

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

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

 **COPY**

WITNESS: Number 41  
PAGES: 1 through 203  
PLACE: Securities and Exchange Commission  
100 "F" Street, N.E.  
Room 3365  
Washington, D.C. 20549  
DATE: Wednesday, May 6, 2009

The above-entitled matter came on for hearing, pursuant to notice, at 10:50 a.m.

Diversified Reporting Services, Inc.

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1 APPEARANCES:

2

3 On behalf of the Securities and Exchange Commission:

4 H. DAVID KOTZ, ESQ. Inspector General

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13 On behalf of the Witness:

14 JOHN NEE, PRO SE

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1           Also, so the record will be clear, please let me  
2 finish my question before you provide your response. I'll  
3 try to let you finish your response before I ask the next  
4 question. In addition, it is important you understand the  
5 questions and give accurate answer. If there's anything you  
6 don't understand or anything you do not know or are not sure  
7 about, please let me know, otherwise I will assume that you  
8 heard and understood the question.

9           Do you understand those instructions?

10          THE WITNESS: Yes.

11          MR. KOTZ: Okay. This will be the perjury warning.  
12 As you can see, your responses and statements given today  
13 after you've sworn an oath and will be taken down verbatim by  
14 the court reporter.

15          This is an official U.S. government law enforcement  
16 investigation. The claims asserted in this case are serious  
17 ones. It is very important you tell me everything you know  
18 about the matter at hand and are completely forthcoming and  
19 truthful with me.

20          I'm formally advising you that your testimony today  
21 is subject to the laws of perjury, providing false or  
22 misleading testimony under oath is a serious offence. If the  
23 evidence shows the testimony you have given is false, we may  
24 refer it as appropriate.

25          Do you understand those instructions?

1 THE WITNESS: Yes.

2 EXAMINATION

3 BY MR. KOTZ:

4 Q Okay. First of all, I'm going to give you a copy  
5 of a notice of rights, which I believe you have seen before,  
6 ask you to read it and sign it and date it and we will then  
7 put it into evidence.

8 Okay. And so you have just signed your name and  
9 dated Exhibit 1, is that right?

10 A Yes, sir.

11 Q Okay. All right. So this is going to be marked as  
12 Exhibit 1. Okay. We'll do a little background and then  
13 we'll get into some specific questions, okay?

14 Describe your education beginning with college,  
15 please.

16 (SEC Exhibit No. 1 was marked  
17 for identification.)

18 A I have a bachelor's degree in accounting.

19 Q Okay. And where did you get that bachelor's  
20 degree?

21 A Manhattan College.

22 Q What year was that?

23 A 1986.

24 Q Okay. And what did you do after graduating  
25 college?

1 A Well, shall I continue with the education?

2 Q Sure.

3 A I have a master's degree in finance from Baruch  
4 College.

5 Q What year did you obtain that degree?

6 A 2002.

7 Q Okay. Anything else in terms of education?

8 A No, that's it.

9 Q Okay. After you graduated college in 1986, where  
10 did you work?

11 A I worked for Drexel Burnham Lambert.

12 Q What did you do for Drexel Burnham Lambert?

13 A I was a mutual fund accountant.

14 Q Okay. How many years did you work for Drexel  
15 Burnham?

16 A The better part of three years.

17 Q What did you do after that?

18 A After that I worked as an accounting supervisor for  
19 Fairchild Publications.

20 Q What did you do for Fairchild?

21 A I was an accounting supervisor in their general  
22 accounting office.

23 Q Okay. And so that was beginning in about 1989?

24 A Approximately.

25 Q Okay. How long did you work there?

1 A About a year.

2 Q Okay. What did you do after that?

3 A After that I worked for the Department of Housing  
4 and Urban Development in the Inspector General's Office as an  
5 auditor.

6 Q Oh, okay. How long did you do that for?

7 A One year.

8 Q Okay. So then we're getting closer to like 1991  
9 now, you think?

10 A Yes.

11 Q Okay.

12 A And at that time I applied for a position with the  
13 Securities and Exchange Commission and was hired as an  
14 examiner.

15 Q Okay. So you're first position with the SEC was as  
16 an examiner --

17 A Yes.

18 Q -- and you think that was about 1991?

19 A Approximately, yes.

20 Q How long did you serve as an examiner?

21 A I think it was about three years, maybe a little  
22 more. And then I applied to be a branch chief and was  
23 promoted to branch chief.

24 Q Okay. That was approximately 1994?

25 A Approximately.

1 Q Okay. What were your duties as an examiner?

2 A To conduct examinations of broker-dealers,  
3 primarily.

4 Q Okay, and what about as a branch chief?

5 A My role as a branch chief would be to, primarily,  
6 supervise examinations of broker-dealers by examiners.

7 Q How long did you serve as a branch chief?

8 A I think it was about three years.

9 Q Who was your supervisor during those three years?

10 A As a branch chief?

11 Q Yeah.

12 A I think John Gentile, and maybe some of it was

13 Personal Privacy

14 Q Okay. So that was until about 1997, do you think?

15 A Maybe even the end of '96. I -- approximately.

16 Q Okay. And then what position did you obtain after  
17 branch chief?

18 A Assistant regional director.

19 Q How long did you serve in that position?

20 A I currently serve in that position.

21 Q Okay, so you've been in that position in the SEC  
22 since, approximately, 1997?

23 A I -- probably '96.

24 Q '96, something --

25 A It may eve -- depending on -- they might be -- give

1 or take a year or two on some of the background -- the actual  
2 dates, but in general that's about it.

3 Q And who did you report to during that period of  
4 time?

5 A Robert Sollazzo.

6 Q The entire time?

7 A Yes.

8 Q Including today?

9 A Yes.

10 Q And what were your duties in that job?

11 A My duties were varied, but primarily I was in  
12 charge of three branch chiefs, who supervised five to six  
13 examiners each. Most of my focus was on large firm  
14 financial-type of reviews and I helped plan out the large  
15 financial and operational examinations of the larger  
16 warehouses with Robert Sollazzo.

17 Other duties include, you know, training, speaking  
18 to outside personnel, outside agencies -- contact with  
19 outside agencies, referring enforcement -- referring findings  
20 to enforcement and to other agencies.

21 Q Okay. And what was Mr. Sollazzo -- what is Mr.  
22 Sollazzo's position?

23 A He's the associate regional director.

24 Q Okay. And who were the branch chiefs, you said  
25 there were three chiefs that you worked under, who were

1 A As an assistant regional director?

2 Q Correct.

3 A Yes.

4 Q Okay. Is that the majority of the exams that  
5 you're not onsite at all or --

6 A I wouldn't say it's the majority. And this is just  
7 sort of in a way speculation, that's not the best word to  
8 use, but I would say maybe half. But it also depends, too,  
9 again, on what the more important program priorities are at  
10 the time.

11 For instance, we had a subprime sweep review in  
12 which I spent a lot of time on the -- out in the field, you  
13 know, probably to the exclusion of other less important exams  
14 in which we'd rely on the examiners, especially if they were  
15 senior examiners or experienced examiners, to relay any  
16 problems and also, obviously, to the branch chief to relay  
17 any serious problems.

18 And the same thing can be said probably for the  
19 consolidated supervised entity examinations that we did. I  
20 was probably more involved with them, probably to the  
21 exclusion of smaller, let's say, introducing firms.

22 Q What about Mr. Sollazzo, would he ever be onsite in  
23 an exam?

24 A Yes.

25 Q And would it be common for him to be onsite?

1           A     I wouldn't say it's common, but on some of the  
2 larger exams and some of the examinations where issues  
3 develop, he will get involved and attend meetings at the  
4 firm. Just recently we completed the field work of an  
5 examination of Examination Material and Mr.  
6 Sollazzo did attend meetings with the firm that were held in  
7 our offices and he was very active in those meetings with  
8 regard to some pension and retirement group issues that the  
9 examination staff developed at the firm.

10          Q     Okay. When did you first hear of Bernard Madoff or  
11 Madoff Securities?

12          A     Well, I can't pinpoint the exact month or even year  
13 because Madoff is -- was a well-known market-maker and had  
14 been known as one of the first to introduce sort of the third  
15 market of payment-for-order flow, so I knew of his firm.

16          Q     In what time period do you think you knew of his  
17 firm?

18          A     I probably knew of his firm, I guess at some point  
19 early on in my career.

20          Q     So, the 1990's you think?

21          A     I would say. I'm sure I would have heard of  
22 Madoff. I knew that he was a market-maker and provided  
23 execution services for other broker-dealers and  
24 professionals.

25          Q     Were you -- was he considered sort of an

1 influential figure in the industry?

2 A That, I subsequently came to realize, probably more  
3 so after we started -- I started doing some background  
4 examination work into his firm in anticipation of our 2005  
5 examination. But before that I didn't -- I don't think I  
6 would have been able to tell you that he was or was not an  
7 influential figure in any way.

8 Q Okay. But as you did the background information  
9 for the exam, you did realize that he was an influential  
10 figure?

11 A Well, I knew he had a large market-making operation  
12 and was well-known, there were articles written about him.  
13 And I guess more to your point in terms of influence, I guess  
14 you -- in the securities industry in general, I knew that he  
15 was involved with NASDAQ in various -- NASDAQ and/or the  
16 NASD, in various capacities.

17 Q Okay. Have you ever met Bernie Madoff?

18 A Yes.

19 Q How many times?

20 A Probably just the once or twice, depending on the  
21 number of times that I was up at his shop for the 2005 exam.

22 Q Okay. How many days were you onsite for that 2005  
23 exam?

24 A Onsite, I would say probably no more than two or  
25 three.

1 Q And so on those two or three days was when you met  
2 Bernie Madoff?

3 A I met him on at least one occasion, I don't know if  
4 he was there the second or the third day --

5 Q Okay. Describe --

6 A -- if there was a third day or -- you know, I don't  
7 have particular recollections of each time I went up there, I  
8 just know I was there. But it would have been no more than a  
9 handful of times at the most.

10 Q Okay. And what were the circumstances of the  
11 meeting you do recall with Bernie Madoff?

12 A After -- I believe -- and, again, this is four  
13 years ago so I -- my recollection may be a little fuzzy, but  
14 I believe I was introduced to him by the examiners.

15 Q Mr. Ostrow or Mr. Lamore?

16 A Probably both, I imagine, were there at the same  
17 time.

18 Q So was it more of an introduction or did you sit  
19 down and talk with Mr. Madoff?

20 A Oh, we talked to him at length.

21 Q Okay. How long was the meeting, do you think?

22 A There wasn't a meeting, per se, there was an  
23 initial introduction and I guess some background talk. And  
24 then I do recall, and this may have been the first day, that  
25 Mr. Madoff was talking to us at length, and you know, after

1           A     I don't know if it was Peter or the other one, to  
2 be honest. It was Andrew?

3           Q     Andrew?

4           A     I don't know. That should be in our report, who  
5 was running that side of the business. I think he gave us  
6 sort of a walk-through of their order execution technology  
7 and how orders are executed.

8           Q     The cause exam that we were just talking about that  
9 was precipitated by Investment Adviser #1 information, was  
10 the that first OC matter involving Madoff that you were aware  
11 of?

12          A     Yes.

13               MS. STEIBER: Did Sollazzo ever talk to you about  
14 prior Madoff exams?

15               THE WITNESS: No, I don't believe he did.

16               BY MR. KOTZ:

17          Q     Okay. So in the 2005 cause exam that we're  
18 speaking about that began because of the Investment Adviser #1  
19 Investment Adviser #1 information, what was your role on the  
20 examination?

21          A     Well, my role was to get the exam signed and direct  
22 the examiners in what they needed to do in terms of, you  
23 know, focusing on trying to identify or determine if the  
24 allegations that were -- that we had read about in the press,  
25 I think there was a Barron's article that said he was either

1 a hedge fund manager or ran money. But there was -- we had  
2 no concrete evidence that that was true at that time.

3 So, our goal was to determine if that, in fact --  
4 excuse me -- was true, so I would have conveyed that to the  
5 examiner to find out if he is -- does have any involvement  
6 with hedge funds. If he does, get the trading and compare it  
7 to the market-making trading. So I believe I was in  
8 constant -- not constant contact, but fairly frequent contact  
9 with the examiners about what was going on.

10 Q Did you select the exam team?

11 A I imagine I -- based upon who we selected I believe  
12 I probably would have spoken about that with Robert Sollazzo.  
13 I think he was -- he may have been the first one to get the  
14 referral. I don't know exactly how the referral came. I  
15 think Dorothy Eschwie was the assistant director at the  
16 time -- I believe she was the assistant director and not a  
17 branch chief, and she forwarded the information, I believe --  
18 I believe it would have gone to Bob, I don't know that I was  
19 cc'd on the original, and I believe Bob somehow conveyed that  
20 to me, but I'm not -- I may have been notified of it at the  
21 same time.

22 But it would have been, I think, his call who to  
23 assign, whether to assign it to me, first of all, and who the  
24 examiners were. I think, at the time, Peter Lamore was --  
25 had been a equities trader for hedge funds, so I think it was

1 recommended that he would be a good person. At the time,  
2 again, this we referenced earlier, I don't believe he was in  
3 my organizational code. And, again, I'm not 100 percent  
4 certain of that but I don't believe he was at the time, but I  
5 believe it was decided that he would be a good person to be  
6 sort of the leader on that.

7 Q And that was decided by Mr. Sollazzo?

8 A I don't know if I can say it was definitively  
9 decided, it may have been recommended and see if we can get  
10 him. Because there can be jockeying for -- and I think this  
11 may have been why the examination didn't start immediately  
12 after the -- I think we were waiting for the right person.  
13 There can be jockeying for certain examiners, you know,  
14 talking to the branch chief and the other assistants when a  
15 person's going to free up.

16 So I think it was a matter of waiting until -- it  
17 was probably determined early on that Peter might be a good  
18 one for that, to do a trading review, since he had been an  
19 equity trader. I guess that pretty much sums it up.

20 Q Okay. Who was the branch chief on the Madoff cause  
21 exam?

22 A Well, I assigned it directly to myself.

23 Q So there was no branch chief?

24 A There was no branch chief.

25 Q So did you act in the role as a branch chief?

1 A Yes.

2 Q Okay.

3 A I would have acted in that role.

4 Q Was it unusual for there to be an exam conducted  
5 without a branch chief?

6 A Yes.

7 Q And you talked before about the information from

8 Investment Adviser #1

and the articles determining the  
9 focus of the exam, but who made the actual decision on what  
10 to focus the Madoff exam on?

11 A Well, I think it was a foregone conclusion that we  
12 would focus on the referral that was -- that had been  
13 forwarded to me as something to conduct a cause examination.  
14 So, I don't know exactly where you can say who made that  
15 decision. I was given a referral to look into, so that was  
16 sort of, as I said a foregone conclusion.

17 If I'm given a referral to look into a specific  
18 matter, that specific matter was the focus of the  
19 examination. I would have been the one to, I guess,  
20 disseminate it to the examination staff.

21 Q Okay. Why don't we show you a document? This  
22 we're going to mark as Exhibit 2. This is a memo from  
23 Dorothy Eschwie to Robert Sollazzo and Richard Lee, April 22,  
24 2004, with attachments.

25 (SEC Exhibit No. 2 was marked for

1 identification.)

2 BY MS. STEIBER:

3 Q And it looks like it incorrectly identifies you as  
4 an associate director on the cover page, is that right?

5 A Identifies me?

6 Q Yes, I --

7 A That's not me, that's Richard D. Lee, he's another  
8 associate.

9 Q Okay. So do you recall getting this document?

10 A I think I -- it looks familiar, again, this is four  
11 years ago. I believe Bob would have forwarded this to me.

12 BY MR. KOTZ:

13 Q Okay, if you could take a little bit and look  
14 through the attachments. You mentioned previously that there  
15 were e-mails from Investment Adviser #1, do you recognize  
16 these as those e-mails that you say were contained in the  
17 referral?

18 A I -- I'm getting a recollection now. Again, I  
19 don't recall any specific language, but I do recall that, now  
20 in hindsight, that Diane Rodriguez would have been probably  
21 the branch chief on that so Dorothy Eschwie would have been  
22 the assistant. So I do believe that we did get e-mails  
23 regarding the Investment Adviser #1 exam from Diane  
24 Rodriguez who was the branch chief.

25 Again, I don't recognize this specific e-mail, but

1 issue?

2 A That the brother-in-law was the auditor?

3 Q It talks about conflicts in his business and  
4 mentions that the brother-in-law is his auditor, yes.

5 A I think by this time we had already received the  
6 report. The -- we probably would have received the

7 Investment Adviser #1 report, I'm not 100 percent certain  
8 of that, which talked about the specific e-mail which said  
9 that he was cherry picking trades. So I think we just  
10 assumed that that's what these conflicts -- that's probably  
11 what they may have been alluding to, if it's, you know, the  
12 same --

13 Q Right, but the question was did you in the exam  
14 look at this issue of conflicts and the brother-in-law is his  
15 auditor.

16 A I can't say we looked at that, we looked at the  
17 issue of conflicts and the conflict was the allegation that  
18 he was conflicted in his role as somehow advising hedge funds  
19 and using information gathered from his market-making or  
20 proprietary business to benefit his hedge fund business.

21 Q Okay, but if his brother-in-law was his auditor  
22 would that be a conflict?

23 A Well, I don't know if it would be a -- well, it's  
24 inherent. It seems to be, on its face, a conflict.

25 Q Okay. So is that something that the SEC would

1 normally look into -- could look into?

2 A In -- on its face, I don't know, to tell the truth.  
3 I don't know that absent any other allegations if you said,  
4 "the --" and I don't know what they mean by auditor, internal  
5 audit compliance person or external auditor. On its face I  
6 don't know that that would cause an examination, but  
7 obviously if you were looking from a control perspective, if  
8 you were doing an examination from scratch you might focus on  
9 that issue.

10 Q Okay. Let's look at another point in this e-mail.  
11 And first of all, take a look at that second full paragraph,  
12 it does reference cherry picking. It says first of all, he  
13 spoke to an ex-Madoff trader who was applying for the  
14 position at Ameritech and he said that Madoff cherry-picks  
15 trades and takes them for the hedge fund.

16 A Right.

17 Q Looking at that, do you think this might be the  
18 e-mail you were referring to before that referenced cherry  
19 picking?

20 A Well, I think probably -- let me backtrack a  
21 second, probably what I was referencing was the referral.

22 Q But isn't this the referral?

23 A Well, there was some -- I think what I was  
24 referencing was the part of the Investment Adviser #1  
25 examination report. So --

1 Q What is this document, Exhibit 2? Is this not a  
2 referral of --

3 A Oh, yes. Oh, yeah.

4 Q -- from Eschwie to Sollazzo?

5 A It seems to be, yes. Yeah.

6 Q Okay --

7 A I think what the document I was thinking of, I  
8 don't recall it in this specific format. I think the  
9 document I was thinking of referenced this, if it was that  
10 report or something else or if it -- maybe even another  
11 e-mail from Dorothy Eschwie, I don't know.

12 BY MS. STEIBER:

13 Q I think what you're referencing now --

14 A It may have been -- I'm sorry.

15 Q -- is a reference in the Investment Adviser #1 report that  
16 just says they've given the e-mails to you. And I'll -- I  
17 can show you that paragraph starting with "During the  
18 examination," and this is the final Investment Adviser #1 report.

19 A Yeah, I just have a -- well, so if -- I -- well,  
20 obviously I don't have time to read this, I don't know if  
21 this references cherry picking at all, but I just seem to  
22 remember another, perhaps subsequent to this, another summary  
23 document that referenced cherry picking.

24 Q Maybe you're thinking of your final report from  
25 your Madoff exam?

1 MR. KOTZ: Yeah, we don't have --

2 THE WITNESS: Again, it's four years ago, so I  
3 don't know.

4 MR. KOTZ: -- 1981. We've not seen any document in  
5 the file other than --

6 THE WITNESS: Okay.

7 MR. KOTZ: -- Exhibit 2.

8 THE WITNESS: All right, then I guess this was the  
9 origin of it. I'm sure I would have received this.

10 By MR. KOTZ:

11 Q Okay. All right, let me ask you about another  
12 point in here. Third full paragraph it says, "Another point  
13 to make here is not only are we unsure as to how  makes  
14 money for us, we are even more unsure as to how  makes  
15 money from us, i.e. why does he let us make so much money,  
16 why doesn't he capture that for himself? There could be a  
17 legitimate -- well be a legitimate reason but I haven't heard  
18 any explanation we can be sure of." Is that an issue that  
19 was looked into?

20 A Well, based on my recollection of the report,  
21 Bernie Madoff -- and this, again, I'm recalling from the  
22 report -- I believe it was looked into and the answer from  
23 Bernie Madoff that he was happy getting commission income on  
24 the trades.

25 Q Okay, was that unusual in your view, Madoff's free

1 structure as described in this e-mail?

2 A Well, this was probably my first -- my entrance into  
3 looking at a hedge fund-associated manager, so I couldn't say  
4 whether it was unusual or not.

5 Q Okay. Let me ask you about another matter in here.  
6 You see at this same page, the bottom of the page it says,  
7 "It's high season on money managers and Madoff's head would  
8 look pretty good above Elliot Spitzer's mantel. I propose  
9 that unless we can figure out a way to get comfortable with  
10 the regulatory retail risk in a hurry we get out." Did you  
11 have the sense from the information that was provided by  
12 Investment Adviser #1  
13 in the referral that they felt that  
14 Madoff had violated securities laws?

15 A Well, based on -- I assume, based on this, but  
16 based on what was referred to me and the background search  
17 that we would have done on Madoff, I think the big concern  
18 was that he was somehow -- and this, I assume, we would  
19 have -- meant the conflicts referred to in this memo, I'm  
20 assuming, the concern was that he was, again, somehow cherry  
21 picking trades, i.e. using his role as a market-maker as an  
22 order executer for other broker-dealers to get -- to somehow  
23 trade ahead of those customers -- excuse me -- and use it  
24 somehow to benefit his hedge fund customers.

25 Q Okay. All right. Let's look at two pages further  
in the April 20, 2004, 2:12 p.m. e-mail. If you look at the

1 number 4, you see number 4 --

2 A Yes.

3 Q -- in this e-mail? It says, "When we examined this  
4 issue before we concluded that maybe he does the options in  
5 the OTC market. We have spoken to several market-makers and  
6 OTC equity options, none of them claim to see any significant  
7 volume in OEX options."

8 A Okay.

9 Q What is the point that they're trying to make  
10 there? Do you understand that?

11 A Well, now I have the benefit of hindsight, so I  
12 don't know if this was my recollection then or just now, but  
13 I believe we sort of addressed the issue of options in the  
14 report but I think the inference was that in order for him to  
15 do his strategy and -- we also found out from background  
16 search that it was widely assumed he was doing this  
17 split-strike conversion strategy that required options on  
18 either end of the basket.

19 I think the inference was that they're saying that,  
20 you know, why aren't we seeing any OTC equity options, volume  
21 in those that would explain his business? But -- and again,  
22 this is what -- the benefit of hindsight of having read the  
23 allegations by Mr. Markopolos. I know that he had some  
24 similar concerns.

25 Q Is this an issue that was looked into, the fact

1 that they --

2 A Well, I believe --

3 Q Let me finish my question.

4 A I'm sorry.

5 Q They'd spoken to several market-makers, none of  
6 them claim to see any significant volume in OEX options. He  
7 claims that he was trading these equity options but they  
8 didn't see any volume. And that's what it says --

9 A Our -- I'm sorry.

10 Q -- the claim on its face.

11 A Yeah, our focus was strictly to look at the trading  
12 to see if he was -- if there was any correlation between his  
13 trading for the hedge funds, if there was, in fact, trading  
14 for hedge funds being done, if he had hedge fund clients in  
15 some way, and compare that to, again, his market-making and  
16 his proprietary business.

17 Q So, with respect to my question, which was did you  
18 look at this issue, what is the answer to that question?

19 A Well, we looked at something that addresses this  
20 issue and that is the fact that the examiners apparently  
21 found that he was no longer using the -- he said that he was  
22 no longer using OTC options in his strategy. Again, we were  
23 not concerned with his strategy, per se, we had -- as most  
24 cause exams, we had a -- this was not a oversight exam, which  
25 is sort of like the -- more akin to exploratory surgery where

1 concern was that he was somehow using customer order flow  
2 that was sort of the general consensus. But when he says,  
3 "So we need an OTC counterparty who's willing to do the  
4 baskets," I guess what he's saying is is there someone out  
5 there who would do that.

6 Q Right. So was that in the --

7 A I don't know if that's what I thought at the time,  
8 but looking at it now that's what I would say.

9 Q And was that an issue that was looked at in the  
10 cause exam?

11 A Well, again, when we got in there he -- according  
12 to the examination team and the documents looked at he was  
13 not doing the OTC options, so I would say no. But obviously,  
14 even that doesn't preclude him from having done the options  
15 or having, at that time, it wouldn't have precluded him from  
16 doing them with an OTC counterparty that we were not aware  
17 of, even if, you know, they had already contacted some of  
18 them. So I would say that the --

19 Q So you don't see anything in Exhibit 2, these  
20 e-mails that were referred to Mr. Sollazzo in April of 2004,  
21 that would lead one to focus an exam on anything but cherry  
22 picking?

23 A Well, the cherry -- I'm sorry -- the cherry picking  
24 is sort of cherry picking/front running.

25 Q Okay.

1           A     I can't say -- well now, of course, we have the  
2 benefit of hindsight, but I can't say that I do. That's not  
3 to say that other people wouldn't. I don't know that --

4           Q     Okay. Page -- the fourth page --

5           A     Fourth from the front?

6           Q     Yeah, a couple -- it has page two at the bottom.

7           A     Yes.

8           Q     See where it says underlined, "We, at Investment Adviser #1  
9 have totally independent evidence that Madoff's executions  
10 are highly unusual," and there's an asterisk next to it or a  
11 star, I guess a star. Do you know if anyone from the exam  
12 team ever went back to Investment Adviser #1 to ask what this totally  
13 independent evidence was?

14          A     I'm not aware of that.

15          Q     Any reason they wouldn't? You're doing a cause  
16 exam based on e-mails and in the e-mails they say we have  
17 totally independent evidence and --

18          A     I don't know that, you know, if that's the case  
19 that the -- maybe the IA staff, since they were doing the  
20 examination of Investment Adviser #1, would have gone back and asked  
21 them if they -- perhaps they did. I don't know.

22          Q     Why wouldn't the cause exam, the folks who were  
23 doing the cause exam on the Madoff matter that originated  
24 from this referral, why wouldn't they go back to Investment Adviser #1  
25 and ask that question?

1 A Well, I mean --

2 Q Doesn't it relate to Madoff?

3 A Oh, without a doubt. I mean, this is a vague  
4 statement that the executions are highly unusual. We may  
5 have inferred that the executions must be, you know,  
6 highly -- well, highly unusual for a number of reasons or it  
7 may have been something that, well, regardless of whether  
8 they're -- they think they're unusual we'll just go through  
9 the books and records of the firm and find out if he is  
10 indeed cherry picking and rely on the actual books and  
11 records of Madoff to determine for ourselves.

12 Q Why don't we go to the next document. Okay, we're  
13 going to mark this as Exhibit 3. And this is an e-mail from  
14 Dorothy Eschwie to Robert Sollazzo, 5/11/2004, 5:21 p.m.

15 (SEC Exhibit No. 3 was marked for  
16 identification.)

17 A Yes.

18 Q Okay. Now, in the e-mail below Bob Sollazzo says  
19 to Dorothy Eschwie, "We've looked at the e-mails you've  
20 forwarded to us and done some research on Madoff, we believe  
21 that this matter is worthy of an examination when resources  
22 permit." So does this seem to confirm that Exhibit 2, the  
23 e-mails attached to Exhibit 2 were the e-mails that the  
24 decisions to go forward with the Madoff exam was based on?

25 A I would assume so, yes.

1 Q Okay. Now, according to Mr. Sollazzo, he says,  
2 "The story, especially the consistent high returns earned  
3 over an extended period, makes you wonder." Does that seem  
4 to be kind of Mr. Sollazzo's sum up of what the exam should  
5 look at?

6 A Well, again, I don't -- I can't say exactly what he  
7 was talking about, but I would imagine his inference would  
8 have been that if he is somehow using the hedge fund or his  
9 order flow -- somehow using information gleaned from his  
10 market-making activity for -- to benefit the hedge fund, it  
11 would help explain a consistent high returns over an extended  
12 period of time. So, I'm assuming that's what he means.

13 Q Did you understand that one of the focuses of the  
14 Madoff cause exam was to try to figure out how it was that  
15 Madoff was maintaining these consistent high returns over an  
16 extended period?

17 A The focus of the exam, again, was to look at the  
18 trading that we hoped to find for hedge funds and see if  
19 there was any correlation, and that would then probably -- if  
20 we did, that would explain, at least to some degree probably,  
21 and then subsequent to -- if that was the case we would do  
22 follow-up work if we did find correlation.

23 But the focus of the exam, again, was very  
24 straight-forward. It was to look at the trading that he may  
25 or may not have been doing, again, going into the exam we

1 weren't certain, for hedge funds compared to the order flow  
2 information and his prop trading.

3 Q Okay, but doesn't it seem as though Bob Sollazzo's  
4 e-mail actually is a broader question?

5 A No. I think he's saying, this story, if, you know,  
6 and the story would be we -- someone thinks that Bernie  
7 Madoff is achieving high returns by cherry picking, obviously  
8 those high returns are -- would be -- the assumption would be  
9 that those high returns are contingent upon the cherry  
10 picking. So first we would have to look for the cherry  
11 picking/front running to determine if it exists, and if not  
12 then --

13 Q And would you ever get to the question of how he  
14 was able to obtain the consistent high returns earned over an  
15 extended period?

16 A Again, the focus was trading, you know, ahead of  
17 customers. There are many people who would say, you know,  
18 Personal Privacy from Legg Mason beat the S&P market for 15 or 20  
19 years," whatever he beat it, "How could he possibly do that??  
20 You know, many learned people assume or are, you know,  
21 convinced you can't do that.

22 But -- so the high returns -- and then again, the  
23 high returns, we did -- we had no evidence of -- other than  
24 anecdotal evidence, of what the returns are or were.

25 According to -- supposed high returns -- according to

1 articles we read, he achieved outside returns. But that was  
2 not the focus of the examination. The examination was very  
3 focused and that's what I understood our role to be.

4 Q Okay. Now this was May 11, 2004 that Sollazzo is  
5 saying to Dorothy Eschwie, based on the April 22, 2004  
6 referral that the matter is worthy of an examination when  
7 resources permit. Do you know when the examination actually  
8 began?

9 A I think it started sometime later in May. I don't  
10 know.

11 Q May of 2004?

12 A No, no, no, 2005.

13 Q Was it unusual for an exam to start so long after a  
14 referral came in?

15 A Not -- I would say not necessarily. Although a  
16 year, that -- a year may seem long, it depends on, again, I  
17 would think if there's some sort of immediate need where we  
18 had direct evidence or a customer complaint that their funds  
19 were somehow being converted against their will or something  
20 along that -- along those lines. So --

21 Q So there was -- there wasn't a particular urgency  
22 in connection with the Eschwie referral in April 2004?

23 A I don't think -- well, I don't think there was a  
24 particular urgency.

25 Q Okay.

1           A     Which is not to say we did not appreciate the  
2 severity of the charges or of the allegation. Again, in --  
3 but -- and also keep in mind that we did know that Bernie  
4 Madoff was a -- I'm talking about the firm because I don't  
5 know anything -- I didn't know, at that time I don't think I  
6 knew anything about the individual -- but we did know the  
7 firm was a fairly large firm, employed a lot of people, was a  
8 very big market-maker, had introduced the, sort of, third  
9 market issue to the market. So it didn't seem to be -- it  
10 didn't seem as if, you know, he was a fly-by-night operation  
11 that was out there to rip people off is I guess what I'm  
12 trying to get to. So that may have tempered our decision to  
13 wait until the proper personnel would have been available.

14           Q     Okay. You say that about the proper personnel, who  
15 particularly -- what type of personnel were you looking for?

16           A     Well, I can't say at this time that we had Pete in  
17 mind. I don't know what Bob had in mind when he said  
18 "resources available." He may not have been talking about a  
19 specific personnel -- person, he may have been talking about  
20 personnel in general because I believe at that time we had a  
21 lot of exams going on, especially in my org code, to do --  
22 with respect to the consolidate supervised entities. I think  
23 there was also -- there may have been another sweep going on,  
24 I think at that time there may have been an information  
25 barrier sweep.

1           So, he may have been talking about waiting until I,  
2   you know, I got involved. I don't know if he had anyone  
3   in -- specific in mind but I think he wanted to, you know,  
4   make sure that whoever was involved was a good examiner  
5   because we have different strata of examiners, some who we  
6   would send on a cause examination and some who we wouldn't.

7           Q     And so there was a determination to pick Mr. Lamore  
8   because of his particular expertise?

9           A     I think -- ultimately that was the determination.  
10   I don't know if there was that determination, you know, back  
11   in 2004, which, you know predates the exam by about a year.

12          Q     How was that determination made to pick Lamore?

13          A     I think it was made primarily because he was an  
14   equities trader for a hedge fund. I believe it was for a  
15   hedge fund.

16                MS. STEIBER: And was Ostrow a particularly strong  
17   examiner?

18                THE WITNESS: I think he's viewed as a good  
19   examiner.

20                BY MR. KOTZ:

21          Q     So was there a reason that Mr. Ostrow was  
22   particularly put on that team?

23          A     I don't recall. That may have been a -- just a  
24   here's a good examiner who is available to go with Pete. I'm  
25   just supposing.

1 Q Who was supposed to take the lead on the exam,  
2 Ostrow or Lamore?

3 A We don't necessarily say, "You're the lead  
4 examiner." If people have a reputation of working well with  
5 each other, you know, there's really no need. A person who,  
6 you know, generally is stronger in a particular area will  
7 gravitate towards that area, but I think it was sort of  
8 predetermined that, you know, Peter would be sort of the  
9 leader on the trading side.

10 BY MS. STEIBER:

11 Q Why didn't you choose someone with investment  
12 advisor experience to be on the team?

13 A Well, to be -- well, our -- I don't know if you  
14 mean investment advisor experience within our broker-dealer  
15 program or investment advisor examiner.

16 Q Well, why don't investment advisor examiner since  
17 they are hedge fund allegations?

18 A That program is completely distinct. There are two  
19 separate -- it's not organized the same way that it's  
20 organized in some other offices. There are two associates or  
21 distinct associates, one on the investment advisor side, one  
22 on the broker-dealer side, and I don't think we have ever,  
23 until maybe this past year, sent examiners out together.  
24 And, again, they are two separate examinations, so it just  
25 wasn't done.

1 BY MR. KOTZ:

2 Q Okay. Now was Mr. Ostrow, at that time, an  
3 experienced examiner?

4 A Yeah, I was thinking about this on the way down and  
5 I don't recall exactly when William started, but I think he  
6 was highly thought of, again. And this was not -- when our  
7 typical examiner does a broker-dealer examination they look  
8 at net capital, they look at churning in customer accounts,  
9 things like that. This was a -- sort of a one off  
10 specialized cause examination where I don't necessarily think  
11 it was necessary to have that sort of broker-dealer  
12 experience. And again, this is with the benefit of  
13 hindsight, I can't recall exactly what we were thinking when  
14 we assigned William, but just to get people who understand  
15 what the issue is and to go out there, look at it, and  
16 determine if what was alleged is exactly happening.

17 Q Right, but given that there was no branch chief on  
18 this exam, do you think that perhaps the team that was put  
19 together had relatively little exam experience?

20 A Well, I thought they had the resources to do the  
21 examination. I think Pete -- Peter Lamore, based on his  
22 equity trading experience as a trader, probably would have  
23 been among one of the best choices of anyone in the  
24 broker-dealer program to work on this examination, in spite  
25 of the fact that he had not been an examiner for that long.

1 But based on his work history, we though he would be a good  
2 fit.

3 Q Right, but in terms of examination experience  
4 wouldn't you say that the team that was put on this without a  
5 branch chief was pretty thin on examination experience?

6 A Again, we don't -- in assigning examinations if  
7 there's another extenuating circumstance to examination  
8 experience such as work experience, I think that was the  
9 overriding factor.

10 Q Okay. So -- but what I --

11 A I will say that Peter had not been an examiner for  
12 an extended period of time.

13 Q Okay. And would you acknowledge that for the  
14 Madoff cause exam, given that there was no branch chief, that  
15 the team assembled was thin on actual examination experience?

16 A Again, I don't necessarily agree with your  
17 categorization as thin. Sort of the inference is there that  
18 they didn't have the experience to do the examination.

19 Q I didn't ask --

20 A Well --

21 Q I asked about examination experience. You said  
22 there were other factors, I'm asking about examination  
23 experience.

24 A Well, I will say that Peter had not been an  
25 examiner for that long. I believe -- I don't know exactly

1 when he was hired and I don't know exactly when William was  
2 hired, but I don't think he was an examiner for an extended  
3 period of time, so you can draw your own inference from that.

4 Q Okay. Yeah. Do you know if at any point -- you  
5 may have mentioned this, but do you know if any point anyone  
6 went back to Investment Adviser #1 to try to get additional e-mails or  
7 documents?

8 A I'm unaware of anyone going to Investment Adviser #1 with  
9 respect to this examination.

10 Q Okay, "this" being the Madoff cause exam?

11 A Yeah. I -- we've had subsequent issues with  
12 Investment Adviser #1 I believe, but with respect to this examination  
13 I'm not aware of anyone going back.

14 Q Okay. All right, why don't we move on. I'm going  
15 to show you the next document, this is --

16 A And again, it's been four years, so there may have  
17 been some -- someone did go back, I don't know. I just don't  
18 recollect it.

19 Q Okay. Okay, let me show you another document.  
20 We're going to mark this as Exhibit 4. And this is an e-mail  
21 from you to William Ostrow and Peter Lamore dated 12/22/2004.

22 (SEC Exhibit No. 4 was marked for  
23 identification.)

24 A Okay.

25 Q What is this document attached to the e-mail?

1           A       It seems to be what, at the time, was the most  
2 recent NASD exam report of Bernard Madoff Investment  
3 Securities.

4           Q       Okay. Now if you see on the first page of this  
5 report it says, "The firm is also a member of CSE, MSRB, DTC,  
6 OCC, NSCC and SIPC."

7           A       Yes.

8           Q       Would that information indicate the names of  
9 different organizations that would be able to provide  
10 additional data regarding the trading activities of the firm?

11          A       Some of them.

12          Q       Okay, which ones?

13          A       I would say DTC, NSCC, OCC if they were doing  
14 options, and I guess this is the Chicago Stock Exchange if  
15 anything was executed on the stock exchange. I would say  
16 those. And MSRB, I don't know if at the time they actually  
17 reported trade data, it went through them it was -- but  
18 generally the bulk of them. SIPC, no.

19          Q       Okay. If you could look at a few pages further  
20 on --

21                   BY MS. STEIBER:

22          Q       Did you ever request data from any of those  
23 organizations that you named to supply trading data?

24          A       I don't believe so. That's typically for -- we get  
25 the trading data -- unless we have reason to get it directly

1 from NSCC it's sort of standard procedure to get it directly  
2 from a clearing firm -- from the firm.

3 Q So you said, "no," you didn't request it from any  
4 of those?

5 A No, I don't recall --

6 Q Okay.

7 A -- us requesting it so I would say no.

8 BY MR. KOTZ:

9 Q Okay, if you could look further on page 12 of this  
10 document -- 12 --

11 A 12 to 26?

12 Q Right.

13 A Okay.

14 Q See, it says at the bottom of the page "internal  
15 audit?" There's a question, "Does the staff responsible for  
16 conducting internal audits have an appropriate degree of  
17 independence from the departments and people they audit?"  
18 And the response is "N/A." And then you can see on the next  
19 page it says, "Description of finding and root-cause  
20 analysis. This firm -- the firm does not have an internal  
21 audit department." Do you see that?

22 A Yes.

23 Q Was that -- is that an issue that would be a  
24 concern for an examiner?

25 A Well, I would say not necessarily, it depends on

1 the size of the firm. Obviously, the way the SEC exam  
2 program is structured, we rely as the SRO, on our front line.

3 It didn't seem to have been a concern for them, they had  
4 more experience with Bernard Madoff Securities, it didn't  
5 seem to have been a concern with them, I believe. So I would  
6 say in hindsight the answer may have been different, but it's  
7 not unusual for a firm not to have an internal audit  
8 department, they may just have a compliance function.

9 Q So at the time this wasn't viewed as a concern?

10 A At the time, no. And again, we were looking for  
11 information regarding trading ahead of customer securities,  
12 front running. It was not our focus to do an examination of  
13 the internal audit function to see if they were in compliance  
14 with all regulatory provisions.

15 Q So, if you're doing an exam and you have a  
16 particular focus, is there something prohibiting you from  
17 changing focus in the middle of an exam?

18 A No, not if we have reason to. But they would have  
19 to be a good reason and also we do have time constraints. We  
20 don't have an unlimited amount of time to stay at a firm.

21 Q But are there occasions where the focus will  
22 change?

23 A Sure.

24 Q Okay. I'm going to show you the next document.

25 We'll mark this as Exhibit 5. This is an e-mail from William

1 with the Madoff cause exam?

2 A Well, this seems to be related to the investment  
3 advisor exam. No, we would not have looked at that.

4 BY MS. STEIBER:

5 Q So if an investment advisor exam had been done they  
6 would have looked at custody of assets and safety of client  
7 assets?

8 A I believe that's part of their examination program.  
9 Again, I'm not overly familiar with their program but I  
10 believe it is.

11 Q And do you know if performance, fund performance,  
12 is something else that they usually look at in an investment  
13 advisor exam?

14 A I believe so.

15 Q Okay.

16 BY MR. KOTZ:

17 Q Why don't we move on to the next document. Okay,  
18 I'm going to mark this as Exhibit 6. This is an e-mail from  
19 William Ostrow to you dated March 24, 2005, 1:12 p.m.

20 (SEC Exhibit No. 6 was marked for  
21 identification.)

22 A Okay.

23 Q Okay. And do you know what the attached document  
24 to the e-mail is?

25 A It seems to be an initial document request for the

1           A     My understanding was that the whole hedge fund  
2 industry is cloaked in secrecy.

3           Q     But to this level?

4           A     To this -- I don't know that that struck me as  
5 being, for a hedge fund manager, particularly telling.

6           Q     Did you take any actions to determine whether this  
7 level of secrecy was common in the hedge fund industry or  
8 particularly telling?

9           A     I don't recall that I did. I would say probably  
10 not, but I don't think I did.

11          Q     Okay. All right, let me show you another article,  
12 we're going to mark this as Exhibit 8. This is an article by  
13 Michael Ocrant and it is -- headline is "Madoff Tops Charts,  
14 Skeptics Ask How." Is this the other article that you were  
15 referring to that you think you may have seen?

16                                 (SEC Exhibit No. 8 was marked for  
17                                 identification.)

18          A     Do you know where this is from?

19          Q     MarHedge.

20          A     I think so. Yeah, probably.

21          Q     And there's all kinds of handwriting Exhibit 8, do  
22 you know who's handwriting that is?

23          A     I don't know.

24          Q     It's not yours, I guess?

25          A     It's not mine.

1 Q Okay. Maybe you could help us kind of decipher it  
2 a little bit. If you see on the first page it says, "OTC  
3 Options. Who is writing these OTC contracts?" Do you see  
4 that?

5 A Yes, I do.

6 Q Okay. Was this an issue that was looked at? I  
7 mean, do you have any idea why --

8 A Well, it wasn't -- I don't think it was an issue  
9 that was the overriding theme of the examination. Again, as  
10 I said before, the -- our concern was to find out if he's  
11 somehow doing trading for hedge fund clients and if he's  
12 using his market-maker business to supplement or to aid his  
13 hedge fund business.

14 Q Okay. What about the --

15 A Well, to -- but --

16 Q Sorry.

17 A I'm sorry -- to elaborate a little further,  
18 examiners do have some discretion. They have, you know, a  
19 lot of discretion to look into things. So, you know, I guess  
20 that was an issue that was brought up perhaps. In the  
21 earlier referral I think they were talking about they were  
22 looking for, you know, what bank would be writing these OTC  
23 contracts so maybe he was just reiterating what the  
24 investment advisor person at --

25 Q At Investment Adviser #1 you mean?

1 identification.)

2 A Okay, yeah.

3 Q "-- so you're document request is perfect timing."

4 A Well maybe it was not as prophylactic, maybe by  
5 that time we had -- the exam had started and we were getting  
6 some feedback. I don't know, but --

7 Q Do you know what he meant; Peter meant, when he  
8 said to you that he's "ready to call his bluff on his refusal  
9 to admit the money-management side?"

10 A I think he had -- the exam team was having a hard  
11 time getting Madoff to admit that he had any involvement with  
12 hedge funds.

13 Q Okay. And then why is he saying, "I'd like to get  
14 the e-mail and trading data we requested in addition to  
15 Barclays information from your request before we confront  
16 him?" Do you have any idea what that was all about?

17 A I guess he must mean e-mail and trading data that  
18 he requested directly from the firm and -- in addition to the  
19 Barclays information. I guess the inference was that if we  
20 say, "We show trading at Barclays for your broker-dealer for  
21 this particular client, you know, how do you explain that?"

22 Q Okay. And then he says --

23 A If you say you don't have any involvement with  
24 hedge funds and if we --

25 Q It says, "I suggest we shoot for Monday, May 24,

1 2005 to confront him as well as be ready to speak to all the  
2 funds." Do you know what that reference about being ready to  
3 speak to all the funds was?

4 A I imagine he's talking to -- about the hedge funds,  
5 actually calling them up to see if they trade with Bernie --  
6 if Bernie Madoff Securities was indeed executing trades for  
7 them. And he's saying that he's refusing -- or the staff is  
8 saying he's refusing to admit the money-management side of  
9 the business, well then if we go directly to the hedge funds,  
10 say "Do you have any involvement with him," maybe that would  
11 sort of open up the spigot.

12 Q Okay. All right, let me show you the next  
13 document. We'll mark it as Exhibit 12. This is a letter  
14 from Personal Privacy, Director of Compliance, to you  
15 dated May 16, 2005. If you see in this letter it says, "No  
16 relevant transaction activity occurred during the period  
17 March 1, 2005 to March 31, 2005. There were no other  
18 customer relationships identified at Barclays Capital Inc.  
19 for the other names provided in your inquiry letter."

20 (SEC Exhibit No. 12 was marked for  
21 identification.)

22 A Right.

23 Q Were you surprised to get a response back that  
24 there was no relevant trading activity during the period you  
25 requested?

1           A     Well, I wasn't 100 percent certain that -- I can't  
2 say whether I was surprised or not. I think that the article  
3 referenced that Barclays Capital was either soliciting or had  
4 Bernie Madoff as a client, but that doesn't necessarily speak  
5 to the individual U.S. broker-dealer. I think that was my  
6 inference before we knew that he executed trades through the  
7 foreign broker-dealer, we thought he was executing the  
8 trading here, I believe my trading would have went. So, I  
9 can't say I'm surprised. But the whole point of this was to  
10 identify customers that we can get trading for, which  
11 subsequently we did, so this sort of avenue became moot in  
12 some respects.

13           Q     Okay. Was there any follow up from this response,  
14 the May 16, 2005 response from Barclays?

15           A     Not that I recall, no.

16           Q     Okay.

17           A     I think -- well, just to elaborate, I think it  
18 maybe became more clear to us that once we found out through  
19 other means that he was executing trades for hedge fund  
20 clients that -- and that it was going through the foreign  
21 broker-dealer, then it made sense that the prime brokerage  
22 relationship might exist with the U.K. affiliate. And since  
23 Barclays is a global organization, that didn't seem to be  
24 unusual.

25           Q     And was there any discussion of following up with

1 the U.K. affiliate?

2 A Again, our whole goal was to just find trading  
3 where it was or to get -- at this point I don't think he had  
4 admitted to us that he was executing trades, and that seemed  
5 to be, you know, part of the battle.

6 MS. STEIBER: Wait, you said you were -- to  
7 identify trading, where did you identify trading?

8 THE WITNESS: Subsequent to this?

9 MS. STEIBER: Yeah, where was the -- what trading  
10 was he doing?

11 THE WITNESS: Well, I'm -- first identify  
12 customers. And I don't know that specifically if ultimately  
13 he just confessed to William and it became a matter of --  
14 he -- I think he may have said it was a matter of semantics,  
15 or subsequently when we found out that he was -- that the OC  
16 personnel had done an exam and actually had trading. I don't  
17 know exactly what precipitated it, but ultimately we found  
18 out that he was doing trading, either from him or through --  
19 I don't know from him or through OC.

20 MR. KOTZ: Either from Madoff directly or from OC  
21 from Madoff directly, right?

22 THE WITNESS: I believe so, yeah, that's my  
23 recollection. So that would have made this, you know -- one  
24 we -- that was the whole -- that seemed to be the early  
25 sticking point in the exam, that once we would find out that

1 he was trading for hedge fund clients and then we could get  
2 that trading, compare it to the market-making trades see if  
3 there is any overlap, any correlation, then, you know, that  
4 would basically tell us whether he was trading ahead of  
5 customers or not.

6 MS. STEIBER: I'm just confused because in the  
7 letter to Barclays that you're sending it seems that you've  
8 identified clients and it looks like these --

9 THE WITNESS: I think these --

10 MS. STEIBER: -- are some of the clients in the  
11 articles.

12 THE WITNESS: Yeah, these are some of the clients  
13 in the articles, yeah.

14 MS. STEIBER: Fairfield, Kingate, Kingsway. And  
15 then you get a letter back from Barclays and the letter says,  
16 "We have -- for these customers we have no relevant  
17 transaction activity." So you get this back and they said,  
18 "Well, maybe -- we don't know, but maybe there could be a  
19 relationship with a Madoff-affiliated entity in our U.K.  
20 affiliate."

21 THE WITNESS: Right.

22 MS. STEIBER: So -- but you didn't send this letter  
23 then to the U.K. affiliate to identify the trading?

24 THE WITNESS: Well, we subsequently, I think --  
25 again, the whole point of this was to get him to admit that

1 he had the customers. Once he admitted, either by William or  
2 Peter calling his bluff because we -- maybe found out from  
3 OC -- I don't recall specifically how they found out, but  
4 once we found out that, you know, he admitted that he had  
5 these client, you know, then it became moot and we would get  
6 the trading directly from him.

7 MR. KOTZ: Did you think it would -- was it odd --

8 THE WITNESS: And -- I'm sorry.

9 MR. KOTZ: Did you think it was odd that he was  
10 first denying that he was doing trading for hedge fund  
11 clients and then through documents you obtained from him it  
12 was acknowledged and clear that he was? I mean, it's not as  
13 if you went to any outside source. He said he wasn't doing  
14 the trading, you got documents from him that show him  
15 trading.

16 THE WITNESS: Ultimately from him. But, again, I  
17 don't know that him giving us the documents and saying,  
18 "These are the clients," was not precipitated by us saying,  
19 "We know you did trading with these firms because we, you  
20 know, from this OC exam we know it." I don't know if that  
21 happened, so -- but in either case, you know, it would be  
22 odd.

23 But people are secretive about things and at the  
24 end of the day, if he can -- if we can get the books and  
25 records, you know, they're not on record with us when they

1 identification.)

2 A Okay.

3 Q Was there any concern -- did the staff have a  
4 concern about Madoff's foreign affiliates?

5 A None that I'm aware of.

6 Q Okay.

7 A At this point they may have, I don't recall any  
8 concerned. I mean, based upon what we looked at when we  
9 ultimately got work papers from OC in D.C., maybe that  
10 referenced some concern, but I don't recall any concern.

11 Q Okay. Let me show you the next document. We'll  
12 mark it as Exhibit 15. See in this -- this is an e-mail from  
13 Peter Lamore to you and William Ostrow, 5/25/2005, 9:54 a.m.  
14 And if you could see at the bottom of it, the last sentence  
15 says, "Anyway, I look forward to speaking to him regarding  
16 the hedge fund issue, which he has opportunistically failed  
17 to mention to us."

18 Were you aware that the examiners on the Madoff  
19 cause exam felt that they were lied to by Mr. Madoff on  
20 numerous occasions?

21 (SEC Exhibit No. 15 was marked for  
22 identification.)

23 A Yes --

24 Q Was that a concern?

25 A -- or misled. Well, ultimately it was a concern,

1 but if ultimately we got the trading and did what we came to  
2 do, as I said, you know, we -- when we speak to people it's  
3 not on the record.

4 Q So is it common in an exam for examiners to come  
5 back and say, "The contact for the exam has lied to us on  
6 numerous occasions?"

7 A I don't -- I wouldn't say it's common and I would  
8 not say that they would necessarily even -- less commonly use  
9 the word lie, but it's not uncommon to say that they're  
10 stonewalling us or they're trying to mislead us or things  
11 like that.

12 Q Did you think it was odd at all that the contact  
13 for this exam was Bernie Madoff himself?

14 A Yes.

15 Q Why?

16 A Well, he's basically the principal owner of the  
17 firm. In hindsight, you know, it's easy to say why he would  
18 have wanted to control all aspects of the examination. I'm  
19 under the understanding that, you know, that it was similar  
20 with respect to the OC examination that preceded ours, I  
21 believe.

22 It just -- it did seem odd, but again, on it's face  
23 it seemed odd but there was nothing inherently wrong with it  
24 that we can, you know, say -- some people, maybe that's the  
25 way he built his business, being hands-on, that he wanted to

1 be. You know, we know that he subsequently -- well, he  
2 became involved with the NASD with NASDAQ to a great degree,  
3 he, you know, he apparently kept up on regulatory issues,  
4 he -- maybe he just wanted to be at the forefront. I really  
5 can't say, but I agree it was odd.

6 Q Had you ever seen another situation with an entity  
7 that was as large as Bernie Madoff's operation where the  
8 point of contact for the exam was the head of the company?

9 A Offhand I would have to say no. I -- maybe but I  
10 doubt it.

11 Q Okay. All right, let me show you the next e-mail.  
12 We'll mark it as Exhibit 16. This is an e-mail from Mr.  
13 Ostrow to Lamore, 5/26/2005, 1:57 p.m. and below it is a  
14 second e-mail from Peter Lamore to William Ostrow, Thursday,  
15 May 26, 2005 at 11:55 a.m.

16 Let me ask you about the one at the bottom first.  
17 It says in Peter Lamore's e-mail, "Shana just gave me another  
18 explanation regarding the firm's e-mail retention policy.  
19 Basically, she has the ability to determine that an e-mail is  
20 non-business related spam and delete it from the system  
21 forever. That just doesn't seem right." Did this issue come  
22 to your attention?

23 (SEC Exhibit No. 16 was marked for  
24 identification.)

25 A I believe so. I believe it did. I don't know that

1 this specific issue, I know that they had problems with the  
2 e-mail.

3 Q What were the problems with the e-mail?

4 A I think it just, in terms of time and it seemed odd  
5 that some people, you know, didn't have access to e-mail  
6 accounts for the firm.

7 Q Like did Bernie Madoff say that he doesn't use  
8 e-mail?

9 A I don't know if he said that, but --

10 Q Okay. Were there others in the Madoff operations  
11 that said they just simply don't use e-mail?

12 A I think -- yeah, I think there was, yeah. And this  
13 is mentioned in the report too, the system -- one of the  
14 computer people -- I don't know if he was a computer person,  
15 but he was one of, I think, one of the top persons in the  
16 tech department or Bernie's, you know, one of his assistants.

17 Q What? Said he didn't use e-mail?

18 A I don't know if he said it or that he -- or they  
19 were told that he does not have an e-mail address.

20 Q That who doesn't have an e-mail address, just to  
21 clarify, Bernie?

22 A Oh, I don't -- no, not necessarily Bernie, although  
23 I don't think -- I don't think he was included on -- we  
24 ultimately did get e-mails from him. No, Frank DiPasquale.

25 Q Okay. Were you aware at the time that Bernie

1 Madoff was known for being at the forefront in technology in  
2 the securities industry?

3 A I learned that throughout the background of the  
4 examination, yeah.

5 Q So was it odd that someone who was well known to be  
6 in the forefront of technology then when you got to the  
7 operation doesn't seem to be a lot of e-mails? Doesn't seem  
8 like they even use e-mail?

9 A Yes, that's odd.

10 Q Okay. Now, this point in here about how Shana  
11 Madoff, who was the compliance officer, is that right? Do you  
12 know? Is that her title?

13 A I know subsequent to -- I -- to this exam that that  
14 was her title. I don't know exactly what her role was during  
15 our examination, but --

16 Q Okay. But would it odd that someone -- somebody in  
17 her position would have the ability to delete any e-mail  
18 forever? Would that be a red flag?

19 A This is a sticking point with a lot of firms. This  
20 fighting back on e-mail and, you know, what's retained and  
21 what's not, is not unusual. And I think the way the rule is  
22 written is is that, you know, it's business-related.

23 So I think there are some firms that go through and  
24 do, say, you know, this is not business-related and so they  
25 can filter it. I think most firms of -- that we deal with

1 probably decide it's easier just to collect them all rather  
2 than filter them, go through them and -- but some firms do  
3 extract out personal things, I believe.

4 Q Okay. Further up on this document, Exhibit 16,  
5 there's a reference to Auriga International Euro. Do you  
6 remember an issue with that?

7 A No.

8 Q Okay.

9 BY MS. STEIBER:

10 Q Do you recall any inconsistencies between the list  
11 of funds Bernie gave you and the list of funds that maybe you  
12 had read about and a list of funds that D.C. provided.

13 A I can't say I recall specifically. There were some  
14 inconsistencies with ultimately the number of dollars  
15 invested I think, but ultimately we came, you know, I think  
16 some of the articles may have referenced 12 to 14 billion him  
17 managing and then what we got maybe only accounted for 8 or  
18 10, so there was some discrepancy there.

19 Is -- at that point as long as we got -- we were  
20 comfortable that, you know, okay, we know the bulk of your,  
21 you know, trading -- your hedge fund personnel or clients,  
22 I'll call them, and we can get the trading for that we can  
23 see if there -- and as long as we -- I guess some of the  
24 bigger ones that we were concerned about was Fairfield in  
25 terms of absolute dollars -- as long as we got that I don't

1 think I was overly concerned with that. So there was an  
2 inconsistency there but, again, the bulk of it was accounted  
3 for so that we could still go on with the actual -- the focus  
4 of the examination, get the trading for those entities  
5 hopefully -- or some of those entities, because we wouldn't  
6 necessarily have looked at all of them anyhow in terms of  
7 trading.

8 Q Okay, but you don't recall there was an issue with  
9 Bernie was saying he only managed 13 hedge funds or 12 hedge  
10 funds so he could stay under the number 15 so he wouldn't  
11 have to register?

12 A I do recall that. I don't recall specifically what  
13 was said, but I think that was an issue.

14 BY MR. KOTZ:

15 Q Okay. Why don't we go on to the next document?  
16 We'll mark this as Exhibit 17. This is an e-mail from Peter  
17 Lamore to you dated 5/26/2005, 3:52 p.m. And he says, "Okay,  
18 he just graced me with his presence for an hour-plus and I  
19 was able to get a better understanding. However, he was  
20 somewhat vague regarding the actual execution and clearance  
21 of trades. Other than the basket is advertised and its  
22 equities in the basket are traded. The model adjusts how  
23 much capital can be put to work and still stay within the  
24 parameters of client agreement."

25 Do you remember this issue in terms of the staff

1 trying to understand the actual execution and clearance of  
2 trades and that Madoff was vague about it? I mean, you can  
3 see below you are the one who asked --

4 (SEC Exhibit No. 17 was marked for  
5 identification.)

6 A Yeah.

7 Q -- Lamore about it.

8 A I think it's sort of standard to find out, you  
9 know, if -- where the trades -- well, you know, how the  
10 trades are executed. I don't know if -- ultimately I think  
11 he explained it to us and ultimately, again, we got the  
12 trading so, you know, that was the biggest concern. And I  
13 think, you know, ultimately we -- well, then it goes on to  
14 talk about the parameters of the model.

15 Q But when Lamore says to you that Madoff was vague  
16 regarding the actual executions and clearance of trades, do  
17 you know if that issue was ever resolved in terms of he's  
18 saying he was vague, whether it was ever clarified?

19 A I think ultimately he was told that he executed the  
20 traded through his foreign affiliate after hours. Well, no,  
21 I shouldn't say -- he used foreign brokers to go through his  
22 foreign affiliate after hours. I think he used other  
23 broker-dealers but they were executed after hours using  
24 foreign brokers.

25 Q Was there any follow up on that point?

1           A     Again, just to get the trading. I don't think -- I  
2     don't believe there was. They may have followed up -- I  
3     asked William to follow up, I don't know if he followed up  
4     with more questions, but I don't think there was -- I don't  
5     recall specifically.

6           Q     Okay. All right. Let me ask you the -- show you  
7     the next document. We're going to mark it as Exhibit 18.  
8     E-mail from Sollazzo to you, 5/26/2005, 3:56 p.m.

9                     Sollazzo says, "Bernie's fessing up. I could only  
10    access part of the memo but it sounds like we may have  
11    something to review, directed executions. You wonder what is  
12    his benefit beyond commissions." First of all, do you know  
13    what he meant by fessing up? What was Bernie fessing up  
14    about?

15                                     (SEC Exhibit No. 18 was marked for  
16                                     identification.)

17           A     I guess that he acknowledges that he is trading,  
18    does have hedge fund clients.

19           Q     Okay. And then Sollazzo says, "You wonder what is  
20    his benefit beyond commissions." Do you know if that issue  
21    was ever resolved, Sollazzo's concern that -- the fact that  
22    he seems to be doubting that Madoff would settle for only  
23    commissions?

24           A     Well, I think that's some -- that was a -- he may  
25    have been thinking back to an earlier -- to the referral

1 about?

2 A No, he may have just asked for, you know, what --  
3 how things are going. I don't know.

4 Q What about in the last paragraph --

5 A Well, I mean, he may have known that we were  
6 meeting or that they were meeting with Bernie and that  
7 specifically that we were going to, you know, ask him about  
8 the hedge fund articles, so he may have asked subsequent --  
9 you know, send me a copy of the write up or let me know how  
10 it goes. I don't know.

11 Q Will you read the last paragraph of the memo?

12 A "B. Madoff was surprised that the staff was unaware  
13 that Madoff conducted this type of business since he had  
14 discussions regarding the firm's hedge funds relationships  
15 with SEC officials approximately one-and-one-half years  
16 earlier.

17 BY MR. KOTZ:

18 Q Were you aware that the way that the examiners  
19 found out that OC and headquarters were doing an exam or had  
20 been doing an exam of Madoff was from Bernie Madoff himself?

21 A Yeah, that was my inference, yeah.

22 Q And was that surprising to you? Was that a concern  
23 that you would find out from the individual that you were  
24 doing the exam on that another part of the agency was also  
25 doing an exam on him?

1           A     Well, it's not unusual for people in OC to do their  
2     own examinations or inquiries. I don't, you know, sometimes  
3     they might not even call them -- you know, there might not  
4     even be a report issued.

5           Q     It wouldn't be unusual for two different parts of  
6     the SEC to be doing exams of the same entity at the same time  
7     without either one knowing about the other?

8           A     Well, they weren't done at the same time were they?  
9     No, he's talking about one-and-one-half years earlier. It  
10    would be unusual to be done at the same time, but --

11          Q     So did you understand that at the time that you  
12    were doing your Madoff cause exam that the OC exam had been  
13    concluded?

14          A     Oh, when we started the examination?

15          Q     Yeah.

16          A     No, I was not aware. I was not aware of them being  
17    in there at --

18          Q     Okay. At a certain point in time then after Bernie  
19    Madoff informed the examiners there were efforts made by you  
20    to find out what OC headquarters was doing, right?

21          A     Yes.

22          Q     Okay. When you went and made those efforts, did  
23    you understand at that time that OC's exam had concluded or  
24    was it still ongoing?

25          A     I believe -- well, it depends what you mean by

1 concluded. I think I ultimately found out that there was no  
2 written report, so in that -- but I don't think -- I was  
3 under the impression, I guess based upon what they told me,  
4 that, you know, it was not ongoing.

5 Q So it wasn't ongoing but it wasn't concluded?

6 A Well, I don't know if they ever closed it out is my  
7 point, in terms of -- when we say examination, you know, we  
8 do a report usually. But so, again, it goes to -- concluded,  
9 but my understanding was that for all intents and purposes it  
10 was finished.

11 Q And did you understand that they had come to any  
12 conclusion?

13 A I was not aware of any conclusion, no. As a matter  
14 of fact, I think ultimately we requested that they send us  
15 trading data because I think there was a lot of trading data.

16 Q So, you understood that for all intents and  
17 purposes it was concluded but what conclusion did they come  
18 to?

19 A Oh, I don't know if they came to a conclusion, I  
20 mean concluded in terms of requesting information and --

21 Q So had they stopped work on the exam?

22 A I believe so but I can't, you know, I -- yes,  
23 that's --

24 Q But you already said that they -- OC headquarters  
25 stopped work on the exam without coming to any conclusions

1 one way or the other?

2 A That's my understanding basically. I don't know  
3 exactly what my thought process was but it's not -- it's not  
4 unusual for a report not to be issued when OC does an  
5 examination or, you know --

6 Q But it would be unusual for them to do an  
7 examination, stop work on the exam and not to come to any  
8 conclusions one way or another.

9 A I don't know if it was held in abeyance to be  
10 completed later or what.

11 Q Okay.

12 A I really can't say.

13 Q Okay.

14 A But it was my understanding at the time that they  
15 were not actively working on the issue, it just so happened  
16 that it looked like they were working on the same issue that  
17 we were.

18 Q Okay. All right. Let me show you another  
19 document. We're going to mark this as Exhibit 20. This is  
20 an e-mail from Eric Swanson to you dated 5/26/2005, 3:57 p.m.

21 (SEC Exhibit No. 20 was marked for  
22 identification.)

23 A Okay.

24 Q See where Eric says, "OC has an open exam of Madoff  
25 on this issue?"



1 A Yeah.

2 Q So their exam was open. So there were two exams  
3 going on at the same time --

4 A Well, when I say --

5 Q -- in different parts of the SEC without either one  
6 knowing about it, right?

7 A Well, let me try to explain exactly what I meant to  
8 convey to you.

9 Q Okay.

10 A Onsite at the firm there were not two examinations  
11 going on. So -- if there were onsite at the firm two exams  
12 going on the firm would be very quick to point out that,  
13 "Hey, you can't come in here," or if we showed up as we do  
14 sometimes without advance warning they would say, "Well, you  
15 know, your counterparts are here." Or even if they were not  
16 onsite, if a firm was actively engaged in a sort of -- in an  
17 examination by, you know, requests going back and forth they  
18 would be quick to bring that up to us as well, I think.

19 MS. STEIBER: Wait, did you just say that you have  
20 gone to an exam before where the subject of the exam says,  
21 "Your counterparts are also here," and you learned there --

22 THE WITNESS: No, no, I shouldn't say that. We  
23 have gone to the exams where the NASD people I think, were --  
24 may have been onsite on some very limited occasions. But I  
25 was saying they would be quick to point that out.

1 BY MR. KOTZ:

2 Q But I mean in this case, OC had an open exam of  
3 Madoff at the same time that you had an open exam of Madoff,  
4 is that right?

5 A Yeah. At this point I think my conclusion would  
6 be, "Okay, OC has an open exam of Madoff on this issue."

7 Q Now is there a process when you start an exam of a  
8 particular entity to determine whether another part of the  
9 SEC is doing an exam of that same entity already?

10 A Yeah, I think there's -- part of the exam  
11 background is they're supposed to check the Starz System to  
12 see if there's an open examination.

13 Q Do you know if that Starz System was checked in  
14 this case?

15 A I assume it was but I don't know for certain.

16 Q So, were you surprised to learn that OC had an  
17 ongoing exam?

18 A Yes.

19 Q Okay. And so you went back to the folks in OC and  
20 asked them what was the story, right?

21 A Yes.

22 Q Okay.

23 A That would be the second e-mail.

24 MS. STEIBER: Is that a -- in the initial interview  
25 is that a question that the examiners are supposed to ask,

1 you know, has -- when was your last exam?

2 THE WITNESS: It may be, I don't really recall.

3 MS. STEIBER: Okay.

4 MR. KOTZ: All right. And so --

5 THE WITNESS: It may not be -- it may -- it may be  
6 for a more general exam, it may not be for a cause exam. I  
7 don't recall.

8 BY MR. KOTZ:

9 Q And so you sent an e-mail to Eric Swanson or to  
10 John McCarthy and then Eric Swanson replied to you. And did  
11 you subsequently have a conversation with the OC folks in  
12 headquarters about their exam?

13 A Yeah, I believe we had a telephone conference  
14 call.

15 Q Okay. Do you know who was on that conference call?

16 A I believe Eric Swanson and myself and William and  
17 Peter I think. I don't recall who else from OC was on it if  
18 anyone.

19 Q Okay.

20 MS. STEIBER: Do you recall if John McCarthy was on  
21 it?

22 THE WITNESS: You know, I really don't.

23 BY MR. KOTZ:

24 Q What about Mark Donohue?

25 A I -- you know, I don't recall.

1 Q Okay.

2 A It should be in the work papers if --

3 Q This phone call?

4 A I there was a write up about --

5 MS. STEIBER: There's no write up.

6 BY MR. KOTZ:

7 Q We have that testimony about the phone call and I  
8 want to ask you about that.

9 A Okay.

10 Q Is it true that in this phone call, someone from  
11 the OC side in headquarters mentioned that Madoff was a  
12 well-connected and powerful figure?

13 A I don't recall that specifically, no.

14 Q What do you recall, generally anything about that?

15 A Basically I just recall them -- the inference being  
16 that it seems that there was a lot of trading activity that  
17 was unlooked at or that they had trading activity that we  
18 could look at. But specific to your question, I -- that --  
19 it -- does sort of ring a bell.

20 Q Okay. It does ring a bell that something about  
21 Madoff being an influential and powerful figure was  
22 mentioned?

23 A Yeah, but not in like a -- but what my recollection  
24 is is not in a way that would say do or not do this  
25 examination or tread lightly, but that, you know, whatever

1 you do -- well, again, this is my inference --

2 A Right.

3 A -- I didn't -- we really -- it didn't make a  
4 difference to me whether it was said or not because by that  
5 time I already knew that, you know, Madoff was a very  
6 well-connected person within the industry, I guess primarily  
7 due to his NASDAQ. But, certainly, I didn't get the  
8 inference that it was to tread lightly.

9 Q So what was the inference you took from that?

10 A You know, I really didn't -- you know, I guess that  
11 he's a -- he could probably be a loudmouth or something and,  
12 you know, you might get a phone call from someone but we  
13 never did.

14 Q Do you remember who said that? Was that Eric  
15 Swanson who said that?

16 A You know, I really can't say in all honesty. And,  
17 again, I'm not even sure who else from OC was on the -- our  
18 phone call.

19 Q Okay. And then did you have any other subsequent  
20 conversations with the OC folks in Washington about their  
21 exam other than that one?

22 A We may have requested work papers, I don't know.

23 Q Okay.

24 A Yeah, I don't know.

25 Q I think there's some record that work papers were

1 requested. Mark the next one as Exhibit 21. This is a  
2 letter from Jacqueline Wood to you dated June 9, 2005.

3 (SEC Exhibit No. 21 was marked for  
4 identification.)

5 A Okay.

6 Q You see this looks like Ms. Wood was sending the  
7 work papers to you.

8 A Yes.

9 Q So does this refresh your recollection that you may  
10 have received work papers from them?

11 A Yeah, yeah.

12 Q Do you know whether the information that you got in  
13 these work papers from the Washington exam was found to be  
14 helpful or useful in your exam?

15 A I think we had made the determination that, again,  
16 our exam was very focused, so we just wanted to find trading.

17 Q What did you understand OC's exam to be focused on?

18 A Well, from the e-mail from Eric Swanson it was  
19 focused on front running.

20 Q Okay.

21 A Well, because he said we were looking at the same  
22 issue, but I guess that doesn't preclude him from having  
23 looked at other issues, but I didn't take it to mean that or  
24 I didn't think of that.

25 Q So, they were looking the same issue you were

1 looking at, right?

2 A Apparently, yes.

3 Q And so what information were you able to get from  
4 them having -- them having been looking at this issue that  
5 would be useful in your exam?

6 A It think primarily what we were looking for was  
7 trading. I think the inference from our phone call was that  
8 there was a lot of trading that they got that might show  
9 customers, hedge funds, and, you know, it would be additional  
10 trading that we could look through and -- which I think we  
11 may have looked through some of it if not all of it. I  
12 don't recall specifically.

13 Q Do you know if there was any follow up from the  
14 examiners on your team to the examiners on OC's team to ask  
15 questions about what they found during their examination?

16 A From our team asking OC what they found?

17 Q Yeah.

18 A I don't believe there were any -- not that I'm  
19 aware of. I think that would have been in -- I think the  
20 general belief was that there was no conclusions and that may  
21 have been from the phone call. And then ultimately we --  
22 "Well, send us what ever trading you have." I don't know if  
23 we asked for other things as well or just the whole work --  
24 well, here it says, "A copy of our entire work file." I  
25 don't know specifically what we asked for but we must have

1 asked for it on the phone call. I'm pretty sure we asked for  
2 the trading anyhow.

3 MS. STEIBER: And did they tell you what occurred  
4 in the conversation that Madoff apparently had with Lori  
5 Richards and John McCarthy?

6 THE WITNESS: Did the OC people tell me?

7 MS. STEIBER: Right.

8 THE WITNESS: I don't have any recollection of  
9 that, no.

10 MS. STEIBER: Okay.

11 BY MR. KOTZ:

12 Q All right, let me show you another document we're  
13 going to mark as Exhibit 22. And this is a document  
14 referenced in the June 9, 2005 letter as being part of the  
15 work files. And this is an e-mail from Mavis Kelly -- I'm  
16 sorry, from [REDACTED] to Mavis Kelly at the SEC,  
17 Wednesday, May 21, 2003, 5:47 p.m. Have you ever seen this  
18 document before?

19 (SEC Exhibit No. 22 was marked for  
20 identification.)

21 A I may have, I don't recall.

22 Q Do you recall any discussion between your exam  
23 folks and --

24 A Well --

25 Q I'm sorry.

1           A     I should preface my response saying I may have seen  
2 it at the time of the examination. I don't recall that. And  
3 I also may have seen it more recently when we found out Peter  
4 Lamore informed the people in my office that he still had  
5 documents from Madoff exam and it was related to OC's exam --  
6 previous examination. So, when I found out about that I  
7 said, "Well, you know, what are they," and I just went -- I  
8 sort of looked, you know, through the folders but I didn't --  
9 so I don't know if I may have seen it then too but I don't  
10 recall specifically.

11          Q     but do you have a recollection of seeing this  
12 document, the [REDACTED] e-mail at that time when you  
13 were doing the cause exam?

14          A     I have no recollection of that. You know, I may  
15 have, it was four years ago. I may have, I don't know.

16          Q     Do you recall any discussion or do you recall  
17 finding out from the OC exam folks what precipitated their  
18 examination?

19          A     You know, I don't have any recollection, I would  
20 just be speculating. At this point I imagine it was probably  
21 some things like the, you know, perhaps some of the articles  
22 of, you know, maybe complaints or about -- I don't --

23          Q     Perhaps this complaint?

24          A     Maybe. I don't know. And they may have spoken --  
25 I have no recollection of them speaking specifically to what

1 precipitated their examination on the phone call.

2 Q Okay.

3 MS. STEIBER: How long was the phone call?

4 THE WITNESS: This -- I'm just guessing, I don't  
5 think it was too long.

6 BY MR. KOTZ:

7 Q So like less than an hour you think or --

8 A I would imagine so, yeah.

9 Q Okay.

10 A Keep again, well, not to beat a dead horse but when  
11 we heard that they were looking at front running and that  
12 was, you know, per I guess the Swanson e-mail, you know,  
13 that -- our focus was that and that, you know, if they had  
14 trading maybe they could, you know, they had additional  
15 customers or additional trading that we might find useful.

16 Q Did you have any idea when the OC exam folks had  
17 started their exam? In other words, how long their exam had  
18 been going on for?

19 A Maybe I did at the time but I have -- I don't  
20 recall.

21 Q Do you recall it being a particularly long time?  
22 For example, this e-mail, [REDACTED] complaint, was  
23 dated May 2003 and the discussions you were having with them  
24 was May or June 2005. Did you have the impression that they  
25 had had this exam open for two years?

1           A     I think they had it open for a long time, but did  
2 we just see something that referenced like a year-and-a-half  
3 or something? Yeah.

4           MS. STEIBER: The Madoff conversation with Lori  
5 Richards --

6           MR. KOTZ: But that wasn't necessarily the  
7 beginning of the exam.

8           THE WITNESS: Right, right.

9           BY MR. KOTZ:

10          Q     So do you feel like that --

11          A     I think that was my belief that it had been open  
12 for a while.

13          Q     Because --

14          A     Well -- I'm sorry.

15          Q     Did you feel like OC had made any significant  
16 progress with this exam that had been open for such a long  
17 time?

18          A     I don't think they were -- we didn't see any  
19 conclusions.

20          Q     Did you find that odd that the exam had been open  
21 for one-and-a-half or two years and no conclusions had been  
22 reached?

23          A     Well, again, I know that sometimes people do  
24 inquiries that do not result in examination reports and  
25 sometimes conclusions can be inferred by the fact that, well,

1 if we found something we would have pursued it. Or -- but --  
2 so I really didn't focus on that. It didn't surprise me that  
3 they would have an ongoing investigation that -- or -- I  
4 shouldn't say investigation but an examination, you know,  
5 for -- in excess of a year. Things -- other things may have  
6 came up that -- so I really can't say. But --

7 Q If it was an exam being worked on under you and in  
8 almost two years no conclusions have been drawn, it was  
9 unclear how much work had been conducted and no closing  
10 report was issued, would you have considered that appropriate  
11 for someone working under you?

12 A Well, ultimately I would have to make sure the  
13 report got issued, so yes.

14 Q You would consider that appropriate if after two  
15 years --

16 A In our broker-dealer examination program at NYRO,  
17 yes. And I think --

18 Q Maybe you don't understand my question. My  
19 question was you have a exam that's under you and in that  
20 exam -- the exam was precipitated by a complaint that came in  
21 in May of 2003. Two years later there were no conclusions  
22 either way, unclear how much substantive work had been done,  
23 the matter wasn't closed but kind of held in abeyance. Would  
24 that have been acceptable to you?

25 A No, no.

1 customer, when you had received information from Barclays  
2 that there was no relevant transaction activity?

3 A Well, I didn't view it as -- well, I don't view  
4 this as something that Pete or William would look at as a red  
5 flag. I don't view it as being totally inconsistent with  
6 this, you know, that there is a relationship with the U.K.  
7 affiliate.

8 Q Okay. All right, why don't we go --

9 A That may have been Peter's inference too that when  
10 prime brokered meaning, you know, hold the assets. I don't  
11 know.

12 Q Okay. I'll show you the next document, we're going  
13 to mark this as Exhibit 25. This is an e-mail from Ostrow to  
14 Lamore, 5/27/2005, 2:13 p.m. And in this e-mail you see at  
15 the below Ostrow says to Lamore, "If Bernie stops in ask him  
16 about Auriga International and whether or not that should be  
17 on the list. And Lamore responds, "Hey, he said he is not  
18 familiar with Auriga International." And then Ostrow  
19 responds, "That's weird because Bloomberg reports Auriga as  
20 discretionary accounts with Bernie Madoff." Did you remember  
21 this issue where it seems as though Bernie was sort of caught  
22 in a lie?

23 (SEC Exhibit No. 25 was marked for  
24 identification.)

25 A I don't recollect this specific issue.

1 Q Okay.

2 A I may have spoken to them about it but I don't  
3 recollect that --

4 MS. STEIBER: You recollect generalized, just  
5 not --

6 THE WITNESS: Well, I recognize that he -- I  
7 recollect that he was telling the examiners initially that he  
8 didn't, you know, do -- have this hedge fund advisory  
9 business and then ultimately, you know, it seemed to the  
10 examiners that he was playing a semantics game. "Oh, they're  
11 not hedge --" you know, when we confronted him and when I say  
12 we I mean the exam team, "Oh, I have a trading relationship  
13 not an advisory relationship," or "I execute trades for them  
14 on, you know a discretionary basis," you know, which is, you  
15 know, he's playing the semantics game.

16 You know, at the time, I mean, you might say,  
17 "Well, I registered --" a broker-dealer is sort of exempt  
18 from being an advisor by, you know by de facto they wouldn't  
19 have to register as a broker-dealer if you were -- they  
20 wouldn't have to register as an advisor. And I'm just  
21 surmising, you know, the word -- the games he may have been  
22 playing with the examiners, you know, we're a broker-dealer  
23 we're not an advisor, you know, he may have been saying  
24 strictly from a registration perspective.

25 BY MR. KOTZ:

1 Q But the examiners have testified that it was their  
2 understanding that Bernie Madoff lied to them on numerous  
3 occasions.

4 A Oh, yeah.

5 Q So it wasn't just a semantics game, they believed  
6 that Madoff lied.

7 A Oh, no, in Bernie's -- yeah, but I didn't -- he may  
8 have been hiding behind the semantics. Well, yeah, I think  
9 the intent was sort of to deceive.

10 Q Okay. All right, I'm going to show you another  
11 document. Mark this as Exhibit 26. This is an e-mail from  
12 Lamore from Ostrow, 5/27/2005. And if we could turn first to  
13 the last page of the document, the bottom e-mail Lamore says  
14 to you and Ostrow, "Bernie failed to give me the account  
15 information for Thema U.S. Equity Fund, which I noted in  
16 yellow on the attached spreadsheet."

17 Do you recall the staff saying that relatively  
18 often Madoff would not provide the information that he --  
19 that was requested?

20 (SEC Exhibit No. 26 was marked for  
21 identification.)

22 A Well, that's my general recollection throughout the  
23 course of the exam but I think ultimately we got the bulk of  
24 what we requested in order to, you know, determine whether he  
25 was front running.

1 Q Okay. So you -- did you get the sense from the  
2 examiners that there was quite a bit of pushback from Madoff  
3 throughout the course of the examination?

4 A When it came to certain things, yeah, like the  
5 model and early on the trading of the hedge funds and  
6 admitting that they were sort of hedge funds in which he sort  
7 of -- he had discretionary or advisory capacity.

8 Q Did the examiners inform you that quite often  
9 Bernie Madoff would name drop people from the SEC or make  
10 reference to his connections on Capital Hill throughout their  
11 conversations?

12 A I believe -- yes, that's my recollection.

13 Q Did you get the impression from the examiners that  
14 Bernie was trying to impress the examiners --

15 A Oh, yes.

16 Q -- perhaps in a way intimidate them by explaining  
17 to them how influential and important and how many  
18 connections he had?

19 A Yeah, I got that impression.

20 Q Okay. And do you think that perhaps it was  
21 difficult for somewhat inexperienced examiners to deal with  
22 that situation where they were dealing directly with Bernie  
23 Madoff and he was name dropping and he was referencing all  
24 these connections?

25 A No, I -- to be honest I think they just thought he

1 was a bit of a blowhard and liked to do that and that it was  
2 just more like fodder, going in one ear and out the other. I  
3 didn't -- no, I didn't look at it from that perspective and  
4 in talking to the examiners, you know, I -- maybe Pete more  
5 than William it was just sort of like a joke that he was  
6 doing that.

7 Q But what about with William? Do you think William  
8 was kind of awed a little bit by Bernie Madoff?

9 A I wouldn't -- well, I can't say for certain. I  
10 don't think he ever expressed any fears to me about, "Oh my  
11 God, he knows this person or that person, what can they do to  
12 us?" So I would say -- I wasn't aware of it.

13 Q Do you think that Mr. Ostrow was maybe just very  
14 impressed by Bernie Madoff and happy that he would -- had the  
15 opportunity to spend hours talking with Bernie Madoff and  
16 listening to stories at his stage in his career?

17 A I never got the impression that he was impressed  
18 with him. I did know that Bernie, according to the examiners  
19 and from my own experience, liked to go on and keep talking  
20 about things irrelevant to the exam program, but it -- you go  
21 into enough firms and that, you know, you get people like  
22 that. Maybe not people who, you know, as we mentioned  
23 earlier are the head of a sizeable trading firm, but I  
24 wouldn't categorize him, you know, as being impressed or  
25 anything like that.

1           Q     Were you aware that Madoff told them who was going  
2 to be the next chairman of the SEC two weeks before it was  
3 announced and he was right?

4           A     I don't know. I don't have any specific  
5 recollection. I -- maybe he did, maybe they did tell me  
6 that. I -- that's possible.

7           Q     Okay.

8           A     I wouldn't -- you know, I wouldn't put too much  
9 stock in it one way or the other because, you know, maybe he  
10 might have, you know, people from the NASD would tell him  
11 who's going to be, you know, the next chairman or, you know,  
12 this is the smart money says. I don't know that I would put,  
13 you know, what inference you would draw from that.

14          Q     Okay.

15          A     They told -- I mean, they did tell me, you know a  
16 lot of, you know, things of the nature of Bernie, you know,  
17 talking, talking and Peter telling me one that once he had  
18 a -- I don't know if it was a sculpture or a painting of a  
19 big screw. And that some Japanese men, I don't know if they  
20 were investors or what they were to tell the truth, but Peter  
21 said that they laughed at -- something to the effect of, you  
22 know, "Oh, this is how you screw your customers." They  
23 thought it was -- or I don't know, something along those  
24 lines, I -- something like that.

25                   But I do recollect that Peter told me that.

1 Although, he told me that after the exam, so -- as a matter  
2 of fact, more recently. But it just goes to, you know, what  
3 Peter's, you know, I think he just thought, you know, there  
4 was a lot of extraneous, non-relevant things being said that,  
5 you know, people might think, "Oh, well, that's interesting  
6 but, you know, who really cares?"

7 Q Okay. All right, why don't we go to the next  
8 document? We'll mark this as Exhibit 27. Okay.

9 (SEC Exhibit No. 27 was marked for  
10 identification.)

11 MS. STEIBER: Thank you

12 MR. KOTZ: Okay, this is an e-mail from Peter to  
13 William Ostrow, 6/1/2005, 11:09 a.m.

14 BY MS. STEIBER:

15 Q Can I ask you a quick question before we go to this  
16 exam?

17 A Sure.

18 Q We've had testimony that in a front running exam it  
19 would be standard practice to request trade data from the  
20 NASD or one of the exchanges. Is that inconsistent with your  
21 knowledge?

22 A Well, I don't know what standard practice is for a  
23 front running exam, but it's not unusual for even  
24 investigations for, you know, and even the enforcement people  
25 to request information, trade information directly from the

1 clearing broker, you know, the -- well, in this case it would  
2 be Madoff itself since -- so, I can't speak to that. I -- we  
3 had no reason not to -- at the time of our examination we had  
4 no reason to believe that the trading was not what it was  
5 purported to be, in question.

6 Q I'm just curious because if the allegation is that  
7 the firm is committing fraud by front running, wouldn't they  
8 have an incentive to give you falsified trade data so you  
9 wouldn't discover the front running?

10 A It would have be a pretty -- yeah, I can see  
11 your -- I take your point. I don't know if it was though  
12 considered -- a standard front running type of a procedure,  
13 but I see your point. But if you get trading activity for x  
14 amount of funds and you see customer statements and things of  
15 that nature, then I guess the idea that, you know, this is  
16 all an elaborate hoax, this would have to be -- as it turns  
17 out it was one of the most elaborate hoaxes. I don't that  
18 thought ever entered anyone's mind, to be honest.

19 BY MR. KOTZ:

20 Q Okay, let me ask you about this document, Exhibit  
21 27. If you go back to the final -- the last page of it, you  
22 see Lamore is emailing you and Ostrow, June 1, 2005? And on  
23 number 2 it says, "Bernie's gut feel tells him when to enter  
24 the market and enter the market. His gut feel includes his  
25 observations to the trading room here in New York, what his

1 European contacts are telling him, what he reads in industry  
2 papers and publications." Do you remember this issue about  
3 Bernie's gut feel?

4 A Yeah. I mean, I -- that's -- that was something  
5 that was mentioned.

6 Q Did the staff find Madoff's explanation credible  
7 that the way he is able to achieve these returns is based on  
8 his gut feel?

9 A I don't know that we ever reached the conclusion  
10 that he wasn't ultimately extracting information from order  
11 flow. We did reach the conclusion that he was not trading  
12 ahead of specific customers. And, you know, we did talk if  
13 he was using -- and this is not just with myself and the  
14 examiners but I guess I, you know, I may have spoken about it  
15 with Bob but I can't say specifically. But I think we did  
16 speak about, you know, that he might be using general, you  
17 know, customer order flow information on a macro level.

18 Q But you were aware at that time that this gut feel  
19 was ridiculous, right? It was ridiculous for anyone to  
20 assume that Bernie has this gut feel by observing the trading  
21 room in New York and know how to time the market exactly  
22 every single time.

23 A I don't think any of us actually believed it was a  
24 gut feeling. We, you know, maybe he was taking advice from,  
25 you know, some of those traders specifically or -- I really

1 don't know. But, yeah, to -- I mean, especially in  
2 hindsight --

3 Q You didn't really think that this could have all  
4 been achieved through Bernie's gut feel, did you?

5 A No, it was, as we said, we never precluded the  
6 possibility that it was something else.

7 Q Okay. And then on page 3 of 4 you could see  
8 there's an e-mail between Ostrow and you and Lamore,  
9 Wednesday, June 1, 2005, 10:14 a.m. I'm sorry --

10 A I'm sorry.

11 Q -- page 3 of 4, where Ostrow says, "Let me know if  
12 there are any transactions during the time period we  
13 requested, February 28th to March 11, 2005 for Kingate, and I  
14 will check to see if they are on the database of orders  
15 entered." Peter Lamore responds, "Hilarious, nothing. Only  
16 transactions on Feb 18 and March 15th."

17 A Yes, I think they ultimately did come to the  
18 conclusion that he was holding some positions that wasn't in  
19 and out trading, I guess is the inference there.

20 Q So was there a particular concern here with  
21 Bernie's or with what you found?

22 A Again, our focus was to look at the trading that we  
23 ultimately did get from him regarding the hedge funds and see  
24 if they correlated to -- so that was the focus of the  
25 examination. I mean, I really can't speak to, you know, the

1 timing issue, whether, you know, we would expect if he had  
2 this strategy that he would be in and out every day or, you  
3 know, that he would -- but I think he said that, you know, it  
4 was generally, in some of the articles it was trade that, you  
5 know, sometimes he did go to cash for extended periods of  
6 time.

7 Q Right. And then if you see on page 1 of 4 Peter  
8 says to Ostrow, "Hey, I'm not quite sure what's going on with  
9 these statements. I'll show you later, but it seems clear as  
10 mud to me." Did the examiners ever report back to you having  
11 trouble understanding what was going on with these  
12 statements?

13 A I don't know specifically what questions he had,  
14 but they may have. I don't know.

15 Q Do you know if the exam staff was ever able to  
16 reconcile the Madoff account statements with the database of  
17 orders?

18 A The account statements for the funds with the  
19 database of orders on the market-making side or -- I'm not  
20 certain.

21 Q See where it -- he says on page 2 of 4 --

22 A Uh-huh.

23 Q -- "I've attached the S&P100 trading data from 1994  
24 to the present. I'll guess that on 1/25 he bought an on 3/15  
25 he sold. Maybe we can look at what the majority of customer

1 orders for those 50 stocks did during the week of data we  
2 had. That may give us a general sense of how the market was  
3 trending."

4 A Okay, let me read that. Okay.

5 Q And then Peter responds, "Hey, I'm not quite sure  
6 what's going on with these statements, it seems clear as  
7 mud." And then Ostrow responds, "That's a funny way but I'm  
8 sure appropriate way to put it. I guess his stomach and gut  
9 were churning if he was buying and selling on the same day."  
10 And then Peter responds, "I'm not sure what he was buying and  
11 selling on the same day, I don't know, but assuming he bought  
12 on or about 1/25 and sold on or about 3/15 he timed the  
13 market pretty well." So it seems as though the examiners we  
14 onto the fact that Bernie's timing was extraordinary.

15 A Oh, yeah, I think that was what it was alleged in  
16 the articles too.

17 Q Okay.

18 A I think going in there we --

19 Q When you say that they were -- that the examiners  
20 in the Madoff examinations realized that Bernie's timing was  
21 unbelievable?

22 A Oh, yeah, I'm sure that they found it to be, you  
23 know, exceptional.

24 Q Wouldn't it be beyond exceptional?

25 A Yeah, there are more things in heaven and earth

1 than, you know -- I would say yes, especially in hindsight.  
2 But again, you know, we went in there to look specifically at  
3 this and I don't know that, you know, there was anything in  
4 the trading that would indicate otherwise. We went in there  
5 to look at -- specifically at the trading, it was sort of a  
6 front end review, we weren't there to really try to see if  
7 the returns he was reporting were correct. I mean, I --

8 Q Okay.

9 A -- it was a very focused review.

10 Q All right. Let's look at this document, Exhibit  
11 28. This is an e-mail that you sent to Bob Sollazzo, June 2,  
12 2005, 10:04 a.m. You say, "Bob, thought you'd find this  
13 interesting."

14 (SEC Exhibit No. 28 was marked for  
15 identification.)

16 MS. STEIBER: What do you think he would find  
17 interesting about the e-mail?

18 THE WITNESS: Okay, let's see. Well, the fact  
19 that -- I'm assuming that he would find it interesting that  
20 the premise of our examination, what we were sent in for was,  
21 according to Peter, there's evidence to disprove that. That,  
22 you know, he in fact, does not seem to be using his customer  
23 order information, his market-making business, in the hedge  
24 fund model.

25 BY MR. KOTZ:

1 right?

2 A Again, what I was trying to satisfy --

3 Q Right, but it's a yes or no question.

4 A I know, I realize that.

5 Q I understand the context but it's still a yes or  
6 now question.

7 A At the end of our examination I could not  
8 definitively say that he wasn't doing anything otherwise  
9 illegal to achieve his outside returns.

10 Q Okay. All right, we're going to go to the next  
11 document, Exhibit 29. This is an e-mail from Lamore to you,  
12 June 6, 2006, 7:47 a.m. And if you see here, Pete says, "We  
13 have still not received the hedge fund contract -- contact  
14 list, nor do the statements contain the address of the 15  
15 entities. We're going to ask him again today for this  
16 information." Do you know if the staff ever received the  
17 hedge fund contact list?

18 (SEC Exhibit No. 29 was marked for  
19 identification.)

20 A I don't know.

21 Q Okay. We'll go to the next one. Okay, the next  
22 one is Exhibit 30, we're going to mark as Exhibit 30. This  
23 is an e-mail from you to Ostrow, cc Lamore, 6/7/2005, 1:47  
24 p.m.

25 In this e-mail below you see Ostrow says to you,

1 "We have been reviewing all the basket trades conducted by  
2 the 15 or so entities using Bernie's proprietary model. For  
3 all of 2004 Madoff executed close to 2 billion shares of  
4 stock, which represents commission equivalent of  
5 approximately 82 million, \$.04 a share. It appears that  
6 without this commission equivalent business derived from the  
7 hedge funds we estimate the firm would loose \$10 to \$20  
8 million per year." On that issue, do you remember finding  
9 out that, in fact, his broker-dealer entity was losing money?

10 (SEC Exhibit No. 30 was marked for  
11 identification.)

12 A Yes. I -- well, I didn't -- I'm not so sure that I  
13 knew -- I recollect that they were losing money, you know  
14 pre-distributions to customer -- to employees and so forth,  
15 but I was aware from William and Peter that the real  
16 money-maker in this was the executions of the hedge funds.

17 Q Was that surprising? Bernie Madoff, this big  
18 market-maker, well-known, find out his market-making business  
19 was losing \$10 to \$20 million a year?

20 A Yeah, well I think the market was -- well, yes, is  
21 the answer to your question.

22 Q Okay. Now, in this e-mail Ostrow says, "We intend  
23 to obtain an expense breakdown for October 2004 to December  
24 2004 to get a better understanding of the commission  
25 equivalent business." And then later in this e-mail he talks

1 about, "We will be researching whether the London office  
2 should be deemed a branch versus an affiliate."

3 And then you respond to him, "Thanks for the  
4 update. Be sure to keep your eyes on the prize. The branch  
5 versus affiliate issue is a secondary, tertiary issue at  
6 best. I don't think we'd get that far with the IA issue as  
7 broker-dealers can, as you know, act in an advisory  
8 capacity." What did you mean by keep your eyes on the prize?

9 A To focus on the issue of front running.

10 Q So, were Ostrow and or Lamore trying to expand the  
11 scope of the exam beyond front running?

12 A I don't -- I think they, you know, I think this is  
13 primarily William behind this.

14 Q Okay.

15 A I don't think Peter was.

16 Q What was William trying to do here?

17 A I thought he thought, you know, there may have been  
18 an issue in terms of like registration of, you know, they  
19 should be registered as an investment advisor or not.

20 Q Yeah, what about that issue?

21 A And again, my general opinion -- well, again, the  
22 focus of the exam was front running.

23 Q Why not expand the focus?

24 A Well, we don't have unlimited time to -- and if  
25 there was a legitimate reason to I think we would have if we

1 found out, for instance, that, you know, he was stealing  
2 customer money and we had evidence of that, obviously we  
3 would have moved in that direction. But the registration of  
4 his investment advisor, you know, that was more an issue for  
5 the IA side --

6 MS. STEIBER: Did you refer it to the IA side?

7 THE WITNESS: I think the -- well, I don't know for  
8 certain when I knew this, but I do believe that the IA side  
9 already knew about it.

10 BY MR. KOTZ:

11 Q How do you -- why do you --

12 A Well, I think Mavis Kelly had been involved. I  
13 think she's like an assistant in the investment advisor side  
14 in OC.

15 Q Did you come to a conclusion in the Madoff cause  
16 exam that Madoff should have been registered as an investment  
17 advisor?

18 A No, I didn't come to that conclusion. And I should  
19 say that, you know, some of that stuff from -- I know that  
20 Mavis Kelly, well I just saw here involved with e-mails that  
21 you showed me, I think she was --

22 Q The OC exam.

23 A -- the OC. Yeah. And in the work papers I know  
24 she was referenced, and that I had seen, you know recently.  
25 I don't know specifically if I knew Mavis Kelly was involved

1 back in the exam, but I do know, you know, that she was now.

2 Q So did William believe that Madoff should have been  
3 registered as an investment advisor?

4 A I -- because coming from this I think it -- there  
5 was probably some indications of this.

6 Q Did you disagree with that opinion?

7 A Oh, well actually, I'm sorry. I'm assuming, you  
8 know, he -- this is branch versus an affiliate not the  
9 investment advisor. But are we -- oh, okay, yeah, so I'm  
10 jumping ahead. Did I agree that he might technically have to  
11 be -- I wasn't sure, but as I mentioned to you earlier,  
12 broker-dealers at that time were generally exempt in many  
13 instances from having to register.

14 Q So why not refer it to the investment advisor side  
15 for them -- you're in a cause exam on the broker-dealer side,  
16 you get information that Madoff maybe should be registered as  
17 an investment advisor, you have another side in --

18 A Well, that was William's take on it.

19 Q Okay.

20 A I don't think he ever really, you know, spelled out  
21 specifically why. And if you look at, you know, the  
22 Advisor's Act, so -- maybe he didn't know --

23 Q Didn't you discourage him from looking into that  
24 issue by telling him to keep his eyes on the prize?

25 A Well, as I said, I thought that -- well, my

1           Q     If you could see there's this issue about  
2 semantics. If you look on the second page Ostrow says to  
3 you, "Here's a quick question, one of the days we requested  
4 trades Bernie was closing a basket. I asked why he did not  
5 have these trades on the CD with all trade entered. Bernie  
6 stated because the basket was originally entered in January,  
7 there were not orders entered in March, only execution orders  
8 place previously. How can this be if a specific price is not  
9 known and you're relying on the fluctuations of 50 stocks in  
10 a basket? Lamore views it as a standing limit order, good  
11 until canceled. What is your take?"

12                     And you respond, "What was the actual language we  
13 used in the report? It could be a matter of semantics." Did  
14 you believe that you were not -- that the examiners were not  
15 sufficiently careful in the language that they used when they  
16 asked for document, Bernie was able to kind of wiggle out of  
17 producing things because of semantics?

18           A     I don't know that that was -- I don't know that you  
19 can generalize to the entire exam from this one e-mail. I  
20 was just more concerned about understanding this e-mail so I  
21 guess I sort of just wanted to get a better idea of  
22 specifically what they asked for.

23           Q     Although, William Ostrow says on page 1 of this  
24 e-mail, "A large portion of this exam has come down to  
25 semantics."

1 A Okay, well I think -- I'm just reading this now --

2 Q Sure.

3 A -- for probably the first time in four years --

4 Q Do you agree with that statement that a large  
5 portion of the exam came down to semantics?

6 A Well, I think he was probably referring to, you  
7 know, is he an investment advisor, does he have -- not is he  
8 an investment advisor, but -- although that was an issue  
9 too -- I think he was primarily referring to were his hedge  
10 fund -- was he acting in an advisory capacity for the hedge  
11 funds.

12 Q But do you think --

13 A We had a hard time getting, as you know, the names  
14 of those individuals.

15 Q Do you think that was an accurate statement that a  
16 large portion of the exam came down to semantics?

17 A Well, that's what he said. Yeah, I'm --

18 Q I'm asking you what you think.

19 A I think early on it was a matter of Bernie trying  
20 to play off and, you know, trying to not identify his  
21 customers in the trading. But I -- towards the end I don't  
22 know if that -- I would categorize it in that way.

23 Q Did Ostrow express a lot of frustration about  
24 Madoff's responses?

25 A I think that's sort of my general recollection.

1 Q Do you think he may have kind of exaggerated that?  
2 I mean did you get the feeling at all that, you know, he was  
3 kind of very frustrated and always claiming that Bernie was  
4 doing this or that but maybe it was a little overblown?

5 A Well, I think I probably eventually reached the  
6 conclusion that if we could identify those hedge fund  
7 customers and get their trading then we could do our job with  
8 this examination. And then regardless of whether we got  
9 there by hook or by crook we would be satisfied that we had  
10 done our job with respect to the allegations.

11 Q So did Ostrow not understand that? I mean --

12 A No, I think he did.

13 Q Did you have any frustration with Ostrow through  
14 the exam where he came kind of pushing for this or pushing  
15 for that or coming back with this and coming back with that?

16 A I don't know that -- I think since then on certain  
17 recent exams I've had some frustration with the timing of  
18 examinations that I, you know, expressed to him that, you  
19 know, this is something we have to move along. But I don't  
20 recollect any specific at that time. I don't know that this  
21 may have been one of the first exams I worked with, directly  
22 with William on. I don't really recall working with him  
23 previously. And I know, as I said, he does have a reputation  
24 as being a good examiner. But I --

25 Q But a slow examiner?

1           A       Well that's just my recollection. It's hard to not  
2 paint a picture in the past with your recent recollections,  
3 but I don't think I had those -- that opinion back then. I'm  
4 just -- there's a specific examination that he worked on that  
5 I had expressed to his branch chief that, you know, this  
6 doesn't seem to be going anywhere and can we please move on.

7           MS. STEIBER: Is there a lot of pressure on you to  
8 complete a lot of exams? To -- for all the exams under you  
9 to get completed within a certain amount of time?

10          THE WITNESS: Well, each exam has a sort of a  
11 completion date we like to get them in. The report has to be  
12 in by, you know, 60 days after the end of field work. And if  
13 the field work goes on too long that's -- there's no hard and  
14 fast rule about field work but, you know, it's generally  
15 viewed that, you know, field work cannot go on indefinitely  
16 because people have a hunch or they're following things.

17           You know, it -- without some legitimate reason to  
18 expand the scope, you know, generally we would like the  
19 examiners to stick to the scope unless in the course of doing  
20 their pre-exam work or in the course of doing what's called  
21 for in the scope they discover something else, then, you  
22 know, they we talk about expanding it. But generally we like  
23 them to hopefully stick to the scope unless otherwise, you  
24 know, it seems logical. And in that case we would change the  
25 scope.

1 BY MR. KOTZ:

2 Q So you feel responsibility to make sure that the  
3 exams are moved on, work is completed, reports are issued and  
4 they move on to the next exam?

5 A I think that's one of my primary responsibilities.

6 Q Okay. Okay, let me show you the next document.  
7 We're going to mark it as Exhibit 32. This is an e-mail from  
8 you to Ostrow and Lamore, 6/16/2005, 8:29 a.m.

9 In this e-mail you're responding to an e-mail from  
10 William Ostrow where he says among other things, "We would  
11 still like to visit some of the hedge funds, example, Tremont  
12 in Rye, New York and Fairfield in Connecticut or New York.  
13 We want to gain an understanding from the hedge funds from  
14 their perspective the strategy used by Madoff." Do you  
15 remember Ostrow saying he wanted to visit the hedge funds?

16 (SEC Exhibit No. 32 was marked for  
17 identification.)

18 A This sounds familiar, this -- mm-hmm.

19 Q Yes? I'm sorry, mm-hmm doesn't --

20 A I'm sorry, yes. Yes, well, this e-mail seems  
21 familiar, I'm still sort of reading it. I don't know if he  
22 says -- he says, "We would still like to visit some of the  
23 hedge funds." Yes.

24 Q Did they visit any of the hedge funds?

25 A No, they did not.

1 Q How come?

2 A Well first of all I don't think it would have been  
3 done until after the report was processed and -- I really  
4 can't say.

5 Q Do you know who decided for them not to visit the  
6 hedge funds?

7 A I don't know if they ultimately agreed that it  
8 would be a good idea for them to visit the hedge funds  
9 either.

10 Q But what was --

11 A He's discussing it.

12 Q What was your opinion on whether it was a good idea  
13 for them to visit the hedge funds?

14 A I think initially I thought it might not be a bad  
15 idea, but --

16 Q You say "initially," what happened -

17 A Well, obviously we didn't visit the hedge funds so  
18 I don't -- and then shortly after the report was issued or  
19 the -- in November -- I really can't say exactly what my  
20 mindset was.

21 Q So you don't remember advising Ostrow -- you see  
22 there's a reference to a meeting, "Let's meet this morning at  
23 11:00." You don't remember in that meeting or subsequent  
24 advising Ostrow and Lamore that you didn't think it was a  
25 good idea to visit the hedge funds?

1           A     Well, I don't specifically remember that but I  
2     imagine I probably would have said that, you know, you can't  
3     just go to customers of a firm, you know, lightly without  
4     raising suspicions of the firm.

5           Q     Okay. Do you remember saying anything about it  
6     would have been a red flag for an \$8 billion client who could  
7     withdraw funds and if they went to those firms the SEC could  
8     be sued?

9           A     Sued? I don't think I would ever say the SEC could  
10    be sued. I may have said something along the lines that we  
11    have to be sensitive to going to customers. And this is an  
12    issue with many exams, you know, you make a call to a  
13    customer about his broker, you can never get that call back.  
14    But --

15          Q     So what would happen if you make a call to customer  
16    about a broker? What do you mean you would never get the  
17    call back?

18          A     Well, if it turns out that the broker had in fact  
19    done nothing wrong -- and we found no evidence of  
20    wrongdoing -- I think ultimately that would have to be some,  
21    you know, something that would -- I would not undertake  
22    lightly.

23                    When I say you can't get the call back I don't mean  
24    you shouldn't contact customers, and in many cases we do, but  
25    in those cases we like to have specific evidence of

1 wrongdoing, which we did not have here. And, you know, as  
2 you say -- or as I say, it can be detrimental possibly to  
3 someone who has not broken the law. I guess we were just  
4 trying to say -- I was -- what I'm trying to say is that  
5 absent any specific evidence of wrongdoing we'd have to be  
6 very careful about going to a hedge fund client.

7           So I don't know if, you know, exactly what the  
8 terminology I used with William or with Peter but I imagine I  
9 would have said something like that. But I don't think I  
10 dismissed it out of hand, you know, initially or at least at  
11 the time of this meeting if I'm saying, you know, let's talk  
12 this morning. So --

13           Q       There's another reference in the e-mail from Ostrow  
14 to you, Wednesday, June 15, 2005, 4:54 p.m. "Option collars  
15 are no longer part of the strategy here at Madoff." Do you  
16 know what that referred to?

17           A       Well, I think as part of the split-strike  
18 conversion, you know, there is an option collar, you know,  
19 where they put the sell a call option and buy a put option.  
20 And Bernie, I think -- I don't know if it was Bernie  
21 specifically, but they -- the examiners were told and found  
22 that, you know, there was no option trading going on at --  
23 during that current period of time.

24           Q       Doesn't that contradict the articles about Madoff's  
25 strategy as well as the documentation provided by OC that

1 showed options transactions?

2 A Well, I don't know -- I don't specifically recall  
3 whether what the OC -- if the OC people saw option collars.  
4 I -- but it contradicts. It says, "Well, the option collar  
5 is an integral part of the strategy."

6 Q Right.

7 A So I imagine you could say, "Well, how can you do a  
8 split-strike conversion strategy without the option collars?"

9 Q Right. So was that question ever asked or it  
10 looked into?

11 A I don't know specifically what his response was as  
12 to why they wouldn't -- or -- maybe this was a -- the  
13 response that the hedge fund itself would have to put on the  
14 collar, but I don't know. I don't know specifically if it  
15 was ever asked.

16 Q Okay. Let's go to the next document, Exhibit 33.  
17 This next document is an e-mail from Lamore to Ostrow with an  
18 attachment. Do you know what this attachment is?

19 (SEC Exhibit No. 33 was marked for  
20 identification.)

21 A Bernard Madoff annual audit write up doc I imagine.

22 Q Okay. You see in this annual audit write up doc it  
23 says, "The annual audit was performed -- prepared by the  
24 firm's independent auditors, Froehling & Horowitz. Do you  
25 know if any inquiry was made into that auditing firm,

1 Froehling & Horowitz?

2 A Oh, I don't think there was, no.

3 Q Had you ever heard of Froehling & Horowitz?

4 A No, I don't believe so.

5 Q Now, given that Madoff didn't use an independent  
6 custodian, directly sends his clients their account  
7 statements, wouldn't the independence of the auditor be  
8 critical?

9 A When you say he didn't use independent custodians,  
10 it seems that -- from our understanding was the trades were  
11 RVP/DVP, that the actual trades were delivered off to the  
12 custodian of the hedge funds I believe. So, you know, and I  
13 don't think -- that's not unusual in the hedge fund world.  
14 I've since come to understand and I think this may have been  
15 our, again, our initial foray into the hedge fund world for  
16 the most part. So I -- the fact that they were not using  
17 their own custodian was sort of offset by the fact that,  
18 well, they didn't have to because they deliver the securities  
19 off to the customer --

20 Q Okay.

21 A -- in an RVP/DVP transaction.

22 Q Okay. Let's go to the next one. The next document  
23 we're going to mark as Exhibit 34. This is an e-mail from  
24 Lamore to Ostrow, 7/5/2005, 8:34 a.m. And then he attaches  
25 to write ups written about the Madoff's hedge fund business.

1 And I guess I'm trying to understand this, it seems as though  
2 these documents simply seem to summarize the articles.

3 (SEC Exhibit No. 34 was marked for  
4 identification.)

5 A Okay.

6 Q What is the purpose of preparing a document that  
7 simply summarizes the articles that you got before you  
8 started the exam?

9 A Oh, well, he may have just been doing it for the  
10 purposes of the -- to have a summary in the work papers. But  
11 I think, you know, obviously we had these articles well,  
12 well, well earlier.

13 Q Right. But it doesn't seem like there was any  
14 analysis in this document of the claims made in the article,  
15 it just seems to kind of recite what the article said. Is  
16 that odd?

17 A I really don't know what, you know, Peter's thought  
18 process was in summarizing the articles when he actually had  
19 the articles and sending it to William. I really can't say.  
20 But it may have been just to summarize them for the -- and  
21 I'm just speculating here, it may have been to summarize them  
22 for the work papers. I don't know.

23 Q Okay. Was there ever a point in time during the  
24 cause exam where you all went back to the articles, looked at  
25 the particular issues, analyzed each issue and, you know, as

1 part of your exam?

2 A Once we found evidence that there didn't seem to be  
3 any correlation between -- in the examiner's -- there didn't  
4 seem to be correlation between the trading done for the hedge  
5 funds and Bernie's market-making business they didn't -- that  
6 seemed to be everything that we were primarily concerned  
7 with. So I didn't know that -- I don't know that there was a  
8 reason, so the answer to your question is no.

9 Q Okay. All right. We'll go to the next one. This  
10 document we're going to mark as Exhibit 35. This is from  
11 Peter to Ostrow, Thursday, July 21, 2005, 9:33 a.m.

12 (SEC Exhibit No. 35 was marked for  
13 identification.)

14 BY MS. STEIBER:

15 Q Do you recall if this summary contains the  
16 conclusions of the exam team?

17 A Trading review doc, I imagine it would just by the  
18 name of it. And I guess to -- this -- since we're getting  
19 into July here, I -- that just sort of reinforces my belief  
20 that perhaps this was to just sort of document things for the  
21 work papers in terms of conclusion. Maybe I -- you know,  
22 maybe I asked for the summary of the work papers, I don't  
23 know specifically. But in any event, we had been in constant  
24 contact so I knew of the issues with respect to the front  
25 running primarily.

1 find that incredulous that he was actually entering the  
2 orders himself.

3 I -- again, was of the understanding that he just  
4 decided when to go in and out of the market and then as long  
5 as the trades hit the parameters of the trading  
6 authorization, which was basically the algorithm, I think,  
7 the algorithm that we got from someone, you know, some -- he  
8 had 200 people working for him.

9 MS. STEIBER: So if he said he did all the  
10 executions himself that would be something you'd want to  
11 investigate, right, because it's so incredulous --  
12 incredible?

13 THE WITNESS: Well, I -- you know, I can't say what  
14 I -- if that -- it sounds, you know, incredulous, but -- that  
15 he actually -- it depends on how he would do executions. It  
16 just doesn't seem, at this point me sitting here today,  
17 likely that he would be able to execute these trades, unless  
18 someone had, you know, done some legwork for him to, you  
19 know, push a button and make it go. So I --

20 BY MR. KOTZ:

21 Q Even if he was just making decisions on when to  
22 enter and exit the market, wasn't he making decisions for a  
23 lot of different clients? A lot of different decisions, I  
24 mean the volume we're talking about?

25 A I don't follow.

1 Q You said that assuming that Bernie was just making  
2 the decision on when to exit and enter the market, wasn't he  
3 making that decisions for a lot of different clients?  
4 Wouldn't that be a lot of decisions?

5 A Well, I thought we were talking specifically about  
6 the hedge fund clients of which there were -- at the time  
7 we -- I don't know, about a dozen or so or less that we knew  
8 about. And my understanding, and I believe this was my  
9 understanding during the examination, is that they were, you  
10 know, they all followed the same --

11 Q Okay, same strategy?

12 A -- strategy.

13 Q Okay. The next one is an e-mail we're going to  
14 mark as 38. It's a copy of the final report on Bernie L.  
15 Madoff Investment Securities LLC dated 9/2/2005, 11:31 a.m.  
16 from Personal Privacy to you and various others. And  
17 this is the final closing report, right?

18 (SEC Exhibit No. 38 was marked for  
19 identification.)

20 A Yes, it looks to be.

21 Q How much involvement did you have in writing this  
22 report?

23 A I would have received a draft and I would have  
24 edited it and/or sent it back for questions.

25 Q Do you remember any particular edits that you made?

1           A     No, I don't remember any specific edits. I'm sure  
2 there were numerous ones. In most of the exams I do -- I  
3 work on, I make significant edits.

4           Q     What about Mr. Sollazzo, would he have been  
5 involved in the editing process?

6           A     Of the exam report? Probably -- no, not in this  
7 particular case, but he would have been, you know, informed  
8 of our findings. As you have seen in the e-mails you've  
9 shown me, you know, he had an interest in what was going on,  
10 so he would have known. And this was an exam that he was  
11 very interested in, whether we were finding evidence of front  
12 running or not.

13          Q     Okay. So, but --

14          A     I don't think -- no, he wouldn't have had final  
15 edit. Generally when it left me -- normally it would go to a  
16 branch chief and they would do the editing, putting it  
17 together and then they would send it to me and then I would  
18 edit again.

19          Q     And do you feel like this was a well written  
20 report?

21          A     Well-written in what context?

22                   BY MS. STEIBER:

23          Q     Strong analysis.

24          A     Well, I believe the examination had strong  
25 analysis. In writing the report, sometimes we think it's

1 better to get the narrative out in terms of getting the point  
2 across rather than putting -- we could have added, you know,  
3 a dozen or so exhibits showing the trading but if we tell the  
4 examination reader what we found and if there are subsequent  
5 questions that's why we have the work papers.

6 Q Okay, if you turn to page 5, I just had a question  
7 about this. It seems like the first paragraph summarizes the  
8 MarHedge article, which you said you had been investigating  
9 the allegations in that article, and the second paragraph  
10 summarizes the Barron's article, which also had allegations  
11 that you were investigating.

12 And then the three paragraphs analyzing those two  
13 articles are just summaries of what Bernie Madoff said.  
14 "Bernie Madoff informed the staff," third paragraph. Fourth  
15 paragraph, "Bernie Madoff states in the article that the  
16 strategy," you know explains it away. And then the last  
17 paragraph is, "Madoff dismisses speculation concerning the  
18 use of the capital --"

19 A Well, that is under the -- yeah, the subparagraph  
20 Barron's and MarHedge articles. So we -- we're just trying  
21 to lay out what the allegations in those articles were, this  
22 is what I'm assuming, and then --

23 Q And then the staff's analysis or the staff's  
24 conclusions are just derived from what Madoff --

25 A Oh, no, no, they did the actual testing that would

1 be primarily in subparagraph A, I believe. No, but that's  
2 just to say, I guess, what his response was in interest of  
3 full disclosure. But the testing is, you know, described  
4 here. And again, this --

5 Q Where's the --

6 A Oh.

7 Q -- the description of how the allegations in the  
8 articles -- what about -- is there a place where the

Investment Adviser #1

9 [REDACTED] e-mails are discussed as well?

10 A I think -- well, that's included in the purpose and  
11 scope.

12 Q Okay. And you felt that all of the allegations in  
13 the [REDACTED] e-mails and in the articles are analyzed  
14 sufficiently in this report?

15 A Well, I wouldn't say that. This is a summary --  
16 it's a summary report. I guess the ultimate conclusions of  
17 each individual testing area and interview that we had would  
18 be in the work papers, but this is, again, it's a summary, it  
19 doesn't include everything. It includes what we believed to  
20 be the most important and pertinent facts.

21 Q And it's typical in a concluding report to  
22 summarize what the registrant said, how they described their  
23 business instead of doing an independent analysis --

24 A Oh, well --

25 Q -- what they think of the allegations?

1           A     I -- well, I think we did do an independent  
2 analysis of the allegation that, you know, precipitated the  
3 examination. This is a summary of, you know, this is  
4 basically giving the firm's response to some of the  
5 allegations. That's not to say that that's, you know, we're  
6 taking everything that he says as gospel.

7           Q     Okay. I'm just going through it. Page 3, which  
8 starts with "Examination findings," it's a summary of the  
9 articles. Page 5 comes from Bernie Madoff, how he's  
10 described his business.

11          A     Yeah, and --

12          Q     Page 6 --

13          A     I'm sorry.

14          Q     -- comes from Bernie Madoff. Page 7 comes from  
15 Bernie Madoff according to BLM model, describing the model.  
16 Top of page 7 comes from Madoff, "according to Madoff,"  
17 "after Madoff decides to implement the strategy." Then we  
18 see beginning of page 8 you say the testing that the staff  
19 has done is described and that goes for one paragraph and  
20 then -- which is concluded on top of page 8. And then we go  
21 into the background, that's all from Bernie Madoff, page 9.

22                 Then the top of that to the middle of the page,  
23 it's the middle of 9. And then the testing, this is the rest  
24 of page 10 and the page 11. And then that's e-mail review,  
25 it's end of the summary of e-mails reviewed and that's the

1 end of the report.

2 Is that typical for a concluding exam to largely  
3 just summarize what the registrant had --

4 A Well, I don't think we're doing it to summarize  
5 what he's saying, I think we're doing it because he was a  
6 source of information about his business. Ultimately, you  
7 know, when you want to talk -- when you want to find out  
8 about someone's business you need to get their explanation of  
9 what it is. And I think, you know, maybe we use the work  
10 "according" too much -- "according to," but ultimately I  
11 think in many of those instances we are just trying to give  
12 explanatory wording to some of the allegations that are in  
13 the article.

14 Well, this is what the article says, this is what  
15 he says, and then ultimately the proof is in the pudding of,  
16 this all comes down to a front running review. And we want  
17 to explain, well, first of all why other -- why -- what  
18 precipitated that review and give a description of how he  
19 does his business, but ultimately it comes down to a front  
20 running review and, you know, the proof is basically in that.  
21 And again, this is a summary report, it's basically used to  
22 summarize the findings of the staff that are, you know,  
23 hopefully more well-documented in the work papers.

24 MR. KOTZ: All right. We'll go to the next  
25 document.

1 THE WITNESS: I guess, I mean, the -- I don't know  
2 if your inference is that, you know, we're relying too much  
3 on him. You know, we didn't rely on him for our testing.

4 MS. STEIBER: But for your trade data you relied on  
5 him, correct?

6 THE WITNESS: Oh, but that's a usual thing, you  
7 know, for -- to get trade data from -- when you come down to  
8 it, all our examinations are books and records examinations.  
9 We rely on the firm to supply us with the required  
10 information and they do so under penalty of law if they  
11 don't. But, you know, we don't have -- well, I'll leave it  
12 at that.

13 BY MR. KOTZ:

14 Q All right, why don't we go to the next document?  
15 This we're going to mark as Exhibit 39. This is an e-mail  
16 later on in time, it's 11/7/2005, 9:35 a.m. from Peter to  
17 you. This is, I believe, if you look -- going through this  
18 e-mail, it starts off with an e-mail from folks in the Boston  
19 office, internally, about a complaint that came forward.  
20 This is the Harry Markopolos complaint.

21 (SEC Exhibit No. 39 was marked for  
22 identification.)

23 A Right.

24 Q And then Walter Ricciardi from the Boston office  
25 sends it to Mark Schonfeld from the New York office and

1 maybe Bob was looking at that?

2 Q So, do you agree that the same issues that were in  
3 the Harry Markopolos complaint were the same issues you  
4 looked at in your cause exam?

5 A I believe one of the issues was the same.

6 Q Okay. What about the --

7 A The Ponzi scheme --

8 Q -- overall, generally, would you agree generally  
9 that, you know, Harry Markopolos comes forward with his  
10 complaint and you guys have kind of already looked at those  
11 issues. Is that a fair statement do you think?

12 A I would not say it's a fair statement to say that  
13 we considered Madoff's firm to be one giant Ponzi scheme.

14 Q Right. So, you would say that in fact -- in your  
15 cause exam you didn't look in at all into the question of  
16 whether Madoff was running a Ponzi scheme, right?

17 A That's correct.

18 Q Okay. Let's go to the next document. The next  
19 document we're going to mark as Exhibit 40. Exhibit 40 is an  
20 e-mail from Simona Suh to you, 11/7/2005, 12:16 p.m. Do you  
21 remember having conversations with the enforcement folks  
22 about the Harry Markopolos' complaint or the fact that they  
23 opened an investigation into Bernie Madoff?

24 (SEC Exhibit No. 40 was marked for  
25 identification.)



1 they're different. Some of them are different in any event.

2 Q And then if you look down on this e-mail it  
3 references the e-mail from Harry Markopolos to Meaghan  
4 Cheung, November 7, 2005, 1:15 p.m. "Meaghan, I spent some  
5 time over the weekend further improving my analysis on why  
6 the Madoff Investment Securities LLC is likely a Ponzi  
7 scheme." So that's the allegation right there in the e-mail.

8 And then Ostrow -- Lamore responds, this is the  
9 same allegations we've heard before. How could he be saying  
10 that?

11 A I think he's -- I think he's referring to the  
12 overall -- again, I'm speculating, trying to put myself  
13 inside his head. I think he's referring to just the thought  
14 that Madoff's firm is doing something illegal, and  
15 specifically, trading ahead.

16 MS. STEIBER: Why don't you respond and say --

17 BY MR. KOTZ:

18 Q Yeah, why don't you respond and say, "What are you  
19 talking about? We didn't look into the Ponzi scheme at all,  
20 we focused entirely on front running. These allegations are  
21 totally different."

22 A When I read -- I imagine when I read, I don't  
23 recall specifically reading this, I know I did, I imagine he  
24 was talking generally about Madoff doing something illegal --

25 Q Right, but then --

1 A -- specifically, the --

2 Q -- if you see in here it says, "I think he's on a  
3 fishing expedition and doesn't have a detailed understanding  
4 of Madoff's operation that we do, which refutes most of his  
5 allegations." So what he's saying is, based on the  
6 information that the exam team had from the cause exam, the  
7 refutes most of Harry Markopolos' allegations. Did you feel  
8 that you had information which refuted Harry Markopolos'  
9 allegations, particularly did you feel you had information  
10 that refuted Harry Markopolos' allegation that Madoff was  
11 running a Ponzi scheme?

12 A I think -- well, I think we had no belief that he  
13 was running a Ponzi scheme.

14 Q But did you have information that refuted Harry  
15 Markopolos' allegation that Madoff was running a Ponzi  
16 scheme?

17 A Did I have information? No, we had information  
18 that it did not appear that he was front running. We did not  
19 consider him running a vast Ponzi scheme.

20 Q Right, so Harry Markopolos comes in, provides a  
21 complaint. The complaint focuses on Madoff running a Ponzi  
22 scheme. It also mentions front running but certainly has a  
23 focus on the Ponzi scheme. How could Peter Lamore think that  
24 the exam, cause exam that you did could have refuted those  
25 allegations?

1 it's a good practice, you know, to start anew.

2 If the enforcement people want to ask you questions  
3 that, you know, obviously I think that's part of our job too,  
4 to assist them when they need it.

5 Q Okay. I think we're kind of toward the end but I  
6 just wanted to ask a couple more questions. We had some  
7 discussions previously about Ostrow and Lamore didn't have a  
8 lot of exam experience, dealing with Bernie Madoff directly,  
9 having a lot of time with Bernie Madoff who was a well-known,  
10 influential figure, charismatic guy. He was able to pull off  
11 a pretty big Ponzi scheme.

12 And I asked you questions about whether they might  
13 have been impressed by Madoff. I want to show you an e-mail,  
14 I'm going to mark it as Exhibit 46 and ask you again whether  
15 you think that these two individuals might have been  
16 impressed by Bernie Madoff.

17 And this is an e-mail from you to Peter Lamore,  
18 June 1, 2005, 7:29 p.m. And in it Mark Schonfeld is saying  
19 to NYRO everyone, "Chairman Donaldson will be stepping down  
20 effective June 30. Here's a link to press release." And  
21 then Lamore writes to you, "Bernie told us he was on the  
22 short list when Chairman Donaldson was selected, maybe this  
23 time." And then you respond, "Maybe you and William could be  
24 his aides."

25 Do you remember at any point Bernie Madoff saying

1 he was on the short list for -- to be the next chairman?

2 (SEC Exhibit No. 46 was marked for  
3 identification.)

4 A To me, no, I don't recall that.

5 Q Do you remember Peter saying that? And it's in the  
6 e-mail, by the way.

7 A Well, it's in the e-mail. I -- he may have said  
8 that but I -- it sounded like this was the first time I'm  
9 hearing it if that's what he writes in the e-mail, but I  
10 can't say for certain. I think, you know, the response is --  
11 was just sort of -- I'm trying to sort of be facetious.

12 Q No, right, I understand that. But my question I  
13 guess is you don't think Peter Lamore and Ostrow, who are  
14 still relatively junior, going in on the exam with Bernie  
15 Madoff. Bernie Madoff is telling them when the -- who the  
16 new chairman is, telling them he's on the short list for the  
17 chairman, telling them all these stories, very charismatic  
18 figure. You don't think they were impressed by Bernie  
19 Madoff?

20 A You know, I -- this is towards the end -- this  
21 e-mail is dated towards, I guess towards the tail-end of the  
22 examination or, you know, certainly well into it and beyond  
23 the half-way mark. So, I don't know how much of an  
24 impression this would have made or had an effect on the  
25 outcome of the exam. I'm certain it would be none. I really

1 don't think, as I said, you know --

2 Q I didn't say anything about the outcome of the  
3 exam.

4 A Oh, okay.

5 Q I just said, in general.

6 A The impression? Well, you could make that argument  
7 but my impression was that, you know, especially Peter  
8 thought of Lamore as sort of -- Peter thought of Madoff as a  
9 buffoon and did not make a spectacular impression at all and  
10 it was certainly no one to be feared in any way.

11 Q What about Ostrow? You don't think Ostrow was  
12 impressed that he was sitting there with Bernie Madoff who  
13 had all these connections, who was talking about how he's  
14 helping the SEC, who knew who the new chairman was, who was  
15 on the short list to be the next chairman. You don't think  
16 Ostrow was impressed?

17 A I don't know if impressed is the right word, I  
18 think sort of maybe wowed. I don't even think that's the  
19 right word, I just --

20 MS. STEIBER: Star-struck?

21 THE WITNESS: I just -- not start-struck, like the  
22 irony of it all that, you know, may perhaps -- and I'm  
23 speculating that, you know, here's this guy and -- you know,  
24 who was -- you know, make -- I believe they said making  
25 copies for him, you know, making copies and he may be a

1     billionaire --

2             MR. KOTZ: Billionaire many -- he's likely a  
3     billionaire.

4             THE WITNESS: Yeah, so I really can't get into his  
5     head. He may have -- I subsequently found out that he had  
6     his wife take pictures of Bernie when he was leaving -- when  
7     Bernie was being brought for arraignment.

8             MR. KOTZ: Who did that, William Ostrow?

9             THE WITNESS: William. You know, but he likes to  
10    take pictures of, as I turn -- found out later, he likes to  
11    take pictures of things and people, of the chairman when he  
12    comes to visit he'll take a camera, things of that nature.  
13    So I don't -- none of those words that you described to me  
14    really seem to fit. Maybe he was, I don't know.

15            MR. KOTZ: Okay.

16            THE WITNESS: Maybe.

17            MR. KOTZ: Okay.

18            THE WITNESS: It's possible but I -- I don't think  
19    that especially -- I don't think that would preclude him  
20    from, you know, focusing on, you know, what we believe was  
21    the proper was to go and look at the trade data and compare.  
22    You know, because regardless of, you know, the stories that  
23    Mr. Madoff may tell and he spoke one -- he told one story, I  
24    don't think I was there for it, but Peter -- Peter told me  
25    about it and maybe William was there when Peter told me too,

1 but it almost makes him -- make Mr. Madoff seem like a  
2 pathetic figure. So I don't think they were, you know  
3 impressed at all.

4 MS. STEIBER: Do you know if Ostrow or Lamore are  
5 interested in getting jobs in the industry eventually?

6 THE WITNESS: No, I have no indication of that.  
7 That would be surprising to me. You know, Peter just came  
8 from the industry and I think he likes his job. I think  
9 Peter likes the job and I think William likes the job as  
10 well. So I would be surprised.

11 MR. KOTZ: Do you think generally the SEC folks,  
12 examiners, investigators, looked into Madoff's operations in  
13 a variety of ways yet they were not able to uncover the Ponzi  
14 scheme, right? Do you think that in some ways, overall, the  
15 SEC folks are simply kind of overmatched by Bernie Madoff and  
16 he was able to snow them?

17 THE WITNESS: Well, the usual downfall of a Ponzi  
18 scheme is when investors stop getting paid, and they -- or  
19 they can't get new investors and that seemed to be the case  
20 with Mr. Madoff. In certain instances I don't know if you  
21 can be proactive when people are, you know, selling interests  
22 and selling their services out the back door and in many  
23 instances just hiding it from the SEC. Again, you know,  
24 we're books and records.

25 So, I really can't say that we were overmatched.