

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

-----X

In the Matter of:

OIG-509

-----X

WITNESS: #11

PAGES: 1 - 85

PLACE: Securities and Exchange Commission
3 World Financial Center
New York, New York

DATE: March 26, 2009

The above-entitled matter came
on for hearing at 11:50 a.m.

COPY

1 A P P E A R A N C E S:

2

3 On behalf of the Securities and Exchange
4 Commission

5

6 H. DAVID KOTZ, ESQ.

7 HEIDI L. STEIBER, ESQ.

8 CHRISTOPHER H. WILSON, ESQ.

9 Securities and Exchange Commission

10 3 World Financial Center

11 New York, New York 10281

12

13

14

15

16

17

18

19

20

21

22

23

24

25

1 MR. KOTZ: We are on the record
2 at 11:50 on March 26, 2009 at the United
3 States Securities and Exchange Commission,
4 New York Office.

5 D O R O T H Y W E L S H E S C H W I E,
6 having first been duly sworn by a
7 Notary Public of the State of New
8 York, was examined and testified as
9 follows:

10 EXAMINATION BY

11 MR. KOTZ:

12 Q. Could you state and spell your
13 full name for the record, please?

14 A. Yes. Dorothy A. Eschwie.
15 That's D-O-R-O-T-H-Y, middle initial A,
16 Eschwie, E-S-C-H-W-I-E.

17 Q. Ms. Eschwie, my name is David
18 Kotz. I'm the Inspector General of the
19 United States Securities and Exchange
20 Commission. This is an investigation by
21 the Office of Inspector General, Case
22 Number 0IG-509. I'm going to ask you
23 certain questions. You will have to
24 provide answers under oath. The Court
25 Reporter will record and later transcribe

1 everything that is said. Therefore,
2 please provide verbal answers to the
3 questions. A nod of the head or some
4 other non-verbal response won't be able to
5 be picked up by the Court Reporter.

6 So the record will be clear,
7 please let me finish my question before
8 you provide your response. In addition,
9 it's important that you understand the
10 questions and give accurate answers. If
11 there's anything you don't understand, if
12 there's anything you do not know or are
13 not sure about, please let me know,
14 otherwise I will assume that you heard and
15 understood the question.

16 Do you understand those
17 instructions?

18 A. Yes, I understand.

19 Q. Now I'm going to give you the
20 standard perjury language. As you can see
21 your responses and statements given today
22 are provided today after you swore an
23 oath, and everything will be taken down
24 verbatim by the Court Reporter. It is an
25 official U.S. governmental enforcement

1 management and broker dealer.

2 Q. You're in the investment
3 management side?

4 A. Yes, I'm on the investment
5 management. And that would include
6 investment advisors and mutual funds,
7 registered investment companies.

8 Q. Going back to Exhibit 1. You
9 stated earlier that there were these
10 E-mails that you forwarded on to Salaso
11 and Lee, and this memo is a copy of the
12 memo that's forwarded on those E-mails.
13 At that time did you review those E-mails
14 for substance?

15 A. No, I did not. No. That was
16 the branch chief would have done that,
17 Diane Rodriguez. She would have apprised
18 me orally, we discussed things, and as
19 well as the examiner. I would have oral
20 representation, but I never reviewed the
21 E-mails.

22 Q. Do you remember what those oral
23 representations were?

24 A. I do remember Tommy in
25 particular saying that the firm that there

1 was -- and I don't remember the name of
2 who said this, but that someone was
3 questioning activities over at Madoff, and
4 in particular that he might be cherry
5 picking trades for the fund, that's what I
6 remember.

7 Q. Was there an indication that
8 Madoff was engaged in some illegal
9 activities when you say cherry picking?

10 A. Well, that sounds like an
11 illegal activity. So, that's why --
12 something sounds questionable. That's why
13 we referred it to the broker dealer staff.
14 And to clarify, that he was not
15 registered, Madoff that is, was not
16 registered as an investment advisor, so
17 that was the reason for the referral. If
18 there's questionable activity and it's a
19 registered advisor, then yes, that would
20 have been questionable and that would be
21 something that, you know, would be a
22 registered advisor that we would want to
23 look at.

24 Q. On the investment management
25 side?

1 A. Yes.

2 Q. Have you ever heard of

3 Investment Adviser #1 [REDACTED] ?

4 A. I have heard of them.

5 Q. Were you familiar with them at
6 the time, were they a known entity?

7 A. Just the fact that we conducted
8 the examination of them.

9 Q. When you conducted the
10 examination, did you find them to be
11 generally sophisticated and knowledgeable?

12 A. Well, based on the examiner's
13 representation out in the field it sounded
14 like it was a very sophisticated place,
15 very complex in that they did a huge
16 amount of trading, that's the part that I
17 remember.

18 Q. So, would you have viewed the
19 E-mails that expressed concern about
20 Madoff's operations as having come from a
21 credible source given that it came from

22 Investment Adviser #1 [REDACTED] ?

23 A. Yes, I believe so. And just to
24 clarify though, when you said, when you
25 had viewed those E-mails, I had not viewed

1 concern that's referenced in that language
2 that I quoted for you?

3 A. I'm not a hundred percent clear
4 on the question, I'm sorry.

5 Q. Well, you stated that you've
6 done examinations, right?

7 A. Yes.

8 Q. So there are times to time that
9 you seen allegations and followed up on
10 them, right?

11 A. Yes.

12 Q. This looks to me like some kind
13 of allegation. And my question to you is,
14 what is this an allegation of, what would
15 you do, do you think there is a
16 significant concern here or would you look
17 at this and say, no big deal or would you
18 look at it and say hmm, I wonder what the
19 point is, I mean what does this mean to
20 you?

21 A. I think I would want to talk to
22 the person who wrote the E-mail and ask
23 them what are they referring to, why does
24 he -- "we're unsure as to how he makes
25 money from us, why does he let us make so

1 much money."

2 Q. Is it fair to say that this is a
3 reference to Madoff's fee structure?

4 A. Yes, it sounds like it is either
5 the fee structure or it sounds like the
6 performance of the account. "Why does he
7 let us make so much money." That sounds
8 more like we're making money. So, that's
9 not fees, that's more like performance to
10 me.

11 Q. And is it fair to say that at
12 least to this individual this structure
13 that he's talking about is a red flag to
14 him or a concern?

15 A. The person writing the E-mail,
16 yes, this is something that he's
17 questioning.

18 Q. And then later it says, "the
19 point is that as we don't know why he does
20 what he does. We have no idea if there
21 are conflicts in his business that could
22 come to some regulated attention. Throw
23 in that his brother-in-law is his auditor
24 and his son is also high up in the
25 organization, imagine that. And you have

1 believe that the size of the firm wouldn't
2 matter. I think the fact that that's the
3 person that's doing it, I think that that
4 would definitely be a conflict of
5 interest.

6 Q. Would you expect that the SEC
7 would look into that matter, that type of
8 matter, is that the kind of thing you
9 would look into in an exam?

10 A. Well, if we're looking at a
11 registered entity and we looked at the
12 auditor and it's a different name, if it's
13 not a Madoff name, and this does say
14 brother-in-law, I don't think we would
15 know that somebody is somebody's
16 brother-in-law.

17 Q. But let's say it was brought to
18 your attention --

19 A. Oh, okay.

20 Q. -- that in a company his
21 brother-in-law was his auditor, would that
22 be something you would follow-up on?

23 A. Yes, I believe we would ask some
24 additional questions as to why this
25 particular person is the auditor and how

1 long and what their, you know, what their
2 expertise is or -- I believe we would ask
3 some additional questions if it was
4 brought to our attention that somebody is
5 somebody's brother-in-law. The same way
6 we do with any other conflicts of
7 interests. We ask additional questions in
8 particular with relatives, that is a
9 common question.

10 Q. In addition to asking those
11 kinds of questions, might you also look
12 closer at the operations from an
13 independence perspective given the fact if
14 it turns out to be true that the
15 brother-in-law or some relative is an
16 auditor?

17 A. I'm trying to think of the
18 requirements of the filings with the --
19 because this is a registered broker
20 dealer, they have requirements for filing
21 the financials, I believe the audited
22 financial statements. And I'm not certain
23 if they have any things they have to
24 attest to whether the person is
25 independent or not. So, I wish I was

1 better versed in the broker dealer
2 requirements, then I would be able to
3 follow-up on that. But as far as on the
4 investment advisor side, we would
5 definitely question whether somebody would
6 be deemed independent.

7 Q. So, whether it was a
8 brother-in-law or not, the independence of
9 the auditor would be something that would
10 be important to look at in terms of an
11 examination; is that right?

12 A. Yes.

13 Q. And so, it's not only a case of
14 looking at whether it's actually the
15 brother-in-law that's an auditor, but it's
16 also looking at whether any auditor that
17 is not independent or the independence of
18 an auditor might -- what that might say
19 about the overall operations; is that
20 right?

21 A. We would definitely question
22 whether if it came to our attention that
23 somebody was not independent. And in
24 particular on the investment advisor side
25 over the years, the issue of custody of

1 client accounts, assets, client assets,
2 over the years before they amended the
3 custody rule we had -- there were areas
4 where if an investment advisory firm had
5 control or had custody of client assets,
6 they could follow no action letters, so
7 that they would not be deemed to have
8 custody. And one of the things that they
9 did, and this is numerous times we saw
10 this, they would have an accountant view
11 the disbursement from the account, and
12 that accountant did have to be
13 independent. So, we are, you know, aware
14 of the independence issues with regard to
15 an accountant.

16 Q. At the bottom of this E-mail it
17 says, "high speed money managers and
18 Madoff's head would look pretty good above
19 Eliot Spitzer's mantle I suppose unless we
20 figure out a way to get comfortable with
21 the regulatory tail risk in a hurry if we
22 get out."

23 Does that seem to indicate to
24 you that there is concern that Madoff
25 would have problems with an entity like

1 and that information is provided to the
2 SEC for perhaps an examination, wouldn't
3 you go back to Investment Adviser #1 in this type of
4 case and say, what is this totally
5 independent evidence that you have?

6 A. Yes, I believe, you know, with
7 that allegation -- I'm trying to think
8 whether -- and you could ask this later,
9 but the examiner may have even asked what
10 do you have, you have anything to show.

11 Q. Are you aware of any reason, any
12 policy, any procedure that would prevent
13 someone from going back to Investment Adviser #1 in
14 a case like this and say, what is this
15 totally independent evidence that you have
16 that Madoff's executions are highly
17 unusual?

18 A. No, I don't have any reason to
19 think that they would not be able to go
20 back and ask them.

21 Q. As a matter of fact, did anybody
22 at the SEC ever contact the individual in
23 this E-mail and say, what is this totally
24 independent evidence that you have?

25 A. Well, as I just suggested, it's

1 words that there weren't enough option
2 contracts or something to support what the
3 amount of money that he was supposedly
4 managing.

5 Q. Then when you see where it says,
6 "we included that maybe he does the
7 options from the OTC market. We have
8 spoken to several market makers in OTC
9 equity options. None of them claim to see
10 any significant volume in OEX options."

11 Do you see that?

12 A. Yes.

13 Q. So does that also indicate to
14 you that they were trying to figure out
15 whether Madoff was actually executing all
16 these options and seems to have no
17 evidence that there was any significant
18 volume?

19 A. Yes, clearly it suggests that
20 they were trying to find out where exactly
21 the trades were taking place.

22 Q. And then if you see the next
23 page it says, "with Madoff so he could
24 choose to use any strength in any total
25 volume he chooses, but the risk must be

1 covered somewhere if he is doing these
2 trades at all."

3 Do you see that?

4 A. Yes.

5 Q. Does that indicate to you that
6 there's some suspicion as to whether
7 Madoff is trading at all?

8 A. Yes, it does.

9 Q. And then you see after that, "so
10 we need an OTC counterparty, not
11 necessarily a bank, who is willing to do
12 the basket of options, plus the underlying
13 with Madoff's prices unfavorable to the
14 OTC counterparty is 10 to 15 billion."
15 And then you have three exclamation
16 points.

17 Do you understand from reading
18 that that he seems to be implying that no
19 one would be an over the counter
20 counterparty for Madoff?

21 A. Could you repeat the question.

22 Q. Sure. Reading that language
23 that I just read to you about the OTC
24 counterparty, based on your experience do
25 you understand that to mean that this

1 individual who wrote this E-mail doesn't
2 believe that anyone would be willing to be
3 an OTC counterparty for Madoff given these
4 facts?

5 A. I can't say that he doesn't
6 believe it. I think that he's questioning
7 --

8 Q. He's questioning whether anybody
9 would want to be an OTC counterparty in
10 this situation?

11 A. That's what I believe he's
12 questioning.

13 Q. And there's three exclamation
14 points, so it's a pretty serious question?

15 A. Yes.

16 Q. Is it fair to say you think he
17 finds it unbelievable?

18 A. I don't think I can answer how
19 he feels. I don't know that I can answer
20 how anyone feels.

21 Q. Okay.

22 Now, is there a way for the SEC
23 to look into this question, if somebody
24 comes and questions whether an OTC
25 counterparty would be willing to engage in

1 personally, I would be able to do a -- if
2 I had a transaction by transaction we
3 could do that, we could check with
4 counterparties. But to get a listing of
5 or dollar amount of how much, I honestly
6 wouldn't know how to get that.

7 Q. But if you were going to do an
8 exam, wouldn't you first get a list of
9 counterparties and then verify it if you
10 had this kind of allegation?

11 A. That sounds reasonable, but I
12 don't know that -- yes. I'm not certain
13 what information when you just contact the
14 counterparty because I have not done that.
15 I'm not certain how they would provide the
16 information. If they -- in other words
17 it's just for -- you have to give them
18 specific transactions. Like you said, you
19 know, here, what did you do with this, how
20 much in that, and I'm not certain how that
21 would work.

22 MS. STEIBER: Could you also do
23 what they say they did, which is contact
24 market makers and OTC options and find out
25 if they're seeing the type of volume?

1 THE WITNESS: Yes.

2 MS. STEIBER: That are being
3 reported by Madoff?

4 THE WITNESS: That sounds
5 reasonable to be able to do that and see
6 what do people see out there. And contact
7 people, could even do that. Just, you
8 know, maybe, you know, if they know
9 particular people to call and see what
10 they see.

11 I would think that firms
12 probably have better resources than I
13 would to know who to call to see what you
14 see. I don't know that if, you know, if I
15 picked up the phone and called someone, I
16 don't know if they would be totally
17 forthcoming with just, you know, a general
18 question like, what do I see.

19 Q. But you could get information
20 from the firm, like going back to these
21 individuals and seeing who they spoke to?

22 A. Yes. And what we really do, we
23 talk to people at the firms and we would
24 follow-up and ask, where did you get that
25 information, do you have any documentation

1 to show us, who did you speak to. That
2 would be the normal way that we would
3 follow-up, and that's why I wouldn't base
4 something on my knowledge or, you know,
5 who I know.

6 Q. You see at the end in this
7 E-mail it says, "none of it seems to add
8 up."

9 Do you see that?

10 A. Yes.

11 Q. You sent this memo to Robert
12 Salaso and Richard Lee, how come you sent
13 it to those two people?

14 A. They still are -- in fact,
15 they're in charge of the broker dealer
16 program, and so the Bernard Madoff
17 investment securities would be under their
18 purview.

19 Q. Do they have different
20 responsibilities, are they both co-heads
21 of the program?

22 A. They're co-heads of the program.

23 Q. And they're both still here?

24 A. Yes.

25 Q. Based on the information in this

1 document, what action do you think should
2 have been taken? Do you think that they
3 should have began a cause exam based on
4 this information? Would the information
5 in this document, Exhibit 1, be sufficient
6 to begin a cause exam in your experience?

7 A. Yes. And they informed me that
8 they would conduct a cause exam.

9 Q. So what would you do in a cause
10 exam, what would be the steps that you
11 would take?

12 A. Well, I can't speak for what the
13 broker dealer cause exam would do because
14 I've never done one, but I could answer
15 for an investment advisor cause exam.

16 Q. Okay. What would you do with
17 the cause exams that you're familiar with?

18 A. We would follow-up on whatever
19 allegations were made. We get complaints
20 all the time. And that's the focus on the
21 cause exam, is the complaint or if there's
22 suspicion of questionable activity, that's
23 what the focus of the exam would be.

24 Q. So given the language that we
25 talked about that's in Exhibit 1, wouldn't

1 you follow-up on the questions that are
2 raised in these E-mails about whether
3 Madoff was actually trading, would that be
4 one thing you would follow-up on?

5 A. Whether he's actually trading?

6 Q. Right.

7 A. Yes.

8 Q. I'm going to show you another
9 document. I'm going to mark this as
10 Exhibit 2. This is a May 11, 2004 E-mail
11 from you to Robert Salaso, a copy to Personal
Privacy
12 [REDACTED], Diane Rodriguez and Thomas
13 Thanasules.

14 (Whereupon, the aforementioned
15 E-mail was marked as Exhibit 2 for
16 identification.)

17 Q. Ms. Rodriguez has passed away;
18 is that correct?

19 A. Yes.

20 Q. Is Personal Privacy still working
21 with the SEC?

22 A. No. He retired in 2006. And
23 that's when Personal Privacy became my
24 supervisor, Personal Privacy. I'm sorry.
25 He retired prior, maybe a few months prior