UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of	:	
MICHAEL R. PELOSI,	:	Administrative Proceeding File No. 3-14194
Respondent.	:	

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DIVISION OF ENFORCEMENT'S
POST-HEARING BRIEF

Respectfully submitted,

DIVISION OF ENFORCEMENT,
by its attorneys,
Richard M. Harper II
John J. Kaleba
U.S. Securities & Exchange Commission
33 Arch Street, 23rd Floor
Boston, MA 02110

Dated: August 5, 2011

INTRODUCTION

From approximately November 2005 through August 2008, Respondent Michael Pelosi, a Connecticut-based investment adviser, knowingly reported overstated investment performance returns to his clients by exaggerating gains and minimizing losses. Virtually every month, Pelosi sent letters to his clients consistently overstating the investment performance returns for total accounts as well as various asset classes.

Once Pelosi's business partners detected his conduct in August 2008, they collected a sample of his client correspondence and compared it to the firm's account records. They saw a distinct pattern of overstating investment performance. Confronted with sample letters and reports, Pelosi pretended not to know why his letters did not match the firm's records and blamed system errors or mistakes by the firm's administrative staff. When Pelosi's business partners indicated that they would continue comparing his client letters to the firm's records, Pelosi returned to his office and started deleting electronic copies of client correspondence. Pelosi subsequently admitted to his business partners that he "did it." He intentionally sent his clients overstated performance returns. Pelosi apologized, requested a second chance, and promised that it would never happen again. He suggested to his business partners that they could provide his clients with excuses that blamed word-processing errors for his misconduct. Ultimately, Pelosi's business partners fired him, but, out of a sense of compassion for Pelosi and his family, agreed not to report his conduct to regulatory authorities. For approximately nine months, Pelosi's business partners withheld the reason for Pelosi's termination. In June 2009, however, they changed their minds and reported Pelosi's misconduct.

Pelosi has twice given sworn testimony--to the Division of Enforcement in July 2009, and to the Court in a hearing held from June 20 through June 27, 2011. In this sworn testimony,

Pelosi has persistently denied knowingly sending his clients overstated performance returns and provided various excuses for why he sent his clients performance figures that were different from those kept in the firm's records. Pelosi's excuses are inconsistent, illogical and incredible. Despite the opportunity to substantiate his excuses with records and data, not one example of a legitimate performance adjustment was presented at the June 2011 hearing.

Through the overstatement of performance results, Pelosi deceived his clients about the true performance of their investments. He lulled them into believing that their investments were performing better than they actually were, as measured against applicable market indices. As a result of this conduct, Pelosi willfully violated Sections 206(1) and 206(2) of the Investment Advisers Act of 1940 ("Advisers Act"). Through his conduct in lying to his business partners, attempting to destroy evidence, suggesting false excuses to be given to his clients, and, ultimately providing the Division and this Court with inconsistent and incredible sworn testimony, Pelosi has firmly established his recalcitrance and total incapacity for rehabilitation as an investment adviser worthy of fiduciary trust. Under these circumstances, a cease-and-desist order, a meaningful civil penalty, and an industry bar are appropriate.

FACTS

The witnesses and evidence established the facts substantially as the Division expected in its prehearing brief.

1. Halsey Associates, Inc. Hires Pelosi As An Experienced Portfolio and Client Manager.

Halsey Associates, Inc. ("Halsey") is an investment adviser located in New Haven, Connecticut. Halsey was formed in 1967 by Robert W. Halsey, a former Chief Investment Officer of the Yale Endowment Fund. James Zoldy ("Zoldy") is the firm's Chairman and Treasurer. Kenneth Julian is the firm's President and Chief Compliance Officer. Statement of Facts ("**SoF**"), ¶¶ 8-9.

In late 2004, the Halsey firm had approximately four full-time portfolio managers who were also owners of the firm. They were: Zoldy, Julian, William Curran ("Curran"), and Grayson Murphy ("Murphy"). Curran and Murphy were members of the firm's first generation of portfolio managers. Zoldy and Julian were younger members of the firm's second generation, who had joined the firm in the 1990s. **SoF**, ¶¶ 8-9. Toward the end of 2004, Halsey was looking to add a new portfolio manager to expand the firm's second generation as its first generation moved closer toward retirement. In interviewing potential candidates, Halsey was looking for an experienced investment adviser who would follow the firm's investment philosophy and business practices. Halsey did not require that the candidate have existing client business. In fact, the Halsey principals expected to provide the newly hired portfolio manager with existing clients as well as any new business that the firm generated. Id. ¶ 11. In 2004, Halsey was a profitable firm, finishing the year with billings of over $2.5 million, which represented growth of 14.5 percent from the previous year. Id. ¶ 10.

In 2004, Respondent Michael Pelosi was an investment adviser with Columbia Management Group, a division of Bank of America, where he had provided investment advisery

services for approximately 16 years. **SoF**, ¶ 6. At the time, Pelosi began looking to leave Columbia Management in order to avoid a company request to relocate to New York or Boston. Some years earlier, in the early 1990s, Pelosi and Julian had worked together at Bank of Boston, which would later be acquired by Bank of America. In late 2004, Pelosi called Julian and informed him that he was leaving Columbia Management Group. Julian inquired whether Pelosi would like to join Halsey. After an interview process, Halsey offered, and Pelosi accepted, a position at Halsey as a portfolio manager and "Vice President" of the firm. Id. ¶¶ 11, 15.

Pelosi's employment agreement with Halsey provided him a base annual salary of $120,000, an entitlement to receive firm billings on client accounts brought in by him or allocated by the firm to him once the total amount of these billings covered his share of firm expenses, and a right to purchase Halsey stock after a year at the firm. **SoF**, ¶¶ 13-14.

2. Halsey's Business Practice for Reporting Client Account Performance: Client Letters Reporting Computer-Generated, Time-Weighted Returns.

At the time Pelosi joined the firm in 2005, Halsey had an established practice for reporting client portfolio account performance. Each portfolio manager was responsible for sending clients letters on a quarterly and annual basis that reported their account's periodic performance in the body of the client letter. The firm staggered the letters so that each month, each portfolio manager would send out letters to one third of his client accounts. **SoF**, ¶ 16.

Within the each client letter, Halsey portfolio managers reported the quarterly or twelve-month returns for the client's accounts, using a computer-generated, time-weighted return calculation. The letter also provided asset class returns for the quarter or twelve-month period, again using the computer-generated, time-weighted return calculation. In addition to the account or asset class performance returns, Halsey client letters also included reference to the S&P 500

and Lehmann Aggregate Bond Indices, as measures of comparison for account or asset class performance. **SoF**, ¶ 17.

All of the information necessary to report time-weighted returns in the client letters came from Halsey's portfolio management software program called Advent. Each month, Halsey's administrative assistants used this program to print out, for each client, a package of Advent reports. These included: (1) an Account Summary, (2) a Portfolio Appraisal, (3) a Performance History By Asset Class Report ("Performance History" or "TWR" Report); and (4) a quarterly Discounted Cash Flow ("DCF") report. The Account Summary and Portfolio Appraisal reports show a snapshot of the account's current holdings, with detail on cost basis, market value and income. The Performance History or TWR Report calculates a percent return for each investment class and the total account over the time period covered by the report. The Performance History report calculates the periodic return using a Time-Weighted Return ("TWR") calculation. **SoF**, ¶¶ 18, 24.

In preparing the periodic client letters, Halsey portfolio managers used the TWR report for the purpose of reporting client portfolio account performance in client letters. **SoF**, ¶ 27. As indicated by the Advent software literature (and admitted by Pelosi's expert), the time-weighted return calculation is the only calculation on Advent that fairly compares the performance of one money manager to an index because it minimizes the effect of cash flows on the portfolio. Id. ¶ 28. The Halsey portfolio managers used the quarterly Discounted Cash Flow or DCF report for the purpose of reviewing additional account detail for the previous three months. Halsey portfolio managers did not use the quarterly DCF report to report account performance. Id. ¶ 29. After drafting the letters, the portfolio managers would enclose the Account Summary and

Portfolio Appraisal, but would not enclose the Performance History Report or the quarterly Discounted Cash Flow Report. Id.¶ 25.

3. Pelosi Was Guided on Halsey's Client Reporting Practices, Was Familiar with Reporting Only Computer-Generated Returns, and Knew That It Is What Halsey Expected Him To Send to His Clients.

Upon Pelosi's arrival at Halsey, Zoldy and Julian instructed Pelosi on Halsey business practices, including the communication of account performance results to clients. Zoldy and Julian also instructed Pelosi that, as a rule, he should use the Performance History or TWR Reports for communicating quarterly and annual performance results in client letters. Pelosi never asked Zoldy or Julian any questions concerning the use of the TWR Report. Pelosi never expressed any concern that the firm was using an inappropriate or improper calculation methodology. Pelosi knew that Halsey expected him to report the computer-generated performance results to firm clients. **SoF**, ¶¶ 30-33.

The practice of providing clients with computer-generated performance results was familiar to Pelosi. For the previous 16 years as an investment adviser at Bank of America/Columbia Management Group, Pelosi had provided his clients with computer-generated performance results. As a result of this experience, Pelosi knew that it was wrong to provide his clients with anything other than the computer-generated performance returns. **SoF**, ¶ 34.

4. 2005 to 2008, Pelosi Progresses at Halsey with The Firm's Full Support.

From the time Pelosi started at Halsey, the firm promoted his professional and financial success. After arriving at Halsey, Pelosi enticed several of his former clients from Columbia Management to join him at Halsey. Halsey allocated Pelosi one hundred percent credit for the clients he brought to the firm. This allocation gave Pelosi all of the revenues attributable to those clients, helping him generate enough fee revenue to receive payments of client billings above his share of expenses. In addition, Halsey reassigned firm clients to Pelosi in order to give him

additional business and allocation credit. Upon the retirement of Bill Curran, Halsey assigned many of Curran's clients to Pelosi. **SoF**, ¶¶ 43-45.

For the calendar year 2007, Pelosi received approximately $322,000 in a gross distribution of client revenue above his salary of $120,000. Zoldy and Julian, however, still generated three times as much as in client fees as Pelosi. In 2008, with Pelosi's input, Halsey hired a business development professional for the purpose of attracting clients to fill Pelosi's excess capacity. Halsey also adopted some of Pelosi's suggestions for improved processes, such as the purchase of research software and the development of a model portfolio. **SoF**, ¶¶ 43-48.

5. Administrative Assistants Discover Pelosi Misconduct After Software Upgrade.

In the spring of 2008, a change in Halsey administrative procedure caused two Halsey administrative assistants, Kathleen Rourke and Maureen Rynne, to discover that Pelosi was overstating account performance in his client letters.

Before the spring of 2008, Halsey's administrative assistants did not have a role in the client-letter drafting process. Instead, the administrative staff provided the Advent reports to each portfolio manager for them to create the client letters. In 2008, however, Halsey went through an upgrade that cut down on the monthly administrative procedures necessary for maintaining Halsey's client accounts. As a result, the portfolio managers had the administrative assistants become more involved in the client letter writing process by creating the first draft of quarterly and annual client letters. This draft letter writing included inserting client account performance figures in each of the client letters. In drafting these client letters after the system upgrade, every administrative assistant employed by Halsey, including Pelosi's current administrative assistant Susan Frois, used the TWR Report for the purpose of inputting quarterly and annual performance results in client letters. After inputting the TWR performance

calculations into the client letters, the portfolio administrators gave the draft letters to the portfolio managers along with the package of Advent reports. **SoF**, ¶¶ 16-23, 37-41.

As Rourke and Rynne began to receive draft letters back from Pelosi, however, they noticed that Pelosi changed the account performance figures from the numbers reported in the TWR report. Although Rourke and Rynne prepared letters for the other Halsey portfolio managers, they did not see such changes being made by any of the other portfolio managers. Both Rourke and Rynne asked Pelosi why he changed the figures, and Pelosi responded either "I calculate those figures in a different way," or "I have to take other things into consideration." Over time, Rourke and Rynne became concerned about Pelosi's changes because they were happening "more frequently" and "repeatedly." **SoF**, ¶¶ 49-52.

6. Pelosi's Business Partners Investigate and Find Pattern of Overstating Performance.

In August, 2008, Rourke and Rynne informed Zoldy that they had observed Pelosi sending out client letters with performance numbers different than the computer-generated reports. Zoldy appeared shocked and upset. After being informed of Pelosi's conduct, Zoldy informed Julian, and they both decided to review a sampling of Pelosi's client correspondence. Zoldy and Julian collected between 20 and 40 of Pelosi's client letters and compared the performance reported in the letters to the Advent-generated reports. Based upon this review, Zoldy and Julian both observed that Pelosi's letters showed a pattern of overstating performance results. More specifically, Julian observed over-reporting of positive returns and under-reporting of negative returns at the account level and at the individual asset class levels. **SoF**, ¶¶ 53-56.

7. When Questioned By His Business Partners, Pelosi Initially Denies Intentionally Changing Performance Results, Destroys Evidence, and then Admits Responsibility.

After observing this pattern of overstating performance results, Zoldy and Julian decided that they would approach Pelosi and ask for his explanation of the performance numbers reported

in his letters. On or about August 14, 2008, Zoldy and Julian called Pelosi into a conference room at Halsey. Zoldy and Julian showed Pelosi copies of his client letters and their corresponding reports. Zoldy asked Pelosi to explain why the numbers were different. Pelosi acted "surprised," "bewildered," and "incredulous." During the August 14 discussion, Pelosi denied that he had made any adjustments. He did not admit or acknowledge that he had intentionally sent his clients altered performance results. Pelosi claimed that the differences were attributable to "system's errors or mistakes by [Halsey's] assistants." The meeting ended when Zoldy and Julian decided, and informed Pelosi, that they would pursue a more exhaustive review of Pelosi's correspondence. **SoF**, ¶¶ 57-64.

After the meeting, Zoldy and Julian asked the Halsey administrative assistants to print out Pelosi's client correspondence from the time he joined the firm. Shortly after the collection process started, Rourke noticed that Pelosi's correspondence was "disappearing" off of the firm's computer system. Rourke reported this situation to Zoldy, who informed Julian. It appeared from Halsey's computer system that a group of Pelosi client letters, within a particular range of the alphabet, had been deleted off the system. Zoldy and Julian confronted Pelosi in his office. Pelosi admitted to deleting the letters, but claimed it was an accident. **SoF**, ¶¶ 65-66.

Several factors show that Pelosi's deletion of these letters was not an accident. First, Pelosi deleted an entire range of the alphabet, at a time when he claims to have been looking at individual letters and Advent reports. A mass deletion of letters is not consistent with a one-by-one review of individual letters and individual Advent reports. Second, Halsey used Microsoft Word software for word processing. This software requires a confirmation before deleting electronic documents off the system. Pelosi therefore must have affirmatively chosen to delete the entire group of letters from the computer. Pelosi admits that he confirmed deletion of these

letters, but he "can't explain how [he] got past that." Third, Pelosi confessed, in a sense; in the days following the meeting, Pelosi sent Zoldy and Julian a typewritten apology in which he stated that he "cringe[d] at [his] behavior after the meeting." During the July 2011 hearing in this matter, Pelosi admitted that intentional deletion of his client correspondence would have been the only "cringe-worthy" event to happen after the August 14, 2008 meeting with Zoldy and Julian. **SoF**, ¶ 67.

After Pelosi deleted his client letters, Zoldy and Julian asked him to leave the Halsey office, which Pelosi did. Later that day, Zoldy was able to retrieve the deleted letters from a Halsey back-up system. At the end of the day on August 14, Susan Frois handed Julian a stack of Pelosi client correspondence about an inch and a half thick. Julian placed this stack of letters on his credenza in his unlocked office and left for the evening. **SoF**, ¶¶ 68-69.

When Julian arrived at the Halsey office the next day, on or about August 15, he observed that Pelosi was already in the office. Julian also noticed that the stack of letters on his credenza was "noticeably smaller" than the evening before. Julian asked Frois if the pile looked smaller than the evening before. Frois confirmed that it did. Julian did a cursory examination of the Pelosi client letters on Halsey's computer system, and saw that some of the electronic copies of Pelosi client correspondence were missing paragraphs. **SoF**, ¶¶ 70-72.

After discovering the missing letters and deleted information, Julian asked Pelosi to leave the office. Before Pelosi left the office, however, Julian encouraged Pelosi to tell the truth about what he had done. Pelosi then left the office. **SoF**, ¶¶ 73-74.

Approximately ten minutes after leaving the office, Pelosi called Julian and asked Julian to meet him outside the office. Julian met Pelosi outside the office building. Pelosi then told Julian, "I did it." Julian and Pelosi then walked together and talked for approximately twenty

minutes. During this conversation, Julian encouraged Pelosi to provide a reason why he sent out altered performance results. Pelosi never did. In discussions with Julian, Pelosi stated that he very much wanted to stay with Halsey. Pelosi was very apologetic and claimed that it would never happen again. **SoF**, ¶¶ 75-78.

Later that same day, Pelosi sent Julian an email. In the email, Pelosi expressed embarrassment and shame for sending out adjusted performance results to his clients. Pelosi also expresses deep shame for not admitting to his conduct in the August 14th meeting with Julian and Zoldy. **SoF**, ¶ 79.

On Monday, August 18, 2008, Pelosi returned to the office and provided Julian with two copies of a type-written note. Pelosi's note again expressed embarrassment and shame for sending out adjusted performance results to his clients. Pelosi also stated that he "cringe[d]" at the thought of his conduct after his meeting with Julian and Zoldy. **SoF**, ¶¶ 80-81.

Between August 18 and August 27, Pelosi made additional pleas to remain employed at Halsey. Pelosi came to Julian's office a couple of times and talked about ways he could make it right with his clients and remain at Halsey. During this time period, Pelosi handed Julian a handwritten note about editing tables in Halsey's word processing system. Pelosi handed the note to Julian and suggested it as a possible excuse to explain to clients why Pelosi sent inaccurate performance results. **SoF**, ¶¶ 82-83.

8. Halsey Terminates Pelosi and Agrees Not To Report Misconduct.

On or about August 27, 2008, Zoldy and Julian decided Halsey needed to disassociate itself from Pelosi. They prepared a separation agreement for Pelosi. Under the terms of the memorandum: (1) Pelosi would resign from the firm's board of directors effective immediately, but he would remain on paid leave until his employment with Halsey ended on September 30, (2)

Pelosi would receive the firm revenues attributable to him as of September 30, minus expenses, and this amount would be paid to him by December 31, 2008, (3) Halsey would buy back Pelosi's firm common stock at the prevailing share price on September 30, as determined by its standard formula; and (4) so long as Pelosi not disparage Halsey or its employees, the firm would not "report the events leading up to and including this separation to the proper regulatory authorities." **SoF,** ¶¶ 84-90.

Zoldy and Julian presented Pelosi with the separation agreement on the afternoon of August 27 and explained its terms. Zoldy and Julian told Pelosi that if he did not sign the agreement, they would report his conduct to appropriate regulatory authorities. Pelosi signed the agreement. **SoF,** ¶ 90.

As reflected in the parties' separation agreement, Halsey (1) continued to pay Pelosi through his leave until September 30, (2) paid Pelosi the firm revenues attributable to him through September 30 (minus expenses), and (3) paid Pelosi fair value for the repurchase of his Halsey stock as of September 30, 2008. **SoF,** ¶ 92.

In addition, on or about October 1, 2008, Julian submitted a Form U5, Uniform Termination Notice for Securities Industry Registration to FINRA and the State of Connecticut, reporting Pelosi's separation from Halsey on September 30, 2008. This form contained a false declaration that Pelosi had not resigned from the firm after allegations were made that accused him of violating investment-related statutes, regulations, rules, or industry standards of conduct. Julian submitted the false declaration because Halsey had promised Pelosi that it would not report him. **SoF,** ¶¶ 93-94.

9. <u>Halsey Reports Pelosi's Misconduct After Negative Reaction from Firm Client.</u>

In March or April of 2009, a Halsey client questioned Zoldy and Julian about the appropriateness of the firm's decision not to report Pelosi's conduct to appropriate regulatory authorities. Following this client questioning, Zoldy and Julian decided to correct the Form U5 to reflect the truth of Pelosi's resignation from Halsey. On or about June 12, 2009, Julian submitted a second Form U5 reporting the termination of Pelosi on September 30, 2008. In this second Form U5, Julian reported that Pelosi had resigned from the firm after allegations were made that accused him of violating investment-related statutes, regulations, rules, or industry standards of conduct. **SoF**, ¶¶ 95-97.

10. <u>Record Evidence of Pelosi Letters and Halsey Account Records Corroborate Witnesses' Observations of a Pattern of Overstating Performance Results.</u>

At the hearing in this matter, the Division presented summary exhibits that compared Pelosi's client reporting of client accounts to the applicable Advent reports produced from Halsey's Advent system. This comparison shows a pattern of Pelosi sending his clients overstated annual and quarterly performance returns consistent with the pattern described by Zoldy and Julian in their hearing testimony. *Compare* **SoF**, ¶¶ 98-108 (Division compilation and summary exhibits) *with* **SoF**, ¶¶ 54-56 (Zoldy's and Julian's observations of overstatements of performance in August 2008).

A. Pattern of Overstatement of Annual and Quarterly Total Account Performance.

When comparing Pelosi's reporting of annual account performance to the TWR Reports, Pelosi's client letters inflated annual performance in 248 instances or 84% of the total accounts compared. Pelosi deflated annual account performance only in 36 instances or 12% of the total accounts compared. Pelosi reported the same performance as the TWR Report in only 14 instances or 4% of the total accounts compared. **SoF**, ¶ 104.

When comparing Pelosi's reporting of quarterly account performance to the TWR Reports, Pelosi's client letters inflated quarterly performance in 214 instances or 82% of the total accounts compared. Pelosi deflated annual account performance only in 31 instances or 12% of the total accounts compared. Pelosi reported the same performance as the TWR Report in only 16 instances or 6% of the total accounts compared. **SoF**, ¶ 105.

These summary exhibits show that Pelosi's letters inflated performance more than five times as often as he deflated performance. This pattern of inflation evidences Pelosi's intent to exaggerate his clients' performance returns.

i. Accounting for Possibility of Rounding Sharpens Picture of Inflationary Intent.

Within client letters, Pelosi typically reported performance to the nearest tenth of a percent or within ten basis points. To account for the possibility of rounding below 10 basis points, the Division presented the same comparison data, but counted differences of less than 10 basis points as "equal." When accounting for rounding, the comparison of Pelosi reporting to TWR Reports shows an even starker pattern of inflation. When differences of less than 10 basis points are counted as equal, Pelosi's instances of deflation decrease by 50 to 75 percent. For example, when accounting for rounding, the instances in which Pelosi deflated annual performance drop in half, from 36 to 18 instances or from 12 or 6 percent. Similarly, when accounting for rounding, the instances in which Pelosi deflated quarterly performance dropped by three quarters, from 31 instances to 8 instances or from 12 percent to 3 percent. By contrast, even when accounting for rounding, Pelosi still inflated annual account performance in 209 instances or 70% of the accounts compared. Similarly, Pelosi still inflated quarterly account performance in 176 instances or 67% of the accounts compared. This comparison shows that Pelosi inflated annual

performance 10 times more often than he deflated it, and he inflated quarterly performance 20 times more often than he deflated it. **SoF**, ¶ 106.

ii. Range of Inflation Shows Many Instances Well Above Rounding Errors.

In comparing Pelosi's account reporting to TWR Reports, the Division also presented evidence summarizing the sizes of Pelosi's inflation of performance. This analysis displayed the number of instances of inflation according to ranges of basis point size. For Pelosi's reporting of annual account results, this analysis showed there were 50 instances of inflation greater than or equal to 100 basis points, 67 instances of inflation between 50 and 99 basis points, 48 instances of inflation between 25 and 49 basis points, 44 instances of inflation between 10 and 24 basis points, and 39 instances of inflation between 1 and 9 basis points. **SoF**, ¶ 107.

For Pelosi's reporting of quarterly account results, the analysis showed there were 40 instances of inflation greater than or equal to 100 basis points, 39 instances of inflation between 50 and 99 basis points, 44 instances of inflation between 25 and 49 basis points, 53 instances of inflation between 10 and 24 basis points, and 38 instances of inflation between 1 and 9 basis points. **SoF**, ¶ 108.

11. Record Evidence Shows Pelosi Overstating Total Account, Individual Asset Class and Combined Asset Class Performance Results.

In addition to the summary exhibits, the Division presented a compilation of Pelosi's correspondence matched with applicable TWR and DCF reports from Halsey's Advent system. At the hearing in this matter, Zoldy testified that he reviewed the Division's compilation and confirmed that the client correspondence relied on by the Division constituted the firm's record of what Pelosi sent to his clients from 2005 through August 2008. Zoldy further testified that he reviewed the TWR and DCF reports accompanying each letter and confirmed that these reports accurately matched the client accounts reported in Pelosi's correspondence. Finally, Zoldy

submitted a sworn declaration attesting to the authenticity of these documents as Halsey business records. **SoF**, ¶¶ 98-103.

As detailed below, a review of this compilation shows Pelosi client letters overstated performance results for total accounts, individual asset classes, as well as combined asset classes.

A. Examples of Pelosi's Overstatement of Total Account Returns.

Pelosi sent a letter to Sandra Lonergan on November 7, 2005. The letter addresses two portfolios: a taxable portfolio and an IRA portfolio. In the first paragraph of the letter, Pelosi reports to Lonergan that, for the period June 30 to October 31, 2005, her IRA portfolio gained 2.1%, claiming that the portfolio beat the return of the S&P 500. The applicable Halsey TWR report shows a gain of only 1.30 percent, a difference of 80 basis points and 40 basis points lower than the reported S&P 500 return of 1.7%. **SoF**, ¶ 110.

Pelosi sent another letter to Sandra Lonergan on August 9, 2006. The letter addresses two portfolios: a taxable portfolio and an IRA portfolio. In the second paragraph of the letter, Pelosi reports to Lonergan that, for the period July 31, 2005 to July 31, 2006, her IRA portfolio gained 5.2%. The applicable Halsey TWR report, however, shows a gain of only 4.05 percent, a difference of 115 basis points. **SoF**, ¶ 111.

Pelosi sent a letter to Dr. Robert George on August 10, 2006. In the letter, Pelosi reported to George for the 12-month period ending July 31, 2006 his total portfolio gained "10.7%, despite difficult stock and bond markets." The applicable Halsey TWR report, however, reports a gain of only 6.82%, a difference of 388 basis points. **SoF**, ¶ 112.

Pelosi sent a letter to Steven Tutolo, Jr. on October 17, 1006. In the letter, Pelosi reported to Tutolo that, for the annual period ending September 30, 2006, the Connecticut Hypodermics

Profit Sharing Plan portfolio gained 9.6%. The applicable Halsey TWR report, however, shows a gain of only 7.02 %, a difference of 258 basis points. **SoF**, ¶ 113.

Pelosi sent a letter to Sandra Lonergan on August 13, 2007. The letter addresses two portfolios: a taxable portfolio and an IRA portfolio. In the letter, Pelosi reports to Lonergan that, as of July 31, 2007, the annual return of her taxable portfolio was 11.6%. The applicable Halsey TWR report, however, shows a gain of only 10.93%, a difference of 67 basis points. **SoF**, ¶ 114. Within the same letter, Pelosi reports to Lonergan that, as of July 31, 2007, the annual return of her IRA portfolio was 13.1%. The applicable Halsey TWR report, however, shows a gain of only 12.53%, a difference of 57 basis points. Id. ¶ 115.

Pelosi sent a letter to Peter Collins on December 13, 2007. In the second paragraph of the letter, Pelosi reports to Collins that, as of November 30, 2007, his portfolio had a quarterly gain of 1.1%. The applicable Halsey TWR report, however, shows a *loss* of 0.55 percent, a difference of 165 basis points. **SoF**, ¶ 116.

Pelosi sent another letter to Sandra Lonergan on February 8, 2008. The letter addresses two portfolios: a taxable portfolio and an IRA portfolio. In the second paragraph of the letter, Pelosi reports to Lonergan that, as of January 31, 2008, her taxable portfolio declined 4.2% during the last quarter. The applicable Halsey TWR report reports a loss of 5.77 percent for the most recent quarter, a difference of 157 basis points. **SoF**, ¶ 117.

Pelosi sent a letter he sent to William Drakely on February 11, 2008. In the letter, Pelosi reported to Drakely that as of January 31, 2008 the portfolio of the Woodbury Cemetery Association "pulled back 4.1% during the recent three months." The applicable Halsey TWR report reports loss of 5.92 percent for the most recent quarter, a difference of 182 basis points. **SoF**, ¶ 118.

B. Examples of Pelosi's Overstatement of Individual Asset Class Returns.

Pelosi's letters also overstated performance returns for individual asset classes. For example, Pelosi sent a letter to Dexter Davenport on October 18, 2007. In the second paragraph of the letter, Pelosi reports to Davenport that, in the most recent quarter as of September 30, 1997, the common stocks "grew in line with the 2% advance in the S&P 500." The applicable Halsey TWR report shows a *loss* of 1.15 percent, a difference of over 300 basis points and the *opposite* direction of the reported S&P 500 return. **SoF,** ¶ 125.

Pelosi sent a letter to Sandra Lonergan on February 8, 2008. The letter addresses two portfolios: a taxable portfolio and an IRA portfolio. In the second paragraph of the letter, Pelosi reports to Lonergan that, as of January 31, 2008, the common stocks within her taxable portfolio declined 7.5% during the last quarter, "well less than the 10.6% decline by the S&P 500." The applicable Halsey TWR report shows a larger loss of 8.52 percent, a difference of 102 basis points and much closer to the reported S&P decline. **SoF,** ¶ 126.

Pelosi sent a letter to William Drakely on February 11, 2008. In the letter, Pelosi reported to Drakely that, as of January 31, 2008, the common stocks with in portfolio of the Woodbury Cemetery Association "were off 7.7 %" for the most recent quarter, "well less than the 10.6 decline in the S&P 500." The applicable Halsey TWR report shows, however, that the common stocks declined 8.88 percent for the most recent quarter, a difference of 118 basis points and much closer to the reported S&P 500 decline. **SoF,** ¶ 127.

Pelosi sent a letter to David Florian on March 11, 2008. In the second paragraph of the letter, Pelosi reports that, as of February 29, 2008, the taxable bonds within Honey Florian's taxable portfolio declined 0.4% in the last quarter. The applicable Halsey TWR report shows a larger loss of 1.33 percent, a difference of over 90 basis points. **SoF,** ¶ 128.

Pelosi sent a letter to Peter Collins on March 12, 2008. In the second paragraph of the letter, Pelosi reports that, in the most recent quarter as of February 29, 2008, the "common stocks" within Collins' portfolio "pulled back" 6.8%, "but less than the 9.7% decline experienced by the S&P 500 index." The applicable Halsey TWR report shows a larger loss of 11.45 percent, a difference of 465 basis points and 175 basis points *worse* than the reported S&P 500 index return. **SoF,** ¶ 129.

C. Examples of Pelosi's Overstatement of Combined Asset Class Returns.

Pelosi's letters also overstated performance returns for combined asset classes. For example, Pelosi sent a letter to Sandra Lonergan on November 7, 2005. The letter addresses two portfolios: a taxable portfolio and an IRA portfolio. In the first paragraph of the letter, Pelosi reports to Lonergan that, for the period June 30 to October 31, 2005, the "equities" within her IRA portfolio gained 3.1%. The applicable Halsey TWR report, however, shows that return of the common stocks was only 2.27 percent and the return of the mutual funds was only 1.73 percent, both well below Pelosi's reported equity return of 3.1 percent. **SoF,** ¶ 120.

Pelosi sent a letter to Dr. Robert George on August 10, 2006. In the letter, Pelosi reported to George for the 12-month period ending July 31, 2006 the "equities" within in his portfolio gained 12.1%, "compared to a 8.9% gain in the S&P 500." The applicable Halsey TWR report, however, shows that return of the common stocks was only 8.41 percent and the return of the mutual funds was only 9.87 percent, both well below Pelosi's reported equity return and not as strong against the reported S&P 500 return. **SoF,** ¶ 121.

Pelosi sent a letter to Dexter Davenport on October 10, 2006. In the second paragraph of the letter, Pelosi reports to Davenport that, for the period April 30 through September 30, 2006, the equities within his inherited IRA gained by 1.8 percent, but "fell short of the 2.4% increase in the

S&P 500." The Davenport IRA held only common stock as equity securities. The portfolio did not hold any mutual fund shares. The applicable Halsey TWR report shows that the common stocks had a *loss* of 0.19 percent, a difference of 199 basis points and much worse than the reported positive return of the S&P 500 index. **SoF,** ¶ 122.

Pelosi sent a letter to Steven Tutolo on October 17, 2006. In the letter, Pelosi reported to Tutolo that as of September 30, 2006 the "equities" within the portfolio of the Connecticut Hypodermics Profit Sharing Plan had an annual return of 14.1 %, "compared to a 10.7% increase in the S&P 500." The applicable Halsey TWR report reports the plan's common stocks gained only 8.44% and its mutual funds gained only 13.31%, both of which were lower than Pelosi's reported "equities" gain of 14.1 percent. Moreover, the common stock holdings of the plan were more than twice as large as the mutual fund holdings. Therefore, the combined weighted return would have been closer to the lower common stock return of 8.44 percent and not as strong against the reported 10.7% return of the S&P 500 index. **SoF,** ¶ 123.

Pelosi sent a letter to Paul Largay on March 7, 2007. In the letter, Pelosi reported that as of February 28, 2007 the "equities" within the portfolio of the Vincent B. Largay 1991 Irrevocable Trust gained 12.6% in the last year, "while the S&P 500 increased 11.9%." The applicable Halsey TWR report, however, reports that the trust's annual return for common stock was only 6.27% and for mutual funds it was only 11.09%, both of which were lower than Pelosi's reported "equities" gain of 12.6 percent *and* the reported S&P 500 gain of 11.9%. Moreover, the common stock holdings of the trust were larger than the mutual fund holdings. Therefore, the combined weighted return would have been closer to the lower common stock return of 6.27 percent and even worse against the reported S&P 500 index return. **SoF,** ¶ 124.

12. During Investigation and Hearing, Pelosi Offered Inconsistent and Incredible Excuses, Which Are Not Supported By Corroborating Evidence.

Pelosi has twice provided sworn testimony regarding the performance returns in his client correspondence. First, Pelosi provided sworn testimony in July 2009, just a month after he received notice that Halsey had reported his conduct to regulatory authorities. Pelosi testified for a second time two years later, during the hearing in this administrative proceeding in June 2011. In providing testimony to the Division staff and this Court, Pelosi has provided inconsistent, incredible and unsubstantiated excuses attempting to explain why his letters overstated performance returns. **SoF**, ¶¶ 130-32.

A. Pelosi's Claimed Use DCF Advent Reports Is Inconsistent, Incredible, and Irrelevant.

Pelosi has made irreconcilably inconsistent claims concerning his use of Advent performance reports. As part of sworn investigative testimony in July 2009, the Division asked Pelosi several times to state his practice in using Advent reports for reporting client account performance. In response to these questions, Pelosi testified several times that he used the Advent Performance History or TWR Report as the basis of reporting annual client account returns in his letters. Pelosi specifically denied using the DCF reports for reporting annual returns. Contrary to Halsey practice, however, Pelosi testified several times that he used a quarterly DCF report for the purpose of reporting quarterly client account returns in his letters. **SoF**, ¶ 133-34.

During investigative testimony, Pelosi stated that he used these two different reports for different periods because he "had a specific recollection of Maureen [Rynne] telling [him] that this is what the guys use for the three month returns, this is what they use for the 12 month returns. And [he has] a less specific recollection of Ken [Julian] and Jim [Zoldy] telling [him] the same thing." **SoF**, ¶ 135. Pelosi further testified that he "didn't know the basis for the

calculation or the methodology used in the calculation" of the TWR Report when he worked at Halsey. Id. ¶ 136. Referring to this ignorance, Pelosi testified had "no basis to choose [the TWR report's] performance over the DCF report's performance." Id. According to Pelosi, he simply used the reports he was instructed to use. Later in the same testimony, Pelosi again relied on his ignorance of the performance calculation methodology to explain why he simply used the reports he was given by the Halsey staff. In response to a question about the difference between his letters and a TWR report, Pelosi stated: "At the time we were preparing these letters, all I knew was that frequently the returns on the DCF report for the quarter were different than the returns on this [TWR] report for the quarter. *I had no basis to form a judgment as to which was more accurate than the other. I only knew they were different.* And I knew this DCF report was the report I believed we were instructed to use for the quarter. If we weren't to use it for the quarter, why else would we use it?" **SoF**, ¶ 137.

During the hearing held in June 2011, Pelosi testified to a completely different practice. Pelosi testified claimed that he used the DCF report for reporting annual returns because "there was never a distinction made between" the TWR and DCF reports. **SoF**, ¶ 138. Pelosi further testified that he preferred the DCF report for reporting annual returns because "it afforded greater transparency." Id. On cross examination, however, Pelosi wavered on whether he used the DCF report for reporting annual returns. First, Pelosi denied that he had. **SoF**, ¶ 139. Then he said "there may have been times when [he] used the [annual] DFC report. It was five years ago, I …" Id. On further cross-examination, Pelosi admitted that the Halsey administrative staff had never given him the annual DCF report as part of the monthly client reporting package. **SoF**, ¶ 140. He further admitted, as he had testified during investigative testimony, that the staff had only given him the TWR Report for reporting annual account performance. Id.

i. Pelosi's Claimed Use of DCF Reports Is Inconsistent With Every Other Halsey Witness, Including Frois.

Not one other Halsey employee testified to using Advent DCF reports for reporting quarterly or annual client account returns in the ordinary course. The other Halsey portfolio managers testified to using the TWR Report for inputting account performance in client correspondence. **SoF**, ¶ 141. In addition, every administrative assistant who prepared client letters, including Pelosi's current administrative assistant Susan Frois, testified that they used the TWR Report for inputting annual and quarterly account performance in client correspondence. Id.

ii. Even If Pelosi Used DCF Reports, His Letters and the Advent Reports Show The Same Pattern of Overstated Returns.

Even if the Court were to credit Pelosi's inconsistent and incredible testimony that he used the DCF reports for reporting client account performance, which no other Halsey employee testified to doing, the evidence shows that Pelosi's performance reporting was overstated as compared to the annual and quarterly DCF reports from Halsey's Advent system. At hearing, the Division presented evidence that compared Pelosi's client reporting of client performance to the applicable DCF reports produced from Halsey's Advent system. **SoF**, ¶¶ 142-43.

The comparison of Pelosi client reporting to applicable DCF reports shows the same pattern of overstating performance returns for both annual and quarterly results. A comparison of Pelosi's reporting of annual account performance to the annual DCF reports shows that Pelosi inflated performance in 222 instances or 74% of the total accounts compared. Pelosi deflated annual account performance only in 69 instances or 23% of the total accounts compared. Pelosi reported the same performance as the annual DCF report in only 7 instances or 2% of the total accounts compared. **SoF**, ¶ 144.

A comparison of Pelosi's reporting of quarterly account performance to the quarterly DCF reports shows that Pelosi inflated performance in 214 instances or 82% of the total accounts compared. Pelosi deflated annual account performance only in 34 instances or 13% of the total accounts compared. Pelosi reported the same performance as the TWR Report in only 13 instances or 5% of the total accounts compared. **SoF**, ¶ 145.

In comparing Pelosi's account reporting to Halsey's DCF reports, the Division also presented evidence summarizing the sizes of Pelosi's inflation of performance. This analysis displays the number of instances of inflation according to ranges of basis point size. For Pelosi's reporting of annual account results, this analysis showed there were 60 instances of inflation greater than or equal to 100 basis points, 62 instances of inflation between 50 and 99 basis points, 50 instances of inflation between 25 and 49 basis points, 28 instances of inflation between 10 and 24 basis points, and 22 instances of inflation between 1 and 9 basis points. **SoF**, ¶ 146.

For Pelosi's reporting of quarterly account results, the analysis showed there were 41 instances of inflation greater than or equal to 100 basis points, 37 instances of inflation between 50 and 99 basis points, 44 instances of inflation between 25 and 49 basis points, 50 instances of inflation between 10 and 24 basis points, and 42 instances of inflation between 1 and 9 basis points. **SoF**, ¶ 147.

In addition, a review of individual correspondence and applicable DCF reports shows the same examples of overstating total account and individual asset class returns. *See* **SoF**, ¶¶ 110-18, 125-27 (each paragraph includes applicable Advent DCF report and shows same or substantially same inflation appearing in Pelosi's letters).

B. Pelosi's Claimed Use of Manual Modified Deitz Calculation Is Inconsistent, Incredible and Unsubstantiated.

Pelosi has also made claims in investigative testimony and at the hearing in June 2011 that he sometimes used a manual "Modified Deitz" calculation to adjust Advent-reported performance figures. Pelosi's testimony on this subject has also been irreconcilably inconsistent.

In investigative testimony in July 2009, Pelosi testified that he sometimes used a "Modified Dietz" calculation to adjust quarterly performance returns for total account or asset class performance. **SoF**, ¶ 148. When asked to explain when he knew when he needed to use the Modified Deitz calculation for calculating three month performance, Pelosi testified that he based his decision on the existence of account cash flows affecting the particular return. Pelosi testified: ". . . . *It was a case of looking at the return and it raising some question as to whether or not cash flows were affecting that return.* And to explore that further, I would look at the cash flows that were listed on that report, either for the portfolio or the class. And the general, my own general kind of rule was if those cash flows amounted to more than 10 percent of a portfolio's market value or the asset class of market value, I would begin to get suspicious." **SoF**, ¶ 149. According to Pelosi's investigative testimony, "the Deitz calculation *was only performed* when there were cash flow issues, significant cash flows." **SoF**, ¶ 150.

During the same investigative testimony, the Division twice asked Pelosi if he used the Modified Deitz calculation to adjust annual returns, and twice Pelosi testified that he did not. **SoF**, ¶ 151. Pelosi testified that he would not have adjusted annual performance based on cash flows because "[c]ash flows make a more significant, performance system is more sensitive to those cash flows over a shorter period of time. I don't believe it would have affected a 12-month period as much as they could affect a three month period. So I don't recall making a change to the 12-month results on that basis." Id. ¶ 152.

At the hearing in this matter in June 2011, Pelosi provided utterly inconsistent testimony regarding his use of the Modified Deitz calculations. On direct testimony, Pelosi testified, as he had during investigative testimony, that he used the Modified Deitz calculation to adjust for cash flows. **SoF**, ¶ 153. In Pelosi's words, "It's a performance calculation methodology that's intended to adjust for cash flows into or out of a portfolio or an asset class or any – any pooled investment." Id. Pelosi further clarified: "So there is no Deitz calculation required when there is no cash flow. . . . When there's cash flow, tried to adjust for it, using the Deitz calculation." Id. On cross-examination, however, Pelosi contradicted himself and claimed (1) that he used the Modified Dietz calculation for some other purpose than adjusting for cash flows, and (2) that he used the Modified Dietz calculation to calculate annual performance. Id. ¶ 154. When asked to identify the specific basis for using the Modified Deitz calculation for a reason other than adjusting for cash flows, Pelosi could not identify one. Id.

Pelosi's claim to have used the Modified Deitz calculation for some reason other than adjusting for cash flows is incredible not only because it is inconsistent with prior testimony, but because it is inconsistent with the purpose of the calculation methodology. As explained by the Advent software literature, the purpose of the Modified Deitz methodology, which Advent calls the "Average Capital Base" method, is to calculate an Internal Rate of Return (IRR) that adjusts for the size and timing of cash flows. **SoF**, ¶ 155. As Pelosi's expert, Dr. Audley, admitted on cross-examination, Advent's TWR calculation methodology is compliant with the CFA Institutes Global Investment Performance Standards because it calculates its time-weighted return by linking together Internal Rates of Return using the Modified Dietz methodology to adjust for cash flows. Id.

In addition, Pelosi did not support his inconsistent and incredible testimony with any substantiating evidence showing how he used the Modified Deitz calculation to arrive at the results he sent his clients. Pelosi provided the court with numerous spreadsheets in which he claims to identify instances where he adjusted performance using the Modified Dietz calculation. **SoF**, ¶ 156. Yet, Pelosi never substantiates any of these assertions with evidence demonstrating how he used specific data with the Deitz calculation methodology to arrive at the supposed adjustments. Id. According to Pelosi's investigative testimony, the Deitz calculation is a "simple" calculation or "quotient." Id. At the July 2011 hearing, Pelosi testified that during discovery he had the necessary data and "ran Deitz calculations to see if that was the issue." Id. Yet, Pelosi did not corroborate his testimony by showing a single instance of how he used data and the Modified Deitz calculation methodology to reach any of the numbers he provided his clients.

Pelosi's failure to provide substantiating evidence is particularly egregious considering his voluntary admission (on direct examination) that the only way to substantiate his claims was to do a systematic showing of the data and calculations that were used to arrive at the client-reported results. **SoF**, ¶ 157. In Pelosi's words, "[A]djusting preferred stocks income isn't something you could talk about in the hallway passing. You need to have information in front of you. The Deitz thing, you need to have market values in front of you. You have to have actual data in front of you." Id. Pelosi had this data and information and chose not to present it to the Court. The only logical inference is that the objective data does not support Pelosi's inconsistent and incredible testimony.

C. Pelosi's Claimed Adding Back of x-Dividends to Preferred Stock Returns Is Inconsistent, Incredible and Unsubstantiated.

Pelosi has also made claims in investigative testimony and at the hearing in June 2011 that he adjusted the performance for preferred stocks by adding back declared but unpaid dividends for preferred stocks that went "x-dividend" just prior to end of a client's reporting period. **SoF**, ¶ 158. Pelosi's testimony on this subject has also been irreconcilably inconsistent. Id. ¶ 159.

Pelsoi first made this claim to the Division staff during his July, 2009 investigative testimony. During this investigative testimony, Pelosi claimed that he added the dividend income to adjust performance because his clients had a "common question" about "fixed income returns." **SoF**, ¶ 160. When questioned about x-dividends during the June 2011 hearing, however, Pelosi initially denied that his clients had questions about investment performance. Id. ¶ 161. In Pelosi's words at the hearing, "I can tell you, I have never had – I don't recall having conversation with any of my clients regarding investment performance." Id. Instead, Pelosi claimed that adding back income had to do with questions about "market value." Id. Upon further cross-examination at the June 2011 hearing, after much combativeness, Pelosi eventually conceded that his purported x-dividend adjustment had to do with changing the reported investment performance, not market values, in his client letters. Id. ¶ 162.

In addition, at the June 2011 hearing, Pelosi also could not state how many times he purportedly performed this adjustment during his three years at Halsey. **SoF**, ¶ 163.

Pelosi's claim that he adjusted preferred stock by adding back x-dividends is incredible for the additional reason that he claims to have diverted from a known firm practice without informing anyone, in an area in which he had no experience, and in which he knew that Zoldy, the firm's Chairman, was the expert. Pelosi never had any experience with preferred securities

prior to arriving at Halsey. **SoF,** ¶ 164. Pelosi knew that Zoldy was the Halsey officer in charge of pricing fixed income securities. Id. Pelosi was also aware that Halsey, as a business practice, did not accrue x-dividends in reporting account performance. Id. Yet, Pelosi claims he made income adjustments to securities with which he was not familiar, going against firm practice, without ever discussing the adjustment with any of the other portfolio managers. Id. Under this set of facts, Pelosi's claim is unbelievable.

Furthermore, Pelosi kept no written record of his purported adjustments. Pelosi claims that he not only added back x-dividends, but also during the following reporting period for the same account he would go back and make the inverse adjustment "so that the next quarter's results were not inflated." **SoF,** ¶ 165. Even though Pelosi claims to have made adjustments each quarter and made inverse adjustments the next quarter, he asserts that he kept no records tracking this repetitive and recurring adjustment. Id. Pelosi's claim that he did this adjustment on a regular basis by adding figures one quarter (within three different cycles) and backing them out the next quarter, without any journal or record-keeping to facilitate accurateness and efficiency, is unbelievable.

Pelosi's claim that he adjusted performance returns by adding back x-dividends is incredible for the additional reason that his purported conduct in making an "inverse adjustment" during the following period is illogical and unbelievable. Pelosi testified on cross-examination that, in first adjusting performance figures to add x-dividend income, he did not make any changes to the Advent system, nor did he ask the administrative staff to do that. **SoF,** ¶ 166. Therefore, when Advent recorded the paid dividend during the following quarter, the account performance would be accurate, not inflated. Pelosi's claim to have made a subsequent inverse adjustment to correct inflation that did not exist is illogical and unbelievable.

Despite ample opportunity, Pelosi has not shown one example of a performance calculation in his client letters that reflected his purported x-dividend adjustment. Pelosi first claimed to have made this x-dividend adjustment during investigative testimony in July 2009. **SoF**, ¶ 167. Since the institution of these proceedings, Pelosi had access to his client correspondence and the opportunity to go back and show examples of his purported adjustments. During the July 2011 hearing, Pelosi acknowledged that he could have gone back and looked "at when each preferred went x-dividend" in order to substantiate his purported adjustments. Id. Despite knowing the issues and the availability of the data, Pelosi did not offer proof of any declared x-dividend he used to reach a performance figures that he reported to his clients. Id.

As with the supposed manual Modified Deitz adjustment, Pelosi's failure to provide substantiating evidence of the "x-dividend" adjustment is particularly egregious considering his admission (on direct examination) that the only way to substantiate his claims was to do a systematic showing of the data and calculations that were used to arrive at the client-reported results. **SoF**, ¶ 168. Pelosi had this data and information and chose not to present it to the Court. The only logical inference is that the objective data does not support Pelosi's inconsistent and incredible testimony.

D. Pelosi's Sworn Testimony Cannot Be Trusted.

Pelosi has offered so much inconsistent and incredible sworn testimony that his word can no longer be trusted. As reviewed above, Pelosi has provided inconsistent and incredible testimony concerning every excuse that he has put forward concerning the overstated performance results in his client letters: the use of Advent reports **SoF**, ¶¶ 133-41, the use of a Modified Deitz calculation, Id., ¶¶ 148-55, and the adding back in of x-dividend income, Id., ¶¶ 158-62.

In addition to this dubious testimony, during the July 2011 hearing in this matter, Pelosi offered completely fabricated testimony that he told Zoldy and Julian about his manual calculations during their first meeting on August 14, 2008. During investigative testimony two years earlier in July 2009, Pelosi testified that during the August 14, 2008 meeting with Zoldy and Julian he lied to them and denied that he had made manual adjustments to performance calculations in his client letters. Respondent Ex. 19 (Pelosi IT) at 163:14-165:1. This testimony is consistent with Pelosi's post-meeting email to Julian, in which Pelosi states: "Beyond being embarrassed and ashamed over the matter at hand, I am deeply ashamed that I didn't just tell you yesterday in the conference room." Division Ex. 34 (Pelosi email to Julian dated Aug. 15, 2008).

During the July 2011 hearing, however, Pelosi testified under oath that during this same meeting with Zoldy and Julian he had in fact told them that he had made manual adjustments. APTr. 703:19-704:13. Pelosi claimed that, during discovery, he read a "chronology" that "reminded" him that he did tell Julian and Zoldy during the meeting that he had made manual adjustments. Id.

During further cross-examination, however, Pelosi was forced to admit that this "remembered" testimony was false. When cross-examined about his August 18 meeting with Julian outside of Halsey's offices, Pelosi testified that he started the conversation by admitting to Julian that he had made manual changes to the Advent performance figures. APTr. 730:15-731:4 (Pelosi) ("I told him I did make changes. That's the first thing I said to him, I said, I did make changes."). At this point, Pelosi was caught in irreconcilable testimony. The reason he admitted to Julian that he had made changes to the Advent-generated performance results was that he had previously denied it. Pelosi then conceded he had never told Julian and Zoldy that he had made manual changes before making his admission to Julian outside of Halsey's offices on August 18:

Q: And you told him that you did it?

A: No. I told him that I did make changes. That's the first thing I said to him, I said, I did make changes.

Q: Because that was different than what you had said before, right?

A: *That was – my initial recollection was that I didn't tell him in the conference room that I did – that I made changes.*

Q: And so when you met him outside for the first time after you had that conversation about marriage, you told him that you had made changes because you had never told him that before.

A: *That must be correct. Yes.*

APTr. 731:1-16 (Pelosi) (emphasis added).

Later during cross-examination, Pelosi confirmed that he abandoned the fabricated memory and again admitted that, during the first meeting with Julian and Zoldy in August 2008, he "did not tell them that [he] made these manual calculations . . . ." APTr. 799:14-800:8 (Pelosi).

Pelosi's willingness to testify untruthfully to this Court demonstrates his complete lack of respect for the truth and casts serious doubt on the credibility of his entire testimony. In the absence of corroborating evidence, Pelosi's testimony should not be credited at all.

PELOSI'S KNOWING PROVISION OF OVERSTATED PERFORMANCE RETURNS VIOLATED SECTION 206 OF THE INVESTMENT ADVISERS ACT

Sections 206(1) and (2) of the Investment Advisers Act of 1940 make it unlawful for an investment adviser "to employ any device, scheme, or artifice to defraud any client or prospective client, or to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client." 15 U.S.C. § 80b-6(1) & (2) (2010). Under the power of these statutory sections, Pelosi is a fiduciary of his investment advisery clients and owes them "an affirmative duty of 'utmost good faith, and full and fair disclosure of all material facts,' as well as an affirmative obligation 'to employ reasonable care to avoid

misleading'" them. SEC v. Capital Gains Research Bureau, 375 U.S. 180, 194 (1963) (internal citations omitted). Contrary to the command of this fiduciary duty, Pelosi violated his clients' trust by knowingly misleading them about their investment performance. Each quarter within each year, for a period of three years, Pelosi intentionally sent his clients investment performance returns that were intentionally overstated without any justifiable basis.

1. Pelosi Acted with an Intent to Deceive His Clients About The Strength of Their Investment Performance.

Pelosi's conduct in sending falsely overstated performance returns violated both Sections 206(1) and (2) because he undertook this action with the intent to deceive his clients about the strength of their periodic performance returns. To establish a violation of Section 206(1), the Division must prove that Pelosi acted with scienter, SEC v. Steadman, 967 F.2d 636, 641 & n.3 (D.C. Cir. 1992), which courts have defined as a "mental state embracing the intent to deceive, manipulate, or defraud." Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 n.12 (1976); Aaron v. SEC, 446 U.S. 680, 686 n.5, 695-97 (1980). Although the evidence in this case shows an intent to deceive, a finding of recklessness is sufficient to satisfy the scienter element. David Disner, 52 S.E.C. 1217, 1222 & n.20 (1997); *see also* Steadman, 967 F.2d at 641-42. In the context of securities fraud, recklessness means conduct that is "highly unreasonable' and . . . represents 'an extreme departure from the standards of ordinary care . . . to the extent that the danger was either known to the defendant or so obvious that the defendant must have been aware of it.'" Rolf v. Blyth, Eastman Dillon & Co., 570 F.2d 38, 47 (2d Cir. 1978) (quoting Sanders v. John Nuveen & Co., 554 F.2d 790, 793 (7th Cir. 1977)). A violation of Section 206(2), on the other hand, does not require any proof of scienter. Capital Gains Research Bureau, 375 U.S. at 195.

The record is filled with evidence demonstrating Pelosi's intent to deceive his clients. First, there is a distinct pattern of overstatement in the representations Pelosi made to his clients. As a

matter of course, Pelosi undertook each quarter to inform his clients about the performance of their investment accounts. And, as a matter of course, each quarter, he overstated most of the investment performance results. In a review of 297 accounts for which Pelosi provided annual performance returns during his three years at Halsey, Pelosi overstated performance in 248 instances (or 84% of the time) and deflated performance in only 36 instances (12%). In a review of 261 accounts for which Pelosi provided quarterly performance returns during his three years at Halsey, Pelosi overstated performance in 214 instances (or 82% of the time) and deflated performance in only 31 instances (12%). In reporting both annual and quarterly returns, Pelosi provided overstated annual performance more than five times as often as he deflated performance. **SoF**, ¶ 105. This distinct pattern of overstating performance returns indicates Pelosi's intent to deceive his clients into believing their returns were better than they actually were.

This empirical evidence gets stronger when the possibility for rounding errors is removed. Pelosi reported investment performance to the nearest tenth of a percent. When accounting for rounding, by removing differences below 10 basis points, the comparison of Pelosi's annual and quarterly client reporting to Advent TWR reports shows that Pelosi overstated annual performance 10 times more often than he deflated it, and that he overstated quarterly performance 20 times more often than he deflated it. **SoF**, ¶ 106. After removing the possibility of rounding to the nearest tenth of a percent, Pelosi's pattern of overstating returns paints a stark and unmistakable intent: Pelosi was boosting performance returns to mislead his clients into believing that their account performance was better than their actual returns.

Pelosi's intent to deceive his clients is also demonstrated by his conduct in August 2008 when he falsely denied to his business partners that he had made the adjustments and

subsequently tried to destroy evidence of his conduct. Lack of candor and efforts to hide misconduct are evidence of an intent to deceive. *See* Monetta Financial Svcs., 2000 SEC LEXIS 574, *63 (2000) (noting lack of candor and attempt to hide misconduct supports finding of intent to deceive); *see also* G. Bradley Taylor, 2002 SEC LEXIS 2429, *35 (2002) (noting efforts to conceal conduct demonstrate consciousness of guilt and support finding an intent to deceive). When first confronted by Zoldy and Julian about the differences between his client letters and Advent reports on August 14, 2008, Pelosi denied knowledge of how this happened and claimed that differences were attributable to "system's errors or mistakes by Halsey's assistants." **SoF,** ¶¶ 60-61. These statements were obvious fabrications because, until this confrontation with other professional investment advisers, Pelosi had been acknowledging to Halsey's administrative staff that he had been changing performance returns for his own purposes. Id. ¶¶ 49-52. When Pelosi learned that Zoldy and Julian would be digging further into his correspondence, Pelosi went back to his office and deliberately deleted a range of letters from the Halsey computer system. Id. ¶¶ 64-67. These acts of deceit and concealment are powerful evidence that Pelosi's conduct in overstating performance results was not innocent, but rather done with an intent to deceive his clients about their investment performance.

Pelosi's intent to deceive is further supported by the fact that he later admitted guilt to his business partners in August 2008 without any suggestion of the justifications or excuses he has presented this to Court. On August 15, 2008, Pelosi admitted to Julian that he had intentionally misstated performance returns in client letters. **SoF,** ¶ 76. According to Pelosi, by August 15 he knew the adjustments he had made and had already started reviewing his correspondence and the Halsey Advent reports. APTr. 716:1-720:23 (Pelosi). Yet, during his conversation with Julian in which he came clean, Pelosi did not even suggest that he had an excuse or justification for the

performance returns he reported to his clients. **SoF**, ¶ 77. Julian encouraged Pelosi to explain his conduct, but Pelosi did not mention any excuse or justification. Id. Pelosi did not mention using DCF reports, making Modified Deitz calculation adjustments, or the addition of x-dividend income. Id. Following this *mea culpa*, Pelosi provided Julian with three written documents: (1) a follow up apology email on August 15, (2) a typewritten a apology note, and (3) a handwritten note in which Pelosi suggested using word processing errors as a means for explaining his overstatements. **SoF**, ¶¶ 79-83. Pelosi also had a couple of follow up conversations with Julian, in which Pelosi made additional pleas to remain at Halsey and talked about ways he could make things right with his clients. Id. ¶ 82. Pelosi also had a final meeting with Julian and Zoldy on or about August 27, during which Pelosi begged for his job and offered to come clean with his clients about his conduct. Id. 90-91. At no time, during any of these communications or meetings, did Pelosi mention any of the excuses or justifications he has presented to this Court. **SoF**, ¶¶ 79, 80, 83; APTr. 504:5-7 (Julian). Pelosi's failure to claim any of these excuses before his termination from Halsey in August 2008 strongly suggests that they are nothing more than recent fabrications.

Finally, Pelosi's inconsistent and incredible testimony offered to the Division in support of his claimed excuses further supports finding an intent to deceive. Pelosi's inability to provide a consistent explanation for (1) his use of the Advent performance reports, (2) his supposed manual Modified Deitz calculations, and (3) his supposed adding back in of x-dividend income to preferred stocks, is further evidence of his lack of candor. Pelosi's failure to provide this court with corroborating evidence, despite the opportunity and claimed ability to do so, confirms that there is no such evidence. Pelosi has foisted these unsupported and contradictory excuses upon

the Court because, in reality, he repeatedly and deliberately sent his clients falsely overstated returns for the purpose of misleading them about the strength of their returns.

2. Pelosi's Performance Misrepresentations Are Material.

Pelosi's hundreds of overstatements of investment performance are material. The standard of materiality in an action under Section 206 is whether or not a reasonable investor or prospective investor would have considered the information important in deciding whether or not to invest. *See* SEC v. Steadman, 967 F.2d at 643; *see also* Basic, Inc. v. Levinson, 485 U.S. 224, 231-32, 240 (1988); TSC Indus. v. Northway, Inc., 426 U.S. 438, 449 (1976). Materiality does not require proof of a substantial likelihood that disclosure of the omitted fact would have caused the reasonable investor to change his decision, but rather whether the omitted fact would have assumed actual significance in the deliberations of the reasonable investor. TSC Industries, Inc., 426 U.S. at 449. This fact-specific determination "necessarily depends on all relevant circumstances of the particular case." Ganino v. Citizens Utilities Co., 228 F.3d 154, 162 (2d Cir. 2000). Here, all of the facts and circumstances demonstrate that Pelosi's overstatements of performance returns, in periodic communications highlighting those returns, were material.

The nature of the performance returns and the method by which Pelosi communicated them to his clients indicate their materiality. Performance returns are the measure of an investment portfolio's success or failure. By its very nature, it is the type of information that would significantly alter the total mix of information available to reasonable investor. In addition, Pelosi's method of communicating performance calculations gave them even greater importance than their inherent value. Pelosi assumed the fiduciary obligation of reporting accurate performance returns by reporting this information on a regular basis. Simply by undertaking this fiduciary obligation and highlighting the value of this information to his clients,

each quarter and each annual period, Pelosi increased its material value. Whether the Court accepts the Division's view of the evidence (fabrication) or the Respondent's (tireless efforts to make legitimate adjustments to performance), both versions of Pelosi's conduct indicate the materiality of the adjustments to Pelosi's clients.

The materiality of Pelosi's overstatements is further evidenced by Pelosi's own admissions concerning why he made these changes. Pelosi made these adjustments to the Advent performance calculations in order to meet what he believed to be the performance expectations of his clients. In Pelosi's words: "[My clients] have seen the growth in their portfolios over time. They have commented on my ability to insulate them from the market. They appreciate that. They have seen me manage their portfolios in good markets and in bad. And I was simply looking at the portfolio through their eyes." Respondent Ex. 19 (Pelosi IT) at 88:13-19. Pelosi's admission that he adjusted investment performance based on the importance of investment growth in his client's eyes is very essence of materiality.

The materiality of Pelosi's overstatements is further evidenced by their size and the degree to which they inflated actual client performance. The record shows that Pelosi overstated annual account performance by greater than or equal to100 basis points, a whole percentage point, in 50 instances. Pelosi overstated quarterly account performance by greater than or equal to 100 basis point in 40 instances. A review of sample Pelosi overstatements in the record shows that these overstatements were often well over 100 basis points:

- Overstatement of annual account performance to Dr. Robert George: 388 basis points. **SoF**, ¶ 112.
- Overstatement of annual account performance to Steven Tutolo: 258 basis points **SoF**, ¶ 113.
- Overstatement of quarterly account performance to Peter Collins: 165 basis points. **SoF**, ¶ 116.

- Overstatement of quarterly account performance to William Drakely: 182 basis points. **SoF**, ¶ 118.
- Overstatement of quarterly common stock performance to Dexter Davenport: 315 basis points. **SoF**, ¶ 125.
- Overstatement of quarterly common stock performance to Peter Collins: 465 basis points. **SoF**, ¶ 129.

These overstatements are not only large, but they also grossly inflated the clients' actual performance. In providing, Dr. George with a 388-basis-point overstatement of annual performance, Pelosi reported to George that the return was a 10.7% gain when Halsey's TWR report showed a gain of only 6.82%. This overstated return was 56.9% higher than the actual return. **SoF**, ¶ 112. Similarly, in providing Peter Collins a 165-basis-point overstatement of quarterly performance, Pelosi reported to Collins that the return was a 1.1% gain when Halsey's TWR report showed a *loss* of 0.55%. This overstated return was 300% higher than the actual return. Id. ¶ 116. In providing Dexter Davenport a 315-basis-point overstatement of quarterly common stock performance, Pelosi reported to Davenport that the return was 2% when Halsey's TWR report showed a *loss* of 1.15%. This overstated return was 273.9% higher than the actual return. Id. ¶ 125. Pelsosi conduct in boosting actual returns by fifty, two hundred and seventy, and three hundred percent are self-evidently material overstatements of actual performance. *See* Warwick Capital Management, Inc., 2007 SEC LEXIS 321, *42 (2007) (finding misrepresentations that "more than doubled performance" were "clearly material").

In addition to the objective evidence of size and degree of inflation, Pelosi has admitted that performance adjustments of 150 basis points or greater, or those that change a negative return to a positive return, would be material to an informed investor. During investigative testimony, Pelosi admitted that, in his view, adjustments to performance would be material if "it was going from a minus sign to a plus sign or if it was going from 7 percent to 8.5 percent or

something." Respondent Ex. Ex. 19 (Pelosi IT) at 95:6-11. As reviewed above, there are several examples of Pelosi overstatements of performance above 150 basis points. There are also examples of overstatements where Pelosi changed a negative return to a positive return:

- On December 13, 2007, Pelosi reported to Peter Collins that his portfolio had a gain of 1.1%, but the applicable TWR report showed a loss of 0.55%. **SoF**, ¶ 116.
- On October 10, 2006, Pelosi reported to Dexter Davenport that his inherited IRA account gained 1.8%, but the applicable TWR report showed a loss of 0.19%. **SoF**, ¶ 122.

Thus, even according to Pelosi's view of materiality, formed by his personal experiences with clients, these overstatements of investment performance were material.

The materiality of Pelosi's overstatements of investment performance is also shown in how Pelosi used them to suggest falsely that his clients' returns beat or performed well against applicable market indices. For example, in March 2008 Pelosi reported to Peter Collins that his common stocks "pulled back" 6.8%, but that this return was "less than the 9.7% decline experienced by the S&P 500." **SoF**, ¶ 129. In fact, however, Collins' common stock return was a *loss* of 11.45%, much worse than the decline of the S&P 500. Id. Similarly, in October 2007, Pelosi reported to Dexter Davenport that his common stocks "grew in line with the 2% advance in the S&P 500." **SoF**, ¶ 125. In fact, Davenport's common stock return was a *loss* of 1.55%, much worse than the S&P 500 positive 2% return. Id. Pelosi's use of overstated performance returns to suggest investment performance better than or in line with industry-wide benchmark is plainly material.

Finally, in addition to this evidence, three former Pelosi clients testified at the June 2011 hearing that the variances between the performance results reported by Pelosi and the true result calculated by Halsey mattered to them. **SoF**, ¶¶ 178-92. One client even characterized the differences as "material," while all three clients testified that they expect their investment adviser

to be honest and accurate in their dealings with them. Id., ¶¶ 182-87, 193. Even the six current clients called by Pelosi acknowledged that they expect their investment adviser to be honest about the performance of their accounts and that it was not acceptable for the investment adviser to lie to them. Id. ¶¶ 194-95. The testimony of all of these client witnesses confirmed that the false presentation of overstated returns by an investment adviser was a matter of "actual significance in the deliberations of the reasonable investor." TSC Industries, Inc., 426 U.S. at 449.

3. Pelosi Acted Willfully In Providing His Clients Overstated Performance Returns.

The Division seeks sanctions pursuant to Section 9(b) of the Investment Company Act and Sections 203(f), (i) and (k) of the Advisers Act. To impose sanctions under these sections, the Commission must find that the Respondent committed willful violations. 15 U.S.C. § 80a-9(b) (2010); 15 U.S.C. § 80b-3(f) & (i) (2010); *see also* David E. Zilkha, 2011 SEC LEXIS 1326, *44 (2011). A finding of willfulness does not require intent to violate the law, but merely intent to do the act which constitutes a violation of the law. Wonsover v. SEC, 205 F.3d 408, 414 (D.C. Cir. 2000); David E. Zilkha, 2011 SEC LEXIS 1326, *44 (2011); Arthur Lipper Corp. v. SEC, 547 F.2d 171, 180 (2d Cir. 1976). As set forth above, Pelosi presented his clients overstated investment performance with the intent to deceive them about the strength of their investment returns. Pelosi's conduct was not mistaken or a matter of clerical error. As Pelosi told Halsey's administrative assistants and later admitted to Julian, he intentionally sent his clients the overstated performance returns. **SoF**, ¶¶ 49-52, 74-75.

PELOSI'S MISCONDUCT AND RECALCITRANCE REQUIRE IMPOSITION OF CIVIL PENALTY, CEASE-AND-DESIST ORDER, AND BAR FROM ASSOCIATION WITH ANY INVESTMENT ADVISER OR INVESTMENT COMPANY

The Division seeks an order barring Pelosi from association with any investment advisor or investment company, and imposing a cease-and-desist order and a second-tier civil penalty. In assessing the need for sanctions in the public interest, the Commission considers the following factors: the egregiousness of the respondent's actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the sincerity of the respondent's assurances against future violations, the respondent's recognition of the wrongful nature of his or her conduct, and the likelihood that the respondent's occupation will present opportunities for future violations. Steadman v. SEC, 603 F.2d 1126, 1140 (5th Cir. 1979) (quoting SEC v. Blatt, 583 F.2d 1325, 1334 n.29 (5th Cir. 1978)).

When a respondent's past conduct involves fraud, the public interest requires a severe sanction because the opportunities for dishonesty recur constantly in the securities industry. Warwick Capital Mgmt., 2007 SEC LEXIS 321, *47 (2007) (citing Richard C. Spangler, Inc., 46 S.E.C. 238, 252 (1976)).

1. Pelosi Should Be Barred From Association With Any Investment Adviser or Investment Company.

Pelosi's conduct in providing his clients overstated investment returns is egregious. He is a *magna cum laude* graduate of the University of Connecticut's undergraduate college and graduate business school, and is a Chartered Financial Analyst. **SoF**, ¶ 7. Prior to arriving at Halsey, Pelosi had 16 years of experience as an investment adviser. Id. ¶ 6. Given Pelosi's education and experience, there is no doubt that he knew his fiduciary obligations, but consciously disregarded them and affirmatively provided his clients falsely inflated returns. Pelosi's misconduct was recurrent: he committed these violations hundreds of times, several

times each month, over a three-year period. As set forth above, Pelosi acted with an intent to deceive his clients about the strength of their investments' performance. During the investigation and the June hearing, Pelosi refused to accept responsibility for his conduct. In fact, Pelosi he continues to deny that he intentionally provided his clients with overstated performance returns. APTr. 621:22-622:2 (Pelosi). Pelosi's current employment, as an investment adviser at YHB Investment Advisers in Hartford, CT, provides him with the same opportunity to deceive clients. **SoF**, ¶ 6.

An industry bar is particularly important in this case for deterring future misconduct in the investment adviser industry of fiduciary relations. The selection of an appropriate sanction includes an assessment of the deterrent effect it will have in upholding and enforcing the standards of conduct in the securities business. *See* Schield Mgmt. Co., 2006 SEC LEXIS 195, *35 & n.46; Arthur Lipper Corp., 46 S.E.C. 78, 100 (1975). Moreover, the Commission treats violations occurring within the context of fiduciary relations with particular seriousness and due regard for the relationship of trust and confidence. James C. Dawson, 2010 SEC LEXIS 2561, *8-9 & n.16 (2010); *see also* Don Warner Reinhard, 2011 SEC LEXIS 158, *21 n.27 ("[T]he importance of honesty for a securities professional is so paramount that we have barred individuals even when the conviction was based on dishonest conduct unrelated to securities transactions or the securities business."). Here, Pelosi, as an investment adviser, owed his clients "an affirmative duty of utmost good faith . . . as well as an affirmative obligation to employ reasonable care to avoid misleading" his clients. Dawson, 2010 SEC LEXIS 2561, at *8. The evidence in this case demonstrates not only that Pelosi intentionally deceived his clients about their investment performance for three years, but also that, to avoid the consequences of this misconduct, Pelosi lied to his business partners, destroyed evidence, provided fabricated excuses

in sworn testimony to the Division and the Court, and defiantly denies that he provided his clients any falsely overstated returns. The Commission must show the investment adviser industry that this type of misconduct, lack of candor, prevaricating excuses, and defiant refusal to accept responsibility for egregious breaches of fiduciary duty will lead to a bar from the fiduciary role of investment adviser.

2. Pelosi Should Receive a Second-Tier Penalty.

The Division seeks imposition of a civil monetary penalty under Section 203(i) of the Advisers Act and Section 9(d) of the Investment Company Act of 1940 ("Investment Company Act"). Under these sections, the Commission may impose a civil penalty if a respondent has willfully violated any provision of the Investment Advisers Act or the rules or regulations thereunder. *See* 15 U.S.C. §§ 80a-9(d), 80b-3(i). Where the misconduct at issue involves fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement, the Commission may impose a "Second Tier" penalty of $65,000 for each act or omission occurring between February 2005 and August 2008. Respondent's conduct here was egregious and recurrent. Because the violations here involved fraud and deceit, and because the fraudulent and deceitful conduct occurred hundreds of times over more than three years, the Division seeks a three-time, second tier penalty of $195,000.

3. Pelosi Should Be Subject To A Cease-and-Desist Order.

The Division also seeks imposition of a cease-and-desist order. Section 203(k) of the Advisers Act authorizes the Commission to impose a cease-and-desist order upon any person who "is violating, has violated, or is about to violate any provision of" the Advisers Act or any rule or regulation thereunder. *See* 15 U.S.C. §§ 80b-3(k). Although the imposition of a cease-and-desist order requires some showing of a future risk of violations, "[a]bsent evidence to the

contrary, a finding of a violation raises a sufficient risk of future violation. To put it another way, evidence showing that a respondent violated the law once probably also shows a risk of repetition that merits our ordering him to cease and desist." KMPG Peat Marwick LLP, 54 SEC 1135, 1185 (2001). Here, Pelosi's egregious and repetitive misconduct in providing his clients with falsely inflated investment performance returns, and his current employment as an investment adviser, presents sufficient risk of future violations to warrant imposition of a cease-and-desist order.

CONCLUSION

For the reasons stated above, the Division respectfully requests that the ALJ:

(i) make findings that Pelosi violated Section 206(1) and (2) of the Investment Advisers Act; and

(ii) based on such findings, issue an order pursuant to Section 203 the Advisers Act and Section 9 of the Investment Company Act, as appropriate, (a) requiring Pelosi to cease and desist from committing or causing violations of and any future violations of Section 206 of the Investment Advisers Act, (b) requiring Pelosi to pay a second-tier civil penalty of $195,000; (c) imposing a bar prohibiting Pelosi from associating with any investment adviser or serving on a registered investment company; and (d) imposing such other remedial relief as the ALJ deems appropriate.

Respectfully submitted,

DIVISION OF ENFORCEMENT,
by its attorneys,

Richard M. Harper II, Senior Trial Counsel
John Kaleba, Senior Enforcement Counsel
U.S. Securities and Exchange Commission
33 Arch Street, 23rd Floor
Boston, MA 02110
(617) 573-8979 (Harper)
HarperR@sec.gov

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