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1 UNITED STATE
SECURITIES AND EXCHANGE COMMISSION

2 In the Matter of:

3)
4 OIG-059)

5
6 WITNESS: #14

7 PAGES: 1-42

8
9 PLACE: [REDACTED]

10
11 DATE: March 26, 3009

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14 The above-entitle matter came on
15 for hearing at 4:50 p.m.
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1 On behalf of the Securities and Exchange
2 Commission:

3
4 H. DAVID KOTZ, Inspector General
5 HEIDI STEIBER, ESQ.
6 CHRIS WILSON, Investigator
7 Securities and Exchange Commission
8 100 F Street, N.E.
9 Washington, D.C. 20549

10
11 [REDACTED]

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1 whereupon, [REDACTED],
2

3 was interviewed as follows:
4 EXAMINATION BY

5 MR. KOTZ:
6 Q. My name is David Kotz. I am Inspector

7 General of the Securities and Exchange Commission.
8 My two colleagues are here, Heidi Steiber and Chris
9 Wilson.

10 We will ask you some questions. We
11 will not administer an oath but we would like to
12 get some information and we will have her
13 transcribe it so we have a record of what was said.

14 Can you briefly give me your
15 educational background?

16 A. Sure. I actually -- I did an
17 undergraduate and graduate in business from

18 [Personal Privacy]
19 Q. What year did you graduate?

20 A. [Personal Privacy]
21 Q. What is your experience kind of in the
22 securities field, just generally?

23 A. Sure. I started, actually, right after
24 undergrad, before going back to Master degree, I
25 spent about [Personal Privacy], which is like

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1 the Chicago Board of Trade. Futures trading.
2 Didn't really like it much. [Personal Privacy]

3 And then went back to complete my Master
4 degree. Then I went to [Personal Privacy], the
5 company, and worked there in different positions.

6 [Personal Privacy]

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8
9 Q. What was your position in 2003?

10 A. 2003, I was [Personal Privacy]
11 [Personal Privacy]. That was a subsidiary of the [Personal Privacy].
12 [Personal Privacy] is the [Personal Privacy] company. I was in

13 [Personal Privacy]

14
15 Q. How knowledgeable at that point in time
16 was [Personal Privacy] in the area of investment
17 management?

18 A. Oh, very much. [Personal Privacy]
19 I mean, you know -- let me recall [Personal Privacy] so we
20 were one of the first ones. Our growth wasn't like
21 [Personal Privacy] or other firms because we had one investor
22 mainly. It was [Personal Privacy]. So, but we had good
23 experience.

24 My previous experience with [Personal Privacy] and
25 other places, I mean, you know, on the securities

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1 side, [Personal Privacy]

2 [Personal Privacy] [Personal Privacy] so...

3 Q. When did you first hear of Bernard
4 Madoff?

5 A. That is where it gets -- we -- when [Personal Privacy]
6 [Personal Privacy] we had a mandate from -- from the

7 life insurance companies of [Personal Privacy] to put some money
8 at work in hedge funds. And, you know, [Personal Privacy] there
9 weren't so many choices. So, you know, normally,
10 you know, Madoff, through the different feeders,
11 comes into radar screen because they had a very
12 interesting track record. So, it was on our short
13 list of funds to see.

14 So, [Personal Privacy] I would say, was the first time
15 we started to look at some of the feeder funds.

16 You know, started to do some work.

17 Q. What was the kind of impression of
18 Madoff at that time? What was the feeling in the

19 investment community?
20 A. It was -- nobody really knew what they
21 were doing at that time, I think [Personal Privacy] That was
22 very early. And the feeder guys were more
23 marketing guys. Fantastic business opportunity for
24 them, I guess, at that time, but they were more
25 marketing, you know, third-party marketing people.

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1 They were not technical people. They were giving
2 an explanation, you know, we have this feeder --
3 At that time he, Madoff, wasn't keen to
4 take a lot of managed accounts.

5 Q. '98 you started to look into the
6 operations there to determine whether you wanted to
7 have an investment?

8 A. That's right.

9 Q. What kind of things did you do at that
10 time?

11 A. We went -- actually the first thing we
12 did, we went and we started discussion with the
13 different feeders. So Fairfield Greenwich was the
14 first one. Then Kingate was another one. I think,
15 as far as I remember, those two were the ones that
16 we looked at.

17 The difference between the two was the
18 amount of fees charged by these guys. So, we went
19 with Fairfield -- I mean we went more in detail
20 with Fairfield, and they suggested a meeting with
21 Bernie and his team.

22 Q. Okay.

23 A. And then I don't remember -- I don't
24 know if it was early '98 or mid -- I think it was
25 mid-'98, spring '98.

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1 Q. So you did meet with Bernie and his
2 team?

3 A. Yes.

4 Q. Who else was there? Do you remember?

5 A. Well, at that time we were [Personal Privacy]
6 of [redacted]. So, him, myself and some other people. I
7 have to look at my...

8 Q. Do you remember who else was there from
9 Madoff? Was Peter Madoff there?

10 A. I don't remember.

11 Q. What was your sense in the meeting with
12 Bernie Madoff?

13 A. It was vague. I mean, it wasn't very --
14 so, we were asking questions. You know, the
15 strategy -- and there are some academic paper on
16 the strategy, but it is very hard to put it at
17 work.

18 Q. That is that split strike strategy?

19 A. Yes. Split strike conversion. My [Personal Privacy]
20 business partner at that time, who was the [redacted]
21 with me for the [redacted] business, had an extensive
22 option background.

23 So, you know, we were asking questions
24 on how he was structuring the strategy, the
25 options, and things like that.

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1 Q. So at that point in time, did you have
2 any concerns or were there any red flags raised?

3 A. We didn't get our answers that we had,
4 so, you know -- for example, the timing of --

5 because the strategy -- you know, they were buying
6 this basket of stocks and then buying -- and the
7 option strategy as well, and it was very hard for
8 them to articulate when they were buying -- you
9 know, the timing of the different things and what
10 was triggering the sale of the basket and/or the
11 options. So, that was the problem that we had at
12 that time.

13 Q. So what were your suspicions exactly?
14 Just that you were trying to get some information
15 and --

16 A. We couldn't get; yes.

17 Q. So you didn't have any particular
18 suspicion as to what he was doing?

19 A. At that time, no. At that time, no.

20 Q. So, you didn't get your answers and
21 then you --

22 A. Then we -- what we do usually with hedge
23 funds, when you don't get an answer and you are not
24 satisfied or not comfortable, you just pass on it.

25 Q. So you passed on it and then later on

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1 you looked at it again?

2 A. Yes.

3 Q. When was the second time?

4 A. It was around '03. Again, dates...

5 Q. So, what led you to look at it a second
6 time?

7 A. The second time, I think we had a
8 specific request.

9 Q. From someone to look at --

10 A. I don't remember. I wonder if it wasn't
11 a client. Again, I just don't remember.

12 Q. So, what did you do then to look at it
13 again?

14 A. The feeders were bigger, so we couldn't
15 have access anymore to Bernie when we went back to
16 these guys. So what we did is that we started to
17 do some more work in the options to see if we can
18 find the volume -- first of all, we did -- in terms
19 of analysis, we tried to look at -- you know, to
20 decompose the different parts of the strategy.

21 And again, we looked at the option
22 strategy and tried to see if we find those OEX
23 options somewhere in the market. That was the
24 question. And we really didn't see, you know, that
25 volume.

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1 The other thing is that we knew that the
2 funds were getting bigger. I mean, we were talking
3 with these guys, so just adding up those feeders,
4 plus we had some high net worth clients in Europe,
5 some of those family officers had, themselves,
6 feeders. So we just guessed it should be between 8
7 and 10 billion.

8 For that type of volume you need to
9 have -- you need to see that volume somewhere.

10 Q. And you didn't see it?

11 A. We didn't see that. And we asked
12 different desks and option market-making places,
13 and we didn't find that.

14 The second thing that was little bit --
15 so we had four or five years more of data as well
16 in terms of -- and we went through a, you know,

17 severe market correction or two and that, you
18 know -- didn't really suffer, that guy.
19 You know, for equity only based
20 strategy, is always funny to not be at all -- even
21 stat arb, statistical arbitrage, which is another
22 equity strategy, more quant-oriented, the same
23 thing -- not the same thing but it is equity based.
24 But they look at erratic value discrepancies
25 between stocks.

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1 Even those strategies get hurt when
2 there is a severe dislocation, which we saw
3 actually in '02. But this thing didn't really
4 move. And that was, you know, another alarm bell.
5 When you have exposure, your main exposure is in
6 equities, your asset class is equity and you don't
7 have any type of -- and not being short. Because,
8 you know, the short only guys actually made money,
9 but this guy wasn't short, obviously.

10 That was something, you know, strange.

11 MS. STEIBER: So were you saying with
12 his trading strategy, you would have expected to
13 have seen that his results would have been affected
14 by major moves in the market?

15 THE WITNESS: Yes, somehow. At one
16 point, at least you need to have to be hurt. The
17 dislocations we had in '02 and last year, the
18 magnitude was such that even market neutral
19 strategies get hurt at one point.

20 So, it was just a little bit of, you
21 know, strange.

22 BY MR. KOTZ:

23 Q. So, is it fair to say that, you know,
24 you saw the returns, how consistent they were, they
25 weren't affected at all by general fluctuations in

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1 the market, and so that prompted you to try to ask
2 more questions?

3 A. Yes.

4 Q. These steps that you took, were they
5 kind of extraordinary --

6 A. No.

7 Q. -- due diligence steps?

8 A. No.

9 Q. These would be the normal things that
10 anyone would do when they look at analyzing whether
11 to invest with somebody like --

12 Personal Privacy: Anyone would do, or that
13 he would do?

14 Q. That you would do? What I am trying to
15 understand -- and, certainly, this, kind of from
16 the SEC regulator perspective, there is kind of
17 this feeling out there that, you know, oh, you had
18 to go through these kind of extraordinary measures
19 to figure this out. But are these kind of the
20 basic steps that one would take?

21 what you did in this case, would you
22 consider those kind of basic due diligence steps
23 that you would undertake, or were they kind of
24 extra or special steps?

25 A. Again, me or --

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1 Q. Let's say you.

2 A. Yeah, I guess it's normal. I mean, that

3 is why we are getting paid.

4 Q. So it wasn't that you had to really dig
5 deep to see red flags? Is that fair to say, that
6 these kind of red flags sort of came out at you and
7 then you looked further?

8 A. To be honest, there were -- there wasn't
9 suspicion in '98, but we didn't have satisfaction
10 on the answer that they gave us, that he gave us.
11 And then you had five years more of data, you have
12 a huge market correction, you don't see the
13 volume -- and also, Personal Privacy
14 [REDACTED] we didn't do an operational due diligence.
15 In 2003, we did it. We started to have operational
16 questions.

17 And, you know, we just started to look
18 at the operation. Who was the auditor, and stuff
19 like that. The auditor, I think, was related to
20 him as well.

21 Q. Right. So that was also a red flag?

22 A. That is a big red flag, yes.

23 Q. How come that is a big red flag?

24 A. Related parties, I guess.

25 Q. It is a lack of independence?

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1 A. Well, I would say yes, it's even worse
2 than that. It is -- I mean -- yes, it is worse
3 than that. It would lack independence, yes,
4 definitely. Not really independence, but conflict
5 of interest, I think.

6 MS. STEIBER: Does it raise the risk of
7 fraud in your analysis?

8 THE WITNESS: Yes. It does.

9 Q. So, at that time, did you have any
10 theory about what was going on? You saw these red
11 flags. The returns were not fluctuating. You
12 checked on the options, you didn't see the trading.
13 Did you have any theory as to what might have been
14 going on?

15 A. Yes. At that time we didn't think about
16 fraud because we thought that the magnitude of that
17 fraud would have been very big for that time. I
18 mean, '03, the hedge fund universe was what? 500
19 or 800 billion? So having a \$10 billion failure,
20 fraud, it was beyond imagination. No. We realized
21 last year it was 50, but...

22 But our first -- I would say our
23 first -- we thought that it was front-running. A
24 big front-running operation.

25 Q. Let me, if I could, put you in the

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1 shoes of a regulator for the SEC, okay? If you had
2 some information such as was provided to you and
3 there were indications of front-running and then
4 you did an exam and you found no evidence of
5 front-running, would you try to find some other
6 explanation as to why there were these suspicions?

7 Personal Privacy If he were a regulator?

8 MR. KOTZ: Right.

9 A. Yes. Yes, because if you can't explain,
10 technically -- basically, you have to have a mosaic
11 type of approach. You have the technical approach,
12 which you can't explain really. Then you say,
13 well, it is front-running.

14 If you do the exam -- we couldn't access

15 that. So I couldn't say it is a front-running
16 exam. If I was an SEC guy and I was there and we
17 went through the exam and he actually -- it wasn't
18 a front-running, then the second guess would have
19 been a fraud. Yes.

20 Q. So at a certain point in time, you
21 decided to let the SEC know right?

22 A. Yes.

23 Q. Through this e-mail, May of 2003? Or
24 was there a phone call before? Let me show you a
25 document. Maybe that will help refresh your

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1 recollection.

2 why don't I show you this document. It
3 is an e-mail from Personal Privacy subject: "
4 [REDACTED]."

5 If you see, it says, "Hi, Mavis. Hope
6 things are okay. I just got off the phone with
7 [REDACTED] from [REDACTED].
8 He was asking about who from OC was in charge of
9 the team that conducted the hedge fund sweep
10 examination of [REDACTED]."

11 A. who is Personal Privacy

12 MS. STEIBER: I think he was doing the
13 exam at [REDACTED].

14 THE WITNESS: That's right.

15 Q. Do you remember initially contacting
16 the SEC?

17 A. Yes. Hold on one second.

18 what happened is that we had an
19 examination, an audit. You know, this -- whatever.
20 Every two, three years SEC comes. And I think they
21 asked us if they can -- at that time the SEC had
22 the task force together, and I think Mavis was part
23 of the task force or she was leading the task force
24 or doing something.

25 Anyway, they asked us at that time if we

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1 could sit with them and give our opinion, as a
2 fund-of-fund, on what to look at. I think at that
3 point you guys were contemplating, you know,
4 strengthening the regulation or doing something.
5 And we accepted.

6 Now, I don't remember -- I don't think
7 it was -- I think that in that discussion -- so
8 they came. There were six or eight of them. They
9 came to our office with Personal Privacy We went
10 through how we see the world in terms of investing
11 in hedge funds, what we would look at and things
12 like that.

13 And at the end of that meeting, if I
14 remember, Mavis asked us, "So who do you think, you
15 know, the -- if there is like a fraud, who you
16 think --" you know, "who are you suspicious of?"

17 And lancer, we knew very well actually.
18 That is another -- actually, it happened to be a
19 fraud. And this was at that time, we knew what we
20 knew, and we said to her that we were suspicious
21 about that as well.

22 I think that she asked us if we could
23 give more detail. And I don't remember very well
24 the discussion. That is why I wrote this to her or
25 we filed this complaint or something.

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1 Q. Before you wrote that e-mail, I don't
2 know if you remember having a conversation with
3 her. I am going to show you some notes that she
4 took of the conversation. Maybe this will refresh
5 your recollection about that conversation.
6 A. That actually is basically this.
7 Q. Very similar. And the MARHedge --
8 A. When was this? Just I don't remember
9 the sequence here.
10 MS. STEIBER: It was the day before you
11 sent this.
12 THE WITNESS: Or that?
13 MS. STEIBER: After this, you called
14 her, and then the day before you sent the e-mail
15 you spoke to her on the phone and those are her
16 notes.
17 THE WITNESS: Okay.
18 Wow. This I don't remember, honestly.
19 I remember we had the discussion when she came with
20 the group in our office. I don't remember when was
21 that.
22 Q. Do you remember anything that she said
23 when you talked to her on the phone? What was her
24 reaction to this either on the phone or -- did she
25 seem to take it seriously?
0019 A. I honestly don't remember. That was
1 what? Six years ago?
2 Q. Sure.
3 A. I see a hundred funds a year.
4 Q. A couple of things to just ask you
5 about. There is a reference here to "doubts about
6 how can replicate strategy," articles about this.
7 So do you recall talking to her about
8 the fact that nobody else seemed to be able to
9 replicate Madoff's strategy?
10 A. Yes. I think that we also said here.
11 Personal Privacy Do you recall the
12 conversation?
13 THE WITNESS: Sorry. The conversation?
14 No. As I said, this I don't recall.
15 Q. Let me ask you something about the
16 e-mail, then. There is a reference in there that
17 the firm does not charge management or performance
18 fees. Do you remember that issue? What was
19 concerning about that?
20 A. I had that discussion before. It's
21 definitely, in the hedge fund land, people that
22 don't charge fees, it is strange. I mean, it is
23 just -- that's how people make their living.
24 So it was another red flag why he
25 wouldn't charge, why he would find these
0020 1 unsophisticated third-party marketers that would
2 charge hedge-fund type of returns for doing
3 nothing.
4 Q. And that was because there really
5 wasn't that much to market because his returns were
6 so good; right?
7 A. That is one reason, yes.
8 Q. What else? What else is it about that
9 third-party marketer? They were getting all this
10 money, Madoff wasn't, and it wasn't clear what they
11 were doing?
12

13 [REDACTED]: Just to be clear, these
14 weren't third-party marketers, per se. That is a
15 term actually used in the hedge fund world. These
16 were actual managers.

17 THE WITNESS: The feeders. Yes. Sorry.

18 Q. It was curious to you that the feeders
19 were getting fees and Madoff wasn't, and it was
20 hard to understand what the feeders -- what they
21 were contributing? Is that right?

22 A. That's correct.

23 Q. The issue about the volume, was it your
24 understanding that based on the volume that you
25 estimated or that you understood based on your

0021 1 having seen them in '98 and then later, you had to
2 see that somewhere, and you were unable to see it
3 anywhere?

4 A. Yes.

5 Q. And you did a pretty thorough search to
6 see if you could find out where that volume was?

7 A. Yes. We actually called a few brokers,
8 a few -- again, my ex-business partner was an
9 ex-option trader himself. So, you know, talked to
10 different market-makers, his contacts.

11 Q. Again, putting yourself in the
12 regulators' shoes for a second, if you were the SEC
13 and, obviously, had different authorities, how
14 would you go about checking to see whether these
15 options were trading? Would there be a way that
16 could be done?

17 A. Me as the SEC?

18 Q. Yes.

19 A. Well, I would have better access than a
20 fund of fund.

21 Q. Right.

22 A. I guess.

23 Q. So with that access, what would you do?

24 A. I would do the same thing. I would just
25 go and see in the different firms -- try to

0022 1 identify the counterparts to Madoff.

2 You know, one specific question we asked
3 them was, you know, why we don't see this in the
4 exchange rate, you know, markets, the futures
5 market basically. And they said, "We actually do a
6 lot of these things on an OTC basis."

7 That is where we actually went back to
8 the brokers and we asked them, "Can you tell us if
9 you see that volume."

10 Again, I don't remember exactly but I
11 think the answer was, "Doesn't matter. Even if you
12 do on an OTC basis, you have to clear that, you
13 know, in the exchange afterwards, to cover
14 yourself." I mean, you know, for this size, there
15 are very few brokers that will take the position
16 themselves.

17 Q. There is a point in here also that
18 there was no correlation to the overall equity
19 markets in over ten years. That is a pretty long
20 period of time for Madoff's performance not being
21 aligned with the overall equity markets, wouldn't
22 you say?

23 A. Sure. That is one of the red flags.

24 Q. This issue with the not taking the

25 fees, had you seen any other hedge funds that
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1 didn't take fees?
2 A. My knowledge, no. That's what makes it
3 unusual.
4 Q. Okay.
5 A. The set-up was unusual.
6 Q. Then the other issue that was raised
7 was the fact that the accounts were typically in
8 cash at month's end. What was unusual about that?
9 A. The unusual thing is that -- and that's
10 something that actually is another red flag. Why
11 at month end there is no assets every month end?
12 Q. Do you have any idea why somebody would
13 go to cash at the end of every month?
14 A. No. That is why --
15 Q. Perhaps to avoid -- thinking about it,
16 maybe to avoid securities regulation requirements?
17 A. I wasn't familiar with that, but that
18 might be the case, yes.
19 Q. Then you said in there, "Given the
20 performance of the different accounts, BMS, Bernard
21 Madoff Securities, never had to face redemption."
22 What was the point there? What were
23 you saying there?
24 A. That is another red flag. Actually,
25 last year was a good exercise to see that. You

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1 know, it's very hard for a fund just to be one way.
2 I mean, that is a typical -- and again, we didn't
3 see the Ponzi scheme coming, but it was very
4 strange to have -- even going through very tough
5 periods of markets, like in '02, but still being
6 able just to have positive in-flows. So, it was
7 going only one way.
8 Q. So is it also the case that where he
9 never had to face redemption he never had to prove
10 that he actually generated his claimed returns?
11 A. I don't think these are connected.
12 Q. He never had to prove that he can
13 produce the funds he claims to hold for investors?
14 Is that not what happens when he never has to face
15 redemption?
16 A. Well, he did have some redemptions but
17 they were not sizeable. That is the idea.
18 Q. So what is the consequence of never
19 having to face redemption?
20 A. For us as we are analyzing this thing?
21 Q. Yes.
22 A. It is more of having a one way -- you
23 know, it is suspicious. It doesn't work like this.
24 Funds have inflows, outflows. Just one way every
25 month, you add it up. And we are looking at only

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1 the feeders. So, it was strange for us.
2 Q. Is it fair to say that it wasn't just
3 one or two; there were a number of red flags with
4 Madoff's operations?
5 A. That's correct.
6 Q. Then you attached to your e-mail
7 several articles, this MARHedge article written by
8 Michael Ocrant called "Madoff Tops Charts, Skeptics
9 Ask How."

10 Personal Privacy: Sorry. I don't know what
Page 10

11 the question is.
12 Q. why did you attach that article?
13 A. Again, I don't remember exactly. I
14 think it was more educational.
15 Q. You were aware of that article at the
16 time?
17 A. Yes. Well, if I attached it, I guess.
18 Q. Was that something that was kind of
19 well known in the industry, or was that kind of an
20 obscure thing, would you say?
21 A. This is, was widely read.
22 Q. Is it fair to say it seems as though
23 the person who wrote the article had some of the
24 same type of suspicions?
25 A. Yes.

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1 Q. There were other attachments to it.
2 There was this invest force performance statistics
3 for Kingate Global Fund and Fairfield Century
4 Limited? Personal Privacy
5 Personal Privacy: Is this before or after?
6 MS. STEIBER: It is before.
7 Q. Was there anything you found
8 significant in those performance statistics?
9 Personal Privacy: This is at the time, to
10 the extent you remember, not looking at it again
11 right now.
12 A. Still look great.
13 Q. They were too great, is it fair to say?
14 A. Yes.
15 Q. Anything else in there that you recall,
16 or was that the primary reason you attached that?
17 A. The regularity -- if you look at the
18 pattern, you don't have significant draw-downs, you
19 don't have volatility. As I said, the years where
20 equity market tanked, this thing was making
21 10 percent.
22 Q. There was another attachment, Momentum
23 Asset Management Limited, A Presentation.
24 Was that a Madoff feeder fund?
25 A. I think so.

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1 Q. Was there anything in those fund
2 highlights that you found suspicious or unusual?
3 A. I don't remember why I put this. I
4 wonder if it wasn't, again, educational, just to
5 give Mavis, I think -- maybe she asked us how the
6 strategy was working. So...
7 Q. Now, after you sent the e-mail, did you
8 ever hear back from Mavis?
9 A. I don't think so. I don't remember
10 but --
11 Q. You don't remember hearing back from
12 Mavis?
13 A. No.
14 Q. Do you remember hearing back from
15 anybody at the SEC?
16 A. I don't think so.
17 Q. Did you ever provide any more documents
18 that you remember to Mavis or anyone at the SEC?
19 A. Again, I don't remember.
20 Q. I am going to show you something maybe
21 that will help refresh your recollection. We have
22 some notes of a phone call in January of '04.

23 A. Okay.
24 MS. STEIBER: There are several
25 different people's notes, it looks like, that are
0028 all attached from the same call.

1 Q. Let me give you a couple of the names
2 of the people that might have talked to you. Maybe
3 that will refresh your recollection.
4 Mark Donohue, Eric Swanson,
5 Genevieve Walker, Jackie Wood?
6

7 A. Let's see --
8 Personal Privacy Just your memory.

9 A. NO, I don't remember.
10 Q. You see in the notes, "Returns are too
11 consistently high for this strategy. Funds use
12 brokerage account concern. Speculate about the use
13 of market-making. Not doing that strategy because
14 option training is high. Entry and exit points of
15 stocks. How does he trade the options?"

16 Then you say -- it says, "[REDACTED]. He
17 doesn't understand how he consistently makes money
18 off this strategy. Perhaps he doesn't really use
19 the strategy."

20 A. This is consistent with this.
21 Q. But I mean, it may have been that you
22 did have a phone call later on with somebody at the
23 SEC where you seemed to have given similar
24 information.

25 A. Maybe. Again, six or...
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1 I don't remember this, so...
2 MS. STEIBER: Going back to the e-mail
3 that you sent and the last red flag, where you talk
4 about BMS never having to face redemption and you
5 say, "In fact, given the fact that the different
6 feeders are closed for new investments, there is
7 always replacement capital: One fifth ratio
8 according to some people."

9 Isn't that a characteristic of a Ponzi
10 scheme, to always have replacement capital coming
11 in?

12 THE WITNESS: Again, I am not a
13 specialist on Ponzi schemes. I am just a
14 specialist, you know, of suspicious things.

15 Having a rarity fund is a way to ramp
16 up demand basically, and that was what he was
17 doing.

18 MS. STEIBER: You are laying out an
19 unusual fact and somebody that is familiar with
20 identifying Ponzi schemes could use this fact to
21 figure out what is going on? You are just laying
22 out a fact that you have noticed that is
23 suspicious?

24 THE WITNESS: That's right.
25 Q. I assume you don't remember any further
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1 communications with the SEC after this?

2 A. NO.
3 Q. Were you surprised that the SEC didn't
4 come back and ask too many other questions or try
5 to get more information?

6 A. No. I mean, again, you know, we were a
7 small operation and we were very busy. So, you
8 know -- although we didn't follow anymore --

9 personally, I didn't follow anymore this Madoff
10 thing, but people familiar with this, how you can
11 be, you know, a rarity fund and then growing so
12 aggressively where you have it in every fund of
13 fund, you know, in Europe, in Switzerland, in
14 Spain -- I mean was even getting worse at the end.

15 So, that would have been, for me,
16 another red flag. I wasn't involved so -- anymore.

17 Q. When you met with Madoff or you dealt
18 with them, did it ever come up that the SEC had
19 looked at them? Were you aware at any point that
20 the SEC had looked at Madoff?

21 A. Not that I remember.

22 Q. And you didn't have contact with them
23 after that period of time when you looked at them
24 in 2003?

25 A. No. As I said, the feeders were really

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1 keeping it closed. I mean, and they were saying --
2 they were calling us every now and then, "Do you
3 want capacity?" We were not interested, obviously.

4 But we never had any more access to
5 Bernie. We didn't really ask for that anyway, so.

6 Q. How long of a process did your analysis
7 or review in 2003 take before you kind of came to
8 the conclusions that it was too suspicious for you?

9 A. You know, just again, top of my head? A
10 week or two.

11 Q. A week or two?

12 A. A week or two. Yes. Just phone
13 calls --

14 Q. But after a week or two you had
15 determined that this was not something for you. Is
16 that right?

17 A. Yes. There were too many holes.

18 Q. Too many holes.

19 And what was your reaction when you
20 heard in December that Madoff was running a Ponzi
21 scheme?

22 A. Shocked. Well, I wasn't surprised, but
23 shocked because of the impact on our industry.

24 Q. Were you surprised that the SEC didn't
25 discover it considering that you knew that you had

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1 provided information to them?

2 A. You know, again, I don't know how your
3 internal workings are. My guess is that you have,
4 how many? Five thousand hedge funds? So, given
5 your staff and -- how many people? 600?

6 Q. Well, we have more than that.

7 But the SEC did look at it. It wasn't
8 as if this is one of many hedge funds out there;
9 they actually did look at it pursuant to your
10 information.

11 A. Obviously I was not alone in, you know,
12 giving some clues; right?

13 Q. Absolutely.

14 A. I was a little more vocal, but --

15 MS. STEIBER: Have you ever met Harry
16 Markopolous? Did you know him?

17 THE WITNESS: No.

18 Q. As time went on after 2003, before
19 Bernie Madoff confessed, were there some kind of
20 whispers in the market about Bernie Madoff? Was

21 there generally this feeling that "we don't know
22 exactly what he's doing," even beyond when you
23 looked at it?

24 A. You know, I think that the world was in
25 two. It was really separated between people that

0033 1 really believed in what he was doing and people
2 that didn't believe in what he was doing.

3 Q. It is fair to say there were a
4 significant number of people, in general, in the
5 industry, who didn't believe in what Bernie Madoff
6 was doing?

7 [Personal Privacy] Do you know that to be the
8 case?

9 THE WITNESS: I guess, yes.
10 Significant, maybe not. But, you know...

11 Q. Some number of people?

12 A. Yes.

13 Q. Okay.

14 A. I guess, I mean, what -- what I say,
15 what the MARHedge guy said, it is consistent. They
16 are the same things.

17 Q. Right.

18 A. Why would you invest if you have those
19 holes?

20 Q. Well, except if you thought maybe he
21 was doing something that was illegal but --

22 A. You liked it.

23 Q. -- you could make a lot of money.
24 But if you are the SEC, then your job
25 is to make sure he is not doing anything illegal.

0034 1 Have you had any conversations with
2 anybody else from the SEC since Bernie Madoff
3 confessed? [Personal Privacy]

4 [Personal Privacy] About this?

5 Q. About the information you provided.

6 A. No. You were the...

7 Q. Is there anyone else that you can think
8 of --

9 A. Starting a fraud?

10 Q. I meant anybody else who might have
11 been aware or have found information about Madoff
12 that we might talk to.

13 A. No.

14 Q. Who is your [Personal Privacy]

15 A. [Redacted]

16 Q. How do you spell [Redacted]?

17 A. [Redacted]

18 Q. Is he still working with you?

19 A. He is at [Redacted]. [Redacted].

20 Q. Where is that? In New York?

21 A. Yes.

22 MS. STEIBER: Did he also speak to the
23 SEC?

24 THE WITNESS: Yes.

25 Q. Have you dealt with the SEC in other

0035 1 capacities in terms of examinations?

2 A. Audits.

3 Q. How do you find them? Do you find that
4 they do a thorough job?

5 A. No.

6 Q. In what way?

7 A. '98, I mean, first examination, the
8 first question was, "Can you show me the --" we had
9 a TV set. "Can you show me the invoice for that?"
10 It was strange.

11 Q. Is there a sense that the SEC exam was
12 focused on kind of minutia rather than big picture
13 issues?

14 A. Again, I used to deal with SEC audits
15 when I was in my firm. At ^{Personal} ~~we~~ ^{Privacy} we have a fairly
16 big compliance. I saw an improvement, though, from
17 '98 to '03.

18 Q. What would you say the area in which
19 the ones you saw were deficient? What was the
20 area?

21 One of the things we are trying to do,
22 in addition in our work, is to provide
23 recommendations for improvement to the agency. So
24 it goes beyond what happened in the Madoff
25 situation but also to try to provide improvements.

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1 The SEC is in a situation now where
2 there is a lot of criticism of it. There is a new
3 chairman and definitely an opportunity for
4 improvement. If we could kind of get a little
5 perspective from you in terms of being on the other
6 side, that might be helpful.

7 A. Sure. You know, I think to your point,
8 there is a lot of minutia, detail-oriented work
9 that is done. I am not sure that the auditors
10 actually relate that detail to the big picture of
11 what is going on, what the firm does for a living,
12 their strategy. You know, the bigger things in
13 terms of the investment strategy, for hedge funds
14 especially.

15 But that actually requires a certain
16 level of, I guess, technical knowledge of, you
17 know, the different hedge fund strategies. That
18 would be, I think, an interesting -- that vision
19 would actually allow you to have, direct what you
20 want to see for each strategy.

21 If you have a fixed income arbitrage guy
22 does it make -- what it makes sense to ask? Where
23 you want to focus your attention? In the
24 financing? In the derivatives? Those are the
25 questions you have to ask yourself, rather than,

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1 you know, "Let me look at your e-mails."

2 That's important, too, but, you know.

3 Q. Do you think that is a function of the
4 vision or approach, or the technical abilities of
5 the individuals doing it?

6 A. I think it is a combination of the world
7 is more complex today than it was 25 years ago
8 when -- or 30 years ago, whenever there were more
9 audits on hedge funds.

10 So, that is one thing. And the second
11 thing is, yes, I mean, you have to be able to
12 either have directly or subcontract some of the
13 work to people that actually can understand.

14 Q. In general, you found that some of the
15 SEC examiners were not necessarily up to that
16 technical level?

17 A. I wouldn't give it quite, but I would
18 say that their concern were more accounting and

19 legal rather than strategy itself.
20 MS. STEIBER: Have you provided other
21 tips to the SEC before you provided this tip or
22 after this tip? You had talked about Lancer.
23 THE WITNESS: Yes.
24 MS. STEIBER: Do you recall if the SEC
25 followed up on the other tips you had provided and
0038 resulted in any action?
1 THE WITNESS: I don't remember. But
2 this one, we did follow up ourselves because we had
3 some investment and we sued Lancer.
4 MS. STEIBER: Could you tell us a
5 little more about that? It is helpful to know.
6 THE WITNESS: Sure. Lancer was equity
7 loan short manager. One of our clients had it in
8 advisory account, and we actually looked at the
9 fund.
10 At the beginning we didn't find
11 anything suspicious. But then we went a little
12 more in detail in terms of the stocks. In fact, we
13 found out that some of the stocks were -- their
14 address was in Florida, the same place where an
15 analyst covering them was. So -- and those were
16 stocks with, you know, a few thousand daily volume
17 trades.
18 So, that was kind of strange, so we
19 started to be a little more focused. And it
20 happened that it was actually a fraud.
21 MS. STEIBER: You contacted Mavis?
22 THE WITNESS: Yes.
23 MS. STEIBER: Was she the only one you
24 talked to about the Lancer issue?
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1 THE WITNESS: Yes. Actually, when we
2 knew that it was a -- something very suspicious, it
3 was already late. So I think that was a few weeks
4 or a month or two later that, actually, this whole
5 Lancer story came in the front page.
6 Q. Was that as a result of an SEC
7 examination or investigation?
8 A. For Lancer?
9 Q. Yes.
10 A. For us? No. For Lancer, I don't think
11 so, no.
12 Q. Do you know if Mavis or anybody at the
13 SEC did anything vis-a-vis Lancer?
14 A. I think, yes, the SEC was definitely
15 involved at one point.
16 Q. Any other tips that you provided other
17 than Lancer and this one?
18 A. I don't remember. I don't think so.
19 MS. STEIBER: Just going back to the
20 complaint that you had sent in, I just wanted to
21 clarify. You have some information in here such
22 as -- that you estimate it is between an 8 to
23 \$10 billion managed by Madoff.
24 Did you get that number just from
25 talking to other funds? How did you estimate that?
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1 Just by talking to people?
2 THE WITNESS: Just adding up the
3 feeders, the money the feeders, and also talking
4 with some of the larger European accounts that we

5 knew, you know, like high net worth individuals
6 that had money with us as well. Adding up those
7 that we knew, that was an estimate.

8 Q. It was a low estimate, would you say?
9 Because you only added up certain amounts that you
10 knew?

11 A. Yes. Well, you know, again, last year
12 we are talking about what? Fifty billion or
13 something like that.

14 MR. WILSON: How did you know that more
15 money was coming in, if the feeder funds -- I don't
16 know if you are saying feeder funds in the United
17 States were closed, but how did you know there was
18 this 20 percent that just keeps coming in?

19 THE WITNESS: Again, we were following
20 these things, the assets under management for these
21 funds. And each time, you know, you were asking
22 them, they were calling -- first of all, they were
23 calling to say if there is capacity or not.

24 So, that was a little bit strange, to
25 say, well, it is closed and then it is open and

0041 1 then you have growth and it is closed. So we were
2 thinking maybe there was a match between
3 redemptions and the money coming in.

4 Again, making a fund a rare thing, it
5 is always a big marketing push for investors.

6 Q. After it came out that Bernie Madoff
7 confessed, did you have interest in the story? Did
8 you have an opportunity to read the complaint that
9 Harry Markopolous provided? It was in the papers.

10 A. I think I actually -- someone here
11 printed the 50-page thing that was there. You
12 know.

13 Q. Did you have any thoughts on whether it
14 seemed credible or it seemed like there was a lot
15 of information in it or did you have any kind of
16 thoughts on it?

17 A. You know, some of his stuff were
18 documented, some were not. So, you know, again,
19 really it sums up to what everybody was saying
20 anyway. So, nothing new.

21 Q. Is there anything else you can think of
22 that we haven't asked about maybe?

23 A. No. I think you guys did a good job.

24 MR. KOTZ: Thank you very much.
25 (Time noted: 5:43 p.m.)

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2 C E R T I F I C A T E
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5 I, DEBRA STEVENS, a Registered
6 Professional Reporter and notary public within and
7 for the State of New York, do hereby certify that I
8 reported the proceedings in the within-entitled
9 matter on March 26, 2009, and that this is an
10 accurate transcription of what transpired at that
11 time and place.

12
13 _____
14 DEBRA STEVENS, RPR-CRR
15
16