

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

In the Matter of:                    )  
  ) File No. OIG-509  
OIG-509                                )

WITNESS: Number 11

 ORIGINAL

PAGES: 1 through 66

PLACE: Securities and Exchange Commission

100 F Street, N.E., Room 2264

Washington, D.C.

DATE: Wednesday, March 25, 2009

The above-entitled matter came on for hearing, pursuant to notice, at 11:02 a.m..

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1 APPEARANCES:

2

3 On behalf of the Securities and Exchange Commission:

4 HEIDI STEIBER, ESQ., Assistant Investigator

5 CHRISTOPHER WILSON, ESQ., Assistant Investigator

6 Office of the Inspector General

7 Securities and Exchange Commission

8 100 F Street, NE

9 Washington, DC 20549

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11 On behalf of the Witness:

12 OCIE Staff Attorney [REDACTED], pro se

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## C O N T E N T S

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WITNESS:

EXAMINATION

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OCIE Staff Attorney

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EXHIBITS:

DESCRIPTION

IDENTIFIED

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E-mail, OCIE Staff Attorney to M. Daugherty  
and T. Eidt, 8/27/03

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Complaint, [REDACTED] to

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M. Kelly, 5/21/03

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E-mail, OCIE Staff Attorney to T. Eidt, cc

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T. Stickley and M. Daugherty,

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9/11/03

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E-mail, OCIE Staff Attorney to T. Eidt, cc

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Daugherty and Stickley, with

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Madoff memo, 9/12/03

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E-mail, OCIE Staff Attorney to E. Swanson,

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10/20/03

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E-mail, OCIE Staff Attorney to E. Swanson,

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10/31/03

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Memo, OCIE Staff Attorney to E. Swanson, re

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examination of Madoff execution

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quality, 11/10/03

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E-mail, OCIE Staff Attorney to A. Sadowski

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P R O C E E D I N G S

1  
2 Whereupon,

3 [REDACTED] OCIE Staff Attorney

4 was called as a witness, and, having been first duly sworn,  
5 was examined and testified as follows:

6 MR. WILSON: We are on the record at 11 a.m. on  
7 March 25, 2009, at the Securities and Exchange Commission,  
8 located at 100 F Street, Northeast, Washington D.C.

9 Could you please state and spell your full name for  
10 the record?

11 THE WITNESS: My name is [REDACTED] OCIE Staff Attorney

12 [REDACTED] OCIE Staff Attorney

13 MR. WILSON: My name is Christopher Wilson. I am  
14 an investigator in the Office of Inspector General in the  
15 United States Securities and Exchange Commission. I am here  
16 today with my colleague, Heidi Steiber, also an investigator  
17 in the IG's office here at the Securities and Exchange  
18 Commission.

19 This is an investigation by the Office of Inspector  
20 General, Case Number 5009. We are going to ask you certain  
21 questions. You are going to provide answers under oath. The  
22 court reporter will record and later transcribe everything  
23 that is said. Please provide verbal answers to the  
24 questions.

25 If you give a nod of the head or other non-verbal

1 Q Do you remember about what date you started working  
2 on that?

3 A I imagine it was when I first started working here,  
4 which would have been late August in 2003.

5 Q Okay. Now, do you recall why you became involved  
6 in that? Was it the Triple Q inspection?

7 A Yeah, I think it was involving Triple Q. As I  
8 understood it, they had done. Eric, and I think Matt  
9 Daugherty had been working on a project regarding  
10 front-running and Triple Qs. There was a lot of locked and  
11 cross markets occurring in that particular security.

12 So they did some data requests before I started  
13 working here, like I think the spring before that. So they  
14 had a bunch of data. They just haven't been able to look at  
15 it yet.

16 So when I started, they're like, here's some data.  
17 Take a look and see what you find.

18 MS. STEIBER: Great.

19 MR. WILSON: The trading data, do you know what the  
20 source of that trading data was?

21 THE WITNESS: For this exam, it would have been  
22 from Madoff, because it would have been a Section 17 exam, so  
23 it came directly from a broker-dealer.

24 MS. STEIBER: I am going to show you a document  
25 that we are going to mark as Division Exhibit 1.

1 (Exhibit No. 1 was marked for  
2 identification.)

3 MS. STEIBER: It is an e-mail from you to Matt  
4 Daugherty and Thomas Eidt. And the date is August 27, 2003.  
5 Okay, now, in the first line you say: "We had a second call  
6 with Madoff and we think we understand these trades a lot  
7 better."

8 BY MS. STEIBER:

9 Q Do you recall who you spoke to, who the Madoff is  
10 that's referenced here?

11 A I believe it was Dana Madoff, the chief compliance  
12 officer of the broker-dealer.

13 Q Could that be Shana?

14 A Shana; that's possible as well. I remember her  
15 last name is Madoff and she was the compliance person.

16 Q But you're fairly certain it wasn't Bernie Madoff?

17 A It definitely was not. It was a female.

18 Q And do you recall if you had two phone calls?

19 A I'm referencing an earlier call so we must have.

20 When you're doing an exam and particularly when it's someone  
21 else's trading data you're looking at, you need to  
22 understand, you know. People use different shorthands to  
23 mean different things.

24 So when you're looking at it, you want to make sure  
25 you understand it like they would so that you're coming to

1 the right conclusion. So it's not unusual, and it's part of  
2 the process really, to contact the firm that provided the  
3 data to make sure you know what the abbreviations mean. So  
4 that's obviously, you know, we went through probably one call  
5 where we thought we had gotten some understanding of what the  
6 different abbreviations and shorthands mean. We obviously  
7 must have had a second call that got some clarification.

8 Q Now, you said "we." Who else do you recall being  
9 on the phone call?

10 A I don't remember anyone else working on this exam,  
11 frankly, so I don't know.

12 Q Now, who is Thomas Eidt?

13 A Tom Eidt started at the same time that I did in OC,  
14 but he actually had worked for the SEC for a period. I don't  
15 know, but for a while before I had started working here, but  
16 when we had started on the same day he was given -- all  
17 related to the Tripe Qs -- he was given the PHLX part, the  
18 Philadelphia Stock Exchange part of the inspection.

19 Q Is that P-H-L-X?

20 A Yeah, there is any, but the Philadelphia stock  
21 exchange, yeah. So he was given their data, and I was given  
22 the Madoff data. And, so, obviously, I felt that he needed  
23 to be cc'd on this e-mail. I don't remember him directly  
24 working with me on this. And, in fact, he didn't have a lot  
25 of time to look at the Philadelphia data, so I ended up

1 taking that part over as well later on.

2 Q And so do you recall if you had any other phone  
3 calls with anybody at Madoff Securities, other than the Shana  
4 Madoff call?

5 A That would have been the only one that I'm aware of  
6 that I can recall, because the only reason we would be  
7 calling them is to get clarification about the trading data.

8 Q Now, what was your role on this Triple Q  
9 examination? Who was your supervisor?

10 A This was an unusual one. Like I said, usually,  
11 there's a branch chief, but it's not so unusual at the time,  
12 because it was a pretty small group when I first started  
13 working there. But I actually directly report to Eric  
14 Swanson. He was the one that handed me, gave me an  
15 assignment. Matt was also, I think involved, because I think  
16 he had been working with Eric on the question before. I  
17 don't know how much direct involvement with Madoff that he  
18 had, but it was essentially a sweep, so there was a lot of  
19 different firms that were involved.

20 Q Okay. When you started working on this Triple Q  
21 examination, did anyone make you aware of any complaints  
22 related to Madoff that OC had received?

23 A No.

24 MS. STEIBER: I'm going to show you what we're  
25 going to mark as Exhibit 2, and if you could just review the

1           A     I am not aware of anyone speaking to Bernie Madoff.  
2 directly, no.

3           Q     And we spoke before that you had a call with Shana  
4 Madoff. Had you ever spoken to anyone at Madoff securities  
5 prior to that call with Shana Madoff?

6           A     No. That's really honestly the only time I ever  
7 remember talking to anyone at the firm when I was working at  
8 the SEC. At Ameritrade, Madoff was one of the big brokers  
9 that Ameritrade would use, so he would talk to like desk  
10 traders and stuff like that. But, I mean, that would be the  
11 extent of our contact.

12          Q     So what was his reputation in the industry?

13          A     He was huge. He was basically the NASDAQ start  
14 market as I understood it, but he was a very large market  
15 maker and basically does the trading for large firms like  
16 Ameritrade and other large brokerage firms behind the scenes.

17          Q     Were there any whispers about him that you are  
18 aware of that he might be engaged in anything illegal?

19          A     Not that I'm aware of.

20          Q     But he was a very prominent person?

21          A     I recognized the name when I first started working  
22 here, yeah.

23   (Exhibit No. 3 was marked for  
24   identification.)

25   MS. STEIBER: I am going to show you another

1 things; and, particularly, John had kind of a tendency to  
2 kind of go from project to project very quickly without  
3 really circling back. So it was kind of dealing with like  
4 whatever current issue John might be dealing with. So this  
5 might not have been something John was asking him questions  
6 about, so he wasn't asking me questions about, but I guess,  
7 actually, not that slow. I suppose it was about a week.

8 Q Do you recall if he ever gave you feedback on your  
9 memo?

10 A I don't remember. I remember sending this memo;  
11 and, frankly, there was a lot of projects at the time that  
12 would just kind of die off. I mean, you know, you do some  
13 initial review and you go up the chain. And I think the  
14 superiors had determined, well, I got other things to worry  
15 about. Those old projects just kind of languished; and, I  
16 had a lot of projects like that.

17 Q You had projects you started and then you were  
18 pulled onto something else, so you never came to any  
19 conclusions?

20 A Well, no. I mean, we do our fact-finding,  
21 whatever, and say like okay, what do we do next. And there  
22 just was never any further direction; or, we'd write a memo  
23 summarizing whatever we thought we had found when the wind  
24 gained further input. So that was a pretty common  
25 occurrence. I don't know if I ever heard back from him. He

1 may have given more feedback. I don't know.

2 Q So was there kind of like no formalized procedure?

3 Do you remember from OC for following-up on old exams they  
4 just kind of prioritized new things over old things?

5 A Frankly, yeah, that happened a lot. So how this  
6 one ended, frankly; and, when we talked the first time, I  
7 couldn't really remember what happened. I remembered that I  
8 may have found some things, but I didn't think they were  
9 major or I didn't find anything. That was how I remembered  
10 it, so this shows you. You know what I mean? Like we did  
11 what we did and that's what happened.

12 Q Well, if you look at the bottom, you follow-up on  
13 the memo and then you say, "The Philadelphia stuff I did had  
14 a different focus than what I was looking at with Madoff and  
15 that I was looking more for trading ahead with Madoff and  
16 BestEx with Philadelphia.

17 Should I look again at Madoff concentrating on  
18 BestEx?" And then Swanson says, "I assume what you are  
19 asking is whether to look at Madoff trades against the  
20 quotes. The answer is yes." My question is weren't you  
21 looking at Best Execution earlier on when you wrote the  
22 report? Could you just explain what this is about?

23 A BestEx is kind of nebulous, right? I mean, I found  
24 and you know my time in doing this that terms and securities  
25 and securities law have different terms, different meanings

1 and different people; and, they might mean different things  
2 in different situations. BestEx is generally the obligation  
3 of a broker to provide the Best Execution for his client.  
4 Now, I think what Eric is asking about and presumably what  
5 I'm talking about here is what prices did clients get versus  
6 what was the best price available in open market.

7           That's I think what is being referenced here. So  
8 that's like saying you must mean looking at the trades versus  
9 what the quotes are at the time, because the quote would be  
10 the best price that's available. Did those clients get that  
11 price? And, generally, that's something that happens and  
12 usually it's not a huge difference. And if the client  
13 notices, they'll call back the broker and said, hey look.  
14 You gave me \$10, but it was \$9 on a different exchange; price  
15 improved, they do it. I mean it happens.

16           Trading ahead, at least I think the way I'm  
17 referencing trading ahead is also a type of BestEx in a way  
18 because the client is providing an order, particularly a  
19 market order that says "Hey, I want to buy this stock. Buy  
20 it for me." But you don't buy it right away. You wait. And  
21 the price isn't as good as it would have been had you done it  
22 when you were supposed to when they first sent in the order.

23           So, you know, you can see why looking for a precise  
24 definition of what BestEx means, and particularly when we're  
25 talking about shorthand looking at e-mails where even over

1 time, the way I probably used the word Best Ex changes over  
2 time. So my recollection is that's probably what's going on  
3 here.

4           When I first looked at Madoff, I was just looking  
5 at did the clients send in their order and did Madoff  
6 front-run that order or trade ahead of that order. And  
7 probably what was happening was that PHLX I was noticing a  
8 lot of orders where PHLX was executing at one price, but  
9 really the market was saying it was a much better price; and  
10 they weren't price improving those clients.

11           So probably in the course of doing that was like  
12 wow, you know what? I never did this with Madoff. I should  
13 probably ask Eric if he wants that sort of analysis done do.  
14 I did. He said yeah, so.

15           Q     Okay. So it seems that from this e-mail, after  
16 this you're going to be doing additional work on Madoff  
17 Securities and expanding the exam that you had done  
18 previously?

19           A     In a way. I mean, it's just another way to go with  
20 the same data, really. Just, it's like saying analyzing it  
21 for another issue; like, we're looking at one rule. Let's  
22 look at that in an analysis of an additional rule.

23           Q     So but in your experience at OC was it possible to  
24 expand the scope of examination or inspection that you were  
25 doing? Once you got in there and you discovered other

1 MS. STEIBER: It's a November 10, 2003 memo to Eric  
2 Swanson from you and it's entitled, "Examination of Madoff  
3 execution quality."

4 THE WITNESS: Okay.

5 BY MS. STEIBER:

6 Q So was this a separate examination than the  
7 Triple Q examination you had done previously, which you wrote  
8 that September 12, 2003 memo?

9 How were these two different?

10 A Well, it's hard to characterize it. This looks to  
11 be. I would have been using the same data, so it's not like  
12 we went back to the firm and asked for more information; and  
13 we would have been using the same stuff we had been using  
14 since, you know, the earlier memo and all the other analysis.  
15 This looks to me that maybe this was the result of what it's  
16 talking about with Eric via e-mail in late October about  
17 going back and checking execution quality; and what were  
18 clients getting versus what was the market offering. And  
19 this looks to be a summary of what we thought we had found.

20 Q I'm still not clear if you had considered this part  
21 of that same Triple Q examination you had been doing earlier,  
22 because you wrote a whole new memo?

23 A Yeah, but I don't think I would consider it as  
24 such. I know in my mind, like, conceptually, if you had  
25 asked me how many exams I had done I didn't want the exam,

1 because it was the same data. But this was, I suppose, a  
2 slightly different issue and I guess I thought I needed a new  
3 memo for whatever reason. Some of them might be cut and  
4 pasted from like the -- but I mean it's a pretty short  
5 memo -- and, I don't know. I would have considered this part  
6 of the same exam, just a different issue.

7 Q And do you think this is the final draft? Do you  
8 recognize this handwritten comment in the corner, "BG final,"  
9 which I think is probably your handwriting.

10 A That is my handwriting. I must have believed that  
11 this must have been the final one I had sent him; and I think  
12 it's actually supposed to be, like, boy Eric. I think it was  
13 supposed to stand for Best Execution.

14 Q Oh, okay. And could you look at what conclusion  
15 you have? I think if you look at page 3 under "Conclusion,"  
16 you'll summarize the conclusion you drew after doing this  
17 work.

18 A It looks like, basically, I believe, that this was  
19 significant activity. But a deficiency letter isn't a  
20 particularly hard stance to take. It's just basically like  
21 we found these deficiencies. You should change them. OC  
22 doesn't really have a ton of heavy-handed ways to go about  
23 it. It's basically that or a referral to Enforcement.

24 Q Now, do you think this behavior from what you see  
25 in your memo would have been something you would have

1 recommended for Enforcement referral where you thought would  
2 be appropriate for an Enforcement referral?

3 A This would have been like two exams. I mean, I  
4 don't know if I had a good concept of what was appropriate.  
5 I'm not even sure I understood exactly what the consequences  
6 were of what we could do. What can we do if we find a  
7 violation? It's marked "Final." Maybe there were some  
8 drafts where Eric had commented on and said basically that's  
9 what we were probably going to do. I don't know.

10 I don't believe any deficiency letter was ever  
11 sent. At least I don't remember drafting one. I honestly  
12 think that this just kind of got sucked into that black hole  
13 wherein some of these exams just went.

14 Q So after you worked on this exam, do you recall  
15 having any other involvement with any Madoff Securities  
16 examinations or investigations?

17 A Not that I can recall. I know that we had  
18 followed-up regarding some of these problems in the Qs with  
19 the other exchanges.

20 (Exhibit No. 8 was marked for  
21 identification.)

22 MS. STEIBER: Can I show you one document, and it's  
23 Exhibit 8 and it is an e-mail from you to Alex Sadowski. It  
24 looks like you're doing some work on the Qs. Do you know  
25 what this e-mail involves?

1 certain people and other people would be looking for stuff.  
2 And there was like maybe three or four kind of senior staff  
3 that we are kind of there; and then, you know, like if they  
4 needed something from somebody else, they go search them out  
5 and say like, hey, give me this. Find this out. I need it  
6 for John. I need it tomorrow. And that kind of thing, but  
7 no. There was definitely cliques. There were definitely  
8 like some sort of social hierarchy.

9 Q And were like Sadowski and McCarthy, Donahue, were  
10 they the kind of inner circle?

11 A Well, no. I apologize. I don't mean to talk over  
12 your questions. Probably, the primary inner circle was the  
13 circle around John, and that would be John, Eric and Alex,  
14 and sometimes maybe a few other people: Matt, in a way; and,  
15 there were certain people not in the circle but were trusted  
16 by the circle. You know what I mean? Like leaned on by that  
17 circle that got a lot of work.

18 There were definitely; and, then there was kind of  
19 a separate social structure with Mark and stuff that went:  
20 him and former OCIE  
Branch Chief and those guys that probably developed  
21 partially. Because in our old building when we were on 9th  
22 Street, they were in a separate part of the floor than most  
23 of the rest of the group, one part of the group was on one  
24 part and then Mark and his folks were kind of off in a  
25 different place. I don't know.

1 Q So did you hear about any other tips for those he  
2 received? I showed you that tip from [REDACTED]. Did  
3 you ever hear of any other complaints or tips?

4 A No.

5 Q When was the first time you heard of Harry  
6 Markopolos? Or have you heard of Harry Markopolos?

7 A Is he the guy that testified at Congress?

8 Q Yes.

9 A stuff happened last fall. I was not aware of him  
10 at all before the news hit.

11 Q You never heard of Lori Richards or John McCarthy  
12 receiving any other tips from anyone?

13 A No, it would have been unusual for them to  
14 communicate something like that to me. I mean, I was just  
15 astounded.

16 Q And did you hear about John McCarthy and Lori  
17 Richard having any phone calls with Bernie Madoff?

18 A I'm not aware of them having any. I think it's  
19 possible and probable, because he is a large market  
20 participant that they might talk to him on occasion.

21 BY MR. WILSON:

22 Q On the QQQ examination, do you know if anybody went  
23 on-site of Madoff Securities to the documents that were  
24 provided or any information was sent to the SEC?

25 A It was sent, and I'm not aware of any. I certainly

1 didn't go on-site to Madoff. I don't think anyone else did  
2 either.

3 Q Okay. Does that happen on occasion that the SRO  
4 group and market oversight group will actually do on-site  
5 examinations?

6 A You can do on-site exams, particularly with the  
7 SROs. But it's also possible to do it on-site. There's a  
8 number of reasons why you would go on-site and you wouldn't.  
9 With this exam, it was primarily looking at trading data and  
10 you can just get them to send that to you and you can look at  
11 it.

12 If all you're worried about is did you front-run an  
13 order, that's going to be held in the numbers, and we would  
14 know whether or not that's in the numbers or not or in the  
15 information that they provided to us. Particularly, I think,  
16 around here they started hitting some budget problems and  
17 that causes problems with going on-site.

18 There's, you know, any reason why you wouldn't go  
19 on-site, but I don't think there was ever any plans to go  
20 on-site with these guys. My understanding was that they made  
21 the request. They got the information and it was just  
22 looking at the information they provided.

23 BY MS. STEIBER:

24 Q We talked before about you working with Eric  
25 Swanson. Are you friends with Eric Swanson?

1 Here's one, two, three and four. Check those four things,  
2 and then you move on to the next firm. I mean, it's very  
3 kind of mechanical. And so when you do those things and you  
4 find a violation, it's kind of like, "Oh, my God. This is  
5 the worst thing to ever happen, ever." And so then you blow  
6 it up and then it turns out to not be a big deal, or maybe it  
7 is.

8 I don't know. And it becomes part of the white  
9 noise. The same people keep complaining about the same  
10 things and it's like, I don't know if this is a rule  
11 violation or not. I guess sometimes, yeah.

12 Q When you came, did you feel like they gave you  
13 adequate training?

14 A Oh, there was no training. This Qs exam was my  
15 training. And I was told that when I came in that this was a  
16 trial by fire kind of job that you get trained as you come  
17 in; and, frankly, I don't know how you trained somebody to do  
18 this side of the job. And I feel over time, luckily I had a  
19 background in some trading activity, so I understood basic  
20 training, how it works, what the terminology is and that sort  
21 of thing, but.

22 Q Do you feel like you worked with some people that  
23 didn't have your background?

24 A Oh, yeah, yeah, there's a lot of people that  
25 weren't familiar with securities laws. They were brought in

1 mean that you're going to get the right people coming through  
2 the door either.

3 Q And we had also heard something about problems  
4 within managers and we touched on that a little bit. How do  
5 you think that the managers should be approved? Do you take  
6 the extreme approach, kind of like Markopolos testified to,  
7 that they should all be fired at the top and new blood needs  
8 to come in because they keep putting the same type of person  
9 forward?

10 A This is a hard question for me to answer, because  
11 I'm not an expert. I mean my personal opinion for what it's  
12 worth is that there are definitely some people that are in  
13 management positions because of the relationship to Lori or  
14 their relationship to John, previously speaking; or, now,  
15 it's like Personal  
Privacy, or whoever.

16 There is a bit of kind of self-replicating problems  
17 here wherein, you know, they promote people that are more  
18 because of personal relationships than because of any sort of  
19 professional background or anything like that. And, I mean,  
20 they just brought back somebody who had left that really, I  
21 don't know, as a branch chief. And you know you kind of  
22 wonder like, well, why are they bringing that person.

23 You know, it's very unusual who, particularly in  
24 the promotion process how that works. So, I mean, I'm not  
25 going to advocate for people to lose their jobs either, so I

1 they're discriminatory in a way, but there was a lawsuit that  
2 was filed.

3 BY MS. STEIBER:

4 Q What are you talking about? Did it involve Mark  
5 Donahue?

6 A Yeah, Mark Donahue and Jan Walker.

7 Q What was your understanding of what that lawsuit  
8 was about?

9 A My understanding was that Jen felt singled out by  
10 Mark because other people kind of in the same way that Mark  
11 got after her about stuff that he wouldn't get after her, say  
12 former OCIE  
Branch Chief or someone else over her. And so she basically decided  
13 she didn't want to take it any more, and I am sure she had  
14 been working on getting a job somewhere else for a while  
15 anyway. And, you know, that was basically my understanding  
16 of the lawsuit. And that wasn't the only time.

17 Personal Privacy

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It's

23 just crazy stuff that goes on in this office. It was weird.

24 It was like a sitcom or something. It didn't exist in the

25 real world and it's hard to explain. It really is.

26 Q Now that you've been out of OC for a while, do you