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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

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In the Matter of

MICHAEL R. PELOSI,

Respondent.

Administrative Proceeding
File No. 3-14194

DIVISION OF ENFORCEMENT'S POST-HEARING REPLY BRIEF

Respectfully submitted,

DIVISION OF ENFORCEMENT,
by its attorneys,
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Dated: August 23, 2011

Pelosi's post-hearing brief is a reflection of his entire case: All hat and no cattle. Pelois's brief misstates record facts and mischaracterizes the Division's case, makes unsubstantiated attacks on Halsey's records as well as the Division's exhibits, and attempts to avoid liability by ignoring Pelosi's fiduciary responsibility. After wading through this charade of excuses, there is one unavoidable and unrelenting fact: After years of investigation, months of trial preparation, and a full and fair opportunity to present his defense, Pelosi has completely failed to substantiate the inflated performance numbers he sent to his clients.

1. The Respondent's Post-Hearing Brief Is Not Reliable.

As an initial matter, it is important to note that the Respondent's Post-Hearing brief is littered with factual errors and misleading characterizations of the Division's case. For example:

- Pelosi states that when he joined Halsey he "was expected to bring in accounts himself (which was a departure from the founder's hiring practice)." Respondent's Brief at 3. In fact, Pelosi testified to the opposite at the hearing: "No portfolio manager has ever been required as a condition of employment or as a criteria for selecting someone to bring in assets before. I wasn't." APTr. 1087:14-17 (Pelosi). The other portfolio managers testified to the same point. *See* APTr. 196:19-197:4 (Zoldy); 471:1-14 (Julian).

- Pelosi states that Halsey had "manual pricing for equities" until March 2008. Respondent's Brief at 6. In fact, Halsey priced all of its securities through electronic downloads from Schwab and IDC throughout Pelosi's employment at Halsey.[1] Division Statement of Facts ("**SoF**"), ¶¶ 19-20. The only exception to this process was Jim Zoldy's manual adjustments to illiquid bond pricing, which Zoldy made on an individual basis after comparing the electronically downloaded prices to those provided by Halsey's bond broker. Id. ¶ 21. There was never any change to the downloaded common or preferred stock prices. Id.

- Pelosi states that Halsey's systems "were incapable of performing" a Modified Deitz calculation. Respondent's Brief at 13. In fact, the Advent program has a specific report, the "Average Capital Base" report, which calculates an internal rate of return using "the Average Capital Base equation (also known as the Modified Deitz method)." *See* Division Ex. 11 (Axys "About Performance Calculations) at 004716 & 004717. A copy of this report is in the record. Id. at 004723 (Average Capital Base report).

[1] Corporate actions, such as stock splits and dividend pay dates, came to Halsey through electronic download from IDC. APTr. 184:22-185:12 (Zoldy). In the Spring of 2008, the Advent system was updated to receive daily downloads of pricing, rather than monthly. **SoF**, ¶ 37; APTr. 45:5-20 (Rourke).

- Pelosi mischaracterizes the Division's case by stating that its fraud charges are based on Pelosi's use of a DCF quarterly report when Halsey required the use of a TWR report. Respondent's Brief at 26. In fact, as set forth in the OIP, the Division's contention is that Pelosi had *no* basis for his inflated figures, not that he used the wrong report. *See* OIP ¶¶ 1-5, 19-22, 44. Indeed, the Court sustained several Division objections during the hearing when Respondent's counsel attempted to mislead client witnesses on this point. APTr. 1429:6-19 (sustained); 1442:4-12 (sustained); 1455:23-1456:21 (sustained). Making the same misleading argument, Pelosi's brief devotes substantial portions to a discussion of whether the DCF or Modified Deitz performance calculations are acceptable under the Global Investment Performance Standards published by the CFA Institute. Respondent's Brief at 12-15. Again, the Division's enforcement action does not question the validity of these performance methodologies, but rather alleges that Pelosi's inflations have nothing to do with them. *See* Division Brief at 21-32.

In light of these factual errors and misleading arguments, the Division respectfully suggests that the Respondent's Post-Hearing Brief is not a reliable source for record facts or an understanding of the Division's case.

2. <u>Division's Evidence of Pelosi's Inflation Pattern Is Reliable and Corroborated By Real-Time Witness Observations.</u>

Pelosi argues that Court should not rely on the TWR and DCF reports in the Division's exhibits because their accuracy is "highly questionable" due to "innumerable additions and changes in them." Respondent's Brief at 15. This argument is, however, is refuted by the three Halsey witnesses who testified that post-reconciliation changes were rare and often fixed prior to the mailing of client correspondence. Moreover, the inflation pattern shown by these documents is corroborated by the credible testimony of witnesses who observed the pattern before any changes could have been made.

A. *The Credible Testimony Is That Halsey's Record Keeping System Is Substantially Free of Post-Reconciliation Changes to Account Records.*

Pelosi's claim of "innumerable additions and changes" has been refuted by several witnesses. Kathleen Rourke, a portfolio administrator who has worked at Halsey for over thirty years, has conducted thousands of account reconciliations and recalls, over these many years,

only "maybe one" post-reconciliation change made to a client account. APTr. 24:23-25:13 (Rourke). Maureen Rynne, another 20-year veteran Halsey portfolio administrator, testified that account changes after reconciliation happened maybe twice a year and were corrected before letters were sent. Id. 107:12-109:14 (Rynne). Zoldy, the firm's Chairman and officer in charge of pricing, said that such changes happened only in "very rare" circumstances. Id. 191:9-22 (Zoldy). These witnesses were consistent. Changes to account records after the completion of account reconciliation were rarely made.

To make his argument of "innumerable changes and additions," Pelosi relies on the dubious testimony of his current administrative assistant, Susan Frois. At the June 2011 hearing, Frois testified that during each reconciliation there were "ten pages of rejects," which she had to investigate extensively, as well as incorrect classification of securities, pricing issues, and "corporate actions." APTr. 853:7-854:13 (Frois). According to Frois's hearing testimony, these errors occurred "all the time" because most of the securities held in the accounts required adjustment. Id. 854:3-13 (Frois). The first problem with this testimony is that it is completely inconsistent with the other three Halsey witnesses described above. The second and more troubling problem is that it is inconsistent with Frois' own investigative testimony given twenty months earlier in October 2009. During investigative testimony, Frois's explanation of the reconciliation process fails to describe any of these supposed errors or their supposed frequency.

> A: The reconciliation process that I used?
> Q: Yes.
> Q: Well, first my Schwab accounts, I would pull up the statement that I was reconciling to, and I would pull up the back office part of Access, which lists all the transactions. And what I'd immediately do is I would go to the day that I'm trying to balance to, which is the end of the month, and I would hit "balance"—"balance cash." And I would see just how much I was off, and then that would give me an idea what I was looking for on the statement.

We always had to manually input the Schwab interest payments, so interest on cash. We would have to manually input any distributions or contributions, and if for any reason securities came in or went out without being a buy or a sell. For instance, if there was a gift—
Q: Um-hum.
A: --or if there was a transfer from another custodian and they were transferred in, we'd have to manually put those in. And for any dividend payment that had a foreign tax, we would have to adjust for the foreign tax.
Q: All right, so what's the objective of this reconciliation process?
A: To reconcile to the custodian.
Q: What does that mean, in other words?
A: Well, first of all for me, I would reconcile to cash. Once cash was reconciled, then I would go to the report side of Advent and pull up an appraisal, and I would look at the market value – the bottom line market value, and I would compare it to Schwab's side. *Usually there was a small difference, but it was normally bond pricing that was the difference.*
Q: *After this reconciliation process, were the custodial statements consistent with the Halsey statements?*
A: *Yes.*
Q: *Was that part of the reasons for doing this reconciliation?*
A: *Yes.*

Respondent Ex. 20 (Frois IT) at 16:24-18:10 (emphasis added). Thus, according to Frois in October 2009, she reconciled client accounts to cash by looking for account distributions, contributions or gifts, and possibly foreign tax. To the extent there were any differences, it was a "small difference" and "it was normally bond pricing that was the difference." There is not even a hint of the pricing issues, corporate actions, or the other litany of errors she rattled off at the June 2011 hearing.

There is more. Toward the end of Frois's investigative testimony, she was asked to identify any other concerns with Halsey's record-keeping system. Frois testified as follows:

Q: Were there any other concerns you had about just record-keeping at Halsey?
A: Record-keeping?
Q: I should say which include the account record-keeping, the Advent system or anything else?
A: In the Advent system—I don't under—could you be more specific?
Q: Do you have any additional concerns about the way that Halsey maintained paper files, client files, anything like that?

> A: We, other than—no, no, I don't think so.
> Q: Okay. What about electronic records, which would include the Advent, the software?
> A: Well, one thing I learned when I got to YHB was that you're not supposed to delete any client emails. And I didn't know that at Halsey.

Respondent Ex. 20 (Frois IT) at 71:23-72:13. The invitation for Frois to describe any other problems with Halsey's electronic records elicited a comment about "email." That is it. Not even a suggestion that there were a catalogue of "mistakes" that occurred "all the time."

Frois' investigative testimony from October 2009 is strikingly consistent with Jim Zoldy's June 2011 hearing testimony. At the hearing in July 2011, Jim Zoldy testified that post-reconciliation errors occurred "very rare[ly]" and, when they did, they usually pertained to gifts of securities in client accounts. APTr. 191:9-22 (Zoldy). This explanation is consistent with Frois' investigative testimony of 20 months ago, when she testified that her reconciliation process consisted of manually inputting transactions that were not securities "buys or sells," but rather gifts, or contributions or distributions from the client accounts. Respondent Ex. 20 (Frois IT) at 16:24-17:13. This consistency shows that the hearing testimony of Zoldy, Rourke and Rynne is the accurate portrayal of the Halsey system and its records.

Frois is not a neutral, third party to these proceedings. In the last twenty years, Frois has followed Pelosi from Bank of America to Halsey, and now to YHB Advisors. Respondent Ex. 20 (Frois IT) at 8:6-9:22, 63:4-13; 65:18-66:21. After the commencement of administrative proceedings, Frois worked on Pelosi's hearing exhibits at YHB during work hours and during her personal time after hours, at her own house, and at Pelosi's house. APTr. 981:10-25 (Frois); 1240:10-1241:5 (Pelosi). Frois received

professional legal representation from Respondent's counsel at no cost to her. According to Frois, Respondent's counsel represented her during investigative testimony at a discounted rate of $500 per hour, but she has yet (as of the June 2011 hearing, twenty months later) to receive a bill for these services. APTr. 992:18-993:2. The corruption of Frois' testimony is vividly demonstrated by the unprofessional conduct of Respondent's counsel in surreptitiously handing Frois working copies of exhibits flagged with post-it notes and handwritten guidance. APTr. 885:22-888:11. Respondent's counsel hand-drew circled areas for her attention and provided notes indicating how she should testify. *See* Division Ex. 49 at 004852, 100061; Division Ex. 51 at E07392 ("Just look at market values"). This misconduct was marked for the record only after it was caught by Division counsel. APTr. 885:22-887:9. The inconsistencies, bias and improper influence lead to only one logical conclusion: Frois allowed her integrity and her testimony to be compromised by Pelosi and his counsel. In resolving any conflicting witness testimony on the subject of the Advent system, the Court should rely on the consistent and credible testimony of Rourke, Rynne, and Zoldy.[2]

B. The Division's Exhibits Remain Unchallenged.

The Division based its summary exhibits on records verified by Halsey. At the hearing, the Division presented a binder set of Pelosi's client correspondence and applicable Advent reports from Halsey's computer system. *See* Division Ex. 17-24.

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[2] Pelosi also tried to use Frois to suggest that Zoldy made adjustments to the Halsey Advent system in connection with in letters sent in August 2008 to Paul and Robert Kovacs. Respondent's Brief at 23. Zoldy testified, however, that he made the corrections to these letters because the administrative staff had made a mistake in reporting the figures from the Advent system. APTr. 392:7-397:13 (Zoldy). Consistent with this testimony, the Advent report in the record shows the same figures as the corrections made by Zoldy. *Compare* Respondent Ex. 16 (Kovacs Letters) *with* Division Ex. 29 (Advent TWR Report for Robert Kovacs account) *and* Division Ex. 40 (Advent TWR Report for Paul Kovacs account). Although Frois claims that she did not make a mistake, she kept no record of the Advent report she supposedly relied on. APTr. 968:13-17 (Frois).

Prior to the June 2011 hearing, Zoldy reviewed the letters and Advent reports in Division Exhibits 17 through 24. APTr. 236:22-238:7 (Zoldy). Zoldy signed a sworn declaration attesting to the Advent reports as true and accurate copies of Halsey's electronic business records. Id. 238:13-21 (Zoldy); Division Ex. 25 (Business Record Certification). At the hearing, Zoldy testified that the letters in the binders represented Halsey's record of what Pelosi sent to his clients. APTr. 238:4-7 (Zoldy). Zoldy further testified that the TWR and DCF reports in the binders had been correctly matched with the letters. Id. 237:24-238:3 (Zoldy). Pelosi did not challenge this testimony. Nor did Pelosi raise any questions concerning the attested-to Advent reports in the Division's binders.[3]

C. Zoldy and Julian Personally Observed Pelosi's Pattern of Inflation In Real-Time.

Even if Pelosi's challenges to the Halsey Advent system had merit (which they do not), Pelosi cannot avoid the personal observations of Zoldy and Julian when they reviewed his correspondence and applicable Advent reports, in real time, back in August 2008. As conceded by Pelosi's expert, Advent reports that have not been the subject of post-reconciliation changes "would be perfectly okay to use for an examination of historical performance." APTr. 1349:11-16 (Audley). In early August 2008, Zoldy and Julian conducted their initial review by pulling and comparing approximately 20 to 40

[3] Instead of discussing the Division's exhibits, Pelosi offered two packages of Advent reports that he pulled from the investigative record and asked witnesses about these records. *See* Respondent Exs. 26 & 27. To their credit, the Halsey witnesses explained most of Pelosi's alleged discrepancies on the spot. For example, the question marks in the Robert Bosco TWR Report appear because Advent does not have a price file for periods that do not stop at the month end. *Compare* Respondent Ex. 26 at Halsey 004912 *with* APTr. 62:9-65:17 (Rourke); 149:2-150:12 (Rynne); 334:6-20 (Zoldy). Question marks would appear in the "short term investments" column of TWR Reports for Sandra Lonergran's account because of debit balances caused by trading on margin. *Compare* Respondent Ex. 26 at Halsey E01302, E00112, E0025, E00589 *with* APTr. 65:19-68:5 (Rourke); 150:25-151:17 (Rynne); 334:21-336:18 (Zoldy). The Account Summary category for estimated income will change with money market rates existing at time of report run. *Compare* Respondent Ex. 27 at Halsey 100106, E07392 *with* APTr. 160:5-19 (Rourke). Even if Pelosi had raised an unanswered question concerning the Advent records in his exhibits, he never demonstrated how they affect the performance calculations in the Division's exhibits or any other document.

Pelosi client letters and corresponding Advent reports. In that review, they personally observed that Pelosi's letters showed a pattern of overstating the Advent 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. On August 14, Zoldy and Julian showed a sample of these letters to Pelosi, and Pelosi observed that they were "recent letters." APTr. 1127:8-19, 1250:4-11 (Pelosi). At the conclusion of the August 14 meeting, Zoldy and Julian continued their review by having the administrative staff pull "all the letters that [Pelosi] had recently sent out and generate performance reports to coincide with these periods." APTr. 901:23-902:25 (Frois). Thus, Zoldy and Julian compared Pelosi's recent correspondence to Advent reports at a time before any of these supposed "innumerable additions and changes" could have been made to the Advent system. And their review confirms the picture created by the Advent data in the record: Pelosi was sending his clients letters that overstated investment performance, at both the account and asset class levels.

3. <u>There Are No "Missing" Letters, And Pelosi Did Not Offer a Single Additional Letter Into Evidence.</u>

Pelosi claims that there are some 250 "missing letters," but the only evidence in the record on this subject is that he did not send these letters. Respondent's Brief at 21-22. To make his missing letters claim, Pelosi relies on his spreadsheet marked as Exhibit 6. Id. at 22 & n.67. According to Pelosi, he marked his spreadsheet "no letter provided" whenever he did not find a client letter for a particular cycle in the records produce by Halsey. APTr. 1140:24-1141:9 (Pelosi). Pelosi uses this marker to suggest that all of these letters are "missing." The fundamental flaw of this approach is that Pelosi did not send client letters to every client, every cycle. As two Halsey portfolio administrators testified at the hearing, Pelosi frequently did not

send his clients letters when he visited with them or met with them in the Halsey office. APTr. 32:6-18 (Rourke); 116:25-117:12 (Rynne). Pelosi's identification of "no letter provided" does absolutely nothing to establish whether these letters are missing or were just never sent. Pelosi did not offer any evidence on this subject (such as client testimony from any of his six client witnesses that they received letters not produced by Halsey). The only evidence in the record on this subject is that Pelosi had a regular practice of not sending out client letters. In the absence of proof that Pelosi actually sent letters that were not in Halsey's records, the only logical conclusion is that client letters do not exist for every client, for every cycle because Pelosi did not send them to every client, every cycle.

Pelosi also claims that he "discovered" in the Halsey document production some 80 more client letters that are not included in the Division's compilation. Respondent's Brief at 22. Based on these alleged 80 additional client letters, Pelosi argues that the Division cherry picked evidence supporting its case. Id. at 31. Pelosi's claim is completely unsupported by the record. As an initial matter, Pelosi ignores that Halsey's Chairman, James Zoldy, reviewed Division Exhibits 17 through 24 and testified under oath that the letters contained therein are the firm's record of Pelosi's correspondence. APTr. 236:22-238:7 (Zoldy). Whatever disagreements Pelosi might have about which letters constitute that collection, his dispute is with Halsey, not the Division.

Second, as it exists today, the record suggests that Pelosi's 80 "additional letters" are merely unsigned duplicates of his signed letters. As Halsey witnesses testified, the firm's record of official correspondence includes (1) signed copies of correspondence until the Spring of 2008, and then (2) unsigned electronic copies after the Spring of 2008 when the firm switched to retaining only unsigned electronic copies of client correspondence. APTr. 45:5-20 (Rourke);

233:14-234:6 (Zoldy). Importantly, during the Division's investigation in 2009 through 2010, Halsey produced an electronic copy of Pelosi's hard-drive, which would have included electronic copies of draft letters he kept on his computer. APTr. 239:12-240:25 (Zoldy), 857:12-858:2 (Frois). At the June 2011 hearing, Pelosi testified that the 80 letters he "discovered" were "unsigned." Id. 1151:21-1152:18 (Pelosi). To the extent that Pelosi's hard-drive contained electronic copies of letters from prior to the Spring of 2008, Halsey would not have included any those unsigned letters in its official record of correspondence. The logical inference is that 80 unsigned letters discovered by Pelosi are simply duplicate copies of unsigned letters from prior to 2008, when the firm retained signed copies.

The final and most compelling point is that Pelosi simultaneously suggests that these additional 80 letters are helpful to his case, but offers no proof of them. Pelosi never offered these letters into evidence. He did not even show them to Zoldy to inquire whether these letters were or should have been part of the firm's official records. If there had been something worthwhile in these 80 letters, Pelosi would have offered them into evidence. He did not. Pelosi's calculated decision to withhold these letters and argue their absence suggests that they are completely irrelevant.

4. Pelosi's Claim That There Is A One to Two Percent "Threshold" For Materiality Is Wrong and Corporate Disclosures Are Qualitatively Different Than This Investment-Adviser Fraud.

Citing two non-published District Court decisions from the Ninth Circuit concerning corporate disclosures, Pelosi contends that "amounts 'under a certain threshold' such as the adjustments in [Pelosi's] Client Letters have frequently been viewed as immaterial as a matter of law." Respondent's brief at 32. This assertion of law is incorrect. Decisions from the Supreme Court of the United States and the Second Circuit Court of Appeals reject the application of a numerical threshold. In *Basic v. Levinson*, the Supreme Court explained: "A bright-line rule

indeed is easier to follow than a standard that requires the exercise of judgment in the light of all circumstances. But ease of application alone is not an excuse for ignoring the purposes of the Securities Acts and Congress' policy decisions. Any approach that designates a single fact or occurrence as always determinative of an inherently fact-specific finding such as materiality, must necessarily be overinclusive and under includsive." Basic, Inc. v. Levinson, 485 U.S. 224, 236 & n.14 (1988). Addressing the specific issue of numerical value, the Court stated: "After much study, the Advisory Committee on Corporate Disclosure cautioned the SEC against administratively confining materiality to a rigid formula. Courts would do well to heed this advice." Id. Following the principles of *Basic,* the Second Circuit has "consistently rejected a formulaic approach to assessing materiality of an alleged misrepresentation." Ganino v. Citizens Utilities Co., 228 F.3d 154, 162-63 (2d Cir. 2000). The assessment of materiality depends not on a single threshold, but rather "on all the relevant circumstances of the particular case." Id. at 162.

In addition, Pelosi's misstatements of investment performance in this case are qualitatively different than corporate disclosures of operating revenue or net income to the investing public. Pelosi is not a large public company reporting periodic financial statement results. He is an investment adviser reporting the financial performance of individual investor assets to fiduciary clients. Pelosi was engaged by his fiduciary clients for the purpose of managing their investment assets to generate performance returns. When Pelosi lied to his clients about investment performance, he was not giving them misleading information about operating details of their accounts. He was lying to them about the core performance of the assets they had placed in his trust.

Even if controlling precedent supported Pelosi's supposed numerical threshold (which it does not), as explained in the Division's opening post-hearing brief, some of Pelosi's overstatements of investment performance were well over 200 basis points or 2 percent. Division Brief at 39. Moreover, the record shows that Pelosi's overstatements of performance boosted his clients' actual returns by as much as fifty, two hundred and seventy, and three hundred percent. These overstatements are material even under Pelosi's purported threshold. Id.; *see* Warwick Capital Management, Inc., 2007 SEC LEXIS 321, *42 (2007) (finding misrepresentations that "more than doubled performance" were "clearly material").

Pelosi also claims that his overstatements of performance were not material because many of his clients stayed with him after his departure from Halsey. These clients, however, have never been informed that Pelosi intentionally sent them overstated performance returns. When Pelosi departed Halsey, the firm sent a letter announcing Pelosi's departure and providing corrected performance information. APTr. 233:13-235:25 (Zoldy); Division Ex. 13. These letters did not disclose the fact that Pelosi had had been overstating their returns. Id. Zoldy and Julian deliberately did not disclose this information to Pelosi's clients because they had agreed not to report Pelosi. Id. Pelosi also never informed his clients that he had intentionally sent them falsely inflated returns. *See, e.g.,* **SoF,** ¶ 196. Therefore, Pelosi has made no showing that his clients made the transition *despite* being informed that he intentionally provided them boosted investment performance returns for three years. At best, it shows that Pelosi's client's automatically transitioned with the relocation of their adviser, rather than investigating the cause of the discrepancies raised in the Halsey letter.

Pelosi also claims that the hearing testimony of his six current clients demonstrates that they did not consider his overstatements of performance to be material. These witnesses, however,

were unaware that Pelosi had lied to them or any other clients about investment performance. **SoF**, ¶ 196. As a consequence, these clients arrived at the hearing still believing in his honesty and integrity. APTr. 146412-1466:7 (Dinto); 1452:6-18 (Platano). Respondent's counsel carefully avoided asking these witnesses what they might think about Pelosi's actual misconduct. Instead, Respondent's counsel asked these witnesses if they cared if Pelosi used a performance calculation different than one authorized by Halsey--a point which has nothing to do with the Division's claim that Pelosi falsely inflated performance. *E.g.*, APTr. 1403:10-17 (Scianna), 1429:22-1430:4 (Bosco), 1443:4-24 (Florian), 1455:24-1457:5 (Platano). On cross-examination, however, all six current clients testified that they expect their investment adviser to be honest about the performance of their investment accounts, and that it was not acceptable for their investment adviser to lie to them. **SoF**, ¶ 195.

Pelosi claims that the hearing testimony of Louis Scianna is "strongly supportive" of Pelosi's lack-of-materiality argument. It in fact it shows the opposite. Scianna's testimony shows how Pelosi's fraudulent overstatements would assume actual significance in the deliberations of a reasonable investor. Prior to the June 2011 hearing, Division counsel conducted a phone interview with Scianna. As part of the interview, Division counsel asked Scianna whether, if the Court decides Pelosi committed fraud by lying to his clients about the performance of their investments, Scianna would keep investing with Pelosi. During the call, Scianna stated he had to think about his answer. He did think about it. He even talked the matter over with his wife. Ultimately, at the hearing Scianna testified that, after deliberating on it alone and with his wife, he decided that would keep investing with Pelosi even if the Court decides Pelosi lied to his

clients about investment performance.[4] APTr. 1411:14-1412:20 (Scianna). As the Supreme Court has explained, materiality does not require proof of a substantial likelihood that the information would cause the reasonable investor to change his decision, but rather whether the information would have "assumed actual significance in the deliberations of the reasonable investor." TSC Indus. v. Northway, Inc., 426 U.S. 438, 449 (1976). As evidenced by Scianna's reaction and careful consideration, a finding that Pelosi lied to his clients about investment performance is clearly a matter that assumed actual significance in Scianna's deliberations about whether to invest with Pelosi.

Finally, with respect to witness testimony, the existence of materiality is not just a matter to be inferred from the subjective testimony of Pelosi's current clients; many of whom expressed personal attachment to Pelosi or gratitude for past investment performance. *See* APTr. 1464:11-1465:5 (Dinto) ("I will tell you that Mike Pelosi has the – is the basis for everything I'd like to see in my son if I had a son."); 1452:8-18 (Platano) ("I probably have more communication with Mike now almost as an advisor with the *other businesses* that we have . . . [W]e kind of use Mike as kind of our moral compass when addressing an issue of ethics or morality…"); 1400:20-1401:1 (Scianna) (noting portfolio has performed "quite well" in Pelosi's care); 1402:25-1403:9 (Scianna) (expressing gratitude that Pelosi built cash in portfolio prior to September 2008 market down turn). The Division called three of Pelosi's former clients, each of whom received Pelosi letters reporting performance returns inflated above the Halsey Advent-generated returns. **SoF,**

[4] Scianna's full testimony reveals how conflicted he was about Pelosi's conduct. While Scianna testified that he would stay with Pelosi, he also testified that (1) he "absolutely" cared about how his investments performed, and (2) he expected his investment adviser to be honest with him about this performance. APTr. 1407:24-1408:11. When asked whether it would be unacceptable for Pelosi to send him falsely inflated numbers, Scianna would only say "[a]ny numbers he sent me, I had trust in." Id. 1411:9-13. Pelosi has never admitted to Scianna that he falsely inflated his performance results. Id. 1408:24-1409:2.

¶¶ 174-193. All of these witnesses testified that the size of the inflation (ranging from 34 basis points to 422 basis points) was of consequence, or material, to them. Id. ¶¶ 178-192.

5. Pelosi's Lack-of-Client-Reliance Argument Is Unsupported By Record, Legally Irrelevant, and Further Evidence of His Lack of Fiduciary Capacity.

Pelosi suggests that he should not be liable for lying to his clients about their quarterly and annual account and individual asset class performance because they received custodian account statements from Schwab, on which they could "directly compare" their quarterly and annual performance. See Respondent's Brief at 7, 29, 33 (stating "direct comparison" could be made). This argument is wrong as a matter of fact and irrelevant as a matter of law. First, Pelosi's argument that his clients could directly compare the performance figures in his letters to Schwab statements is not supported by the Schwab statements in the record. There is no entry for quarterly or annual total account performance similar to the Pelosi client letters. See Respondent Ex. 27 (Random Collection of Documents) at October 2005 Statement for Louis Scianna & August 2005 Statement for Robert Bosco.[5] Second, as a matter of law, Pelosi cannot avoid responsibility for securities fraud in an enforcement action by claiming that his clients did not have to rely on his lies. See *In re New Allied Development Corp.*, 1995 SEC LEXIS 2256, *3-4 (1995) ("It is well settled . . . that neither reliance nor investor losses need be shown as a prerequisite to finding a violation of the antifraud provisions of the securities laws has occurred."); *SEC v. Simpson Capital Mgmt., Inc.*, 586 F. Supp.2d 196, 201 (S.D.N.Y. 2008) ("Unlike private litigants, the SEC is not required to prove investor reliance, loss, causation, or damages in an action for securities fraud."). Therefore, even if Schwab reported the same

[5] Pelosi also claims that his client could review their account statements online. Respondent's Brief at 7. The record does not contain any evidence of what account information is reported in the online statement.

information as the Halsey client letters (which it did not), Pelosi's overstatements of investment performance would still be violations of the Advisers Act.

To the extent Pelosi argues that his clients could do the math from the Schwab statements, this particular argument reflects his complete disregard for his role as an investment adviser. Pelosi owed his clients a fiduciary duty not to mislead them about their investment performance. SEC v. Capital Gains Research Bureau, 375 U.S. 180, 194 (1963). Pelosi owed this duty of utmost good faith precisely so that his clients would not have to do the math in order to figure out whether he was providing truthful or fictitious statements of investment performance. Pelosi abused this position of trust when he lied to his clients about their investment performance. Now, in a rather defiant shirking of his fiduciary obligation, Pelosi argues against his enforcement liability by suggesting that the very clients to whom he owed the duty could have figured out the performance for themselves. This disregard for fiduciary obligation is exactly what led to Pelosi's misconduct and is the precise reason why the Commission should bar him from the investment adviser and investment company industries.

6. Pelosi Still Has Not Explained the Inflated Figures He Sent To His Clients.

Since Pelosi's investigative testimony in July 2009, Pelosi has known that the Division questioned the substance of the inflated performance figures appearing in his client letters.[6]

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[6] During investigative testimony in July 2009, the Division showed Pelosi a February 13, 2006 letter he sent to David Belowski. Within the letter, Pelosi states that the quarterly performance for "equities" was a 12% gain and the quarterly performance for the total account was a 5.7% gain. During this testimony, Pelosi was shown the Halsey TWR Report for the account, which shows a gain of only 11.08 for the account's common stock and a gain of only 5.58 for the total account. Pelosi suggested that the differences were attributable to his use of the DCF reports. Respondent Ex. 29 (Pelosi IT) at 115:17-131:17; Division Ex. 1 (IT Ex. 3) & Division Ex. 2 (IT Ex. 4). Since the taking of this testimony, the Division collected the DCF report and it also shows a lower common stock return of 11.10% and a lower total account return of 5.58% for the total account. Division Ex. 18—Tab 16 at Halsey E09438. From July 2009 to the present, Pelosi has not offered any additional evidence that explains how his supposed manual adjustments led to the inflated figures appearing in this letter.
During the same investigative testimony, the Division showed Pelosi a February 8, 2008 letter he sent to David Belowski. Respondent Ex. 29 (Pelosi IT) at 137:18-149:15; Division Ex. 3 (IT Ex. 5) & Division Ex. 4 (IT Ex. 6).

Since the commencement of this administrative proceeding in January 2011, Pelosi has known that the Division alleges that his inflated performance figures were unsubstantiated and a fraud upon his clients. During the hearing in June 2011, the Division presented compelling evidence of Pelosi's inflation, including his client letters, corresponding Advent reports (both TWR and DCF) as well as the contemporaneous observations of his business partners and administrative assistants. And in response to this evidence, Pelosi has done absolutely nothing to substantiate the inflated performance figures he sent to his clients. From DCF reports to Modified Deitz calculations to preferred stock x-dividends, Pelosi has failed to offer any objective evidence showing a connection between his purported excuses and the inflated figures. The reason Pelosi has not offered such evidence is that it does not exist.

CONCLUSION

Pelosi has had several months, with the assistance of legal counsel and a team of supporters, to establish the validity of his supposed manual adjustments. With all of this time and all of this assistance, it turns out that Pelosi's excuses have been nothing more than an empty charade. He does not have any objective evidence supporting the validity of these inflated figures. Respondent Pelosi should now be held accountable for his misconduct.

Within the letter, Pelosi states that the total account performance had been a 6.4 percent loss for the most recent quarter ending January 31, 2008. Pelosi could not explain why his letter reported a 6.4 loss percent, but the Halsey TWR report showed a larger loss of 8.87 percent. Pelosi could not explain this inflation, but indicated that he used the DCF report for reporting quarterly performance. Again, the Division collected the applicable DCF report. It shows substantially the same total account loss of 8.88 percent. Division Ex. 23—Tab 193 at Halsey E09522. As of today, Pelosi has not offered any evidence explaining how his supposed manual adjustments led to this 240-basis-point inflation of total account performance.

Respectfully submitted,

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