ATTACHMENT B

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re: BERNARD L. MADOFF INVESTMENT SECURITIES LLC, Debtor,	Adv. Pro. No. 08-01789 (LGB) SIPA LIQUIDATION (Substantively Consolidated)
IRVING H. PICARD, Trustee for the Liquidation of Bernard L. Madoff Investment Securities LLC, Plaintiff, v. FAIRFIELD INVESTMENT FUND LIMITED, STABLE FUND, FAIRFIELD GREENWICH LIMITED, FAIRFIELD GREENWICH (BERMUDA), LTD., FAIRFIELD GREENWICH ADVISORS LLC, FAIRFIELD INTERNATIONAL MANAGERS, INC., THE ESTATE OF WALTER M. NOEL JR., MONICA NOEL, in her capacity as Executor of the Estate of Walter M. Noel, Jr., JEFFREY TUCKER, ANDRES PIEDRAHITA, AMIT VIJAYVERGIYA, PHILIP TOUB, CORINA NOEL PIEDRAHITA, FAIRFIELD GREENWICH CAPITAL PARTNERS and SHARE MANAGEMENT LLC, Defendants.	Adv. Pro. No. 09-01239 (LGB)

REBUTTAL EXPERT REPORT OF
AMY B. HIRSCH

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Appendix I: Documents Considered

1. I have been retained by Baker & Hostetler, LLP, counsel for Irving H. Picard, Trustee ("Trustee") for the substantively consolidated Securities Investor Protection Act ("SIPA") liquidation of Bernard L. Madoff Investment Securities LLC ("BLMIS")[1] and the chapter 7 estate of Bernard L. Madoff ("Madoff").[2] This report is offered pursuant to Federal Rule of Civil Procedure 26(a)(2).

2. I have been asked to review and respond to the Expert Report of Cameron K. Funkhouser ("Funkhouser"), dated August 22, 2025 (the "Funkhouser Report").[3] I submitted a report in the above-captioned proceeding on August 22, 2025 (the "Hirsch Report" or my "Initial Report"). The opinions that I rendered in my Initial Report, the accompanying Appendices, and the documents I considered in support of my Initial Report, are all incorporated herein by reference. All capitalized terms not defined herein shall have the meaning assigned to them in my Initial Report.

I. Summary of Opinions

3. Funkhouser's opinion that "Defendants' actions were consistent with a good faith belief that BLMIS was trading securities"[4] is not supported by the contemporaneous documents and information available to FGG during the life of the Fairfield BLMIS Accounts. FGG was the investment manager of the Sentry Funds, which were invested in the Fairfield BLMIS Accounts, from inception through the collapse of BLMIS in December 2008.[5] As such, as an investment professional, I considered the due diligence materials actually

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[1] As in my Initial Report, "BLMIS" refers to the Investment Advisory business (the "IA Business") of BLMIS. There was also a market making and proprietary trading business of BLMIS, which is collectively referred to as the "Proprietary Trading Business." If I am referring to the Proprietary Trading Business, I will explicitly indicate as such.

[2] Kroll, LLC, a global advisor in the areas of valuation, corporate finance, investigations, disputes, cyber security, compliance and regulatory matters, and other governance-related issues ("Kroll"), was retained to assist me in the preparation of this report. Employees of Kroll worked under my direct supervision in the preparation of work supporting my opinions contained herein.

[3] It should not be assumed that I agree with any point made in the Funkhouser Report on which I do not comment herein.

[4] Funkhouser Report, ¶18. There is no *per se* notion of "good faith" in the investment industry but there are fiduciary obligations to act with a duty of care and duty of loyalty to each client. I am using those obligations and duties as the foundation for my discussions of "good faith."

[5] *See* Hirsch Report, Section V.C.

available to FGG during the time of their investment with BLMIS, not post-December 2008 news articles and publications that were not available to FGG at the time. I reached the conclusion that the contemporaneous documents and information maintained by FGG along with publicly available information, showed that no trading was taking place in the Fairfield BLMIS Accounts, that BLMIS was not trading as it represented to investors, and that numerous other red flags cumulatively confirmed that BLMIS was not trading securities.

4. Funkhouser's conclusions regarding the significance of regulatory action or inaction are predicated on the false premise that regulatory exams equate to a "good seal of approval" for an investment manager. As a due diligence expert, I review regulatory websites regarding any firm I am reviewing. However, I give them little weight in my investment decisions because: (i) the information related to regulatory action or examination is often scant or not available, and (ii) FINRA regulatory examinations at the time of the Fairfield BLMIS Accounts were limited to investigating non-compliance with regulations, not on discerning fraud. Unlike a regulatory examination that is a snapshot at a particular moment in time, due diligence and risk management are continuous throughout the life of an investment and yield qualitative and quantitative analyses from which an investment manager can discern performance and risks, including fraud. Regardless of the result of any regulatory finding, I would review it for its merits, not accept it blindly. Further, many of the regulatory processes Funkhouser points to for the identification of fraud risks were not even in place prior to December 2008 but instead were created specifically in response to the regulators' failure in identifying the Madoff Ponzi scheme. Investment managers, as fiduciaries, must rely on their own examination (due diligence) of the investment, not a regulatory examination.

5. Funkhouser ignores the difference between a regulatory exam and due diligence and/or risk management. Regulators typically examine firms on an irregular basis, and the focus of the exam is predominantly rules and regulation based, e.g., are the required filings accurate and timely, are the required licenses in place, is the firm in compliance with securities regulations. Due diligence incorporates those issues and then examines the entire firm, the investment strategy, and vendors (e.g., auditors), as specified in my Initial Report.

6. Funkhouser is incorrect in claiming that FGG's efforts "to monitor and assure themselves BLMIS was trading securities[] is inconsistent with the actions of a knowing participant of a Ponzi scheme or any other fraud at BLMIS."[6] As the hedge fund industry matured, investors required more reporting from investment managers. As a practitioner in the hedge fund industry, I saw this pressure on investment managers to report and to provide greater transparency from the institutional investors who were just starting to invest in hedge funds in a significant manner. To compete and to raise assets like any other hedge fund, FGG commenced greater reporting and monitoring, and presented institutional quality due diligence and risk management.

7. Funkhouser also ignores the difference between an audit and due diligence and is incorrect in claiming that PwC audited BLMIS. PwC did not audit BLMIS; it was only responsible for auditing the financial statements of the Sentry Funds which is evidenced in the audit engagement letters.[7] In no way does the audit of financial statements equate with due diligence.

8. Funkhouser inappropriately relies on Madoff's reputation to sustain FGG's "assurances" that the investments with BLMIS were legitimate. Investment professionals typically do not invest with people who have a "bad" reputation and instead expect them to have a "good" reputation. The known reputation of an investment advisor must be relevant to the potential investment. Thus, Madoff's reputation in the broker-dealer community does not equate to his reputation as an investment manager. Madoff was open and willing to speak with people about his broker-dealer business; that was not the case for his investment advisory business. In any event, due diligence, not reputation alone, should be the overriding factor in whether or not to invest.

9. Funkhouser's claim that personal investment in the Sentry Funds is "contrary to how persons aware of a Ponzi scheme would act and invest"[8] does not take into consideration

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6 Funkhouser Report, ¶20; *see also* ¶¶18, 152.

7 *See, e.g.*, PwC engagement letter with Fairfield Greenwich Group, November 7, 2008 [10-03800_FGG_0015084-095 at -084], ("[PwC] will audit the financial statements of the Funds as at December 31, 2008 and for the year then ending.").

8 Funkhouser Report, ¶20.

the industry custom and practice of self-investment by the manager. In hedge funds, investment by the investment manager is important to investors. Investing in the Sentry Funds would have been necessary to provide assurances and attract more capital. Indeed, when compared to the hundreds of millions of fees and returns earned by FGG, the investments by its principles are insignificant.

10. Funkhouser inappropriately relies on the ability to meet redemptions to support his opinion of lack of knowledge of fraud at BLMIS. First, fulfilling redemption requests is expected by investors and a normal operational process of hedge funds; it is irrelevant to knowledge of a fraud. Second, these redemptions were funded with either cash on hand in the Sentry Fund's bank account or by a withdrawal from BLMIS, as determined by FGG. Where redemptions were funded with money on hand, the notion of assurances of legitimacy at BLMIS through the ability to withdraw money is illogical, at best, and irrelevant.

11. It remains my opinion that due diligence and risk analysis conducted in a similar manner to that represented by FGG, using the documents and information that were available to FGG during its investment with BLMIS, shows that: no trading was taking place in the Fairfield BLMIS Accounts; BLMIS was not trading as it represented to investors; and numerous other red flags cumulatively confirmed that BLMIS was not trading securities. None of the theories and speculation raised by Funkhouser alter, affect, or undermine these findings.

12. A complete list of the documents I considered in connection with this report is included as **Appendix I**. To the extent that additional information becomes available, I reserve the right to amend or supplement my opinions.

II. Opinion I: There Are Differences Between a Regulatory Investigation and the Due Diligence Required of an Investment Manager

13. Funkhouser opines (i) that he "would not recommend Defendants for further investigation or an enforcement action"[9] and (ii) that "the absence of civil or criminal

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[9] Funkhouser Report, ¶¶20, 140, 146.

enforcement actions against the Defendants by agencies that thoroughly investigated the fraud strongly suggests that the Defendants were not aware of the Ponzi scheme until December 11, 2008."[10] However, the lack of regulatory action does not mean that FGG was not a participant in fraud, simply that FGG was not charged. Nor is regulatory review synonymous with investment or operational due diligence conducted by an investment manager. Instead, it is a single touchpoint in the due diligence process. Where due diligence analysis confirms that there were no trades being executed in the Fairfield BLMIS Accounts, that BLMIS was not executing the trading strategy FGG and BLMIS presented to investors, and cumulative red flags existed that confirmed the lack of trading at BLMIS, findings of regulatory compliance or lack of regulatory action carry little or no weight at all.

A. The Tasks and Goals of a Regulatory Investigation and Due Diligence Are Different

14. In the financial industry, due diligence is fundamental to meeting the fiduciary obligations of an investment manager. Clients rely on the investment manager to not only guide them in making investments but also to keep them informed of concerns and risks associated with the investment, as well as to make recommendations to stay in the investment or redeem based on those risks and the best interest of the client. In order to do this, the investment manager conducts due diligence to understand the investment: the strategy of the investment, performance metrics, potential risks and losses associated with the investment, and the returns and potential returns for the investment considering market conditions.

15. Due diligence is continuous and allows the investor to "connect the dots" throughout the life of an investment.[11] Due diligence requires investment and operational experience. In my experience, many, if not most, due diligence professionals have worked on Wall Street or at a fund or fund-of-funds in some capacity, which is typically not true of regulatory staff.

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10 Funkhouser Report, ¶139.
11 *See* Hirsch Report, Section VII.A.

16. On the other hand, the review conducted by a regulatory agency differs significantly from investment due diligence. Regulatory reviews are just that, reviews, typically of a moment in time or period. In many, if not most cases, regulators are alerted to potential fraud by non-regulatory entities, persons, or trades *after the fact*. For example, of approximately 342 actions cited on the FINRA website between August 2014 and May 2022, more than 100 were insider trading violations,[12] which, by the nature of the violation, are always discovered after the fact. These types of investigations are important, but they do not help *prevent* fraud. Other reported violations, such as "pump and dump" schemes,[13] are again violations found after the fact.

17. This is not to say that the existence of regulatory or governmental action is irrelevant to due diligence. If there has been regulatory action against an investment advisor, that is a concern and would prompt me to investigate and obtain as much information as possible about the regulatory action. I would examine the available information (which is often scant or incomplete because of non-disclosure by the regulatory or governing body) in order to assess the risk of regulatory action on the investment and whether that risk is in the best interest of the client.

18. But the lack of any regulatory or governmental action against an investment advisor is just one piece of information. The absence of an action does not provide an investment advisor with a clean bill of health, suggest that due diligence is not necessary, or indicate that red flags and/or risks identified during due diligence should be ignored. One reason for this, as noted above, is that information related to regulatory or governmental actions is typically not disclosed or is incomplete and thus, the full scope and facts of regulatory or governmental action cannot be verified in real-time.

19. In addition, the focus and changing priorities of regulatory agencies, such as the SEC and FINRA, raise questions regarding the reliability of regulatory action or lack of action

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12 FINRA, Actions Resulting from Referrals to Federal and State Authorities, August 15, 2014 – May 20, 2022 [PUBLIC0709420-437]. I have provided this post-2008 data to illustrate that a large portion of the violations cited on FINRA's website are *after the fact* violations.

13 "Pump and dump" schemes are where the price of a security is artificially inflated by using false or misleading statements that induce investors to purchase the security, creating a rise in the price which the perpetrator then sells at a profit.

prior to December 2008.[14] Regulatory priorities change year by year as new regulations are created, new ways to defraud investors are uncovered, and regulations are changed to meet new challenges. The National Exam Program Office of Compliance Inspections and Examinations ("OCIE") sets and communicates the SEC's priorities.[15] During the early 2000s, the National Association of Securities Dealers ("NASD") (which became FINRA in 2007[16]) focused on two types of examinations: (i) routine/cycle examinations, and (ii) cause examinations. Routine examinations are conducted on a regular schedule, whereas cause examinations are conducted in response to a particular problem identified through a variety of sources such as customer complaints or terminations for cause of registered representatives by broker-dealers.[17]

20. In fact, although NASD, and later FINRA, conducted routine exams of "Madoff's broker-dealer operations at least every other year . . . [the] examinations tended to focus on areas such as the firm's financial and operational condition, supervisory system, supervisory and internal controls, [Anti-Money Laundering] compliance, internal communications and business continuity plans."[18] These examinations did not rise to nearly the level of detail that an investment manager would be expected to conduct in their due diligence consistent with industry customs and practices. Most importantly, FINRA did not

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14 For example, in its March 2008 Regulatory and Examination Priorities Letter, FINRA listed Senior Investors, Anti-Money Laundering, Supervisory Controls, Protection of Customer Information, and other topics as exam priorities, all of which are distinct from due diligence. These topics are reiterated in FINRA's May 2008 issue of Improving Examination Results Letter. 2008 Regulatory and Examination Priorities Letter, FINRA Rules and Guidance, March 24, 2008 [PUBLIC0709408-413]; Improving Examination Results, FINRA Rules and Guidance, May 2008 [PUBLIC0709588-597].

15 The OCIE was renamed the Division of Examinations in 2020. This branch of the SEC is responsible for conducting the agency's National Exam Program using risk-focused strategies to improve industry practices and compliance, prevent fraud, monitor risk, and inform policy. *See,* SEC website, Division of Examinations [PUBLIC0709903-907].

16 FINRA was created in 2007 as a result of the consolidation of the NASD and the member regulation, enforcement, and arbitration functions of the New York Stock Exchange (NYSE). Report of the 2009 Special Review Committee on FINRA's Examination Program in Light of the Stanford and Madoff Schemes, September 2009 [PUBLIC0709677-756 at -688].

17 Testimony Before a Hearing on Examination of Financial Institutions and Their Affiliated Broker-Dealers, Daniel M. Sibears, October 8, 1997 [PUBLIC0709812-817]; Testimony Before the Committee on Banking, Housing, and Urban Affairs, Stephen Luparello, January 27, 2009 [PUBLIC0709818-821].

18 Testimony Before the Committee on Banking, Housing, and Urban Affairs, Stephen Luparello, January 27, 2009 [PUBLIC0709818-821 at -819].

consider Madoff's investment advisory business or assess any of Madoff's returns and strategy.

21. FINRA did not conduct cause examinations of BLMIS. Prior to 2009, FINRA was not focused on identifying or addressing fraud at BLMIS. As described by FINRA's Special Review Committee, "FINRA's examination program during the relevant period was not designed to detect the type of fraudulent activities in which the Madoff firm engaged."[19] The FINRA Special Review Committee also noted that their "cycle exams principally rel[ied] on the representations of member firms, and, thus, [were] heavily dependent on the honesty and completeness of the member firm's response."[20]

22. In June 2009, following the collapse of BLMIS, the Director of the OCIE Lori A. Richards stated "[i]n the wake of Madoff and other frauds, we're making changes to examination oversight that will sharpen examiners' ability to detect fraud and other types of violations. In many instances, these changes have been formulated collaboratively with FINRA." Specifically, Richards identified "enhancing examiners' training and expertise in fraud detection . . . improving the tools available to examiners to detect fraud, and leveraging the work performed by the firm's independent auditor" as key changes being implemented. Richards explained that these tools include "more rigorous pre-exam due diligence of the firm and its employees and operations, and a sharper focus on not only the 'red' flags that could indicate a potential fraud – but also the more subtle 'yellow' flags …."[21]

23. FINRA reiterated these changes in its September 2009 Special Review Committee Examination, stating:

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19 Report of the 2009 Special Review Committee on FINRA's Examination Program in Light of the Stanford and Madoff Schemes, September 2009 [PUBLIC0709677-756 at -736]. ("SEC-required cycle exams play a role in ensuring that member firms are adequately capitalized and compliant with regulatory requirements, they are not an effective means for uncovering complex frauds." [PUBLIC0709677-756 at- 682]).

20 Report of the 2009 Special Review Committee on FINRA's Examination Program in Light of the Stanford and Madoff Schemes, September 2009 [PUBLIC0709677-756 at -685]. ("The Madoff case also highlights the need to improve the exchange of information within FINRA and between the SEC and FINRA, including the sharing of information about potentially fraudulent conduct at member firms.").

21 Speech by SEC Staff: Strengthening Examination Oversight: Changes to Regulatory Examinations, Lori A. Richards, June 17, 2009 [PUBLIC0709767-773 at -767-770].

> … subsequent to the Madoff and Stanford schemes coming to light, FINRA has made changes to its regulatory programs to strengthen its efforts in a number of areas. These include the following: enhancing fraud training for examiners; developing more detailed procedures [to] better support examiners' efforts to detect potential fraud during examinations; enhancing use of publicly available information during the pre-examination process….[22]

24. FINRA changed its priorities following the collapse of BLMIS. In its 2009 FINRA "Year in Review," FINRA's CEO stated the following:

> For FINRA and all regulators, 2009 was a year to act on lessons learned from the financial crisis and revelations of fraud and move ahead with new measures to strengthen investor protections and preserve the vitality of the financial markets. The necessary reform and regulatory restructuring of our financial system will take time.[23]

25. He further stated:

> We created an Office of the Whistleblower in March to encourage individuals with firsthand knowledge of, or material information about, potentially fraudulent, illegal or unethical activity to come forward and share it with regulators. In October [2009], we established the Office of Fraud Detection and Market Intelligence. This office provides a heightened and expedited review of allegations of serious frauds, a centralized point of contact internally and externally on fraud issues, and consolidates recognized expertise in expedited fraud detection and investigation. FINRA also enhanced its examination programs, procedures and training in a variety of ways intended to help us better detect conduct that could be indicative of fraud.[24]

26. After the collapse of BLMIS, the SEC likewise shifted its focus, processes, and capabilities toward efforts to avoid future frauds:

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22 Report of the 2009 Special Review Committee on FINRA's Examination Program in Light of the Stanford and Madoff Schemes, September 2009 [PUBLIC0709677-756 at -748].

23 2009 Year In Review, FINRA, June 2010 [PUBLIC0709414-419 at -414].

24 2009 Year In Review, FINRA, June 2010 [PUBLIC0709414-419 at -414].

> In December 2008, Bernard L. Madoff admitted to perpetrating a massive Ponzi scheme. Shortly thereafter, the SEC began taking decisive and comprehensive steps to reduce the chances that such frauds would occur or be undetected in the future. Today, the agency is continuing to reform and improve the way it operates. Among other things, the SEC has been:
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> - Revitalizing the Enforcement Division
> - Revamping the handling of complaints and tips
> - Encouraging greater cooperation by 'insiders'
> - Enhancing safeguards for investors' assets
> - Improving risk assessment capabilities
> - Conducting risk-based examinations of financial firms
> - Improving fraud detection procedures for examiners
> - Recruiting staff with specialized experience
> - Expanding and targeting training
> - Improving internal controls
> - Advocating for a whistleblower program
> - Seeking more resources
> - Integrating broker-dealer and investment adviser examinations
> - Enhancing the licensing, education and oversight regime for 'back-office' personnel.[25]

27. Notably, nearly all of the SEC and FINRA processes and capabilities Funkhouser points to were created *after* BLMIS collapsed. In particular, Funkhouser states that his professional opinion is based on his experience as Executive Vice President of FINRA's Office of Fraud Detection and Market Intelligence ("OFDMI") and cites to this program heavily throughout his report. However, OFDMI was formed in 2009, in response to regulatory failures in connection with the Madoff fraud and other matters. As stated within Appendix C of the Funkhouser Report:

> The OFMDI *[sic]* was created in the wake of tumultuous times in the financial industry, following the 2008 financial crisis and the **revelation of the Bernie Madoff** and Allen Stanford Ponzi schemes. The 2008 financial crisis and subsequent collapse of two

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[25] The SEC Post-Madoff Reforms, July 15, 2019 [PUBLIC0709828-832 at -828].

> massive Ponzi schemes **exposed significant gaps in regulatory oversight and response, including a failure to detect** the two long-standing frauds.[26]

28. As described by the Chairman and CEO of FINRA in 2009, the OFDMI was created to "provide a heightened review of **incoming allegations** of serious frauds, a centralized point of contact internally and externally on fraud issues and consolidate recognized expertise in expedited fraud detection and investigation."[27] By FINRA's own admission, the OFDMI is not proactive, rather reactive only when alerted to fraud.

29. Further, FINRA's interim CEO Stephen Luparello ("Luparello") acknowledged the limitations of the past exams in his testimony before the U.S. Senate Committee on Banking, Housing, and Urban Affairs, stating that "FINRA regulates broker-dealers, but not investment advisers . . . . FINRA's authority, as noted above, does not extend to writing rules for, examining for or enforcing compliance with the Investment Advisers Act of 1940."[28]

30. In short, Funkhouser's reliance on a lack of regulatory action against BLMIS is misplaced. A regulatory examination of an investment advisor is a snapshot of a single moment in time, and, prior to December 2008, those examinations were focused on regulatory compliance and filings, not proactive examination intended to discern fraud. On the other hand, due diligence and risk management are continuous examinations throughout the lifetime of the investment, specifically intended to identify red flags and discern fraud. Regulatory examinations and due diligence/risk management are not equivalent.

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26 Funkhouser Report, Appendix C, ¶1 (*emphasis added*).

27 Testimony Before the Committee on Financial Services, Richard Ketchum (Chairman & CEO, FINRA), October 6, 2009 [PUBLIC0709822-827 at -822] (*emphasis added*).

28 Testimony Before the Committee on Banking, Housing, and Urban Affairs, Stephen Luparello, January 27, 2009 [PUBLIC0709818-821 at -820].

B. Funkhouser's Hypothetical Regulatory Non-Referral of FGG is Irrelevant to and Does Not Undermine My Findings of Lack of Trading

31. Funkhouser's finding that he would not refer the Defendants for further investigation or an enforcement action does not mean that they were not participants in fraud, simply that they were not (or would not be) charged.[29] Nor, contrary to Funkhouser's contentions, is there a standard in either the financial industry or the regulatory field of "behavior consistent with a good-faith belief" of trading.[30] In the regulatory context, referring for further investigation simply means possible non-compliance with regulations, while not referring for further investigation simply means the entity is likely in compliance with regulations. Neither equates to the presence or absence of "good faith." In fact, the government is not concerned with whether the failure to comply with regulations was in good faith, as good faith does not absolve you of regulatory sanctions, including fines.

32. On the other hand, due diligence is primarily focused on identifying and examining representations and risks associated with a particular investment and decision-making in the best interest of the investor. As set forth in my Initial Report, due diligence is the process of verifying whether what the investment advisor is telling its investors is accurate and truthful.[31] What matters in due diligence is verifying that trades are being executed; verifying that the represented strategy (in this case, the SSC) is being executed and the returns are consistent with the strategy; and verifying that the securities and other assets exist. What matters in due diligence is protecting the interests of the investor from misrepresentations and unnecessary or unreasonable risks.

33. The Defendants were investment managers who conducted and represented that they conducted extensive investment and operational due diligence.[32] As such, as set forth in my Initial Report, I conducted due diligence and risk analysis in a similar manner to that represented by FGG, using the contemporaneous information and documents in the

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[29] *See, e.g.*, Funkhouser Report, ¶20.

[30] Funkhouser Report, ¶18 ("Defendants exhibited behavior consistent with a good-faith belief that Mr. Madoff was executing trades in furtherance of his purported [SSC] strategy and consistent with unawareness of the Ponzi scheme until it was publicly disclosed in December 2008.").

[31] Hirsch Report, ¶¶5, 119.

[32] *See* Hirsch Report, Section VII.B.1.

Defendants' possession. I took the information as presented – either by BLMIS or FGG's respective agents and vendors – and reviewed and analyzed it. Those sources showed that there were no trades being executed in the Fairfield BLMIS Accounts, that BLMIS was not executing the trading strategy FGG and BLMIS presented to investors, and cumulative red flags confirmed the lack of trading at BLMIS.

34. Unlike Funkhouser, I did not rely primarily on newspaper articles, investigative reports, and other materials issued after BLMIS's collapse on December 11, 2008. While these later documents and information reveal information about BLMIS's Ponzi scheme, such sources were not in the possession of FGG during their investment with BLMIS and thus could not have been considered by FGG during their contemporaneous due diligence and risk analysis.

35. As to the allocutions of Madoff, DiPascali, or other BLMIS employees and vendors and the deposition testimony of FGG's management, employees, and consultants, I did not disregard them even though they were taken after BLMIS collapsed. However, as with due diligence, witness testimony should not be taken at face value and should be verified against contemporaneous documents, available information, and/or independent third-party sources.

36. For example, Funkhouser relies upon Madoff's generalized statements years after BLMIS collapsed that "no one suspected that the BLMIS IA business was fraudulent."[33] These statements should not be taken as true without independent verification. Madoff offers uncorroborated statements of what people knew (or did not know), thought, and said. Without the identities of the individuals, the statements cannot be verified.

37. In fact, Madoff's claim that everyone was ignorant of his fraud was debunked by the report titled U.S. Securities and Exchange Commission Office of Investigations, Investigation of Failure of the SEC to Uncover Bernard Madoff's Ponzi Scheme (the "OIG Report"), cited and relied upon by Funkhouser. For example, the OIG Report cites

[33] Funkhouser Report, ¶142 and footnote 187 (citing to Deposition of Bernard Madoff, December 20, 2016, p. 219-220 [08-01789_MABCAD0000001]); *see also* Funkhouser Report, ¶95 and footnote 122 (citing to Deposition of Bernard Madoff, April 26, 2017, p. 179-80 [08-01789_MABCAB0000001]).

to the following interviews of people[34] who acknowledged contemporaneous red flags or suspicious activity related to Madoff's operations prior to the collapse of BLMIS, including:

- **Unidentified Chief Executive Officer (CEO) of Research Firm, unidentified independent hedge fund research and advisory firm:** noting impossible returns, paper statements, insufficient option volume, foregoing hedge fund fees to charge commissions, and the use of an unknown auditor.[35]
- **Unidentified Investment Bank Due Diligence Team, unidentified investment bank:** the due diligence team was conducting due diligence on a transaction that included structured products with underlying Madoff exposure. They noted impossible returns, especially during the tech bubble, impossible pricing compared to "VWOP *[sic]*," lack of management fees, and impossible option volumes.[36]

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34 OIG Report, p. 15-20 [PUBLIC0006358-834 at -392-397].

35 OIG Report, p. 419, 428 [PUBLIC0006358-834 at -796, -805], Exhibit 71 [PUBLIC0709459-480 at -460-461, -466-469, -471-472]. (The CEO of the research firm stated that he was "cynical about the whole thing" because "[t]he returns were impossible. Absolutely impossible in [his] opinion. No financial strategy could produce those sort of returns." Another suspicion arose when the CEO asked "the Maxam people" how they got "total transparency" regarding Madoff's trading activity and a binder with "zillions of trade tickets" was produced, something he had "never in [his] life seen… in this industry." The CEO found this "unbelievably unusual" and "really strange," noting the trade tickets were sent via U.S. Mail and the fact that "we are in the 21st century." The CEO also stated he was suspicious of Madoff's purported trading since the market for "[S&P] 100 options [was] nowhere near deep enough to trade $13 billion dollars. I thought there was $13 billion in all the feeder funds. The liquidity of listed S&P 100 options could not handle 1/20th of that size." Furthermore, the CEO questioned the need for "all the feeder funds," and "why wouldn't [Madoff] collect hedge fund fees just by running a hedge fund and become a multi-billionaire as opposed to earning -- I think if he -- on commissions he would probably earn $200 million a year and running a fund he would probably earn $1 billion a year." Lastly, the CEO was surprised that he didn't know who Madoff's auditor was and as a result reached out to "kind of industry titans" but "[n]obody had ever heard of Friehling and Horowitz." "The research firm then hired a private investigator to find out more about the auditor and discovered that the firm had three employees, Friehling, Horowitz, and a secretary, and that Jerome Horowitz was 78 years old and lived in Florida.").

36 OIG Report, p. 413 [PUBLIC0006358-834 at -790], OIG Report, Exhibit 72 [PUBLIC0709481-488 at -481-484]. (A large investment bank, who "wanted to expand its customer activity in the U.S." was considering a transaction that included structured products which had underlying Madoff exposure. Upon review of a Fairfield returns chart, which was "part of the marketing returns showing trading profits for 2000-2002 of 9-12%. They thought the **returns were impossible, especially considering that the technology bubble burst** during this time. They determined that particularly in the years 2000, 2001 and 2002, there was no way Madoff's performance could be that good, saying it was 'readily apparent' that the returns were not possible (noting that Madoffs returns in the years 2000-2003 were in the neighborhood of 8% which was not conceivable in that type of down market.)" "One of the major tip-offs that Madoff's claimed performance could not be legitimate arose when [redacted] obtained from Fairfield records of all transactions for a 12- month period. The records showed that Madoff's performance driver was the price he was selling at as compared to the Volume-Weighted Opening Price (VWOP) … He was buying the stocks at 1 % below VWOP and selling at 50-100

- **Unidentified Chief Executive Officer (CEO), unidentified fund of funds firm:** noting suspicion of Madoff always being profitable, Madoff's returns not being consistent with the SSC strategy description, performance too consistent, "weird" pattern where stock buys "were all at or close to the lows of the day and sales were at or close to the highs of the day," lack of option volume, obscure auditor, and lack of customer activity on BLMIS financial statements.[37]
- **Michael Ocrant, Journalist, Institutional Investor, former Managing Editor, MARHedge:** noting impossible returns, insufficient option volume, and unusual fee structure.[38]

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basis points above VWOP. Because of their industry experience, [redacted] knew that this type of perfect timing was simply not possible… Madoff was beating VWOP by 100 basis points consistently on every stock, outperforming the market 90% of the time. [redacted] did not understand how this could be possible, and there was a concern that Madoff owned a market-making business and that there was a lack of independence. [redacted] noted that it was a red flag for them when they were not able to understand or explain a matter like this. Another red flag to [redacted] was that Madoff **did not take a management fee** on the accounts he managed… he has never seen a hedge fund manager forego a management fee. A further red flag for [redacted] was the **huge volume of options** that Madoff claimed to purchase" despite them not knowing anyone "trading options for Madoff," specifically noting that they had never seen any "broker on the floor who was actively trading for Madoff.").

37 OIG Report, Exhibit 73 [PUBLIC0709874-889 at -876-878, -880-885]. (The CEO testified that "the first thing [he] noted was that the description of what [Madoff] was doing seemed to be inconsistent with what [he] knew about what you could achieve in a strategy like that." "[T]hat's a strategy that will make money most of the time, but it's going to lose money if there's exposure and volatility. It's going to lose money if there's big market moves. It won't produce the kind of pattern of returns that…was the Madoff pattern." "[T]he fact that he never lost money was suspicious." The CEO obtained a sample of 3 or 4 months of Madoff's account statements from a friend and "saw this pattern which really seemed weird where the --where the purchases were all at or close to the lows of the day and the sales were at or close to the highs of the day and, of course, nobody can do that." In addition, the CEO "looked at the volumes that he was transacting in this account and [he] could not imagine that activity taking place a thousandfold. It just -- it just seemed wildly out of proportion to the purported trading volumes in those shares or those options." The CEO noted the accounting firm Madoff was using was "totally obscure" and that "95 percent or 99 percent of all investment operations are handled by either the Big 4 accounting firms or maybe it was 5 in those days." And if not "there are a handful of other specialist firms." The CEO obtained and reviewed Madoff's financial statements, which was filed with the SEC, and "[i]t showed no receivables from customers. It showed no payables to customers… no evidence at all of customer activity." "[H]ere's a guy who's a prominent big-scale operator with customer money and the statement doesn't show anything… for customers.")

38 OIG Report, Exhibit 74 [PUBLIC0709489-503 at -491-493]. (Ocrant testified that analysis performed by "a guy who ran a quantitative analysis with a Japanese bank for a Fund to funds" concluded that that if Madoff was managing $5-$7 billion, his returns would be "[i]mpossible. It has to be a Ponzi scheme." Ocrant further testified that "[i]n this case, it was just consistent with everybody, saying no, it has to be the front money or Ponzi. There's no other possibility." Ocrant also testified that "[t]he trading volume [for options] doesn't exist.").

Michael Ocrant wrote the MARHedge article, *Madoff Tops Charts; Skeptics Ask How*, in May 2001. As noted within my Initial Report, this article raised concerns regarding the consistency of returns, lack of volatility, a "seemingly astonishing ability to time the market," and the ability to buy and sell stocks without noticeably affecting the market. Hirsch Report, ¶402. *See also* OIG Report, p. 80-81 [PUBLIC0006358-834 at -457-458]

- **James Hedges IV, President and Chief Investment Officer, LJH Global Investments:** noting consistency of returns, explanation of how Madoff made money that did not make sense, enough red flags to "even alert the lay person" to the track record being "too good to be true."[39]
- **Laura Goldman, Investment Advisor, LSG Capital:** potential investor contacted the SEC; noting that Madoff was not losing money, option trading that could not be confirmed by counterparties, consistency of returns, Madoff's preference that she not advertise him.[40]
- **Gregory Stahl, Chartered Financial Analyst, SEI Investments:** noting lack of correlation with the market, including high returns when the market was weaker and volatility decreased, and despite Gateway, a mutual fund with a similar strategy, generating weaker returns during those same periods.[41]
- **Paul Broder, Risk Manager, Renaissance Technologies Corporation:** noting insufficient option volume, lack of counterparties, steady, non-volatile returns, small auditor, "strange" fee structure. The OIG Report states that in a November 2003 email, Broder "provided a step by step analysis of why he did not think that

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("[R]ed flags about the lack of volatility in Madoff's returns, his unbelievable ability to time the market, the fact that his trading was not seen or felt in the market, and his unusual fee structure.").

39 OIG Report, p. 412-413, 420 [PUBLIC0006358-834 at -789-790, -797], Exhibit 75 [PUBLIC0660619-638 at -625-627, -630-635]. (Hedges, whose "investment advisory firm was asked to approve investments with Madoff for a variety of clients, stated that 'there was a preponderance of suspicion among hedge fund industry insiders that something was awry at Madoff Securities'" and that "[he] believe[d] that many others arrived at similar conclusions as [he] did in 1997." Hedges stated that the consistency of Madoff's returns was a "substantial red flag" because it "was not in keeping with the type of strategy that we understood him to be implementing…." In reference to his initial meeting with Madoff, Hedges stated that Madoff's explanation of how he made money simply did not make sense to him. Hedges stated that it was "fair to say that there [were] enough red flags that I came across that would even alert the lay person to the potential for the Madoff track record being too good to be true.").

40 OIG Report, p. 420 [PUBLIC0006358-834 at -797], Exhibit 76 [PUBLIC0709504-511 at -506-510]. (Goldman, a potential investor, noted that "when she met with Madoff [in 1997] and began asking him questions, 'he started shuffling' and 'didn't really answer questions.'" For example, Goldman asked Madoff "how many assets do you have under management, [and] he didn't want to answer." Goldman was concerned with Madoffs trading of options and the respective counterparties. She attempted to track Madoff's trading of options and reached out to "big players" (e.g., Susquehanna, Market Street Securities), but "none of these people were trading with Madoff." As a result, Goldman thought something was wrong and called the SEC. Goldman also highlighted the consistency of Madoff's returns and the fact that Madoff preferred she didn't advertise him as additional items that raised suspicion / were red flags at the time.).

41 OIG Report, p. 416-417 [PUBLIC0006358-834 at -793-794], Exhibit 77 [PUBLIC0709512-520 at -517-519] (Stahl, a fund of funds manager, "whose firm considered a Madoff feeder fund in 2005 for a possible investment, stated that he found it odd that the strategy that the Madoff feeder fund described 'was a relatively common strategy.'" Stahl stated "Madoff's 'strategy has been around forever' and he knew of a mutual fund [Gateway] that adopted the same strategy, but while that mutual fund's returns got weaker as the overall market got weaker, Madoff's returns 'remained very high.'").

Madoff was actually trading options as indicated by Madoff's customer statements[.]" Within this email, "Broder concluded Madoff could not be trading on an exchange because of insufficient volume, and could not be trading options over the counter because it was inconceivable that Madoff could find counterparties for the trading."[42]

- **Henry Laufer, Chief Scientist, Renaissance Technologies Corporation:** noting "totally independent evidence that Madoff's executions are highly unusual," unusual fee structure, unknown counterparties, scalability issues, and market timing.[43]
- **Nathaniel Simons, Portfolio Manager, Renaissance's the Meritage Fund:** noting rumors of front running and cherry-picking trades, involvement of related parties, implementation of an illogical fee structure, and concluding that Madoff could not be trading options based on the lack of volume and evidence.[44]

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[42] OIG Report, p. 148-153 [PUBLIC0006358-834 at -525-530]. (Broder also found Madoff's "steady, non-volatile returns initially to be 'suspicious,'… 'It was just too steady'… Broder noted that no matter what happened in the market, no matter what crisis occurred, Madoff's returns remained almost the same." Broder also listed the small size of Madoff's auditor as an issue since "Madoff was reportedly managing billions of dollars for investors." Broder also cited Madoff's fee structure as a red flag: "[R]emember at the time he had a fantastic system but he didn't charge anybody any fees. That seemed a little bit strange.").

[43] OIG Report, p. 147-148, 150-154, 157, 174 [PUBLIC0006358-834 at -524-525, -527-531, -534, -551]. (Unresolved questions lead Renaissance to take a closer look at their indirect investment with Madoff and "[a]fter performing their due diligence, Laufer stated that 'we were very worried" about the investment with Madoff.'" In an email from November 14, 2003, Laufer replied to Nathaniel Simons stating: "[w]e at Renaissance have totally independent evidence that Madoff's executions are highly unusual" and agreed with Simons' "sentiment" which proposed that "unless we can figure out a way to get comfortable with the regulatory tail risk in a hurry, we get out. The risk-reward on this bet is not in our favor." In addition, "Laufer estimated that Madoff could be foregoing $200 million a year in fees, something he and Broder found unusual." Laufer's team at Renaissance performed an analysis of Madoff's purported options trading and "found Madoff was reporting on his customer statements that he had purchased stocks at extremely low prices and sold stocks at extremely high prices… Laufer explained, 'this was statistically almost impossible to do if you were trading in an ordinary way.'… '[I]f you looked at those monthly statements and looked at the executions of the stock side, that the prices were just too good from any mode of execution that we were aware of that was legitimate.'" "Renaissance also noticed that Madoff's predictions for when to stay out of the stock market were extraordinary." "Renaissance determined it was unlikely Madoff's incredible fills were the result of cherry picking the best trades for his institutional clients because of the large number of customers they estimated Madoff had." "('But you have to wonder whether he could do it for a large' operation… So it's a question of scale, of how many customers you have versus how many you want to cherry-pick.')." Laufer noted that they "made inquiries. We didn't see anybody saying he did a lot of trading. We didn't understand why anybody in the business of options would take the other side. … [Y]ou ask yourself, why would somebody do this? Because he's going to lose money doing the trade, so far as we know.'" Laufer noted that they could not find out who took the other side of the option trades).

[44] OIG Report p. 145-147, 149-150, 153, 157-158, 412 [PUBLIC0006358-834 at -522-524, -526-527, -530, -534-535, -789]. (The Meritage fund held an "indirect investment with Madoff through a swap agreement with HCH." In a November 13, 2003, email, "Simons expressed concern that they did not understand how Madoff

- **Unidentified Hedge Fund Manager:** noting inability to identify counterparties, insufficient option volume, unusual fee structure, returns not correlated to the overall market, rumors that the auditor was related to Madoff, no assets at month end, lack of redemptions.[45]

- **Unidentified Chief Information Officer (CIO), unidentified fund-of-funds firm:** noting lack of ISDA master agreement, impossible option volume, lack of counterparties, information that appeared to be false. The CIO noted that the "volume [on the CBOE] was never there for Madoff" and that none of the equity derivatives departments he called were trading with Madoff.[46]

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was making money or why he used a fee structure that gave such a large percentage of profits to feeder funds…for doing absolutely nothing." In addition, Simons noted that there are potential conflicts of interest in Madoff's business. "Simons' only possible explanation for Madoff's fee structure was to speculate that there might be 'some underlying agreement between Fairfield and Madoff, and maybe some of that [fees] could come back to him. … Maybe he had an interest in Fairfield.'" "Simons had heard Madoff kept a restricted floor at BMIS. … The secrecy of the floor coupled with the rumors about the lack of auditor independence was a red flag for Simons." "After concluding Madoff was not trading options, Renaissance had no reason to come to a final conclusion that he was engaged in fraud. The unanswered questions were enough reason to begin divesting themselves of their investment with Madoff." Simons noted that the most common rumor about BLMIS was that "they were actively front-running their institutional clients on the brokerage side," however, Simons noted that even "if examiners ruled out the possibility of front-running, Simons thought there were still unanswered questions in the Renaissance e-mails that needed to be pursued, such as Madoff's purported 'OEX option position[.]'" Simons' email from 2003 "triggered the 2005 NERO examination" which "stated that there were rumors from industry insiders that Madoff was cherry-picking trades and that a related party was his auditor." "No one from the SEC contacted Simons, Laufer, or Broder about their e-mails until the OIG conducted its investigation in 2009.").

45 OIG Report, Exhibit 84 [PUBLIC0709521-537 at -523-526, -529-531]. (The hedge fund manager met with FGG and Madoff in 1998 and passed on the investment since they were not "satisfied" or "comfortable" with the lack of answers to their questions, such as "what was triggering the sale of the basket and/or the options." In 2003, they considered investing again but were unable to identify the respective counterparties or see where the volume in the market was for the purported options trading. Madoff countered the inquiry by stating that BLMIS "actually do[es] a lot of these things on an OTC basis." The hedge fund manager reached back out to brokers asking if they could see this volume, but they stated that it "[d]oesn't matter. Even if you do on an OTC basis, you have to clear that, you know, in the exchange afterwards, to cover yourself." The Hedge Fund Manager also noted the fee structure was unusual, the returns were not correlated to the overall equity markets, there were rumors the auditor was related to Madoff, no assets every month end, and BLMIS never had to face redemptions (positive in-flows). The hedge fund manager contacted the SEC as a result.).

46 OIG Report, p. 78 [PUBLIC0006358-834 at -455], Exhibit 85 [PUBLIC0709538-548 at -540-543]. (The CIO met with Madoff and a representative of Fairfield Greenwich around 1997/1998 and established that "[t]he Fairfield Century *[sic]* funds had a discretionary brokerage account with Madoff Securities," but no ISDA master agreement, which the CIO found to be "odd." "The CIO[,] former options trader, pressed Madoff for information about his options trading…" and to his "surprise, Madoff claimed to trade options through the Chicago Board of Options Exchange (CBOE)," which the CIO found "exceptionally odd" and immediately asked Madoff "How are you doing that? Because I don't think there's enough volume on the Chicago Board of Options Exchange for you to get that sort of coverage for the amount that you're managing." After the meeting with Madoff, the CIO called the CBOE to find out how much daily volume traded on the exchange and noted "that the volume was never there for Madoff. So that was problem No. 1 for me. Problem No. 2 was … I

- **John Guthery, Vice President, LPL Financial:** noting lack of transparency, lack of a third-party administrator, lack of access to the manager, returns inconsistent with the strategy.[47]

- **Neil Chelo, Director of Research, Benchmark Plus Management LLC:** noting Madoff's SSC strategy was not consistent with the purported returns, lack of trading counterparties, impossible option volume, and "crazy" fee structure.[48] As

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called up buddies of mine around the street who were now running the equity derivatives departments of a number of firms, and I asked them all if they were trading with Madoff. And nobody was. Nobody was doing these OEX options. And in fact, the funny part about it was they all said, yeah. You know, I hear that he's doing all these trades but, you know, we don't see it anywhere …And so things just began to, you know, not match up…. [T]he biggest issue was the fact that I couldn't reconcile a big part of that strategy. And the information that was being told to me on the surface seemed to be false.").

47 OIG Report, Exhibit 89 [PUBLIC0709549-559 at -551-554, -556, -558]. (Guthrey, head of manager research and due diligence, performed due diligence on the Rye select Broad Fund (owned by Tremont Group). He noted that no manager or sub-advisor was listed in the TPM and that he was unfamiliar with how the strategy being implemented, split strike synthetic conversion, was "getting the results for the trades they were doing." Guthrey also cited other red flags, including: the lack of transparency, lack of a third-party administrator, and lack of access to the manager. Guthrey reached out to people within the industry to get a better understanding of the fund / Madoff and they pointed to the Barron's article, mentioned Madoff might be front running, and one contact wrote back: "'we think it's a Ponzi scheme. Don't do it.' But they all said 'I'd look pretty closely at it. He's known for not providing enough information to make a great decision.'").

48 OIG Report, Exhibit 15 [PUBLIC0709843-873 at -851-853, -855-857, -860-861, -863, -868-869] (Chelo noted that "whenever someone mentioned Madoff, [he] kind of went out of [his] way to outline why [he] thought Madoff was a fraud …" Chelo stated Madoff's returns were "fishy" because Rampart had implemented a split strike strategy before … "[s]o to see someone claiming to do split strike strategy and have, like, a stellar ten-year track record of earning 1 to 1 1/2 percent [a month] … it just seemed way too fishy." "I just don't know how you can produce these types of returns given the strategy that was outlined in the marketing material. It was just, in my mind, impossible." Chelo stated that given the consistency of the returns, "you'd have to have basically like perfect market timing every month or every year … It's like impossible. No one has that ability to forecast market direction for such a long period and so consistently." In addition, Chelo noted that he and Harry Markopolos "called pretty much every broker we knew on the streets" and "we couldn't find anyone on the street who claimed to do trading with him, which was just another red flag because, you know, frankly, … people talk, especially back in the '90s and … early 2000. If a large trade went up in the options market, you can make one phone call and figure out, you know, within two minutes who did the trade." During these conversations with brokers, Chelo noted that he had a conversation with a broker "at the Solomon desk or Citigroup" who also concluded that Madoff's operation "[didn't] seem right" or that it "seemed impossible." Chelo stated that "Harry [Markopolos] and I just literally went to the Wall Street Journal, you know, went to the options page, looked at the open interest, and basically figured out, like, it was impossible. He would have been more than the entire open interest." "So for Bernie to be running like $5 billion in this strategy and not have any market impact or people be talking about him in the market and seeing his options raise, it just seemed really fishy to us." Chelo stated that he researched and put together models and that "the more [he], you know, tried to put together something that would duplicate Madoff's returns, the more convinced [he] was that it was impossible." "[A]nother huge red flag in our mind was we heard that, you know, Bernie was raising all his money through these feeder funds. So my logical question was: Why would he give up the ability to charge 1 and 20 or 2 and 20 to clients and let all the feeder funds earn the bulk of the returns? That just made no sense to me at all. I mean, any legitimate businessman would have said: Hey, I'm going to cut out the middleman and do it myself." Chelo stated that they had "heard he was only charging commissions. So that was just crazy" and that "[i]t didn't make any sense. You know, why was he leaving so much money on the table?"

discussed in my Initial Report, Chelo's concerns were shared with FGG contemporaneously.[49]

- **Harry Markopolos, Chartered Financial Analyst and Certified Fraud Examiner:** sent submissions to the SEC in May 2000, March 2001, November 2005, and June 2007 – noting unusually consistent returns, possible Ponzi scheme, returns unachievable using the purported trading strategy, Madoff's "perfect market-timing ability[,]" Madoff not allowing outside performance audits, numbers that were "too good to be true."[50]

38. The foregoing excerpts from the OIG Report demonstrate that Funkhouser's reliance on Madoff's claim that everyone was ignorant of his fraud is misplaced.

39. My Initial Report examines the contemporaneous documents and information available to FGG. Neither Funkhouser's opinion on regulatory review nor information disclosed after the collapse of BLMIS contradict my findings or undermine my opinions.

C. Regulatory Review of BLMIS and the Lack of Action or Referral Does Not Confer Legitimacy

40. Funkhouser opines that "it was reasonable for the Defendants to rely on the apparent legitimacy conferred by Mr. Madoff's regulatory standing."[51] Namely, Funkhouser relies

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[49] *See* Hirsch Report, ¶¶236-239.

[50] OIG Report, p. 27, 41 [PUBLIC0006358-834 at -404, -418], Exhibit 268 [PUBLIC0709560-579 at -560-561]. (Markopolos' submission in 2000 provided the "following two explanations for Madoff's unusually consistent returns: (1) that '[t]he returns are real, but they are coming from some process other than the one being advertised, in which case an investigation is in order;' or (2) '[t]he entire fund is nothing more than a Ponzi Scheme.' Markopolos' submission in 2000 stated that Madoff's returns were unachievable using the trading strategy he claimed to employ, noting Madoff's 'perfect market-timing ability.' Markopolos also referenced the fact that Madoff did not allow outside performance audits." In Markopolos' 2001 complaint, he "concluded that Madoff's 'numbers really are too good to be true.' Markopolos' analysis was supported by the experience of two of his colleagues, Neil Chelo and Frank Casey, both of whom had substantial experience and knowledge of investment funds." Markopolos' complaint in 2005 was titled *The World's Largest Hedge Fund is a Fraud* and identified 29 red flags regarding Madoffs operations that made Markopolos "very suspicious that Bernie Madoff's returns aren't real[.]" His 2005 complaint concluded that "[t]here are 2 possible scenarios that involve fraud by Madoff Securities:" (i) Madoff is front-running ("Unlikely") or (ii) "Madoff Securities is the world's largest Ponzi scheme" ("Highly Likely"). Markopolos' 2005 complaint also noted that he had "spoken to the heads of various Wall Street equity derivative trading desks and every single one of the senior managers I spoke with told me that Bernie Madoff was a fraud." His 2007 submission attached "some very troubling documents that show the Madoff fraud scheme is getting even more brazen.").

[51] Funkhouser Report, ¶110.

on the SEC and FINRA/NASD jurisdiction over BLMIS and the SEC's conclusion that "no evidence of fraud" was found at BLMIS.[52] In support of his opinions, Funkhouser also relies on the OIG Report issued after the collapse of BLMIS.[53] The OIG Report, however, entirely undermines Funkhouser's opinion, finding serious deficiencies in both the SEC's and FINRA's examinations of BLMIS. As to the SEC:

> … despite numerous credible and detailed complaints, **the SEC never properly examined or investigated Madoff's trading and never took the necessary, but basic, steps to determine if Madoff was operating a Ponzi scheme**. Had these efforts been made with appropriate follow-up at any time beginning in June of 1992 until December 2008, the SEC could have uncovered the Ponzi scheme well before Madoff confessed.[54]

41. As to FINRA:

> Although reviewing recent NASD/FINRA Exam Reports was a standard part of an examination, members of the exam team stated they generally found NASD/FINRA Exam Reports to be "not very helpful." Sollazzo Testimony Tr. at p. 52; Lamore Testimony Tr. at p. 52. Ostrow stated, "…I don't think [the Report] had any reference to the hedge fund account. So we also take, you know, these reports with a grain of salt." Ostrow Testimony Tr. at p. 49. Ostrow explained that when he performed oversight examinations of NASD/FINRA examinations, he had found there were issues that "were completely missed." Ostrow Testimony Tr. at p. 51. He thought it was possible that the weaknesses in the NASD/FINRA Exam Reports were attributable to FINRA's connections to industry or examiner incompetence, but more likely the result of FINRA's examination procedures, which he described as "a check box system and they don't think outside the box." *Id.* at p. 50. Lamore had a similar view of the weaknesses of NASD/FINRA Exam Reports, stating, "**Well, I think – in general I think the NASD exams are a little less in-depth. It's more … checklist-type reviews that**

52 Funkhouser Report, ¶¶110-114, 121.

53 Funkhouser Report, ¶¶111-121.

54 OIG Report, p. 41 [PUBLIC0006358-834 at -418] *(emphasis added)*.

> **they conduct. So they don't go into great detail about specific areas**." Lamore Testimony Tr. at p. 161.[55]

42. The OIG report attributed the SEC's failure to discover Madoff's fraud to inexperienced and untrained examiners. In considering the SEC examinations, including the 2006 examination into whether BLMIS was operating as an unregistered investment advisor and whether BLMIS was operating a Ponzi scheme,[56] the OIG found:

> …although the SEC conducted five examinations and investigations of Madoff based upon these substantive complaints, they never took the necessary and basic steps to determine if Madoff was misrepresenting his trading. **We also found that had these efforts been made with appropriate follow-up, the SEC could have uncovered the Ponzi scheme well before Madoff confessed . . . . The OIG found that the conduct of the examinations and investigations was similar in that they were generally conducted by inexperienced personnel, not planned adequately, and were too limited in scope**. While examiners and investigators discovered suspicious information and evidence and caught Madoff in contradictions and inconsistencies, they either disregarded these concerns or relied inappropriately upon Madoff's representations and documentation in dismissing them. Further, the SEC examiners and investigators failed to understand the complexities of Madoff's trading and the importance of verifying his returns with independent third-parties.[57]

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55 OIG Report, p. 176 [PUBLIC0006358-834 at -553] *(emphasis added)*. FINRA's Special Review Committee also noted that FINRA did not review or inspect BLMIS's Form ADV, stating that had they done so, they would have seen inconsistencies with the representations BLMIS made to FINRA, including the following: "the Form ADV stated that the firm had 23 customers (it actually had thousands more), even though [BLMIS] told FINRA it had none. The Form ADV stated that [BLMIS] (rather than a related person or third party) had custody of $17 billion of assets belonging to those customers, even though it represented to FINRA that it did not hold any customer assets. Finally, the Form ADV stated that the Madoff firm executed trades for its customers—trades that were not reflected in the firm's broker-dealer records because they had not, in fact, taken place." FINRA's Special Review Committee stated that a "careful review of the Form ADV would have led to questions about where advisory clients' assets were being kept and how transactions for those clients were being executed." Report of the 2009 Special Review Committee on FINRA's Examination Program in Light of the Stanford and Madoff Schemes, September 2009 [PUBLIC0709677-756 at -736-737].

56 SEC Division of Enforcement, Case Closing Recommendation, November 21, 2007 [FG-03941837-838].

57 OIG Report, p. 456-457 [PUBLIC0006358-834 at -833-834] (*emphasis added)*.

43. I agree with the foregoing assessments made by the OIG. I am in no way offering criticism of either the SEC or FINRA, but in my experience with regulatory and governmental examinations, the examiners are often junior and inexperienced with appreciable turnover and the examinations are perfunctory, with little follow up.[58] For example, while at Merrill Lynch, each year I participated in the Commodity Futures Trading Commission ("CFTC") examinations, and as an investment manager, SEC examinations. Each year, a new examiner was sent who we had to train on derivatives. My experience with regulatory agencies is that despite their best efforts, there are reasons why they may not have the ability to uncover fraud, including but not limited to turnover of examiners and the lack of training of examiners in the relevant investment vehicles or strategy. Finally, if a manager or firm is not charged, there is little or no public record and nothing for an investor to review. As an investment manager, these failings and shortcomings further add to the reasons why I do not place weight on regulatory action or inaction over the actual results of due diligence when evaluating an investment advisor.

44. Funkhouser further offers that FGG's "cooperation with the SEC during [the 2005-2006] investigation is demonstrative that Defendants were compliance-oriented and law abiding and is inconsistent with the way someone would behave if they were aware that BLMIS was operating fraudulently."[59] As discussed in more detail below and in my Initial Report, the "cooperation" that Funkhouser discusses was actually preceded by a lengthy discussion between FGG and Madoff, during which Madoff scripted what FGG should or

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[58] *See Brokerage Fraud: What Wall Street Doesn't Want You to Know*, Tracy Pride Stoneman & Douglas J. Schulz, 2002, p. 132-133 [PUBLIC0709913-923 at -919-920] ("For years, regulators have been overworked and understaffed. High turnover at the SEC is a problem."). The President of the NASD admitted to shortcomings in examinations in a November 2000 speech:

> To be frank, historically we haven't done the best job of giving our examiners the cutting-edge tools and training they need to work most efficiently. And because we are tied to a routine cycle exam program, we don't always focus our resources on the riskiest firms – those that require our attention onsite and often.
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> *Id*, at 133.

See also Bloomberg Businessweek, Commentary: *Don't Bother Calling the Hedge Fund Cops*, Mara Der Hovanesian, July 22, 2002 [PUBLIC0709924] ("It's not as if the SEC is asleep at the switch … They don't have a switch, or at least not much of one…The SEC's approach is scattershot; they have to be told about potential problems first,… [t]hey don't get to just march in and look around.").

[59] Funkhouser Report, ¶117. *See also* Funkhouser Report, ¶112.

should not say during the SEC inquiry, including facts that FGG acknowledged were not true.[60]

45. Funkhouser also theorizes that FGG was assured that BLMIS was trading because Madoff had discussed trading directives and guidelines with them: "[i]t would have been illogical for Mr. Madoff to discuss with Defendants trading details in the IA business if Mr. Madoff believed that Defendants knew he was not doing any such trading."[61] Again, this theory is unsupported by any reference to contemporaneous documents or information available to FGG. Rather, Funkhouser is again speculating about Madoff's and FGG's state of mind. In conducting due diligence, I do not rely on conjecture or guesses about what the investment manager or investment advisor thinks or why they do or do not take certain actions; I rely on the contemporaneous documents and available information.

46. In conclusion, regulatory compliance and actions taken or not taken by regulators are, at most, factors to be considered as part of the due diligence process, not substitutes for due diligence.

III. Opinion II: FGG's Efforts to "Monitor" BLMIS Were Necessary to Attract and Maintain Investors

A. FGG Used its Due Diligence as a Marketing Tool

47. Funkhouser's claim that FGG would not have done their due diligence if they knew BLMIS was a Ponzi scheme or any other fraud ignores that FGG had to show to their investors that they conducted due diligence, in large part to justify the fees that they charged. FGG said they were going to conduct due diligence, and they did because investors expected it. FGG confirmed this objective in Vijayvergiya's 2005 performance review self-evaluation, stating:

> As FGG's client base becomes more sophisticated and 'institutional' in their level of due diligence, I am increasingly called upon to

[60] *See* Hirsch Report, Section VII.B.3(f), ¶¶429-441 (e.g., Madoff "never want[s] to be looked at as the investment manager," Madoff should only be identified as the executing broker, "[t]he options are not part of the model.").

[61] Funkhouser Report, ¶118.

> communicate our risk management systems and methodology to a savvy group of investors.
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> ***
>
> I have managed the growth of our risk and investment compliance platform, built systems to exploit our position transparency and played a key role in raising and protecting a significant amount of Sentry assets.[62]

48. As a practitioner in the hedge fund industry, I saw this pressure in the early 2000s for greater transparency and reporting from the institutional investors who were just starting to invest in hedge funds in a significant manner.[63]

49. In my experience, investors want to know exactly what is being done to earn the fees. In hedge funds, the typical range of fees is 1 and 20 or 2 and 20. That equates to a 1% or 2% management fee based on the net asset value of the fund ("NAV") and 20% of the gross profits of the fund.[64] In a typical hedge fund, the manager earns its fees because it

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62 Vijayvergiya FGG Employee Self Evaluation, November 23, 2005 [FG-05640881-886 at -882, -886]. *See also* Email from Carla Castillo to McKenzie, et al., October 22, 2004 [FG-01794420_R-425 at -424-425] (relaying questions from an existing Fairfield Sentry investor, asking FGG to: "1. Describe in detail the internal risk control. Provide a description of systems, organisation and procedures used for assessment, monitoring, and control of the risks associated with the asset management operations. 2. Describe the compliance department in terms of: staffing, place in organisation, responsibilities, powers, reporting structures. 3. Describe the reporting procedures. Which reports are prepared and analysed internally? Enclose examples of internal and external reports.").

63 *See*, Pensions World, *Hedge funds: Precious metals or fool's gold?*, October 2005 [PUBLIC0709930-937 at -932] ("Worldwide, and especially in the US, pension fund interest in hedge funds has been keen. According to Watson Wyatt, global pension schemes invested $16bn in fund of hedge funds (FoHFs) in 2004 (over a quarter of their total alternative asset class spend). The growth has partly been in response to the difficult market environment since 2000, with schemes seeking greater diversification and investment strategies that achieve desired returns while matching liabilities."); "The Hedge Fund," Institutional Investor, June 2002 [PUBLIC0709925] ("In the past decade the number of hedge funds has exploded from 2,000 to 6,000, according to Van Hedge Fund Advisors International, which calculates that the funds' assets have soared from $67 billion to some $600 billion. In addition, their investors, once primarily wealthy individuals, now include pension funds, endowments and foundations, which are more demanding about disclosure."); *Who's winning institutional mandates in the hedge fund arena, Sorting the fund-of-funds goats from the sheep*, PlanSponsor, Barclay T. Leib, June 2002 [PUBLIC0709926-929 at -929] ("Many fund-of-funds also have learned from past mistakes and, by adapting new procedures, are now able to provide institutional investors with a different level of discipline and transparency than in yesteryear.").

64 *See* Hirsch Report, Section VII.B.2.c(2), ¶¶323-326.

is making all the investment decisions and is charged with managing the totality of the operations of the fund.

50. In the case of FGG investments in the Fairfield BLMIS Accounts (which were never less than 95% of the Sentry Funds' assets), FGG did not choose the securities or options, did not manage cash, and did not trade.[65] To justify the management and incentive fees, FGG had to present some form of actual investment management. They did this by presenting a formal due diligence process, and risk management in the form of risk reports. This was consistent with FGG's numerous claims of superior due diligence and risk management in their presentations to investors.[66]

B. RiskMetrics Was Not Used by FGG to Manage the Risks of Investments with BLMIS.

51. Funkhouser points to the use of RiskMetrics ("RM") by FGG as evidence of "good faith." However, the factual underpinnings of that opinion are flawed. Funkhouser states:

> As I explain in Section V below, there is substantial information indicating that the Defendants built and maintained a reasonable compliance monitoring system for their investments, including the development and use of automated risk analytics software, RiskMetrics, to track BLMIS' purported investments over time.[67]

52. First, it is inaccurate that the Defendants developed RM – they did not. RM is an off-the-shelf risk monitoring product developed by J.P. Morgan in the early 1990s, which provides banks, fund managers, and asset managers, among others, "a framework for measuring, managing, and mitigating financial risk."[68] FGG licensed RM like any other user of the system.[69]

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65 *See, e.g.,* Hirsch Report, ¶80, ¶102 at footnote 175, ¶370.

66 *See* Hirsch Report, Section VII.B.1.

67 Funkhouser Report, ¶18 *(emphasis added)*; *see also* Funkhouser Report, ¶¶66, 152.

68 RiskMetrics Service Summary Presentation, May 2024 [PUBLIC0709764-766]; RiskMetrics: Explained, TIOmarkets, August 15, 2024 [PUBLIC0709757-763].

69 RiskMetrics Group Product Subscription and License Agreement, July 1, 2004 [FG-08759900-918]; RiskMetrics Group Renewal Agreement, July 11, 2008 [FG-02751271-277].

53. Second, the RM system was not "automated." Rather a user had to feed it specific trade information to be analyzed.[70] Here, as Funkhouser recognizes in paragraph 67 of his report, all of "the monthly positions in stocks and options gathered from the BLMIS monthly account statements" were what was fed into RM.[71] RM merely analyzed the trades fed into it – based on purported trading information provided by BLMIS – and created risk based reports using pre-determined parameters, as specified by either standard RM parameters or custom parameters set by FGG.[72] Pricing and reconciliation of the purported trades were only done by RM for the purpose of statistical analysis, not for trade verification.[73]

54. Third, Funkhouser's claim that RM is a "reasonable compliance monitoring system"[74] is incorrect. RM is a quantitative risk measurement system, not a compliance tracking system. Compliance tracking includes far more than "quantitative market risk."[75] Based on my review of the RiskMetrics Reports produced by FGG, FGG was not using RM beyond collecting trading positions and analyzing that data from BLMIS.[76]

55. Fourth, FGG was not using RM to manage the risk of the investments with BLMIS. Risk management can only be effectuated through decision-making authority over the investment. FGG had no decision-making authority over the trading in the Fairfield

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70 RiskMetrics Group Product Subscription and License Agreement, July 1, 2004 [FG-08759900-918]; FGG Single Manager List, June 29, 2004 [FG-00149942-946 at -946] ("RMG to collect positions from Manager"); Email from Vijayvergiya to Brian Moss (RiskMetrics), RE: FGG Contacts at Managers and Prime Brokers, June 30, 2004 [FG-00149941].

71 Funkhouser Report, ¶67.

72 *See, e.g.,* RiskMetrics Reports dated: February 28, 2005 [FG-00180051-057]; April 28, 2006 [FG-00258263-269]; February 28, 2007 [FG-06575027-033]; February 29, 2008 [FG-06184190-198]; December 30, 2005 [FG-00258235-241]; December 30, 2006 [FG-00281933-939]; December 31, 2007 [FG-01880643-649].

73 RiskMetrics Group Product Subscription and License Agreement, July 1, 2004 [FG-08759900-918]; RiskMetrics Group Renewal Agreement, July 11, 2008 [FG-02751271-277].

74 Funkhouser Report, ¶18.

75 Vijayvergiya Dep., 1/30/25, 82:1-82:4, 123:9-124:1 [10-03800_09-01239_VIJCAA0000001-348]. (Vijayvergiya testified that quantitative market risk was his sole risk management responsibility, stating "[m]y duties as head of risk management was entirely in the domain, as I recall, of quantitative market risk analytics.").

76 RiskMetrics Group Product Subscription and License Agreement, July 1, 2004 [FG-08759900-918]; RiskMetrics Group Renewal Agreement, July 11, 2008 [FG-02751271-277]. *See, e.g.,* RiskMetrics Reports dated: February 28, 2005 [FG-00180051-057]; April 28, 2006 [FG-00258263-269]; February 28, 2007 [FG-06575027-033]; February 29, 2008 [FG-06184190-198]; December 30, 2005 [FG-00258235-241]; December 30, 2006 [FG-00281933-939]; December 31, 2007 [FG-01880643-649].

BLMIS Accounts as Madoff had full and sole discretion over trading activity in the Fairfield BLMIS Accounts.[77]

56. Fifth, Funkhouser mistakenly equates trade level transparency and market risk analysis with his notions of "good faith." Trade level transparency simply means visibility into the trading activity in the investment account. It is gained through receipt of trade confirmations and monthly statements that itemize trades in the account. Risk analysis means identifying and quantifying investment risks. But, as discussed in my Initial Report within Section VII.A.2, trade level transparency and risk analysis are meaningless without the ability to manage or modify the investment portfolio to mitigate the risk. Without those abilities, the subsequent reports are merely window dressing for investors. While RM's capabilities did include "sensitivity analysis, scenario analysis, value-at-risk (VaR) assessment, and stress testing,"[78] I have found no evidence in FGG's documents and other information available to me that FGG used the information from RM's analyses to ask Madoff to modify the purported portfolios in the Fairfield BLMIS Accounts.[79] Having the documents and information from RM's analyses and doing nothing with them, except for marketing, does not equate to any definition of due diligence, risk management, or good faith.

57. And finally, Funkhouser mistakenly contends that RM was used "to track BLMIS' purported investments over time" and thus this tracking is consistent with "good faith."[80] While FGG was invested with BLMIS starting in 1990, FGG did not engage RM until

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[77] *See* Initial Report, Section VII.A.2.

[78] Funkhouser Report ¶66; Vijayvergiya Dep., 1/30/25, 127:8-128:5 [10-03800_09-01239_VIJCAA0000001-348 at -127-128]; RiskMetrics - RiskManager Overview and Key Features, with data as of May 2024 [PUBLIC0709764-766]. Notably missing from the list of RM's capabilities selected by FGG is skewed delta, which would have assessed the actual downside risk of the collar strategy, an integral part of risk management.

[79] While Funkhouser claims, at ¶66, that "Mr. Mr. Vijayvergiya developed alternative software, HFO, to analyze streams of Net Asset Value reports," Vijayvergiya acknowledged that these tools were not implemented until mid-2003 to 2005, at the earliest; whichever application he used, it certainly would not have been used to "analyze streams of Net Asset Value reports." In addition, he did not develop "HFO," he merely "implemented … alternative softs, HFO, amongst others." Vijayvergiya Dep., 1/30/25, 82:1-83:24 [10-03800_09-01239_VIJCAA0000001-348].

[80] Funkhouser Report, ¶¶18, 152.

July 2004,[81] almost 14 years later, around the time it began to charge management fees.[82] As discussed in my Initial Report, tracking the investments would have included verifying that the assets actually existed.[83] RM never purported to, and in fact, never verified the existence of the securities or trades purportedly executed in the Fairfield BLMIS Accounts or compared purported trading information from BLMIS to any independent trade data. I have seen no evidence that verification of the purported securities or trading purportedly executed in the Fairfield BLMIS Accounts was done by FGG,[84] its administrator, its custodian, Citco, or any vendor on behalf of FGG.[85]

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81 RiskMetrics Group Product Subscription and License Agreement, July 1, 2004 [FG-08759900-918 at -900], RiskMetrics Group Renewal Agreement, July 11, 2008 [FG-02751271-277 at -271].

82 FGG had previously used GlobeOp and Measurisk, which FGG found to be "inadequate" risk management tools. Vijayvergiya Dep., 1/30/25, 87:22-88:5 [10-03800_09-01239_VIJCAA0000001-348]; Email from Christopher Filiberto to Charles Oddy, April 24, 2008 [FG-00438704-707 at -705]; Email from Amit to Greisman and Blum, Subject: Risk Vendor Review, February 26, 2004 [FAIRFIELD_01739918]; Email from John Wartman to Blum and Vijayvergiya, RE: Comparison of Risk Vendors, August 11, 2003 [FG-00125013-016 at -014]; *see, e.g.*, Fairfield Sentry, Ltd. Monthly Performance as of December 31, 2004 [FGG00091985-986 at -986 / SECSEV0088124-125 at -125] ("[e]ffective October 1, 2004, the Fund began charging investors a 1% management fee plus a 20% performance fee. Returns prior to October 2004 reflect only a 20% performance fee."). *See also* Fairfield Sentry, Ltd. Monthly Performance as of September 30, 2004 [SECSEV0088112-113 at -112] (detailing a management fee of 0%).

83 *See* Hirsch Report, Section VII.B.

84 Funkhouser states that following the MAR/Hedge and Barron's articles, Tucker visited BLMIS in 2001 and viewed a single screen of a single stock purportedly in the Fairfield BLMIS Accounts on a DTC screen at BLMIS's office. Funkhouser Report, ¶¶72-73. Tucker testified that this visit was at Madoff's invitation. Funkhouser's recitation of the testimony fails to appreciate that FGG had been invested with BLMIS for approximately 11 years before Tucker was invited for the first time to review stock ledgers, blotters, and trading ledgers. Anwar Deposition of Jeffrey Tucker, June 28, 2013 ("Tucker Anwar Dep., 6/28/13"), at 382:20-383:17 [FG-00010844 -930 at -865]. Funkhouser further fails to note that Tucker admitted that he only saw the Fairfield Sentry Accounts' purported holdings on the DTC screen on that single occasion over the 18 years of the investments with BLMIS.

> Q: You gave some testimony earlier about your 2001 visit to Mr. Madoff's offices when you had seen – he had shown you the screens. Prior to that 2001 visit, had you ever had occasion to view a DTC screen?
>
> A: No.
>
> Q: Since that 2001 visit, did you ever have occasion to view a DTC screen?
>
> A: No.

Tucker Anwar Dep., 6/27/13, at 259:3-12 [FG-00010732-843 at -797]. None of the documents produced by FGG included this purported DTC screen. Even if it did occur, inspection of ledgers and viewing a DTC screen on a single occasion is not verification of the existence of assets.

85 As discussed in my Initial Report in Section VII.B.3.c, Citco never had custody of the securities purportedly purchased by BLMIS for the Fairfield BLMIS Accounts. As previously stated, a "good faith" effort includes verification that the assets in fact existed.

C. Funkhouser Ignores that FGG's Due Diligence Showed Trading Impossibilities, Trading Impossibilities Given the SSC Strategy, and Significant Red Flags Confirming Lack of Trading

58. Funkhouser discusses the fact that FGG conducted due diligence, but he never discusses the analyses or the results of its due diligence. Any determination of FGG's knowledge and "good faith" cannot ignore those findings.

59. As discussed in my Initial Report, the contemporaneous documents and information in FGG's possession, as well as contemporaneous publicly available information, showed that BLMIS was not trading securities as of 1997, if not earlier.[86] That did not change through 2008, as additional information and documents and cumulative red flags only confirmed the absence of real trading at BLMIS.

60. FGG had direct access to Madoff and almost two decades of information, documents, and cumulative red flags confirming that BLMIS's reported trades were impossible, and additional red flags confirming the lack of trading, including:[87]

- impossible option volumes;
- out of range trades;
- source of returns were inconsistent with the SSC strategy;
- impossible execution of trades;
- out of the market at year-end and quarter-end;
- lack of scalability;
- speculative option trades;
- returns far exceeding returns of peers;
- during periods of market stress, returns were inconsistent with the SSC strategy;
- no correlation to the index the strategy was replicating;
- lack of downside risk;
- excessive concentration of duties;
- BLMIS not charging fees other than commissions;
- lack of volatility;
- unknown counterparties;
- lack of real-time access to accounts;

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[86] Hirsch Report, ¶¶5, 175, 180, 516.

[87] *See* Hirsch Report, Section VII.B.2.

- backward trade confirmations;
- lack of credentials;
- reporting a security that no longer existed; and
- atypical frequency of dividends.

61. In addition, my opinion is based on the misrepresentations and actions taken by FGG related to its investments with BLMIS, including:[88]

- changing the description of the Sentry Funds' relationship with Madoff;
- moving Fairfield Sentry's investment management company offshore at Madoff's request, to avoid regulatory scrutiny;
- changing the description of the BLMIS SSC strategy over the years;
- misrepresentations regarding the services performed by Citco;
- response to industry rumors;
- misrepresentations to the ISE;
- following Madoff's script during the SEC's investigation of concerns regarding BLMIS;
- misrepresentations regarding the scope of the audit of FGG by PwC, namely that it did not extend to the underlying securities purportedly held by BLMIS;
- misrepresentations regarding counterparties;
- misrepresentations regarding BLMIS's auditor, F&H, and its inability to audit a firm with assets the size of those under management at BLMIS; and
- breach of fiduciary duties by FG Limited and FG Bermuda.

62. The great lengths that Madoff went to in order to carry out the fraud has no bearing on the foregoing results of the due diligence conducted by FGG.

63. Similarly, Funkhouser's claims that exclusivity of the investment and restrictions on subscriptions support the belief that BLMIS was not a Ponzi scheme are likewise not persuasive.[89] Even assuming the veracity of these statements, any assurances are

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88 *See* Hirsch Report, Section VII.B.3.

89 Funkhouser Report, ¶¶59-60. In fact, Funkhouser's claim of assurances that BLMIS was not a Ponzi scheme because of restrictions on subscriptions is belied by FGG's own internal communications and discussions regarding insufficient market volume for BLMIS to execute trades as reported based on the amounts under management. *See* Hirsch Report, Section VII.B.2.b(3), Lack of Scalability. The restrictions on subscriptions are consistent with the concerns that there was already insufficient market volume for BLMIS to purportedly execute trades; an increase in the amounts under management would only be further evidence that there was no trading in the Fairfield BLMIS Accounts.

outweighed by the vast number of documents and volume of information discussed in my Initial Report and herein that make plain there was a lack of trading, a lack of trading consistent with the represented SSC strategy, and red flags confirming lack of trading in the Fairfield BLMIS Accounts.

64. Against the foregoing, Funkhouser identifies only a small universe of documents to assert that FGG was acting and communicating "in a manner that is inconsistent with the allegation that Defendants were aware of the fraud,"[90] even though he acknowledges "it is necessary to consider the totality of facts and circumstances" and highlights the requirement of a "holistic assessment of all available evidence."[91]

65. Funkhouser then mischaracterizes some of the documents in the small set he identified. For example, Funkhouser mischaracterizes FGG's conversation with Madoff regarding the SEC interview. Despite acknowledging that Madoff instructed FGG that "first of all, this conversation never took place," Funkhouser characterizes the discussion as relating to Madoff's "use of new trading directives and guidelines."[92] As discussed in my Initial Report at Section VII.B.3.f, this was far from the case. The conversation was arranged at Madoff's request to specifically discuss what FGG should or should not say at an upcoming SEC inquiry regarding the operational and compliance aspects of Madoff's investment strategy and BLMIS's relationship with Fairfield Sentry. FGG had sent BLMIS an outline to review prior to the call.[93]

66. Funkhouser also overlooks numerous documents showing red flags and suspicious activity discussed in my Initial Report.

67. First, out of the more than 2,000 pages of Vijayvergiya's notebooks, Funkhouser only

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90 Funkhouser Report, ¶132.

91 Funkhouser Report, ¶57 ("In my experience evaluating whether a matter warrants a recommendation for further investigation or an enforcement action, **it is necessary to consider the totality of facts and circumstances** developed through the investigative process. The analysis requires a **holistic assessment of all available evidence** to determine whether the facts support a finding or indication of potential fraud." *(emphasis added)*).

92 Funkhouser Report, ¶113.

93 Vijayvergiya Dep., 1/31/25, Ex. 27 [FG-08776132-134]; Ex. 28 [FG-06605992-593] 362:18-364:23; Telephone call excerpt between Madoff, McKeefry and Vijayvergiya [Vijayvergiya Dep., 1/31/25, Exs. 29a-d / McKeefry Dep., 2/5/25, Ex. 14 (FG-03982369-433 at -402].

includes 2 pages within his "Materials Relied Upon" (Appendix B).[94] He does not address the rest, including the following excerpts:

- **December 2003 – April 2004**: noting "Custody Issue - @ BLM"[95]
- **July 2004 – September 2004**: questioning "Risk – independent custodian; how do we verify assets are @ BLM"[96]
- **February 2006 – May 2006**: noting "Big concern is op'l risks / fraud"[97]
- **June 2008 – November 2008**: noting "Verify that assets exist" and "Verify that assets are segregated"[98]

68. Second, while Funkhouser cites to a compilation of Berman Reports at footnote 83, he does not discuss any of the specific red flags raised in the Berman Reports,[99] including:

- May 2008 Berman Report and surrounding emails/notes – Berman raises the issue of *unusual* activity that is difficult to explain, encourages Vijayvergiya to investigate further, and notes that trades "can't all be profitable – 100%[,] not even Madoff." Berman's call notes also include "Backdating? Confirms rec'd on settlement date;"[100]

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94 *See* Hirsch Report, ¶100. A total of 22 notebooks, containing more than 2,000 pages, dated June 2003 through December 2007 and February through December 2008, were made available to me. The Funkhouser Report only includes a 2-page excerpt from one of Vijayvergiya's notebooks in its list of Materials Relied Upon (Appendix B). [FG-00013463-464] (excerpt from Vijayvergiya's Notebook February 2006 – May 2006. *See also* [FGG00098291-391 at -371-372 / SECSEL0001209-309 at -289-290]).

95 Vijayvergiya's Notebook, December 2003 - April 2004 [FGG00092432-530 at -432 / SECSEL0000001-099 at -001]; Hirsch Report, Figure 98.

96 Vijayvergiya's Notebook, July 2004 - September 2004 [FGG00092631-731 at -639 / SECSEL0000403-503 at -411]; Hirsch Report, footnote 426.

97 Vijayvergiya's Notebook, February 2006 – May 2006 [FGG00098291-391 at -375 / SECSEL0001209-309 at -293]; Hirsch Report, Figure 100.

98 Vijayvergiya's Notebook, June 2008 – November 2008 [FGG00099197-297 at -252 / SECSEL0002016-116 at -071]; Hirsch Report, Figure 101.

99 Hirsch Report, Section VII.B.3.i.

100 Berman Report re: Fairfield Sentry Limited May 2008 Trading Activity, June 13, 2008 [SECSEV1210868-869]; Email from Berman to Vijayvergiya, re: Sentry reports for May, June 13, 2008 [FGGE000633382-383 at -382 / SECSEV1210905-906 at -905] *(emphasis added)*; Email from Berman to Vijayvergiya, re: Sentry report for May, June 13, 2008 [GBESAA0043765]; Berman's handwritten notes, "FGG call on 6/25/08" [GBESAA0043767]; Email from Gil Berman to Amit Vijayvergiya, re: Our Conference Call, June 25, 2008 [FGGE000665020 / SECSEV1242543].

- In April 1996, Berman highlights a sale of Oracle shares that occurred above the high price for the day: "The sale of Oracle Corporation shares on April 15th occurred at a price of 45 7/8, above the listed high of 44 1/2 for that date."[101]

69. Third, Funkhouser overlooks documents showing the comprehensive removal of BLMIS from various pages on FGG's website and Private Placement Memoranda ("PPMs"),[102] including:

  - June 2004 email from McKenzie regarding FGG's new website, stating "need to take out all mention of Madoff."[103]
  - June 2004 email from Andrew Ludwig regarding the website, stating:

    > Could you please do a global site search…and make sure that, as discussed, there are NO references to Bernard L. Madoff Investment Securities anywhere on the site.…This is critical.[104]

  - June 2004 email from Vijayvergiya regarding the website, stating "I also agree with the Finance Group to remove any mention of our accounts at BLM from the Investment Manager description paragraph." McKeefry replied, "No mention of BLM agreed."[105]
  - The January 2002 PPM for Fairfield Sentry mentions BLMIS and Madoff and notes that BLMIS "makes the investment decisions on behalf of the Fund,"[106] yet the October 2004 PPM for Fairfield Sentry makes no mention of Madoff or BLMIS as an investment advisor, and instead only identifies BLMIS, together with other entities, as the "Sub-Custodians" for certain assets.[107]

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101 *See* Hirsch Report, footnote 292, Berman Report for April 1996, May 15, 1996 [FGGE000263785-808 at -801-802 / SECSEV0841308-331 at -324-325].

102 Hirsch Report, Section VII.B.3.a.

103 Email from Gordon McKenzie to Nancy Ng, RE: Announcing FGG's New Web Site, June 23, 2004 [FGGE000015601-606 at -601 / SECSEV0593124-129 at -124].

104 Email from Andrew Ludwig to Alla Wilder, Subject: Edits to Sentry, Sigma, Lambda Strategy pages, June 29, 2004 [FGGE000016805-806 / SECSEV0594328-329].

105 Email Chain between Vijayvergiya, Lipton, McKeefry, and Andrew Ludwig, RE: Website Terms & Conditions for Sentry, Sigma & Lambda, June 24, 2004 [FGGE000015820-821 / SECSEV0593343-344].

106 Confidential Private Placement Memorandum, January 1, 2002 [FG-03978789-836 at -799, -805].

107 Confidential Private Placement Memorandum, October 1, 2004 [FGGE001771798-866 at -818-819 / SECSEV2348748-816 at -768-769].

70. A consideration of these documents (and others disregarded by Funkhouser) is necessary to complete a "holistic assessment of all available evidence" and made plain the trading impossibilities and red flags over the eighteen years the Sentry Funds were invested in BLMIS.

IV. Opinion III: There Is a Difference between an Audit and Due Diligence

71. Funkhouser incorrectly claims that FGG engaged "a Big Four auditor to review the controls at BLMIS and test for completeness and existence of the securities BLMIS purportedly held on behalf of clients."[108] As discussed in my Initial Report, at Section VII.B.3.g, FGG falsely claimed that PwC audited Madoff's returns. PwC did not audit BLMIS. PwC was retained as the auditor for the Sentry Funds, not for BLMIS. As such, the PwC audits of the Sentry Funds did not include an audit of the investments of the Sentry Funds or its performance, a fact which FGG acknowledged.[109]

72. For example, PwC did not "test for completeness and existence of the securities" with independent sources, as the information received originated from BLMIS. PwC looked only at "a sample of the trades" from FGG's records and compared them to the investments of the Sentry Funds that were reported on the account statements. PwC stated: "we have not (in the past) done specific detailed testing for all the [Sentry] funds represented."[110] PwC further explained that "***[s]hould this really be an audit,*** we would have to take statistical samples (such as dates) according to our internal procedures."[111] In an email sent in December 2002, Lipton acknowledged that "PwC doesn't audit the 'performance' of any of our funds."[112]

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108 Funkhouser Report, ¶18.

109 Lipton Anwar Dep., 5/14/13, Ex. 34, Email from Daniel Van Veen to Gordon McKenzie, RE: BLM summary report of procedures [FG-00001769-771 at -769]. Lipton Anwar Dep., 5/14/13, Ex. 26 [FG-00001733-735 at -733]; Emails between Richard Landsberger, Rob Blum, and Patrick Blake, RE: Banknord meeting notes, February 25, 2004 [FGGE000264323-325 at -324-325 / SECSEV0841846-848 at -846].

110 Lipton Anwar Dep., 5/14/13, Ex. 34, Email from Daniel Van Veen to Gordon McKenzie, RE: BLM summary report of procedures [FG-00001769-771 at -769].

111 Lipton Anwar Dep., 5/14/13, Ex. 34, Email from Daniel Van Veen to Gordon McKenzie, RE: BLM summary report of procedures [FG-00001769-771 at -769] (*emphasis added*).

112 Lipton Anwar Dep., 5/14/13, Ex. 26, Email from Dan Lipton to Lakshmi Chaudhuri, RE: Due Diligence Info for Lourdes' prospect [FG-00001733-735].

73. Although PwC did visit BLMIS, Citco summarized its December 2002 visit to BLMIS with PwC, by stating "that the 'mission' has failed." Citco explained that the "agreed upon procedures (e.g. walkthrough tests) [it] received from PwC Amsterdam . . . were <u>not</u> performed." [113] As discussed in my Initial Report,[114] Citco verified that only "some" of the trades from Kingate's BLMIS account were checked against what was reported on customer statements from BLMIS; "no Fairfield trades were reconciled." Citco stated: "[n]o other substantive audit procedures/test of controls were performed."[115]

74. Funkhouser misconstrues the purpose of an audit and conflates an audit with due diligence. An audit includes a spot check or sampling at specific times during the life of an entity,[116] whereas due diligence and risk management connect the dots from the inception of an investment through the end of the investment. More can be seen by connecting the dots and looking at all information than by spot checking once a year. Due diligence and risk management take place throughout the life of an investment. During this time, you must always "connect the dots" of information, particularly information that does not conform to what you would expect to see as an investment manager.

75. As discussed in my Initial Report, at no time should an audit ever be considered due diligence.[117] The audit process is different than due diligence and may not include key data points or processes used by the manager of the investments. While an investment manager can employ a third-party vendor such as PwC to conduct due diligence, this was not the case at FGG. PwC was not hired to perform due diligence, it was hired to conduct

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[113] Email from Albert van Nijen to William Keunen, Anuschka Cova, Michael van Zanten, Ronald Irausquin re: Visit Madoff, December 17, 2002 [ANWAR-C-ESI-00357244-247 at -245-246].

[114] Hirsch Report, ¶¶448-449, Figure 117.

[115] Email from Albert van Nijen to William Keunen, Anuschka Cova, Michael van Zanten, Ronald Irausquin re: Visit Madoff, December 17, 2002 [ANWAR-C-ESI-00357244-247 at -245].

[116] *See*, e.g., PwC engagement letter with Fairfield Greenwich Group, November 7, 2008 [10-03800_FGG_0015084-095 at -084-085], ("[PwC] will audit the financial statements of the Funds as at December 31, 2008 and for the year then ending … [PwC] note[s] that we have not been engaged to complete a review of any unaudited interim financial statements… [i]t is important to recognize that there are inherent limitations in the auditing process such as: (i) the use of selective testing of the data underlying the financial statements….").

[117] Hirsch Report, ¶446.

a specific review in order to complete the annual audited financials of the Sentry Funds. In fact, the engagement letter signed by FGG clearly specifies the limitations of the audit and processes used.[118]

76. There is a distinction between what an audit encompasses and what due diligence by an investment manager encompasses. In an audit, FGG, as the investment manager, produces the financial statements that are reviewed by the auditor. Furthermore, the BLMIS accounts went to cash at the end of each year starting in 1995 and every quarter starting in the third quarter of 2002, leaving no positions to audit at quarter-end and year-end during those periods.[119]

77. The January 11, 2007 engagement letter between PwC Canada and FGG, signed by Dan Lipton, states the following regarding PwC's responsibilities:

> We will audit the financial statements of the Funds at December 31, 2006 and for the year then ending prepared in accordance with International Financial Reporting Standards.
>
> We note that we have not been engaged to complete a review of its unaudited interim financial statements.
>
> ***
>
> We will consider the Funds' internal control over financial reporting solely for the purpose of determining the nature, timing and extent of auditing procedures necessary for expressing our opinion on the

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118 *See, e.g.*, PwC engagement letter with Fairfield Greenwich Group, December 9, 2003, Anwar Deposition of Daniel Van Veen, 10/11/12, Ex. 42 [10-03800_FGG_0017759-767 at -761], ("In this regard, management [FGG] is responsible for safeguarding the assets of the Funds, maintaining proper accounting records and maintaining an appropriate system of internal control (including procedures regarding … prevention and detection of fraud, other irregularities and errors and non-compliance with law or regulations[.]) [PwC's] audit is not designed to specifically detect fraud."). FGG acknowledged this in an email from Lipton to Vijayvergiya, forwarding questions from an investor: "There is a misconception [by the investor] of what an auditor's job is – the opinion states the purpose is to find material misstatements not to find fraud." Lipton Anwar Dep., 5/14/13, Ex. 27 [FG-00001736-738 at -736]. *See also,* PwC Draft Memo, March 15, 2005 [FG-00006095-103 at -099-103], ("the procedures performed are not directed to the providing of assurance in respect of internal control, nor to the detection of fraud, errors or illegal acts. The procedures performed do not constitute an audit nor an investigation of the internal controls of/at BLM. The procedures consisted of gathering factual information through an interview with Mr Madoff (hereafter 'BM'). No testing of controls and procedures was performed.").

119 *See* Hirsch Report, Section VII.B.2.b(2), ¶¶229-233.

> financial statements. This consideration will not be sufficient to enable us to render an opinion on the effectiveness of internal control over financial reporting nor to identify all significant weaknesses in the Funds' system of internal financial controls.[120]

78. The PwC engagement letter further states the following regarding FGG's responsibilities:

> **The Funds' management is responsible for the financial statements** and information referred to above including establishing **and maintaining an effective system of internal control.** In this regard, management is responsible for establishing policies and procedures that pertain to the maintenance of accounting records, the authorization of receipts and disbursements, the **safeguarding of assets**, the proper recording of transactions in the accounting records, and for reporting financial information in conformity with International Financial Reporting Standards.
>
> ***
>
> Management also is responsible for the design and implementation of programs and controls to prevent and detect fraud….[121]

79. In short, Funkhouser's opinions regarding PwC are both inaccurate and irrelevant to a proper due diligence review.

V. Opinion IV: Any Assurances Provided by Madoff's Reputation and Experience Are Outweighed by the Trading Impossibilities and Cumulative Red Flags

80. In his report, Funkhouser provides a lengthy description of Madoff's reputation, implying that it provided FGG with assurances about the investments in the Fairfield BLMIS Accounts, including the following:

> Mr. Madoff was recognized in the securities industry for his innovative ideas and vision for the future structure of the U.S. financial markets. He was also well recognized for his leadership

[120] PwC engagement letter with Fairfield Greenwich Group, on behalf of various funds including Fairfield Sentry Limited, January 11, 2007 [PwC_Canada__0000003315-324 at -315-316, and -320].

[121] PwC engagement letter with Fairfield Greenwich Group, on behalf of various funds including Fairfield Sentry Limited, January 11, 2007 [PwC_Canada__0000003315-324 at -317] (*emphasis added*).

> role in promoting electronic trading and providing advice to U.S. government officials on market structure and rule changes to improve trade competition. Beginning in the 1980s, Mr. Madoff's reputation and stature on Wall Street grew, and he was recognized as a competitor to the traditional floor-based trading specialists of the NYSE.[122]
>
> BLMIS was positioned to benefit as the securities industry was advancing to a decentralized market structure where computerized trading would thrive.[123]
>
> Mr. Madoff "was thought of as a great philanthropist, a pillar of the community." His reputation preceded him both in personal and professional circles.[124]

81. However, while reputation is one factor for consideration in due diligence – you do not solely rely on it.[125] As an investment professional, I conduct background checks on all managers regardless of their reputation. For example, Mark Kingdon, CEO of Kingdon Capital, was on the Board of Columbia University when my firm invested in his hedge fund. I nonetheless required a background report on Kingdon as part of my due diligence.

82. As part of my due diligence, I assess whether the manager's known reputation is relevant to the potential investment. For example, in assessing a potential opportunity for my firm to invest with Amaranth Advisors, LLC, we were aware of the reputation of Nick Maounis, the founder of Amaranth, and knew Maounis when he traded convertible arbitrage at Paloma Partners. He was an excellent convertible arbitrage trader. At Amaranth, however, Maounis formed a multi-strategy fund and was responsible for

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122 Funkhouser Report, ¶26.

123 Funkhouser Report, ¶27.

124 Funkhouser Report, ¶33.

125 *See also* Investment Process and Risk Management Overview, January 2006 [FG-06132609-652 at -642-643] (FGG explaining that Bayou touted itself as having characteristics of a well-positioned hedge fund such as having a "[f]ounder with a Wall Street pedigree" and "[e]xperience at a well-known hedge fund firm," and that "[f]or some firms, [that] is enough but [FGG] look[s] for other characteristics…."); Hirsch Report, ¶149.

managing the firm as well as various strategies.[126] Because Maounis had no experience in this new role, I did not consider his particular reputation and experiences in convertible arbitrage when I conducted due diligence on the new multi-strategy fund because it was irrelevant. Ultimately, we did not invest with Amaranth because of Maounis's lack of experience managing a multi-strategy fund. Reputation and past experiences incongruent with the current investment would not have provided me with assurances.

83. It was widely known that Madoff, in his role as the investment advisor running the SSC strategy, was secretive about controlling the flow of information. The reputation of Madoff in his capacity as a broker-dealer was irrelevant to his reputation as a money manager or investment advisor. The lack of information about Madoff as an investment manager and his strategy was part of the reason my firm never invested with BLMIS or a feeder fund with investments in BLMIS. Indeed, the aspects of Madoff's reputation that Funkhouser points to are unrelated to investment decision making, rendering such reputation irrelevant.

84. Notably, the concept of investing based on a "good" reputation is not only inconsistent with the due diligence required of an investment manager but also brings unacceptable risk. Investors trust investment managers as stewards of their money, to invest in funds managed by people with good reputations and to generally avoid people with "bad" reputations. But identifying a good versus bad investment based on whether an investment advisor has a good or bad reputation is unreliable. There were numerous examples of financial blow-ups and fraud by people considered "reputable," such as:

Manhattan Investment Fund Ltd. – Michael Berger (1996)

85. Michael Berger, the investment manager of Manhattan Investment Fund Ltd., had a "good" reputation. Before creating Manhattan Investment Fund, Berger managed money at a savings and loan bank and for wealthy individuals, and authored "Wall Street Notes,"

[126] *The Amaranth Collapse: What Happened and What Have We Learned Thus Far*, Edhec Risk and Asset Management Research Centre, August 2007 [PUBLIC0709448-458 at -449, -451]. Amaranth Advisors, a $9.2 billion hedge fund, collapsed in September 2006 after losing $6.6 billion in assets on a bet on the natural gas market. The biggest energy trading disaster happened through classic rogue trading mistakes and a complete breakdown in risk control.

a financial newsletter.[127] Berger founded the Manhattan Investment Fund in 1996 and managed Manhattan Capital Management, Inc., an investment adviser owned by Berger.[128]

86. During the operation of his fund, I recall investors saying they found him charming and persuasive, as well as competent, but my firm had a negative experience with Berger. Based on our due diligence, we believed that his returns were fake because he was short-selling[129] technology stocks in a raging bull market. We never recommended his fund to our clients.

87. When the Manhattan Investment Fund collapsed, my firm's concerns about fake returns were confirmed. On January 18, 2000, the SEC filed its complaint against Berger, Manhattan Investment Fund Ltd., and Manhattan Capital Management, Inc., alleging federal securities law violations. It was revealed that Berger was manufacturing fake account statements showing positive performance, grossly overstated profits, and hundreds of millions of dollars in assets. In reality, the fund lost over $300 million of investor money through short-selling technology stocks, effectively betting that technology stocks prices would fall. However, the technology stock prices increased dramatically resulting in significant losses to the fund.[130]

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[127] *Fund Manager Accused of Fraud*, January 19, 2000, Los Angeles Times, Business Section [PUBLIC0709580-583].

[128] SEC Litigation Release No. 16412, *SEC Charges Hedge Fund and Its Adviser With Fraud Emergency Relief Ordered*, January 19, 2000, [PUBLIC0708478-479].

[129] Short selling is a trading strategy where an investor borrows an asset, sells it at a high price, and then buys back the asset when the price has declined. The investor "nets the price difference minus fees and interest as profits." *Short Selling Guide*, Anna-Louise Jackson, July 30, 2024 [PUBLIC0709833-842].

[130] Complaint, *SEC v. Berger, et al*, No. 00-CV-333 (S.D.N.Y.) [PUBLIC0709938]; SEC Litigation Release No. 16412, *SEC Charges Hedge Fund and Its Adviser With Fraud Emergency Relief Ordered*, January 19, 2000, [PUBLIC0708478-479].

Dreier LLP – Marc Dreier (2002)

88. Marc Dreier, a graduate of Harvard and Yale, was a high-profile attorney in New York with a "good" reputation who once led a 250-member law firm called Dreier LLP. Dreier was known for his attempt to revolutionize the business of law – hire the best attorneys, pay them top dollar, and keep the profits for himself. The business plan, however, required more start up and cash on hand than Dreier anticipated.[131]

89. In order to save his firm, Dreier started his Ponzi scheme in 2002 with a fake promissory note in the amount of $20 million, allegedly issued by one of his biggest clients, Solow Realty. Dreier sold the fake promissory note to a Connecticut hedge fund with the promise to repay the note with interest. He continued this scheme of creating promissory notes and selling to hedge funds until 2008, when the financial markets weakened and hedge funds reigned in investments.[132] He ultimately admitted to a $400 million investment fund fraud at the same time as the BLMIS Ponzi scheme was uncovered, was arrested in December 2008, and was sentenced to 20 years in prison in July 2009.[133]

Millenium Management – Israel Englander (2005)

90. Israel "Izzy" Englander has a great reputation as a savvy money manager and controller of risk. I knew Izzy from the industry and was invested with him for a short time. His firm, a multibillion-dollar hedge fund, was structured more like a series of proprietary trading desks than a traditional hedge fund which allowed him to control risk at the fund level rather than potentially impact individual trader portfolios. It was that concept that attracted some of the best traders on Wall Street to join him.

91. In 2005, Englander's firm, Millenium Management, was caught up in the mutual fund market timing scandal and found to have violated federal securities laws by employing "deceptive practices" and "devices, schemes or artifices to defraud" in the trading of

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[131] *Marc Dreier's $400M Scam, The Inside Story*, Ira Rosen, October 2, 2009 [PUBLIC0709643-651].

[132] *Diary of a Scam: The Fall of Power Attorney Marc Dreier*, Constance Parten, April 13, 2011 [PUBLIC0709438-447].

[133] *Marc Dreier's $400M Scam, The Inside Story*, Ira Rosen, October 2, 2009 [PUBLIC0709643-651]; *Lawyer Gets 20 Years in $700 Million Fraud*, Benjamin Weiser, July 13, 2009 [PUBLIC0709652-654].

securities, which shocked the hedge fund industry. The violations resulted in a $180 million settlement:

> The Commission's Order finds that from at least 1999 to 2003, the respondents generated tens of millions of dollars in profits for Millennium by engaging in deceptive market timing. Englander, Feeney, Stone and Pillai knew that mutual funds sought to detect market timers and frequently blocked Millennium's trades and, therefore, devised and carried out various fraudulent means to conceal Millennium's identity and thereby avoid detection and circumvent restrictions that the mutual funds imposed on market timing.[134]

<u>Bayou Funds – Samuel Israel (2005)</u>

92. Bayou Management, which managed the Bayou Funds, was founded in 1996 by Samuel Israel and partners. "Investors liked Mr. Israel's constant communications, via e-mail, about the markets and the progress of their investments. He was down to earth, not arrogant. He spoke plainly and didn't seem to fall for Wall Street fads."[135] The firm and its founders' reputation was enhanced when fund advisory firms such as The Hennessee Group recommended the Bayou Fund to their client base.

93. As discussed in my Initial Report,[136] from 1996 through 2005, Bayou "defrauded current investors, and attracted new investors, by grossly exaggerating the Funds' performance to make it appear that the Funds were profitable and attractive investments, when in fact, the Funds had never posted a yearend profit." Bayou fabricated account statements, performance summaries, and audited financial statements. They created a fictitious accounting firm, Richmond-Fairfield Associates, to issue "independent" audit reports to support the fraudulent claims and results. They misappropriated investor funds and

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[134] *SEC Charges Millennium Partners, L.P., Israel Englander, and Others for Engaging in Fraudulent Market Timing Scheme*, December 1, 2005 [PUBLIC0709674-676 at -674]; Securities and Exchange Commission, Release Nos. 33-8639, 34-52863, IA-2453, IC-27172, File No. 3-12116, December 1, 2005 [PUBLIC0709655-671 at -663]. Even Englander, used in my Initial Report as an example of an elite investment advisor, and who remains an elite investment advisor today, was involved in a mutual fund market timing scandal despite his great reputation.

[135] Gretchen Morgenson, Jenny Anderson, and Geraldine Fabrikant, *Clues to a Hedge Fund's Collapse,* The New York Times, September 17, 2005 [PUBLIC0703275-284].

[136] Hirsch Report, p. 55-56.

diverted their customers' money into fraudulent investments, among other violations.[137]

94. FGG's own due diligence process highlighted the Bayou fraud as a "headline[] to avoid": "[Bayou] Duo Pleads Guilty to Fraud." Furthermore, FGG put the Bayou fraud "[t]o the test" of their own due diligence process, stating actions they would have performed and items it would have revealed.[138]

<u>Omega Advisors, Inc. – Leon Cooperman (2010)</u>

95. Leon Cooperman built up Goldman Sachs's asset management group, spending over 25 years there before founding Omega Advisors, Inc. in 1991. Omega Advisors had significant success during the technology boom in the late 1990s and Cooperman "gained a reputation for his ability to spot undervalued companies and recognized the potential of emerging technologies."[139]

96. On September 21, 2016, the SEC charged Cooperman and Omega Advisors with insider trading relating to the purchase of securities in Atlas Pipeline Partners (APL). In 2010, Cooperman was one of APL's largest shareholders and had information regarding its anticipated sale of a large asset, a natural gas processing facility. APL's stock price jumped by 31 percent following the public announcement of the facility sale.[140] In 2017,

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[137] SEC Litigation Release No. 19406, *SEC Charges Samuel Israel III, Daniel E. Marino, Bayou Management, And Bayou Funds For Defrauding Hedge Fund Investors And Misappropriating Investor Assets, Commission Seeks Freeze of Assets and Appointment of Receiver,* September 29, 2005 [PUBLIC0706546-548]. *See also,* Complaint for Injunctive and Other Equitable Relief, and for Civil Monetary Penalties Under the Commodity Exchange Act, *Commodity Futures Trading Commission v. Bayou Management, LLC et al.* No. 05 Civ. 8374 (S.D.N.Y. September 29, 2005), ECF No. 1 [PUBLIC0706549-573]; Complaint, *SEC v. Samuel Israel III; Daniel E. Marino; Bayou Management, LLC; Bayou Accredited Fund, LLC; Bayou Affiliates Fund, LLC; Bayou No Leverage Fund, LLC; And Bayou Superfund, LLC*, September 29, 2005, p.5 [PUBLIC0706574-589 at -578]; Gretchen Morgenson, Jenny Anderson and Geraldine Fabrikant, *Clues to a Hedge Fund's Collapse,* The New York Times, September 17, 2005 [PUBLIC0703275-284].

[138] FGG Due Diligence Process, July 2007 [SECSEV0040123-141 at -129, -139-140]. *See also, Bayou Duo Plead Guilty to Fraud*, Wall Street Journal, September 30, 2005 [PUBLIC0706590-595].

[139] *Leon Cooperman: The Billionaire Investor Who Built Omega Advisors*, FinanceGates, February 2, 2025 [PUBLIC0709598-604]; Leon G. Cooperman, Forbes Profile [PUBLIC0709605-609].

[140] *SEC Charges Hedge Fund Manager Leon Cooperman With Insider Trading*, SEC Press Release, September 21, 2016 [PUBLIC0709808-809]; Complaint, *Securities and Exchange Commission v. Leon G. Cooperman and Omega Advisors, Inc.*, September 21, 2016 [PUBLIC0709774-807].

Cooperman and Omega Advisors agreed to a settlement with the SEC for violations of insider trading and beneficial ownership reporting violations.[141]

97. The examples above, both before and after the collapse of BLMIS, show why an investment advisor's reputation should provide no assurances. Madoff's reputation was irrelevant to due diligence. Reputations, like people, can change and fund managers need to always be vigilant about not placing inappropriate weight on it. Further, someone can have a good reputation as a broker, but what cemented that reputation may have nothing to do with a new role as an investment advisor.

98. Furthermore, much of the information regarding Madoff's reputation referenced by Funkhouser is not contained in any of the contemporaneous due diligence notes and presentations produced by FGG, or in any information available to FGG at the time. These include multiple New York Times articles after Madoff was arrested; multiple Reuters articles after Madoff was arrested; a Jewish Chicago article after Madoff was arrested; a 2009 Traders Magazine article about Madoff; a 2009 Guardian article; Madoff's deposition in 2016; a 2019 Morningstar article; a 2021 Future Nexus article about Madoff; and a 2021 American Bar Association article on Madoff.[142]

99. Reputation should not be conflated with good due diligence. One of the most important factors of due diligence is verification of what the investment advisor states and represents with independent, credible sources. If the statements and representations are not or cannot be confirmed, then the reputation and experience of an investment advisor have no import and can never assuage the concerns that the investment advisor is not doing what he says he is doing.

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141 Statement on Leon Cooperman Settling Insider Trading Charges, Stephanie Avakian, May 18, 2017 [PUBLIC0709810-811].

142 *See* Funkhouser Report, Section IV.A. Note that Funkhouser cites at footnote 15 to The New York Times article, *Madoff fraud rippled around the World*, with a November 21, 2008 date [10-03800_FGG_0024876 -883 at -880-881]. I question the date because it discusses the impact from the collapse of Madoff's Ponzi scheme and his arrest on December 11, 2008, two weeks later. That said, the article pointed out the mutual benefits of the Fairfield-Madoff relationship:

> It was Tucker who introduced Fairfield to Madoff . . . . That began a long partnership that helped the Fairfield firm earn enviably steady returns, even in down markets – and that lifted Madoff into a global orbit . . . ."

VI. Opinion V: Personal Investment in FGG Is Consistent with Industry Practice

100. Funkhouser argues that personal investment by principles of FGG in Sentry is inconsistent with knowledge of a fraud or a Ponzi scheme.[143] This is essentially a "who would invest in a fraud" argument. This position overlooks two key investment realities: (i) investment by a hedge fund's manager is common and often required by investors; and (ii) one may choose to invest for the profits, believing that they are smart enough or will be lucky enough to get out before the fraud collapses.

101. In hedge funds, investment by the investment manager is important to investors. It shows that the manager believes in the investment and has "skin" in the game. Investing in the Sentry Funds would have been necessary to provide assurances and attract more capital. It is industry custom and practice for investors to expect co-investment by the manager of the fund in which they are investing.[144] For example,

- James Hedges, in ***Hedges on Hedge Funds***, states: "Hedge fund managers tend to invest a significant portion of their own capital in their partnerships, thereby reinforcing their commitment to their fund's performance."[145]

- James Owen, in ***The Prudent Investor's Guide to Hedge Funds***, states "A hedge fund's general partners are almost always significant investors in the funds they manage – and they should be, as this creates a powerful alignment between the interests of the managers and the investors."[146]

102. Notably, Funkhouser's view of FGG's personal investment ignores that investment managers also reap both management and performance fees. FGG was making hundreds

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143 Funkhouser Report, ¶¶19-20, 76-85, 153.

144 FGG, in other investments, acknowledged skin in the game. Rob Blum of FGG, in a 2004 internal email, states "… if we are going to do this hedge fund, **we need to see some personal money in it from them, no excuses**, even if it requires our lending part of it to them out of their incentive fee share (we used to do that at [Oppenheimer & Co] for 'cash poor' portfolio managers – **Nate [Gantcher of Oppenheimer & Co.] never wanted to invest with a manager who didn't have his own blood on the line, and I feel that with this crew this is a doubly important thing to do.**" Email from Rob Blum to Jeffrey Tucker, Dan Lipton, and Corina Piedrahita (Harold Greisman cc'd), RE: Sentry Cash Forecast, February 8, 2004 [FG-02206068-069 at -068] *(emphasis added*) (Tucker replied to this email stating: "Agreed.").

145 James R. Hedges IV, *Hedges on Hedge Funds*, p. 5-8 (2005) [PUBLIC0709890-902 at -899, 902].

146 James P. Owen, *The Prudent Investor's Guide to Hedge Funds: Profiting from Uncertainty and Volatility*, p. 203-204 (2000) [PUBLIC0709908-912 at -911-912].

of millions of dollars in fees from the BLMIS accounts in the Sentry Funds. Indeed, when compared to the hundreds of millions of fees and returns earned by FGG, the investments by its principles are insignificant.

103. For example, Funkhouser claims Jeffrey Tucker and his family invested $9.9 million in FGG (including in Greenwich Emerald), Noel and his family invested at least $15 million (including in Greenwich Emerald), and Piedrahita and his family invested at least $10.5 million.[147] Funkhouser also claims that Vijayvergiya invested approximately 40-45% of his net worth in FGG and that "Philip Toub, a shareholder of FGL, even deferred a portion of his compensation for it to be invested in the Sentry fund."[148] Funkhouser completely ignores the exorbitant fees that these individuals were generating as principals and shareholders of FGG. As discussed in my Initial Report, from 2002 through 2008, FGG received fees totaling over $800 million from Fairfield Sentry alone, which benefited the principals and shareholders of FGG.[149]

104. As to the question of why one would invest in a fraud, there are a number of possible answers, including greed. In my experience, investors and investment managers are often seduced by the possibility of large or consistent returns and, in the case of investment managers, exorbitant fees associated with those returns, and may consider the risk to be worth the potential (and real) rewards.

VII. Opinion VI: The Existence of Redemptions from Either BLMIS or from FGG Do Not Support Funkhouser's Opinions

105. Funkhouser takes the position that FGG being "consistently able to obtain large withdrawals from BLMIS in a timely manner" supports his opinion that Defendants were unaware of the fraud at BLMIS.[150] However, Funkhouser's reliance on redemptions is incorrect for multiple reasons.

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[147] Funkhouser Report, ¶¶76-78.

[148] Funkhouser Report, ¶¶79-80.

[149] Hirsch Report, ¶4.

[150] Funkhouser Report, ¶87. The Funkhouser Report uses the terms "withdrawals" and "redemptions" interchangeably, so I have done the same.

106. First, fulfilling redemption requests is expected by investors and is a normal operational process. Redemptions upon request are what are expected from an investment; it is irrelevant to knowledge of a fraud.

107. Second, while attempting to highlight BLMIS's "ability to satisfy" large redemptions over a short time period, Funkhouser is entirely incorrect when he claims, that, "as of the beginning of April 2006, [FGG's] year-to-date net redemptions from BLMIS exceeded $1 billion."[151] The email Funkhouser cites mentions $1.025 billion in net redemptions "**[t]o date**," meaning since inception of the Fairfield BLMIS Accounts in 1990, not for the period January 2006 through April 2006.[152]

108. Last, Funkhouser conflates two distinct types of "redemptions" that should be viewed separately: (i) redemptions from the Sentry Funds by investors, and (ii) "redemptions" (i.e., withdrawals) from BLMIS by the Sentry Funds. Redemptions from the Sentry Funds by investors were funded by either cash on hand in the Sentry Fund's bank account or by a withdrawal from BLMIS, as determined by FGG.[153] Funkhouser cites to the Fairfield Funds' "record of consistently processing redemption requests in a timely manner,"[154] but redemptions from the Fairfield Funds do not equate to redemptions from BLMIS. As Funkhouser states, FGG would first look to cash in the relevant Fairfield Fund's "bank accounts and incoming subscriptions,"[155] which has nothing to do with BLMIS. Further, where redemptions were funded with money on hand, the notion of assurances of legitimacy at BLMIS through the ability to withdraw money is illogical, at best, and irrelevant.

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[151] Funkhouser Report, ¶90.

[152] Email from Gordon McKenzie to Tucker, Noel, Corina Piedrahita, and Andres Piedrahita, April 6, 2006 [FG-02202756-757 at -756] *(emphasis added)*. The $1.025 billion figure reflecting net redemptions to date is consistent with my review of the activity in the Fairfield BLMIS Accounts. *See* Settled Cash table, StorQM Customer Statements, Customer Ledgers.

[153] *See, e.g.* Email from Gordon McKenzie to Blum, Tucker, Noel, Corina Piedrahita, and Andres Piedrahita, Subject: Sentry Cash Forecast updated for March 31, 2005, March 31, 2005 [FAIRFIELD_01815941] (noting funding redemptions with both cash on hand and withdrawals from BLMIS); Email from Nancy Ng to Tucker, Noel, Corina Piedrahita, and Andres Piedrahita, Subject: Sentry cash forecast for August 31,2005, August 31,2005 [FAIRFIELD_01860807] (same).

[154] Funkhouser Report, ¶89.

[155] Funkhouser Report, ¶86.

VIII. Conclusion

109. Funkhouser's opinion, that FGG could not have had actual knowledge that BLMIS was not trading, is based primarily on post-2008 materials, conflation of the lack of regulatory action with a legitimate business or lack of knowledge of fraud, citation to SEC and FINRA processes and policies that were not in place during the life of the Sentry Funds but were in fact created in response to the public discovery of the BLMIS Ponzi scheme, misstatements of facts, and reliance on speculation.

110. There is no substitute for due diligence and risk management in verifying the veracity of a manager's statements, the existence of assets, and confirming that the strategy is implemented in accordance with the foundational documents of the fund. You cannot rely on someone's "good" reputation or the review conducted by a regulator in place of due diligence.

111. FGG presented to investors that they had robust due diligence and risk management processes and had access to the same documents that I reviewed.

112. It remains my opinion that due diligence and risk analysis conducted in a similar manner to that represented by FGG, using the documents and information that were available to FGG during its investment with BLMIS, shows that: no trading was taking place in the Fairfield BLMIS Accounts; BLMIS was not trading as it represented to investors; and numerous other red flags cumulatively confirmed that BLMIS was not trading securities. None of the theories and speculation raised by Funkhouser alter, affect, or undermine these findings.

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Amy B. Hirsch

October 15, 2025

Amy B. Hirsch
Assumptions and Limiting Conditions

1. The conclusions arrived at herein are valid only for the stated purpose of this report.
2. Public information and industry and statistical information have been obtained from sources I believe to be reliable. However, I make no representation as to the accuracy or completeness of such information and have performed no procedures to corroborate the information. All information obtained from databases is deemed to be complete and accurate unless otherwise noted. All performance numbers are estimates until final audit.
3. Financial statements, portfolio information, track records, marketing material, and other related information in the course of this engagement, have been accepted without any verification as fully and correctly reflecting the portfolio, fund, or program's financial performance and/or operating results and/or AUM, etc., for the respective period, except as specifically noted herein.
4. This report is for the exclusive use in the referenced matter for the sole and specific purposes noted herein. It may not be used for any other purpose or by any other party for any purpose. Furthermore the report is not intended by the author or should not be construed by the reader to be investment advice in any manner whatsoever.
5. Neither all nor any part of the contents of this report should be disseminated to the public through advertising media, public relations, news media, sales media, mail, direct transmittal, or any other means of communication without our prior written consent and approval.
6. No change of any item in this report shall be made by anyone other than me, and I shall have no responsibility for any such unauthorized change.
7. My compensation is fee-based and is not contingent on the outcome of the litigation.
8. I have no obligation to update the report or the opinion for information that comes to our attention after the date of the report. However, I reserve the right to amend or supplement this report should documents or information come to my attention which would have a material impact on our analysis and/or conclusions.
9. I am not and attorney or legal expert. Nothing contained in this report shall be construed to constitute legal advice or legal opinion.