and appointed a receiver to marshal those assets.

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<sup>1</sup> Stanford's co-defendants include SIB, Houston-based broker-dealer and investment adviser Stanford Group Company ("SGC"), and investment adviser Stanford Capital Management ("SCM"). The SEC also charged SIB Chief Financial Officer James Davis and Laura Pendergest-Holt, Chief Investment Officer of Stanford Financial Group ("SFG"), for their alleged role in Stanford's fraud.

<sup>2</sup> The SEC Complaint against Stanford is attached as Exhibit 1.

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After reviewing documents obtained from the court-appointed receiver, the SEC filed an amended complaint on February 27, 2009, further alleging that Stanford was conducting a Ponzi scheme.<sup>3</sup>

### Scope of the Investigation

The OIG interviewed Steve Korotash, Associate Regional Director of the SEC's Fort Worth Regional Office ("FWRO"), on May 12, 2009, regarding the chronology of the SEC's Stanford investigation. The OIG also interviewed (b)(7)(C) the FWRO (b)(7)(C) assigned to the Stanford matter, on March 14, 2009.<sup>4</sup> A second interview with (b)(7)(C) was conducted on June 8, 2009.<sup>5</sup> In addition, the OIG reviewed numerous documents related to the investigation of, and the litigation against, Stanford, including: (1) a referral from the Office of Compliance Inspections and Examinations ("OCIE"); (2) a copy of the Action Memorandum (b)(5) dated October 11, 2006, (b)(5) (3) the Formal Order of Investigation dated October 26, 2006; (4) a Memorandum to the United States Department of Justice ("DOJ") regarding the criminal referral ("DOJ Referral") dated April 22, 2008; (5) a June 19, 2009 Indictment of Robert Stanford and others ("Indictment"); (6) information from the SEC Division of Enforcement's internal case tracking systems; (7) the SEC's February 16, 2009 Complaint (the "Complaint"); (8) the SEC's First Amended Complaint filed on February 27, 2009 (the "First Amended Complaint"); and (9) the SEC's Second Amended Complaint filed on June 19, 2009 (the "Second Amended Complaint").

### Relevant Legal Standard

The SEC's Enforcement staff has the obligation to continuously and diligently investigate instances of securities fraud, as set forth in the Commission Canon of Ethics in the Code of Federal Regulations. The Policy of the Canon recognizes that "[i]t is characteristic of the administrative process that the Members of the Commission and their place in public opinion are affected by the advice and conduct of the staff, particularly the professional and executive employees."<sup>6</sup> Hence, "it shall be the policy of the Commission to require that employees bear in mind the principles specified in the

<sup>3</sup> The SEC's First Amended Complaint against Stanford is attached as Exhibit 2.

<sup>4</sup> (b)(7)(C) did not participate in the Stanford investigation until (b)(7)(C) (b)(7)(C) 2007. The previous (b)(7)(C) assigned to the matter was (b)(7)(C) has since transferred (b)(7)(C) A transcript of the March 14, 2009 interview with (b)(7)(C) 3/14/09 Tr.") is attached as Exhibit 3.

<sup>5</sup> A transcript of the June 8, 2009 interview with (b)(7)(C) 6/8/09 Tr.") is attached as Exhibit 4.

<sup>6</sup> 17 C.F.R. § 200.51 (2009.)

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Canons.”<sup>7</sup> The Preamble of the Canon clearly states the serious duty placed upon members of the Commission and the staff, as follows:

Members of the Securities and Exchange Commission are entrusted by various enactments of the Congress with powers and duties of great social and economic significance to the American people. It is their task to regulate varied aspects of the American economy, within the limits prescribed by Congress, to insure that our private enterprise system serves the welfare of all citizens. Their success in this endeavor is a bulwark against possible abuses and injustice which, if left unchecked, might jeopardize the strength of our economic institutions.<sup>8</sup>

The Canon further provides: “In administering the law, members of this Commission should vigorously enforce compliance with the law by all persons affected thereby.”<sup>9</sup> The Canon also affirms that: “Members should recognize that their obligation to preserve the sanctity of the laws administered by them requires that they pursue and prosecute, vigorously and diligently but at the same time fairly and impartially and with dignity, all matters which they or others take to the courts for judicial review.”<sup>10</sup>

#### Results of the Investigation

The FWRO staff investigators opened a formal investigation of Stanford (FW-02973) on June 15, 2005, which was precipitated by a referral from FWRO examination staff after its examinations of Stanford Group Company (“SGC”).<sup>11</sup> OCIE’s referral indicated its concern<sup>(b)(5),(b)(8)</sup>

(b)(5),(b)(8)

<sup>7</sup> *Id.*

<sup>8</sup> 17 C.F.R. § 200.53 (2009).

<sup>9</sup> 17 C.F.R. § 200.55 (2009).

<sup>10</sup> 17 C.F.R. § 200.64 (2009).

<sup>11</sup> Memorandum from OCIE on Referral to Enforcement (Mar. 14, 2005) (attached as Exhibit 5).

<sup>12</sup> *Id.* at 5. The OCIE referral further stated:<sup>(b)(5),(b)(8)</sup>

(b)(5),(b)(8)

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(b)(5),(b)(8)

After opening the investigation, the FWRO Enforcement staff sent a questionnaire to 140 of SIB's U.S. and foreign investors and interviewed some of those investors.<sup>14</sup> The responses from those investors generally confirmed that the investors were receiving their promised payments.<sup>15</sup> The FWRO staff also requested and reviewed documents from former SGC sales representatives; interviewed former SGC sales representatives; and requested and reviewed documents from brokerage firms doing business with SGC.<sup>16</sup>

The FWRO staff also sent voluntary document requests to SGC and SIB, and reviewed several hundred boxes of documents that SGC produced in response to those requests.<sup>17</sup> However, (b)(5) the FWRO staff was hindered by jurisdictional issues and Stanford's lack of cooperation.<sup>18</sup> The (b)(5) SIB refused to produce any documents it deemed were "bank-related," citing Antiguan bank secrecy laws and also took the position that the CDs were not securities.<sup>19</sup> Consequently, the FWRO staff (b)(5) did not receive any documents from SIB or related to the CD product.<sup>20</sup>

At the outset of its investigation, the FWRO staff asked the SEC's Office of International Affairs ("OIA") for assistance in resolving these jurisdictional issues. On June 9, 2005, OIA sent the Antigua Financial Services Regulatory Commission ("AFSRC") a "detailed letter and request for assistance in obtaining SIB account documents."<sup>21</sup> In a letter dated June 21, 2005, Leroy King, the Administrator and Chief

<sup>13</sup> *Id.* at 1.

<sup>14</sup> (b)(5)

<sup>15</sup> (b)(7) (C) 3/14/09 Tr. at 10 (Ex. 3).

<sup>16</sup> (b)(5)

<sup>17</sup> *Id.* at 1, 5.

<sup>18</sup> *Id.* at 5.

<sup>19</sup> *Id.*

<sup>20</sup> (b)(7) (C) 3/14/09 Tr. at 4 (Ex. 3). *See also* (b)(5)

(b)(5)

<sup>21</sup> (b)(5)

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Executive Officer for AFSRC represented that if Stanford were running a Ponzi scheme AFRSC would have detected it.<sup>22</sup>

In October 2006, the FWRO staff described the status of its efforts to obtain records from Antigua as follows:

(b)(5)

Because Stanford continued to be non-responsive to requests to produce any bank-related documents, the FWRO staff requested (b)(5) on October 11, 2006.<sup>24</sup> In support of its request, the FWRO staff explained:

(b)(5)

The Commission issued a formal order of investigation on October 26, 2006.

During 2007, while the FWRO staff continued its unsuccessful efforts to obtain records related to the SIB CDs, it also pursued its investigation of SBC's sales practice

<sup>22</sup> This letter is described in paragraph 49, pp. 21-22, of a June 19, 2009 indictment of Leroy King for, *inter alia*, criminal obstruction of the SEC's Stanford investigation. That indictment is attached as Exhibit 7.

<sup>23</sup> (b)(5)

<sup>24</sup> *Id.* at 5.

<sup>25</sup> *Id.* Until April 2008, the staff's concern that Stanford was operating a Ponzi scheme was based on the aggressive sales practices Stanford employed to sell the CDs. *Id.* at 6. Without a witness or the SIB records that it sought but were denied, the staff believed it had no evidence of a Ponzi scheme. (b)(7) 6/8/09 Tr. at 26-27 (Ex. 4). As discussed below, in April 2008 a whistleblower alleged that Stanford might be operating a Ponzi scheme. Although the whistleblower did not have evidence that Stanford was operating a Ponzi scheme, the staff contacted DOJ at that point with its concern. *Id.* at 8, 10.

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and disclosure issues.<sup>26</sup> After obtaining the formal order, the FWRO staff subpoenaed testimony and documents from several individuals, including Robert Allen Stanford.<sup>27</sup> However, according to (b)(7)(C) the FWRO staff's efforts to obtain records related to Stanford's CD program continued to be frustrated due to jurisdictional issues.<sup>28</sup>

In April 2008, the FWRO staff was contacted by two whistleblowers, (b)(7)(C), (b)(7)(D) and (b)(7)(C), (b)(7)(D) who had been involved in sales of SBC's proprietary mutual fund wrap program, Stanford Allocation Strategy ("SAS").<sup>29</sup> (b)(7)(C), (b)(7)(D) and (b)(7)(C), (b)(7)(D) were concerned that false and misleading information regarding the past performance of the SAS mutual funds was being used to market the SAS program to investors. (b)(7)(C), (b)(7)(D) and (b)(7)(C), (b)(7)(D) were (b)(7)(C), (b)(7)(D) but had no direct involvement with the SIB CD program. On April 15, 2008, the FWRO staff received an e-mail through the SEC's Enforcement Complaint Center from a third whistleblower, (b)(7)(C), (b)(7)(D) (the "Witness"). In the e-mail, the Witness stated:

Please take a deeper look into Stanford International Bank. I know there has been an [investigation] into sales practices, but you need to focus on the bank. (b)(7)(C), (b)(7)(D) and am 100% sure that the SIB CD is a complete fraud. I only wish I had hard proof for you, but I assure you that thousands of U.S. investors are being duped and stand to lose their life savings.<sup>30</sup>

On April 22, 2008, the FWRO staff made a written criminal referral regarding Stanford to (b)(7)(C) in the Fraud section of the Criminal Division at DOJ, and (b)(7)(C) forwarded the written referral on to (b)(7)(C) supervisors.<sup>31</sup> The referral detailed the FWRO staff's investigative work to that point and the Witness' allegations.<sup>32</sup> As the referral indicated, it was motivated by the FWRO staff's heightened concern, based on the Witness' suspicions, that Stanford might be operating a Ponzi scheme and by frustration over its inability to obtain records that might expose that scheme.<sup>33</sup> In the referral, the FWRO staff expressed its concerns and frustration as follows:

<sup>26</sup> (b)(7)(C) 3/14/09 Tr. at 6-7 (Ex. 3).

<sup>27</sup> Stanford Subpoena (June 5, 2007) is attached as Exhibit 8.

<sup>28</sup> (b)(7)(C) 3/14/09 Tr. at 4-5 (Ex. 3).

<sup>29</sup> *Id.* at 19-20 (Ex. 3).

<sup>30</sup> DOJ Referral at 2 (attached as Exhibit 9).

<sup>31</sup> See DOJ Referral (Ex. 9).

<sup>32</sup> *Id.* at 2-3.

<sup>33</sup> *Id.* at 2.

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(b)(5)

In response to the referral, DOJ asked the FWRO staff to not pursue any investigative action with respect to SIB or the CD product while it considered how to launch its own investigation of possible wire fraud and/or money laundering activity associated with the CD offerings.<sup>35</sup> While DOJ considered its course of action, the FWRO staff continued working with the first two whistleblowers (b)(7)(C), (b)(7)(D) and (b)(7)(C), (b)(7)(D) in consultation with DOJ, regarding the SAS program.<sup>36</sup> The FWRO staff continued to review documents related to the marketing of the SAS program that these individuals provided. The FWRO staff also reviewed a (b)(7)(C)

By July 2008, the FWRO staff believed, based on conversations with DOJ, that it could not continue its investigation of SCG's sales practices without jeopardizing DOJ's ongoing investigation.<sup>38</sup> The FWRO staff contacted DOJ and asked if it could continue its investigation of the SAS program, and DOJ told the FWRO staff that it preferred that the SEC wait before taking any additional investigative steps.<sup>39</sup> The FWRO staff deferred to DOJ's request in order to avoid compromising DOJ's investigation.<sup>40</sup>

After December 11, 2008, when Madoff's Ponzi scheme collapsed, the FWRO staff felt an increased sense of urgency regarding any ongoing investigations of possible Ponzi schemes.<sup>41</sup> The FWRO staff contacted the FBI and inquired as to the status of its Stanford investigation and learned that the FBI's investigation was in the preliminary

<sup>34</sup> *Id.*

<sup>35</sup> (b)(7)(C) 3/14/09 Tr. at 14-15 (Ex. 3).

<sup>36</sup> *Id.* at 19.

<sup>37</sup> *Id.* at 11.

<sup>38</sup> *Id.* at 19.

<sup>39</sup> (b)(7)(C) 6/8/09 Tr. at 20 (Ex. 4).

<sup>40</sup> (b)(7)(C) 3/14/09 Tr. at 21 (Ex. 3).

<sup>41</sup> *Id.* at 21-22.

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stage.<sup>42</sup> The FBI told the FWRO staff that any investigative steps the FWRO staff contemplated might compromise the FBI's investigation and asked the FWRO staff to continue to wait.<sup>43</sup> At that point, the FWRO staff contacted DOJ and expressed its concern about deferring the SEC investigation any longer, and DOJ told the FWRO staff that, in light of the revelations about Madoff's Ponzi scheme, it no longer objected to the staff pursuing its investigation.<sup>44</sup>

Continuing the investigation, the FWRO staff interviewed former Stanford employees in Houston, Texas.<sup>45</sup> One former employee, (b)(7)(C),(b)(7)(D) provided critical documents and sworn testimony in January 2009.<sup>46</sup>

On February 13, 2009, the FWRO staff recommended (b)(5)

(b)(5)

(b)(5) the complaint was filed on February 16, 2009.<sup>48</sup>

The SEC's February 16, 2009 Complaint (the "Complaint") alleged that certain representations to investors regarding the safety of their CD investments were fraudulent.<sup>49</sup> According to the Complaint, Stanford represented that the clients' funds were invested in "liquid" investments, but the records available to the staff at that time indicated that investors' funds were "placed in illiquid investments, such as real estate and private equity."<sup>50</sup> In addition, the Complaint alleged that Stanford had used "materially false and misleading historical performance data" to sell investments in its

<sup>42</sup> *Id.* at 22-23.

<sup>43</sup> (b)(7)(C) 6/8/09 Tr. at 14 (Ex. 4).

<sup>44</sup> *Id.* at 14-15.

<sup>45</sup> *Id.* at 16.

<sup>46</sup> *Id.* at 18.

<sup>47</sup> (b)(5)

(b)(5)

<sup>48</sup> *Id.* at 7.

<sup>49</sup> Complaint at ¶ 1 (Ex. 1).

<sup>50</sup> *Id.* at ¶ 9.

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SAS program.<sup>51</sup> The Complaint did not allege that the SIB CD program was a Ponzi scheme because the staff had no evidence to support such allegations.<sup>52</sup>

On February 16, 2009 the Court granted the SEC's request and appointed Ralph Janvey as receiver for Stanford.<sup>53</sup> After the appointment of a receiver, the SEC was able to obtain bank records related to the CD program which it had been previously denied.<sup>54</sup> Those records revealed that the illiquid investments, such as real estate and private equity, that had purportedly been purchased with the CD proceeds did not exist, and that the SIB CD program was a Ponzi scheme.<sup>55</sup> Based on the new evidence, the FWRO staff filed a First Amended Complaint on February 27, 2009, adding allegations of a Ponzi scheme.<sup>56</sup>

On June 19, 2009, Robert Stanford, Laura Pendergest-Holt, Chief Investment Officer of SFG, and Leroy King, the Administrator and Chief Executive Officer for AFSRC, were indicted for, *inter alia*, conspiring to obstruct the SEC's Stanford investigation since sometime in 2005.<sup>57</sup> Leroy King "was responsible for Antigua's regulatory oversight of [SIB's] investment portfolio ... and the response to requests by foreign regulators, including the SEC, for information and documents about [SIB's] operations."<sup>58</sup> According to the indictment:

Stanford would make regular secret corrupt payments of thousands of dollars in cash to [Leroy] King ... to ensure that ...

- b. [Leroy] King corruptly would provide to Stanford ... information about official inquiries that the [AFSRC] had received from United States regulators who had requested information from the [AFSRC] regarding 'possible fraud perpetrated upon investors' by [SIB]; and

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<sup>51</sup> *Id.* at ¶ 11.

<sup>52</sup> (b)(7)(C) 6/8/09 Tr. at 25 (Ex. 4.)

<sup>53</sup> Receiver's Motion for Order Authorizing Release of Certain Customer Assets (filed March 4, 2009) is attached as Exhibit 11.

<sup>54</sup> (b)(7)(C) 3/14/09 Tr. at 9 (Ex. 3).

<sup>55</sup> First Amended Complaint at ¶ 37 (Ex. 2).

<sup>56</sup> *Id.* at ¶ 1.

<sup>57</sup> See Indictment attached as Exhibit 7 at 41-45.

<sup>58</sup> *Id.* at 5.

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- c. [Leroy] King would make false representations in response to official inquiries of regulators, including U.S. regulators, and would ... prepar[e] false responses to such inquires.<sup>59</sup>

Also on June 19, 2009, the SEC amended its complaint and charged Leroy King with aiding and abetting Stanford's fraud.<sup>60</sup> The Second Amended Complaint also added two defendants, Mark Kuhrt and Gilberto Lopez. Kuhrt and Lopez were accountants for Stanford and were charged in the Second Amended Complaint for allegedly fabricating financial statements.

### Conclusion

The OIG investigation found that the FWRO was actively investigating Stanford well before the December 2008 revelations about Madoff's Ponzi scheme. However, the FWRO staff's efforts to pursue its suspicions of a Ponzi scheme in the Stanford investigation were hampered by a lack of cooperation on the part of Stanford and his counsel; certain jurisdictional obstacles; and, according to a recent DOJ indictment, criminal obstruction of the FWRO's Stanford investigation by several individuals including the head of Antigua's Financial Services Regulatory Commission.

The OIG did find that after April 2008, when the FWRO staff referred its concern that Stanford might be running a Ponzi scheme out of Antigua to DOJ, the FWRO, at DOJ's request, effectively halted its Stanford investigation. Immediately after the revelations of the Madoff Ponzi scheme became public in December 2008, the Stanford investigation became more urgent for the FWRO and, after ascertaining that the DOJ investigation was in its preliminary phase, the FWRO staff asked DOJ if it could move forward with the Stanford investigation. After DOJ gave the FWRO staff the go-ahead, the FWRO staff gathered more evidence of certain fraudulent marketing practices by Stanford. That evidence allowed the SEC to file a civil action against Stanford on February 16, 2009. That action did not include allegations of a Ponzi scheme because, at that point, Stanford and the Antigua authorities continued to deny the staff access to records related to the SIB CD program and the FWRO staff did not believe that it had sufficient evidence to include such allegations in the SEC's Complaint.

Finally, the OIG found that the SEC's February 16, 2009 Complaint and Request for Emergency Relief resulted in the appointment of a receiver who gained access to records regarding the SIB CD program, and provided those records to the FWRO staff. Based on those records, the FWRO staff filed an Amended Complaint on February 27, 2009, adding allegations that the SIB CD program was a Ponzi scheme.

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<sup>59</sup> *Id.* at 18.

<sup>60</sup> See Second Amended Complaint attached as Exhibit 12.

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Accordingly, the OIG did not conclude that the SEC breached its obligations to vigorously pursue allegations of wrongdoing in the Stanford matter as the SEC's decision to halt its Stanford investigation was made in response to a specific request from the DOJ. The OIG did find that the SEC's urgency in the Stanford matter increased significantly once Madoff confessed to a Ponzi scheme and, at that point, the SEC impressed upon the DOJ that it could no longer hold its investigation in abeyance. The OIG further found that once DOJ informed the SEC that it no longer had any objection to the SEC continuing to pursue its investigation, the SEC moved quickly to bring an action against Stanford.

Submitted: Samuel W. Morris Date: 6/19/2009  
Samuel W. Morris

Concur: J. David Fielder Date: 6/19/2009  
J. David Fielder

Approved: H. David Kotz Date: June 19, 2009  
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