
From: Walker, Genevieve
Sent: Wednesday, February 04, 2004 2:03 PM
To: Donohue, Mark J.; Wood, Jacqueline
Subject: RE: Food for Thought re Madoff as an Investment Adviser

Per Sec 203(b)1

Madoff needn't register as an IA as long as "...during the course of the preceding 12 months [he] has had fewer than 15 clients and who neither holds himself out generally to the public as an investment adviser nor acts as an investment adviser to any investment company..."

As we know, Madoff disclaims himself to be an investment adviser. Also, although 16 customers-2003, 14 customers-2002 and 13 customers-2001 were identified by Madoff, we asked for all institutional customers, so, unless all of these clients are hedge funds, which I don't think is the case, i.e. "Sway Pension Fund", Madoff probably falls below the 15 client threshold. Nevertheless, we don't know the classification of all clients, when these entities became clients and when clients were dropped/added...we could verify the nature and duration of the customer relationships via their prime brokerage agreements with Madoff, if we felt that that was necessary. However, I'm sure he is well aware of the 15 client limitation on the exemption from registration..

-----Original Message-----

From: Donohue, Mark J.
Sent: Wednesday, February 04, 2004 1:38 PM
To: Walker, Genevieve; Wood, Jacqueline
Subject: RE: Food for Thought re Madoff as an Investment Adviser

I just read something that suggested that we (SEC) is considering whether or not to require hedge-fund mgrs to register as investment advisors. This may have already been published as a proposed rule or it may still be in the drafting stage.

-----Original Message-----

From: Walker, Genevieve
Sent: Wednesday, February 04, 2004 1:29 PM
To: Donohue, Mark J.; Wood, Jacqueline
Subject: Food for Thought re Madoff as an Investment Adviser

Food for Thought re: Madoff and his status as an adviser pursuant to the IA Act

Sec. 202 [80b-2] (a) (11)

"Investment adviser" means any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities; but does not include (A) a bank, or any bank holding

DIVISION
EXHIBIT

14

company as defined in the Bank Holding Company Act of 1956 (12 U.S.C. 1841 et seq.) which is not an investment company, except that the term "investment adviser" includes any bank or bank holding company to the extent that such bank or bank holding company serves or acts as an investment adviser to a registered investment company, but if, in the case of a bank, such services or actions are performed through a separately identifiable department or division, the department or division, and not the bank itself, shall be deemed to be the investment adviser; **(B)** any lawyer, accountant, engineer, or teacher whose performance of such services is solely incidental to the practice of his profession; **(C)** any broker or dealer whose performance of such services is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefore; **(D)** the publisher of any bona fide newspaper, news magazine or business or financial publication of general and regular circulation; **(E)** any person whose advice, analyses or reports relate to no securities other than securities which are direct obligations of or obligations guaranteed as to principal or interest by the United States, or securities issued or guaranteed by corporations in which the United States has a direct or indirect interest which shall have been designated by the Secretary of the Treasury, pursuant to section 3(a)(12) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(12)), as exempted securities for the purposes of that Act (15 U.S.C. 78a et seq.); or **(F)** such other persons not within the intent of this paragraph, as the Commission may designate by rules and regulations or order.

Bernie Madoff claims that he neither manages nor advises hedge funds. However, pursuant to the Investment Advisers Act, he may fall under the definition of investment adviser. Madoff's trading, on behalf of his hedge fund clients, is composed of two parts, the trading and the strategy.

According to the above-referenced definition, although the trading may not be considered advice, the strategy could be considered either advice or analyses of securities constituting advice, if it involves more than just executing the split-strike forward conversion stock and option combinations pursuant to the hedge fund's instructions. For example, Madoff stated in his response to our request that he executes trades according to client-defined conditions. Madoff has described these conditions in his response, however, it would be important to know *who* defines these conditions and is his description complete regarding the conditions. (NOTE: Does "client defined" mean that the fund specifies all of the conditions or does it mean that conditions for trading on behalf of clients, using the split-strike conversion strategy, are further specified, by client. I would think that any advice provided by Madoff, in addition to the split-strike forward conversion strategy, would constitute advice and/or analyses of securities under the definition of an investment adviser, especially if he considers that information to be proprietary in nature. Additionally, the fact that Madoff may have discretionary trading authority on behalf of the fund accounts may help to further determine whether or not he is acting as an adviser to the hedge funds. Lastly, if Madoff is in fact acting as an adviser, he may be receiving compensation for his services in the form of "commission equivalent revenue", if we can show that the revenue includes something in addition to commissions for the actual trades.

Furthermore, the definition of an investment adviser excludes Madoff's activities if he is performing services for the hedge fund clients, via Madoff Securities, that are solely incidental to Madoff's brokerage function and he is not receiving special compensation. Therefore, even if Madoff can prove that his trading on behalf of the hedge funds is solely incidental to Madoff's brokerage function, if he is receiving special compensation, pursuant to his receipt of "commission equivalent revenue", Madoff's activities would not fall under the exception for broker-dealer services. (This is assuming that we can show that the "commission equivalent revenue" is not solely attributable commissions for the actual trading effected on behalf of the hedge funds.)