SIRF Question: Jeopardizing Investments.

Many of the issues discussed in the IRS' "Jeopardizing Investments" notice, i.e. margin, option trading and risk-reward imbalance, are features of Hod and Chesed. The Karfunkel foundations have (occasionally) had $8-$9 million margin balances—what securities do they trade with margin? Do they trade AFSI on margin in their foundations? Why do they do this (despite IRS warning)?

Karfunkel Response: Jeopardizing Investments

Neither the Karfunkel Foundations nor the Karfunkels themselves trade AFSI on margin. Beyond this, the Karfunkels have proven themselves to be very astute successful investors. Their investment expertise spans 40 years. Options are a tool that they and other well-established successful investors use from time-to-time. Any margin balances, including the $8-9 million you reference, represent an extremely small portion of the investment portfolios of either Foundation and do not jeopardize the investment profiles of the Foundations.

SIRF Question: Risk/Reward Balance. Per [question above], one of the IRS' concerns are trades with problematic risk-reward frameworks. SIRF found a Hod trade from 2008-2009 that is illustrative: writing puts on Fannie Mae. The trade lost a net of $10.5mm by the time it was closed out. As constructed, the FNM puts trade offered massive downside, or money losing risk, with only the premium sold as profit ($2.6mm in this instance.) Why was this trade entered into? There are also Chesed trades in Citigroup, Lehman and AIG with similar characteristics, e.g. high-risk and resulting in losses. Why are trades like this made in these portfolios?

Karfunkel Response: Risk/Reward Balance

You mention several securities with respect to risk/reward balance, including a Hod trade from 2008-2009 regarding, as you inquired: "...writing puts on Fannie Mae. The trade lost a net of $10.5mm by the time it was closed out..." It should be noted that Hod's net worth during this period only declined $1.5mm. The 2008-09 period was characterized by the Great Recession and a major erosion in stock market values. Many investors, institutional and retail, were affected. And stocks you cite, in addition to Fannie Mae--i.e. "Chesed trades in Citigroup, Lehman and AIG"—all suffered at that time. Again the Karfunkels are sophisticated, successful investors. The losses those large investment portfolios incurred at that time were both entirely manageable and not material to the portfolios.