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U.S. SECURITIES AND EXCHANGE COMMISSION

BEFORE THE SENATE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
CONCERNING ALLEGED STANFORD FINANCIAL GROUP FRAUD: REGULATORY AND
OVERSIGHT CONCERNS AND THE NEED FOR REFORM

Chairman Dodd, Ranking Member Shelby, Senator Vitter and other Members of the Senate Banking Committee:

Thank you for the opportunity to appear today on behalf of the Securities and Exchange Commission ("SEC") to discuss certain information concerning the alleged fraud perpetrated at Stanford Financial Group ("SFG") and the SEC's procedures with respect to the handling of tips and complaints. I am submitting this written testimony on behalf of the Securities and Exchange Commission.

During our discussion today, please remember that both the Department of Justice and the SEC continue to have open investigations into this matter. Unlike other circumstances where we may be more at liberty to discuss all of a case's details at a Congressional hearing, our efforts to bring potential wrongdoers to justice in this case are still ongoing, and the defendant vigorously contests our allegations. It is critical at this point that I not say anything today that could compromise the Commission's ability to bring the wrongdoers to justice or to recover as many funds as possible for investors. The Commission's focus is on ensuring that harmed investors are recompensed, to the fullest extent possible. Because of this focus, and despite the fact that the Commission and its staff fully appreciate the importance of the questions raised by the Committee regarding our receipt of complaints and tips involving SFG, I may not be able to respond to all questions posed by Committee Members. Please understand that this is not an effort to avoid public discussion of Commission action or inaction, but is solely for the purpose of protecting the integrity of both our investigation and any resulting prosecution.

Before addressing the Committee, I would like to say that no one is satisfied with the circumstances as they occurred. Anytime investors are harmed, it is tragic. Many of the investors that lost their savings as a result of their Stanford investments have joined us here today. Going forward we must focus on bringing to justice the wrongdoers and preserving as many funds as possible for the harmed investors. The SEC is dedicated to protecting you, and we are pursuing this case -- and others like it -- with your interests in mind. It is the SEC's mission to zealously pursue those who defraud investors and to mitigate harm by ensuring that as much money as possible is returned to investors.

In this case, the SEC filed an emergency civil action in February of this year to halt sales of the Stanford CDs and seek the return of funds to investors. Shortly thereafter, the SEC filed an amended complaint alleging a massive Ponzi scheme in the sale of Stanford International Bank (“SIB”) CDs, naming R. Allen Stanford, James M. Davis and SIB, among others, as defendants. 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. But our 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. We 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 closely 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.

In June, the SEC also sued Leroy King, the former Administrator and Chief Executive Officer for the Antigua Financial Services Regulatory Commission (“AFSRC”), whom we allege Stanford bribed to help him conceal his fraud and thwart the SEC’s investigation. Our complaint contains detailed allegations describing the assistance provided by Mr. King to help Stanford with his fraud. According to our complaint, by structuring his fraud around foreign CDs issued from a foreign bank with the local regulator in his pocket, Stanford managed to keep his fraud alive for years despite active efforts to pursue him. In addition to our 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.

Complaints and Tips Concerning Stanford Financial Group and Contacts with Investors

As the Committee is aware, the SEC received a number of tips of different types over the years regarding Stanford and SIB CDs. The SEC followed up on these tips. The SEC’s current action against Stanford springs from an investigation opened by the Division of Enforcement in 2005, based on the concerns of the agency’s Office of Compliance Inspections and Examinations (“OCIE”) which examined the firm in late 2004. Prior to OCIE’s April 2005 referral to the Enforcement Division, OCIE and/or Enforcement staff reviewed at least four complaints that questioned SIB’s operations. One such complaint was received during the 2004-2005 examination. In response to this information, the SEC interviewed the complainant and, as noted above, reviewed the allegations as part of its ongoing examination of SGC’s U.S operations.

During the same time period, the SEC received information that SGC sales representatives may have misrepresented that the SIB CD was FDIC insured, and the SEC reached out to investors in the form of questionnaires and interviews. The SEC's staff in Fort Worth contacted approximately 140 investors to seek information that would help to assess these allegations. The investors generally confirmed that they had been receiving promised payments and did not have complaints.

The staff also contacted the AFSRC, the Stanford companies, and former SGC sales representatives. Leroy King, the head regulator at the AFSRC, assured the SEC that Antigua had conducted annual audits of SIB that confirmed SIB's compliance with safety and solvency requirements. The Stanford companies produced some limited documents but would not turn over any bank-related materials, which included records related to the certificates of deposit.

The Commission issued a formal order of investigation in October 2006, which gave the staff the authority to subpoena documents and testimony. SGC did not produce any bank related documents in response to the SEC subpoena, claiming any such documents were solely in the possession of SIB and located outside of the United States. SIB also refused to produce crucial documents, arguing that its CDs were not securities and, therefore, not within the SEC's jurisdiction. Likewise, SIB and the AFSRC argued throughout 2007 that SIB was precluded from producing any bank-related information by Antiguan bank secrecy laws. SIB's refusal to produce information effectively prevented the SEC from compelling meaningful investigative testimony from SGC executives because, without the underlying documents regarding the bank's assets, it would have been impossible to effectively examine Stanford and other executives.

In light of the jurisdictional and legal obstacles, the SEC staff focused its attention on information provided by former SGC employees. In April 2008, a former employee of SGC sent a complaint by e-mail to the SEC alleging fraud in the CD program. Although the former employee regretted that he had no proof of misconduct, the staff interviewed the witness immediately after receiving the email. The witness provided crucial information about, among other things, the whereabouts of documents relating to SIB's assets and red flags regarding SIB's accounting practices, which caused the SEC to formally refer the matter to the Department of Justice. Within a few weeks of the SEC's referral, DOJ opened its own investigation of Stanford International Bank.

In April 2008, two other witnesses contacted the SEC with concerns about the information used to market a proprietary mutual fund wrap program called the Stanford Allocation Strategy to investors. Within days of receiving this information, the SEC interviewed both witnesses and began investigating possible improprieties in the mutual fund wrap program. Ultimately, the SEC included allegations relating to the mutual fund wrap program in the SEC's February 2009 emergency action.

Throughout the second half of 2008, the SEC staff continued to provide information to DOJ and the Federal Bureau of Investigation. But, to avoid compromising the criminal investigation, the SEC did not take any overt public actions in its own investigation until mid-December 2008. In making the decision to refer the investigation to the Department of Justice, the SEC was mindful that DOJ might be able to avoid certain jurisdictional issues present in the SEC's investigation by pursuing the matter under broader statutes, utilizing its more extensive investigative tools.

However, by mid-December 2008, the SEC and DOJ agreed that the SEC should resume its overt efforts to investigate the fraud in parallel to the DOJ, and the SEC initiated an around-the-clock investigative effort. OCIE initiated a cause examination of SGC's Houston office and interviewed employees in SGC's office in Memphis, Tennessee. At the same time, the SEC's enforcement staff continued to interview current and former Stanford employees, including the bank's former Senior Investment Officer, who had returned from Antigua. The former Senior Investment Officer provided the enforcement staff, for the first time, with documents and information indicating that SIB's investment portfolio was inconsistent with the bank's disclosures to investors. This conclusion was buttressed by information learned by the SEC and FINRA examination teams during an interview with a Stanford Financial Group employee in Memphis. The SEC brought its emergency civil action in February 2009.¹

Procedures Relating to Complaints, Tips, and Referrals and the Non-Public Nature of Investigations

In answering the Committee's questions, it may be helpful to understand the context in which complaints, tips, and referrals are received by the SEC. The SEC receives hundreds of thousands of tips each year from various sources – some are credible and provide detailed information in support of the tip, and some consist of nothing more than a newspaper clipping or printed promotional material sent with no further explanation. Some come from industry competitors, some from present or former employees, some from present or former investors, and others are totally anonymous with little detail. Although complaints, tips and referrals from the public often provide valuable information about potential securities violations and are screened by SEC staff, we do not have the resources to fully investigate them all. We use our experience, skill and judgment to triage these thousands of complaints so we can devote our attention to the most serious potential violations. Here, the SEC in fact investigated complaints involving Stanford over a period of years while, as described above, facing numerous jurisdictional and logistical impediments.

¹ The SEC's Office of the Inspector General ("OIG") conducted an independent investigation regarding the conduct of the Stanford investigations, including the receipt and handling of complaints and tips from whistleblowers. The OIG's Report of Investigation, issued June 19, 2009, determined that although the investigation was obstructed by Stanford and others, including Leroy King, and delayed by jurisdictional obstacles, the SEC did vigorously pursue allegations of wrongdoing.

SEC investigations are non-public and confidential, and SEC employees are prohibited from disclosing non-public information by law, including even the fact of an investigation.² As a result, the SEC staff is prohibited from disclosing to investors that it is engaged in an investigation or any information that it obtains in the course of that investigation. When the SEC investigates potential violations of the Federal securities laws, the SEC does not file a civil action until it has sufficient evidence to support its allegations. However, when a civil action is filed, the SEC publicizes that filing through press releases and its website. The SEC's website, www.sec.gov, contains updates for investors, including specific updates for investors involved in the Stanford case.

Although the SEC followed up on all of the tips and complaints related to the SIB CD, the Committee may be interested more generally in our efforts to improve our handling of tips and complaints. We retained the Center for Enterprise Modernization, a federally funded research and development center operated by The MITRE Corporation, to help us establish a centralized system to more effectively identify valuable leads for potential enforcement action as well as areas of high risk for compliance examinations. The MITRE Corporation helped the SEC to scrutinize the agency's processes for receiving, tracking, analyzing, and acting upon the tips, complaints, and referrals from outside sources. Having recently completed this review, the MITRE Corporation has made recommendations to the SEC regarding how it can begin immediately to improve the quality and efficiency of the agency's current procedures, and to recommend potential technology solutions that can assist the SEC staff in more effectively tracking, managing and utilizing tips, complaints, and referrals. We are now in the process of creating these new policies and procedures for the entire agency. The next phase will be to procure and implement a centralized information technology solution that will provide the agency with an automated mechanism for, among other things, tracking, analyzing and reporting on tips and complaints on an agency-wide basis. We are also watching with interest proposed legislation to incentivize whistleblowers to come forward immediately and work with us directly rather than anonymously.

SIB Certificates of Deposit Were Not Exempt From Registration

The Committee has asked us to address whether Stanford brokers had an exemption to sell SIB certificates of deposit. Under the federal securities laws, an offering of securities is either registered, exempt or illegal. The offering of these CDs was not registered, nor were the sales of these CDs exempt under the U.S. securities laws. Rather, SIB claimed that the CDs were not "securities" at all. SIB marketed its CDs as high-rate foreign CDs regulated by a foreign government, which if true, could mean that the CDs would not meet the definition of a security under U.S. law, and therefore, the SEC would not have jurisdiction over the sales of the CDs. The premise of SIB's claim is a Supreme Court decision holding that when certain banking products such as CDs are

² See 17 C.F.R. § 200.735-3(b)(7) and 17 C.F.R. § 202.5(a).

appropriately governed by another Federal regulatory scheme, investors do not need the protection of the federal securities laws. In the case of foreign bank CDs, issuers assert that the CDs are being regulated by a scheme that is roughly equivalent to the US regulatory scheme, and therefore they are not securities. In this case, Stanford argued that the SIB CDs were regulated as Antiguan CDs, not securities. His position was backed up by Leroy King who bolstered Stanford's claims that SIB and its products were appropriately regulated. Of course, we now know that was not the case, and the SEC has asserted in its action that these CDs are securities.

Current Status of SEC v. Stanford Financial Group

Upon filing its civil action in February 2009, the SEC moved the district court to appoint a receiver over the defendants' assets to prevent waste and dissipation of these assets to the detriment of investors. To complement the Receiver's efforts, the SEC, in coordination with the DOJ, moved quickly for the benefit of investors to freeze Stanford International Bank assets that were being held in international financial institutions. To date, the SEC and the DOJ have frozen approximately \$290 million that will be distributed to victims of the fraud following a criminal conviction. The SEC has also objected to the Receiver's motion to the Court for interim fees of approximately \$19.9 million, and asked the Court to modify the Receivership order to prevent the "clawback" of principal investments previously returned to innocent investors.

I would be happy to answer any questions you may have within the confines of my obligation to guard the ongoing civil and criminal matters.