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OVERSIGHT OF THE SEC INSPECTOR GENERAL'S REPORT ON THE ``INVESTIGATION OF THE SEC'S RESPONSE TO CONCERNS REGARDING ROBERT ALLEN STANFORD'S ALLEGED PONZI SCHEME'' AND IMPROVING SEC PERFORMANCE

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HEARING

before the

COMMITTEE ON
BANKING,HOUSING,AND URBAN AFFAIRS
UNITED STATES SENATE

ONE HUNDRED ELEVENTH CONGRESS

SECOND SESSION

ON

EXAMINING THE OVERSIGHT OF THE SEC INSPECTOR GENERAL'S REPORT ON THE ``INVESTIGATION OF THE SEC'S RESPONSE TO CONCERNS REGARDING ROBERT ALLEN STANFORD'S ALLEGED PONZI SCHEME'' AND IMPROVING SEC PERFORMANCE

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SEPTEMBER 22, 2010

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WEDNESDAY, SEPTEMBER 22, 2010

U.S. Senate,
Committee on Banking, Housing, and Urban Affairs,
Washington, DC.

The Committee met at 10:13 a.m., in room SD-538, Dirksen Senate Office Building, Hon. Christopher J. Dodd, Chairman of the Committee, presiding.

OPENING STATEMENT OF CHAIRMAN CHRISTOPHER J. DODD

Chairman Dodd. The hearing will come to order. Let me first of all express my apologies to my colleagues and to our witnesses and to those who gathered for being a few minutes late getting started. I was just with the National Head Start Association, which has a gathering and invited Senator George Voinovich and I to address them and we were backed up a little late in getting our program going this morning, so I am late getting up here and I apologize to everyone.

I will make some brief opening comments, then I will turn to Senator Shelby for any opening comments he may have, and my hope is we can go right to our witnesses so we don't delay. Obviously, we are a little behind and want to complete the hearing if we can by noon. And so if people want to be heard, obviously, I always give people the right to express themselves on these issues.

Today is an important hearing. And by the way, let me thank my colleagues yesterday, as well. I had a funeral to attend in the morning, and I want to apologize to Richard Shelby and the others. These things happen, and I understand it was a very good hearing on the Infrastructure Bank issue----

Senator Shelby. It was.

Chairman Dodd. ----and I am very grateful to Senator Merkley and Senator Jack Reed, who chaired the hearing, and my colleagues who showed up to participate. Kay, I have been talking about you and that Infrastructure Bank idea, and we have talked about that possibly pilot program in that San Antonio-Dallas-Houston triangle, and so I encourage these Members who are going to talk about this--I said, go and see you and talk to you about this if you have an interest in the subject matter.

Senator Hutchison. Yes. I very much am interested in doing something that would promote infrastructure and private sector investments.

Chairman Dodd. Exactly.

Senator Hutchison. You started that operation. I think you have passed the baton to Senator Kerry, and I attended a meeting yesterday----

Chairman Dodd. Good.

Senator Hutchison. ----where we talked about some of the concerns and parameters.

Chairman Dodd. How to make it work. Great.

Well, this morning, this is a hearing, an oversight hearing of the SEC's Inspector General's report on the Investigation of the SEC's Response to Concerns Regarding Robert Allen Stanford's Alleged Ponzi Scheme and Improving SEC Performance.

And I will mention that Senator Shelby and Senator Vitter were two of our colleagues who wanted to see this Committee conduct this hearing, and rightfully so, in my view. We have new leadership at the SEC, but I think it is very important to go back and examine what happened, how did it happen, what is presently occurring to minimize this from ever happening again, and so it is an opportunity for us to discuss. I am grateful to Senator Shelby and Senator Vitter for raising the spectrum of this particular question and the hearing this morning is as a result of their efforts.

The Banking Committee today is holding a hearing, as I said, on the oversight of the SEC Inspector General's report on the Stanford alleged Ponzi scheme. The Committee will review the Inspector General's report on the Commission's failure to stop the Stanford financial fraud in a timely manner, and we will hear about the steps that it has taken to fix the problems and restore investor confidence.

Last August, the Banking Committee held a field hearing on the alleged Stanford Financial Group fraud, regulatory and oversight concerns, and the need for reform at the request of my colleague. Senator Vitter had a hearing in Louisiana. In fact, he asked me if he could do that and I agreed to allow him to do it. He did a very good job, I might point out, with that hearing in Louisiana. It was a very well conducted hearing, done in a very responsible manner, and I thank him for that.

Last year, we held two hearings surrounding the SEC's failures in regard to the Bernard Madoff fraud. Those three hearings contributed to reforms that we included in the Dodd-Frank Wall Street Reform and Consumer Protection Act to better empower and equip the SEC to do its job.

Today's hearing builds on those and reflects our work with Ranking Member Richard Shelby. The hearing looks not only to the past Commission performance, but also to future Commission actions for improvement.

Let me review very quickly this situation. In January of 2009, the SEC charged Robert Allen Stanford and several associates with orchestrating an $8 billion Ponzi scheme. According to the SEC's complaint, the defendants for almost 15 years promised improbably high interest rates and misrepresented to purchasers of Certificates of Deposit that their deposits were safe, falsely claiming that the bank reinvested clients' funds primarily in liquid financial instruments.

Although the Commission examine staff found strong evidence that Stanford was likely operating a Ponzi scheme as early as 1997, the Commission did not bring charges against Mr. Stanford until 2009, 12 years later, only months after Bernie Madoff's own Ponzi scheme was exposed. Both cases revealed deeply troubling failures by the SEC.

In March of this year, the SEC Office of the Inspector General released its report on the Commission's response to Stanford's scheme. The report found that a central problem was the failure of the SEC Fort Worth District Office Enforcement staff to heed the warning of the Examination staff. The IG report shows that the examiners at the Fort Worth District Office raised red flags about Mr. Stanford's operation in four exams conducted over 8 years, beginning in 1997, concluding in each examination that Stanford's CDs were likely a Ponzi scheme or a similar fraudulent scheme.

However, the Enforcement staff disregarded the examiners' repeated warnings, continually turning a blind eye for nearly a decade. We seemed to have an instance in which one side of the agency was screaming that there was a fire and the other side said that the fire was too hard to put out or that it didn't exist. The Inspector General's report found that one reason that the Enforcement Division did not want to investigate Mr. Stanford was the perception that the case was difficult, novel, and not the type favored by the Commission.

The report also raised a number of troubling facts about the former Enforcement head of the Fort Worth Office, who played a significant role in multiple decisions over the years to quash investigations of Mr. Stanford. All these pieces paint a picture of regulatory disconnects and mistakes that allowed this fraud to harm families and communities all across our

Nation.

So we look forward this morning to learning to what the Commission attributes this regulatory shortcoming. Investors in Stanford's Ponzi scheme may have lost as much as $8 billion, as I mentioned earlier, and the damage to investor confidence, obviously you cannot put a number on that as a result of news such as this one and the Bernie Madoff scam, as well.

So I look forward, as my colleagues do, to Inspector General Kotz's insights and a discussion of his findings and I appreciate the SEC being here with us to let us know what the Commission is doing to correct what went wrong. I hope that this hearing will provide the Committee, the Senate, and the American public with a clear view of how such a large and audacious fraud was allowed to perpetuate and to grow and what is being done to fix the system and prevent similar frauds in the future.

The Dodd-Frank bill was one step in a long journey to righting this ship, giving the SEC more power, doubling its funding over 5 years, and having periodic GAO reviews. But our work is obviously not done. The Inspector General's report also makes several thoughtful recommendations regarding bringing enforcement actions in complex cases, evaluating the performance of the Enforcement staff, coordination among SEC offices and divisions, staff training, and other matters. Investors deserve to know there is a cop on the beat working hard to protect them from the scam artists like Robert Allen Stanford and Bernie Madoff.

Restoring investor confidence and certainty in the fairness of our financial system is vitally important as we recover from this economic crisis. The SEC should use all of its resources at its disposal to work toward that end.

Let me also say very quickly, before I turn to Senator Shelby, because I always think it is important to make this point, obviously we are going to talk about an office in Fort Worth. We are going to talk about some people even here in Washington who should have done a better job. But I always think it is important in moments like this to also point out and recognize that there are thousands of people who work in the SEC who do an incredible job every day, and I don't want a hearing like this, where we focus on the misfeasance or malfeasance even of some to contaminate the hard work done by others who do a good job every day.

So even though our remarks are tough and the questions will be tough this morning about what happened here, I want also the employees who are not in this room but work for the SEC to know how much we appreciate how hard they work every day and how determined they are to do a good job for our country. And so I want our opening remarks to reflect those attitudes, as well, as we go forward.

Senator Shelby.

STATEMENT OF SENATOR RICHARD C. SHELBY

Senator Shelby. Thank you, Mr. Chairman. Thank you very much for holding this hearing.

The Stanford case, as you have pointed out, represents a major failure by the Securities and Exchange Commission in carrying out its investor protection mandate. Investors, as you have pointed out, were defrauded of billions of dollars and thousands of victims have had their lives shattered as a result. One of those victims from my home State of Alabama, Craig Nelson, testified at last August's field hearing on the Stanford case that you referenced Senator Vitter presided over.

We now know that Allen Stanford openly flaunted the money that he stole from his victims. He used it to buy part of a Caribbean island, to bribe foreign securities regulators, and fund sporting events. His victims deserve to know how this could have happened, hence this hearing.

Last October, Senator Vitter and I sent a letter to the Inspector General of the SEC asking him to supplement the limited review that had been conducted of the SEC's record in the Stanford matter. We asked him to look into, among other things, the history of the SEC's oversight of Stanford. What we learned was extremely disturbing.

The IG's findings, which we will get into later here today, indicate that the SEC produced reports, as Senator Dodd pointed out, in 1997, 1998, 2002, and 2004 that determined that fraud was occurring at Stanford. Further, the IG found that enforcement action was not taken following the findings, even though the Examination staff repeatedly requested that the Enforcement staff pursue such action at the SEC. Finally, the Inspector General found that a particular member of the Enforcement staff involved in making the determination not to pursue enforcement action later sought employment with Stanford.

Ultimately, it was not until after the Madoff Ponzi scheme was uncovered that any action was taken in the Stanford case, despite all these warnings. In the end, SEC inaction allowed the fraud to grow larger and swallow the life savings of numerous additional victims.

I believe that the SEC's gross negligence with respect to the handling of the Stanford case involves even more significant failures than were present in the Madoff fraud in some ways. In contrast to Madoff, where the SEC's examiners did not find fraud, in the Stanford case, give them credit. The SEC's examiners were not only aware of the fraud, they prevailed upon the Enforcement Division in the SEC to take action and they refused.

The findings of the SEC's gross negligence in the IG's report are not the only troubling aspect of the SEC's conduct in the Stanford case. The Securities and Exchange Commission chose to release the report in the height of Congressional action on regulatory reform and on the very same day that it announced its decision to pursue charges against Goldman Sachs. Think about it. In many ways, it appears that the timing of the release was intended to draw the least amount of scrutiny to the SEC for their failures.

Today, we will hear from the SEC Inspector General, the heads of the SEC's Examination and Enforcement programs, and the head of the Fort Worth Office. I believe that this should mark just the beginning of our review of this troublesome episode. We need to know exactly why evidence of fraud was not more thoroughly pursued. We need to know who was involved in reviewing this evidence and why they failed to connect the dots. Moreover, we need to examine the Commission's general response to these findings so that we can be sure that corrective measures are being taken to prevent a repeat of these institutional failures. Otherwise, we will go down the road again.

Senator Dodd, I appreciate again you holding this hearing and look forward to the Inspector General.

Chairman Dodd. Thank you, Senator, very, very much.

I mentioned, David, before you came in that you had a very good hearing in Louisiana, back 6 months ago, 7 months ago, whenever it was, and I thank you for that and thank Senator Shelby.

Unless someone would like to be heard, I am going to go right to our witness. Yes, certainly, go ahead.

STATEMENT OF SENATOR DAVID VITTER

Senator Vitter. I won't take long, Mr. Chairman, but very briefly, first of all, thank you and thanks to the Ranking Member for all of your help to me and all of your leadership on this. This is a very important matter to me for an unfortunate reason, because so many victims live in Louisiana, and you all have been extremely supportive in helping us follow up on this, including that field hearing in Louisiana, including this hearing today.

I completely concur with your comments and Senator Shelby's comments. This isn't just one major disappointing scandal. It is really three. It is the original Stanford Ponzi scheme fraud, which is horrible and created so many victims, including so many in Louisiana. On top of that, it is the inaction by the SEC, which I think is absolutely scandalous now that we are finally discovering all of the facts. And on top of that, number three is this conscious effort that Senator Shelby alluded to of the SEC to cover its tracks, to basically try to rewrite history in terms of when it knew about the problem.

So this is very disappointing and very frustrating and we have to ensure that this doesn't happen again. We also have to do everything possible to properly handle the ongoing issues with the Stanford victims.

So thank you, Mr. Chairman.

Chairman Dodd. Thank you very much, Senator.

Senator Hutchison. Mr. Chairman, could I just----

Chairman Dodd. Yes, certainly, Senator Hutchison.

STATEMENT OF SENATOR KAY BAILEY HUTCHISON

Senator Hutchison. I won't belabor this long, but I also want to add that so many of my constituents in Texas were victims. Reading the IG report, it is stunning. It is stunning, the times that the SEC had notice both from the Texas Securities Board and from internal reports from within the SEC at the field office, and yet years went on.

And so I thank you for holding this hearing. I hope that with the IG report, we will be able to assure that there are systems in place at the SEC that will eliminate this in the future and go forward so that people can have confidence in their investments with someone as big as Mr. Stanford. Thank you.

Chairman Dodd. I appreciate that.

Senator Johnson. Mr. Chairman?

Chairman Dodd. Senator Johnson.

Senator Johnson. May I submit my statement.

Chairman Dodd. Certainly. By the way, any opening statements that all of our colleagues have and any other data or information will be included.

Let me just say, as well, as we will hear obviously from our witnesses, and I suspect that we did some things in the financial reform bill that we enacted, but as I indicated, I think there are a lot of other areas where it may require some legislative action, and that will be the job for Tim Johnson and Richard Shelby and Members of this Committee. Jim Bunning and I won't be here to be a part of it, but I suspect you have got some----

[Laughter.]

Chairman Dodd. No, no. Well, I will regret not being here. I have enjoyed my work with my colleagues immensely, but I think there are some areas here that we didn't include and cover in our legislation that may warrant some legislative action. I will leave that to others to make the determination, Tim and Richard in the coming months.

But this morning, I want to introduce briefly our Inspector General--and I will also just take a minute and introduce all of the second panel, as well, and then we will get just right to it.

David Kotz has served as the Inspector General for the SEC since December of 2007. He leads a very distinguished team of auditors, investigators, administrative staff in the Office of the Inspector General's efforts to uphold the effectiveness, efficiency, and integrity of the SEC. He has testified before this Committee last September, in fact, in our hearing on the oversight of the SEC's failure to identify the Bernard Madoff Ponzi scheme and how to improve SEC performance, and we thank you very much for being back before us again today.

Robert Khuzami is the Director of the Division of Enforcement of the U.S. Securities and Exchange Commission. He joined the staff in February of 2009, and as Director, Mr. Khuzami is responsible for the civil law enforcement efforts of more than 1,200 SEC personnel located in 12 offices around the country. Previously, he worked as General Counsel for the Americas for Deutsche Bank, and before that served as a Federal prosecutor. He also testified before the Committee last September.

Carlo V. di Florio became the Director of the Office of Compliance Inspections and Examinations at the SEC in January of 2010. Prior to joining the Commission, Mr. di Florio was partner in the Financial Services Regulatory Practice at PriceWaterhouse Coopers, with expertise in corporate governance, enterprise risk management, and regulatory compliance and ethics.

Rose Romero has been the Regional Director for the Fort Worth District Office of the SEC since March of 2006. In that role, she oversees the enforcement and examination programs for the region. Prior to joining the SEC staff, Ms. Romero was the Executive Assistant United States Attorney for the Northern District of Texas. She testified representing the SEC at the Banking Committee's hearing last August on the alleged Stanford Financial Group fraud. That was the hearing, David, I think, in Louisiana that Ms. Romero testified.

So we welcome the witnesses this morning, all of you, and again, David, we will begin with your testimony. And again, any data and information that you and the rest of the witnesses have will be included in the record. I will just make a blanket acceptance of any documentation you would like for us to have on this oversight hearing. With that, the floor is yours.

STATEMENT OF H. DAVID KOTZ, INSPECTOR GENERAL, SECURITIES AND EXCHANGE COMMISSION

Mr. Kotz. Thank you. Good morning. Thank you for the opportunity to testify before this Committee today on the subject of the SEC Inspector General's report on the SEC response to Robert Allen Stanford's alleged Ponzi scheme. I appreciate the interest of the Chairman, the Ranking Member, as well as the other Members of the Committee and the SEC and the Office of Inspector General.

In my testimony today, I am representing the Office of Inspector General and the views that I express are those of my office. They do not necessarily reflect the views of the Commission or any Commissioners.

I would like to begin my remarks this morning by briefly discussing the role of my office and the oversight efforts we have undertaken. The Office of Inspector General has staff in two major areas, audits and investigations. Over the past 2\1/2\ years since I became the Inspector General of the SEC, my office has issued numerous audit reports involving matters critical to SEC programs and operations, as well as the investing public, including an examination of the Commission's oversight of Bear Stearns and the factors that led to its collapse, an audit of the SEC Division of Enforcement's practices related to naked short-selling, complaints and referrals, a review of the SEC's bounty program for whistleblowers, and an analysis of the SEC's oversight of credit rating agencies.

My office's Investigative Unit has also issued numerous investigative reports regarding the failures by the SEC Enforcement Division to pursue investigations vigorously or in a timely manner, improper securities trading by Commission employees, whistleblower allegations of contract fraud, preferential treatment given to prominent persons, and retaliatory termination.

In August 2009, we issued a 457-page report of investigation analyzing the reasons why the SEC failed to uncover Bernard Madoff's $50 billion Ponzi scheme.

On October 9, 2009, I received a letter from the Ranking Member of this Committee, the Honorable Richard Shelby, and the Honorable David Vitter, requesting a comprehensive investigation of the handling of the SEC's investigations and examinations into Robert Allen Stanford and his various companies. Very shortly thereafter, on October 13, 2009, we opened our investigation.

As part of this effort, we made numerous requests to the SEC's Office of Information Technology for the e-mails of current and former SEC employees for times pertinent to the investigation. The Office of Information Technology provided e-mails for a total of 42 current and former SEC employees for time periods ranging from 1997 to 2009. We estimate that we obtained and searched over 2.7 million e-mails during the course of our investigation.

In addition, we sent comprehensive document requests to Enforcement and the SEC's Office of Compliance Inspections and Examinations, own as OCIE, specifying the documents and records we required to be produced for the investigation. We also sought documents from FINRA, including documents concerning communications between FINRA or its predecessor, the NASD, and the SEC concerning Stanford. We carefully reviewed and analyzed the information received as a result of our requests.

We also conducted 51 testimonies and interviews of 48 individuals with knowledge of facts or circumstances surrounding the SEC's examinations and/or investigations of Stanford and his firms. I personally led the questioning and the testimony interviews the witnesses in this investigation.

On March 31, 2010, we issued to the Chairman of the SEC a comprehensive report of our investigation in the Stanford matter, containing over 150 pages of analysis and 200 exhibits. Our investigation determined that the SEC's Fort Worth Office was aware since 1997 that Robert Allen Stanford was likely operating a Ponzi scheme, having come to that conclusion a mere 2 years after Stanford Group Company, Stanford's investment advisor, registered with the SEC.

We found that over the next 8 years, the SEC's Fort Worth Office conducted four examinations of Stanford's operations, finding in each examination that the CDs Stanford was promoting could not have been legitimate and it was highly unlikely that the returns Stanford claimed to generate could have been achieved with the purported conservative investment approach utilized. The SEC's Fort Worth examiners conducted examinations of Stanford in 1997, 1998, 2002, and 2004, concluding in each instance that Stanford's CDs were likely a Ponzi or similar scheme. The only significant difference in the Examination Group findings over the years was that the potential fraud was growing exponentially, from $250 million to $1.5 billion.

The Fort Worth Examination Group made multiple efforts after each examination to convince the Enforcement Group to open and conduct an investigation of Stanford. However, we found that the Enforcement Group made no meaningful effort to investigate the potential fraud until late 2005.

In 1998, the Enforcement Group opened a brief inquiry, but closed it after only 3 months when Stanford failed to produce documents evidencing the fraud in response to a voluntary document request. In 2002, no investigation was opened, even after the examiner specifically identified multiple violations of securities laws by Stanford. In 2003, after receiving three separate complaints about Stanford's operations, the Enforcement Group decided not to open up an investigation or even an inquiry and did not follow up on the complaints.

In late 2005, after a change in leadership in the Enforcement Group and in response to continuing pleas by the examiners, who had been watching the potential fraud grow in examination after examination, the Enforcement Group finally agreed to seek a formal order from the Commission to investigate Stanford. However, even at that time, the Enforcement Group missed an opportunity to recommend an action against Stanford Group Company, or SGC, for its admitted failure to conduct any due diligence regarding Stanford's investment portfolio, which could have potentially halted the sales of the Stanford International Bank CDs through the SGC Investment Advisor and would have provided investors and prospective investors with notice that the SEC considered SGC's sales of the CDs to be fraudulent. We found that this particular action was not considered partially because the new head of the Enforcement Group in Fort Worth was not aware of the findings of the investment advisors' examinations in 1998 and 2002, or even that SGC had registered with the SEC as an investment advisor, a fact she learned for the first time during our investigation in January of 2010.

We did not find that the reluctance of the Enforcement Group to investigate Stanford was related to any improper professional, social, or financial relationship on the part of any current or former SEC employee. We did find evidence, however, that SEC-wide institutional influence within the Enforcement Group factored into its repeated decisions not to undertake an investigation of Stanford, notwithstanding staff awareness that the potential fraud was growing.

We found that senior Fort Worth officials perceived that they were being judged on the number of cases they brought, so-called ``stats,'' and communicated to the Enforcement staff that novel or complex cases were disfavored. As a result, cases like Stanford, which were not considered quick-hit or slam-dunk cases, were not encouraged.

We also found that the former head of Enforcement in Fort Worth, who played a significant role in multiple decisions over the years to quash investigations of Stanford, sought to represent Stanford on three separate occasions after he left the Commission, and, in fact, represented Stanford briefly in 2006 before he was informed by the SEC Ethics Office that it was improper for him to do so.

In summary, our report concluded that the SEC's Fort Worth Office was aware since 1997 that Stanford was likely operating a Ponzi scheme after conducting examination after examination for a period of 8 years, but merely watched the alleged fraud grow and failed to take any action to stop it.

We provided our report to the Chairman of the SEC on March 31, 2010, with the recommendations that the Chairman review its findings and share with Enforcement management the portions of the report that related to the performance failures by employees who still work at the SEC so that appropriate action would be taken.

We also made the following specific recommendations to improve operations within the SEC. One, that Enforcement ensure that the potential harm to investors if no action is taken is considered as a factor when deciding whether to recommend an enforcement action.

Two, that Enforcement emphasize the significance of bringing cases that are difficult but important to the protection of investors in evaluating the performance of an Enforcement staff member or a regional office.

Three, that Enforcement consider the significance or the presence or absence of United States investors in determining whether to open an investigation or recommend an enforcement action that otherwise meets jurisdictional requirements.

Four, that there be improved coordination between Enforcement and OCIE on investigations, particularly those initiated by an OCIE referral to Enforcement.

Five, that Enforcement reevaluate the factors utilized to determine when referral of a matter to State securities regulators in lieu of an SEC investigation is appropriate.

Six, that there be additional training of Enforcement staff to strengthen their understanding of the laws governing broker-dealers and investment advisors.

And seven, that Enforcement emphasize the need to coordinate with the Office of International Affairs and the Division of Risk, Strategy, and Financial Innovation as appropriate early in the course of the investigation.

My office is committed to following up on all the recommendations made in our Stanford report to ensure that there are appropriate changes and improvements in the SEC's operations. We are aware that many improvements have already been undertaken under the direction of Chairman Schapiro and Enforcement Director Khuzami as a result of the findings and many recommendations arising from our Madoff investigation. We also understand that Enforcement has initiated actions on our Stanford recommendations and are confident that the SEC will take the appropriate steps to implement our recommendations and ensure that fundamental changes are made in the SEC's operations to remedy the errors and failings we found in our investigation.

I appreciate the interest of the Chairman, the Ranking Member, and the Committee in the SEC and my office, and in particular in the facts and circumstances pertinent to our Stanford report. I believe that the Committee's and Congress's continued involvement with the SEC is helpful to strengthen the accountability and effectiveness of the Commission. Thank you.

Chairman Dodd. Thank you very much, Mr. Kotz. I appreciate that very much.

Let me ask the clerk, why don't you put on 7 minutes here? We do not have a full complement here. That will give people a chance at least to get a couple of questions in as we try and move along.

Some of the questions I have you anticipated to some degree in your comments, but I want to pursue a couple of them in a little more detail, if I can, anyway. The SEC brought its action against Stanford 12 years--12 years--after the first reports from examiners that he was likely operating a Ponzi scheme, a conclusion that examiners reached on four separate occasions. Again, Senator Shelby emphasized this point. I think a good point he made, that unlike the Madoff issue, here you actually had examiners--Madoff, there were reports from individuals to the SEC that they thought something was wrong, but as I recall, it was nothing within the SEC itself--not to excuse that behavior but, nonetheless--but in this case, here you had four occasions of examiners over a 12-year period making those reports. And then, of course, immediately after--2 months after Madoff confessed to law enforcement officials that he was running a $50 billion scheme, you ended up with the SEC acting.

So my question obviously comes: Had Madoff not confessed, in your view, as you looked over these materials now and raised awareness about Ponzi schemes, would the Commission have brought this case against Stanford, in your view?

Mr. Kotz. I certainly think that there was a connection. I mean, the SEC was investigating Stanford----

Chairman Dodd. Please turn on your mic.

Mr. Kotz. Yes, I certainly think there was a connection. I mean, the SEC was investigating Stanford prior to the Madoff confession. However, they were sort of at a standstill at that point. But I think the dynamic shifted in the SEC when Madoff confessed.

As I talked about in my testimony, there was a feeling that you did not want to bring a novel or complex case. You wanted to bring the quick-hit, slam-dunk case. And you might be criticized if you came up with something that was difficult. And because Stanford had international issues, it was a more complicated case.

But after Madoff confessed, at that point the dynamic shifted, and at that point, if you were holding onto a potential Ponzi scheme case that you did not bring, you would be criticized more for that than you would if you brought forth a complicated case. So I do think it had an impact in that way.

Now, certainly they were investigating it. They started finally--after many years of the examiners pushing, they finally started investigating in late 2005. They were moving forward with the investigation. The Department of Justice asked them to hold off because the Department of Justice was conducting a criminal investigation. But when Madoff hit, they went to the Department of Justice and essentially said, ``We are not holding off anymore. We are going forward. We cannot have a case going on in our midst that relates to a Ponzi scheme that we are not bringing.''

So there was certainly----

Chairman Dodd. So let me just--in your opinion, then, in the absence of the Madoff confession, we might have then gone a longer time before the Stanford case went forward.

Mr. Kotz. Right. I mean, I think it probably would have been eventually brought anyway, but there was a clear urgency at that point.

Chairman Dodd. Let me ask you, if I can--obviously, we know about the troubles in the SEC's Fort Worth district office regarding suspicions about Stanford's operations, but let me ask you this: Do you believe that the Commissioner staff of the SEC's Washington office should or could have done more to bring an end to this fraud?

Mr. Kotz. This was a matter that really was not raised with Washington. I mean, it is interesting because----

Chairman Dodd. They were not aware of this at all?

Mr. Kotz. Not really, no. I mean, the offices are, you know, relatively independent. They work on matters themselves. Certainly at a certain point in time in late 2005, when they finally decided to bring the action, they have to go the Commission and----

Chairman Dodd. In 1997, 1998, nothing managed to make way up to the Washington office that something was going on down there?

Mr. Kotz. No. There is no evidence that anyone in the Washington office knew about the examinations that occurred in 1997, 1998, 2002, 2004, until the formal order was made.

Chairman Dodd. Let me go back, if I can, on this point on stats and easy cases, as you point out. Your report--and I am quoting from it here--says, ``SEC-wide institutional influence within the enforcement did factor into repeated decisions not to undertake a full and thorough investigation of Stanford, notwithstanding staff awareness that the potential fraud was growing. We found''--speaking of your report--``that senior Fort Worth officials perceived that they were being judged on the numbers of cases they brought, so-called ``stats,'' and communicated to the enforcement staff that novel or complex cases were disfavored. As a result, cases like Stanford were not considered quick-hit or slam-dunk.''

Have you looked beyond this matter? I mean, if that is the case, were there other matters that are now showing up nationwide that were ``novel or more complex cases,'' that recommendations made by enforcement officers that were not brought because they were novel or complex and did not fit into the--what did you call it?--the slam-dunk or quick-hit? It seems to me like this was not sort of a narrow path between enforcement and Fort Worth. It sounds like it was a nationwide issue. And to what extent have you looked at or has the IG's office looked at other offices around the country to determine whether or not matters are lingering out there such as this?

Mr. Kotz. Well, we have not done sort of a broad audit of the matter, but, I mean, certainly it was--there was a competition between the regional offices to see who could get the best numbers, and the Fort Worth office was very proud of the fact that their numbers were very high, and so it was something that was not limited to just Fort Worth at that time.

Now, I think that things have changed somewhat and there have been efforts by Director Khuzami to move away from that----

Chairman Dodd. Some what have changed?

Mr. Kotz. Well, I think that there have been efforts made--and he can certainly talk about it more than me--to change that perception, for example, to change the evaluations of senior officials so they are not evaluated on the numbers of cases they brought. But I do think it takes time to change that culture. When you have such an embedded culture in an agency, you know, that you want to just bring--you want to show how many cases you brought--I mean, there was a conversation, a speech made by a former SEC person who said that, you know, Worldcom was one, Enron was one. You know, those were only counted as one case, and yet obviously they are very important, significant cases. And there are ways where you can bring a lot of little cases and get your numbers up. So it is a matter of great concern, and I do think that it went beyond the Fort Worth office.

Chairman Dodd. Well, I will be anxious to hear from Mr. Khuzami what steps have been taken. You mentioned March 2010, the recommendations. But, clearly, I hope there is going to be some examination beyond this. I hate to think we are having these hearings repeatedly as matters surface later on and we find out these were not one-off, but this was more of a broader problem. That is what I am getting at.

Mr. Kotz. Right.

Chairman Dodd. You do not seem to have any indication, or at least you do not believe there is any broader problems that we ought to be paying attention to.

Mr. Kotz. We are not aware of any specific cases. You know, it is sort of hard to know what cases were not brought. But, I mean, I think it is something to----

Chairman Dodd. Examiners, have the examiners, has anyone been talking to examiners around the country to find out whether or not there were similar problems anyplace else?

Mr. Kotz. Well, I do think that the examiners--we have had discussions with the new head of the examination----

Chairman Dodd. What about the old ones? I know the new ones are OK, but tell me about the old ones. Has anyone brought them in and said, ``Did you have problems anywhere else in the country besides Fort Worth?''

Mr. Kotz. Yes, I am not aware specifically that has been----

Chairman Dodd. Why didn't we do that?

Mr. Kotz. I do not know. I think that you could talk to the head----

Chairman Dodd. Yes, but you are the IG. You are the guys who did the report. Did you ask them whether or not--were there any problems like this anywhere else in the country we ought to be aware of?

Mr. Kotz. Yes, I mean, I think that generally there are some instances where there are frustrations on the part of examiners, but that is something that, you know, can be looked at certainly on a broader level. We could interview examiners all over the country.

Chairman Dodd. Well, I would hope so. It seems to me that, otherwise, you are having a bunch of quick-hit stat kind of approach--and it was not just the Fort Worth office. This was sort of a systemwide approach. Then to what extent were examiners frustrated in other parts of the country on matters that were ``novel or more complex'' that may have involved a lot more damage than the small cases? I presume the quick-hit, stat numbers are that small insider trading piece or something. I do not want to minimize the problem, but it seems to me in the context of the damage done.

Mr. Kotz. Right. I mean, our recommendation was that they should consider the amount of investors that was affected, because you can have a small matter that affected five investors, or you can have a complicated matter that affected millions.

Chairman Dodd. Right. Others may have similar point, but I hope you might go back. I would like to know the answer to whether or not from examiners they had any other areas around the country where they felt frustrated about conclusions they were drawing and the reluctance either on the regional office or in the national office to respond to those requests.

Mr. Kotz. Absolutely.

Chairman Dodd. All right. I have gone over my time. I apologize. I have several more questions, but let me turn to Senator Shelby.

Senator Shelby. Thank you, Senator Dodd.

I want to pick up on the area Senator Dodd was in, Mr. Inspector General. Where was the SEC Enforcement Division? You talked about there were recommendations made in the Stanford case on, what, four or five occasions?

Mr. Kotz. Yes.

Senator Shelby. And they ignored it, basically. Was it the atmosphere there or the working conditions, as you indicated, for--in the metric area, how many cases we could have, we could get the easy ones, but the difficult ones, the big ones, gosh, they were tough, they were strong. But that is where the big frauds are.

Mr. Kotz. Right.

Senator Shelby. Where was the leadership of the Enforcement Division not just in Fort Worth but at the SEC here? Because it came from here. It had to. Where were the--and are those same people still in Enforcement?

Mr. Kotz. Yes, well, I mean, certainly----

Senator Shelby. And if so, why? Why are they still there?

Mr. Kotz. Certainly in Fort Worth, the head of Enforcement and to some extent the head of the Fort Worth office very much believed in this metrics approach, and they certainly perceived that the Enforcement Division in Washington thought that approach was important because, as I said----

Senator Shelby. Were they counting beans? In other words, they wanted to count how many cases they had, they had solved, but in the scheme of things, they were small cases compared to Madoff and the case in hand, Stanford, involving billions of dollars.

Mr. Kotz. Right.

Senator Shelby. Were they not competent enough or were they afraid of something this big? Or was it leadership from Washington? Leadership had to come from the SEC here to Fort Worth or to New York or to Los Angeles, or wherever else.

Mr. Kotz. Right. I mean, certainly the fact that the Fort Worth office thought it was being sort of graded on how many cases it brought, that came from Washington, because that is the way they would look at the offices and determine how good a job they are doing.

Senator Shelby. And when they were talking about how many cases, did they look into the substance? Just to use an analogy to criminal cases, were they speeding cases or reckless driving as opposed to fraud, murder, robbery, and so forth? In other words, were these statistically minor cases compared to complicated cases?

Mr. Kotz. Right. I mean, I think probably many of them were more minor cases because, obviously, it is easier to do a minor case quicker. You know, they had decisions to make about resources, and they did not want to use the resources on Stanford because it would take a long time to get a case. And so they could have people working on it for a year and not have a stat to show for it in that whole year. Well, if they worked on other cases----

Senator Shelby. But that is no way to do business, is it?

Mr. Kotz. Absolutely.

Senator Shelby. And what did you say in your report about doing this instead of substance, which they should have gone

doing this instead of substance, which they should have gone after, statistical stuff?

Mr. Kotz. Right. I mean, you know, we----

Senator Shelby. What did you say in your report, you, the Inspector General?

Mr. Kotz. We said that it is inappropriate to act that way and that that is not the responsibility of the SEC. The SEC's responsibility is with respect to investors. There were investors out there who were getting hurt. The examiners knew that they were getting hurt. Even the enforcement folks knew that they were getting hurt. In fact, some of the enforcement folks we talked to said, ``Oh, we thought that it was a Ponzi scheme.'' So, I mean, they were sitting there watching a potential Ponzi scheme go on, but making decisions, you know, for their own betterment of stats and not looking into it and not taking appropriate action. It is outrageous.

Senator Shelby. Well, any way you look at it, this is a colossal failure of the SEC. I mean, let us be honest. You are the Inspector General. This is a colossal failure to do their job. And why was the SEC set up? To protect the investor. Is that right?

Mr. Kotz. Right.

Senator Shelby. So they failed big time in protecting the investor in both the Madoff and in the current Stanford case. And in the Stanford case, as Senator Dodd says, they had all these warnings from their own staff.

Mr. Kotz. Yes.

Senator Shelby. Did the people in enforcement in Fort Worth--I mean, when the examiners recommended things, brought it to the attention of enforcement, did the people in enforcement in the regional area--when they did not do anything, did the examiners take it further up? Is there a chain of command they could have brought this right to somebody like you or somebody in Washington? What the heck is going on here? Is this a cover-up? It is obviously gross negligence if not a cover-up and a failure of leadership.

Mr. Kotz. Right. I mean, they did not take it----

Senator Shelby. Is it not?

Mr. Kotz. Yes, absolutely. They did not take it to our office or Washington, but they did take it up the chain. And finally they were able to convince the enforcement group in Fort Worth to bring it because there was a new head of enforcement, and they went to that person and lobbied, and there were memos back and forth and great efforts by the examiners to convince this new leader, and this new leader finally agreed to open the investigation.

Senator Shelby. These people that I mentioned, whoever they are, are they still working in enforcement after such a failure like this? And if so, why?

Mr. Kotz. Well, many of the people are different. The head of the Fort Worth office has changed since then. The head of enforcement in the Fort Worth office has changed since then. Some of the line people are still there, and, you know, in our report, we recommended that the SEC look to see if disciplinary action has been taken.

Senator Shelby. Well, why are they there? It dumfounds me as to why these people who failed on one of the biggest frauds in SEC history, where they had information, did not pursue it--not once, not twice. How many times? Four times. You are the Inspector General, and I know you are sincere and you are doing your job, but this just looks like the SEC failed the investor, not once, not twice, but four times, big time.

Mr. Kotz. Yes, no, I agree. And, you know, we recommended that action be taken as a result.

Senator Shelby. So the SEC basically broke down in their job and responsibility, didn't they?

Mr. Kotz. Yes.

Senator Shelby. OK. Thank you, Mr. Chairman.

Chairman Dodd. Senator Bunning.

Senator Bunning. Thank you, Mr. Chairman.

Mr. Kotz, it seems impossible and outrageous that it took 8 years from the time that possible fraud was identified before the SEC spent any energy on enforcing the law. Now, the SEC's job is to protect the investors. That is their only job. I mean, they have got a lot of other peripheral jobs, but they are basically paid to protect the investor.

Now, if the investigations four times said, you know, here we have got a guy here or a company here who is running what we think is a Ponzi scheme--and I do not care what credits you get at the SEC in Washington. Your job is to protect the investor. And every day that they did not do that, the scandal got bigger. It went from hundreds of millions of dollars. It is approximately $8 billion. We drink more than that in a week up here. I mean, that is so outrageous that the investor has been bilked out of $8 billion because of incompetence, because that is exactly what it was. Or they were trying to make points with the SEC in Washington, DC, by this scheme of metric approach.

Tell me what is going on. Tell me. Tell me how that happens.

Mr. Kotz. Yes, I mean, I agree, you know, and our report discusses it. It is outrageous. And, in fact, you know, one of the issues initially that they looked at in deciding not to bring an investigation is that there were no U.S. investors. Ironically, had they brought an investigation at any of those stages, they would have been potentially able to stop the fraud, the alleged fraud, before----

Senator Bunning. Yes, and stop the losing of the money.

Mr. Kotz. Right, before any U.S. investors came in, because initially there were no U.S. investors, and then over time there were U.S. investors. So, you know----

Senator Bunning. Ask the people in Texas and Louisiana.

Mr. Kotz. Right. Right. And so, I mean, if they had been able to take action earlier, they could potentially have made it such that there would never have been U.S. investors. And, in fact, when they did their examinations and did not necessarily take investigative action, the investors' message that they got was everything is OK. And as in Madoff, Stanford used that--you know, when there would be questions about his returns, he would say or his financial advisers would say, ``Well, we just got a clean bill of health from the SEC.'' And the SEC would come and do an examination. They would issue these deficiency letters, which are relatively minor, depending on the type of deficiency, and something that a lot of folks get in examinations. And so he would say, well, you know, we just came, and we talked to many investors who said that if there was any hint at all that there was a problem, they would have stopped, absolutely.

Senator Bunning. One of the troubling parts of your report involves the former head of enforcement at the Fort Worth branch of the SEC. He made several important decisions over the years about not pursuing the Stanford case. Then he left the SEC. He represented Stanford briefly and tried to represent them over and over again, even after being told no on three separate occasions by the SEC Office of Ethics. He also told the Office of Ethics that he did not remember--he did not remember participating in decisions about the Stanford case while he was at the SEC. Are you kidding me?

Mr. Kotz. It is stunning. It is absolutely stunning.

Senator Bunning. I mean, that to me is criminal negligence, and the sooner they get him before a U.S. court, the better I will like it.

Mr. Kotz. Absolutely.

Senator Bunning. I mean, to allow that to happen--I almost fell out of my chair when I heard the reasons he gave you for trying to represent Stanford. This is a quote from your----

Mr. Kotz. Right.

Senator Bunning. ``Every lawyer in Texas and beyond is going to get rich over this case. OK? And I hate being on the sidelines.''

That is the quote he gave you?

Mr. Kotz. Yes.

Senator Bunning. Well, does that look to you like a little bit of criminal negligence or something like that?

Mr. Kotz. Yes, well, I mean, I do not want to go into the details, but we have had discussions with criminal authorities about whether there would be any criminal action arising out of that.

Senator Bunning. But the SEC for 13 years has sat on their hands. So if you do not get the Justice Department involved in this, shame on you as the Inspector General.

Mr. Kotz. Again, we have had those discussions. You know, to the extent that they are ongoing cases, I do not want to talk about them specifically.

Senator Bunning. Fine. You do not have to talk about the case specifically.

Mr. Kotz. But we have had those discussions, absolutely.

Senator Bunning. You mentioned in your testimony that his behavior appears to violate State bar rules. Can you tell me first whether this issue was referred to the State bar for possible discipline; and, second, whether this was referred to the Justice Department for possible prosecution or false statements made to the SEC Office of Ethics?

Mr. Kotz. Yes. On both counts, essentially yes. The Ethics Office in the SEC is the one that refers it to the bar. We recommended they do so, and my understanding is they either have or are in the process of doing so now. And, yes, we have had discussions with, as I said, the Department of Justice and/or FBI.

Senator Bunning. This is a stunning case, knowing that the SEC has changed hands and things, that they would not jump down this after the Madoff--Bernie--after his case hit the papers and then they released all the documents on the one in Fort Worth trying to say, oh, we got one but it is not as big.

Mr. Kotz. Right.

Senator Bunning. I have gone over my time, but it just is stunning to me.

Thank you.

Chairman Dodd. Thank you, Senator.

Senator Hutchison.

Senator Hutchison. Thank you, Mr. Chairman.

How has the SEC responded to your report?

Mr. Kotz. Well, we have, as I said, those specific recommendations. They have provided information to us explaining how they have attempted to resolve the recommendations. We go through a very rigorous process where we review exactly what they provide. We are in the process of looking at their responses. In most cases, we think they are sufficient. In a couple cases, we have gone back and asked for additional information. In a couple cases, we are going to ask for them to do more. But they have been responsive to the specific recommendations in the report.

Senator Hutchison. Could you be more specific about the areas where you do not think they have provided enough information? Or are there areas that have not been addressed to your satisfaction to date?

Mr. Kotz. Sure. I mean, the first issue we are looking at is to talk about the focus on potential harm to investors, that that be something that be a clear factor that outweighs other factors, such as litigation risk. And so where you have a situation where there is some litigation risk, but on the other side you have clear harm to investors, that you have to in some cases value the clear harm to investors over the potential litigation risk. That is one they have responded to us. They have made some changes. We would like a little more clarity. We would like it to be even clearer in their policies and procedures that harm to investors could outweigh litigation risk; that even if you have litigation risk, sometimes it is worth it to bring a case, even if you are going to lose, if there is significant investors involved.

So, for example, if you brought a case and you believe legitimately that there was a fraud or a Ponzi scheme, the investing community would be aware of it. And so even if there was some possibility that you would lose, nevertheless, there would be a benefit. So that is one that we are asking for follow-up.

There are certain clarifying procedures that they have showed us that we are asking for a little bit more information in. So I would not say that they are not being responsive to any particular one, but, you know, when we look at these responses to our recommendations, we are very careful and very tough, frankly, to make sure that they respond in all ways.

But I am happy that they have come back with responses, and we do believe we are going to be able to close out all the recommendations in short order.

Senator Hutchison. Well, let me ask you on the issues of the bottom information getting to the top. Both the State Securities Board in 2003, according to your report, and then the Fort Worth regional office starting in 1997 had raised flags. How did you feel the response was to the procedures at the SEC in Washington to address that both the State Securities Board and the regional office had given notice that had not gotten up--I mean, it closed at the Fort Worth regional office four examinations, according to your report, separate examinations that were started, and then the State Securities Board in 2003. So--1997. How do you feel about the response of the SEC in assuring that information gets from these lower-level yellow flags, at least, if not red, to Washington.

Mr. Kotz. Right, no, that was a concern, and that is something we tried to address in our recommendations. You know, the lower-level folks, or even some higher-level folks, in the examination group in Fort Worth appealed to the enforcement folks. But there was not that mechanism for them to go back to Washington and potentially have the head of the whole program go to the head of the enforcement program and say, ``We have got a big problem in Fort Worth. Your folks in Fort Worth are not taking appropriate action.''

So they felt comfortable only within the independent office, but there needs to be better collaboration between the examiners and the enforcers so that the examiners can go all the way to the top, as far as they could go, to say, ``Look, here is what is happening in our office. Our office is too focused on stats, and so, therefore, if there is a fraud, it is growing.'' You know, they made great efforts in Fort Worth, but there needs to be a mechanism where they can go beyond Fort Worth and potentially get Washington's support for their concerns.

Senator Hutchison. But you do not see that connecting yet? Or do you?

Mr. Kotz. Right, I mean, they are putting in policies and procedures to reflect all this. And, you know, our view is that is a very good thing for policies and procedures to be put in. But we need to make sure that they work appropriately. And so, you know, it is all well and good to put in new procedures, and that is really all you can do now. But we need to make sure that it works well, you know, in the actual case. And so as these procedures are put in, we are going to then test them and audit them to make sure that they are actually doing the job that they are supposed to be doing.

Senator Hutchison. What about in the area of respect for, coordination, credibility of State boards? Now, in this case the State Securities Board was the first one to bring it up, but in general, in your investigation did you see that there was a respect for State Securities Boards--or what other States call them, I do not know. But is that something that needs to be addressed more carefully as well?

Mr. Kotz. Yes. That was one of our recommendations. You know, first of all, there were referrals from the State Securities Board to the SEC which they essentially ignored. At the same time, in one case a complaint came into the SEC which involved this Stanford matter, so it was obviously a complicated matter involving jurisdiction overseas. They referred it to the State Securities Board. Well, I mean, if the SEC with its resources was not going to be able to take a case that involved overseas issues, the small Texas State Securities

Board would not.

So one of our recommendations is to promulgate specific procedures on that, because in some ways I believe that they sent it to the Texas State Securities Board as a way to do something. Well, they had to do something. A complaint came in. And they did not want to take the case because, of course, it was a complicated case. Well, if the SEC is not going to take a complicated case, the Texas State Securities Board is not going to be able to do it. And then when the Texas State Securities Board comes back, they need to take those things seriously. So that is one of the specific issues that we addressed in our recommendations.

Senator Hutchison. And what about the response on that point?

Mr. Kotz. Yes, and so, again, they have told us that they are going to promulgate these procedures to deal with this issue. We have not seen the procedures yet, and so until we see them, we are not going to close them out. Obviously, we will give them some time to put them together. So we are on the right track. But that is another one that we have not finally closed.

Senator Hutchison. OK. Thank you, Mr. Chairman.

Chairman Dodd. Thank you very much, Senator.

Senator Vitter.

Senator Vitter. Thank you, Mr. Chairman. Thank you, Mr. Kotz, for your work.

I want to go to this SEC official who later worked for Stanford and tried to do a lot more work for Stanford.

Mr. Kotz. Right.

Senator Vitter. What was his name and title at the SEC?

Mr. Kotz. His name was Spence Barasch, and he was the Director of Enforcement for the Fort Worth office.

Senator Vitter. And specific, Director for Enforcement for Fort Worth?

Mr. Kotz. Right.

Senator Vitter. And what involvement did he have in the Stanford matter as it was passed over for enforcement over and over and over again?

Mr. Kotz. Well, as I said, initially they opened this matter under inquiry, which is kind of a prelude to an investigation, in 1998. He made the decision to close it. There were also complaints that he reviewed. He participated in decisions to refer the complaint to the Texas State Securities Board as opposed to taking the action by the SEC.

Senator Vitter. So it is clear from your investigation that he affirmatively made the decision to close the matter at that time, in 1998?

Mr. Kotz. That is what we found, yes.

Senator Vitter. And he claims he does not remember any involvement?

Mr. Kotz. Well, I mean at the time that he went back to the SEC's Ethics Office to try to represent Stanford he claimed that he did not remember any involvement. When we interviewed him, it came back, and he certainly did remember some involvement, and we discussed the fact that he was involved in those decisions. And, in fact, he was the one who told us a lot about this issue with stats. He explained that this is what he was looking at, and so a lot of that information did come from him. So when we interviewed him, he did recollect that he had some involvement.

Senator Vitter. And have you, or any others, investigated whether he had conversations while he was at the SEC with Stanford about future employment?

Mr. Kotz. Yes. Well, there was no evidence of that that we found. However, as I indicated, there are follow-up efforts that we are doing in conjunction with other authorities, and they are going to be looking at those issues as well.

Senator Vitter. OK. I also want to go to Senator Hutchison's questions about the SEC's reaction to your report. Specifically, how would you grade their reaction so far about becoming much less of a statistics-driven culture?

Mr. Kotz. As I said, I think that the intention is there. I think Chairman Schapiro has proven some leadership on this issue. I think Director Khuzami has proven some leadership on this issue. But I do not know that it has necessarily taken.

I mean I think it takes time for a culture to be changed. I think that the clear message from the top is we are no longer focused on stats; we are focused on important cases. I think there have been some examples of that, but what we need to make sure is that trickles down, all the way down the line.

Senator Vitter. OK. And about when could we expect your written analysis about how adequate or inadequate the SEC's reaction to your specific recommendations are?

Mr. Kotz. Yes. So I think we would have to give them, say, a year or two potentially after the procedures are in place to figure out whether they are actually working. But yes, I would say in that timeframe, shortly thereafter, we need to figure out whether it is just paper procedures or whether it is actually having an impact.

Senator Vitter. Well before that, could we get a report about what paper procedures they are at least saying they are going to implement to address this?

Mr. Kotz. Absolutely.

Senator Vitter. OK. Now Mr. Kotz, you issued your report to Chairwoman Schapiro and the rest of the SEC on March 31st. As you know, the report was not released to the public until 3 weeks later, the day, the specific day the SEC charged Goldman Sachs with fraud which was a bit of a news story. Do you personally consider that timing coincidental?

Mr. Kotz. Well, I mean that is actually a matter that we are, in some measure, looking into now. I mean we have been requested to look at specifically the timing of the Goldman case because there were allegations made that the timing of the Goldman case was related to financial regulatory reform, other allegations about that timing. So that is a matter that actually we are looking at and we are investigating right now.

We have not concluded the investigation. So it is a little hard for me to give a full answer, but I will tell you that we are almost finished with that investigation. That investigation should be completed within a couple weeks, and it will outline the more broader issue of what led the SEC to file the Goldman case the day it did and whether it was related to any other factors, such as financial regulatory reform, such as to mask the Stanford case, et cetera.

Senator Vitter. Well, that is certainly important, but I am not asking about the timing of the Goldman case. I am asking about the timing of the release of your report the day the Goldman case was made public in terms of the fraud charges. Based on what you know, do you think that timing of the release of your report was coincidental?

Mr. Kotz. I guess certainly one would, it would strain credulity to think it was coincidental. I cannot say that I have concluded that for sure because we have a process we go through when we look at these matters, but certainly it was suspicious that the day that our report was finally issued was on the same day as the Goldman action.

However, I would say that there was a process where our report was redacted. There was a process that actually we were involved in, and it took some time. So it was not suspicious per se that it took a few weeks after we issued the report to have the report issued.

The particular timing with the Goldman case is certainly something worth looking into. I cannot give you a conclusion right now because we are still looking at it, but I would certainly say it is suspicious.

Senator Vitter. Final question about the SEC's reaction to all this: Who at the SEC has been fired or demoted because of this gross mismanagement of the Stanford case?

Mr. Kotz. I have not been informed that anyone has.

Senator Vitter. Thank you.

Thank you, Mr. Chairman.

Chairman Dodd. Thank you. Before turning to my colleague from Tennessee, I want to make a point. In the Madoff hearings, stats, I asked for there to be reports every 3 months from the SEC. We have received one, on the progress being made on these matters.

Again, I am not going to be here, but others will be. This Committee is going to want to follow this, and you are hearing it from Members up here. So I will raise the same with the people who follow you at the table, but it is very important the Committee be kept abreast of exactly what is happening with recommendations on these matters, so if you could.

Mr. Kotz. Absolutely, I agree. As I said, I think that this Committee's involvement is crucial to ensuring that there be improvements.

Chairman Dodd. Yes. Well again, the promise, the commitment was made. The question I specifically raised at that hearing was every 3 months. We have had one.

Mr. Kotz. Yes.

Chairman Dodd. Senator Corker.

Senator Corker. I actually really came to question the second panel. I think my colleagues have done a very good job, and I think our witness has too. But since you did mention the Goldman report, that will be made public in 2 weeks, is that correct?

Mr. Kotz. Well, the process that we have, and this is not something within our office's control. Investigative reports are internal, and then there can be request made for them to be made public. And then there is a process where the SEC, not our office, reviews it and redacts it and issues it. That is what happened in the Stanford case.

So we will, we plan to, issue our report internally within the next couple of weeks, likely by the end of next week. As far as how long it will take for the SEC to release, that is not something that I have any control over.

Senator Carper. OK. I will just wait for the second panel.

Chairman Dodd. Well, fine. Let me just emphasize I want get to the second panel as well too, but I want to underscore the point raised by Senator Bunning. I was going to raise the question myself, regarding--Senator Vitter raised it as well, I believe--and that is with this head of the Enforcement Division. I mean this whole issue of then going off and trying to represent the matter here. I mean obviously, you could spend a whole day just on that issue alone, but it is stunning to me in many ways and looks like it was very much a part of the problem that went on here.

But second, I would really like to request, if I may, this issue because I have a tendency to believe these are not sort of one-off matters.

Mr. Kotz. Yes.

Chairman Dodd. It is a national policy or, excuse me, it is a Commission policy, or it was anyway, to get the sort of quick hits, the stats up. That was not just focused on the Fort Worth office. To what extent are you looking at other offices around the Country as to whether or not a similar conflict emerged?

Now there was a report in the Washington Post back a few, I do not know whether days or weeks ago now. I had the question here, that the problems still persist. The Washington Post, in June, reported that a few years ago the SEC Fort Worth office changed how it performed inspections, and this ``opened up a rift between Fort Worth managers and staff that continues today, undercutting the efforts by SEC leaders in Washington to build the agency and promote coordination after years of setbacks, according to current and former SEC officials and internal agency documents including three separate reports by the SEC's Inspector General.''

``SEC's regional offices present managerial problems, become an obstacle to reform'' is the title of the Washington Post article.

Can you comment on this assertion, the June report in the Washington Post? Is this still a problem in this office?

Mr. Kotz. We have issued other investigative reports about the Fort Worth office where we found concerns. So I do not know if I would go as far as that article, but certainly in other cases we have found situations there where folks had spoken out, and when they spoke out they were disciplined. And we issued reports recommending that action be taken against those who engaged in that. So we have issued more than our fair share of investigative reports regarding the Fort Worth office.

Chairman Dodd. Is it ongoing?

Mr. Kotz. Well, we look at particular issues, and those issues are resolved by our investigation, but it is hard to know what else is going on. We have information. We look into it. But these other investigations were involving matters that were relatively recent. Unlike the Stanford where most of the time was many years ago, these were relatively recent. So they may very well be ongoing.

Chairman Dodd. Let me just do this then with you. First of all, I would like to get as soon as you can, and you can maybe do it in a written form to the Committee. We do not have to bring you all the way back here. But I would like to know whether or not there are ongoing problems within that office regarding conflicts between the Enforcement Division as well as the Examination Division. If this is an ongoing problem in that office, I want to know why and what is being done at the national level to correct it.

And two, whether or not we are looking at other offices regionally to determine during this period of time, when the quick hits and the stat approach was being taken, were other matters being reported by examiners to enforcement people where actions were not being taken that we ought to be aware of?

Mr. Kotz. OK. Absolutely. Certainly.

Senator Bunning. May I have one?

Chairman Dodd. Senator Bunning, yes.

Senator Bunning. Let me get one thing straight. You are the Inspector General for the SEC, correct?

Mr. Kotz. Yes.

Senator Bunning. Are you independent?

Mr. Kotz. Yes.

Senator Bunning. Then why do you submit your reports to the SEC so they can redact anything, to prevent the public and our Committee from knowing exactly what you said in the report?

Mr. Kotz. Again, this is not my decision, but I will tell you that----

Senator Bunning. No, no, no. Why is it your decision to report to the SEC and not to the public which you have an obligation to do?

Mr. Kotz. The concern is that there may be nonpublic information in the reports that I write, and so the----

Senator Bunning. That is up to you.

Mr. Kotz. Well----

Senator Bunning. Listen, I mean I have had inspectors general before this Committee before, and they did not report to their specific agency. They reported to us, what you found out. Now are you telling us that you report to the SEC and they can redact specific things out of your report so that we never get to see them?

Mr. Kotz. Our office does not have the authority to make decisions on nonpublic information by itself. That is something we have asked for. We do not have that authority, and so therefore if there is a concern about nonpublic information it goes through the entire Commission.

Now we are involved in the process to try to ensure that the information that is redacted is limited, that is only----

Senator Bunning. You need a change in the law then.

Mr. Kotz. All right. I mean we would be happy to issue the report directly.

Senator Bunning. You have the authority to issue your reports as you see fit. I thought that is what all inspectors general had the authority to do. You do not have that authority.

Mr. Kotz. Right. I would welcome that.

Senator Bunning. Thank you.
Chairman Dodd. Thank you, Senator.
Mr. Kotz, thank you.
Unless there are some other questions here, we will move to our second panel. But I am going to leave the record open. Obviously you may have, one, some additional questions from Members who are here, but certainly those who could not be here this morning I presume may want to raise some questions with you as well. So we will leave the record open.
I appreciate very much your coming before us, and I appreciate the work you are trying to do. I do not want you to think our lines of questioning here are necessarily targeted specifically at you, but clearly some of the issues I raised about a broader look at all of this, it seems to me, are worth the Inspector General spending a little time. Obviously, you had to focus on Fort Worth. But, because I am getting nervous that if you had a policy like this nationally, I do not want to find out later as I am sitting in a different place somewhere, reading about hearings up here because there were problems in other offices around the Country. You get my point.
Mr. Kotz. Absolutely.
Chairman Dodd. OK. Thanks.
Mr. Khuzami, I appreciate your joining us here, and Carlo di Florio and Ms. Rose Romero. Come on up and join us here, and thank you all very much for your work and your efforts.
I am going to ask, if you would, we have got you, Mr. di Florio in the middle. Mr. Khuzami, you are right there, very good. And Ms. Romero, thank you. I will begin in the order I have introduced you, and if you could try and keep your remarks down to about 5 minutes or so if you can, so we can jump right in with you on the questions. And your full statements and any data and material that you think would be worthwhile for the Committee to be looking at, we will include certainly in the record as well. OK? Thank you.

STATEMENT OF ROBERT KHUZAMI, DIRECTOR, DIVISION OF ENFORCEMENT, SECURITIES AND EXCHANGE COMMISSION

Mr. Khuzami. Certainly, Mr. Chairman, thank you. I thank Members of the Committee for the opportunity to testify before you today.
The Commission commends the work of the Inspector General with respect to the Stanford matter, and the depth and analysis of the report. They have conducted an extensive investigation, clearly identifies missed opportunities at the SEC. We cannot evade responsibility for the handling of the Stanford matter and deeply regret our failure to act more quickly to limit the tragic investor losses suffered in the case.
We are doing three things that respond directly to the Stanford case and the IG's recommendations: first, vigorously pursuing Stanford and others who were involved in the misconduct, and trying to reclaim as much money as possible for investors; two, embracing all the recommendations that the Inspector General proposed; and three, continuing what started prior to the report by both Mr. di Florio and I of a top to bottom review of our respective division and offices, and to implement new structures and processes to make sure that this does not happen again.
You know about the details of the filing of the Stanford case.
With respect to the recommendations, we are doing a number of things including revising the metrics used to manage and evaluate the performance of the division, and clarifying the procedures with respect to coordination between the exam program and the Enforcement Division that underlie some of the matters in the Stanford case, and third, we have both conducted this review over the last 18 months.
With respect to the Division of Enforcement, what has been described as the most significant restructuring of the division in over 30 years. That includes new training, hiring new outside staff with market and private sector expertise, streamlining management, putting more attorneys back on the front lines of conducting investigations, improving risk assessment techniques, leveraging the knowledge of third parties, new initiatives and, most importantly perhaps, totally revamping the way we handle our tips, complaints and referrals of which we get tens of thousands per year.
We are also doing new initiatives, launching specialized units focused on particular areas of the law or conduct or transactions that are particularly relative to Stanford, including a specialized unit focusing on investment advisors.
We are also doing risk-based investigative techniques, so that we look at problems early on, identify red flags and move more quickly.
Much more needs to be done. As was mentioned earlier, our mission of investor protection demands nothing short of a full commitment to do all that we can to minimize the chance that another Stanford happens and we do not act as quickly, as promptly as possible.
Now I will turn it over to Mr. di Florio.

STATEMENT OF CARLO V. DI FLORIO, DIRECTOR, OFFICE OF COMPLIANCE INSPECTIONS AND EXAMINATIONS, SECURITIES AND EXCHANGE COMMISSION

Mr. di Florio. Mr. Chairman, Ranking Member Shelby, and Members of the Committee, the Inspector General's recommendations identify the need for better coordination between the enforcement program and the exam program. We are committed to doing just that.
OCIE and Enforcement are working together on multiple fronts to identify misconduct earlier and move to shut it down more rapidly. We have introduced joint committees to proactively evaluate potential referrals and new governance processes to ensure early escalation of any concerns. Finally, OCIE has undertaken a top to bottom review of our strategy, our structure, our people, our processes and our technology. In each of these critical areas, we are breaking down silos and implementing significant new reforms to better protect investors and ensure market integrity.
In conclusion, both OCIE and Enforcement are committed to reforms that address the kind of issues that led to the Stanford case. We would be happy to respond to any questions you might have. Thank you.
Chairman Dodd. Ms. Romero.

STATEMENT OF ROSE L. ROMERO, REGIONAL DIRECTOR, FORT WORTH REGIONAL OFFICE, SECURITIES AND EXCHANGE COMMISSION

Ms. Romero. Chairman Dodd and Members of the Committee, thank you for the opportunity to testify today about the reforms the Fort Worth Regional Office is making in response to the issues raised in the Inspector General's report on the office's performance in the Stanford matter.
Like Mr. Khuzami and Mr. di Florio, I regret that the SEC failed to act more quickly to limit investor losses suffered by the Stanford victims. All of us at the SEC share responsibility for the handling of the Stanford matter, and we are taking significant steps to ensure that we implement the needed reforms.
Mr. Khuzami has summarized the status of the current litigation, but I wanted to highlight a few additional points.
Immediately after filing the civil action, my staff worked closely with the Justice Department to ensure that responsible executives of the Stanford Company were brought to justice. We aggressively continued our investigation, aided by access to Stanford financial records and other key documents obtained by the receiver, and access to key employees. In particular, my staff played a significant role in securing the cooperation of James Davis, Stanford Financial Group's Chief Financial Officer. We also developed critical evidence in support of the allegation that Leroy King, Antigua's head of the Financial Services Regulatory Commission, conspired with Stanford and obstructed the Commission's efforts to investigate Stanford over many years.

We have recently notified several former Stanford executives that we intend to recommend fraud charges against them. These persons include former high level executives and financial advisors. Our investigation of these matters is continuing, and I have directed my staff to determine if others at Stanford were involved in fraudulent conduct.

Over the course of the past 12 months, we have collected and reviewed tens of thousands of documents, reviewed e-mail communications of more than 150 former employees, interviewed and taken sworn statements of more than 60 former employees and other witnesses, and interviewed approximately 200 victims of the Stanford fraud. We have worked with the Stanford Victims Coalition, State regulators and FINRA to gather relevant information and evidence to further this important investigation.

Since filing the Stanford case, we have worked to minimize receivership expenses and ensure that the receiver's efforts are focused properly on investor recovery. As a result of our efforts, the receiver agreed to reduce his rates by 20 percent, and the court, at our request, has held back an additional 20 percent of the receiver's fees and expenses. We continue to monitor the receiver's work closely.

The initiatives outlined in the remarks of Mr. Khuzami and Mr. di Florio are, from a regional perspective, making a significant impact upon the Commission and its staff. For example, this fiscal year alone investigations by the Fort Worth Regional Office have resulted in criminal charges against 14 individuals, and many members of our staff now serve as special Federal prosecutors assisting in the prosecution of important criminal cases in the securities area.

Since last year, the Fort Worth staff has filed 19 emergency actions in Federal court, preserving millions of dollars for investors.

During the past 4 years, the Fort Worth Regional Office has worked to bridge the gap between broker-dealer and investment advisor examination staff and programs. In late 2006, it was clear to me that we could not adequately oversee an increasing integrated registration population unless we brought to each examination the skills and expertise to effectively review a firm's business activities, whether advisory, brokerage or both. Another top priority has been to enhance collaboration and teamwork among examination and enforcement programs. The success of this initiative over the past 4 years is demonstrated by the fact that the percentage of enforcement cases stemming from examination referrals and information has increased from 12 percent in fiscal year 2005 to 39 percent in fiscal year 2009.

In conclusion, while I certainly believe that our efforts have enhanced the Commission's ability to protect investors, we will not forget the painful lessons taught to us by past mistakes. The Fort Worth Regional Office is dedicated to protecting investors and aggressively pursuing those who defraud them.

I thank you for the opportunity to appear before you today, and I would be pleased to answer your questions. Thank you.

Chairman Dodd. Well, thank you all very, very much, and let me begin by thanking you all for the work you are trying to do. I realize in addition to staying on top of all the other matters that are occurring, getting into this is obviously important as well. So at least from my standpoint I want you to know that my line of questioning here is not to reflect obviously the work that you are trying to do. You were not part of all of this obviously. You are all new hires in these matters. So again, I appreciate your efforts going back over the time.

One is, just quickly as I say, I raised this with Mr. Kotz earlier, and that is that we have asked for these progress reports in the Committee in the past. We asked for it on the Madoff matter. As I pointed out, staff informs me we have had one report in the last 5 months. I made the request back then on behalf of the Committee. I make it again in this matter here. This Committee is going to want to be kept informed, and I guarantee you in my absence Senator Shelby will want to be informed, Senator Johnson will be, and other Members of this Committee. So I will make that request of you.

Second, I think we would like to have you keep us posted regarding personnel actions being taken as a result of the performance of SEC staff. I think Senator Vitter may have raised the question whether anyone has lost their job in any of this, and the Inspector General indicated that he did not know of any at this point.

But again, there are some serious questions being raised, Ms. Romero, in that office. And it seems to me again it is not our business here to hire and fire people at the SEC, but in light of what went on it seems to me that people may have left and again a little hard to understand why people have not been fired in light of what occurred--billions being lost, lives ruined as a result of actions and inactions taken. So I would like to be kept informed on that if I can.

Now again I raised issues, Mr. Khuzami, before. I thought Senator Shelby made a very good point in his opening statement, in drawing a distinction between the Madoff case and this case, in that in the Madoff case there were reports coming--the gentlemen in Massachusetts who, on numerous occasions, raised what he thought were very important matters, that the Madoff matter was clearly a Ponzi scheme, but that was an outsider in a sense, a knowledgeable one.

But in this case here you have had an Examination Office bellowing fire, fire, fire in one office and an Enforcement Division saying no fire or the fire is too complex or we have to respond to other matters here. So this is a different set of matters.

You talked about the perfect storm in response to a question by Senator Schumer on the Madoff matter, describing the perfect storm on Madoff. How do you describe this one? What happens here? What is your quick analysis of what went wrong here?

Mr. Khuzami. Well, Senator, I think in this case the people in Fort Worth were focused on the issue as to whether or not this was Ponzi scheme. It was not like Madoff when they were trying to figure out whether or not the split strike conversion strategy that Mr. Madoff was operating was really a Ponzi scheme or not.

The discussion and the debate within the office was going on. The shortcoming occurred because there was not, in my view, sufficient follow-up to get as much evidence as we could and then once we did that, to do, to try and proceed with perhaps a more narrowly tailored case, not prove the full-blown Ponzi scheme, but not proceed with the full-blown case, so that we may have been able to start the process of alerting the world that Mr. Stanford may have been involved in wrongdoing and there was a problem with this product.

Now sometimes that is easier said than done because obviously we have to go into court and have admissible evidence to show that this was a Ponzi scheme or there was some other violation of law. My sense is that we did not do as good a job. We were not as creative as we should be under these kinds of circumstances, with these red flags, to figure out what that narrowly tailored case was and go in and try and do it even if we had a significant risk of loss.

Now I think going in and losing a case is not a great thing because obviously if you do that one thing that can happen is the perpetrators of the fraud can use that as the Good Housekeeping Seal of Approval and say the SEC has tried to stop this, the judge rejected their claim, the investment is safe. So you always have to be a little concerned about that.

But under circumstances where you have got high returns and a lack of volatility, like we did here, as I sit here I wish we had gone in with a narrower theory, a sales practice theory or a failure to disclose commissions, or some other theory that might have been able to do.

Chairman Dodd. Is this fairly commonplace, where you have this kind of a debate?

I mean this were four instances over a period of years, 12 years, where your examiners, unless there was some huge debate among the examiners which no one has indicated yet. That may have been the case. But let's assume for a second you had a pretty united view. They came back four different times to the Enforcement Section. Is this commonplace, where you have had that happen?

I could understand one time. But on four occasions over a period of 12 years?

Mr. Khuzami. Well, it would not happen today. I can assure you that, Senator. There is much more collaboration and coordination and more immediate decision making on these issues.

I will say that again the focus, as I read the report, was whether or not they had the admissible proof--not that they did not understand the exam team was not saying this is a Ponzi scheme, but that they needed and wanted a level of proof in order to go into court and make their case that perhaps was higher than we should have. We should have been more creative and tried to go in quicker and stop it.

Chairman Dodd. Well, that is a different answer than we got from Mr. Kotz because he said it was more like the question of this is the quick fix, the stats approach, rather than the novel, more complicated case.

Then second, had the Madoff matter not come forward as it was, he is not sure, frankly, that any action would have been taken, even as late as it was.

You have a different point of view.

Mr. Khuzami. Look, well, certainly in light of Madoff, we took a hard look at everything that was in the pipeline to make sure that we were operating appropriately.

I think the other factor that happened here, of course, that happens in many Ponzi schemes is that the economy soured. It became more difficult to keep Ponzi schemes afloat. Fewer investors willing to invest and more people demanding redemptions, that puts pressure on the scheme.

Chairman Dodd. Yes.

Mr. Khuzami. We also were able to get some evidence from insiders that we did not have before in the 2006, 2007, 2008 timeframe.

Chairman Dodd. Yes. Last, would you answer the question I asked the Inspector General? Are you looking at other offices where that approach of the quick fix stats number and that other matters might have missed, whether Ponzi schemes or others, that could have put investors at greater risk?

Mr. Khuzami. Yes. Senator, I do not see--more importantly, I am not telling the rank and file that quick hits and numbers are what drive the division. If you look at the course of cases that we have brought in the last 18 months, particularly across the credit crisis--New Century, Countrywide, Goldman, Dell, State Street, Evergreen, ICP, CitiGroup, Bank of America--these are hugely complicated accounting frauds, structured product cases. We are not getting quick stats on those cases, I assure you.

In addition, even during the 2000s, if you look at the history of the cases--auction rate securities, market timing, research analysts, options backdating, Enron, WorldCom there are plenty of examples of complicated, difficult cases.

Now I am not going to say that one or more individual offices were not focused on stats, and maybe they even came from Washington. I just do not know. But it is not the standard today, I assure you.

Chairman Dodd. I appreciate that.

Senator Bunning.

Senator Bunning. Thank you, Mr. Chairman.

Mr. Khuzami, what kind of actions were taken by the SEC to discipline SEC enforcement employees who were responsible for mishandling this case?

Mr. Khuzami. Senator, that process is underway. We have to follow certain procedures by regulation and otherwise. The process is fully underway.

Senator Bunning. 1997 through the present time, that is 13 years. You have not had enough chance to accumulate evidence?

Mr. Khuzami. Well, the process commenced upon the release of the IG's report, which has been approximately 5 months, and that is the process that we are following, to review the information gathered by the Inspector General and to make the appropriate decision.

Senator Bunning. OK. Now, aside from that, the Inspector General reported to you 5 weeks ago about insider trading with Tyco. What has happened to that report?

Mr. Khuzami. Senator, I am not familiar with that matter, but I would be happy to get back to you and provide you information in response to your question.

Senator Bunning. You do not know anything about the report?

Mr. Khuzami. The report----

Senator Bunning. By the Inspector General, the gentleman who was just here, on insider trading with Tyco. He submitted a report 5 weeks ago.

Mr. Khuzami. I am not familiar with that matter, Senator.

Senator Bunning. Well, who at the SEC would be?

Mr. Khuzami. I will find out as soon as I return to the office and will respond to your question.

Senator Bunning. OK.

Senator Bunning. Five weeks is a pretty good time to be able to read the report and, according to the Inspector General, redact those things that should not be made public. And we would like to know about that because that is--insider trading, that also affects a lot of investors. If you bought Tyco Industries in that time or in the past years and you had somebody that was doing insider trading in that stock, it surely affected your holding.

Mr. di Florio, in your opinion, does the Office of Compliance Inspections and Examination bear any responsibility for the spectacular failure in this case? Or should the majority of the blame fall on the Enforcement Division?

Mr. di Florio. Senator, I think the IG's report laid out

Mr. di Florio. Senator, I think the IG's report laid out the facts effectively. Going forward, I see that we both have responsibility to make sure that we address the Inspector General's recommendations, and one of those key recommendations was that Enforcement and Exam work more collaboratively together to ensure it does not----

Senator Bunning. How about Washington and Fort Worth?

Mr. di Florio. Correct, likewise. So we look at those programs on a national basis and on a regional basis, and we now have governance mechanisms, escalation protocols, and joint initiatives across divisions and with our regions to make sure matters like this do not happen in the future.

Senator Bunning. Do you know how much money just the two cases have cost the--just two cases have cost our investment public? If you take the one in the east and the one in Texas.

Mr. di Florio. Yes, Senator, and it is with that in mind and the----

Senator Bunning. $58 billion.

Mr. di Florio. Correct.

Senator Bunning. Or right around that, give or take a few billion here or a billion there. Do you know how long it takes for people to save $58 billion? I mean, we can print it up here. It is a little different for the Government. But individual investors trying to preserve their capital and getting taken by crooks. I think the SEC better be capable of better things.

Mr. di Florio. Senator, we have implemented a number of reforms.

Senator Bunning. The Chairman of this Committee has tried to convince others how important it is to protect the investor, and that is the SEC's job. I worked in that business for 30 years, and if I messed up, the SEC was there to tell me. They should be there to do it and do it better than they are doing it right now.

Mr. di Florio. Absolutely, Senator.

Senator Bunning. Thank you.

Chairman Dodd. Thank you, Senator, very much.

Senator Hutchison.

Senator Hutchison. Thank you, Mr. Chairman.

Many of the victims of this Ponzi scheme and the misappropriation of people's funds have come to our office. They are seeking some kind of help, and they really have fallen through a crack in a way because there is really nothing there for them.

One of the things that they have raised is that the SEC has refused--I guess in 2009 they filed civil suits, but not criminal--I am sorry, civil suits, but they did not go further and seek bankruptcy of the Stanford companies, which many of the victims believe would give the bankruptcy judge more authority to go after assets. And, of course, they are trying to go after assets.

Why did the SEC never initiate bankruptcy proceedings in an effort to try to give all opportunities to the bankruptcy judge for asset availability for the victims? Mr. Khuzami.

Mr. Khuzami. Senator, if you do not mind, I think I will defer to Ms. Romero on that, who I think has been more integrally involved in some of the details of the proceeding.

Ms. Romero. Thank you. Senator Hutchison, the court was approached with that idea of whether or not the Stanford receivership should be converted into a bankruptcy. At that stage, the SEC--we came in and we disagreed with the investors who were wanting to take it to a bankruptcy because, in our view, in our analysis, it would have cost the estate a lot more money. So the court had a different view, and he wanted to take it to--what he did was he appointed an investor committee that would serve much like a bankruptcy committee or a creditor's committee, but it would not cost the estate any money. In other words, they are not going to be able to charge the estate any money where you would in a bankruptcy setting.

This committee, this investors committee was announced a couple of weeks ago. We supported that effort. It is going to give investors a more--they are going to have a closer working relationship and more say in the receivership than they had previously.

The examiner that the court appointed to protect investor interests is also part of that committee, and we expect that that is going to help return more monies back to investors.

Senator Hutchison. I did not understand what you meant by ``cost the estate more money'' if they did not go through bankruptcy than if they are where they are now, in receivership.

Ms. Romero. Right. At the stage that we were when the bankruptcy issue came forward, there would have been costs in terms of creditors that would have had claims perhaps in a bankruptcy setting that they do not have in a receivership setting, and that meant that that pot of money that we had would have been even thinner or----

Senator Hutchison. Would have gone to creditors rather than victims.

Ms. Romero. Exactly. And so given that, it was our view that perhaps this investor committee, which serves like a creditors committee, would give the investors the same type of control, if you will, or access to the receivership as they would if it were in bankruptcy, but without the cost.

Senator Hutchison. So is it your view--and I assume as regional director you are being given the SEC's authority here. And your view is that the assets are being protected to the maximum for the victims at this time?

Ms. Romero. Senator Hutchison, we have worked very hard over the past 18 months to make sure that the assets--that we protect the assets, every dollar, for investors. We have taken a number of steps to do that. We continue to oversee the receiver's activities. We continue to work with the Justice Department, the Office of International Affairs, and regulators throughout the world, quite frankly, to make sure that the assets that we have had frozen in these different foreign jurisdictions remain there until they are repatriated here to the U.S. for investor benefits, yes.

Senator Hutchison. One of the complaints of the victims has been the time that it has taken, that frozen assets--that even assets that were owned by the victims, not owned by the company were frozen for so long and people could not get access. Let me ask you two things.

One, how much longer will it be before frozen assets will be able to be distributed that have not already been? And I know some have, but--and number two--and I realize that there are different types of investments and you cannot make a blanket estimate, probably. But in the area that you can, how much can victims count on or at least have some expectation of being returned, not the assets that are already actually the victims', but in the assets that were under management that will be distributed, with the foreign assets as well? What would be the timetable? And what could be the expectation?

Ms. Romero. As to your question on the timetable, there are, like I said, assets, Stanford assets all over the world that have been secured and hopefully will be repatriated soon. In order to secure those, particularly those in Europe, the Department of Justice took the lead there so that the determination of when we get them back and when we can get them in investors' hands is going to be made in that criminal case, when there is a conviction in that criminal case. As you know, that is set right now for January of this coming year, so hopefully once there is a conviction in that case--that is why getting a conviction in that case is so important, because a lot of this money is tied to that.

So we expect that some time after that we would hopefully begin the process of distribution of these monies to investors.

Senator Hutchison. I am sorry. I know I am over my time, but just last, any type of percentage that people could expect?

Ms. Romero. It is hard for me to predict that at this point in time. The receiver is working hard to continue to gather assets. Like I said, there are ongoing efforts in, for example, South America, where we cannot predict how much money there is going to be--that we are going to be able to recover there. So it is hard for me to say.

After we go through a claims process, we can better determine how many victims are going to make claims, you know, how much money they may have received during the course of the Stanford Ponzi scheme, and then, you know, do those calculations. It is a long and arduous process. So I am sorry I do not have any specific numbers for you at this time.

Senator Hutchison. Thank you, Mr. Chairman.

Chairman Dodd. Thank you very much, Senator.

Senator Vitter.

Senator Vitter. Thank you, Mr. Chairman. I am going to continue with Ms. Romero.

Ms. Romero, just remind us, what is your full title and general responsibility?

Ms. Romero. Yes, sir. I am the regional director for the Fort Worth regional office, and I am charged with overseeing the examination program and the enforcement program in the Fort Worth office for the SEC.

Senator Vitter. OK. And how long have you been in that particular position?

Ms. Romero. I started there in March of 2006.

Senator Vitter. In that position?

Ms. Romero. Yes, sir.

Senator Vitter. And were you at the SEC previously?

Ms. Romero. I was not. I was a Federal prosecutor for 16 years prior to coming to the SEC.

Senator Vitter. OK. You testified at our field hearing in August 2009 in Baton Rouge, and I appreciate that, so obviously you were in the same role then.

OK. When did the SEC first look into and investigate, either formally or informally, Stanford?

Ms. Romero. Well, the formal investigation began October 26, 2006.

Senator Vitter. And what about anything informal?

Ms. Romero. There was an informal inquiry, which is really a term of art at the SEC, that was opened in 2005. I believe it was late 2005.

Senator Vitter. And that is the first time the SEC looked into and investigated Stanford?

Ms. Romero. No, but the answer to the question whether it was an informal or a formal investigation, given that they are terms of art at the SEC, the formal investigation began October 26, 2006, and the informal in late 2005. I do not know the exact date.

Senator Vitter. And when was the first look-see at Stanford--that is my term of art--at the SEC?

Ms. Romero. OK. As you know, I came into the SEC in 2006. From what I have reviewed, they looked at the--the SEC was looking at Stanford back in 1997.

Senator Vitter. 1997.

Ms. Romero. Yes.

Senator Vitter. And what would you describe that activity as?

Ms. Romero. It was my understanding that there were--the examination program does periodic exams of various firms in the region, and Stanford, they did four examinations between 1997 and 2006.

Senator Vitter. And that is not an investigation in any way, even informal?

Ms. Romero. No, sir.

Senator Vitter. OK. And the name of that division is what?

Ms. Romero. The name of the examination? They are called OCIE.

Senator Vitter. Which stands for what?

Ms. Romero. Office of Compliance and Examinations.

Senator Vitter. It is Office of Compliance Inspections and Examinations, but they do not investigate in any way?

Ms. Romero. No, sir. I mean, they inspect and they examine books and records of different firms. You know, so, yes--no, they do not investigate like the Enforcement----

Chairman Dodd. They make recommendations.

Ms. Romero. Yes.

Senator Vitter. The reason I am asking--and I know you are aware of this--is I asked you about this in Baton Rouge in August 2009.

Ms. Romero. Yes, you did.

Senator Vitter. But apparently I did not lawyer up enough when I asked the question. I asked, ``When did the SEC formally begin an investigation of Stanford and exactly what provoked that?'' You responded, ``We began the formal investigation in--well, there was an informal investigation that began in 2004, then the formal investigation. That is where we asked for authority to issue a subpoena, was in 2000--end of 2005, early 2006.''

Were you aware at the time that significant activity, inspection activity, happened well prior to that?

Ms. Romero. Yes, I was aware at the time that significant inspection activity had happened. I was truthfully and candidly answering your question as to when the informal and then formal investigation began and what provoked it. I noted in my answer that several things provoked the formal investigation, including the tips and complaints.

That said, sir, if my answer created any confusion for you or your staff, I sincerely apologize.

Senator Vitter. Well, in your testimony you also said, ``I think in total we had about four tips or complaints, some were anonymous, that were questioning the legality of Stanford International Bank. We followed up on all of those tips, and then that led to our informal and then our formal investigation.''

That summary seems to leave out something pretty significant, because you just did not have tips and complaints from the outside. You had instance after instance after instance of your own enforcement--excuse me. What is the name of the Division?

Ms. Romero. Examination.

Senator Vitter. Examination Division saying this is a big problem. Is there any particular reason you did not put that in the summary? That is a lot different than an outside, uncertain, anonymous tip.

Ms. Romero. As I told you, Senator, in 2009, there were several things that provoked the investigation, the informal and formal investigation of Stanford in 2006. Some of those things were the tips and complaints that were received by our office. But I also noted in my answer that there were other factors, and I was fully prepared to describe those factors to you during the hearing. Again, if my answer created----

Senator Vitter. Did you describe those pleas from that division?

Ms. Romero. I am sorry, sir?

Senator Vitter. Did you, in fact, go into all of that activity within the SEC itself starting in 1997?

Ms. Romero. No, sir, I did not.

Senator Vitter. You did not. So you were open to that, but you did not go into it.

Ms. Romero. Well, I was prepared to. I was answering your specific question, and if I created confusion, I again apologize. But I was answering your specific question, yes.

Senator Vitter. OK. What was the preparation you undertook before that testimony? Did you prepare your testimony in consultation with other folks at the SEC?

Ms. Romero. Yes, sir, I did.

Senator Vitter. And who were they?

Ms. Romero. Members of the Stanford team, obviously, to get facts down about the Stanford case, numbers, you know, where we were, getting updates on the investigation.

Senator Vitter. Who in the Washington office did that preparation include?

Ms. Romero. In Washington, there was preparation regarding the opening--or the written submission.

Senator Vitter. Who was involved----

Ms. Romero. I am trying to think. I am sorry. There were a number of people involved. There were lawyers from the General Counsel involved; there were lawyers from the Chairman's office involved; there were lawyers from the Division of Enforcement involved. As I sit here, I cannot think of everybody's name, but I would be happy to send that to you.

Senator Vitter. OK.

Senator Vitter. Do you remember as part of that preparation written timelines being put together?

Ms. Romero. I am sorry. I do not understand your question.

Senator Vitter. As part of that preparation for your testimony, do you remember putting together with the help of others written timelines regarding SEC activity about Stanford?

Ms. Romero. Actually, Senator, the day that we filed the Stanford case, on February 16, 2009, we began to put together a detailed chronology of the Stanford events, beginning in 1997 through 2009.

Senator Vitter. Do you remember putting together a chronology specifically in preparation for your testimony?

Ms. Romero. No, sir.

Senator Vitter. OK. You do not remember that being distributed and discussed by e-mail?

Ms. Romero. No, I do not.

Senator Vitter. OK. You do not remember the original chronology that was put together to help you prepare for your testimony starting in 1997?

Ms. Romero. I remember that there was a--we did a chronology the day--we started a chronology the day that we filed the Stanford case.

Senator Vitter. Again, I am talking about specifically in preparation for your testimony.

Ms. Romero. I do not remember that. I do not recall.

Senator Vitter. And you do not remember, as that was looked at and discussed in preparation for your testimony, that chronology was changed to start around 2004?

Ms. Romero. No, sir, I do not remember that. I do not.

Senator Vitter. And you do not remember the fact that that new revised chronology is what basically you testified about?

Ms. Romero. No, sir. No, sir.

Senator Vitter. OK. In the same vein, do you remember an SEC Commission meeting with you prior to your testimony where Chairman Schapiro said, ``Any disclosure that is made now is meant to be quite narrow and was not meant to expose the agency''?

Ms. Romero. No, sir. I did not participate in any such closed Commission meeting.

Senator Vitter. I do not know it was closed or not. Do you remember a Commission meeting before the testimony?

Ms. Romero. No, sir.

Senator Vitter. You do not remember any such comment by Chairman Schapiro?

Ms. Romero. No, sir, I do not, not in relation to Stanford or any other case.

Senator Vitter. OK. Well, there is a lot of background to this. The bottom line, which I am obviously going to, is I think you actively misled me and the Committee. I am not saying--I am not saying--I could have been more careful in devising my question. Shame on me. I am a recovering lawyer. I am saying you actively misled me and the Committee. Do you have any response to that?

Ms. Romero. I do, sir. I have dedicated--I did not actively mislead you, Senator. I have dedicated my life to the public good. I am a 4-year veteran of the Armed Services. I served as a police officer in the city of Fort Worth for 4 years. Three of those years I worked undercover. I served as an assistant district attorney with the Tarrant County DA's office. I went to the Fort Worth--to the Dallas--I am sorry, to the U.S. Attorney's Office in the Northern District, where I served for 16 years. I have earned and I enjoy the deepest respect and reputation of excellence with the judiciary in the Northern District, with county judges, State judges, with members of the Fifth Circuit, and my integrity has never been--ever been questioned. I make mistakes. I am human, and I am getting old, quite frankly, so if that happened, I apologize. I am prepared in this forum, Senator Vitter, or any other, briefing you or your staff, to go into full detail about the Stanford matter as I know it. But I did not then and I am not now in any way misleading you, or have any reason to. The events that happened before 2006 I was not a part of. I was not there.

Senator Vitter. OK. Well, again, you laid out a timeline in our field hearing in August 2009 that started in 2004. The SEC's direct knowledge of all these problems started 7 years before that. Would you disagree with any of that?

Ms. Romero. No. No, I would not. You are right. They started in 1997.

Senator Vitter. Do you think that is sort of a big omission, those 7 years?

Ms. Romero. I was answering a specific question, and I am sorry. I was prepared to go into all of that. We moved on to other questions, and as I read the transcript, I saw that. For my part in that, sir, again, I sincerely apologize, and I am prepared to fully brief you in any forum that you would like and go through the Stanford matter detail by detail.

Senator Vitter. Well, as the whole Committee and others look at this, I think it is going to be very important and instructive to look at the preparation that went on at the SEC Washington office with you and others directly preparing your testimony and specific discussion about the timeline and specific discussion about answering everything absolutely as narrowly as possible and using every opportunity to shorten the timeline as much as possible.

Ms. Romero. I would be happy----

Senator Vitter. That is going to be a continuing focus of mine. That is there. That is in e-mails. That is in writing. That is part of the record. And that is part of the travesty of this entire case.

Thank you, Mr. Chairman.

Chairman Dodd. Thank you very much. Let me thank our witnesses here. I am going to leave the record open for a number of days here so that Members can have an opportunity to submit some additional questions. But I want to end where I began. I have great respect for the work that people do at the SEC, and I would not want this hearing to conclude without emphasizing that point again. This is hard work.

I note that in our financial reform bill we call for the doubling of the budget of the SEC. I think we go from $1.1 billion in this fiscal year to $2.25 billion by 2015. And my hope is that additional resource capacity will provide additional staff as necessary as we go forward. We have a lot more we are going to be asking you to do as a result of the financial reform bill itself, and I will acknowledge that the heads are nodding. I am not sure you are nodding necessarily you agree with that number. You probably want more. But I wanted to make the record at least clear that we are acknowledging the problems and the necessity of having a resource capacity to do the job. And you are all new to this in many ways, and so it falls in your lap to try and help weave our way through this to get some right answers so we see that--there will invariably be crises again. There will be problems that get missed somehow. It is a human endeavor as well. But we ought to be able to set up procedurally the ability so that when you have a conflict such as existed in that office, there has got to be a manner by which that can be resolved in a way that does not leave the gaping hole and, of course, the tremendous damage done to so many people.

So, with that, I thank you again for coming. The Committee will stand adjourned.

[Whereupon, at 12:12 p.m., the hearing was adjourned.]

[Prepared statements and responses to written questions supplied for the record follow:]

PREPARED STATEMENT OF CHAIRMAN CHRISTOPHER J. DODD

The Banking Committee today is holding a hearing on ``Oversight of the SEC Inspector General's Report on the `Investigation of the SEC's Response to Concerns Regarding Robert Allen Stanford's Alleged Ponzi Scheme' and Improving SEC Performance.'' Regulatory oversight is a prime responsibility that this Committee takes seriously. The Committee will review the Inspector General's Report on the Commission's failure to stop the Stanford financial fraud in a timely manner and will hear about the steps it is taking to fix the problems and to restore investor confidence.

Last August, the Banking Committee held a field hearing on the ``Alleged Stanford Financial Group Fraud: Regulatory and Oversight Concerns and the Need for Reform'' at the request of my colleague Senator Vitter. And last year, we held two hearings surrounding the SEC's failures in regard to the Bernard Madoff fraud. Those three hearings contributed to reforms we included in the Dodd-Frank Wall Street Reform and Consumer Protection Act to better empower and equip the SEC to do its job. Today's hearing builds on those, and reflects my work with Ranking Member Shelby. The hearing looks not only to the past Commission performance, but also to the future Commission actions for improvement.

Let me review this situation. In February of 2009, the SEC charged Robert Allen Stanford and several associates with orchestrating an eight billion dollar Ponzi scheme. According to the SEC's complaint, the defendants for almost 15 years promised improbably high interest rates and misrepresented to purchasers of certificates of deposit that their deposits were safe, falsely claiming that the bank reinvested clients' funds primarily in ``liquid'' financial instruments.

Although the Commission examination staff found strong evidence that Stanford was likely operating a Ponzi scheme as early as 1997, the Commission did not bring charges against Mr. Stanford until 2009, only months after Bernard Madoff's own Ponzi scheme was exposed; both cases revealed deeply troubling failures by the SEC.

In March of this year, the SEC Office of the Inspector General released its report on the Commission's response to Stanford's scheme. The report found that a central problem was the failure of the SEC Fort Worth District Office Enforcement staff to heed the warning of the Examination staff.

The IG report shows that the examiners at the Fort Worth District Office raised red flags about Mr. Stanford's operation in four exams conducted over 8 years, beginning in 1997, concluding in each examination that Stanford's CDs were likely a Ponzi scheme or a similar fraudulent scheme. However, the enforcement staff disregarded the examiners' repeated warnings, continually turning a blind eye for nearly a decade. We seem to have an instance in which one side of the agency was screaming that there was a fire, and the other side said that the fire was too hard to put out.

The Inspector General report found that one reason that the Enforcement Division did not want to investigate Mr. Stanford was the perception that the case was difficult, novel and not the type favored by the Commission.

The Report also raised a number of troubling facts about the former enforcement head of the Fort Worth office, who played a significant role in multiple decisions over the years to quash investigations of Mr. Stanford.

All these pieces paint a picture of regulatory disconnects and mistakes that allowed this fraud to harm families and communities across our country. We look forward to learning to what the Commission attributes this regulatory shortcoming. Investors in Stanford's Ponzi scheme may have lost as much as $8 billion, and the damage to investor confidence may be greater still.

I look forward to Inspector General Kotz's insights and discussion of his report's findings, and I appreciate the SEC being here with us to let us know what the Commission is doing to correct what went wrong. I hope that this hearing will provide the Committee, the Senate, and the American public with a clear view of how such a large and audacious fraud was allowed to perpetuate and grow, and what is being done to fix the system and prevent similar frauds in the future.

The Dodd-Frank bill was one step in a long journey to righting this ship--giving the SEC more power, doubling its funding over 5 years, and having periodic GAO reviews--but our work is not done. The Inspector General's report also makes several thoughtful recommendations regarding bringing enforcement actions in complex cases, evaluating the performance of enforcement staff, coordination among SEC offices and divisions, staff training, and other matters.

Investors deserve to know that there is a cop on the beat, working hard to protect them from scam artists like R. Allen Stanford and Bernard Madoff. Restoring investor confidence and certainty in the fairness of our financial system is vitally important as we recover from the economic crisis. The SEC should use all the resources at its disposal to work toward that end.

PREPARED STATEMENT OF SENATOR TIM JOHNSON

Mr. Chairman, thank you for holding today's hearing. Following the release of the SEC's Inspector General's Report, ``Investigation of the SEC's Response to Concerns Regarding Robert Allen Stanford's Alleged Ponzi Scheme,'' I think it is crucial that this Committee continues its oversight role of the SEC, especially the agency's responsibility to protect investors. I also think it is important that we delve deeper into the ``alleged'' Stanford Ponzi Scheme and the SEC response, as there are constituents in my State who were victims.

The report highlights grave errors made by the SEC, particularly when the examinations conducted since 1997 at SGC (Stanford Company Group) indicated fraud, but no enforcement action was taken. The inaction by the Enforcement Division elicits grave concern about the priorities of the SEC in this case, especially when Americans' life savings were lost.

While massive cases like the Madoff Ponzi scheme rightfully grab headlines, I am pleased that we are taking a closer look at the fraud perpetrated by Stanford, the impact on investors, the response of the SEC, and the IG's investigation into the SEC's response to concerns about Robert Allen Stanford.

I applaud Chairman Schapiro for the efforts she has made to reform how the SEC regulates markets and protects investors. I also think the Dodd-Frank bill makes some important changes at the SEC to better protect investors. That said, it is the role of this Committee to help determine if these are the right changes to prevent fraud, like that which was perpetrated by Allen Stanford, from happening again, and to ensure that these changes are working.

It is my goal to ensure that the SEC has the right tools and appropriate resources; that investors have access, information, and protection, and that industry participants follow the rules, while also having certainty. I look forward to hearing more from today's witnesses, and I look forward to working with Members of this Committee to ensure that investors are protected from fraud before it happens.

PREPARED STATEMENT OF H. DAVID KOTZ
Inspector General, Securities and Exchange Commission
September 22, 2010

Introduction

Thank you for the opportunity to testify before this Committee on the subject of ``Oversight of the SEC's Inspector General's Report on the `Investigation of the SEC's Response to Concerns Regarding Robert Allen Stanford's Alleged Ponzi Scheme' and Improving SEC Performance.'' I appreciate the interest of the Chairman, the Ranking Member, as well as the other Members of the Committee, in the Securities and Exchange Commission (SEC or Commission) and the Office of Inspector General (OIG). In my testimony, I am representing the OIG, and the views that I express are those of my Office, and do not necessarily reflect the views of the Commission or any Commissioners.

I would like to begin my remarks by briefly discussing the role of my Office and the oversight efforts we have undertaken during the past few years. The mission of the Office of Inspector General is to promote the integrity, efficiency and effectiveness of the critical programs and operations of the SEC. The SEC Office of Inspector General includes the positions of the Inspector General, Deputy Inspector General, Counsel to the Inspector General, and has staff in two major areas: Audits and Investigations.

Our audit unit conducts, coordinates and supervises independent audits and evaluations related to the Commission's internal programs and operations. The primary purpose of conducting an audit is to review past events with a view toward ensuring compliance with applicable laws, rules and regulations and improving future performance. Upon completion of an audit or evaluation, the OIG issues an independent report that identifies any deficiencies in Commission operations, programs, activities or functions and makes recommendations for improvements in existing controls and procedures.

The Office's investigations unit responds to allegations of violations of statutes, rules and regulations, and other misconduct by Commission staff and contractors. We carefully review and analyze the complaints we receive and, if warranted, conduct a preliminary inquiry or full investigation into a matter. The misconduct investigated ranges from fraud and other types of criminal conduct to violations of Commission rules and policies and the Government-wide conduct standards. The investigations unit conducts thorough and independent investigations into allegations received in accordance with the applicable Quality Standards for Investigations. Where allegations of criminal conduct are involved, we notify and work with the Department of Justice and the Federal Bureau of Investigation as appropriate.

Audit Reports

Over the past 2\1/2\ years since I became the Inspector General of the SEC, our audit unit has issued numerous reports involving matters critical to SEC programs and operations and the investing public. These have included an examination of the Commission's oversight of Bear Stearns and the factors that led to its collapse, an audit of the SEC Division of Enforcement's (Enforcement's) practices related to naked short selling complaints and referrals, a review of the SEC's bounty program for whistleblowers, and an analysis of the SEC's oversight of credit rating agencies. In addition, following a comprehensive investigative report related to the Madoff Ponzi scheme in which our Office identified systematic breakdowns in the manner in which the SEC conducted its examinations and investigations (discussed in more detail below), we performed three comprehensive reviews providing the SEC with 69 specific and concrete recommendations to improve the operations of both Enforcement and the Office of Compliance Inspections and Examinations (OCIE).

Investigative Reports

The Office's investigations unit has also conducted numerous comprehensive investigations into significant failures by the SEC in accomplishing its regulatory mission, as well as investigations of allegations of violations of statutes, rules and regulations, and other misconduct by Commission staff members and contractors. Several of these investigations involved senior-level Commission staff and represent matters of great concern to the Commission, Congressional officials and the general public. Where appropriate, we have reported evidence of improper conduct and made recommendations for disciplinary actions, including removal of employees from the Federal service, as well as recommendations for improvements in agency policies, procedures and practices.

Specifically, we have issued investigative reports regarding a myriad of allegations, including claims of failures by Enforcement to pursue investigations vigorously or in a timely manner, improper securities trading by Commission employees, conflicts of interest by Commission staff members, unauthorized disclosure of nonpublic information, whistleblower allegations of contract fraud, preferential treatment given to prominent persons, retaliatory termination, perjury by supervisory Commission attorneys, failure of SEC attorneys to maintain active bar status, falsification of Federal documents, and the misuse of official position, Government resources and official time. In August 2009, we issued a 457-page report of investigation analyzing the reasons why the SEC failed to uncover Bernard Madoff's $50 billion Ponzi scheme. More recently, we issued a thorough and comprehensive report of investigation regarding the history of the SEC's examinations and investigations of Robert Allen Stanford's (Stanford's) $8 billion alleged Ponzi scheme. The report is discussed in detail below and is the subject of this hearing.

Commencement of Stanford Investigation

On October 9, 2009, I received a letter from the Ranking Member of this Committee, the Honorable Richard Shelby, and the Honorable David Vitter requesting a comprehensive investigation of the handling of the SEC's investigation into Robert Allen Stanford and his various companies, including the history of all the SEC's investigations and examinations regarding Stanford. On October 13, 2009, the OIG opened our investigation into the Stanford matter.

Document and E-mail Review

Between October 13, 2009 and February 16, 2010, the OIG investigative team made numerous requests to the SEC's Office of Information Technology (OIT) for the e-mails of current and former SEC employees for various periods of time pertinent to the investigation. The e-mails were received, loaded onto computers with specialized search tools and searched on a continuous basis throughout the course of our investigation.

In all, OIT provided e-mails for a total of 42 current and former SEC employees for various time periods pertinent to the investigation, ranging from 1997 to 2009. We estimate that we obtained and searched over 2.7 million e-mails during the course of the investigation.

On October 27, 2009, we sent comprehensive document requests to both Enforcement and OCIE specifying the documents and records we required to be produced for the investigation. We carefully reviewed and analyzed the information we received as a result of our document production requests. These documents included all records relating to the SEC's Fort Worth office's examinations in 1997 of Stanford Group Company's Broker-Dealer, in 1998 of Stanford Group Company's Investment Advisor, in 2002 of Stanford Group Company's Investment Advisor, and in 2004 of Stanford Group Company's Broker-Dealer. These also included investigative records relating to the Fort Worth office's 1998 inquiry regarding Stanford Group Company and its investigation of Stanford Group Company, which was opened in 2006.

We also sought and reviewed documents from the Financial Industry Regulatory Authority (FINRA), including documents concerning communications between FINRA or its predecessor, the National Association of Securities Dealers (NASD), and the SEC concerning Stanford, and FINRA documents pertaining to the SEC's examinations and inquiries regarding Stanford.

Testimony and Interviews

The OIG conducted 51 testimonies and interviews of 48 individuals with knowledge of facts or circumstances surrounding the SEC's examinations and/or investigations of Stanford and his firms. I personally led the questioning in the testimony and interviews of the witnesses in this investigation.

Specifically, we conducted on-the-record and under oath testimony of 28 individuals, including all of the relevant examiners and investigators who worked on SEC matters relating to Stanford. We also conducted interviews of 20 other witnesses, including former SEC employees, whistleblowers, victims of the alleged Ponzi scheme, and officials from the Texas State Securities Board.

Issuance of Comprehensive Report of Investigation

On March 31, 2010, we issued to the Chairman of the SEC a comprehensive report of our investigation in the Stanford matter containing over 150 pages of analysis and 200 exhibits. The report of investigation detailed all of the SEC's examinations and investigations of Stanford from 1997 through 2009 and the agency's response to all complaints it received regarding the activities of Stanford's companies, tracing the path of these complaints through the Commission from their inception and reviewing what, if any, investigative or examination work was conducted with respect to the allegations in the complaints.

Results of the OIG's Stanford Investigation

The OIG's investigation determined that the SEC's Fort Worth office was aware since 1997 that Robert Allen Stanford was likely operating a Ponzi scheme, having come to that conclusion a mere 2 years after Stanford Group Company, Stanford's investment adviser, registered with the SEC in 1995. We found that over the next 8 years, the SEC's Fort Worth Examination group conducted four examinations of Stanford's operations, finding in each examination that the certificates of deposit (CDs) Stanford was promoting could not have been ``legitimate,'' and that it was ``highly unlikely'' that the returns Stanford claimed to generate could have been achieved with the purported conservative investment approach utilized. The SEC's Fort Worth examiners conducted examinations of Stanford in 1997, 1998, 2002 and 2004, concluding in each instance that Stanford's CDs were likely a Ponzi scheme or similar fraudulent scheme. The only significant difference in the examination group's findings over the years was that the potential fraud was growing exponentially, from $250 million to $1.5 billion.

The first SEC examination occurred in 1997, just 2 years after Stanford Group Company began operations. After reviewing Stanford Group Company's annual audited financial statements in 1997, a former branch chief in the Fort Worth Broker-Dealer Examination group stated that, based simply on her review of the financial statements, she ``became very concerned'' about the ``extraordinary revenue'' from the CDs and immediately suspected the CD sales were fraudulent. In August 1997, after just six days of field work in an examination of Stanford, the examiners concluded that Stanford International Bank's statements promoting the CDs appeared to be misrepresentations. The examiners noted that while the CD products were promoted as being safe and secure, with investments in ``investment-grade bonds,'' the interest rate, combined with referral fees of between 11 percent and 13.75 percent annually, was simply too high to be achieved through the purported low-risk investments.

The branch chief concluded after the 1997 examination was finished that the CDs declared above-market returns were ``absolutely ludicrous'' and that the high referral fees paid for selling the CDs indicated that they were not ``legitimate CDs.'' The Assistant District Administrator for the Fort Worth Examination program concurred, noting that there were ``red flags'' about Stanford's operations that caused her to believe Stanford Group Company was operating a Ponzi scheme, specifically noting the fact that the interest being paid on these CDs ``was significantly higher than what you could get on a CD in the United States.'' She further concluded that it was ``highly unlikely'' that the returns Stanford claimed to generate could be achieved with the conservative investment approach Stanford claimed to be using.

In the SEC's internal tracking database, where it recorded information about its examinations, the Broker-Dealer Examination group characterized its conclusion from the 1997 examination of Stanford Group Company as ``Possible misrepresentations. Possible Ponzi scheme.'' Our investigation found that in 1997, the examination staff determined, as a result of their findings, that an investigation of Stanford by the Fort Worth Enforcement group was warranted, and referred a copy of their examination report to the Enforcement group for review and disposition. In fact, when the former Assistant District Administrator for the Fort Worth Examination program retired in 1997, her ``parting words'' to the aforementioned branch chief were to ``keep your eye on these people [referring to Stanford] because this looks like a Ponzi scheme to me and some day it's going to blow up.''

We also found that in June 1998, the Investment Adviser Examination group in Fort Worth began another examination of Stanford Group Company. This Investment Adviser examination arrived at the same conclusions that the broker-dealer examination had reached. The Investment Adviser examiners found very suspicious Stanford's ``extremely high interest rates and extremely generous compensation'' in the form of annual recurring referral fees, as well as the fact that Stanford Group Company was so ``extremely dependent upon that compensation to conduct its day-to-day operations.''

In November 2002, the SEC's Investment Adviser Examination group conducted yet another examination of Stanford Group Company. In this examination, the staff identified the same red flags that had been noted in the previous two examinations, including the fact that ``the consistent, above-market reported returns'' were ``very unlikely'' to be able to be achieved with Stanford's investments.

The Investment Adviser examiners also found that the list of investors provided by Stanford Group Company was inaccurate, as the list they received of the CD holders was inconsistent with the total CDs outstanding based upon referral fees. The examiners noted that although they did follow up with Stanford Group Company about this discrepancy, they never obtained ``a satisfactory response, and a full list of investors.''

After the examiners began this third examination of Stanford, the SEC received multiple complaints from outside entities reinforcing and bolstering the examiners' suspicions about Stanford's operations. However, the SEC failed to follow up on these complaints or take any action to investigate them. On December 5, 2002, the SEC received a complaint from a citizen of Mexico, who raised the same concerns the examination staff had raised. While the examiners characterized the concerns expressed in this complaint as ``legitimate,'' we found that the SEC did not respond to the complaint and did not take any action to investigate the claims made therein.

In 2003, the SEC Enforcement staff received two new complaints that Stanford was a Ponzi scheme, but we found that nothing was done to pursue either of them. On August 4, 2003, the SEC was forwarded a letter that discussed several similarities between a known Ponzi scheme and Stanford's operations. Then, on October 10, 2003, the NASD forwarded a letter dated September 1, 2003, from an anonymous Stanford insider to the SEC's Office of Investor Education and Advocacy, which stated, in pertinent part:

> Stanford Financial is the subject of a lingering corporate fraud scandal perpetuated as a ``massive Ponzi scheme'' that will destroy the life savings of many; damage the reputation of all associated parties, ridicule securities and banking authorities, and shame the United States of America.

Our investigation found that while this letter was minimally reviewed by various Enforcement staff, the Enforcement group decided not to open an investigation or even an inquiry into the complaint. The Enforcement branch chief responsible for the decision explained his rationale as follows:

> [R]ather than spend a lot of resources on something that could end up being something that we could not bring, the decision was made to--to not go forward at that time, or at least to--to not spend the significant resources and--and wait and see if something else would come up.

In October 2004, the Fort Worth Examination staff conducted a fourth examination of Stanford Group Company. The examiners once again analyzed the CD returns using data about the past performance of the equity markets and concluded that Stanford Group Company's sales of the CDs violated numerous Federal securities laws.

While the Fort Worth Examination group made multiple efforts after each examination of Stanford Group Company to convince the Enforcement group to open and conduct an investigation of Stanford, we found that the Enforcement group made no meaningful effort to investigate the potential fraud or to consider an action to attempt to stop it until late 2005. In 1998, the Enforcement group opened a brief inquiry, but then closed it after only three months, when Stanford failed to produce documents evidencing fraud in response to a voluntary document request. In 2002, no investigation was opened even after the examiners specifically identified in an examination report multiple violations of securities laws by Stanford. In 2003, after receiving the three separate complaints about Stanford's operations, the Enforcement group decided not to open up an investigation or even an inquiry, and did not follow up to obtain more information about the complaints.

In late 2005, after a change in leadership in the Enforcement group and in response to the continuing pleas by the Fort Worth examiners, who had been watching the potential fraud grow in examination after examination, the Enforcement group finally agreed to seek a formal order from the Commission to investigate Stanford. However, even at that time, the Enforcement group missed an opportunity to have the SEC bring an action against Stanford Group Company for its admitted failure to conduct any due diligence regarding Stanford's investment portfolio. Such an action could have potentially halted the sales of the Stanford International Bank CDs though the Stanford Group Company investment adviser, and would have provided investors and prospective investors with notice that the SEC considered Stanford Group Company's sales of the CDs to be fraudulent. We found that this particular action was not considered, partially because the new head of the Enforcement group in Fort Worth was not aware of the findings of the Investment Adviser group's examinations in 1998 and 2002, or even that Stanford Group Company had registered as an investment adviser, a fact she learned for the first time in the course of our investigation in January 2010.

We did not find that the reluctance of the SEC's Fort Worth Enforcement group to investigate Stanford was related to any improper professional, social or financial relationship on the part of any current or former SEC employee. We found evidence, however, that SEC-wide institutional influence did factor into the Enforcement group's repeated decisions not to undertake a full and thorough investigation of Stanford, notwithstanding staff awareness that the potential fraud was growing. We found that senior Fort Worth officials perceived that they were being judged on the numbers of cases they brought, so-called ``stats,'' and communicated to the Enforcement staff that novel or complex cases were disfavored. As a result, cases like Stanford, which were not considered ``quick-hit'' or ``slam-dunk'' cases, were not encouraged.

We also found that a former head of Enforcement in Fort Worth, who played a significant role in multiple decisions over the years to quash investigations of Stanford, sought to represent Stanford on three separate occasions after he left the Commission, and in fact, represented Stanford briefly in 2006 before he was informed by the SEC Ethics Office that it was improper for him to do so.

Our investigation revealed that this individual while working at the SEC was responsible for decisions: (1) in 1998 to close an inquiry opened regarding Stanford after the 1997 examination; (2) in 2002, in lieu of responding to a complaint or investigating the issues it raised, to forward it to the Texas State Securities Board; (3) also in 2002, not to act on the Examination staff's referral of Stanford for investigation after its Investment Adviser examination; (4) in 2003, not to investigate Stanford after a complaint was received comparing Stanford's operations to a known fraud; (5) also in 2003, not to investigate Stanford after receiving a complaint from an anonymous insider alleging that Stanford was engaged in a ``massive Ponzi scheme;'' and (6) in 2005, to summarily inform senior Examination staff after a presentation was made on Stanford at a quarterly summit meeting that Stanford was not a matter they planned to investigate.

Yet, in June 2005, a mere two months after leaving the SEC, this former head of the Enforcement group in Fort Worth e-mailed the SEC Ethics Office that he had been ``approached about representing [Stanford] . . . in connection with (what appears to be) a preliminary inquiry by the Fort Worth office.'' He further stated, ``I am not aware of any conflicts and I do not remember any matters pending on Stanford while I was at the Commission.''

After the SEC Ethics Office denied the former head of Enforcement in Fort Worth's June 2005 request, in September 2006, Stanford retained this individual to assist with inquiries Stanford was receiving from regulatory authorities, including the SEC. The former head of Enforcement in Fort Worth met with Stanford Financial Group's General Counsel in Stanford's Miami office and billed Stanford for his time on this representation. In late November 2006, he called his former subordinate, the Assistant Director working on the Stanford matter in Fort Worth, who asked him during the conversation, ``[C]an you work on this?,'' and in fact told him, ``I'm not sure you're able to work on this.'' After this call, the former head of Enforcement in Fort Worth belatedly sought permission from the SEC's Ethics Office to represent Stanford. The SEC Ethics Office replied that he could not represent Stanford for the same reasons given a year earlier and he discontinued his representation.

In February 2009, immediately after the SEC sued Stanford, this same former head of Enforcement in Fort Worth contacted the SEC Ethics Office a third time about representing Stanford in connection with the SEC matter--this time to defend Stanford against the lawsuit filed by the SEC. An SEC Ethics official testified that he could not recall another instance in which a former SEC employee contacted the Ethics Office on three separate occasions trying to represent a client in the same matter. After the SEC Ethics Office informed the former head of Enforcement in Fort Worth for a third time that he could not represent Stanford, he became upset with the decision, arguing that the matter pending in 2009 ``was new and was different and unrelated to the matter that had occurred before he left.'' When asked during our investigation why he was so insistent on representing Stanford, he replied, ``Every lawyer in Texas and beyond is going to get rich over this case. Okay? And I hated being on the sidelines.''

Based upon this evidence, our investigation determined that the former head of Enforcement in Fort Worth's representation of Stanford appeared to violate State bar rules that prohibit a former Government employee from working on matters in which that individual participated as a Government employee.

In summary, our report of investigation concluded overall that the SEC's Fort Worth office was aware since 1997 that Stanford was likely operating a Ponzi scheme after conducting examination after examination for a period of 8 years, but merely watched the alleged fraud grow, and failed to take any action to stop it.

Recommendations of the OIG's Stanford Report of Investigation

We provided our Report of Investigation on the SEC's handing of the Stanford matter to the Chairman of the SEC on March 31, 2010. We recommended that the Chairman carefully review the Report's findings and share with Enforcement management the portions of the Report that related to the performance failures by those employees who still work at the SEC, so that appropriate action (which may include performance-based action, if applicable) would be taken, on an employee-by-employee basis, to ensure that future decisions about when to open an investigation and when to recommend that the Commission take action are made in a more appropriate and timely manner.

We also made numerous recommendations to improve the operations of several divisions and offices within the SEC. Specifically, we recommended that:

1. Enforcement ensure that the potential harm to investors if no action is taken is considered as a factor when deciding whether to recommend an enforcement action, including consideration of whether this factor, in certain situations, outweighs other

whether this factor, in certain situations, outweighs other factors such as litigation risk;

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

3. Enforcement consider the significance of the presence or absence of United States investors in determining whether to open an investigation or recommend an enforcement action that otherwise meets jurisdictional requirements;

4. There be improved coordination between the Enforcement and OCIE on investigations, particularly those investigations initiated by an OCIE referral to Enforcement;

5. Enforcement reevaluate the factors utilized to determine when referral of a matter to State securities regulators, in lieu of an SEC investigation, is appropriate;

6. There be additional training of Enforcement staff to strengthen their understanding of the laws governing broker-dealers and investment advisers; and

7. Enforcement emphasize the need to coordinate with the Office of International Affairs and the Division of Risk, Strategy, and Financial Innovation, as appropriate, early in the course of investigations.

We also referred our Report of Investigation to the Commission's Ethics Counsel for referral to the Bar Counsel offices in the two States in which the former head of Enforcement in Fort Worth was admitted to practice law.

Follow-up on Recommendations

My Office is committed to following up with respect to all of the recommendations made in our Stanford report to ensure that appropriate changes and improvements are made in the SEC's operations as a result of our findings. We are aware that many improvements have already been undertaken under the direction of Chairman Schapiro and Enforcement Director Khuzami as a result of the findings and many recommendations we made as a result of our Madoff investigation. We note that Enforcement has indicated that it has taken action on the recommendations of our Stanford report, and we are in the process of reviewing those actions to ensure that they are adequate and fully address the OIG's concerns. We are confident that under Chairman Schapiro's leadership, the SEC will carefully take the appropriate steps to implement fully our Stanford recommendations and ensure that fundamental changes are made in the SEC's operations so that the errors and failings we found in our investigation are properly remedied and not repeated in the future.

Similarities to Failures in the Madoff Matter

While my Office has not conducted any formal analysis of similarities between the findings in our Madoff and Stanford reports, we have identified some striking parallels between the two situations. First, in both cases, the SEC received credible and substantive complaints about possible fraud, but failed to follow up appropriately on these complaints. Second, in both the Madoff and Stanford matters, the SEC had in its possession ample evidence of potential fraud, which should have triggered thorough and comprehensive Enforcement investigations and actions. Third, and most unfortunately, in both situations, prompt and effective action on the part of the SEC could have potentially uncovered fraud and prevented investors from losing billions of dollars.

Our Office intends to remain vigilant to ensure that the SEC benefits from the lessons learned as a result of its failures in both these cases and makes the necessary improvements to ensure that such failures do not occur again in the future.

Conclusion

In conclusion, I appreciate the interest of the Chairman, the Ranking Member and the Committee in the SEC and my Office and, in particular, in the facts and circumstances pertinent to our Stanford report. I believe that the Committee's and Congress's continued involvement with the SEC is helpful to strengthen the accountability and effectiveness of the Commission. Thank you.

JOINT PREPARED STATEMENT OF

ROBERT KHUZAMI

Director, Division of Enforcement, Securities and Exchange Commission

And

CARLO V. DI FLORIO

Director, Office of Compliance Inspections and Examinations, Securities and Exchange Commission

September 22, 2010

Chairman Dodd, Ranking Member Shelby, and Members of the Committee, thank you for the opportunity to testify today on behalf of the Securities and Exchange Commission (SEC).

The Commission commends the work of the Inspector General and his staff investigating this matter and drafting the report, Investigations of the SEC's Response to Concerns Regarding Robert Allen Stanford's Alleged Ponzi Scheme, OIG-526 (Inspector General Report). The Office of the Inspector General conducted an extensive investigation that clearly identifies missed opportunities for protecting investors, and no one should evade responsibility for the SEC's handling of the Stanford matter. We deeply regret that the SEC failed to act more quickly to limit the tragic investor losses suffered by Stanford's victims.

The Inspector General Report makes important recommendations identifying areas for improvement throughout the SEC and, as we will discuss today, both the Division of Enforcement and the Office of Compliance Inspections and Examinations (OCIE) have instituted various measures to address those recommendations.

In addition to the Inspector General Report's recommendations, as new leaders, each of us has engaged in a top to bottom review of our respective Division and Office since joining the Commission within the last year and a half and have implemented measures to reform our organizational processes and improve our effectiveness. We have vastly expanded our training programs; hired staff with new skill sets; streamlined management; put seasoned investigative attorneys back on the front lines; improved our examiners' risk-assessment techniques; revised our enforcement and examination procedures to improve coordination and information-sharing; leveraged the knowledge of third parties; instituted new initiatives to identify fraud; and revamped the way that we handle the tremendous volume of tips, complaints, and referrals that we receive annually.

Despite the many changes, more needs to be done. This will require commitment and creativity. We embrace the challenge and are confident that our efforts will continue to enhance investor protection and the integrity of our financial markets.

Status of the Stanford Case

In February 2009, the SEC filed an emergency civil action to halt sales of Stanford Certificates of Deposit (CDs) and seek the return of funds to harmed investors. Shortly thereafter, the SEC filed an amended complaint against Robert Allen Stanford, James M. Davis, Stanford International Bank (SIB), and others alleging a massive Ponzi scheme in the sale of SIB CDs.

By the end of 2008, SIB had sold more than $7.2 billion of CDs by touting the bank's safety and security, consistent double-digit returns on the bank's investment portfolio, and high rates of return on the CDs that greatly exceeded rates offered by U.S. commercial banks. The SEC's complaint alleged that Stanford and Davis misappropriated billions of dollars of investor funds and invested funds in speculative, unprofitable private businesses controlled by Stanford. In an effort to conceal their fraudulent conduct, Stanford and Davis allegedly fabricated the performance of the bank's investment portfolio and lied to investors about the nature and performance of the portfolio. The SEC alleged that, rather than making principal redemptions and interest payments from earnings, Stanford made purported interest and redemption payments from money derived from CD sales.

Working in close coordination with the SEC, the Department of Justice, on June 19, 2009, unsealed indictments against Stanford, Davis and three other former Stanford employees, alleging that they committed securities, wire and mail fraud and obstructed the SEC's investigation. On June 30, 2009, the court ordered that Stanford be detained in jail pending his criminal trial.

In June 2009, the SEC also sued Leroy King, the former Administrator and Chief Executive Officer for the Antigua Financial Services Regulatory Commission (AFSRC), alleging that Stanford bribed King to help him conceal his fraud and thwart the SEC's investigation. As alleged in the SEC's complaint, while King received bribes from Stanford, he rebuffed SEC inquiries into Stanford's conduct by stating, among other things, that further investigation of Stanford was ``unwarranted,'' and that his bank was ``fully compliant'' with Antiguan bank regulations. \1\ King also permitted Stanford to, in effect, ``ghost write'' the response by the AFSRC to the SEC, which rejected the SEC's demand for information. Bribing King permitted Stanford to keep his fraud alive for years. In addition to the SEC's charges, the Department of Justice indicted King for charges, including obstruction of justice, for allegedly accepting tens of thousands of dollars in bribes to facilitate the scheme.

\1\ SEC v. Stanford International Bank Ltd., et al., No 3:09-cv-0298-N (N.D.Tex), Second Amended Complaint at par. 88.

The SEC is vigorously pursuing its case against Stanford and the others charged in this massive Ponzi scheme. In addition, the staff's investigation into possible misconduct by others (including former employees and third parties) is ongoing.

Status of Recovery for Stanford Investors

The SEC's focus in the Stanford matter is to hold wrongdoers accountable while providing maximum recovery to investors harmed by this egregious fraud. We are proceeding on several fronts:

First, after filing its civil action in February 2009, the SEC filed a motion requesting that the district court appoint a Receiver over the defendants' assets to prevent waste and dissipation of those assets to the detriment of investors. Second, to complement the Receiver's efforts, the SEC, in coordination with the DOJ, moved to freeze SIB assets held in international financial institutions. Freezing assets in international jurisdictions poses complex litigation challenges, but this step was crucial to ensure the protection of investor funds. Third, the SEC is working with the Receiver, DOJ, and securities regulators and law enforcement agencies in the United Kingdom, Switzerland, Canada, Mexico, and in several countries throughout Central and South America, to identify, secure, and repatriate for the benefit of investors over $300 million in cash and securities held in non-U.S. bank accounts.

In a status report filed July 1, 2010, the Receiver identified several categories of major assets for possible distribution to harmed investors:

$80.5 million in cash on hand;

$17.2 million in private equity investments already recovered and liquidated, with an additional $7.7 million in proceeds from additional pending transactions expected;

$2.3 million in inventory and accounts receivable, specifically in coins and gold bullion;

$6.4 million in real estate sale proceeds, with an additional $11.7 million expected from sales of other identified properties; and

$511 million in pending fraudulent transfer and unjust enrichment claims. \2\

\2\ This figure includes amounts claimed in lawsuits filed or intended to be filed by the Receiver; actual recovery may vary depending on litigation outcome.

In conjunction with the SEC, the Receiver is focused on identifying and liquidating the largest possible pool of obtainable assets for distribution to harmed investors.

The SEC is closely monitoring the Receiver's costs to ensure optimal recovery for the victims of this massive fraud. We have strongly urged the Receiver to stringently apply a cost-benefit analysis and pursue only those legal claims that could generate maximum proceeds for the benefit of investors while minimizing the Receiver's legal fees and expenses. We also have cautioned the Receiver that we are carefully scrutinizing all bills requesting payment for fees and expenses. In fact, on at least three occasions, the SEC has formally challenged the Receiver's bills. We will continue to do so where appropriate.

Status of SIPC Determination in Stanford

The Commission oversees the activities of the Securities Investor Protection Corporation (SIPC), which plays a critical role in protecting the customers of a broker-dealer entering liquidation under the Securities Investor Protection Act (SIPA). In the Stanford matter, SIPC has indicated that, in its view and based on the facts presented, there is no basis for SIPC to initiate a proceeding under SIPA. \3\ The Commission is investigating the facts to determine whether that determination is appropriate, including meeting with the Stanford Victims' Coalition and reviewing documents provided in support of their claims. The Commission will continue to monitor the issues surrounding the Stanford matter as it relates to SIPC.

\3\ http://www.stanfordfinancialreceivership.com/documents/SIPC_Letter.pdf

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Enforcement and OCIE Responses to Inspector General Recommendations

On April 16, 2010, the SEC released a report by the Inspector General concerning the investigation of the Stanford matter. The report identified the need for reforms in the Division of Enforcement and in the Office of Compliance Inspections and Examinations.

Division of Enforcement

The Division of Enforcement has taken action on all seven of the formal recommendations identified in the Inspector General Report. On July 20, 2010, Enforcement submitted a closing memorandum to the Inspector General containing information that we believed fully addressed all seven recommendations. We are working with the Inspector General and hope to receive his concurrence on closing the recommendations as soon as possible.

First Recommendation. The Inspector General recommended that we evaluate the potential harm to investors when deciding whether to bring an enforcement action that also may involve litigation risks. The Division's Enforcement Manual, \4\ developed in October 2008, provides that staff should consider several factors when determining whether to open an investigation, including: (i) the potential losses involved or harm to investors and (ii) the egregiousness of the potential violation. In addition, the Enforcement Manual also states that first among the factors the staff should consider before closing an investigation is the seriousness of the conduct and potential violations. As these Enforcement Manual provisions indicate, prior to the Inspector General Report, the Division encouraged staff to carefully assess factors such as potential harm to investors and seriousness of potential violations when deciding whether to open or close investigations. In response to the Inspector General Report, we have instituted mandatory Enforcement Manual training for all Division staff to ensure compliance.

\4\ http://www.sec.gov/divisions/enforce/enforcementmanual.pdf

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In addition to its Enforcement Manual provisions and related training, the Division regularly files actions in Federal court seeking emergency temporary restraining orders and asset freezes to prevent imminent investor harm and protect assets for the benefit of investors--actions that often present litigation risk given the exigent circumstances of the very early stages of an investigation. In fiscal year 2010 to date, Enforcement has obtained 45 emergency temporary restraining orders to halt ongoing misconduct and prevent imminent investor harm and 56 asset freezes to preserve funds for the benefit of investors. We believe that these measures address the Inspector General's concern that Enforcement staff should carefully consider the potential harm to investors when deciding to bring an enforcement action that may otherwise pose litigation risks.

Second Recommendation. The Inspector General recommended that we consider promulgating and/or clarifying staff and regional office performance evaluation procedures that recognize the significance of bringing difficult cases focused on investor protection. The Enforcement Division has revised the metrics used to manage and evaluate the performance of its staff. Rather than emphasizing the number of actions filed, we focus on the programmatic priority of the case, which reflects a consideration of multiple factors, including whether the matter:

1. presents an opportunity to send a particularly strong and effective message of deterrence, including with respect to markets, products and transactions that are newly developing, or that are long established but which by their nature present limited opportunities to detect wrongdoing and thus to deter misconduct;

2. involves particularly egregious or extensive misconduct;

3. involves potentially widespread and extensive harm to investors;

4. involves misconduct by persons occupying positions of substantial authority or responsibility, or who owe fiduciary or other enhanced duties and obligations to a broad group of investors or others;

5. involves potential wrongdoing as prohibited under newly enacted legislation or regulatory rules;

6. involves potential misconduct that occurred in connection with products, markets, transactions or practices that pose particularly significant risks for investors or a systemically important sector of the market;

7. involves a substantial number of potential victims and/or particularly vulnerable victims;

8. involves products, markets, transactions or practices that the Enforcement Division has identified as priority areas (i.e., conduct relating to the financial crisis; fraud in connection with mortgage-related securities; financial fraud involving public companies whose stock is widely held; misconduct by investment advisers; and matters involving priorities established by particular regional offices or the specialized units); and

9. provides an opportunity to pursue priority interests shared by other law enforcement agencies on a coordinated basis.

We further consider in our evaluations the difficulty, complexity and investigative challenges of the case, as well as the efficiency of the resources used, the swiftness of the action, and the success of the outcome.

In addition, the Division now generates a national priority case report that identifies and tracks cases deemed programmatically significant to ensure that appropriate resources are devoted to these cases. Finally, the SEC's Strategic Plan for Fiscal Years 2010-2015--as circulated for public comment--identifies the performance standards that it will use to gauge the success of its enforcement program. Those performance measures are not exclusively focused on the number of cases filed per fiscal year, but rather include: (i) the percentage of enforcement cases successfully resolved; (ii) the percentage of enforcement cases filed within 2 years, and (iii) our success in collecting and returning money to investors in a timely fashion. We believe that these new procedures and metrics address the issues raised in the Inspector General Report regarding the role that metrics played in the Stanford matter and the need for an enhanced qualitative assessment of staff performance.

Third Recommendation. The Inspector General recommended that we consider promulgating and/or clarifying procedures regarding the significance of the presence or absence of U.S. investors in determining whether to open an investigation or bring an enforcement action that otherwise meets jurisdictional requirements. As previously described, the Division's Enforcement Manual identifies a number of factors that the staff should consider when deciding whether to open an investigation including, but not limited to, potential losses and harm to any investor, namely: (i) the egregiousness of the potential violation; (ii) the potential magnitude of the violation; (iii) whether the potentially harmed group is particularly vulnerable or at risk; (iv) whether the conduct is ongoing; (vi) the size of the victim group; and (vii) the amount of potential or actual losses to investors. As demonstrated by these provisions, prior to the Inspector General Report, the Division encouraged its staff to assess victim losses and victim impact when deciding to open an investigation. Moreover, in response to the Inspector General Report, the Division instituted mandatory Enforcement Manual training to ensure full compliance.

In addition, the Division currently is evaluating a recent Supreme Court decision, Morrison v. National Australia Bank, that placed jurisdictional limitations on securities fraud claims involving conduct and activities outside the U.S., in light of certain Dodd-Frank Wall Street Recovery and Reform Act of 2010 (Dodd-Frank Act) provisions concerning the territorial scope of the Federal securities laws. In connection with the Inspector General's recommendation, we are assessing the impact of that decision and the related Dodd-Frank Act provisions, and currently are working with other SEC offices to determine whether any additional guidance should be provided to Enforcement staff. We continue to work with the Inspector General to address his concern that staff should evaluate the presence or absence of U.S. investors when deciding to open an investigation.

Fourth Recommendation. The Inspector General recommended that we consider promulgating and/or clarifying procedures regarding coordination between Enforcement and OCIE on investigations, particularly those investigations initiated by a referral to Enforcement by OCIE. As a result of various Enforcement/OCIE initiatives, there now exists a significantly increased level of collaboration between Enforcement and OCIE staff. Enforcement and OCIE hold regular meetings to discuss issues raised in ongoing examinations. In addition, the many risk-based investigative initiatives undertaken as part of the overall restructuring of the Enforcement Division require early and frequent contact between Enforcement and OCIE to: (i) jointly develop risk metrics; (ii) identify entities with risk profiles indicative of the need for a risk-based examination; (iii) discuss the findings of ongoing examinations; and (iv) discuss the scope and nature of referrals to Enforcement for investigation.

In November 2006, Enforcement and OCIE established a process to facilitate the tracking of examination referrals, and ensure that there is a record of all OCIE referrals that are both accepted and declined by Enforcement (or are accepted and later closed), and the reasons why. This process includes referral committees at both the regional and headquarters office. To ensure ongoing coordination with OCIE where appropriate, Enforcement's new guidance for written investigative plans encourages staff to carefully evaluate and reevaluate issues throughout an investigation to minimize the risk that investigative steps are overlooked, and to better identify issues that require consultation with OCIE or other Divisions or Offices.

Lastly, as part of the Chairman's initiative to improve the handling of tips, complaints and referrals (TCRs), Enforcement has established the Office of Market Intelligence (OMI) and staffed it with market surveillance specialists, accountants, attorneys and other support personnel, and additional hiring is expected. OMI's mission is to ensure that we collect all TCRs in one place, combine that data with other public and confidential information on the persons or entities identified in the TCRs, and then dedicate investigative resources to those TCRs presenting the greatest threat of investor harm. OCIE's referrals to Enforcement are tracked through this new TCR system to ensure proper Enforcement staff assignment. We believe that these measures will address the issues identified in the Inspector General Report regarding poor coordination between Enforcement and OCIE.

Fifth Recommendation. The Inspector General recommended that we consider promulgating and/or clarifying procedures regarding when to refer a matter to State securities regulators. Prior to the Inspector General Report, the Enforcement Manual identified factors to guide referrals to Federal or State criminal authorities, SROs, the Public Company Accounting Oversight Board, or State agencies, including: (i) the egregiousness, extent and location of the conduct; (ii) the involvement of recidivists in any suspected conduct; and (iii) the potential for additional meaningful protection to investors upon referral. In response to the Inspector General Report, we now require mandatory Enforcement Manual training for all Enforcement staff.

The Inspector General recommended that we consider promulgating and/or clarifying procedures regarding when to refer a matter to State securities regulators. Prior to the Inspector General Report, Enforcement had strong working relationships with our law enforcement and regulatory partners, including State securities regulators. Moreover, the Enforcement Manual identifies factors to guide referrals to Federal or State criminal authorities, SROs, the Public Company Accounting Oversight Board, or State agencies, including: (i) the egregiousness, extent and location of the conduct; (ii) the involvement of recidivists in any suspected conduct; and (iii) the potential for additional meaningful protection to investors upon referral.

In addition, as indicated, Enforcement has created the Office of Market Intelligence to oversee and coordinate Enforcement's collection, analysis and distribution of TCRs. OMI staff has been directed to provide relevant information and data obtained in its initial triage of TCRs to the appropriate State or Federal agencies or other regulatory partners. Further, in connection with our work on the Financial Fraud Enforcement Task Force, we continue to work closely with our law enforcement and regulatory partners, including State securities regulators. These strengthened relationships facilitate effective information-sharing and provide us with clear points of contact for referrals to State securities regulators. We continue to work to address the Inspector General's concern related to the appropriate and timely referral of relevant investigative information to State securities regulators.

Sixth Recommendation. The Inspector General recommended that we consider promulgating and/or clarifying procedures regarding training of Enforcement staff to strengthen staff understanding of the laws governing broker-dealers and investment advisers. Newly created specialized units in the Enforcement Division, including one dedicated to Asset Management issues (including investment advisers) have unveiled intensive training modules in their respective specialty areas, which have been made available to all staff throughout the Division. In addition, Enforcement has strengthened training both for new hires and for existing staff, including training specifically focused on the laws governing broker-dealers and investment advisers. Enforcement also has created a new formal training unit led by a senior Enforcement official. This training unit will coordinate further training for the staff and has created a training site on our intranet to allow staff to easily find training opportunities and materials from prior training events. These formal training initiatives are complemented by Enforcement staff's efforts to take advantage of substantive expertise within other Divisions and Offices. We believe that these initiatives address the Inspector General's concerns related to the staff's working knowledge of the laws governing broker-dealers and investment advisers.

Seventh Recommendation. The Inspector General recommended that we consider promulgating and/or clarifying procedures regarding coordination with the Office of International Affairs (OIA) and the Division of Risk, Strategy, and Financial Innovation (RiskFin), as appropriate, at the early stages of investigations where relevant documents, individuals or entities are located abroad. As indicated above, the Division has adopted new guidance concerning written investigative plans that requires the staff to identify issues appropriate for coordination with other Divisions or Offices, such as OIA or RiskFin. In addition, Enforcement has established a formal quarterly case review process to assist the staff in identifying whether and when to consult with experts in OIA and RiskFin.

Also, both OIA and RiskFin have designated Enforcement liaisons to serve as a point of contact for staff with questions requiring investigative assistance. Enforcement staff regularly consults with and seeks assistance from OIA to obtain documents and information from foreign regulators, to locate and freeze assets abroad, and to assist with other international enforcement issues. Moreover, OIA and RiskFin provide training to Enforcement staff concerning their available resources. We believe that these measures address the Inspector General's concern that staff properly consult with other SEC Divisions and Offices to further their investigations.

Office of Compliance Inspections and Examinations

The Inspector General Report made several recommendations relating to coordination between Enforcement and OCIE on investigations of potential violations of the Federal securities laws, particularly those investigations initiated by a referral from OCIE to the Enforcement Division. OCIE has undertaken specific policy changes and instituted procedures to improve coordination and communication between the Enforcement Division and OCIE.

Through a number of structural and process reforms, OCIE and the Enforcement Division are working to identify misconduct earlier and to move to shut it down more rapidly. OCIE and Enforcement staff and leadership have been directed to evaluate potential referrals from the OCIE Exam staff against Enforcement's criteria (referenced above) regularly and determine the disposition of referrals. If there is disagreement on a case at the regional level, Exam staff has been instructed to escalate the matter to the attention of senior leadership in Washington. These processes ensure that concerns can be escalated in a timely manner to senior leadership of both the Exam and Enforcement programs for appropriate review and resolution.

Exam and Enforcement coordination with respect to particular matters is also the subject of periodic reviews. OCIE policy now requires that OCIE Exam staff hold quarterly Exam Reviews, in which the progress and status of every exam in the Regional Office is discussed and evaluated for several factors, including evaluating any significant issues with the firm that is the subject of the exam, determining whether more staff resources are needed on the exam and deciding if the exam is a potential referral to the Enforcement Division. These reviews are an opportunity to summarize and preview findings that appear likely to trigger possible Enforcement referrals, as well as to flag any potential differences in the assessment of urgency, potential harm to investors, or other issues that can then be raised at the joint regional meetings or to OCIE senior management.

Finally, OCIE Exam staff is working closely with the Specialized Units created recently within the Enforcement Division to identify key risks presented by entities registered with the SEC and key risks to the markets. This partnership with the Specialized Units has already resulted in new approaches to joint efforts to identify risky firms that may warrant examination or an Enforcement investigation. In addition, OCIE recently announced the creation of several Specialized Working Groups that will focus on areas where OCIE plans to increase its specialization and market knowledge.

Additional Significant Enforcement and OCIE Reforms

In addition to the reforms prompted by the Inspector General Report, we are engaged in a number of significant initiatives designed to enhance our performance.

Division of Enforcement

The Division is embracing a range of initiatives designed to increase our ability to identify hidden or emerging threats to the markets and act quickly to halt misconduct and minimize investor harm. Across the Division, we are launching risk-based investigative initiatives, tapping into the expertise of our colleagues in OCIE and other SEC offices and divisions, hiring talent with particularized market expertise, and reaching out to academia, law enforcement, and the regulated community to collect data on fraud hotspots.

One example of this new approach is our new national specialized units, which were formally staffed and fully launched in May 2010. These units are focused on the key areas of Structured and New Products, Market Abuse, Municipal Securities and Public Pensions, Asset Management, and violations of the Foreign Corrupt Practices Act. The creation of these units further demonstrates the Division's emphasis on the programmatic significance--rather than the quantity--of cases. To assist them in their investigative efforts, the units are hiring industry experts to work directly with our teams of experienced attorneys and accountants to ensure that we stay on the cutting edge of industry trends for the benefit of investors.

In addition to investigative work, the specialized units are engaged in a number of initiatives with our colleagues in OCIE and other Divisions to develop risk analytics that proactively identify red flags for further examination and investigation. To take but one of numerous examples, Enforcement, OCIE and RiskFin developed metrics and risk analytics for an Aberrational Performance Inquiry to identify those investment advisers whose operations shared characteristics of those of a Ponzi or other illegal scheme. Specifically, working with RiskFin's computer platform, we applied performance and volatility benchmarks to thousands of hedge fund advisers, and those that emerged from that analysis as outliers (e.g., those with above-market returns coupled with an absence of expected volatility) are being subject to further examination or investigation. This kind of proactive, risk-based investigative approach is being duplicated across the Division.

In addition, the completion of other organizational reforms--such as streamlining our management structure and obtaining delegated authority from the Commission to allow us to swiftly obtain formal orders and related subpoena power--has enabled our staff of attorneys and accountants to focus on what they do best, investigate and stop securities fraud. Across the Regional Offices and throughout the Home Office, our staff has responded to challenging times by concentrating on making smart investigative decisions, obtaining key evidence, tracing investor funds and aggressively pursuing wrongdoers.

To support our staff's efforts, we continue to build on our already strong working relationships with our law enforcement partners, particularly the Department of Justice and the FBI, as well as the banking regulators, other Federal and State agencies, and our other partners around the world. In particular, our work as cochair of the Securities and Commodities Fraud Working Group of the Financial Fraud Enforcement Task Force facilitates effective communication with our law enforcement partners nationwide engaged in parallel investigations alongside of our own.

Finally, we are rapidly integrating the new authority and responsibility granted to us under the Dodd-Frank Act. The Act authorizes the creation of a Whistleblower Program, which will be housed in our Office of Market Intelligence, and provides us with numerous measures to further our investigations, including: nationwide service of process; the ability to seek civil penalties in cease-and-desist proceedings; the ability to seek penalties against aiders and abettors under the Investment Advisers Act of 1940; and the ability to charge aiding and abetting violations under the Securities Act of 1933 and the Investment Company Act of 1940, among other initiatives. We are grateful that Congress included these legislative initiatives in the Dodd-Frank Act, and we are now focused on using these new tools to enhance our mission of investor protection.

Office of Compliance Inspections and Examinations

In addition to specific Exam/Enforcement coordination reforms, OCIE has instituted several recent changes to its examination program and has plans for significant additional strategic initiatives, all to increase the effectiveness and efficiency of the National Exam Program.

Recent Changes at OCIE

OCIE has instituted significant reforms to sharpen its focus on a risk-based examination process that also provides clear data for coordination and decision making with Enforcement. OCIE is improving its risk assessment procedures and techniques, to better identify areas of risk to investors and more effectively allocate limited resources to their highest and best use. For instance, OCIE is enhancing the information that financial firms submit and is improving techniques to better identify those particular firms that represent the highest risk profiles and therefore warrant a closer look. Once we select firms for examination using a risk-focused methodology, OCIE Exam staff are more rigorously reviewing information about these individual firms before sending examiners out to the field, so that we can use our limited resources more effectively and target key risk areas at those firms with the greatest overall risk profiles.

We also have instituted measures to improve the ability of examiners to detect fraud involving theft of assets and other types of violations. OCIE Exam staff across the country now routinely reaches out to third parties such as custodians, counter-parties and customers during examinations to verify the existence and integrity of all or part of the client assets managed by the firm. The measures also include expanded use of exams of an entire entity when firms have joint or dual registrants such as affiliated broker-dealers and investment advisers.

OCIE also has been hiring new staff with diverse skill sets to expand its knowledge base and improve its ability to assess risk, conduct examinations, detect and investigate wrongdoing, and focus our priorities. We have hired new Senior Specialized Examiners--and will bring on board more--who have specialized experience in areas such as risk management, trading, operations, portfolio management, options, compliance, valuation, new instruments and portfolio strategies, and forensic accounting. We also have been hiring additional staff with expertise in financial products and techniques--such as derivatives, structured products and hedge fund activities. This will permit other staffers to tap into that expertise to help them identify emerging issues and understand the ways the industry is changing. Such expertise can also be helpful in efforts to improve the techniques used in examinations and the collection and analysis of data.

In addition, OCIE has instituted several measures to integrate the activities of the broker-dealer and investment adviser examination programs. The New York Regional Office, for example, has adopted a protocol that integrates examination teams to make sure people with the right skill sets are assigned to examinations. Under the protocol, a single team of examiners, drawn from the broker-dealer and investment management units, jointly examines selected dually registered firms to ensure that the examination team includes those personnel relevant to the subject of the exam. In addition, the examination program has expanded opportunities for examiners to cross-train and increase coordination between broker-dealer and investment management staff on their examination plans. Finally, the examination program has begun to include experts from other SEC divisions and offices in exams to ensure we are leveraging SEC expertise and knowledge across the exam process. For instance, we recently involved RiskFin colleagues with algorithmic model experience in exams of High Frequency Trading firms.

OCIE's Ongoing Strategic Initiatives

In March, OCIE launched an intensive nationwide self assessment program. We reviewed the OCIE Examination Program by looking at the five components of Strategy, Structure, People, Process and Technology. Since July, we have moved quickly to implement additional reforms from the nationwide self-assessment.

OCIE has focused our strategy to identify the areas of highest risk and deploy our examiners against these risks, in order to improve compliance, prevent fraud, monitor risk and inform policymaking. We have reinforced our strategy by developing a highly specific set of Key Performance Indicators (KPIs) which we have shared with Enforcement, and on which we plan to report periodically.

OCIE also has already implemented a new governance structure, which is transforming our lines of communication and accountability. As mentioned above, the OCIE National Leadership Team now includes Directors of the Regional Offices, who manage both the Enforcement and Examinations programs in each Regional Office. This strengthens the OCIE/Enforcement partnership and speeds alerts, information hand offs, and transitions from OCIE Exam staff to the Enforcement Division when warranted. OCIE governance also forges interrelated bonds of policymaking, information sharing, and communication among staff in our Washington Home Office and our mission-critical examination teams in the 11 Regional Offices.

In addition, OCIE has outlined a new ``open architecture'' structure for staffing exams that will enable management to reach across disciplines and specialties to better match the skills of examination teams to the business models and risk areas of registrants. OCIE is also redesigning our exam team structure to redeploy the expertise and experience of managers from office administration to on-site exams in the field. These changes will help ensure that managers spend additional time and attention on supervision and oversight in the field on exams of registrants.

Our self assessment concluded that we needed not only to streamline our processes and policies, but also to create an environment for our staff of open, candid communication and personal accountability for quality, in order to build on OCIE's core strengths and eliminate repetition of the systemic flaws that may contribute to situations like the Stanford case. Accordingly, OCIE has accelerated enrollment of OCIE managers in the SEC's Successful Leaders Program and volunteered as the pilot site for many of the SEC's Office of Human Resources' new initiatives on hiring and professional development.

Finally, OCIE is placing continuous, focused attention on technology, another area that our self assessment identified as essential to a healthy examination program. We have developed and are about to test a standardized examination tool across the national exam program. We are also upgrading equipment and connectivity for examiners to match that available to examiners and auditors at other regulatory agencies and in the private sector.

Conclusion

The scope and egregiousness of Stanford's conduct and the resulting injury to investors underscores that it is essential for us to push forward with our efforts to hold the wrongdoers accountable and seek maximum investor recovery. The Inspector General Report identified numerous areas for reform, and we have moved aggressively to implement these reforms. There is much more work that remains to be done, but we are confident that we are putting in place the people and structures to prevent another occurrence of Stanford-type problems.

Finally, we would note that both the SEC and the Department of Justice continue to have open investigations into the Stanford matter. Our efforts to bring potential wrongdoers to justice in this case are still very much ongoing, and the defendants vigorously contest our allegations. In responding to your questions today, we intend to be as forthcoming and candid as possible and will identify when we are concerned that disclosure of information through an answer could compromise the Commission's ability to bring the wrongdoers to justice or to provide maximum recovery for investors.

We thank you for the opportunity to appear before you today.

PREPARED STATEMENT OF ROSE L. ROMERO

Regional Director, Fort Worth Regional Office, Securities and Exchange Commission

September 22, 2010

Introduction

Chairman Dodd, Ranking Member Shelby, and Members of the Committee, thank you for the opportunity to testify today about the reforms the Fort Worth Regional Office (FWRO) is making in response to the issues raised in the Inspector General's Report on the Office's performance in the Stanford matter.

Like Mr. Khuzami and Mr. di Florio, I regret that that the SEC failed to act more quickly to limit the investor losses suffered by Stanford's victims. All of us at the SEC share responsibility for the handling of the Stanford matter and are taking significant steps to ensure that we implement the reforms recommended by the Inspector General.

I want to begin by saying that, from a regional perspective, the initiatives outlined in the remarks of Mr. Khuzami and Mr. di Florio are making a significant impact upon the Commission and its staff. A streamlined management structure; delegation of authority to the staff; expanded training opportunities; improvements to risk assessment and examination procedures; specialization initiatives; and procedures to insure coordination and information sharing are some of the critical reforms that have greatly enhanced our capabilities.

By way of background, I served for 4 years in the United States Air Force. I have served as a Fort Worth police officer, an assistant district attorney and, prior to joining the Commission staff, I worked as a Federal prosecutor for 16 years. I came to the Commission in 2006 with many objectives. Principal among them was to bring a more aggressive, law enforcement-like focus to the way we do our job. During my tenure, the staff of the Fort Worth Regional Office has performed with dedication and diligence, and with an aggressiveness and integrity that has earned for it a true partnership with its criminal agency counterparts. In fact, the Justice Department has commended us for our ``remarkable collaboration'' with them. This fiscal year alone, investigations by the FWRO staff have resulted in criminal charges against 14 individuals, and many members of our staff now serve as special Federal prosecutors, assisting in the prosecution of important criminal cases. Since last year, in addition to their regular case-loads, Fort Worth's 25 staff attorneys have filed 19 emergency actions in Federal court, preserving millions of dollars stolen from investors.

While we certainly believe that our recent efforts have enhanced the Commission's ability to protect investors, we must not forget the painful lessons taught to us by past mistakes. The team that is leading us now has done much and is prepared to do more. I have every confidence that Chairman Schapiro and Directors Khuzami and di Florio will continue to shape an agency that will stand as a bulwark for the investing public.

Status of the Stanford Case

Mr. Khuzami has summarized the status of the current litigation. I wanted, however, to highlight a few additional points.

Status of Ongoing Investigation

Immediately after filing the civil action, my staff worked closely with the Justice Department to ensure that responsible executives of Stanford were brought to justice. We aggressively continued our investigation, aided by access to Stanford financial records and other key documents obtained by the Receiver, and access to key employees in Stanford's auditing and accounting departments. Our work allowed us to understand how Stanford manipulated its financial documents to further the scheme. In particular, my staff played a critical role in securing the cooperation of James M. Davis, Stanford Financial Group's Chief Financial Officer. We developed critical evidence in support of the allegation that Leroy King, Antiguan's head of the Financial Services Regulatory Commission, conspired with Stanford and obstructed the Commission's efforts to investigate Stanford over many years. Our work assisted the criminal authorities in filing a criminal case in June 2009 and was recognized by Assistant Attorney General Lanny A. Breuer as ``resilient dedication.''

I have directed my staff to continue our investigation of the Stanford matter to determine if other executives and employees at Stanford deceived U.S. investors in the sale of fraudulent certificates of deposit. Over the course of the past 12 months, we have collected and reviewed tens of thousands of documents; reviewed e-mail communications of more than 150 former employees; interviewed and taken sworn statements of more than 60 former employees and other witnesses; and interviewed approximately 200 victims of the Stanford fraud. We have worked with the Stanford Victims Coalition, State regulators, and FINRA to gather relevant information and evidence to further this important investigation.

We have, through our Wells Process, notified several former Stanford executives that we intend to recommend fraud charges against them. These persons include former high level executives and financial advisors. Our investigation of these matters is continuing, as are our efforts to maximize the recovery for the Stanford victims.

Status of Recovery

Upon filing its civil action in February 2009, the SEC filed a motion requesting that the district court appoint a Receiver over the defendants' assets (including over 100 Stanford-related entities operating around the world) to prevent waste and dissipation of those assets to the detriment of investors. While a Receiver was a necessary tool in this case, the SEC has closely monitored the receivership to help maximize investor recovery. To complement the Receiver's efforts, the SEC, in coordination with the Justice Department, moved to secure assets held in international financial institutions. Securing assets in international jurisdictions poses complex litigation challenges, and those challenges have been magnified in this case by, among other issues, the appointment in Antigua of a competing Receiver that has not cooperated with the staff and that, in fact, has challenged various steps taken by the Receiver, the SEC and the Justice Department. But, securing international assets was crucial to ensure the protection of investor funds and we continue to work closely with the Receiver, Justice Department, and securities regulators and law enforcement agencies in the U.K., Switzerland, Canada, Mexico, and in several countries throughout Central and South America, to identify, secure, and repatriate for the benefit of investors over $300 million in cash and securities held in non-U.S. bank accounts.

Mr. Khuzami has set forth categories and amounts of assets recovered for possible distribution to harmed investors. While I will not repeat those items again here, I want to point out that we have worked vigorously with the Receiver to recover assets in Panama, Ecuador, Colombia, Venezuela, Peru, and Mexico.

In conjunction with the SEC, the Receiver is focused on identifying and liquidating the largest possible pools of assets to prepare for a future distribution to harmed investors. In addition, the SEC has recently worked with other involved parties in the creation of an investor committee to provide an additional mechanism for investor input as to the receivership operations.

Throughout this case, the SEC has worked closely with a court-appointed Examiner to monitor the Receiver's costs and ensure maximum recovery to the victims of this massive fraud. These efforts have had tangible benefits. For example, the Receiver and the professionals assisting him have reduced their customary fees by at least 20 percent and have capped the rates charged by senior lawyers. In addition, we carefully scrutinize the Receiver's bills for fees and expenses. In fact, in response to our objections, the district court has held back, on an ongoing basis, an additional 20 percent from the Receiver's fees and expenses. We have strongly urged the Receiver to stringently apply a cost-benefit analysis and pursue only those legal claims that could generate maximum proceeds for the benefit of investors while minimizing the Receiver's legal fees and expenses. As with our monitoring of the Receiver's fees and expenses, the SEC has intervened when it believed the Receiver was pursuing inappropriate claims. For example, the SEC challenged the Receiver's lawsuits seeking net profits from innocent investors. Conversely, when the Receiver properly pursues assets, we intervene in support of that effort where appropriate. For example, the SEC recently submitted an amicus brief in the Fifth Circuit supporting the Receiver's efforts to maintain a freeze over approximately $24 million in accounts held by former Stanford financial advisers. We will continue to be closely involved with the Receiver's activities.

Status of SIPC Coverage

As you know, the Commission oversees the activities of the Securities Investor Protection Corporation. Prior to the emergency filing of the Stanford action, I directed my staff to contact SIPC, notify them of the proposed enforcement action and consider whether coverage under SIPA would be appropriate under the facts and circumstances of this case. Since the filing of this action, we have communicated with counsel for the Stanford Victims Coalition regarding its position with respect to SIPC coverage and assisted them where possible. My staff has also responded to informational requests and worked with the Commission's Division of Trading and Markets in its evaluation of the relevant facts of this case. I understand that the Commission continues to investigate whether SIPC coverage is appropriate for the victims of the Stanford fraud.

Reforms

In an effort to reform and improve its Programs, the Fort Worth Regional Office has worked to integrate its broker-dealer and investment adviser examination programs and to build strong collaboration ties between its Enforcement and Examination staff.

Exam Program Integration

During the past 4 years, the FWRO has worked to integrate the activities of its broker-dealer and investment adviser examination programs. In late 2006, it was clear that we could not adequately oversee an increasingly integrated registrant population, unless we brought to each examination the right skills and expertise to effectively review a firm's business activities, whether those were advisory activities, brokerage activities or some combination thereof. We immediately took action to: (1) break down the long-standing silos that divided the investment adviser and broker-dealer exam programs; (2) provide cross-training opportunities for exam staff to allow them to expand their knowledge and experience; (3) routinely employ joint teams of exam staff drawn from both sides of the program; (4) employ strategic techniques to quickly assess risks to investors, especially at firms who operate as both a broker dealer and an investment adviser; and (5) significantly increase the level of coordination and collaboration across the program. In 2009, the FWRO moved to a fully integrated examination program with investment adviser, broker-dealer and some fully crosstrained examiners working together under managers responsible for the program as a whole rather than two distinct programs. This formalized integration has allowed us to use staff expertise more strategically, in conformity with the new OCIE initiatives.

Collaboration Between the Examination and Enforcement Programs

Another top priority has been to build collaboration and teamwork across the examination and enforcement programs, so that we are better able to find fraud and significant problems through examinations and quickly take action to stop the fraud and protect investors. We have taken a number of specific actions to increase coordination between exam and enforcement staff, starting with collaboration between senior management across the office. The success of this increased collaboration, as well as the integration of the examination program, can be measured by the accomplishments we have achieved. For example, the percentage of enforcement cases brought by the FWRO resulting from examination referrals to Enforcement has increased from 12 percent in fiscal year 2005 to 38 percent in fiscal year 2009.

Conclusion

The Fort Worth Regional Office is dedicated to protecting investors and aggressively pursuing those who defraud them. We thank you for the

and aggressively pursuing those who defraud them. We thank you for the opportunity to appear before you today. I would be pleased to answer your questions.

RESPONSES TO WRITTEN QUESTIONS OF CHAIRMAN DODD
FROM ROBERT KHUZAMI AND CARLO V. DI FLORIO

Q.1. Dealing with managerial ``Bad Apples''. Mr. Khuzami/di Florio, the Inspector General's report found that the former head of Enforcement in Fort Worth, who played a significant role in multiple decisions over the years to quash investigations of Stanford, sought to represent Stanford on three separate occasions after he left the Commission, and in fact represented Stanford briefly in 2006 before he was informed by the SEC Ethics Office that it was improper to do so. How does your Division prevent abuse of discretion by senior staff such as this? What are the current relevant policies and how are they enforced?

A.1. We share your concern about ethical violations by any SEC personnel. With respect to the conduct of the former Head of Enforcement in the Fort Worth Regional Office, it appears that this individual twice contacted the SEC Ethics Office and inquired about his ability to represent Stanford. On both occasions, he was told that such representation was not permitted. When he contacted his former colleagues in the Fort Worth Regional Office, they too questioned the appropriateness of his involvement. These circumstances indicate that Fort Worth personnel were sensitive to the ethical issues presented, and that the Ethics Office gave the appropriate advice. The fact that the individual, at some point in that process, may have disregarded some or all of that advice and billed Mr. Stanford for approximately twelve hours of representation is unacceptable. We can never guarantee, however, that former SEC personnel will comply with ethical advice that they have received from the Commission. While we have not undertaken a survey of the actions of all former SEC personnel, we are not aware of another instance where this has occurred. We also understand that the former Head of Enforcement in the Fort Worth Regional Office has been referred to the proper State bar committee based on his actions in representing Mr. Stanford.

As a general matter, all employees and members of the SEC are bound by Government-wide postemployment restrictions based on Section 207 of Title 18 of the U.S. Code. This statute contains several postemployment restrictions, including a permanent bar on representations and appearances before the Commission on any matter in which a former employee or member participated, personally and substantially, while at the Commission; a 2-year bar on representations and appearances before the Commission on matters that were under the former employee's official responsibility while at the Commission; and a 1-year ``cooling off'' period for former senior officials which prohibits communicating with or appearing before the agency on any matter on behalf of another with an intent to influence. In addition, the SEC has enacted supplemental ethics regulations which require former employees and members, within 2 years of leaving the agency, who are employed or retained as the representative of any person outside the Government in any matter in which it is contemplated that he or she will appear before the Commission, or communicate with the Commission or its employees, to file with the agency for clearance to do so.

In addition, the Government-wide standards of conduct contain provisions that prohibit any current Federal employee from working on a matter in which someone with whom he is seeking employment is, or represents, a party to the matter. Further, Section 208 of Title 18 of the U.S. Code prohibits any Federal employee from working on any matter that could have a direct and predictable effect on the financial interests of someone with whom he is negotiating for employment.

In addition, due to the unique work of the exam staff that requires them to spend considerable time on-site at regulated entities, the Office of Compliance, Inspections, and Examinations (OCIE) has in place ethics guidelines specific to the examination program. This guidance covers various potential personal and financial conflicts of interest, as well as circumstances that may create the appearance of a conflict of interest. The goal of OCIE's guidance is to ensure that examiners do not engage in conduct that could create even the appearance of a personal or financial conflict of interest related to an examination. OCIE provides mandatory annual training on its ethics guidelines to all examination staff. In addition, OCIE managers conduct exit interviews with departing examiners to evaluate if any potential conflicts of interest could arise based on the examiner's new employment and to discuss with the examiner any restrictions on the examiner's ability to work on SEC examination matters based on those potential conflicts.

Q.2. How will SEC funding increase impact SEC work? Mr. Khuzami/di Florio, the Dodd-Frank Act authorizes the SEC budget to double by 2015. That will be an increase from $1.1 billion in 2010 to $2.25 billion in 2015. How would this large increase in funding improve the enforcement, compliance and Ft. Worth Office efforts to protect investors?

A.2. Although Section 991 of the Dodd-Frank Wall Street Reform and Consumer Protection Act increases the authorized level of funding for the SEC, the actual level of funding will depend upon the appropriations Congress provides over the next several fiscal years. Recently, the SEC's House and Senate appropriations subcommittees each marked up bills that would provide the agency with an FY2011 appropriation of $1.3 billion. If enacted, this funding level would allow us to build out new oversight programs for derivatives, private funds, credit rating agencies and other requirements imposed by the Dodd-Frank Act. The funding would also help enhance the SEC's base program capabilities. Notably, the enforcement program would add 45 positions, a portion of which would go to strengthen its new Office of Market Intelligence that handles the thousands of tips, complaints, and referrals the agency receives each year. The SEC also would hire 67 new personnel in its examination program to augment its risk assessment, monitoring, and surveillance functions and conduct additional adviser and fund inspections.

It is worth noting that pursuant to the funding reforms adopted in Section 991 of Dodd-Frank, whatever amount we are appropriated would be fully offset by matching fee collections.

Q.3. Will staff provide ongoing progress reports to Committee? Mr. Khuzami/di Florio, in order for the Committee to remain apprised of efforts that the Commission is taking to improve its effectiveness, would you provide this Committee with reports every three months describing your efforts to prevent problems similar to those raised by the Stanford fraud?

A.3. We are happy to provide any updates requested by Chairman Dodd or the Committee. We understand that Chairman Schapiro intends to coordinate with Enforcement and OCIE to provide updates to the Committee approximately every three months until the recommendations from the Inspector General's Report on Stanford are closed.

Q.4. Issues from Emphasis on ``Stats''. Mr. Khuzami, the Inspector General Report found evidence that

> SEC-wide institutional influence within Enforcement did factor into its repeated decisions not to undertake a full and thorough investigation of Stanford, notwithstanding staff awareness that the potential fraud was growing. We found that senior Fort Worth officials perceived that they were being judged on the numbers of cases they brought, so-called ``stats,'' and communicated to the Enforcement staff that novel or complex cases were disfavored. As a result, cases like Stanford, which were not considered ``quick-hit'' or ``slam-dunk'' cases, were not encouraged.

Have you conducted or will you conduct a review of whether other cases at other SEC Offices were passed over because they were deemed ``too difficult'' and share the results with the Committee?

A.4. There is no reason to believe that any matter has been declined because it was ``too difficult'' in the absence of careful evaluation of the facts, evidence, and legal issues presented. The Enforcement Division has a series of robust systems and procedures in place to assure that matters receive appropriate investigative attention. Each region has a case review process that includes, among other things, discussions between supervisors and members of each investigative team in order to perform a detailed review of ongoing matters.

In addition, there is a Division-wide quarterly case review protocol that involves an evaluation of all matters under investigation. As part of the protocol, topics for discussion include investigative planning, staffing considerations, techniques to gather evidence, quality of evidence, relevant legal theories and appropriate investigative steps. Quarterly case reviews are conducted at the staff-Assistant Director level; the Assistant Director-Associate Director level; and between the Director and Deputy Director with the Associate Directors and Regional Directors at each Regional Office and the Home Office.

In these reviews, we discuss performance metrics with individual senior officers, including both quantitative and qualitative factors. We assess qualitative factors to insure that we give proper recognition to the challenges that certain cases present, so that staff members receive due credit and are not penalized for taking on difficult cases. This recognizes that there are many worthwhile cases that present unique challenges, such that they will take longer, and more resources, to bring, and that this fact should be taken into account in assessing performance. The qualitative factors we consider include (i) investigative creativity and perseverance (overcoming unique challenges and vigorous defenses, adoption of successful investigatory strategies that lead to resource efficiencies or that avoid pitfalls and hurdles, persistence that uncovers or develops critical evidence); (ii) unique or particularly effective deterrent message in the case; (iii) breadth of misconduct, harm and victims, including vulnerable victims; (iv) involvement of persons occupying substantial authority, responsibility, or fiduciary obligations; (v) case of first impression (violative of newly enacted legislation, or new or previously unprosecuted products, transactions or practices); (vi) challenging coordination issues with other law enforcement authorities; (vii) novel or complex legal issues; (viii) large number of defendants or violations; and (ix) number of defendants and amount of monetary recovery, bars and other relief.

Additionally, the clear message from Division leadership is to escalate matters of concern. We also have established an e-mail-based suggestion box that provides a forum for staff and managers to submit comments and suggestions if desired on an anonymous basis. The suggestion box is monitored on a weekly basis and provides a direct link to Division leadership.

The cases filed by the Enforcement Division in the past approximately 18 months reflect the fact that cases are not declined because of a fear of difficulty. They have been complex and challenging investigations, and certainly do not result in ``quick hits.'' Examples include investigations involving wrongdoing in the areas of complex mortgage-related securities and disclosure (Countrywide, New Century, Beazer Homes, American Home Products), COOs and other structured products (Goldman Sachs, ICP), complex insider trading (Galleon), intricate accounting fraud (Bally/E&Y, AIG, Dell, Diebold, GE), TARP fraud (Colonial Bank), nondisclosure of subprime risk (Citigroup, State Street Global Advisors, Evergreen, Morgan Keegan), interdealer market manipulations (ICAP), municipal securities violations (State of New Jersey), and Ponzi Schemes (Petters). Included in the list are cases brought by the Fort Worth Regional Office, including Acxiom (insider trading), Home Solutions (financial statement fraud and related-party transactions), Perot Systems (insider trading case brought in two days following tip), and Lightspeed (short sale order violations). This list is evidence that the message currently being communicated to the staff is that cases are not to be avoided because they present difficult investigative challenges.

Q.5. Emphasis on ``Stats'' and Easy Cases. Mr. Khuzami, the Inspector General's Report found evidence of an SEC-wide institutional influence against novel or complex cases during the period under investigation. As a result, cases like Stanford, which were not considered ``quick-hit'' or ``slam-dunk'' cases, were not encouraged. This is a poor practice and appears to mean that investors lured into more complex frauds were less protected than others. Such a practice sends a signal to potential fraudsters that if you veil your crime well, the SEC will not come after you.

Please describe the genesis of the emphasis on ``quick-hit'' and ``slam-dunk'' cases. When did the Commission stop this practice? Please describe the current policy.

A.5. The Enforcement Division has emphasized the importance of pursuing investigations and cases with a high deterrent impact that involve complex schemes. Senior management designates select investigations as National Priority investigations. These matters involve cases of programmatic importance, where the alleged misconduct could significantly undermine the integrity of the U.S. securities markets, or disproportionately harm a broad number of investors, or is of a significantly egregious or extensive nature, or involves wrongdoing by persons occupying positions of substantial authority or responsibility. We are developing a series of robust metrics to capture the quality of cases and investigations in the Division. These metrics allow us to evaluate the workload, productivity, quality, timeliness, and efficiency of the Division's investigative and litigation efforts. By tracking the progress of each ongoing matter in the Division, we are better able to pursue matters across a broad spectrum of potential violative conduct.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR SHELBY
FROM ROBERT KHUZAMI AND CARLO V. di FLORIO

Q.1. Mr. Khuzami/di Florio, your testimony was made explicitly on behalf of the SEC, whereas Ms. Romero did not state that she was speaking for the SEC. Are there aspects of Ms. Romero's testimony at this hearing or last year's hearing on the Stanford fraud that the SEC does not stand behind? If so, what are they and why?

A.1. On September 22nd, we each testified in response to the September 15th invitation from the Senate Committee on Banking, Housing, and Urban Affairs to Mary Schapiro, Chairman of the SEC. The invitation allowed Chairman Schapiro to testify personally, or designate individuals to testify on behalf of the Commission. In that manner, our statements were offered as Commission witnesses before the Committee. We understand that Ms. Romero was a witness designated by the Minority for invitation to the hearing, and thus testified in response to the Committee's request for her individual testimony. In any event, prior to the testimony, the Commission reviewed and approved the written testimony submitted to the Committee by Ms. Romero, as well as the written testimony submitted by us.

Q.2. Mr. Khuzami/di Florio, aside from Commission-wide reforms you described in your testimony, have you discovered any problems unique to the Fort Worth District Office that you are addressing with solutions tailored to that office?

A.2. As you know, in 2010, the Division of Enforcement completed its comprehensive internal review and subsequent structural reforms--the most Significant in four decades. Similarly, OCIE has undertaken a top to bottom review of OClE's strategy, culture, people, processes, and technology. Throughout these reviews, all members of OCIE and Enforcement, including those in the Fort Worth Regional Office, were encouraged to submit their ideas for enhancing the programs and processes of OCIE and Enforcement.

One area of improvement identified by our Forth Worth examiners is the need to enhance collaboration between examination and enforcement staff, particularly on matters that could give rise to an enforcement referral. As you know, the SEC's Inspector General also identified this as an area in which we could improve. OCIE and Enforcement are working together to develop collaborative relationships and improve coordination on examination referrals to enforcement.

Further, as recently reported in the press, some personnel issues have been identified that appear to be unique to the Fort Worth Regional Office. OCIE senior management is continuing to monitor and evaluate the operations and culture of the Fort Worth Regional Office to ensure the change process includes any solutions that should be specifically tailored to the Fort Worth Regional Office.

Q.3. Mr. Khuzami, at the hearing, you contended that the ``stats'' culture that contributed to the failure by the Fort Worth District Office's failure to pursue an enforcement action against Stanford is a relic of the past. Nevertheless, several hours later, at a hearing before the Senate Committee on the Judiciary, you touted the Enforcement Division's statistics--634 enforcement actions brought so far this year. As you acknowledged, cases brought by the SEC include some very complex cases and some more simple cases. Moreover, an incredibly complex enforcement action that is based on an internal investigation might involve less work than an apparent simpler case. If the head of the Enforcement Division touts numbers of cases as a measure of achievement, how can regional offices of the SEC be expected to assume that they will not be measured on the numbers of enforcement actions they generate?

A.3. The clear and unambiguous message from the leadership of the Enforcement Division has been to emphasize the importance of high-quality investigations with maximum deterrent impact. Managers and staff repeatedly have been assured that they will not be evaluated simply on the basis of quantitative statistics. We are introducing a series of metrics to capture this principle, including metrics designed to measure the workload, productivity, quality, timeliness, and efficiency of the Division. In addition to these metrics, Division leadership designates select investigations as National Priority cases. These include, among others, cases of programmatic importance, where the alleged misconduct could significantly undermine the integrity of the U.S. securities markets, or disproportionately harm a broad number of investors.

At the same time, it is important to have a vibrant and robust enforcement program across various types of cases that may involve large, smaller, complex, and simpler matters. Quantitative measures are therefore not irrelevant. If by tracking quantitative measures one learns that there has been a sharp increase (or decrease) in the number of cases filed, or in how long it takes to file a case, that is an important data point to discuss with a senior officer. There may well be a perfectly appropriate explanation for the change (an unusually large number of complex cases, more cases than expected proceeded to trial rather than settled, delay due to obtaining overseas evidence, etc.), but it is important to ask the question to understand why the change occurred. That is the proper use of metrics--as a starting point upon which to further inquire. What must be avoided, and what we do not do, is to present quantitative targets or quotas. Indeed, I have given out awards during this past year for cases that took a great deal of time and resources to investigate, and that we ultimately declined to pursue. That certainly sends the message that persons are not evaluated and rewarded based on the number or ease of cases.

My testimony was entirely consistent with this approach. For example, I described the number of enforcement actions, the amounts of ordered disgorgement and penalties, and the numbers of asset freezes and emergency temporary restraining orders. I also highlighted that the Division had, thus far, distributed nearly $2 billion to injured investors. At the same time, I emphasized the complex, wide-ranging and programmatically significant casework of the Division, including descriptions of nearly twenty cases involving mortgage-related securities, structured products, institutional market abuses, financial fraud, municipal securities, undisclosed executive compensation and other types of securities law violations. I also described our continued cooperation and coordination efforts with criminal and other regulatory authorities; our internal process reforms and management streamlining; our new initiatives to identify securities fraud; and new tools provided under the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Q.4. Mr. Khuzami, I understand that you have instituted a number of structural changes and procedural changes in the SEC's Division of Enforcement. Real change, however, will only come if the culture in your division changes. People need to know that they will be recognized for bringing good cases and dropping bad ones. A good case might be a small dollar case that prevents many small investors from getting defrauded down the road. If SEC employees perceive that they will only be recognized for enforcement matters that involve household name companies, that is where they will focus their attention. What are you doing to change the culture of your Division?

A.4. As noted in my answer above, throughout the Division senior management emphasizes the importance of high-quality investigations rather than simply the number of investigations or enforcement actions. Similarly, the Enforcement staff works diligently to detect, deter, and obtain strong remedies in response to unlawful conduct regardless of the notoriety, or lack of notoriety, of the entity involved in the misconduct. As described above, we have instituted a robust quarterly case review protocol that involves an evaluation of all matters under investigation. As part of the protocol, topics for discussion include investigative planning, staffing considerations, techniques to gather evidence, quality of evidence, relevant legal theories and appropriate investigative steps. Quarterly case reviews are conducted at the staff Assistant Director level; the Assistant Director-Associate Director level; and between the Director and Deputy Director with the Associate Directors and Regional Directors at each Regional Office and the Home Office. The message within and beyond the Division is clear: we are focused on timely detecting and preventing securities law violations in order to protect investors and deter unlawful conduct.

Q.5. Mr. Khuzami, the SEC's revised performance metrics do not seemed designed to encourage enforcement staff to work on cases like Stanford early enough to prevent investor harm. The factor seems to push staff toward pursuing cases that involve violations prohibited under new laws, violations that pose systematically important risks, or violations in so-called ``priority areas'' that the SEC is emphasizing at the particular time. Ponzi schemes are a very old form of fraud that often target middle class investors using boring investment products, like the supposed certificates of deposit that Stanford was selling. These cases may not involve cutting-edge legal arguments, but marshaling of evidence may be difficult. What are you doing to ensure that sufficient SEC resources are devoted to detecting and shutting down plain vanilla frauds that target ordinary Americans before those frauds swell to the size of the Stanford fraud?

A.5. As noted in my response above, the Division focuses on quality cases across the spectrum of potential securities law violations. Offering frauds and Ponzi schemes, which are described in the question as ``a very old form of fraud,'' continue to evolve and remain an important focus of our enforcement program. In FY2010, offering frauds comprised approximately 22 percent of the cases brought by the Commission. In these actions, the Commission seeks to freeze assets, where possible, in order to maximize the recovery to investors and prevent new investors from being harmed.

For example, in an action expedited by Enforcement's newly created Asset Management Unit, the SEC charged a New Jersey-based investment adviser, Sandra Venetis, and three of her firms with operating a multimillion dollar offering fraud involving the sale of phony promissory notes to investors, many of whom were retired or unsophisticated investors. Venetis falsely stated that the promissory notes were guaranteed by the FDIC, would earn a high rate of interest and would be used to fund loans to doctors. In April, the Commission charged a prominent Miami Beach-based businessman and philanthropist, Nevin Shapiro, with fraud for orchestrating a $900 million offering fraud and Ponzi scheme involving the sale of securities that Shapiro claimed would fund his company's grocery diverting business, were risk-free, and had rates of return as high as 26 percent annually. The SEC also filed an emergency asset freeze and fraud charges against Daniel Spitzer, a purported fund manager based in the U.S. Virgin Islands, who perpetrated a $105 million Ponzi scheme against 400 investors. Spitzer's investors were promised that their money would be invested in funds that would be invested in foreign currency with annual returns that could reach over 180 percent.

Even recently, in an emergency action filed on October 6, 2010 against Imperia Invest IBC, the Commission obtained a temporary restraining order and emergency asset freeze against Imperia for defrauding more than 14,000 investors worldwide. The Commission's complaint alleges that Imperia solicited investor funds via the Internet; promised returns of 1.2 percent per day; and raised in excess of $7 million, $4 million of which was collected primarily from deaf investors in the United States. The Commission's complaint alleges that Imperia took proactive steps to conceal the identity of its control persons by using an anonymous browser to host its Web site, by communicating with all investors via e-mail without disclosing the identity of the control persons, and by establishing offshore PayPal style bank accounts to conceal the identity of the recipient of the investment proceeds. Despite these challenges, the case was filed without the typical evidence in an offering fraud, including knowledge of the identity of the perpetrators. Rather than being stymied by this absence of proof, or taking weeks or months to gather it, we developed a theory that did not rely on this proof, and moved quickly because we suspected that investors were being defrauded on an ongoing basis. Even on these unique facts, the Division was able to act swiftly to halt the fraudulent offering activity, and seek a court order to secure assets related to the offering.

The many things we are doing to ensure that sufficient resources are focused on detecting and preventing Stanford-type frauds have resulted in: improved collection, investigation and referral of tips, complaints and referrals through our newly created Office of Market Intelligence; increased communication with the Office of Compliance, Inspections and Examinations (OCIE), including joint inquiries and escalation procedures to resolve differences over referrals; greater sensitivity in Ponzi scheme investigations to factors such as outsized investment returns, absence of volatility and related-party transactions; an increased number of executed Memorandums of Understanding with foreign governments to facilitate the securing of evidence in foreign jurisdictions; and improved access to ``insider'' evidence of wrongdoing, including our new cooperation initiative and the Dodd-Frank whistleblower legislation.

RESPONSES TO WRITTEN QUESTIONS OF CHAIRMAN DODD
FROM ROSE L. ROMERO

Q.1. Dealing with managerial ``Bad Apples''. Ms. Romero, the Inspector General's report found that the former head of Enforcement in Fort Worth, who played a significant role in multiple decisions over the years to quash investigations of Stanford, sought to represent Stanford on three separate occasions after he left the Commission, and in fact represented Stanford briefly in 2006 before he was informed by the SEC Ethics Office that it was improper to do so. How does your Office prevent abuse of discretion by senior staff such as this? What are the current relevant policies and how are they enforced?

A.1. During my tenure with the SEC, I have personally participated in the periodic review of all cases within the FWRO. These reviews function, in part, to prevent any single individual from having the sole discretion to close an investigation. Also, Rob Khuzami has instituted additional procedures that require, each quarter, that every level of management (assistant directors, the enforcement associate and the regional director) conduct a detailed review of all matters being handled by their staff. Subsequent to these reviews, Mr. Khuzami personally conducts a review of pending matters with the Regional Director and the Associate Director of Enforcement.

In regard to the conduct of the former head of Enforcement, it should be noted that when the FWRO staff learned that Stanford had retained this individual in 2006, the staff immediately objected to the representation. Shortly thereafter, he ceased all work in connection with the investigation. My staff is trained each year on their ethical obligations in connection with seeking outside employment and their duties regarding the permissible range of post-SEC employment.

Q.2. Issues from the Emphasis on ``Stats''. Ms. Romero, the Inspector General Report found evidence that ``SEC-wide institutional influence within Enforcement did factor into its repeated decisions not to undertake a full and thorough .investigation of Stanford, notwithstanding staff awareness that the potential fraud was growing. We found that senior Fort Worth officials perceived that they were being judged on the numbers of cases they brought, so-called `stats,' and communicated to the Enforcement staff that novel or complex cases were disfavored. As a result, cases like Stanford, which were not considered `quick-hit' or `slam-dunk' cases, were not encouraged.''

Have you conducted or will you conduct a review of whether other cases at your Office were passed over because they were deemed ``too difficult'' and share the results with the Committee?

A.2. As noted in the answer to the previous question, the management of our office continuously reviews matters to insure that they are handled appropriately. I personally participated in frequent reviews of pending matters, and have done so since coming to the Commission in 2006. I am unaware of any matter that was not pursued because it was perceived as ``too difficult.'' I have attached hereto a brief description of complex cases handled by the Fort Worth office beginning in 1998. As you review this document, you will see clearly that the Fort Worth staff frequently has tackled difficult and significant matters and has obtained outstanding results.

Q.3. How will SEC funding increase impact SEC work? Ms. Romero, the Dodd-Frank Act authorizes the SEC budget to double by 2015. That will be an increase from $1.1 billion in 2010 to $2.25 billion in 2015. How would this large increase in funding improve the enforcement, compliance and Ft. Worth Office efforts to protect investors?

A.3. While I am not in a position to predict the nationwide impact of the above-referenced budget increases, additional resources would, from a regional perspective, no doubt, enhance the Commission's enforcement and examination programs. Simply put, I believe that the additional resources will enhance the Commission's ability to protect U.S. investors.

Every day, managers in the SEC's Enforcement Division and Office of Compliance Inspections and Examinations are required to make difficult choices about which investigations and examinations to prioritize. Under the leadership of Director Khuzami and Director di Florio, the Enforcement Division and OCIE have implemented procedures designed to identify investigations and examinations that can best protect the greatest number of investors. That said, the scope of the SEC's jurisdiction is daunting. And increased resources will enable regional managers to effectively carry out their mission.

Q.4. Comment on Post article on the Fort Worth District Office. The Washington Post, in an article entitled ``SEC's regional offices present managerial problems, become an obstacle to reform'' published on June 10, 2010, reported that some years ago the SEC Fort Worth office changed how it performed inspections and this ``opened a rift between Fort Worth managers and staff that continues today, undercutting the effort by SEC leaders in Washington to rebuild the agency and promote coordination after years of setbacks, according to current and former SEC officials and internal agency documents, including three separate reports by the SEC's inspector general.''

Ms. Romero, would you comment on this assertion based on your knowledge?

A.4. During the time period referenced in the Washington Post article, the FWRO's examination staff of 40 was responsible for examining more than 735 investment advisers, 350 broker-dealers, and 15,000 branch offices. This significant resource mismatch meant that many of these registrants would likely never be examined. Moreover, the financial services industry and our registrant population, is becoming increasingly integrated--with firms and individual representatives routinely offering both investment management services and also selling products to those same clients and acting as a broker-dealer--presenting significant conflicts of interest and heightened regulatory risks.

Accordingly, the FWRO examination staff, in consultation with the OCIE's senior management at SEC headquarters, developed a pilot, risk assessment program designed to more efficiently assess risks to investors by obtaining basic information about a firm's business activities and controls through document reviews and on-site interviews of senior officers and other key staff. OCIE's National Examination Program now uses certain information gathering techniques based on the principles of this pilot program to conduct risk assessments of firms registered with the Commission to determine candidates for examination.

Despite the market realities associated with examining such a sizeable registrant population and the clear need for a better approach to assessing risk, two FWRO managers strongly objected to the program. Nonetheless, the examination staff, working as a team with managers, put in place a highly successful risk assessment program. Moreover, examiners and managers have effectively broken down the long-standing ``silos'' that previously existed between the broker-dealer and investment adviser exam teams as well as between exam and enforcement staff. These collective efforts have allowed us to quickly identify and halt fraudulent activities. The increase (from 2005-2010), in the number of enforcement cases that stemmed from examination referrals clearly demonstrates that our efforts to build a more cohesive team have resulted in significant improvements for the benefit of investors.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR SHELBY
FROM ROSE L. ROMERO

Q.1. When did you first learn that there were Potential problems at Stanford? As Director of the SEC's Fort Worth Office, what was your role with respect to deciding whether and when to bring enforcement actions related to the Stanford fraud?

A.1. I first learned of potential problems at Stanford in early 2006, shortly after my arrival at the SEC from the Department of Justice. At that time, the FWRO staff was working with the SEC's Office of International Affairs in an effort to obtain information from Antiguan authorities, about Stanford International Bank, Ltd. The staff also had contacted other Federal agencies in hopes of leveraging any information they might have about the bank. In June of 2006, I authorized the FWRO staff to seek formal order authority from the Commission so that the staff could compel documents and testimony from Stanford-related entities and individuals.

After an extensive review by the SEC's divisions and offices, the Commission authorized the issuance of a formal order of investigation in October of 2006. As noted in the Inspector General's June 19, 2009, report, the FWRO staff, following issuance of the formal order, actively investigated Stanford's bank and its principals, including the review of thousands of pages of documents produced by Stanford Group Company, an SIBL-affiliated broker-dealer and investment adviser located in Houston, Texas.

By April of 2008, the FWRO staff concluded, based on information provided to the FWRO by former Stanford employees and the bank's refusal to produce documents and information, that the case was appropriate for a criminal referral. Accordingly, I authorized the FWRO staff to contact the Fraud Section of the Department of Justice. Following a meeting with DOJ in June 2008, DOJ and the FWRO staff decided that DOJ was better Positioned to uncover evidence of wrongdoing at the Antiguan-based bank. In December of 2008, the DOJ and FWRO staffs jointly concluded that a parallel investigation was appropriate. As a result of our staff's efforts, I was able to authorize the staff to seek authority to file an emergency action in mid-February 2009.

Q.2. In advance of your testimony in August 2009 before this Committee, were you ever asked to limit your testimony to avoid revealing the length of time between the Fort Worth office's original suspicions of fraud at Stanford in 1997 and the SEC's filing of an emergency action to halt the fraud? If so, from whom did this request come?

A.2. I was not asked to avoid revealing any information.

Q.3. The Inspector General's report describes some very commendable performances by employees in your office and some very poor decision making by others. Are you taking, or have you taken, any personnel actions B positive or negative B in response to the Inspector General's report?

A.3. In recognition of their around-the-clock efforts and fortitude in overcoming efforts to obstruct the investigation by Stanford and his cronies, I nominated the attorneys, examiners and managers that completed the investigation for a ``Director's Award.'' On my recommendation, Robert Khuzami, Director of the Division of Enforcement, issued the awards on July 1, 2010. As to those individuals that were involved in examining and investigating SIBL and its affiliates prior to my arrival at the SEC, it is my understanding that a review of the Inspector General's recommendations is being conducted by SEC's headquarters.

Q.4. During the hearing, you mentioned the efforts that are being made to collect additional assets for the benefit of the Stanford victims. It appears, however, that assets collected will fall far short of investor losses. Based on collections to date and reasonably likely additional collections, how many cents per dollar invested do you anticipate defrauded investors will receive?

A.4. It is difficult to provide an accurate estimate in response to this question, given that a variety of factors influence the return defrauded investors may receive. For example, while a pro rata distribution among investors is common, the details of any distribution (including how claims by investors will be treated in comparison to claims by other creditors) will be known only after a claims process and distribution process have been proposed to and approved by the district court. Moreover, it is difficult to estimate the amount of reasonably likely additional collections. For example, according to the Receiver, some assets are in the form of private equity that has a value not yet determined. Moreover, the Receiver has reported that a significant category of uncollected receivership assets is related to potential recovery in litigation against third parties.

While the Receiver believes there are valid claims in that litigation, it is simply not possible at this stage to know with any degree of certainty what receivership assets may result from that litigation. Additional details about that litigation, including the amount claimed, have been discussed in previous submissions, and I would happy to supplement this response with more details if doing so would be helpful. Unfortunately, regardless of the outcome of that litigation, as you note, it appears that available assets will fall far short of investor losses. Nevertheless, we continue to use every effort to work help make as many assets as possible available to defrauded investors.

Q.5. The receiver's July 2010 interim report stated that $185,000 had been spent in April 2010 alone on responding to the SEC, among others, in connection with Government investigations. These expenses ultimately diminish the amount of money available for defrauded investors. Has the SEC considered the steps that it can take to limit the expenses incurred by the receiver in assisting the SEC with the SEC's enforcement work?

A.5. Throughout this case, the SEC has worked closely with a court-appointed Examiner to monitor the Receiver's costs and ensure maximum recovery to the victims of this massive fraud. These efforts have had tangible benefits. For example, the Receiver and the professionals assisting him have reduced their customary fees by at least 20 percent and have capped the rates charged by senior lawyers. In addition, we carefully scrutinize the Receiver's bills for fees and expenses. In fact, in response to our objections, the district court has held back, on an ongoing basis, an additional 20 percent from the Receiver's fees and expenses.

Accordingly, we have worked with the Receiver to reduce any expenses associated with the SEC's ongoing investigations. For example, we worked with the Receiver to allow SEC staff to review voluminous hard copy documents stored by the Receiver with as little involvement (and expense) from receivership personnel as possible. We also earlier conferred with counsel to the Receiver to help minimize costs associated with examining voluminous electronic records that had potential relevance to both the SEC's ongoing investigations and possible third party receivership claims.

Recently, the staff obtained approval of a contract with the Receiver's forensic accounting firm under which the SEC will directly absorb the cost (rather than seeking reimbursement out of the receivership estate) for certain expenses incurred responding to requests for information from the SEC's staff in connection with ongoing enforcement-related investigations. It is our understanding that the Department of Justice has entered into a similar contract. As we do regarding a variety of expenses, we will continue to confer with the Receiver and his counsel to identify ways to minimize any expenses associated with responding to requests for information from Government agencies.