EXHIBIT 23

(Part 2 of 2)

applies to securities that were registered after April 26,1979. Thus, third market firms experience some competition from member firms, but only in newer issues.

For example, Home Depot (HD) was registered after 1979. As such, we make a market in it as a 19c3 - we trade it in NASDAQ, represented by the MADF mnemonic displayed in the NASDAQ marketplace beside the quotes of the exchanges and any other third market firms. MADF is linked to the exchanges and the other third market firms. This linkage comes in the form of CAES lines maintained by NASDAQ. These lines were described earlier under the heading of "methods for trading." Any trade that takes place in the third market is overseen by NASDAQ, and compliance and regulation oversight is handled by them.

Madoff is by far the largest third market participant. Our firm has played a significant role in defining this market place and has worked closely with NASDAQ to develop this trading arena. However, there are other participants that make markets in 1 9c3 stocks. Some large member firms (major brokerage firms) have been expanding their foray into making markets in the third market (in 1 9c3 stocks only) and they are capable of providing significant competition. The upside is they can add further validation to the integrity of the marketplace.

As mentioned earlier, every transaction greater than 100 shares that takes place must be reported to the tape within 90 seconds. In order to prevent double reporting, only one party of each trade is responsible for reporting the transaction. The seller of the security is always the one responsible for reporting the trade except in the instance where the seller is not a market maker in the security and the buyer is a market maker. In that case, the buyer will report the transaction since he is the market maker.

C. Over the counter NMS trading

As stated above, NASDAQ is responsible for governing all over the counter trades - this includes both third market trading (listed securities) and the more traditional over the counter market place, the NMS stocks.

NMS stands for national market securities. They represent companies that have registered with NASDAQ and meet Nasdaq's requirements as the largest and most active securities. They must meet similar registration requirements as the exchanges require, but most of the requirements are much less stringent than the exchanges. For this reason, NASDAQ typically attracts younger and smaller companies that don't yet meet the listing criteria of the exchanges. For example, computer software firms, biotechs, and small growth companies typically select NASDAQ to gain access to a huge number of investors to raise their capital.

NASDAQ displays two-sided quotes for all market makers (dealers) in the NMS stocks and oversees their trading. The market makers on NASDAQ are firms that are members of NASDAQ and represent trading departments of investment banks, trading firms, and brokerage firms.

In addition to displaying quotes for NMS stocks and 1 9c3 stocks, NASDAQ also maintains market maker quotes in two additional types of securities: the small cap issues and bulletin board issues. Small cap issues are securities registered with NASDAQ that do not meet the filing requirements to be considered NMS issues. These issues tend to be much less active than the NMS stocks, but otherwise they trade in the same manner as NMS issues, with market makers displaying two sided quotes in NASDAQ. The bulletin board (also referred to as the pink sheets since a hard copy is distributed daily on pink paper) represents even less active issues. Their quotes may or may not be displayed in NASDAQ, the quotes that do appear may be entered as firm or non-firm. It is usually necessary to call the market maker to ascertain an accurate quote in an issue.

For NMS securities and small cap issues, trading occurs in four ways. The primary method is the traditional basis of the dealer to dealer market - investors and market makers communicate via the telephone to effect transactions based on quotes displayed in NASDAQ. As the market has evolved, electronic means of trading have been developed to supplement the telephone trading. First, a private company called Instinet has emerged

with an anonymous electronic means of displaying quotes and allowing participants to buy or sell electronically (this will be discussed in detail later when we talk about systems). Another more recent development is SOES, the small order execution system. It was developed after the crash of 1987 when investors complained that they couldn't get through to NASDAQ market makers to sell stock. It is an electronic system that allows small customer orders to be entered which are automatically routed to market makers and executed automatically (it will be discussed in more detail when we talk about the NASDAQ systems). NASDAQ is filing to replace this system with an improved version called N-Access. Most recently, NASDAQ developed the SelectNet system which allows customers and market makers alike to enter limit orders to be displayed on NASDAQ. If someone wants to or has to execute an order, it can be done so electronically (the specifics of this system will be discussed later).

As is the case described in the section on third market trading, every transaction in an NMS and non-NMS security must be reported to the tape within 90 seconds. The rules governing who reports the trade are the same as for the third market; the seller always reports unless the seller is not a market maker and the buyer is a market maker. In this case, the buyer will report the trade since he is the market maker.

D. After hours trading.

Most of the trading in US registered securities occurs during normal trading hours (9:30 am to 4 p.m. EST for the stock exchanges and NASDAQ). However, some trading in these issues does occur after hours in several arenas. First, third market firms may trade after hours. Jefferies (JEFF) is the best known example of this. They will make markets in most US securities around the clock (however, they command a significant premium for the lack of liquidity after hours). Instinet also provides a forum for trading around the clock. Subscribers can enter limit orders and/or execute other participants limit orders. Another way to trade after hours takes place overseas, where foreign offices trade US securities during their normal hours. Madoff's own London office is an example of this. Our office will make a bid or offer for overseas customers when our market is closed. Many "Wall Street" firms have overseas offices that do the same. One important distinction is that Madoff London does not make markets when US markets are open and they do not "hand off' their order book to the New York office as other firms may.

Furthermore, the world's exchanges operate on hours that correspond to their normal operating hours, which vary significantly from the US'. Thus, the global marketplace in essence follows the sun around the world.

All of these market places that exist in addition to "normal" US trading hours contribute to the further establishment of a more liquid, continuous market, which will probably be the norm down the road. However, Madoff US currently only makes transactions during normal US trading hours. We don't trade after US hours.

E.Other major markets that affect or are derived from securities markets.

Securities markets take their lead from activities taking place in the world markets. However, the US securities markets are the most developed and liquid of all the world markets. As a result, the US markets usually (but not always) dictate the activity in other markets instead of vice versa. Sometimes markets become de-linked as events affecting one country have little or no affect on others (for example, the Kobe earthquake in Japan had a significant impact on the Japanese markets, but little effect on US markets). In general, most markets take their lead from the US, but occasionally we can derive information from activity in the European market and/or Japans markets.

Many other types of exchanges exist besides the securities exchanges in the US. Their are options exchanges (American, Philadelphia, New York, Chicago - the CBOT, and the Pacific option exchanges). Options prices are derived directly from the underlying security's price, thus they mirror moves in the

securities markets. Of all the option markets, the CBOT is by far the most active. In addition to security option markets, there are futures markets and index markets, all based on underlying securities and most trading in Chicago. Heavy arbitrage activity between the futures/index markets and the securities markets allows the futures and indexes to serve as indicators of market direction. Another example of a marketplace is the huge market for treasury securities (bills and bonds). Benchmarks in this marketplace also provide insight into the direction of securities markets. Finally, there are commodities markets where obligations for individual commodities change hands. Most of this trading takes place on the New York Mercantile Exchange. Since these commodities are the raw materials for most companies, there trading can have a significant impact on the profitability of companies. Thus, activity in the commodities markets affect activity in the securities markets (for example, a severe rise in oil prices will probably have a negative impact on airline issues).

In sum, most security traders rely heavily on the bond market's benchmark index, the S&P index and its futures, the XMI index and its futures, and the specific commodities that most affect their individual securities to provide guidance of security directions. Further guidance is provided by continuously monitoring news (stock specific, industry specific, and general) and related securities.

F. How securities clear

1. In the early days of the securities markets, all transactions were settled at the end of the day by the parties involved. Securities and cash were physically delivered at the close of each day to all parties involved. (If I buy 100 shares of IBM from Prudential and sell 200 shares to Goldman, I had to take a check to Prudential, pick up my 200 shares, go to Goldman, give them 200 shares and pick up their check.) Physical delivery became a cumbersome and inefficient method of settling transactions as trading activity and volume flourished.

2. To address the inefficiencies of physical settlements, market participants agreed to the establishment of a public clearing corporation (the National Securities Clearing Corporation - NSCC). NSCC is often referred to as "the clearing corp.". The N.A.S.D. National Association of Security Dealers) purchased and is responsible for maintaining NSCC. All firms that are a member of an exchange and/or NASDAQ are NSCC members. In essence, each member has an account with NSCC. At the close of each day, NSCC was sent a list of each members transactions, then they credited or debited each account for the appropriate number of shares for each security. The clearing corporation improved efficiency drastically by removing the individuality of each trade. They operate on a continuous net settlement basis. In other words, instead of posting every single trade, they simply record the net transactions for the day on a security by security basis. (For example, if Madoff does three hundred trades in IBM -140 purchases for a total of 30,000 shares at an average price of $100 and 160 sales for a total of 29,000 shares at an average price of $101- on a given day, instead of NSCC recording each transaction, they record the net purchases (at the average price) and the net sales (at the average price), then they adjust the firm's total position in the security accordingly and disburse (or collect) a check reflecting the profit (or loss). In this example, Madoff's position in IBM would be increased by 1,000 shares.) If IBM closed with a bid price of $100, NSCC would also send Madoff a check for $29,000 - the $1 profit per share on 29,000 shares and no profit on the additional 1,000 shares purchased at $100 and marked to $100.) All positions at NSCC are marked to market - adjusted to the current market every day. Current Wall Street convention is to mark long positions to the bid price and short positions to the offering price. In summation, NSCC ledgers the net positions of all securities for all the firms that are members of NSCC. It also handles the distribution and collection of profits and losses on these net transactions.

If a discrepancy arose, NSCC notified both parties involved in the transaction and it was their responsibility to resolve it.

In conjunction with NSCC, the industry also established the Depository Trust Company (DTC). They handle the clearing of trades not eligible for NSCC. These trades are then settled on a non-continuous net settlement basis. DTC also moves positions to and from the NSCC, pays dividends, and provides broker to broker billings for many different items (for example, mark to markets for open exchange borrows). (A leading example of the type of firms that are DTC members and not NSCC members are banks - who are prohibited from joining NSCC). Thus, trades clear either DTC or NSCC.

In addition to performing clearing services for NSCC and non NSCC firms, DTC also serves as a depository for long positions. These long positions can be in the form of physical certificates (if they exist) or in ledger form. DTC acts as a trust for these securities and the maintenance of positions at a central clearing house such as DTC drastically improved the ease and efficiency of transferring these positions as trades occur.

3. Trade problems that were noticed by NSCC often took several days to resolve, especially since it took time for NSCC to notify firms whether or not a trade had been confirmed by both parties. This became unacceptable when the volatility of the markets increased dramatically around the crash of 1987. As a result, firms looked for a way to protect themselves against "open" trades. To speed up the settlement and confirmation of trades, the NASD established a new system called ACT. ACT only applies to trades done away from an exchange (OTC and third market trades). Exchange transactions utilize there own electronic services to get transaction information to NSCC in a timely fashion, reducing their time exposure on open trades. Non-exchange transactions lacked this ability prior to ACT. ACT is an on-line system in which both parties of a trade report their side of the trade to NASDAQ in a timely fashion (90 seconds for the trade reporting firm). NASDAQ members can then view the data to see if the trade compared (both parties know the same information). This gives firms the opportunity to contact the contra party the same day, even minutes later, to resolve possible trade problems. If the two parties can't get their information to match by 1 p.m. the following day, the information is passed along to NSCC and it reverts back to the old method of DTC and NSCC trade reconciliation. If the trade does match up in ACT, NASDAQ reports this information to the clearing corporation and they credit and debit the appropriate accounts. This drastically reduced firm's exposure to open trades. In summation, ACT came in to being to fulfill three main objectives: to serve as a means of reporting trade data to NASDAQ, to serve as a means of getting trade data to NSCC, and as a means of firms to monitor the exposure of any firms that may use them for clearing their trades. By being able to see, online, the activity of their correspondent firms, firms are able to closely monitor their exposure.

Now there are three ways to get the appropriate transaction information to NSCC to ensure proper clearing:

a. QSR (qualified special representative) - an agreement between firms in which one firm takes the responsibility of submitting both sides of the trade directly to NSCC, relieving the other party of their reporting obligations. The QSR firm acts as a representative of the other firm. These trades are reported via NASDAQ just like ACT trades, except only the QSR firm submits the information instead of both parties having to submit and compare. These transactions are reported on a real-time basis (reported within ninety seconds of the trades occurrence.) Further, these trades arrive at NSCC already compared, since the reporting firm is submitting both sides.
b. locking the trade in on ACT - both parties must input the same data via NASDAQ. These trades are submitted on a real-time basis as well.
c. send data directly to NSCC and let them compare both sides - this is done via a terminal linked directly to NSCC.

4. A further step to faster trade reconciliation came when the street instituted t + 3 (trade date + three days). Previously, all trades settled in five business days unless specified otherwise. With the new rule,

of Assistant Dut

effective in July of 1995, all trades now settle in three business days.

5. Every firm has a P&S department (purchase and sales). They are in direct contact with DTC and the NSCC and monitor the status of trades. They note which trades have been confirmed and further, which trades have settled. They also monitor the exchange of payments and the firms positions versus the house position. For trades that do not reconcile, they will contact the trader to settle the problem with the contra-party.

6. Certain types of transactions occur outside the realm of normal automated clearing procedures and must be handled differently by the two firms involved. The most common examples are special settlement trades and trades in which one party is not an NSCC member. In the case of special settlement trades, the most common are cash trades (which settle the same day the transaction occurs) and next-day trades (which settle the day after the transaction occurs). These trades are referred to as" ex-clearing" trades since they bypass NSCC. With ex-clearing trades, the two parties don't submit the trade data to NSCC. Instead, they exchange transaction comps (comparisons of the trade). Then, on settlement date, the trade is delivered or received through DTC and is settled in that system. DTC then makes the appropriate ledger adjustments to reflect the change in the firms' positions.

In the case of transactions involving a non NSCC member, the most common examples are our trades with institutional trading firms (like Wells Fargo) and foreign brokers, both of whom are prohibited from joining NSCC. With these types of trades, the trade data is sent to DTC via a computer to computer link, on a real-time basis. The actual chain of events on these types of trades is as follows. The transaction takes place between the two parties and the terms of settlement are agreed on. Then the cage (a department at Madoff and all trading firms - they are discussed in the next section) sends the trade information to DTC via their terminal linked directly to DTC. DTC then sends a comp (comparisons) to the contra-parties (in the case where both parties of the transaction are NSCC members) or the agent of the contra-party (in the case where the other party is not a member of NSCC). When the contra-party or agent affirms the trade in a timely fashion (on trade date - t, trade date plus one business day - t+1, or trade date plus two business days - t+2), then DTC will make delivery and adjust the firm's trade ledgers to reflect the net effect of the transaction.

It is worth noting that these types of trades are in the minority. Approximately 98% of all Madoff transactions are cleared in a regular fashion through NSCC. This number should continue to rise as Wall Street and technology become more automated.

Conventional wisdom on Wall Street is that anyone wishing to sell a security for special early settlements (cash or next day) must accept a price 1/8 below the bid price to compensate the buyer for putting up the cash earlier than a regular settlement would require. In the opposite transaction, the seller will receive cash earlier, so no other compensation is necessary and the trade is done at the offering price.

G. Cage responsibilities

H. While the P&S department handles the reconciliation of all trades, they are only handling the paper aspect of it. The actual exchange of securities and money that is transacting at NSCC and DTC is monitored by the "cage". The cage is the area of the office where stock delivery and payment occurs. As stated above, the physical settlement of transactions has been greatly reduced, most of it is handled electronically. However, the cage still oversees the process to make sure it is correct. They do still handle the rare physical settlement of some transactions that settle ex-clearing. This includes the types of trades described above under ex clearing - special settlement trades and trades with non NSCC members. Remember, the cage is responsible for receiving and delivering securities through DTC for overseas firms and any other firms that may use Madoff for clearing purposes and aren't members of

NSCC. The cage must constantly looking for the comparisons on all Madoff ex clearing trades and monitor the firm's positions at DTC in order to allow them to make appropriate deliveries as stock comes into the house. As comparisons occur, they can key in the appropriate data to DTC and ensure the efficient and proper clearing and delivery of these trades.

In addition, the cage has other responsibilities concerning the actual handling of securities. One of their largest responsibilities is a function known as "short-borrow".

I'll preface this by saying that Madoff has agreements with its banks and its marketplaces NASDAQ and the Cincinnati exchange) concerning how much margin we must put up on trades. While this has a very significant impact on the firm's capital and profitability, it can be set aside for the purpose of the individual traders' actions. It is important to understand how transactions affect the firm, but that is management's responsibility. Here we will concern ourselves with how transactions affect the traders on the trading desk at Madoff. Things may be done differently at other firms, but the basic concepts remain the same across the street.

When a trader takes a long position (buys a security), the firm pays out cash and receives stock certificates (which are left at the depository DTC). Keep in mind that the actual exchange takes place in t + 3 days (trade date plus three business days). Since the firm is paying out cash, there is a cost of capital involved. It costs the firm money to put up cash to hold a security. The prevailing interest rate on Wall Street that represents this cost of capital is called the "broker call" rate - the rate of interest firms must pay to borrow the cash to buy securities. Currently, this rate is 7%. Whenever a long position settles, from that point on the firm pays 7% annualized interest to hold the position. This is a real cost and must be factored into the decision making process of expected profits from taking a position and how it will affect the total return of a trade.

Understanding this concept, it shouldn't be difficult to believe that the converse holds also. If a trader goes short a stock, he delivers the security in exchange for receiving cash. He should be able to generate a return on the cash he holds by lending out the cash. While the mechanics of how this is accomplished are a little detailed, the concept is straight forward. We will save the detailed explanation of exactly how short borrow works for our discussion of the firms P&L run analysis in part II. Just keep in mind that you have to pay interest to carry a long position and you receive "short borrow" when you are short a security. (However, due to certain costs, risks, and inefficiencies in all short-borrow activities, Madoff on average receives 60% of the net short borrow amount - thus, a long position costs 7% and a short position earns 4.2% (60% of the 7%)).

The cage handles the mechanics of actually paying out and receiving the interest due based on the firm's daily positions.

In addition, the cage is responsible for receiving and delivering securities through DTC for overseas firms and any other firms that may use Madoff for clearing purposes and aren't members of NSCC. The cage must constantly monitor the firm's positions at DTC in order to allow them to make appropriate deliveries as stock comes into the house.

Finally, the cage is responsible for cross drafting NSCC and DTC net transaction records daily for any dollar discrepancies that may occur. In other words, they monitor the firm's positions and cash flows in conjunction with NSCC and DTC to ensure that it occurs correctly.

H. Dividends.

Equity securities often pay dividends. These dividends are determined by the board of directors of these companies and represent a way for firms to distribute a portion of the company's earnings to its shareholders. Dividends usually come in the form of a cash distribution, but there are other types of dividends. These other types include stock dividends, stock splits, rights distributions, and spin-off distributions.

1. Cash Dividends. All cash dividends have four key dates surrounding their distribution. The first important date is the announcement date. This is when the company notifies the public of its intent to pay a dividend. The

announcement will include the type of dividend, the amount, and the date(s) of importance regarding the dividend. The next date to arrive is the ex-dividend date (more commonly referred to as the ex-date). This is the day on which any purchaser of the stock will no longer have the right to receive the dividend (unless he makes a cash or next day trade). Anyone who purchases the stock before the ex-date (and holds on to it through the-ex date) will receive the dividend. The next date to arrive is the record date. This is the date, selected by the company, on which all shareholders of record (the list of all shareholders of all shares on the transfer agent's books that day) are the ones who will be given the distribution. Since stocks take three business days to settle, the ex-date will always fall two business days before the record date. The logic is that a purchase before the ex-date will settle by the record date, making that shareholder eligible to receive the dividend. Any purchase on or after the ex-date will settle after the record date (excluding cash and next day trades) and the purchaser will not be entitled to receive the dividend. The last date of importance is the payment date, determined by the company and falling any time after the record date. This is the date that the actual dividend will be paid by the firm to the shareholders of record. The time line below shows the order of the key dates regarding cash dividends:

announcement date ex dividend date ---------- record date payment date
(ex date is 2 business days before record date)

2. Stock dividends. In the case of a stock dividend, a company will distribute new shares to its current shareholders. In accounting terms, the net affect of a stock dividend is a wash (the market capital of the company is the same before and after the distribution), but the psychological impact can have value - often interpreted as a positive signal from management. An example of a stock dividend would be the case where a company declares that each shareholder will receive 1/10 of a new share for each share held. (In this example, a company worth 1 billion dollars with 100 million shares trading at $10 each announces a 10% stock dividend. After the stock dividend, the company is still worth 1 billion dollars, but has 110 million shares trading a $9.09.) As long as the size of the stock dividend is less than 20% of the current stock price, the dividend is handled in the same format as a cash dividend, with the same time sequence:

announcement date ex dividend date ---------- record date payment date
(ex date is 2 business days before record date)

3. Stock splits. A stock split is similar to a stock dividend, but usually represents a significantly larger distribution. Again, it represents a distribution of new shares to current shareholders, but has no material impact on the balance sheet. In general, stock splits are viewed in a positive light as an endorsement by the company. Another reason companies may split their stock is to attain a stock price that they feel makes the stock more attractive as an investment vehicle. (The argument is that an investor is much more likely to invest in a $40 stock than a $140 stock.) An example of a typical stock split would be a 2 for 1 split. In this case, each shareholder will receive an additional share from the company for every share currently held. Since the company's net worth hasn't been affected by the split, it follows that the market price of the stock after the split takes affect should be 1/2 the price immediately before the split. (If the company is worth 1 billion dollars and has 100 million shares trading at $10 each before a 2 for 1 split, after the split there will be 200 million shares and they should trade at 5$ each). It is worth noting that stock splits can also be applied in reverse. A company can declare a reverse stock split in which case the number of shares outstanding will be reduced and the price of each share should increase correspondingly. If the stock split will result in a distribution of stock valued greater than 20% of the current stock price, the distribution is handled differently than the scenarios above (cash dividends and stock dividends <20%). In this case, the announcement date comes first. Then the record date arrives (as previously determined by the company). The next day to arrive is the payable date, the day on which the actual distribution occurs. The time between the record date and payment date can be as long as the

company chooses, and is different in every case. The ex date will now be the very next business day. The time ıe is as follows:

announcement date record date payment date ex date
(ex date is next business day after payment date)

The logic for changing the order of events is that the previous cases usually represent relatively small amounts of distributions in relation to the stock price. However, a stock split of 20% or more represents a significant size. Since many investors and financial institutions maintain margin accounts (accounts were transactions are not paid in full, but are paid for on margin - in essence a loan based on a minimum "down payment" as collateral, with a minimum maintenance level of collateral required in the account at all times. This minimum amount varies based on price fluctuations.) Since a stock split will dramatically affect the price of the security, it will have repercussions on the amount of margin required, possibly forcing people to put up more cash or to lose margin on the value of securities currently held (depending on whether the split is regular or reverse). By altering the time line of events, this can be avoided. Thus, the company distributes the new shares first, then the next business day the price of the security adjusts correspondingly.

4. Rights distributions. Companies may also distribute rights to their shareholders. In a rights offering, companies distribute to its shareholders a specified number of rights per share (at no cost to the shareholder). These rights give the holder the "right" but not the obligation to purchase additional shares of stock for a pre-specified price (usually at a discount to the current stock price.) Rights represent a method for a company to raise additional capital (from the money the rights holder must pay to receive additional shares of stock) while rewarding its current shareholders (since they have the option to purchase shares at a discount.) There is no hard rule for how to handle a rights distribution. It can be done the same way as a cash dividend described above (with a very short time between the record date and ex date since rights are short lived to begin with) or it can be handled like a stock split described above. It is entirely up to the company, but more often than not, it is handled ˙˙ke a stock split.

5. Spin-off distributions. Sometimes, a corporation will spin off certain businesses into entirely separate ventures. The most notable example is the break up of Ma Bell into the seven regional telephone companies. If the parent company decides to spin it off to current shareholders, it will result in a distribution of the stock of the new company to these shareholders. The method of handling this distribution depends on the value of the new stock. If the value is less than 20% of the current company's stock price, it is handled like a cash distribution. If the new stock represents more than 20% in value, it is handled like a stock split for the same reasons regarding margin accounts described above.

Regardless of the type of distribution to be made, all such distributions will have an affect on the stock price on the ex-date. On the ex-dividend date, the price of a stock needs to be adjusted downward (except in the case of a reverse stock split - where the price would be adjusted upward) to reflect the amount of the dividend. The logic is that a buyer on or after the ex-date will not receive the dividend, so should be willing to pay less for the stock, all other factors held constant. The adjustment of the stock price occurs as follows: the amount of the dividend is always rounded up to the nearest 1/8, and then the previous night's closing stock price is reduced by this amount. For example, a dividend of .10 will be rounded to *.125*. If the closing price before the ex date was $20, the ex date stock price is adjusted down to $1 9.875. In addition to adjusting the price of the stock, all customer open limit orders residing on the books of the market makers must be adjusted downward as well by this same amount (the amount of the dividend rounded up to the nearest eighth). Only the buy orders are adjusted, not the sell orders. The logic of this is that all orders to buy were based on the expectation of being entitled to receive

of Assistant Dut

the dividend. Since the ex-date has arrived without the customer's order being executed, the customer is now not entitled to receive the dividend. If the customers limit price were not adjusted downward, the customer would in essence be paying an effective price higher than his initial limit price, adversely affecting the customer. On the opposite side, a customer selling the stock after the ex date will not be adversely affected by the downward adjustment in the stocks price, thus no adjustment to their limit orders is necessary (although these customers are free to lower their limit themselves at any time - it will not be done automatically). (One further note, a customer buy limit order that is specifically marked DNR - do not reduce - will not be automatically adjusted downward on the ex date.)

I. When Issued Securities

An offshoot of the dividend distribution section above is a discussion of when issued securities. When a company announces that a distribution of securities is forthcoming (a stock dividend> 20%, a stock split, a rights offering, a spin-off, etc.), often times an active market develops for the new securities before they are actually issued by the company. The market for these securities will develop after the record date and last until the payment date. These securities trade on a "when issued" basis. A when issued basis means that while all trades occur and are recorded on a real-time basis, no settlement (exchange of securities and cash) will occur until the company actually distributes the new securities. It is very important to note that the real meaning behind the words "when issued" is "when and if issued". If, for any reason, the distribution is canceled, none of the trades will settle and there will be no exchange of money or securities. Thus, any profit that was thought to have been made will be wiped out as though the trade never took place. While a rare occurrence, it can and has happened. In most situations, especially stock dividends and splits, it is a pretty safe bet the distribution will actually occur. The more common occurrence of a distribution not becoming effective can be in the case of a proposed takeover or merger that falls through. Just be aware of the uncertainty involved in when issued securities.

Another key point regarding when issued securities is the fact that, since the trades won't settle until the distribution occurs, a purchaser of when issued securities will not have to put up cash right away. This can have a significant cost savings impact since the buyer doesn't have any carrying costs associated with the long position until settlement.

When trading a when issued security and its underlying component (i.e. IBM common stock and IBM common stock when issued), the firm calculates its current position by taking the net of the two securities in terms of the current common stock. For example, if the firm is short 500 share of IBM common and long 2000 shares of IBM when issued (assume the company declared a 4 for 1 split, thus 1 when issued share = 1/4 of the current IBM common), the net firm position is 0. The net position is important to know at all times, both from a risk exposure standpoint and for knowing whether each subsequent transaction involving a sale should be marked as a long or short sale (in accordance with short sale rules).

Finally, it is vital to be aware of the date on which a security begins trading without conveying the right to receive the new distribution. This will be the ex-date as described in the previous section (stock div.> 20%, splits, rights offerings, spin-offs). Any transaction that settles between the record date and the ex-date will trade with "due bills", signifying that the purchaser will be entitled to receive the distribution when it occurs. Any transaction on or after the ex-date will not entitle the purchaser to receive the distribution. As is the case in all transactions, you must be aware of exactly what you are buying or selling.

An example of this type of trading follows: A company with its stock trading at $100 per share announces a 4 for 1 stock split. Each new share will be worth 1/4 the current stock price. Knowing that the new stock is worth 1/4 the current price, traders and investors can value the new security based on current prices and may actually wish to begin trading. I.e. customers who before thought they didn't want to purchase a $100 stock may be

enticed to purchase a *$25* stock and want to participate immediately.

Madoff's Role in the Industry

Madoff is a specialist firm - we perform all the duties of a specialist in the stocks we trade - currently this is most stocks in the S&P 500 plus the 120 most active NMS stocks. In each stock, we maintain a continuous, two sided quote (while the market is open) and are required to maintain an "orderly market". This means honoring our quotes, recognizing the quotes of competitors (the other exchanges and other third market firms) and handling our customer orders properly. The trader adjusts his market in each stock as he sees fit, striving to maintain a position that corresponds to his/her opinion (and falls within management's guidelines for position and risk management). In addition to making markets in both listed and NMS securities, Madoff also trades a list of pilot stocks in which we do not display a continuous, two-sided quote but do accept and represent customer orders by either automatically generating a one-sided quote in the Cincinnati marketplace or by representing the order on the floor of the NYSE via DOT. Once the customer's trade is executed or canceled, Madoff's exposure of the order is automatically canceled.

In making markets, several factors interact that may cause a trader's desired position to differ from his/her current position. This is generally the result of other players interacting with the trader.

Madoff's position in a stock can change through several means:

1. Customer order flow - our customers (mostly discount brokerage firms, some trading firms, some mutual funds, some trusts) send us orders from their customers to buy and sell stock. Depending on the customer, we generally guarantee to give an execution of up to 5,000 shares priced at the best inside market (whether we are actually on the inside market or not). These executions go directly into the trader's position. This is a passive form of trading since the trader has no previous knowledge of when or where orders will come in and cannot influence them.
2. Bid/Offer stock ourselves - Madoff can bid or offer stock in our own marketplace NASDAQ or Cincinnati) and wait for a competitor to execute it (a passive form of waiting for the market to come to you)
3. Use a broker on another exchange to interact with a specialists and customers on that exchange (can be either DOT or an actual broker). Various types of orders can be given (i.e. limit order, market order, best efforts orders, etc.) This is more aggressive than waiting for a competitor to come to us, but not the most aggressive form of establishing a position. (Since the NMS marketplace is a dealer to dealer market, this type of trading is not available in NMS securities).
4. Place a bid or offer in between the current spread. This can be done with your own quote in Nasdaq or Cincinnati, or an electronic service like Instinet (for listed and NMS securities) and SelectNet (for NMS securities). 5. Ship orders directly to other exchanges (listed) or call the other market makers (NMS and 1 9C3), either taking their offering or hitting their bid, in essence you are meeting their price. This is the most aggressive form of trading.

Madoff participates in listed stocks either 1 9C3 (we only display our quote in NASDAQ) or Cincinnati (we display our quote in NASDAQ and Cincinnati). If a stock qualifies for 1 9c3 trading, we will make a market in it in the OTC market, if it does not qualify as a 1 9c3 issue, we will make a market on the Cincinnati Stock Exchange. We quote NMS and bulletin board stocks in NASDAQ, and we participate in the pink sheets for inactive issues.

Madoff, in addition to trading listed and NMS stocks as specialists, engages in other strategies such as technical spread trading, option strategies, and convertible arbitrage.

Brief Systems Overview (just the basics)

Each trading station at Madoff has a state of the art plasma screen and computer to run applications. The plasma screen allows the integration of several different trading services onto a single screen, reducing desk clutter and simplifying the monitoring process. The systems below comprise the majority of the tools traders use to guide their decision making process. The majority of them appear as separate quadrants on the plasma screen. Where noted, they may be a stand-alone terminal.

Price and news services: the firm currently receives several forms of price and news data to be disseminated through the room and used by the traders to monitor market activity. They include:

ILX - an all-encompassing service (news - Dow Jones and Reuters, prices, trade data, symbols, options, research - First Call inf.) that appears on each traders computer. It is an on-line service that updates all data real time. This is the traders primary source of market data and can be tailored to the needs of each trader.

First Call - a stand alone computer in research (it also appears on ILX terminals), it provides research stories that are put out by various analysts on Wall Street on specific stocks and industries. Madoff does not have access to all reports that are on First Call, but we do get many of them. Research reports, especially changes in recommendations, can move stocks.

Bridge - a stand alone computer in research that provides trade history, stock specific data (i.e. dividends, # of shares, etc.), and Dow Jones news

Bloomberg - a highly sophisticated stand alone terminal that provides numerous pricing, data, valuation, technical, and other extensive information. It can provide almost anything a trader could need to know, but it takes time to learn and is very expensive (thus, there are only a few terminals spread throughout the trading room).

2. Instinet - Instinet is a trading vehicle established by Reuters to allow anonymous bids and offers to interact. It appears as a partition on every traders computer (although several traders use the same Instinet line and share). It usually provides a place to trade in between the spread or see bids and offers in stocks. It currently accounts for 13% of all NASDAQ trading (remember, this includes third market trades in OTC stocks and listed securities)

3. NASDAQ - a separate partition on each traders computer. It shows where securities (listed, NMS, and bulletin board) are bid and offered and by who. The trader learns who is at the inside quote and calls them to initiate a trade. It also contains the SOES and SelectNet systems described earlier. Finally, it contains the ACT system for trade reporting and clearing executions. It is currently being replaced with an upgraded version called NASDAQ Workstation II. At the moment. the NWII's are stand-alones used by the NMS traders, but they will eventually be integrated into the trader's plasma screens.

4. Cincinnati - this is a customized screen monitoring Madoff's quotes and the inside quotes being disseminated by the Cincinnati stock exchange. It only represents listed securities and appears on each traders plasma screen.

5. Madoff quote (K-quote) - this is an internally developed, proprietary system that allows a trader to simultaneously view all of his current positions, his market in each, and the inside market in each. It appears as

an individual quadrant on each traders plasma.

. Miss - this is another internally developed, proprietary system. It is at the heart of Madoff's ability to provide superior service. It is a highly sophisticated system that aides in efficiently pricing orders. For now, be more concerned with the traders functions that appear on MISS. These include the ability to monitor all trading activity by the trader in each stock (includes positions, individual trades, order books, current prices, current Madoff quotes, current inside quotes, and current P&L data. It also serves as Madoff's link to the other exchanges through ITS/CAES and DOT (all to be discussed in detail later). It is highly complex and takes time to fully appreciate all of its functions. As such, Madoff is very sensitive about maintaining the confidentiality of this proprietary system. It's functions are closely guarded and should never be discussed with anyone outside of the firm. (This includes Madoff customers!)

7. Telephones - each desk has a phone bank comprised of direct lines (lines that ring directly into other trading firms trading departments or to our brokers) and external lines that operate as normal incoming and outgoing phone 'P lines. They are a vital connection to the rest of the industry and timely and professional handling of the "wires" is required at all times!

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