Bernard Madoff: How "One Big Lie" Can Destroy Thousands of Lives

In the 1920s, Charles Ponzi introduced the "Ponzi" scheme to the American public. The scheme's simplicity is one of its best traits. By promising above-average returns for their investment, individuals appear willing to stand in line to give you their money. The only problem is that the Ponzi scheme makes no "real" investments other than paying back previous investors. The cycle of paying one investor (and pocketing a lot for himself) by collecting from another investor should only work for a short period before the "pyramid" of investors collapses under the weight of money owed.

Almost 100 years after Charles Ponzi showed the world how the scheme worked, people are still convinced that the administrator of the investments can guarantee above market returns. The underlying reason why Ponzi schemes will continue to be tried in the future is greed. As long as some people believe they can get more money from an investment than the average investor, they will continue to line up to give their money away in return for this empty promise.

Bernard Madoff went to prison for pulling off the largest Ponzi scheme in history, a fraudulent investment scheme that lasted an estimated 20 years.[1] The eventual downfall of Madoff's Ponzi scheme was not caused by regulators, investors, or even his employees but, rather, was the result of a global financial recession. When the financial crisis hit, Madoff had many billions of dollars of outstanding debt. Typical of a Ponzi scheme, when Madoff's investors made a "run on the bank" to take out the money that they invested with his firm, he did not have enough money to pay the above-average returns that he had promised. He did not even have enough to cover his clients' initial investment money.

Furthermore, there is no evidence that Madoff even made any trades to invest the money that his clients gave him. For example, Madoff had listed transactions in Fidelity Investments' Spartan Fund, yet Fidelity had no record of any account or transactions by Madoff's company.[2]

On the morning of December 11, 2008, the pyramid collapsed on Madoff when he was arrested in his apartment for criminal securities fraud. As a well-respected investor and part of New York's social elite, Madoff pulled off the largest Ponzi scheme in the history of commerce. Estimates are that Madoff stole more than $50 billion from investors over three decades. It is also estimated that Madoff, the former chairman of the NASDAQ Stock Exchange, had defrauded thousands of people including individuals, corporations, endowments, universities, foundations, and other investment funds. Before he was arrested, he told his sons Andrew and Mark, who worked for him, that his financial operations were "all just one big lie . . . basically a giant Ponzi scheme."[3] The day before his arrest, his wife Ruth withdrew $10 million from a brokerage firm that was partly owned by Bernard. This followed a withdrawal made November 25, 2008, for $5.5 million.[4]

As early as 2001, one of *Barron's* staff writers interviewed financial experts who questioned how only Madoff was able to achieve these types of above-average returns regardless of the market movement.[5] Madoff's standard response as to how he was the only person who could create these "miracle" returns was that his business strategy was too complicated for anyone outside the company to understand how he did it.[6]

In his response to the charges after being caught in 2008, Madoff stated, "'there is no innocent explanation' . . . and he 'paid investors with money that wasn't there.'"[7] After his confession to his sons, the sons turned him in to federal authorities.

Madoff ran his investment department of the company on a separate floor from the other parts of the company. He would not disclose his financial reports to anyone and would not tell his employees how he was able to provide guaranteed returns for the investors. He told one of the sons that investors had asked for approximately $7 billion in redemptions of their investments, and Madoff did not have enough money to cover those demands.

The day after Madoff's arrest, the first of many class-action lawsuits were filed against him. The lawsuit claimed that Bernard L. Madoff Investment Securities represented itself as a legitimate broker and dealer when in actuality it was a fraudulent Ponzi scheme.[8] His impact is staggering. A total of 13,567 customer accounts were listed with Madoff Securities. Young and old, famous and rich, the listing demonstrated that the fraud Madoff committed was global and piercing in its reach.[9]

Bernard Waving the Red Flags

The first fundamental red flag is a major one that occurs in all Ponzi schemes. The underlying premise of the Ponzi scheme is to guarantee a certain level of financial returns over an extended period. This guarantee cannot be proved. Wild fluctuations in markets both up and down ensure that no one can predict what the return will be next month or even next year. Therefore, both regulators and investors should have identified this guarantee as the basis of a Ponzi scheme. Harry Markopoulos, who was trying to identify how Madoff could make those guaranteed returns, wrote a letter to the Securities and Exchange Commission (SEC) in 2000 stating, "Madoff Securities is the world's largest Ponzi scheme."[10] For 8 years, Markopoulos tried to convince the SEC that Madoff was a fraud. After Madoff's arrest, the SEC stated that it would reopen the case.

Another red flag was the closed trading system developed by Madoff that ensured that no one else was able to verify the true asset value of the investment Madoff was

making. In addition, a manager of funds should not use a related firm as a broker/dealer to make the trades because it creates an inherent conflict of interest. There were incentives for Madoff to encourage high trading volume because he would receive the benefit from his connection as asset manager and broker of the trades.[11]

A third red flag was that the volume that Madoff's reported trades for his clients does not correspond with the actual volume of trading on the Standard & Poor's (S&P) options market.[12]

When private investigators were hired by Aksia LLC, an independent hedge fund research and advisory firm, to examine Madoff's due diligence, they found the accounting firm he used to manage billions of dollars, Friehling & Horowitz, had three employees. One of the employees was 78 and lived in Florida, and a second employee, the secretary, operated the business in a 13-by-18-foot office.[13]

Where Was the SEC?

The SEC investigated Madoff numerous times during a 16-year period at Madoff's operations and found no evidence of any wrongdoing. In 1992, the SEC investigated Madoff in connection with two Florida accountants who were selling unregistered stock with very high return rates. The SEC traced the money under investigation to Madoff, and Madoff's response was that he did not know the accountants had collected the money illegally. In 1999 and 2000, the SEC investigated Madoff's trading practices with his firm. The SEC charged Madoff with not disclosing his order to other firms in the market, which is considered a trading violation. Madoff agreed to develop new procedures to remedy the problem. Markopoulos, who in 2000 claimed Madoff was running a Ponzi scheme, met with SEC officials in 2001 to explain in detail his concerns about Madoff's operations. The SEC found no wrongdoing. In 2004, the SEC again investigated the type of trading Madoff was doing and found no wrongdoing. In 2005, the SEC investigated whether Madoff was violating SEC rules related to the number of clients it was advising and the obligation to have Madoff's firm registered with the SEC. In November 2005, Markopoulos met again with the SEC investigators and provided them with a 21-page report highlighting his concerns.[14] Madoff used the investigation to his advantage by boasting to investors that the SEC had investigated his operation many times and still found nothing wrong with his company. The critical weakness of the SEC was that, despite repeated complaints about Madoff's operations, the SEC never verified the trades that Madoff claimed to be making over the decades.[15]

Madoff was described as a person who told the SEC "wonderful" stories during their interviews and bragged about his connections both in Wall Street and the SEC. He also became angry and refused to provide documents the SEC requested to review and told the SEC which documents investigators should request. When the investigators went back to their supervisor in the SEC Northeast regional office, the supervisor discouraged them from perusing the requested documents any further. In explaining why they did not follow up on the complaints from Markopoulos, the best rationalization the investigators came up with is that some of the SEC agents did not like Markopoulos personally. Another blatant lack of effort related to the idea of investigators requesting the National Association of Securities Dealers (NASD) to send the SEC independent trade data directly to verify Madoff's claims. The SEC decided not to make the request because it would become too time-consuming to actually review the data to verify

the trades made by Madoff.[16] Furthermore, the SEC also should have realized that the steady profits obtained from Madoff could *never* work in the volatile financial markets. The chairwoman of the SEC, Mary Schapiro, summed up the SEC's lack of due diligence as "a failure that we continue to regret."[17] In November 2011, the SEC announced it had punished eight workers for their errors during previous investigations related to Madoff. The punishment varied from 3- to 30-day suspensions with and without pay reductions, and two people received "counseling memos," which is the lightest level of discipline the SEC allows.[18]

The Family Connections

Madoff boasted that his company was a close-knit family working for the investors. However, those family connections raised many ethical issues. Both of Madoff's sons, Andrew and Mark, worked for the company. Andrew was the director of trading, and Mark was director of proprietary trading. Madoff's brother, Peter, was the senior managing director and chief compliance officer, and Peter's daughter was Madoff Securities' compliance attorney. The closeness of these family members to the investment money should have raised multiple red flags. How could the company have an effective and objective evaluation of compliance when Madoff's brother and niece were in charge of compliance? How could Madoff state there was nothing to hide when both of his sons were top executives in the trading operations? Although not part of the "asset management" group where the fraud was committed, the sons may have had access to information that was being generated during the Ponzi scheme.[19]

The Impact on Charities

The impact of the Madoff fraud on charities was immense. Madoff was both a donor and, in many cases, the person responsible for investing money for the charities. Because of his religious faith, Madoff focused on many Jewish charities as being the "key" person for the financial sustainability. The promises of above-average returns convinced these charities that they were doing the right thing by having Madoff manage their money. From bone marrow transplants to human rights, Jewish charities have been desecrated by Madoff's fraud. For some charities such as the Justice, Equality, Human dignity, and Tolerance (JEHT) Foundation, which focused on criminal justice issues, the shutting down of its operations due to lack of funding was the only option. In addition, the Robert I. Lappin Charitable Foundation, which focused on Jewish youth, had to temporarily close its doors because of Madoff's actions. Yeshiva University lost $110 million from its Madoff investments. Madoff had served on the university's board of trustees since 1996. The $110 million was equal to approximately 8% of the university's total endowment.[20] Nobel Peace Prize winner, Elie Wiesel, was also a victim of Madoff, losing almost all of his $15.2 million in assets for his foundation. A concentration camp survivor, Wiesel has written more than 50 books and his Foundation for Humanity fights to resolve issues of indifference, intolerance, and injustice.[21]

The Social Network of Bernard Madoff

From Boca Raton to Park Avenue, London to Geneva, Bernard Madoff was a master of convincing ultra-wealthy people to invest in his company. Madoff used his image and

status as the former chairman of the NASDAQ Stock Exchange to encourage people to beg him to accept their money. He refused some investors, heightening the intrigue and demand for his services. The elite group that was allowed to invest with him made Madoff in demand around the world. Madoff's clients usually referred potential new clients informally by word of mouth. The clients who invested usually did not understand if they were invested directly with Madoff or with feeder funds that would take clients' money, charge a fee, and then give it to Madoff. The largest hit feeder fund was the Fairfield Greenwich Group, which lost an estimated $7.5 billion from Madoff investments. With connections to the social elite around the world, Fairfield received a fee and then handed the investment over to Madoff. This arrangement lasted for 19 years.[22]

The Legal Issues Commence

On December 19, 2008, Bernard Madoff was placed under 24-hour home detention with electronic monitoring. In addition, Madoff's wife was ordered to pay for round-the-clock monitoring of the building where they lived, including supplying communication devices that transmitted a direct signal from Madoff's monitor to the FBI. Madoff also paid a $10 million personal recognizance bond for his release until his trial started.[23]

In what can only be considered one more bizarre twist in this story, Madoff and his wife Ruth were accused of mailing expensive jewelry and valuables to their sons and Madoff's brother in violation of the bail agreement. As part of the agreement, Madoff was not allowed to dispose of any of his assets because they could be sold with the proceeds going to the victims of the fraud. A total of three packages were sent containing expensive watches, a diamond necklace and emerald ring, other types of diamond jewelry including a Cartier diamond and Tiffany watch. Madoff's lawyers described the items as "a few sentimental personal items" that are valued at more than $1 million.[24] This information was revealed at the same time it was disclosed that Madoff had signed 100 checks worth $173 million that were found in his desk drawer on the day he was arrested. It is hypothesized that the 100 checks were for selected family members, close friends, and employees.[25]

The Consequences for Their Actions

On March 12, 2009, the 70-year-old Madoff pleaded guilty to all 11 felony counts brought against him and faced a sentence of as many as 150 years in prison. The charges included securities fraud, money laundering, and perjury. Government prosecutors announced that the amount of the estimated fraud had increased from $50 billion to $65 billion. The U.S. Department of Justice (DOJ) alleged that Madoff had maintained an ill-trained and inexperienced clerical staff so the fraud could work for so long. The staff generated "false and fraudulent documents" and provided false records and misinformation to regulators while moving money back and forth between numerous accounts to make it appear that actual trades were taking place.[26] Immediately after his plea, Madoff was handcuffed and led off to jail. His $10 million bail was revoked because he was considered a risk to flee the charges against him.[27] Six days later, Madoff's accountant was arrested. David Friehling was not charged with knowing about the Ponzi scheme but was charged with not doing the proper due diligence in his audits of Madoff's accounts. The "sham" audits allowed Madoff to commit the fraud for a much longer period than if the proper audits had been done on Madoff's books. The Federal Bureau of Investigation (FBI) stated that Friehling did not verify the existence of assets claimed by Madoff, nor did he examine the main bank account through which billions of dollars flowed with the clients' money.[28]

On June 30, 2009, Madoff was sentenced to 150 years in prison, the maximum allowed. There were no members of Madoff's family in the courtroom when the sentence was read. Ruth Madoff released a statement in which she says that she was expressing her grief for the victims of the fraud and that her reaction was of shock and betrayal when she "learned" about the fraud committed by her husband.[29] Prisoner number 61727–054 was sent to the Butner Federal Correctional Complex in Butner, North Carolina, to serve out his sentence. Madoff was sentenced to the medium security prison within the complex.[30] Madoff now rises at 6 a.m. and reports for mandatory work duty by 7:30 a.m. Inmates at the Butner facility are paid between 12 cents and $1.15 per hour based on the job they are performing. The end of the day occurs at 11 p.m. when the lights are turned off. Inmates tried to get Madoff to sign items for them in the hopes of trying to sell the items on eBay when they get out of prison because they are not allowed Internet access.[31]

On November 3, 2009, Madoff's accountant, Friehling, pleaded guilty to nine criminal charges including one charge of securities fraud, one charge of investment advisor fraud, four counts of making false filings with the SEC, and three counts of obstruction of the administration of federal tax.[32] Ten days later, two computer programmers who worked for Madoff were arrested for their role in the Ponzi scheme. Jerome O'Hara and George Perez were alleged to have created the software needed to generate a detailed paper trail of Madoff's "transactions." Both men had closed their accounts with Madoff in April 2006 because they had become uneasy about the fraud. In September 2006, Madoff confronted the men, who had remained quiet, but had demanded pay raises and bonuses—"hush money" in return for staying with Madoff and for not saying anything about the fraud to any outsiders. The software included programs that generated fake customer account statements as well as fake trading confirmations from the London Stock Exchange.[33]

The Impact of the Fraud on Family and Friends

In August 2009, Frank DiPascali Jr. pleaded guilty to 10 criminal charges for his role in the Madoff fraud. DiPascali admitted in court that the scheme was fake and fictitious, and he knew it was a fraud. He faces 125 years for his convictions. The SEC alleged that DiPascali and other Madoff associates used a "random number generator program" to give fictitious trading orders the appearance that trades were occurring at different periods. In addition, Madoff ordered that all old stationary and letterhead could not be destroyed in case they had to "backdate" a fictitious order to show to a client or regulators.[34]

On February 25, 2010, Daniel Bonventre, a senior executive who had worked with Madoff for more than 30 years, was arrested on federal fraud and conspiracy charges. Bonventre is accused of manipulating financial records to conceal the fraud. These fake records misled investors concerning the poor financial position of Madoff Securities. Bonventre was also accused of profiting from the fraud by collecting almost $2 million by using fake transactions in his own accounts at Madoff Securities.[35]

On November 18, 2010, two longtime Madoff employees were indicted for their roles in the fraud. Both Annette Bongiorno and JoAnn Crupi were considered "back room" employees but contributed valuable roles in maintaining the fraud throughout the years. Bongiorno had worked for Madoff for more than 40 years, and Crupi had worked for Madoff for 25 years. Bongiorno used a computer program to create blank account statements and to revise information on existing account statements. On occasion, she asked clients to return account statements that had been issued to them so she could adjust them to facilitate the fraud. Crupi was in charge of giving Madoff handwritten notes containing the daily balance from the primary bank account used to transfer funds in the fraud. She also produced a handwritten daily summary of the listing of clients and amounts that had been redeemed and those that had been requested but not yet fulfilled by Madoff. Crupi and other employees were in charge of creating the "special" financial books that were shown to the SEC during its investigations. Crupi also generated the listing of all the false transactions claimed to have taken place by Madoff. From 1975 to 2008, Bongiorno received more than $14 million from the fraud, and Crupi received more than $2.7 million in just 2008 from the fraud. During the final days before Madoff's arrest, Bongiorno convinced Madoff to use the last remaining money in the company to redeem the balances owed to employees, family, and friends instead of Madoff's other clients. More than $350 million in checks, which included the $173 million found in Bernard's desk, were seized by authorities before they could be sent. Bongiorno faces as many as 75 years in prison, and Crupi may have to serve as many as 65 years in prison. Authorities sought the forfeiture of approximately $5 million in assets owned by the two women, including a 2005 Bentley Continental and a 2007 Mercedes-Benz owned by Bongiorno and a New Jersey beach house owned by Crupi.[36,37]

In a tragic twist of fate, Mark Madoff, the eldest of Madoff's two sons, hung himself in his Manhattan apartment on the second anniversary of his father's arrest. Mark's 2-year-old son was asleep in another room in the apartment at the time of his death, while his wife, Stephanie, was vacationing at Walt Disney World with their daughter. Mark had become bitter and angry toward his father and had become increasingly anxious about the flood of lawsuits filed against him related to his father's fraud. Mark was also upset that a trustee had named his children as defendants in a lawsuit filed in the previous month. He was bothered by the rumors about his family, the news reports that stated that criminal charges against himself and his brother would likely take place in the near future, and his inability to find a job.[38] Bernard Madoff announced that he would not attend his son's funeral "out of consideration for the family's privacy." Madoff had his own private service for his son inside the federal prison where he is incarcerated. The Bureau of Prisons stated that inmates can request permission to attend a funeral of an immediate family member and the approval of the request is on a case-by-case determination.[39]

In January 2011, the estate of longtime Madoff friend Jeffry Picower agreed to return $7.2 billion to give to investors who were victims of the Ponzi scheme. Picower's widow, Barbara Picower, agreed to give what is the largest amount of money ever returned through a civil forfeiture proceeding. By agreeing to give up this money, the Picower estate is no longer liable for any future lawsuits related to Madoff. Jeffry died of a drowning resulting from a heart attack in October 2009. At the time, he was estimated

to be worth $10 billion. Barbara stated she would continue her philanthropic contributions with the remaining money in the estate.[40,41]

In June 2011, another close friend of Madoff's, Eric Lipkin, pleaded guilty to conspiracy, bank fraud, and creating false financial records. Lipkin created false documents to mislead SEC investigators and created false payroll records. By using the false payroll records, Madoff paid friends retirement and other benefits even though they were not employees at Madoff Securities.[42]

In November 2011, yet another close friend of Bernard pleaded guilty for his action during the fraud. David Kugel pleaded guilty to conspiracy, securities fraud, bank fraud, falsifying business records, and falsifying the books of an investment advisor. Kugel could serve as many as 85 years in prison. Kugel admitted in court that Madoff had been using a Ponzi scheme since the 1970s, and he agreed to forfeit $3.5 million he received while working for Madoff.[43]

In December 2011, Madoff's former controller pleaded guilty to falsifying company records and filing false information to government officials. Enrica Cotellessa-Pitz starting working with Madoff in 1978 and was responsible for closing the company's financial statements monthly.[44]

In a haunting reminder of Mark Madoff's death, the U.S. bankruptcy judge ruled in April 2012 that the trustee could make financial claims against current and former spouses of Madoff's sons to collect money for Madoff's victims.[45] On June 29, 2012, Bernard's brother, Peter Madoff, pleaded guilty to fraud charges. Peter Madoff admitted that he falsified documents, lied to government regulators, and participated in other illegal activities to help Bernard Madoff cover up his Ponzi scheme. It was estimated that Peter Madoff received approximately $40 million from the Madoff firm between 1998 and 2008.[46] On December 20, 2012, Peter Madoff was sentenced to 10 years in prison and received a forfeiture order of $143 billion. That amount was selected to ensure that all of Peter Madoff's assets would be handed over to the government so the proceeds could be distributed to the victims. In the courtroom, Peter stated that he was "deeply ashamed. . . (and) tried to atone by pleading guilty. . . I am profoundly sorry that my failures have let so many people down, including my own loved ones and family."[47] On January 7, 2014, J. P. Morgan agreed to pay $2.6 billion to resolve the allegations that it had failed to notify government regulators about Madoff's Ponzi scheme. The United States Attorney and the FBI had alleged that J. P. Morgan had failed to put in place the proper controls that would have identified the fraudulent activities occurring in Madoff's firm. A number of internal documents demonstrated that various J. P. Morgan employees were raising red flags about Madoff's operations, but J. P. Morgan failed to act on this information.[48] On March 25, 2014, five former members of Madoff's staff were found guilty of fraud. Jerome O'Hara and George Perez, both computer programmers, were found guilty of creating false customer accounts. Annette Bongiorno and JoAnn Crupi, both former Madoff portfolio managers, were found guilty of creating fake trading records including backdating nonexistent trades. In addition, former operations director Daniel Bonventre was found guilty of generating false financial records.[49] On September 3, 2014, the only living son of Bernard Madoff died from mantle cell lymphoma cancer. He was 48 years old.[50] On June 24, 2014, Madoff's former accountant, Paul Konigsberg, pleaded guilty to falsifying records and conspiracy, which included illegally backdating trades.[51] On

December 8, 2014, Daniel Bonventre was sentenced to 10 years in prison and was also ordered to forfeit $155 billion. In court, Mr. Bonventre stated, "I was used by the ultimate con man. . . Bernard Madoff lied to me every day and I believed and trusted him."[52] On December 9, 2014, Annette Bongiorno was sentenced to six years in prison. In addition, Jerome O'Hara was sentenced to 30 months in prison and received a forfeiture order of $19.7 billion for his role in the Madoff fraud.[53] On February 9, 2015, Irving Picard, the trustee in charge of distributing the assets collected to the victims, announced that the payout to the victims had totaled more than $7.2 billion.[54]

Questions for Thought

1. Trust is extremely important in business transactions. Greed also plays a role in some business transactions. Discuss how these two concepts were intertwined in this case.
2. Describe a Ponzi scheme. Find several examples of other Ponzi schemes that have occurred in recent years.
3. In this case, it appears that Madoff had many friends and family members who were involved in the fraud. Speculate about how likely it is that Madoff's own sons, who were employees of the firm, knew nothing of the fraud, as they stated.
4. Explain the ethical issues associated with running a family-owned business. Were these issues present at Madoff's firm?

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Siemens: How the Wheels Slid off the Et

Headquartered in Munich, Germany, Siemens foc for electronic and electronic engineering based i global manufacturing conglomerates, Siemens's c and governments around the world. Within these ind long-term contracts with the clients that can be worth m is critical that Siemens and their competitors convince a ple that their products provide the best overall value to and its competitors may always have the temptation to u to persuade decision makers to sign contracts with thei comes the temptation to give illegal financial incentives

The Allegations Start

Siemens's illegal method of obtaining orders from clie announced that six Siemens executives had been arrest giving bribes to German and other clients in the tele addition, the executives were also accused of embezzli for the bribes. One of the executives arrested was Thon of the telecommunications equipment unit. At this po the bribes was 200 million euros and allegedly includ security systems contract at the 2004 Olympic Games i

The concerns started for Siemens when a senior exec claimed he got a very worrisome phone call from Bel Etisalat worked at a Saudi consulting firm that was a b Al Etisalat demanded that he be paid $910 million i Siemens for his role in winning telecommunication c Etisalat continued by stating that he threatened to go bribes offered by Siemens related to the contracts if the c mission payments. Kutschenreuter notified his superi CEO Klaus Kleinfeld and the then current CEO Heinrich