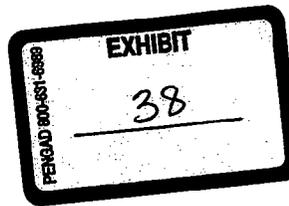


RE: Madoff

From: Bachenheimer, Doria G.
 To: Suh, Simona Personal Privacy

8/3/2006 8:50:00 AM



The outline is excellent - thanks!

From: Suh, Simona
 Sent: Wednesday, August 02, 2006 4:16 PM
 To: Bachenheimer, Doria G.
 Cc: Cheung, Meaghan S.
 Subject: FW: Madoff

Attached are the documents that I have forwarded to IM in preparation for our discussions (an outline of possible arguments on why the Madoff firm is an investment adviser, as well as the trading authorizations relevant to these arguments), and below is a brief summary of the facts that I have sent to IM.

<< File: BLM as IA - Outline.doc >> << File: NY-7563 Ex. 7.pdf >> << File: NY-7563 Ex. 8.pdf >> << File: BLM individual acct trading authorizations.pdf >>

Madoff - Facts

In Certain Hedge Fund Trading Practices, NY-7563-A, we are looking into the activities of Bernard L. Madoff Investment Securities LLC (□BLM□), a registered broker-dealer based in New York. BLM has three areas of business: market making, proprietary trading, and institutional trading, which is the focus of our investigation. In BLM's institutional trading business, the customers, predominantly large hedge funds, open brokerage accounts at BLM and give BLM and its principal, Bernard Madoff (□Madoff□), trading authority over the accounts. The limitations on that authority are set forth in two key documents, a Trading Authorization Directive and Terms and Conditions for Option Hedging Transactions (collectively, □trading authorizations□). The trading authorizations are drafted by BLM, without any input from the customers; BLM simply presents these documents to the customers who accept them without any adjustments or negotiation. BLM trades the assets in the customer accounts pursuant to its proprietary trading strategy, which is a form of split strike forward conversion. The strategy has three aspects: (1) a proprietary BLM computer program that creates and monitors potential baskets of equities (Model MA 2.06); (2) Madoff's market timing judgment; (3) a hedge consisting of a collar of S&P100 index options. The computer program constantly searches for baskets of about 50 equities from the S&P 100 index whose performance would strongly correlate to the performance of the index as a whole. Once a potential basket is available, Madoff, based on his own judgment of market conditions, decides whether to □execute the strategy□, i.e., whether to purchase the basket and to put in place the corresponding hedge. If Madoff decides to execute the strategy, then BLM purchases the basket of equities and also purchases and sells the options for the hedge. The positions then remain unchanged until the earlier of two events: (1) a signal from Model MA 2.06 that the correlation between the performance of the basket and the entire index is no longer sufficient; (2) Madoff's decision that it is time to sell. Once the positions are sold, customer assets remain invested in cash until the next time that Madoff decides to execute the strategy. The customers take no part in any of the trading decisions and only learn of the trades that occurred in their accounts after the fact, when BLM sends them trade confirmations and account statements.

We initially began looking at BLM's institutional trading business because of suggestions in the press that the returns reported by BLM's customers were too good to be true and that BLM could be engaging in some improper conduct, such as front-running or false reporting of returns. So far, we have not found evidence of any such wrongdoing. It does appear to us, however, that BLM's institutional trading business is actually investment advisory business and that BLM should be registered with the Commission as an investment adviser.

Madoff insists that BLM is not an investment adviser because: (1) BLM does not charge any performance- or asset-based fees, but only charges a □commission equivalent□ of 4 cents per share on equity trades and a commission of \$1 per contract on option trades; (2) BLM's investment discretion is limited by the terms of the trading authorizations.

Recently, we learned that BLM's institutional trading business also includes five non-institutional accounts. The only difference between these accounts and the institutional accounts is that the trading authorizations for the non-institutional accounts allow the customers to reject transactions after the receipt of the confirmations.

