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# AMERICA'S BIGGEST PONZI SCHEME

How Bernard Madoff ran the biggest Ponzi scheme  
in America

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# America's Biggest Ponzi Scheme

## Introduction

In 2008, America's biggest Ponzi scheme came to collapse. This scheme was all in the hands of Bernard L. Madoff. This resulted in the disappearance of \$65 billion of people's invested money, suicide, multiple lawsuits, reversals of investment profits and more. Madoff's Ponzi was simple to manage. Money would come in from investors who were promised a huge return, and the same money would be used to pay previous investors. There was nothing in between besides falsified documents to make it seem like investment was used for security purchases and sales.

## Madoff's History

Madoff had highs and lows in his ventures and as a young individual, he was not the scammer he later turned out to be. He started hedge funding using monies of his friends, families, and neighbors. At that period, new stock issues were the best way of making profits and so that was his investing in system. It worked initially, but in 1962, the Cuban Missile Crisis destroyed the US stock market, which caused him to lose several investor's monies. Lucky for him, he was bailed out by his wife's father.

Soon after that he began an honest automated trading system. Him and his brother developed a computer program that purchased and sold securities from the New York exchange market, which helped them control 50% of the market at this time. This program allowed him to make speedy purchases, that put him ahead of his competitors. During the 80s, Madoff would be making over \$100 million a year, until the stock market crashed which again destroyed his investment business. However, this time Madoff was a well-known and trusted as a hedge fund manager. Bernard L. Madoff Investment Securities LLC flourished even after this crash. Madoff took the role of Investment Advisory (IA), and his brother took charge of the programming and coding required for trading and monthly reporting.

Madoff did not refuse the money coming into his investment firm, according to his own words, 'It was hard to turn down.' Hedge funds, major banks, country clubs, nonprofits, and many more would pour their money to Madoff. This is how the America's biggest Ponzi scheme started.

Madoff mostly hired families and people he trusted most. This was how he managed to get his employees to be complicit in his fraud. He would put himself at risk such as sneaking in at night to his own office to read SEC investigators' notes, have his right-hand man act as a CFO because realistically he didn't have one...


# America's Biggest Ponzi Scheme

## How the Ponzi Worked

Madoff's investment security Ponzi scheme had 2 parts. One was a computer-generated securities trades, and the other was his part where he convinced clients to invest in his company. Clients would bring in a cash amount and deposit it into his firm, where each were given an account number. Clients thought their money would be invested into stocks, options, and bonds, and would have a return rate between 12 – 20%. It would be revealed during the investigations that Madoff was at times blackmailed into giving a return rate of up to 900%. No one questioned the unusually high return rate and lack of commissions on trade profits as it's industry standard to charge commissions on trades.

The money clients put in was simply kept in Madoff's personal account. This money was used to pay a previous client his principal and interest. As long as the money coming in was significantly bigger than the money leaving his firm, there was nothing for Madoff to worry about.

Clients were given a monthly report of the firm's investments. In order to create the sense that the money was invested properly, the phony report was made using past stocks. For example, if stock 'X' was priced \$80 on Monday, and \$100 on Wednesday, a report would be made to make it look like there was a purchase of the stock on Monday, and its sales on Wednesday. Trusted employees were responsible on finding the right numbers to make the right returns.

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PERIOD ENDING  
9/30/08

PAGE  
1

YOUR ACCOUNT NUMBER  
[REDACTED] 3-0


YOUR TAX PAYER IDENTIFICATION NUMBER  
\*\*\*\*\*

DATE	BOUGHT RECEIVED OR LONG	SOLD DELIVERED OR SHORT	TRN	DESCRIPTION	PRICE OR SYMBOL	AMOUNT DEBITED TO YOUR ACCOUNT	AMOUNT CREDITED TO YOUR ACCOUNT
				BALANCE FORWARD		23,154.61	
9/02				MAL-MART STORES INC	DIV		117.09
9/09				DIV 8/15/08 9/02/08 JOHNSON & JOHNSON	DIV		273.70
9/09				DIV 8/26/08 9/09/08 UNITED PARCEL SVC INC	DIV		99.45
9/10	+			CLASS B DIV 8/25/08 9/09/08	+		4.31
9/10				FIDELITY SPARTAN	DIV		276.25
9/10				U S TREASURY MONEY MARKET	DIV		65.28
9/10		4,525		DIV 09/10/08 CHEVRON CORP	1	4,525.00	
9/10	2,728			DIV 8/19/08 9/10/08 UNITED TECHNOLOGIES CORP	1	2,728.00	
9/11		+		DIV 8/15/08 9/10/08 FIDELITY SPARTAN	DIV		185.13
9/11	8,653			U S TREASURY MONEY MARKET	1	8,653.00	
9/16				DIV 8/21/08 9/11/08 FIDELITY SPARTAN	DIV		89.25
				U S TREASURY MONEY MARKET MCDONALDS CORP	DIV		
				DIV 9/02/08 9/16/08			
				CONTINUED ON PAGE 2			

PLEASE RETAIN THIS STATEMENT FOR INCOME TAX PURPOSES

## America's Biggest Ponzi Scheme

The image above is a monthly report provided to an unknown client of Madoff. It shows purchase of Treasury bills from 'Fidelity Spartan' in 2008, only 2 problems come with it. The company's name was changed to just 'Fidelity', and it was not accepting new clients starting from 2005.



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**2**

YOUR ACCOUNT NUMBER  
**3-0**

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DATE	BOUGHT RECEIVED OR LONG	SOLD DELIVERED OR SHORT	TRN	DESCRIPTION	PRICE OR SYMBOL	AMOUNT DEBITED TO YOUR ACCOUNT	AMOUNT CREDITED TO YOUR ACCOUNT
9/17		833		ORACLE CORPORATION	19.310		16,052.23
9/17		187		APPLE INC	150.770		28,186.99
9/17		340		PEPSICO INC	72.460		24,623.40
9/17	+	323		ABBOTT LABORATORIES	58.960		19,032.08
9/17		1,428		PFIZER INC	18.360		26,161.08
9/17		561		AMERICAN INTL GROUP INC	15.290		8,555.69
9/17		646		PROCTER & KIMBERLY CO	72.780		46,990.88
9/17		238		ANGEN INC	63.320		15,061.16
9/17		442		PHILLIP MORRIS INTERNATIONAL	54.170		23,926.14
9/17		1,003		BANK OF AMERICA	33.040		33,099.12
9/17		340		QUALCOMM INC	48.390		16,439.60
9/17		1,173		CITI GROUP INC	18.220		21,326.06
9/17		255		SCHLUMBERGER LTD	87.210		22,228.55
9/17		323		CONGOCOPHILIPS	72.510		23,408.73
9/17		1,292	+	AT&T INC	31.370		40,479.04
9/17		1,258		CISCO SYSTEMS INC	23.050		28,946.90
9/17		221		UNITED PARCEL SVC INC	67.860	+	14,989.06
9/17		425		CLASS B			
9/17		204		CHEVRON CORP	83.210		35,347.25
9/17		204		UNITED TECHNOLOGIES CORP	63.720		12,990.88
9/17		2,125		GENERAL ELECTRIC CO	27.440		58,225.00
9/17		612		VERIZON COMMUNICATIONS	34.570		21,132.84
9/17		51		GOOGLE	432.200		22,040.20
9/17		731		WELLS FARGO & CO NEW	33.390		24,379.09
9/17		85		GOLDMAN SACHS GROUP INC	154.700		13,146.50
				CONTINUED ON PAGE	3		

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The monthly statement above shows a settlement date of September 17, 2008, which is a Sunday when the US stock market is closed.

There are several other examples that were unusual for investment firms, such as purchasing and selling an entire portfolio of stocks, over-the-counter trading, trades always making profits for the big client... These were unusual activities that an experienced investment firm would not participate in.

To add to what's stated above, some impossible numbers that would clearly show investors the numbers were fake existed. Statements exist that show sales of stock at prices it never reached. Nevertheless, Madoff was trusted by his clients because of his reputation for returning principal and a high interest amount, and the ability for clients to receive any amount of their invested money at any period, mostly a check would be mailed to them within 24 hours of request.

# America's Biggest Ponzi Scheme

## Investigation into Bernard L. Madoff Investment Securities LLC

Several investigations were made into Madoff's investment firm. But Madoff and his team had a brilliant way of evading all of them. Investigators either were the SEC or auditors of big investors who would like to know how the firm operates. To Madoff, they were all the same.

U.S. Securities and Exchange Commission (SEC) is a federal agency that enforces laws against market manipulation. Its intent is to, 'protect investor; maintain fair, orderly, and efficient markets; and facilitate capital formation.' SEC was involved in several investigation into Madoff's firm, but it came with its own short comings. For one, SEC didn't make the right investigation. Although other parties reported to the SEC that Madoff was involved in a Ponzi scheme, the SEC ignored these reports and decided to investigate into frontrunning by Madoff. Frontrunning is an insider trading system where a trader knows before huge amounts of stocks of a certain stock was bought. Knowing that this would bump up its price due to the laws of supply and demand, the trader makes his own purchase of the same stock before the big purchase was made. To Madoff, frontrunning made is seem like he was a real investor, such investigations were blessings in disguise.

Furthermore, the SEC sent junior investigators, usually recent college graduates to investigate into Madoff's firm. In an interview, Madoff explicitly stated that they were easily duped, he told them that he could be the next chairman and would like to promote them. They enjoyed his company and were thrilled to be around him.

FBI's investigation into Madoff's firm was slightly different. They would question Frank DiPascali, the right-hand man of Madoff, and as stated by the FBI investigator, 'he sang like a canary.' DiPascali revealed that the SEC and auditors would request certain documents to Madoff. Madoff would then transfer the request to his programmers who created the documents in a matter of minutes, but there's more to it. They would put the papers in a freezer for a few minutes to cool it off (since the paper just came out of a printer), smudge it, then play football with it before presenting it to Madoff and the investigators. This way, it looked like it has been stashed for some time. SEC were also lazy investigators for the most part. It was later revealed that they never checked whether Madoff's stock purchases were made or not.

DiPascali also revealed that Madoff once snuck into his own office at midnight after an SEC investigation to inspect the content of an SEC investigator's bag, to which he found that he was being investigated for frontrunning.

# America's Biggest Ponzi Scheme

## The Downfall

In the year 2008, housing market of the US crashed, and the economy was in a recession. To Madoff, this meant that his firm was about to be revealed for its illegal activities. As mentioned earlier, the business only works if more money was coming in, than was going out. The housing crisis caused clients of Madoff to withdraw money at a staggering amount, and this meant that the money leaving was significantly higher than the money coming in. Bernard L. Madoff Investment Securities soon had no cash to keep the Ponzi scheme running. At this point, a total of \$64.8 billion of investor's money was lost.

According to Madoff, he confessed his business practices to his son, who then reported it to the FBI the next day. Even though his two sons were part of the company, they had no knowledge of how the firm was run.

This led to the investigation mentioned above and Madoff was arrested in 2009.

## Conclusion

When it comes to fraud and cooking books, the SEC needs to take a closer look into financial documents and make the necessary investigation, no matter the size of the company. In the case of Madoff, a simple look into whether the stocks that were reported as purchased and sold could be checked for its legitimacy, and several red flags were there to make these investigations reasonable. A financial analyst by the name of Harry Markopolos reported to the SEC that the returns Madoff made were mathematically impossible, but his reports were ignored. Currently, Markopolos is going after General Electric (GE) for fraud and false financial reporting.

Madoff was highly protective over his employees. He took all the blame and mentioned Frank DiPascali as his only accomplice to the fraud. Because of this, we cannot be sure if anyone else besides the arrested parties were involved in the fraud.

# America's Biggest Ponzi Scheme

## Falsified Balance Sheet

BERNARD L. MADOFF INVESTMENT SECURITIES LLC  
STATEMENT OF FINANCIAL CONDITION  
AS OF OCTOBER 31, 2007

ASSETS

Cash and cash equivalents	\$ 24,696,565
Cash segregated under federal and other regulations	2,604,995
Securities borrowed	249,818,562
Receivable from broker-dealers clearing organizations and others	55,333,291
Securities owned at market value:	
U.S. government obligations	79,493,600
Equities	431,608,041
Corporate obligations	86,468,644
Options	118,138,569
Securities owned not readily marketable, at estimated fair value	29,580,483
Other investments not readily marketable, at estimated fair value	4,226,029
Membership in exchange, owned at cost	69,400
Furniture, equipment, and leasehold improvements, at cost, net of accumulated depreciation	7,916,476
Other assets	<u>3,359,484</u>
 <u>TOTAL ASSETS</u>	 <u>\$1,093,314,139</u>

x — ( ) / \ ( ) — x

BERNARD L. MADOFF INVESTMENT SECURITIES LLC  
STATEMENT OF FINANCIAL CONDITION  
AS OF OCTOBER 31, 2007

LIABILITIES AND MEMBER'S EQUITY

Securities loaned	\$ 31,775,773
Payable to brokers-dealers, clearing organizations, and others	1,694,278
Securities sold, but not yet purchased at market value:	
Equities	222,883,432
Corporate obligations	12,170,000
Options	150,917,391
Accounts payable, accrued expenses, taxes and other liabilities	<u>5,873,265</u>
 TOTAL LIABILITIES	 \$ 425,314,139
 MEMBER'S EQUITY	 <u>668,000,000</u>
 <u>TOTAL LIABILITIES AND MEMBER'S EQUITY</u>	 <u>\$1,093,314,139</u>

**Note:** The image above is the last balance sheet by Madoff's firm. This is a completely made-up balance sheet used to make the firms practice seem legitimate.

# America's Biggest Ponzi Scheme

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