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1 P R O C E E D I N G S

2 COURT REPORTER: We are on the record at 10:04 a.m.
3 on April 17, 2009, the United States Securities and Exchange
4 Commission. I'm going to swear you in now. Would you please
5 raise your right hand?

6 Whereupon,

7 Whereupon,

8 LORI ANN RICHARDS

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

11 MR. KOTZ: Could you state and spell your full name
12 for the record?

13 THE WITNESS: Lori Ann Richard; L-o-r-i A-n-n
14 R-i-c-h-a-r-d-s.

15 MR. KOTZ: Okay. My name is David Kotz. I'm the
16 Inspector General of the United States Securities and
17 Exchange Commission.

18 This is an investigation by the Office of Inspector
19 General, case number OIG-509. I have with me my colleagues
20 Heidi Steiber and Chris Wilson. And you have your counsel
21 Mr. Taylor.

22 MR. TAYLOR: William Taylor.

23 MR. KOTZ: William Taylor. I'm going to ask you
24 certain questions; you're going to provide answers under
25 oath. Court reporter will record and later transcribe

1 everything that is said. Please provide verbal answers to
2 the questions, a not of the head or another non-verbal
3 response won't be picked up by the court reporter.

4 Also, so the record will be clear, please let me
5 finish my question before you provide your response and I'll
6 try to let you finish your response before I ask my next
7 question.

8 In addition, it is important that you understand
9 the questions and give accurate answers. If there's anything
10 you don't understand or anything you do not know or are not
11 sure about, please let me know, other wise I will assume that
12 you heard and understood the question. Do you understand
13 those instructions?

14 THE WITNESS: I do.

15 MR. KOTZ: Okay, great. Let me give you the
16 standard perjury language. As you can see, your responses
17 and statements given today are provided after you've sworn an
18 oath and will be taken down verbatim by the court reporter.

19 This is an official U.S. Government law enforcement
20 investigation. Claims asserted in this case are serious
21 ones. It is important that you tell me everything you know
22 about the matter at hand and are completely forthcoming and
23 truthful with me.

24 I'm formally advising you that you're testimony
25 today is subject to the laws of perjury. Providing false or

1 misleading testimony under oath is a very serious offense.
2 If the evidence shows that the testimony you have given is
3 false, we may refer it as appropriate. Do you understand
4 those instructions?

5 THE WITNESS: I do.

6 MR. KOTZ: Okay, great. Okay. So, let's just put
7 into evidence two documents. The first document we're going
8 to mark as Exhibit 1 and that is Voluntary Notice of Rights
9 that -- tell me if it's true you signed this today.

10 THE WITNESS: I did.

11 MR. KOTZ: Okay. That we're going to mark as
12 Exhibit 1. And then as Exhibit 2 is a Confidentiality and
13 Non-Disclosure Agreement signed by William Taylor. Is that
14 right?

15 (SEC Exhibits No. 1 and 2 were marked
16 for identification.)

17 MR. TAYLOR: Yes.

18 EXAMINATION

19 BY MR. KOTZ:

20 Q Okay, great. So, let's get started. Could you
21 describe your education beginning with college?

22 A I graduated with a BA degree from Northern Illinois
23 University, Political Science, in 1982.

24 Q Okay.

25 A I went to American University Washington College of

1 Law and graduated with a JD in 1985.

2 Q Okay. And can you give me your, kind of, general
3 employment after law school?

4 A I started work with the SEC as a staff attorney in,
5 the Division of Enforcement in 1985 in the SEC's Los Angeles
6 office. I became a branch chief and an assistant director
7 and then an associate director in the Los Angeles Regional
8 office, the Enforcement Division of the SEC.

9 I then became executive assistant to Chairman
10 Arthur Levitt and moved back to Washington, D.C. in 1994, I
11 believe.

12 Q Okay.

13 A And in 1995 I became the director of the Office of
14 Compliance, Inspections and Examination, a position I've held
15 since then.

16 Q Okay. And that was your position between the
17 period 2003 and 2005?

18 A Yes.

19 Q Okay. Okay. Tell me, how is an inspection
20 different from an examination, if it is.

21 A It's nomenclature, largely.

22 Q Okay.

23 A Examinations is the -- are the -- it's a term
24 that's used generally to apply to compliance reviews,
25 examinations of broker-dealers, investment advisors,

1 investment companies. The term inspection is historically
2 used to refer to the same type of a review at a
3 self-regulatory organization.

4 Q Okay. So, in terms of the type of review there's
5 no difference?

6 A In terms of the nomenclature -- in terms of
7 the -- the examinations, obviously, are governed by different
8 laws with respect to the entity under review, different staff
9 people. But the -- they're very similar. An examination and
10 an inspection are very similar.

11 Q Are examinations considered more thorough and more
12 involved than inspections?

13 A No.

14 Q Okay. What about -- what is the difference between
15 a cause exam and a routine exam?

16 A A cause examination is conducted when the staff
17 have "cause" to believe there may be a problem or a
18 violation. A cause exam is conducted when the staff learns
19 of information from a press article, for example, a complaint
20 or a tip. Other information comes to our attention that
21 indicates there's a possible problem or violation and the
22 staff will go in and really focus discreetly on that issue.

23 Routine examination, we conduct routine
24 examinations of investment advisors and investment companies
25 on a cycle. And in those examinations we're looking at the

1 firm's compliance with the law in generally a specified
2 number of areas. They're conducted based on the passage of
3 time rather than based on a particular incident or complaint.

4 Q Okay. So, is there a difference in terms of
5 urgency vis-a-vis a cause exam versus a routine exam?

6 A Yes, cause exams take priority in the program. If
7 we learn of something that indicates a violation of the law,
8 in particular if it's an ongoing violation of the law, those
9 take priority.

10 Q Okay. So, the cause exam would be more urgent than
11 a routine exam in terms of --

12 A Yes, in terms of priority. If staff is in the
13 middle of a routine examination and they get information
14 about another firm that indicates a problem, the cause exam
15 has priority.

16 Q Okay. All right, let's talk a little bit about
17 tips and complaints, okay? Are there formal policies and
18 procedures for handling tips and complaints in OC?

19 A I don't know. There may be, I just am not aware of
20 them.

21 Q Okay, okay. Were you aware -- in the period 2003
22 and 2004, do you know if there were formal policies in place
23 about tips and complaints?

24 A I don't know.

25 Q Okay. Do you know how generally tips were handled

1 A I don't recall.

2 Q Okay. But I mean, in -- generally, in OC are they
3 supposed to follow up, are they supposed to document? I mean
4 are there some kind of general guidelines that they're
5 supposed to follow?

6 A I don't know if there are --

7 Q Okay.

8 A -- written guidelines. I can tell you clearly that
9 cause examinations are a priority for us because if we've
10 already received information that indicates a violation, you
11 know, that's information that the staff should follow up on
12 quickly.

13 Q Okay.

14 BY MS. STEIBER:

15 Q You said they're urgent or they're a priority. How
16 long would you expect it to take between the time you receive
17 a tip or complaint and the cause examination begins if the
18 allegations in the complaint are serious?

19 A Well, it depends on the nature of the allegations.
20 It might be that the staff -- this is hypothetically, this is
21 just my opinion -- that the staff would want to do some
22 research before jumping in. We'd want to do a LexisNexis
23 search, look at the firm's filings, look at the firm's
24 examination history, the results of the last exam, maybe
25 communicate with other regulators. But all that said, you

1 know, there's a fair amount of urgency, as I said, around
2 cause exams, so you would expect it to be very quickly that
3 they would --

4 Q Like what would that be, like a month, two months?

5 A No, days, hours, weeks perhaps.

6 BY MR. KOTZ:

7 Q And let's say you get a tip or complaint in and you
8 decide that it is registered, right? So, you can do a cause
9 exam. How would you make the determination for OC to do a
10 cause exam or perhaps to send it to enforcement for an
11 enforcement investigation?

12 A Well, if it's a registered entity, registered with
13 the SEC, and we have exam authority, our preference -- I mean
14 my -- speaking from my personal opinion -- is that an exam is
15 a good way to go because we can obtain documents quickly.
16 For unregistered entities it definitely goes to enforcement,
17 assuming the allegation in the complaint is serious, because
18 we don't have that authority.

19 Q Okay. So, if it's a registered entity you would
20 just assume do an exam rather than send it to enforcement?

21 A Yes, and it -- I mean, it's hypothetical, but if
22 the conduct implicates the federal securities laws and it
23 appears that it's an allegation with respect to the
24 registered entity, yes. But, there -- you know, there are
25 other, you know, there are other criteria. If enforcement

1 had a preexisting enforcement investigation, that's a
2 situation that we wouldn't do an exam, we would ask
3 enforcement If they wanted to include it in their ongoing
4 enforcement investigation.

5 Q Okay. And how would you determine the focus of a
6 cause exam? Let's say you had a complaint came in and it
7 kind of related to a few different issues, how would you
8 determine what to focus on?

9 A if the complaint implicated violations of the
10 federal securities laws and they were serious, yeah, and they
11 seemed to be serious violations, then we would -- I think the
12 expectation would be we'd focus on the most serious
13 allegations in the complaint.

14 Q Okay.

15 A But as well, we would want to be careful and make
16 sure that we were reviewing all possible violations of the
17 law as implicated in the complaint.

18 Q Okay. And how are these decisions to start a cause
19 exam monitored? In other words, let's say a complaint comes
20 in, you're saying that, you know, cause exam should be
21 started very soon, you know, hours, days, weeks. How would
22 that -- how would you ensure -- how would your office ensure
23 that that actually happens and that a cause exam does start
24 right away?

25 A In the regional offices?

1 of completes the exam?

2 A Yes, generally.

3 BY MS. STEIBER:

4 Q Do you expect that all examinations are logged into
5 Starz?

6 A All of them should be.

7 Q Okay. We've had testimony that the Market
8 Oversight Group didn't usually log their exams into the Starz
9 System; would that surprise you?

10 A I'm aware of that. When they -- I'm aware of that.
11 They -- when the office was -- the office, its function was
12 for a long time, examining stock exchanges, the
13 self-regulatory organizations and in those inspections they
14 didn't use Starz. When they then shifted and began to do
15 more broker-dealer exams, I think there was a lack of
16 understanding of the Starz System. So, I think that that
17 would explain why some of their examinations weren't always
18 logged into Starz.

19 Q Has that changed? Do they now log them into the
20 system?

21 A I don't know. I hope so.

22 BY MR. KOTZ:

23 Q Is there a method to kind of track an exam as it's
24 ongoing so that to ensure that if there is a cause exam that
25 was initiated it's worked on continuously and it isn't kind

1 of shelved or put on the back burner?

2 A Examinations in Washington and in the regional
3 offices are supervised.

4 Q Okay.

5 A There is at the first level, a branch chief, at the
6 second level an assistant director, at the third level an
7 associate director, who are responsible for managing all
8 examinations underway at any one time within the program and
9 responsible for making sure that they're conducted
10 appropriately and in a timely way.

11 Q Okay. So, the monitoring takes place on
12 that -- with those individuals?

13 A They're the management officials who are
14 responsible for managing and overseeing the conduct of
15 individual examinations.

16 Q Okay. We had a witness who worked on one of the
17 Madoff exams and he said the following, I wanted your
18 thoughts on it, okay? "Frankly, there was --" and this is
19 the period of time 2003 to 2005 -- "Frankly, there were a lot
20 of projects that would just kind of die off. I mean, you do
21 some initial review, you go up the chain, I think the
22 superiors had determined, "Well, I got other things to worry
23 about." Those other projects just kind of languished. I had
24 a lot of projects like that. We do our fact-finding and say,
25 like, "Okay, what do we do next?" And there was never any

1 further direction. We'd write a memo summarizing whatever
2 we'd thought we'd found. So, that was a pretty common
3 occurrence, I don't know if I ever heard back from them."

4 What is your response to that? Did that happen?
5 Are you aware of that happening kind of in a regular
6 occurrence?

7 A No, I'm not aware of it as a regular occurrence.

8 Q Okay, but from time to time it might have happened?

9 A Without knowing more specifically --

10 Q Okay.

11 A It may be that the management officials in that
12 case didn't place priority on that -- those particular
13 projects that person was speaking about and there were other
14 priority projects in the office at the time. We are
15 constantly prioritizing and triaging given the nature of the
16 inspection responsibilities, so it's possible that person was
17 speaking about a project that wasn't considered to have
18 priority at that point in time.

19 Q Okay. How would -- if a complaint came in about a
20 particular company, how would they be able to tell whether
21 there was another part of OC also doing an exam about that
22 same company at the same time? Is there a mechanism in place
23 for that?

24 A The Starz System. They would log into the Starz
25 System and identify past examination history. First they

1 would identify whether it was a registered entity and then
2 identify past examination history. In addition, there's a
3 geographical assumption that firms located in a particular
4 region of the country are subject to examination by that
5 regional office so that staff would likely call the exam
6 leaders in the particular regional office and ask about any
7 examination history.

8 Q So, there shouldn't be two cause exams that are
9 going on at the same the same entity at the same time without
10 two people -- the two groups who are doing the exams talking
11 to each other?

12 A Without knowledge -- there should certainly be
13 knowledge.

14 Q Okay. Let me ask you some questions about Bernie
15 Madoff, okay? When did you first hear of Bernie Madoff?

16 A I don't know specifically. I became aware of the
17 Madoff firm in the 90's.

18 Q Okay. And what was the reputation of the Madoff
19 firm in the 90's?

20 A Best of my recollection, a market-maker. A
21 successful market-maker seeking to challenge the business of
22 the New York Stock Exchange. At some point that -- it's a
23 firm that began to pay for order flow from other
24 broker-dealers, a practice that was legal at the time. It's
25 still legal. Reputation was a competitor of the large exchanges.

1 Q Okay. What about closer to early 2000, were there
2 any -- do you have any other knowledge about the Madoff
3 firm's reputation at that point that was different than what
4 you understood in the 90's?

5 A No.

6 Q And were there any whispers that you were aware of
7 of Madoff getting returns that were very strong, very
8 consistent? Were there any -- did you -- were you aware of
9 any whispers about Madoff, the Madoff firm, being kind of too
10 good to be true?

11 A At some point there were press articles that
12 suggested that the firm's returns in its investment advisory
13 business were, perhaps, too good to be true. And there
14 was -- there were allegations that the rationale for that was
15 that the investment advisory firm was front-running its
16 market-making orders in order to generate those returns.

17 Q And that information you got from the press
18 articles?

19 A I don't recall where I got that, but I was aware
20 that there was this issue.

21 Q What time period was that do you think?

22 A I don't recall specifically.

23 Q Okay. But sometime in the 2000 range? The
24 year --the decade of 2000?

25 A I'm sorry I can't be more specific. I don't know.

1 Q Okay. Have you ever spoken to Bernie Madoff?

2 A Yes.

3 Q Okay. When was the first time you spoke to him?

4 A I recall specifically two conversations with him.

5 Q Okay.

6 A And those are just the conversations I recall.

7 Q Okay.

8 A I recall telephoning him in advance of an exam that
9 we were going to perform to tell him that we expected full
10 cooperation of the firm, that the examiners would be
11 conducting the exam and it -- and to notify him of it. Was
12 one conversation.

13 Q Do you remember when that was?

14 A I don't remember specifically.

15 Q Okay.

16 A It -- I don't remember specifically.

17 Q All right. Well, we may have some documents that
18 will help --

19 A Okay.

20 Q And what was the other one you remember?

21 A I remember running into him in a lobby of a hotel
22 at a industry conference and having a brief conversation with
23 him.

24 Q When was that?

25 A I'm sorry, I don't recall.

1 Q Was in the last couple years or was it --

2 A It would have been within the last five years.

3 Q Okay. And so what was that conversation like?

4 What did you guys talk about?

5 A How's the conference going? Going well.

6 Q Okay.

7 A When are you speaking? Tomorrow. You know --

8 Q But you didn't --

9 A -- five minutes maximum.

10 Q Okay. And you didn't talk in that conversation
11 about any exams or investigations?

12 A Oh, no.

13 Q Okay. What about other members of Bernie Madoff's
14 family? Have you spoken to other members of Bernie Madoff's
15 family?

16 A Yes.

17 Q Okay. Who were those and when were those?

18 A Peter Madoff I have talked with twice that I
19 remember.

20 Q Okay.

21 A The first time at the SEC's CCO Outreach Program.

22 We -- the SEC sponsors a program for chief compliance
23 officers to communicate about strong compliance practices and
24 deficiencies. He was at the CCO Outreach Program for
25 broker-dealer CCOs, I believe last year and I said hello to him.

1 Q Do you remember when last year?

2 A To the best of my recollection, February or March.

3 Q 2008?

4 A 2008.

5 Q And that was also a brief conversation?

6 A Yes.

7 Q And you didn't talk anything about the exams or
8 investigations?

9 A No.

10 Q Okay. You said there was another time I think you
11 talked to him?

12 A I attended Eric Swanson's wedding when he married
13 Shana Madoff --

14 Q Okay.

15 A -- and had a conversation at the wedding with Peter
16 Madoff.

17 Q Okay. What was that conversation about?

18 A The -- we spoke about the Immigrant Museum in New
19 York City.

20 Q Okay. Nothing to do with SEC business?

21 A No.

22 Q Okay. When was that wedding?

23 A To the best of my recollection, September 2007.

24 Q Any other conversations with people in Bernie
25 Madoff's family?

1 A Yes.

2 Q Okay. Do you -- can you tell me what they were?

3 A That was Peter Madoff. Shana Madoff is the
4 daughter of Peter Madoff.

5 Q Right.

6 A To the best of my recollection I've talked with her
7 maybe five times.

8 Q What were the context there?

9 A The CCO Outreach Program that I mentioned before;
10 SEC Speaks -- she was at SEC Speaks, one of the events; I
11 recall that she came to a SIA committee meeting, meeting of
12 Compliance Officers in the SEC, to talk about compliance
13 issues, issues we were finding in exams; at the wedding -- at
14 her wedding to Eric Swanson; and finally, at Eric Swanson's
15 going-away party, she was there.

16 Q And in any of those conversations did you talk
17 about any exams or investigations or any regulated activities
18 of the SEC?

19 A No.

20 Q Okay.

21 A To the best of my recollection.

22 Q Okay. Any other members of the family, Bernie
23 Madoff's family, that you spoke to?

24 A I -- to the best of my recollection, I believe I
25 met Peter's wife, Peter Madoff's wife, at the

1 wedding -- but -- introduced to her.

2 Q Okay. Anybody else that you can remember in Bernie
3 Madoff's family that you talked to?

4 A Shana has a daughter who's five years old. I was
5 introduced to her at the wedding.

6 Q Okay. Anyone else?

7 A Not that I recall.

8 Q Okay. Were you involved in any examinations of
9 Madoff securities in Bernie Madoff's firm?

10 A Examinations of the firm were conducted by staff
11 who report to me.

12 Q Okay. So, let me show you a document, we're going
13 to mark this as Exhibit 3. This is a letter from you to
14 Bernie Madoff dated February 6, 1998. If you could take a
15 look at this?

16 (SEC Exhibit No. 3 was marked for
17 identification.)

18 A Okay.

19 Q Okay. So, what do you remember about this letter
20 or this examination?

21 A I don't specifically remember this particular
22 letter. I remember generally the examinations.

23 Q Okay, but what about specifically related to this
24 one that -- you say in your letter in February 6, 1998, "The
25 staff completed an examination of your firm's order-handling

1 practices." What do you remember about that one?

2 A Well, this examination was part of a larger series
3 of examinations. And I remember the series of examinations
4 and the issues raised by those examinations collectively.

5 Q Okay.

6 A This -- the Madoff firm was one of many firms that
7 was examined as part of an exam sweep.

8 Q Right. What do you remember about the exam sweep
9 generally?

10 A Immediately following or soon after the commission
11 adopted new order-handling rules that were designed to
12 protect the execution quality of securities transactions for
13 retail investors, my staff commenced a series of exams of
14 many firms to look at how they were implementing those new
15 rules and whether they were providing the best prices on
16 transactions that were routed to those firms.

17 Q Okay. And from your recollection and from this
18 letter, what was the finding with respect to Bernie Madoff's
19 firm?

20 A From my recollection, we found many -- we found
21 that firms were not generally providing execution quality
22 that they should and that resulted in a series of follow-up
23 examinations of the broker-dealers that were routing orders
24 to these firms.

25 With respect to the Madoff firm specifically, I

1 have no recollection of the particular findings or issues
2 raised.

3 MS. STEIBER: I think the second page --

4 MR. KOTZ: Yeah, it does -- you do in say in your
5 letter, "The staff recommends that Bernard L. Madoff
6 Investment Securities inform its customers of any relevant
7 execution practices that could affect price improvement
8 statistics or execution quality.

9 MS. STEIBER: So, was this a deficiency letter?

10 THE WITNESS: Yes. And this was -- this reflects
11 generally -- other -- the findings of this firm and other
12 firms in the examination.

13 MR. KOTZ: Okay. Was this examination onsite, do
14 you know?

15 THE WITNESS: I don't know.

16 MS. STEIBER: But you didn't travel onsite?

17 THE WITNESS: No.

18 MR. KOTZ: Okay. I'm going to show you another
19 document. This -- you mentioned previously articles. I'm
20 going to show you a couple of articles, why don't we start --

21 MS. STEIBER: This is the same article but this is
22 a clean copy so she can see above the highlights.

23 MR. KOTZ: Okay, great. So, this is a -- an
24 article -- a Barron's article -- "Don't ask, don't tell.
25 Bernie Madoff is so secretive he even asks his investors to

1 keep mum."

2 And there's another version of that article with
3 some handwriting on it, so we want to show you both the
4 version with the handwriting and the cleaner version and
5 we're going to mark them together as Exhibit 4.

6 If you could, you know, you can use this version to
7 read it a little better and then we can ask you a couple of
8 questions about the notes on the other version.

9 (SEC Exhibit No. 4 was marked for
10 identification.)

11 MR. TAYLOR: This is Exhibit 4?

12 MS. STEIBER: Four.

13 MR. KOTZ: Four, yeah. Both of them are
14 collectively Exhibit 4.

15 MR. TAYLOR: Okay.

16 THE WITNESS: Okay.

17 BY MR. KOTZ:

18 Q Okay. If you could see on the document with the
19 hand-written notes, could you take a look at that? Is that
20 your notes?

21 A It looks like my handwriting.

22 Q Okay. So, you say, "John, she is very good. This
23 is a great exam for us. Lori." Is that -- that's your
24 handwriting?

25 A It looks like it, yes.

1 Q Okay. If you can take a look at the bottom of that
2 document, the footer says -- it's hard to read a little bit,
3 but it's listed as 2001. 5/15/2001. You can see the date of
4 the article is 5/7/2001. Do you think that you would have
5 read this article in 2001?

6 A I have no idea.

7 MS. STEIBER: Do you regularly read Barron's?

8 THE WITNESS: No.

9 BY MR. KOTZ:

10 Q Okay. Is Barron's considered a reputable
11 publication?

12 A Yes.

13 Q Okay. So, what do you remember about the notes you
14 made or reviewing this article?

15 A I don't remember.

16 Q Okay. But it does seem to indicate in your notes
17 that you -- what would you mean by "she is very good. This
18 is a great exam for us?"

19 A The reporter, Erin Arvedlund, I respect.

20 Q Okay. So, she's credible?

21 A I believe she is. I -- she's written great
22 articles; I think she's very good.

23 Q Okay. When you say "this is a great exam for us,"
24 would you be referring to a cause exam do you think or
25 routine exam?

1 A I don't know.

2 Q And you don't know whether you would have -- you
3 read this article, you know, shortly after it came out or
4 maybe years after it came out?

5 A I have no recollection. I have no recollection of
6 this document, I don't know when I would have read it.

7 Q Okay. But you did have a recollection that you had
8 read articles about Madoff. Is this the article that you
9 were talking about that you recollected reading?

10 A The allegations in this article are the ones I was
11 referring to.

12 Q Okay. In this article it references another
13 article, a May 2001 report in something called MarHedge, do
14 you know if you ever read that article in MarHedge?

15 A I don't know. I may have -- I don't subscribe to
16 MarHedge, I may have seen it more recently but at the time I
17 don't know.

18 MS. STEIBER: Is John -- are you referring to John
19 McCarthy do you think? Would there be any other John that
20 you would be referring to?

21 THE WITNESS: Likely it would be John McCarthy.

22 BY MR. KOTZ:

23 Q Is MarHedge a reputable publication?

24 A I don't know.

25 Q Okay. Now, if you look at the document there's

1 compliant officer as an investment advisor notified Mavis
2 that he was concerned about the returns Fairfield was
3 posting? Do you know if this e-mail refers to Exhibit 5,
4 which is the [REDACTED] complaint that went to Mavis
5 Kelly during that same time period?

6 A I don't know.

7 Q Okay. But it's possible that you did actually see
8 the complaint at the time?

9 A No, I did not see -- I do not recall seeing this --

10 Q Okay.

11 A -- complaint at the time.

12 Q But it's possible you were aware of the complaint
13 of the time, judging from Exhibit 6, the e-mail?

14 A This e-mail is addressed to me.

15 Q Okay.

16 A But other than what's in this e-mail I have no
17 other recollection of seeing the actual -- assuming this is
18 it -- the actual Exhibit 5.

19 Q Okay. Were you aware in that time period of a
20 complaint that came in, maybe not seeing that exact complain
21 but a complaint that came in from an investment advisor about
22 Madoff?

23 A No, other than this -- what's -- the information
24 that's in this e-mail --

25 Q Okay.

1 A -- Exhibit 6.

2 Q So, you don't know whether a cause exam was
3 initiated as a result of Exhibit 5, [REDACTED]
4 complaint?

5 A Of Madoff?

6 Q Yeah.

7 A I don't know.

8 Q Just a couple of things I wanted to ask you about
9 with respect to Exhibit 5. It says, "According to BMS,"
10 which is Bernie Madoff Securities, "the options are traded
11 with a number of traders and crossed on the CBOE. With an
12 8- to 10 billion size you must see the volume, but
13 unfortunately you don't. We actually check with some of the
14 largest brokers, UBX, Merrill, et cetera, which told us they
15 never traded with them OEX options."

16 Do you remember, at any point, OC looking into this
17 question of -- in the 2003 time frame, of how it could be
18 that Madoff was trading this amount of options but they
19 weren't able to find people who actually traded with them?
20 Do you remember that issue being something that OC was
21 looking at in their cause exam?

22 A No. No, I don't remember.

23 Q Okay. Would you have expected that a firm who
24 would have been that kind of size, 8 to 10 billion, would
25 have registered as an investment advisor if it had assets

1 Then separate from that, a routine part of an
2 investment advisor exam is to seek confirmation of -- in a
3 sample basis -- of particular trades from an independent
4 party. So, a routine practice is to ask DTC or another
5 counter-party if they can confirm the accuracy of particular
6 trades. And that's intended to obtain some third party from
7 outside the firm, some third party verification that the
8 trade, the transaction was real.

9 Q And that has always been a routine part of an OC
10 investment advisor exam, going to DTC? Or is that something
11 new?

12 A It was -- I don't know if it's always been a
13 routine part, it has been -- it's been done in the past.
14 Going forward it's clearly going to be a part of examination
15 protocol and already it for investment advisor and
16 broker-dealer exams.

17 Q Okay.

18 BY MR. KOTZ:

19 Q Do you recall in 2003 receiving a tip about Madoff
20 from Steve Cutler?

21 A No.

22 Q All right, let me just show you a document. This
23 is -- Exhibit 7. This is an e-mail from you to John
24 McCarthy, 12/10/2003, 7:13 p.m. You see at the bottom
25 there's a e-mail exchange between you and John McCarthy about

1 not proof. They're allegations that then should be
2 investigated to determine if they have merit and to determine
3 if we can create evidence that would be used, potentially, in
4 court.

5 BY MR. KOTZ:

6 Q Okay. All right, let me show you another document.
7 This is 12/16/2003. I'm going to mark this as Exhibit 9.
8 this is an e-mail from you to Annette Nazareth.

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

11 A Okay.

12 Q You see -- you say in there, "Remind me to tell you
13 what we're looking at too with Madoff." Do you remember
14 talking to Annette Nazareth about Madoff?

15 A No.

16 Q Okay. Do you know why you would be communicating
17 with Annette Nazareth about what you were looking at -- I
18 assume it refers to some kind of exam?

19 MR. TAYLOR: Was that a question or a --

20 MR. KOTZ: Yeah. I mean, do you have any idea --

21 MR. TAYLOR: The last participle in the question
22 makes it confusing.

23 BY MR. KOTZ:

24 Q Okay. Do you have any idea why you would be
25 talking to Annette Nazareth about what you're looking at too

1 with Madoff?

2 A I would generally communicate with the director of
3 Trading and Markets about matters that we were examining.
4 This e-mail reflects, you know, other issues that are of
5 mutual interest so I would likely have just told her what we
6 were looking at.

7 Q And you don't remember what -- if you did tell her
8 what you're looking at with Madoff or what that was about?

9 A I don't remember any conversation with her, no.

10 Q Okay. All right, I'm going to show you another
11 document. This is dated 12/18/2003, also in that same time
12 period. It's from you to John McCarthy, 4:25 p.m. We'll
13 mark it as Exhibit 10.

14 (SEC Exhibit No. 10 was marked for
15 identification.)

16 A Okay.

17 Q And then I think I'm going to show you the next
18 document as well, which is a 12/19/2003 e-mail, the next day.
19 And that's from Mark Donohue to Matt Daugherty, 12/19/2003 at
20 2:13 p.m., and we'll mark that as Exhibit 11.

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

23 A Okay.

24 Q Okay. So, in the first e-mail John says to you,
25 "Can we try to put a call to them today?" You say, "Sure,

1 cooperation. And that's the purpose for the call is to make
2 sure that heads of firms or, you know, management at firms
3 knows they shouldn't -- they should cooperate with the
4 examination, we expect that they will do so, they won't jerk
5 us around. And the purpose for the call is to make sure that
6 they know it's important.

7 Q Do you remember -- were there any substantive
8 discussions about the issues in that call?

9 A I don't recall specifically. I recall generally
10 saying what we would be looking at.

11 Q Go ahead.

12 A I don't recall specifically but it would likely
13 have been we're looking at allegations of front-running.

14 Q And do you remember if Bernie Madoff ever provided
15 any information in response to that in that call?

16 A I don't recall. And it wouldn't have mattered,
17 really.

18 Q Okay.

19 A Because we were there to do an examination whether
20 he said we didn't -- you know, the allegations are inaccurate
21 or unfounded, it wouldn't have mattered.

22 Q Well, although if he had said the allegations are
23 true it would have mattered, right? I mean, on some level it
24 was relevant what his response would be, you know, to the
25 allegations, don't you think?

1 BY MS. STEIBER:

2 Q Do you usually take notes of your conversations
3 with registrants?

4 A It depends on the context. Calls like this where
5 I'm really just calling to tell them we're doing an exam, get
6 prepared, cooperate. No. But I would be doing the speaking
7 so John McCarthy might have.

8 Q And is it normally you that would make a call prior
9 to a cause exam to let the registrant know that you'll be
10 performing a cause exam?

11 A It's -- in situations where it's important, where
12 we want their cooperation and expect it promptly -- so I do
13 many of those calls, yes, because the message is best
14 communicated from the director of the exam program in those
15 instances. It doesn't happen all the time, but where the
16 exam, it could be a cause exam, it could be a sweep exam,
17 where it's important and where I really want them not to jerk
18 around the staff --

19 Q Right.

20 A -- in those cases I do.

21 Q So, even when there are allegations of fraud you
22 give the registrant notice that you'll be --

23 A It would depend.

24 Q What would it depend on?

25 A If there's a possibility that documents would be

1 destroyed or if there's -- then we would send examiners in
2 without notice. If we're asking for the production of
3 documents and it's going to take some time then I might call.
4 And at the call, then there would be a document request that
5 would come immediately after that so any destruction of
6 documents following that would be, you know, obstruction.

7 Q So, how often have you had it where you send a
8 cause exam team in without giving this notice to the --

9 A I don't know off the top of my head. It's
10 sometimes effective, it's sometimes not effective because
11 you're just sitting in a reception area waiting for them to
12 pull documents.

13 Q I'm just wondering how serious the allegations have
14 to be in order for you to take that step, you know, rather
15 than the steps that you took, by calling and giving them
16 notice to prepare their documents.

17 A It depends. It very much depends on the particular
18 situation.

19 BY MR. KOTZ:

20 Q Did you take any notes of that conversation?

21 A Not that I recall.

22 Q Okay. Do you know if John McCarthy did?

23 A I don't know.

24 Q Okay. Did you have any involvement in Exhibit 12,
25 in the drafting of this letter to Peter Madoff?

1 front-running, yes.

2 Q Is there a difference between cherry-picking and
3 front-running?

4 A Yes.

5 Q What is the difference?

6 A Cherry-picking is trading and then deciding which
7 account to allocate the trade to after it's done. After you
8 know whether it's profitable then you decide which account
9 gets it. So, you cherry pick the profitable trades and put
10 them in a favored account and leave other accounts with
11 losing trades. It's a violation of the law if it's not
12 disclosed as such.

13 Q Okay. So, would you consider the allegations in
14 these e-mails attached to the April 22, 2004, should there
15 have been an immediate cause exam as a result of these
16 e-mails or not necessarily?

17 A I would want this -- I would want us to look at it
18 but I would want to know what else -- what other cause exams
19 are going on in the office at that moment. I would, you
20 know, I would want to know what else is happening in the
21 office and how it fit within the priorities. But allegations
22 of cherry-picking are not unusual.

23 Q Okay.

24 A Cherry-picking is a type of violation that we
25 investigate in examinations and that we bring enforcement

1 cases against.

2 Q You don't see anything else in these e-mails other
3 than cherry-picking allegations?

4 A Well, I -- I only read it for the first time just
5 now and I read it very quickly. But --

6 MS. STEIBER: What about the last e-mail? There's
7 nothing else except for cherry-picking?

8 THE WITNESS: Well, as I said, it looked like what
9 this person was trying to do is to understand where the
10 trading took place and they couldn't come to a conclusion
11 about where it occurred.

12 MR. KOTZ: So, would that be something that OC
13 would look at?

14 THE WITNESS: Yes, I mean, as part of the e-mails
15 that the examiners identified as being suspicious and brought
16 to the attention of the broker-dealer exam team is an
17 indication that they should follow up.

18 MS. STEIBER: So, based on this you would expect
19 that they followed up on where there was -- based on these
20 e-mails you would have expected that they would have followed
21 up on whether or not Madoff was actually trading option?

22 THE WITNESS: Yes.

23 MR. KOTZ: Okay. If you look at the second e-mail,
24 it says at the -- on the second page, "We at Investment Adviser #1
25 have totally independent evidence that Madoff's executions

1 previously. Did you encourage your employees to attend those
2 events?

3 THE WITNESS: Depended -- depends on what they
4 were.

5 MR. KOTZ: Okay, so explain, what ones would be
6 encouraged -- they would be encouraged to attend?

7 THE WITNESS: There's a legal and compliance annual
8 meeting sponsored by the SIA, now SIFMA. My staff spoke on
9 panels at that meeting. There were other meetings that the
10 SIA sponsored that -- here in Washington and other locations
11 in the country, about compliance and other issues that I
12 encouraged my staff to attend.

13 MR. KOTZ: Okay. And you were saying that that was
14 where you had conversations with Shana Madoff?

15 THE WITNESS: I remember specifically an event in
16 New York, a meeting of -- I think it was the legal and
17 compliance committee of the SIA with -- widely attended by
18 representatives of lots of firms, I recall she was one of
19 them.

20 MR. KOTZ: Okay. Other than at Eric Swanson and
21 Shana Madoff's wedding have you ever seen the two of them
22 together? I guess the going-away party was the second one,
23 but other than those two?

24 THE WITNESS: At SEC Speaks last year.

25 MR. KOTZ: Okay. Anything else? Any of these SIA

1 THE WITNESS: Well, there's a ethics policy that
2 applies to OC employees that stricter than the policy that
3 exists for other SEC employees. Generally, if there could be
4 an appearance of impropriety or bias we would encourage
5 employees to communicate with the ethics office about whether
6 they should recuse themselves from any ongoing examination.

7 And then more specifically, OC employees can't
8 participate in an examination where a family member is
9 employed at the firm or where they have a financial interest,
10 where they hold an account with the firm. And there are
11 other specific situations where there is specific guidance
12 provided to OC employees with the goal of ensuring that there
13 is the appearance and the actuality of examiners performing
14 their functions without bias.

15 MS. STEIBER: So, if you become involved with a
16 registrant, you don't have -- do you have to say anything to
17 your superior affirmatively until you've been assigned a
18 matter that deals with that registrant?

19 THE WITNESS: You would -- hopefully, if you think
20 that there's a possible ethics issue as an employee, you
21 would communicate with the ethics office and get specific
22 guidance about the situation. But employees could not
23 examine the firm where -- if they had a family member
24 employed by the firm. In other situations, other
25 relationships, I would want the employees to communicate with

1 the ethics office.

2 MS. STEIBER: What if like in this case you
3 have -- you find out that there is enforcement investigation
4 of a registrant, and you become involved with that registrant
5 while you know there is an enforcement investigation. Would
6 there be any reason why you would need to, you know, tell
7 your supervisor or contact the ethics office or could you
8 just -- could you keep that a secret?

9 THE WITNESS: I don't know. I mean there's no
10 general disclosure obligation to disclose people you're
11 dating to your supervisor. But, certainly, if it was a firm
12 that the examiner was going to examine or was examining, that
13 would be very clear that in that situation you could -- you
14 should not have a personal relationship with someone you're
15 examining.

16 Another process in the agency, outside of the exam
17 process, disclosure review process, enforcement
18 investigation, I don't know what the ethics counsel would say
19 about that. I don't -- I just don't know.

20 BY MR. KOTZ:

21 Q Do you know if Eric Swanson ever informed the
22 ethics office about his relationship with Shana Madoff?

23 A I don't know.

24 Q Okay. Do you know if there was any connection
25 between the Eric Swanson relationship with Shana Madoff and

1 phone book kept by Bernie Madoff in their exam?

2 A Yes.

3 Q Okay. Are you aware of whether your name and
4 telephone number was in that book?

5 A I was told in the last couple of weeks that it is.

6 Q Do you have any idea why your name and number would
7 be in that book?

8 A I was also told it had an inaccurate phone number
9 associated with it --

10 Q Okay.

11 A -- and that there were -- as I understand
12 it -- lot's of other SEC people in the phone book. But other
13 than that I don't know.

14 Q Okay. Now, you have recused from the Madoff work
15 post December 2008, is that right?

16 A Yes, December 17th.

17 Q Okay. And why -- did you choose to recuse
18 yourself?

19 A Yes.

20 Q Why?

21 A Because I attended the wedding and because --

22 Q Of Eric Swanson and Shana Madoff?

23 A Of Eric Swanson and Shana Madoff. And Eric Swanson
24 was an employee of mine in my chain of command.

25 Q Okay. Any other reason?

1 A No.

2 Q Okay. Did you ever place a phone call to or inform
3 any examiner to back off of a Bernie Madoff examination?

4 A Never.

5 Q Okay. Did you ever communicate with anyone with
6 respect to what actions they should take in an investigation
7 of Bernie Madoff?

8 A Investigation?

9 Q In an examination of Bernie Madoff. Did you ever
10 indicate anything to a OC examiner about how much they should
11 push in a Bernie Madoff examination?

12 A I don't recall having conversations about specific
13 tactics or strategies. I never would have said, "Go light on
14 this firm. Back off this firm." I never would have said
15 that. In fact, the -- my writing on this document you showed
16 me earlier indicates, "Go get them."

17 Q Okay.

18 MS. STEIBER: Were you ever told to back off on
19 Bernie Madoff by anyone in a powerful position?

20 THE WITNESS: Never.

21 MR. KOTZ: Okay.

22 THE WITNESS: I would never have received any
23 suggestion -- it would be highly inappropriate for anyone
24 senior to me to suggest that we back off in any way, in any
25 matter.

1 MR. KOTZ: And you never heard any words from
2 somebody in Congress suggesting that you back off or
3 your -- the agency back off of a matter involving Bernie
4 Madoff?

5 THE WITNESS: No.

6 MR. KOTZ: And you're not aware of any such
7 communication occurring?

8 THE WITNESS: No.

9 MR. KOTZ: Okay. What was your reaction when you
10 did hear in December that Madoff had admitted to conducting a
11 Ponzi scheme?

12 THE WITNESS: I was very surprised.

13 MR. KOTZ: How come?

14 THE WITNESS: He stated that it was \$50 billion;
15 it's a significant sum of money.

16 MR. KOTZ: Do you think Bernie Madoff got special
17 treatment at the SEC because he was a well-known entity?

18 THE WITNESS: I can only speak for examinations, I
19 can't speak about any other office or division in the SEC.
20 But categorically, no.

21 MR. KOTZ: Okay.

22 THE WITNESS: Because we examine well-known
23 entities and we find violations and make enforcement
24 referrals involving well-known entities and not-so-well-known
25 entities everyday. It's what we do.