

BUSINESS NEWS

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Bernard Madoff arrested over alleged \$50 billion fraud

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NEW YORK (Reuters) - Bernard Madoff, a quiet force on Wall Street for decades, was arrested and charged on Thursday with allegedly running a \$50 billion “Ponzi scheme” in what may rank among the biggest fraud cases ever.

The former chairman of the Nasdaq Stock Market is best known as the founder of Bernard L. Madoff Investment Securities LLC, the closely-held market-making firm he launched in 1960. But he also ran a hedge fund that U.S. prosecutors said racked up \$50 billion of fraudulent losses.

Madoff told senior employees of his firm on Wednesday that “it’s all just one big lie” and that it was “basically, a giant Ponzi scheme,” with estimated investor losses of about \$50 billion, according to the U.S. Attorney’s criminal complaint against him.

A Ponzi scheme is a swindle offering unusually high returns, with early investors paid off with money from later investors.

On Thursday, two agents for the U.S. Federal Bureau of Investigation entered Madoff’s New York apartment.

“There is no innocent explanation,” Madoff said, according to the criminal complaint. He told the agents that it was all his fault, and that he “paid investors with money that wasn’t there,” according to the complaint.

The \$50 billion allegedly lost would make the hedge fund one of the biggest frauds in history. When former energy trading giant Enron filed for bankruptcy in 2001, one of the largest at the time, it had \$63.4 billion in assets.

U.S. prosecutors charged Madoff, 70, with a single count of securities fraud. They said he faces up to 20 years in prison and a fine of up to \$5 million.

The Securities and Exchange Commission filed separate civil charges against Madoff.

“Our complaint alleges a stunning fraud -- both in terms of scope and duration,” said Scott Friestad, the SEC’s deputy enforcer. “We are moving quickly and decisively to stop the scheme and protect the remaining assets for investors.”

Dan Horwitz, Madoff’s lawyer, told reporters outside a downtown Manhattan courtroom where he was charged, “Bernard Madoff is a longstanding leader in the financial services industry. We will fight to get through this unfortunate set of events.”

A shaken Madoff stared at the ground as reporters peppered him with questions. He was released after posting a \$10 million bond secured by his Manhattan apartment.

Authorities, citing a document filed by Madoff with the U.S. Securities and Exchange Commission on January 7, 2008, said Madoff’s investment advisory business served between 11 and 25 clients and had a total of about \$17.1 billion in assets under management. Those clients may have included other funds that in turn had many investors.

The SEC said it appeared that virtually all of the assets of his hedge fund business were missing.

CONSISTENT RETURNS

An investor in the hedge fund said it generated consistent returns, which was part of the attraction. Since 2004, annual returns averaged around 8 percent and ranged from 7.3 percent to 9 percent, but last decade returns were typically in the low-double digits, the investor said.

The fund told investors it followed a “split strike conversion” strategy, which entailed owning stock and buying and selling options to limit downside risk, said the investor, who requested anonymity.

Jon Najarian, an acquaintance of Madoff who has traded options for decades, said “Many of us questioned how that strategy could generate those kinds of returns so consistently.”

Najarian, co-founder of optionmonster.com, once tried to buy what was then the Cincinnati Stock Exchange when Madoff was a major seatholder on the exchange. Najarian met with Madoff, who rejected his bid.

“He always seemed to be a straight shooter. I was shocked by this news,” Najarian said.

‘LOCK AND KEY’

Madoff had long kept the financial statements for his hedge fund business under “lock and key,” according to prosecutors, and was “cryptic” about the firm. The hedge fund business was located on a separate floor from the market-making business.

Madoff has been conducting a Ponzi scheme since at least 2005, the U.S. said. Around the first week of December, Madoff told a senior employee that hedge fund clients had requested about \$7 billion of their money back, and that he was struggling to pay them.

Investors have been pulling money out of hedge funds, even those performing well, in an effort to reduce risk in their portfolios as the global economy weakens.

The fraud alleged here could further encourage investors to pull money from hedge funds.

“This is a major blow to confidence that is already shattered -- anyone on the fence will probably try to take their money out,” said Doug Kass, president of hedge fund Seabreeze Partners Management. Kass noted that investors that put in requests to withdraw their money can subsequently decide to leave it in the fund if they wish.

Bernard L. Madoff Investment Securities has more than \$700 million in capital, according to its website.

Madoff remains a member of Nasdaq OMX Group Inc’s nominating committee, and his firm is a market maker for about 350 Nasdaq stocks, including Apple, EBay and Dell, according to the website.

The website also states that Madoff himself has “a personal interest in maintaining the unblemished record of value, fair-dealing, and high ethical standards that has always been the firm’s hallmark.”

The company’s website may be found here: www.madoff.com/

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