

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

In the Matter of:)

ORIGINAL

) File No. OIG-509

OIG-509)

WITNESS: Number 68 (Via Telephone)

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PLACE: Room 6465

Securities and Exchange Commission

100 F Street, N.E.

Washington, D.C. 20549

DATE: Thursday, June 25, 2009

The above-entitled matter came on for hearing, via telephone, pursuant to notice, at 2:07 p.m.

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1 APPEARANCES:

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3 On behalf of the Securities and Exchange Commission:

4 H. DAVID KOTZ, ESQ. Inspector General

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12 On behalf of the Witness (Via Telephone):

13 TERRI REICHER, ESQ.

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20 Also Present:

21 April Elliot, SEC Intern

22 Cristina Katz, SEC Intern

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P R O C E E D I N G S

1
2 MR. KOTZ: All right. We are on the record at five
3 minutes after 2:00 p.m., on June 25, 2009, at the United
4 States Securities and Exchange Commission Office of Inspector
5 General. The individual who is giving testimony is on the
6 telephone, along with his counsel. I'm going to swear you in
7 over the telephone. Is that okay, Gene?

8 MR. DEMAIO: Yeah, that's fine.

9 MR. KOTZ: Okay. Could you please right hand?
10 Whereupon,

11 GENE DEMAIO

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

14 EXAMINATION

15 BY MR. KOTZ:

16 Q Okay, great. And could you state and spell your
17 full name for the record?

18 A Sure. My name is Gene, G-e-n-e DeMaio,
19 D-e-m-a-i-o.

20 Q Okay. Mr. DeMaio, my name is David Kotz. I'm the
21 Inspector General of the United States Securities and
22 Exchange Commission. I have with me fellow members of the
23 office of Inspector General, David Witherspoon, Chris Wilson,
24 April Elliot, Christina Katz.

25 This is an investigation by the office of Inspector

1 team for NASD at the American Stock Exchange. So within the
2 American Stock Exchange division, the equity and options
3 surveillance fell under my leadership.

4 Q Okay. And what are your duties as -- in your
5 current job?

6 A Currently I am charged with regulating a number of
7 options markets, the NASDAQ Option Market, the Boston Options
8 Exchange. I handle investigations and enforcement for the
9 International Securities Exchange. I handle floor broker and
10 specialist exams for the New York Exchange and for the
11 American Stock Exchange. I do some work for -- with respect
12 to reporting in over the counter options, and I think that's
13 everything that I'm currently doing.

14 Q All right. It sounds like you've got a lot there
15 by itself. Maybe we should move this along so you can get
16 back to all of that. Okay, great. Let me ask you this. Do
17 you recall a conversation you had -- our notes show it
18 occurred on May 17, 2006. You may not remember the exact
19 date, but do you remember a conversation you had with an
20 enforcement attorney from the New York regional office of the
21 SEC concerning options trading or Bernard Madoff?

22 A Yeah, I do recall. I don't recall the specific
23 date as you say, but I do remember the conversation.

24 Q And was there only one conversation, so that if our

1 notes point to it occurring on May 17, 2006, it likely
2 occurred on that date?

3 A Yeah, I think that's very likely. I do only recall
4 one conversation.

5 Q So what do you recall about that conversation?

6 A I remember that the team -- I think there were
7 actually two people from the SEC that contacted me.

8 Q Okay.

9 A And they had questions about various options
10 strategies, and they had been directed to me through people
11 at our company because I headed up the option team at the
12 American Stock Exchange, you know, performing the regulatory
13 services. And having been a former options market maker,
14 often people within NASD and now FINRA, will direct option
15 related questions over to me.

16 So I recall that these questions focused on option
17 strategies, and I was told that the SEC was going to be
18 having on the record testimony with Mr. Madoff. I believe
19 they had indicated it was going to be the next day, though I
20 could be wrong about that --

21 Q Okay. And do you remember who was on the call?
22 Was it a woman named Simona Suh? Do you remember if she was
23 on the call?

24 A I don't recall the names.

1 Q Okay. Meaghan Cheung? No?

2 A Again, I don't remember.

3 Q But it was two women?

4 A I actually thought it was two men.

5 Q Oh.

6 A But again, this was three years ago, so I could be
7 remembering incorrectly.

8 Q Okay. There may have been a guy, Stephen Johnson,
9 on the call?

10 A It's possible, but I don't recall.

11 Q Okay. And so what about the option strategies did
12 they ask you?

13 A They were asking me to provide them with some
14 information as to what certain strategies were, and how they
15 would be utilized.

16 Q Okay. Did they mention the split strike conversion
17 strategy?

18 A I don't remember the term split strike conversion,
19 but I do remember them asking me about strategies like that,
20 like reversals and conversions, which are similar in nature.

21 Q Okay. And do you remember what you said to them,
22 or --

23 A I recall walking them through the dynamics of how
24 those trades are executed, what they mean in terms of

1 position management, how a trader might put such a trade on,
2 and why they might put it on.

3 Q Did you get the impression that they had a good
4 understanding of these issues relating to options trading in
5 your conversation with them?

6 A I do not believe they had a good understanding at
7 all.

8 Q Okay. And did they ask you anything about
9 obtaining any records?

10 A No. No, they did not.

11 Q Was there any discussion about how one could
12 achieve certain returns based on certain strategies?

13 A I don't recall specifically, but that -- I would
14 think that would likely be part of the conversation, simply
15 because generally when you're talking about options
16 strategies, it's a function of, you know, determining what
17 the -- you know, the best way to put the position on to
18 achieve a certain return would be. It's almost always part
19 of the conversation.

20 Q Okay. Did they ask you anything about how you
21 could or NASD could -- excuse me, assist them in determining
22 whether options trades had actually occurred?

23 A No, I don't remember anything like that.

24 Q Okay. Was there a Danny Malito? Do you know who

1 that is?

2 A Yes, Danny Malito is a director at FINRA. He works
3 for me.

4 Q Do you know if he was on the call?

5 A He most definitely was.

6 Q Okay. And so did it seem like a lot of the
7 questions they were asking on that call were kind of basic
8 questions?

9 A Yeah, they were extremely basic questions.

10 Q And so if they were going to take Bernard Madoff's
11 testimony, would there be some concern that they didn't seem
12 to understand the issues very well? Did you get the sense
13 they needed some, sort of, significant coaching to get to a
14 point where they would be able to confront somebody like
15 Bernard Madoff in testimony?

16 A It's interesting that you ask that question,
17 because before the call was over, I recall specifically
18 saying that I thought they needed to do a little bit more
19 homework before they were ready to talk to him.

20 Q Did you say that to them?

21 A Yes, I did.

22 Q Okay. Did they indicate whether they would?

23 A No, I believe they indicated that they were going
24 to continue to go forward with taking the testimony. And of

1 course, that was none of my business one way or the other,
2 but it was just my observation that it seemed like the
3 questions were, as you say, very basic, and it concerned me
4 to some extent.

5 Q Did Mr. Malito share that perspective as well, do
6 you know?

7 A He did.

8 Q He mentioned that to you, or you talked to him
9 about it at some point?

10 A Yeah, almost as soon as we hung up the phone. We
11 were in my office. I recall it very clearly. And I had said
12 that right near the end of the call, and when we hung up, we
13 were both, sort of, shaking our heads, saying that, you know,
14 it really seemed like some of these strategies were over
15 their heads.

16 Q Anything else specific that was said on the call
17 that you remember?

18 A Nothing specific. As I mentioned, we talked about
19 the different strategies. But in the past, I've done quite a
20 bit of option training, so often I'll go through the same way
21 of explaining these strategies. So, you know, I can
22 generally recall the type of conversation we would have had,
23 but I don't remember the specific language that was used.

24 Q Okay. Did they indicate anything specifically

1 about investigating Bernard Madoff for a Ponzi scheme?

2 A No.

3 Q Did they say anything at all about what they were
4 looking at Madoff for?

5 A No, they didn't, at least that I recall.

6 Q Okay. And you don't remember any further
7 conversations with those folks, or other folks working on the
8 Madoff case, other than that one you described?

9 A No, I'm almost sure that at the end of the
10 conversation, that Danny and I indicated to them that if they
11 needed anything from us they could call us at any time, but
12 we never heard back from them.

13 Q How long was the conversation, about, do you think?

14 A It was lengthy. I would say it was over an hour,
15 and it was mostly, again, me going through what different
16 strategies were.

17 Q Okay. All right, let me ask you a couple
18 questions, kind of, just generally, if you could help me,
19 kind of, understand some more generic issues. Let's say I
20 was in a position where I was trying to find out where
21 someone was trading equities or options, or both.
22 Would there be certain types of information that one could
23 get from FINRA, or then NASD, that would help with that
24 effort?