

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

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

WITNESS: Number 4

A rectangular stamp with the word "COPY" in a bold, sans-serif font. The letter "C" is enclosed in a small square box.

PAGES: 1 through 105

PLACE: U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC

DATE: Monday, February 23, 2009

The above-entitled matter came on for hearing, pursuant to notice, at 10:35 a.m.

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1 APPEARANCES:

2

3 On behalf of the Securities and Exchange Commission:

4 DAVID KOTZ, ESQ., Inspector General

5 HEIDI STEIBER, ESQ.

6 CHRISTOPHER WILSON, ESQ.

7 Securities and Exchange Commission

8 100 F St., NE

9 Washington, DC

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11 On behalf of the witness:

12 MAVIS KELLY, PRO SE

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C O N T E N T S

1			
2			
3	WITNESS		EXAMINATION
4	Mavis Kelly		6
5			
6	EXHIBITS:	DESCRIPTION	IDENTIFIED
7	1	E-mail to Edward R. Perkins;	
8		e-mail to E. Perkins, 5/13/03	15
9	2	Mavis Kelly notes with [REDACTED]	
10		[REDACTED] contact information	17
11	3	E-mail [REDACTED] to Mavis	
12		Kelly 5/21/03	24
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P R O C E E D I N G S

1
2 MR. KOTZ: Okay, we are on the record at
3 10:35 a.m. on February 23, 2009, at the United States
4 Securities and Exchange Commission Office of Inspector
5 General.

6 I am going to swear you in, if that's all right.
7 Could you please raise your right hand?
8 Whereupon,

9 MAVIS KELLY

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

12 MR. KOTZ: Could you state and spell your full name
13 for the record?

14 THE WITNESS: Mavis Helene Addison Kelly.
15 M-A-V-I-S, H-E-L-E-N-E, A-D-D-I-S-O-N, K-E-L-L-Y.

16 MR. KOTZ: My name is David Kotz. I'm the
17 Inspector General at the U.S. Securities and Exchange
18 Commission, 100 F Street, NE, Washington, DC.

19 This is an investigation by the Office of Inspector
20 General, Case Number 509. I'm going to ask you certain
21 questions. You'll have to answer them under oath. The court
22 reporter will record and later transcribe everything that's
23 said. Please provide verbal answers to the questions. A nod
24 of the head or some other nonverbal response will not be able
25 to be picked up by the court reporter.

1 there was a referral to your side?

2 A I can't think of one specifically, but I'm sure
3 that there has -- it has happened. But I can't think of one.

4 Q When did you first hear of Bernie Madoff or Madoff
5 Securities?

6 A It first came to my attention when we -- as part of
7 the 2002 review, we visited [REDACTED] -- [REDACTED]
8 [REDACTED] I think is the full name. And some time
9 later --

10 Q What's [REDACTED]

11 A Oh, they're a hedge fund -- they're a fund-to-fund
12 manager located in New York.

13 Q How come you looked at them, just part of your
14 general sweep?

15 A This is in 2002. We visited them in October, and
16 they weren't originally part of the plan to examine, but one
17 of the New York examiners that was participating on the sweep
18 with us was going to be -- he was finishing up the sweep with
19 us, and he was going to go back to his normal examination
20 program, and he was going to look at [REDACTED] as his
21 next exam, and he thought we might want to talk to them, to
22 get a different perspective, because we were looking at
23 funds -- we'd heard that funds of hedge funds were how it was
24 becoming -- hedge fund access was becoming more retail
25 oriented.

1 sent Tuesday, May 13th, 2003, 4:26 p.m.; we're going to mark
2 it as Exhibit 1. Do you remember who [REDACTED] is?

3 A Yeah, he was the [REDACTED] Personal Privacy [REDACTED]
4 [REDACTED]. He was our primary contact.

5 Q And so, do you remember a communication with Ed
6 around this time that was reflected in this e-mail?

7 A Do I remember communicating with -- I don't
8 remember this e-mail.

9 Q But what do you remember about what happened?

10 A That [REDACTED] called me, and I don't know how to
11 pronounce his last name, but he called me.

12 Q Do you remember when he called you?

13 A I didn't remember when he called me, but I think it
14 was shortly thereafter.

15 Q So around May 2003?

16 A Sure.

17 Q And do you remember what that conversation was all
18 about?

19 A Yes. He had concerns that there was a -- that
20 Bernard Madoff -- he couldn't understand how he was
21 maintaining his performance. And [REDACTED] was a very
22 thorough firm, in terms of -- they were a fund of hedge fund
23 manager. They had all offshore funds. They are the only
24 place we've been to that had full transparency to their
25 underlying funds. I mean, they were very analytical, very

1 experienced, very technically savvy firm. And he had
2 concerns and he couldn't figure out how he was -- how Bernard
3 Madoff was earning returns.

4 Q So would you consider [REDACTED] to be a credible
5 source of information?

6 A Highly.

7 MR. KOTZ: I'm going to show you another document.
8 It looks like their notes. It says on the top of the inside
9 [REDACTED] and then it says on the left side, [REDACTED]
10 [REDACTED], and we're going to mark this as Exhibit 2.

11 (SEC Exhibit No. 2 was marked for
12 identification.)

13 BY MR. KOTZ:

14 Q Why don't you take a look at this.

15 A These look like my notes. Okay.

16 Q These are your notes, Exhibit 2?

17 A They appear to be my notes.

18 Q And going back to Exhibit 1 for a second, it looks
19 like [REDACTED] initially called Ed Perkins.

20 A Mm-hmm.

21 Q Is that what happened?

22 A Ed -- as I said earlier, Ed was going to be leading
23 an exam of [REDACTED], so we went in sort of before the
24 exam and just talked to them, and then Ed completed the exam.
25 So Ed was his contact for the longer period of time.

1 as quite a lot?

2 A It is a lot, but we had -- several of the hedge
3 fund managers we visited had billions in their management.

4 Q And then it says, "For volume, must see options on
5 Street yet never see them." What does that mean?

6 A In order to execute the strategy using -- as
7 described, you'd have to see some level of option
8 transactions on the Street.

9 Q And yet [REDACTED] was telling you that he wasn't
10 seeing that.

11 A Correct.

12 Q And you put that in a box, with an asterisk. Was
13 that because you felt that was particularly important?

14 A Yes, that's how I take it now.

15 Q Do you remember if this was the only page of notes?

16 A Like I said, I think this was a very brief phone
17 call, extremely brief phone call.

18 Q Well, we appreciate that you took --

19 A I can't even find these notes, though, stumbling
20 over looking at them six years later.

21 Q Do you know at the time -- he mentioned the
22 articles. Did he attach any articles, or did you go and look
23 up the articles?

24 A I believe I was -- I can't find anything, so I
25 don't have anything more.

1 for records?

2 A I assume that's what the SRO group does. I've
3 never done that.

4 Q And then a couple lines down, it says, "We actually
5 checked with some of the largest brokers, UBS, Merrill, et
6 cetera, which told us they never traded with them OEX
7 options. What are OEX options?

8 A Over the exchange -- they're exchange-traded
9 options.

10 Q And is the implication here, given that there's an
11 \$8 billion to \$10 billion in size, you must see the volume
12 but you don't, they check with the brokers and they never
13 traded with them the options, that Madoff is lying about his
14 option trading?

15 A That's why he was -- the question is, do they
16 really implement the full strategy, is what he is asking or
17 what he's stating.

18 Q So [REDACTED] is implying that Madoff Securities may
19 be lying about his option trading.

20 A Yes.

21 Q And then it says at the bottom, "There are no third
22 party brokers involved in the process. The auditor of the
23 firm is a related party to the principal." What would the
24 relevance of that be, that the auditor of the firm is a
25 related party to the principal?

1 characteristics of a Ponzi scheme?

2 A I mean, a Ponzi scheme is where you just take new
3 money and you pay out old money, and obviously skim some off
4 the top for yourself. What are you asking?

5 BY MR. KOTZ:

6 Q How would -- in the regulator situation, what would
7 be brought to your attention, specifics, facts, about a
8 particular situation that would lead you to be concerned that
9 perhaps it was a Ponzi scheme?

10 A This lays out some concerns. *✓*

11 Q So the -- just to get this clear, the e-mail from
12 [REDACTED] on May 21st, 2003, lays out concerns that Madoff may
13 be engaged in a Ponzi scheme.

14 A He is saying he doesn't understand how he could
15 keep those returns. So he is saying that there are concerns
16 that this is not -- that he doesn't know how he could keep
17 them going.

18 Q Right, so does that mean that [REDACTED] was providing
19 information in May 2003 that would lead one to indicate that
20 this might have been a Ponzi scheme?

21 A He was laying out factors that said didn't make
22 sense, and needed to have answers to them.

23 Q And those factors that [REDACTED] laid out that didn't
24 make sense and needed to have answers, would they be -- could
25 they be potentially a Ponzi scheme?

1 A Well, they turned out to be a Ponzi scheme, so --

2 Q Right, but I'm saying at the time, based upon the
3 information that was provided by [REDACTED], was he giving you
4 some indication that there may be a Ponzi scheme?

5 A He was giving indication that there are areas that
6 need to be answered, and we needed to look into them more.

7 Q Okay. Was there anything specific in [REDACTED]
8 e-mails that would lead you to believe that perhaps it was a
9 Ponzi scheme?

10 A Other than the fact that he couldn't understand the
11 returns, the consistency of the returns, and the fact that he
12 believed the returns hadn't been tested, in terms of getting
13 the money out -- that's what he laid out that the concerns
14 were that needed to be checked. I don't -- I mean, it's hard
15 to say, you know, hindsight, reading into -- of course it's
16 all laid out there. But at the time, that's what the issue
17 seemed to be, is he couldn't understand the strategy and how
18 he was implementing it.

19 MR. KOTZ: Okay so -- all right, go ahead.

20 BY MS. STEIBER:

21 Q Do you remember during this 2003 to 2005 time
22 period, were Ponzi schemes generally recognized by OC as an
23 area of concern?

24 A It's always been an area of concern. I mean, there
25 were several hedge funds that blew up during -- there was

1 Madoff's status in the hedge fund world are baffled by the
2 way the firm has obtained such consistent, nonvolatile
3 returns month after month and year after year."

4 A Yes.

5 Q And so this would -- is written by -- is this
6 publication generally well known?

7 A It is well known. It's not one we normally get, or
8 at least that I know we normally get here on the Commission,
9 but MAR/Hedge is a big hedge fund performance database.

10 So --

11 Q Would you consider it a credible publication?

12 A Yes, it's long standing.

13 Q And in this case, so then [REDACTED] -- this wasn't
14 only information [REDACTED] was providing, but also something
15 that this publication was saying, is that right?

16 A Correct.

17 Q And then if you look at the next page, which is
18 page 16 of this --

19 A Correct.

20 Q And you see on the right side, about halfway down,
21 the paragraph starts, "Skeptics who express a mixture of
22 amazement, fascination and curiosity about the program
23 wonder, first, about the relative complete lack of volatility
24 in the reported monthly returns."

25 A Mm-hmm. Yes, this is --

1 Q "But among other things, they also marvel at the
2 seemingly astonishing ability to time the market and move to
3 cash in the underlying securities before market conditions
4 turn negative; and the related ability to buy and sell the
5 underlying stocks without noticeably affecting the market.

6 "In addition, experts ask why no one has been able
7 to duplicate similar returns using the strategy and why other
8 firms on Wall Street haven't become aware of the fund and its
9 strategy and traded against it" --

10 A Mm-hmm.

11 Q -- "as it has happened so often in other cases; why
12 Madoff Securities is willing to earn commissions off the
13 trades but not set up a separate asset management division to
14 offer hedge funds directly to investors and keep all the
15 incentives for itself."

16 So this information that is in this article, as a
17 regulator, what does this tell you?

18 A That other -- I'm sorry, I'll let you finish.

19 Q What would be your reaction to this, just
20 generally? What is the concern that would come out of the
21 information in this article?

22 A That others can't seem to replicate the
23 information, as well.

24 Q And so what does that mean? As a regulator, what
25 does that mean to you?

1 also the funds that he was -- that are in here were part of
2 Tremont, and we were looking at Tremont and the due diligence
3 process. It's not as if I dismissed his concerns, and said,
4 ahh -- he was a very credible person.

5 Q This is [REDACTED]

6 A [REDACTED] yes.

7 Q And then is that credibility --

8 A Supported.

9 Q -- even supported by the article?

10 A Yes.

11 MR. KOTZ: Okay.

12 BY MS. STEIBER:

13 Q When you see the line and he talks about why other
14 firms on Wall Street haven't become aware of the fund and
15 traded against it, as has happened so often in other cases --
16 do you see that line -- "Experts ask why no one has been able
17 to duplicate similar returns using the strategy and why other
18 firms on Wall Street haven't become aware of the fund and
19 traded against it, as has happened so often in other cases."

20 Do you have any reaction to that? In this line is
21 he implying that Madoff really wasn't trading?

22 A No, it --

23 Q Why they're not aware --

24 A No, it says they haven't been able to replicate the
25 strategy, because part of what people try to do is reverse

1 might be smoothing returns, the hedge fund manager might be
2 smoothing returns or misreporting returns?

3 A The lack of -- lack of volatility is what absolute
4 managers are trying to get at. The fact that he maintains it
5 with such consistency is what raises concerns about the
6 performance.

7 Q What are things that if you see consistent lack of
8 volatility over many years, as an examiner, what would you
9 wonder about? What would be some of your suspicions?

10 A Well, it depends on what type of investments they
11 are -- they're in. In this case, it's over the -- it's
12 exchange traded securities, so that's a different
13 perspective, but oftentimes what we find with smooth
14 performance it's in illiquid security holdings, and they're
15 not really using -- they're using a lot of fair value instead
16 of market quotations. It depends on what kind of portfolio
17 manager --

18 Q But in here, where he's trading what he claims to
19 be trading, using the strategy he claims to be using, what
20 would be something that you would -- as an examiner -- look
21 at when you see this lack of volatility for this long of a
22 period?

23 A I would look at the trading download; I would look
24 at the trading activity and we would compute the performance
25 ourselves.

1 Q But just as an examiner, when you -- before you go
2 in and you are thinking about possible risks, what would
3 something that you would -- what would you think that it's a
4 possible indication of fraud or possibly an indication of
5 smoothing returns if you see this lack of volatility for this
6 long period of time using this trading strategy that Madoff
7 was claiming he was using?

8 A Lack of volatility in the market, or lack of
9 volatility in returns?

10 Q Volatility in his returns.

11 A That's one of the things we would look to validate,
12 is the performance returns.

13 Q I feel like we're talking about two different
14 things, and I just want to -- I do want to make it clear, and
15 then we can -- that when you see -- when you go into a hedge
16 fund, or you look at an advisor who is claiming to use the
17 strategy that Madoff was claiming to use, using equity
18 securities, and he claims to have had, for 10 years, very
19 smooth, unvolatile returns, what are some of the
20 possibilities that would go through your mind that you would
21 want to investigate?

22 A How is he getting those returns? What are some of
23 the things that I might think is happening?

24 Q Right, exactly.

25 A I would look for, now -- I would look for the

1 misrepresentation of performance to see if he was just
2 falsifying the performance; I would look for the individual
3 accounts to see, is he using specific -- because a lot of
4 times they report performance from -- for a specific set of
5 clients, so is he manipulating the specific clients that he
6 was using in his composite, and only those highly profitable
7 accounts; I would look towards the population as a whole to
8 see -- we do a client account review, we do a performance
9 review. And in doing the client account review, I would
10 notice if the trades were there and activities reported, who
11 was the custodian, how -- is that what you're asking?

12 Q Yeah, exactly.

13 A Partially?

14 Q So there are many different things you as an
15 inspector -- I mean, not one thing in particular. You would
16 see these smooth returns over a long period of time, or these
17 unvolatile returns over a long period of time, and that would
18 be suspicious, correct?

19 A Correct.

20 Q And so then there would be many different
21 possibilities that you would think of --

22 A Mm-hmm.

23 Q -- maybe they're legitimate, but maybe they're not
24 legitimate, correct?

25 A Correct.

1 A Depending on the strategy, I said it could be very
2 much higher.

3 Q Is there anything else in here that you -- as you
4 look through this document that would cause you to view it as
5 unusual or concern, in terms of this document that [REDACTED]
6 provided you?

7 A It says 90 percent of the months are profitable, so
8 it's just letting you know more about the consistency of the
9 returns. The largest losing month was negligible. He
10 describes the strategy. It seems to be like a pitch book.

11 Q So is it fair to say that this information that
12 [REDACTED] provided you gave you information about very
13 remarkable returns that Madoff was getting?

14 A It supported his line of questioning, as to how he
15 could achieve the returns given what information he had. He
16 questioned it. This is backup for why he was questioning it.

17 Q And he was questioning how Madoff was able to
18 achieve such remarkable returns.

19 A Correct.

20 Q Was there anything in what [REDACTED] provided you
21 that you looked at and thought, you know, he's wrong; he's
22 overly concerned about this; this is something that I just
23 don't agree with?

24 A No, there was nothing that we didn't -- that I
25 remember not agreeing with. I don't remember all these

1 A I don't know.

2 BY MR. KOTZ:

3 Q Do you remember following up with [REDACTED] at all
4 after you received the materials?

5 A I don't believe we did, I did, anyhow.

6 Q Did you believe that the information [REDACTED]
7 provided gave red flags about Madoff's operations?

8 A I believe it provided information that raised
9 questions.

10 Q But you wouldn't say it was red flags?

11 A Well, the red flags are -- questions are red flags.
12 It raised concerns for information that we could not get.

13 Q So you would say that [REDACTED] materials raised
14 red flags about Madoff's operations.

15 A [REDACTED] materials raised a lot of questions that
16 should be answered.

17 Q Did you forward the information [REDACTED] provided
18 you to Enforcement?

19 A No, I gave it to our broker -- SRO group.

20 Q How come you didn't give it to Enforcement?

21 A Because, I believe -- I don't remember who I
22 talked -- I wouldn't have made the decision on my own. I
23 don't have any records as to who I talked to about this, but
24 I believe I talked to Gene Gohlke, because that makes sense.
25 And based on the fact that it was -- he was a market maker,

1 and that this is something that you should see on certain
2 exchanges, thought it made sense to give it to our
3 broker-dealer group.

4 And I think we made that decision in the fall. I
5 don't think it was -- I don't remember the exact date. I
6 don't remember how -- I remember making a phone call, and I
7 think it was to Mark Donohue, but I don't remember -- I don't
8 remember the details surrounding the timing.

9 Q But you think it was a few months after you got the
10 e-mail from [REDACTED].

11 A Correct, because we were looking at it from some of
12 the hedge funds, the fund of hedge funds. We were looking at
13 the due diligence process, and we were looking at, you know,
14 the information that they got and how they analyzed it,
15 whether they would get sufficient information to --

16 Q So there were -- you said there were questions
17 raised by the information that [REDACTED] provided. What was
18 your theory at that time about what Madoff was doing?

19 A I don't know that I had a theory at that time as to
20 what he was doing. I don't remember specifically anything
21 about -- other than doing research on the firm and the
22 parties raised in here, I don't know. I don't remember.

23 Q Do you remember if there was any discussion about
24 the possibility that Madoff was engaged in a Ponzi scheme
25 after you received [REDACTED] material?

1 Q So when you received --

2 A So I would say yes. I don't know if the others had
3 procedures. This is what we did in investment company
4 investment advisor group.

5 Q So could you walk through that process, of what you
6 were supposed to do with the tips in your group?

7 A If we received a complaint --

8 Q If you received it --

9 A Or an inquiry, OCIE Assistant Director, who was my supervisor at
10 that time, would log it before we forwarded it on to another
11 office.

12 Q Log it where?

13 A He has a spreadsheet.

14 Q That he kept, or that everyone could look at?

15 A Now it's available on the website. At that time, I
16 don't know where -- you know, how he kept it.

17 Q And so he would keep this, he'd log it in, and then
18 it was forwarded somewhere else. Did you regularly check in
19 on the tip or the complaint that you received to make sure it
20 had been handled?

21 A No, once it was forwarded -- I don't think so.
22 Once it was forwarded on to the office, it was for whatever
23 action they deem appropriate, generally.

24 BY MR. KOTZ:

25 Q Do you know if anybody ever followed up with

1 A I don't remember that specifically.

2 Q Was there discussions with your boss about
3 referring it to Enforcement?

4 A I don't remember specifically. I might have -- I
5 don't know, I don't know. I do know that I gave it to the
6 broker-dealer -- SRO group. I don't know whom else it was
7 given to or why or when.

8 Q I assume over the years that you've been in the SEC
9 you've seen a number of tips that have come in, is that
10 right?

11 A Yes.

12 Q As compared to the other tips you've seen, would
13 the [REDACTED] tip be more credible and detailed than others?
14 How would you compare it?

15 A Not as credible -- I wouldn't say "credible." He
16 is a credible person, so -- his is using public information,
17 some of the other tips I have is using non-public
18 information. So it was more targeted and more specific
19 because of the supporting documentation is right on.

20 Q But given that he was using non-public -- given
21 that [REDACTED] was using public information, as compared to
22 other tips, weren't there a larger number of questions that
23 were raised in [REDACTED] document than you usually get in
24 tips?

25 A [REDACTED] document, or documents, his information

1 to be doing an exam of anyway.

2 Q What about a situation where it wasn't a registered
3 advisor, what would be the way to look into what -- the
4 information that [REDACTED] provided?

5 A We would give it to Enforcement if there was no
6 regulated entity, like there's no registered advisor, no
7 registered broker-dealer, there's nobody that would give us
8 authority to go in and obtain the records.

9 Q And so you gave it to who again, in this case?

10 A I gave it to the SRO group. I believe, I'm not
11 positive, that I gave it to Mark Donohue.

12 Q And what was your sense of what Mark Donohue would
13 do at that point?

14 A That he would look into the trading volume
15 question, that they would look into how the activity took
16 place, because if he's a broker-dealer he would have the
17 trading volume, he would get the information about the
18 accounts, he would get the information necessary to
19 understand whether the performance was falsified.

20 Q And would you think that Mark Donohue would also
21 look into whether Madoff Securities should have been
22 registered as an investment advisor?

23 A Right. At this time, you could have discretionary
24 accounts, brokerage accounts, commission-based brokerage
25 accounts and not be registered as an advisor.

1 Q But would there be aspects of the investor --
2 investment advisor operation that you would expect Mark
3 Donohue to look at?

4 A But it wouldn't be an investment advisor, it would
5 only be a broker-dealer, because it's discretionary brokerage
6 accounts, from what he says in here.

7 BY MS. STEIBER:

8 Q So you can look at everything to do with those
9 accounts --

10 A Right.

11 Q -- correct?

12 A Right. Yeah, yeah, yes.

13 Q Can you talk about any procedures for handling tips
14 that OC might have had in the 2003 to 2005 time period?

15 A Okay.

16 Q Did they have any procedures that you were aware of
17 for handling tips in 2003 when you received this?

18 A OC as a whole?

19 Q OC as a whole, or one that applied to you --

20 A In our group, if we have a tip that is being
21 forwarded on to another office. So if we're going to send it
22 out to New York or Boston or enforcement, then we log it.

23 Q So did each group have their own procedures for
24 handling tips?

25 A I don't know what the other procedures might be.

1 specific firm because there's liability concerns under
2 Section 210b of the Advisor's Act. So is it a policy --
3 there's no prohibition that you can't talk to anybody, but
4 there is a lot of concern about how you go about doing it and
5 whether it's appropriate.

6 Q So were you saying that your boss -- what was his
7 name, [REDACTED] --

8 A [REDACTED]

9 Q [REDACTED] would be the best person to speak with
10 about how tips were handled from 2003 to 2005 in your group?

11 A Yes, yes. He still handles the tips now.

12 BY MR. KOTZ:

13 Q Okay, so you sent it over to the SRO group.

14 A Correct.

15 Q And do you know what was done subsequent by the SRO
16 group --

17 A I followed up at one point, and they said that they
18 were thinking he might be using his market making business to
19 front run the accounts. That was their concern or area of
20 focus, and that's the last I heard.

21 Q Who was that? Who did you follow up with?

22 A I think what happened is I called Mark Donohue,
23 said Eric was working on it, but I do not remember
24 specifically.

25 Q Would that be Eric Swanson?

1 A Eric Swanson, yes.

2 Q Do you think you might have talked to Eric Swanson
3 about it?

4 A I don't think I talked to Eric. I think -- I got
5 an e-mail from him saying that he was following up on the
6 matter.

7 Q So was your sense that the decision to focus on the
8 front running was made by Eric and Mark?

9 A Was made by the SRO group. I don't know who --
10 whom specifically.

11 Q Do you know why they made the decision to focus on
12 front running?

13 A No, other than trying to make sense of the
14 performance, I don't know.

15 BY MS. STEIBER:

16 Q So after you forwarded the tip on, did anyone call
17 you to ask you about your conversation with [REDACTED]?

18 A No, not that I remember, and actually I called Mark
19 at the time -- and this is why I think it was sometime around
20 September, because it was after market timing, and I was
21 trying to -- and I think it was Mark, I'm not positive who I
22 spoke to -- I was trying to impress upon them the importance
23 of following up on this, because I found this to be a very
24 credible source.

25 And he said, you know, especially in light of what

1 was happening at the time, they would take it -- regardless
2 they would take a tip seriously, but especially in light of
3 what was happening at that time, they were taking it -- they
4 would take it very seriously.

5 BY MR. KOTZ:

6 Q Based on the information that [REDACTED] provided,
7 would you have focused on the front running exclusively?

8 A I wasn't focused on front running. I was focused
9 on doing the fund to funds. I did not look at the front
10 running.

11 Q So what did you look at?

12 A I looked at the fund to funds to see what
13 information they might have, like what type of information
14 they would get about the portfolio managers, what sort of due
15 diligence would they do; from that perspective. I wasn't
16 looking at --

17 Q So what did you do in that respect?

18 A We visited several fund to funds, and one of them
19 was among the group specifically mentioned. We weren't
20 looking at Madoff -- the due diligence that they'd done of
21 Madoff in particular, because what we had learned is that the
22 fund to funds don't really get a whole lot, they rely on what
23 the managers give them. So basically you could get
24 information, but it wouldn't say much.

25 Q So what did you -- when you did that review, what

1 did you find?

2 A Not much. That's why we made the referral to the
3 SRO group after we had concluded our reviews of the
4 fund-to-fund managers.

5 BY MS. STEIBER:

6 Q But when you read [REDACTED] tip, you did not think
7 it completely focused on front running. Did you -- that
8 isn't what it said to you, correct?

9 A No, he had said he didn't know how he could get the
10 performance results he was getting; he didn't understand why
11 he wasn't seeing the movement in the market. It didn't say,
12 you know, it's a Ponzi scheme, it didn't say -- it just said
13 things aren't making sense to him.

14 Q You thought there were many different things to
15 follow up on from the tip.

16 A I would say there -- he gave different angles from
17 which to pursue the matter.

18 BY MR. KOTZ:

19 Q Do you know whether the market oversight group or
20 the investment advisor group followed up on this tip? Or did
21 the broker-dealer side or the investment advisor side? What
22 was done by Donohue and Swanson?

23 A They did a review looking at the market making
24 activity for -- I believe that that's what they were looking
25 at.

1 hedge fund -- I don't know specifically why. I don't
2 remember specifically why. But the information that we got
3 from the hedge fund fund-to-fund managers was not terribly
4 useful.

5 Q What about the information from -- that you got
6 from [REDACTED]?

7 A We only have access to what we have from the
8 advisor and the fund perspective, from our perspective.
9 That's all we can get.

10 Q Okay, but you said that in the past, where there
11 wasn't a registered advisor, and you only had access to
12 information if there was a registered advisor, it would be
13 forwarded to enforcement.

14 A Because I thought that they could get -- it wasn't
15 an advisor, but it was discretionary brokerage accounts, so I
16 thought that they could get it -- to it from the
17 broker-dealer standpoint. I didn't think I needed to refer
18 it to enforcement -- I don't remember.

19 But I'm guessing that I didn't think it was
20 necessary to refer it to enforcement, because if it's
21 executed through the discretionary brokerage accounts, you
22 would see all the information we would get from an advisor.
23 One of the things we would look at from an advisor exam is
24 all the trading download. Well, you get that from the
25 broker-dealer transactions. So there would be no need to go

1 to enforcement if you have a registered broker-dealer that
2 would have all the same information. I'm assuming that
3 that's the basis.

4 Q Do you know what other actions or exams were taken
5 relating to Madoff as a result of this tip?

6 A No. I don't -- I think that the SRO gave it to New
7 York, but I don't know. I wasn't involved anymore.

8 Q So if you were doing an exam that came out of
9 [REDACTED] information that he provided, and you were looking
10 for front running, and you didn't find evidence of front
11 running, what would you do, in your experience, at that
12 point?

13 A If I didn't find front running but I found
14 reasonable explanations for all of the areas of concern, I
15 might be willing to close it out.

16 Q Okay, what if you didn't find front running but you
17 didn't find reasonable explanations of the other issues that
18 [REDACTED] raised, what would you do then?

19 A If it was because I didn't have access to that
20 information, for whatever legal, structural, I don't know
21 what, then I would refer it to Enforcement. But if it's
22 something that is because there were -- I don't know, if
23 there were answers to it or if there was something that
24 helped resolve the issues, then I might be willing to close
25 it out.

1 Q All right, but if you -- you got this information
2 from [REDACTED], and then later on there was an exam done that
3 focused entirely on front running, and once the front running
4 didn't materialize, nothing else was reviewed, would that --
5 would you consider that to be appropriate follow-up from
6 what -- the information [REDACTED] provided?

7 A And they didn't find an explanation for the --
8 you're just saying, just looking at it from a front running
9 angle, and didn't find answers based on that front running, I
10 might try a different angle.

11 Q What would that angle be?

12 A What we do from the investment advisor program is
13 we follow the trades. We look at the transactions, we follow
14 the assets, custodial arrangements, we look at it from a
15 portfolio manager perspective.

16 Q And those are the kinds of things you would do
17 based upon some information that [REDACTED] provided?

18 A I would validate the performance -- is this
19 actually the performance derived. I would ask that accounts
20 were comprised of -- the Kingate, was it all of the -- the
21 whole fund, is it just -- actually, in this case, it's a fund
22 to fund, so it would just be Bernard Madoff.

23 But anyway, I would look to recreate the
24 performance to see if it made sense, because at that point
25 you would know, you know, were the trades real, would he have

1 the ability to pay back cash, would he -- although that
2 wouldn't get at the auditor issue, but if everything added up
3 then --

4 BY MS. STEIBER:

5 Q What if you didn't have an independent custodian?
6 You had just brought up a custodian issue.

7 A If there's a dual registrant that is often the case
8 that they use the affiliated custodian, and it's permitted
9 under the advisor's act.

10 Q So what would you do to trade the assets? You had
11 said you would trace the assets.

12 A Up until this point, what we've done is it's
13 believed that there are safeguards in place for the
14 broker-dealer. They have broker-dealer reviews that come in
15 and validate the existence of assets, so that would suffice
16 for purposes of custody. But if it's affiliated self
17 custodian, that doesn't -- you have to have a qualified
18 custodian.

19 Q So how -- I guess I'm getting a little confused
20 about that. You said, you used to do something, meaning you
21 do something else now. So talk about what you used to do,
22 and then talk about what contrast --

23 A What we're doing now? Well, what we're doing now
24 is we're doing custody verification reviews, where we're
25 actually sending confirmations directly to clients and

1 Q So was there something the broker-dealer side could
2 do to determine whether Madoff was actually trading?

3 A Since it says that they were discretionary
4 accounts, felt that they could look at the trading activity
5 in the brokerage accounts, and could validate the information
6 from a brokerage level.

7 BY MS. STEIBER:

8 Q Can I just show you two sets of -- first, let me
9 back up. Do you know if these documents are from your file?
10 Was this part of the research you were doing after you had
11 your conversation with [REDACTED]?

12 A It's possible. I do remember doing Internet
13 searches, trying to understand what was referenced. I see
14 momentum -- I don't know whose highlights these are, if
15 they're copied highlights. But I did -- timing wise, it
16 looks like it would have been around the time, but I don't
17 remember specifically.

18 MR. KOTZ: Okay, let's just put this document into
19 evidence.

20 MS. STEIBER: Sorry.

21 MR. KOTZ: This is --

22 MS. STEIBER: Number 6, I think.

23 MR. KOTZ: We're going to mark this as Exhibit 6.

24 MS. STEIBER: No, I'm sorry, you already had 6.

25 MR. KOTZ: We're going to mark this as Exhibit 7,

1 So I don't know that they needed to go to
2 management side, but if they weren't understanding how the
3 returns were achieved, we are used to doing that. That is
4 something we could have done, because I don't know that on
5 the broker-dealer side that they're really worried about
6 performance. That is a routine part of what we're doing. If
7 you're advertising performance or if that's your major
8 selling point, we're looking at it.

9 Q So if the broker-dealer side did an exam and even
10 after their exam there was still some questions unanswered,
11 would it have been appropriate at that point to bring in the
12 investment advisor side?

13 A Sure.

14 Q Do you have any idea --

15 A At least consulted with them.

16 Q And you're aware now, from what happened on
17 December 11th, that it seems as though Mr. Madoff was running
18 a Ponzi scheme, is that right?

19 A Yeah, yes.

20 Q So how do you explain that this information came in
21 and, you know, you said you read through the broker-dealer
22 exam -- how do you explain that this was not revealed?

23 A I don't explain it, I don't know.

24 Q Do you think that if the broker-dealer side had
25 gone to the investment advisor side in New York, they would

1 BY MR. KOTZ:

2 Q So what was your reaction when you heard that
3 Madoff admitted to conducting a Ponzi scheme, when you heard
4 in December of 2008?

5 A A little shocked. I mean, it's one of those
6 rememberable moments.

7 Q Were you surprised that OC didn't discover the
8 Ponzi scheme?

9 A Yes.

10 Q Do you have any -- why do you think OC didn't
11 discover the Ponzi scheme?

12 A I don't know enough about -- other than there was
13 no trading and it seemed to truly be just a flow of funds,
14 and that's only from reading news reports, not from anything
15 we perceived otherwise. I can't believe that we didn't see
16 anything that would indicate that there wasn't trading
17 activity in those accounts. Like, how could you generate the
18 returns if there weren't account trading activity? I don't
19 know.

20 Q Did you at that point think back to the information
21 that [REDACTED] provided?

22 A No, I'd actually forgotten about the specific
23 e-mail.

24 Q But now that you've looked at the e-mail, and we've
25 gone over it, do you understand now that some of the issues

1 that [REDACTED] was raising had some indicia of a Ponzi scheme?

2 A Yes. I mean, I can see it now. At the time, I
3 don't think I would have said, you know, red flag, Ponzi
4 scheme. I probably would have said, I wonder if he's fudging
5 his performance numbers, not, the money doesn't exist. That
6 wouldn't have been my first thought.

7 Q But it's fair to say that from the information at
8 the time that you received from [REDACTED], there were
9 significant red flags provided about Madoff's operation.

10 A Correct. And that's why I felt it was -- I would
11 be -- forwarded it on anyway, but that's why I felt it was
12 particularly important to forward it on.

13 Q Have you ever heard of Harry Markopolos?

14 A I have now, but at the time, no, I have not -- had
15 not.

16 Q Were you aware at the time of any further tips
17 being provided to the SEC about Madoff, other than the
18 [REDACTED] one?

19 A No.

20 Q Did you have an occasion to read what Harry
21 Markopolos provided?

22 A I have not read it. I watched some of his
23 testimony.

24 Q And what was your impression of that, in terms of
25 the information that Harry Markopolos provided?

1 from [REDACTED] and those attached materials if they were
2 forwarded to the New York exam staff?

3 A No. I think -- I don't even know that I ever
4 forwarded the e-mail on to anybody, I think -- because he
5 asked to keep it confidential. I think I was asked to make
6 photocopies of it and not actual e-mail, to limit the
7 distribution. I don't remember specifically though.

8 Q But do you recall making any photocopies?

9 A Yes, I did make photocopies.

10 Q Do you remember how many photocopies you made?

11 A No, I don't. But Brian Snivley I know had one.

12 Q And is there anyone else that you know had a copy?

13 A I don't know.

14 BY MR. KOTZ:

15 Q So you made a photocopy for Brian Snivley?

16 A I believe I did.

17 Q What's Brian Snivley's role?

18 A He at the -- he was on the team that did the hedge
19 fund exam, so he was on the [REDACTED] exam. He might
20 have been present for these; I don't know. I don't remember
21 him being physically present, but he had -- he came into my
22 office with a file when we were being responsive to your
23 review, and asked me what he should do with this file, and I
24 said give it to John Walsh.

25 Q Now was there a record showing this conversation