

1 APPEARANCES:

2

3 On behalf of the Securities and Exchange Commission:

4 H. DAVID KOTZ, ESQ.

5 Inspector General

6 HEIDI STEIBER, ESQ.

7 CHRISTOPHER WILSON, ESQ.

8 Office of the Inspector General

9 Securities and Exchange Commission

10 100 F Street, NE

11 Washington, DC 20549

12 (202) 551-6037

13

14 On behalf of the Witness:

15 ROBERT ANDREW SOLLAZZO, PRO SE

16

17

18

19

20

21

22

23

24

25

1 evidence shows the testimony you have given is false, we may
2 refer it as appropriate.

3 Do you understand those instructions?

4 THE WITNESS: Yes.

5 MR. KOTZ: Okay, great.

6 EXAMINATION

7 BY MR. KOTZ:

8 Q Okay, first thing I'm going to put into evidence is
9 Exhibit 1, a Notice of Rights which you were given -- you
10 signed and dated. Confirm to me that this is your signature
11 and -- on Exhibit 1.

12 A That is my signature.

13 Q Okay, great. All right, so we're going to mark
14 this as Exhibit 1. Now we'll start with a little background
15 and then we'll get into some specifics, show you some
16 documents. Okay?

17 Could you describe for me, please, your education
18 beginning with college?

19 (SEC Exhibit No. 1 was marked for
20 identification.)

21 THE WITNESS: Yes. I'm a graduate of Brooklyn
22 College, graduated in 1978 with a BS degree in accounting.
23 After graduating, I took a couple of additional accounting
24 courses because I didn't have sufficient credits to qualify
25 as a certified public accounting accountant. And that's the

1 extent of my formal education.

2 BY MR. KOTZ:

3 Q Okay. What was your first job after college?

4 A I worked for the Comex Clearing Association, which
5 is a clearing association for commodities, futures, exchange,
6 you know, primarily metals, and I was an accountant for them.
7 And that job lasted approximately one year.

8 Q Okay. What did you do after that?

9 A I got a job with the U.S. government. It was the
10 Department of Health Education and Welfare, HEW. And that
11 job was an auditor.

12 Q Okay.

13 A And that job lasted approximately two years.

14 Q And what about after that?

15 A After that I was able to transfer to the Securities
16 and Exchange Commission as an -- I got a job as an examiner,
17 I believe it was at the GS-9 level. And that job entailed
18 doing field inspections. And I was employed with the SEC for
19 about two-and-a-quarter years.

20 Q So that was starting in about 1981?

21 A That's approximately right.

22 Q Okay, so from 1981 for a little over two years you
23 worked as an examiner?

24 A That's right.

25 Q All right. And then what did you do after that?

1 A Then I left because I had some difficulty becoming
2 a certified public accountant, so I went into public
3 accountant -- public accounting for approximately one year, a
4 little less than one year, and was able to work on a variety
5 of audits, a lot in the financial service industry, and was
6 able to get my experience to qualify as a certified public
7 accountant.

8 Q Okay. And then what did you do?

9 A Then I came back to the SEC, this is in -- I
10 believe it was in April of '84, and I came back as a
11 senior-level examiner, at that time I believe it was a GS-12.
12 And came back and did field examinations.

13 Q Okay. And have you been with the SEC since that
14 date?

15 A Yes.

16 Q Okay. So what promotions have you received over
17 time?

18 A Okay, the dates are going to be approximate.

19 Q Sure.

20 A I was promoted to a branch chief, I think it was in
21 '87 or so, 1987. And then about a year later I was promoted
22 to an assistant director -- and then in -- it was probably
23 about 1988 or so, okay? And then in -- I believe it was 1992
24 I was promoted to an associate regional director and I've
25 acted in that capacity -- I've had that job ever since.

1 Q Okay. Give me, generally, the duties that you had
2 when you were a branch chief.

3 A As a branch chief my duties were to do field
4 examinations. I spent a lot of time in the field doing
5 examinations of large broker-dealers. I was also involved
6 with writing reports, supervising staff, and reviewing
7 reports as well.

8 Since I was, you know, pretty experienced with
9 large firm examinations, in my -- you know, my position as a
10 branch chief was a little bit unusual, you know, I spent more
11 time in the field than most other branch chiefs because I was
12 more of a sort of technical expert and so I spent more time
13 in the field.

14 Q Okay. What about as an assistant director, what
15 were your --

16 A Assistant director, again, I spent quite a bit of
17 time in the field continuing, you know, -- step up in
18 responsibilities and also providing more guidance to staff,
19 you know, I was -- I think at that time instrumental in
20 getting together like a new method of hiring people, which
21 was, you know, a the very -- you know, at the very early
22 stage in people leaving school, it would be the GS-7 level,
23 you know, going to schools, you know, and outreach programs
24 at schools.

25 It was also -- you know, reviewing reports,

1 managing the branch chiefs that were assigned to me. I think
2 there was two branch chiefs assigned to me at the time but
3 I'm not 100 percent certain on that, it was like one or two.
4 So it was still field work mixed with more -- a step up in
5 supervisor responsibilities.

6 Q Okay. What about when you began as an associate
7 regional director?

8 A As an associate director -- you know, still going
9 out in the field a fair amount of time -- in the early years,
10 anyway. At that time, we had two associate directors. Marty
11 Coverberg was the other associate, so he was in the office,
12 more working with the administration of program.

13 Once again, I was more the technical expert so I
14 spent a fair amount of time in the field. But then again,
15 you know, more administrative responsibilities, you know,
16 taking more responsibilities for training and reviewing
17 reports, you know, it would be more large firm type of
18 reports that I would be involved in, those type of issues.

19 BY MS. STEIBER:

20 Q How many days a week would you expect your branch
21 chiefs to be in the field?

22 A We talking about currently or --

23 Q Currently. For an exam, how many days --

24 A It really varies. I encourage the branch chiefs to
25 be in the field as much as possible, but it does vary

1 depending upon the seniority of the staff that's involved. I
2 have a number of senior staff now, but I encourage people to
3 be out there as a branch chief. Even as an assistant
4 director because I think it's real important that people have
5 their eyes and ears open in doing that review work while
6 they're in the field where the work's ongoing. I would hope
7 it would be, you know, a day or two a week, that's not always
8 possible, okay? And sometimes with the experienced examiners
9 it's unnecessary so it's really -- it really does vary.

10 Q So if you had a junior examiner you'd expect them
11 to be in the field more.

12 A It would be more, exactly.

13 BY MR. KOTZ:

14 Q What about assistant directors, how much time would
15 you expect them to be in the field?

16 A They're in the field less, you know, because we do
17 have quite a few branch chiefs at this point. I -- we have
18 about 12 or 13 in the broker deal inspection program. Once
19 again, I encourage the assistant directors to be out in the
20 field as well. Especially in the large firms, the large
21 firms, you know, I think there we need, you know, that type
22 of coverage.

23 BY MS. STEIBER:

24 Q Why?

25 A Well, the issues at large firms tend to be much

1 more complex. You know, there's -- first of all we assign
2 more people to those exams, you know, it could be six to
3 eight people on a large firm exam. Issues are more complex
4 and, you know, I think the assistant directors, I have
5 several that are very experienced with large firm
6 examinations and it's important that they share their
7 knowledge, train people and guide people.

8 You know, I don't want people coming back, you
9 know, with an exam report and dropping it on the assistant
10 director's desk for review, you know, that's not what we
11 want, especially large firm exams. You know, we want, you
12 know, we want the process to be pretty integrated
13 so -- especially with large firms I want -- you know, I
14 expect the assistant to be out there. We're
15 somewhat -- again, this would always happen -- most of the
16 time I'd say it does with large firms. With smaller and
17 medium-size firms I don't think that happens.

18 BY MR. KOTZ:

19 Q So if you had a six-week exam, how many days would
20 you expect the assistant director to be there?

21 A Now, what are we talking about, are we talking
22 about --

23 Q Well, either. I mean, tell me first for a large
24 firm and then for a medium-size.

25 A Okay, for small medium-size firm I would not be

1 surprised if they're not out there.

2 Q At all?

3 A At all, yeah. In which, you know -- again, you
4 have a branch chief. Okay, we have a branch chief that, you
5 know, maybe will be out there, I mean, you know, but
6 depending on experience level of the staff. But for small-,
7 medium-size exam it's -- it possibly would not go out.

8 For a larger exam I would hope that the assistant
9 director would be out there at least once or twice to make
10 sure, you know, things are going well. We don't have a
11 standard amount, like they're, you know, saying you have to
12 be out there once a week or have to be out there, you know,
13 twice a week, you know, it's not like that. A lot of it
14 depends upon your supervisor who's assigned to the exam, the
15 nature of the exam. So it, you know, there's no hard answer
16 to that question.

17 Q And --

18 A And, you know, it really does, you know, some of
19 the assistant directors could add a real lot and they're real
20 interested in working the field, so if sometimes they do want
21 to get out there just to -- just sort of to add what they can
22 add.

23 Q And what about as an associate director? Would you
24 be out in the field at all for an exam?

25 A That's my favorite part of the job, which

1 unfortunately, I do less and less these days. I do go out,
2 but it's not to the level that I would like. You know, I go
3 out on large-firm examinations, you know, occasional
4 meetings, sometimes exit interviews. In the course of like a
5 very large exam I could be out there once or twice. And, you
6 know, I'm talking about, you know, the biggest firms, the
7 large bracket firms. I don't generally go out for medium,
8 even some of the smaller large firms. And sometimes I don't
9 go out. Sometimes I will not go out because you're just
10 pulled in a lot of different directions.

11 And also, one of the things that I have to be
12 concerned about, I have a number of very -- you know, very
13 capable assistant directors who have been with me over
14 15 years, and -- you know, I have to -- you know, trust their
15 abilities, too. You know, these are very seasoned people
16 and, you know, I've worked with them over the years and I
17 don't want to sort of, you know, overstep in my authority at
18 times or upset what they're trying to do. So, you know, I've
19 got to deal with -- I try to balance that.

20 Q Okay. All right, let me ask you some questions
21 about tips and complaints. Go back to -- wait, before I get
22 to that, you were associate regional director from 1997 to
23 the present?

24 A I'm sorry, it was 1992.

25 Q '92, I'm sorry, 1992 to the present. And how many

1 assistant directors did you have generally during that period
2 of time under you?

3 A It has grown. I think when I first started out it
4 may have been -- it was like two or three and now there's
5 five.

6 Q Okay, who are the five now?

7 A [Personal Privacy], [OCIE Assistant Regional Director] John Nee, [Personal Privacy]
8 [Personal Privacy] and -- someone's going to be mad at me -- oh,
9 God -- [Personal Privacy]. Oh, if [Personal Privacy] knew -- forgetting [Personal Privacy]
10 name, boy.

11 Q And how long has Mr. Nee been in that capacity
12 under you?

13 A Excuse me -- John has been in that capacity a
14 number of years. I would estimate it's eight years or so,
15 ten years. It's been a while.

16 Q Okay. All right. So, with respect to handling
17 tips or complaints, going back to the 2004 time frame, okay?
18 Were there formal policies and procedures for handling tips
19 or complaints in the New York office in 2004?

20 A We have a group, we have a -- there's several
21 different, you know, I think, groups that handle complaints
22 in the office. But during that period in the broker-dealer
23 section we have a complaints group that would -- you know,
24 different complaints from the public would be routed to that
25 group and then there's a staff attorney, she's actually a

1 senior special counsel that reports to me, Ellen Hersh, and a
2 branch chief Sandy Sadwin who provide oversight for that
3 group.

4 Q So are there formal policies and procedures that
5 they're supposed to follow?

6 A Written policies, not to my knowledge. But you
7 know, there are general policies and it's been discussed but
8 we don't have like a sort of a rule book of specific
9 policies.

10 Q So do they log the complaints in somewhere when
11 they get them?

12 A Yes, I believe they do.

13 Q Do you know where?

14 A I am not sure.

15 Q Okay. And do they follow up from there once it's
16 logged in? What would they do once it's logged in?

17 A They take some action, either depending upon
18 whether, you know, they believe it's something that's
19 relevant for the staff to investigate. If they think, you
20 know, talking about the complaint analysts, if they think
21 it's something that the staff should investigate it would
22 probably be referred to Ellen Hersh who then would evaluate
23 it. And if she thought it was something interesting she
24 would speak to me about it, either speak or send me an e-mail
25 about it, that's generally how it works.

1 Q So let's --

2 A Sometimes, you know, an analyst would also go to an
3 assistant director, that type would happen also. I just want
4 to make clear that there are other complaint systems as well.
5 I think there's an Enforcement complaint system --

6 Q Right.

7 A -- complaints, tips and referrals, which -- you
8 know, goes on in Enforcement. I have less knowledge of that
9 system, but, yeah, I just want to make you aware that it
10 exists.

11 Q But let's say a complaint comes in and it's looked
12 at, the determination is they should do a cause exam based on
13 the complaint, right?

14 A Yes.

15 Q So then they would refer it to you or an assistant
16 director?

17 A It would go to Ellen Hersh. She would, you know,
18 if she thought it would -- it merited an examination, she
19 would generally speak to me about it and then we would, you
20 know, if we thought it was a very hot item, we'd try to get
21 someone signed immediately. If not, we have -- you know,
22 these reports that we put out weekly, we put it on the front
23 page of the report as an item to consider for future exams.

24 Q Now, would she follow up to make sure that it
25 actually does develop into a cause exam?

1 A She generally would monitor that report.

2 Sometimes, you know, she'd come in and say -- and tell me,
3 "Bob, there are some items that are unassigned on that facing
4 page for a while," and I would be made aware of that. But --

5 Q Okay.

6 A -- generally people were pretty good assigning them
7 out.

8 Q But if there was some time that went by after the
9 complaint came in and it was -- the determination was made to
10 have a cause exam but the cause exam hadn't been initiated,
11 Ellen would go and say, you know, "Where are we on this?
12 What's going on?"

13 A I get a copy of that report, you know, I'm getting
14 the weekly report. And she may come into my office and
15 remind me that this hasn't been assigned.

16 Q Okay.

17 A Would that happen in every case? I'm not sure.

18 Q Okay.

19 A Okay?

20 Q Okay. Let me show you an e-mail. We're going to
21 mark it as Exhibit 2. And this is an e-mail dated 11/2/2004,
22 2:56 p.m., from OCIE Assistant Regional Director to a variety of people. And
23 then below that you can see there's an e-mail from you to a
24 group of people dated Monday, October 25, 2004, 9:10 a.m. and
25 it references following up on an e-mail from Mark Schoenfeld.

1 (SFC Exhibit No. 2 was marked for
2 identification.)

3 THE WITNESS: Can I read this --

4 MR. KOTZ: Sure.

5 THE WITNESS: Okay.

6 BY MR. KOTZ:

7 Q Okay. And there you can see attached to it is a
8 memo from you and Richard Lee to all BBIP staff, subject:
9 complaint, tip, referral procedures. And it says, "In
10 January 2004 the Commission institute a new procedure for the
11 processing of complaints and tips received from the public."

12 Do you know what -- why there was this new
13 procedure instituted?

14 A I believe it was a result of some past problems
15 that occurred with complaints received.

16 Q Okay. And so this CTR process, were you involved
17 in this?

18 A It was sort of an odd system. You know, we had
19 some involvement, obviously from these documents, but it was
20 not something that, sort of, we controlled or had, you know,
21 free access to. So it was strange, based upon what I
22 understand, we -- you know, we can't directly access that
23 system in the exam program. It was more an
24 Enforcement-type -- you know, tracking system for complaints.

25 But -- you know, when it first came out I

1 understood our obligation is to make sure that -- you know,
2 if we opened up something that related to a complaint we
3 should be inserting something -- making sure it's inserted
4 within the CTR system. And this is what these memos were
5 about.

6 Q So you -- we talked before about a situation where
7 a complaint would come in and it would be referred for a
8 cause exam. Were there other situations where a complaint
9 would come in and it would be referred to Enforcement through
10 this kind of process?

11 A I have rarely referred to Enforcement, personally.

12 Q Okay.

13 A You know, I have heard of complaints being referred
14 to Enforcement by our analysts -- the complaint analysts. I
15 don't believe it is done through this CTR process, per se, I
16 think they just -- you know, let some of the complaint
17 people -- the Enforcement people -- duty officer in
18 Enforcement who handles the complaints, during the period
19 with Jason -- they give them some awareness of the matter.

20 Q But it says in here, "Following up on
21 Mark Schoenfeld's recent e-mail, we are obligated to report
22 to Enforcement any significant complaints, tips or referrals
23 that we've become aware of."

24 Mark Schoenfeld was the head of the office?

25 A Right, right.

1 Q So what is this referring to? You -- it says in
2 here you're obligated to report to any -- to Enforcement any
3 significant complaints, tips or referrals.

4 A Well, if we got a complaint -- you know, in -- and
5 it would be through one of our analysts generally, okay, or,
6 you know, sometimes, you know, we got an informant or
7 something like that which -- someone to complain, and we
8 decided to do a cause exam as a result of that complaint,
9 then we should reporting it through the CTR system. Okay?

10 Q And then --

11 A So it's a little bit different than, you know, than
12 you referring a complaint over to them.

13 Q Okay. And so is the idea there that then
14 Enforcement will have that information so they can look at it
15 and determine whether, in addition perhaps, to a cause exam
16 or maybe instead of a cause exam, Enforcement decides to do a
17 full-blown investigation or open a MUI.

18 A Yeah, it's possible. I think they also just wanted
19 to track what was coming into the house. I think that was a
20 part of the process.

21 Q But who would --

22 A I don't recall being pushed aside and saying, you
23 know, "We're going to do an investigation," on one of these
24 matters that we sent over.

25 Q So who would have access to the CTR system? You

1 said it would be Enforcement; right?

2 A Yes.

3 Q Okay.

4 A It's Enforcement.

5 Q So --

6 A Yeah, I don't know exactly who David has access to
7 that system, but I know that we do not routinely have access
8 to that system.

9 Q Okay. But I mean the purpose of this system put in
10 place in January 2004 was to have matters that that came in
11 as complaints that you were doing cause exams on, reported to
12 Enforcement in some manner.

13 A That's what I understand, yes.

14 Q Okay.

15 MS. STEIBER: And do you know if this system was
16 implemented throughout the examination program, in the other
17 offices and in headquarters, or was this just a change to the
18 New York program?

19 THE WITNESS: I am not sure how it was implemented
20 in other offices.

21 MR. KOTZ: Do you know if, generally, complaints
22 that came in that initiated cause exams were reported in this
23 system?

24 THE WITNESS: I don't know for sure. I don't know
25 if all complaints -- that process were reported.

1 MR. KOTZ: Okay.

2 MS. STEIBER: Is this system still in place?

3 THE WITNESS: I believe it is.

4 BY MR. KOTZ:

5 Q Okay. Let's say the determination was made to do a
6 cause exam based on a tip or a complaint. How would one
7 determine the focus of that exam?

8 A Well, generally, the way it works, you know, with a
9 complaint, it's pretty specific, you know, the language of
10 the complaint -- sort of a lead-in in terms of what to do.
11 But, you know, before a cause examination is undertaken we
12 would look for similar complaints, obviously, that's one of
13 the things that we consider. But then there would generally
14 be a discussion with, you know, the staff assigned, you know,
15 the branch chief, possibly the assistant director do some
16 research on the firm and try to make the determination what
17 else should be covered during the course of the exam,
18 determine the scope of the examination.

19 Q Okay.

20 A But the primary scope is going to be sort of that,
21 you know, that complaint.

22 Q Okay. But so who would make the final decision in
23 determining the scope of the exam based on a complaint?

24 A It's generally the branch chief working with the
25 assistant director. It's that sort of dialogue that should

1 be going on.

2 Q So at the associate director level you wouldn't
3 necessarily get involved in that?

4 A I could get involved in some, you know, and I have
5 been involved in some cause exams where I've opined and had,
6 you know, have indicated, you know, I want this included in
7 the scope.

8 Q And so when you were to get involved you would be
9 the one who made the final decision because of your position?

10 A That's right. But, you know, many times, you know,
11 this is -- you try to hear different people's views and
12 frankly, sometimes I'm not close enough or I'm wrong. And
13 so, you know, occasionally, you know, I'll defer to the
14 judgment of someone who maybe is a little bit more
15 knowledgeable in a product area or maybe has a little bit
16 better insight. So, you know, that sometimes does happen.
17 But ultimately, I'll concur.

18 Q Right, but in the end it'll be your decision, even
19 if your decision is based on what somebody else said?

20 A That is correct.

21 BY MS. STEIBER:

22 Q And you said at the beginning you look for similar
23 complaints. Do you look just in the New York office or is
24 there a system where you can see complaints that have come in
25 throughout the Commission on the firm?

1 A They look in the New York office and then, you
2 know, they would try to do like some sort of review of the
3 ACT system nationwide and try to see what else --

4 Q The ACT system?

5 A Yeah, I believe that's the acronym for the
6 complaint system, nationwide complaint system, which, you
7 know, we have access in New York and I think we had searched
8 like New York based complaints, but then it's a more global
9 system so it's a nationwide system as well. But that, again,
10 is apart from the CTR system.

11 Q Okay. And all of the complaints are also supposed
12 to be logged into this ACT system? Or all the exams are
13 logged into the ACT system?

14 A The exams are not logged in, the complaints that we
15 receive should be logged into that ACT system.

16 Q And was that in place in 2004?

17 A I believe it was, yes.

18 Q Okay.

19 A I believe so, you know, because it -- there has
20 been changes in the complaint system over the years, I'm not
21 sure when point of change occurred. Okay?

22 BY MR. KOTZ:

23 Q What about in terms of other exams, how would one
24 determine that? Would you look at the Starz System?

25 A In terms of other exams --

1 Q Yeah.

2 A -- going on at an entity when considering an exam?

3 Q Yeah or if they'd done an exam two years
4 previously, I mean wouldn't that be something you would do
5 when you start an exam to see if somebody else had done an
6 exam at some point?

7 A Absolutely. You review past examination reports.

8 Q How would you figure that out?

9 A You get that information from Starz. We also have,
10 you know, most of the time if you look at a broker-dealer in
11 our region you have access to our PD drive, you know,
12 regional drive, and has all the reports there so you could do
13 a search with reports there, but Starz is probably the
14 easiest way and that's the way it -- you know, I know I've
15 checked that on occasion to see when the last exams are and
16 that's probably the most practical way.

17 Q What about NRSI, would you do an NRSI search before
18 you did an exam?

19 A Generally, NRSI searches are done as part of the
20 exam process.

21 Q But they wouldn't pick up an exam they would only
22 pick up investigations?

23 A Right, right, indications of investigations. But
24 that becomes very important, especially, you know, in
25 cause-related matters.

1 Q Okay.

2 A Okay, so we want to know what's out there, what the
3 landscape is, so it is generally done.

4 Q Okay. Now, you receive a tip or complaint and the
5 determination is made to begin a cause exam. How long would
6 it normally take from the time the tip or complaint is
7 received until the cause exam was initiated?

8 A I don't think there's really typical there. You
9 know, if something, you know, we hear someone is stealing
10 money, it's going to be quick, we're going to try to move
11 quickly on that. If it's a Ponzi scheme where someone's
12 stealing money we're going to try to get the staff out as
13 soon as possible.

14 Q Are there situations where --

15 A -- it could be the same day, it has happened the
16 same day. But what we try to do is -- the reason I answered
17 it's hard to answer and I think you'll understand this, is
18 depending upon what the matter is we have to get staff that,
19 you know, if it's a technical matter, has some background in
20 that. I may not have anyone who is available. At any point
21 in time I have a large number of exams going on in a program,
22 especially these big firm exams, you know, we have six,
23 eight, ten people out there, you know, and I just can't take
24 people off those exams.

25 So sometimes you have to wait for certain exams to

1 end and the people roll off those exams. So, it's a matter
2 of getting the correct -- the right expertise and having
3 people available. So it's sometimes very hard to judge.

4 Q So, sometimes it will take months?

5 A It could take months.

6 Q Okay, years?

7 A I would not hope years, especially -- if we deem
8 it's a significant complaint I would not expect it to take
9 years. Sometimes it could take months, though.

10 Q Okay.

11 BY MS. STEIBER:

12 Q So you don't think there's any point that it takes
13 too long, more than a year. Like let's say it takes nine
14 months to get out, do you think that that is too long to --

15 A It depends upon what the issue is, what the
16 circumstance is.

17 Q What if --

18 A Nine months, it could conceivable happen. You
19 know, if you're really looking at a very technical matter and
20 we're trying to match a person we believe has the appropriate
21 skills, you know, it could happen. Some of the exams -- I've
22 had exams go on for quite a while and then sometimes people
23 are needed on other matters, you know, so it -- sometimes it
24 could take a while. Nine months is getting long, though I
25 hear what you're saying.

1 BY MR. KOTZ:

2 Q And how long should it take normally to complete a
3 cause exam?

4 A It varies. It could be a week, it could be several
5 months. It depends upon the investigative work that's
6 necessary, and part of what we do, and I'm sure you've
7 probably seen a fair amount of this in your own review, is we
8 review e-mail. And that e-mail is a wild card. You know, in
9 the cause exams it's very important and that sometimes takes
10 a while to get, and then once we get it we got to review it,
11 so it takes time.

12 Q So, usually a fixed period of time that is
13 determined before the exam starts in terms of, say being
14 onsite, that the cause exam is supposed to take --

15 A We generally try to give people estimates of the
16 amount of time -- you know, the expected field work time.

17 Q Okay.

18 A That's what we try to do. Those are not hard
19 numbers, though --

20 Q Okay, so if there's --

21 A -- they can change.

22 Q -- if there's a situation where they're doing an
23 exam and they still have questions at the end of that time
24 period, they could extend it?

25 A That's right.

1 Q And would you say they should extend it in that
2 situation?

3 A Yes. Well, the process is they should have
4 discussion with their branch chief and assistant director,
5 you know, and try to get that extension. And, yeah, we
6 frequently go longer than that sort of planned period, which
7 sometimes gets me a little annoyed to be quite honest, but I
8 understand, you know, the -- especially with matters that are
9 of a cause nature or possible Enforcement referrals, I
10 understand we have to put the time in, we have to review the
11 e-mails, so I understand it going long.

12 Q Why would it get you a little annoyed?

13 A Well, I'm trying to run a program which is diverse,
14 aggressive, and we're trying to conclude a number of exams
15 each year.

16 Q Right.

17 A So, with that and trying to have some sort of
18 reasonable time limits for exams to be done in. And, you
19 know, each exam is a little bit different, staff is a little
20 bit different, but it -- if I have certain exams that are
21 oversight and we don't have too many findings, you know,
22 those are the exams I expect to be tighter and to be closer
23 to that estimated time frame. Cause exams are a little
24 different if you don't know what direction they're going to
25 go in.

1 Q Is there a particular number of exams that you kind
2 of look to complete in a year?

3 A Yeah, generally we do. We have projected numbers
4 we work out with the Office of Compliance and Inspection of
5 Examinations, so, you know, we have that number.

6 Q And the assistant directors are aware that there
7 are certain numbers of exams that they're kind of responsible
8 to make sure move along?

9 A They have an awareness that we have to complete a
10 certain number of exams per year. We don't sort of divide it
11 up and say, "You got to do 25, you got to do 25," because,
12 you know, I may have an assistant director doing, you know,
13 very large -- firms, that person's not going to do but maybe
14 three to five exams a year. So, overall, we try to complete
15 that, you know, that target, the exam target. And, you know,
16 most of the times we're successful, this year we're running
17 very tight, other years we've missed, but you know, we try to
18 meet it to the extent we can.

19 Q And so the assistant directors are aware that there
20 is an interest in the office to ensure that the exams move
21 and are finished so that you guys can get the work in?

22 A Absolutely. Absolutely.

23 Q Okay. But there are situations where -- are there
24 situations where you have an exam, there's a particular
25 focus, and then once you get in there you decide to enlarge

1 the focus?

2 A That happens, you know, it happens all the time and
3 we're -- you go in there and you may see something a little
4 bit different and you have to address the --

5 Q And would that kind of situation cause the exam,
6 potentially, not to get finished within the original time
7 period because now you're looking at something else?

8 A It could, yes.

9 Q Okay. So -- but I mean, are there situations where
10 you feel like there was a particular focus of the exam, that
11 was the focus that you were supposed to look at. They looked
12 at that focus, you know, the time period is ending, you know,
13 we have responsibilities vis-a-vis other matters, and at this
14 point it doesn't make sense to change the focus and kind of
15 start from scratch?

16 A Well, you know, it depends upon what we're finding.
17 If we're finding something that could be significant and we
18 think that there may be some securities law violation, yeah,
19 I would encourage people -- you know, to go further.

20 You know, it's something that -- you got to try to
21 balance all the needs of the program, but it, you know, if
22 there are issues, potential issues out there that may lead to
23 securities law violations -- I'm not talking about if it's
24 somewhat highly technical and not that substantively -- can
25 cut this down, you know, we would cut it down. But if it's

1 something that could be meaningful in some sort of
2 substantive way, you know, we should expand that exam.

3 Q Okay. Okay, let me ask you some question about
4 Bernie Madoff. Probably not surprised that that would
5 surprised at some point.

6 A Not surprised at all.

7 Q When did you first hear of Bernie Madoff from
8 Madoff Securities?

9 A Oh, God, I don't know the exact date. It was
10 probably sometime in the '80s -- heard of Madoff, Madoff
11 Securities.

12 Q And what was your awareness of him or his firm at
13 that time?

14 A My awareness was that he essentially sort of
15 created a third market, was a big market-maker and -- both in
16 listed and over-the-counter securities. And there was
17 certainly knowledge of Bernie Madoff.

18 Q And then over the '90s, you were also aware that he
19 was continuing to be kind of a leading industry figure?

20 A That is correct.

21 Q Okay. Did you ever hear any whispers at any point
22 about Bernie Madoff, in terms of maybe he wasn't doing
23 something right or --

24 A Whispers --

25 Q Like in the industry, people kind of saying, "Oh,

1 you know, he's a little not kosher, so to speak," to use
2 Bernie's --

3 A Well, you know, obviously there was something that
4 led to our examination that took place in 2005.

5 Q But I mean before that. I mean before that.

6 A Way back when, I think in the -- I think it was the
7 mid-'90s, I believe I heard of Madoff being involved with
8 investing money for certain individuals and they were -- I
9 believe it was Avellino & Bienes.

10 Q Right.

11 A Yeah, they were sort of -- you know, they would
12 charge by the commission with some sort of offering fraud,
13 and from what I understand, they had their money invested in
14 Madoff. And Madoff was able to sort of get the money back
15 and so, you know, there was charges in offering fraud against
16 the individuals and Madoff himself was not charged.

17 Q All right, we'll get into that a little bit more in
18 detail. Have you ever met Bernie Madoff?

19 A I don't recall meeting Bernie Madoff.

20 Q Okay. Talk to him on the phone?

21 A No, I have not.

22 Q Other -- have you met other members of the Madoff
23 family?

24 A Yes, I met Peter Madoff and Shana Madoff.

25 Q What were the circumstances -- when you met them?

1 A It was the day I was first notified about a
2 potential Ponzi scheme and I essentially went running up with
3 a couple staff members, Peter Lamore and Mike Cress and a
4 number of people from Investment Management. It was on a
5 Thursday, I think it was December 12th --

6 Q Oh, this is 2008?

7 A Yes.

8 Q Okay.

9 A This is the big Ponzi scheme.

10 Q Okay, so --

11 A So, that's when I, you know, first met these
12 people.

13 Q What -- did you have conversations with them or --

14 A Oh, yeah. Yeah. We introduced ourselves and we
15 wanted to know what was going on. We were trying to meet
16 with FBI agents and get a full understanding of what was
17 going on at the time.

18 Q So that was in the context of post-Madoff
19 confession investigative --

20 A That's right.

21 Q -- examination activities. Okay. Prior to that,
22 prior to December 2008, had you ever met any other member of
23 the Madoff family?

24 A No.

25 Q Okay. Okay, yeah, let's show you a document, we're

1 going to mark this document as Exhibit 3. This is a
2 memorandum dated November 16, 1992 to Demetrios Vasilakis and
3 Former Examiner #2, and you are cc'd on it
4 and it references a NASD cause examination. John J. Gentile,
5 chief broker-dealer inspection program.

6 First, is Mr. Gentile -- was that an SEC employee;
7 do you know?

8 (SEC Exhibit No. 3 was marked for
9 identification.)

10 THE WITNESS: John was an SEC employee, yes.

11 BY MR. KOTZ:

12 Q But do you know if he was an SEC employee at this
13 time? Was he with NASD at that time?

14 A No, the -- Gentile was an employee of the SEC at
15 this time, Gentile worked for me.

16 Q Okay. So -- and if you can look in this document,
17 it's a several page document, the last two pages are comments
18 and it says, "Pursuant to an assignment memorandum dated
19 November 16, 1992, a cause exam of Bernard L. Madoff, BLM,
20 was conducted to verify certain security positions carried
21 for the accounts of Avellino & Bienes. The need for the
22 examination was triggered by events involving an
23 investigation of A&B, specifically the staff filed court
24 papers seeking a preliminary injunctions on November 18,
25 1992, in U.S. District Court Southern District of New York."

1 Is this the matter you were just referring to?

2 A Yes, that's correct.

3 Q So were you aware that there was a referral to the
4 NASD to do a cause exam?

5 MS. STEIBER: First of all, is that what occurred
6 here?

7 THE WITNESS: This was a staff examination, it was
8 not something that was referred to the NASD to do an
9 examination, this is a staff examination.

10 MR. KOTZ: SEC staff examination?

11 THE WITNESS: That's correct. That's right.

12 MR. KOTZ: Okay.

13 BY MS. STEIBER:

14 Q So what's the reference to the NASD on the cover
15 page, NASD cause examination on the cover page?

16 A It's just noted that the SRO is the NASD but the
17 examination was done as a cause examination as opposed to an
18 oversight exam. It's just sort of noting which is the
19 self-regulatory organization that's responsible for the firm.

20 Q And so why did the SEC do a cause examination in
21 this case?

22 A This was related to that offering, again,
23 Avellino & Bienes that was mentioned. It's referenced right
24 here on the third page. And it was a need based upon the
25 concern that it may be some sort of a fraud.

1 Q And what was your involvement in this cause
2 examination?

3 A I was not involved in this cause examination to my
4 recollection. I did -- I do recall hearing bits and pieces
5 of the matter, you know, because John worked for me, but, you
6 know, [Personal Privacy] did a lot of the Enforcement-related work at the
7 time. And I remember --

8 Q Who's [Personal Privacy]

9 A [Personal Privacy] -- I'm sorry, [Personal Privacy]. He was
10 the -- another associate director. He was a little more
11 senior to me so he did more of the Enforcement-related work.
12 But -- go ahead.

13 Q No, say -- and John Gentile, you said that he
14 reported to you at the time, were you an assistant director
15 or an associate director at the time?

16 A I think I was an associate director at this time.
17 It was right around the time I think I was promoted to
18 associate director, so either -- you know, tail-end of my
19 assistant directorship or an associate -- it was -- '92 is
20 the time period, okay?

21 Q And do you remember, did Enforcement refer this to
22 the exam program?

23 A This was a strange little world back in the day
24 here. We had -- back in the, I think late '80s and early
25 '90s, we had our own Enforcement group in broker-dealer -- it

1 was called Broker-Dealer Enforcement. I think there was a
2 similar-type group in investment management. And so -- you
3 know, there was as many as 15 attorneys -- Enforcement
4 attorneys -- that reported up ultimately to Personal Privacy
5 And -- you know, he was heavily involved in that part of the
6 business. But I became involved also, especially to the
7 extent something was referred over out of the exam program I
8 became involved as well.

9 Q So was this exam done by these Enforcement
10 attorneys within the BD group or is this done by someone
11 else?

12 A John Gentile was an examiner, okay? And it was
13 done by John Gentile, I guess he was a branch -- I'm sorry,
14 branch chief at this point with an examination background, so
15 it was done by John, you know, as a branch chief. And I
16 guess Demetrios worked with him as well, he was a junior
17 examiner.

18 Q So would you say that they performed this exam and
19 if they had found that Madoff had been committing some
20 securities violation they would have then referred it to
21 their own Enforcement people?

22 A It would have been referred to Enforcement
23 immediately, absolutely.

24 Q So it would be Enforcement people within the BD
25 group, or --

1 A That's right. That's right.

2 Q And can you tell in this exam what occurred?

3 A Based upon my recollection and what I'm seeing here
4 is they did an asset verification of the Madoff position
5 because there was concern that there's no securities there.

6 BY MR. KOTZ:

7 Q Right, I mean, wasn't there a concern in that
8 matter that there might have been a Ponzi scheme? Wasn't
9 that referenced?

10 A There was that concern. I -- you're right.

11 Q And what -- do you remember why there was a concern
12 that there was a Ponzi scheme going on?

13 A I believe the amounts of money involved were very
14 large, like \$400,000 to \$500,000 -- 4- to \$500 million -- you
15 know, the numbers were quite large. I'm not sure but it
16 states here. And it seemed like a very unusual circumstance
17 to have Madoff investing the money. And also I think the
18 returns were deemed to be, you know, pretty high. The
19 returns were consistent and high.

20 Q So, in this cause exam that the SEC did, did they
21 look into the question of whether there was a Ponzi scheme?

22 A They went in to verify whether the assets existed.
23 And Madoff would have claimed that there were certain
24 positions, you know, supporting the, you know, the customer
25 holdings, you know, the monies that were invested to run the

1 program, whatever the program was at that point in time. And
2 we were doing an asset verification to make sure the
3 positions were in place. And from what I'm reading here and
4 from what my recollection is, we found the securities did
5 exist.

6 MS. STEIBER: Okay, I have two questions.

7 MR. KOTZ: Go ahead.

8 BY MS. STEIBER:

9 Q Okay, if you look on the first page of that memo
10 they say that the staff's review was a direct result of
11 NYRO's investigation of A&B. And you had said previously
12 that the BD group had its own Enforcement group.

13 A That's right.

14 Q Was it the BD's Enforcement group that had been
15 investigating and filed the suit against Avellino & Bienes?

16 A That is correct.

17 Q Okay. And so at that point they then referred it
18 to the examiners to look at Madoff. Do you know how that
19 occurred?

20 A What I believe happened here, and part of this is,
21 you know, what I can recall and then also my understanding of
22 how things worked, is that obviously if we have an offering
23 fraud there's a lot of money involved here, and then the
24 question is, you know, how are the assets going to be repaid
25 and -- you know, does Madoff have the wherewithal, does he

1 have the actual assets he's claiming to be. So that's more
2 of an exam function. You know, it could be -- could
3 Enforcement do that, too? They probably could do it, but
4 with examiners who are accountants, finance people, probably
5 more able to do that so it was flipped over to us. And we
6 worked very closely with Enforcement, as we do today,
7 so -- you know, we took on that responsibility.

8 Q And if you see the second page of the memo there is
9 a reference to the staff tracing all of BLM's stock record
10 positions to the DT participant statement for November 12,
11 1992. And it said, "The staff observed that BLM's stock
12 record exactly matched the DTC participant statement. It is
13 also noted that all positions were segregated at DTC and not
14 in any type of loan account."

15 Okay, my first question is can you tell from this
16 memo or from your memory whether the records were actually
17 sought from DTC or if these DTC records came from Madoff?

18 A I don't know from reading this document and I don't
19 recall because I wasn't really actively involved in the exam.
20 Typically, however, we would rely on third-party records,
21 records in existence at a registrant. This is a special
22 circumstance because we suspect fraud. I don't know if we
23 went to DTC, we may have but I'm not sure.

24 BY MR. KOTZ:

25 Q And why would -- in this kind of situation, would

1 you go to DTC? What's the purpose of that?

2 A Well, in this type of situation, if there's
3 potential fraud is it possible that someone could falsify a
4 document? You know, confirmation from an independent
5 third-party is a much, you know, better form of evidence in a
6 third-party document.

7 Q So if you were investigating as they were here,
8 whether Madoff was running a Ponzi scheme, you would go to
9 DTC?

10 A I would go to DTC.

11 Q Okay.

12 BY MS. STEIBER:

13 Q Okay. Here it also says that the positions were
14 segregated at DTC. Could you explain what that means?

15 A DTC has several locations for a particular
16 participant, you know, one could be like a pledge for a bank
17 loan, one could be in a segregated account free of any lien
18 or claim, and that's what this means.

19 There's, you know, probably four or five
20 sub-accounts and somebody could be segregated for commodities
21 purposes, sometimes pledged to OCC, you know, which is for
22 option positions. So, there's various possibilities.

23 Q Now in this case when they say "segregated," are
24 they talking about that his -- these discretionary accounts
25 are segregated from the market-maker accounts? Can you tell?

1 Starting with the paragraph "through prior requests to
2 the --"

3 A That would not be what they're referring to. It
4 would mean that the securities are in a segregated account at
5 DTC. Okay? Again, they would be free from any lien or claim
6 at DTC. Because, you know, a participant could take those
7 securities and pledge them for a bank loan or try to convert
8 those securities into cash and that was a problems that rule
9 15(c) purport.

10 Q Okay. And in this case, if you went to DTC he
11 would obviously have -- Madoff would have market-maker trades
12 that would be reflected at DTC. How would you as examiners
13 be able to tell which DTC records go with these discretionary
14 accounts as opposed to the market-maker accounts?

15 A Well, when you get a stock record from a
16 broker-dealer it should contain all the firm's proprietary
17 and customer positions. Okay? So, you know, it's composed
18 of, you know, long entries, which basically show ownership,
19 you know, you have various customers long and then you have
20 the firm long accounts. Then you would have the short
21 accounts, which are locations, which would, you know, should
22 be the DTC, OCC, possibly bank loan pledges. And they should
23 equal one another. Okay? But it should be the entire firm's
24 custodial holdings, both for its own proprietary positions
25 and customers.

1 Q Okay. So how difficult would it have been in this
2 case to go to DTC and to find out that Madoff had actually
3 had -- made these trades for these clients?

4 A I don't know how difficult it would have been.
5 It'd probably be a -- you know, I would say a letter and
6 a -- I don't know if we had a formal order of investigations,
7 we get a formal order we could send a subpoena. It probably
8 wouldn't have been -- the regulated entity also, you know, so
9 we could get the information, you know, from them because
10 they're a regulated entity. But I will say, normal course
11 during that period, you know, there was tremendous reliance
12 on third-party documents. Okay? Now in this situation --

13 Q What do you mean by that, "there's tremendous --"

14 A Documents are existent -- you know, that are
15 received by a registrant from a bank, DTC, whatever. You
16 know, so that's a third-party document that examiners would
17 be relying upon as opposed to confirming directly to
18 depositories or directly to a bank.

19 Q So even in a case where there's allegations of
20 fraud you would rely on what the registrant provided?

21 A I think there's good reason not to, you know,
22 especially in hindsight. But, you know, back then, you know,
23 I wasn't heavily involved in this back then, you know, I
24 could see a reason to send out, you know, an independent
25 confirmation.

1 BY MR. KOTZ:

2 Q And so do you know what was done on the
3 investigative side to look into the issues related to Madoff
4 particular -- I mean, in that matter?

5 A I don't know a huge amount. I know there was a
6 review that was concerned about Madoff, whether they had the
7 assets, don't have the assets. I knew we did some sort of
8 review but I wasn't, like, heavily involved.

9 Q But was the review mostly the cause exam by the
10 examiners or was there investigative steps that --

11 A I believe it was basically the examiners.

12 Q Okay.

13 A I don't believe the Enforcement staff got heavily
14 involved in that.

15 Q Okay. Do you have any idea why?

16 A Generally it's because the examiners would -- you
17 know, the accountants, finance people are more familiar, you
18 know, with those types of records and the verification
19 process. And again -- you know, we worked very closely with
20 Enforcement, and today we still work -- you know, on a
21 matter -- a bigger matter. Not every matter, but -- you
22 know, a fair number of matters we work very closely, so it
23 becomes almost like an investigative team.

24 Q Right. So this issue came up related to
25 Avellino & Bienes and they looked at the question of whether

1 Bernie Madoff was involved in fraud and the actions that they
2 took were to conduct this cause exam, verify the assets and
3 then close the matter. Is that right?

4 A That's what I understand.

5 Q Okay. Is John Gentile still with the SEC?

6 A No, he's not.

7 Q Do you know where he is now?

8 A He was with a consulting firm, National Regulatory
9 Services, but if -- you know, several years there. I haven't
10 spoke to him in a couple of years, a year-and-a-half, two
11 years. He started out on his own. He's with another
12 consulting firm but it's, sort of, he's a partner in a
13 consulting firm and I don't --

14 Q Is he in the Washington area or New York area?

15 A No, no, I believe he's in New York or Connecticut.
16 He lives in Connecticut.

17 Q Okay. What about Demetrios Vasilakis?

18 A Demetrios is no longer with us. Demetrios is at a
19 hedge fund now, I think it's Atticus Capital is the name of
20 it.

21 Q Okay.

22 A I still -- I saw Demetrios about a year ago for
23 lunch and still, you know, e-mail with him periodically.

24 Q And those are the two people that you remember
25 being most involved in this cause exam?

1 A I don't remember a lot about the cause exam.

2 Q Okay.

3 A Okay? But based upon the document that you're
4 showing me and the names and the way it's reading, those
5 would be the two that would be most involved. I remember

6 Gentile's involvement because I remember in talking to Personal Privacy

7 and overhearing one or two conversations with Personal Privacy

8 Q Okay. What about Personal Privacy is he still with the
9 Commission?

10 A No, Personal Privacy is no longer with the Commission. Personal Privacy

11 he's sort of like semi-retired. He does some consulting
12 work, though.

13 Q Okay.

14 BY MS. STEIBER:

15 Q Do you know if you referred your findings to the
16 NASD?

17 A I don't believe these would have been referred to
18 the NASD. There's nothing -- no letter went out here, they
19 don't get copies of these reports. Back at this time I don't
20 even think, you know, even if we had findings I don't think
21 we were routinely sending them to the NASD. We do that now,
22 but back then I don't think we were.

23 Q So when you do a cause exam of an SRO you don't let
24 the NASD know about the cause exam?

25 A That is right. They may sometimes learn about it,

1 you know, because we -- sometimes we'll speak to them to try
2 to get information and they'll have sort of an awareness.
3 They may not -- let me sort of back up a little
4 here -- they -- if we find nothing -- if we find any
5 deficiency they get a copy of the deficiency letter, okay,
6 which outlines the deficiencies, you know, that's been in
7 place for a number of years now. If we find nothing, I don't
8 believe they get a notice -- although, you know, we do -- we
9 send out this letter saying, basically -- you know -- to the
10 firm that we found deficiencies in our examination. I'm not
11 100 percent sure that goes to the NASD. It may or may not.
12 I'm just not sure in terms of that correspondence. But any
13 sort of findings -- you know, we would have would go on a
14 cause exam.

15 Q Do you think it would be a better practice to share
16 complaints that you receive about an SRO with the NASD or is
17 there a reason why that wouldn't be a good practice?

18 A I think it would be a good idea. I think the
19 complaint process should be as integrated as possible and we
20 should share as much information as possible with the NASD on
21 the SROs.

22 Q And would you say that the collaboration right now
23 with the NASD needs to be improved?

24 A I think we generally work well together. I think,
25 though, we don't have access to each other's information

1 maybe as well as we should. I think there could be more
2 sharing of information. But, you know, in terms of
3 complaints, you know, we have very frequent conversations
4 with the NASD, you know, before we start exams there's
5 usually conversations. We -- there's FINRA now, I'm
6 sorry -- we get periodic updates on large firm issues from
7 them and we generally have good communication, we get their
8 reports, we send them our letters, so, you know, that's
9 happening. The complaint side, you know, probably, you know,
10 a better access to that information on a routine basis would
11 not hurt, would be helpful.

12 Q Did you have any involvement with the 1995
13 oversight examination performed by the SEC?

14 A I don't -- that examination.

15 Q Okay.

16 BY MR. KOTZ:

17 Q Do you recall any other examinations of Madoff
18 other than the '92 one we just discussed and the 2005?

19 A I know other exams were performed, but I really had
20 no involvement with them, per se. Okay?

21 Q Okay. But in 2005 you did become involved in a
22 cause exam, is that right -- of Madoff?

23 A That's right. As -- again, as an associate
24 director here I had felt we had a pretty good staff assigned
25 to this matter.

1 Q Okay. Who were the staff assigned to that matter?

2 A It was -- John Nee was an assistant director, Peter
3 Lamore and William Ostrow.

4 Q Okay. And who was the branch chief on that matter?

5 A There was no branch chief assigned on that.

6 Q Okay. Any particular reason?

7 A Sometimes assistant directors assign examinations
8 directly to staff.

9 Q Okay. So that happened --

10 A It does happen occasionally. Does it happen
11 frequently? I would say not really, but it does happen
12 occasionally.

13 Q So does the assistant director's role change when
14 there is no branch chief on an exam?

15 A It does change to an extent.

16 Q Would the assistant director be required to be
17 onsite more like the branch chief would be if there's no
18 branch chief on an exam?

19 A Okay, again, required is -- I don't think we have a
20 standard of, you know, an examiner -- that a branch chief or
21 assistant director has to be out a certain number of days,
22 but the expectation is that since there's no direct
23 supervisor that they'd be more involved in the day-to-day
24 work of the examination. And that may involve more frequent
25 visits to the firm.

1 Q So would you expect if there was an exam and there
2 was no branch chief that the assistant director be onsite
3 more than just a couple of days in an exam?

4 A You know, it would really depend upon the matter.
5 You know, you get into the experience of staff and what the
6 matter involves.

7 Q Okay. And how did you determine who to put on the
8 team, in terms of Lamore and Ostrow?

9 A You know, I think -- you know, I had
10 conversations -- I'm trying to recollect as best I can -- I
11 believe I had conversations with John and I think we
12 recognized that we needed someone -- experience --

13 (Interruption to proceedings.)

14 THE WITNESS: We don't have too many people like
15 that, unfortunately, in the office. We believe
16 Peter -- Peter does have some trading experience, Peter
17 Lamore, so we felt he would be a good fit, so we wanted to
18 have him on that exam.

19 And the second person, I'm not exactly sure how we
20 decided on William, but William tends to be a very good
21 investigator. He's a little bit out of the box -- you know,
22 his thinking. He's very good with e-mail reviews and he sort
23 of looks at things a little differently, so you know, it
24 would probably be a good fit working with someone like Peter.
25 But I think Peter was really -- you know, one of the

1 primary -- you know, the primary person that we want in
2 there.

3 And John Nee, he was a sophisticated guy who's done
4 a lot of work, large firms, but also understands trading
5 practices probably better than most of the assistant
6 directors.

7 BY MR. KOTZ:

8 Q So who was considered the lead between Lamore and
9 Ostrow?

10 A I believe it was Peter.

11 Q Okay. Did he have more experience than Ostrow?

12 A I don't think so, I'm not sure, but I don't think
13 so. It's possible William had a little more experience, but
14 you know, given this -- the nature of this exam it would be
15 probably more natural for Peter to be the leader. I -- you
16 know, it's sort of a little odd, you know, sometimes you
17 have, like, two senior examiners and who's really leading it,
18 it's not clear. Usually, it's the order shown on the
19 assignment memo sort of has the lead. That's sort of the way
20 we generally work it.

21 Q Okay. And what was the level of their experience
22 in terms of actually doing examinations, Peter and Williams
23 at that time?

24 A I don't recall specifically. I know they each had
25 at least a few years experience -- I believe they each had a

1 few years experience. You know, I think, you know, William
2 probably had a little more and I think Peter, you know, had
3 some industry-related experience, not necessarily exam
4 experience, but he had some exam experience as well.

5 Q Okay.

6 A I'm not sure when Peter came onboard, though, but I
7 know they both had some exam experience under their belt.

8 Q And what initiated that cause exam of Madoff?

9 A We received a notice from our investment management
10 examination team discussing --

11 Q Okay. All right, let me show you that document.
12 Okay, we're going to mark this document as Exhibit 4. This
13 is a memo from Dorothy Eschwie to you and Richard Lee,
14 April 22, 2004. It's a cover memo with several pages of
15 attachments which are e-mails.

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

18 THE WITNESS: Okay.

19 BY MR. KOTZ:

20 Q Okay. Is this the memo with the attached e-mails
21 that triggered the cause exam of Madoff in 2005?

22 A Yes, it is.

23 Q And how did you determine -- let me back up. Who
24 determined the focus of the 2005 cause exam of Madoff
25 Securities? You said earlier that, you know, sometimes you

1 would get involved, sometimes you wouldn't, in this case, in
2 the Madoff 2005 cause exam, who determined the scope or
3 focus?

4 A Well, to a great extent, you know, this complaint
5 sort of outlined a concern, you know, with trading practices
6 primarily, and other issues as well, but -- with trading
7 practices. So with that, you know, I knew that was going to
8 be one of the central themes of the exam. In terms of what
9 else was covered, that would be the, sort of, exam team
10 working together.

11 Q But -- so was there a particular focus that was
12 determined after reading the documents? And if so, who
13 determined that focus? Or was it just that the information
14 was brought to the exam team and they should do an exam about
15 the information in these documents, the Eschwie April 22,
16 2004 memo and attachments?

17 A Well, this, you know, came to our attention
18 as -- you know, obviously given to the exam team. In terms
19 of the focus, you know, clearly, you know, the allegations
20 here were something we were going to focus on, anything
21 beyond that would be sort of determined by the exam team
22 working together. And part of that would result from the
23 pre-exam work, to the extent we find other issues during the
24 pre-exam work, or issues that would sort of amplify our
25 concern here, you know, and I think we found a couple of

1 indications that other people felt similarly about Madoff.

2 But it would -- you know, I know I wanted an exam
3 done of this entity because these practices outlined here,
4 you know, they were a concern. They were a concern and it
5 looked more like, you know, this seemed to be abusive trading
6 practices. And at that time I knew we had a lot of focus on
7 order leakage, you know, leakage of information, customer
8 order information, front-running, it was just a big issue
9 that was -- and it's still an issue in the marketplace now.

10 Q So you referred or instructed John Nee and the team
11 to do a cause exam based on the information that you received
12 from Dorothy Eschwie, is that right?

13 A That is basically it. You know, it would be -- I
14 spoke to John and John sort of worked to get a team, once he
15 identified a team, you know, I believe he spoke to me about
16 it. But I think we sort of identified Peter as one person we
17 wanted on it.

18 Q So, John's instructions were to do a cause exam
19 based on the information that Dorothy Eschwie provided you,
20 is that right?

21 A That's basically it. Structure a cause exam, you
22 know, targeting this issue. That's right.

23 Q Okay, did you read and review these documents
24 yourself when they came in or did you refer them on just to
25 John --

1 A No, I read through them.

2 Q Okay. So let me ask you a couple questions about
3 some of the specific points, okay? If you look at the third
4 page, which is an e-mail, you can see the third paragraph
5 down it says, "Another point we make here is that not only
6 are we unsure as to how [Personal Privacy] makes money for us, we are even
7 more unsure as to how [Personal Privacy] makes money from us, i.e., why does
8 he let us make so much money? Why doesn't he capture that
9 for himself?"

10 Do you know what the point was here? Later on it
11 says, "It's not clear why Madoff allows an outside group to
12 make \$100 million per year in fees for doing absolutely
13 nothing unless he gets a piece of that."

14 A Well, I believe what the writer was saying is why
15 is he allowing us such a significant return, which seemed to
16 be an interesting point. It was -- I was concerned with that
17 point.

18 Q Okay. And then if you could see later on in that
19 same paragraph it says, "The point is that as we don't know
20 why he does what he does we have no idea if there are
21 conflicts in his business that could come to some regulators
22 attention. Throw in that his brother-in-law is his auditor
23 and his son is also high up in the organization, imagine
24 that, and you have the risk of some nasty allegations, the
25 freezings of accounts, et cetera, et cetera." Was -- is that

1 a point that would be something to be concerned about -- to
2 look into?

3 A Certainly, what's outlined there should be
4 considered. Obviously the conflicts issue, you know, is a
5 big consideration. You have a brother-in-law who's an
6 auditor, that's obviously an issue. It's a family-run firm.
7 You know, there are red flags here.

8 Q Okay. Do you know whether in the 2005 cause exam
9 this issue was looked at, whether the brother-in-law was an
10 auditor, potential conflicts, that red flag you identified?

11 A Well, I believe the conflicts issue was looked at
12 very thoroughly, the conflicts issue being the potential for
13 front-running. The using of information that was coming in
14 to the market-making business to somehow advantage, you know,
15 the firm's other business which would be that advisor
16 business. So, you know, that I sort of read as the conflict,
17 you know, possibly front-running or using that information in
18 some way to sort of improve returns, you know, for the
19 advisor business and have, you know, Madoff profit from that.

20 Q So did they in the cause exam, the 2005 cause exam
21 of Madoff, did they look at the auditor to determine if it
22 was his brother-in-law or otherwise?

23 A I don't recall that as being part of the review.

24 Q Okay. All right. Now, if you can turn to the next
25 page you see in it, it says, "We at Investment Adviser #1 have totally

1 independent evidence that Madoff's executions are highly
2 unusual." You see that? You remember noting that particular
3 phrase when you read the -- read through these e-mails?

4 A I recall questions about the execution practices.

5 Q Okay. Do you know if anyone in connection with the
6 2005 cause exam of Madoff went to Investment Adviser #1 and asked them
7 what their "totally independent evidence that Madoff
8 executions are highly unusual" was?

9 A I -- I'm not certain but I don't believe that was
10 done..

11 Q Any particular reason why that wouldn't be done?
12 If you have information that says they have totally
13 independent evidence of something that seemed to be relevant
14 to the exam why wouldn't they go back to Investment Adviser #1 and ask
15 them what that totally independent evidence was?

16 A Sometimes what happens is if you go to people
17 within the industry asking about another party they're not
18 that forthcoming. I think that sometimes happens. Maybe
19 that was the thought process here, but I'm not sure.

20 Q But in retrospect would you acknowledge that that
21 was clearly a mistake not going back to Investment Adviser #1 and
22 asking them what the totally independent evidence was?

23 A Given what we know now I'd have to agree with you,
24 yes.

25 Q Okay. All right, let's go on to the next page,

1 which is another e-mail. I'll ask you about some things in
2 here. If you look at point four, talking about options,
3 option volume, they say, "We examined the issue before, we
4 concluded maybe he does the options in the OTC market. We've
5 spoken to several market-makers in OTC equity options, none
6 of them claim to see any significant volume in OEX options."

7 Do you remember what this issue referred to? What
8 were they talking about here in terms of not seeing any
9 significant volume in OEX options?

10 A From what I understand, Madoff's strategy
11 requires -- which is a -- some sort of a
12 conversion -- split-strike conversion strategy, requires the
13 use of options. So I guess this point is questioning the
14 volume of options in the over-the-counter market to sort of
15 accommodate the strategy, and then having parties who sort of
16 are acting as counterparties.

17 Q Okay. Was that an issue that was looked into in
18 connection with the 2005 cause exam of Madoff?

19 A I don't know specifically.

20 Q All right, let me show you the next part of this.
21 In part five in this e-mail it says, "Are we to believe that
22 the market-makers would take on 15 billion of market risk on
23 the close. Of course, they might be willing to take the
24 option risk if Madoff provided the market hedge in the
25 underlying, i.e., they did the whole package with Madoff.

1 But we already know the trades in the underlying compared
2 with the closing price would leave the OTC counterparty
3 showing losses as our account always shows gains."

4 And then if you look at the next page it says, "But
5 the risk must be covered somewhere if he's doing these trades
6 at all. So we need an OTC counterparty, not necessarily a
7 bank, who's willing to do the basket of the options plus the
8 underlying with Madoff at prices unfavorable for the OTC
9 counterparty in 10- to 15 billion." And then later he says,
10 "None of it seems to add up."

11 Do you know what they were getting at there with
12 this issue with the counterparty?

13 A Essentially, what they're saying is you need some
14 sort of a counterparty who's willing to take on substantial
15 risk at what would appear to be unfavorable OTC options
16 prices.

17 Q Does that make sense to you as a red flag?

18 A It seems to be a red flag, yeah.

19 Q And so was there anything done in the 2005 cause
20 exam of Madoff Securities that looked at this issue?

21 A I don't know specifically.

22 Q Okay. Now you notice in here on that same page it
23 says, "But the risk must be covered somewhere if he is doing
24 these trades at all." And then previously there's a
25 reference to the fact that "he is claiming to do these

1 options but none of them claim to see any significant volume
2 in OEX options."

3 So reading this document -- these e-mails; doesn't
4 it seem as though there's at least a possibility there's the
5 implication here that Madoff may not be executing trades at
6 all?

7 A Well, given what we know now, I'd have to agree
8 with what you're saying; however, I guess my first read of
9 these documents when we looked at it, it just appeared more
10 that there were execution issues and potential abuses in that
11 regard. Options, obviously, would be part of trading, that
12 would sort of be considered -- look at the -- option
13 executions.

14 Q Okay. Well, let me show you an e-mail, actually,
15 we're going to mark as Exhibit 5. This is an e-mail from
16 Dorothy Eschwie to you, 5/11/2004, 5:21 p.m. and it -- below
17 it is an e-mail from you to Dorothy, May 11, 2004, 3:22 p.m.
18 And so -- you know, you say initially at 3:22 p.m. to Dorothy
19 in response to these -- the memo that Ms. Eschwie provided to
20 you that was dated April 22, 2004, "We have looked at the
21 e-mails forwarded to us, done some research on Madoff. We
22 believe this matter worthy of an examination when resources
23 permit. Since the trading scheme appears somewhat complex we
24 will have to assign an experienced examiner who is
25 sophisticated in knowledge of options. When the time is

1 right we will strike." So, clearly, you understood the issue
2 of options being a critical issue in this exam, right?

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

5 THE WITNESS: That's right.

6 BY MR. KOTZ:

7 Q And then you say also, "The story, especially the
8 consistent high returns earned over an extended period, makes
9 you wonder." What did you mean by that sentence?

10 A What I was saying is that it looked like there was
11 a possibility of some sort of manipulation, fraud,
12 and -- because of the high returns, consistent high returns.

13 BY MS. STEIBER:

14 Q So you expected the examiners would look and
15 analyze the returns?

16 A I don't know if that was an expectation. See, we
17 do broker-dealer exams, you know, and outside -- we're not
18 expert in sort of portfolio trends and returns over time, you
19 know, it's not something that we spend a huge amount of time
20 doing.

21 Q But don't you have examiners --

22 A I think, though, the returns, to the extent we get
23 that information -- you know, for these accounts and
24 portfolios, it would be something that we should consider,
25 you know, -- the trend of those returns. But, you know, what

1 I'm getting at is we don't necessarily have the, you know,
2 that sort of discipline in terms of doing comparatives to
3 other portfolios. It's not something that is ordinarily done
4 in our exams.

5 BY MR. KOTZ:

6 Q Right, but obviously -- you know, this is a very
7 important matter, very important question. And I know that
8 certainly, you know, you are going to stand up for people who
9 work for you, you know, you have loyalty. But at the same
10 time, you know, this is kind of a critical question, so I
11 want to just have you think about the answer. I mean, isn't
12 it a fact that you essentially when back to this team and you
13 gave them the documents that Dorothy Eschwie provided to you
14 on April 22, 2004 and asked them to look into the issues in
15 these documents, correct?

16 And then you say, specifically, to Dorothy, "The
17 story, especially the consistent high returns earned over an
18 extended period, makes you wonder." Weren't you saying to
19 them, "You need to get to the bottom of the issues in the
20 e-mails that were attached to the Dorothy Eschwie memo. And
21 you need to get to the bottom of this question of the
22 consistent high returns." I mean, weren't -- didn't you
23 understand that that was the appropriate issue and weren't
24 you instructing the staff to look at that?

25 A Absolutely. You know, we wanted to understand how

1 he was earning, you know, those sort of high returns, you
2 know, whether there could be any sort of abusive practices
3 that were sort of -- that were leading to those high returns.
4 You know, that was clearly part of the scope of the exam.

5 Q Okay.

6 A And that would require looking at sort of
7 executions and, you know, understanding the trading strategy.
8 I don't know if my expectation was for the staff to do an
9 extensive portfolio analysis of returns going back three
10 years, though, because that's generally not the way we
11 approach our exams. You know, it's more of, you know, here
12 are the nuts and bolts, understand the trading strategy, we
13 sort of know there's -- size returns, you know, why is this
14 happening? Dig in and try to figure out what's happening.

15 Q Okay.

16 BY MS. STEIBER:

17 Q Did you think of assigning someone from the
18 investment advisor exam team to this exam since you have
19 these hedge fund issues and these return issues that they
20 specialize in?

21 A Never did. Never did.

22 BY MR. KOTZ:

23 Q You didn't think about it?

24 A Never considered it.

25 Q How come?

1 A Well, part of the reason is we didn't work that
2 many joint exams, we rarely did joint exams at that time.

3 Q Right, I mean it --

4 A We're a bit better now, and I've -- frankly, I felt
5 also that if it related to broker-dealer trading practices
6 that we could figure it out.

7 Q But isn't it fair to say that that was not
8 something anybody thought about, bringing in the other side?
9 They did their exams, you did your exams, the two didn't do
10 them together at that time.

11 A We rarely did joint exams at that time.

12 Q So when did --

13 A I don't know if we did any back in this period.

14 Q Right. So it wouldn't be even something that
15 would -- you would think about because, you know, you
16 guys -- you would choose from your pool of people on the BD
17 side, you wouldn't even think of the IA side?

18 A That's generally correct.

19 Q Okay. Okay, let's go to the next document. By the
20 way, do you know if the cause exam that was done in 2005 on
21 Madoff Securities was ever entered in the CTR system?

22 A I don't know for sure.

23 Q Okay.

24 A I'd like to add something on that response. I do
25 know the Enforcement people had an awareness of that we did

1 an exam. Okay?

2 Q The Enforcement people were aware of the 2005
3 Madoff cause exam at that time?

4 A Not necessarily at the time, but later on.

5 Q Later on, okay. Let me show you another document.
6 These are a series of e-mails and our records do not show
7 them being in the work papers. We don't have any evidence at
8 present that they were reviewed by the exam team on the 2005
9 Madoff cause exam, we were just wondering whether you have
10 ever seen them or were aware whether these particular
11 documents, which we're marking as Exhibit 6, were reviewed by
12 the exam team. And this is several pages of e-mails, the
13 front page is from Investment Adviser #1
Portfolio Manager dated Thursday, November 13,
14 2003.

15 (SEC Exhibit No. 6 was marked for
16 identification.)

17 THE WITNESS: These were received from what
18 examination; I'm sorry?

19 BY MR. KOTZ:

20 Q Well, we received them from Investment Adviser #1, but we
21 don't have any record to show that they were received by the
22 exam staff.

23 MS. STEIBER: These e-mails were actually in the
24 Investment Adviser #1 exam papers.

25 MR. KOTZ: Right, but they were not in the 2005

1 Madoff cause exam work papers.

2 THE WITNESS: So they were in the [REDACTED] --

3 MS. STEIBER: They were in the [REDACTED] exam
4 papers at the SEC --

5 THE WITNESS: All right.

6 MS. STEIBER: -- but they were not in the cause
7 exam papers.

8 THE WITNESS: I don't recall seeing these,
9 but -- you know, it is possible that -- you know, they were
10 referred to me at a point, though. I just don't recall
11 seeing them specifically.

12 BY MR. KOTZ:

13 Q Okay. All right, next document we're going to mark
14 as Exhibit 7. This is an e-mail from John Nee to Dorothy
15 Eschwie, 12/22/2004, 11:03 a.m.

16 Dorothy Eschwie references the [REDACTED] report
17 to John Nee and John Nee says, "Thanks Dorothy, we'll talk to
18 them after the New Year as we plan to do an examination at
19 Madoff. Merry Christmas."

20 And I guess I just wanted to get a bit of sense of
21 timing from your perspective. April 22, 2004 is when the
22 documents came in from Dorothy Eschwie to you. It looks to
23 me like you had given them over to John Nee, certainly prior
24 to December 2004. So when -- at that point you had already
25 made the determination that Nee was going to run the exam, is

1 that right?

2 (SEC Exhibit No. 7 was marked for
3 identification.)

4 THE WITNESS: That's correct. I don't recall
5 exactly when I gave the documents to John, but in generally
6 if I get something and I feel we need an exam it's pretty
7 prompt, but I'm not exactly sure of the day.

8 BY MR. KOTZ:

9 Q So you think you would have given John those
10 documents, you know, within a month after April 22, 2004?

11 A I don't know for sure. This is a big time gap. I
12 know we had trouble staffing the exam, I recall that.

13 Q Okay.

14 A But I don't know the exact time period.

15 Q Okay. Yeah, do you know when the exam actually
16 began? In other words, when the examiners began work on this
17 exam?

18 A It's sometime in 2005, I'm not exactly sure of the
19 start date.

20 Q Would it surprise you to learn that it was in about
21 mid to late March of 2005?

22 A I don't know if it was a surprise. I knew we had
23 trouble staffing the exam --

24 Q Okay.

25 A -- you know, so I don't think it was a surprise.

1 Q So, it was a pretty long period of time between
2 April 22, 2004 when you received the documents from Dorothy
3 Eschwie, until March 2005 when the exam work had begun kind
4 of in earnest.

5 A I agree, I think that is a pretty long period of
6 time.

7 Q Okay. Now, before this exam was started, do you
8 know if anyone took steps to ascertain if any other SEC
9 offices were already conducting or had recently conducted an
10 exam on Madoff?

11 A Well, as part of the pre-exam work we check Starz,
12 we check NRSI, so --

13 Q Do you know if that was done in this case?

14 A I am not certain.

15 Q If say Starz had not been checked in this case,
16 would that be something that you would consider to be kind of
17 an improper or incorrect practice in terms of the pre-exam
18 work?

19 A We should check Starz to find out the history of
20 exams and if there's a current exam, obviously look at the
21 findings. With a cause exam -- you know the focus is narrow
22 so we're not going to necessarily follow up on -- you know,
23 your entire -- your findings from past exams, but you want to
24 have an understanding of the firm and some of the
25 examinations history, NRSI is also important to check, so it

1 should be routinely checked.

2 Q Okay. All right, why don't we go to the next
3 document? We'll mark that as Exhibit 8. This is an e-mail
4 from John Nee to Ostrow and Lamore, 12/22/2004, where he
5 attaches -- calls most recent NASD exam report. Do you know
6 why he would attach this kind of report?

7 (SEC Exhibit No. 8 was marked for
8 identification.)

9 THE WITNESS: Generally, again, on doing a firm, we
10 try to get as much information as possible about the firm.
11 And even though this is not an SRO oversight exam, if an SRO
12 did an exam, a recent exam on an entity, you know, we'll try
13 to look at what -- at the work that they got.

14 BY MR. KOTZ:

15 Q Okay. So it's fair to say that the exam team
16 should look at this exam report for potential issues or
17 information that they might want to consider looking at in
18 terms of the cause exam?

19 A They should review this report.

20 Q Let me ask you a couple questions about some things
21 in the report.

22 A Sure.

23 Q If you look at the first page of the report it
24 references that the firm is a member of CSE, MSRB, DTC, OCC,
25 NSCC and SIPC. Wouldn't this information indicate the names

1 of organizations that may be able to provide additional data
2 regarding the trading activities of the firm?

3 A We generally don't go to these entities for trading
4 data.

5 Q But you could go to these entities for trading
6 data -- or some of these entities?

7 A Well, SIPC, you know, is the Securities Investor
8 Protection Corp., you know, that's unfortunately who's
9 caretaker over Madoff now. NSCC we generally do
10 not -- that -- NSCC shows you -- it's the clearing -- for the
11 equity side of the business, we generally don't go to them
12 for information during an exam. We do if we're doing like
13 a -- some sort of a net capital review, sometimes we'll check
14 the -- the firm will have the NSCC reports, we'll check to
15 see if the fail to receives and delivers are in agreement
16 with them on that. DTC is participant positions, it also
17 shows you deliverers and receives.

18 BY MS. STEIBER:

19 Q Why do you say you don't go to them?

20 A We generally do not go to these -- it's not trading
21 data necessarily. You know, it's not the front-end trading
22 data, it's a lot of clearance settlement records. And to the
23 extent like we're doing some sort of a financial review or
24 capital review, then, you know, maybe we'll test, you know
25 positions at DTC records, you'll test your fail balances to

1 NSCC records. But it's not, you know, sort of that front-end
2 trading data that you'd be probably most concerned about an
3 exam, you know, when we're looking at trading practices.

4 Q So if you're doing a Ponzi exam you wouldn't go to
5 DTC or would you go to the -- go to FINRA? Where would you
6 go?

7 A No, if you were doing some sort of a Ponzi review,
8 that's where asset verification becomes very important.

9 Q So you would go to DTC.

10 A And so we go to -- so DTC would be important, yeah.

11 Q What about OCC, why wouldn't you go to OCC?

12 A OCC is the Options Clearing Corp. We rarely go
13 there, you know, again, they provide periodic statements and
14 daily statements usually -- firms and will generally align
15 with statements that are provided by OCC. That would have,
16 you know, open positions, margin balances, things of that
17 nature. But --

18 Q So if you're doing a Ponzi exam would you go to OCC
19 like you would go to DTC?

20 A If we were doing a Ponzi review and options were
21 implicated -- you know, it's something that we very well may
22 do.

23 Q Okay.

24 A We brought up the term Ponzi exam and, you know, I
25 don't know if we've sort of defined a Ponzi exam if it just

1 came up in this discussion. You know, I don't know if the
2 exam that we conducted of Madoff in '05 I would consider a
3 Ponzi-type review, okay?

4 Q We'll get there.

5 BY MR. KOTZ:

6 Q Okay, would you turn to page 12? It's on the
7 left-hand corner, it says 12 of 26 pages.

8 A Okay.

9 Q It says, "Internal audit. Question: Does the staff
10 responsible for conducting internal audits have an
11 appropriate degree of independence from the departments and
12 people they audit." "Response: Not Applicable."

13 And then you can see on the next page it says,
14 "Description of finding and root cause analysis. The firm
15 does not have an internal audit department. The firm has
16 approximately 80 employees. Trading, financials, compliance,
17 et cetera, are reviewed on a daily basis by the appointed
18 supervisory personnel. The firm's business has not changed
19 since inception. The firm primarily deals with
20 broker-dealers and trading for its own account."

21 Would that be a concern that the firm doesn't have
22 an internal audit department?

23 A It may be a concern. You know, some firms don't
24 have internal audit departments, you know, smaller firms.
25 The question is an 80-person firm, should it have an internal

1 audit department? Quite possibly. This was, as we know it,
2 you know, a tightly controlled firm and sort of a family-run
3 business. And most of the large broker-dealers clearly have
4 internal audit departments, but you know there are many that
5 don't, smaller, ever some medium-size firms don't.

6 Q Okay. I'll show you the next document. This is an
7 e-mail we're going to mark as Exhibit 9, an e-mail from John
8 Nee to William Ostrow dated 4/25/2005, 4:26 p.m. And it
9 references on the second page of this Exhibit 9 an article by
10 Erin Arvedlund entitled, "Don't Ask, Don't Tell. Bernie
11 Madoff is so secretive he even asks his investors to keep
12 mum," dated May 7, 2001 in Barron's. Have you ever seen this
13 article before?

14 (SEC Exhibit No. 9 was marked for
15 identification.)

16 THE WITNESS: I'm familiar with the author's name,
17 and I believe I either read the article or read excerpts of
18 the article.

19 BY MR. KOTZ:

20 Q At the time or recently?

21 A I don't recall if I read it at the time, I know
22 I've read through recently. I believe parts of this are
23 extracted in -- are in the exam report.

24 Q Okay.

25 A That's my recollection.

1 Q Do you know if this article was given over to
2 Ostrow and Lamore and Nee, I guess, as kind of additional
3 information in connection with the 2005 cause exam of Madoff
4 Securities?

5 A It looks like they had access to the document, you
6 know, from --

7 Q Right.

8 A -- and I believe it's referenced in the exam report
9 as well. That seems to be from Ostrow to me and so it seems
10 like they've had access to this.

11 Q Okay. If you look at this document on the page 2
12 or 4 there's a reference in the third paragraph down of the
13 article, "But what few on the street know is that Bernie
14 Madoff also manages more than 6 billion for wealthy
15 individuals. That's enough to rank Madoff's operation among
16 the world's five largest hedge funds according to a May 2001
17 report in MarHedge trade publication." Were you aware or was
18 the team aware at that time of the amount of managing of
19 money in the amount of \$6 billion that Bernie Madoff was
20 doing?

21 A I believe that we knew it was in the billions of
22 dollars. I think we knew it was very substantial. I don't
23 know if we knew there were any individuals personally
24 involved, we thought it was mostly hedge fund, professional
25 money, money managers.

1 Q Okay.

2 A But it was very substantial, we knew that.

3 Q Okay. If you look on the next page there's a
4 reference, middle of the page, "Some on Wall Street remain
5 skeptical about how Madoff achieves such stunning
6 double-digit returns using the options alone. Three option
7 strategists for major investment banks told Barron's they
8 couldn't understand how Madoff churns out such numbers using
9 the strategy. Adds a former Madoff investor, "Anybody who's
10 a seasoned hedge fund investor knows the split-strike
11 conversion is not the whole story and to take it at face
12 value is a bit naive."

13 Did you and/or the exam team, were you aware at
14 that time of this concern or skepticism about how Madoff
15 would achieve these -- what they're called here, "stunning
16 returns?"

17 A I believe we were aware of that. And that was one
18 of the reason we were doing that -- the cause examination.

19 Q Right. And then if you look later on in the
20 second-to-last paragraph, it says, "What Madoff told us was,
21 'If you invest with me, you must never tell anyone that
22 you're invested with me. It's no one's business what goes on
23 here.'"

24 And he says, "When we could explain to -- when he
25 couldn't explain to my satisfaction how they were up or down

1 a particular month, he added, 'I pulled the money out.'

2 Were you aware -- or you and the exam team, were
3 you aware at the time of this secrecy issue that seemed to be
4 Madoff was very secretive about even letting people know that
5 they had invested with him? A lot of people are secretive
6 about the strategy they use, he was secretive about whether
7 you invested with him at all.

8 A I had knowledge that, you know, he was very
9 secretive, because I think in some of the meetings like he
10 excluded -- he didn't want anyone else from the firm
11 involved, it was just sort of him. This is what I heard from
12 the exam team. It was kind of strange. And also even kind
13 of trying to figure out who some of the customers were wasn't
14 the easiest thing, from what I understand.

15 Q Was that sort of a red flag, the so much
16 secretiveness on the part of Madoff?

17 A I think it's strange and probably could be
18 considered a red flag.

19 Q Okay. All right, let me show you the document
20 that's referred to as the other article in here and that
21 we're going to mark as Exhibit 10. And this is an article
22 called, "Madoff Tops Charts, Skeptics Ask How," by Michael
23 Ocrant, dated May 2001. Tell me if you recall seeing this
24 article before.

25 (SEC Exhibit No. 10 was marked for

1 identification.)

2 THE WITNESS: I don't recall seeing this specific
3 article, but -- you know, I may have.

4 BY MR. KOTZ:

5 Q Okay.

6 A It's -- you know --

7 Q Do you recognize any of the handwriting on the
8 article?

9 A I don't recognize the handwriting.

10 Q I just want to ask you a couple of things that are
11 referenced in the article; I'll just ask you if that was an
12 issue that you were aware of. If you look at the second page
13 of the article about half-way down on the left side there's a
14 star.

15 It says, "What is striking to most observers is not
16 so much the annual returns which, though considered somewhat
17 high for the strategy, could be attributed to the firm's
18 market-making and trade execution capabilities, but the
19 ability to provide such smooth returns with so little
20 volatility."

21 And then if you look at the next page it also
22 references that point where at the top of the page it says,
23 "Skeptics who express a mixture of amazement, fascination and
24 curiosity about the program wonder first about the relative
25 complete lack of volatility in the reported monthly returns."

1 Do you remember that issue being a concern in terms of the
2 Madoff examination, the complete lack of volatility in
3 Madoff's returns? And in fact, isn't that what you said
4 early on in this e-mail that you sent on May 11, 2004? "The
5 story, especially the consistent high returns over an
6 extended period, makes you wonder," weren't you referring to
7 this point?

8 A We -- and, you know, I was concerned about the
9 returns, the fact that they appeared to be reasonably high
10 and consistency had to be one of the considerations also.

11 Q Okay. And then the next paragraph says, "In
12 addition, experts ask why no one has been able to duplicate
13 similar returns using the strategy." I'm sorry -- I'm sorry,
14 go to the paragraph above, "But among other things they also
15 marvel at the seemingly astonishing ability to time the
16 market and move to cash in the underlying securities before
17 market conditions turn negative, and the related ability to
18 buy and sell the underlying stocks without noticeably
19 affecting the market." What about that issue? Madoff's
20 astonishing timing, was that an issue that was looked at in
21 connection with the 2005 cause exam?

22 A Well, what we tried to do during that cause exam,
23 you know, the primary emphasis was the trading practices, you
24 know, so we would be looking at, you know, the executions
25 and, you know, how were the executions being performed, were

1 there being done, and were they somehow benefiting from
2 information that was being derived from the market-making
3 part of the business. That was, you know, the sense of where
4 we were spending most our time and we felt --

5 Q Right, but do you remember anything, though,
6 specifically about the timing? How Madoff was able to time
7 entering and exiting the market?

8 A You know, I think I heard at a point in time that
9 to avoid conflicts the executions were being done in London
10 and I think the trades were taking place in the evening. I
11 think that was from either the conversations or from the exam
12 report.

13 Q Okay. All right, well, we'll have some documents
14 we can show you on that. Do you know if any of the exam
15 folks ever went back to either the authors of the two
16 articles to get more information about Madoff in connection
17 with their cause exam?

18 A I don't know for sure, but generally we don't reach
19 out to the press.

20 Q Okay.

21 A Generally we haven't done that.

22 Q Okay. We're going to get into the substance of the
23 exam in a second. Why don't we take five minutes, is that
24 all right?

25 (A brief recess was taken.)

1 BY MR. KOTZ:

2 Q Okay, I'm going to show you the next document.
3 We're going to mark it as Exhibit 11. This is an e-mail from
4 John Nee to William Ostrow and Peter Lamore dated 5/3/2005,
5 3:18 p.m. and it attaches a letter dated May 3, 2005 from
6 John Nee to Erin Ashley Mansfield, Director of Compliance,
7 Barclays Capital Inc.

8 Do you know -- were you aware that this document
9 had -- there was a document request sent out to Barclays?

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

12 THE WITNESS: I was aware certain document requests
13 were going out to, I believe, the actual investors, different
14 investors, and possibly custodians. I think I heard that.

15 BY MR. KOTZ:

16 Q Do you know why they would have sent a document to
17 Barclays?

18 A Well, from what I understand, trying to get an
19 understanding of whether the other party was acting custodian
20 or had a knowledge of the trading, that type of thing.

21 Q Okay. All right, let me show you the next
22 document, which is the response from Barclays. We're going
23 to mark it as Exhibit 12. This is a letter from Erin Ashley
24 Mansfield, Director of Compliance, Barclays Capital, to
25 John Nee, May 16, 2005.

1 If you see in this letter, in response to the
2 request for information about trading the letter responds,
3 "No relevant transaction activity occurred during the period
4 March 1, 2005 to March 31, 2005," which, if you look back at
5 the previous document, Exhibit 11, was the time period in
6 which the information was requested. And it says, "There
7 were no other customer relationships identified at Barclays
8 Capital Inc. for the other names provided in your inquiry
9 letter."

10 Were you aware that the exam team or John Nee
11 received a letter back from Barclays saying, "There was no
12 transaction activity during that period?"

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

15 THE WITNESS: I did become aware of this, I'm not
16 exactly sure when. I did become aware of this. And, you
17 know, and I've seen this letter before.

18 Again, I'm not exactly sure when, but I think I've
19 seen it somewhat recently. I think one of the issues,
20 though, that -- here is that "It should be noted that a prime
21 brokerage and trading relationship with Madoff-affiliated
22 entities exists now with our U.K. affiliates, Barclays
23 Capital Securities Limited, and FSA -- institution is
24 stated."

25 BY MR. KOTZ:

1 Q Right.

2 A Which makes you think there's some relationship
3 there.

4 Q Okay, so did -- do you know if John Nee and the
5 staff confirmed that there is some relationship there by
6 contacting the U.K. affiliate?

7 A I don't believe it was done.

8 Q Do you have any idea why?

9 A I believe it was not done because of the difficulty
10 at times reaching outside of the U.S. It's not as easy as
11 going to a U.S. broker-dealer where, you know, we have open
12 channels of communication. But this is a foreign entity that
13 we don't regulate, it becomes much more difficult to get that
14 type of information.

15 Q But there was no attempt, as far as you know, to
16 get the information, right?

17 A That is correct, okay? I'm not sure when I became
18 aware of that. I don't know if I was fully aware of it
19 during the course of the exam, but I am aware of it.

20 Q Okay. And would you acknowledge that this kind of
21 leaves sort of an opened matter in that, you know, there was
22 an effort to go to Barclays to try to find trading during
23 this period. Barclays came back and said there was no
24 relevant transaction activity. They reference that there
25 could be a relationship with the U.K. affiliate, the U.K.

1 affiliate was never contacted. Isn't that kind of an
2 open -- unanswered question or --

3 A I agree, it is an unanswered question.

4 Q Okay. All right, let me show you another document
5 we'll mark as Exhibit 13. This is an e-mail from Peter
6 Lamore to John Nee, William Ostrow, dated 5/25/2004,
7 9:54 a.m. And in the e-mail at the bottom he says -- and
8 he's talking I guess about Bernie, "He started to bash the
9 SEC program," et cetera, et cetera, and then he says,
10 "anyway, I look forward to speaking to him regarding the
11 hedge fund issue which he has opportunistically failed to
12 mention to us."

13 First of all, I guess, how much were you in the
14 loop on these e-mails? I mean, you're not copied on it.
15 Were you aware of these things as they were going on?

16 (SEC Exhibit No. 13 was marked for
17 identification.)

18 THE WITNESS: I heard bits and pieces that he was
19 being difficult. I had heard that during the course of the
20 exam.

21 BY MR. KOTZ:

22 Q Did you hear specifically that the exam team felt
23 that Bernie was lying to them on numerous occasions?

24 A I don't know if I heard that. I may have, but I
25 think there was a feeling that he wasn't being as cooperative

1 and he may have been hiding some things. Lying, I don't
2 know. I don't know if I recall hearing that.

3 Q Let me ask you this, you were aware that when
4 William Ostrow and Peter Lamore went onsite they dealt almost
5 exclusively with Bernie Madoff himself.

6 A That's right.

7 Q Was that odd a little bit that, you know, you have
8 a company with the amount of money that was being managed or
9 involved in where the point of contact for the examiners was
10 the head of the company?

11 A It is odd, but from what we've heard and I
12 understand, he's a pretty controlling guy. I guess for good
13 reason in retrospect, but it certainly is odd.

14 Q Was that a concern at all to you that, you know,
15 you had to guys who are, you know, relatively junior
16 examiners, I mean they had done some exams but they were
17 relatively junior examiners, there was no branch chief on the
18 exam, and they were dealing with Bernie Madoff, who you know,
19 is a -- potentially a billionaire -- you know, very
20 charismatic guy, very influential.

21 Was there any concern that, you know, they might be
22 influenced by dealing with directly with somebody that
23 probably they would never be used to talking to anybody like
24 that in their lives?

25 A When you're saying influenced, you mean like

1 somehow corrupted, is that what you're implying?

2 Q Well, not necessarily corrupted but, you know, just
3 you might take something that somebody says with more
4 credibility if you're talking to somebody like that who was,
5 as you described previously, well-known, obviously very
6 smart, very rich, very successful, and he is speaking
7 directly with two junior examiners. Wouldn't there be
8 concern that they would kind of be very impressed with Bernie
9 Madoff to a point where it would be more difficult for them
10 to discern when he may be not giving them full information?

11 A You know, it's unusual that he was dealing directly
12 with the examiners. I don't know if I fully understood that
13 he was the only one they were dealing with. I knew there was
14 Peter, who is the compliance director and I think he had some
15 involvement, so I don't know if it was entirely, you know,
16 dealing with Bernie.

17 Q There's a reference here to "some highlight of my
18 two-hour discussion with Bernie," and these were junior
19 examiners that are getting to spend two hours on a daily
20 basis with this very well-known billionaire.

21 A I don't know if it was two hours on a daily basis,
22 but someone, you know, with that reputation and supposed
23 world of knowledge could he overcome, stonewall examiners?
24 It's a possibility, you know, it is a possibility.
25 Obviously, you know, John was also -- had some involvement

1 with the exam. I know he attended at least some meetings and
2 he was -- you know, John was pretty -- he is a pretty
3 sophisticated guy, so we did have that knowledge as well, you
4 know, working on the exam.

5 Q Guys like Ostrow and Lamore, you know, isn't there
6 realistic possibility that, you know, they would be impressed
7 talking to a guy like Bernie Madoff. I mean, how can really
8 two folks like that, you know, compete with somebody like
9 Bernie Madoff who, you know, is a very, you know, smart,
10 successful, reputable guy? I mean, isn't it kind of a
11 mismatch to have William Ostrow and Peter Lamore dealing
12 directly with somebody like Bernie Madoff?

13 A The examiners, you know, we had on this exam,
14 you're saying they don't -- didn't have that much experience.
15 And, you know, they didn't have a huge amount of experience,
16 but someone -- and Ostrow is a very skeptical guy, you know,
17 and I know he sort of thinks a little bit differently, it's
18 outside the box and he's very good with analyzing e-mails.
19 And Lamore was one of our strongest people in terms of
20 knowledge of trading.

21 So, is it possibly they could have been overwhelmed
22 by Bernie? Yes, but I think for the exam I think they were a
23 reasonably good fit, they may have been outmatched a bit, you
24 know, they probably were as it turns out, but we did
25 have -- obviously, we did have, you know, someone like John

1 involved with the process also.

2 Q Okay. All right, let me show you the next
3 document. We'll mark it as Exhibit 14. It's an e-mail from
4 Ostrow to Lamore, 5/26/2005.

5 A couple of things in here I wanted to ask you
6 about. One is Ostrow is saying to Lamore, "That's the
7 feeling I had, we're not getting all the e-mails." Do you
8 remember particularly concerns among the exam staff that they
9 weren't getting documents or e-mails, they weren't getting
10 some information from Madoff that they were requesting, there
11 was pushback?

12 (SEC Exhibit No. 14 was marked for
13 identification.)

14 THE WITNESS: I was aware that they were having
15 some difficulty getting some records. I don't recall being
16 told that there was a problem with the e-mail, but -- you
17 know, that's no surprising, a lot of firms e-mail production
18 is a little bit iffy, and -- you know, they splice it
19 sometimes, the firms, a little bit too tight. But that would
20 be a concern but I don't think I was aware of the e-mail
21 issue. But I -- you know, I think with some of the records I
22 was -- I had some awareness they were having some difficulty
23 getting some of the trading records and things of that
24 nature.

25 BY MR. KOTZ:

1 Q Now, at the bottom of this e-mail, where Lamore is
2 e-mailing Ostrow, Thursday, May 26, 2005, 11:55 a.m., it
3 says, "Shana just gave me another explanation regarding the
4 firm's e-mail retention policy. Basically, she has the
5 ability to determine that an e-mail is non-business-related
6 spam and delete it from the system forever. That just
7 doesn't seem right." And this is Lamore saying that.

8 Do you remember -- I mean, what do you think of
9 this issue that she was able to just delete whatever e-mails
10 she wanted forever? Is that common?

11 A It's not common. The retention policies for
12 broker-dealers, though, is that you have to retain -- you
13 know, communications that relate to your business as such, so
14 what most firms do is they retain all the e-mails. To try to
15 sort through, you know, what's not business-related is just
16 huge and --

17 Q Right, and that would be pretty unusual for a
18 compliance person like Shana Madoff, who of course, is
19 related to Bernie Madoff, to be able to determine, "Oh,
20 that's non-business-related spam," delete it forever.

21 A It is strange. I don't know why something like
22 that would be going on at that level.

23 Q Okay. Let me show you the next document, we'll
24 mark this as Exhibit 15. This is an e-mail from you to John
25 Nee, 5/26/2005, 3:56 p.m. where you say, "Bernie's 'fessing

1 up. I can only access part of the memo but it sounds like we
2 may have something to review, directed executions. You
3 wonder what is his benefit beyond commissions." Do you
4 remember what you were referring to with "Bernie's 'fessing
5 up?"

6 (SEC Exhibit No. 15 was marked for
7 identification.)

8 THE WITNESS: I believe what I was referring to was
9 our ability to access information, you know, on the
10 underlying clients. That we were having difficulty getting
11 information on the underlying advisory clients and then we
12 were able to make a breakthrough where he was admitting to
13 some of the clients and we were starting to get some of the
14 information.

15 BY MR. KOTZ:

16 Q So, initially, Bernie didn't admit to any clients
17 or -- and then admitted only to a few clients?

18 A Yeah, I don't think he -- he wasn't forthcoming
19 with the client list or the number of clients.

20 Q Was that a concern that he was so not forthcoming?

21 A It definitely was a concern.

22 Q Okay. Now if you look at the attached document,
23 which is a summary, "Objective: Discuss Bernard L. Madoff's
24 business in relation to hedge fund articles written about the
25 firm." See at the last paragraph of this it says, "B. Madoff

1 was surprised that the staff was unaware that Madoff
2 conducted this type of business since he had discussions
3 regarding the firm's hedge fund relationships with SEC
4 officials approximately one-and-a-half years earlier." Were
5 you aware that Bernie Madoff was the one who told the exam
6 staff that there was another SEC exam of him going on and
7 that they found that out from Bernie Madoff?

8 A I think we received some information from
9 Washington on an open exam -- to our exam. I thought we did,
10 no?

11 Q The testimony we've had from the examiners is that
12 the first they heard about it was from Bernie.

13 A Okay.

14 Q And then, because they heard about it from Bernie,
15 there was an effort to go back to Washington and say, "What
16 is this matter that Bernie tells me you were looking at?"
17 And then there was the documents that were provided.

18 A Okay.

19 Q If that's the case wouldn't -- that would be a
20 concern that here we are at the SEC and we kind of don't know
21 what the other half is doing? There's another exam going on
22 in Washington and we find out from the registrant?

23 A I agree, we should know it. I thought we had -- we
24 knew of some OC exam, but maybe you're right if that's what
25 the examiners had said in testimony. They are closer to it

1 than I am, so you know, they probably -- if that's what they
2 said that's probably what happened.

3 Q Okay.

4 BY MS. STEIBER:

5 Q Okay, if you go back to the first page of that memo
6 you'll see that what the staff says early on is, you know,
7 first Madoff told them he did not conduct any management of
8 outside money. Then he begins to admit that he conducts some
9 management of outside money. Then if you go down to the next
10 paragraph it says at first he said that he didn't -- that
11 there were four hedge funds using the model. Subsequently,
12 he tells them that there are 15 entities, including the four
13 hedge funds and two corporate accounts, using the model.

14 So the staff seems to be pointing out that Madoff
15 has been changing his story. Right? And you said that you
16 were also aware the staff was having trouble getting
17 information about his investment management business from
18 him. Do you agree with that?

19 A That's generally correct, right.

20 Q Well, at that point do you think it would be more
21 likely that you would seek verification from an independent
22 third party of what Madoff is telling them since his story is
23 constantly changing?

24 A The way I think Madoff was trying to argue this and
25 he was trying to be a little slick, and we see this more than

1 we like to admit, I think it was his belief or his view that
2 these accounts were not really advised accounts. You know,
3 because they were subject to a Commission business they
4 really weren't advisory accounts, so, you know, he really
5 didn't have any advisor accounts. And so I think he was
6 trying to play that angle in that --

7 Q But as he's constantly telling a different story,
8 and then I think at the front page Nee tells you, "We're
9 following up with more requests, including trade info," at
10 that point did you think that the staff was going to someone
11 like FINRA to get this trade information?

12 A Well, no. We were going to try to get the trade
13 information from his internal records to see what existed.
14 We wouldn't be going to FINRA to get the trade information.

15 Q You wouldn't -- we've had testimony that in a
16 front-running exam going to FINRA is typical or not out of
17 the ordinary.

18 A We -- I -- the way I understand, you know, it would
19 be was you'd get the firm's trade blotters and get the times
20 and see, you know, what's going on with the firm records.
21 Now, to try to determine what orders were executed and the
22 sequence of execution you may have to get an audit trail.
23 And an audit trail would be required to -- you know, you go
24 to FINRA, okay? But that depends where the trades are sort
25 of executed as well, you know, if they're not executed in the

1 U.S. I don't think it's going to part of the FINRA audit
2 trail. And that was, I think, what was going on, supposedly
3 they were not executed in the U.S., it was executed overseas,
4 so I don't know if the audit trail would have helped in this
5 situation.

6 BY MR. KOTZ:

7 Q There's another thing you say in this document; you
8 say you "wonder what is his benefit beyond commissions."
9 What were you referring to there?

10 A I was just wondering whether, you know, besides the
11 commissions if he's in some way benefiting, you know, some
12 sort of undisclosed fees, kickbacks, whatever, you know, from
13 these customers. I don't know if I put into place in my mind
14 at this point, you know, the extent of the revenue that was
15 being derived from this business, turns out it was a, you
16 know, very significant amount, so maybe that question was
17 sort of -- target. But, you know, obviously you still have
18 to think there's something else even beyond the commissions,
19 you know, that's a lot of money being made, you know, there
20 could be something else happening as well.

21 Q Was that issue looked at in connection with the
22 cause exam?

23 A I don't know.

24 Q Okay. All right, we'll go to the next document.

25 Okay, I'll show you the next document, we'll mark as

1 Exhibit 16. This is an e-mail from John Nee to Lamore, copy
2 to Ostrow, Thursday, May 26, 2005, 4:19 p.m.

3 He says, "Thanks Pete. In talking to William I
4 asked him to find out more about the actual execution and
5 clearance of the trades, executing brokers, London exchange,
6 prime broker used -- I think they use Barclays -- shown in
7 the article role of U.K. affiliate and e-mails they seem to
8 be involved with Barclays, and one of the parameters or at
9 least the factors that his model uses." Do you know if this
10 issue was ever nailed down?

11 (SEC Exhibit No. 16 was marked for
12 identification.)

13 THE WITNESS: I don't know for sure, but it's quite
14 possible it never was.

15 BY MR. KOTZ:

16 Q Okay. All right, this goes back to the other exam.
17 We're going to mark the next exhibit as Exhibit 17. This is
18 an e-mail from Eric Swanson to John Nee with a copy to
19 John McCarthy, 5/26/2005. And then below it, John Nee is
20 e-mailing McCarthy with a copy to you and this is where they
21 talk about the fact that there were these two exams going on.

22 And John says, "We are currently conducting an exam
23 at Madoff, a major focus has been the possibility that Madoff
24 is using his vast amounts of customer order flow. In initial
25 inquiries he either denied or was evasive. When he finally

1 admitted to executing trades for billions of dollars in
2 customer's money, he said, "We should know about this as he
3 told Lori Richards and John McCarthy about this
4 one-and-a-half years ago." We're hoping that if what he's
5 saying has any truth you might have some info related to the
6 hedge fund related activities that you could send us."

7 And then Swanson says above to John Nee, "OC has an
8 open exam of Madoff on this issue. I'm on the road today but
9 I'm available tomorrow."

10 So do you see that this seems to indicate as well
11 that they found out this from Madoff himself?

12 (SEC Exhibit No. 17 was marked for
13 identification.)

14 THE WITNESS: Meaning that the OC folks found
15 out --

16 BY MR. KOTZ:

17 Q That -- you know, John Nee and I guess Ostrow and
18 Lamore found out from Madoff when Madoff said, "You should
19 know about this because I told Lori Richards and John
20 McCarthy about this a year-and-a-half ago." Then they go
21 back to Swanson and say, "What's the story? Did -- was there
22 a conversation like that?" And he says, "Actually, we got an
23 open exam."

24 A Yeah, okay. Just trying to firm it up to the
25 timeline and brings us to -- this is May, okay, which is

1 after the exam started. Okay.

2 Q Okay, do you remember then there was a phone call
3 between the folks in Washington with perhaps Swanson,
4 McCarthy and Donohue on it and folks down in New York? I
5 think you were on that call, as well, or at least it seems to
6 indicate that you were on that call. Do you remember that?

7 A I don't recall that.

8 Q Okay. Do you remember any information that you
9 guys received from the Washington OC folks about their exam?

10 A I don't recall who received information. I would
11 think if they had any documents they would have been more
12 than happy to send out the file.

13 Q Yeah, I mean, we have records showing that there
14 was documents that were sent up. Do you -- did you know at
15 the time what prompted the OC exam? Why they did their cause
16 exam of Madoff?

17 A No, I did not know.

18 Q Okay. Let me show you a document just to confirm
19 that. This was a complaint that they received in May 21,
20 2003, 5:47 p.m. from somebody named [REDACTED] went to
21 Mavis Kelly. We're going to mark it as Exhibit 18.

22 Did you ever see this document? This was a
23 complaint that was brought in to the OC folks that then
24 triggered the cause exam.

25 (SEC Exhibit No. 18 was marked for

1 identification.)

2 THE WITNESS: I don't recall seeing this.

3 BY MR. KOTZ:

4 Q Okay. Do you know if the exam team saw this?

5 A I don't know.

6 Q Okay, but it would have been a relevant document;
7 don't you think? If OC was doing an exam at the same time
8 around front-running and there was a complaint that
9 precipitated that exam; wouldn't that be something that the
10 New York exam team would want to look at?

11 A Yes.

12 Q Okay. We'll go to the next document. The next one
13 we're going to mark as Exhibit 18, this is a --

14 MS. STEIBER: This is 19. You just --

15 BY MR. KOTZ:

16 Q I'm sorry, we'll mark this as Exhibit 19. This is
17 an e-mail from Ostrow to Lamore, 5/27/2005 at 2:13 p.m.
18 There's a reference here about this Auriga International
19 where Ostrow says, "If Bernie stops in ask him about Auriga
20 International and whether or not that should be on the list."

21 And Lamore says to Ostrow in response, "Hey, he
22 said he's not familiar with Auriga International, although
23 they could be an investor through one of the feeder funds."
24 And then Ostrow says, "That's weird because Bloomberg reports
25 Auriga has discretionary accounts with B. Madoff."

1 Do you remember anything about this where it seems
2 like they kind of caught Bernie in some kind of falsehood?

3 (SEC Exhibit No. 19 was marked for
4 identification.)

5 THE WITNESS: I don't recall this specifically. I
6 don't know if this ever came to my attention.

7 BY MR. KOTZ:

8 Q Okay. Let me show you the next document marked as
9 Exhibit 20. This is an e-mail from John Nee to Peter Lamore,
10 dated June 1, 2005, 7:29 p.m.

11 Were you aware that Bernie Madoff told Lamore that
12 he was on the short list to be the next chairman of the SEC?

13 (SEC Exhibit No. 20 was marked for
14 identification.)

15 THE WITNESS: I think I heard that. I think I did
16 hear that.

17 BY MR. KOTZ:

18 Q Were you aware that Bernie Madoff told the
19 examiners that Chris Cox was going to be the new chairman of
20 the SEC several weeks before it was announced to anyone else
21 in the SEC?

22 A That, I don't recall.

23 Q Okay. Do you recall generally Bernie when he
24 talked to the examiners dropping names, talking about his
25 influence, he's helping the SEC in this issue, he's going to

1 Capitol Hill to deal with important matters?

2 A I did hear that, yeah.

3 Q So is that a concern in terms of, you know, you
4 have two examiners that are still relatively junior, Bernie
5 Madoff could have been the next SEC chairman, he told them he
6 was on the short list, then he knew who it was before anybody
7 else knew. He was talking about all his contacts. I mean
8 wouldn't that make it more likely that these examiners would
9 believe Bernie Madoff when he told them something?

10 A Yeah, I hear what you're saying, you know, it seems
11 like he's a man with, you know, a lot of knowledge and
12 contacts, could conceivable have been intimidating. But
13 again, I think the exam team, these people, you know, there
14 was a fair amount of skepticism and, you know, someone with
15 pretty good trading practices in the background. But could
16 you be influenced by someone with senior status and apparent
17 knowledge? I think it could happen. I don't know if it
18 happened here but it could happen.

19 Q Okay. Let me show you the next document. We'll
20 mark this as Exhibit 21. This is an e-mail from Lamore to
21 Ostrow, 6/1/2005, 11:09 a.m.

22 If you look at the last page it's an e-mail from
23 Lamore to Nee and Ostrow, June 1, 2005, 10:11 a.m. and
24 it -- he says, "Cliff notes version of my discussion with
25 Bernie this morning. Bernie reiterated that his model only

1 identifies the basket of securities in the S&P 100, which
2 would replicate the S&P 100, at the least cost in number of
3 securities and shares. It does not tell him when to enter
4 and exit the market, too, Bernie's gut feel tells him when to
5 enter the market and exit the market. His gut feel includes
6 his observations of the trading room here in New York, what
7 his European contacts are telling him and what he reads in
8 industry papers and publications." Do you remember this
9 issue about Bernie's gut feel?

10 (SEC Exhibit No. 21 was marked for
11 identification.)

12 THE WITNESS: I do recall hearing about that. I
13 think we may have heard that in a meeting. I think -- and
14 it's referenced in the exam report.

15 BY MR. KOTZ:

16 Q Okay. As someone in your position -- you know,
17 very experienced person, when you read this, that Bernie's
18 gut feel tells him where to enter and exit the market based
19 on his observations of the trading room, what his contacts
20 are telling him and what he reads in industry papers and
21 publications, I mean isn't that just ridiculous?

22 A I don't necessarily believe that's ridiculous.

23 Q No?

24 A No. You know --

25 Q You think that somebody could have this kind of gut

1 feel from reading papers?

2 A Well, a trader is getting information from various
3 sources and, you know, it's different information flowing in.
4 It could be, you know, market-related information which is, I
5 guess, not one of the chief things here, but you know,
6 different -- he has different sources, it's European
7 contacts, what's happening to the market conceivable in
8 Europe. You know, there are different flows of information
9 and people make decisions based upon that information. I
10 don't know what makes a good trader in every instance, but --

11 Q Okay, but --

12 A -- I've heard, you know, gut feel does play a part
13 of it at times.

14 Q Okay, but given Bernie's returns that he was
15 getting, I mean wasn't it the case that his gut feel was
16 always right and it was always exactly right? He always
17 entered at the right time and always exited at the right time
18 and he did this over years and years and years during a time
19 period when the market was going up and down. In fact,
20 during a time period when there was a -- almost a crash in
21 the tech market and yet Bernie's gut feel, based on
22 observations of the trading room, looking around the trading
23 room, talking to European contacts about the markets in
24 Europe, and what he reads in industry papers and
25 publications. I mean, that -- isn't that impossible?

1 A Well, I hear what you're saying, but it's one of
2 the reasons that we were also exploring, you know, the
3 potential information that he was receiving from the other
4 side of the business. You know, was he developing some sort
5 of an edge, you know, from what was happening in the
6 market-maker part of the business? Was he in some way, you
7 know, extracting that data, because that was really our
8 primary concern and primary focus.

9 Q Right. And what did you determine on that issue?
10 Didn't you determine that he was not?

11 A At the end of the day I don't think we --
12 We concluded that we had no evidence that he was,
13 although I think we felt that -- you know, it's possible that
14 he was -- because he talked of -- you know, sophisticated
15 technological ability -- you know, we felt that somehow the
16 data could have been feeding into one of his models and
17 possibly providing trend information -- you know, over time
18 that could give him an edge. Whether that's -- is that
19 possible every month to be favorable? That would be very
20 difficult, probably, in every situation.

21 But he did talk of this -- you know, sophisticated
22 model with various data reads. And -- you know, the focus
23 was, though -- you know, for that consistency, was he
24 getting -- you know, that edge -- you know, from
25 potentially -- you know, market information where he could

1 have been -- you know, he could have been front-running
2 or -- him -- did he develop -- you know, sort of -- some sort
3 of secret methodology of getting in front of the trading
4 based upon all this information? Because he was getting a
5 fair amount of trading information with that market --

6 Q Right.

7 A -- you know, the market-maker side.

8 Q But the strategy only went so far, it was really
9 his determination of when to enter and exit the market that
10 made those returns, right?

11 A Obviously, you know, a net return is based upon
12 when you enter and exit the market.

13 Q Right. And so --

14 A You know, you have the clues -- the clues from
15 entry, though, would be based upon -- you know, information
16 that -- you know, he's outlined a bunch of potential issues.
17 But you know, obviously one of the things that we're looking
18 for is market information, you know, if there's front-running
19 or order leakage or something that could have been, you know,
20 beneficial to his trading.

21 Q So if you ruled out front-running aren't we left
22 with his gut feel? Is there any other explanation for his
23 uncanny ability to enter and exit the market at just the
24 right time all the time?

25 A Well, we didn't find evidence of front-running but

1 we also recognized that he was receiving a lot of information
2 and he did have some trading models which conceivably could
3 have been directing his trading and could have been helping
4 with the timing. It -- we weren't sure. There are other
5 potential avenues, you know, was he getting some phone calls
6 or contacts, you know, from Europe --

7 Q Right, but --

8 A -- and possibly also -- you know it is possible.
9 We didn't find that.

10 Q But this explanation, that it's based on his gut
11 feel, given the consistency of his returns, isn't it fair to
12 say that this explanation is not a credible one?

13 A Well, he's saying his gut feel and his observations
14 of the trading room here, which what is the observations of
15 the trading room? You know, I'm not exactly sure what that
16 means but it could be, you know, a lot of data that's coming
17 into the trading room, you know and --

18 Q Just by observing the trading room?

19 A -- potential order and balances, you know, the
20 actual -- observing the trading room. But I take that to
21 mean trading data, you know, not just like peaking your head
22 in and just saying, "Oh, look, they're busy in there," I
23 think it goes -- I sensed it went a little deeper. He
24 mentions contacts. You know, at the end of the day many a
25 trader develop a gut feeling.

1 Q But it -- do they ever have gut feelings that are
2 that consistent?

3 A Consistency every month, I agree, is very, very
4 unusual.

5 Q And since the team was aware of the consistency of
6 the return, wouldn't this explanation as to how he achieves
7 those returns based on a gut feel be not a credible
8 explanation?

9 A Well, again, it could also mean that he's in some
10 way cheating.

11 Q Right.

12 A You know, cheating in a sense he's taking advantage
13 of some trading information, different data that's coming in,
14 and, you know, he's basing his decisions on that. And that
15 was really the focus on how we spent our time.

16 Q But isn't it fair to say that at the end of the
17 day, given the consistency of returns and given his
18 explanation of his gut feel, the conclusion was there had to
19 be something else other than his gut feel that was
20 responsible. Maybe you weren't able to figure out what it
21 was, but wasn't the conclusion there had to be some other way
22 he was achieving these returns?

23 A But look at what his gut feel is, though. It
24 includes trading room, it includes European contacts and
25 industry papers and publications, that's, you know, maybe

1 just global trends, but trading room data was sort of what
2 we're looking at and, you know, we couldn't figure it out but
3 maybe there was something there in that trading room data.
4 European contacts, possibly them somehow discerning order
5 flow information that, you know, we cannot understand, you
6 know, we had no knowledge of. Is it possible? I don't know.

7 Q But is it fair to say that at the end of the exam
8 you still didn't understand how Bernie was able to achieve
9 those consistent returns?

10 A That is correct.

11 Q Okay. Yeah, if you look at page 3 of 4 in this
12 same Exhibit 21, Ostrow says to Lamore and John Nee, June 1,
13 2005, 10:14 a.m., "Let me know if there were any transactions
14 during the time period we requested, March --" I'm sorry
15 "-- February 28th to March 11, 2005 for Kingate, and I will
16 check to see if they are on the database of orders entered.

17 Lamore responds, "Hilarious, nothing, only
18 transactions on February 15th, February 18th and March 15th."
19 Were you aware of the fact that when they looked to see if
20 there were transactions they didn't find them?

21 A I was not fully aware, I was not aware of this.
22 I'm just trying to figure out what -- where are they getting
23 the information from, "Let me know if there were transactions
24 during the period --" do you know the source document that
25 Ostrow's talking about? Was it the customer statement? What

1 was the source document, do we know?

2 It may have been the customer statement, comparing
3 it to the database of orders entered. I'm not sure what's
4 being compared but I -- you know, it's most likely, you know,
5 two trading runs, one being a customer's summary statement to
6 some sort of a database of trading activity and there seems
7 to be a lack of consistency. I was not aware of that.

8 Q Well, if you see on the front page of this
9 document, Exhibit 21, continuing the e-mail exchange, Lamore
10 says to Ostrow, "Hey, I'm not quite sure what's going on with
11 these statements. I'll show you later but it seems clear as
12 mud to me."

13 And then Ostrow responds, "That's a funny way, but
14 I'm sure appropriate way to put it. I guess his stomach and
15 gut were churning if he was buying and selling on the same
16 day."

17 So it seems as though, clearly, the examiners
18 didn't really believe this explanation about Bernie's gut.
19 And then if you see Lamore says at the top, "I don't know,
20 but assuming he bought on or about 1/25 and sold on or about
21 3/15, he timed the market pretty well."

22 A Is that a question? I'm sorry.

23 Q Yeah, doesn't it seem to indicate that the
24 examiners didn't believe Bernie's story about his gut feel
25 being responsible for these -- his timing ability?

1 A I think the examiners were skeptical, yeah.

2 Q And by the end of the exam they remained skeptical,
3 isn't that right?

4 A Is this series of e-mails at the very end of the
5 exam, at the very end of the field work, do you know?

6 Q Yeah, when did the field work end?

7 MR. WILSON: June 20th.

8 MR. KOTZ: June 20th.

9 THE WITNESS: These are June 1st. I don't know for
10 sure.

11 MS. STEIBER: About June 16th.

12 THE WITNESS: Yeah, I don't know if I could say
13 they're still skeptical.

14 MR. KOTZ: Okay. This issue about he's -- Lamore
15 is saying he's not quite sure what's going on with the
16 statements --

17 MS. STEIBER: They're clear as mud.

18 BY MR. KOTZ:

19 Q -- information was -- yeah, unclear. Did that come
20 up? Were you made aware of that?

21 A No.

22 Q Okay. I'm going to show you the next e-mail, which
23 is marked as Exhibit 22. This is an e-mail from you to
24 Bob -- I'm sorry, from John Nee to you, 6/2/2005, 10:14 a.m.
25 And John says, "Bob, thought you'd find this interesting."

1 It says, "After reviewing the Kingate account
2 statements for January through April, I don't believe the
3 retail customer order flow information from Madoff's
4 market-making business has anything to do with his hedge fund
5 model." Then it says, "Granted, his purchase and subsequent
6 sale time was excellent, buy low and sell high. But he held
7 the basket for approximately six weeks, therefore I don't
8 believe he's using any short-term signals that would come
9 from his retail order flow."

10 Was that essentially the conclusion that he
11 didn't -- they didn't think it was front-running?

12 (SEC Exhibit No. 22 was marked for
13 identification.)

14 THE WITNESS: That's what it appears to be, yes.

15 BY MR. KOTZ:

16 Q And then it says, "I suspect that he is extremely
17 well-connected to European order flow information through his
18 brokers and possibly the investors in his fund and is timing
19 the market based on that information rather than his retail
20 order flow information." If he was doing that, as John
21 Nee -- I'm sorry, as Peter Lamore was telling John Nee then
22 it was forwarded to you, would that be legal?

23 A Well, connected to European order flow information,
24 it depends what we're talking about there. You know,
25 they -- if it's specific orders and he's front-running

1 specific orders, I think you have a problem. If it's
2 some -- somehow data that's giving us trends of
3 market-movements or specific movements in issuers that he's
4 somehow using, you know, to his -- as a flow in one of his
5 models, not necessarily.

6 Q So, was that issue looked into in the cause exam of
7 Madoff Securities?

8 A I don't believe it was, no.

9 Q Do you know why not if at the end of the day there
10 was at least a possibility that there was another explanation
11 for his returns that was also illegal, potentially
12 front-running?

13 A Well, part of it is how far do you take an exam.
14 Now the finger's pointing to Europe and, you know, where are
15 we going to get the information? You know, where -- what are
16 the sources of the information? How do we find this out? I
17 don't really have an idea even as we sit now knowing this is
18 fictitious, but if it wasn't I'm not too sure how we'd figure
19 that piece out.

20 It's sort of -- it's in the realm of Europe, we're
21 getting some flow information -- possibly, how do you figure
22 that out? We're looking through e-mails trying to figure out
23 what's going on with the e-mails, seeing any context in that,
24 you know, that's apparently not popping up. It leaves us in
25 a difficult position. We, you know, it's not something that

1 we could, you know investigate necessarily.

2 Q Okay.

3 MS. STEIBER: Have you ever worked with OIA before
4 to request trading records from Europe or any other records
5 from Europe?

6 THE WITNESS: We have. Yeah, I have, yes.

7 BY MR. KOTZ:

8 Q Okay, next document I'm going to mark as
9 Exhibit 23. It's an e-mail from Lamore to Nee, 6/6/2005,
10 7:47 a.m.

11 He says, "Hey, John, we still have not received the
12 hedge fund contact list, nor do the statements contain the
13 addresses of the 15 entities. We are going to ask him again
14 today for this information."

15 Were you aware of that particular issue where they
16 were trying to get this hedge fund contact list, statements
17 containing addresses of these 15 entities?

18 (SEC Exhibit No. 23 was marked for
19 identification.)

20 THE WITNESS: I know John mentioned it to me and
21 possibly the examiners mentioned the were having difficulty
22 getting information, you know, on the -- these customers.

23 BY MR. KOTZ:

24 Q Okay. Going back to the previous exhibit, another
25 issue I wanted to ask you about in Exhibit 22. It says,

1 "Bob," which I guess refers to you. Spoke to Personal Privacy
2 yesterday and he agreed that the documents associated with
3 the black box model should be subject to the books and
4 records requirements since the model is used in the
5 conducting of the firm's business." Do you remember

6 Personal Privacy ?

7 A I remember they were talking about, you know, some
8 sort of proprietary model and he was very hesitant, didn't
9 want to give us the information that we were sort of pushing
10 him, we wanted the information.

11 And then, you know, we -- and the question came up,
12 you know, whether it's something if it's part of books and
13 records should we have access to it and we kind of felt
14 pretty comfortable that we should have access to it, but you
15 know, we figured, you know, run it up the chain just to make
16 sure we have support. I don't -- frankly I don't recall the
17 specific conversation with Personal Privacy, but if it's here,
18 you know, I'm sure I had the conversation with him.

19 Q But you do remember that kind of general
20 determination that, you know, you were the SEC and you were
21 entitled to anything --

22 A That's right.

23 Q -- that you wanted --

24 A That is, essentially correct.

25 Q -- from Madoff. Okay. All right, let me show you

1 the next document, it's been marked as Exhibit 24. This is
2 an e-mail from John Nee to Ostrow, cc Lamore, 6/7/2005,
3 1:47 p.m.

4 And if you look first at the e-mail below from
5 Ostrow to Nee with a copy to Lamore, he says, "We've been
6 viewing all the basket trades. For all 2004 Madoff executed
7 close to 2 billion shares of stock which represents a
8 commission equivalent of approximately \$82 million. It
9 appears that without this commission equivalent business
10 derived from the hedge funds, we estimate the firm would lose
11 10- to \$20 million per year." Were you aware of this
12 revelation that this big, well-known market-maker, the
13 market-maker side was actually losing money without the hedge
14 fund side?

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

17 THE WITNESS: I'm just trying to remember what I
18 recall. I think we recognized -- I remember hearing that it
19 was a very significant part of the revenue, I don't know if I
20 recall specifically that it -- there would have been a loss
21 situation without it. But -- you know, it's possible, but --

22 BY MR. KOTZ:

23 Q Would there be --

24 A -- I knew it was a big part of the revenue.

25 Q Wouldn't that be a pretty stunning development?

1 You're going in to look at a, you know, well-known
2 market-maker and it turns out the market-maker is losing
3 money, it's being propped up by the investment side?

4 A It's a red flag, I agree.

5 Q And then Nee responds, "Be sure to keep your eyes
6 on the prize." Do you know what he was referring to there?

7 A It's -- I'm not 100 percent sure but I would think
8 maybe the front-running issue, you know, the fact that, you
9 know, the trading should be the emphasis. Sometimes, you
10 know, with the examiners, you know, you have to sort of rein
11 them in a bit. You know, maybe John was feeling that
12 William's straying a little bit from the intended cause
13 nature of the exam and --

14 Q Do you think --

15 A -- that was it possibly. I'm not, you know --

16 Q Do you think in this case --

17 A -- 100 percent --

18 Q Do you think in this case that the examiner should
19 have been reined in a little bit or maybe perhaps they should
20 have been allowed to look at some of these open questions?

21 A These are good questions. They're fair questions,
22 you know, to sort of explore.

23 Q Do you remember whether --

24 A In all fairness to someone, you know, like John,
25 you know, someone like Bob, me, is also looking at the exams,

1 how long they're taking, all that. So, you know, I think in
2 the back of John's mind is, you know, how long we been out
3 here, you know, this is an important exam and all these
4 issues, but we have an exam program we're running and, you
5 know, that may be something in the back of someone's mind
6 who's supervising this exam. Okay?

7 Q Right. Do you remember this issue with the
8 examiners pushing about whether Bernie Madoff should be
9 registered as an investment advisor?

10 A I don't recall that issue, no.

11 Q Okay.

12 A I heard about it later on, you know, apparently
13 that happened during the investigation but I don't recall
14 this.

15 Q Okay. All right, next document.

16 THE WITNESS: I guess no one takes lunch around
17 here, huh?

18 MR. KOTZ: Hey, if you want to stop, we can.

19 THE WITNESS: That's fine.

20 MR. KOTZ: We're kind of moving along, so we could
21 maybe get it done.

22 THE WITNESS: Yeah.

23 MR. KOTZ: Yeah, they were shocked I took five
24 minutes to go to the restroom, so --

25 BY MR. KOTZ:

1 Q The next document, we're going to mark as
2 Exhibit 25. This is an e-mail from Ostrow to Nee, 6/8/2005,
3 8:43 a.m.

4 Ostrow at the bottom of this page sends an e-mail
5 to Nee and it's actually in response to the next page,
6 page 2 of 3, where there's a back and forth between Ostrow
7 and Nee where Ostrow is saying, "One of the days we requested
8 trades Bernie was closing a basket. I asked why he did not
9 have these trades on a CD with all the trades entered between
10 2/28/05 and 3/11/05. Bernie stated that because the basket
11 was originally entered into in January there were not entered
12 in March, only execution of orders placed previously. How
13 can this be? The specific price is not known and you're
14 relying on the fluctuation of 50 stocks in a basket. Lamore
15 views it as a standing limit order, good until canceled."

16 And then Nee responds, "What was the actual
17 language we used in this request? It could be a matter of
18 semantics." And then Ostrow responds, "A large portion of
19 this exam has come down to semantics."

20 Do you remember this issue of semantics being
21 something that was talked about?

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

24 THE WITNESS: I know that was something that Madoff
25 was sort of trying to use. That's why when we were

1 requesting access to the advisory accounts, since the
2 accounts technically, in his mind, weren't advisor accounts
3 we weren't getting that information. You know, he felt that
4 they were, you know, commission-based accounts. But I do
5 recall the artful delay process that we sometimes see during
6 exams. If you're not very specific or use the exact language
7 that these people feel you should be requesting something
8 with, you sometimes do not get it.

9 BY MR. KOTZ:

10 Q And do you remember the examiners expressing
11 frustration by Madoff responding in this kind of semantic way
12 to a lot of requests?

13 A I do recall some frustration, yes.

14 Q Okay. Why don't we go to the next document? We'll
15 mark this as Exhibit 26. This is an e-mail from John Nee to
16 Ostrow, 6/16/2005, 8:29 a.m. There's a reference below, an
17 e-mail from Ostrow to Nee, copy to Lamore, Wednesday, June
18 15, 2005, 4:54 p.m. where he says -- and this is June 15th,
19 the -- I think we determined the exam work ended on the 16th
20 of June?

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

23 MS. STEIBER: Yep.

24 BY MR. KOTZ:

25 Q On June 15th, Ostrow says, "We still have some

1 outstanding questions and plan on requesting a limited amount
2 of e-mail from a few individuals tomorrow." And then he goes
3 on to say, "We would still like to visit some of the hedge
4 funds, example, Tremont in Rye, New York, and Fairfield, in
5 Connecticut or New York. We want to gain an understanding
6 from the hedge funds from their perspective the strategy used
7 by Madoff." And he mentions, "option collars are no longer a
8 part of the strategy here at Madoff. We hope to have a draft
9 request list for the hedge funds by mid-next week." And then
10 Nee responds, "Let's meet this morning."

11 Were you aware that the examiners wanted to visit
12 the hedge funds?

13 A I knew that we wanted to have at least a
14 communication with the hedge funds, I don't know about
15 necessarily meeting with the hedge funds. I thought we
16 wanted to actually send correspondence to the hedge funds.

17 Q Was that ever done?

18 A I don't know for sure. I think what maybe Kingate,
19 you know, we sent certain correspondence out to them. I
20 believe that may have happened. No, that didn't happen? I
21 thought we may have sent out some correspondence --

22 Q Do you remember something about John Nee saying
23 that he didn't want to visit or send any correspondence to
24 these hedge funds because there was a lot of money involved
25 and, you know, it could trigger something, potentially even

1 the SEC could get sued if they sent something out that, you
2 know, provided some allegation of something improper?

3 A You know, I don't recall that, per se.

4 Q Okay. Do you think it would have been prudent to
5 visit some of the hedge funds or at least send some
6 communications to the hedge fund to follow up on these
7 outstanding questions that Ostrow had as of June 15th?

8 A It's easy to say in retrospect what the answer
9 should be. I'm just trying to think that, you know, at the
10 time knowing what we knew -- he's essentially saying that the
11 split-strike conversion strategy is no longer being put on by
12 Madoff, which is a difference -- than what we sort of
13 expected.

14 You know, do we -- is this something that's -- that
15 we do? It'd be very unusual. But could we do it? We could,
16 we could ask for voluntary cooperation and try to get people
17 to talk to us. You know, it's -- you know, one of the things
18 that we have difficulty with sometimes, like you're running
19 an exam program, you know, when is this thing crossing over
20 to an investigation, how far do you take it? Obviously, if
21 we're suspecting major fraud, you know, we should just go as
22 far as we can.

23 You know, contacting customers, you know, we do it
24 often with micro-cap and offering frauds, we do a fair amount
25 here. A little bit different scenario with professional

1 investors. I would like to say, yeah, we should have visited
2 them, but I -- frankly, I'm not certain. I'd have to
3 probably think about it. Knowing what I know now I would
4 say, "Of course, yes." But I don't know, at the time, I'd
5 have to really think it through.

6 Q Okay. And to the extent that Nee made this point
7 about his reluctance to contact and \$8 billion client who
8 could pull out money and the effects of that, if -- assuming
9 that that is true, would that be a reasonable decision or
10 explanation for why not to go the --

11 A Well, it becomes a concern, but you know, I think
12 we have to do what we feel is the correct thing. If we
13 have -- if we believe there's some sort of a fraud here we
14 have to contact who we have to contact. And that's, you
15 know, that's the truth of the matter. You know, we
16 don't -- you know, one of the challenges you have with
17 contacting customers is that they become very agitated and
18 disturbed. And what happens is they call the firm right away
19 and everyone's up in arms and then we get calls, the regional
20 director gets calls. And it doesn't happen every time, but
21 it happens a fair amount of time. But, you know, when it
22 should be done, it should be done.

23 Q Yeah, okay. And, I mean, -- think that we
24 shouldn't be worried about getting calls or somebody being
25 upset. Our job is to focus on the issues that we see, to

1 follow up on unanswered questions and somebody gets upset,
2 somebody gets upset.

3 A Yeah, you're right. If we have an indication that
4 something is going wrong and we can discern that and can get
5 more information by contacting -- we should contact that
6 customer. I think we have to be in a position, though, to
7 understand whether that contact is meaningful -- you know; is
8 it well thought out. That's really -- you know, I think the
9 controlling issue. You don't want to just alarm people for
10 no good reason because -- you know, it's not normal process
11 to contact customers during the exam process.

12 Q Okay. I'm going to show you the next document
13 marked as Exhibit 27. This is an e-mail from Personal Privacy
14 Personal Privacy to Ostrow, Lamore and you -- or with you copied
15 and a variety of others, 9/2/2005, 11:31 a.m. And it
16 attaches the final report on the cause exam, September 2,
17 2005 report.

18 How much of a role did you have in drafting this
19 report?

20 (SEC Exhibit No. 27 was marked for
21 identification.)

22 THE WITNESS: Really no role in drafting.

23 BY MR. KOTZ:

24 Q No? And what about in editing or reviewing it?

25 A No. I get involved -- you know, I'll review the

1 reports, read through them when they're complete, most of
2 them, with the exception of Enforcement referrals.
3 Enforcement referrals, I'll actually review a good number of
4 those. This was not an Enforcement referral, so I read
5 through it, but I didn't review it and edit it in that sense.

6 Q Okay. Did you feel it was a well-written report?

7 A I do and did at that time, yes.

8 Q Okay. Looking at a couple of parts of this report,
9 if you look at page 3 under examination findings there's a
10 reference to these two articles, Barron's and MarHedge
11 articles.

12 A Right.

13 Q But -- and I don't know if this is kind of how it
14 works or not, but if you read -- kind of just read over it
15 quickly, this discussion of the articles, bottom of page 3,
16 all of page 4, half of page 5, it seems to be just kind of a
17 recitation of what the article says. So if you look at the
18 bottom of page 3, page 4, the Barron's article was written by
19 Erin Arvedlund, according to the article it's x, Arvedlund
20 explained, according to Arvedlund. And then they reference
21 what the investor told Arvedlund. And then on page 5, it
22 talks about the MarHedge article, discusses certain things.

23 And then there's several paragraphs which purport
24 to be some kind of assessment of the articles but yet all
25 they say is Bernie Madoff refused to provide details, Bernie

1 Madoff pointed out this, Bernie Madoff informed the staff
2 that, Bernie Madoff pointed to this experience, Bernie Madoff
3 states, according to Bernie Madoff, Bernie Madoff states,
4 Bernie Madoff dismisses speculation. It doesn't seem like
5 there's any analysis at all. It seems as though you have
6 kind of a recitation of what the articles say and then
7 Bernie's response. And I just don't understand where is the
8 exam analysis?

9 A This is sort of a background. This is the
10 background of the report, this is not the --

11 Q Well, it's under examination
12 findings -- v. Examination Findings on page 3. I mean,
13 shouldn't they have analyzed in some way?

14 A There is a review of trading I know that we did and
15 it's somewhere in here.

16 Q But at least in this section --

17 A Well, the testing comes later, you know, this is
18 sort of --

19 Q Okay.

20 A -- discussion --

21 Q All right, so let's take --

22 A -- of some of, you know, what's being alleged in
23 the articles.

24 Q And then Bernie's response, right?

25 A This is his verbal response.

1 Q Right. And then the next section is IA business
2 structure, has a little recitation of the structure. And
3 then also if you look at page 6, according to B. Madoff,
4 according to B. Madoff, according to B. Madoff, first, Bernie
5 Madoff. And then page 7, according to B. Madoff, I guess
6 this is Bernie Madoff's kind of description of his structure.

7 A Right.

8 Q Then you have model MA2.06, again, according to
9 BLM. This is, you know, the next page is, again, "After
10 Bernie Madoff decides to implement the strategy the model is
11 "x." And it says, "According to B. Madoff it acts as a
12 settlement agent." Okay?

13 Then we get to the testing, which is one paragraph,
14 right?

15 A Right.

16 Q Page -- bottom page 8. And it says, "Staff also
17 conducted a cursory review of the parameters." And then we
18 go back to firm trading and market-making, again, background.
19 Okay, so then that is all background, that is also, again --

20 A Right.

21 Q -- just kind of background. Then you have testing
22 again and there's some on page 10, bottom of page 10, about
23 testing. But then on page 11, even in the testing section
24 you see a lot of -- at the bottom of page 11, according to
25 the firm the stop order policy is "x," the firm states,

1 during interviews with B. Madoff, P. Madoff and -- the staff
2 was told, according to these individuals.

3 And then you -- next is just e-mail review and
4 conclusion. Just seems as though from looking through the
5 report, it's heavy on Bernie Madoff's version of things and
6 light on analysis, wouldn't you say?

7 A One of the problems is we didn't find that much
8 that we can consider, you know, securities law violations or
9 weaknesses in internal controls. So, you know, we described,
10 you know, the articles and the allegations, we give his
11 explanation of some of the issues and, you know, a lot of
12 this is in his head, so you know, we're quoting him because
13 that's where we got the information.

14 And then we get into the testing and the testing is
15 what it is, you know, it was done, it was performed, they
16 looked at statements, they looked at some trading and they
17 didn't find a heck of a lot, you know, for the investment
18 advisory business. And then, you know, the testing and the
19 proprietary trading we found some issues but there -- you
20 know, they were some smaller, best execution issues, they
21 weren't that major.

22 Q What about these open questions, these unanswered
23 question, all the things we saw in these e-mails we showed
24 you? Bernie not providing information, the issues with the
25 volatility -- lack of volatility in the strategy, the

1 consistency, the gut feel, where is all that? Where are all
2 the --

3 A Isn't some of that in the background here in terms
4 of the articles and what they said in the articles?

5 Q Yeah, but that's just the article.

6 A Yeah.

7 Q Where are -- if you look at this from our
8 perspective, what we see is, we see an exam where there are a
9 lot of questions. You know, we have examiners saying, Nee
10 saying, they were aware that Bernie had lied to them, a lot
11 of things that didn't add up. They couldn't prove
12 front-running but nevertheless, these issues were still out
13 there.

14 But then if you read the report, you know, it's
15 almost entirely, you know, Bernie Madoff's version of his
16 company. It just seems like there's a disconnect between the
17 e-mails, the examiners, and these explanation of what
18 happened in the exam, and the report. Can you explain that?

19 A Well, you would hope that if we had open items in
20 the exam, most of them would have been resolved by the time
21 the report was written.

22 Q And if those open items were not
23 involved -- resolved by the time the report was written,
24 shouldn't they have been included in the report?

25 A I don't know if we necessarily put every, you know,

1 open item in the report, if it would go in there as a
2 featured item.

3 MS. STEIBER: How about any open items?

4 THE WITNESS: You know, where we had continuing
5 concerns or we couldn't conclude, that's something that may
6 be -- may have entered into -- if you have continuing
7 concerns or an issue with -- I think, you know -- before you
8 get the report you try to resolve most of the open items.
9 And, you know, if there are continuing concerns or, you know,
10 a practice that you think should be referred, you know, then
11 we'll mention that. You know, sometimes in the -- it'll be
12 mentioned in the report.

13 BY MR. KOTZ:

14 Q Do you feel like this report answered all the
15 questions raised in the Investment Adviser #1 e-mails?

16 A This report is issued months later. I don't know
17 what went on in, you know, regard to the June -- e-mails from
18 June and the report is issued in September.

19 Q No, I mean in April 2004 you received a memo from
20 Dorothy Eschwie with e-mails.

21 A Right.

22 Q You instructed the team to look at those documents
23 and do a cause exam.

24 A Right, right.

25 Q At the end of the day, based on this report, were

1 those issues that were raised in the e-mails that you gave
2 the team, were they resolved?

3 A What I felt was that we were looking primarily at
4 the execution practices. That's really what were concerned
5 with. You know, we weren't suspecting a Ponzi scheme at that
6 point in time, so, you know, I felt that they had spent a
7 fair amount of time, you know, looking at the trading
8 practice, trying to understand the trading practice, and
9 trying to see whether it's front-running, order leakage,
10 somehow they were using, you know an advantage to sort of
11 garner those returns. We could not find that.

12 So in that sense I felt that -- we did an exam, we
13 found what we could, which was some slight errors, slight
14 problems, you know, with the best execution in the
15 market-making desk, but we didn't find the solution to those
16 returns. We never found why he was making those returns.

17 Q Right, so --

18 A But we didn't find any evidence of wrong-doing
19 either, other than the FINRA, the NASD violation.

20 Q But when you said in this e-mail on May 11, 2004,
21 "The story, especially the consistent high returns over an
22 extended period, makes you wonder." That wondering was never
23 resolved by the end of the exam, is that right?

24 A We never figured out how he was able to get those
25 consistently high returns.

1 Q Okay.

2 A But the thought process was that by looking at the
3 trading, you know, looking at the trading that was going on,
4 that we would -- you know, if there was some sort of illegal
5 activity we would be able to figure it out. And we did not
6 figure it out.

7 Q Okay. Let me show you the next document, we'll
8 mark as Exhibit 28. So, is it fair to say that in your view
9 the 2005 cause exam of Madoff Securities did not look
10 directly at the issue of whether Madoff was running a Ponzi
11 scheme, would you agree with that?

12 (SEC Exhibit No. 28 was marked for
13 identification.)

14 THE WITNESS: That is correct.

15 BY MR. KOTZ:

16 Q Okay. So this is an e-mail dated 11/7/2005,
17 9:35 a.m. from Peter Lamore to John Nee. And in this e-mail,
18 you can see it's a long e-mail string, but if you start at
19 the back it starts with an e-mail from the Boston Office,
20 John Dugan, dated Tuesday, October 25, 2005 to various folks
21 in the Boston Office. It talks about an informant, says "the
22 informant believes that Madoff may be running one giant Ponzi
23 scheme."

24 Do you see that on page 2? Sorry -- page 2, John
25 Dugan's e-mail --

1 A Yeah.

2 Q -- he says to Ricciardi and Bergers, "The informant
3 believes that Madoff may be running one giant Ponzi scheme,"
4 this is Harry Markopolos.

5 A Right, right.

6 Q And then Walter Ricciardi sends an e-mail to Mark
7 Schoenfeld, "Mark, it's outlined below. We met yesterday
8 with an informant that raised some significant concerns about
9 Bernie Madoff and his broker-dealer, Madoff Investment
10 Securities."

11 Then it goes along, Doria Bachenheimer sends it to
12 you, "Hi Bob, we're going to look into this. Do you know who
13 the exam team on Madoff?"

14 And then you respond, Thursday, November 3, 2005,
15 as follows, "These are basically some of the same issues we
16 investigated and I recognize at least one of the hedge funds,
17 Fairfield Century. Some of these comments are not new, I
18 remember looking at these similar allegations back in the
19 '90s at Madoff."

20 Now when you say "these are basically some of the
21 same issues we investigated --"

22 A Right.

23 Q -- so you get an e-mail saying, "An informant
24 believes Madoff may be running one giant Ponzi scheme," and
25 your response is, "These are basically some of the same

1 issues we investigated." How are they some of the same
2 issues you investigated? You didn't investigate the Ponzi
3 scheme at all.

4 A We didn't investigate the Ponzi scheme but we
5 investigated -- let me read through this.

6 Q Sure.

7 A The issue I thought was similar here "as an
8 alternative to the Ponzi scheme theory the informant believes
9 Madoff may be actually investigating -- returns but is doing
10 so by front-running." That's the issue that sort I
11 was -- you know, we reviewed some of the same issues, that
12 was the issue that I was really focused on.

13 Q But wasn't Markopolos' complaint saying, "I believe
14 it's a Ponzi scheme, if it's not a Ponzi scheme it may be
15 front-running?" Isn't that your understanding of the
16 Markopolos complaint?

17 A I saw the Markopolos complaint just recently,
18 probably within the last six months, and it was either
19 front-running or Ponzi scheme.

20 Q Okay, so it's either front-running or a Ponzi
21 scheme.

22 A Right.

23 Q You guys had looked into the front-running issue --

24 A Right.

25 Q -- determined there was no front-running.

1 A Right.

2 Q So why wouldn't your response be to this, "Look at
3 the Ponzi scheme because we looked at --" "The informant
4 came in and said, "It's front-running or a Ponzi scheme," we
5 came in and looked at front-running, let's look -- I think
6 based on our exam you should look at the Ponzi scheme because
7 we didn't look at the Ponzi scheme at all." Instead the
8 response is, "These are basically some of the same issues we
9 investigated. Some of the comments are not new, I remember
10 looking at similar allegations back in the '90s at Madoff."

11 And then John Nee responds, "Oh, no." And Lamore
12 responds, "I don't believe we missed anything." Why would
13 they be concerned about missing anything? Why wouldn't they
14 go back and say, "We didn't look at the Ponzi scheme, you
15 should look at the Ponzi scheme because we know that the
16 alternative is wrong?"

17 A Well, there was going to be a meeting and some
18 discussion --

19 Q Wasn't John Nee in this case, concerned about the
20 fact that it might look bad for him and his group that they
21 just did this exam. So instead of going back and saying,
22 "Here's what we did and here's what we didn't do," there is
23 an effort there to say, "We looked at this, we didn't do
24 anything wrong, we didn't miss anything," when in fact, they
25 hadn't even looked at that issue at all.

1 A I don't know what took place -- you know, what
2 conversations were had between John and Doria. You know, my
3 intention -- when you're running a program, I have, you know,
4 90, 95 people reporting up to me, John's much more familiar
5 with what we did, what the issues are. You know, I read the
6 report, I have some familiarity but I can't talk about the
7 details of what went on.

8 MS. STEIBER: Well, what are some -- oh --

9 THE WITNESS: Okay, but you know, the similarity, I
10 know we looked at the front running, but the other issue we
11 obviously didn't. So my thinking here is get -- and I do
12 this all the time -- get the people who did the exam work
13 together with the Enforcement staff and they talk it over so
14 this way they could come up with some sort of strategy.

15 MR. KOTZ: And when you say, "I remember looking at
16 similar allegations back in the '90s at Madoff," you were
17 referring to that 1992 cause exam?

18 THE WITNESS: That's -- that is right, yes.

19 MS. STEIBER: The one about a Ponzi --

20 THE WITNESS: And which, you know, we didn't look
21 at, but it's conceivable that could have been a Ponzi scheme.

22 BY MR. KOTZ:

23 Q But would you say it would -- would you say it was
24 fair to say that you had looked at the issue of Madoff being
25 a Ponzi scheme in the '90s such that it could go back to

1 Enforcement and say, "Harry Markopolos is coming in saying a
2 Ponzi scheme," and your response is, "We already looked at
3 it?"

4 A Well, the truth of the matter is we did look at it.
5 In '92, you know, there was work done because there was
6 concern that there may have been a Ponzi scheme back in -- at
7 that time period. You know, we brought a case on
8 registration issues but there was some work done to see if
9 there was a Ponzi scheme, that's where that asset
10 verification piece -- you know, took place.

11 Q Okay, let me show you the next document. Mark the
12 next one as Exhibit 29. Yeah, this is marked as Exhibit 29.
13 This is an e-mail from Peter Lamore to Nee and Ostrow,
14 11/10/2005, 12:21 p.m.

15 If you see, Harry Markopolos sends an e-mail to
16 Meaghan Cheung, Monday, November 7, 2005. And he says,
17 "Meaghan, I spent some time over the weekend further
18 improving my analysis on why Madoff Investment Securities LLC
19 is likely a Ponzi scheme." You see that?

20 (SEC Exhibit No. 29 was marked for
21 identification.)

22 THE WITNESS: Yes.

23 BY MR. KOTZ:

24 Q And then Peter Lamore says to John Nee and Ostrow,
25 "I'm going to meet with Meaghan and Simona on Monday at 3:00

1 to provide my input regarding these allegations. In short,
2 these are basically the same allegations we've heard before."
3 When did Peter Lamore hear before that Madoff was running
4 a -- likely a Ponzi scheme? And then he says, "I think he's
5 on a fishing expedition, doesn't have the detailed
6 understanding of Madoff's operations which we do, which
7 refutes most of his allegations."

8 So, one of two things has to be true here, either
9 from Lamore's perspective, the 2005 cause exam looked at the
10 Ponzi scheme issue and determined that it wasn't the case, or
11 the 2005 cause exam didn't look at the Ponzi scheme issue and
12 he's giving an inaccurate description of what they looked at.

13 A I can't get into Peter's head. Obviously, there's
14 talk of the front-running issue here and that's maybe what
15 he's referencing, but there's -- the Ponzi scheme issue was
16 really not part of --

17 Q Would you say it was accurate to say, in the 2005
18 cause exam, that that 2005 cause exam refuted most of Harry
19 Markopolos' allegations? Is that an accurate statement?

20 A Well, I think we couldn't find evidence of the
21 front-running, so -- refute that.

22 Q Right, but -- all right, but do you think it's
23 accurate to say that the exam refuted most of Harry
24 Markopolos' allegations?

25 A Are we talking about just his brief description --

1 Q The next page, "The World's Largest Hedge Fund is a
2 Fraud."

3 A Oh, God. All these.

4 Q If you see on page 2 it -- there it says -- on
5 page 1 it says, "There are two possible scenarios that
6 involve fraud by Madoff Securities." See on the first page
7 of Harry Markopolos' complaint? The first one -- it says,
8 "Scenario one unlikely." You see that?

9 A Mm-hmm.

10 Q And then the second page it says, "Scenario two,
11 highly likely. Madoff Securities is the world's largest
12 Ponzi scheme." Okay? "Highly likely. Madoff Securities is
13 the world's largest Ponzi scheme." That's attached to this
14 document. Peter Lamore's response is, "We did an examination
15 which refuted most of his allegations." Isn't that false?

16 A I think what Peter was trying to say here is that
17 we refuted the allegations regarding the front-running.

18 Q Okay.

19 A I believe he's trying to say here --

20 Q Right, but that's not what he's saying. What he's
21 saying is a false statement, correct? The examination didn't
22 refute most of Harry Markopolos' allegations, particularly
23 since his allegation that is highly likely is that it's Ponzi
24 scheme. That is not an accurate statement.

25 A But don't you have to go through this whole -- you

1 have to go through the whole document, though, too. You
2 know, he -- you're right, we did not refute the fact that
3 this is a Ponzi scheme, I agree with that.

4 Q Do you think that --

5 A You know -- you're right.

6 Q -- the Enforcement lawyers would get the impression
7 from this kind of statement that the exam had a greater focus
8 than it did by virtue of forwarding a complaint that talks
9 about Bernie Madoff running a Ponzi scheme and Lamore
10 responding that it refutes most of the allegations?

11 A It's possible, yes.

12 Q Okay. Let me show you the next document.

13 I'll mark this as Exhibit 30. This is an e-mail
14 from Lamore to John Nee, 11/10/2005, 12:51 p.m.

15 This is the response from John Nee to this e-mail
16 that I showed you, where John Nee says on 11/10/2005,
17 11:42 a.m., "No Peter, I don't have anything to add, I think
18 the report speaks for itself. There is still a little
19 mystery as to what Madoff does, but a Ponzi scheme or
20 directly trading on immediate customer order flow doesn't
21 likely from what we've seen."

22 Is that true that based on the examination the
23 determination was a Ponzi scheme wasn't likely?

24 (SEC Exhibit No. 30 was marked for
25 identification.)

1 THE WITNESS: I don't see that fully in the scope
2 of the examination.

3 BY MR. KOTZ:

4 Q In fact, isn't it true that the examination made no
5 determination one way or another about whether Madoff was
6 running a Ponzi scheme because it didn't look into that
7 issue?

8 A That was not the primary issue of the exam.

9 Q Was it a secondary issue?

10 A Doesn't seem like it was a secondary issue. The
11 primary issue was the front-running and the trading issues,
12 that was -- those were the issues.

13 Q Okay, I'm going to show you the next document,
14 which is Exhibit 31, which is then Lamore -- you can see
15 below it says to Meaghan Cheung, Simona Suh, 11/14/2005,
16 9:29 a.m. "Hi Meaghan and Simona," he says, "In general the
17 informant raises some valid questions, but I believe most
18 of his allegations can be refuted based upon the examination
19 that we conducted this year." How can he say that most of
20 Harry Markopolos' allegations can be refuted based on the
21 examination that we conducted this year if at least some
22 significant portion of Harry Markopolos' allegations are that
23 Bernie Madoff ran a Ponzi scheme? Isn't this a false
24 statement as well?

25

(SEC Exhibit No. 31 was marked for

1 identification.)

2 THE WITNESS: Well, his next sentence, though, he's
3 talking about how -- refute all of his allegations, we may
4 want to request some documentation from one or more
5 fund-to-funds, and I think he's getting to the asset
6 verification piece. And I think that's what his intent is
7 there, like you're going to some of the -- you know, the
8 custodians and possibly other entities who would have the
9 ability to sort of confirm for us the existence of the
10 assets.

11 BY MR. KOTZ:

12 Q But it isn't true that most of the allegations
13 could be refuted based on the examination that they did,
14 right?

15 A The Ponzi scheme aspect, it was not part -- it was
16 not the scope of the examination.

17 Q Okay. All right, let me show you the next
18 document. We'll mark this as Exhibit 32. And now you see
19 Doria Bachenheimer to Andrew Calamari, 11/22/2005, 10:29 a.m.
20 They're talking about what to do and they say, "The exam team
21 doesn't think there is anything here. Simona is going to
22 seek information from some of the hedge funds on a voluntary
23 basis to test some of the explanations that Madoff gave to
24 the exam team. If they work out we won't do anything."

25 So isn't it what happening here is that the

1 Enforcement lawyers are relying on the representations made
2 by the exam team that there wasn't anything there, when in
3 fact, the exam team hadn't even looked at it?

4 (SEC Exhibit No. 32 was marked for
5 identification.)

6 THE WITNESS: That appears to be what's happening.

7 BY MR. KOTZ:

8 Q Okay. Were you involved at all in the Enforcement
9 investigation?

10 A No, I was not.

11 Q Okay. But you know that Peter Lamore was?

12 A Yes. I know I green-lighted his involvement -- you
13 know, to assist because he had more of a first-hand knowledge
14 of the trading operation.

15 Q Were you aware that William Ostrow also wanted to
16 be involved in the Enforcement investigation?

17 A Was I aware? I don't know if I was fully aware. I
18 may have had some awareness. You know, if I was made aware,
19 I probably would have said no, because usually, the way it
20 works is -- you know, you have one person to work on it, not
21 to have two examiners. We have to get some exams done, too.
22 At the end of the day, I have to have people -- you know, do
23 work in the exam program as well.

24 Q Right. Did you ever hear any frustration that
25 Peter Lamore expressed about working with Enforcement?

1 A Yeah.

2 Q What was that?

3 A He -- on occasion he mentioned that he wasn't sure
4 if they were following up on certain questions, certain
5 issues, that type of thing.

6 Q Did he indicate why they weren't following up?

7 A No.

8 Q Were you aware that the matter was then closed?

9 A Yeah, I'm aware --

10 Q Were you aware at the time? I mean, you're
11 obviously aware --

12 A I think I became aware, you know, before this thing
13 broke I became aware --

14 Q Okay.

15 A -- that it was closed.

16 Q Okay. And what was your reaction when you found
17 out in December of 2008 that Madoff had confessed to a Ponzi
18 scheme?

19 A I was not happy, you know, I was shocked. And I
20 was surprised. It was -- it's a horrible, horrible
21 experience to know that there are certain allegations that
22 were out there, you know, be it front-running, you know,
23 later a Ponzi scheme, and -- that we didn't find. You know
24 that's one of the worse things for a professional person
25 who's charged with regulating or examining to sort of miss

1 something. And, you know, unfortunately we do not give 100
2 percent seal of approval on all the work and we occasionally
3 miss things. But it's a terrible, terrible feeling.

4 Q Okay. Let me -- I'm going to show you a couple
5 e-mails that reflect Peter Lamore's views after December 11th
6 and he found out about this.

7 This is an e-mail dated 12/13/2008, 1:19 p.m.,

8 we're going to mark it as Exhibit 33. Lamore says to

Enforcement
Assistant Regional
Director

9 [REDACTED] -- do you know who [REDACTED] is?

Enforcement Assistant Regional
Director

10 (SEC Exhibit No. 33 was marked for
11 identification.)

12 THE WITNESS: Yeah.

13 BY MR. KOTZ:

14 Q Okay, he's a fellow SEC examiner?

15 A He's a --

16 No, he's not an examiner. He's a lawyer --

17 Q A lawyer.

18 A -- and he's very aggressive. He's actually very
19 good. He heads up the hedge fund working group. He's very
20 good.

21 Q Peter Lamore says in this e-mail, "Our hesitancy
22 towards rocking the boat also is something that should be
23 reconsidered." Do you know what he might be referring to,
24 "hesitancy towards rocking the boat?"

Enforcement Assistant Regional Director

25 A Not specifically here, but, you know, [REDACTED] has

1 challenged a lot of the ways we do things. You know, within,
2 you know, the SEC New York office, you know, he's thinking we
3 should have been more specialization, more teamwork,
4 so -- and I think he feels we could be more aggressive at
5 times.

6 Q Okay.

7 A So he's probably, you know, in a way discussing
8 that.

9 Q And then further down in the e-mail Lamore says to

10 Enforcement Assistant
Regional Director Saturday, December 13, 10:00 -- December 13, 2008,

11 "I just can't believe I've been duped again by another
12 industry superstar." You know what that refers to, "duped
13 again?"

14 A I'm not sure, no.

15 Q Were you aware of another situation where Lamore
16 did an exam and something came out afterwards that was
17 different from what he found?

18 A I am not aware.

19 Q Okay.

20 MS. STEIBER: Can we go off the record for a
21 minute?

22 MR. KOTZ: Go off the record.

23 (A brief recess was taken.)

24 BY MR. KOTZ:

25 Q After the -- it all came out that Madoff had

1 confessed to a Ponzi scheme there was an effort made to do
2 further exam work, is that right?

3 A When you say "do further exam work" are you talking
4 about the --

5 Q Assisting the Enforcement lawyers, and, I guess,
6 the U.S. Attorney's Office and FBI in bringing a criminal
7 case against Bernie Madoff.

8 A Yes. Yes, we essentially opened up an exam. It
9 was a new exam --

10 Q Right.

11 A -- looking into the various issues.

12 Q And you were the one who opened up that exam?

13 A Yeah. I got an e-mail from Andy, I think at like
14 7:30 on a Thursday morning, it was the 12th, and you know,
15 when I heard about this, you know, we got to get to the firm
16 immediately. So I went with a team of people and I think we
17 arrived there about 9:30 in the morning. Now the actual
18 assign -- the assigning of the assignment memo and all that,
19 I don't recall doing that, someone else may have done that.

20 Q Okay. But do you have involvement in that ongoing
21 activity assisting the Enforcement division?

22 A I did for probably about six to eight weeks. Now
23 I'm pretty far removed from that.

24 Q How -- was there any reason for the change?

25 A Well, what happens is, you know, I was onsite -- I

1 actually was onsite for, you know, about a week or two and
2 then, you know, I just got to run a program so I just can't,
3 you know, stay with one matter for an extended period. So we
4 got -- we had some issues, we had to put a different branch
5 chief on. We got the branch chief in there and then we had
6 Peter work on it having his -- benefit of his continuing
7 knowledge, and some other individuals as well.

8 Q Okay. Let me show you a document. This is an
9 e-mail from John Nee to Personal Privacy, Michael Kress,
10 Personal Privacy, cc: Robert Sollazzo, you, 1/7/2009,
11 7:19 p.m.

12 You sent an e-mail out saying, "I need two staff
13 people to assist on the Madoff exam." And John Nee responds,
14 "Ethan, do not consider William due to his previous
15 involvement." Were you aware that John Nee was saying not to
16 have Ostrow work on it because he previously was involved?

17 (SEC Exhibit No. 34 was marked for
18 identification.)

19 THE WITNESS: I had spoken to John, I think he was
20 a bit concerned about having folks who had previously worked
21 on the last matter involved with the current matter. So, I
22 got -- he would be one of the people I would have considered
23 putting on the matter, but I sensed some -- I don't think he
24 was in that day or I didn't speak to him, but I sensed that
25 he was very, very uncomfortable.

1 BY MR. KOTZ:

2 Q Wouldn't that be a valid concern that somebody
3 worked previously on it might be conflicted in working on it
4 after?

5 A I agree, I think it is a valid concern.

6 Q So how come Peter Lamore is essentially the main
7 person on the post-Madoff confession exam?

8 A He was -- I don't know about main person, but he
9 was an important person. It was my decision, and the reason
10 I put him on that is because when allegations of a
11 \$50 billion Ponzi scheme are going on, and you don't
12 know -- you know, what exactly is happening, you walk into a
13 firm and it's not -- you know, Morgan Stanley, but it's a big
14 firm, and you want to have an understanding of at least what
15 the firm told us in the past, what the records look like, and
16 how to sort of try to work through the fraud. And you know,
17 Peter, I felt, would be instrumental in getting us to that
18 point.

19 Q Notwithstanding the potential conflict?

20 A I felt getting him involved was more important. I
21 made that decision.

22 Q Okay. Did anyone come to you and suggest that
23 perhaps Peter not be involved in it because he had been
24 involved previously?

25 A It was just the -- we've had discussion with John

1 and then --

2 Q Was there anybody on the Enforcement side who came
3 to you and said, "We don't think it's a good idea for Peter
4 to be involved?"

5 A I don't recall. It's possible, I don't recall.

6 Q Okay.

7 A I did hear bits and pieces that people felt maybe
8 it wasn't the best idea and it may have come from several
9 sources.

10 Q Did you ever consider recusing yourself entirely
11 from the process since you were involved in, you know, a high
12 level way in the previous exam as well?

13 A Didn't ever consider that, no.

14 Q Okay. And you went onsite?

15 A Yes, I was onsite for several days in the, you
16 know, the weekend and several days.

17 Q Were Madoff family members onsite when you were
18 onsite?

19 A Yes, Peter Madoff, Shana Madoff. Bernie was not.
20 I'm not sure about the sons, I never met the sons.

21 Q Was the area closed off such that the Madoff family
22 members weren't able to access documents after you came
23 onsite?

24 A No, no. It wasn't closed off, it took a while.
25 And, you know, it went to SIPC and a trustee was assigned and

1 then closure occurred.

2 Q We heard that when people went onsite they saw
3 Shana Madoff at the copy machine making copies of things,
4 handling documents. Was that happening?

5 A It probably was happening, yes.

6 Q Wouldn't there be a concern that she would, as an
7 interested party, be shredding things or taking things for
8 herself?

9 A I, you know, I think that that is a reasonable
10 concern, but at this point I felt we didn't have the
11 authority to -- you know, it's their firm. You know, it's
12 their firm at this point, even though, yeah, you have a Ponzi
13 scheme, he's confessed, we're bringing a case, you
14 know, -- brought the case on the Thursday or Friday, but you
15 know, Peter and Shana were principals of the firm and we
16 needed information. It was -- they were sort of like the
17 go-between helping us out.

18 Q Was there any discussion with the U.S. Attorney's
19 Office or the FBI about whether you could secure the firm and
20 not allow them access to certain things?

21 A I think those discussions came later, and not in
22 the first few days.

23 Q Okay.

24 A It was -- when you go into one of these -- this is
25 not my first one, when you go into one of these things it's

1 generally like a real mess and people are like panicked and
2 shocked and it's a very difficult situation. so you're trying
3 to learn what you can.

4 Q Okay, just for the record, the last document -- I
5 guess I didn't put it officially in, this is marked as
6 Exhibit 34, the e-mail from John Nee to Personal Privacy, Cress,
7 Personal Privacy with a copy to you, 1/7/2009, 7:19 p.m.

8 This is another document I'm going to show you, I'm
9 going to mark as Exhibit 35. This is an e-mail from Lamore
10 to Michelle Trillhaase, 12/15/2008, 3:09 p.m. This is also
11 Lamore reflecting after December 11th. If you look on the
12 second page --

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

15 THE WITNESS: Can I ask who Michelle Trillhaase is?

16 BY MR. KOTZ:

17 Q I don't know, I was going to ask you.

18 A Okay.

19 Q Maybe it's a friend of his.

20 A Yeah, obviously.

21 Q If you could see on page 2 of 3 Lamore is saying to
22 Michelle Trillhaase, Sunday, December 14, 2008, 4:33 p.m.,
23 the second paragraph, "It's been a tough couple days for me.
24 Although I gave the exam and follow-up our 110 percent, we
25 just didn't uncover it. I think we were very close, probably

1 only one or two phone calls away from blowing it open but we
2 didn't." Do you agree with Peter's assessment that
3 he -- you -- the exam team was one or two phone calls away
4 from blowing it open?

5 A One or two phone calls, I don't know about that. I
6 don't know if we were one or two phone calls away from
7 blowing it open.

8 Q Okay. Were you aware at any point in time that any
9 of the folks who worked on the exam post the Madoff
10 confession had identified some documents that they wanted to
11 provide to our office?

12 A Yes, there is -- there's one situation that -- it
13 happened I think within the first week, and there was a
14 directory brought to my attention, it was a telephone
15 directory that was pulled from Bernie's handbag. And Mike
16 Kress, who was a branch chief on the matter, he was going
17 through a difficult period, this is very stressful for
18 everyone involved.

19 Q Right.

20 A And he sort of brought it to my attention saying
21 that, you know, maybe this is something we should show the
22 Inspector General, like immediately. I looked it over and,
23 you know, I saw it was a telephone directory, had a bunch of
24 names, you know, he's pulling up those SEC names. And there
25 were, there were a bunch of SEC names and I think we've

1 provided the document to you so you know what I'm talking
2 about.

3 But I didn't feel like it was anything that was so
4 severe or a smoking gun, and what happened -- you know,
5 unfortunately, with the stress and everything we had to make
6 some personnel changes because, you know, people got very
7 upset at what went on, so we had to make those changes, I
8 won't go into detail on those.

9 Q Were you aware we never did get the document? The
10 only way we found out about this was because we interviewed
11 Mr. Kress and saw e-mails that Kress wrote where he wrote in
12 e-mails, this is an important document that should go to the
13 Inspector General?

14 A I --

15 Q Then we asked him about it -- hold on -- and he
16 said that he talked to you about it and you assured him it
17 would go to the Office of Inspector General and in fact, it
18 didn't until we found out about this through an interview
19 with Kress.

20 A Okay. I know I did not provide it to you, okay?
21 And I don't believe I assured Mike that I would send it. You
22 know, when Mike -- that was like a late night, he came into
23 my office, he was agitated. I don't know if you saw the
24 e-mail traffic that was going on --

25 Q Yeah.

1 A -- you know, it's -- you know, some of the stuff I
2 just felt that, you know, the conclusions that were being
3 reached were not totally logical. I just felt, you know,
4 there was something going on a little bit, you know, a little
5 bit different than my normal working group Mike. And the
6 document comes to my attention, you know, I didn't feel it
7 was necessary to move that document to the Inspector General.

8 Q Are there any other documents out there that you've
9 seen that were determined not to provide to us?

10 A There are no documents that in my belief would make
11 your investigation clearer. Frankly, I didn't think that
12 document would be that -- would be helpful to the
13 investigation, I just thought it was a telephone list and it
14 had a bunch of names. And some of them were SEC names, I
15 realize that, but I didn't think it was really relevant.
16 That was my belief, okay?

17 Q Right, but if you had a phone book and it had
18 personal phone numbers of SEC high level employees in Bernie
19 Madoff's phone book, you don't think that would be something
20 we'd want to follow up on?

21 A Not necessarily, because there were -- there was
22 probably like 200, 300 people in that phone book and there
23 were a lot of industry contact, people from -- from NASD,
24 there were people from all over the place. You know, I went
25 through it, I didn't think it was that important to the

1 investigation.

2 Q All right, well, we would ask that if you become
3 aware of any documents that have any relevance at all to our
4 investigation, you either -- through you personally, or
5 through John Walsh, turn it over and let us determine whether
6 we believe it's something that should be followed up on.

7 A And by that, you mean anything -- you know,
8 anything implicated either staff in wrongdoing or any sort of
9 issue --

10 MS. STEIBER: A potential conflict of interest with
11 staff --

12 MR. KOTZ: Right.

13 THE WITNESS: Okay. Yeah, I will do that.

14 BY MR. KOTZ:

15 Q I mean, whether it's the most important document we
16 have or just a document that we might consider following up
17 on, we don't know until we get the document. And when we
18 have a situation where we don't get it and we read these
19 e-mails and then interview somebody, then we may view the
20 document as being withheld or much more significant than it
21 is, right, because it wasn't provided. So in some ways it's
22 better to just provide it to us rather than hold it back
23 because probably at the end we're going to see it anyway.

24 A No, I appreciate what you're saying. You know,
25 again, I just didn't think it was really relevant, that was

1 my view. But I understand what you're saying --

2 Q Okay.

3 A -- and I will -- that.

4 Q Anything else? In connection with an exam you
5 would do an initial interview, right?

6 A Right.

7 Q Is that part of the exam process?

8 A Yes.

9 Q Would asking about whether there's an open SEC
10 exam, would that be something that would be raised in an
11 initial interview?

12 A That's not one of the questions that we'd ask.

13 Q Okay.

14 A It's -- it is embarrassing to find out that there's
15 an open exam for a registrant, we should have full awareness
16 of that. You know, it -- first going in and asking that
17 question doesn't make any sense, that's shows, like, you
18 know, the right hand doesn't know what the left hand is
19 doing. Generally, I think we're much better than that.

20 Q Have you had any substantive conversations with
21 anyone like Lamore, Ostrow or Nee about what went wrong in
22 these exams?

23 A After -- yeah, after the matter broke everyone
24 got -- everyone is obviously worried so people started
25 looking through documents and trying to figure out what went

1 on.

2 One thing that was pointed out to me -- there's a
3 couple things that I saw, but one thing that was pointed out
4 to me, one of the documents that they were provided during
5 the exam, which you know, it's sort of -- this is sort of
6 like in the week following when it broke, you know, it showed
7 inactivity listing for one of the hedge funds. It showed a
8 lot of the securities being delivered off, you know, to a
9 custodian. It was a bank I believe, I'm not sure what bank
10 it was, I don't recall at this point. But you know, in my
11 mind I said, "Oh God, you know, the way he structured this is
12 in such a way that, you know, he's doing sort of the trading
13 here but then he's DVP'ing, RVP'ing everything away."

14 So then -- you know, we're not going to find it
15 through the custody piece which is going through looking at
16 DTC because I thought maybe -- you know, they're alleging
17 that there was, you know, positions at DTC or something like
18 that, but that would not be the case when I saw that, which
19 would, in my mind, make it a little more difficult to find if
20 we were looking for that type of Ponzi scheme. That, you
21 know, that I remember seeing and thinking that.

22 What else, there were -- you know, we sort of
23 looked through this and tried to come up with some
24 improvements in the exam program. Obviously asset
25 verification confirmation when we think there's issues in

1 risk, but which, you know, we routinely do not do that.

2 I'm on a committee now actually, with the OC level
3 coordinated with FINRA as well, trying to work through, raise
4 some of the limitations here and have better policies for
5 verification. Because the -- in the exam world, most of the
6 time we do not send out confirmations and do asset
7 verification, but clearly there has to be times where we do
8 that and it'd have to be more effective. So, you know,
9 that's some of the -- what we're working on.

10 But the people, you know, I think you're aware of
11 this, you've spoken to -- people are very upset, you know, I
12 was upset. And I think we're trying to do the right thing
13 here. And obviously, you have -- it's horrible to miss
14 something like this.

15 Q What about the investigation? Any discussion about
16 the Enforcement investigation; how they could have missed it
17 at that point? They had Harry Markopolos' complaint.
18 Clearly, it talks about a Ponzi scheme.

19 A Yeah, I heard bits and pieces that -- you know,
20 they were doing -- do some asset verification -- you know,
21 send out to possibly DTC or something like that, which -- you
22 know, it was a little bit different than I sort of saw in the
23 other records because I thought they were telling us DVP/RVP.
24 But they're saying that we may have to reach out to DTC
25 and -- but I think Peter mentioned he wasn't sure if that was

1 on.

2 One thing that was pointed out to me -- there's a
3 couple things that I saw, but one thing that was pointed out
4 to me, one of the documents that they were provided during
5 the exam, which you know, it's sort of -- this is sort of
6 like in the week following when it broke, you know, it showed
7 inactivity listing for one of the hedge funds. It showed a
8 lot of the securities being delivered off, you know, to a
9 custodian. It was a bank I believe, I'm not sure what bank
10 it was, I don't recall at this point. But you know, in my
11 mind I said, "Oh God, you know, the way he structured this is
12 in such a way that, you know, he's doing sort of the trading
13 here but then he's DVP'ing, RVP'ing everything away."

14 So then -- you know, we're not going to find it
15 through the custody piece which is going through looking at
16 DTC because I thought maybe -- you know, they're alleging
17 that there was, you know, positions at DTC or something like
18 that, but that would not be the case when I saw that, which
19 would, in my mind, make it a little more difficult to find if
20 we were looking for that type of Ponzi scheme. That, you
21 know, that I remember seeing and thinking that.

22 What else, there were -- you know, we sort of
23 looked through this and tried to come up with some
24 improvements in the exam program. Obviously asset
25 verification confirmation when we think there's issues in

1 risk, but which, you know, we routinely do not do that.

2 I'm on a committee now actually, with the OC level
3 coordinated with FINRA as well, trying to work through, raise
4 some of the limitations here and have better policies for
5 verification. Because the -- in the exam world, most of the
6 time we do not send out confirmations and do asset
7 verification, but clearly there has to be times where we do
8 that and it'd have to be more effective. So, you know,
9 that's some of the -- what we're working on.

10 But the people, you know, I think you're aware of
11 this, you've spoken to -- people are very upset, you know, I
12 was upset. And I think we're trying to do the right thing
13 here. And obviously, you have -- it's horrible to miss
14 something like this.

15 Q What about the investigation? Any discussion about
16 the Enforcement investigation; how they could have missed it
17 at that point? They had Harry Markopolos' complaint.
18 Clearly, it talks about a Ponzi scheme.

19 A Yeah, I heard bits and pieces that -- you know,
20 they were doing -- do some asset verification -- you know,
21 send out to possibly DTC or something like that, which -- you
22 know, it was a little bit different than I sort of saw in the
23 other records because I thought they were telling us DVP/RVP.
24 But they're saying that we may have to reach out to DTC
25 and -- but I think Peter mentioned he wasn't sure if that was

1 ever done or not, but it was something that he left, you
2 know, up to Enforcement.

3 Peter was on -- he was helping out with the
4 investigation, but -- you know, he's also doing exam work,
5 too, so he was probably doing a couple days in -- you know,
6 frankly, I tried to yank him back and -- you know, tried to
7 get him to do some of the exams.

8 Q Right.

9 A You know, and that's one of the references in the
10 Carpoti e-mail, he was helping out on another investigation
11 for months. You know, because when we're trying to develop
12 these issues and trying to, you know, you break something, he
13 was on the investment banks that failed. But periodically I
14 have to yank these people back try to get them into the
15 program.

16 Q Did Peter ever indicate that or express any
17 frustration that Enforcement wasn't really listening to him,
18 perhaps sometimes the Enforcement lawyers don't listen to the
19 examiners as much as they could?

20 A I don't recall that. You know, I think he was just
21 a little skeptical whether, you know, they followed through
22 on some procedures. He wasn't sure, you know, if they did
23 it. You know, I think if they weren't going to listen to
24 Peter I don't think he would have been part of -- I think he
25 sat in on testimony --

1 Q Right.

2 A -- and the whole bit. I don't think he would have
3 been in on testimony. They would use -- they were trying to
4 use him to sort of help out.

5 Oh yeah, just one or two other things. I've
6 reviewed the testimony of DiPascali and Bernie Madoff and
7 it's clear they were just lying -- you know, in terms of
8 the -- especially the custody aspect.

9 Q Right.

10 A You know, and that's -- you know, part of the
11 problem, too, is these people were just -- you know,
12 obviously lying for an extended period, too.

13 And that's something, also, when I looked at this,
14 I said, "Oh, my God, look at this."

15 And -- you know, I showed -- after the fact,
16 pointed that out to Andy, in terms of evidence
17 against -- especially, you know, DiPascali.

18 Q Did you hear anything that -- said by either Lamore
19 or Ostrow that the thought Enforcement wasn't pushing hard
20 enough on Bernie Madoff?

21 A I don't recall hearing that.

22 Q Okay.

23 BY MS. STEIBER:

24 Q Were there any third parties that you think
25 Enforcement could have reached out to that would have

1 revealed the fraud?

2 A Yeah, the pieces that you'd have to look through is
3 the custody aspect, you know, where the assets would be in
4 custody, and sending out, you know, letters to those parties.

5 Q Well, you had questioned whether DTC would be one
6 of those parties you would reach out to, were there other
7 parties? OCC?

8 A Well, in -- not necessarily OCC. Well, they were
9 saying these were over-the-counter options. Over-the-counter
10 options don't clear through OCC, that's more for listed
11 options, so you'd have to figure out who the counterparties
12 are. And I don't think we knew who the counterparties are,
13 if you knew the counterparties you could reach out to them to
14 confirm the terms of the contract, but we didn't really know
15 that.

16 Q What about on the equities side?

17 A The equities side, you know, the custodial agents,
18 you know, I think they were mostly banks. And you could have
19 sent out asset verification letters, but with banks in
20 general you need a subpoena, you need a formal order of
21 investigation. There are some processes I think you could
22 follow to get the information voluntarily but it's not used
23 widely. We're starting to try it -- we're looking into that
24 now how we could use it in the exam program, but we're having
25 some difficulty. The banks, you know, because of the privacy

1 issues, are very hesitant to give it out without a subpoena.

2 BY MR. KOTZ:

3 Q Did Lamore or Ostrow ever express any frustration
4 that Enforcement didn't bring a formal order so they would
5 have subpoena power in the Madoff investigation?

6 A I don't recall hearing that.

7 MR. KOTZ: Okay. Okay, I think we're done.

8 Is there anything else that you can think of that
9 we haven't covered that might be relevant?

10 THE WITNESS: No, I think that was a pretty
11 comprehensive review, back from 1992. I think I've tried to
12 be as open and as truthful as possible.

13 MR. KOTZ: Yeah, we appreciate that.

14 The one thing we would ask -- and this is very
15 important, and that is to preserve the integrity of the
16 investigation for you not to discuss anything about the
17 testimony today with anyone.

18 THE WITNESS: That's -- I will not.

19 MR. KOTZ: Obviously, there are other people we are
20 going to be talking to, maybe calling people back, so it's
21 very important that you not discuss anything.

22 THE WITNESS: I will -- I respect that, I will not
23 do --

24 MR. KOTZ: Okay, thank you. Off the record.

25 (Whereupon, at 2:24 p.m., the examination was