Journal of Forensic & Investigative Accounting
Vol. 7, Issue 1, January - June, 2015

Peregrine Financial Group Inc./Best Direct Securities LLC: Anatomy of A 21st Century Fraud

Steven A. Solieri
Joan Hodowanitz*

The Peregrine Financial Group Inc./BEST Direct Securities LLC (PFG-BEST) should have celebrated its 20th anniversary as a registered Futures Commission Merchant (FCM) on July 15, 2012. But instead of toasting its success as the nation's second largest FCM, the company found itself in a corporate death spiral. Its founder and sole owner, Russell Wasendorf Sr., attempted suicide on July 9th, and the company filed for Chapter 7 bankruptcy protection on July 10th. By July 20th, it had liquidated 98 percent of its customer accounts, and a trustee had taken control of all corporate assets. These events were precipitated, not by a sudden market panic, but by the implementation of electronic confirmation of customer account balances, a process that was certain to uncover a $215 million fraud that stretched over a 20-year period. Like most frauds, this one should have been uncovered shortly after it first began. The fact that Wasendorf escaped detection for so long is a reflection of his ingenuity as a criminal and a lack of professionalism on the part of the watchdogs who were charged with monitoring this company's activities.

HISTORY OF PFG-BEST

Based in Cedar Rapids, Iowa, PFG-BEST was once hailed as the nation's second largest non-bank, non-clearing Futures Commission Merchant (FCM) (Girard Gibbs 2012). It had been incorporated by its founder, Russell Wasendorf Sr., in 1990 as an outgrowth of Wasendorf & Son, Inc., an electronic trading platform for commercial clients (see Appendix A). The company was registered as an FCM on July 15, 1992. An FCM is a brokerage firm that receives monies, securities, and other property from customers ("customer funds") in order to margin, guarantee, or

* The authors are, respectively, Assistant Professor of Accounting at Queens College, and LTC, US Army (Ret).

secure futures and option trades (Phelps 2013). FCMs are regulated by the U.S. Commodity Futures Trading Commission (CFTC) and the National Futures Association (NFA), a futures industry self-regulatory organization. Current Commodity Exchange Act (CEA) regulations mandate the segregation of customer funds from other monies. Under no circumstances are these segregated accounts to be commingled with other funds.

PFG-BEST grew significantly over the next two decades, merging with American National Trading Corporation in 2007 and Alaron in 2009. The company expanded its product line to include foreign exchange (forex) in 1995 and precious metals in 2009. It even developed markets in Canada in 2002, New York in 2004, Asia in 2005, and Shanghai in 2006. In 2011, the company won an Iowa Character Award for demonstrating and promoting trustworthiness, respect, responsibility, fairness, caring, and citizenship. Also in 2011, *Smart Money Magazine* ranked the firm first in forex trading and customer service (Morgan 2011). In July 2012, PFG-BEST boasted of nearly 200 employees and more than $400 million in customer accounts. How could such a seemingly successful company go from its role as an industry leader to a cautionary tale for other brokerage firms and industry regulators in the space of a single day?

This question can be answered partly by the NFA's new mandate to replace the traditional paper-based confirmation of customer account balances with an electronic confirmation system. Just nine months earlier in October 2011, MF Global, another high-profile FCM, suffered a major financial meltdown following the misappropriation of more than $891 million from customer funds to cover losses from European sovereign debt. By the time the company declared bankruptcy on October 31st, there was at least a $1.6 billion shortfall in customer accounts. In an effort to better protect customer funds in the future, the NFA decided to start using electronic confirmation of customer account balances, and it contracted with Confirmation.com to provide this service.

In July 2012, the NFA was in the process of auditing PFG-BEST. Wasendorf had long resisted adopting Confirmation.com to verify customer account balances, but on Sunday, July 8th, he finally gave in and approved its use. The next day, July 9th, as the Confirmation.com software poured over his company's accounts, Wasendorf attempted suicide by asphyxiating himself in his car. He knew that his 20-year fraud was about to be exposed, and suicide seemed to be the only solution to a hopeless situation. On July 10th, Russell Wasdendorf Jr., his son and the company's President and Chief Operating Officer, filed for Chapter 7 bankruptcy protection. PFG-BEST's wild ride in the futures industry was finally over.

THE FRAUD TRIANGLE: ANATOMY OF YET ANOTHER CORPORATE CRIME

There have been many examples of corporate fraud in the 20th and 21st centuries. Some, like the FCM MF Global in 2011, approached the $1 billion mark. The one thing that all these frauds have in common is that they can all be analyzed using the Fraud Triangle developed by criminologist David Cressey (see Appendix B). According to Cressey, there are three basic elements in all crimes including fraud. First, there is the pressure or motivation to commit the fraud. This element may be difficult to determine since the perpetrator is the best source of such information. Motivating factors can be very complex, and sometimes the perpetrator lies even to himself. The second element is the opportunity to execute the fraud. This can often be explained by examining financial audits and other regulatory tools, but there are times when only the perpetrator can fill in the gaps in our understanding. The third and final element involves the perpetrator's rationalization of the fraud, how he justifies his actions to himself and others. Like the element of pressure, it helps to have an explanation from the perpetrator himself. In the case of Wasendorf and the PFG-BEST fraud, we have the advantage of a detailed suicide note in which Wasendorf tries to explain what happened and why (see Appendix C. Excerpts from this note are italicized.)

Pressure: What Was I Thinking?

Wasendorf claims he was motivated to commit fraud by an ongoing financial crisis in his company and his own overblown ego. He needed more money because CFTC regulators were constantly pressuring him to maintain a much higher level of capitalization just to continue as a going concern. Money was also needed to pay various regulatory fines and legal fees and to finance an $18 million office building in Cedar Rapids. In short, Wasendorf had backed himself into a corner, but he just could not admit defeat. "*I had no access to additional capital and I was forced into a difficult decision: Should I go out of business or cheat? I guess my ego was too big to admit failure. So I cheated.*"

Opportunity: Wasendorf's Confession

Wasendorf boasts that it was very easy for him to continue the fraud for 20 years. All he had to do was doctor the company's bank statements and then make sure no one else saw the real documents.

> "*The forgeries started nearly twenty years ago and have gone undetected until now. I was able to conceal my crime of forgery by being the sole individual with access to the US Bank accounts held by PFG. No one else in the company ever saw an actual US Bank statement. The Bank statements were always delivered directly to me when they arrived in the mail. I made counterfeit statements within a few hours of receiving the actual statements and gave the forgeries to the accounting department*."

He also needed a bogus post office box to fool his independent auditor and industry regulators.

> "*When it became a common practice for Certified Auditors and the Field Auditors of the Regulators to mail Balance Confirmation Forms to Banks and other entities holding customer funds I opened a post office box. The Box was originally in the name of Firstar Bank but was eventually changed to US Bank. I put the address 'PO Box 706, Cedar Falls, IA 50613-0030' on the counterfeit Bank Statements. When the auditors mailed Confirmation Forms to the Bank's false address, I would intercept the Form, type in the amount I needed to show, forge a Bank Officer's signature and mail it back to the Regulator or Certified Auditor*."

And if those tricks were not sufficient, Wasendorf could always rely on the regulators' bureaucratic tunnel vision to avoid detection.

> *"It was relatively simple to deceive the Regulators during the Annual Audits since their Audit Modules guided them to find a number, tick a box, tie out totals, etc. They counted on the mailed back Bank Balance Confirmations to detect any shortfall in cash balance totals. They had no way to detect a counterfeit bank statement. They were actually distracted by their own agenda — to catch firms unknowingly violating regulations*."

Opportunity: Red Flags Galore

Consider the many red flags that Wasendorf does not discuss in his suicide note, but that competent regulators and auditors should have recognized (see Rothfield, Patterson, Bunge 2012; Wasik, 2012, and PrivCo, 2012). First there were the whistleblower tips. According to the *New York Times*, letters were sent to NFA and/or CFTC in 2004 and 2009 asking one or both agencies to investigate the misuse of customer funds. No one knows how seriously these tips were taken, and there is no record of follow-up investigations.

Then there was the obvious conflict of interest between the NFA and Wasendorf. The NFA actually audited PFG-BEST while Wasendorf was a member of the NFA's Board of Advisors. The NFA never challenged his position on that board even though the CFTC and the NFA both cited PFG-BEST for numerous violations of the rules. Consider the following list of red flags dating back to 1995.

1. 1995: The NFA cited PFG-BEST for failure to have segregated funds on two separate dates.
2. 1995-2011: PFG-BEST was involved in 31 NFA arbitration disputes with customers with more than half of the disputes occurring after early 2011. There were also 38 similar cases with the CFTC (see Rothfeld, Patterson, and Bunge 2012).
3. 1996: Problems with promotional material claims of huge profits with PFG-BEST paying $75,000 in fines.

4. 2000: The CFTC fined PFG-BEST $90,000 for reporting failures and improper reporting of capital requirements.
5. 2004: The NFA fined PFG-BEST $5,000 for failing to audit one of its brokers as directed by the NFA.
6. 2007: A client brought a civil lawsuit alleging that PFG-BEST opened and maintained accounts fraudulently. In 2009, the judge ruled that PFG-BEST had violated Section 4b of the Commodity Exchange Act and awarded $500,000 to the client (see PrivCo 2012).
7. 2011: The NFA performed a routine annual audit of PFG-BEST in early 2011. According to the written confirmation received from U.S. Bank, there was less than $10 million in the customer segregated account. The auditors, however, were expecting over $200 million. When NFA's auditors asked PFG-BEST's management about the discrepancy, they were given a new confirmation document that had been faxed on U.S. Bank's letterhead and dated just days after the original. It stated that the account had in excess of $218 million (see PrivCo 2012). No one knows why the bogus fax was accepted over the direct mail version or why further inquiries were not made considering the amount of the discrepancy (over $200 million). In his written testimony at a Senate hearing on futures markets, Terrence Duffy, Chairman and President of CME Group Inc., stated that a call to the bank is a lower form of evidence than a written confirmation.
8. 2011: BEST Direct's Vice Chairman, Neil Aslin, was the subject of disciplinary action when he worked for Brewer Financial Services, his previous employer. Because of his position at BEST Direct, PFG-BEST was subject to the Financial Industry Regulatory Authority (FINRA) "*Taping Rule*". This meant that calls between brokers and clients had to be recorded. BEST Direct, in an effort to avoid the requirement to tape calls, pretended to fire

Aslin when, in fact, he continued to work as a company officer. Apparently no one at FINRA ever questioned why BEST Direct was so reluctant to have its calls taped (see PrivCo 2012). Was there something they did not want recorded?

9. 2012: The NFA charged PFG-BEST and its senior executives with unauthorized trading in client accounts and fraudulent sales tactics. PFG-BEST settled for a minor fine (see PrivCo 2012).
10. January, 2012: The CFTC and NFA performed a joint "spot check" of 70 FCMs including PFG-BEST, but they detected no problems with customer funds (see Rothfeld, Patterson, and Bunge 2012).

<u>Opportunity: The Understaffed Independent Auditor</u>

Considering the size and complexity of PFG-BEST's activities, Wasendorf's choice of an independent auditor should have raised all kinds of red flags. Veraja-Snelling & Company (VS&Co) was an obscure Illinois-based audit firm run by Jeannie Veraja-Snelling, a certified public accountant. Unfortunately, the phrase *"& Company*" meant nothing at all. According to reports filed with the Public Company Accounting Oversight Board (PCAOB), VS&Co was a one-woman operation. Although some documents filed with the PCAOB state that VS&Co occasionally employed trained per diem staff, there is no evidence that this staff assisted in the audits of PFG-BEST.

As a CPA in New York, Pennsylvania and Florida, the lead author of this article is required to complete two ethics courses annually that detail the licensing laws and rules in those states. There is a rule that states that a CPA may not practice in a false or misleading manner. This includes the choice of a firm name. According to Rule 502 of the American Institute of Certified Public Accountants (AICPA), a CPA cannot engage in false, misleading, or deceptive advertising. Illinois, the state that licensed VS&Co, has its own rule that says "a registered public accountant shall not practice under a firm name that is misleading . . .", but VS&Co did just that. Its name suggests that the firm is larger than it actually is. Veraja-Snelling should have billed herself as a sole practitioner.

From July to January 2014, there is no record of any disciplinary action against VS&Co or Jeannie Veraja-Snelling by Illinois or the PCAOB. According to Illinois's database, VS&Co was registered until November 30, 2012 when its license either lapsed or was not renewed. Although the PCAOB only discloses disciplinary action after settlement or the issuance of final orders, discussions with the PCAOB's staff indicate that some type of disciplinary action is currently underway. Not surprisingly, VS&Co requested withdrawal as a registered PCAOB firm as of October 18, 2012, and its request has been approved.

According to the PCAOB, VS&Co's last known address was 1326 Glen Ellyn Road, Glendale Heights, Illinois 60139-3209. Before that it was located at 567 James Court, Glendale Heights, IL 60139, in a one-bedroom home (PrivCo 2012). Both addresses are residential rather than commercial properties. While many small auditing firms operate from a home office, it is unusual for a company the size of PFG-BEST to engage an auditor with no commercial offices.

VS&Co had other clients in the futures industry, and it did find internal control weaknesses in those clients. Ironically, some of those weaknesses existed at PFG-BEST, but somehow they escaped the auditor's notice. This suggests either a considerable degree of professional incompetence or a lack of integrity on the part of the independent auditor.

Whenever a major fraud is uncovered, the question that is most often asked is "where were the auditors?" That question is especially relevant since PFG-BEST had a history of questionable practices that should have alerted the independent auditor and industry regulators to the potential for fraud. Unfortunately, those who were paid to act as public watchdogs did not react to the obvious red flags. According to the latest Securities and Exchange Commission (SEC) reports on internal controls for BEST Direct Securities, LLC for fiscal years ending 2008 through 2011, VS&Co "noted **no** matters involving internal control structure that **we** consider would be a material weakness . . ." [emphasis added] The reports for Peregrine Financials & Securities, Inc. indicate a similar pattern in 2001 and 2002 (see Appendix D). There are no reports for BEST Direct Securities, LLC for fiscal year 2007 or earlier. A search is ongoing for any missing reports, but nothing has been found as of the date of this paper. The BEST Direct reports were signed by VS&Co, but the reports for Peregrine Financials & Securities, Inc. were signed by DiMaggio, Veraja & Company, LLC, a firm located at VS&Co's old address at 567 James Court.

According to the PCAOB, VS&Co audited only one other client prior to 2010, Corporate Investments Group, Inc. in Chicago, Illinois. VS&Co detected one internal control material weakness in 2006 and two in 2007. Of the two weaknesses uncovered in 2007, one dealt specifically with the improper segregation of customer funds for a private placement. This is eerily similar to the situation at PFG-BEST, a weakness that VS&Co failed to identify.

On August 26, 2012, Veraja-Snelling was permanently prohibited from practicing before the CFTC for violations of regulation 1.16. The specific charges included:

1. Lack of expertise to audit an FCM (lack of knowledge of the client and the industry).
2. Failure to exercise due professional care (ordinary negligence).
3. Failure to identify material weaknesses in internal controls because of exclusive control by Wassendorf over customer segregated accounts and financial reporting, and
4. Improper conduct of the confirmation process of bank balances.

According to David Meister, CFTC's Director of Enforcement, these violations "constituted improper, unprofessional conduct." He summed up the CFTC's action as follows.

> "As the Peregrine debacle shows, the importance of the independent accountant's gatekeeper function cannot be overstated. FCMs and, most importantly, their customers, rely on auditors to approach each and every auditing assignment professionally and with due care. There is no place in the CFTC-regulated world for **below-standard audits** or **auditors who do not have a sufficient understanding of the futures industry**." [emphasis added] (CFTC Release #6675-13, 2013).

Opportunity: U.S. Bank's Role in the Fraud

Another series of red flags involved U.S. Bank National Association, the fifth largest bank in the nation. On June 5, 2013, the CFTC filed a complaint against U.S. Bank for "unlawfully using and holding Peregrine's customer segregated funds" in violation of CEA, 7 U.S.C. §§ 1 et seq., and CFTC regulations, 17 C.F.R. §§ 1 et seq. These regulations prohibit financial institutions from holding customer funds "as though they belong to anyone other than the customers" (Touryalai 2013). They also prohibit the granting of credit based on such customer funds (see the Ponzi Book blog quoted below).

According to the CFTC's complaint, U.S. Bank served as the depository institution for PFG-BEST from September 2008 to July 2012. The bank accepted PFG-BEST customer funds as collateral for loans to Wasendorf, his spouse, and his construction company and treated those funds as a PFG-BEST commercial checking account. The complaint also highlights the scope of the fraud. Over $215 million from 24,000 PFG-BEST customers was misappropriated. Wasendorf's bogus reports reflected a minimum balance of more than $200 million since May, 2005, but the average balance was actually more like $15.7 million. When Wasendorf was finally convicted of fraud, he was sentenced to 50 years in prison which, given his age of 64, is a virtual life sentence. He was also ordered to pay more than $215 million in restitution (Benoit 2013).

An Internet blog known as the "Ponzi Book" cites the commingling of funds as one reason for the CFTC's unprecedented inclusion of U.S. Bank in its complaint.

> " . . . the CFTC alleges [that] U.S. Bank held and used Peregrine's customer funds as security on a $3 million loan to Wasendorf and his wife and to make a $6.4 million loan to Wasendorf Construction, L.L.C. The CFTC also alleged that customer funds were in an account that U.S. Bank treated as if it were Peregrine's commercial checking account and knowingly allowed and facilitated Wasendorf's transfers of customer funds out of this account to pay for Wasendorf's private airplane, his restaurant and his divorce settlement, among other things. It is alleged that U.S. Bank knew that these transfers were not for the benefit of Peregrine's customers."

The Ponzi Book also points to a possible bank insider (the unnamed *"Banker A"*) who may have unintentionally, yet negligently, assisted in the fraud (see Phelps 2013).

> "An intriguing aspect of the complaint alleges that '*Banker A'*, an 'Assistant Relationship Manager' who worked at a Cedar Falls branch of the Bank, handled much of Peregrine's transactions for the Bank. The complaint does not identify '*Banker A'* by name or disclose why her identity is concealed. The CFTC alleges that Wasendorf instructed the Bank to communicate only with him, and that any communications about the Bank had to be with '*Banker A'*. In summary, the complaint alleged that, 'U.S. Bank knew that Wasendorf's mandates concerning the 1845 Account were highly unusual.'"
>
> "The complaint also painstakingly describes how '*Banker A*' and U.S. Bank knew that Peregrine's account was a customer segregated account and that the funds in it came from customers. The complaint goes on to allege that the Bank knowingly facilitated the transfer of customer funds in violation of the commodities laws. Although it comes close, the complaint does not allege that the Bank knew of Peregrine's fraudulent scheme." [emphasis added]

Given the allegations against U.S. Bank, "a complaint for negligence, breach of fiduciary duty, or possibly aiding and abetting does not seem out of the realm of possibilities."

As might be expected, U.S. Bank's attorney filed a motion to dismiss the lawsuit claiming that the CFTC was trying to shift responsibility for the fraud to the bank even though the bank was just another victim. The motion, however, was rejected (U.S. Commodity Futures Trading Commission vs. U.S. Bank, N.A., U.S. District Court, Northern District of Iowa, No 13-cv-2041 (see Reuters 2013 or http://www.theponzibook.com/CFTC_v_US_Bank_Complaint.pdf to view the actual complaint).

Rationalization: The Devil Made Me Do It

Even though Wasendorf admitted his guilt in his suicide note, he tried to rationalize his actions by shifting the blame to one particular regulator who made it his mission to catch PFG-BEST violating the rules.

> *"The rogueries started after I was in a battle with the Kansas City Commodity Futures Trading Commission's office. I was specifically attacked and harassed by CFTC's Branch Manager Robert Agnew. The reason for his vindictive actions was that I appear to have embarrassed him!"*

When Agnew accused Wasendorf of breaking the rules, Wasendorf countered that Agnew's rules were out of date.

> *"When I told Agnew that he had given me the outdated rules, he was livid! He apparently didn't like being told that he was wrong. During the ensuing 5 months he and his team performed 6 onsite audits of PFG, until they found a technical violation."*

Having been caught in a "technical violation," Wasendorf believed all CFTC regulators were now singling him out for "*heightened scrutiny*."

> *"It was [during] this encounter with CFTC's Agnew that I discovered that the Industry's regulators often used audits of Firms as punishment and for retaliation. And I saw for the first time the mean spirited nature of the industry's Regulators."*

The elements of rationalization and pressure are also evident when Wasendorf explained what he did with his ill-gotten fortune.

> *"I know the question remains, what did I do with the money? Most of the misappropriated funds went to maintain the increasing levels of Regulatory Capital to keep PFG in business and to pay business loses [sic]. A portion went to build the office building at One Peregrine Way, (I had hoped that a mortgage on the building would pay back the cost of building but the appraisal came in tragically low). I even used Customer Funds to pay Fines and Fees charged by the regulators".*

Wasendorf's claim that he intended to repay at least part of the stolen funds allowed him to justify his conduct in his own mind. Even though the fraud was not his fault, he would make everything right in the end.

Wasendorf's contempt for the "mean spirited" industry regulators was first expressed in letters to the *Wall Street Journal* that he wrote years earlier. He made no secret of his disdain for the regulatory process and the auditors who were part of it. In his opinion, PFG-BEST neither needed nor benefited from regulation. The CFTC's capital requirements were nothing more than a veiled attempt to limit his success as a businessman. Consider the following excerpt from an open letter to the *Wall Street Journal* in which he rails against high capital requirements (Wasendorf 2008).

> "*The effect [of high capital requirements] will be elimination of 65% of FCMs from participating in an investment sector that investment banks virtually monopolize — investment banks so large and complex that it has taken months to determine their exposure to subprime loan bundles. But it penalizes smaller firms that are accessible, which open their books to inspections, and which represent American innovation to keep markets fair and transparent*."

Opposed to the planned merger of the Chicago Merchantile Exchange and the Chicago Board of Trade, Wasendorf had this to say about the Futures Industry Association (FIA) (Wasendorf 2007).

> "*The FIA does not represent the best interests of the futures industry with this stand nor in general. The association purports to be an advocate for all futures firms, but its board is dominated by the big New York investment banks and the global wire houses. The organization had its roots in New York, where it was founded in 1955, and it has always given short shrift to Chicago, the home of the U.S. futures industry*."

CONCLUSION

While the PFG-BEST case is far from the largest financial fraud in the past 20 years (think MF Global and its $1.6 billion shortfall in customer funds), it does illustrate how ineffective many of our traditional auditing processes are and how little we seem to have learned from previous scandals. The electronic confirmation of bank statements has been available for more than a decade, but we are just now mandating the use of 21st century technology. Auditors and industry regulators continue to ignore what, in hindsight, are clear and unambiguous red flags. Even the agency tasked with oversight of auditors – the PCAOB – sometimes fails to identify and weed out incompetent members of the auditing profession. We can always use models like David Cressey's Fraud Triangle to perform post mortems on companies like PFG-BEST to reduce the risk of future frauds.

Nevertheless we, the investing public, may be too naïve for our own good. We still trust the auditing profession to provide accurate assurances in the assessment of companies that take our money. If the PFG-BEST scandal teaches us anything, it is this: "Let the buyer beware!"

REFRENCES

Benoit, David. PFG Best's Wasendorf was a Mouthpiece for Futures Industry, *Wall Street Journal*, July 10, 2012. http://blogs.wsj.com/deals/2012/07/10/pfgbests-wasendorf-was-a-mouthpiece-for-futures-industry/

Benoit, David. Wasendorf Gets 50 Years: How That Ranks With Other Schemers, *Wall Street Journal*, January 31, 2013. http://blogs.wsj.com/deals/2013/01/31/wasendorf-gets-50-years-how-that-ranks-with-other-schemers/

Bunge, Jacob. Peregrine's Wasendorf Jr. Sues U.S. Bank, *Wall Street Journal*, September 17, 2012. http://online.wsj.com/news/articles/SB10000872396390443995604578002181256493010

CFTC Regulation 1.16. http://www.law.cornell.edu/cfr/text/17/1.16

Commodities Futures Trading Commission Press Release #6675-13 dated August 26, 2013 about Jeannie Veraja-Snelling and Veraja-Snelling & Company. http://www.cftc.gov/PressRoom/PressReleases/pr6675-13

Commodities Futures Trading Commission Press Release #6675-13 dated August 26, 2013 about U.S. National Bank Association (U.S. Bank). http://www.cftc.gov/PressRoom/PressReleases/pr6601-13

Girard Gibbs, LLP website. Class Action Lawsuit Against U.S. Bank, JPMorgan Chase and Former Officers of Peregrine Financial Group, Inc., undated. http://www.girardgibbs.com/peregrine-financial-group/

In the United States District Court for the Northern District of Iowa Eastern Division, United States Commodity Futures Trading Commission vs. U.S. Bank, N.A., Case No.: 13–Civ–2041–EJM, Complaint Seeking Permanent Injunction, Civil Monetary Penalties, And Other Equitable Relief, filed 06/05/13. http://www.cftc.gov/ucm/groups/public/@lrenforcementactions/documents/legalpleading/enfusbankcomplaint060513.pdf

Morgan, Sarah. The Best Brokers for Forex Trading, *Smart Money Magazine*, May 10, 2011. http://www.marketwatch.com/story/the-best-brokers-for-forex-traders-1304970934690

National Futures Association, News Release, dated May 29, 2012. http://www.nfa.futures.org/news/newsRel.asp?ArticleID=4032

Phelps, Kathy Bazoian. CFTC Sues U.S. Bank for Its Role in the Peregrine Financial Ponzi Scheme, in the Ponzi Book-A Legal Resource for Unraveling Ponzi Schemes, June 7, 2013. http://theponzibook.blogspot.com/2013/06/cftc-sues-us-bank-for-its-role-in.html or http://www.theponzibook.com/CFTC_v_US_Bank_Complaint.pdf

PrivCo (Private Company Financial Intelligence), Inside Peregrine Financial's Secret Web; Multiple Private Companies Devastated By Broker's Collapse; Peregrine's 1-Woman "Work From Home"

Audit Firm, July 12, 2012. http://www.privco.com/press/inside-the-secret-world-of-peregrine-financial-undetected-red-flags

Reuters. Judge Rejects U.S. Bank's Motion to Dismiss CFTC Lawsuit, November 5, 2013. http://www.reuters.com/article/2013/11/06/usbank-cftc-lawsuit-idUSL3N0IR0V720131106

Rothfeld, Michael; Patterson, Scott and Bunge, Jacob. Red Flags at Failed Broker: Firm Was Subject of Multiple Actions; Investigators Study 'Incredible Forgeries', *Wall Street Journal*, updated July 13, 2012. http://online.wsj.com/news/articles/SB10001424052702303644004577523283640238486

The Illinois Joint Committee on Administrative Rules, Administrative Code-Title 68 Professions and Occupations, Chapter VII Department of Financial and Professional Regulation, Subchapter b Professions and Occupations, Part 1430 Public Accounting Act Professional Conduct, Section 1430.5050 Form of Organization and Name, Section 1430.5050 subparagraph b. http://www.ilga.gov/commission/jcar/admincode/068/068014300F50500R.html

Touryalai, Halah. US Bank Also to Blame for Peregrine's Missing $215 M: CFTC Suit, *Forbes Magazine*, June 5, 2013. http://www.forbes.com/sites/halahtouryalai/2013/06/05/us-bank-also-to-blame-for-peregrines-missing-215m-cftc-suit/

Wasendorf, Russell R. Congress Hits Smaller Forex Traders, *Wall Street Journal*, October 24, 2008. http://online.wsj.com/news/articles/SB122481079648865205

Wasendorf, Russell R. In Futures Trade, New York Battles Chicago, *Wall Street Journal*, May 7, 2007. http://online.wsj.com/news/articles/SB117850405479594112

Wasik, John. Pergrine's Red Flags, *Forbes Magazine*, July 12, 2012. http://www.forbes.com/sites/johnwasik/2012/07/12/peregrines-red-flags/

Written Testimony of Terrence A. Duffy, Executive Chairman & President CME Group Inc. before the Senate Committee On Agriculture, Nutrition &Forestry Hearing On Examining the Futures Markets: Responding to the Failures of MF Global and Peregrine Financial Group" August 1, 2012 (available on-line via PDF). http://www.ag.senate.gov/hearings/examining-the-futures-markets-responding-to-the-failures-of-mf-global-and-peregrine-financial-group (all Testimony) or http://www.ag.senate.gov/download/?id=0f4d1221-3ff7-46ea-a45f-00f43452abaa

APPENDIX A: PFG-BEST TIMELINE

PFG BEST
The BEST thing about our technology is our people.

1972

In 1972, Russell R. Wasendorf, Sr., a futures trader in Cedar Falls, Iowa, begins hosting seminars and educational programs for commodity firms and introduces the technical-driven Wasendorf Trading System™.

Russell R. Wasendorf, Sr.

1980

1980 Wasendorf & Son, Inc. is created to satisfy growing demand for futures market education and research. Initial goals are to alert clients to long-term price trends, provide global intelligence and develop and distribute index products.

1986 Wasendorf launches work on an electronic trading platform that will be a proprietary tool for the firm's commercial clients. This involved scouring the industry for the best minds in technology. This very early work became the foundation for direct access to the markets. Wasendorf himself became deeply involved in electronic trading best practices.

1987 It was widely reported in the Financial Times, The Wall Street Journal, Business Week and other global news sources that Wasendorf clients, following an Oct. 9 advisory, went short financial futures markets just before "Black Monday" occurred Oct. 19. Wasendorf used an enormous profit windfall to expand the enterprise and to invest in online trading technology development.

1990

1990 Peregrine Financial Group, Inc. (PFG) was born of the original Wasendorf & Son, Inc., founded on the belief that an educated trader will enjoy a longer, more satisfying experience of the market. New offices continued to open and headquarters moved to Chicago.

1992 JULY 15, Company is incorporated as a Futures Commission Merchant, officially registered with the National Futures Association.

1995 PFG launches its forex business.

1998 The BESTDirect online trading system is created, tested and ready to make a direct connection for personal traders into the CME's Globex trading engine. It was among the first to do so.

2000

2002 PFG Canada, a wholly-owned subsidiary, is established.

2003 PFG creates its own trading competition to identify emerging trading talent that can be leveraged for managed futures and managed FX accounts.

2004 PFG New York hires a team from Royal Bank of Canada to provide institutional forex execution as part of its established New York Forex Division.

2005 PFG Asian Division is established.

2006 PFG Shanghai office is opened.

2007 PFG acquires customer assets of American National Trading Corporation, growing customer segregated accounts by 10%.

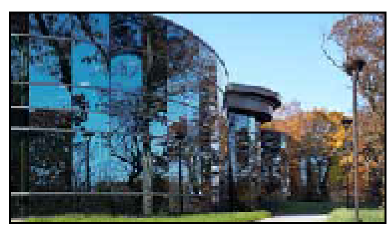
2008 Taking advantage of its website URL (www.PFGBEST.com) the company changes its brand to PFGBEST, and creates the enduring tagline, "The BEST thing about our technology is our people." That same year was the 10th anniversary of its BESTDirect online trading platform.

2009 PFGBEST acquires the customer assets of futures trading firm Alaron, bringing together two family-owned businesses and growing its customer-segregated accounts by more than $80 million, for combined customer assets of nearly $500 million.

2009 PFGBEST opened its magnificent facility at One Peregrine Way in Cedar Falls, Iowa.

2009 PFGBEST creates the wholly-owned subsidiary BESTDirect Securities, LLC to further its multi-asset-class trading and investing solutions.

2009 PFG Precious Metals, Inc. begins to offer a full suite of precious metals capabilities, such as the Gold and Silver Accumulation Program (GSAP).



2010

2010 PFGBEST rolls out its proprietary Typhoon liquidity aggregator, created to allow the world's largest banks and precious metals dealers to compete for the best bids and offers for both retail and institutional traders.

2010 PFGBEST signs on as the first FCM member firm of Nadex, enabling customers to access retail-sized, limited-risk and fully-collateralized binary options contracts offered on the Nadex platform.

2011 PFGBEST wins an Iowa Character Award from Character Counts in Iowa. The achievement honors individuals, schools and organizations that consistently demonstrate and promote the six pillars of character: trustworthiness, respect, responsibility, fairness, caring and citizenship.

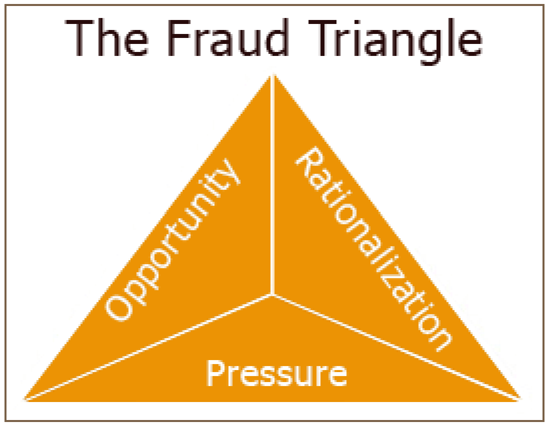
2011 PFGBEST ranks #1 in forex customer service in a June 2011 Smart Money magazine feature on the "Best Firms For Forex Trading;" PFGBEST was also ranked #1 in Customer Service by the editors.

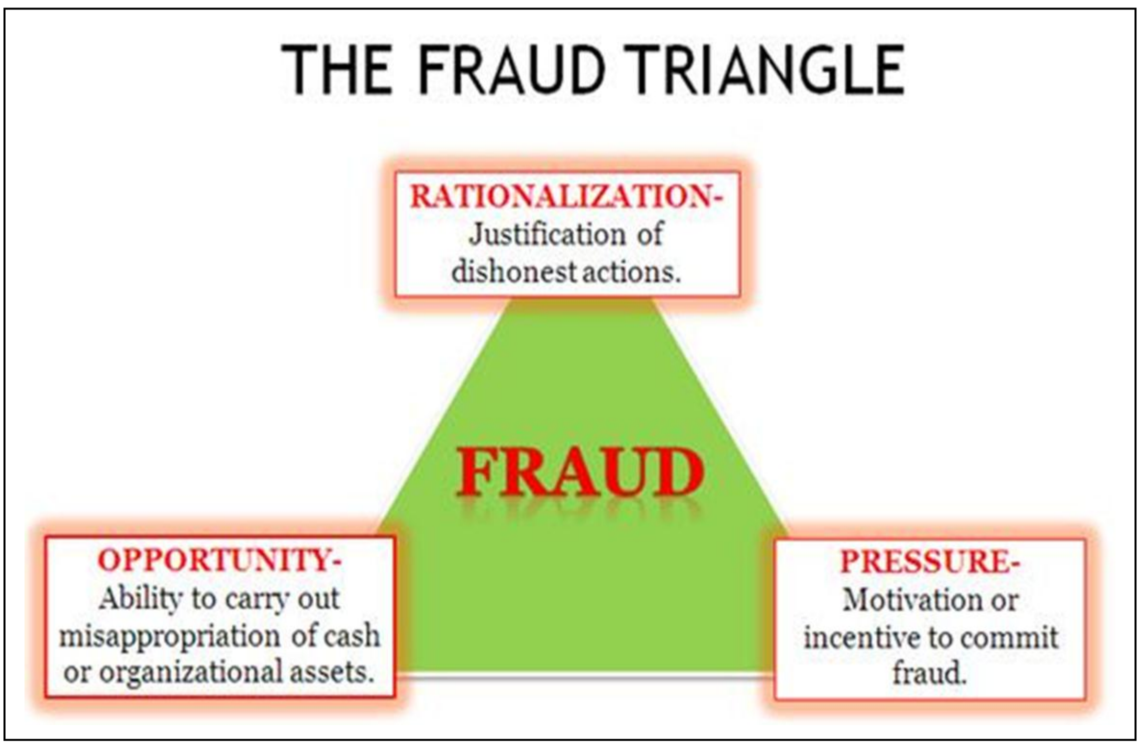
2012 On July 15, PFGBEST celebrates its 20-year anniversary as a registered U.S. Futures Commission Merchant.

One Peregrine Way, Cedar Falls, IA 50613 • 319.553.2100 > 800.553.1711 | 311 W. Monroe St., Suite 1300, Chicago, IL 60606 • 312.775.3000 > 800.333.5673 | www.PFGBEST.com

http://www.pfgbest.com/about/docs/AnniversaryTimeline.pdf

APPENDIX B: THE FRAUD TRIANGLE





https://www.google.com/search?q=fraud+triangle&biw=1366&bih=651&tbm=isch&tbo=u&source=univ&sa=X&ei=5Z52UrnqK7XfsASwg4LABA&sqi=2&ved=0CC8QsAQ

Institute of Internal Auditors
Fraud Triangle

APPENDIX C: EXCERPTS FROM WASENDORF'S SUICIDE NOTE

If you are reading this than I will have already punished myself for my transgressions and this is my last confession.

I have committed fraud. For this I feel constant and intense guilt. I am very remorseful that my greatest transgressions have been to my fellow man. Through a scheme of using false bank statements I have been able to embezzle millions of dollars from customer accounts at Peregrine Financial Group, Inc. The forgeries started nearly twenty years ago and have gone undetected until now. I was able to conceal my crime of forgery by being the sole individual with access to the US Bank accounts held by PFG. No one else in the company ever saw an actual US Bank statement. The Bank statements were always delivered directly to me when they arrived in the mail. I made counterfeit statements within a few hours of receiving the actual statements and gave the forgeries to the accounting department.

The rogueries started after I was in a battle with the Kansas City Commodity Futures Trading Commission's office. I was specifically attacked and harassed by CFTC's Branch Manager Robert Agnew. The reason for his vindictive actions was that I appear to have embarrassed him!

In the winter of 1993, Agnew performed a routine audit of the Iowa based headquarters of PFG. During the audit Agnew claimed I was in violation of the rules regarding the way customer funds can be invested. I asked to see the rules and he gave me a copy of them. I took the rules to the Bank where PFG's customer funds were deposited, (at that time it was Firstar Bank, which eventually became US Bank). The Bank's legal department examined the rules and soon told me that, in their opinion, there was no way they could comply with these rules. I was somewhat surprised to hear this since I knew of other firms investing customer funds the same fashion as I was doing. So I talked to some of my peers and even to the compliance department of the Chicago Mercantile Exchange. I discovered that Agnew had given me outdated rules! New rules regarding the investment of customer funds had been written and had been in force for quite some time. I gave the new rules to the people at the Bank and their near immediate response was that they would have no problem complying.

When I told Agnew that he had given me the outdated rules, he was livid! He apparently didn't like being told that he was wrong. During the ensuing 5 months he and his team performed 6 onsite audits of PFG, until they found a technical violation.

We were always careful to have adequate regulatory capital in PFG's accounts at the end of each month. Because at the end of each month we were required to report our financials to the Regulators and we wanted to make sure that we were showing adequate capital on the report. Agnew was able to show that, in a few instances, sometime prior to our addition of the capital at the end of the month we had already fallen below the required amount. So he was able to prove that we were below the capital requirements for a couple days prior to our addition of capital. He claimed that we failed to file notice to the CFTC immediately when the breach occurred. The CFTC decided not to pursue PFG with a formal complaint after negotiations with our Attorney but we knew we would be under heightened scrutiny. We knew we would need to maintain a higher level of capitalization.

It was this encounter with CFTC's Agnew that I discovered that the Industry's regulators often used audits of Firms as punishment and for retaliation. And I saw for the first time the mean spirited nature of the industry's Regulators.

The cost of an Attorney and the requirement to maintain a greater capitalization pushed us into a financial crisis, I had no access to additional capital and I was forced into a difficult decision: Should I go out of business or cheat? I guess my ego was too big to admit failure. So I cheated, I falsified the very core of the financial documents of PFG, the Bank Statements. At first I had to make forgeries of both the Firstar Bank Statements and the Harris Bank Statements. When I choose to close the Harris Account I only had to falsify the Firstar statements. I also made forgeries of official letters and correspondence from the bank, as well as transaction confirmation statements.

Using a combination of Photo Shop, Excel, scanners and both laser and ink jet printers I was able to make very convincing forgeries of nearing every document that came from the Bank. I could create forgeries very quickly so no one suspected that my forgeries were not the real thing that had just arrived in the mail.

With careful concealment and blunt authority I was able to hide my fraud from others at PFG. PFG grew out of a one man shop, a business I started in the basement of my home. As I added people to the company everyone knew I was the guy in charge. If anyone questioned my authority I would simply point out that I was the sole shareholder. I established rules and procedures as each new situation arose. I ordered that US Bank statement were to be delivered directly to me unopened, to make sure no one was able to examine an actual US Bank Statement. I was also the only person with online access to PFG's account using US Bank's online portal. On US Bank side, I told representatives at the Bank that I was the only person they should interface with at PFG.

When it became a common practice for Certified Auditors and the Field Auditors of the Regulators to mail Balance Confirmation Forms to Banks and other entities holding customer funds I opened a post office box. The Box was originally in the name of Firstar Bank but was eventually changed to US Bank. I put the address "PO Box 706, Cedar Falls, IA 50613-0030" on the counterfeit Bank Statements. When the auditors mailed Confirmation Forms to the Bank's false address, I would intercept the Form, type in the amount I needed to show, forge a Bank Officer's signature and mail it back to the Regulator or Certified Auditor.

When online Banking became prevalent I learned how to falsify online Bank Statements and the Regulators accepted them without question.

* * *

It was relatively simple to deceive the Regulators during the Annual Audits since their Audit Modules guided them to find a number, tick a box, tie out totals, etc. They counted on the mailed back Bank Balance Confirmations to detect any shortfall in cash balance totals. They had no way to detect a counterfeit bank statement. They were actually distracted by their own agenda — to catch firms unknowingly violating regulations. They knew they had a better chance to gain a "gotcha" in the areas where the "letter of the law" was desecrated by their constantly evolving interpretations. If the Firm didn't interpret a rule the same way as the Regulator was currently interpreting it then the

Firm was violating the rule, even though the Firm was not in violation under a previous interpretation of the same rule.

Earlier I said I felt a great deal of guilt and remorse for my transgressions. I feel particularly bad for the damage I have done to my family, friends and loved ones. Many have counted on me to be the "good guy" and I know I am an enormous disappointment. I am extremely sorry that my son ever got involved with this business. I know he will feel betrayed, deceived and disillusioned.

* * *

I know the question remains, what did I do with the money? Most of the misappropriated funds went to maintain the increasing levels of Regulatory Capital to keep PFG in business and to pay business loses [sic]. A portion went to build the office building at One Peregrine Way, (I had hoped that a mortgage on the building would pay back the cost of building but the appraisal came in tragically low). I even used Customer Funds to pay Fines and Fees charged by the regulators.

* * *

I know the Regulators will try to make other executives at PFG culpable for my crime but they will discover that I am the only guilty party and I have already imposed a punishment far greater than they could have hoped to impose. There are many honest, talented people at PFG, they don't deserve the predicament I have now put them in and I am deeply sorry.

I am ready to die. I guess this is the only way out of a business I hate so much.

I believe in a loving, forgiving God.

(Signed) Russell Wasendorf Sr.

Source: http://blogs.wsj.com/deals/2012/07/17/excerpts-from-russell-wasenforf-sr-s-confession/

APPENDIX D: PERGERINE FINANCIALS & SECURITIES, INC. PUBLIC FILINGS ON INTERNAL CONTROLS (IC)

Source: Edgar Search of Annual Audited Report Form X-17a-5 required for all Brokers and Dealers pursuant to Section 17 of the Securities & Exchange Act of 1934 and Rule 17a-5.

FYE/ Registrant	Date Filed SEC	Internal Control Findings-Level of Assurance	Date IC Report Signed
2011/ BEST	05/31/2012	"...we noted no matters involving the internal control structure that we consider a material weakness as defined above."	02/24/12
2010/ BEST	06/23/2011	"...we noted no matters involving the internal control structure that we consider a material weakness as defined above."	02/24/11
2009/ BEST	03/01/2010	"...we noted no matters involving the internal control structure that we consider a material weakness as defined above."	02/20/10
2008/ BEST	03/02/2009	"...we noted no matters involving the internal control structure that we consider a material weakness as defined above."	02/22/09
2007/ Unknown		No Information is Available-SEC Contacted No Formal Response Received to date.	
2006/ Unknown		No Information is Available-SEC Contacted No Formal Response Received to date.	
2005/ Unknown		No Information is Available-SEC Contacted No Formal Response Received to date.	
2004/ Unknown		No Information is Available-SEC Contacted No Formal Response Received to date.	
2003/¤ PF&S	03/01/2004	"...we noted the following matter involving the internal control environment we consider to be a material weakness…NASD investigation and enforcement action…Letter of Acceptance, Waiver & Consent…" [Settlement ($268,100 Note 9 and 10)]	02/22/04
2002/ PF&S	02/28/2003	"...we noted no matters involving the internal control structure that we consider a material weakness as defined above."	02/18/03
2001/ PF&S	03/01/2002	"...we noted no matters involving the internal control structure that we consider a material weakness as defined above."	02/16/02

Legend:
Reported under BEST=BEST Direct Securities, LLC (CIK #0001421257 File#008-67777) – State Iowa
Reported under PF&S = Peregrine Financials & Securities, Inc. (CIK#0001047214 File#008-50521) – State Illinois .
¤ = This weakness in Internal Control does not DIRECTLY tie to the fraud that was committed, but is a possible red flag of management's general attitude toward regulation.