

## VI. FACTS AND ALLEGATIONS

### A. Background and Structure of Relationship Between Fairfield and Madoff Investments

#### 1. *Background of Sentry Funds' Relationship with Madoff Investments*

15. In 1989, Jeffrey Tucker's father-in-law introduced Walter Noel and Tucker to Bernard Madoff.

16. At that time, Noel testified that he thought that Madoff was doing business under Cohmad Investments, a firm founded by Madoff and Maurice Cohn.

17. Approximately, July 1, 1989, Noel and Tucker gave Madoff \$1.5 million to invest for an entity called the Fairfield International Fund.

18. Tucker testified that about six months later, in January 1990 Fairfield added another \$1 million for Madoff to manage.

19. At some point in the early 1990s, Madoff ceased managing a portion of the Fairfield International's assets.

20. The Fairfield Sentry Limited fund was first offered November 30, 1990.

21. Initially that fund had about \$4 million under management, all of which was managed by Madoff.

22. On January 1, 1993, Fairfield offered the Greenwich Sentry, L.P. a fund whose objective sought to "obtain capital appreciation of its assets principally through the utilization of a nontraditional options trading strategy described as 'split strike conversion...'"

23. On May 1, 2006, Fairfield began offering the Greenwich Sentry Partners, L.P. which was also utilizing the “nontraditional options trading strategy described as ‘split strike conversion...’”

24. As of December 11, 2008, there were three Sentry funds: Fairfield Sentry Limited (which included share classes Fairfield Lambda Limited (valued in Swiss francs) and Fairfield Sigma Limited (valued in Euros)), Greenwich Sentry L.P. and Greenwich Sentry Partners L.P. The Fairfield Sentry Fund marketed primarily to international investors and the Greenwich Sentry funds marketed primarily to domestic investors. Those funds were managed the same way (and the same due diligence was conducted with respect to each) and they will be referred to herein collectively as the “Sentry funds”.

25. The Sentry funds have been offered and sold to investors in The Commonwealth of Massachusetts.

26. Sentry funds have been marketed by Noel, Tucker, and a worldwide staff of over 100 people that helped raise money for it.

27. By the Fall of 2008, the Sentry funds had grown to in excess of \$7 billion in assets under management.

2. *Structure of Relationship With Madoff Investments*

28. Ninety-five percent or more of the Sentry funds’ assets were (supposedly) held and managed by Bernard L. Madoff Investment Securities LLC (“Madoff Investments”). (Since October 2002, up to 5 percent of the Sentry funds were eligible to be invested in non-Madoff-related investments, but by

October 2008 the percentage of non-SSC assets had been reduced to approximately 1 percent.)

29. Madoff Investments was marketed as the executing broker who executed a split-strike conversion strategy on behalf of the Sentry funds.

30. CITCO Fund Services was the custodian of assets for the Sentry funds.

31. Madoff Investments was the sub-custodian that supposedly held the actual stock, options and U.S. Treasuries that comprised the bulk of the assets of the Sentry funds.

32. Madoff Investments did not charge any fee for its sub-custodian services.

33. Madoff Investments purportedly earned his fees off of commissions he charged while executing the split-strike conversion strategy, earning \$.04 per share for equity trades and \$1.00 per option contract. See Exhibit 53.

34. Madoff Investments was supposed to be operating the split strike conversion strategy within guidelines furnished by Madoff Investments (see Exhibit 53) and approved by Fairfield.

35. Fairfield was supposedly monitoring Madoff's trades and informing him if and when he was operating outside of those guidelines.

36. The contracts entered into included a Customer Agreement, a trading authorization, options agreements and options hedging agreements. See Composite Exhibit 53.

37. The agreements setting forth the parameters under which Madoff Investments was supposedly operating were created by Bernard L. Madoff (“Madoff”) and supposedly approved by Fairfield.

38. However, Jeffrey Tucker testified that he was not aware of any time that Fairfield told Madoff Investments that it was operating outside of those parameters. Specifically, Tucker testified as follows:

Q. Did Fairfield ever inform Madoff Investments that – of any instances where the guidelines had not been complied with?

A. I don’t recall. I don’t – I did not.

Q. Are you aware of any instance where anyone at Fairfield communicated to Madoff that the guidelines had not been complied with?

A. I’m not aware.

39. According to the testimony of Walter Noel, Madoff limited the total amount of money Sentry could invest with him.<sup>7</sup>

40. That limit appears to have increased slowly over the years.

41. Upon information and belief, Sentry was frequently at that cap or near to it.

42. Upon information and belief, when an investor redeemed, Sentry worked diligently to replace the investment.

43. Up until the Fall of 2008, when redemptions exceeded subscriptions, Fairfield was typically able to immediately or promptly replace redemptions with new subscriptions.

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<sup>7</sup> The Division attempted to obtain additional information with respect to those limitations through interrogatories and document requests. Even though the date for responding to those interrogatories and document requests has passed, Fairfield has not provided the additional information requested.

44. The redemptions and subscriptions were typically netted out, so the bulk of the outflows from redemptions never had to be transferred out of Madoff Investments. See Exhibit 51.

45. Gordon McKenzie testified that redemptions were paid out of subscriptions received, before money would be withdrawn from Madoff Investments.<sup>8</sup>

3. *Madoff's Purported Split Strike Conversion Strategy*

46. Madoff Investments purportedly<sup>9</sup> was conducting a split strike conversion ("SSC") strategy for the Sentry Funds.

47. Under this strategy, Madoff would use proprietary algorithmic models to determine when to enter and exit the market.

48. When Madoff was in the market, he would buy a basket of stocks that was intended to correlate with the S&P 100. He would also buy out-of-the-money puts on the S&P 100 to protect the downside of the basket and would sell out-of-the-money calls on the S&P 100 in order to fund the purchase of the protective puts.

49. When Madoff was out of the market he purchased U.S. Treasury Bills.

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<sup>8</sup> In his on the record testimony, Vijayvergiya stated that the fact that redemptions were always received from Madoff without problem gave him comfort as to the legitimacy of Madoff's operation. He did not mention that those redemptions typically came from new Sentry subscriptions.

<sup>9</sup> Instead of adding "supposedly" or "purportedly" in every paragraph, it should be assumed that any description of Madoff's activities with respect to his operation of the split-strike conversation strategy are descriptions of what he was supposedly doing.

50. Madoff conducted the strategy for a variety of clients and allocated equities, options and U.S. Treasuries pro rata to each client based on the amount of investments that client had with him.

51. Tucker testified that it was a strategy that was supposed to take advantage of upward momentum in the markets.

4. *Returns Boasted by Fairfield to Investors and Potential Investors*

52. Marketing materials for the Sentry Funds offered uncannily consistent and positive returns.

53. For example, in a marketing sheet dated October 2008, Fairfield indicated that it had posted positive returns 92.09 % percent of all months since 1993. See Exhibit 3.

54. Many people outside of Fairfield questioned whether those returns were, in fact possible.

55. For example, a Barron's article in 2001 titled "Don't Ask, Don't Tell" by Erin Arvelund questioned whether these returns were possible.

56. Harry Markopolos, an independent fraud investigator, submitted a lengthy report to the SEC in 2005 providing a number of reasons why Madoff's returns were simply not possible. (Madoff, apparently with Fairfield's assistance, was subsequently able to dodge meaningful SEC scrutiny of his operation. See Section VI(F)(1) below).

57. According to testimony of Noel, Ticker, Lipton and Vijayvergiya, it never crossed their mind that those returns were simply not possible.

58. As of October 2008, the Sentry funds were (supposedly) up 4.5 %, for the year despite the fact that the index the Sentry funds tracked, the S &P 100 DRI, was down 30.84 % for the year. See Exhibit 3.

59. These favorable returns were reported by the Sentry funds despite the fact that, according to the Division's review of account statements produced by Fairfield for the Sentry funds against the daily closing price of the S&P 100, Madoff appears not to have exited the SSC strategy in 2008 when the S&P 100 was higher, on average, than when he entered it.

5. *Fees Earned by Fairfield and its Principals in Connection with the Sentry Funds*

60. Fairfield charged a fee of one percent of assets under management for the Sentry funds, as well as a fee that was 20 percent of the increase of the net asset value of the Sentry funds month-to-month, payable quarterly.

61. Tucker testified that Fairfield earned approximately \$100 million in fees from the Sentry funds in each of 2008, 2007 and 2006.

62. Gordon McKenzie, in his testimony, put the figure at over \$100 million for each of 2008, 2007, 2006 and 2005.<sup>10</sup>

63. Tucker testified that he personally earned approximately \$100 million from the Sentry Funds over the last 10 years.

64. However, documents produced to the Division indicate that the principals of Fairfield made substantially more.

65. For example, a document titled Partner Comp Worksheets 2008 produced by Fairfield appears to indicate that in 2007 alone Andres Piedrahita

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<sup>10</sup> The Division sent an interrogatory to Fairfield asking: "For each year from 1998 to the present, provide the annual fees Fairfield generated from its Sentry Funds." Even though the date for response has passed and no extension was granted, Fairfield has not provided this information.

(Fairfield Partner and Noel son-in-law) earned in excess of \$45 million and Tucker and Noel earned in excess of \$30 million. See Exhibit 61, which is comprised of a cover email dated December 13, 2008 and certain attachments to the email.

66. Upon information and belief, the Division believes that Noel earned fees on the same order of magnitude from the Sentry Funds over the last ten years.

67. Noel and Tucker, according to their testimony, each had less than \$10 million tied up with the Sentry funds and/or Emerald funds at the time Madoff was exposed as a fraud.

6. *Madoff's Arrest*

68. On December 11, 2008, Madoff turned himself in to federal authorities and confessed that he had been conducting a Ponzi-scheme and that his firm's liabilities were estimated at \$50 billion.

69. Subsequently, the Division received a number of calls from Madoff victims located in The Commonwealth of Massachusetts.

70. Many of those victims indicated that they had been exposed to Madoff through feeder funds and affiliated brokers, including Fairfield.

71. The court-appointed trustee charged with sorting out what Madoff assets remain reported that Madoff never (or at least not over the last thirteen years), in fact, engaged in any trades.

72. In his confession at his sentencing, Madoff indicated that his fraud began in the early 1990s.

73. Rather, his whole money-management operation, including the money he managed for Fairfield over their eighteen-year relationship, was nothing more than one big Ponzi scheme.

74. Fairfield claims to have had no idea whatsoever that Madoff was anything other than the legitimate and broker and brilliant market-timer they promoted him as.

B. Contrast Between The Due Diligence Fairfield Represented it Was Doing and The Due Diligence it Actually Undertook

1. *Fairfield's Representations with Respect to the Due Diligence it Undertook Generally and Specifically with Respect to the Sentry Funds*

75. In marketing materials, Fairfield portrayed itself as an advisor that engages in exceptionally rigorous due diligence.

76. In a 2008 marketing piece titled "Fairfield Greenwich Group: Due Diligence and Risk Monitoring: FGG's Value-Added Investment Process", Fairfield states that: "Fairfield's business model enables the firm to have privileged access to all aspects of a manager's operation and investment process, including security level transparency which is employed on a confidential basis."

See Exhibit 4.

77. The same April 2008 marketing brochure went so far as to state:

"Operational" risk refers to the risk of loss resulting from inadequate or failed internal processes, human resources, or systems, or from external events. **Operational failures, including misrepresentation of valuations and outright fraud, constitute a majority of instances where massive investor losses occur.** Other operational risks include staff processing errors, technology failure, and poor data. The inadequacy or lack of independence or transparency of valuation procedures, contingency plans, and other

trading and settlement procedures may cause FGG to reject an otherwise appealing manager.<sup>11</sup>

78. Another 2008 marketing brochure titled “Fairfield Greenwich Group: The Firm and its Capabilities”, which discussed the Sentry fund as Fairfield’s “flagship single-manager fund” and which was provided to a Massachusetts investor who subsequently invested in a Sentry fund, states:

Structural and operational risks exist to varying degrees in all hedge funds. “Operational risk” refers to the risk of loss resulting from inadequate or failed internal processes, human resources, or systems, or from external events. Operational failures, including misrepresentation of valuations and outright fraud, constitute a majority of instances where massive investor losses occur. Other operational risks include staff processing errors, contingency plans, and other trading and settlement procedures may cause FGG to reject an otherwise appealing manager.

... FGG carefully assesses the controls and procedures that managers have in place and seeks to determine actual compliance with those procedures, often suggesting modifications, separation of responsibilities, and remedial service provider, technology, or staff additions.

See Exhibit 5.

79. This piece also speaks of “FGG’s deep, ongoing joint venture relationships with its managers” and “greatly facilitated communication and a continuing dialogue with its managers”, as well as FGG’s “ongoing activity is to ensure that the fund continues to . . . act[] in accordance with its operational and risk framework that was approved during the due diligence phase”. The piece states that “[a]ny divergences

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<sup>11</sup> In their testimony before the Division, certain Fairfield personnel stated that the representations in the preceding exhibits were not meant to apply to the Sentry Funds, but could not point to anywhere in the document where it stated or otherwise indicated that the document only applied to the non-Sentry Funds. They were also unable to provide any coherent rationale why Madoff Investments would be exempted from the promised ongoing due diligence.

are discussed with the manager and addressed or resolved”. See Exhibit

5.

80. The implication is that the failures described in the excerpt could never happen at a Fairfield fund because Fairfield’s hyper-vigilant due diligence would cause it to reject a manager that does not provide it with ongoing transparency with respect to its procedures such as its trading and settlement procedures.

81. Fairfield published a plethora of marketing materials over the years geared towards giving investors comfort with the level of due diligence it performs on its managers (both its single-manager fund managers like Madoff and its multiple-manager-fund fund managers).

82. In an April 2006 piece titled, “Fairfield Greenwich Group, Investment Process and Risk Management Overview April 2006”, Fairfield included a page titled: “Due Diligence: Headlines to Avoid”. See Exhibit 6. Those headlines included the headline “Bayou<sup>12</sup> Duo Plead Guilty to Fraud”. (Ironically, after the Bayou fraud was exposed, a client or potential client asked Fairfield to explain how Madoff’s operation was different from the Bayou operation and Fairfield was quick to point out that they had nothing in common. See Exhibit 18.)

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<sup>12</sup> In 2005, Bayou Group founder, Samuel Israel III and the CFO, Daniel Marino, pled guilty to criminal fraud charges that they stole more than \$450 million from investors in the Bayou hedge funds. The S.E.C. charged Israel and Marino with creating a sham accounting firm, Richmond-Fairfield Associates, that issued fake audits. See <http://money.cnn.com/2005/09/29/markets/bayou/index.htm>.

83. Exhibit 6 also included a page titled: “Due Diligence – Review of Financials and Documents”, which included the line item “Check for ‘reputable’ auditor”.

84. It also includes a page titled “Due Diligence – Onsite Backoffice Review”, which states: “FGG must know: Who performs trade executions? . . .”  
See Exhibit 6.

85. One part of the document indicated that Fairfield would never have invested in Bayou because “We would question Bayou’s obscure auditing firm”.  
See Exhibit 6. (The irony of this statement can be seen when one examines Fairfield’s due diligence with respect to Madoff’s auditors, see Section VI(C)(2)(b) below).

86. Another part of the document indicated that Fairfield would never have invested in Bayou because it would “Visit office, have several face-to-face meetings” and “Watch for inconsistent answers, refusal to given information.” (The irony of this statement can be seen in Section VI(E)(3)(a) below.) See Exhibit 6.

87. The document also stated that Fairfield: “Verif[ies] assets under management for all funds directly with the prime broker/administrator” and “provides independent, third party confirmation of assets”. See Exhibit 6.

88. Specifically, with respect to the Sentry Funds, Fairfield’s marketing materials promise “rigorous portfolio oversight” and indicated under the heading: “Value Added by FGG”, that it maintained “full transparency to

BLM accounts” and “independent verification of prices and account values”. See Exhibit 7.

89. A document titled “Fairfield Sentry Limited Standardized Responses (December 2008)”, which included a compilation of standardized responses to customer questions indicated that Fairfield conducted “detailed daily compliance monitoring of portfolio activity against all risk limits” and that it “conducts daily positions-based risk measurement, performance attribution and other quantitative analytics”. See Exhibit 8.

90. As an example of the types of representations Fairfield was making to its clients regarding its due diligence into Madoff, on September 1, 2008, a Fairfield investor indicated that it was going to switch its investments to another Madoff feeder fund which charged lower fees. In response, Lauren Ross, a Fairfield employee, emailed the investor and stated, among other things: “At a high level, [Fairfield’s] value contribution centers on: . . . “[d]aily compliance monitoring of all trade activity against compliance limits” and “[o]perational DD of BLM using information gathered over almost two decades working with that firm . . .” See Exhibit 9.

2. *In Contrast to the Rigorous Due Diligence Promised to its Investors, Fairfield Never Took Even Basic Steps to Make Sure That Madoff Was Making the Trades he Said he was Making or Holding the Assets that he Said he was Holding on Fairfield's Behalf*

a. Having Madoff Investments Serve as Both the Sub-Custodian and the Executing Broker Made it So Fairfield was Checking Information Received from Madoff Investments Against Other Information Received from Madoff Investments; Fairfield Sought no Independent Verification of Transactions

91. Fairfield never engaged in any meaningful check to determine whether Madoff was actually holding the assets he said he was holding on behalf of the Sentry funds.

92. Fairfield never engaged in any meaningful check to determine whether Madoff was actually making the trades he said he was making.

93. Fairfield acquiesced to the unusual relationship whereby Madoff Investments served as both the sub-custodian of the assets and the executing broker, which made it so when Fairfield checked the custodian's records against the broker's records, it was checking information received from Madoff Investments against other information received from Madoff Investments.

94. No other Fairfield fund had the same entity serving as the sub-custodian and the executing broker.

95. Both Vijayvergiya and Lipton acknowledged in their testimony to the Division that this was a "risk" or a "risk factor", but that risk factor was not disclosed to investors.

96. The only risk disclosed about Madoff Investments in the Greenwich Sentry Partners offering memorandum provided to a Massachusetts

investor was that “The service of the General Partner’s principals and key employees and BLM are essential to the continued operations of the Partnership. If their services were no longer available, their absence would have an adverse impact upon an investment in the Partnership.” See Exhibit 54.

97. Investors were not aware of the risk of having the executing broker and sub-custodian being one in the same. As an example, on December 15, 2008, after Madoff was arrested, one investor in the Sentry funds emailed Vijayvergiya and asked the following questions: “1. Does Fairfield approve every transaction and confirm the transactions with the custodian directly? 2. How could the fund hire broker-dealer as an advisor and as custodian?” See Exhibit 10.

98. Fairfield never made certain basic checks such as insisting that Madoff provide him with the names of at least one of his options counterparties and confirming with that counterparty that Madoff was in fact buying and selling options from them.<sup>13</sup>

99. Fairfield did not check with any counterparties to Madoff’s equity trades to discern that the trades he said he was making were actually being made.

b. Fairfield Personnel in Charge of Madoff Due Diligence Never Saw the Part of Madoff’s Offices Where the SSC Strategy was Supposedly Occurring and Did not Know the Names of Any of the Traders who Were Supposedly Executing the Strategy

100. Jeffrey Tucker, a Founding Partner of Fairfield, Dan Lipton, Fairfield’s CFO or Amit Vijayvergiya, Fairfield’s Chief Risk Officer, were the

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<sup>13</sup> McKenzie testified: “To my knowledge, we’ve never received a list [of Madoff’s options counterparties], nor has any counterparty been named specifically.” Vijayvergiya testified that “[Madoff] did say he would not be able to provide [Fairfield] with a list of counterparties for the reasons of confidentiality.”

three people at Fairfield most directly responsible for conducting Madoff diligence, according to Dan Lipton's testimony

101. In their on the record testimony neither Tucker nor Vijayvergiya could name anybody by first and last name at Madoff Investments involved in executing the split-strike conversion ("SSC") strategy other than Madoff himself or Frank DiPascali. (Lipton was not asked that question.)

102. Tucker, Lipton and Vijayvergiya all received tours of Madoff's market-making operation, yet none of them had actually seen the floor where Madoff supposedly ran the SSC strategy or had met any of the individuals (other than Madoff and Frank DiPascali) who were involved in implementing or executing the strategy.

103. Specifically, on this point, Vijayvergiya testified as follows:

Q. Who were some of the key personnel at Madoff Investments who were involved in the split strike conversion strategy in 2008?

A. Bernard L. Madoff and Frank Dipascali are the two names that I know of who are the key people involved in the split strike conversion strategy.

Q. Who else? Do you know the names of any other people?

A. I don't.

Q. Did you guys push and try to get some names?

A. Well we certainly asked the question.

...  
Q. So you asked and didn't get any names. Did you push the issue or just leave it at that?

A. I don't recall.

Q. How would you know that these people actually existed and were conducting the strategy?

A. Well, in the first case Madoff had described that to us, Madoff after, you know, 18 years of a very lengthy and trusted relationship, an individual who had a stellar reputation and great credibility in the industry provided use with this information so we had every reason to believe it was true.

In the second case at some point in the last couple of years, I don't remember exactly when, I was present for an on-site, maybe the last two to three years, I was present for an on-site visit with Madoff where Madoff took use for a tour of his market making floor. I believe Jeffrey Tucker was at that meeting and I think also Mark McKeefry might have been at that meeting.

Q. When did you go on that tour?

A. It would have been either two or three years ago. It feels in that time frame. I'm not entirely sure.

Q. Is that the same floor that did the Sentry trades?

A. No, it was the market making floor and we saw in the market making business that there were dozens of traders.

Q. But did you take an analogous tour of the floor that was trading the split strike conversion strategy for Sentry?

A. I did not.

Q. Did you ask to?

A. I had not asked to that I can recall. I don't recall asking Madoff.

104. Similarly, Tucker testified as follows:

Q. Have you ever had a tour of the part of Madoff's offices where he engaged in the split strike conversion strategy?

A. No.

Q. Do you know of anyone else at Fairfield who has had a tour of the portion of Madoff's offices where he engages in the split strike conversion strategy?

A. I don't know.

Q. You don't know of anybody?

A. I'm not aware of anybody that had access to it.

105. In their on-the-record testimony, neither Tucker nor Vijayvergiya could describe anything about the proprietary models and algorithms that Madoff supposedly used to run the SSC strategy.

106. On this point, Tucker testified as follows:

Q. With respect to the SSC strategy that Madoff had been executing for the Sentry Fund, could you please describe those proprietary models and algorithms?

A. I don't --- I'm not familiar with them.

Q. Do you know anything about them?

A. No.

Q. Who at Fairfield would know anything about them?

A. Amit [Vijayvergiya] would -- may have some knowledge of this, but the models themselves, I don't think anybody at the firm [Fairfield] had access to.

107. On this point, Vijayvergiya testified:

Q. So as far as you know you just don't know who anybody might have been other than Frank DiPascali and Bernard Madoff? You have no idea who these other people that were executing the split strike conversation strategy were: is that correct?

A. I'm saying I did not know, correct.

Q. Who ran the algorithmic trading platform?

A. I know I heard from Madoff that he had a number of quants, MIT PhDs, who—I think they were MIT PhDs, certainly PhDs and quants -- who as Madoff described built the algorithm systems and models to produce the signals to activate the entry and exits.

Q. Buy you don't know the names of any of these people; is that correct?

A. No, I did not.

...

Q. So the split strike conversion side of it, there are algorithms, I'm assuming there's computers, people presumably typing in inputs and receiving outputs. Where was that all occurring?

A. I have not seen those systems to your question. Where they were occurring we understood, I understood from hearing Madoff say this and from hearing Jeffrey and others describe this, that they were on the floor, I think it was 17<sup>th</sup> floor of his offices.

Q. But you never actually saw that portion of his offices?

A. No, I did not.

Q. Do you know if anyone else at Fairfield did?

A. I don't know if anyone else at Fairfield did.

c. Fairfield Completely Neglected to Monitor the Proxy Voting with Respect to the Equities Madoff Supposedly Held on Sentry's Behalf

108. According to Fairfield's promotional materials, Fairfield had limited-discretion brokerage accounts with Madoff. See Exhibit 12.

109. However, Fairfield never received any proxy materials from Madoff in connection with the equities he was supposedly holding on their behalf.

110. On or about October 23, 2003, Vijayvergiya, in response to questions from Sentry funds' investors, called Madoff Investments to ask it if had a proxy voting policy.

111. It is unclear why Fairfield never thought to inquire about proxy voting in connection with the equities Madoff supposedly held on its behalf until 2003.

112. On the call, Vijayvergiya posed the following question:

[W]e've been asked, I guess, increasingly by some of our clients doing their due diligence, as well as, you know, for our own internal purposes about how the equities within the split strike within the split strike conversion strategy how we vote proxies on them and I was curious whether you had any sort of insight on that.

113. Frank DiPascali assured Vijayvergiya that Madoff Investments did have a proxy voting policy and promised to send it to him.

114. Specifically, DiPascali told Vijayvergiya "as soon as I get a free moment to jot down a letter to you, I will get that out, and this way you can have [proxy policy] for your file and we've both done our jobs."

115. The proxy voting policy that DiPascali actually sent on November 6, 2003 is attached as Exhibit 11.

116. Notably, it is not a cover letter enclosing a preexisting policy. Rather, it is a cover letter dated approximately two weeks after the call stating what Madoff Investments will do with respect to proxy voting.

117. Vijayvergiya apparently never thought to question why he had not been sent Madoff Investment's preexisting proxy voting policy or whether any such policy had existed prior to his inquiry.

118. The supposed proxy policy evidenced in Exhibit 11 stated that Madoff will "maintain accurate records as to voting of such proxies that will

enable the investment advisor to periodically review voting procedures employed and actions taken on individual voting situations.”

119. Fairfield never asked to look at or verify those records.

120. Keeping track of proxies was a basic, normal-course-of-dealings due diligence step that Fairfield did not engage in.

121. Had it been asking for proxy statements, or records of the proxy votes that Madoff made on its behalf, Fairfield would have discovered that Madoff was not, in fact, buying and selling the securities he said he was.

d. Fairfield’s “Daily” Monitoring of Madoff’s Activities Was Subject to a Three to Five Day Time Lag

122. Fairfield repeatedly included in its marketing materials the statement that it conducted “detailed daily compliance monitoring of portfolio activity against all risk limits” and “conducts daily positions-based risk measurement, performance attribution and other quantitative analytics”. See Exhibit 8.

123. Fairfield also represented that “portfolio holdings are reconciled daily. Proprietary software is used.” See Exhibit 12.

124. Fairfield also stated: “The Investment Manager monitors compliance of the SSC strategy against these risk limits and guidelines each day.” See Exhibit 8.

125. These statements would give investors comfort that Madoff did not have time to fabricate results, because results were being monitored by Fairfield on a daily basis.

126. While it appears to be true that Fairfield conducted daily monitoring of the information it received from Madoff, Fairfield did not tell its investors that the daily monitoring had a three to five day time lag.

127. According to Dan Lipton, Fairfield did not receive trade confirmations from Madoff until three to five days after the trade had been entered.

128. According to responses to interrogatories provided by Fairfield, the time lag was two to three business days.

129. Fairfield did not inform its clients that its "daily" monitoring of positions and risk profiles had a three-to-five day time lag.

130. In addition, the trade tickets received by Fairfield typically contained not the prices at which a security was bought or sold, but weighted average prices of a group of securities supposedly bought and sold during the day.

131. Upon information and belief, this time lag, which Fairfield investors were not aware of, allowed Madoff time to concoct his fake results.

132. The purported reason for the time lag was that Madoff apparently insisted on mailing the trade confirms to Sentry instead of faxing them.

133. Fairfield did not have Internet access to its accounts at Madoff Investments.

134. When asked about why Fairfield did not receive trade tickets by fax, Mr. Vijayvergiya initially testified that that would raise confidentiality issues (but could not explain why a fax posed greater confidentiality concerns than a

letter) but was then reminded by his counsel of a conversation regarding front running.

135. Mr. Vijayvergiya then went on to testify that because it often took three days for Madoff to enter or exit the SSC strategy, the three day time lag imposed by mailing the confirms was necessary to avoid front-running by Fairfield personnel.

136. Vijayvergiya's testimony regarding the reasons for Madoff mailing the trade tickets is completely contradicted by the facts that (a) the records Madoff provided indicated that it typically did not take three days to enter or exit the strategy and (b) Frank DiPascali routinely called Fairfield personnel to tell them that they were intending to enter or exit the strategy.

137. For example, in an email dated from Vijayvergiya to the Executive Committee, Noel and Tucker, Vijayvergiya said:

Gord and I spoke with Frank Di Pascali this morning and have another call with him later this morning once he gathers more details:

-- we are still 19% invested in the SSC  
-- BLM/Frank do not want to sell into weakness today and are looking for an exit opportunity tomorrow morning or Wednesday

...

See Exhibit 13.

138. In a follow-up email, Vijayvergiya stated that DiPascali told him that "he is looking to do an orderly exit [from the equities part of the SSC strategy] tomorrow." See Exhibit 13.

139. In a November 4, 2008 email from Gordon McKenzie to Vijayvergiya, McKenzie titled "looks like we may be getting in the strategy this

week” which states: “Frank called to day about the redemptions and just said they have their buying hats on”. See Exhibit 14.

140. When a client asked, via email on November 13, 2008, “Is it true that you don’t get daily madoff positions, via statements which are a few days old”, Richard Landsberger asked Andrew Smith, the Fairfield Executive Committee and Mr. Vijayvergiya, “do we need to answer?” See Exhibit 15.

C. Fairfield’s Representations to its Clients with Respect to the Basis of its Confidence in the Validity of Madoff’s Operation Were Extremely Misleading

1. *Examples of Representations Made*

141. Fairfield was quick to assure its clients that they had nothing to worry about when it came to Madoff. Fairfield kept a database of responses to questions frequently asked by its investors.

142. On November 14, 2008, Disha Attavar, Vice President and Analyst, sent an email to the Sentry team, containing a standard response for distribution to clients, setting forth the basis on which Fairfield was satisfied that adequate controls existed to ensure that the Madoff assets were properly supervised:

...  
CITCO has not been charged with the responsibility to verify the existence of assets in the accounts of BLM.  
--Based on the following points, it is the opinion of the Investment Manager that adequate controls exist to ensure that the assets are properly supervised:  
a) Federal regulatory authorities (SEC and NASD) conduct periodic inspections of BLM to monitor compliance with rules and regulations; BLM has a virtually spotless record;  
b) Friebling and Horowitz, the independent auditors of BLM, conduct an annual report of the internal controls at BLM and have always provided a clean opinion;

- c) PwC, the [Sentry] Fund's auditors, conduct a bi-annual internal review of the controls and systems at BLM, the front-office and trading practices, procedures in respect to supervision and monitoring, procedures in respect of stock reconciliation, procedures in respect to trade allocation of bunched orders, error handling and a number of other items;
- d) Members of FGG's Finance, Operations, Risk and Investment teams periodically conduct on-site due diligence visits to BLM and independently assess the suitability of operational controls, systems and procedures.

See Composite Exhibit 16.

143. In his on-the-record testimony, when asked what the purpose of the email was, Vijayvergiya described that email as follows: "without being able to say with certainty it seems that this would be consistent with the general kind of business answering questions clients would pose."

144. When asked: "So you believe that this e-mail was probably generated in response to a question a client had?," Vijayvergiya responded that "it seems certainly consistent with our approach to doing business . . ."

145. The text of this email was sent to Sentry clients and prospective clients. See Exhibit 16.

2. *Why Those Representations were Baseless*

a. Reliance on SEC Oversight

146. Fairfield's reliance on SEC and FINRA (formerly NASD) oversight of Madoff Investments was unfounded.

147. In December 2005, Mark McKeefrey, Fairfield's General Counsel and Chief Operating Officer, and Amit Vijayvergiya, Fairfield's Chief Risk Officer, had a telephone conversation with Madoff in preparation of an examination of Fairfield by SEC attorneys.

148. Upon information and belief, the SEC was looking into Madoff Investments in response to concerns that had been brought to its attention by Harry Markopolos, and one of the ways the SEC was looking into Madoff was by interviewing Fairfield, his largest customer.

149. In this conversation, Fairfield told Madoff of the upcoming meeting with the SEC and Madoff gave McKeefrey and Vijayvergiya precise instructions as to what to say in response to questions from SEC examiners. See Exhibit 1.

150. From this conversation, Fairfield clearly knew that Madoff knew what to tell SEC and FINRA examiners to avoid deeper scrutiny of his operations. See Exhibit 1.

151. Specifically, as discussed below, Madoff told Fairfield to provide answers to the SEC that perpetuated the false impression that Madoff was not acting as an investment adviser.<sup>14</sup> See Exhibit 1.

152. Madoff needed to do that because he was not registered as an investment advisor at the time.

153. Fairfield was agreeable to tailoring its story to the SEC to his needs. See Exhibit 1.

154. In its closing memorandum on the Madoff matter in 2007 in which it found that Madoff had committed no fraud, the SEC explicitly referred to information it received from Fairfield. See Exhibit 17.

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<sup>14</sup> Yet, Lipton, Vijayvergiya and McKenzie all testified that they thought they were dealing with Madoff Investments the investment adviser.

155. Having received detailed instructions from Madoff as to what to tell SEC examiners, Fairfield could not possibly in good faith have relied on the fact that Madoff had a spotless record with the SEC as a basis for believing its assets were being properly supervised at Madoff Investments.

b. Reliance on Friebling and Horowitz

156. Fairfield's reliance on the supposed audits by Friebling & Horowitz was unfounded.

157. Fairfield did not know a thing about this three-person auditing firm that was operating out of a strip mall in New City, New York.

158. When Fairfield inquired, it found out that Friebling & Horowitz only had one employee and approximately \$180,000 in annual sales.

159. No-one at Fairfield had ever spoken to Friebling & Horowitz other than a five to ten-minute conversation Dan Lipton had with a partner at Friebling & Horowitz (whose name Lipton cannot remember) in 2005.

160. In a September 5, 2005 email from a Sentry client, the client asked the following question about Madoff's auditor: "Bernard L. Madoff Securities LLC has employed a small accounting firm. **Is that accounting firm checked and approved by Fairfield Greenwich Group?**" See Exhibit 18.

161. Dan Lipton, on September 12, 2005, sent the following statement for Jeffrey Tucker to communicate to the client:

Friebling & Horowitz, CPAs are a small to medium-sized financial services audit and tax firm specializing in broker/dealers and other financial services firms. They are located in Rockland County, New York. They have hundreds of clients and are well-respected in the local community.

See Exhibit 18.

162. In his on the record testimony, Lipton testified as follows:

Q. How did you determine they had hundreds of clients?

A. That's what the partner said on the phone to me.

Q. Did you corroborate that in any other way?

A. No.

...

Q. How did you determine that they were well-respected in the local community?"

A. That's what our conversation – my conversation with one of the partners at Friehling & Horowitz, that's what was told to me.

Q. So he told you they were well-respected in the local community?

A. That's correct.

Q. And that's what you based this statement on?

A. Plus I had looked up on the Internet to see if he was in good standing with the CPA license, which he was and it listed that he - - or members of the firm were members of the local chapters of the CPA.

163. When Vijayvergiya was asked how he knew that Friehling & Horowitz were independent auditors, he testified that "on the front of the report it said independent auditor".

164. Vijayvergiya represented to the Division that he made a note to himself to do some research on Friehling & Horowitz, but never got around to it.

165. On September 14, 2005, Gordon McKenzie emailed Tucker, Lipton, McKeefry and others at Fairfield. In the email he stated: "It appears Friehling is the only employee" of Friehling and Horowitz. See Exhibit 18.

166. Jeffrey Tucker emailed back: "thank you". See Exhibit 18.

167. Gordon McKenzie testified that the only information Fairfield had obtained with respect to Friehling & Horowitz prior to 2005 was the information contained in Friehling & Horowitz's filings with the SEC.

168. Tellingly, in an August 20, 2008 email, in response to a client's question regarding Friehling & Horowitz, Lipton asked Vijayvergiya: "Do we know any of the other client of BLM's auditors? Or how big they are?" See Exhibit 19.

c. Reliance on PriceWaterhouseCoopers

169. Fairfield's supposed reliance on reviews by PwC was also unfounded.

170. PwC<sup>15</sup> made two visits to Madoff Investments, in 2002 and 2004.

171. While the 2002 visit was not memorialized in any document PwC provided to Fairfield, Fairfield did receive a summary of the review PwC conducted in 2004.

172. In 2005, PwC set forth the scope of its 2004 visit, which consisted of nothing more than an interview with Madoff.

173. In the report that PwC provided to Fairfield, it explicitly stated:

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<sup>15</sup> According to Lipton's and McKenzie's testimony, when PwC visited Madoff Investments, it was conducting its review on behalf of both Fairfield and an apparently unaffiliated entity, Kingate, which also had money invested with Madoff Investments.