



Sobel & Co., LLC

CERTIFIED PUBLIC ACCOUNTANTS
AND CONSULTANTS

PONZI SCHEMES:

Regulatory & Enforcement Developments

Fourth Annual Fraud and Forensic Conference
Atlanta, Ga. May 14, 2010

Richard Barry
Director of Securities Compliance and Litigation Support
Sobel & Co., LLC



PONZI SCHEMES AND FEEDER FUNDS


REGULATORY AND ENFORCEMENT
DEVELOPMENTS SINCE MADOFF



- Ponzi overview
- The conman
- The scheme
- Elements and red flags
- Feeders – the accomplice?
- Impact of Madoff

Illustration- Time/CNN – 25 people to blame for the financial crises-
Andrea Renault



- 
- Ponzi schemes typically have seemingly legitimate cover story
 - May originate as real business venture or business concept
 - Eventually rely on bringing in new money which exceeds the outflow of cash
 - Pressures from redemptions eventually collapse and expose these schemes



The Scheme

Hedge Funds

Pyramid Schemes

Prime Bank Schemes

Viatical and Life Settlement

Housing and Mortgage related

Exotic, secret and/or tax free investments



Wolf in Sheep's clothing


- Individuals who have access to financial information and the confidence and trust of clients
- Registered investment advisors, insurance agents, financial planners and stock brokers
- Hedge fund operators and investment advisers
- Recidivists, gamblers, sociopaths, liars and, well, con men




Top ten reasons to suspect you have been Ponzi'd

- You pay unusually high fees or commissions or are told there are no fees or commissions
- You are promised **notably higher returns**
- The return of your investment is guaranteed
- You receive **constant returns in the face of volatile markets**
- You are told that proprietary features of the investment require **secrecy** or claim to be tax exempt



- 
- You are pressured to roll over your investment or offered incentives to do so
 - Your advisor fails to answer or return calls
 - You do not receive your interest or principal payment timely – or at all
 - You receive a call from the government asking questions about your investment
 - The check you receive bounces





...in **2001**, a prescient article raised questions about his inscrutable strategies:

"Madoff's investors rave about his performance — even though they don't understand how he does it," wrote Barron's Erin Arvedlund, who quoted a "very satisfied investor" as conceding, **"Even knowledgeable people can't really tell you what he's doing."** But for investors pocketing windfalls, the lure of easy money outstripped suspicions raised by Madoff's shroud of secrecy.



Hedge Funds

- Private investment vehicles – LPs or LLCs
- Unregistered securities
- May short sell and use leverage
- Charge management and performance fees
- In 2005 over 8000 hedge funds had over \$1 trillion in management



Feeders and the Ponzi

The capital provided by so called feeders and lack of due diligence further perpetuated the largest schemes including Madoff


Billions of dollars have been lost by clients of the feeders who were unaware that their money had been invested with others




Feeder Funds

- Fund which acts as pass through vehicle to master fund
- Serve as middlemen; aggregators and distributors
- May have specific purpose ie: economies of scale for management and administration; favorable tax efficiencies for US investors; other




- 
- Investors brought in through the feeder fund
 - The feeder invests its money in the master
 - The master fund trades/invests proceeds and manages the money
 - The feeder shares in the profits of the master on a pro-rata basis




- 
- Master returns proceeds to feeder who pays out to investors
 - Fees charged at the feeder level – based on net asset value and/or net gain of the fund





- 
- Surge in enforcement actions increasingly involve hedge funds
 - Enforcement and private actions have expanded to include feeder funds and others
 - SEC has been criticized for its failure to promptly respond in Madoff and Stanford
 - SEC has made significant changes in its enforcement policies
 - Madoff had profound implications on SIPC





So many alleged scams have collapsed amid the worst national recession in generations and heightened investor wariness prompted by the Madoff case that Bart Chilton, a commissioner of the Commodity Futures Trading Commission, last month dubbed the phenomenon "**rampant Ponzimonium.**"

Kevin McCoy, USA Today 4/17/09



The so-called feeders

Reprehensibly greedy

- Ponzi Schemes induced feeders to invest offering extraordinary high fees
- Managers ignored red flags including their own excessive fees, and
- Misled and concealed their actual lack of participation in the management of the funds and that the funds were managed by others



Madoff Feeders

- **Faifield Greenwich Group**; Walter Noel - \$7.2 billion invested, 95% of the fund- Suit filed by Mass Secretary of State
- Earned 1% of money under management for the money steered to Madoff and 20% of the gains which averaged 11% for 15 years- about \$100 million a year



Westport/Silverman

- Westport National Bank and Robert L. Silverman– suit filed April 19, 2010 by Connecticut Attorney General
- Referred pension funds and IRA accounts to invest with Madoff through Westport
- Bank misrepresented its role as custodian
- Fees charged by bank and Silverman were excessive - included custodial fee paid to bank



Ascot Partners

- Ascot Partners LP;
Gabriel Capital Corp and
J.Ezra Merkin – Suit
filed by New York
Attorney General
- Charged with secretly
steering \$2.4 billion to
Madoff
- Collected over \$470
million in fees



Madoff Impact on SIPC

- Madoff is once in 40 thousand year event
- Claims based on net losses not last statement balance
- Substantial recovery from clawbacks
- Over \$50 million paid in legal fees and over \$670 million in claims approved to date
- Assessments increased from \$150/firm to $\frac{1}{4}$ of 1% of net operation revenues (\$480 mill)
- Increase target reserves from 1 to 2.5 billion



Other Developments

- Stanford and the SEC
- Enforcement Changes at the SEC
- Rule changes involving custody of clients assets by Investment Advisors
- SIPC





\$1.6 million (elderly)

- March 7, 2009 Michael D'Angelo indicted -24 investors; \$690,000
- December 18, 2008 Jeffrey Southard; arrested - Ohio Bonds;
- March 9, 2009 Serafino Holding lawsuit filed- 80 investors; \$15 million
- April 9, 2009, Wayne Puff pleads guilty; NJ Affordable Homes-
- \$80 Million
- April 9, 2009, James Hankins , Jr. indicted, Hankins Life Settlements LLC- \$12 million
- April 15, 2009, Janet Neeley sentenced to 97 months; 45 investors; \$2.5 million- Fictitious municipal bond fund
- May 8, 2009, Maxwell Smith, criminal complaint filed, 13 investors- \$10 million- fictitious municipal bonds
- May 19, 2009 Raphael Romero sentenced to 150 months; 70 victims, \$2 million

