

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

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

ORIGINAL

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 265 Franklin Street
 Boston, MA 02110
DATE: Tuesday, March 31, 2009

The above-entitled matter came on for hearing, pursuant to notice, at 11:45 a.m.

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2

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P R O C E E D I N G S

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MR. WITHERSPOON: We're on the record at 11:45 a.m. on Tuesday, March 31, 2009, at the law firm of McCarter & English, 265 Franklin Street, Boston, Massachusetts. The witness is appearing today via conference call.

Whereupon,

NEIL CHELO

was called as a witness and was examined and testified as follows:

EXAMINATION

BY MR. WITHERSPOON:

Q Please state and spell your full name for the record, if you would.

A Neil Chelo: First name, N-e-i-l; last name, C-h-e-l-o.

Q Thank you. Good morning, Mr. Chelo. My name --

A Good morning.

Q Thank you. My name is David Witherspoon and I'm an attorney in the Office of the Inspector General, United States Securities and Exchange Commission. With me today is my colleague David Fielder, who is the assistant inspector general at the SEC. This is an investigation by the Office of Inspector General, Case Number OIG-509, regarding Madoff Securities and Bernard L. Madoff.

I'm going to ask you certain questions today,

1 1993 with a bachelor's degree in finance. I then later
2 earned my master's in finance, I believe in the year 2000. I
3 have also obtained the following credentials: I'm a
4 chartered financial analyst, I'm a chartered alternative
5 investment analyst, and a financial risk manager.

6 Q Okay. And your MA in finance, was that also
7 obtained at Bentley College as well?

8 A Correct.

9 Q All right. Any additional coursework or, I guess,
10 training in the finance areas subsequent to your master's?

11 A Well, with the CFA program, it's voluntary to do, I
12 guess you'd say continuing education, and I've done that, you
13 know, every year since I earned my CFA, which I believe was
14 in 1999.

15 Q And is that a mandatory part of maintaining your
16 CFA license?

17 A Continuing education is not a mandatory part of
18 the CFA, but I've done it anyways.

19 Q Just so you can stay up on the latest and greatest
20 of what's going on in the industry?

21 A Trying to make money for my investors, exactly.

22 Q I understand. Thank you very much. Any other
23 programs or additional training that you take on a regular,
24 annual, or any other basis?

25 A I mean, over the years, I've, especially when I was

1 in Boston, I tried to participate in nearly every one of the
2 Boston security analyst events. A lot of those events were
3 luncheons where there'd be some type of educational speaker,
4 obviously talking about, you know, something finance related.
5 I even hosted a few of those programs and brought in people,
6 you know, for example, brought in a couple guys who talked
7 about how the S&P index was constructed and how the committee
8 added and deleted securities. Went to another group in Boston
9 called QWAFAFEW, which is a quantitative finance group out
10 here in Seattle. I do less so but I try to attend the
11 Seattle Security Analyst Society luncheons, just always
12 trying to keep myself up to date and educated in the latest
13 topics in finance. On that note too, I'm an avid reader and,
14 you know, probably read every finance book out there.

15 Q Wow, okay. So is it safe to say that you immerse
16 yourself in the subject matter?

17 A Yes.

18 Q Is that accurate?

19 A Yes.

20 Q And anything else come to mind in terms of training
21 or coursework? Seems like you've done quite a bit. Is there
22 anything else that you can think of?

23 A Well, I've been lucky enough to work with, you
24 know, some of the best people in the business including Harry
25 and Personal Privacy who's been in the

1 business for [Personal Privacy] years and ran the [Personal Privacy] pension fund,
2 which was one of the top performing pension funds. So I've
3 been lucky enough to have some really good mentors over the
4 years as well.

5 Q Thank you for that, Mr. Chelo. And you mentioned
6 your current boss. I guess now would be a good time to go to
7 your employment history. Why don't we try and make that a
8 little brief and a little bit more relevant.

9 A Sure.

10 Q Why don't we go back to the time when, I think you
11 said it was around '98 when you got your CFA?

12 A In 1999. So I actually, to go back a little
13 further, when I graduated from college, I took one
14 brief job at a discount brokerage which I left in two weeks
15 because I thought they were shady and were doing illegal
16 things basically.

17 Q I understand.

18 A I literally left after, I think, less than two
19 weeks.

20 BY MR. FIELDER:

21 Q Who was that?

22 A It was [Personal Privacy]. I think they were
23 eventually bought out by [Personal Privacy] and then went out of
24 business. Then I worked for the Boston Company, which was, I
25 believe, taken over by Mellon and taken over by Bank of New

1 York. I worked there for two and a half years in the
2 accounting department, working with large pension funds. So
3 that was a very educational experience dealing with, you
4 know, large pension funds, dealing with investment managers,
5 dealing with the accounting and the cash movements of the
6 custodial business. In 1995 Harry had called me to join him
7 at Rampart because I had previously done an internship with
8 him in, I believe it was 1992, and I'd always had kept in
9 touch with Harry. I joined Rampart, I believe, sometime in
10 late '95, and then really started off more on the back office
11 side of Rampart Investment Management, and then within a year
12 or two moved up to
13 trading, and then a couple years later was really Harry's
14 right-hand man doing virtually, you know, all the trading
15 with him, working on investment strategies that ranged from,
16 you know, quantitative equity management to sophisticated
17 hedging strategies for pension funds and high-net-worth
18 individuals.

19 Q So were you and Harry running quant funds; is that
20 what you were doing with Harry?

21 A Yeah. So we ran a quantitative equity fund for a
22 while in conjunction with, you know, a couple other people,
23 but our primary business at Rampart was dealing with large
24 pension funds and hedging some of their equity risk. Did
25 that up until October of 2003, and in November of 2003, I

1 joined Benchmark Plus.

2 At the time Benchmark Plus was a relatively small
3 fund of funds or hedge fund of funds, I should say. And I'm
4 not sure if you're familiar with fund of funds, but we
5 basically invest in other hedge funds. However, Benchmark is
6 a little unique in that we do a lot of internal hedging to
7 make sure that we're market neutral. So whether the market
8 goes up or down, we're trying to earn returns. At the time I
9 started, there was basically five of us here and we were
10 running, I think, slightly over \$300 million and got up to a
11 peak of about \$2.2 billion before the market kind of
12 imploded.

13 A key part of kind of my experience too in the
14 hedge fund business and kind of feeding information to Harry
15 over the years was that my job at Benchmark was to go out and
16 find what I believe are the most talented investment or hedge
17 fund managers in the world. And over those, I guess I've
18 been here a little bit more than five years now, I've met,
19 you know, probably a couple thousand hedge fund managers.

20 So I have a very good idea of when someone is
21 frankly trying to bullshit me or the story doesn't make
22 sense, because after you see and research a few thousand
23 stories, you have a good idea of what smells fishy and what
24 is really good.

25 Now, one of the other key aspects to my job is I

1 have the privilege of going to nearly every one of these
2 hedge fund conferences that exist, and I've been to every
3 major one, especially the ones sponsored by, you know, the
4 prime brokers like Goldman Sachs, Morgan Stanley, Deutsche
5 Bank, UBS, Merrill, Morgan, Lehman, Bear Stearns, you know,
6 I've been to, you know, tons of these conferences, meeting
7 with managers and, you know, while I'm there, you deal with a
8 lot of your peers.

9 And, you know, over the last five-plus years, I've
10 met a lot of people in this business, you know, running hedge
11 fund of funds or doing due diligence for hedge fund of funds
12 and, in my opinion, are just clueless. Over those years,
13 I've met plenty of people who, you know, claim to have some
14 investments with Madoff and was always reluctant, in a sense
15 that they're my competitors, to tell them it was a fraud but
16 I just couldn't help myself.

17 So whenever someone mentioned Madoff, I kind of
18 went out of my way to outline why I thought Madoff was a
19 fraud, and it appeared that very few people listened.

20 Q Okay. Maybe that's a good segue into sort of the
21 meat of what we want to talk to you about today, which is can
22 you tell us when and why you first started having concerns
23 about Madoff and his fund. Was that independent of Harry or
24 just if you could just start telling us the story of how you
25 first started having suspicions about Madoff.

1 A Sure. I think it was sometime in late 1999, our
2 colleague at the time, Frank Casey, who is on the
3 marketing/sales side, came back, I want to say from a
4 conference in Bermuda and brought back some marketing
5 materials, I believe it was from Fairfield Century, which was
6 a, you know, Bernie Madoff feeder fund, and the marketing
7 materials basically said they were doing split strike
8 conversion, which is basically buy stock, buy put, sell call.

9 And the returns were, I mean, almost like 1 percent
10 a month or 1 1/2 percent a month. I think he had just like a
11 handful of down months. Like, he was up, like, 96 percent of
12 the time, and I think at that point, the track record was
13 almost ten years long, if I remember right. So Harry and I
14 had a wealth of experience, more so Harry, in a similar
15 product that we ran called -- I think we called it PEP, the
16 Protected Equity Program, which was very similar to a public
17 mutual fund called Gateway.

18 I believe the ticker symbol is G-A-T-E-X. And, you
19 know, we just -- we knew it was fishy because we've done that
20 split strike strategy before, more for tax reasons for some
21 clients because back in the day there were some -- I can't
22 remember the name of it but there was a loophole in the tax
23 laws basically where you could realize gains risk-free to
24 offset your losses.

25 So we did some similar strategies for some specific

1 clients, and we knew with split strike conversion, the way to
2 make money is you had to have a market bias, meaning you had
3 to have a good idea if the market was going up or down and
4 you would change your bias by the option strikes you got
5 into.

6 So to see someone claiming to do split strike
7 strategy and have, like, a stellar ten-year track record of
8 earning 1 to 1 1/2 percent, and that's net of, you know, the
9 fees which the feeder funds charge, which are roughly 1 and
10 20, it just seemed way too fishy. So Frank had brought this
11 to the attention of the partners at Rampart as well, Personal Privacy

12 Personal Privacy --

13 Q Mr. Chelo, let me interrupt you there, and I
14 apologize, probably going to do this several times, but in
15 the nature of our conversation today, as you mention things
16 that I want to get further explanation of --

17 A Sure.

18 Q -- I'm going to interrupt you rather than try to
19 circle back. You said that your experience was that you had
20 to have a market bias and that your market bias would inform
21 -- obviously I'm paraphrasing -- the option strikes that you
22 would buy. I want to make sure I understand that.

23 So depending on your market bias, which way you
24 were guessing in general the market was going to go, that
25 would inform the -- I'm going to -- well, I'm going to ask,

1 would it inform the series of options you would buy or just
2 the strike price at which you would buy options?

3 A So it's basically you would -- if you had a market
4 bias up, for example, you would sell, you know, more
5 out-of-the-money calls. If you had a market bias down, you
6 would, you know, protect yourself with, you know, a better
7 strike put.

8 Q Okay.

9 A So basically you had to have a bias up or down or
10 even flat and then you would construct your position to
11 generate the greatest amount of returns given your market
12 bias.

13 Q Okay. And was that a bias -- a broad-market bias
14 you had to have or was it specific to the companies that you
15 were buying the options in?

16 A So Bernie Madoff, at the time, was claiming to use
17 OEX index options, which the OEX was basically very similar
18 to the S&P 500. So he was basically making a market call,
19 not an individual stock direction call.

20 Q Okay. Sorry for the interruption. Go ahead.

21 A So Frank had, you know, also brought this to the
22 attention of the three partners at Benchmark - Personal Privacy
23 Personal Privacy - and Personal Privacy especially
24 kind of -- what's the best word -- rode Harry and I,
25 especially Harry, saying: Hey, look, you know, this Bernie

1 guy is making a killing and he's raising billions of dollars,
2 you know, what the hell are you guys doing? How come you
3 can't duplicate this?

4 And, you know, after like a five-minute review of
5 it, Harry said: Because this is impossible and, you know,
6 the partners asked me the same thing. I looked at it and I
7 said: I just don't know how you can produce these types of
8 returns given the strategy that was outlined in the marketing
9 material. It was just, in my mind, impossible.

10 Q When you say, "these types of returns," you're
11 referring to the magnitude, the consistency, or both?

12 A Both. Mainly the consistency because you'd have to
13 have basically like perfect market timing every month or
14 every year, depending on how he structures his split strike
15 conversions. It's like impossible. No one has that ability
16 to forecast market direction for such a long period and so
17 consistently.

18 Q Right.

19 A And if you did have that ability, you would do
20 another strategy besides split strike conversion. You would
21 do like a levered future strategy. You'd make way more
22 money, and it just didn't make sense. It just didn't make
23 sense, period.

24 Q Well, that's a very -- that's a very interesting
25 take on it. I hadn't thought about that, because it's our

1 understanding that, you know, Madoff and certain
2 marketing-type, you know, convinced people that he did have a
3 perfect sense of the market and where it was going and that
4 explained his returns, but your point is if you had that
5 perfect sense and you really were confident that you had that
6 perfect sense, you would
7 use it to make more money in a less conservative strategy?

8 A Oh, yeah. You would just, you know, buy futures or
9 out-of-the-money options, and you would make, you know,
10 probably hundredfold of what he actually claimed he was
11 making.

12 Q Right. Okay. So after the sort of that initial
13 look at those Fairfield marketing materials, what was the
14 next time or circumstances of which you and -- you reviewed
15 something that made you suspicious?

16 A Sure. So I guess during that whole time period,
17 Frank was a little bit more into the market of kind of
18 getting feedback of what was going on, and eventually, like,
19 we would just start hearing different, you know, tidbits of
20 information of, you know, claims of how much Bernie was
21 actually running and, you know, the more we heard from just
22 different people in the industry, it just didn't make sense.

23 And for example, I can't remember exactly when we
24 did this, but I want to say it was sometime in early 2000,
25 Harry and I kind of just got so kind of ticked off,

1 especially because our bosses were riding us about, you know,
2 why can't you do this --

3 Q Right.

4 A -- we called pretty much every broker we knew on
5 the streets and we did a ton of trading. So we knew like,
6 you know, the tiniest brokers to, you know, the big people
7 like Goldman Sachs and Morgan and Deutsche Bank, and we asked
8 like everyone: Do you do business with Bernie Madoff? Have
9 you ever heard of Bernie Madoff?

10 And for the most part, people would be like: I've
11 heard of him. I heard he's a big player in the options
12 market, but we've never done a trade with him. Do you know
13 him? Any way you can get me an introduction because I'd love
14 to get some of his business?

15 Q Okay.

16 A So, you know, no, we couldn't find anyone on the
17 street who claimed to do trading with him, which was just
18 another red flag because, you know, frankly, people, you
19 know, people talk, especially back in the '90s and, you know,
20 early 2000. If a large trade went up in the options market,
21 you can make one phone call and figure out, you know, within
22 two minutes who did the trade.

23 Q Okay.

24 A That's just the way the market worked back then.

25 Q Is it fair to say when you were working these phone

1 calls, that you had canvassed all of the major firms that
2 would be underwriting options?

3 A Yeah, I wouldn't say, "underwriting." I'd say, you
4 know, trading listed options, like S&P or OEX options in the
5 market.

6 Q Okay.

7 BY MR. WITHERSPOON:

8 Q How many people would we be talking about? What's
9 the universe?

10 A Oh, God, I mean we -- again, we spoke to a lot of
11 the major firms. I mean, we specifically did a ton of
12 business with Goldman Sachs and Merrill Lynch at the time and
13 then we used a lot of, I'd say, like second-tier brokers.
14 I'd have to dig through my notes to remember all the names
15 but, yeah, we traded with a lot of people.

16 BY MR. FIELDER:

17 Q Okay. Was it -- at that time were you guys, was it
18 your understanding from either what Frank Casey was hearing
19 or what you were hearing that Mark -- I mean, that Madoff was
20 employing listed options in his strategy or was it your
21 assumption that he was using listed options?

22 A It was our assumption, and I believe it was in the
23 marketing literature, which I don't have in front of me, but
24 I think Harry submitted in his congressional testimony --

25 Q Right. Okay.

1 A -- that it specifically said they were using OEX
2 listed options, I believe.

3 Q Okay. And you -- you didn't find a single broker
4 in those phone calls that had done a trade with him?

5 A Correct. And, you know, at the time, there was
6 always the possibility that, you know, I would call Goldman
7 Sachs and the guy, you know, wouldn't say he'd done business
8 with Bernie, you know, because they're not supposed to
9 anyway.

10 Q Right. Right.

11 A But, you know, I'm just being totally truthful with
12 you, like, during those times, if a large trade went up, you
13 know, you can make a couple phone calls and pretty much
14 figure out who did it or someone would tell you.

15 Q Okay. So this was early 2000 when you and Harry
16 were -- started making these canvassing phone calls in
17 response --

18 A Yeah, I believe that's the right time frame.

19 Q Okay. So what did you and Harry make of that?

20 A It was just another red flag, just another red
21 flag. And I guess the biggest red flag too at the time was
22 Frank had heard and then, you know, kind of corroborated it
23 with some other people, I think, you know, just he met at
24 conferences that Bernie was running anywhere from 3 1/2 to, I
25 think, \$5 billion at the time.

1 Q Right.

2 A So, I mean, Harry and I just literally went to the
3 Wall Street Journal, you know, went to the options page,
4 looked at the open interest, and basically figured out, like,
5 it was impossible. He would have been more than the entire
6 open interest.

7 Q Okay.

8 A So something was definitely off. Something didn't
9 make sense because, again, we did a ton of trading. I mean,
10 and if we put up a large trade, like, A, you'd move the
11 market instantly and, you know, people knew exactly who you
12 were, and next time you went to trade out of that position or
13 put a new trade on, I mean, they're -- it's Wall Street,
14 they're there to try to gain you --

15 Q Right.

16 A -- and screw you. So for Bernie to be running like
17 \$5 billion in this strategy and not have any market impact or
18 people be talking about him in the market and seeing his
19 options raise, it just seemed really fishy to us.

20 Q When you were making this series of phone calls
21 again, did you share with anyone, you know, in general,
22 the reason you were calling or your suspicions?

23 A Maybe with a few people.

24 Q Okay.

25 A And I don't want to speak for Harry. Like, I

1 didn't go out of my way to say: Hey, do you know this guy
2 Bernie Madoff and I think he's a fraud.

3 Q Right.

4 A I wasn't saying that to the brokers, no.

5 Q Did any of the calls that you participated in, did
6 any of the brokers mention any suspicions they had or
7 questions about Madoff?

8 A God, I can't say with a hundred percent confidence
9 because it's been so long ago --

10 Q Okay.

11 A -- but I want to say yeah. There were quite a few
12 brokers, I mean, I can think of one in particular we had a
13 conversation with that, you know, basically said it just
14 doesn't -- doesn't seem right.

15 And then I know -- not to jump ahead, and I can't
16 remember the time frame, but Harry -- I'm pretty sure I had
17 participated on this phone call -- had a discussion with

18 Personal Privacy at one point, who was at the Solomon desk or Citigroup
19 -- I can't remember who they were at that point -- and just
20 talking about, you know, the strategy and, you know,
21 basically coming to the same conclusion that it just, you
22 know, it seemed impossible.

23 Q Okay.

24 A So in May -- I think it was in May of 2000, enough
25 had happened to really fire Harry up, and I think what really

Personal
Privacy

1 provoked Harry was the fact that our bosses at Rampart were
2 kind of, you know, really riding him to, you know, make some
3 type of similar product and generate similar type of returns.

4 And Harry felt like, hey, this -- like, something
5 is wrong here. The playing field isn't level and it, you
6 know, for lack of a better word, pissed him off enough to put
7 together a little summary and bring it to the SEC's Boston
8 office.

9 Q Okay. Let's back up just a second. In those
10 conversations that you either heard about or were part of
11 with the three partners at Rampart, did you guys tell them:
12 Listen, we don't think they're -- they actually are earning
13 these returns or they're earning them with this strategy?

14 A Yes, we did.

15 Q And were they just -- did they just blow you off on
16 that? Were they skeptical of that or what was the reaction?

17 A Yeah. They -- in my opinion, they didn't -- I
18 should say Personal Privacy and Personal Privacy did not believe Harry
19 and I. Personal Privacy believed
20 us.

21 Q Okay. All right. Well, before you put together or
22 -- before Harry put together the presentation to the SEC, I
23 mean, is there anything else that you did or you know that
24 Harry or Frank did leading up to that? I gather you made the
25 phone calls, looked at the Wall Street Journal for the volume

1 of options to determine that they -- that there was no way
2 that the actual volume would equate to Harry running 3 to 5
3 billion with a strategy -- I'm sorry, with Madoff --

4 A We actually got -- I'm sorry to interrupt.

5 Q No. Go ahead. I just want to know if there's
6 something else you guys did before the submission?

7 A We got pretty quantitative, not to sound geeky, but
8 I remember putting together, you know, spreadsheets of, you
9 know, literally trying to replicate the strategy of: Hey, if
10 I buy replicated basket of the OEX, what's my tracking error?
11 How much will it cost me to get, you know, into these stocks,
12 like, big offer spread, commissions, what options can I
13 write, looking at different strikes and figuring out, you
14 know, quantitatively, hey, like, is there something we're
15 missing? Is -- you know, is there a way that this can be
16 done?

17 So we spent -- I remember particularly myself
18 spent a good amount of time just trying to research it and
19 look at, like, a scenario modelling-type situation of, hey,
20 you know, if the market goes here, if the market goes here,
21 if the market goes here, what are my returns? What's my
22 risk? And, you know, the more I, you know, tried to put
23 together something that would duplicate Madoff's returns, the
24 more convinced I was that it was impossible.

25 Q Okay.

1 BY MR. WITHERSPOON:

2 Q Just curious, Mr. Chelo, you've said that two of
3 the -- I guess two of your bosses at the time did not
4 believe --

5 A Correct.

6 Q -- Harry and yourself that this just couldn't
7 happen. Did they offer any kind of plausible explanation as
8 to how it could have happened?

9 A Well, yeah. So there was one kind of missing piece
10 that at least I think made both Harry and I question if the
11 returns were legitimate or not, and that's the fact that what
12 Madoff at the time was, you know, and was until very
13 recently, a very prominent person in the industry. He had
14 his own market-making business.

15 You know, from the surface, you would say: Why
16 would a guy who's so successful and has this market-making
17 business, been in business for, you know, years and years,
18 why would he try to pull off a fraud, which was a very, you
19 know, legitimate like counter to our claims. The other thing
20 that made us question whether it was legit or not was the
21 fact that we thought maybe he was using his market-making
22 operation to basically front run clients and generate the
23 returns to the hedge fund.

24 BY MR. FIELDER:

25 Q Was that something that you hypothesized yourself

1 or had you heard from others that they thought that's how he
2 was doing it?

3 A I think -- I'd have to give probably full credit to
4 Harry for coming up with that kind of quick conclusion that
5 you may be -- the only way to generate those returns was by
6 somehow front running order flow or using Bernie's
7 market-making business to have some specific type of edge
8 where he could have generated these returns.

9 At the same time, we said: If that's what he's
10 doing, then, A, he's lying to his investors about, like, the
11 real reason why he's generating returns, and you can make the
12 argument that he was screwing people who were trading with
13 him through his market-making business.

14 Q Right. Now, under that hypothesis or theory, would
15 you -- was the hypothesis that he was front running and
16 that's purely how he was generating the returns and he wasn't
17 even employing the split strike strategy or was it that he
18 might be -- he might be front running and that -- really
19 doing the split strike strategy but he was front running the
20 purchase of the equities?

21 A I would say we were thinking that maybe the whole
22 story of, you know, him doing split strike was, you know,
23 just a story to mask the real reason he was generating
24 returns, which was front running, you know, order flow.

25 Q Did you have a sense at the time in early 2000, a

1 quantitative sense of whether, you know, in a perfect
2 front-running scheme, that would have possibly generated the
3 returns he was -- he was claiming for his investors?

4 A Yeah. Harry actually built a little model that I
5 don't have in front of me but I believe is in the
6 congressional testimony and I had reviewed it. We were
7 basically looking at, and I think we used some research
8 papers to kind of come up with some of the assumptions of how
9 much is -- how much can you earn by having information about
10 order flow.

11 And this is something I had also worked on when I
12 was getting my master's, because at the time there was a
13 huge -- there was a huge issue in the market about what's
14 called payment for order flow. And, you know, I was very
15 against it. I mean, people were buying order flow, and
16 they're only buying it for a reason because you can make
17 money.

18 Q Right. Right.

19 A Basically screwing people.

20 Q Right.

21 A You know, something that should be abolished. So,
22 yeah, I had read at the time, you know, when I was doing my
23 master's, you know, a bunch of academic papers about payment
24 for order flow, you know, what's good about it, what's bad
25 about it, the informational edges and, you know, to me it

1 kind of bordered along, you know, it was like the gray area
2 to me.

3 Q Right.

4 A But, you know, we could see how maybe he was using
5 his market making business to somehow generate those types of
6 returns for the hedge fund.

7 Q What about the consistency of the returns, if he
8 was doing it with access to order flow and front running,
9 would that have explained the consistency or, I mean, would
10 he still --

11 A I think it would have, because when I started at
12 Benchmark, you know, I started meeting more and more of
13 these, you know, secretive hedge funds, a lot of them
14 who did, you know, statistical arbitrage trading and had very
15 similar, I guess, kind of quantitative models of looking at
16 -- basically looking at the tape and how things are trading,
17 and for a long time, you know, these guys just, you know,
18 were generating returns of, you know, 10 to 20 percent net
19 with very little volatility.

20 Q Okay.

21 A But that pretty much, you know, faded as soon as
22 decimalization got more and more prevalent.

23 Q Okay. Okay. So anything else you want to tell us
24 about looking at the Madoff operation and your suspicions
25 before the early 2000 submission to the SEC?

1 A Yes. Another one that -- another huge red flag in
2 our mind was we heard that, you know, Bernie was raising all
3 his money through these feeder funds. So my logical question
4 was: Why would he give up the ability to charge 1 and 20 or
5 2 and 20 to clients and let all the feeder funds earn the
6 bulk of the returns? That just made no sense to me at all. I
7 mean, any legitimate businessman would have said: Hey, I'm
8 going to cut out the middleman and do it myself.

9 Q Right.

10 A You know, we had heard he was only charging
11 commissions. So that was just crazy. So, you know, we
12 had -- we had asked different people in the industry and,
13 especially when I got, you know, on this side of the
14 business, no one could ever answer that question.

15 Like, Pete -- the best answer was: Well, these
16 feeder funds have access to capital that Bernie doesn't and
17 they have great marketing operations. And I'm saying to
18 myself, well, God, just, you know, Fairfield alone was raking
19 in a couple hundred million dollars in fees a year, you know,
20 Bernie could go out and hire the entire graduating class of
21 Harvard to do, you know, marketing and back office for them.

22 Q Right.

23 A It didn't make any sense. You know, why was he
24 leaving so much money on the table?

25 Q I mean, maybe that ex -- I mean, I want your

1 what you saw. So is it safe to say that if someone actually
2 pays attention to what's going on here, their antenna should
3 go up?

4 A I -- I totally agree. So Harry and I, obviously,
5 have a better background to understand this. We've been in
6 the equity derivatives business and that was what we did at
7 Rampart. So we were probably, you know, obviously, more
8 informed than the average Wall Street guy. Having said that,
9 I think you could have just taken someone out of business
10 school with some real common sense, and they would have
11 looked at the picture and came to the conclusion that
12 something -- something is at least fishy and that you should
13 stay away.

14 Q Right.

15 A You know, maybe not be able to prove or come to the
16 analytical reasons of why it was fishy but, you know, there
17 was a couple big red flags that were just common sense.

18 BY MR. FIELDER:

19 Q I want to sort of come to the end of the story
20 while you were at Rampart, fairly quickly, so we can move on.
21 That's kind of a logical breaking point for today's
22 discussion, not end point but just breaking point.

23 A Sure.

24 Q So two questions. I mean, first off, is there
25 anything -- any red flags that you recall popping up in your

1 mind or anything else that you did with Harry to explore
2 those red flags while you were at Rampart?

3 A While I was at Rampart --

4 Q That you haven't shared with us, you know, already
5 today? We kind of got off -- we sort of stopped with Harry's
6 return, if you will, after the trip to Europe --

7 A Yeah.

8 Q -- with the gentleman from Access.

9 A Nothing particular comes to my mind but hold on. I
10 just want to look at some brief notes I had written down.
11 No, I think that's most of it.

12 Q Okay. Were you aware, before you left Rampart,
13 that sometime about a year after or a little more than a year
14 after Harry made his first submission to the SEC in Boston,
15 he resubmitted that material along with some supplemental
16 material?

17 A Yeah. Throughout the entire time period, Harry and
18 I, you know, would always talk and, you know, he would tell
19 me about, you know, resubmitting the -- he would tell me
20 about how he tried to get the Wall Street Journal to publish
21 an article. Yeah. Throughout the years I'd say Harry and
22 Frank and I, you know, spoke, you know, on and off about
23 Madoff throughout the entire time period.

24 Q Why did Harry make that second supplemental
25 submission to the SEC? And I'll represent that it was in

1 late two thousand -- or in the latter part of 2001? Do you
2 recall if he was invited to do that or was hopeful that it
3 might --

4 A I believe he did that totally on his free will.

5 Q Okay. Do you know if leading up to it he had
6 stayed in communication with Ed Manion about it?

7 A I believe that is the case but you'd really have to
8 ask Harry that.

9 Q Sure. Do you recall hearing from any source, after
10 Harry made that submission, what the SEC's reaction was?

11 A I just remember hearing Harry get frustrated that
12 nothing seemed to be happening.

13 Q Okay.

14 BY MR. WITHERSPOON:

15 Q Did Harry ever tell you who he submitted that
16 second complaint to, I guess resubmission of the complaint
17 to?

18 A I'm sure he did and I'm sure I have that in my
19 notes somewhere but I can't recall the name. I'm not sure if
20 the resubmission was to Ed Manion or not, to be honest with
21 you.

22 BY MR. FIELDER:

23 Q All right. So you leave Rampart to go to Benchmark
24 sometime in 2003. Do I recall that correctly?

25 A Correct.

1 Q Okay. And I gather that when you went to
2 Benchmark, you stayed in communication with Frank and Harry
3 about several matters including Madoff, correct?

4 A Correct.

5 Q What was the next, you know, sort of substantive
6 development after you joined Benchmark and you and Frank and
7 Harry's discussions about Madoff?

8 A Sure. I'm actually going to back up in the
9 timeline for one brief moment. In May of 2001, there was a
10 Barron's article, you know, a few pages long about Madoff
11 discussing, you know, his hedge fund and, you know, I just --
12 I would have sworn that after that article and especially
13 after Harry's SEC submissions to that point, that something
14 was going to happen.

15 And when nothing ever happened, you know, it
16 actually started to put doubts in my mind that, you know,
17 maybe -- maybe we were wrong, maybe -- you know, there was a
18 small percentage of me, like, maybe a 1 or 2 percent chance,
19 I was thinking that, God, maybe Bernie really is just so much
20 smarter than everyone else and I'm an idiot because I
21 couldn't reverse engineer it, but like how -- how could he
22 pull off this fraud for so long. I started to have some
23 doubts personally.

24 Q Well, let me ask you about the origin of those
25 seeds of doubt because I want to explore why that Barron's

1 article and the lack of activity afterwards would have raised
2 those doubts in your mind. Is it because you assumed that
3 someone at the SEC or in the regulatory environment would
4 have looked into the matter after the Barron's article?

5 A Yes.

6 Q And is it safe to say that you assumed that if
7 they'd looked into it and nothing had happened, it must be
8 because there was some legitimacy to Madoff's operation?

9 A Exactly.

10 Q Okay. Would it have occurred to you after the
11 Barron's article that maybe -- and knowing that Harry had
12 also made his submission, would it have occurred to you that
13 no one at the SEC was looking into the matter?

14 A I mean, I would have -- you know, my assumption was
15 that the SEC in some shape or form had to have looked at it
16 or was looking at it, and the Barron's article was just,
17 like, another reason why it should be looked at. And then
18 Michael Ocrant, I believe in like January of '01, he was a
19 writer for MarHedge, I believe, you know, had written a very
20 similar article, you know, just kind of pointing out the red
21 flags.

22 So I would have thought that somehow the SEC was
23 already in there and looked at it or was going to look at it,
24 but, you know, a few years passed after those articles and
25 nothing happens, it starts to put more doubt in your mind.