

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

COPY

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

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DATE: Wednesday, April 1, 2009

The above-entitled matter came on for hearing, pursuant to notice, at 10:30 a.m.

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1 APPEARANCES:

2

3 On behalf of the Securities and Exchange Commission:

4 H. DAVID KOTZ, INSPECTOR GENERAL

5 DAVID B. WITHERSPOON, ESQ.

6 JAMES D. FIELDER, ESQ.

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13 On behalf of the Witness:

14 MICHAEL GARRITY, PRO SE

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P R O C E E D I N G S

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2 MR. KOTZ: We are on the record at 10:30 a.m. on
3 April 1, 2009, at the United States Securities and Exchange
4 Commission. I have with me my colleagues David Witherspoon
5 and David Fielder.

6 Whereupon,

7 MICHAEL GARRITY

8 was called as a witness and, having been first duly sworn,
9 was examined and testified as follows:

EXAMINATION

10
11 BY MR. KOTZ:

12 Q The oath has been given and so I would ask you to
13 state and spell your full name for the record, please.

14 A Sure. Michael, M-i-c-h-a-e-l; Emmett, E-m-m-e-t-t;
15 Garrity, G-a-r-r-i-t-y.

16 Q As you know, my name is David Kotz. I'm the
17 inspector general of the United States Securities and
18 Exchange Commission. This is an investigation by the Office
19 of Inspector General, Case Number OIG, all caps, dash, 509.
20 I'm going to ask you certain questions. You'll have to
21 provide answers under oath. The court reporter will record
22 and later transcribe everything that is said.

23 Please provide verbal answers to the questions, as
24 a nod of the head or some other nonverbal response won't be
25 able to be picked up by the court reporter. Also, so the

1 aware of that prior to Harry bringing up Madoff?

2 A Yes, that's correct.

3 Q Okay. All right. And so what do you recall about
4 when Harry talked about Madoff?

5 A You know, the -- first of all, how I found out
6 about it, I think I received -- Harry described -- I saw his
7 written testimony and he described Ed Manion facilitating a
8 meeting between us, and I don't know what else was going on
9 but I know that I found out about Harry's additional
10 information from David Bergers. Harry was -- Harry had
11 information he wanted to pass along. It wasn't a direct call
12 to me initially because David -- David got me involved in the
13 mix, and this is before -- this is when I was still reporting
14 to Ricciardi.

15 So it could have even been Walter but my memory is
16 it was David, and he said, Harry wants to come in and talk,
17 something to that effect.

18 Q And what time period was that, do you think?

19 A Late October, mid to late October of 2005.

20 Q Late October of 2005. And so did you then speak
21 with Harry?

22 A We did. We ended up -- I set up the logistics for
23 the meeting, and it was a meeting -- it wasn't just me. It
24 was Andy Caverly, who's now an assistant director in the
25 broker-dealer group, and at the time I think he was a branch

1 chief but I don't remember what his title was at the time,
2 and John Dugan, who is now the associate for enforcement. I
3 don't remember if he was -- he probably wasn't the associate
4 then. He was probably in enforcement.

5 So anyhow, the three of us met with Harry in late
6 October.

7 Q Okay. And you know, we'll show you some e-mails
8 about that.

9 A Okay.

10 Q But before --

11 A That will help. Frankly, that will help.

12 Q Before that meeting, given that, you know, you were
13 aware of Harry, what was your sense of Harry's level of
14 expertise in terms of financial issues?

15 A I thought he was knowledgeable about financial
16 issues and I liked talking to him. There was -- that's the
17 question you asked. That's the one I'll answer.

18 Q Why do you say you liked talking to him?

19 A I just enjoyed the conversation. I enjoyed talking
20 about the business. I -- I have -- he's not such a
21 conventional guy and so when you're -- had an organization
22 like this, you tend to be surrounded by -- there's a certain
23 conventionality to the organization. So I try to maintain
24 contacts in the industry that are different so I think
25 creatively, so I hear more buzz.

1 And Harry is -- you know, Harry also just liked to
2 talk the business and so do I.

3 Q And -- but he was knowledgeable about the business?

4 A Yeah. He was knowledgeable about aspects of the
5 business. He wasn't -- if I asked Harry about, you know,
6 transactions, you know, among money managers or sales
7 practice, he wouldn't be onto that but --

8 Q So what aspects of the business was he
9 knowledgeable about?

10 A The investment side. He knows the investment side,
11 who was doing what, what portfolio managers were going where.
12 You know, he was tuned in. He liked that stuff. He cared
13 about it.

14 Q And so did you have any assessment of his
15 credibility based on -- before you started talking to him
16 based on what you heard about him having provided information
17 previously to the SEC, particularly the State Street case?

18 A Could you --

19 Q Sure. Did you have any assessment of his
20 credibility prior to meeting with him? I mean, you said
21 that --

22 A You mean from the telephone conversations at State
23 Street?

24 Q Yeah.

25 A Yes. I had some assessments of his credibility and

1 it all evolved, but yes.

2 Q What were those assessments?

3 A My assessments were that he was factually
4 knowledgeable but I was concerned about the -- I came to
5 understand that he'd become a bounty hunter, and I was
6 concerned about the bias that that would bring to anybody who
7 came to us with information. I knew if I had a case and I
8 brought it and we actually had to litigate it, that would
9 make for a great cross. So you've got this bounty hunter
10 here, you've taken a step, you've driven it, that would just
11 make for a great cross, you can just imagine.

12 So I was -- you always want to try to figure out
13 the biases of your -- of the people who are talking to you
14 and so that was -- that was sort of a counterbalance to
15 Harry's knowledge.

16 Q Okay. But if -- let me try to understand this. If
17 somebody is providing information to the SEC, right, and that
18 information then leads the SEC to follow up, what would be
19 the difference of who's providing the information? Wouldn't
20 it be the information that would be important, not the
21 individual who's providing it?

22 A I just want to step back in your question a little
23 bit. We were about to conduct an exam on market timing
24 issues at SSGA even if Harry hadn't come to us. So one of the
25 questions you asked me was whether or not Harry contributed

1 to what happened. He did, but we -- SSGA had responded to a
2 letter that Lori Richards had sent and Steve Cutler had sent
3 in September, and so we were about to initiate an exam there.
4 So that was going to happen, you know.

5 And so whether -- if Harry had been a nonfactor, we
6 would have gotten the market timing at State Street, I
7 believe. So I just want to be clear about that piece of it.

8 Q But I guess what I'm trying to understand is if
9 there's information that's brought to the attention of the
10 SEC, right, and that information then, you could -- the SEC
11 could check out, whether through an exam or through an
12 enforcement investigation, what would -- how would -- why
13 would it matter who brought the information? Isn't it a
14 question of whether the information checks out or not?

15 A It is a question of whether the information checks
16 out or not, but information is always subject to multiple
17 interpretations and you're trying to be efficient about how
18 you investigate. So you're trying to understand how credible
19 the person is that you're talking to in terms of their
20 analysis of the information so it helps you in terms of how
21 you staff an exam, how you do a lot of other things.

22 Q So did the fact that Harry's information previously
23 had helped in the State Street matter, did that provide a
24 little more credibility --

25 A Yes.

1 Q -- to Harry when he provided his Madoff
2 allegations?

3 A Yes. Also my conversations with Harry.

4 Q Explain that to me.

5 A I just felt Harry was knowledgeable. He had gotten
6 into the bounty -- he had moved away from running money and
7 he was doing the bounty hunter business. So I came to know
8 him a little bit more, and the more I talked with him, the
9 more I thought he was, you know, knowledgeable and so it
10 increased his credibility overall. There were still bias
11 issues that I was concerned about but, you know, the more I
12 worked with him, the more credible he was.

13 Q And did Personal Privacy ever, or the other folks who
14 had dealt with him, Personal Privacy, did they ever say anything
15 about his credibility that you can recall? Did they give you
16 their opinions of his credibility?

17 A If they did, I don't remember. They may -- you
18 know, there's so many casual conversations, they may well
19 have but --

20 Q Okay. I'm going to show you some documents. Why
21 don't we start with Exhibit 1. We're going to mark this
22 document as Exhibit 1, and it is an e-mail from you to Personal Privacy
23 Personal Privacy dated Friday, October 21, 2005.

24 (SEC Exhibit No. 1 was marked for
25 identification.)

1 BY MR. KOTZ:

2 Q Okay. You had mentioned that it was late October
3 2005, and this is October 21, 2005. So obviously you have a
4 good memory. I wonder if you could just read this and then,
5 you know, see if that refreshes or clarifies your
6 recollection. Did Harry contact you or how did it initially
7 work, that you recall?

8 A It looks to me -- it looks to me like Bergers
9 reached out for me and tried to get me to connect with Harry.
10 I bet -- I bet Bergers reached out to me orally because
11 that's -- but I can't -- I don't remember but what I don't
12 clearly remember was, like, Ed Manion facilitating this. I
13 just --

14 Q You don't remember having lunch with Harry at one
15 point?

16 A Never. I've never had lunch with Harry.

17 Q And so you say to Personal Privacy was your boss at the
18 time, right?

19 A She was not.

20 Q Okay. So what was --

21 A My boss at the time would have been Walter or I was
22 reporting to Walter.

23 Q So why would you be communicating with Personal Privacy?

24 A Personal Privacy had become the associate director of the -- of
25 the regulation unit. I continued to report to Walter but she

1 was not sort of in my direct line but she was superior to me.
2 So I'm sure I was looping her in to give her some sense of
3 what was going on on our side just to try and keep her
4 apprised.

5 Q And it says, "I thought I would try you first
6 before winding in others." Was that, do you think, to let
7 her know or to have her involved in a meeting with Harry or
8 discussions with Harry?

9 A Could have been. I could have been giving her the
10 option to -- yeah. I'm probably giving her a heads up, you
11 know, do you want me to -- how do you want me to proceed type
12 of thing? Do you want me to -- is there somebody you want me
13 to get involved? Is there -- is there some way you want me
14 to proceed?

15 It was -- I was probably just trying to get some
16 feedback if there was a way she wanted me to go forward.

17 Q All right. Let me show you another document just
18 so you have the full record here.

19 The second document, which we're going to mark as
20 Exhibit 2, is an e-mail from you to John Dugan and David
21 Bergers, Friday, October 21, 2005, at 11:37 a.m. So we'll
22 mark this as Exhibit 2.

23 (SEC Exhibit No. 2 was marked for
24 identification.)

25 BY MR. KOTZ:

1 Q And then I'm going to show you the other e-mails as
2 well so you have kind of the full picture.

3 A Sure.

4 Q The next one we're going to mark as Exhibit 3.

5 This is an e-mail from Personal Privacy to you Monday, October
6 24, 2005.

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

9 MR. KOTZ: And then, finally, we're going to mark
10 as Exhibit 4 an e-mail from John Dugan to Mike Garrity,
11 Monday, October 24, 2005, at 9:20 a.m.

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

14 MR. KOTZ: Actually, we're going to have one more.
15 We're going to mark this as Exhibit 5. It's an e-mail from
16 Andrew Caverly to Mike Garrity, Monday, October 24, 2005, at
17 3:26 p.m. as Exhibit 5.

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

20 BY MR. KOTZ:

21 Q So in kind of looking through these e-mails, the
22 one we had before where you say to Personal Privacy "thought I might try
23 you first before winding in others," you could see --

24 A Did I do that?

25 Q -- she says, "Thanks for the e-mail, Mike."

1 A There you go. Okay.

2 Q Okay. And then the e-mail that's Friday, October
3 21, 2005 --

4 A That's -- which exhibit would that be?

5 Q That's Exhibit 2.

6 A Okay.

7 Q You see, "I'll check in with Personal
Privacy and the others.
8 Since we talked last night, I left a message for Harry that I
9 didn't think Monday or Tuesday would work but would call him
10 back. Let's see if we can do something Tuesday. Harry was
11 unavailable Wednesday through Friday."

12 A Okay.

13 Q Okay. And then you can see Number 4 involves John
14 Dugan where John Dugan says, "I'm available but could you
15 tell me what is it about." You see that you're communicating
16 with John Dugan about --

17 A Yeah.

18 Q Okay. And then the final one, Exhibit 5, involves
19 Andrew Caverly who says, "Mike, I'll be the B-D
20 representative and I'm available at 10 tomorrow."

21 A Okay.

22 Q Okay. So given all of that, what do you recall --
23 it seems like there were a whole bunch of people involved in
24 this meeting with Harry; is that right?

25 A The actual attendance at the meeting was just

1 Caverly, Dugan, and myself, but the knowledge of this meeting
2 was broad-based and my understanding was Walter had knowledge
3 of it too, though it's not reflected in any of this -- these
4 e-mails. But, you know, maybe my memory might be imprecise
5 on that because I remember at some point Walter being
6 involved so --

7 Q Walter Ricciardi?

8 A Yes, that's correct.

9 Q And so why is it that so many people were
10 communicated with about this meeting?

11 A I don't know that I can tell you in particular why.
12 It's -- they're all senior people. It came to me. I was
13 sort of reporting to Ricciardi. Bergers was the number one
14 guy in enforcement and it came to me through him. Lucy was
15 the number one person in regulation.

16 Q Okay.

17 A I don't -- I don't know if I can tell you why.

18 Q Sure. Why was Andrew Caverly invited, do you know?
19 He says, "I'll be the B-D representative."

20 A I -- specifics from the time, I don't recall, but
21 I'm sure what it was was to have -- my background and
22 experience is in investment advisors. Andy's background is
23 in broker-dealers. I'm sure the idea was to have somebody
24 with expertise in both areas to talk to Harry.

25 I don't know -- I don't recall whether I knew what

1 this was about. I think I did not -- Dugan says, "Can you
2 tell me what this is about." I -- I think that there's
3 probably some conversation with Bergers where he said: Harry
4 wants to come in and he's got, you know he's got a tip for
5 us, but I don't think I knew what it was about. But Harry
6 was -- clearly other people in the -- above me thought Harry
7 was credible, and I -- if someone said Harry is coming in to
8 talk about something, then we're all ears because we wanted
9 to hear what Harry had to say.

10 Q So, I mean, the fact that there were a variety of
11 people and senior people involved, when all you knew really
12 was Harry Markopolos wants to come in, demonstrates the
13 credibility of somebody like Harry Markopolos?

14 A Yeah, that's fair to say.

15 Q And so, you know, there might be a lot of people
16 who would have tips or provide complaints, just call up the
17 SEC and say: I want to come in, and you wouldn't necessarily
18 have this kind of meeting set up for them?

19 A That's fair to say, yes.

20 Q I mean, did it -- did it happen that, you know,
21 there were a lot of sort of tips and complaints that came in
22 every so often to the Boston office?

23 A Yes.

24 Q Okay. And so the meeting was in the office here in
25 Boston?

1 A It was but it was not in this office. We were on
2 -- I mean, a different office, 73 Tremont Street.

3 Q And you recall, again, who was at the meeting?

4 A I do clearly. It was Dugan, Caverly, and myself,
5 and it took place in John Dugan's office.

6 Q And did Harry give you a document in that meeting?

7 A He did, probably more than one, I think -- I'm
8 pretty sure more than one.

9 Q Let me show you a document and see if you recall if
10 that was the document or documents that Harry gave.

11 We're going to mark this as Exhibit 6, and this is
12 a multipage document. There's a Bates stamp at the
13 bottom MARK0051 through MARK0070 and it states on the top,
14 "The world's largest hedge fund is a fraud." Would you take
15 a look at this document.

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

18 THE WITNESS: This looks like the document Harry
19 gave me. It's conceivable that it's different in some way,
20 but it resembles the document that was provided to me. I
21 can't swear to you that it's exactly the same one.

22 BY MR. KOTZ:

23 Q And so what do you remember about -- let me start
24 back. How long did the meeting last, do you think?

25 A I don't know. I don't know. Did it last -- but I

1 can -- let's put some ranges on it. Did it last, for
2 example, all morning or all afternoon, it did not, but was it
3 20 minutes, it was not.

4 Q Would you guess maybe a couple hours?

5 A It wasn't three, you know, it wasn't three. I'm
6 not trying to be cute with you.

7 Q Was it more than one?

8 A It was at least one, you know, but I just --

9 Q That's fine. Okay. And what do you recall from
10 the meeting; what did Harry say in the meeting in addition to
11 giving the document?

12 A He -- we talked about a document, I'm going to say
13 presumably it's this document, and he referred to it a lot.
14 And he went through, if you will, a narrative punctuated by
15 questions, you know, explaining what the story was that he
16 had and he was telling us this, and that's -- you know, there
17 was some back and forth among us but it was primarily Harry
18 trying to explain it and we asked questions. I may have
19 asked the most questions.

20 I don't -- I don't recall but I was -- remember
21 being engaged by the story. You know, it was -- I remember
22 being engaged by the story.

23 Q Now, you said you asked a lot of questions. Did
24 you have trouble understanding what Harry was saying?

25 A I did and that is not atypical when I'm talking to

1 Harry. Sometimes he starts out in the middle of things, my
2 experience is, and he also can go -- he starts out in the
3 middle of things and deep in terminology, and I'm not a money
4 manager, and so I have -- but he's patient with me. So I'd
5 say, you got to give me cease by run version here. So I
6 could back him up and we would do it.

7 So I do remember it being -- it was dense for me.

8 Q But when you would ask the questions, would Harry
9 answer them and explain it?

10 A We kept rewinding. You know, we kept rewinding and
11 I would -- I'd come to understand it, not to the same level
12 of detail that Harry did, but I came to -- the allegations as
13 allegations were not tremendously hard to understand. The
14 underpinning factual support of the allegations were more
15 elusive and it took a while to get those.

16 Q But at a certain -- by the end you were able to
17 generally understand the allegations?

18 A Yes. Yes.

19 Q And what about the other people at the meeting,
20 John and Andy, did they ask a lot of questions too?

21 A I don't -- I don't remember specifically. I
22 probably asked more but I -- again, I don't remember.

23 Q Do you know if those two, John and Andy, understood
24 what Harry was saying?

25 A I don't know. I don't know whether -- Dugan --

1 Dugan clearly understood the gist of the allegations because
2 he summarized them aptly. I suspect -- well, you don't want
3 my suspicions so --

4 Q So what was your sense of the allegations? Did you
5 think they were -- they seemed credible to you?

6 A They did. They seemed credible, yes. I never take
7 it the first inning of something coming in, so you never just
8 adopt them, but they seemed credible. They seemed intriguing
9 to me as much as they seemed credible. It was an interesting
10 story and there are aspects of it that troubled me.

11 Q Did you think that it was -- the information that
12 Harry Markopolos was providing was something the SEC should
13 follow up on?

14 A Yes. Yes.

15 Q Is there any doubt that that was information that
16 the SEC should follow up on?

17 A No. Zero. Zero.

18 Q And do you know if that was the view of John Dugan
19 and Andy Caverly as well?

20 A I remember Dugan wrote an e-mail summarizing the
21 meeting, and Walter reacted. It was certainly -- I can't
22 speak to Andy's specific memory but I know that for Dugan, it
23 was something he felt he had a duty to follow up on, and I
24 remember having the same feeling on Walter.

25 Q Ricciardi?

1 A Yeah. Sorry.

2 Q Okay. Let me show you, I think, some notes --

3 A Okay.

4 Q -- that you have. I think they may actually be
5 your notes.

6 A I took notes.

7 Q So that might help.

8 MR. KOTZ: These are several pages of notes. On
9 the bottom it's M00013 through 00022, and we are going to
10 mark this as Exhibit 7.

11 (SEC Exhibit No. 7 was marked for
12 identification.)

13 BY MR. KOTZ:

14 Q Would you take a quick look and --

15 A They're my notes. I can identify them. That's my
16 handwriting for better or for worse.

17 Q And these are notes from that meeting that we've
18 been talking about that took place in late October 2005 you
19 think?

20 A I should look just to make sure. I mean, I've got
21 "Harry" on the top of this thing. Yeah. This is -- yes.
22 This is -- I can -- yes. These are my notes from the
23 meeting.

24 Q These are pretty substantial notes, I mean, several
25 pages of notes?

1 A Yes. And I don't know if I want to characterize
2 them any particular way, but you're right.

3 Q There's several pages of notes?

4 A There are several pages of notes, yes.

5 Q Could you take a quick look through them and just
6 tell me if there's anything in these notes that kind of
7 strike you as maybe more information about what was talked
8 about in the meeting?

9 A Sure. Yes. I can -- I do -- I can remember --

10 Q Well, let me start by asking you a few questions
11 and then you can add to that. On the first page of Exhibit
12 6, which is the document that Harry provided --

13 A Yep.

14 Q -- it says at the bottom, "There are two possible
15 scenarios that involve fraud by Madoff Securities." And if
16 you can see on page 1, it says, "Scenario 1 unlikely," and it
17 describes front running. And then if you look on the next
18 page, MARK0052, it says, "Scenario Number 2 highly likely,
19 Madoff Securities is the world's largest Ponzi scheme."

20 Do you recall Harry mentioning in the meeting that
21 he felt that Madoff was running a Ponzi scheme?

22 A I don't specifically recall it but I'm sure he said
23 it. You know, I'm just confident knowing Harry and his --

24 Q Was that your sense of the gist of what Harry was
25 presenting was this concern that Madoff was running a Ponzi

1 scheme?

2 A I would say that's his primary focus, yep. He
3 allowed for the front running, which intrigued me, but his
4 primary focus was the Ponzi scheme angle, yes.

5 Q And so if you can recall, what discussion was there
6 in the meeting about the possibility that Madoff was running
7 a Ponzi scheme?

8 A The -- he tried to explain how and there was other
9 paper --

10 Q It may be attached to this document.

11 A Ah, yes. Yes. Yes. Yes. And he's got the
12 Barron's story too, yep. I remember after the meeting
13 reading the Barron's story, and I remember the Fairfield -- I
14 spent some time with these documents after the meeting.

15 Q So what do you remember about in terms of what
16 Harry said at the meeting relating to a possible Ponzi scheme
17 on the part of Bernie Madoff?

18 A I remember the -- I remember coming to try and
19 understand -- what I really remember was laboring with split
20 strike conversion and trying to get there, because the gist
21 of his allegations weren't tremendously hard to understand.
22 You know, some -- it's a Ponzi scheme, but he didn't have any
23 Madoff paper and that was -- that was sort of a weakness in
24 the complaint. And without any Madoff paper that would
25 function as some sort of an admission, I was left to try and

1 puzzle out what was Madoff saying because we didn't have
2 Madoff saying anything.

3 So Harry explained what Madoff was saying and then
4 why it wouldn't work. So there was some hoops to jump
5 through, and much of what I remember about the meeting was
6 trying to capture that, because he would -- he told the
7 narrative and then I'd be trying to test it and we got fairly
8 granular on what it was he said Madoff was saying and why it
9 couldn't be so.

10 Q And so do you recall, and if you can look at this
11 document, Exhibit 6, that Harry in that meeting presented a
12 variety of red flags?

13 A I do recall that, yes.

14 Q And what was his point about the red flags?

15 A His point was generally that collectively these are
16 a sign of a problem. I mean, he'd speak for the issue
17 himself more clearly. If Harry were speaking in response to
18 that, he'd say: This was a sign there was a Ponzi scheme,
19 but I viewed it as, you know, these are troubling red flags.

20 Q So in your expertise based on your experience in
21 the securities industry, is it fair to say that when you
22 looked at these same red flags that Harry provided to you,
23 you also found them troubling?

24 A I don't know that each and every red flag troubled
25 me the way it did -- it troubled Harry, but in the aggregate

1 they troubled me and my recollection is a couple of them
2 bugged me more than others.

3 Q Do you remember which ones bugged you more than
4 others?

5 A You know, I don't remember which red flags, I don't
6 even know that it's a red flag, but the thing that bugged me
7 is when I came to understand, in a sort of primitive way, the
8 split strike conversion strategy, I couldn't imagine, and it
9 goes back to what I spent time on after the meeting, this
10 Fairfield document, I couldn't understand how if you were
11 selling calls, how you could have a big upside.

12 And Harry and I spent a fair amount of time during
13 the meeting trying to work through that because it was a new
14 concept for me, but I just -- and so I had to take it on
15 faith that that's -- Madoff was actually saying he was doing
16 because I didn't have any paper to show me that and that was
17 a big hole. That was a big hole.

18 I had to take it all -- Harry is telling me and
19 Harry is telling me that this guy is a competitor of mine.
20 So I have all that hanging out there, but when taken in its
21 purest form, I didn't understand how if you're selling -- if
22 you're giving up your winners, how you could -- how you could
23 do what this guy was doing. And I didn't understand on the
24 Fairfield documents -- after the meeting I didn't understand,
25 on the Fairfield documents, how you can only have a couple

1 months of losers. It highlighted these things.

2 So for me there was -- it was something of a
3 gestalt, right. There was the meeting itself that raised red
4 flags, and then I went back and I read the Barron's story. I
5 don't remember if these came together. I remember looking at
6 this and I remember reading the Barron's story, but as I
7 worked through it all, then I -- I became more troubled than
8 I was -- it was a lot to assimilate at the meeting itself
9 so --

10 Q And what was your sense of -- impression of the
11 Barron's article when you read it?

12 A There was -- the Barron's article was -- first of
13 all, it's a comparatively independent source, and you don't
14 know what the agenda of the reporter is. But as a former
15 reporter, there are certain trade publications I have a lot
16 of respect for and for their editing process.

17 So something from Barron's in their journal about
18 questions arise, and there's stories that have anonymous
19 sources but I tend to think the sources are better at those
20 publications and I'm always watchful to make sure that it
21 isn't the shorts that are talking to the publications because
22 then I reduce the credibility of it.

23 So for me it's important that a Barron's story is
24 important or a journal story or Forbes by Tom Easton or so
25 many other reporters I follow.

1 Q So Barron's was a publication that you thought was
2 credible and a story in that would be credible as a result?

3 A I did think that, yes.

4 Q And -- but so you were saying that one of the
5 things you weren't sure about was whether Madoff was actually
6 saying that he was using this split strike conversion
7 strategy; is that right?

8 A I didn't have primary documents. I remember -- I
9 can't remember if I asked Harry or there wasn't -- there
10 wasn't documents. A lot of times when we get tips, somebody
11 will bring us their statements, you know, and say: I can't
12 get out of it. There was nothing like that.

13 Q But if you had been able to confirm by
14 communicating with Bernie Madoff or his operation that he
15 was, in fact, stating that he was using the split strike
16 conversion strategy, would that have allayed that concern
17 somewhat?

18 A I would have wanted to match it up with claim
19 performance, because as I understand -- and I also would have had
20 to educate myself more about the split strike conversion if I
21 was investigating it, but the claim of split strike
22 conversion in and of itself isn't problematic. It's split
23 strike conversion and the performance.

24 Q Right. But based on the information that Harry
25 provided to you, assuming that Madoff was saying he was using

1 a split strike conversion strategy, that would have troubled
2 you given the information that Harry provided?

3 A Yes. Yeah. Okay. If you link it to the
4 performance in the other document, yes, it would have.

5 BY MR. FIELDER:

6 Q That's a very good point. If I hear you correctly,
7 you're saying based on the meeting, you know, less than three
8 hours, more than an hour perhaps with Harry, you know, you
9 didn't know for sure whether Madoff was claiming that a split
10 strike conversion strategy was responsible for his returns
11 but that you agreed with the predicate of Harry's complaint
12 which is that a split strike conversion strategy cannot
13 generate the kind of reported returns that Madoff had?

14 A I didn't know if they were Madoff's returns. It
15 was another act of faith. It was --

16 Q Right.

17 A -- the Fairfield returns. So, again, it was
18 another -- none of these were fatal but they were things that
19 you can't assume are accurate until you have evidence, you
20 know.

21 Q I'm just trying to get a gist of in your first
22 introduction to split strike conversion strategy and what its
23 limitations were, what it could and couldn't do. Is it fair
24 to say that based on that hour-plus meeting, you did walk
25 away with an understanding that, okay, split strike

1 conversion strategy can't generate 15 percent annual returns
2 for 20 years with three down months, for example?

3 A That's correct. That's definitely my take-away of
4 it.

5 BY MR. KOTZ:

6 Q And so there had to be some other explanation for
7 it, whether it was a Ponzi scheme or something else?

8 A Right. Or front running or who knows what.

9 Q And so what happened then? You said after the
10 meeting, you looked at the documents, immersed yourself a
11 little bit. And what happened then?

12 A You know, I don't know that I can remember all of
13 the details, but what I do remember is going through,
14 spending some time -- Harry had wetted my appetite and I
15 wanted to try and understand it better. So I spent some time
16 looking at the -- working through the Barron's story, looking
17 at the -- at this thing. There was something about this thing
18 that really got me going.

19 He's got some things highlighted here. I can't
20 tell what he's got highlighted, but these months, these may
21 have been -- on this whole grid, these may have been the only
22 losing months. It was just highly improbable, you know,
23 unless you're in a CD, I don't know how you can do this over
24 this period of time. And that -- that's what I remember
25 being -- taking away with, that it was just improbable.

1 Q So after Harry came in, provided information, you
2 kind of did your own assessment of the documents, and you
3 came to the conclusion that this was something that should be
4 investigated; is that fair?

5 A I did. Yes, I did.

6 Q And so -- yeah. Well, let me show you an e-mail.
7 Why don't we start with that. This is an e-mail from Walter
8 Ricciardi dated Wednesday, October 26, 2005, at 9:11 a.m. to
9 John Dugan, David Bergers with a CC to you and Andrew
10 Caverly.

11 Can we mark this as Exhibit 8.

12 (SEC Exhibit No. 8 was marked for
13 identification.)

14 MR. KOTZ: Let me add to that one other document
15 and that is we're going to mark as Exhibit 9. There's an
16 e-mail from Walter Ricciardi, Wednesday, October 26, 2005,
17 9:16 a.m. to Mark Schonfeld with a copy to Bergers, Dugan,
18 Caverly, and you, and that we're going to mark as Exhibit 9.

19 (SEC Exhibit No. 9 was marked for
20 identification.)

21 BY MR. KOTZ:

22 Q If you take a look at Exhibits 8 and 9, you see in
23 Exhibit 9 and, I think, part of it is in Exhibit 8 as well,
24 John Dugan's e-mail on Tuesday, October 25, 2005, at 4:26
25 p.m. and is that the synopsis that you were talking about

1 that John Dugan did?

2 A It is. It is.

3 Q And do you see that there's some discussion back
4 and forth between Walter Ricciardi, John Dugan about what to
5 do with the referral, what to do with the information?

6 A Before we get to that, can I tell you one other
7 thing that I remember from the time and it -- when I see it,
8 it strikes me, Walter's concern about the independent audit,
9 just to give you -- Walter was, for 20 years, general counsel
10 of PWC. He had, you know, sort of significant experience,
11 and Harry must have talked about that at the meeting. I
12 can't stand here and tell you that I remember it, but it's
13 something that would have engaged me, but what I can remember
14 is seeing Walter's e-mail and saying: Oh, my goodness, you
15 know, you've already got all these factors and then you've
16 got the brother-in-law.

17 I didn't know for sure whether it was right that it
18 was the brother-in-law, but you've got the independent audit
19 performed by a relative, and Walter seized on that. So that
20 resonated with me because I hold Walter in high regard, and I
21 knew he had seen tons of accounting cases.

22 Q And so why -- why would the auditor's lack of
23 independence along with the other red flags that Harry raised
24 be a concern?

25 A It's -- the -- as an examiner, you -- when you look

1 at a firm, you look for as many independent sources of
2 information and verification as you can find. And part of
3 what you do when you try to assess the risk of a firm is take
4 a look at, well, are consultants coming in and conducting due
5 diligence exams? Is anybody performing a SAS 70 on this
6 firm? Are there independent auditors? Who are the
7 independent auditors?

8 And so the absence of an independent auditor
9 strikes at the reliability of what the firm is reporting.

10 So --

11 Q Would you -- is it fair to say that that would be a
12 major red flag?

13 A It -- it was for these facts. There are times when
14 you can go into a place and there isn't an auditor --

15 Q Okay. But for these facts it was?

16 A For these facts, yes, it was. It was a significant
17 issue for me.

18 Q And so then there was discussion about what to do
19 with it. Do you remember that?

20 A I do. I do -- I remember these e-mail exchanges,
21 yes.

22 Q So what was the discussion about?

23 A I don't know that I would have been involved in any
24 oral discussions. So it's possible that there was another
25 tier, because now I become -- I'm sort of a doer in this mix

1 and now it's more jurisdictional. So I don't remember any
2 oral discussions on this, but what I do remember is where
3 does it belong. I'll take -- can I go back? I can remember
4 discussions with Dugan after Harry left, Andy, Dugan, and I
5 talking, and Andy talking about -- and Dugan saying words to
6 the effect that it ought to go to New York. That's where it
7 is. They've recently done an exam of this place.

8 So, you know, John was assessing it in terms of
9 where it made sense jurisdictionally.

10 Q And was there any talk about keeping this case in
11 Boston?

12 A If there was, I wasn't a party to it. If there
13 was, I don't remember.

14 Q Was this a case you would have wanted to pursue
15 yourself if it had been kept in Boston?

16 A Yes.

17 Q Why was that?

18 A It was just intriguing. You know, it was just --
19 it was fundamentally interesting. It's, you know, the kind
20 of thing I get excited about.

21 Q Okay. And was it your understanding that the
22 reason it was referred to New York was because of
23 geographical proximity?

24 A Efficiency. It's important to us institutionally.
25 There recently had been an exam of Madoff, and to not

1 leverage the knowledge from that made no sense. So I
2 supported the idea of referring it there.

3 Q Okay. And it was eventually referred there. Do
4 you remember that?

5 A I do. I think -- does it say here, did Walter send
6 it to -- it talks here about sending it to Schonfeld.

7 Q Yeah. And you can see on Exhibit --

8 A On 8, I'm looking at 8.

9 Q -- 9.

10 A Oh, 9. Here we go. Yeah. How can it -- there's
11 nothing more significant than the head of one office sending
12 a referral to the head of another office saying it raises
13 some significant concerns.

14 Q Right. So explain that to me. Why would it be
15 different that it would be Walter sending it to Mark
16 Schonfeld than just someone else?

17 A In the ordinary course when you're dealing with
18 tips, there may be -- I can only talk about my own
19 experience. I don't know what the global experience is, but
20 if a tip gets referred, you wouldn't refer it to the head of
21 the office. It's just too operational. You'd send it to the
22 -- to the associate or if you knew an assistant that had done
23 the last exam, you would send it to that assistant. You'd
24 look for a link below the person in charge because it would
25 -- it would -- the person in charge would say: I'm just

1 going to pass it down anyhow.

2 Q So would you say it was rare that there would be a
3 complaint like this that was sent directly to the head of the
4 New York office?

5 A In my experience, I don't have a panorama view of
6 the thing, but in my experience yes.

7 Q Had you ever seen a case like this at another time
8 in your experience?

9 A No, not that I recall, but if I -- this is rare for
10 sure.

11 Q And would it be sent from the head of the Boston
12 office to the head of the New York office as a way to bring
13 to New York's attention that this is a matter that Boston
14 office thought should be taken seriously?

15 A Yeah -- yes, definitely. But here's -- I mean,
16 here's Ricciardi's own words, "Let's try to make sure that
17 Neil recognizes the potential urgency of the situation."

18 Q And so was it fair to say that the urgency that --
19 the view that the situation had some urgency, that was shared
20 by you as well or is that just Walter?

21 A I felt that there was an urgency to conduct an exam
22 or conduct an investigation.

23 Q Okay. Do you think that that was the view of the
24 others as well, Dugan and Caverly?

25 A I believe it to be. I think Dugan's e-mail sort of

1 other types of complaints and tips come in?

2 A I have.

3 Q Was it rare for information to be brought to your
4 attention in the form of a tip or a complaint as detailed as
5 the information that Harry brought?

6 A No, but can I -- can I describe for you?

7 Q Yes.

8 A The -- we can get a tip that's very detailed but it
9 only has to do with Personal Privacy who hasn't gotten
10 her statements and so we can get a lot of detail from Personal Privacy.
11 She'll give us a year's worth of statements. And so in
12 that -- in the four corners of that, it will be pretty
13 detailed. What is unusual is to have something of this
14 breadth this detailed. That is rare.

15 Q How many other times have you seen, in your time, a
16 complaint come in of this breadth and this detail --

17 A Never.

18 Q -- that Harry Markopolos --

19 A Never. I'm sorry to cut you off. Never.

20 Q Now, Walter Ricciardi stated that he felt if the
21 matter had been left in Boston and you had been involved in
22 it, you would have uncovered the Ponzi scheme. What do you
23 think of that? Is Walter Ricciardi telling the truth?

24 A Is that not my mom saying that?

25 Q This is no time for false modesty. I want to know

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

In the Matter of:)

) File No. OIG-509

OIG-509)

 ORIGINAL

WITNESS: Number 19

PAGES: 86 through 102

PLACE: Securities and Exchange Commission

33 Arch Street

Boston, Massachusetts

DATE: Thursday, April 2, 2009

The above-entitled matter came on for hearing, pursuant to notice, at 2:30 p.m.

Diversified Reporting Services, Inc.

(202) 467-9200

1 APPEARANCES:

2

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1 questions. But to the extent you disagree, please feel free
2 to.

3 A Right.

4 Q I want your assessment, not mine.

5 If someone is, like in this Madoff situation, where
6 fundamentally the allegations boil down to a Ponzi scheme,
7 which in a specific situation would mean that he's taking
8 money that he's telling people that he's investing and
9 actually not investing it and just redeeming people out when
10 they need to be redeemed out with some of the principal that
11 he's raised, or even if, sort of the lesser of the offenses,
12 the front running allegation is what he's involved in, is it
13 your sense that if someone was involved in either of those
14 two activities there, you have to expect that they would be
15 willing to falsify documents if they had the opportunity to
16 do so and cover their trail?

17 A Yes.

18 Q Okay. With respect to the Ponzi scheme allegations
19 that Mr. Markopolos was making in this case, I think you
20 probably know from either at the time or sources now that Mr.
21 Madoff was a significant market maker in a lot of equities
22 and that he also self-cleared.

23 A Yes, I know that now. I didn't at the time.

24 Q You know that now.

25 A Yes.

1 Q What I want to ask you is how you would address
2 probing the allegations that Mr. Markopolos made in light of
3 those two facts. And let's first start with the Ponzi scheme
4 scenario.

5 A Yes.

6 Q If he's not executing any trades at all for the
7 money that he's managing, purportedly managing, but is
8 executing trades in the broker/dealers market maker function,
9 et cetera --

10 A Yes.

11 Q -- he's self-clearing, so there's no clearing
12 broker you can go to, what would be one of your first
13 fundamental steps to take to go about confirming that he
14 actually is executing trades on behalf of the money that he's
15 managing?

16 A My goal would be to keep working my way back
17 through the food chain to get to an independent source that
18 could verify the existence of the assets. So that would be
19 my objective. So I would -- presumably the next step up the
20 food chain would be Depository Trust Company and its entity.
21 And so I would try to reach up there and confirm the
22 existence of the assets at that level. And that can be --
23 that can be a very time-consuming process or not, but that's
24 what I'd be trying to do.

25 Q And that's what triggered my wanting to come back

1 and pursue this with you. Just to remind you, you mentioned
2 yesterday in response to, I think, a question from Mr. Gotz
3 that it could be time-consuming to go through the DTC
4 records. But -- and I've never seen DTC records and what you
5 get from DTC records before. I've only personally done
6 investigations where there was an independent clearing
7 broker, and that's where I got the data. So part of my
8 questioning today is just to try to gain from your experience
9 what you see when you get data from DTC.

10 And you said it was a time-consuming process, but
11 if I recall, and the record will speak for itself, I think
12 that question was in the context of going through records of
13 trades that actually had been made and then trying to match
14 those trades to trade tickets that Mr. Madoff was supplying,
15 correct?

16 A Yes.

17 Q Okay.

18 A But I need to correct you, because I don't want you
19 to think I have more experience than I do. I've never had an
20 exam where I had to reach all the way up to DTC myself.

21 Q Okay.

22 A I've had to go up the food chain. That's just
23 another step I would take if I couldn't reconcile.

24 Q Okay. Is the reason you've never had an occasion
25 to go to DTC is that you've never done an exam of a self-

1 clearing broker?

2 A I think the reason I haven't had to do it is
3 because I was always able to reconcile the existence of
4 assets.

5 Q Okay.

6 A Rather than the self-clearing broker angle. I just
7 have always been able to confirm to a high level of comfort
8 that the assets that an adviser says it has, it has.

9 Q Okay. Confirmed through independent sources?

10 A Yes, up the food chain enough to get to an
11 independent entity.

12 Q Fair enough. Okay.

13 If it turned out to be the case that with respect
14 to the money that he was purportedly managing for hedge
15 funds, he was executing no trades, how easy or difficult do
16 you think it would have been to ascertain that fact from the
17 DTC records?

18 A I think if there was no trades at all, I think it
19 would be fairly self-evident. Presumably there'd be an
20 account for the broker/dealer as broker/dealer, and you'd
21 request -- my understanding was he was running a separate or
22 purported money management business, and there should be a
23 separate account, and that would be in the name for the
24 benefit of the clients of the firm. And the absence of the
25 existence of an account would cause me worry immediately,

1 done.

2 A Right.

3 Q But if you go and you see that there's only one
4 account and it's got, you know, beaucoups of trades, and
5 two-part question: One, if it turns out that he's
6 represented to you that he does have two accounts at DTC or
7 that he has a separate money management account, and it turns
8 out not to be the case, would that concern you or be a red
9 flag?

10 A Clearly. Clearly. Because that's a very
11 fundamental misrepresentation, and it would concern me
12 greatly, and I'd move pretty quickly.

13 Q Okay. If you find out that he's just got one
14 account and there's a large volume of trades in there, and
15 you go back to him and you say, "How can this be? Where is
16 the account that has the trades for the money management part
17 of your business?"

18 And he says, "Well, I just -- I never set up two
19 accounts; I just commingle them."

20 What would be your concern about that response,
21 independent of the fact that he might have earlier
22 misrepresented the facts to you?

23 A Trying to divine out what accounts are for the
24 broker/dealer and the money manager would be -- would be
25 opaque, and I'd also have -- there's a couple of other

1 concerns I'd have.

2 One is if it was an account in the name of the
3 broker/dealer, my fear would be somehow the broker/dealer
4 itself would become involved in litigation or some other
5 action, someone could reach and apply and in effect attach
6 that account where the beneficial interest was really held
7 for the money management clients, and it would look like the
8 firm's account, especially for a market maker. So I would be
9 afraid that the money management clients, even if all their
10 money was in there, was at risk.

11 Q Okay.

12 A Because it could get effectively attached. And
13 that's why you segregate accounts, and that's why it's for
14 the benefit of the clients rather than for the firm. So it
15 insulates them from litigation. So that would be my first
16 concern.

17 My second concern would be about the accuracy of
18 it, that money was getting siphoned off or, at a minimum,
19 there's a greater chance for negligence in the accounting of
20 who owns what, what does Harry, Fred, and Jane own as part of
21 that account.

22 Q If the assets were commingled in that manner, would
23 that be -- and this is not a rhetorical question -- would
24 that be a violation of any kind of regulatory requirement for
25 broker/dealers that you know of?

1 A I don't know about the broker/dealer regulator
2 requirement, but it would be for investment advisers, if it
3 was commingled like that, yes, it would be a problem for the
4 custody role.

5 Q Okay.

6 A I also -- my understanding is that broker/dealers
7 have to report periodically under Exchange Act rules; they
8 have to verify with the next custodian in line their assets,
9 I think on a quarterly basis, which should be another easy
10 way to match up whether what they say their broker/dealer
11 assets are with whether or not there's additional in that
12 account --

13 Q Okay.

14 A -- to represent the money management clients.

15 Q Okay. That's been helpful. So there'd be a whole
16 lot of reasons why that would be troubling and concerning, et
17 cetera. But let's say hypothetically you're either not
18 concerned about that or you run those all to ground and
19 you've got a situation where he's created this commingling
20 and that creates, again, all the problems that you've stated,
21 but he's not running a Ponzi scheme; the money that he's
22 managing really is there, and a subset of the trades that the
23 DTC has for that account are executed on behalf of the money
24 management business.

25 A Okay.