

1 UNITED STATES SECURITIES AND EXCHANGE COMMISSION

2

3 In the Matter of:)

4) File No. OIG-509

5 OIG-509)

6 PAGES: 1 through 55

7 PLACE: [REDACTED]

8 [REDACTED]

9 [REDACTED]

10 DATE: Monday, January 12, 2009

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12 The above-entitled matter came on for interview,
13 pursuant to notice, at 11:00 a.m.

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15 TAPE TRANSCRIPTION

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24 Diversified Reporting Services, Inc.

25 (202) 467-9200

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1. APPEARANCES:

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2 On behalf of the Securities and Exchange Commission:

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10

11 On behalf of the witness:

12 [REDACTED]
13 [REDACTED]
14 [REDACTED]
15 [REDACTED]
16 [REDACTED]

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PROCEEDINGS

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MR. KOTZ: Okay. So, I mean, if you could just

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kind of go through for us when you first heard, what you

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first heard of Bernard Madoff and, you know, what was the

5 process you went through as you inquired about him?
6 [REDACTED] Well, this is -- I'm not going to
7 be very accurate, unfortunately, about dates because this was
8 a pretty long time ago.

9 MR. KOTZ: Yeah.

10 [REDACTED] Probably five years or so, and,
11 you know, we have hundreds of managers. We don't get files
12 on the ones we decide to pass on.

13 MR. KOTZ: Right.

14 [REDACTED] So, you know, I'll do the best I
15 can.

16 MR. KOTZ: Okay.

17 [REDACTED] But don't swear to it. Anyway,
18 Madoff was -- was certainly a known name in the hedge fund
19 money management world. It was sort of -- the name's pretty
20 prominent. He was running close to \$20 billion at that time
21 and --

22 MS. STEIBER: How did you know that?

23 [REDACTED] I mean, it was just -- I mean, you
24 can't be that big and be under the radar screen.

25 MR. KOTZ: Right.

4

1 [REDACTED] It was just sort of common
2 knowledge. We -- the hat which I was wearing that would have
3 any knowledge of this at all is we have a Fund to funds
4 business which we started **personal privacy** which I think
5 you know that business model we -- we have investors and then
6 we put the money out with -- with various hedge fund managers
7 and -- and Madoff had a -- you know, this sort of stream of
8 -- of results that seemed very smooth, very even, and kind

9 of attractive on that level.

10 We were offered a slug of Madoff capacity, like a
11 \$100 million, and I don't remember who -- who brought it to
12 us, but we kind of wanted to believe because it was a very
13 attractive profile, if you can believe it's right, --

14 MR. KOTZ: Right.

15 [REDACTED] -- and the first thing I noted was
16 that the description of what he was doing seemed to be
17 inconsistent with what I knew about what you could achieve in
18 a strategy like that.

19 I mean broadly, it was a strategy described as
20 being long a bucket of -- of pretty common variety listed
21 stocks and writing options and trading options around that
22 kind of bucket and that's a strategy that will make money
23 most of the time, but it's going to lose money if there's
24 exposure and volatility. It's going to lose money if there's
25 big market moves. It won't produce the kind of pattern of

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1 returns that was the -- was the Madoff pattern.

2 MS. STEIBER: Did you determine that by doing some
3 kind of analysis on the computer and the firm you --

4 [REDACTED] This was just sort of my own
5 knowledge of the way options strategies work. I mean, if you
6 just sort of think about it for a minute, if you buy -- let's
7 say you buy a stock at a 100 and you write an option against
8 it and you get a \$5 premium. Well, you're protected for \$5
9 move in the stock and if nothing happens, you collect the
10 premium and, you know, you might be able to trade around the
11 option position. You might be able to trade around the stock

12 position, but you certainly know that if the stock drops
13 fairly precipitously, your \$5 is not complete protection
14 against loss. You can lose money in a trade like that.

15 MR. KOTZ: Right.

16 [REDACTED] And the fact that he never lost
17 money was suspicious.

18 MR. KOTZ: And so this was a period of time when
19 the market was down?

20 [REDACTED] It didn't matter. It didn't
21 matter. I mean, you could -- I mean options strategies, you
22 can lose money --

23 MR. KOTZ: Right.

24 [REDACTED] -- when the -- if the market gaps
25 up.

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1 MR. KOTZ: Right.

2 [REDACTED] And his track record at that point
3 was a very, very long track record. Market's down, markets
4 didn't really matter. You can construct a strategy like that
5 where you'll make money most of the time but you cannot
6 construct a strategy where you make money all the time.

7 MR. KOTZ: And have you ever seen anything before
8 like that? Have you ever seen other instances where you had
9 a track record like that so consistent or was that --

10 [REDACTED] It's certainly one of the most
11 consistent track records I was aware of. I mean, there are
12 certain strategies that in effect of writing insurance
13 against unlikely events that make money most of the time.

14 MR. KOTZ: Right.

15 [REDACTED] But an unlikely event happens

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16 and, --

17 MR. KOTZ: Right.

18 [REDACTED] -- you know, every once in awhile,
19 they trip up.

20 MR. KOTZ: Right.

21 [REDACTED] But he didn't have that every once
22 in awhile. It was like so consistent that it -- it seemed to
23 me to be suspect whether the strategy description was --
24 seemed inconsistent with the results and that -- I mean for a
25 lot of people that was sort of the end of the inquiry. They

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1 just said I don't believe this and I don't really understand
2 it and move on.

3 But I also thought that there was a possibility
4 that he was doing something kind of more interesting.

5 MS. STEIBER: Just to go back for a second, you
6 were getting information from Madoff himself or --

7 [REDACTED] No, I never met -- I never met
8 with Madoff and the description came from -- I think the
9 description was in one of the Feeder funds, but I think
10 people have described it in a fairly generic way. I mean, if
11 you look at what's his name, Personal Privacy offering circular or
12 what's the one up in Connecticut? Fairfield Greenwich.

13 They all sort of use similar language to describe
14 the strategy. In Personal Privacy case, he never identified it as
15 Madoff.

16 MR. KOTZ: Right, right.

17 [REDACTED] But anyway, there's kind of a form
18 of language that people have used to describe it and I --

19 even though I was sort of skeptical just at that level, you
20 know, maybe this guy is really doing something unusual and
21 something interesting --

22 MR. KOTZ: Right.

23 [REDACTED] -- that he doesn't want to put --
24 that he wants to describe in kind of a vague way just in
25 order to protect something proprietary or special about what

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1 he's doing.

2 MR. KOTZ: Right.

3 [REDACTED] So I took it another step and I
4 asked a friend of mine who runs a Fund of funds to share with
5 me the -- his last three or four account statements from --
6 from Madoff Securities and I said, you know, share that with
7 me and if I come up with anything interesting, I'll share it
8 with you, so fine, and I get, I mean, this three months of
9 statements. It was like a stack, huge stack of confirmation
10 slips and trades and, I mean, it was very -- you know, you
11 could just look at this and say how the hell am I ever going
12 to analyze it?

13 MR. KOTZ: Just to clarify, the person, somebody
14 sent you what, the quarterly or monthly statements that
15 Madoff -- that he got as an investor in Madoff?

16 [REDACTED] Yes, exactly, exactly. And so I
17 thought how the hell am I ever going to figure this thing
18 out, and I'm sort of statistically oriented. So I thought,
19 well, why don't I just look at a sample of trades and
20 purchases and sales and compare them with what was actually
21 going on in the markets on the days that he was trading, and
22 I saw this pattern which really seemed weird where the --

23 where the purchases were all at or close to the lows of the
24 day and the sales were at or close to the highs of the day
25 and, of course, nobody can do that.

9

1 MR. KOTZ: Right.

2 [REDACTED] And the particular account I was
3 looking at was approximately a \$20 million account and he was
4 running like \$20 billion at the time, so one-one thousandths,
5 in other words, of the money that he was -- he was running,
6 and then I looked at the volumes that he was transacting in
7 this account and I could not imagine that activity taking
8 place a thousandfold. It just -- it just seemed wildly out
9 of proportion to the purported trading volumes in those
10 shares or those options.

11 MR. KOTZ: Mm-hmm.

12 [REDACTED] So that -- that really was the
13 sort of endpoint in a way of our analysis, and I just
14 couldn't imagine what --

15 MS. STEIBER: What was going on? What activity did
16 you think? Did you question if these were legitimate --

17 [REDACTED] well, I'm going to get to that.
18 I'm going to get to that.

19 So I'm just -- you know, I was sort of perplexed as
20 to what -- what was going on and I asked this guy -- you
21 know, every broker-dealer sends an annual auditing statement
22 to customers. That's a standard requirement and, you know,
23 if you ever have a brokerage account, you're sort of used to
24 getting a statement of the brokerage firm, its own financial
25 statement, once a year.

1 So I asked this guy, I'd like to look at Madoff
2 Securities' statement, and so, sure, no problem, can't find
3 it. I said fine.

4 MS. STEIBER: He's just a regular hedge fund
5 customer? He's just a regular broker-dealer customer?

6 [REDACTED] Yeah. This guy had an account
7 with Madoff Securities. This guy, meaning a Fund to funds.
8 This Fund to funds had an account with Madoff Securities.

9 And I asked one or two other people who had -- who
10 I knew also had Madoff Securities accounts could they just
11 send me the Madoff Securities' own balance sheet, you know,
12 and nobody had any problem with it but nobody could find it.
13 So that was pretty curious, and I thought, I don't even know
14 why I persisted so much, but I figured it had to be filed
15 with the SEC --

16 MR. KOTZ: Right.

17 [REDACTED] -- and I got our lawyers to go and
18 get it, to physically sign out, track it down within the SEC
19 and get a copy of it.

20 MR. KOTZ: Okay.

21 [REDACTED] And this -- this was really to
22 me -- so -- so I look at the statement and it's audited by a
23 firm in New City, New York.

24 MR. KOTZ: Right.

25 [REDACTED] I knew nothing about it. I had

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1 never heard of it, but it just seemed like why? I mean that
2 seems really weird. New City, New York? I mean some
3 suburban little shopping mall kind of accounting firm?
4 What's going on here? So that was Number 1.

5 MR. KOTZ: And normally you would have heard of the
6 firm?

7 [REDACTED] Oh, yeah. I would say 95 percent
8 or 99 percent of all investment operations are handled by
9 either the Big 4 accounting firms or maybe it was 5 in those
10 days.

11 MR. KOTZ: Right.

12 [REDACTED] And there are a handful of other
13 specialist firms.

14 MR. KOTZ: Right.

15 [REDACTED] Maybe a half a dozen that people
16 will use if not using one of the majors.

17 MR. KOTZ: Right.

18 [REDACTED] But this was like totally obscure.

19 MR. KOTZ: Right.

20 [REDACTED] But everything I'm saying so far
21 in a sense is a matter of judgment. I mean, you'd have to
22 have some industry judgment in order to know that the
23 strategy was -- couldn't produce the results it was -- in
24 order to produce, you'd have to make the -- the account
25 statements themselves were not -- would never be filed with

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1 the regulatory body. So -- but the -- but the statement that
2 was filed with the SEC was really telling and right on the
3 face of it, right on the face of it, because it showed no
4 customer activity at all.

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5 MR. KOTZ: Right.

6 [REDACTED] It showed no receivables from
7 customers. It showed no payables to customers. It was a
8 statement. I mean, what Madoff was is an over-the-counter
9 market-maker in listed stocks and the statement looked like
10 the statement of that kind of a firm. It had a couple
11 hundred million dollars in capital. It had securities longs,
12 securities shorts, securities in the process of collection,
13 but no evidence at all of customer activity.

14 So I thought, gosh, this is really -- made me think
15 either I'm looking at the wrong thing, that maybe he's got
16 some other accounting, other affiliated entity --

17 MR. KOTZ: Right.

18 [REDACTED] -- that -- that does carry
19 customer business or all of these confirmation slips and all
20 of this stuff is just run off on a printing press somewhere.

21 MR. KOTZ: Right.

22 [REDACTED] And, you know, at that point, I
23 mean, I mean, that was the -- to me the element that I would
24 most fault the SEC for not twigging to because it's a
25 statement that's filed with the SEC and you wouldn't have to

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1 Look beyond the face of the statement to really say hold it a
2 second, here's a guy who's a prominent big-scale operator
3 with customer money and the statement doesn't show
4 anything --

5 MR. KOTZ: Right.

6 [REDACTED] -- for customers. I mean, if --
7 if the accounts were on his books and he was manipulating

8 them or taking money away from them or, you know, somehow,
9 you know, skimming money from customer accounts, that might
10 require a real forensic audit, but to not see it on the -- to
11 not see any customer activity on the face of the statement
12 that should leap off the page. That should really leap off
13 the page.

14 I'm not -- I'm not an accountant. I have no
15 accounting training. I'm not a --

16 MS. STEIBER: Did you have your own --

17 [REDACTED] Yeah. Actually, I looked at this
18 on my own. Yeah. I run a company. I'm used to reading
19 financial statements, but, you know, I'm not a professional
20 or forensic or anything. It's just like what do you expect
21 to see on a financial statement for somebody dealing with
22 customers?

23 MS. STEIBER: Right.

24 [REDACTED] It's not so hard.

25 MR. KOTZ: Right.

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1 MS. STEIBER: Right. We'll be back, you know, to
2 both these points.

3 what did you really think was going on? I mean,
4 what did you suspect, based on the buying at the lowest
5 point, selling at the highest point?

6 [REDACTED] My suspicion was that the fact
7 pattern that I had seen seemed consistent with a Ponzi
8 scheme. I didn't conclude that that was the case, but I
9 certainly thought there was enough of a risk that that was
10 the case that, you know, I certainly wouldn't touch it with a
11 10-foot pole. My friend had shared these statements with me

12 and I'm pretty sure he pulled out.

13 MR. KOTZ: Right.

14 [REDACTED] But we've told this story a fair
15 number of times because it's like showing off our own due
16 diligence.

17 MR. KOTZ: Right, right. But would you say it was
18 kind of extra special due diligence that you did or was it
19 just kind of following up on a few things? How would you
20 describe what you did?

21 [REDACTED] well, I think we did a lot more
22 than most people would do. I think most people -- I mean
23 anybody with a reasonably sophisticated understanding of --
24 of markets should have -- should have been warned about --
25 should have had the idea that you just can't produce this

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1 level of consistency with the strategy as described.

2 I would say the notion of actually getting
3 statements and the sampling, that you wouldn't have. That's
4 sort of beyond what most people would do. It was sort of
5 obvious that he never sent the -- the statements of Madoff
6 Securities around that he was supposed to --

7 MR. KOTZ: Right.

8 [REDACTED] -- and that --

9 MS. STEIBER: You're talking about the Fund to
10 funds that you had, he never sent the statements to the
11 customers?

12 [REDACTED] Yeah. He didn't seem to send
13 statements of Madoff Securities to any of his customers, even
14 though that's an annual requirement.

15 MS. STEIBER: Yeah. As far as, you know, the dates
16 of the statements, were they different than ones you had seen
17 previously in due diligence, in a format, like usually were
18 they electronic and these were in paper, or were they --
19 [REDACTED] No, they were for the most part
20 standard statements and that's -- that was another thing,
21 another reason why this, I think, lasted so long, is that if
22 your Fund to funds, let's say, or a hedge fund and you have a
23 brokerage account with Goldman Sachs or Merrill Lynch or
24 Madoff Securities and you have auditors come in, they will
25 try to reconcile your books to the financial statements or

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1 the account statements you've got from your broker, you know.
2 If you say you have X amount of cash, they want to see the
3 brokerage accounts in which it lies. If you say you've got X
4 amount of securities, they want to tie that, but they aren't
5 going to go beyond those statements. They're not going to go
6 to Goldman Sachs and say prove it --

7 MR. KOTZ: Right.

8 [REDACTED] -- or to Merrill Lynch or to
9 Madoff, and the most they'll do is send out an audit confirm
10 which says will you confirm XYZ customer balance --

11 MR. KOTZ: Right.

12 [REDACTED] -- and, of course, I'm sure Madoff
13 just cheerfully sent it right back and confirmed it.

14 MR. KOTZ: Right.

15 [REDACTED] So the audit of his customers
16 would not in a routine way have shown this to be a problem,
17 and I -- and I believe that that's why he operated in the
18 form he operated in.

19 MR. KOTZ: Right.

20 [REDACTED] I mean very unusual for somebody
21 who could generate those kind of returns to not create their
22 own hedge funds.

23 MR. KOTZ: Right.

24 [REDACTED] If they created their own hedge
25 fund, then their auditor would be looking at individual

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1 positions and that probably would --

2 MR. KOTZ: Right.

3 [REDACTED] The idea that these positions were
4 basically just pieces of paper.

5 MR. KOTZ: Was it usual that he didn't collect all
6 those substantial fees out there?

7 [REDACTED] Yeah. It was extremely unusual.
8 I mean, the whole structure of -- I mean, I can't think of
9 anybody else really who's running a large fund account, large
10 hedge fund money in managed account format.

11 MR. KOTZ: Right. I mean that's -- there's all
12 that money left on the table.

13 [REDACTED] Or not.

14 MS. STEIBER: Right.

15 MR. KOTZ: Right. You had mentioned that -- I read
16 somewhere that it was difficult to get the documents that
17 were filed with the SEC. Can you tell us a little bit about
18 that process, because, you know, one of the things we're
19 looking at here is kind of beyond the Madoff case, so if
20 there's information out there that, you know, folks can get
21 that's filed with the SEC but yet it's, you know, very

22 difficult to get and in other cases people wouldn't have
23 gotten it, you went to that, you know, extreme measure to get
24 it and others wouldn't --

25 [REDACTED] Yeah. Well, I don't really know.

18

1 I mean, I didn't -- that was not part of the thing I did
2 personally. I had somebody around here, --

3 MR. KOTZ: Okay.

4 [REDACTED] -- I won't say who, try to get it
5 and they couldn't get it electronically.

6 MR. KOTZ: Right. It wasn't like it was easy at
7 that time in 2003 or some time before then. Right now I
8 could go to my office and get -- get this --

9 [REDACTED] I'm not so sure you could.

10 MR. KOTZ: No? You could probably still get the
11 focus reports and things like that through CRD, but I'm not
12 -- you know, I'm saying back at this time I think somebody
13 had to, you know, actually write a letter and maybe go
14 somewhere, pay to copy it and bring it back.

15 So do you think a lot of folks who kind of saw the
16 initial description of the strategy might not have gone
17 forward and just said it's not for me and not necessarily dug
18 deep like you did?

19 [REDACTED] Yeah. Interestingly enough in the
20 Fund to funds world, which is huge, there's actually
21 relatively little Madoff exposure. I mean relatively small
22 number of professional investors in Fund to funds were really
23 tagged by this.

24 MS. STEIBER: There are many sophisticated
25 investors, though, that did invest with Madoff. Why do you