CASE ID: SEC-001

EVIDENCE No. 47B

CONFIDENTIAL // EVIDENCE FILE 1934-PRESENT

THE SEC: A CASE FILE ON REGULATORY CAPTURE

An Investigation into the Decades-Long Corruption of America's Top Financial Regulator

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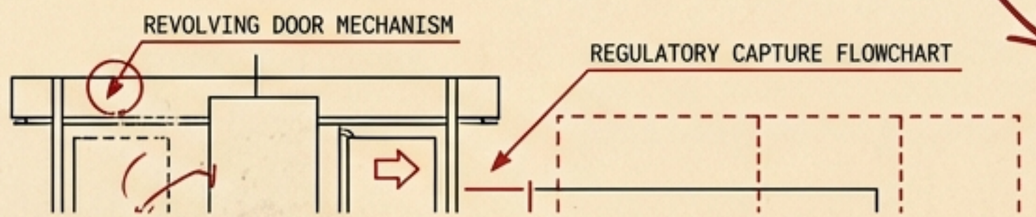
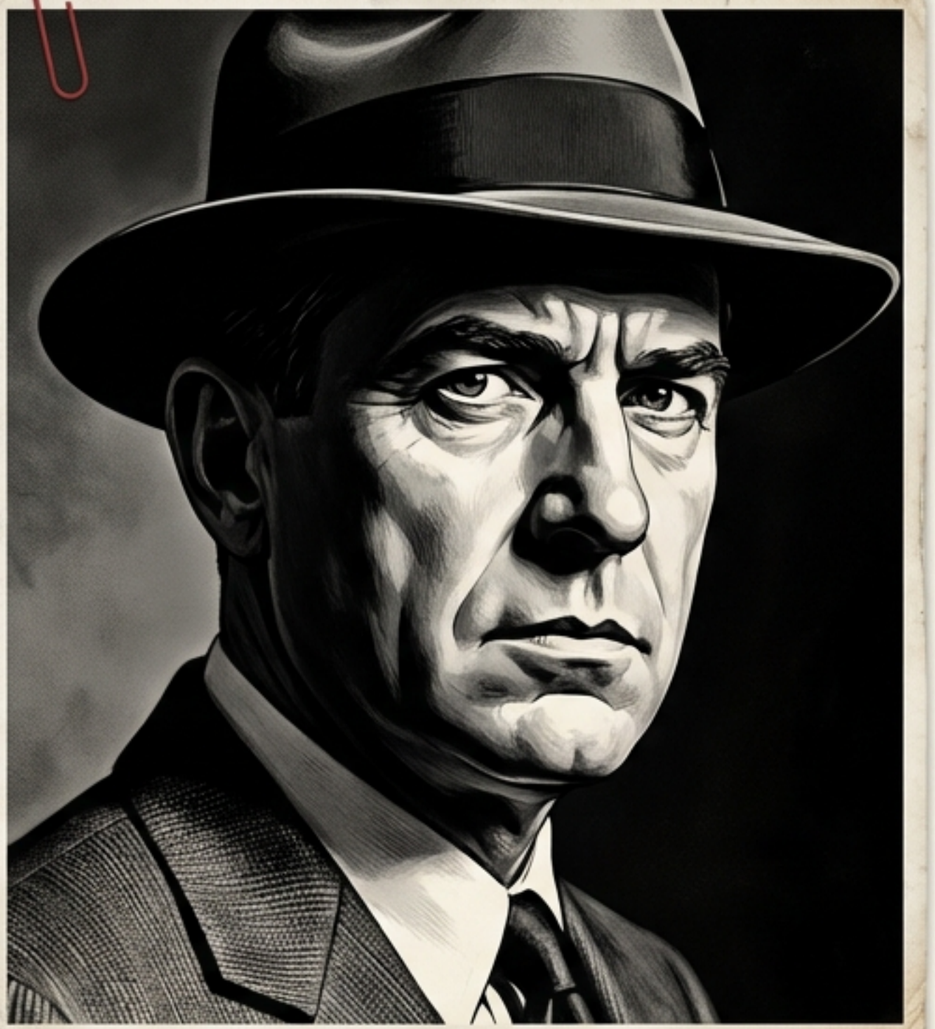


Based on the investigative reporting of Lucy Komisar

The Original Sin: “Legal Chicanery and Pitch Darkness”



EVIDENCE TAG #42-A: FERDINAND PECORA

“Had there been full disclosure... [these schemes] could not long have survived the fierce light of publicity and criticism. Legal chicanery and pitch darkness were the banker’s stoutest allies.”

- Ferdinand Pecora, *Wall Street Under Oath*

The 1929 market crash was fueled by rampant manipulation: counterfeit stock certificates (an early form of naked short selling) and “pools” to artificially pump stock prices.

The Pecora Commission, led by prosecutor Ferdinand Pecora, exposed the rot, revealing how institutions like National City Bank (now Citibank) hid bad loans in securities sold to unwary investors.

This public exposure created the political will for reform, leading to the Glass-Steagall Act and the Securities Exchange Act of 1934, which created the Securities and Exchange Commission (SEC).

SOUND FAMILIAR?

Then: Coordinated pools to pump stocks. **Now:** GameStop?

Then: Selling off packaged bad loans. **Now:** The 2008 mortgage-backed securities crisis?

The Sheriff is Hired—And Immediately Captured

CONFIDENTIAL

The Promise (1934–1939)

- FDR appoints Joseph Kennedy, a known financial manipulator, as the first SEC Chair.
- The rationale: “He knew where the bodies were buried.”
- For five years, the SEC makes genuine progress in cleaning up Wall Street.

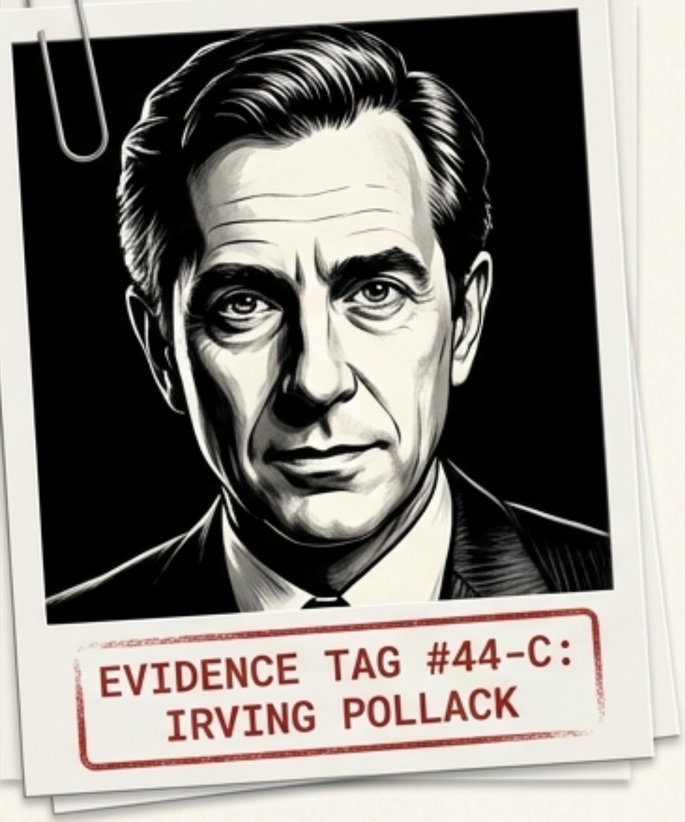
The Capture (Post-1939)

- Wall Street’s “bitterly hostile” reaction to regulation never faded.
- After Kennedy’s tenure, his “buddies of the financial oligarchy” took charge.
- This marked the beginning of “early regulatory capture,” a pattern of neutering the securities acts by ensuring the SEC would not enforce them. The foxes were now in charge of the henhouse.

EVIDENCE TAG #43-B1
JOSEPH KENNEDY

A Blueprint for Reform, Ignored for Decades

CASE NOTE: 1985 - The Pollack Report



The **National Association of Securities Dealers** (now **FINRA**) hires **Irving Pollack**, an **honest former SEC commissioner**, to study **short selling abuses**. His report proposed clear, common-sense solutions that would have curbed market manipulation.

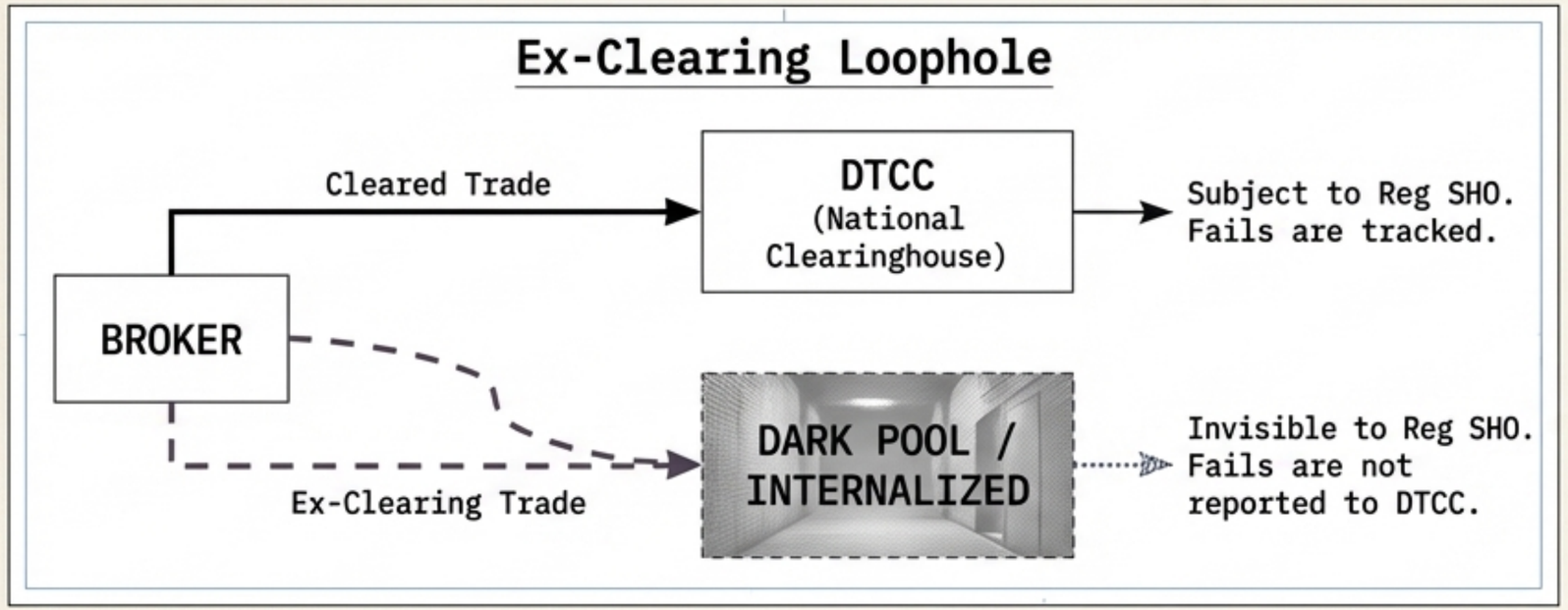
Key Proposals:

- ☒ Make short interest data public and more frequent.
- ☒ Require actual borrowing for delivery (no “locates”).
- ☒ Adopt a **mandatory buy-in** for failed trades after a reasonable period.
- ☒ Implement surveillance of large short-interest positions.

Conclusion: The SEC did not adopt these proposals with enthusiasm. The result: Short interest reporting remains infrequent, brokers use “locates” or counterfeit shares, mandatory buy-ins were rejected (as they would hurt short sellers by driving stock prices up), and surveillance is non-existent.

Regulation Designed to Fail: The Swiss Cheese of Reg SHO (2004)

"Think of Al Capone writing the tax laws."



Battered by complaints, the SEC enacted Reg SHO.

Lobbied by the very hedge funds and brokers engaging in illegal shorting, the final rule was riddled with intentional loopholes.

The SEC even rejected a proposal for penalties for failing to deliver shares.

Two Giant Loopholes:

1. **"Ex-Clearing**: The rule only applied to trades cleared through the DTCC. By routing trades through dark pools (now ~40% of all trades) or clearing internally, brokers could make fails "invisible." *If a trade failed ex-clearing, it didn't fail at the DTCC!*
2. **"The 'Madoff Exception"**: A massive loophole was created for options market makers, designed and pushed for by Bernie Madoff himself, allowing them to skirt the rules.

**Additional Failures*: *A "grandfather clause" allowed existing fails to continue indefinitely.*
Brokers used options conversions to put off fail dates forever.
Brokers used options conversions to put off fail dates forever.

EVIDENCE TAG #45-D: REG SHO

2008: A Sudden Panic Reveals the Truth

The Contradiction

OFFICIAL STANCE (Pre-2008)

The SEC repeatedly claimed naked short selling and fails-to-deliver were not a problem. Reg SHO had *not* reduced outstanding fails.

EMERGENCY ACTION (July 2008)

As the market imploded, the SEC banned naked short selling in 17 financial stocks (the very banks/brokers carrying out the scam on others) plus Fannie and Freddie.

The Revelation

The SEC's solution for the banks was exactly what reformers had demanded for years: a "pre-borrow" requirement, forcing traders to have shares in hand before shorting.

This proved the SEC knew naked short selling was a destructive force and had the tools to stop it. They chose to act only when the perpetrators themselves were "hoist on their own petard."

FOOTNOTE The SEC opened an investigation into the collapse of Bear Stearns, which had been massively naked shorted. It never made any findings public.

The System Protects Itself: How a ‘Hard Locate’ Was Killed

EVIDENCE TAG #45-E:
KAUFMAN ‘HARD LOCATE’

The Kaufman-Isakson Plan (2009)

- Following the 2008 meltdown, Senators Ted Kaufman (D-DE) and Johnny Isakson (R-GA) determined current SEC regulations were unenforceable.
- They proposed a “hard locate” rule: ban all short sales unless the broker first obtains a unique ID number for the shares from a centralized system, preventing the same share from being shorted multiple times.

SABOTAGE

The Internal Sabotage

Kaufman’s Chief of Staff, Jeff Connaughton, learned that the DTCC (the national stock clearing agency) had *already proposed a similar solution to the SEC.*

What happened? The DTCC told Connaughton, “**We got pulled back.**”

The reason: The DTCC’s board is composed of the very Wall Street powers-that-be who profit from the current system. **They ordered the DTCC to stand down.** The fox wasn’t just guarding the henhouse; it was on the board of the security company.

EVIDENCE LOG: A PATTERN OF IMPUNITY

Exhibit A: Goldman Sachs (2007)

Crime: For over two years (2000-2002), allowed customers to unlawfully short securities by falsely marking orders "long." Goldman's own records showed they knew this was happening.

Penalty: A $1 million civil penalty.

EVIDENCE

Exhibit B: Sedona / Badian Brothers (2003)

Crime: A "death spiral" financing scheme. A massive shorting attack drove a company's stock from $6 to $0.20.

Penalty: A $1 million fine for the primary actor, settled without admitting guilt. High-profile broker-dealer Ladenburg Thalmann, which facilitated the deals, was not charged.

UNRESOLVED

Exhibit C: OptionsXpress / Charles Schwab (2012)

Crime: Repeatedly used sham "reset" transactions to create the illusion of covering fails-to-deliver while perpetuating massive massive short positions. In one month, these accounts were 48% of the daily trading volume in Sears.

Penalty: $4 million.

REPEAT OFFENDER

DOSSIER: THE SILENCED WHISTLEBLOWER

Name: Gary Aguirre, Senior Counsel, SEC Division of Enforcement (hired 2004)

Motto: 'I understood what SEC was supposed to be doing: keep Wall Street from running amok.'

The Case: Assigned to investigate potential insider trading by John Mack, a powerful Wall Street 'industry captain,' in a deal involving Pequot Capital Management.

EVIDENCE

The Obstruction

- A senior SEC official warned Aguirre it would be 'very difficult' to take Mack's testimony due to his political influence and powerful lawyer, Mary Jo White (future SEC Chair).
- Aguirre was told powerful people could call Linda Thomsen (Head of Enforcement) to kill the investigation.
- When Aguirre refused to back down, senior officials blocked the subpoena for Mack's testimony.

RETALIATION

The Retaliation

Three days after contacting the Office of Special Counsel, Aguirre was fired by phone while on vacation (Sept 1, 2005).

The Aftermath

Aguirre sued the SEC and won. An Inspector General report later raised 'serious questions about the impartiality and fairness' of the SEC's investigation. The SEC ignored the IG's recommendations for reform.

THE WATCHDOGS TURN ON THE INVESTIGATORS

THE INVESTIGATION (2005)

EVIDENCE

Overstock.com CEO Patrick Byrne provides evidence to SEC investigator Mark Fickes, alleging a coordinated "bum rush" on his stock.

The pattern: A hedge fund shorts the stock, pays for negative reports from research firm Gradient Analytics, and sympathetic journalists write "hatchet jobs" to drive the price down.

Fickes, with approval from Enforcement head Linda Thomsen, subpoenas journalists Herb Greenberg, Carol Remond, and Jim Cramer to investigate their role.

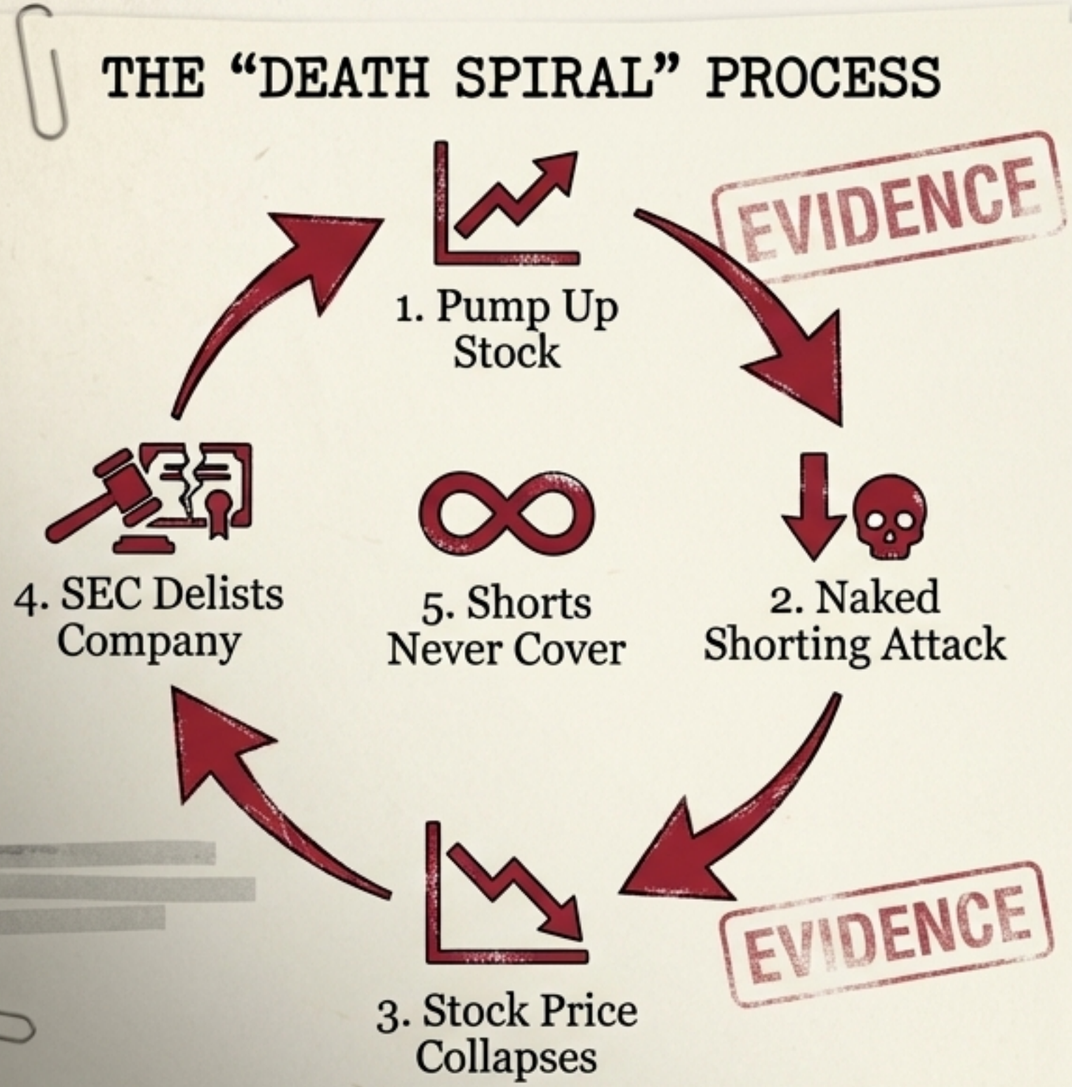
THE BACKLASH & THE CAVE-IN

The media frames the investigation as an attack on freedom of the press. The new SEC Chair, Chris Cox (the same chair who fired Gary Aguirre), summons Fickes to Washington.

Under pressure, Cox kills the subpoenas and the SEC drops its investigation into Gradient. The question of whether press freedom protects market manipulation was left unanswered.

RETALIATION

Finishing the Mob's Work: The Case of Eagletech



THE CRIME (2005)

- Organized crime figures work with Salomon Smith Barney officers on a financing scheme against Eagletech.
- A pump-and-dump scheme combined with massive naked shorting drops the stock from $14 to $0.02, wiping out $113 million in market value.
- The FBI busts the mob members involved. The SEC fines them and bans them from penny stock trading.

THE BETRAYAL

- No penalties were brought against the Salomon Smith Barney team or their market maker collaborators who facilitated the scheme.
- The SEC then sued the victim, Eagletech, to deregister its shares because it could no longer afford to file audited financial reports.
- **The result:** The delisting is like a bankruptcy. All investors are wiped out, and the naked shorters are permanently freed from their obligation to buy back and deliver the shares. The SEC finished what the mob started.

The Pattern of Corruption: A Closing Argument

The evidence presented in this case file reveals a clear and repeating pattern:

1. **Intentional Loopholes**: Regulations like Reg SHO are deliberately written with exceptions (ex-clearing, market maker exemptions) that render them ineffective.

2. **Reforms Ignored & Blocked**: Sensible solutions proposed by experts like Pollack (1985) and Kaufman (2009) are consistently ignored or actively sabotaged by Wall Street interests within the system (e.g., the DTCC board).

3. **Penalties as a "Cost of Business"**: Enforcement actions, when they occur, result in trivial fines ($1M, $4M) that are insignificant compared to the illicit profits, encouraging repeat offenses.

4. **Whistleblowers Silenced**: Honest staffers like Gary Aguirre and Mark Fickes who attempt to prosecute powerful players or uncover are obstructed, overruled, and forced out.

5. **Selective Enforcement**: The SEC's full power is deployed insself is at risk (Eagletech), or against the victims of io ordinary investors.

The Mandate for Reform

The solutions have been known for decades. The only missing element is the will to implement them.

Required Actions:

- ☑ **Mandatory Buy-Ins:** Require the broker of a buyer who doesn't receive shares to buy them on the open market and charge the seller's broker. This directly penalizes fails-to-deliver.
- ☑ **Restore the Uptick Rule:** Prohibit short sales at a price lower than the previous trade to stop 'bear raids' designed to hammer a stock into bankruptcy.
- ☑ **Finish the Consolidated Audit Trail (CAT):** Over a decade after it was promised post-2010 'flash crash,' create the system to track all orders and executions to identify illegal trading.
- ☑ **Impose Real Penalties:** Move beyond trivial fines. Introduce meaningful deterrents, including the loss of license for serial offenders.
- ☑ **Criminal Prosecution:** Refer cases of serial trading cheats to the Department of Justice for criminal charges.
- ☑ **End the Revolving Door:** Stop the seamless flow of personnel between the SEC and the Wall Street firms it is supposed to regulate.

EVIDENCE

The Final Question: Who Does the SEC Serve?

What will Gary Gensler do? And will he listen most to the pushback from the big brokers or to investors?

The history is clear. The patterns are undeniable. The solutions are known. The future of American market integrity depends on the answer to this one question.