

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

In the Matter of: )  
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1 background?

2 A I graduated in 1993 from the United States Coast  
3 Guard Academy. My major was management. I graduated in  
4 January of 1999 from New York University with a master's in  
5 business administration, emphasis was in finance.

6 Q And what do you do between '93 and '99?

7 A When I graduated from the Coast Guard Academy, I  
8 had a five-year commitment, so I was in the United States  
9 Coast Guard. At the last -- I think the last two years of my  
10 service time, I started the part-time program at NYU, so I  
11 did business school at night.

12 Q Okay. And so then in 1999, you graduated. How  
13 long was that program, the master's program from NYU?

14 A I did that part-time. It was approximately three  
15 and a half years.

16 Q On a part-time basis?

17 A Yes.

18 Q Okay. And so after you got your master's from NYU,  
19 what did you do then?

20 A Actually, prior -- I completed my service time in  
21 the Coast Guard Academy -- in the Coast Guard in  
22 approximately May of 1998, at which time I started an equity  
23 trading position at First New York Securities. My last  
24 semester at NYU, I was also working at First New York  
25 Securities.

1 Q Okay. What -- so what was your title at First New  
2 York Securities?

3 A I was initially an assistant equity trader. After  
4 approximately one year, I became an equity trader, which I  
5 was given approximately \$1 million in capital that I could  
6 use overnight and I was able to trade intraday as well.

7 Q How long did you do that for?

8 A I was an assistant for a year. I traded my own  
9 book for two years, and then the last two years, I worked for  
10 a hedge fund under the First New York umbrella. It's called  
11 FNY Millennium Partners.

12 Q What years were that, the two years that you worked  
13 for FNY Millennium Partners?

14 A I believe it was 2001 and 2002.

15 Q What did you do after that?

16 A The hedge fund -- the woman who ran the hedge fund  
17 was moving to another firm. I did not want to go with her to  
18 the new firm, so I stayed at First New York. So at the  
19 beginning of 2003, I went back to trading my own book, but I  
20 was also seeking employment as a trader elsewhere. I was  
21 hired by a firm called Axiom Global. I stayed there a very  
22 brief time. I wasn't happy with the position. It really  
23 wasn't trading. It was more to me sort of doing currency  
24 spreadsheets. It just wasn't a good fit, so I left there and  
25 took a -- I'm not sure. There might've been a month or two

1 off, but I took a sort of similar position that I had at  
2 First New York as an equity trader at a firm called Schonfeld  
3 Securities. Again, I didn't stay there very long, maybe a  
4 month or two.

5 I was -- I also -- I found a job at a firm called  
6 Louis Dreyfus. It's a big corporation that trades  
7 commodities and they were looking to start an equity trading  
8 desk and they brought me onboard to do that. At the same  
9 time I was interviewing for that position, I also had applied  
10 to the SEC. So I started at Louis Dreyfus, but once the SEC  
11 position was made available to me, I decided to take the  
12 position with the SEC.

13 Q So how long did you work for Louis Dreyfus?

14 A Approximately two months.

15 Q Okay. And how long did you work for Axiom?

16 A Approximately two weeks.

17 Q Oh, okay. And what year is this?

18 A This is all in 2003.

19 Q Okay. So 2003, you worked for really four places,  
20 right --

21 A Yes.

22 Q -- with the SEC being the fourth?

23 A Yes.

24 Q Okay.

25 BY MS. STEIBER:

1 Q And when you were trading, did you trade options?

2 A We did. We traded equity -- equities and equity  
3 options.

4 Q Did you trade them on an exchange or did you trade  
5 over the counter?

6 A They were all exchange traded. We traded them with  
7 counterparties, though. We traded with -- I can't think of  
8 the name, but it's a broker-dealer that we would call up and  
9 they would execute the orders. I think they actually had  
10 option four brokers is how they executed them.

11 Q And did you -- how did that work operationally?  
12 Did you get a contract and did you execute the contract?  
13 Could you just --

14 A Well, I did more of the frontend. I did the  
15 trading aspect, so I would call up and I would say, you know,  
16 "What's the price of -- I want to buy 300 General Electric  
17 March 20 calls," and they would come back to me and say,  
18 "\$1.20," and I would say, "Done." And then I'd fill out the  
19 trade ticket and then send it to the back office and then it  
20 would get processed. The next day I would make sure that,  
21 you know, the position hit the sheets properly.

22 BY MR. KOTZ:

23 Q So when exactly did you start with the SEC?

24 A I started with the SEC in November of 2003 --  
25 November 2003.

1 Q Okay. And what was your first position with the  
2 SEC?

3 A I was brought onboard as a securities compliance  
4 examiner. My level was a nine.

5 Q And who was your supervisor at that time?

6 A My branch chief was OCIE Assistant Regional Director.

7 Q Okay. And so how long did you serve as a  
8 securities examiner?

9 A My title was securities compliance examiner, and I  
10 stayed -- that was my title until I earned sufficient  
11 accounting credits to be -- to become a staff accountant.

12 Q When did you become a staff accountant?

13 A It was approximately three years, so I believe in -  
14 - I'm sorry. I believe it was in 2007, November of 2007.

15 Q Okay.

16 A I went 9, 11, 12, 13. At the point I reached level  
17 13 is when I became a staff accountant, and each of those  
18 increments was one year.

19 Q Okay. All right. So you started as a securities  
20 compliance examiner as an SK-9.

21 A Correct.

22 Q And when did you become an 11?

23 A One year later.

24 Q Okay. So say November 2004?

25 A Right.

1 Q Okay. All right. In the period between November  
2 2003 to November 2004 where you were a securities compliance  
3 examiner at the SK-9 level, what were you doing?

4 A I was conducting examinations. I conducted  
5 approximately three examinations. The first examination, I  
6 was sent out within the first week that I showed up at the  
7 SEC. The exam was approximately halfway done and lasted  
8 another, I would say, four weeks.

9 Q And what was your role in that exam that you went  
10 on immediately -- almost immediately after you joined the  
11 SEC?

12 A Really it was just to sort of get my feet wet, just  
13 to see how the exam process worked. I was shown some very,  
14 you know, basic reviews that were done, like, for brokers,  
15 like churning and things like that.

16 Q Okay. So you first come in, you're there a week,  
17 you go in to kind of see what the exam's like. The exam had  
18 already started.

19 A Uh-huh.

20 Q You continued to work on the exam for a few weeks  
21 until it ends. What do you do next?

22 A Following that, the -- you know, we did the -- sort  
23 of the end of exam process, which is putting together work  
24 papers and writing the report and things like that. That may  
25 have lasted two to three weeks, and then my second exam -- I

1 was assigned to my second exam and that started in January of  
2 that month.

3 Q January --

4 A January of 2004.

5 Q January of 2004 you did your second exam. And how  
6 long did that last?

7 A That was a very long exam. I would say four to  
8 five months.

9 Q Okay. So say until about June 2004 or May 2004?

10 A Correct.

11 Q Okay. And then did you do another exam after that?

12 A I did a third exam, which I recall it being pretty  
13 long as well, three to four months I would say.

14 Q And did that start right after the second exam?

15 A No, I would say we had a month or two to wrap  
16 things up.

17 Q Okay. So the third exam took you until around  
18 November of 2004 when you became the SK-9 -- 11?

19 A Yeah. I mean it may have been September/October.  
20 I'm not sure exactly.

21 Q Okay. And then shortly after the third exam ended,  
22 you got bumped up to an SK-11; is that right?

23 A Every year I was promoted to the next level.

24 Q Okay.

25 A So --

1 Q All right. And so then when you became a staff  
2 accountant -- or I'm sorry. When you became an SK-11, did  
3 you have the same branch chief?

4 A There was a turnover. I'm not -- I think -- I'm  
5 pretty sure I did. My branch chief subsequently became

6 [REDACTED] New York Branch Chief

7 Q Okay.

8 A I'm not sure -- I don't recall exactly when.

9 [REDACTED] OCIE Assistant Regional Director

was promoted to assistant regional director.

10 [REDACTED] New York Branch Chief

became branch chief.

11 Q Okay. And so the third exam ends. You get bumped  
12 up to an SK-9 because it was about a year after you came in,  
13 right?

14 A Eleven.

15 Q I'm sorry, 11. And then you worked on additional  
16 exams after that?

17 A I do recall -- yeah, we did one exam. It was very  
18 short, maybe a month, but, yeah, that's --

19 Q Okay. And on these exams, I think we talked about  
20 four exams, were you the lead person on those exams?

21 A No.

22 Q Okay. So the branch chief was the lead person?  
23 Was there another auditor?

24 A There was always another auditor on the exam.

25 Q Okay.

1           A     There were instances where -- you know, every exam  
2 is sort of different. In some cases, you know, there will be  
3 a branch chief that's very involved. In other exams, really  
4 the lead examiner will be more involved. I've done exams  
5 where the ARD has been very involved. It just -- it really  
6 sort of depends on the firm and the type of reviews that are  
7 being done.

8           Q     Okay. So then you get bumped up to an 11 in  
9 November 2004, and then after -- you said you did a short  
10 exam. And what did you do after that?

11          A     I'm sorry; I'm blanking out. I think the next exam  
12 that I was assigned to was the Madoff exam, if I'm correct.

13          Q     Okay. Okay. And then you got promoted again or  
14 you got a grade increase in November of 2005?

15          A     Correct.

16          Q     Okay. So that would go up to a SK-13?

17          A     Twelve.

18          Q     Twelve. Oh, okay. So it goes from a 9 to 11 to a  
19 12.

20          A     Correct.

21          Q     Okay. Okay. And what about after that? Then the  
22 next bump up was to staff accountant in November of 2007?

23          A     Correct, that was in November of 2007.

24          Q     Okay.

25          A     So I had -- I was sort of attending accounting --

1 taking accounting classes prior to that, and then once I  
2 earned sufficient accounting credits, I applied to become a  
3 staff accountant.

4 Q And is that your current position today?

5 A Correct.

6 Q Okay. And who's your current supervisor?

7 A My current supervisor is Michael Kress.

8 Q How long has he been your supervisor?

9 A I believe approximately one year. There was a  
10 shift. I was moved from New York Branch Chief branch to his  
11 branch.

12 Q Okay. Did at any point you work for John Nee or  
13 Bob Sollazzo?

14 A Directly?

15 Q Well, in the chain. I mean in some --

16 A Currently -- currently John Nee is in my chain.

17 Q Okay.

18 A Michael Kress reports to John Nee.

19 Q Okay. And then Nee reports to Sollazzo?

20 A Correct.

21 Q And so throughout the entire period, you were  
22 reporting to Sollazzo because he was always at the top of the  
23 chain; is that right?

24 A Correct.

25 Q And what about Nee?

1 A Well, my initial branch chief was [OCIE Assistant Regional Director]  
2 who reported to [Personal Privacy] who reported to John Nee.

3 Q Okay.

4 A Subsequently it was [New York Branch Chief] who reported to  
5 [OCIE Assistant Regional Director] who -- I believe [OCIE Assistant Regional Director] reports to  
6 Richard Lee.

7 Q Okay.

8 A And then about a year ago, I was switched to  
9 Michael Kress's branch, who reports to John Nee who reports  
10 to Bob Sollazzo.

11 Q Okay. Any particular reason that you were switched  
12 to Kress's branch or --

13 A My understanding was that it was a better fit for  
14 sort of my background and the types of exams that they  
15 envision me working on.

16 Q Okay. Okay. All right. Let me ask you the next  
17 kind of set of questions. When did you first hear of Bernard  
18 Madoff of Madoff Securities?

19 A I first heard of the firm when I was assigned to  
20 the exam.

21 Q Okay. So before that -- before you were assigned  
22 to the exam, you had never heard the name Bernie Madoff?

23 A No. I mean I may have heard, just as a trader,  
24 Madoff, but not -- I mean I never really focused on it as  
25 anything -- any other -- like an unusual or unique firm.

1 Q Okay, but the name was familiar to you when you  
2 began the exam, the Madoff name?

3 A I believe it was because they're a pretty prominent  
4 market maker.

5 Q Okay. Had you heard anything about their market  
6 making operation?

7 A No.

8 Q You were just kind of aware that they were one of  
9 the large ones?

10 A As a trader, the big market makers are listed on  
11 the screens. So I think their four letters designation is  
12 MADF. So that's what I recall.

13 Q Okay. You mentioned that you were assigned to the  
14 Madoff 2005 cause exam.

15 A Correct.

16 Q Prior -- when you were assigned to that 2005 cause  
17 exam, what awareness, if any, did you have of previous exams  
18 that the SEC had done of Bernard Madoff and Madoff  
19 Securities?

20 A I wasn't aware of any -- I didn't see any reports.  
21 I think Mr. Sollazzo may have mentioned we had looked at them  
22 at some point, but I don't -- I didn't see any reports or  
23 anything.

24 Q When did Sollazzo say we had looked at them at some  
25 point? That was at the beginning of the exam?



1 case that at some point in the middle of the 2005 cause exam  
2 you became aware that the Washington OCIE headquarters office  
3 had done or was doing an exam?

4 A Correct.

5 Q But when you started the 2005 cause exam of Madoff,  
6 you weren't aware of that exam going on?

7 A Correct.

8 Q Okay. Were there any searches done by you when you  
9 started the 2005 Madoff cause exam of databases to determine  
10 whether there were other exams that were done of Madoff by  
11 the SEC?

12 A Normally that's what we would do as part of the  
13 pre-examination work. I don't recall specifically doing, you  
14 know, that sort of a search.

15 Q Okay. Okay. And so you were assigned to work on  
16 the 2005 cause exam. Were you told what your role would be  
17 in that exam?

18 A We didn't really -- there were no roles designated.  
19 On most exams, there really aren't. It's more, you know,  
20 this is the exam, and they have some sort of discussions  
21 about the firm, but really you kind of just attack it as a  
22 team.

23 Q Okay, but was it your understanding that you would  
24 have a pretty prominent role in the examination?

25 A I don't think any more so than any other exam. I

1 mean typically I'm given or assigned to exams where they're  
2 sort of trading related issues.

3 Q Okay.

4 A And I guess just from my background, that makes  
5 sense.

6 Q Okay. So were you aware that they waited to do the  
7 exam until you came on because they wanted your particular  
8 expertise on the exam?

9 A No.

10 Q Okay. But you were aware that one of the reasons  
11 you were assigned to that exam was because of your trading  
12 experience?

13 A I thought it made sense based on sort of the  
14 suspicions regarding the firm.

15 Q And you were aware that that was a factor that they  
16 had in their mind as to why you were assigned?

17 A Well, I think I -- I thought that's why we were  
18 basically doing the exam was based on some suspicions  
19 regarding the firm.

20 Q Right, but were you aware that one of the reasons  
21 that you were specifically put on the exam was because of  
22 your previous trading experience outside the SEC?

23 A I mean that was not directly said to me.

24 Q Okay. Okay. In the other exams that you did prior  
25 to the Madoff exam, was there a branch chief on the exam?

1           A     Usually.  There was one exam where there was no  
2 branch chief.  There was just an ARD.

3           Q     Okay.  Was there a branch chief on the Madoff cause  
4 exam?

5           A     No.

6           Q     Okay.  So what is the role that a branch chief  
7 usually plays on a cause exam?

8           A     I think a branch chief generally plays the same  
9 role on a cause exam or just an oversight exam.

10          Q     Okay.

11          A     It's -- I guess it's really to serve as someone  
12 overseeing the exam, someone with a little more experience  
13 that you can speak with to get ideas, to discuss issues with.  
14 Some, based on their experience, obviously are more helpful  
15 than others.

16          Q     Okay.  Generally when a branch chief is working on  
17 an exam, is the branch chief onsite at times?

18          A     It really -- it varies dramatically.  In some cases  
19 they're onsite practically every day.  In other cases,  
20 they're rarely onsite.

21          Q     Okay.  Okay.  In this case because you didn't have  
22 a branch chief, who served in that role?

23          A     Well, I don't -- I think we sort of tried to keep  
24 Mr. Nee updated as far as what we were finding, any issues we  
25 were having.  The things that would, I suppose, normally go

1 to a branch chief were going to him.

2 Q Did -- was John Nee in the field at all during the  
3 examination?

4 A I recall him being in the field once, I believe.

5 Q Okay. So on one day?

6 A Correct. I think an afternoon.

7 Q Okay. What about Bob Sollazzo? Did he have any  
8 particular role in the examination?

9 A No, I don't recall having any formal discussions  
10 with him. We may have bumped into him in the hall and sort  
11 of let him know how things were going.

12 Q Okay. Was he -- he was never in the field, though,  
13 during the examination?

14 A No.

15 Q Okay. Did you have occasion to interact with  
16 Bernie Madoff during the examination?

17 A Yes.

18 Q Okay. How often would you interact with Bernie  
19 Madoff?

20 A Daily. He was our primary -- really exclusive  
21 contact for the firm.

22 Q And how long -- so when you say daily, for how long  
23 of a period of time?

24 A Intraday.

25 Q No, no. I mean, in other words, how long of a

1 period of time were you onsite such that you would interact  
2 with him daily?

3 A We were there two and a half or three months, I  
4 would say.

5 Q Okay.

6 A So there was a time where we were -- I'm sorry.  
7 There was a time when I think we had vacations or we were  
8 moving off -- moving to a new office where we weren't, but  
9 essentially it was two and a half to three months.

10 Q Okay. And so you interacted with Bernie Madoff  
11 daily during that two and a half to three months?

12 A Correct.

13 Q And how -- for how long of a period during a day  
14 would you interact with Bernie Madoff?

15 A It varied. I mean in some cases it was for several  
16 hours. In other cases, very little, maybe a "Good morning"  
17 or a "Hello," but in some cases it was for numerous hours.

18 Q Okay. Did you have interactions with other Madoff  
19 family members during the cause exam?

20 A Very little. We may have -- I think we were  
21 actually conducting the exam out of one of the son's offices,  
22 so he might walk through occasionally, but really didn't have  
23 any conversations with him. Bernie's brother, Peter Madoff,  
24 was the compliance officer, so we may have had a meeting or  
25 two with him, but very little interaction.

1 Q What about Shana Madoff?

2 A She was a compliance person as well. The only --  
3 my only recollection of dealing with her was when we were  
4 conducting or asking about emails and that's --

5 Q Okay.

6 A -- my only --

7 Q But that was a relatively small amount of time?

8 A Correct, maybe a day or so.

9 Q Okay. Did you ever speak to Bernie Madoff after  
10 completing the examination?

11 A No.

12 Q Okay. Did you find it odd at all that your primary  
13 contact on the exam was the head of the firm?

14 A Yes.

15 Q How come?

16 A It just seemed odd to me that someone of his  
17 stature, at least what we knew to be his stature, would be  
18 dealing with us directly. You know, at smaller firms, you  
19 sometimes have that situation where you'll deal with a very  
20 senior person, but at most firms, you'll deal with the  
21 compliance person.

22 Q Particularly a firm the size of Madoff Securities?

23 A Correct, with the businesses that he had.

24 Q Okay. When you first were assigned to the Madoff  
25 cause exam in 2005, did you have any role in determining what

1 the focus of the exam was or was that focus kind of  
2 determined for you?

3 A That focus was determined for me.

4 Q Okay. How did you understand what the focus was?

5 A Well, we had been given -- I believe we had been  
6 given a report or some emails that sort of alleged suspicious  
7 activities at the firm.

8 Q Okay.

9 A So I think that was to be our emphasis, but sort of  
10 any firm we do, we try to look at as much as we can.

11 Q Okay. All right. Why don't I show you those  
12 emails. We're going to mark this as Exhibit 4.

13 (SEC Exhibit No. 4 was marked for  
14 identification.)

15 BY MR. KOTZ:

16 Q This is a memorandum from Dorothy Eschwie to Robert  
17 Sollazzo and Richard Lee dated April 22, 2004, and it has  
18 attached to it several pages of emails. If you could take a  
19 look at this document and tell me if this is the document  
20 that you're referring to of what you received as a basis to  
21 start the Madoff cause exam in 2005.

22 A Yes, I believe these are the emails that --

23 Q Okay. And so did you review these emails carefully  
24 before you started the 2005 cause exam?

25 A Definitely reviewed the emails.

1 Q Okay. And so was it your understanding that the  
2 exam was precipitated because of these emails and you were  
3 supposed to look into issues in these emails?

4 A Yes. I mean I think most cause exams, you're sort  
5 of -- you definitely want to be aware of what people are  
6 suspecting, but it doesn't limit you or --

7 Q Okay, but this was kind of starting point. These  
8 emails were a starting point for what you should look at  
9 during the Madoff cause exam?

10 A Yes.

11 Q Okay. All right. I'm going to ask you a couple  
12 questions about some points in this -- in these emails. If  
13 you can look on the third page of the document. Yeah, that's  
14 the page right there. By the way, there's some handwriting  
15 on this.

16 A Yes.

17 Q Is that your handwriting?

18 A Yes.

19 Q Okay. We've asked a lot of people whose  
20 handwriting it was. Finally got to the guy.

21 A I barely got through the second grade. I don't  
22 write very well --

23 Q No, actually this is pretty good considering some  
24 of the handwriting I haven't been able to read at all. So I  
25 mean I could see you're saying, "Is this just an investment?"

1 So you -- and you underlined "Total return swap agreement,"  
2 do you think?

3 A Correct.

4 Q Okay. And you say, "Is this just an investment?"  
5 Is that what you wrote in your --

6 A I did write --

7 Q You wrote that?

8 A I don't think I fully understood the term "total  
9 swap agreement." I think I was sort of struggling with  
10 understanding that.

11 Q Okay. And then if you could look on the next page  
12 just to kind of ask you about the handwriting.

13 A Okay.

14 Q There is a star and there's some underlines under -  
15 -

16 A Yeah.

17 Q -- "Investment Adviser #1", totally independent evidence, many  
18 of the executions are highly unusual." Was that your  
19 underlining and starring?

20 A Yes.

21 Q Okay. Okay. All right. Let me ask you a few  
22 questions -- go back and ask you a few questions about these  
23 documents, so go back to the page before. If you see the  
24 third full paragraph, it says, "Another point to make here is  
25 that not only are we unsure as to how  makes money for us,

Personal  
Privacy

1 we are even more unsure as to how Personal  
Privacy makes money from us,  
2 i.e., why does he let us make so much money? Why doesn't he  
3 capture that for himself? There could very well be a  
4 legitimate reason, but I haven't heard any explanation we can  
5 be sure of."

6 It says, "Additionally, there is a 4 billion Madoff  
7 pass-through fund, Fairfield Century, that charges 0 and 20  
8 percent. It's not clear why Madoff allows an outside group  
9 to make \$100 million per year in fees for doing absolutely  
10 nothing unless he gets a piece of that." Do you know what  
11 they were getting at here in this email? What is the point?

12 A I think the point is that they're questioning why  
13 Bernard Madoff would not set up his own fund and collect the  
14 20 percent profits himself.

15 Q Uh-huh. So did it seem as though he was leaving  
16 kind of a lot of money on the table, allowing other people to  
17 make significant sums of money for not doing very much?

18 A Yes.

19 Q And was that something that concerned you as well  
20 when you read this --

21 A Yes.

22 Q -- in terms of the cause exam?

23 A Yes.

24 Q Okay. So were there actions that were taken in the  
25 cause exam to look into this issue?

1 A Yes.

2 Q Okay.

3 A I asked Bernard Madoff directly why he would do  
4 this, why doesn't he want to set up a fund and collect the  
5 fees himself.

6 Q Okay. And what did he say?

7 A His response was essentially, "A lot of people ask  
8 me that question. I'm not a marketing person. I don't want  
9 to deal with customers. I have no interest in doing that.  
10 I'm perfectly happy making my commission equivalent 4 cents  
11 per share."

12 Q Okay. And did you find his answer suspicious at  
13 all?

14 A Most people on Wall Street are extremely greedy, so  
15 yeah. I mean people don't typically -- I mean -- but, you  
16 know, it's hard to -- to sort of rebut that. You know, at  
17 that point I wasn't sure what else I could say to him.

18 Q Okay. So there wasn't anything further on that  
19 point that was done?

20 A Correct.

21 Q All right. So let me ask you about another point  
22 in here in this same email. It says, "The point is that as  
23 we don't know why he does what he does, we have no idea if  
24 there are conflicts in his business that could come to some  
25 regulator's attention. Throw in that his brother-in-law is

1 his auditor and his son is also high up in the organization,  
2 imagine that, and you have the risk of some very -- some  
3 nasty allegations, the freezings of accounts, et cetera, et  
4 cetera."

5 Just generally, conflicts and potentially having a  
6 brother-in-law as an auditor, is that something that would be  
7 a red flag to an examiner?

8 A Yes.

9 Q Okay. Was this something that at the time when you  
10 looked at this email for the 2005 cause exam, you were  
11 concerned about?

12 A I think we were really -- my recollection is during  
13 the pre-exam, I came across some returns and it was about a  
14 four-year period where he was only down, I think, four or  
15 five months and my recollection is that returns weren't  
16 extremely high, but they were very consistent.

17 Q Right.

18 A So my concern was he was somehow cheating the  
19 market, taking advantage of, you know, his regular orders to  
20 the benefit of his other accounts.

21 Q Right.

22 A So really my focus was on his trading and how, you  
23 know, the conflicts that could be occurring based on his  
24 trading.

25 Q Okay. Did you ever look into who the auditor was,

1 whether actually his brother-in-law was his auditor?

2 A I don't recall looking into that.

3 Q Okay. Okay. Going back in the same document, if  
4 you see the last full paragraph, it says, "High seasonal  
5 money managers and Madoff's head would look pretty good above  
6 Eliot Spitzer's mantel. I propose that unless we figure out  
7 a way to get comfortable with the regulatory tail risk in a  
8 hurry, we get out."

9 Did you get a sense that, at least according to  
10 these individuals, Madoff was doing something illegal? That  
11 would be why there would be a reference to Eliot Spitzer's  
12 mantel?

13 A I think a lot of people were suspicious for years.  
14 I think this, you know, was sort of another thing in my mind,  
15 and again, this was sort of pre-exam, so we had some -- we  
16 had an idea or I had a mentality of what to -- what I thought  
17 the firm would be going in. So that's, you know, something I  
18 really wanted to sort of emphasize and focus on.

19 Q And you understood that at least the folks at  
20 Investment Adviser #1 believed that Madoff may be violating the law?

21 A I see what you're saying. I don't think at the  
22 time I just imagined that. I mean I think I was -- violating  
23 the law in that I thought he was sort of cheating the market  
24 or front running or --

25 Q Okay.

1 A -- cherry picking, not necessarily stealing.

2 Q Okay. Okay. And then if you could turn to the  
3 next page, this is the part that you underlined and put an  
4 asterisk. "We at Investment Adviser #1 have totally independent  
5 evidence that Madoff executions are highly unusual."

6 A Yes.

7 Q Did you or anyone else on the exam team go back to  
8 Investment Adviser #1 and ask them what that totally independent  
9 evidence was?

10 A No.

11 Q Any particular reason?

12 A My understanding is that we really, as an agency,  
13 don't do that and I mean it wasn't my call. I didn't ask to,  
14 nor was I directed, but it's just an understanding that we  
15 sort of do our examinations and investigations without going  
16 to sort of third parties.

17 Q Okay. Okay. Going to the next email, you see at  
18 the top the second paragraph, it says, "I also looked at some  
19 daily volume data." Do you see that, sir?

20 A Yes.

21 Q "On and around the OEX option transaction dates as  
22 indicated by Madoff's statements." And then going further  
23 down a little bit --

24 A Uh-huh.

25 Q -- there's a little bit of analysis, and then under

1 the third paragraph of .1, it says, "By this measure, Madoff  
2 could only do 750 million. That is with him doing 100  
3 percent of the option volume in his chosen strike with the  
4 generous 50 percent assumption." Do you see that?

5 A Yes.

6 Q Okay. Do you know what he's saying there? First  
7 of all, why would he look at the daily volume data on and  
8 around the OEX option transaction dates as indicated by  
9 Madoff's statements?

10 A Well, I think he's looking sort of at -- he's just  
11 looking at option trading activity and volume and comparing  
12 it to the quantity being traded by Mr. Madoff.

13 Q Okay. And then when he says, "By this measure,  
14 Madoff could only do 750 million, that's with him doing 100  
15 percent of the option volume in his chosen strike," what is  
16 he saying here about the volume?

17 A He's essentially saying that according to the  
18 exchange -- according to the quantity of options traded on  
19 the exchange, he would only be able to do \$750 million worth.  
20 That's exchange traded.

21 Q Okay. And then if you see at .4, it says, "We  
22 examined this issue before. We concluded maybe he does the  
23 options in the OTC market. We have spoken to several market  
24 makers and OTC equity options. None of them claim to see any  
25 significant volume in OEX options." What was the point

1 there?

2 A Well, I think you can either trade the options,  
3 exchange traded, or over-the-counter and these folks seemed  
4 to have contacted some over-the-counter options traders and  
5 they weren't aware of Madoff's volume.

6 Q So was he saying in this email that Madoff is  
7 saying he's doing these options, but he couldn't see the  
8 volume anywhere, so he was questioning whether that was  
9 actually true?

10 A Correct.

11 Q Was that an issue that was a concern when you did  
12 the pre-exam material for the 2005 Madoff cause exam?

13 A I don't recall focusing on the options. We were  
14 more focused on the equities.

15 Q Okay. And then in -- if you look at paragraph 2,  
16 it says -- .2, "Another important point, in every case the  
17 MRB examined the option strike calls, the ones closest to the  
18 close in the underlying market. Of course the market close  
19 is not known until the close. Does this mean that all the  
20 options are done almost at the close?" What does that mean?  
21 Do you know?

22 A I believe they're saying -- I'm not -- I don't --  
23 actually, I don't know.

24 Q Okay. Okay. And then if you look at 5 -- .5, it  
25 says in the second full paragraph, second full sentence, "Are

1 we to believe that the market makers would take on 15 billion  
2 of market risk at the close? Of course they might -- might  
3 be willing to take the option risk if Madoff provided the  
4 market hedge in the underlying, i.e., they did the whole  
5 package with Madoff. We already note that the trades in the  
6 underlying compare with the closing prices, but leave the OTC  
7 counterparties showing losses as our account always shows  
8 gains." And then if you look at the next page, he says, "But  
9 the risk must be covered somewhere if he's doing these trades  
10 at all. So we need an OTC counterparty, not necessarily a  
11 bank, who's willing to do the basket of the options plus the  
12 underlying with Madoff at prices unfavorable to the OTC  
13 counterparty in 10 to 15 billion. Any suggestions who that  
14 might be? None of it seems to add up."

15 Do you know what the point is there?

16 A He's saying that if somebody's going to take the  
17 opposite side, the counterparty to the options trading would  
18 either have to, you know, be exposed or have to hedge  
19 themselves, and he's saying that it's a lot of money to  
20 hedge.

21 Q Right. Was that something that was a concern when  
22 you reviewed these emails in connection with pre-exam for the  
23 Madoff 2005 cause exam?

24 A I recall thinking about it or seeing it. I just  
25 don't recall the focus -- the amount of focus we put into it.

1 Q Okay. Do you know if at any point in time anything  
2 was done to kind of look into this issue of who the possible  
3 OTC counterparty could be?

4 A Well, during the exam, we were told he no longer  
5 traded options.

6 Q Okay.

7 A Subsequent to the exam, the 2006 investigation, we  
8 looked into this issue and we -- I think we got a list of  
9 option counterparties. That's my recollection.

10 Q Okay. And was there any effort to contact the list  
11 -- the folks on the --

12 A Not to my knowledge.

13 Q Okay. Okay.

14 BY MS. STEIBER:

15 Q Did you discuss these emails with John Nee or  
16 anyone else?

17 A I don't recall discussing them. I think we sort of  
18 worked on our own.

19 BY MR. KOTZ:

20 Q Okay. Okay. Why don't we go to the next document.  
21 Okay, let's see the next document marked as Exhibit 5.

22 (SEC Exhibit No. 5 was marked for  
23 identification.)

24 BY MR. KOTZ:

25 Q This is an email from Dorothy Eschwie to Robert

1 Sollazzo, 05/11/2004, 5:21 p.m. And the email from Dorothy  
2 Eschwie responds to an email from Sollazzo dated Tuesday, May  
3 11, 2004, 3:22 p.m., where he says, "We believe this matter  
4 is worthy of an examination where resources permit." Said,  
5 "The trading scheme appears somewhat complex. We'll have to  
6 assign an experienced examiner who has sophisticated  
7 knowledge of option. When the time is right, we will  
8 strike."

9 Did -- so did you know that, I mean, that was the  
10 case and that you were the guy with this sophisticated  
11 knowledge of options?

12 A No.

13 Q Okay. And then at the end of this email Sollazzo  
14 says, "The story, especially the consistent high returns  
15 earned over an extended period, makes you wonder." Sollazzo  
16 has testified that that was his understanding of kind of the,  
17 you know, the basic issue from the emails. Is that  
18 consistent with your understanding of what the issue was kind  
19 of in a nutshell?

20 A Right. I had a little more detail of --

21 Q Sure.

22 A -- what might be causing those returns, but yes.

23 Q And so you had said earlier that one of the central  
24 issues you were looking at in the Madoff cause exam was how  
25 Madoff was able to generate these consistent high returns.

1 A Correct.

2 Q Okay. And did you also think it was important to  
3 look at why there was so little volatility in Madoff's  
4 returns, you know, as kind of part of this issue of that they  
5 were so consistent and high over time?

6 A Yes, I recall -- again, my thinking was that it was  
7 not -- was not the -- how high the returns were for the year.  
8 It was more just the consistency, and I recall it wasn't a  
9 lot per month. It was more half a percent or one percent,  
10 and yeah, that's --

11 Q Okay, but in your experience, had you seen any  
12 other situations where returns were so consistent over such a  
13 long period of time?

14 A No.

15 Q Okay. So that was something that was suspicious  
16 and should be looked into?

17 A Yes.

18 Q Okay. Okay. I'm going to show you another set of  
19 documents. I don't know whether you ever saw these  
20 documents. We did not see the documents in the work papers  
21 and they're internal Investment Adviser #1 emails, so we wanted to just  
22 ask you about them.

23 A Okay.

24 Q I'm going to mark it as Exhibit 6.

25

//

1 (SEC Exhibit No. 6 was marked for  
2 identification.)

3 BY MR. KOTZ:

4 Q It's an email from Investment Adviser #1  
Portfolio Manager dated Thursday,  
5 November 13, 2003, and it has numerous pages of additional  
6 emails, and I just want to know if in the course of preparing  
7 for or conducting the 2005 cause exam of Madoff, did you ever  
8 see these documents?

9 A The first page looks familiar.

10 Q Okay. The first page?

11 A Yes.

12 Q What about the rest of it?

13 A The second page looks familiar to me.

14 Q Okay.

15 A The third page does not look familiar to me.

16 Q Okay.

17 A I'm not sure about the fourth page.

18 Q Okay. I mean the fourth page --

19 A Yeah.

20 Q -- the second part of the fourth page is just the  
21 previous email you saw.

22 A Okay.

23 Q It's just the first part.

24 A Okay.

25 Q Have you -- do you recognize the first part where

1 [Investment  
Adviser #1  
Portfolio] is -- from [Investment Adviser #1 Portfolio  
Manager] to [Personal Privacy] where it says, "We  
2 did not know that they are two different people"? Just the  
3 first kind of blurb.

4 A Right here. That doesn't look familiar to me.

5 Q Okay. All right. Keep going, keep going.

6 A Yep.

7 Q Okay. Why don't we go -- because some of these are  
8 kind of similar versions of the previous email. Why don't we  
9 go -- if you look a few pages further, at the top it says,  
10 "Subject Re [Personal Privacy] from [Personal Privacy], date Friday, November  
11 14th, 2003, 12:09. Yeah --

12 A Okay.

13 Q -- that document.

14 A Okay.

15 Q The part -- [Personal Privacy] email to [Investment Adviser #1  
Portfolio Manager] do  
16 you think you saw that? Just the top part.

17 A The top part? I don't recall seeing that.

18 Q Okay. And then the next document, it says at the  
19 top, "Subject Re [Personal Privacy] from [Investment Adviser #1 Risk  
Manager], date Friday, 14  
20 November 2003, 12:33 to [Personal Privacy]. The top part as well  
21 where it starts, "Like background radiation, my concern about  
22 Madoff."

23 A I don't recall seeing this.

24 Q Okay. Okay. Thank you. All right. We'll show  
25 you the next document we'll mark as Exhibit 7.

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

3 BY MR. KOTZ:

4 Q This is an email from John Nee to Dorothy Eschwie,  
5 12/22/2004, 11:03 a.m. Yeah. Now, the previous document  
6 that we showed you from Dorothy Eschwie to Sollazzo, which  
7 attached the emails which precipitated the exam, which we  
8 marked as --

9 A Yes, I know what you're referring to.

10 Q -- okay -- as Exhibit 4, that was dated April 22,  
11 2004. Were you aware of kind of the time lag between that --  
12 when that came in on April 22, 2004 and you see in this email  
13 in Exhibit 7 that I'm showing you where they're talking about  
14 after the new year, they plan to do an exam at Madoff. Were  
15 you aware of that time lag at all?

16 A No, I just conduct exams. I don't really --

17 Q Okay. So you don't have any role in, you know,  
18 when exams are going to be started?

19 A No.

20 Q Okay. So when you're told to do an exam, you do  
21 it?

22 A Yes.

23 Q Okay.

24 BY MS. STEIBER:

25 Q And do you recall when the actual exam work

1 started?

2 A It was around April Fool's Day, I remember.

3 BY MR. KOTZ:

4 Q April of 2005?

5 A April 1 of 2005, correct.

6 Q Okay.

7 BY MS. STEIBER:

8 Q And do you recall when you started to go in the  
9 field at Madoff?

10 A Right about that time, April of 2005, I believe.

11 Q Okay.

12 BY MR. KOTZ:

13 Q Okay. I want to talk a little bit about some of  
14 the pre-exam work. Mark the next document as Exhibit 8.

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

17 BY MR. KOTZ:

18 Q This is an email from you to Ostrow dated  
19 03/30/2005, 11:55 a.m., and it is responding to an email from  
20 Ostrow to Lamore and Paul Pocress, Wednesday, March 30, 2005,  
21 11:16 a.m. Do you remember receiving this email and -- just  
22 to get a sense of why you were looking at this?

23 A I don't recall specifically receiving it, but I  
24 think as part of background -- as part of pre-examination  
25 background work, you sort of look for articles, look for

1 anything related to the firm that we can. So this was --  
2 this was obviously found as part of the sort of background  
3 work.

4 Q Okay. And so what did you kind of determine as  
5 part of the background work, that, you know, Madoff had a  
6 reputation? You know, here it refers to it as the Madoff  
7 Dynasty.

8 A Yeah, I mean I think -- I think on Wall Street,  
9 people either are highly educated and sort of go that route  
10 or sometimes they're street smart and they make their way  
11 based on being street savvy and street smart, and I think  
12 Bernard Madoff was sort of a street smart kind of guy.

13 Q Okay. All right. Let me show you the next  
14 document we're going to mark as Exhibit 9.

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

17 BY MR. KOTZ:

18 Q This is an email from Ostrow to you, 03/28/2005,  
19 4:14 p.m., and this also references -- does it reference some  
20 background information about Bernard Madoff?

21 A Correct.

22 Q Okay. And in here it mentions that he and his  
23 family have been deeply involved in leading the dramatic  
24 transformation that is currently underway in U.S. securities  
25 trading. So were you to understand that Bernard Madoff and

1 his family had pretty dramatic influence on the securities  
2 industry when you started the exam?

3 A I think when we started the exam somewhat, but  
4 during the course of the exam, he made a point to tell us  
5 that and emphasize that.

6 Q Okay. And then -- and then later on in this email,  
7 it says, "He had served as chairman of the board of directors  
8 of the NASDAQ Stock Market as well as the member of the board  
9 of governors of the NASD, a member of numerous NASD  
10 committees." It also says that he opened a London office  
11 which became one of the first U.S. members of the London  
12 Stock Exchange and was a founding member of the board of  
13 directors of the International Securities Clearing  
14 Corporation in London. So you certainly had the sense that,  
15 you know, he was a kind of a pretty impressive figure and  
16 influential?

17 A Yes.

18 Q Were you excited to work on an exam with somebody  
19 who was kind of this well-known or this --

20 A I would -- I mean I sort of try to take every exam  
21 I'm eager and excited to work on. You know, this guy, I  
22 didn't expect -- you know, during the pre-exam, I didn't sort  
23 of expect to have the interaction --

24 Q Right.

25 A -- I ended up having with him. So --

1 Q Right.

2 A -- I mean while it was an impressive sort of  
3 background, I just wasn't anticipating that.

4 Q That you'd actually be speaking to him so much?

5 A Right, if at all.

6 Q Right. Right. Okay. Okay. As you went through  
7 the exam and were speaking to him, was it exciting in some  
8 way that you got to speak to this guy, you know, for so many  
9 hours every day who was so well-known and --

10 A I think it was he's a -- clearly he's a wonderful  
11 storyteller, very captivating speaker, and he has an  
12 incredible or had an incredible background of knowledge in  
13 the industry. So for me that was very interesting. I mean  
14 it became a little frustrating at times, though, because, you  
15 know, we obviously were there to conduct business, and so it  
16 can be sort of distracting.

17 Q But it was better than dealing with kind of a --  
18 your own compliance person?

19 A Yes.

20 Q Okay. Okay. Let me show you the next document  
21 we're going to mark as Exhibit 10.

22 (SEC Exhibit No. 10 was marked for  
23 identification.)

24 BY MR. KOTZ:

25 Q And this is an email from John Nee to William

1 Ostrow and you dated 12/22/2004, 2:17 p.m. Do you see that?

2 A Yes.

3 Q And you see it attaches most recent NASD exam  
4 report for Bernard Madoff?

5 A Yes.

6 Q Why would you -- or why would Nee send you this  
7 document? Excuse me.

8 A I think it's a normal practice as part of pre-exam  
9 to -- you'd want to look at prior reports such as this.

10 Q Okay. And when the SEC does their exams, do they  
11 look back at other exams that NASD/FINRA has done of entities  
12 or kind of rely on them in terms of previous exam work?

13 A Typically. In oversight exams, very much that's  
14 emphasized because you're overseeing what they did.

15 Q But even in a cause exam?

16 A Try to. I mean any way you can get information  
17 about the firm, you try to.

18 Q Okay.

19 BY MS. STEIBER:

20 Q How helpful have you found NASD exams in the past?

21 A The exams I worked on, not very helpful.

22 BY MR. KOTZ:

23 Q Okay. All right. If you could look at the first  
24 page of this exam report, it references that the firm is also  
25 a member of CSE, MSRB, DTC, OCC, NSCC, and SIPC. Does this

1 indicate that these are organizations that you could get  
2 information or data from regarding the firm?

3 A I suppose so, but it's not a normal practice to  
4 reach out to them.

5 Q Okay.

6 BY MS. STEIBER:

7 Q Who told you it's not a normal practice?

8 A No one's told me. I -- just from my experience.

9 BY MR. KOTZ:

10 Q Normal practice within the SEC, you mean?

11 A I guess in the exam program, I haven't experienced  
12 ever reaching out to I don't think any of these entities.

13 Q Okay.

14 BY MS. STEIBER:

15 Q Did you -- who regulates DTC? Do you know?

16 A I believe the SEC does.

17 BY MR. KOTZ:

18 Q Okay. Let me show you a couple more pages in this.

19 A I'd just say I've never done an exam of them, so --

20 Q If you look at page 12 of this document, you can  
21 see on the left-hand side -- upper left-hand side it has the  
22 page numbers. At the bottom of page 12, it says, "Internal  
23 audit." It says, "Question, does the staff responsible for  
24 conducting internal audits have an appropriate degree of  
25 independence from the departments and people they audit?"

1 Then there's a response, "N/A," not applicable. And if you  
2 look at the next page it says, "Description of finding and  
3 root cause analysis. The firm does not have an internal  
4 audit department. The firm has approximately 80 employees.  
5 Trading, financials, compliance, et cetera reviewed on a  
6 daily basis by the appointed supervisory personnel. The  
7 firm's business has not changed since its inception. The  
8 firm primarily deals with broker-dealers and trading for its  
9 own account."

10 The fact that the firm does not have an internal  
11 audit department, is that something that is odd?

12 A I don't know -- I mean I don't know the  
13 requirements. You know, in some cases you might have one or  
14 two person broker-dealer that would -- I would assume they  
15 would not have an internal department, but a firm like  
16 Goldman Sachs would certainly have an internal department.

17 Q What about a firm the size of Madoff? Would it be  
18 odd that it doesn't have an internal audit department and,  
19 you know, Bernie Madoff was responsible for all the firm's  
20 internal controls?

21 A I just -- I don't know how to answer that. I mean  
22 he -- you know, it was a family run business. It wasn't a  
23 public company, so I mean I don't think during the pre-exam,  
24 I gave it any thought.

25 Q Okay. Okay. All right. Let's go to the next

1 document and mark this as Exhibit 11.

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

4 BY MR. KOTZ:

5 Q This is an email from Ostrow to Nee, Thursday,  
6 March 24, 2005, 1:12 p.m., and it attaches, it looks like, an  
7 initial documentation request list to Bernard Madoff  
8 Investment Securities, LLC, dated April 1, 2005. Do you know  
9 if you had any involvement in crafting or reviewing or  
10 editing this documentation request?

11 A I believe I did.

12 Q Okay. Let me ask you a couple questions on it.  
13 You don't remember how much involvement John Nee did? He  
14 mentions corrections. Do you remember what his corrections  
15 were?

16 A I don't remember his corrections. I would say  
17 normally -- normally before going out to an exam, you know,  
18 the examiners will put together the initial request list and  
19 then the supervisor will normally have some input. I don't --  
20 - I don't recall what his input was.

21 Q Okay. Did you all look at those Investment Adviser #1 emails  
22 and craft the documentation list based on those emails or was  
23 there some other process used?

24 A I think generally we'll have -- we have sort of  
25 standard -- we have standard information that we request, and

1 then based on the exam, you somewhat tailor it.

2 Q Do you know how much this one was tailored to the  
3 particular precipitating cause of the exam?

4 A I don't recall. I think if it would've been  
5 probably in the sales practice section if it was tailored.

6 Q Okay.

7 A In some cases, I'll just say that especially in  
8 cause exams, that's not disclosed to the registrant. So you  
9 don't want to limit or you don't want to tip your hand to  
10 them maybe too early, so sometimes you intentionally maybe  
11 not put things in.

12 Q Okay. Do you think that might've happened here?

13 A I just don't recall. I --

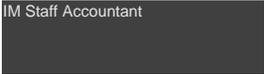
14 Q Okay. Why wasn't there any request for trading  
15 data in connection with the documentation request?

16 A I don't know.

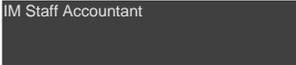
17 Q Okay. Okay. Why don't we go to the next document.  
18 The next document we're going to mark is Exhibit 12.

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

21 BY MR. KOTZ:

22 Q This is an email from  to you dated  
23 03/31/2005, 3:51 p.m.

24 A Okay.

25 Q And you're responding to -- 

1 responding to you saying, "Hi, IM Staff Accountant Thanks for the  
2 information regarding Madoff, Peter," and IM Staff Accountant responds, "No  
3 problem." Do you recall what the information you got from  
4 IM Staff Accountant was?

5 A I don't.

6 Q Okay. Do you remember IM Staff Accountant worked on the  
7 investment advisor's side? Do you know that?

8 A Yes, I know that.

9 Q Okay. I want to show you another document to be  
10 able to fresh refresh your recollection.

11 A Okay.

12 Q We'll mark this Exhibit 13.

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

15 BY MR. KOTZ:

16 Q This is an email dated 04/14/2005 from Ostrow to  
17 you, 2:41 p.m., and it references IM Staff Accountant

18 A At this point, we were at the firm conducting the  
19 exam, I believe.

20 Q 04/14/2005 is this email, so if you said it started  
21 on April 1st --

22 A Yes.

23 Q In here he -- Ostrow says to you, "I just finished  
24 boxing the rest of the items Christy found. I have only a  
25 few other things to do. Do you want me to contact the IA guy

1 to find the name of the mutual fund he was at?" And you  
2 respond, "Okay, his name was [IM Staff Accountant]." Do you remember  
3 that [IM Staff Accountant] did some work on a Madoff related matter on the  
4 IA side and you were asking him questions about that?

5 A I vaguely do. I just -- I don't have a good  
6 recollection of the discussion or if he --

7 Q Okay. There was an exam done of [Examination Material]

8 A That doesn't --

9 Q Okay.

10 A -- ring a bell.

11 Q Okay. So you don't remember if [IM Staff Accountant] was able  
12 to give you any specific information that was helpful in your  
13 Madoff cause exam?

14 A I don't.

15 Q Do you think he was or do you think you would  
16 remember if he was -- if he did?

17 A I honest -- I don't know.

18 Q Okay. Okay. Okay. I'll show you the next  
19 document. Okay. We'll mark the next document as Exhibit 14.

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

22 BY MR. KOTZ:

23 Q This is an email from John Nee to William Ostrow,  
24 04/25/2005, 4:26 p.m., and if you go to the second page of  
25 this document, there's a reference to a very similar article

1 to the one we originally read on Bernie and hedge funds and  
2 it actually quotes an article by Erin Arvedlund in Barron's  
3 dated May 7, 2001. Have you seen this article as part of  
4 pre-exam work for that 2005 Madoff cause exam?

5 A Yes, I believe so.

6 Q Okay. I'm going to ask you a couple questions  
7 about this article. If you look at the first page of the  
8 article, the third paragraph, it says, "What few on the  
9 street know is that Bernie Madoff also manages more than 6  
10 billion for wealthy individuals." So were you aware at that  
11 time when you were starting the Madoff cause exam of the  
12 amount of Madoff's management of funds? It says, "That's  
13 enough to rank Madoff's operations among the world's five  
14 largest hedge funds."

15 A I recall reading this article and seeing that, yes.

16 Q Okay. Okay. And if you then -- if you turn to the  
17 next page of it --

18 A Okay.

19 Q -- kind of in the middle of the page the paragraph  
20 starts, "Still" --

21 A Yes.

22 Q -- "some on Wall Street remain skeptical about how  
23 Madoff activity -- Madoff achieves such stunning double digit  
24 returns using options alone. Three options strategists for  
25 major investment banks told Barron's they couldn't understand

1 how Madoff churns out such numbers using this strategy. Adds  
2 a former Madoff investor, 'Anybody who's a seasoned hedge-  
3 fund investor knows the split-strike conversion is not the  
4 whole story. To take it at face value is a bit naive.'" So  
5 was it your understanding at that time that Madoff's claim  
6 that he was achieving these returns using the split-strike  
7 conversion strategy was at least suspect to some?

8 A Yes.

9 Q Okay. Going further down in this page to the  
10 second to last paragraph, it says, "What Madoff told us was  
11 if you invest with me, you must never tell anyone you've  
12 invested with me. It's no one's business what goes on here."  
13 And then later he says, "When he couldn't explain to my  
14 satisfaction how they were up or down a particular month, he  
15 added, 'I pulled the money out.'" Were you aware also in --  
16 when you began the Madoff cause exam that there was this  
17 issue of secrecy, that Madoff was very secretive, asking  
18 people to be very secretive about even investing with him?

19 A Yes, I remember reading that in this article.

20 Q And was that something that struck you as  
21 suspicious?

22 A Yes, to a certain degree, but on Wall Street, a lot  
23 of hedge funds are very secretive.

24 Q Now, when those hedge funds are secretive, are they  
25 secretive about the particular strategy they use or are they

1 also secretive like Madoff about letting anybody even know  
2 that they invested with him?

3 A I know it more from the perspective of they don't  
4 want you to know their positions, what they're doing as far  
5 as trading.

6 Q Okay. Okay. I'll show you the next document.  
7 Mark this as Exhibit 15.

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

10 BY MR. KOTZ:

11 Q This is the other article that's referenced in the  
12 previous document, Exhibit 14, and I'll first ask you -- this  
13 is an article by Michael Ocrant called Madoff Tops Charts:  
14 Skeptics Ask How, dated May 2001. We're going to mark it as  
15 Exhibit 15. First, have you seen this document before and  
16 are those your handwriting notes?

17 A Yes, I've seen the document before and yes, those  
18 are my handwritten notes.

19 Q Those are a little bit harder to read, so maybe  
20 you'll help us out with that --

21 A Sure.

22 Q -- although I think maybe it's been copied a couple  
23 of times, so maybe that's why. If you look over here --

24 A Okay.

25 Q -- it's -- has the words, "OTC options," two

1 underlines, "Who is writing these OTC contracts?"

2 A Yes.

3 Q Is that what it says?

4 A Yes.

5 Q And do you know what you were -- what was the point  
6 there?

7 A I --

8 Q What you were trying --

9 A -- was trying to figure out who the counterparty  
10 was.

11 Q Okay. And that was an issue that was also  
12 addressed, I think, in that Investment Adviser #1 emails, right?

13 A Correct.

14 Q Okay. And then above that, will you read what that  
15 says there, "Off" --

16 A Offsetting costs.

17 Q Okay. And then there's one, two, and three.

18 A Right, that's the strategy that Bernard Madoff was  
19 supposedly using.

20 Q Okay. And what does it say there for one, two, and  
21 three?

22 A Number one says, "Buy baskets similar to index, 30  
23 to 35 names." Number two says, "So OTM," which stands for  
24 out-of-the-money calls. And number three says, "Buy OTM,"  
25 which is out-of-the-money puts.

1 Q Okay. And so that was Madoff's explanation of how  
2 he was able to achieve these returns, that was his strategy?

3 A I don't know if it was Madoff's explanation --

4 Q Okay.

5 A -- or how I understood the split-strike conversion  
6 strategy to work.

7 Q From the articles or other pre-exam work you did?

8 A Correct.

9 Q Okay. Okay. And then right over here above where  
10 it says, "Section cover story" --

11 A Yes.

12 Q -- do you see what those words are?

13 A Yes.

14 Q What are they?

15 A At the top it says, "Madoff" and --

16 Q Okay.

17 A -- it's circled. And I've -- it looks like I've  
18 made some sort of note that says, "Manages money," and then  
19 below that I have essentially four items leading to Madoff  
20 and it says, "Feeder number one, feeder number two, feeder  
21 number three," and under feeder number three I say, "Thema,"  
22 and then nothing's written under the fourth line.

23 Q Okay. So is it fair to say that, you know, you  
24 scrutinized or analyzed this article pretty carefully. You  
25 wrote all these notes?

1 A Yes.

2 Q Okay.

3 BY MS. STEIBER:

4 Q Do you recall when you wrote all these notes? At  
5 the same time?

6 BY MR. KOTZ:

7 Q Was that when you first got the article, in the  
8 pre-exam, or do you think it might've been later while you  
9 were doing the --

10 A I don't recall -- I don't recall going back to this  
11 article during the exam. I just -- I think we were just  
12 doing things real time, so I imagine this was pre-exam.

13 Q Okay. Okay, let me ask you a couple of things  
14 about the article. If you could turn to the second page --

15 A Yes.

16 Q -- there's a bunch of things that you star. One  
17 is, "He has reported losses of no more than 55 basis points  
18 in just four of the past 139 consecutive months." Do you see  
19 that?

20 A Yes.

21 Q And then further down you have a star next to,  
22 "What is striking to most observers is not so much the annual  
23 returns, which though considered somewhat high for the  
24 strategy could be attributed to the firm's market making and  
25 trade execution capabilities." And then this you underline,

1 "But the ability to provide such smooth returns with so  
2 little volatility." So is it fair to say given the  
3 underlines and the starring, that those were issues you were  
4 particularly struck by?

5 A Yes.

6 Q Okay. Okay. All right. And then we'll go to the  
7 next page. Again, you have something with a star and that's  
8 the sentence, "But among other things, they also marvel at  
9 the seemingly astonishing ability to time the market and move  
10 to cash in the underlying securities before market conditions  
11 turn negative and the related ability to buy and sell the  
12 underlying stocks without noticeably affecting the market."  
13 That you also -- it seems was something that you were  
14 particularly concerned about.

15 A I definitely thought it was an issue, correct.

16 Q Okay. Particularly the ability of Madoff of to  
17 time the market, was that something that was --

18 A Yes.

19 Q -- a concern?

20 A That was -- that was my focus.

21 Q Your focus in the cause exam?

22 A Yes.

23 Q Okay.

24 A I mean with my trading background, I mean that's  
25 what stuck out to me.

1 Q Okay.

2 BY MS. STEIBER:

3 Q Why did it stick out to you?

4 A Because it's very hard to generate such consistent  
5 returns.

6 Q And did you discuss the issue of returns with Nee  
7 or anyone else?

8 A I don't remember having a discussion, but he was  
9 aware of it. I just remember some sort of talk back and  
10 forth about the returns, you know, that they're really good,  
11 but I don't -- it's not like -- you know, we were just I  
12 guess trying to figure out how he was doing it.

13 BY MR. KOTZ:

14 Q What about this part of this sentence where it  
15 says, "And the related ability to buy and sell the underlying  
16 stocks without noticeably affecting the market"? Do you see  
17 that?

18 A Yes.

19 Q "And the related ability to buy and sell the  
20 underlying stocks without noticeably affecting the market" --

21 A Yes.

22 Q -- in your experience, if you had a 7 to 12 billion  
23 dollar hedge fund buying and selling S&P 100 stocks, would  
24 you expect this volume to be noticed in the market?

25 A Yes, depending on how the orders were executed --

1 Q Okay.

2 A -- but in general, I mean I think it's a lot of  
3 capital.

4 Q And one would think that if it was really  
5 happening, there would be some evidence of that in the  
6 market, right?

7 A Again, depending on how the orders were executed,  
8 over multiple days or throughout the day, it would be less  
9 noticeable --

10 Q Okay, but it's still noticeable?

11 A I would think so.

12 Q Okay. Okay. Okay. Yeah, the next document is  
13 Exhibit 16.

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

16 BY MR. KOTZ:

17 Q This is an email dated 04/20/2005 from Ostrow to  
18 Nee, and Ostrow is reporting back to Nee, "Just to make you  
19 aware of the current situation, Bernard Madoff is getting  
20 increasingly agitated regarding our examination. He keeps on  
21 insisting in knowing exactly what we are looking for. He  
22 repeatedly mentions front running as something we should be  
23 looking for. He thinks our request for an execution data and  
24 three securities is outrageous. We keep informing Bernard  
25 that this is an examination of his book and records and we

1 are only requesting information that would apply to SEC and  
2 NASD rules and regulations."

3 Now, this is 04/20/2005, so this is shortly after  
4 you start. Do you remember that, you know, pretty soon after  
5 you started, Madoff was already agitated regarding the exam?

6 A Yes. I -- I'll just take a step back and say --

7 Q Sure.

8 A -- you know, prior to doing -- our normal course of  
9 business in New York is to not make the registrant aware of  
10 an exam before we go out and do it. We show up unannounced.  
11 In this case, for the larger firms, we typically announce  
12 ahead of times that we're going. Mr. Nee typically focuses  
13 on the larger firm exams.

14 For this examination of Bernard Madoff, he called,  
15 I believe, Peter Madoff, the compliance officer, to let him  
16 know that we would be conducting an exam of Bernie Madoff and  
17 within, I believe -- I believe I recall within five minutes  
18 or, you know, shortly thereafter, Bernard Madoff called Mr.  
19 Nee back and wanted to know essentially, "What's this about?  
20 Why you doing an exam," et cetera. So I think, you know,  
21 from the very beginning that we informed him that we were  
22 doing the exam, he was, you know, sort of agitated or just  
23 not easy to deal with. He was difficult.

24 Q And was that a little bit suspicious that he seemed  
25 so agitated at an exam?

1           A     A lot -- most registrants are. I mean it's not,  
2 I'm sure -- you know, it's not a pleasant thing when we come  
3 in because they're trying to conduct business, and based on  
4 sort of the information I had beforehand about him being  
5 secretive and so forth, I guess it wasn't incredibly unusual,  
6 but definitely during the course of the exam, like Mr. Ostrow  
7 said, you know, he got pretty agitated and, you know, he was  
8 pretty upset.

9                     BY MS. STEIBER:

10           Q     Now, you said Nee's notice to him was out of the  
11 ordinary for a cause exam; is that right?

12           A     Well, just typically we don't announce beforehand,  
13 but in some cases we do such as at a large firm because it  
14 enables them to get the documents together and so forth, so  
15 that when we show up, we're not sitting there with nothing to  
16 do. We have, like, documents right away to look at.

17           Q     What would be the reason for not providing notice  
18 to the registrant? So they can't, you know, create  
19 documents?

20           A     Create documents or destroy documents, things like  
21 that.

22                     BY MR. KOTZ:

23           Q     And wouldn't that be more pronounced in a situation  
24 like this where, you know, there were these suspicions about  
25 Madoff, he was secretive? Wouldn't it be a detriment to let

1 him know in advance that the exam was happening?

2 A Well, I think -- I think the mentality of his firm  
3 was that, again, he was cheating. He was taking advantage of  
4 the market somehow. Never -- never was it thought at any  
5 time that there was some sort of criminal activity or he was  
6 creating fake documents or certainly not a Ponzi scheme. Our  
7 focus was on his trading, and we thought, you know, we could  
8 identify that by getting the trading documents we needed.  
9 You know, we just -- it just never occurred to anyone that he  
10 would be, you know, creating these --

11 BY MS. STEIBER:

12 Q But even in a front running exam, couldn't he  
13 create false documents so that you wouldn't see that he was  
14 front running?

15 A Well, I think -- I don't think that would -- it's  
16 really realistic. I mean I think the trading documents,  
17 normally you can -- I mean I guess you're correct. It just  
18 really isn't a thought, I mean, if you're going to a major  
19 firm. Goldman Sachs, I mean -- the trading is the trading.  
20 So you just wouldn't -- or at least at the time we never  
21 anticipated that being possible, to create, you know, false  
22 trading documents.

23 BY MR. KOTZ:

24 Q In this email, Exhibit 16, Ostrow says, "He  
25 repeatedly mentions front running is something we should be

1 looking for." Bernie Madoff was mentioning front running is  
2 something we should be looking for?

3 A Well, I think -- if I remember this correctly, we  
4 were asking for documents or something and he got -- I mean I  
5 think this email was sent because it was actually -- it was  
6 sort of disconcerting how angry he became. I mean his veins  
7 were popping out of his neck, and during that -- it was a --  
8 I think his brother Peter might've been there, and he just  
9 repeatedly said, you know, "What are you looking for?" And  
10 his voice level got increasingly loud and the veins were  
11 popping out, and one of us -- I may have said something, you  
12 know, "What do you want us to look for? What do you think  
13 we're looking for?" And then he -- that's when he said  
14 something like, you know, "Front running. Aren't you looking  
15 for front running," or something -- something to that effect.

16 Q So he was kind of reacting to the fact that some of  
17 your document requests related to issues other than front  
18 running? Was that the concern?

19 A I just don't think he knew -- I think he was  
20 frustrated because he couldn't figure out exactly why we were  
21 there, and I think at this point, we had asked him about all  
22 of his businesses and he had not revealed his investment  
23 advisory business. So I think we were hinting around things,  
24 trying to get him to admit or acknowledge he was conducting  
25 this business, and I think that frustrated him.

1 Q Okay. And so when Ostrow would report back to Nee  
2 that Madoff was getting agitated, do you know what the  
3 response was from Nee?

4 A I don't think we got any response.

5 Q Okay. Okay. Okay. We're going to mark the next  
6 document as Exhibit 17.

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

9 BY MR. KOTZ:

10 Q This is an email from you to John Nee, 04/28/2005,  
11 and it says on the top, "Re FRB and Market Reg Training and  
12 Basel Capital Accord and CSE Rule." And I guess you're  
13 relating back to John what's going on. You mention, "Bernie  
14 came in this morning and told us the reg NMS. William took a  
15 shot across his bow regarding whether anyone else uses/has  
16 access to his algorithm. After pausing he said; 'No, it's  
17 for us.' I stated that it seems the algorithm has the  
18 capacity to handle more money. He didn't respond. He then  
19 went to story mode regarding why no one can make money in the  
20 markets. Market 100 points up, down 100 points. He then  
21 looked at his watch and left. According to Bernie,  
22 compliance is only Peter M. Since Peter's son is back in the  
23 hospital, it may be a few days before we have an opportunity  
24 to sit down and speak to him. We expect to get emails and  
25 trading data next week. He was appalled that we asked for

1 ten days worth of trading data since no one has ever asked  
2 for that."

3 Do you remember that -- his particular response on  
4 the request for ten days worth of trading data?

5 A He was appalled at pretty much everything we asked  
6 for.

7 Q Okay.

8 A I don't remember that particular response, but he  
9 was -- again, I would describe him as sort of difficult to  
10 deal with, sort of evasive.

11 Q Defensive?

12 A Protective.

13 Q Okay. Was there a lot of pushback from him in the  
14 exam?

15 A There was some pushback, but it wasn't nasty or  
16 mean-hearted. It was more, "Why do you need that? What are  
17 you looking at?" You know --

18 Q All right. And did -- were there ever any times  
19 where got Nee involved because of the pushback or because he  
20 was getting agitated?

21 A I don't recall any.

22 Q Okay. Did you feel like you were getting  
23 sufficient support from Nee in terms of, you know, "I know  
24 he's difficult, I know he's pushing back, but, you know,  
25 you've got to go in and do what you've got to do"?

1           A     I guess at that point, I really didn't know what  
2     was appropriate and what was not appropriate. My -- I think  
3     my goal -- my goal was really just to keep him informed as to  
4     what was going on and I felt like it was his -- his decision  
5     on whether he felt to come out or to be more involved based  
6     on what we were sending him. I mean so my objective was  
7     really to keep him as sort of informed as possible.

8           Q     But at a point did Nee come and say, "Look, guys,  
9     obviously, you know, he's a difficult guy. You know, I'm  
10    going to come onsite more and help you out or, you know, get  
11    in the middle, get more involved"?

12          A     I don't recall that.

13          Q     Okay. All right, the next document.

14               MR. TALARICO: That didn't come up.

15               THE WITNESS: Okay.

16               MR. TALARICO: That's your explanation --

17               THE WITNESS: Okay.

18               MR. TALARICO: -- and that was related to --

19               THE WITNESS: We can get to that --

20               MR. TALARICO: Yeah, Exhibit 15. Okay. Well, if  
21    you do, you do. I'm just saying.

22               THE WITNESS: Okay.

23               MR. TALARICO: Okay.

24               MS. STEIBER: Do you want to go off?

25               MR. TALARICO: No, we're okay.

1 THE WITNESS: We're okay.

2 BY MR. KOTZ:

3 Q Okay. And I'll show you the next document we'll  
4 mark as Exhibit 18.

5 (SEC Exhibit No. 18 was marked for  
6 identification.)

7 BY MR. KOTZ:

8 Q This is an email from John Nee to you, 04/26/2005,  
9 and there's an attachment which is a document request that  
10 you say, "We intend to submit to Bernie tomorrow." Just one  
11 thing about this document request. The second page of the  
12 request --

13 A Yes.

14 Q -- it says, "All executions in accounts FS-1 and  
15 FS-2 for January 1, 2005 through March 31, 2005." What were  
16 accounts FS-1 and FS-2?

17 A I just don't recall, but the date of this request,  
18 I believe, is before he acknowledged the business. So I  
19 imagine that these accounts related to his market making.  
20 I'm just not sure.

21 Q Okay.

22 BY MS. STEIBER:

23 Q Would -- now why would you be requesting data only  
24 from market making accounts?

25 A I think at that point, that's all he provided us

1 information about. I think that's the only accounts we  
2 officially knew about, so I believe that's why.

3 Q So how would you even be able to do a front running  
4 exam from market making accounts?

5 A Well, I'm not sure at this point -- you know, we  
6 knew he had a proprietary trading business and a market  
7 making business. So I think the idea was to get a handle on  
8 his market making, sort of the order flow, and again,  
9 before -- you know, as part of the pre-exam, we had an idea  
10 of what the firm would be, the types of orders, the types of  
11 clients, and then as we got into the exam, you know, we  
12 learned more about the firm and it was sort of different than  
13 what we expected. Whereas we expected to see lots of, you  
14 know, institutional, large orders, multi 100,000 share  
15 orders, we got to the firm and the market making side of the  
16 business was -- it was more retail investors, small orders,  
17 things like that. So --

18 BY MR. KOTZ:

19 Q Let's go to the next document. Mark the next one  
20 as Exhibit 19.

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

23 BY MR. KOTZ:

24 Q This is an email from you to John Nee and Ostrow,  
25 05/03/2005, 10:46 a.m. You say, "Hi, John. I know you have

1 mentioned that Barclays may be conducting prime brokerage  
2 services for some of the funds." And later on, "There are no  
3 transactions with Lehman, Goldman, Merrill, et cetera. After  
4 going to sit with his staff, he stated that Barclays clears  
5 for the brokers in London." What does that mean that  
6 Barclays clears for the brokers in London?

7 A Well, I think Barclays was the -- I imagine the  
8 prime broker and ensured that when one of the -- when a trade  
9 was done by his London office against a counterparty, that it  
10 cleared and settled properly. Barclays is doing that.

11 Q Okay. And then later on it says, "Additionally, in  
12 the same operating account, I came across some weird  
13 descriptions and I asked Bernie to explain."

14 A Yes.

15 Q Do you know what those weird descriptions were?

16 A I think I listed them, OB/ --

17 Q Okay.

18 A -- or I'm sorry, O/B melon pit, I believe --

19 Q Did he explain what they were?

20 A He gave me an explanation. I don't recall exactly  
21 what it was.

22 Q Do you recall if it kind of resolved the issue or -  
23 -

24 A I think so. To the best of my knowledge, I think I  
25 sort of sent this to John to see if he felt that it seemed

1     okay.

2           Q     Did you get anything back from John?

3           A     I don't recall on this. I'm not sure what I got.

4           Q     Okay. I'll show you the next document. Mark it as  
5     Exhibit 20.

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

8           BY MR. KOTZ:

9           Q     It's an email from John to you and William Ostrow,  
10    05/03/2005, 3:18 p.m., and it attaches a letter from John Nee  
11    to Erin Ashley Mansfield, Director of Compliance, Barclays  
12    Capital, Inc., May 3, 2005, and the letter it seems asks for  
13    all trading done by or on behalf of any of the following, the  
14    time period March 1, 2005 through March 31, 2005.

15                   How come this request was sent to Barclays?

16           A     I think John -- right, I think Mr. Nee put this  
17    request together. I don't remember having any sort of  
18    discussion. I think it was just part of -- maybe because he  
19    wasn't acknowledging that the accounts existed or --

20           Q     Okay.

21           A     I think that may have been it.

22           Q     Yeah. And if you look at the document, which we're  
23    going to mark as Exhibit 21, an email from you to William  
24    Ostrow, 05/03/2005 at 3:47 p.m., you can see going all the  
25    way back, John Nee, "Dear Ms. Mansfield, attached please find

1 our information request." And then you say to Nee, "The  
2 request looked good. I suspect it will generate some  
3 fireworks. I'll let you know if there's any fallout from  
4 your request." And then after Nee responds, "Thanks," you  
5 respond, "I'm ready to call his bluff on his refusal to admit  
6 the money management side of the business. So your document  
7 request is perfect timing."

8 A Yes.

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

11 BY MR. KOTZ:

12 Q Does that refresh your recollection about what this  
13 --

14 A Yeah. Yes. I think, again, you know, Bernard  
15 Madoff was extremely difficult to deal with. He wouldn't --  
16 various issues came up that he would just not acknowledge or  
17 not admit to, and this whole -- I mean, again, our emphasis  
18 was to look at the LIA business, and at this point, he hadn't  
19 -- he hadn't acknowledged that it existed. So I think -- and  
20 he had shown some sort of aggression or irritation during the  
21 exam. So I -- my thought was because word on Wall Street  
22 travels very quickly, my thought was if Mr. Nee sends this  
23 request to Barclays, it's -- they're going to pick up the  
24 phone and immediately call Bernard Madoff and he'll come  
25 walking into that -- into our office immediately. So that's

1 kind of what I anticipated.

2 Q And give you a hard time about it?

3 A "What's this all about," and things like that.

4 Sure.

5 Q And so if you have a situation where a guy's being  
6 evasive or not providing the information, you would also want  
7 to go to outside third parties to get information because you  
8 didn't necessarily get as much as you needed from him?

9 A You know, from my experience, I mean almost every  
10 exam, you have this problem --

11 Q Okay.

12 A -- where people, you know, they don't want to deal  
13 with us. They provide incomplete paperwork and the answers  
14 are incomplete. So you do this round and round situation.  
15 So I don't -- I don't know that this was anything more  
16 unusual. Again, the thinking was he's secretive, you know,  
17 he's quirky, things like that.

18 Q Okay. Okay. So I'm going to show you the next  
19 document which is the response from Erin Ashley Mansfield to  
20 John Nee dated May 16, 2005, which we're going to mark as  
21 Exhibit 22.

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

24 BY MR. KOTZ:

25 Q You could see in the response that Mansfield

1 makes -- it says, "No relevant transaction activity occurred  
2 during the period March 1, 2005 to March 31, 2005. There  
3 were no other customer relationships identified at Barclays  
4 Capital, Inc. for the other names provided in your inquiry  
5 letter."

6 So Barclays comes back and says there was no  
7 transaction activity in that period. What was your response  
8 or the team's response to that information?

9 A Well, I never saw this letter.

10 Q Okay.

11 A I don't know that anything more than a very brief  
12 conversation or email, you know, took place between Mr. Nee  
13 and Mr. Ostrow and myself. I think it sort of -- we were  
14 focused on the exam at this point. We were conducting the  
15 exam, whereas Mr. Nee seemed to be in the office taking care  
16 of this issue. So -- and my recollection is that while  
17 something like they didn't see any activity, there's another  
18 Barclays, a separate Barclays that may have had the activity,  
19 but I don't -- I don't recall spending very much time dealing  
20 with it or thinking about it.

21 Q Okay. Was there any discussion of going to that  
22 other Barclays to see trading activity?

23 A No, I don't recall any discussion. I guess, you  
24 know, I'm not sure that we were depending on where the  
25 Barclays -- these other Barclays entity was located. I don't

1 know that we had jurisdiction.

2 Q But do you remember that being an issue discussed,  
3 the possible jurisdictional issue at the time?

4 A I don't remember that being discussed.

5 Q Okay. Okay. I mean when we want to try to get his  
6 recollections at the time, not --

7 MR. TALARICO: Sure. Well, I'm just going based on  
8 what -- I just remember -- do you want to go off a second or  
9 do you want me to put this on?

10 MR. KOTZ: We can go off the record.

11 (Whereupon, a brief recess was taken.)

12 BY MR. KOTZ:

13 Q Okay. Let me show you the next document. This is  
14 an email from you to William Ostrow, 05/04/2004, 10:12 a.m.  
15 Mark it as Exhibit 23.

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

18 BY MR. KOTZ:

19 Q And you're responding to Ostrow who says the -- in  
20 an email Wednesday, May 4, 2005, 11:11 a.m., "The salary  
21 information is interesting. The letter John Nee sent to  
22 Barclays seems right on target. Any more info on the OCC  
23 options account?"

24 Do you know, first of all -- then there's a  
25 reference in an email from you to Ostrow about salary

1 information for nine individuals. "The most interesting part  
2 of the salary and bonus information is the high amount paid  
3 to compliance guy Personal  
Privacy. Also, why did his salary drop  
4 dramatically in 2003 and then jump in 2004?" Do you remember  
5 this issue about the salary?

6 A I don't remember the issue regarding Personal Privacy  
7 salary. I remember requesting salary information, and I  
8 think we actually included Bernard Madoff on that list, and I  
9 recall his -- his response was, "I take whatever I need for a  
10 salary."

11 Q So he never gave you a specific amount that he  
12 made?

13 A Correct.

14 Q Do you remember anything particularly unusual or  
15 interesting about anyone's salary, like this compliance guy?

16 A I guess in this email I say, "The high amount paid  
17 to the compliance guy," and the drop in -- the salary drop  
18 between 2003 -- I'm sorry. "The salary dropped dramatically  
19 in 2003 and then jumped in 2004." I don't remember at this  
20 point focusing on that as a huge issue.

21 Q Okay. Do you remember if that kind of issue was  
22 ever resolved?

23 A I don't recall, but I'm sure I asked and I'm sure I  
24 was given an explanation.

25 Q From Madoff?

1 A From Bernard Madoff.

2 Q Okay. And you say -- Ostrow says here, "Any more  
3 info on the OCC options account?" Do you know what that  
4 reference is to?

5 A I don't. I just don't recall.

6 Q All right. All right. We'll show the next  
7 document we'll mark as Exhibit 24.

8 (SEC Exhibit No. 24 was marked for  
9 identification.)

10 BY MR. KOTZ:

11 Q This is an email from Ostrow to you, 05/18/2005,  
12 10:24 a.m. This is about a complaint, customer complaining  
13 about a trade done through Fidelity which in turn was routed  
14 through Madoff. Do you remember at any point in time where  
15 the exam team that worked on the 2005 cause exam of Madoff  
16 was given a complaint to look into?

17 A I don't -- I don't recall it. I just don't -- I  
18 don't recall it.

19 Q Okay. Okay.

20 A I think -- I mean there's complaints against firms  
21 sort of all the time, but -- especially a market making firm  
22 like this, so I don't recall.

23 BY MS. STEIBER:

24 Q Do you recall you were specifically given this  
25 complaint because you were working on the Madoff examination

1 when this complaint came in? So it's --

2 A I mean I just -- I see the email. I just -- I just  
3 don't recall. I just don't think it was a big part of the  
4 exam. I just don't.

5 Q Okay.

6 BY MR. KOTZ:

7 Q Okay. All right. Let me show you the next  
8 document. Mark it as Exhibit 25.

9 (SEC Exhibit No. 25 was marked for  
10 identification.)

11 BY MR. KOTZ:

12 Q It's an email from you to John Nee and Ostrow,  
13 05/23/2005, 10:56 a.m., and it's forwarding an article  
14 regarding the status of foreign affiliates and you say,  
15 "Interesting that this article was forwarded." Was there an  
16 issue about Madoff's foreign affiliates?

17 A MSIL, Madoff Securities International London --  
18 again, I think this is one of the -- this is one of the  
19 issues that we had difficulty with him. I think on his  
20 letterhead it said MSIL was an affiliate, and -- but if my  
21 recollection's correct, he -- he refused to acknowledge that  
22 it was an affiliate. So we, you know, would go back and  
23 forth, and it got to the point where I think, you know,  
24 "We're going to call it an affiliate and, you know, if you  
25 don't want to call it an affiliate, you don't have to," but I

1 do recall something to that effect.

2 BY MS. STEIBER:

3 Q Do you know if that issue ever got resolved about  
4 the affiliate?

5 A I think we just -- I don't recall if -- I don't  
6 think he ever admitted that it was an affiliate, but I think  
7 we felt that it was an affiliate if my memory's correct.

8 BY MR. KOTZ:

9 Q Okay. All right. Let me show you the next  
10 document. Mark it as Exhibit 26.

11 (SEC Exhibit No. 26 was marked for  
12 identification.)

13 BY MR. KOTZ:

14 Q This is an email from Ostrow to you, Tuesday, May  
15 24, 2005, 11:57 a.m. It has attachments to it. Do you know  
16 what those attachments are?

17 A These appear to be trade executions for Bernard  
18 Madoff's market making business.

19 Q Okay.

20 A And on the left, the first column, I believe are  
21 his accounts, the account that it was traded in. The second  
22 column is the stock. The third column's date -- do you want  
23 to continue?

24 Q That's okay. So these were for the market making  
25 business, not the investment advisory side?

1 A Correct.

2 Q Did you get something similar for the investment  
3 advisory side?

4 A We got a trade blotter for the investment advisory  
5 side, I believe.

6 Q But not something like this?

7 A My recollection is that it was a huge document. It  
8 was like a paper-based document for the trade blotter. When  
9 I -- I think this was electronic or something.

10 BY MS. STEIBER:

11 Q Did you get electronic records for the investment  
12 advisory business?

13 A I think the account statements may have been  
14 electronic, but I don't -- I don't think the trade blotter  
15 was electronic.

16 Q Was that unusual considering that the market making  
17 trades, you know, electronically?

18 A I don't -- I don't know that I thought at the time  
19 it was unusual. I just -- I don't know.

20 Q Can you tell -- tell from this data if any of the  
21 trades take place during non-U.S. trading hours?

22 A Well, it appears that the fourth column from the  
23 left is the time of the trade, execution time of the trade.  
24 I mean, I guess U.S. -- normal U.S. market hours are 9:30 to  
25 4:00, but certainly, these stocks can trade in the after

1 hours market. So some of these execution times appear to be  
2 after 1600 or 4:00.

3 Q And you're pretty certain that there is no  
4 investment advisor trades reflected in this document, right?

5 A Yes, I believe -- I believe the accounts on the far  
6 left were the accounts -- sort of the way he annotated the  
7 market making accounts.

8 Q Okay.

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

11 BY MR. KOTZ:

12 Q Okay. For the next document, we'll mark as Exhibit  
13 27. This is an e-mail from you to William Ostrow, 5-24-2005,  
14 2:51 p.m. At the bottom of the document, there's an e-mail  
15 from you to Ostrow, Tuesday, May 24th, 2005, 2:36 p.m. In  
16 the last paragraph it says, "He wants an idea of when we're  
17 going to finish the exam. He's getting more aggressive about  
18 trying to find out. I told him we would speak to him  
19 tomorrow. Based upon our questions and requests, he should  
20 have a better idea." And then at the top, you say, "Again,  
21 be ready for his badgering about us leaving."

22 So was Madoff aggressive about trying to get you  
23 guys to finish already?

24 A Every firm is aggressive about us trying to get up.

25 Q But I only asked about the Madoff one.

1           A     Yes, I believe he's aggressive.

2           Q     Did -- when you had these conversations with Bernie  
3 Madoff, did he throw in names of people he knew and his  
4 various political connections?

5           A     Yes. I remember him throwing in a couple of names,  
6 actually, SEC employees. One was -- one was the  
7 commissioner, Commissioner Annette Nazareth. He'd throw  
8 in -- at one point I believe an individual named Henry  
9 Kaufman who was formerly Salomon and Smith  
10 Brothers -- Salomon chief economist. I think he was there  
11 one day. And I think he actually -- at the time we conducted  
12 the exam was the time when Chairman Cox took over, and he  
13 seemed to have -- he thought he had some insight as to who  
14 was going to get named. And I think he actually even named  
15 at one point in the past he was in the running to become  
16 commissioner of the SEC.

17          Q     Chairman you mean?

18          A     Yes.

19               BY MS. STEIBER:

20          Q     What did he say about his relationship with Annette  
21 Nazareth?

22          A     I don't recall what he said. I'm not sure if it  
23 was in reference to a meeting he had or rulemaking or  
24 something, but I just remember that name. It just struck me  
25 as -- I mean, oftentimes on exams, people will drop names,

1 but that was -- you know, that's a commissioner at the SEC is  
2 a pretty big name, I'd say, to mention.

3 BY MR. KOTZ:

4 Q So he was doing that to try to impress you with all  
5 his connections, do you think?

6 A I would say so.

7 BY MS. STEIBER:

8 Q And do you think he was doing it to intimidate you,  
9 like I want to hurry up and finish this exam, I know all  
10 these other people I could call if you don't finish up when I  
11 think you should?

12 A Well, we take the stance that we -- like it doesn't  
13 matter. I mean, he can say whatever he wants to say. I  
14 mean, generally, until we get the work done, we're not going  
15 to leave. Until we get our documents, we won't leave.

16 Q But do you think that was his -- maybe his  
17 intention, to try to intimidate you?

18 A It's possible. I don't -- I mean, I'm not sure  
19 exactly what he was thinking.

20 BY MR. KOTZ:

21 Q Okay. Do you want to take five minutes?

22 A Yes.

23 (A recess was taken.)

24 (SEC Exhibit No. 28 was marked for  
25 identification.)

1 BY MR. KOTZ:

2 Q All right. The next document we're going to mark  
3 as Exhibit 28, and that's an e-mail from you to John Nee and  
4 William Ostrow, 5-25-2005, 9:54 a.m. And in this e-mail, the  
5 last paragraph you say, "FYI, he's started to bash the SEC  
6 program for not having a full understanding of time slicing,  
7 et cetera, et cetera." You defended the program. Then you  
8 say, "Anyway, I look forward to speaking to him regarding the  
9 hedge fund issue which was opportunistically -- he has  
10 opportunistically failed to mention to us."

11 So tell us a little about these conversations back  
12 and forth about the hedge fund issue, what you meant by "he  
13 has opportunistically failed to mention to us."

14 A Well, before that, I'll just say one of the -- you  
15 know, his firm was -- he promoted how advanced technology,  
16 you know, they really utilized a lot of technology to help  
17 them execute orders and so forth. And I think, you know,  
18 this Robo and automatic market making and so forth was really  
19 a way to eliminate actual human traders. So we talked a lot  
20 about that, and then he brought up the fact that they used  
21 algorithms to help execute orders. And, I mean, from my  
22 experience, I had never used algorithms or had been familiar  
23 with them from my trading, so I said, "You know, we really  
24 don't have a good handle on algorithmic trading."

25 And I think, you know, that's when he started

1 bashing us for how could you not, algorithmic is the wave of  
2 the future, you know, et cetera, et cetera.

3 So I'm not sure. I know you've asked about the  
4 hedge fund issue.

5 Q Yeah, you say, "He has opportunistically failed to  
6 mention to you." What does that mean?

7 A I just -- I don't recall what I'm referring to,  
8 what issue. I don't know if it was the IA -- IA hedge fund  
9 or his proprietary trading hedge funds that I'm referring to  
10 because at this point, it seems like May 25th, we were still  
11 talking a lot about the market making and, you know, Robo  
12 trading and so forth. So at this point, we may have also  
13 been focused on his proprietary trading hedge funds.

14 Q Okay.

15 A How they -- how they operated, they had a couple  
16 different strategies and so forth. So we spent some time on  
17 that.

18 Q And was he sort of not willing to give you  
19 information about that aspect, his proprietary trading?

20 A He really -- I mean, it was tough getting any  
21 information from him. So you really had to pull it out of  
22 him.

23 Q Okay. Were there situations where he would say  
24 something and then later on you would realize it wasn't  
25 entirely truthful what he was saying?

1           A     Sure. I mean, it started off I would say, you  
2     know, by his failure to acknowledge the IA business even  
3     existed. It wasn't until -- it wasn't until we put the  
4     articles in front of him and said, "How can -- how can you  
5     say you don't manage money for anyone?"

6           And he said, "Oh, you know, that's not -- we're not  
7     a money -- you know, that's not managing money. We execute  
8     orders for these certain funds."

9           BY MS. STEIBER:

10          Q     How long into the exam did it take you to show him  
11     those articles and --

12          A     It was awhile. I mean, it was -- I mean, I think  
13     we tried to do it sort of methodically by allowing -- you  
14     know, giving him the opportunity to tell us about it. So it  
15     was probably three or so weeks, three, four weeks into the  
16     exam before he actually or we actually presented that hedge  
17     fund article.

18          Q     Why did you wait so long when that was what you  
19     were trying to get to right at the beginning of the exam?

20          A     Well, I think -- I mean, part of it, we're trying  
21     to sort of build background information and understand the  
22     firm, how it all operates. And especially when you're  
23     looking for things like front running and cherry picking or  
24     whatever, you sort of want to understand where the orders  
25     are, what the order flow. So in some cases for cause exams,

1 you try to get as much information as you can before you  
2 really focus on that one issue that you're there for because,  
3 you know, you don't want him to cut you off like -- you know,  
4 sometimes like e-mails, for example, you don't ask for till  
5 the end of the exam because it's typically something that  
6 people get very upset about when you ask them for their  
7 e-mails.

8 Q But didn't you have a certain time frame that this  
9 exam had to be completed in when you started the exam?

10 A No. I mean, they sort of generate projected  
11 lengths, I think, for exams, but if issues arise, you know,  
12 exams can be extended.

13 BY MR. KOTZ:

14 Q But Ostrow testified that he felt like from Nee's  
15 perspective he -- Nee really wanted the exam to be finished  
16 in the period that was set. Was that not your sense?

17 A I didn't get that sense. I mean, I've never -- I  
18 think my -- my feeling is if you can explain well enough to  
19 the supervisor why it's taking longer than it should, they  
20 normally will give you additional time. And I don't recall  
21 in the Madoff case -- in the Madoff exam that we were feeling  
22 any extra pressure.

23 BY MS. STEIBER:

24 Q Okay. So you were in no real hurry to get to this  
25 investment advisor issue, it sounds like?

1           A     We were trying to get to it, but we were sort of  
2     trying to get as much information surrounding it that we  
3     could until we were ready to like really focus on it.

4           BY MR. KOTZ:

5           Q     Okay. Let's go to the next one.

6                                 (SEC Exhibit No. 29 was marked for  
7                                 identification.)

8           BY MR. KOTZ:

9           Q     This is an e-mail from Ostrow to you, 5-26-2005,  
10    1:57 p.m. He says, "That's the feeling I had, that we were  
11    not getting all e-mails." And then at the bottom, there's an  
12    e-mail from you to Ostrow, Thursday, May 26, 2005, 11:55 a.m.  
13    "Shana just gave me another explanation regarding the firm's  
14    e-mail retention policy. Basically, she has the ability to  
15    determine that an e-mail is non-business-related spam and  
16    delete it from the system forever. That just doesn't seem  
17    right."

18                               Was that a concern to you that Shana could just  
19    delete whatever e-mails she had?

20           A     I think that was a concern to both Mr. Ostrow and  
21    me, but I don't know -- I think the firm is permitted to  
22    determine what's considered personal versus business.

23           Q     But if you have somebody like Shana who's in the  
24    compliance unit making determinations on her own which  
25    e-mails can be deleted, isn't that a concern?

1           A     I guess I don't know what's typical at most firms.  
2     Again, I think they have the ability to when they provide  
3     e-mails to us as regulators to decide what's considered  
4     business versus what's considered personal. So I don't know  
5     that it struck me at that point.

6           Q     Was there a concern in the fact that you weren't  
7     getting the e-mails like Ostrow mentions here at the top of  
8     this e-mail chain?

9           A     I think it was another sort of frustration, another  
10    frustration, frustrating part of the exam. It's -- often  
11    exams, you know, e-mails are a real stickler issue, a real  
12    touch issue.

13          Q     And so you felt like Madoff was not being -- was  
14    not giving you all the e-mails that you were seeking?

15          A     I don't -- I don't know about that. I remember  
16    that a lot of people didn't have e-mails or didn't e-mail  
17    accounts.

18          Q     Do you remember Bernie saying he didn't use e-mail?

19          A     Yes.

20          Q     Did you think that was odd given that, you know, he  
21    was promoting himself as being in the forefront of advanced  
22    technology?

23          A     Yeah, I don't -- I don't know that I thought of it  
24    as that he couldn't. Like, I think he had the technological  
25    capabilities of having e-mail. I mean, other people within

1 the firm had it. He just chose not to have an account, and I  
2 think, you know, sort of -- it may be in line with his  
3 secretive nature. And I think he may have made a comment to  
4 the fact that, you know, business is conducted by phone.  
5 Like, you know, it's not necessary to e-mail back and forth,  
6 something like that.

7 BY MS. STEIBER:

8 Q And you found that credible, that he wasn't  
9 e-mailing?

10 A I didn't think at the time he was lying. I didn't  
11 know really what to think. I mean, I took it but, yeah.

12 BY MR. KOTZ:

13 Q Okay. Let's go to the next document.

14 (SEC Exhibit No. 30 was marked for  
15 identification.)

16 BY MR. KOTZ:

17 Q It's marked as Exhibit 30. This is an e-mail from  
18 you to OCIE Examiner, 4-27-2005 at 3:15 p.m. Do you remember  
19 having these discussions with OCIE Examiner? He had worked,  
20 I think, for some other company and that company had some  
21 relationship to Madoff and you were trying to get some  
22 information from him?

23 A Yes.

24 Q What do you remember about that?

25 A OCIE Examiner -- I remember initially I learned

1 that he had worked somewhere that had invested money with  
2 Bernie Madoff informally in the office, I think. Often we'll  
3 say what are you working on, what are you working on. And I  
4 think I said I was working on Madoff, and he said, "Oh, we  
5 used to have money there."

6 And I think I requested or I asked him if -- sort  
7 of some background because I think we were having trouble  
8 sort of getting anywhere at that point and what's going on,  
9 do you know anything about Madoff, can you help me out. But  
10 at some point, I think <sup>OCIE Examiner</sup> [REDACTED] was relatively new to  
11 the firm or new to the SEC, and at some point he said he had  
12 some sort of employment agreement that precluded him from  
13 speaking about his prior position. And I think Mr. Nee said,  
14 you know, it's sort of off limits. You can no longer talk to  
15 him about that.

16 Q Okay. And so that you never got the information  
17 you needed from <sup>IM Staff Accountant</sup> [REDACTED] or asked for from --

18 A From <sup>OCIE Examiner</sup> [REDACTED].

19 Q From <sup>OCIE Examiner</sup> [REDACTED], I'm sorry.

20 A No, I don't recall, and I don't recall ever -- I  
21 think we were sort of not permitted to use it, sort of  
22 learned outside the scope of the exam or something to that  
23 effect.

24 Q Okay. But did you ever go -- did you ever have  
25 anyone go back to the company that he had previously worked

1 for and try to seek any information?

2 A No. I googled it. I think I tried to use the  
3 Internet to search for it, and I couldn't find anything.

4 Q Okay. I'm going to go to the next document.

5 (SEC Exhibit No. 31 was marked for  
6 identification.)

7 BY MR. KOTZ:

8 Q The document we'll mark as Exhibit 31. This is an  
9 e-mail from Ostrow to you, 5-27-2005, 2:13 p.m. This was  
10 something related to Auriga International. And Ostrow's  
11 saying to you, "Bernie stops in asking about Auriga  
12 International, whether or not it should be on the list."

13 You respond, "Hey, he said he's not familiar with  
14 Auriga International. It could be investor through one of  
15 the feeder funds."

16 And Ostrow says, "That's weird because Bloomberg  
17 reports Auriga has discretionary funds with B. Madoff."

18 Remember this issue?

19 A I don't remember that name at all.

20 Q Okay. Do you remember generally kind of catching  
21 Bernie in lies? Ostrow testified that he felt like Bernie  
22 lied to you-all on numerous occasions?

23 A Well, I think extremely evasive which -- so he  
24 starts off by saying he doesn't have this investment advisory  
25 business. Put the article in front of him. "Oh, I have a

1 few accounts."

2 "How much in assets?"

3 He says, "4 or 6 billion."

4 Okay. So we submit a request for the information.  
5 It comes back. It's 15 or 16 accounts with 8 billion. You  
6 know, to me, the -- I don't know if that's evasive or lying,  
7 but that's not good. And then, of course, you know, the  
8 strategy, you know, it's supposed to be with options. After  
9 we learned he had the accounts, he says he doesn't have  
10 options. These sorts of things, I mean, we now know are  
11 lies. Back then, I don't know that we -- you know, we knew  
12 that.

13 Q But did you get the sense, though, generally that  
14 kind of he would change his story as new information was  
15 brought to his attention? So if you didn't know something,  
16 he would say X and then when you found that out, he would  
17 change his story to something else?

18 A Yes.

19 Q Okay. All right. Let's go to the next document.

20 (SEC Exhibit No. 32 was marked for  
21 identification.)

22 BY MR. KOTZ:

23 Q The next document we'll mark as Exhibit 32. This  
24 is an e-mail from Bob Sollazzo to John Nee, 5-26-2005, 3:56  
25 p.m. And Sollazzo says to Nee here, "Bernie is 'fessing up.

1 I could 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."

4 Do you know what he was referring to when he said,  
5 "Bernie's 'fessing up"?

6 A I'm speculating, but I assume it's that he  
7 has -- he's managing money for outside accounts.

8 Q And this point about you wonder what is his benefit  
9 beyond commissions, do you think that that's that issue we  
10 talked about earlier about, you know --

11 A Yes, that beyond, you know, he's not taking a  
12 percentage of the profits while he's allowing other people to  
13 do that.

14 Q And then attached to that is a draft of a  
15 memorandum. It says, "Objective, discuss Bernard L. Madoff  
16 business in relation to hedge fund articles written about the  
17 firm."

18 You see there's a reference on the first page of  
19 that in the last paragraph, "B. Madoff developed the model  
20 approximately eight years ago and is the only individual  
21 authorized to execute trades on behalf of the 15 entities  
22 using the model."

23 So at this point, he kind of 'fessed up to 15  
24 entities?

25 A Yes, I think this is what I referred to earlier

1 when I said we put the articles in front of him and he  
2 finally acknowledged it.

3 Q Now, was there a kind of a limit in terms of  
4 registration, a certain number of clients that you could have  
5 before you have to register?

6 A I know now there is. I think at the time I did not  
7 know. It's 15.

8 Q Okay.

9 BY MS. STEIBER:

10 Q So when you brought this issue of the 15 entities  
11 that he's 'fessed up to Nee, did Nee suggest that you should  
12 get Bernie to register as an investment advisor?

13 A I don't recall. I don't recall. I don't recall  
14 having that discussion or talking about that.

15 BY MR. KOTZ:

16 Q Okay. The last paragraph for this document, it  
17 says, "B. Madoff was surprised that the staff was unaware  
18 that Madoff conducted this type of business since he had  
19 discussions regarding the firm's hedge fund relationships  
20 with SEC officials approximately one and a half years  
21 earlier." It says -- and then the footnote, "B. Madoff  
22 stated he communicated with Lori Richards and John McCarthy  
23 regarding the firm's hedge fund relationships."

24 So isn't it a fact that you found out about the SEC  
25 conducting another examination of Madoff from Madoff

1 himself? A Yes.

2 Q Was that somewhat embarrassing that you guys didn't  
3 know about that before?

4 A Yes.

5 Q And in that communication with -- he had with you  
6 when he talked about how he communicated with Lori Richards  
7 and John McCarthy, was -- do you think he was kind of -- was  
8 he also saying oh, he talked to Lori Richards who obviously  
9 was very high up at the SEC as a way to show who -- who he's  
10 been dealing with?

11 A I'm not sure I thought that at the time. I mean, I  
12 was sort of shocked that Washington had looked at this issue  
13 and also, it was -- once he finally acknowledged it, he  
14 became -- it was pretty condescending, I think, and because  
15 we didn't -- weren't even aware of it, I think that was sort  
16 of the tone he took like when I didn't understand algorithmic  
17 trading. So I think that's kind of what my thinking was at  
18 that point. And then we asked, I think, who -- you know, who  
19 did you deal with or speak with so we could follow up with  
20 them.

21 Q Okay. All right. Let me show you the next  
22 document and mark it as Exhibit 33.

23 (SEC Exhibit No. 33 was marked for  
24 identification.)

25 BY MR. KOTZ:

1           Q     It's an e-mail, 5-26-2005 from John Nee to you,  
2     copy Ostrow, 4:18 p.m., Exhibit 33. And it attaches the same  
3     document, but in this e-mail Nee says, "Thanks, Pete. In  
4     talking to William, I asked him to find out more about the  
5     actual execution and clearance of the trades. Executing  
6     brokers London exchange, prime brokers were used. I think  
7     they used Barclays. Show them the article. Were all of U.K.  
8     affiliate?"

9                     Do you know if you and/or Ostrow were ever able to  
10    find out more about the actual execution and clearance of the  
11    trades?

12           A     We asked -- we asked Bernard about this. My -- my  
13    recollection is that Barclays -- Barclays London served as  
14    the clearance and settlement for the account that conducted  
15    this business. His -- his London MSIO, his London affiliate  
16    served as a settlement agent. Bernard said that in order to  
17    conduct securities trades in Europe, you had to have a  
18    settlement agent, and that's how it went.

19           Q     Did you do anything further beyond talking to  
20    Bernie Madoff to resolve this issue?

21           A     No.

22           Q     All right. Let's go to the next document. Mark  
23    this as Exhibit 34.

24                     (SEC Exhibit No. 34 was marked for  
25                     identification.)

1 BY MR. KOTZ:

2 Q This is an e-mail from Eric Swanson to John Nee,  
3 5-26-2005, 3:57 p.m.

4 So when you found out from Bernie Madoff that there  
5 was this other headquarters --

6 A Yes.

7 Q -- then John Nee went back to the folks in  
8 headquarters to ask about it, right? What do you remember?

9 A Yes. I remember taking their names down. I'm not  
10 sure. We ended up having some sort of conference call.

11 Q Okay.

12 A I guess John contacted them first.

13 Q Okay. Do you remember who was on the conference  
14 call?

15 A From New York, it was myself, John Nee, and William  
16 Ostrow. From Washington, I believe it was two people, Eric  
17 Swanson and Mark Donohue.

18 Q Okay. Do you remember on that call -- we've had  
19 testimony to this effect -- somebody from Washington  
20 specifically stated, "You should just be aware that Madoff  
21 was a well-connected and powerful individual"?

22 A Yes, something to that effect. I'm not sure if  
23 those were the exact words, but it struck me as odd at the  
24 time. It's what I remember from that call was -- you know,  
25 we're always professional, of course, when we go do our

1 exams, but that kind of elevates your sense of your need to  
2 be professional.

3 Q Who do you remember saying that? Was it Swanson or  
4 Donohue?

5 A I don't think I knew who was speaking when we were  
6 on the conference call, so I'm not sure. And I think it was  
7 early -- sort of early on in the conference call.

8 Q But you think it was one of those two?

9 A I believe so.

10 BY MS. STEIBER:

11 Q Do you recall what they said about the focus of  
12 their exam?

13 A It seems similar to what we were looking at, and  
14 so, you know, we requested -- I think they sent up documents  
15 or requested them. And some of those documents appeared to  
16 be very similar to sort of the stuff we were looking at.

17 Q And did they -- do you recall what they concluded  
18 in their exam?

19 A I don't think they wrote a report. I mean, I  
20 think -- I think I asked John Nee about the report, and he  
21 said oftentimes they'll, you know, conduct -- I don't know if  
22 it's exams or inquiries and not write a report. I thought it  
23 was strange.

24 BY MR. KOTZ:

25 Q Did you have the impression, though, that they had

1 kind of finished their work and come to a conclusion, just  
2 not written their report?

3 A I remember being it several months before -- a year  
4 and a half or so before, so I thought -- I mean, obviously,  
5 we -- you know, we have sort of a time constraint or somewhat  
6 of a -- I mean, we don't go beyond five, six, seven months  
7 generally. So for them to be -- this to be a year, year and  
8 a half later, I think I thought they were pretty much done.

9 Q And did they indicate to you what their conclusion  
10 was, if any?

11 A I don't recall any conclusion being told to us.

12 Q Okay. Did they provide to you any substance about  
13 what they did, what questions they asked, what information  
14 they gleaned?

15 A I think they sent out, you know, a lot of  
16 documents, and I think some of that information was contained  
17 in the documents.

18 BY MS. STEIBER:

19 Q Do you think they discouraged you from thinking  
20 that Madoff was engaged in illegal activity?

21 A No, no, I don't -- I don't think they did that. I  
22 think that the one comment that you made earlier was what I  
23 remember as sticking out.

24 BY MR. KOTZ:

25 Q Other than the documents that they sent you and

1 we'll show you a cover letter for those documents, did you  
2 get any other substantive information from them about what  
3 they did or what they found or didn't find?

4 A No.

5 Q Okay. All right.

6 BY MS. STEIBER:

7 Q What was your reaction to finding out headquarters  
8 had done this -- pretty much this exam already? Did you have  
9 any reaction to it? Like gosh, why are we in here, what are  
10 we doing, we should --

11 A Yes, that type of reaction and like the word you  
12 used earlier, sort of embarrassing, I mean.

13 BY MR. KOTZ:

14 Q Did you kind of feel like well, they've already  
15 looked at some of these issues and so why do we have to look  
16 at them again?

17 A Somewhat.

18 Q Okay. I want to show you the next document. We'll  
19 mark it as Exhibit 35.

20 (SEC Exhibit No. 35 was marked for  
21 identification.)

22 BY MR. KOTZ:

23 Q This is a letter from Jacqueline Wood to John Nee,  
24 a cover letter dated June 9th, 2005, and it references  
25 various documents that were sent. Is this -- do you think

1 that these are the documents that were sent up from  
2 Washington or sent down from Washington about their exam?

3 A Yes.

4 Q Okay. And do you remember if you ever understand  
5 specifically what precipitated the Washington exam of Madoff?

6 A No, not at the time. I'll just -- as far as part  
7 of your investigation into this matter --

8 Q Okay.

9 A -- when I came back from the Madoff assignment that  
10 I was most recently on, I came back to my office and I  
11 realized that the boxes of documents they had shipped down  
12 did not include the two boxes that came up from Washington.  
13 So at that point, I called Mr. Nee who told me to go through  
14 them and copy any of the memos and any -- not all the  
15 documents, just the memos. So at that point, I did come  
16 across some sort of complaint or suspicious -- someone  
17 suspicious of Madoff. But at the time, back in '05, I don't  
18 recall.

19 Q Okay. Let me show that document. We'll mark it as  
20 Exhibit 36.

21 (SEC Exhibit No. 36 was marked for  
22 identification.)

23 BY MR. KOTZ:

24 Q It's an e-mail from [REDACTED] to Mavis  
25 Kelly, Wednesday, May 21, 2003, 5:47 p.m. Is this the

1 document that you say you realized was within the materials  
2 that DC headquarters had sent to you as part of their Madoff  
3 exam?

4 A Correct.

5 Q Okay. But at the time when you were conducting  
6 your 2005 cause exam of Madoff, had you read this document?

7 A I had conducted some sort of like cursory review of  
8 the documents, but it seemed so similar to what we were  
9 receiving in real time, that I didn't spend a lot of focus  
10 and I just -- this didn't stick out to me at the time.

11 Q Okay. So you may have glanced at it, but you  
12 didn't really kind of analyze it.

13 A Right, right.

14 BY MS. STEIBER:

15 Q And you say you never considered calling [REDACTED]  
16 [REDACTED]?

17 A No. Like that's not a call like an examiner would  
18 make. That would be -- you -- this is the sort of thing you  
19 might bring to a supervisor and then sort of --

20 BY MR. KOTZ:

21 Q And you didn't bring that -- that idea to anybody's  
22 attention about calling [REDACTED]?

23 A No.

24 BY MS. STEIBER:

25 Q Did John Nee look at the documents that you

1 received from headquarters?

2 A I don't believe so.

3 Q Did William Ostrow look at the documents that you  
4 received from headquarters?

5 A I don't know. The documents were in my space. We  
6 had cubes at the time, so I'm not sure if he did or not.

7 Q Do you recall the trading data that DC provided you  
8 with, did you ever look at it?

9 A I may have flipped through it. I think it was in  
10 hard copy format, so I didn't do any sort of analysis. I  
11 sort of felt like they probably had done that.

12 Q Did you recall that it reflected options trading?

13 A I'm not sure. I'm not sure.

14 Q If it had reflected options trading, the DC data,  
15 and you had looked it, would that have been a red flag to  
16 you? Because would it be inconsistent with what Bernie  
17 Madoff had told you?

18 A Yeah, if I recall correctly, he stated he stopped  
19 doing it in 2004, stopped trading options in 2004. But I  
20 guess it would have been suspicious, like his sort of refusal  
21 to acknowledge the business, refusal to acknowledge his MSIO  
22 was an affiliate. But I mean, you know, if he's not going to  
23 provide the documents and he's going to say he doesn't do it  
24 anymore, whether it's Bernard Madoff or anyone else, it's  
25 hard -- I mean, it's hard to know -- I mean, other than to

1 tell your supervisor, there's not -- not much more you can do  
2 with the registrant.

3 BY MR. KOTZ:

4 Q Okay. Why don't we go to the next document and  
5 mark it as Exhibit 37.

6 (SEC Exhibit No. 37 was marked for  
7 identification.)

8 BY MR. KOTZ:

9 Q This is an e-mail from you to William Ostrow,  
10 5-27-2005, 8:06 a.m. And if you look at the last -- the  
11 second page of this document. There's an e-mail at the  
12 bottom of the page from Ostrow to you, Friday, May 27th,  
13 2005, 8:31 a.m. He says, "Maybe we should put in motion a  
14 written request for." And then the next page has several  
15 things on it, one, two, three, four, five, six. "One,  
16 customer statements and confirmations; two, correspondence;  
17 three, what markets in London is Bernie using? How does his  
18 securities settle? Would not be DTC or NSCC. Four,  
19 description of the algorithm. Five, what is Barclays' role  
20 in facilitating the transactions? Six, what role does the  
21 U.K. office play?"

22 Do you recall whether a written request was ever  
23 sent for that information?

24 A I don't recall.

25 Q You don't recall there being a written request?

1           A     I don't recall putting together a written request  
2     for this information. I do recall speaking about like  
3     Barclays and the role of the U.K. office, as we discussed  
4     earlier.

5           A     Okay.

6           Q     What about, "What markets in London is Bernie  
7     using? How does his securities settle?" Do you remember  
8     asking Bernie that question?

9           A     We definitely got into the strategy on how he was  
10    able to execute his orders.

11          Q     Okay. Did you review account statements?

12          A     We received account statements, yes.

13          Q     Okay. And did you ever notice that the account  
14    balances on the account statements went to zero at the end of  
15    every month?

16          A     I know that now. I'm not -- I don't know -- I  
17    don't recall seeing that back then.

18                   BY MS. STEIBER:

19          Q     If you had noticed it at the time, would that have  
20    raised a red flag?

21          A     Well, I think -- I believe the way he explained the  
22    business was that the security -- it was each of the 15 or 16  
23    accounts had an account like a custody account elsewhere.

24    And then it was set up in a RVP/DVP format, receipt versus  
25    payment, delivery versus payment. So in order for him to be

1 able to access the money in the custody accounts, he had to  
2 deliver the securities and vice versa. So I think that's  
3 why -- I guess that's why, I mean. I'm not sure if I  
4 answered that.

5 Q Well, no, I'm saying wouldn't -- if it -- he was  
6 supposedly going to zero every month, wouldn't that raise  
7 some suspicions about transaction costs, how could he making  
8 be these returns with these significant transaction costs of  
9 going into cash?

10 A I -- no, I don't think he was going -- I mean,  
11 according to the documents that we were provided, he wasn't  
12 going -- he wasn't zeroing out every month. In some cases,  
13 he had -- he had the strategy going for multiple months. So  
14 which I think was different than what some people had raised  
15 in articles or during the pre-exam.

16 Q Going back to that prior issue that you just raised  
17 about the custody of assets, did he ever produce any  
18 documentation of these custody of asset issues, supposedly  
19 from the bank that was custodialing the assets?

20 A No.

21 BY MR. KOTZ:

22 Q Okay. In this same e-mail on page 2 of 4, e-mail  
23 string, you say to Ostrow on Friday, May 27th, 2005,  
24 8:35 a.m., "Okay. I'll write this request. I asked about  
25 correspondence, and he said there were none, of course." And

1 then it says, "I'll address any missing docs as well."  
2 Were there -- was there a concern that Madoff was not being  
3 forthright or providing all the information or that you would  
4 ask him about correspondence and he had said there were none?  
5 Was that kind of an overall concern in the exam?

6 A Yes. I mean, I think we thought it was strange  
7 there was such a lack of -- or there was no correspondence.

8 Q Okay. And then later on, Ostrow says to you,  
9 above, Friday, May 27th, 2005, 8:39 a.m., "Even as you hand  
10 the request to him, you can say if some of the questions  
11 don't apply, you can just write NA on it and give us a copy.  
12 Questions like Barclays or the U.K. office might not apply,  
13 according to Bernie."

14 Wouldn't that be odd for an examiner to say in  
15 connection to a cause exam, here's a request. You can  
16 say -- you can write NA.

17 A Well, I just think we wanted him to acknowledge in  
18 writing that certain things didn't apply to him rather than  
19 him just giving us a verbal response. I think that was -- I  
20 believe that's the idea.

21 Q Did you get him to acknowledge in writing these  
22 things?

23 A I don't recall.

24 Q You don't recall doing it?

25 A I don't recall receiving anything in writing.

1 Q Okay.

2 BY MS. STEIBER:

3 Q And why would questions like Barclays or the U.S.  
4 [sic] office might not apply according to Bernie, I don't  
5 understand.

6 A I imagine it's because -- does the SEC have  
7 jurisdiction over London offices or affiliates?

8 Q Did you ever research that issue?

9 A I did not.

10 BY MR. KOTZ:

11 Q Okay. Why don't we go to the next one?

12 (SEC Exhibit No. 38 was marked for  
13 identification.)

14 BY MR. KOTZ:

15 Q Okay. So we're going to mark as Exhibit 38. This  
16 is an e-mail from you to William Ostrow, Friday, May 27th,  
17 2005, 10:48 a.m. And then below that is an e-mail from you  
18 to Ostrow Friday, May 27, 2005, 10:28 a.m. And there's a  
19 reference to Commerce Bank. "One of the brokers Bernie  
20 mentioned was Commerce Bank which I believe they either built  
21 or they were going to build the technology platform form  
22 for."

23 Do you or Ostrow ever contact Commerce Bank to  
24 verify its relationship with Madoff?

25 A No.

1 Q Okay. There's a reference to regarding the  
2 settlement and clearance process. "He stated that Barclays  
3 clears the trades and then delivers the funds, shares to the  
4 customers. There's no prime broker. Barclays clears the  
5 trades for Madoff."

6 Isn't that inconsistent with the letter before that  
7 Nee got back from Barclays which said that there was no  
8 transaction activity?

9 A Right. I'm not sure if -- if we're referring to  
10 Barclays -- which Barclays. I think there was an issue about  
11 two different Barclays.

12 Q Okay. Do you know if at the time you thought let's  
13 go back to the Barclays letter and look at it vis--vis the  
14 point in this, that Bernie was saying about Barclays?

15 A I know we did not go back.

16 Q And then above Ostrow says in an e-mail to you,  
17 Friday, May 27th, 2005, 10:43 a.m., "We also want to know how  
18 that basket of trades is submitted to the 50 brokers in  
19 London. Maybe he just logs onto Barclays' website and is  
20 interfaced with them. How's the basket represented to these  
21 50 brokers? Is it showing that Madoff being the customer?  
22 Is Barclays considered the customer? Is the whole side shown  
23 at once? Does it get shown piecemeal it's done over three  
24 days? Why does he use Barclays as opposed to his London  
25 affiliate? What does Barclays charge per share?"



1 says to you, "Did he get you the RVP/DVP instruction sheet?  
2 Also, we'd like a list of corresponding contacts of each  
3 account or who is the investment manager that is authorized  
4 to call on behalf of the fund and increase the trading  
5 limits."

6 You said, "I'll ask him to provide this  
7 information."

8 But you had testified earlier you don't think he  
9 ever provided that information.

10 A Correct.

11 Q And then up above that, William Ostrow says, "Try  
12 to get a month or two of a big account like Fairfield Sentry,  
13 Kingate or Tremont printed out today and put in geek bag just  
14 so we get a feel for what the rest should look like.  
15 Otherwise, he has three days to come up with a sample."

16 Do you recall this issue of Bill Ostrow not  
17 trusting the -- the statements that Madoff was providing and  
18 wanting to put them in this geek bag?

19 A I don't recall ever thinking or discussing with him  
20 the fact that he might be fabricating statements.

21 BY MR. KOTZ:

22 Q What about this issue of the geek bag, just the  
23 idea that when you asked for something, you don't give him  
24 significant time to come up with it as a method in the exam?

25 A I don't think -- I think Mr. Ostrow in general was

1 pretty good about -- you know, is very suspicious of people  
2 and things. So I don't know that he was particularly  
3 concerned about this one exam or about Bernie doing that sort  
4 of thing. I'm not sure if he -- I don't know that his -- he  
5 was any more concerned or he wouldn't say anything  
6 differently if he was on another firm.

7 Q Did you get the feeling during the exam that Ostrow  
8 was being too suspicious?

9 A No. I mean, he's -- I would say people think, you  
10 know, he's a good examiner. He's sort of relentless and, you  
11 know, that's -- you know, that's a good thing, I think. You  
12 know, Bernard sort of felt that. I mean, he felt William  
13 really pushing him on things.

14 BY MS. STEIBER:

15 Q Okay. And then if you move up a little bit, you  
16 write to Bill Ostrow, "I submitted the request. He said this  
17 instruction sheet was provided. It is the sheet that was the  
18 custodian bank's along with the account number that I listed  
19 on the spreadsheet."

20 A I'm sorry. Could you tell me what page it is?

21 Q Sorry. As you move up, you say in the e-mail that  
22 you submitted this request to Bernie and Bernie replied oh, I  
23 already gave you these documents. Do you recall this issue  
24 about the DVP/RVP?

25 A I'm sorry. Could you repeat the question?

1 Q Okay. I'm sorry. Let's go -- let's continue going  
2 up the chain. You say on May 27th to Bill Ostrow, "I  
3 submitted the requests."

4 A Yeah.

5 Q That's for the DVP/RVP instruction sheet. It was  
6 provided. You know, Bernie replies that it was provided.

7 A Okay.

8 Q And then if you move up the chain, Ostrow says to  
9 you, "Wouldn't those account numbers you listed in the  
10 spreadsheet correspond to the account at Barclays or the  
11 Madoff account number? I can't believe that is the bank  
12 account information for each of the 15 accounts. I can't  
13 believe that Bank of America and HSBC both have account  
14 ranges that start with 1FR."

15 Do you recall this issue of receiving a document  
16 from Bernie Madoff that Mr. Ostrow found suspicious or found  
17 didn't add up to what he would have expected to have been  
18 produced?

19 A I don't really -- I don't recall this e-mail or  
20 this issue.

21 MS. STEIBER: Could we go off the record for just a  
22 minute?

23 MR. KOTZ: Let's go off the record.

24 (A recess was taken.)

25 BY MS. STEIBER:

1 Q I'd like to show you a document and mark it as  
2 Exhibit 40.

3 (SEC Exhibit No. 40 was marked for  
4 identification.)

5 BY MS. STEIBER:

6 Q And I just want to know -- I think these are  
7 documents that were produced by Madoff, and if you look at  
8 these --

9 MR. KOTZ: Let's just identify the document. It's  
10 a list of entities, a two-page document with a list of  
11 entities on the first and addresses and telephone numbers,  
12 and then two columns on the second page.

13 BY MS. STEIBER:

14 Q Do you recall when these were produced, whether it  
15 was during your exam or later on during an investigation by  
16 enforcement?

17 A I'm not sure. I recall seeing this, certainly this  
18 first page. I'm not sure if it was part of the exam or the  
19 investigation.

20 Q Okay. What about the second page?

21 A This doesn't look familiar to me. I don't recall  
22 seeing this second page.

23 Q Okay.

24 BY MR. KOTZ:

25 Q Okay. Show you the next document. We're going to

1 mark it as Exhibit 41.

2 (SEC Exhibit No. 41 was marked for  
3 identification.)

4 BY MR. KOTZ:

5 Q This is an e-mail from John Nee to you of 6-1-2005,  
6 7:29 p.m. Seen in this e-mail chain, Mark Schonfeld, who I  
7 guess was the head of the New York office sends an e-mail  
8 around saying, "Chairman Donaldson will be stepping down  
9 effective June 30. Here's a link to press release."

10 You say to Nee, "Bernie told us he was on the short  
11 list when Chairman Donaldson was selected. Maybe this time."

12 And Nee says, "Maybe you and William can be his  
13 aides."

14 So Bernie did say that he was on the short list for  
15 the next chairman?

16 A Something to that effect, I recall it.

17 Q Okay. So did you think at the time that it was a  
18 possibility that Bernie Madoff would be the next chairman of  
19 the SEC? He was a well respected figure. Ostrow said he  
20 thought it was possible.

21 A I don't know. I took it as blowhard comment. I  
22 mean, trying to talk about his status in the industry and  
23 status on the markets. But I don't know that I ever thought  
24 he could really be chairman. I just -- I don't know.

25 Q And then isn't it true that -- and this is

1 something Ostrow testified to as well that Bernie told you  
2 who was going to be the next chairman, that it was going to  
3 be Chris Cox several weeks before it was announced at the  
4 SEC?

5 A I don't think it was several weeks before. I think  
6 right about the time it was announced -- I don't even -- I'm  
7 not even sure he said who it was going to be. He may have  
8 said he knows. There may have been news reports or press  
9 releases about the next chairman about the next chairman of  
10 the SEC is going to be named, and he may have said something  
11 like I know who it's going to be or something. I don't  
12 recall specifically him knowing prior to the announcement,  
13 certainly not weeks before.

14 Q That was what Ostrow said. You think maybe he had  
15 a different conversation with Bernie?

16 A I don't think -- I mean, I'm not even sure the  
17 chairman was selected weeks before. I mean, I don't know --

18 Q No, no, no. What Ostrow said was that several  
19 weeks before it was announced who the next person was.  
20 Donaldson stepped down. Then there was a lot of speculation  
21 as to the different people, who would be the next chairman.

22 A Right.

23 Q According to Ostrow, Bernie told him at least that  
24 the next chairman's going to be Chris Cox, and several weeks  
25 later, it was announced to be Chris Cox.

1           A     I don't recall that.

2           Q     Okay. All right. Let me show you the next  
3 document. I'm going to mark it as Exhibit 42.

4                                 (SEC Exhibit No. 42 was marked for  
5 identification.)

6           BY MR. KOTZ:

7           Q     This is an e-mail from you to William Ostrow,  
8 6-1-2005, 11:09 a.m. If you go to the last page of this  
9 e-mail string in Exhibit 42, there's an e-mail from you to  
10 John Nee and William Ostrow, Wednesday, June 1, 2005,  
11 10:11 a.m. And it says, "Cliff Notes version of my  
12 discussion with Bernie this morning. Bernie reiterated that  
13 his model only identifies the basket of securities in the  
14 S&P 100 which will replicate the S&P 100 at the least cost  
15 number of securities in shares. Does not tell them when to  
16 enter and exit the market. Bernie's gut feel tells him when  
17 to enter and exit the market. His gut feel includes his  
18 observations of the trading room here in New York, what his  
19 European contacts are telling him, what he reads in industry  
20 papers and publications."

21                         You have some experience with trading.

22           A     Yes.

23           Q     In your experience, was that possible that Bernie  
24 had this gut feel based on his observations of the trading  
25 room in New York, what his contacts were telling him and

1 reading in papers and publications exactly when to enter and  
2 exit the market?

3 A. I've heard -- I've never seen the returns, but  
4 Steve Cohen is known as the greatest, you know, hedge fund  
5 trader out there. And I think his returns are similar and  
6 consistent with what Bernard Madoff was producing.

7 Q So you didn't -- it didn't strike you as anything  
8 particularly odd that Bernie had this gut feel based on  
9 observations of the trading room, what Europeans are telling  
10 him and reading in the newspapers that he was able to achieve  
11 the returns he was able to achieve with so little volatility?

12 A I asked him repeatedly, you know. I thought his  
13 gut feel was, you know, strange, suspicious. You know, I  
14 kept trying to press him. I thought there was something  
15 else. You know, I thought, you know, he was getting some  
16 sort of insight into the overall broad market that other  
17 people weren't getting. So I repeatedly sort of pressed him  
18 on that.

19 Q Did you ever figure out that -- the answer to that  
20 question, what he was getting?

21 A No, I don't -- I mean, I don't -- he never  
22 acknowledged -- and I think in testimony during the  
23 investigation, he talked about some models or something.

24 Q But in the examination --

25 A Right.

1 Q -- he tells you this is his gut, it's his gut feel.  
2 You don't -- you think it's suspicious that his gut feel  
3 would be able to achieve that. How come you never get to the  
4 bottom of how he was able to do it?

5 A Right. I mean, I think we asked repeatedly over  
6 and over again -- I went -- you know --

7 Q You asked Bernie?

8 A I asked Bernie repeatedly over and over again, and  
9 at some point, I mean, I'm not sure what else to do.

10 Q Well, but if you're doing a cause exam, the SEC's  
11 doing a cause exam of a registrant and you're suspicious that  
12 he may be engaged in inappropriate or illegal activity,  
13 you're telling all you can do is ask him whether he's engaged  
14 in illegal or inappropriate activity, he says "no," there's  
15 nothing more you can do?

16 A Well, I think the -- the suspicions were such that  
17 he was stealing from the market, he was front running, he was  
18 cherry picking. Mr. Nee's thought was that it had something  
19 to do with the systems, data mining, analyzing order flow.  
20 Based on what we learned during the exam, it didn't seem  
21 possible that either he was front running, he was cherry  
22 picking or there was -- there was data analysis going on. At  
23 that point, I don't think we had any other -- we weren't sure  
24 what else to do.

25 Q What about taking further efforts to try to do

1 figure out what he was doing to achieve these returns given  
2 that it couldn't be his gut feel?

3 A Well, I think we sort of tried to get trade  
4 documents, trade blotters, trade executions reports, things  
5 like that. At the time, it appeared -- they appeared  
6 legitimate. You know, the other -- I mean, coming from the  
7 industry, you know, it's very -- there's a lot of networking  
8 that goes on. You can pick up the phone and call other  
9 people whether you're analyzing a company or what have you.  
10 The SEC doesn't seem to be that way. We don't have an open  
11 relationship with the industry. So, you know, I think  
12 ideally we could have spoken to professionals in the industry  
13 to get their insight into the returns he was generating, the  
14 strategy he was using and find out if it made sense.

15 Q So at that point in the exam, even though you  
16 had -- were unable to get to the answer of how he was able to  
17 achieve these consistent returns with so little volatility,  
18 it was your understanding that there was nothing more that  
19 the SEC could do?

20 A It was my understanding -- right. I didn't have  
21 any other suggestions at that point.

22 Q Okay. Yeah, let me ask you something more about  
23 this document, if you could look at page 3 of 4. Ostrow says  
24 to you on June 1, 2005, 10:14 a.m., "Let me know if there  
25 were any transactions during the time period we requested,

1 February 28th to March 11th, 2005 for Kingate and I will  
2 guess -- I will check to see if there are on the database of  
3 orders entered."

4 You respond, "Hilarious. Nothing. Only  
5 transactions on Feb 18 and March 15th."

6 So wasn't that odd that you checked to see if there  
7 were any transactions and there weren't any? What do you  
8 mean by "hilarious"?

9 A I think that during this time that he had a  
10 basket -- he had this -- supposedly had this strategy on. So  
11 there's a basket of securities. He was long and he  
12 had -- just he would long the securities. So I'm not sure  
13 why the dates -- I'm not sure why Mr. Ostrow is asking me  
14 specifically about those dates.

15 Q Yeah, he was checking to see if there were  
16 transactions during a certain time period, and you found  
17 there weren't any.

18 A Okay.

19 Q So -- but why would that be -- I don't understand  
20 the hilarious, nothing. Wouldn't that be a major red flag  
21 rather than hilarious?

22 A No. Again, I think he had the basket on during  
23 this time period. So on -- and I think on  
24 February -- sometime in mid February, he adjusted the basket  
25 and then in mid March, he closed out the basket. I'm not

1 sure why I wrote hilarious.

2 Q Okay. And then you can see on the front page of  
3 this document, page 1 of 4, Exhibit 42, you say in e-mail to  
4 Ostrow, Wednesday, June 1, 2005, 10:59 a.m., "Hey, I'm not  
5 quite sure what's going on with these statements. I'll show  
6 you later, but it seems clear as mud to me."

7 Remember what the issue was with his statements?

8 A His statements were not easy to read. They  
9 were -- you know, I think most people when you have an  
10 account with a broker-dealer, it has sort of the securities  
11 you have, the trades you made during the month, your balance.  
12 His, I believe, just had the securities listed, no balances,  
13 information like that.

14 Q So did you ever get to a point where you were able  
15 to understand the statements better?

16 A I think we had a better understanding. At some  
17 point we asked Bernie to explain them to us.

18 Q And then you were able to understand them?

19 A We were able to understand the information that was  
20 on there, sure, yes.

21 Q Okay. Okay. And then he responds to you,  
22 11:07 a.m., "It's a funny way and I'm sure appropriate way to  
23 put it. I guess his stomach and gut were churning if he was  
24 buying and selling on the same day."

25 And then you respond, "I don't know, but assuming

1 he bought on or about 125 and sold on or about 315, he timed  
2 the market pretty well."

3 So is it fair to say that you were aware at the  
4 time that his timing abilities were extraordinary?

5 A Yes.

6 Q Okay. And suspicious?

7 A Yes. I think we tried to -- we did a little  
8 historical look back to see just the market in general, sort  
9 of the timing of his purchases and sales. And one of the  
10 things that seemed that when there was sort of a downturn in  
11 the market -- and there's an indicator that's used often in  
12 the market called the volatility index. So it's sort of a  
13 contrarian indicator. When the volatility index goes up,  
14 it's because the market has gone down a lot. And I remember  
15 seeing an article or some information about, you know, high  
16 points in the volatility index. And it seemed like he was  
17 pretty well correlated. He would buy when the volatility  
18 index spiked, hence the market was down. But that's -- so I  
19 think, yes. I mean, he seemed like a pretty -- you know, he  
20 was entering the baskets at a pretty good time.

21 BY MS. STEIBER:

22 Q Did you ever consider going to -- or discuss with  
23 Mr. Nee going to OEA to have them do an analysis to see if  
24 his timing was even possible?

25 A I don't recall having any conversation with Mr. Nee

1 about that. I believe during the investigation part, OEA was  
2 contacted.

3 BY MR. KOTZ:

4 Q But you didn't think about contacting them during  
5 the exam part?

6 A No. I'm not even sure I knew that existed, so.

7 Q Okay. Let's go to the next document.

8 (SEC Exhibit No. 43 was marked for  
9 identification.)

10 BY MR. KOTZ:

11 Q Marked as Exhibit 43, this is an e-mail from Nee to  
12 Sollazzo, 6-2-2005, 10:04 a.m. And at the bottom of this  
13 page, there's an e-mail from Nee to you and Ostrow, Thursday,  
14 June 2nd, 2005, 9:27 a.m. It says, "William and Pete, Bob  
15 spoke to Macaroli" --

16 A Macaroli.

17 Q -- "Macaroli yesterday and he agreed the document  
18 associated with the black box model should be subject to the  
19 books and records requirements since the model is used in the  
20 conducting of the firm's business."

21 Do you -- did you -- do you remember this issue  
22 where you were trying to get information about the black box  
23 and there was a question of whether you were able to?

24 A Yes. I believe it was sort of a verbal request  
25 initially for information regarding -- Bernard referred to it

1 as Model MA206. That's when -- initially, he sort of balked  
2 at wanting to provide any information about that. So I  
3 believe I contacted Mr. Nee who contacted Mr. Macaroli.

4 Q And so did you understand that after the  
5 conversations between Nee and Macaroli or how they were  
6 responded back to you that there was nothing proprietary or  
7 otherwise that you weren't able to get from Madoff in the  
8 exam?

9 A Yes.

10 Q Okay. Let's go to the next one. Mark this as  
11 Exhibit 44.

12 (SEC Exhibit No. 44 was marked for  
13 identification.)

14 BY MR. KOTZ:

15 Q This is an e-mail from you to John Nee, 6-6-2005,  
16 7:47 a.m. You say, "Hey, John, we still have not received  
17 the hedge fund" --

18 A I'm sorry. I don't think I have that.

19 MS. STEIBER: Oh, I'm sorry.

20 THE WITNESS: Okay.

21 BY MR. KOTZ:

22 Q "Hey, John, we still have not received the hedge  
23 fund contact list nor do the statements contain the address  
24 of the 15 entities. We're going to ask him again today for  
25 this information."

1           Do you remember that issue in terms of trying to  
2 get this hedge fund contact list or addresses?

3           A     I don't recall it.

4           BY MS. STEIBER:

5           Q     Do you recall if this is the list we showed you as  
6 a previous Exhibit 35?

7           A     I have seen that list. I've just -- I'm not sure  
8 if it was in the exam or the investigation.

9           BY MR. KOTZ:

10          Q     Going back to -- I'm sorry. Going back to Exhibit  
11 43 for a second, in this e-mail that you sent John Nee June  
12 2nd, 2005, 10:03 a.m., you say, "I don't believe the retail  
13 customer order flow from Madoff's market making business has  
14 anything to do with his hedge fund model. Granted, his  
15 purchase and subsequent sale time was excellent. Buy low and  
16 sell high but he held the basket for approximately six weeks,  
17 therefore, I don't believe he's using any short-term signals  
18 that would come from his retail order flow."

19                 Was the point there that you didn't find evidence  
20 of front running?

21          A     Yes.

22          Q     Okay. But then you say, "I suspect that he is  
23 extremely well connected to European order flow information  
24 through his brokers and possibly the investors in his fund  
25 and is timing the market based on that information rather

1 than his retail order flow information."

2 Do you know whether if that was true what you  
3 suspect, would that have been legal or illegal?

4 A I'm not sure if I knew it was legal or illegal. I  
5 think at this point I was just trying to theorize how he  
6 could be timing the market so well.

7 Q Did you ever go back, talk to Nee or Sollazzo or  
8 anyone else, say this is a suspicion I have, how would we go  
9 about determining whether this is accurate and whether this  
10 is illegal activity?

11 A I never had that conversation.

12 Q Okay. All right. Let's go to the next document.  
13 I'm going to mark this next document as Exhibit 45.

14 (SEC Exhibit No. 45 was marked for  
15 identification.)

16 BY MR. KOTZ:

17 Q This is an e-mail from John Nee to Ostrow with a  
18 copy to you, 6-7-2005 at 1:47 p.m. First, if you look down,  
19 Ostrow sends an e-mail to Nee with a copy to you, June 7,  
20 2005, 12:26 p.m. "We're reviewing all the basket trades  
21 conducted by the 15 or so entities using Bernie's proprietary  
22 model. For all of 2004, Madoff executed close to 2 billion  
23 shares of stock which represents a commission equivalent of  
24 approximately 82 million 0.4 cents a share. It appears that  
25 without this commission equivalent business derived from the

1 hedge funds, we estimate that the firm would lose 10 to \$20  
2 million per year."

3 Do you remember this kind of revelation during the  
4 exam that, in fact, the market making business was losing  
5 money and actually, it was the investment side business that  
6 was propping up the market making business?

7 A I don't remember discussing this or even --

8 Q Do you remember --

9 A I don't recall even seeing this e-mail. I mean,  
10 again, I think, you know, my focus was trying to figure out  
11 sort of how he's generating his returns.

12 Q You don't remember at any point in time that Bernie  
13 Madoff big market making business, well-known market maker  
14 and then you come and do an exam and see the market maker  
15 loses 10 to \$20 million a year. It's only propped up because  
16 of his investment advisor side which you guys weren't even  
17 aware of when you started.

18 A We never discussed that. I don't recall discussing  
19 that.

20 Q Okay. Would that have been sort of a major  
21 revelation in an exam to find out that, you know, what you  
22 originally thought was so different from what you found in  
23 the exam?

24 A I don't know that that's the right  
25 characterization. I think that I guess it would have been

1 surprising to learn that, you know, his sophisticated market  
2 making operation was a money loser.

3 Q And, in fact, he had this other operation which  
4 wasn't well known at all before which was the money maker.

5 A Yes. I mean, I think in our report we noted that  
6 the majority of the revenues for the firm were generated by  
7 that -- by the IA business.

8 Q Okay.

9 BY MS. STEIBER:

10 Q So it was notable to you?

11 A It's definitely striking that his -- this -- one of  
12 the three businesses generated so much and it was, you know,  
13 essentially very small number of people doing this.

14 BY MR. KOTZ:

15 Q Okay. And then in this e-mail that Ostrow sends on  
16 June 7th, 2005, 12:26 p.m., he also says, "Another issue we  
17 have is with the London affiliated office of Madoff. Since  
18 the London affiliated Madoff service is a settlement agent  
19 for the U.S. office through Barclays, we will be researching  
20 whether the London office should be deemed a branch versus an  
21 affiliate."

22 There was some discussion about that before. And  
23 then Nee responds to Ostrow with a copy to you, 6-7-2005,  
24 1:47 p.m. "Thanks for the update. Be sure to keep your eyes  
25 on the prize. The branch versus affiliate issue is a

1 secondary, tertiary issue at best. I also don't think we'd  
2 get that far with the IA issue as broker-dealers can, as you  
3 know, act in an advisory capacity."

4 Now, Ostrow testified that this was a very  
5 significant e-mail in the course of the examination where  
6 John Nee was saying I want you to keep your focus to a  
7 specific issue, the front running issue. Was that your  
8 understanding?

9 A My interpretation of be sure to keep your eyes on  
10 the prize was that he wanted us to focus on the IA business,  
11 the issues that we thought -- suspected, front running,  
12 cherry picking or his theory of data analysis, order flow  
13 analysis. You know, we started, you know, getting involved  
14 with the branch versus affiliate issue and other issues, and  
15 I think John was just trying to keep us focused on, you know,  
16 what we wanted to emphasize.

17 Q But if there are other issues that come up in the  
18 course of an exam, shouldn't you follow up on them and not  
19 just focus on whatever you started with months ago?

20 A Yes, yes.

21 Q So would you rather have followed up on some of  
22 those issues than be told to keep your eye on the prize?

23 A I don't think we were told not to follow up on  
24 them. I think he was just trying to keep us primarily  
25 focused on why we were there.

1 Q So did you follow up on these other issues?

2 A I didn't follow up on them.

3 Q So you raised an issue. Nee wasn't telling you not  
4 to follow up, but you decided yourself not to follow up?

5 A I didn't raise the issue. I think Mr. Ostrow did.

6 Q Okay.

7 A I think he was sort of focused on the branch versus  
8 affiliate more so than me.

9 Q Okay. Okay. Let's continue. The next e-mail  
10 we're going to mark as Exhibit 46.

11 (SEC Exhibit No. 46 was marked for  
12 identification.)

13 BY MR. KOTZ:

14 Q This is from Ostrow to Nee, 6-8-2005, 8:43 a.m. If  
15 you could look kind of back all the way to the second-to-last  
16 page, page 2 of 3, there's an e-mail from Ostrow to Nee with  
17 a copy to you, June 7, 2005, 3:11 p.m. "On one of the days  
18 we requested trades, Bernie was closing a basket. I asked  
19 why we did not have these trades on the CD with all trades  
20 entered between 2-28-05 and 3-11-05. Bernie stated that  
21 because the basket was originally entered into in January  
22 there were not orders entered in March but only executions of  
23 orders placed previously. How could this be if a specific  
24 price is now known and you're relying on the fluctuation of  
25 stocks in a basket? Lamore views it as a standing limit

1 order good till cancel. What is your take?"

2 And then Nee responds, "What was the actual  
3 language we used in the request? It could be a matter of  
4 semantics."

5 And then if you could look on the next page, Ostrow  
6 responds to Nee saying, "A large portion of this exam has  
7 come down to semantics."

8 Do you remember this issue about semantics being a  
9 concern?

10 A Yes, I think it goes back to Bernard being  
11 difficult, being evasive. He didn't deem the investment  
12 advisory business an investment advisory business. He deemed  
13 it an execution -- executing trading platform. So throughout  
14 the exam, there were things that would come up where we would  
15 have discussions about and he would just refuse to sort of  
16 acknowledge it. So I guess semantics is the right word, I  
17 mean.

18 Q So how did you deal with that situation where he  
19 would kind of use this semantics to stop questions or not  
20 give information?

21 A Well, I think we would go back and forth until a  
22 point where -- for instance, the investment advisory  
23 business, we were going to deem it an investment advisory  
24 business even though he didn't want to call it that.

25 Q But you were getting different information from him

1 about how many clients he had, right?

2 A Yes, right. So it started off he didn't really  
3 acknowledge the business, and then it was a handful, four,  
4 six. And then when he actually provided the documents, it  
5 was more.

6 Q But isn't it possible that it could have been even  
7 more than that? It could have been hundreds, right?

8 A Now, we know, yes.

9 Q But even at the time, if he's telling you -- you  
10 ask about a particular business, he says I don't have it and  
11 you have evidence that he has it. He says oh, I only have a  
12 few. Then you have evidence that he has more. He says well,  
13 I only have 15. At that point, is there any reason to  
14 believe he's telling you the truth then?

15 A I guess not.

16 Q Let's go to the next one. Mark the next document  
17 as Exhibit 47.

18 (SEC Exhibit No. 47 was marked for  
19 identification.)

20 BY MR. KOTZ:

21 Q This is an e-mail, 6-16-2005, 8:29 a.m., John Nee  
22 to Ostrow and you. Below this, Ostrow sends an e-mail to Nee  
23 with a copy to you, June 15, 2005, 4:55 -- I'm  
24 sorry -- 4:54 p.m. "Bernie's provided us all the documents  
25 recently requested. We still have some outstanding

1 questions. We'll stop by to see if you have any thoughts.  
2 We would still like to visit some of the hedge funds.  
3 Example, Tremont in Rye, New York and Fairfield in  
4 Connecticut or New York. We want to gain an understanding  
5 from the hedge funds from their perspective the strategy used  
6 by Madoff."

7 Do you remember Ostrow suggesting that you visit  
8 some of the hedge funds?

9 A Yes.

10 Q Did you agree with that suggestion?

11 A Yes, I thought it was a good idea.

12 Q Did you guys visit the hedge funds?

13 A No.

14 Q How come?

15 A When we went back to the office, we spoke to  
16 Mr. Nee. We had a discussion about visiting the hedge funds  
17 and Mr. Nee said essentially no, we could not do that. He  
18 was concerned about potentially being liable if the hedge  
19 funds turned around and pulled their assets from Bernard  
20 Madoff.

21 Q Do you remember if he specifically said the SEC  
22 could get sued if you did that?

23 A I don't recall specifically the SEC. He may have  
24 even thought personally he could be sued.

25 Q Okay. Personally, meaning him, John Nee?

1 A Yes.

2 Q So he indicated that he might be sued personally if  
3 you went through this?

4 A I think he said us, individually rather than the  
5 agency.

6 Q Okay. And so basically, he made the determination  
7 not to go and he was the boss, so you didn't go?

8 A Right.

9 Q Okay.

10 BY MS. STEIBER:

11 Q Back to this e-mail, what did the staff learn with  
12 regard to this MISS system?

13 A I think we -- I think we were provided some  
14 information about the MISS system, a document that discussed  
15 it, but I think it was sort of the -- I think it helped sort  
16 of route orders and sort of used in the -- as part of the  
17 advanced technology that he used.

18 Q And did you consider requesting documents or data  
19 from this MISS system so that you would be able to have some  
20 electronic tracing of these alleged trades Madoff was making  
21 for the investment advisor business?

22 A I don't recall any. I think we asked for certain  
23 documents like the trade blotter. I'm not sure we ever  
24 thought to go specifically to a system.

25 Q Okay. Have you become aware of any other systems

1 that may have been able to provide trading activity reports  
2 or logs? And I'm going to show you an article I'm going to  
3 mark as Exhibit 48 called "Could Trade Messages Help Unravel  
4 Madoff Fraud" written by John Sandman.

5 (SEC Exhibit No. 48 was marked for  
6 identification.)

7 BY MS. STEIBER:

8 Q And see if you are familiar with the system that is  
9 discussed in this article. Let me just direct you to the  
10 second column.

11 A Sure.

12 Q It talks -- at the last full paragraph, second  
13 column talks about this FIX technology that apparently Madoff  
14 Securities had. Were you ever familiar with this FIX  
15 technology as a source of trade data?

16 A I remember seeing that term. I don't recall  
17 exactly what it was, FIX. I think it was referred to as the  
18 FIX technology.

19 Q But you never considered requesting these FIX logs?

20 A I don't think we ever requested the FIX logs, but I  
21 know again, Mr. Nee was pretty focused on the systems and, I  
22 guess, the technology. So I don't recall. We definitely  
23 touched on things related.

24 Q But you don't recall requesting any FIX logs?

25 A I don't recall any.

1 BY MR. KOTZ:

2 Q Okay. Let's go to the next document. We're going  
3 to mark it as Exhibit 49.

4 (SEC Exhibit No. 49 was marked for  
5 identification.)

6 BY MR. KOTZ:

7 Q This is an e-mail from you to Ostrow, July 5, 2005,  
8 11:03 a.m. with an attachment. It's a one-page document.  
9 It's some kind of memorandum summary to obtain an  
10 understanding of the registrant's financial condition and  
11 business operation from the perspective of an independent  
12 auditor. What is the purpose of this document?

13 A This is for exams for different sections. We  
14 typically put them in different folders. And this appears to  
15 be a what's called summary control sheet. So if you review  
16 information, you write up a summary control sheet and include  
17 it with the folder.

18 Q Okay. Did you draft this document?

19 A Yes. It appears to be based on my initials.

20 Q Okay. That PAL at the bottom?

21 A Correct.

22 Q Okay. It references here, "The annual audit was  
23 prepared by the firm's independent auditors Friehling &  
24 Horowitz."

25 Had you ever heard of Friehling & Horowitz when you

1 did this exam?

2 A No.

3 Q Did you take any actions to look into Friehling &  
4 Horowitz during the cause exam?

5 A No.

6 Q Okay. Go to the next document. Mark it as Exhibit  
7 50.

8 (SEC Exhibit No. 50 was marked for  
9 identification.)

10 BY MR. KOTZ:

11 Q This is an e-mail from you to Ostrow, 7-5-2005,  
12 8:34 a.m. and it also has an attached document. It's a  
13 two-and-a-half-page summary. Is this summary also a document  
14 that you prepared?

15 A I believe so based on the initials at the end, yes.

16 Q Right. And this is kind of for the -- for the  
17 report. You put together these summaries and then you  
18 incorporate this into the report?

19 A Correct. Again, it's sort of included with each  
20 folder and then can sort of be used, translated into a  
21 report.

22 Q Okay. And so in this document, you summarize the  
23 two articles about Bernie Madoff, right?

24 A Yes.

25 Q Now, I guess what I don't understand is the

1 document summarizes what it said in the article and then has  
2 Madoff's response, you see. So for the Barron's article, it  
3 says, "According to the article," and then you, you know, you  
4 quote several things from the article. Then you say,  
5 "According to Arvedlund," et cetera, et cetera. And then,  
6 you know, it just ends with the discussion of exactly what  
7 was in the article. Then you go to the MarHedge article, and  
8 you describe what was written in the MarHedge article, right?

9 A Yes.

10 Q But I guess I'm trying to understand what is the  
11 purpose of this. Wouldn't there -- shouldn't there be some  
12 kind of analysis of what you think of the points in the  
13 article based on your exam? This just regurgitates what the  
14 article says.

15 A Yeah, I think it's a summary of -- it's intended to  
16 be a summary of the articles. The -- what you were -- the  
17 items that you wanted to look into for the exam should be  
18 contained in another folder. So if you're, you know, looking  
19 for front running, then that would be in another folder.

20 Q Was there any analysis done in the cause exam of  
21 the statements made in these two articles?

22 A I think what -- you know, my recollection of these  
23 articles was people were very suspicious of his returns.  
24 They were suspicious of somehow using the market making  
25 business to either smooth returns or using order flow

1 analysis to help him either front run or, you know, if he had  
2 big orders to short of cherry pick during the day and then  
3 put those into the hedge fund, to the investment advisory  
4 hedge funds. Based on -- based on what we saw as the trading  
5 activity from the trade blotter and based on the execution  
6 times of the trades, it didn't seem as though either of those  
7 two suspicions made sense.

8 Q Did you go point by point of the information in the  
9 articles and then write here's what we found in response to  
10 what was written in the articles?

11 A We didn't do that. I mean, I don't -- the articles  
12 were written in 2001, so at some level, it was used for  
13 background information to help us think of things and ideas  
14 to look at. But I think that when we did the exam, it was a  
15 few years later, so we weren't testing or really trying to  
16 figure out if the article was completely accurate.

17 Q Okay. Okay. Let's go to the next document.

18 (SEC Exhibit No. 51 was marked for  
19 identification.)

20 BY MR. KOTZ:

21 Q The document is Exhibit 51. This is another e-mail  
22 from you to Ostrow, Thursday, July 21st, 2005, 9:33 a.m. and  
23 it attaches another document to analyze the firm's market  
24 making and proprietary trading activity.

25 What was the overall kind of conclusion of this

1 summary or your findings in this issue?

2 A My recollection is these are -- these were stocks  
3 that he traded in his market making business, and what we  
4 found was -- what I found was that for certain order types,  
5 he seemed to not be giving appropriate execution prices for  
6 these order types.

7 Q Okay.

8 A So we found that -- I believe that was cited as a  
9 violation in the report.

10 Q Okay. On the last page of this document, you say,  
11 "The staff suspects the firm is using the bad tick reason as  
12 an excuse to not program the MISS system."

13 What does that mean?

14 A Well, I think the MISS system again was  
15 their -- their technology that allowed them to -- allowed  
16 them to execute orders automatically without human  
17 intervention. It's part of their overall system. So when we  
18 presented this issue to them, they explained that whatever  
19 order type it was, that they were having -- that we cited as  
20 they were giving inferior price or execution prices to, it  
21 was very hard to program the system and that, you know, bad  
22 ticks when they -- when they -- the term bad ticks mean, you  
23 know, if a stock is trading at 25, there could be a price of  
24 26 that somehow gets into the market system, and that's  
25 considered a bad tick because it really didn't trade at 26.

1 It traded at 25.

2 Q Okay. I'm going to go to the next document. Mark  
3 the next document as Exhibit 52.

4 (SEC Exhibit No. 52 was marked for  
5 identification.)

6 BY MR. KOTZ:

7 Q It's an e-mail from you to Ostrow, Monday, July 25,  
8 2005, 8:51 a.m. and it attaches another summary, "To gain an  
9 understanding of Bernard L. Madoff Investment Securities,  
10 written supervisory compliance procedures."

11 And this is a document you drafted as well, right?

12 A Yes.

13 Q Okay. So this talks about written supervisory  
14 procedures, right?

15 A Yes.

16 Q What about the issue of family members in key  
17 executive positions in the firm? Is that a potential  
18 supervisory compliance procedure issue?

19 A It is.

20 Q How come that's not referenced in this document?

21 A I raised that issue to -- you know, it's one of the  
22 things that, you know, as we conducted the exam, we certainly  
23 communicated back to Mr. Nee. And, you know, nobody seemed  
24 to have a problem with that.

25 Q So you went back to Nee, Nee didn't seem to think

1 it was a concern, so you didn't put it in the document?

2 A Right.

3 Q Okay. What about lack of an independent custodian,  
4 was that an issue that was also raised?

5 A That they were self -- self clearing firm?

6 Q Right. Wouldn't that be a supervisory compliance  
7 procedure issue?

8 A I don't think I thought that at the time. I mean,  
9 I don't know that I had enough experience to know if that  
10 should be considered.

11 Q That kind of issue?

12 A Correct.

13 Q Okay. What about the e-mail retention policy  
14 issue, the fact that Shana in the compliance department could  
15 delete whatever she wanted if she determined that it was  
16 spam, would that be a supervisory compliance procedure issue?

17 A The fact that she -- I mean, I think the fact  
18 that -- now sitting here, the fact that she was a family  
19 member is, to me, a bigger issue than she could delete  
20 personal issues before providing them to us.

21 Q But isn't it that she could determine whether the  
22 e-mail was personal or not, so you wouldn't know whether it  
23 was personal. She would delete whatever she wanted.

24 A My understanding is that every registrant can do  
25 that before they provide us e-mails.

1 Q Okay. But I mean, isn't that something, though,  
2 that generally you would put in a summary of issues and maybe  
3 it happens a lot, but nevertheless, it's a compliance issue.  
4 You would reference it as something that you found.

5 A Well, I think that's permissible at any registrant,  
6 so I don't -- I don't think it's --

7 Q Okay.

8 BY MS. STEIBER:

9 Q You didn't think it increased the risks that -- the  
10 issues that increased the risks should have been in this  
11 memo?

12 A Right.

13 Q They should have been put in the memo or they  
14 shouldn't have been put in the memo, things that increased  
15 the risk --

16 A No --

17 Q -- like the family members, the lack of segregation  
18 of duties?

19 A I don't -- I think we didn't realize at the time.  
20 I mean, we didn't -- again, firms have the ability to do  
21 that. I don't necessarily agree with it, and at the time I  
22 may have even said it's strange. I don't recall saying that,  
23 but I was pretty new to this whole examination program. So I  
24 mean, if firms are -- if we as the SEC permit firms to delete  
25 personal e-mails or to decide whether or not something's

1 personal or not, I mean, as an examiner, I don't know that I  
2 can do anything or it should be included in a document like  
3 this.

4 BY MR. KOTZ:

5 Q Okay. And the next document we'll mark as Exhibit  
6 53.

7 (SEC Exhibit No. 53 was marked for  
8 identification.)

9 BY MR. KOTZ:

10 Q This is a e-mail from you to Ostrow, Thursday, July  
11 28th, 2005, 8:11 a.m. And this is another summary that is  
12 attached to this document, several page summary. "Gaining an  
13 understanding of B.L.M.'s investment advisory business."

14 And again, this is a document you prepared?

15 A Correct.

16 Q Okay. Now, this was to gain an understanding of  
17 B.L.M.'s investment advisory business. Did you ever think  
18 about the question of how Madoff could personally trade so  
19 many trades per year. Didn't he say that he personally did  
20 the trading, Bernie Madoff?

21 A He was responsible. He was the -- made the  
22 decision on whether or not to enter or exit the market, yes.

23 Q Okay. But did he do the trading as well?

24 A The trading, my understanding, it's all fake, but  
25 it was all electronic or for the most electronic. So he sort

1 of leveraged off the technology he built in his other  
2 businesses to help him execute the orders for his IA  
3 business.

4 Q But he was the one who -- he himself did it all,  
5 right, according to him?

6 A No, I believe he said he had someone help him,  
7 Frank DiPascali. During the exam is -- I believe is what we  
8 learned. I mean, subsequently, I know a lot more, but during  
9 the exam, my recollection is he said he had one other person  
10 helping him.

11 BY MS. STEIBER:

12 Q And did you interview that person who was helping  
13 him do the trading during the exam?

14 A No.

15 BY MR. KOTZ:

16 Q What about the issue of the options volume? You  
17 know, there were questions of we don't see the volume.  
18 Questions about the low volatility compared to the market,  
19 his returns aren't correlated to the market necessarily, just  
20 the fact that he was able to achieve those consistent  
21 returns. How come that information is not put in this  
22 memorandum which summarizes his investment advisory business?

23 A I think again this is a summary control sheet of  
24 sort of what we found. I don't -- not in every case does it  
25 have sort of the analysis or something like that. And so for

1 this case, I'm not sure why -- I'm not sure why we chose not  
2 to or didn't include it.

3 BY MS. STEIBER:

4 Q Is it -- is it a summary of what you found or is it  
5 a summary of what Bernie Madoff told you? If you start going  
6 through the memo --

7 A The summary control sheet, I mean, it's -- it can  
8 be -- I guess it's -- I guess it can include analysis of what  
9 you learned. In some cases, it's just straight, you know,  
10 summarizing issues you come across. In other cases, it's  
11 issues you come across and then as well as analysis or things  
12 you learned.

13 BY MR. KOTZ:

14 Q Okay. Why don't we go to the next document. We'll  
15 mark it as Exhibit 54.

16 (SEC Exhibit No. 54 was marked for  
17 identification.)

18 BY MR. KOTZ:

19 Q This is an e-mail from you to John Nee, 9-1-2005,  
20 4:50 p.m. It attaches an e-mail and a document. And this is  
21 the final cause exam report of the Madoff examination, right?

22 A Yes, it appears to be.

23 Q Now, who drafted that report?

24 A I would suspect I drafted the majority of it, but  
25 I'm sure William had input -- Mr. Ostrow had inputs and then

1 it's forwarded to Mr. Nee.

2 Q Do you know how much input Mr. Nee had?

3 A My recollection is that I sent it to him. Usually,  
4 the way it work is the examiner will draft the report, send  
5 it to the supervisor. The supervisor will send it back for  
6 corrections, questions, addition. My recollection in this  
7 case is I sent it to him, and he made the corrections and  
8 finished and finalized the report.

9 Q Do you remember if there were a lot of corrections  
10 that he made?

11 A I don't recall if there were a lot or not.

12 Q Do you remember if it was more kind of substantive  
13 corrections of more editorial? Did he take anything out?

14 A I would characterize them as editorial.

15 Q Okay. Did he take anything out, any kind of  
16 substantive thing out that you had put in or Ostrow had put  
17 in?

18 A Not that I recall.

19 Q Okay. All right. I want to ask you a couple  
20 questions about the actual document.

21 A Okay.

22 Q If you look at the document and you have a  
23 background section, right?

24 A Yes.

25 Q Background section talks about a little bit of

1 background about B.L.M., Bernie L. Madoff Securities. Then  
2 you have a section, examination and purpose of scope, on page  
3 3, risk assessment. And then at the bottom of page 3, you  
4 have examination findings. Do you see that?

5 A Yes.

6 Q Okay. So these are the findings in the  
7 examination, starting really on page 4. Page 4 has Barron's  
8 and MarHedge articles. This document essentially simply  
9 regurgitates what was in the articles. All right. Do you  
10 see -- if you're reading it, it's similar to the previous  
11 control sheet.

12 A Okay.

13 Q It simply states what was in the articles. Then  
14 the next section is business structure, IA business structure  
15 on page 5. Business structure talks a little bit about the  
16 background of Bernie's business and then -- okay. So if you  
17 look on page 6, it has some information. Most of this  
18 information is according to Bernie Madoff. You see it says  
19 several times, three times in the first paragraph on this  
20 page, "According to B. Madoff, according to B. Madoff,  
21 according to this document." Then the next paragraph,  
22 "According to B. Madoff," and the next paragraph again,  
23 "According to B. Madoff."

24 And then finally, if you look on page 7, again,  
25 "According to B. Madoff." Then you have, "See Model MA2.06,

1 according to B.L.M., this is information that Madoff provided  
2 about his operations," right?

3 A Yes.

4 Q And then if you look on page 8, you have another  
5 two paragraphs that talk about Madoff's operations according  
6 to him. And then you have a testing section. The testing  
7 section is on page 8. It's two paragraphs, one big  
8 paragraph, one small paragraph. Then if you go to 9, you  
9 have firm trading and market making background. Again, this  
10 is background information to page 10. And then you have B.  
11 testing and you have about a page and a half of testing. And  
12 then on page 12 is just the e-mail review and the conclusion.

13 And I guess what I'm struck by in this document is,  
14 you know, it's a 12-page report of the cause examination, but  
15 almost all of it -- I'd venture to say 90 percent of it -- is  
16 information that Bernie Madoff supplied to you. Other than  
17 the testing sections which are relatively short, everything  
18 else in here is simply what Bernie said. Do you see that?

19 A Yes. He was our primary contact, and we got the  
20 information from him, yes.

21 Q But it doesn't seem like there's much analysis  
22 other than this is what Bernie told us. I don't see anywhere  
23 other than those testing sections where you say well, Bernie  
24 said this but we looked at this issue, we had this question.  
25 And there were open questions, right? He talked about the

1 volume, how he was able to achieve the returns. How come  
2 none of that is in there?

3 A Well, the option volume issue and the questions  
4 that were raised there went away because, you know, according  
5 to Bernard that he no longer traded options. That sort of  
6 went away.

7 Q Okay. What about the kind of central issue in the  
8 beginning which was he has these very consistent returns?  
9 You were never able to figure out why, right? And there was  
10 still some suspicions. How come none of that is in this  
11 report?

12 A I don't know.

13 Q And was there a sense in general from Nee or in  
14 general in the SEC exam program that, you know, when you  
15 wrote a report you were supposed to only write up the issues  
16 that you resolved? If there were open issues, those issues  
17 aren't generally put in a report.

18 A I mean, the report was written -- I mean, I  
19 don't -- I'm not really sure how to answer that. I mean, we  
20 wrote the report or I wrote the report or William and I wrote  
21 the report as we thought best to do that, provided it to the  
22 supervisor and then based on his feedback, if questions were  
23 outstanding, then we would adjust the report.

24 Q Okay. So at no point did Nee or anyone else come  
25 back to you and say wait a minute. You know, you should put

1 in some of these open questions that you had.

2 A Correct.

3 BY MS. STEIBER:

4 Q But you don't say anything here about wanting to go  
5 visit the hedge funds because you still had open questions.  
6 Did Nee ever say anything to you about that issue, like you  
7 should leave that out of the report, we're done?

8 A No.

9 BY MR. KOTZ:

10 Q Okay. We're going to take a break, and we can  
11 figure out what we want to do. But one more question just  
12 before the break. In the 2005 cause exam that you did of  
13 Bernard Madoff, were you looking at the question of whether  
14 Madoff was running a Ponzi scheme?

15 A No.

16 MR. TALARICO: Why would you expect him to put a  
17 question in the report?

18 MR. KOTZ: Want to go off the record?

19 MR. TALARICO: No. Why would you expect him to put  
20 a question in the -- well, it doesn't matter. Yeah, we can  
21 go off.

22 MR. KOTZ: Let's go off.

23 (A lunch recess was taken.)

24 MR. KOTZ: Okay. We're continuing at 1:55 p.m.

25 BY MR. KOTZ:

1 Q I just want to ask you a couple questions to follow  
2 up on some things from before. In some examinations, we've  
3 seen a planning memorandum that kind of lays out the scope of  
4 the exam. Was there one like that in this case? We haven't  
5 come across anything.

6 A No, I don't believe there was one, and I believe  
7 they became more -- they were written subsequent to that  
8 exam. It seems -- I did a larger firm exam, and I think I  
9 remember putting -- helping to put something like that  
10 together.

11 Q Okay. So you do understand that there are planning  
12 memos with -- in general with these types of exams, but that  
13 may not have been something they did at the time?

14 A Correct.

15 Q And also, you mentioned previously that NASD exams  
16 were not necessarily always helpful. Is there anything you  
17 can elaborate on? Was there a particular aspect of it that  
18 sometimes you felt like they didn't give you or go deep  
19 enough or what?

20 A Well, I think -- in general I think the NASD exams  
21 are a little less in-depth. It's more -- it's more  
22 checklist-type reviews that they conduct. So they don't go  
23 into great detail about specific areas.

24 Q Okay. At some point in time after the cause exam  
25 closed, you became aware that enforcement was looking into

1 Madoff; is that right?

2 A I became aware of a report written by Harry  
3 Markopolos.

4 Q Okay. I'm going to show you some e-mails and ask  
5 you some questions about that. Okay. The first e-mail we're  
6 going to mark as Exhibit 55.

7 (SEC Exhibit No. 55 was marked for  
8 identification.)

9 BY MR. KOTZ:

10 Q And this is an e-mail dated 11-7-2005, 9:35 a.m.  
11 from you to John Nee. And if you go back to the beginning of  
12 the e-mail string on page really 2 of 3 of this e-mail, it's  
13 an e-mail from John Dugan who's in the Boston office to  
14 Walter Ricciardi, David Bergers, other various people in the  
15 Boston office. And it says, "Subject, meeting with  
16 informant." Today you can see it says, "In a nutshell an  
17 informant came in, passed on information about Bernard L.  
18 Madoff." And it says, "In fact, the informant believes that  
19 Madoff cannot possibly be achieving the returns that the  
20 hedge funds claim he's getting. The informant believes that  
21 Madoff may be running one giant Ponzi scheme and there are  
22 signs that it may be close to crashing down on him."

23 Do you see that?

24 A Yes.

25 Q Okay. And then so then this get forwarded up, and

1 then if you see on page 1 of 3, it gets forwarded from Doria  
2 Bachenheimer who's in the enforcement division to Bob  
3 Sollazzo. And he says, "Hi, Bob, we're going to look into  
4 this. Do you know who the exam team is on Madoff?"

5 And then Sollazzo then forwards it on -- responds  
6 to Doria Bachenheimer with a CC to John Nee and says, "These  
7 are basically some of the same issues we investigated, and I  
8 recognize at least one of the hedge funds, Fairfield Sentry.  
9 Some of these comments are not new. I remember looking into  
10 a similar allegation back in the 90s at Madoff."

11 Do you know what he was referring to in terms of  
12 similar allegations in the 90s?

13 A I don't -- I don't know. I just remember a  
14 comment, offhanded comments such, you know, we looked -- we  
15 looked at him before, but there was never any detail.

16 Q Okay. At this point, did Sollazzo ever say to you  
17 by the way, here's what happened in the 90s, we looked at  
18 Madoff for a Ponzi scheme, here's what we found?

19 A No, no detail.

20 Q Okay. And then John Nee responds to you, "Oh, no."

21 Was John Nee concerned perhaps that this was a new  
22 matter that was coming up with some information and he was  
23 concerned that you guys hadn't spotted it in the exam? Is  
24 that maybe why he says "oh, no"?

25 A I'm not sure why he said oh, no. But, I mean,

1 because we conducted the exam, anything -- you know, any sort  
2 of issue like this would, you know, be disconcerting, I  
3 guess.

4 Q Okay. And he says these are basically some of the  
5 same issues we investigated. Do you know whether he's  
6 referring to in your exam that you conducted, Sollazzo says  
7 to Bachenheimer with a copy to Nee?

8 A Could you point that out to me?

9 Q Sure. Sollazzo says these are basically some of  
10 the same issues we investigated, right?

11 A Yes.

12 Q And he's referring back to an e-mail from John  
13 Dugan in which, "The informant says that Madoff may be  
14 running one giant Ponzi scheme and there are signs it may be  
15 close to crashing down on him."

16 But isn't it true that you guys didn't at least in  
17 the examination look at the Ponzi scheme issue at all?

18 A That's correct.

19 Q So --

20 A We never thought we -- that never -- anything like  
21 that was never raised.

22 Q So, I mean, I'm not sure exactly what he's  
23 referring to, but it would inaccurate, don't you think, to  
24 say that the issues that Harry Markopolos was raising -- he  
25 being the informant -- were the same issues that you guys

1 looked at in the exam, right?

2 A Correct, certainly not the issues regarding the  
3 Ponzi scheme.

4 Q Okay. And then you say in the response to Nee  
5 you'd "be happy to sit down with anyone, provide them with an  
6 understanding of Madoff's strategy and our findings." And  
7 you say, "I don't believe we missed anything."

8 Do you know what you referred to there?

9 A Just, you know, sort of our emphasis of the exam, I  
10 thought we had done a -- or we had at least gotten the  
11 documents that would disprove the front running and cherry  
12 picking.

13 Q Right. You didn't mean to say in there I don't  
14 believe we missed anything that you -- you didn't miss  
15 anything relating to the Ponzi scheme, right?

16 A Correct.

17 Q All right. Let's go to the next document.

18 (SEC Exhibit No. 56 was marked for  
19 identification.)

20 BY MR. KOTZ:

21 Q Okay. The next document is an e-mail from you to  
22 Simona Suh, 11-10-2005, 3:34 p.m. and we're going to mark  
23 that as Exhibit 56.

24 So if you go to page -- this is a very long string  
25 of e-mail, but if you go to page 3 of 5, it seems like they

1 were setting up a meeting with Simona and the enforcement  
2 folks about this matter, is that right, and Meaghan Cheung?

3 A Correct.

4 Q So you met with them? Who was in this meeting?

5 A My recollection of what first happened after we got  
6 the report was there was sort of a flurry of activity.  
7 Everyone, you know -- at least I was nauseous. So we -- you  
8 know, they asked me to -- I think it was Mr. Sollazzo asked  
9 me speak with them, help them out as best I can, give them  
10 some background on the firm. In my -- my first memory of  
11 discussing it, there was a meeting with myself, Ms. Suh, an  
12 individual named Steven Johnson, an individual named Robert  
13 DeLeonardis, and it was -- it was just initial thoughts sort  
14 of meeting, what we thought was going on.

15 Q Now, you said you were nauseous?

16 A Sure. I mean, I did the exam. I helped conduct  
17 the exam of this firm, and when a report like that comes out  
18 with the title that has the word "Ponzi" in it, I mean, yes,  
19 I was nauseous.

20 Q You felt like somebody might blame you for not  
21 finding something in the exam or you might look bad?

22 A Well, I mean, I just feel responsible. I mean, I  
23 was there.

24 Q Okay. Okay. And then if you look on the first  
25 page of this document, page 1 of 5, in the e-mail to Simona

1 Suh, Monday, November 7, 2005, 2:36 p.m. --

2 A Can I just take one step back --

3 Q Sure.

4 A -- to that meeting? You know, one of the things I  
5 recall from that meeting, so I was -- you know, I was pretty  
6 upset when that report first came out, and one of the things  
7 that I emphasized at that meeting from what I recall  
8 is -- are the returns. Steven Johnson was a trader as well  
9 in the industry. I believe he traded -- he was a market  
10 working trader. And we had a discussion where we were  
11 talking about the returns, and I think -- my recollection is  
12 Steve felt that the returns were possible. He worked for  
13 someone who was that good who could generate those sorts of  
14 returns, and that I sort of spoke up and said, "I don't  
15 think -- I think you really need to look into this. This is  
16 abnormally consistent."

17 And I think I was a little overly emotional, you  
18 know, sort of the trader came out in me. And I remember, you  
19 know, someone -- I think it was Simona saying, you know, calm  
20 down, let's take a step back, you know. And I almost felt  
21 like I got -- you know, I sort of lost my -- a little bit of  
22 professionalism at that point, so going forward, I definitely  
23 sort of tried to tone it down a little with my thoughts and  
24 sort of my thinking about the exam and what was going on. I  
25 never held anything back, but I certainly, you know, tried to

1 take a more calm approach.

2 Q So did you get the impression that Steven Johnson  
3 and the other enforcement attorneys were kind of initially  
4 skeptical about Markopolos' allegations?

5 A I think so. I mean, I think they felt because  
6 of -- I think he was looking for money or looking or  
7 concerned about -- I think he wanted to remain anonymous  
8 because he was concerned about his family or something being  
9 killed or -- I think that someone discredited him a little  
10 bit, but I think, you know, the red flags were the red flags,  
11 that they were still going to go through them.

12 Q Okay. All right. Let me ask you about this  
13 e-mail at the bottom of page 1 of 5 in Exhibit 56. It's an  
14 e-mail from you to Simona, and you say, "Attached is a  
15 spreadsheet that helped to explain Madoff's strategy. As you  
16 can see, it's pretty plain vanilla."

17 What did you mean by plain vanilla?

18 A It didn't seem to be an exotic strategy where he's  
19 trading currency, he's trading mortgage-backed securities.  
20 He was just trading equities.

21 Q And so given that it was a plain vanilla strategy,  
22 wasn't it more likely that there was something else to the  
23 story? In other words, how was he able to achieve these  
24 returns with a plain vanilla strategy? It wasn't like he had  
25 some fancy, complicated strategy that could explain the

1 returns. It was a plain vanilla strategy that a lot of other  
2 people used, and so wouldn't it be more likely because of a  
3 plain vanilla strategy that -- that there needs to be some  
4 explanation for the returns?

5 A Right. I don't know that a lot of people used it,  
6 but, I mean, it wasn't -- right. The types of securities he  
7 was trading weren't exotic. I think it goes back to, you  
8 know, the very start, the pre-exam work that I did. You  
9 know, you always sort of consistency that he was able to  
10 generate.

11 Q And the consistency would be even more in question  
12 given that the strategy was plain vanilla, right?

13 A Yes. I mean, for instance, Steve A. Cohen pretty  
14 much just trades stock and options which you would consider  
15 plain vanilla as well, but he has, you know, exceptional  
16 returns.

17 Q Okay. But, I mean, overall in order to achieve  
18 those kinds of returns, in general you would think there  
19 would be some kind of elaborate, complicated strategy.  
20 Otherwise, everybody could do it, right?

21 A Right. I mean, he had some edge, and the question  
22 was what was his edge.

23 Q Okay. You also say, "Thus we don't believe that he  
24 is front running his market making desk."

25 And that was the conclusion of the exam, right?

1 A Right.

2 Q And so were you aware that Harry Markopolos'  
3 complaint essentially said there were two options of what was  
4 happening to explain Madoff's returns. One was front running  
5 which I think he termed as less likely, and one was Ponzi  
6 scheme which he termed as more likely. So given that there  
7 wasn't front running which you had determined in your cause  
8 exam, wouldn't that lead one to believe that it's more likely  
9 of the two that it would be a Ponzi scheme?

10 A I would think so, yes.

11 Q And then if you see in this e-mail, Simona asks to  
12 you, "Is it correct that the statements in the spreadsheet  
13 and the CD and the work papers is generated by B.L.M., not  
14 the custodians? If so, do you know whether the custodians  
15 provide any statements directly to the customers?"

16 A Yes.

17 Q Okay. And then you say, "I don't know what the  
18 custodians provide to the hedge funds. However, I would  
19 expect that the funds have online access to their account at  
20 the custodian banks and can review the activity, cash,  
21 stocks, et cetera."

22 Do you see that?

23 A Yes.

24 Q Did you check that? You say I would expect that  
25 that would be the case, but in the exam, did you check that

1 to confirm that?

2 A No. Again, during the exam, we chose or we were  
3 directed not to speak to the hedge funds.

4 Q Right. Okay. All right. Why don't we go to the  
5 next document? Okay. The next document we're going to mark  
6 as Exhibit 57.

7 (SEC Exhibit No. 57 was marked for  
8 identification.)

9 BY MR. KOTZ:

10 Q And this is a e-mail from you to John Nee and  
11 William Ostrow, 11-10-2005, 12:21 p.m. with an attachment.  
12 And this is -- there's an e-mail from you and below that is  
13 Harry Markopolos' e-mail to Meaghan Cheung. And it  
14 says -- it's dated Monday, November 7th, 2005. And he says,  
15 "Meaghan, I spent some time over the weekend further  
16 improving my analysis on why Madoff Investment Securities,  
17 LLC is likely a Ponzi scheme."

18 Okay. Did you understand that basically the  
19 primary part of Harry Markopolos' complaint was his  
20 allegation that Madoff was running a Ponzi scheme? I mean,  
21 if you could see in his complaint, if you turn to the next  
22 page. He says, "There are two possible scenarios that  
23 involve fraud by Madoff Securities. One, Scenario No. 1,  
24 unlikely." And that talks about front running. And then you  
25 can see on the next page, it says, "Scenario No. 2, highly

1 likely. Madoff Securities is the world's largest Ponzi  
2 scheme."

3 I mean, wouldn't you agree that the essence of  
4 Harry Markopolos' complaint here is that Madoff was running a  
5 Ponzi scheme?

6 A Yes. If you're going to prioritize what you're  
7 going to look at, I would say that it is correct. But again,  
8 you know, I was -- just so everyone knows, I mean, my role in  
9 this was sort of support enforcement and assist them as  
10 directed. I had no sort of authority in what we could look  
11 at, what to prioritize, who to speak with.

12 Q Right. Did enforcement prioritize the Ponzi scheme  
13 in their investigation of Madoff?

14 A I don't recall that. I recall going sort of one by  
15 one through the red flags. I think that was the methodology  
16 but not ever really expressed to me. I assumed to be.

17 Q You say in this e-mail to Nee and Ostrow,  
18 11-10-2005, 12:21 p.m. "In short, these are basically the  
19 same allegations we have heard before."

20 But you hadn't heard allegations about a Ponzi  
21 scheme before, right?

22 A Right, that's correct. I was -- that was  
23 incorrect.

24 Q And you say this thing about the author's motives  
25 are to make money. You mentioned that that was something

1 that Steve Johnson raised as well?

2 A No.

3 Q Okay. That was something --

4 A I think that was -- my sense was speaking with the  
5 attorneys initially, Meaghan Cheung and Simona Suh, was that  
6 somewhat -- they were somewhat skeptical of Markopolos  
7 because he had added, you know, the fact that he was looking  
8 to make money and sort of paranoid as well.

9 Q Okay. But under the question of making money,  
10 wouldn't Harry Markopolos only make money if actually  
11 something was found?

12 A I'm not familiar with how that works, but I assume  
13 that's correct.

14 Q Okay. So if the guy was looking to make money,  
15 would there be any point to send allegations to the SEC that  
16 are just kind of made up that have no basis? Would he make  
17 any money that way?

18 A No.

19 Q So I don't understand why that would be a matter of  
20 skepticism, that he was making money. I mean, wouldn't he  
21 have the same interest as the SEC? In other words, he'd only  
22 want to bring to you guys stuff that actually comes to  
23 something. Otherwise, he's wasting his time and doesn't make  
24 any money. I mean, it's in his interest to help find the  
25 Ponzi scheme and to identify a Ponzi scheme, right?

1           A     I agree.

2           Q     Okay.  Why don't we -- let's talk a little bit  
3     about the document.  So at that time, did you read Harry  
4     Markopolos' submission?

5           A     Yes.

6           Q     Okay.  And you went over this with the enforcement  
7     folks or separately?

8           A     Separately.

9           Q     What did you -- did you -- what was your general  
10    sense of the document?

11          A     Lengthy.

12          Q     Okay.

13          A     Well put together.

14          Q     Okay.

15          A     Definitely, work was put into it.

16          Q     Okay.

17          A     Effort.

18          Q     I'm going to show you a document -- the next  
19    exhibit we're going to mark as 58.

20                                 (SEC Exhibit No. 58 was marked for  
21                                 identification.)

22           BY MR. KOTZ:

23          Q     I believe that this may be the complaint with your  
24    notes on it.

25          A     Okay.

1 Q So why don't we work with that one. We're going to  
2 mark this as Exhibit 58. Are these your notes?

3 A Yes.

4 Q Okay. Can you see what you write there at the top?  
5 I know some of it is cut off.

6 A Yes. I'll read it from the top. "We cannot reveal  
7 Bernie's strategy to this guy." The second note is "Did he  
8 pitch this case to Washington?" And then my third note is  
9 "Why not go directly to NERO?"

10 Q Okay. Well, what did you have in mind with these  
11 points?

12 A Well, I was -- I guess I was concerned about not  
13 knowing his ultimate motives. I think from the industry  
14 people who are jealous of other people and think that maybe  
15 they have some edge that they can sort of look into -- maybe  
16 looking to get the information or the edge that Bernie had.

17 Q Okay. But rather than focus on the personality of  
18 the individual who provides information, wouldn't -- wouldn't  
19 one just focus on what the information is, take it based on  
20 the information, follow up based on the information?

21 A Sure. I mean, ultimately, that's what you do.

22 Q Okay. Then at the bottom of the page on the right  
23 side, there's an arrow, and it says something like multi  
24 billion.

25 A "Multi billion dollar funds."

1 Q What is the rest?

2 A "Do no due diligence."

3 Q Okay. So what was your point there?

4 A I suspect I felt like if you're a fund to funds  
5 with multi billions of dollars that you would do sufficient  
6 or good due diligence on a manager that's taking your money.

7 Q Right. Okay. If you look on the second page of  
8 this document, at the bottom of the page, you write, "Wrong"  
9 with an arrow, right?

10 A Yes.

11 Q Why -- what was wrong there?

12 A Well, during our exam we learned that -- or we were  
13 told that he had approximately \$8 billion under management,  
14 and in this report, he's noting 20 to 50 billion.

15 Q Now, that 8 billion number, you got that from  
16 Bernie Madoff, right?

17 A Correct.

18 Q And Markopolos is saying that Bernie Madoff is a  
19 liar and running a Ponzi scheme?

20 A Correct.

21 Q So, I mean, is it -- do you know that that's wrong  
22 or you're just saying Bernie Madoff doesn't agree with that  
23 statement?

24 A It's the latter. I mean, I don't know that that's  
25 wrong. I'm just -- as I'm -- when I first got the report,

1 I'm making notes.

2 Q Okay. Okay. So in terms of the particular red  
3 flags in this report, you say you went through them and I  
4 guess it sounds like enforcement went through them one by  
5 one. What are the particular red flags that, you know, you  
6 felt like were clear issues that needed to be followed up  
7 on? A Well, I think if you get a report like this, every  
8 red flag has to be followed up on this, I mean.

9 Q Okay. Were there particular red flags that you  
10 thought were more credible than others? Did you find the red  
11 flags --

12 A Well, just based on the exam, I thought some were  
13 maybe less credible than others.

14 Q Okay.

15 A But again, that's knowledge I learned during the  
16 exam and the fake documents that I was provided.

17 Q Right. But it was also knowledge you learned  
18 straight from Bernie Madoff, right?

19 A In -- in many cases, yes.

20 Q Okay. So if you knew something that Bernie Madoff  
21 told you and that would contradict something that Harry  
22 Markopolos said in this document, that doesn't necessarily  
23 mean that Harry's wrong. It could be Bernie was lying.

24 A That's correct.

25 Q Okay. So your understanding was the enforcement

1 staff kind of went through this point by point, flag by flag?

2 A I believe that's what their objective was.

3 Q Okay. And do you know what they concluded as to  
4 particular red flags?

5 A I don't.

6 Q So did they ask you for your comments on the red  
7 flags?

8 A No, I never -- I mean, we had a meeting or two or  
9 three, but it was never detailed sort of -- never really  
10 sought my analysis or understanding of the red flags and so  
11 forth.

12 Q Okay. Did you ever talk to Harry Markopolos?

13 A No.

14 Q What about the other individuals that are  
15 identified? There's several other individuals identified in  
16 this document. Did you talk to anyone else outside the SEC  
17 about these issues?

18 BY MR. WILSON:

19 Q Do you know any of these individuals are? Have you  
20 ever heard of them?

21 A No, I was not familiar with them. I'm not looking  
22 at it now, but back then I recall not knowing any of those  
23 people.

24 BY MR. KOTZ:

25 Q Do you know if the enforcement attorneys contacted

1 Harry Markopolos?

2 A I believe I've read that Meaghan Cheung did, but at  
3 the time, I don't believe I was aware that she ever spoke to  
4 him directly.

5 Q Okay. Did the enforcement attorneys ever comment  
6 about Harry Markopolos at all?

7 A No. I think just what I -- what I mentioned  
8 earlier about him, you know, sort of the motives, questioning  
9 his motives. But it wasn't -- I don't -- I still think, you  
10 know, they really were focused on going through the red flags  
11 that he presented.

12 Q Did they ever mention anything about the fact that  
13 he kept calling a lot and kind of was bugging them?

14 A No.

15 Q Okay. I'll show you the next document. Mark it as  
16 Exhibit 59.

17 (SEC Exhibit No. 59 was marked for  
18 identification.)

19 BY MR. KOTZ:

20 Q This is an e-mail from you to John Nee, 11-10-2005,  
21 11:51 a.m. Now, in this e-mail, Exhibit 59, John Nee  
22 responds to your previous e-mail that we showed you where you  
23 say these are basically the same allegations we've heard  
24 before. He says, "No, Pete, I don't think have anything to  
25 add. I think the report speaks for itself. There's still a

1 little mystery as to what Madoff does, but a Ponzi schemer  
2 directly trading on immediate customer order flow doesn't  
3 likely from what we've seen."

4 Now, John Nee is saying that, but isn't it the case  
5 that John Nee would really have no way of knowing whether a  
6 Ponzi scheme was likely since the examination didn't actually  
7 look at that issue?

8 A That's correct.

9 Q And you also say you were "a bit spooked, but  
10 having a read the informant's analysis, I feel much better  
11 that he is incorrect."

12 What'd you mean by that?

13 A I don't know. I must have been referring to the  
14 red flags and what -- you know, what we learned during the  
15 examination being contradictory to the red flags.

16 Q But again, what you learned during the examination  
17 was from Bernie himself?

18 A That's correct.

19 Q Okay.

20 A But, I mean, the documents, you know, were from  
21 Bernie himself but they were from systems at Madoff.

22 Q Okay. Show the next document. Mark it as Exhibit  
23 60.

24 (SEC Exhibit No. 60 was marked for  
25 identification.)

1 BY MR. KOTZ:

2 Q Okay. This is an e-mail from you to Lamore -- I'm  
3 sorry -- from Ostrow to you, 11-14-2005, 10:36 a.m. And  
4 below it is an e-mail from you to Meaghan and Simona, and you  
5 say, "In order to refute all of his allegations, we  
6 need -- may need to request some documentation from one or  
7 more of the fund to funds, FOF. In particular, I would  
8 suggest obtaining the marketing material regarding the  
9 strategy, 2005 statements, including trade confirmations and  
10 a copy of the audit performed on the FOF."

11 Why -- why did you think that those were things  
12 that needed -- needed to be done?

13 A I think the marketing material may have been  
14 because of the strategy, the fact that he told us he no  
15 longer traded options.

16 Q So did you feel that an important issue in this  
17 investigation would be determine whether Bernie was telling  
18 the truth when he said he didn't trade options?

19 A Yes. I recall, you know, sitting in the testimony  
20 when he -- basically, you know, it was my word versus his  
21 word, and, you know, that was -- you know, that's one of the  
22 biggest things that I remember from his testimony. I mean,  
23 it was my word versus his word.

24 Q So in the testimony, Bernie Madoff admitted to  
25 trading options, right?

1           A     Correct. He supplied documents prior to his  
2 testimony that included options.

3           Q     And he had previously told you that he didn't trade  
4 options?

5           A     During the examination, he told us he did not trade  
6 in options.

7           Q     So that would be a pretty major suspicious red flag  
8 in an investigation of somebody for a fraud or a Ponzi  
9 scheme, that he told you one thing in the exam and then under  
10 oath he told a different story, right?

11          A     Yes.

12          Q     And you pointed that out to the enforcement  
13 people?    A     I was furious. I didn't -- I didn't think it  
14 needed to be pointed out. I mean, my report is my report,  
15 you know. That's -- I mean, that's official, an official  
16 report. I mean, it's not -- you know, there's nothing  
17 questionable that should go in that report. So essentially,  
18 it became my word versus his word. He explained it away by  
19 saying that we must have requested documents related to the  
20 model which the options don't include, but I knew that wasn't  
21 the case.

22          Q     Now, did Simona and/or Meaghan give the impression  
23 that they weren't -- didn't necessarily believe you that  
24 Bernie had said this before?

25          A     No. We never -- I don't ever remember having a

1 around. I didn't -- I mean, I never -- I mean, I couldn't  
2 imagine someone doing this Ponzi scheme. And, you know, I  
3 know the report was written, the Markopolos report, but it  
4 was just -- it was unimaginable. I mean, I just --

5 Q Even though that was what enforcement was  
6 investigating, whether he was running a Ponzi scheme?

7 A Yeah. I mean, I thought -- I mean, obviously, you  
8 have to go through the steps to ensure that it's not, but it  
9 just -- I mean, it was just --

10 Q But you knew at that point that Bernie Madoff was a  
11 liar, right?

12 A Yes. I didn't -- I didn't -- right, I agree.  
13 He -- there were too many inconsistencies with what he told  
14 me.

15 Q And so if he's a liar, then there was at least the  
16 possibility that he was engaging in fraud, right?

17 A Right. But, I mean, lying or misleading to fraud,  
18 Ponzi scheme to me was a huge step, a huge leap.

19 Q Okay. Okay. What about requesting documentation  
20 from one or more of the fund to funds? Why were you  
21 suggesting that that be done?

22 A Well, I just -- I think I believed, you know, it  
23 was a third -- it was a third party, something we considered  
24 during the exam. So I thought it was an idea or a suggestion  
25 that they should hear.

1 Q Now, if Madoff self cleared, generated his own  
2 trade confirmations and client statements, wouldn't the  
3 documents he sent his clients be the same?

4 A He self -- during the examination, he told us he  
5 self cleared his proprietary market making business. The IA  
6 business was supposedly cleared through Barclays. It wasn't  
7 self -- self clearing.

8 Q Right. But you never confirmed that, right?

9 A Correct.

10 Q So wasn't it possible that given he said he self  
11 cleared in his market making business, he might have self  
12 cleared on the other side, too? And so getting the  
13 information from the fund to funds wouldn't really tell you  
14 anything.

15 A Well, my thinking, I think, was he -- the assets  
16 were actually custodied offshore so that they would actually  
17 have information regarding -- regarding the money or the  
18 assets.

19 Q Okay. Was there any discussion of maybe going to a  
20 independent source rather than his feeder fund to get  
21 confirmation?

22 A I don't recall that.

23 Q Okay. And then Ostrow says, "You also mentioned to  
24 me the FOF materials should not refer to the strategies but  
25 strike conversion since no options were involved in recent

1 years." And then it says, "In addition, the main thing that  
2 informant does not know is that the trades are done in  
3 Europe."

4 But again, that information is simply from Bernie  
5 Madoff. There was no attempt to confirm that?

6 A Correct.

7 Q Okay. Now, were you familiar with the split strike  
8 conversion strategy that Madoff was saying he was using?

9 A Prior to the examination, no.

10 Q But what about as you went through the examination,  
11 did you gain an understanding of it?

12 A Yes.

13 Q Could you execute a split -- the split strike  
14 conversion strategy without trading options?

15 A No, it was part of the strategy.

16 Q So how could he have executed the split strike  
17 conversion strategy if he said he wasn't trading options?

18 A Well, I think when he stopped trading options it  
19 was no longer a split strike conversion strategy. It was  
20 more of a, you know, almost like an index fund, long mutual  
21 fund.

22 Q Did Bernie Madoff tell you that he'd stopped using  
23 the split strike conversion strategy?

24 A He told us he stopped trading options.

25 Q Did he say anything about he had a new strategy

1 without options?

2 A No.

3 Q Okay. Now, this issue about trades being done in  
4 Europe, do you know if there was any discussion among the  
5 enforcement staff of trying to get information about trading  
6 in Europe?

7 A I don't know.

8 Q You don't -- you're not aware of any effort in that  
9 respect?

10 A No.

11 Q All right. Let's go to the next document. We're  
12 going to mark that as Exhibit 61.

13 (SEC Exhibit No. 61 was marked for  
14 identification.)

15 BY MR. KOTZ:

16 Q This is an e-mail from you to Simona Suh,  
17 11-17-2005, 10:18 a.m. Now, below it Simona says to you and  
18 Meaghan Cheung, Wednesday, 11-16-2005, 6:48 p.m., "Meaghan,  
19 prior to sending out this request, maybe it makes sense for  
20 us to call Fairfield's legal or compliance department to warn  
21 about the request and also to give a heads-up as to its  
22 scope."

23 Do you see that? That's the middle paragraph in  
24 Simona's e-mail.

25 A Okay.

1 Q Do you know why in an enforcement investigation of  
2 fraud you would call up the entity first to warn them about  
3 the request and give them a heads-up?

4 A I have no idea.

5 Q Would it seem to you, odd, that if you're doing an  
6 investigation of fraud that you would call the entity you're  
7 getting information from and tell them, "Hey, I'm going to be  
8 asking for some documents or some information soon."

9 A I guess, yes.

10 Q Okay. Did you ever get the sense that there was a  
11 concern on the part of -- Simona or Meaghan's part of not  
12 offending Fairfield or wanting to make sure that they were  
13 not upset about this request?

14 A No, I never got that sense.

15 Q Okay. Do you know if Fairfield did provide  
16 information to --

17 A Yes.

18 Q Yes. Okay. Did you review those documentation?

19 A I helped review some of those documents.

20 Q What did you find?

21 A My recollection is I reviewed some option trading  
22 and I found one instance where it seemed as though a very  
23 strange trade where one leg of the option -- I'm sorry, one  
24 leg of the split-strike conversion strategy was taken off and  
25 put back on a couple days later for around a \$5 million

1 profit. And I pointed that out to Ms. Suh and I believe it  
2 was asked about during the testimony of Bernie Madoff.

3 Q Okay. All right, let me show you the next document  
4 we're going to mark as exhibit 62. This is an e-mail from  
5 Doria Bachenheimer to Andrew Calamari, 11/22/2005, 10:29 a.m.

6 Doria says to Andrew, "The exam team doesn't think  
7 there's anything here. Simona is going to seek information  
8 from some of the hedge funds on a voluntary basis to test  
9 some of the explanations that Madoff gave to the exam team.  
10 If they work out we won't do anything."

11 Now, did it seem to you at the time that for  
12 whatever reason, Doria or the rest of the enforcement team on  
13 the Madoff case wasn't looking to do very much? I mean they  
14 get this very long involved complaint and they decide they're  
15 going to seek information on a voluntary basis and after that  
16 not do anything?

17 (SEC Exhibit No. 62 was marked for  
18 identification.)

19 A I remember Ms. Suh working extremely hard on this.  
20 I can't speak to either Meaghan Cheung or Doria Bachenheimer,  
21 but there was a lot of information that Simona was reviewing.

22 Q But was there kind of an initial sense when they  
23 got the complaint and the matter was opened that there  
24 probably wouldn't be anything there?

25 A I don't know if I could evaluate whether or not how

1 serious they took it. I know that we met and, you know,  
2 talked about sort of going through the red flags, I just, you  
3 know, how serious they took the complaint I don't know. But  
4 for me, I mean, just the title of the report in and of itself  
5 was pretty serious, so I figured not only them but pretty  
6 much everyone, the top people in enforcement would be  
7 following up on it.

8 Q So you took it very seriously, Harry Markopolos'  
9 complaint?

10 A Yes.

11 Q And you felt that it was important to do a thorough  
12 analysis or investigation of the points that Harry made?

13 A Yes, both because of calling it a Ponzi scheme and  
14 also just the size. The size of what he was alleging in the  
15 Ponzi scheme was enormous.

16 Q Right. And is it fair to say that even after the  
17 exam there were things that didn't add up and so that maybe  
18 brought a little more credibility to having somebody look at  
19 this issue?

20 A Yes.

21 Q Okay. All right, why don't we go to the next  
22 document? The next one we're going to mark as exhibit 63.  
23 And this is an e-mail from you to John Nee, 12/14/2005, 9:10  
24 a.m.

25

//

1 (SEC Exhibit No. 63 was marked for  
2 identification.)

3 MR. TALARICO: Do you have another one?

4 MR. KOTZ: Yeah, sorry.

5 BY MR. KOTZ:

6 Q Okay. This is kind of an interesting e-mail.

7 Let's go to the back page first.

8 A Okay.

9 Q Simona sends an e-mail to you and Meaghan Cheung,  
10 Tuesday, December 13, 2005, 3:17 p.m. And in here -- in this  
11 second full paragraph Simona says, "Well, I've not yet  
12 completed the review of the general binder. One odd  
13 discrepancy did catch my eye, as you know, Madoff told Peter  
14 he stopped using options as part of his trading strategy in  
15 January 2004, yet the account statements and trade  
16 confirmations produced by Fairfield Greenwich show trading in  
17 S&P index option all through 2004 and up to October 2005."

18 A Yes.

19 Q So this was a pretty significant finding, don't you  
20 think?

21 A Yes.

22 Q Okay. And do you think that Simona appreciated  
23 that, she refers to it as kind of an odd discrepancy?

24 A I think she did. You know, again, during the  
25 testimony he somewhat explained it away.

1 Q Now, she says to you, "Peter, would you have time  
2 to take a look at the data and see if I'm missing some  
3 obvious and innocent explanation for this?" Did you do that?

4 A I reviewed -- I definitely reviewed option trading  
5 data, I'm not sure if that's what's being referred to.

6 Q Did you find some obvious and innocent explanation  
7 for why he told you that he wasn't doing options and then the  
8 documents show that he was?

9 A No.

10 Q And you, I assume, reported that back to Simona?

11 A I assume so, I --

12 Q Okay. Then there's an e-mail, this is kind of a  
13 little bit eerie. John Nee sends an e-mail to you,  
14 Wednesday, December 14, 2005, 8:04 a.m. "Did you see the  
15 Madoff scandal in The Post, something about a hedge fund and  
16 a manager, something blowing up, a scandal?" And you  
17 respond, "You are hilarious."

18 A I'm not sure if that article actually was just  
19 speaking about a hedge fund in general or --

20 Q I think it was a joke --

21 A Oh.

22 Q -- and he was referring to, you know, Harry  
23 Markopolos said this is a big Ponzi scheme, it's going to  
24 come out any day. And Nee is saying, "Hey, did you see in  
25 the paper, a Ponzi scheme came out?" And you're responding

1 that it was a joke.

2 A I'm not sure, because when I say "it looks like I'm  
3 in for a lot of fun," I don't -- I mean, I think that's, you  
4 know, it -- I think it was saying jokingly that I'm going to  
5 have -- there's going to be a lot of work to do.

6 Q Okay. And then you say at the top in the e-mail to  
7 John Nee, 12/14/2005, 9:10 a.m., "I'm actually looking  
8 forward to looking at the documents, trying to figure out how  
9 they structured everything. The letter Simona from the GC  
10 was clear as mud." What did you mean by that?

11 A The last part?

12 Q Yeah, the letter from -- to Simona from the GC was  
13 clear as mud.

14 A I just -- I don't recall what that letter is, I'm  
15 not sure what I'm referring to.

16 Q Okay. Okay, I'll show you the next document.  
17 Let's mark this as exhibit 64. And this is an e-mail from  
18 you to Simona, 12/13/2005, 5:46 p.m. And this is in response  
19 to an -- another response to Simona's e-mail we showed you  
20 previously where she asked you to look at documents and you  
21 say, "Hi Simona, I will definitely make time to help review  
22 these documents. The option strategy account is an issue  
23 because Madoff specifically told us that he stopped  
24 incorporating options as of January 1, 2004 because it became  
25 too complicated."

1           Now, did that strike you as kind of an odd  
2 explanation for -- from Madoff that he would stop  
3 incorporating options because it was too complicated? Did  
4 Madoff seem like the kind of guy who would have trouble with  
5 complicated issues?

6                               (SEC Exhibit No. 64 as marked for  
7                               identification.)

8           A     It was odd.

9           Q     Okay. And so it seems to indicate clearly here  
10 that, you know, you were interested and had concerns and were  
11 going to make whatever time was needed to help with this  
12 investigation, right?

13          A     Yes.

14          Q     Okay. Okay, why don't we go to the next document.  
15 Okay, let's mark this as exhibit 65. This is an e-mail from  
16 Simona to you, 12/14/2005, 7:42 p.m.

17               And in this e-mail Simona says, "Fairfield  
18 Century's private placement memo discloses the following  
19 potential conflict of interest. The broker-dealer through  
20 with the fund conducts its SEC investment activities in its  
21 role as a market-maker may affect transactions in equity  
22 securities with the fund as principal. This may provide such  
23 broker dealer with the ability to use the fund's assets to  
24 enhance its equity market-making function."

25               Do you know what that was referring to?

1 (SEC Exhibit No. 65 was marked for  
2 identification.)

3 A I don't, but it would seem to indicate sort of that  
4 the assets could be -- I'm not -- I'm just -- I'm not sure.

5 Q Do you know if this issue was ever -- do you  
6 remember this issue ever being followed up on?

7 A I don't remember.

8 Q And then Simona says, "What is this about? I'm  
9 sure this is basic stuff but I am still pretty new to all  
10 things BD." Did you get the sense that Simona was kind of  
11 inexperienced with these kinds of matters?

12 A I think there were certainly aspects of the  
13 investigation that, you know, she may not have had, nor I  
14 had, sort of a level of expertise.

15 Q Were there other people in the Commission who had  
16 that level of expertise?

17 A I don't know. I mean, if I knew I think I would  
18 have recommended to go to them. We did, at one point, seek  
19 assistance from the Office of Economic Analysis, but I don't  
20 think they were able to provide any assistance.

21 Q What was the particular expertise that you felt you  
22 and Simona didn't have?

23 A Well I think an understanding was the actual  
24 strategy that he was -- that he had claimed to do, not just  
25 the split-strike conversion strategy but the actual -- the

1 execution of the orders overseas, you know, was that  
2 feasible, was that possible. I think that was a question  
3 that we didn't get answered that, you know, would have been  
4 helpful.

5 Q Do you know if there's an Office of International  
6 Affairs at the SEC that deals with those issues?

7 A I do know there's an Office of International  
8 Affairs, but did not know that they would deal with an issue  
9 like that.

10 Q Do you know if there was any efforts made to go to  
11 them, given that this was an international issue you would go  
12 to the Office of International Affairs?

13 A I don't recall anyone speaking about that.

14 Q Okay. Was there any effort to go to anyone else in  
15 either the BD side or the IA side that might have more  
16 experience on these kinds of issues that you and Simona  
17 didn't have?

18 A I know I tried to reach out to some people, I think  
19 Michael Kress is someone I reached out to at one point to try  
20 to get some guidance, somebody that had more experience. I  
21 don't know if Simona did or not.

22 Q Okay. Is it fair to say that Simona had difficulty  
23 understanding Bernie's operation?

24 A I would say yes.

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

1 We'll mark the next document as exhibit 66. This is an e-  
2 mail from Simona to you, 12/21/2005, 1:25 p.m.

3 The top of the e-mail you say -- she says,  
4 "Thanks," but previously there's an e-mail from her to you,  
5 Wednesday, December 21, 2005, 12:14 p.m. where she says, "The  
6 relative's firm that audits Madoff, it's not Berkow,  
7 Schechter & Company LLP by any chance? This company audits  
8 Greenwich Century LP. The domestic -- events with Madoff.  
9 Thanks." And you say, "Friedling & Horowitz, CPAs PC. And  
10 she says, "Thanks," to you.

11 Do you know if there was any further follow up by  
12 Simona or the enforcement team on the issue of the auditor?

13 (SEC Exhibit No. 66 was marked for  
14 identification.)

15 A I don't know.

16 Q You're not aware of any?

17 A No.

18 Q Now, Simona is saying in this e-mail that "the  
19 relative's firm that audits Madoff," right?

20 A Yes.

21 Q Wouldn't it be -- wouldn't it seem logical that if  
22 Simona believes that in the context of this kind of  
23 investigation that a relative audits Madoff, to look at that?

24 A Yes, a relative's firm is certainly a question.

25 Q Okay. Are you aware that after the Madoff -- in

1 mid-the Ponzi scheme, folks went in to look at the books and  
2 records and a guy named [New York Staff Attorney] who is a enforcement  
3 attorney, looked at the audit records of Friehling &  
4 Horowitz?

5 A Yes.

6 Q And in fact, as [New York Staff Attorney] testified to me that  
7 in a very short period of time he realized that there were no  
8 work papers and there was no real auditing done. Were you  
9 aware of that?

10 A I believe I'm aware he got charged, I'm not sure --  
11 I didn't know that it was a short amount of time.

12 Q Okay. Did you think that if Friehling & Horowitz  
13 was followed up on that same information would have been  
14 discovered that there was no work papers and no real auditing  
15 done?

16 A I imagine.

17 Q Okay. Okay, let's go to the next document. Okay,  
18 we're going to mark this as exhibit 67. This is an e-mail  
19 from you to [OCIE Assistant Regional Director], 12/22/2005, 9:25 a.m. Who is  
20 this guy [OCIE Assistant Regional Director]?

21 (SEC Exhibit No. 67 was marked for  
22 identification.)

23 A [OCIE Assistant Regional Director], he was my initial branch chief.  
24 At this point he may have been promoted to assistant regional  
25 director, and I was doing -- at this point I was doing a --

1 an examination for him of a market-making trader at JP Morgan  
2 Securities.

3 Q Okay. During this time period when you were  
4 assisting enforcement with their Madoff investigation, were  
5 you kind of working on a whole bunch of things at the same  
6 time and maybe had difficulty with competing interests for  
7 your time?

8 A Yes. I mean, my role -- again, I mean, I'm a  
9 broker-dealer examiner, so my primary function is to conduct  
10 broker-dealer examinations. You know, Mr. Sollazzo asked me  
11 to provide assistance to the attorneys as I could so that's  
12 what I tried to do.

13 Q But were there times at which some of your  
14 supervisors in the BD side kind of said, "Look, you know,  
15 focus on what you're supposed to do. Don't spend too much  
16 time on the enforcement examination, you got to get your  
17 exams done?"

18 A I don't recall any specific instance, but in  
19 general I think that's been communicated to the broker-dealer  
20 examiners.

21 Q Was that something that was communicated to you  
22 while you were helping enforcement with their investigation  
23 of Madoff?

24 A I don't recall that specifically being communicated  
25 to me.

1 Q Okay. And you say in this e-mail, "I'll be writing  
2 up my notes from the Fairfield -- Madoff Fairfield Greenwich  
3 Group conference call that I participated in yesterday.  
4 Also, I'm going to provide the attorneys with a list of  
5 differences, lies, from what we were told and provided during  
6 the Madoff exam versus what we learned about Madoff's  
7 operation for various documents provided by FFG and during  
8 the conference call yesterday."

9 So, even before Madoff's testimony, based on this  
10 conference call you learned that there were lies or  
11 differences between what Madoff told you in the exam and what  
12 you found out now.

13 A Well, I think the options trading in and of itself.

14 Q Was there anything else, because you say "list of  
15 differences, lies," plural? Were there any other lies or  
16 differences that you recall?

17 A I don't specifically recall which -- any additional  
18 ones.

19 Q Okay. Do you know if this issue was ever kind of  
20 raised higher? You have a very, very prominent individual  
21 and you're finding out that he lied to you in the exam, do  
22 you know if this was ever kind of raised above Meaghan or  
23 above anyone in your circle?

24 A I know, you know, just the testimony of Bernard  
25 Madoff was sat in on by Doria Bachenheimer, who's an ARD, but

1 I don't know above her who knew about this.

2 Q Did the fact that you learned during the  
3 enforcement investigation that Madoff had lied to you, did  
4 that cause you to question the findings in your examination  
5 since in some ways you relied on what Bernie Madoff said?

6 A Yes, but I felt the investigation was being  
7 conducted and it would identify any, you know, what was going  
8 on. If there were -- was in fact, a problem.

9 Q But isn't it fair to say it kind of changed your  
10 perspective on the exam given that now you were realizing  
11 that a lot -- that at least some of the things you were told  
12 were lies.

13 A Yes.

14 Q Okay. Okay, let's go to the next e-mail. Mark it  
15 as exhibit 68. And this is an e-mail from you to Simona,  
16 12/22/2005, 7:10 p.m. And, actually, down here in the e-  
17 mail to Meaghan and Simona, Thursday, December 22, 2005,  
18 12:31 p.m., you do list a few of the discrepancies between  
19 the Madoff exam and our recent communication with FFG.

20 (SEC Exhibit No. 68 was marked for  
21 identification.)

22 A Okay.

23 Q And so you say, "According to Bernie Madoff, all  
24 equity transactions occur in Europe and clear through  
25 Barclays Capital. According to yesterday's call he believed

1 the equity transactions occurred through Madoff's trading  
2 desk in New York in conjunction with Madoff's market-making  
3 operations. Also, this individual did not seem to know that  
4 Madoff's London office served as the settlement agent for the  
5 trades."

6 So does -- didn't this call into question Madoff's  
7 claim at all that the equity transactions occurred in Europe?

8 A Yes.

9 Q Okay. So, previously, there was information that  
10 Madoff was trading equities, but no one could see the volume.  
11 And that was a question of whether he was really trading  
12 those equities, right?

13 A Yes.

14 Q Well, the response from Bernie Madoff was he's  
15 trading them in Europe.

16 A Yes.

17 Q Now you see he's not trading them in Europe.

18 A This individual is saying that he's not trading  
19 them in Europe.

20 Q Right. Okay. Wouldn't that give a lot of credence  
21 to the Ponzi scheme allegation?

22 A Yes. I mean, I think all red flags needed to be  
23 reviewed.

24 Q Okay. And then the number two, "I am certain that  
25 Bernie -- in the examination he no longer incorporated

1 options into the hedge fund strategy because it became too  
2 complicated, however, made a point to tell us that the hedge  
3 funds themselves may use options but he's not involved, he's  
4 unaware they are using options.

5 And according to this guy in the statements  
6 provided, he does use over-the-counter S&P calls and puts. I  
7 believe we should find out more about the counterparties to  
8 these options transactions and the agreements arranged  
9 between Madoff and the counterparties."

10 Do you know if that was ever done?

11 A I believe that we got a list of counterparties --  
12 or the exam -- I'm sorry, the investigator -- the  
13 investigation team received a list of the counterparties for  
14 the option transactions.

15 Q And did they follow up with people on that list?

16 A I don't know.

17 Q Do you know what would have happened if they had  
18 followed up with the counterparties to these options  
19 transactions?

20 A I think the same thing would have happened if they  
21 spoke to the counterparties to the equities and they didn't  
22 exist, they didn't trade, so --

23 Q So the Ponzi scheme would have been revealed,  
24 right?

25 A I believe so.

1 Q So if they had done, essentially, what you  
2 suggested, "Find out more about the counterparties at the  
3 options transactions and follow it up," the Ponzi scheme  
4 would have been revealed, right?

5 A Yes.

6 Q Okay. And then in number three you say, "As we  
7 previously discussed there's a second 2.5 billion FFG equity  
8 account which Bernie Madoff failed to give us an account  
9 statement for. At this point, however, I don't know what  
10 documents were accurate during the examination." Do you see  
11 that?

12 A Yes.

13 Q So at this point in time you weren't sure whether  
14 Bernie Madoff had given you accurate or false documents in  
15 the exam, right?

16 A Yes.

17 Q And that was conveyed to the enforcement lawyers?

18 A Yes.

19 Q Okay. Do you know if there was any discussion at  
20 any point in time among the enforcement staff about  
21 subpoenaing records from Bernie Madoff?

22 A I don't recall any -- I mean we received records  
23 from Fairfield Greenwich Group, but I don't recall any  
24 subpoena.

25 Q Any discussion of a subpoena?

1           A     Correct.

2           Q     Did you deal mostly with Simona or Meaghan Cheung  
3 as well?

4           A     Just Simona.

5           Q     You didn't deal much with Meaghan at all?

6           A     No.  A couple of meetings I sat in on with her, but  
7 my -- exclusively I dealt with Simona.

8           Q     Did it seem like Simona was more involved in the  
9 case than Meaghan?

10          A     Yes.

11          Q     Did it seem like Meaghan was involved at all in the  
12 case?

13          A     It's hard to evaluate how much she was involved  
14 because I don't know what happened between Simona and  
15 Meaghan, but it seemed as though Simona did the bulk of the  
16 work.

17          Q     Okay.  You say on the first page of this exhibit,  
18 68, "Thanks for putting together the interview memo, you're  
19 doing all the work, you're a machine.  After I compare your  
20 memo to my notes I'll be certain to destroy my notes."  Why  
21 would you be destroying your notes?

22          A     Well, I think -- my recollection is that we only  
23 wanted one set of notes for the interview --

24          Q     Do you find that odd that that was a suggestion to  
25 destroy notes?

1           A     No, I mean I -- I don't think I ever worked with  
2     the enforcement staff.

3           Q     Okay, so you assumed that this was kind of protocol  
4     that they had?

5           A     Yeah, I believe I was even told it was so that we  
6     have one consistent set of notes or something to that effect.

7           Q     Okay. Okay, let's go to the next document. Okay,  
8     mark the next document as exhibit 69, this is an e-mail from  
9     Doria to Meaghan Cheung and Simona, 12/29/2005, 11:13 a.m.

10           Doria says at the bottom to Sollazzo, "Peter is  
11     looking at the trading records for us, he's been very  
12     helpful, but I was wondering if you could direct us to  
13     someone in the office who is particularly knowledgeable about  
14     options trading."

15           And then Sollazzo responds, "Peter is one of our  
16     more knowledgeable staffers in respect to trading practices.  
17     We don't have anyone in BD who is particularly knowledgeable  
18     in options trading."

19           Do you know -- I mean, were you the -- really the  
20     most knowledgeable person in all of BD about options trading?

21                                 (SEC Exhibit No. 69 was marked for  
22                                 identification.)

23           A     I can't speculate on that. I mean, I don't know of  
24     anyone else who has traded equity options in my group.

25           Q     Okay. And then Doria says to Meaghan and Simona,

1 "When Peter is finished his review of the trading let's call  
2 Bill Dale in OEA. He may be able to give us some general  
3 advice, maybe it'll help to -- find something by analyzing  
4 the trading."

5 You mentioned earlier there was some efforts to  
6 talk to OEA, what do you know about that?

7 A I participated in a conference call, I believe one  
8 or two, with OEA. I don't remember who, if it was Bill Dale  
9 or not. I believe we were -- Simona was going to send to OEA  
10 some of the trading data and see if they could analyze it.  
11 And I'm not sure if they were able to or not, I don't believe  
12 I ever heard anything back on that.

13 Q From Simona?

14 A From Simona, right. Correct.

15 Q Okay. Let's go to the next document. Short -- off  
16 the record for a minute.

17 (A brief recess was taken.)

18 BY MR. KOTZ:

19 Q Okay, we're going to mark the next document as  
20 exhibit 70. Okay, this is an e-mail from Simona to you and  
21 Meaghan, 12/22/2005, 5:33 p.m. And it attaches a memo of the  
22 interview with this guy from Fairfield Greenwich Group.

23 (SEC Exhibit No. 70 was marked for  
24 identification.)

25 A How do you say his name?

1 Q Do you know how to say his name?

2 A I don't.

3 Q In this telephone call with this individual from  
4 Fairfield Greenwich Group, Amit Vijayegiya, did you find him  
5 credible?

6 A I don't -- I don't really recall.

7 Q Okay. But, I mean, would he have any reason to  
8 provide false information, do you think?

9 A I don't think so.

10 Q Okay. If you look at a couple of things in this  
11 document, look at page 3, the second full paragraph. The  
12 middle of the paragraph it says, "With respect to the timing  
13 of SSCS implementations, AV said he believe the computerized  
14 model of BLM gave signals when to implement the strategy.  
15 This seems inconsistent with Madoff's statement to our exam  
16 staff that he makes these decision personally based on his  
17 gut feel."

18 A Yes.

19 Q So is this, again, kind of another situation where  
20 it seems as though a lot of the information -- you now  
21 realize that a lot of the information you got in the exam  
22 didn't turn out to be correct?

23 A Yes.

24 Q Okay. And so if they're different versions of how  
25 Bernie Madoff achieves those returns with such consistency,

1 wouldn't that make the allegations seem more credible in  
2 terms of coming up with another explanation for how he was  
3 able to achieve the returns?

4 A Yes, I think it would raise the concern level.

5 Q Okay. So if you had a -- had you had any  
6 experience with Ponzi schemes prior to this investigation?

7 A No.

8 Q But you do understand that in a Ponzi scheme -- if  
9 you were doing a Ponzi scheme that's one way to get  
10 consistent returns, right? Because there's no real trading,  
11 you can just make them up.

12 A Yes.

13 Q Okay. Okay, why don't we go to the next document?  
14 The next document is exhibit 71. This is an e-mail from you  
15 to Simona, 12/23/2005, 11:41 a.m.

16 (SEC Exhibit No. 71 was marked for  
17 identification.)

18 A Yes.

19 Q Simona says to you at the bottom of the page, "For  
20 your reading pleasure. He sounded very somber and concerned  
21 and it sounded like he was mostly concerned about your friend  
22 Bernie. I talked to Meaghan about this and while she found  
23 this annoying, she too agreed there's not much else we can do  
24 about this." And then you can see there's an attachment  
25 which is the call memo.

1 Do you remember what the issue was here in terms of  
2 their concern that their inquiry may have serious  
3 consequences from Madoff? Because it seems like this was an  
4 effort for the General Counsel of Fairfield Greenwich Group  
5 to kind of push back against the investigation.

6 A I don't recall.

7 Q Okay. You respond to Simona by saying -- on  
8 Friday, 12/23/2005, 7:59 a.m., "Bernie can be very  
9 intimidating. Do you know what McKefrey meant by when he  
10 said, "Our inquiry may have serious consequences from  
11 Madoff?" If there's no problem with his activity then why  
12 would there be serious consequences?" Do you see that?

13 A Yes.

14 Q What did you mean by "Bernie can be very  
15 intimidating?"

16 A I think, you know, during the exam he, like I said  
17 earlier, he'd become volatile, condescending, you know,  
18 espouse how much knowledge he had on the markets and so  
19 forth. Intimidating might be a little strong, but --

20 Q Well you said "very intimidating," though.

21 A When he's screaming at you and he's, you know -- if  
22 you, for instance, when we discussed algorithm -- algorithmic  
23 trading, even though I was a trader before I had no knowledge  
24 in that. I mean, he can belittle you to the point were you,  
25 you know, you feel pretty low.

1 Q And -- but I think, you know, you correctly point  
2 out here that all the pushback, whether it's from Bernie or  
3 from this guy, is kind of a red flag in an of itself. As you  
4 say, "If there's no problem with his activity, why would  
5 there be serious consequences?"

6 A That's correct.

7 Q And then Simona responds, "Well, I guess even if  
8 the fact that we are looking at Bernie gets out it's a big  
9 deal for his reputation, et cetera." So did it seem that she  
10 was a little bit downplaying that point that you made?

11 A I guess so. Lawyers can sometimes, I think, you  
12 know, do that sort of thing.

13 Q Okay. Yeah, we've had testimony previously that  
14 there was some concern among exam staff at times that the  
15 enforcement staff didn't necessarily treat you -- the exam  
16 staff -- as well as they might have. They didn't kind of  
17 appreciate your perspectives on things. You weren't kind of  
18 one of them. Did you feel that at all?

19 A At times, you know, I've sort of presented things  
20 to them where they're extremely receptive. I've worked with  
21 some of them extremely closely and they really value my  
22 opinion, my experience and so forth. Others, less so. It  
23 really -- I think it's sort of enforcement attorney  
24 dependent.

25 Q What about in connection with the Madoff

1 investigation, were there times where you felt like they  
2 weren't taking you as seriously, being as receptive as they  
3 could have been?

4 A It's hard to say. I mean, a lot of the -- I think  
5 a lot of the communications I had with them were when I was  
6 working in the field, not necessarily dealing with them on a  
7 fact-to-face basis --

8 Q Okay.

9 A -- so it's kind of hard to tell. Never to my face  
10 did they sort of belittle me or say anything that indicated  
11 that, but I have no idea what was going on behind the scenes.

12 Q Okay. All right, why don't we go to the next  
13 document?

14 A Okay.

15 Q All right. The next document we're going to mark  
16 as exhibit 72. And this is an e-mail from Meaghan to Simona  
17 and you dated 12/28/2005, 7:41 p.m.

18 (SEC Exhibit No. 72 was marked for  
19 identification.)

20 MR. TALARICO: Okay, thanks.

21 THE WITNESS: What page is that, I'm sorry.

22 MR. TALARICO: He's not there yet.

23 THE WITNESS: Oh.

24 BY MR. KOTZ:

25 Q Yeah, we're going to look at page 2 of 3, there's

1 an e-mail from Simona to Meaghan with a copy to you, Tuesday,  
2 December 27, 2005, 3:40 p.m.

3 And there's one, two, three in this e-mail and  
4 three it says, "Peter has been analyzing the Fairfield  
5 account statements and he has found, in fact, that the number  
6 of S&P100 index options traded by Madoff, reportedly over-  
7 over-the-counter, is in order of magnitude greater than the  
8 total exchange traded volume for these options."

9 A Yes.

10 Q What was the consequence of that? What did that  
11 mean?

12 A Well it's similar to what had been raised before  
13 regarding the number of options that traded on the exchange  
14 versus he was supposedly trading.

15 Q Okay. And did it also confirm one of the points  
16 that Harry Markopolos made in his complaint?

17 A Which point was that?

18 Q That, you know, the options don't add up.

19 A Yes. Again, we were told it was sort of over-the-  
20 counter options, so again, it makes sense that it -- the fact  
21 that the number of traded on the exchange may not make sense  
22 relative to the over-the-counter market.

23 MR. TALARICO: Can we go off for one second?

24 MR. KOTZ: Sure.

25 (A brief recess was taken.)

1 BY MR. KOTZ:

2 Q Back on the record. Yeah, so this point about the  
3 options that you noted here in the e-mail, Tuesday, December  
4 27, 2005, or that Simona noted in the e-mail about your  
5 analysis, that was an issue that was raised both by

6 Investment Adviser #1

and by Markopolos, is that right?

7 A I believe so.

8 Q Yeah, okay. Okay, and then in four Simona says to  
9 Meaghan and you, "Last week Peter raised questions about the  
10 custody arrangements for Fairfield assets traded through  
11 BLM."

12 A Yes.

13 Q Do you know if that was ever followed up on?

14 A I don't.

15 Q And then on the first page of this document  
16 Simona's e-mail to you with a copy to Meaghan Cheung,  
17 12/28/2005, 10:05 a.m., she says, "We can add a request for  
18 documents sufficient to identify all persons who has custody  
19 of the assets in the Fairfield, Kingate and Tremont accounts  
20 during the relevant period." Do you know if that was ever  
21 done?

22 A I don't.

23 Q Okay. Let's go to the next document. All right,  
24 the next document we're going to mark as exhibit 73, and this  
25 is an e-mail from Simona Suh to you, 12/28/2005, 10:27 a.m.

1           This is in response to Simona saying we can add a  
2           request for documents sufficient to identify all persons who  
3           have custody of the assets in Kingate and Tremont accounts.  
4           And you respond to here, "Sounds good. I'll sleep better  
5           with the answer to this question." So does this indicate  
6           that you thought that this was a significant issue to follow  
7           up on?

8                                 (SEC Exhibit No. 73 was marked for  
9                                 identification.)

10          A     Yes.

11          Q     Okay. And then you say, "On a side note, if Bernie  
12          calls me regarding the request list, I do intend to speak to  
13          him about it or refer him to you. I'm still puzzled by the  
14          options trade I pointed out to you yesterday. I ran it by  
15          the exam supervisor, John Nee, and he thought it was strange  
16          too." Do you know what that was all about? Do you remember  
17          your conversation with Nee?

18          A     I believe that's the trade that I seemed to  
19          identify that generated a huge profit for the Fairfield  
20          Greenwich Group.

21          Q     Right, and what was Nee's response to that?

22          A     I don't think -- I don't recall what his response  
23          was.

24          Q     Okay, but he obviously thought it was strange, or  
25          at least you said that here.

1 A Yes.

2 Q Okay. Okay, so we can move on here now. Okay, the  
3 next document is dated 12/29/2005, 2:06 p.m., from Simona to  
4 you. Exhibit -- mark it as exhibit 74.

5 And in this e-mail Simona says Happy New Year to  
6 you and then you previously said to her, "I appreciate the  
7 heads-up regarding the timing of our Madoff workload. I'm in  
8 the process of completing a few projects and have been  
9 assigned to begin an exam in late January, early February on  
10 Wall Street. In my opinion Madoff should take precedence  
11 over any of my current or future works. I will speak to the  
12 supervisor next week."

13 Why did you think that Madoff should take  
14 precedence over any of your current or future work?

15 (SEC Exhibit No. 74 was marked for  
16 identification.)

17 A The Markopolos report title alone, I think, should  
18 have made it important to take precedence.

19 Q Did your supervisors necessarily agree that this  
20 matter, helping enforcement out, should take precedence over  
21 your current exam work?

22 A I don't recall specifically. I mean, I know I was  
23 assigned to an exam beginning in early February. And sort of  
24 the exams, you know, you start them when you're supposed to.  
25 Sometimes you'll start them and they'll try to get you back,

1 you know, as time permits, back to the office.

2 Q Kind of in hindsight, do you wish you had been able  
3 to spend more time assisting enforcement in this  
4 investigation?

5 A Yes. Like I said, I mean, I think clearly now it  
6 was -- it should have been the priority of the entire agency,  
7 so, yes.

8 Q But at least for your supervisors it was one of  
9 many priorities with the other priorities being the exam work  
10 that they were charged with doing?

11 A Correct. I mean we're the BD program so our goal  
12 is to do BD exams.

13 Q Not help enforcement with their investigations.

14 A Correct.

15 Q Okay. Okay, let's go to the next document. Okay,  
16 the next document we're going to get -- the next document  
17 we're going to mark as exhibit 75. This is an e-mail from  
18 you to Simona, 12/29/2005, 4:51 p.m.

19 And in this you're responding to Simona saying,  
20 "Ugh, I wish he'd just get a lawyer. But did he make it  
21 sound as though -- he did make it sound as though he was  
22 planning to handle the whole thing himself, bad idea for him  
23 and a lot more hassle for us."

24 (SEC Exhibit No. 75 was marked for  
25 identification.)

1 A That's Simona to me?

2 Q Right.

3 A Okay.

4 Q And then you respond, "Yes, he will handle  
5 EVERYTHING himself, which always seems strange to us."

6 A Yes.

7 Q You had testified previously that you thought that  
8 was odd that he was always the point person.

9 A Correct.

10 Q And did Simona also share that concern that this  
11 was odd when she said, "Bad idea for him."

12 A I remember her saying it was sort of frustrating  
13 not having some sort of buffer between the firm and Bernard  
14 and her. I think her -- my recollection she said it would  
15 make, sort of, the investigation a lot easier if she could  
16 deal with an attorney.

17 Q Right. Was there also any discussion of the fact  
18 that since the allegation was he was running a Ponzi scheme  
19 and he was very secretive that they would be suspicious that  
20 he was handling everything by himself without a lawyer?

21 A I never had that discussion. I don't know if  
22 Meaghan or Simona or Doria had that discussion.

23 Q Okay. Okay, we'll go to the next document. We'll  
24 mark the next document as exhibit 76. This is an e-mail from  
25 you to John Nee, 1/17/2006, 10:17 a.m.



1           A     Yes, I agree.

2           Q     Okay. Do you think that there was something going  
3 on there in terms of the enforcement lawyers seemed to be  
4 very trusting of Bernie Madoff or not believing that he could  
5 be engaged in this Ponzi scheme even though he kept lying  
6 over and over again?

7           A     Could you repeat the question?

8           Q     Do you think that the enforcement lawyers were for  
9 some reason continuing to trust Bernie Madoff in not  
10 believing that he was involved in a Ponzi scheme even though  
11 there were a lot of suspicious activity and he seemed to be  
12 lying a lot?

13          A     I'm not quite sure what they were thinking. I  
14 mean, I just know what they asked me to do and, sort of, what  
15 I did. A lot of it happened -- I didn't even sit on the same  
16 floor as them, so I'm not sure I can answer that.

17          Q     Did you have any indication from the folks on the  
18 enforcement team, Meaghan, Simona, or others, that they  
19 believed there was a possibility that Bernie Madoff was  
20 running a Ponzi scheme?

21          A     I don't recall hearing that. I mean, again, I  
22 think their objective is just go through the red flags one by  
23 one.

24          Q     But at the end of the day, wouldn't you agree the  
25 objective in looking at Harry Markopolos' complaint was to

1 determine whether his central allegation, that Bernie was  
2 running a Ponzi scheme, was true or not?

3 A Yes, that's should be the priority and the  
4 objective.

5 Q Do you know if that was ever done, whether they  
6 ever confirmed one way or another?

7 A I don't.

8 Q Okay. And then Simona says to you in the same e-  
9 mail, Friday, January 13, 2006, 5:08 p.m., "Doria has  
10 suggested we talk to somebody in the Office of Economic  
11 Analysis about Bernie's trading. To be honest, I'm not  
12 entirely sure what questions we'd want to ask them, so if you  
13 have any thoughts on what they can do for us, let me know."  
14 Do you remember if you gave them any feedback on what to ask  
15 Office of Economic Analysis?

16 A I don't even think I understood what they did, so  
17 no, I don't believe I gave her any feedback.

18 Q Okay. And then he's -- she says to you also, "If  
19 you have time at some point during the next week or so, no  
20 rush at all, could you go over your notes from the exam and  
21 find places where you made -- where you made notes of  
22 conversations about Bernie no longer trading options?" Do  
23 you know if you did that?

24 A I don't recall. I'm not sure.

25 Q Okay. Okay, let's go to the next document. Okay,

1 the next document we're going to mark as exhibit 77. This is  
2 an e-mail from you to Simona, 1/20/2006, 2:18 p.m.

3 If you go to the bottom of this page Simona says to  
4 you in an e-mail, January 19, 2006, 3:53 p.m., "I have been  
5 having -- I have been having trouble figuring out how to tell  
6 from the produced account statements the balances of assets  
7 managed for each customer. Each statement includes an ending  
8 new balance and also the total values of securities  
9 positions, in the former it's usually lower than the later,  
10 even zero. If you could take a look at the statements and  
11 try to figure out what these number mean that would be  
12 helpful. Also, I'm am puzzled by the fact that the ending  
13 balances in the equities sub-accounts also equal the ending  
14 balances in the corresponding option sub accounts. Do you  
15 know how that works?"

16 And then you respond in an e-mail, Friday, January  
17 20, 2006, 11:24 a.m. to Simona, "Unfortunately, after  
18 reviewing the accounts and speaking with my supervisor, I  
19 don't have clean answers to your questions."

20 And then Simona responds to you on Friday, January  
21 20, 2006, 12:29 p.m., "Thank you. I am glad I'm not the only  
22 one confused."

23 And then you respond to her at 2:18 p.m. on January  
24 20, "Ha, no problem. It's very confusing to me as well." Do  
25 you see that?

1 (SEC Exhibit No. 77 was marked for  
2 identification.)

3 A Yes.

4 Q Given the confusion -- so, you acknowledge that  
5 there were matters here involving Madoff's operations and  
6 particularly the account that you and Simona both had trouble  
7 understanding?

8 A Yes.

9 Q So given that lack of understanding and confusion,  
10 why didn't anyone go to Harry Markopolos and ask him? Was  
11 that ever raised?

12 A I don't know that they didn't. I didn't do it.

13 Q Was that ever discussed?

14 A I never heard that discussed.

15 Q And from Harry Markopolos' complaint, did you get  
16 the impression that he might have had some of the answers to  
17 these questions? Had a better understanding based on the  
18 complaint he filed?

19 A Yes, I mean, like I said earlier, I think speaking  
20 to people in the industry is a good thing and should be done.

21 Q And in this case you had a person in the industry  
22 who was available to speak to, right?

23 A Yes.

24 Q And were you aware that Harry Markopolos also  
25 identified other names in his complaint of individuals who

1 were experts in the field who you could have spoken to?

2 A Yes.

3 Q But you're not aware of any point Simona coming  
4 back and saying, "We're all confused about these issues, I'm  
5 going to call Harry Markopolos about it?"

6 A Right.

7 Q That never happened?

8 A I don't believe that ever happened.

9 Q Okay. And then ever particularly one of the areas  
10 of confusion you note in the e-mail to Simona on 11:24 a.m.  
11 on Friday, January 20, 2006, is, "I do believe your questions  
12 go back to the custody of assets issue." Do you see that?

13 MR. TALARICO: Second line. However -- starting  
14 with "however."

15 THE WITNESS: Yes.

16 BY MR. KOTZ:

17 Q And that was a pretty significant issue, the  
18 custody of assets, right?

19 A Yes.

20 Q Okay. So knowing what you know now, do you think  
21 that if you had able to get to the bottom of the custody and  
22 assets issue by perhaps going back to Harry Markopolos that  
23 the Ponzi scheme would have been uncovered?

24 A Yes.

25 Q Okay. Okay, let's go to the next document. Okay,

1 the next document we're going to mark as exhibit 78. This is  
2 an e-mail from you to Simona, 1/25/2006, 4:19 p.m.

3 Simona, in an e-mail below in this exhibit, on  
4 Wednesday, January 25, 2006, 2:24 p.m. writes to you, "When  
5 you have time, could you check if we have information on  
6 commission rates that BLM charges other non-IA customers?  
7 Are the rates as uniform as in the IA business, same rate for  
8 everybody? Are they lower, higher than the IA business  
9 rates?" And then she continues in the next e-mail on 2:31  
10 p.m., "The question below as far as for both for equities and  
11 options."

12 Do you know why she was interested in this issue  
13 about BLM commission rates?

14 (SEC Exhibit No. 78 was marked for  
15 identification.)

16 A I don't know.

17 Q And you respond, "BLM doesn't trade options for  
18 customers." What did you base that on?

19 A I know he's a, you know, he had a market-making  
20 business, but in his market-making business he only traded  
21 equities, he didn't trade options. I believe that's what I'm  
22 referring to.

23 Q Okay. Simona wasn't aware of that?

24 A I'm not sure if she was or not.

25 Q Do you remember that -- this commission issue

1 becoming an issue that continued or --

2 A I don't remember that, you know, being an issue.

3 Q What about the issue of him trading options for  
4 customers, do you know if that was further discussed?

5 A Only in the testimony it came out.

6 Q Okay. Okay, why don't we go to the next document?  
7 Mark the next document as exhibit 79. And this is an e-mail  
8 to Simona dated 1/27/2006, 1:01 p.m.

9 First, let's go to the bottom of the page. There's  
10 an e-mail you sent to Simona, Friday, January 27, 2006, 10:38  
11 a.m. The first point you say, "I meant to ask Frank why the  
12 strategy is implemented only in Europe and during European  
13 trading hours and not New York time. What if there is  
14 breaking news having huge impact on the market such as 9/11?"

15 I assume that's Frank DiPascali in that?

16 (SEC Exhibit No. 79 was marked for  
17 identification.)

18 MR. TALARICO: Is that right?

19 THE WITNESS: Frank DiPascali, correct.

20 BY MR. KOTZ:

21 Q DiPascali, sorry. Do you know if that question was  
22 ever asked?

23 A I don't know. It -- this must have been after his  
24 testimony and I didn't -- I don't know.

25 Q Do you know if that was ever followed up on at all,

1 the question of why the strategy was implemented only in  
2 Europe and during European trading hours?

3 A I don't.

4 Q You're not aware that it was followed up?

5 A I'm not aware if it was followed up.

6 Q Okay. Then in number 2 you reference a point that  
7 has been referenced before which is, "I am still puzzled that  
8 Bernie is able to always find counterparties willing to trade  
9 options in the side that he needs to for the strategy without  
10 freaking out the market. Talk about having difficulty  
11 finding liquidity, try calling a large broker-dealer in the  
12 U.S. with such a huge options order. I'm confident that you  
13 would move, scare, the market. Maybe the counterparties are  
14 able to hedge themselves somehow but I don't see how."

15 Isn't this the same issue that was raised in the  
16 Investment Adviser #1 e-mail?

17 A No. The Investment Adviser #1 e-mails is talking  
18 about the volume of options traded on the exchange and  
19 they're saying that based on the amount of assets that he had  
20 in the strategy he wouldn't be able to trade that quantity of  
21 options on the exchange. So, in other words, for the S&P100  
22 contract, the call options on the exchange according to  
23 Bloomberg, 1000 contracts may have traded, but based on the  
24 amount of assets in his strategy you would need to trade  
25 5000. So I think those were the issues that were raised by

1 [REDACTED]

2 But if you traded them in the over-the-counter  
3 markets you may be able to find someone to trade 5000. My  
4 point here is that even if you find someone in the over-the-  
5 counter markets to trade those options with, they're still  
6 going to have to hedge it somewhere.

7 Q Right. Didn't the [REDACTED] e-mail, though, talk  
8 about difficulty of finding counterparties in the over-the-  
9 counter markets?

10 A It may, I haven't -- I mean I -- I would like to  
11 see it actually to stir my memory.

12 Q Okay. This is exhibit 4.

13 A Okay. Yes, it did.

14 Q Okay, so this issue that you raised in this e-mail,  
15 January 27, 2006, to Simona is the same e-mail -- same issue  
16 that was raised in the [REDACTED] e-mails?

17 A Yes.

18 Q Okay. Do you know if that issue was ever resolved?  
19 To your knowledge was that issue resolved in the enforcement  
20 investigation?

21 A Not to my knowledge.

22 Q Okay, and then Simona responds on Friday, January  
23 27, 2006 at 11:46 a.m., to you, "On the momentum tools issue,  
24 if we had any real reason to suspect some kind of wrongdoing  
25 in Bernie's market-timing decisions I would send a document

1 request on the issue. But I'm not sure how much stress we  
2 want to put on him is all we suspect is disclosure problems.  
3 I will talk to Meaghan about it. We can definitely question  
4 him about it."

5 Did you have -- did you agree at that time that  
6 there was no real reason to suspect some kind of wrongdoing  
7 in Bernie's market-timing decisions and it was only  
8 disclosure problems?

9 A I didn't suspect that.

10 Q So you believed that there was a real reason to  
11 suspect some kind of wrongdoing in Bernie's market-timing  
12 decisions, right?

13 A I still wasn't clear on how he was doing that,  
14 right.

15 Q Yeah. What about his point about, "I'm not sure  
16 how much stress we want to put on him if all we suspect is  
17 disclosure problems?" Why was that a consideration in an  
18 enforcement investigation, how much stress to put on Bernie  
19 Madoff?

20 A I'm not sure. Simona is not -- I'm not sure  
21 English is her first language, so it could be a little bit of  
22 a translation. Stress, I think stress -- I read it stress  
23 making him uptight, but stress to her might be like emphasis,  
24 work. I'm not sure if I'm explaining that properly, but --

25 Q But even if it's emphasis, work, would it seem odd

1 to you that in an enforcement investigation of fraud there  
2 would be a concern from the enforcement lawyers about stress  
3 or work they would put on the subject?

4 A I agree.

5 Q Okay. Okay, give me the next one. Okay, we're  
6 going to mark the next document as exhibit 80. This is an e-  
7 mail dated 1/27/2006, 3:43 p.m. from Peter -- from you to  
8 Simona Suh.

9 And halfway down in this e-mail string there's an  
10 e-mail from you to Simona, Friday, January 27, 2006, 3:31  
11 p.m. You say, "When we were conducting the exam there was a  
12 day when Weintraub was in our office without Bernie. I think  
13 that she was dropping off some data or something. We seized  
14 the opportunity to ask her about the systems.

15 After a couple of minutes an employee came into the  
16 office and said, "Liz, you're urgently needed," thus she left  
17 before we could get into much detail about anything. When I  
18 asked Bernie later why she was urgently needed he said  
19 something like, "Her lunch arrived." That was strange to  
20 William and I because it was around 3:00 p.m. William and I  
21 suspected that Bernie sent the employee to our office because  
22 he did not want her speaking with us alone"

23 Wasn't that a pretty suspicious event?

24 (SEC Exhibit No. 80 was marked for  
25 identification.)

1           A     Yes, it -- you know, along with Bernie being so  
2     secretive and --

3           Q     And being the only person who was your contact?

4           A     Yes.

5           Q     And not -- essentially, not letting you talk to  
6     anybody else?

7           A     Yes.

8           Q     And particularly, as you now -- or enforcement is  
9     now looking at him in terms of a Ponzi scheme, this would be  
10    suspicious.

11          A     Right, that's why I think I communicated that.

12          Q     Do you remember if there was any further discussion  
13    about this?

14          A     I don't.

15          Q     You don't remember any such discussion?

16          A     I don't remember any such discussion.

17          Q     Okay. Okay, let's go to the next document. Okay,  
18    the -- document we're going to mark as exhibit 81. This is  
19    an e-mail from Simona to you, 2/6/2006, 5:34 p.m.

20                 Below is an e-mail in this e-mail string from  
21    Simona dated Monday, February 6, 2006, 4:21 p.m. to Vance  
22    Anthony. Was this the reference to Office of Economic  
23    Analysis that we discussed before?

24                                 (SEC Exhibit No. 81 was marked for  
25                                 identification.)

1           A     I don't recognize that name, but it seems as though  
2     that's what it is.

3           Q     Okay. Take a look a little -- brief -- review this  
4     e-mail from Simona and try to get a sense for me of what  
5     exactly she was asking Office of Economic Analysis to do.

6           A     I think she was trying to determine if the returns  
7     that he was supposedly generating made sense or possible.

8           Q     But to your knowledge, nothing came back from  
9     Office of Economic Analysis.

10          A     I don't recall anything coming back from them.

11                   BY MS. STEIBER:

12          Q     Was there a discussion of why the Markopolos  
13     complaint wasn't sent to Office of Economic Analysis?

14          A     No.

15                   BY MR. KOTZ:

16          Q     Okay. The next document we're going to mark as  
17     exhibit 82. This is an e-mail from you to Simona, 3/15/2006,  
18     11:33 a.m.

19                   In this e-mail string below you ask Simona in an e-  
20     mail dated Tuesday, March 14, 2006 at 12:13 p.m., "Perhaps we  
21     could ask the FSA so share information regarding the  
22     activities of Madoff Securities International London, MSIL."  
23     What is the FSA?

24                                   (SEC Exhibit No. 82 was marked for  
25     identification.)

1           A     It's the one -- it's the UK's equivalent of the  
2     SEC.

3           Q     Okay. And then Simona responds, "Unfortunately, I  
4     doubt we can avoid going through our OIA no matter how many  
5     cooperation agreements the SEC signs. My experiences with  
6     that office so far have been less than satisfying. Besides,  
7     I think UK was never a problem for us, from what I've heard  
8     FSA generally cooperates with the SEC."

9                     Do you remember Simona saying anything about her  
10    concerns about OIA, Office of International Affairs?

11          A     I see the e-mails but I don't recall having any  
12    discussions.

13          Q     Did you all ask the FSA for information?

14          A     Not to my knowledge.

15          Q     Okay. Next document I'm going to mark as exhibit  
16    32. This is an email from Simona -- I'm sorry --

17                     MR. TALARICO: 83.

18                     BY MR. KOTZ:

19          Q     83, that's a big mistake. Exhibit 83, e-mail from  
20    Simona to you, 4/28/2006, 3:09 p.m.

21                     And then Simona at the bottom of this e-mail string  
22    says to you in an e-mail on Friday, April 28, 2006 at 12:53  
23    p.m., "OEA finally responded that they want to talk next  
24    week, are you available?" And then you say, "I returned from  
25    the field today, good timing."



1 minutes?

2 A I think it was not a long call but it took a little  
3 time to explain sort of what we were trying to do.

4 Q Now, this call was several months after documents  
5 had been sent to OEA. Do you recall that enforcement kind of  
6 expected OEA to have some information already and yet on the  
7 call they had to kind of go back and explain to them again  
8 what they wanted?

9 A I remember something to that effect.

10 Q Okay. Do you remember Stewart Mayhew as a guy  
11 being on the call? Kind of -- he was supposedly an options  
12 expert.

13 A The name doesn't sound familiar but I'm not -- he  
14 may have been on the call.

15 Q Okay. Okay, next document we're going to mark as  
16 exhibit 85. This is an e-mail from you to Simona, 5/4/2006,  
17 9:08 a.m.

18 (SEC Exhibit No. 85 was marked for  
19 identification.)

20 MR. TALARICO: Thanks. You want to --

21 THE WITNESS: Sure.

22 BY MR. KOTZ:

23 Q And you, in the bottom of the e-mail string, say to  
24 Simona in an e-mail, Thursday, May 4, 2006, at 8:50 a.m., "I  
25 will create a spreadsheet for the days in which the strategy

1 was implemented versus the S&P500's performance broad-market  
2 prior to and while the strategy was being implemented." Do  
3 you know what the purpose of that was?

4 A I think we were just trying to compare the returns  
5 of the overall market versus what he was supposedly  
6 generating for Fairfield Century.

7 Q Do you know if this was information that the Office  
8 of Economic Analysis asked for?

9 A I don't think so but I'm not sure.

10 Q Okay. And then you say, "I can also review the  
11 options agreements for settlement terms and whether the  
12 options are European versus American style." Simona says, "I  
13 don't think we have the options agreement though, I could be  
14 wrong, I'll check." Do you know if you ever got the options  
15 agreements to review?

16 A I reviewed the options trading but the options  
17 agreements I don't recall reviewing.

18 Q Okay. Okay, we're going to mark the next document  
19 as exhibit 86. This is an e-mail from you to Simona,  
20 5/8/2006, 11:11 a.m., OEA spreadsheet.

21 Do you remember compiling this -- putting this  
22 spreadsheet together?

23 (SEC Exhibit No. 86 was marked for  
24 identification.)

25 A I don't, but I believe I put it together.

1           Q     You say in the e-mail -- cover e-mail to the  
2     spreadsheet, "I believe we should ask Madoff for  
3     documentation regarding the yellow-highlighted options trades  
4     whenever those type of requests become appropriate. These  
5     trades seem too good to be true." Is it fair to say that as  
6     you continued to assist enforcement in their investigation  
7     you became more and more suspicious of Madoff?

8           A     I think as -- you know, going through, like,  
9     identifying, you know, strange trades that seem to generate  
10    profits out of thin air, and as well as the testimony, yes, I  
11    would say that's correct.

12          Q     All right, let's go to the next document. All  
13    right, I'm going to ask you -- show you another document  
14    marked as exhibit 87. This is an e-mail from Simona to Vance  
15    Anthony, Stewart Mayhew, 5/9/2006, 2:43 p.m., cc to you,  
16    Meaghan Cheung and William Dale.

17                 And they say, "Attached is a spreadsheet that Peter  
18    Lamore prepared based on the account statements Madoff  
19    provided to Fairfield Century Limited." Just -- if you could  
20    just look at the spreadsheet and just confirm that this is  
21    the spreadsheet that you created that was then sent to Vance  
22    Anthony and Stewart Mayhew.

23                         (SEC Exhibit No. 87 was marked for  
24                         identification.)

25          A     I believe it is based on the heading.

1 Q Okay. The next one is 88. The next document we're  
2 going to mark as exhibit 88. This is an e-mail from you to  
3 Simona, 5/12/2006, 9:15 a.m.

4 In this e-mail you say, "Hi Simona, I've spoken to  
5 Ellen Hersch in our office regarding DTC. She suggested that  
6 I speak to Sunam Varghese, the branch chief familiar with  
7 DTC. I've left a message for Sunam to call me back." Do you  
8 know if you ever did speak to Sunam Varghese?

9 (SEC Exhibit No. 88 was marked for  
10 identification.)

11 A I don't recall speaking to her.

12 Q Okay. Do you know if anybody contacted DTC in  
13 connection with Madoff -- I connection with the  
14 investigation?

15 A I'm not aware of anyone during the investigation  
16 contacting DTC.

17 Q Were you aware that after Bernie Madoff confessed,  
18 enforcement lawyers went in and contacted DTC and immediately  
19 verified that there were no trades?

20 A Say that again.

21 Q Are you aware that after Madoff confessed to the  
22 Ponzi scheme, enforcement lawyers and examiners went into  
23 Madoff's firm and contacted DTC to check on some of Madoff's  
24 trades and in a short period of time determined that, in  
25 fact, there were no trades.

1           A     I'm not aware that's how they determined there were  
2 no trades.

3           Q     Okay. Are you aware of another way in which they  
4 determined there were no trades?

5           A     I think just --

6           MR. TALARICO: Yeah, sure.

7           MR. KOTZ: Sure.

8           BY MR. KOTZ:

9           Q     Okay. I heard something about a DTC terminal at  
10 Madoff's headquarters in Madoff's offices. Were you aware of  
11 that?

12          A     I was not aware of that during the examination or  
13 the investigation.

14          Q     But afterwards you were aware of it? After Madoff  
15 confessed?

16          A     I've heard that -- yes, after he confessed.

17          Q     Okay. All right, let me ask you another question  
18 about this e-mail in front of you. In the e-mail from Simona  
19 to Meaghan with a copy to you on Wednesday, May 10, 2006,  
20 4:55 p.m. -- there's five sevens, but in one of -- the second  
21 seven it says, "Rob suggested that we talk to his contact at  
22 CBOE --"

23          A     Yes.

24          Q     Do you know -- you know what -- do you know what  
25 CBOE is?

1 A I do.

2 Q Okay, Chicago Board of Options Exchange?

3 A Correct.

4 Q Make sure I get it right. "Rob suggested that we  
5 talk to his contact at CBOE about the volume of Bernie's  
6 option in trading. Peter, Steve and I will try calling him  
7 on Friday afternoon." Do you know if that call was ever made  
8 to CBOE?

9 A I believe we did speak to someone in CBOE, I don't  
10 know if it happened on that day.

11 Q Okay. What was the conversation with the guy at  
12 CBOE?

13 A My recollection, it was regarding the quantity of  
14 options that Bernie Madoff was supposedly trading in the  
15 over-the-counter markets and whether or not that seemed  
16 reasonable, could be done, and things like that.

17 Q So what did the individual at CBOE tell you?

18 A It seemed as though he thought it was possible. I  
19 don't -- that's kind of the extent to what I recall from that  
20 conference call.

21 Q How long of a call was that, do you remember?

22 A I don't recall. I don't think it was extremely  
23 long.

24 Q Do you remember any particular individual that you  
25 talked to at CBOE?

1           A     I don't. I think Rob DeLeonardis may have set it  
2 up.

3           Q     Okay. Was there any effort to confirm any specific  
4 options trading with CBOE?

5           A     I don't recall, I think it was more just generally.

6           Q     Okay. It says in here also, "Peter will find out  
7 who examines DTC, hopefully they will be able to give us more  
8 information about what data to ask for in what format." Do  
9 you know if you were able to find that out?

10          A     I don't recall.

11          Q     You don't recall finding it out?

12          A     I don't.

13          Q     And then it says, "Unless you disagree we will hold  
14 off making requests to Bank of New York and Barclays until  
15 Bernie's testimony when we should be able to talk to him in  
16 more detail about the function of those accounts." Do you  
17 know -- do you -- are you aware of whether those requests to  
18 Bank of New York and Barclays were ever made?

19          A     I don't know.

20          Q     Okay. There's also a reference to talking to  
21 Personal Privacy, the head of market surveillance in DC. Do you  
22 know if that was done?

23          A     I don't know.

24          Q     Do you know if there was any conversation with  
25 anybody at NASD?

1 A Regarding Madoff?

2 Q Yeah.

3 A Not that I'm aware of.

4 Q Okay. Okay, we'll mark the next document as  
5 exhibit 89. This is an e-mail from you to Simona, 5/16/2006,  
6 7:27 a.m.

7 You say, "I spoke to our DTC contact in BD  
8 regarding our DTC questions, however, I didn't get any clear  
9 answers. The only piece of advice was to find out if MISL  
10 participates in DTC." Do you remember this conversation, who  
11 the DTC contact person in BD was?

12 (SEC Exhibit No. 89 was marked for  
13 identification.)

14 A I don't remember speaking -- I mean, I imagine it  
15 was Sunam Varghese but I don't -- I just don't recall having  
16 that conversation.

17 Q Do you recall something about not getting clear  
18 answers from somebody about DTC?

19 A I just don't recall that conversation.

20 Q Okay. Okay, the next document we're going to mark  
21 as exhibit 90. This is an e-mail to Simona Suh, 6/26/2006,  
22 2:16 p.m.

23 In this e-mail it says at the top, and I believe it  
24 is from you although it's not clearly referenced, "I don't  
25 understand why these accounts were excluded during our exam

1 when we asked for a list of all customers." Do you know what  
2 that referred to?

3 (SEC Exhibit No. 90 was marked for  
4 identification.)

5 A I don't recall this.

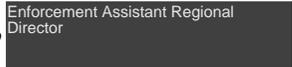
6 Q Okay. There's a reference in the e-mail from  
7 Simona, June 26, 2006, 12:49 p.m., in the -- under II, "On  
8 the other hand, when we ultimately do talk to Bernie about  
9 registration it may be helpful to know if we should consider  
10 these accounts to be advisory accounts. For now we can wait  
11 to see what IM says on the issue."

12 Do you know if the Division IM, Investment  
13 Management, was ever contacted?

14 A I don't know.

15 Q You don't -- you're not aware that they were.

16 A I'm not aware that they were.

17 Q Okay. Okay, the next document we're going to mark  
18 as exhibit 91. This is an e-mail from you to   
19 dated 12/13/2008, 1:19 p.m.

20 First, what was your reaction when you heard on  
21 December 11th that Bernie Madoff had admitted to a Ponzi  
22 scheme?

23 (SEC Exhibit No. 91 was marked for  
24 identification.)

25 A I guess just utterly shocked. I mean, despite, you

1 know, everything we went though you just never think -- you  
2 can't imagine, I mean, it's just sort of unimaginable. I  
3 mean, it's -- it turned from sort of shocking to anger to,  
4 you know, sort of other emotions, so --

5 Q Okay. You say in an e-mail to Enforcement Assistant  
Regional Director shortly  
6 after that, "I agree that additional authority access would  
7 have possibly enabled us to detect it. Our hesitancy towards  
8 rocking the boat also is something that should be  
9 reconsidered. I'll explain when we chat." What did you mean  
10 by hesitancy toward rocking the boat?

11 A I just think that, in general, the agency, you  
12 know, we don't reach out to third parties. You know, we  
13 don't seek assistance from the industry, people who are doing  
14 trading, you know, on a daily basis, we don't have a good  
15 contact to really do that.

16 And there -- in general I think there's -- you  
17 know, we try to be professional and so forth on exams, but at  
18 some point when somebody isn't telling you the truth,  
19 misleading you, you know, instead of dealing with them on an  
20 exam level they should probably haul them in for testimony.

21 And sometimes the exam program, I think, is -- can  
22 sort of not be taken seriously at times. You know, if the  
23 people are going to give us, you know, half answers or  
24 incomplete documents, you know, sort of right now we try to  
25 remain professional, try to continue the exam, but maybe a

1 harder line might be necessary.

2 Q So there are times as an examiner where you feel  
3 like you're trying to find some information out and you're  
4 really kind of at the behest of the registrant as to whether  
5 -- as to whatever they tell you?

6 A Every exam.

7 Q And so, the agency maybe isn't aggressive or  
8 assertive enough in exams in your opinion? A Yes. When,  
9 you know, when incomplete documents are provided despite  
10 whatever explanation they give you, I mean, I think it's  
11 sometimes necessary for enforcement or someone to raise the  
12 bar and make it a serious matter.

13 Q And is that a view necessarily shared by your  
14 superiors in the exam side?

15 A I don't know, I mean, I've never had the  
16 discussion, this is my opinion.

17 Q Okay. Do you think that this hesitancy towards  
18 rocking the boat may be even more pronounced where you have  
19 somebody like Bernie Madoff who's a well-known person in  
20 industry?

21 A I mean, I'd like to say that we're sort of  
22 professional and that sort of thing, treat everyone equally,  
23 but maybe at senior levels that could be the case.

24 Q But even at a junior level, isn't there a greater  
25 concern in rocking the boat with somebody who has the ability

1 to make a call, who has connections, who knows people, who's  
2 well-known.

3 A Well, I think it's -- it's not only just the person  
4 but the type of firm. Because if you're dealing with a, you  
5 know, a penny-stock firm, you know, it's much easier to call  
6 them out, you know, say to their face that you think they're  
7 a liar rather than if you're at a Goldman Sachs and you're  
8 dealing with a compliance person. You know, sort of the  
9 level of professionalism that's expected differs by they type  
10 of firm you're dealing with.

11 Q And it would be very difficult for you in your  
12 position to tell Bernie Madoff that he's a liar.

13 A Absolutely.

14 Q Okay. And in some ways was that made clear to you  
15 initially in the phone call with headquarters when they  
16 talked about their exam of Bernie Madoff and said, "Just  
17 remember, Bernie Madoff is a influential figure?"

18 A Yes. I mean, I think it caused us to remain  
19 professional.

20 Q Okay. In this same e-mail string below, you also  
21 say to Enforcement Assistant Regional  
Director, "I just can't believe I've been duped  
22 again by another industry superstar."

23 A Yes.

24 Q Do you know what that refers to?

25 A Yes. When I was a trader I was an execution trader

Personal Privacy

1 for a woman, her name was [REDACTED], and she was accused  
2 of insider trading. And I was her execution trader so I was  
3 called in for testimony and had to deal with that as well.  
4 And, you know, here I thought she was a great trader when it  
5 turns out -- well, she was a very good trader but she also  
6 was doing this on the side, which I had no idea about.

7 Q And that was before you got to the SEC?

8 A Correct.

9 Q Okay. All right, next document. The next document  
10 is an e-mail from you dated 12/15/2008, 3:08 p.m. to Michelle  
11 Trillhaase.

12 (SEC Exhibit No. 92 was marked for  
13 identification.)

14 A Yes.

15 Q If you look at the second page of this e-mail, page  
16 2 of 3, there's an e-mail from you to Michelle Trillhaase,  
17 Sunday, December 14, 2008, 4:33 p.m. You say, "It's been a  
18 tough couple of days for me. Although I gave the exam and  
19 follow-up investigation 110 percent we just didn't uncover  
20 it. I think we were very close, probably only one or two  
21 phone calls away from blowing it open." What were those one  
22 or two phone calls away?

23 A You know, I think had we been able to contact the  
24 counterparties to the -- equities of the options, I think  
25 that would have, you know, that would have been the call that

1 would have revealed the entire Ponzi scheme because there  
2 would have been no executions.

3 Q Okay. Just for the record, this is exhibit 92, the  
4 12/15/2008 e-mail from you to Michelle Trillhaase. Why don't  
5 we go off the record for a second?

6 (A brief recess was taken.)

7 BY MR. KOTZ:

8 Q Was there a time period in the enforcement  
9 investigation where there was a lot of work done and then  
10 kind of the case was a little dormant?

11 A I mean, I was -- you know, I was on another exam, I  
12 mean, I was conducting a broker-dealer examination at the  
13 time, so I mean, I'm not sure I recall, sort of -- any sort  
14 of dormant period.

15 Q So, Bernie Madoff comes in, gives testimony, and  
16 you know, it was described to us that during his testimony  
17 you were sort of jumping up and down as to all the things he  
18 was saying that turned out to be -- that were false or at  
19 least inconsistent with what he told you.

20 A Right. I mean, I think it was -- I don't know if --  
21 - jumping up and down is -- to me it was obvious that it was  
22 -- the strategy was different, the number of accounts, in  
23 particular, was different, the assets under management were  
24 different. And, I mean, I just want to --

25 MR. TALARICO: No, she's still on, go ahead.

1 THE WITNESS: I want to emphasize that, you know,  
2 during the testimony when -- I'm not sure why but I'm pretty  
3 sure that they emphasized that they needed to ask about  
4 additional accounts, because there's additional accounts. I  
5 don't remember how I knew, why I knew, but I said, "You need  
6 to ask that question." So in the testimony there was, "Are  
7 there additional accounts?" "No." "Are you sure there are  
8 additional accounts?" "No." "Are you positively sure there  
9 are additional accounts?" "Well, there might be a few  
10 additional accounts."

11 So I'm sitting there thinking, "You got to be  
12 kidding me, I mean, this is huge. This guy just lied on the  
13 record testimony to your face." So, I mean, did I -- I don't  
14 think it was necessary -- I mean, it -- they did it to them,  
15 it's not like they weren't there, so --

16 BY MR. KOTZ:

17 Q Was there any consideration in charging Madoff with  
18 perjury?

19 A I never heard that. Again, once I left the  
20 testimony, honest, I don't recall having any substantive  
21 discussions about the investigation at all.

22 Q So you weren't involved in the investigation post-  
23 Madoff testimony?

24 A Correct.

25 Q Do you have any idea why?

1 A No.

2 Q Did you follow up to see what happened with this  
3 investigation?

4 A I may have crossed paths with Simona in the  
5 corridor and I said, you know, "What happened?" And I think  
6 something like, "He's going to register as an IA." And I  
7 just -- you know, I don't think I had much of a reaction, I  
8 think I was just so stunned, you know, based on the  
9 testimony.

10 Q You were stunned that what? That they didn't find  
11 more?

12 A Right, that that, sort of, was it. I mean, again,  
13 I just remember sitting there in the testimony thinking he's  
14 lying during the testimony. It was just remarkable to me.

15 Q And did you get the sense that the enforcement  
16 lawyers didn't share that perception or didn't share that  
17 concern that you had?

18 A I don't think I ever discussed it with them, I just  
19 -- I mean, to me, I was a relatively new guy, you know,  
20 they'd been doing this a long time. I mean, I didn't even  
21 know what the process was if they thought he was lying what  
22 to do, you know, charge him with perjury or what have you. I  
23 just, you know, was in sort of a more support role at that  
24 point.

25 Q And so was it odd that you were pretty heavily

1 involved, we showed all these e-mails assisting, seemed to be  
2 kind of instrumental in some ways in providing information to  
3 them, and then suddenly it dropped off?

4 A Yes, I was -- wasn't in charge of directing what  
5 was going on, I guess, more of a support role, but it was odd  
6 to me, yes.

7 Q And you have no idea why all of a sudden they  
8 stopped communicating with you and seeking your assistance?

9 A I have no idea.

10 Q Okay. I don't want to ask you too many questions,  
11 but just generally, you were chosen to work on the  
12 examination post-Madoff confessing, right?

13 A Correct.

14 Q Is there any concern about the fact that you had  
15 worked on the exam previously, maybe you shouldn't be the  
16 person who works on it after Bernie confessed?

17 A I think Mr. Nee raised that concern to Mr. Sollazzo  
18 and to me and then I raised it again to Mr. Kress, maybe Mr.  
19 Sollazzo as well. And, you know, right after the whole thing  
20 was exposed, you know, Andrew Calamari asked me to talk to  
21 him. And his -- he was just interested to understand what  
22 sort of analysis I performed as part of the investigation.

23 And in conjunction with that I said to him, you  
24 know, I am participating now in the current Madoff matter,  
25 you know, do you think that's -- that makes sense or is that

1 okay? I said, you know, I don't want this to become a  
2 problem down the road, something to that effect. And he  
3 said, really, it's Bob Sollazzo's call. So at that point, I  
4 mean, I just, you know, do what I'm told.

5 Q And Sollazzo determined that you should stay on the  
6 post-Madoff confession exam?

7 A He thought it was fine.

8 Q As part of that effort, are you doing a Ponzi exam  
9 -- Ponzi scheme exam -- sorry? I mean, what is it exactly  
10 that you're doing?

11 Law Enforcement



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BY MS. STEIBER:

Q Well, early on, what did you do try to trace customer assets, if anything?

A We had a -- one of the things we received were bank statements, so we were able to -- not myself, but another colleague Personal Privacy, has put together spreadsheets regarding wire activity, check activity, things like that. So that's sort of the analysis that was done.

Q Are you familiar with the steps of a basic Ponzi exam? If you were an examiner and there's -- you believed there could be a possible Ponzi exam, the steps that you would take?

A I mean, I've never really reviewed any sort of module or anything.

Q Have you ever been on a Ponzi exam?

A No.

MR. KOTZ: Okay. I think we're done. Just one thing I wanted to --

MS. STEIBER: Quick can we ask a couple of questions?

MR. KOTZ: Oh, okay.

MS. STEIBER: This one --

MR. KOTZ: Sure.

BY MS. STEIBER:

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Q Anything else like that?

A Not that I'm aware of.

BY MR. WILSON:

Law Enforcement



MR. KOTZ: Okay, I just want to ask and caution you if you could not discuss this testimony with anyone to preserve the integrity of the investigation.

THE WITNESS: Yes.

MR. KOTZ: Otherwise, thank you very much for your time. We're off the record.

(Whereupon, at 4:20 p.m. the examination was concluded.)

\* \* \* \* \*