

# Bernie madoff

Finance, Investment



The business world is faced with various ethical issues. Although some never make it to the headlines, there are some that make it to both the local and global news. One such story is that of Bernard Lawrence Madoff, popularly known as Bernie Madoff whose fraudulent activities have had a financial and a human factor impact on the economy of the United States.

Bernie Madoff was a former American stock broker and investment adviser. He was also a non-executive chairman of the NASDAQ stock market and was the founder of Bernard L. Madoff Investment Securities (BLMIS) which he initiated in 1960. He was accused and later on charged with being involved and orchestrating the largest Ponzi scheme. His ponzi scheme has been rated as the largest investor fraud ever committed by a single person. A ponzi scheme is a form of investment operation which is fraudulent in nature because it pays returns to those who have invested from their own money or money that has been paid by other subsequent investors rather than from any actual profit earned (Management Ethics, 2010).

According to the United States District Court of Southern District of New York, Mr. Bernie Madoff had committed unethical business behavior and was therefore charged with eleven counts of fraud all related to his Ponzi scheme. The first charge against him was security fraud. His investment securities Inc. (BLMIS) was a broker dealer which consisted of three types of businesses. They included; market making, propriety trading and investment advisory services. The Madoff Securities International Ltd (MSIL) was a U.

K partner that was involved in trading property. Although these businesses and their activities looked legitimate, they were however unethical. To execute his scheme, Madoff solicited and caused other people to solicit

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prospective clients to open trading accounts with BLMIS. It is reported that on 1st December 2008, BLMIS issued statements to its 4, 800 account holders showing them that they had a total balance of \$64. 8 while in actual fact the firm held only a fraction of this amount.

He erroneously presented his ' split strike conversion' investment strategy claiming that he had put the investors money in common stocks that would impersonate price movements like those of the Standard and Poor's 100 index, which invests from time to time in government-issued securities and buys and sells contracts in stocks. Additionally, in order to give the impression that he ran a legitimate investment business where the funds of clients were actively traded, he created a broad infrastructure.

Many unqualified back office employees were employed who he directed to generate false account statement for the clients and confirmations of trade that reflected fictitious returns and ostensibly showed that the firm was buying and selling securities. Moreover, he directed the transfer of \$250 million from the funds of his investment advisory clients to his making and propriety trading businesses. These transfers gave the false impression that transactions were being conducted in Europe on behalf of the investors.

As such his business behavior can be termed as unethical because he never made any investments but rather deposited them into his business accounts (Management Ethics, 2010). The second unethical behavior was international money laundering to promote specified unlawful activity. Madoff was accused of transferring funds from BLMIS investor accounts in New York to MSIL accounts in London and then later on back to New York. This gave the false appearance that BLMIS was operating a legitimate investment advisory

business where the funds from clients were being used to purchase and sell securities as Madoff had initially promised them.

This was also meant to conceal the fact that no such activities of sale or purchase were actually being made. Additionally from 2002 to 2008 December, he requested more funds to be transferred from New York to MSIL accounts in London. From there these funds were transferred back and used for the purchase and maintenance of property and services for the personal use and benefit of Madoff, his immediate family members and close associates. This money was derived from fraud in the sale of securities and theft from a benefit plan for employees (Voreacos, 2009).

The third illegal business behavior was investor adviser fraud. It was presented in court that from 1980 through to 11th December 2008, Madoff took on the role of an investment adviser for the clients of BLMIS. It was claimed that Madoff intentionally and unlawfully employed devices and schemes such as the use of mails and wire transfer to defraud the existing clients and other prospective ones. As such on 1st December 2008, he sent and delivered through the post office services a fake and fraudulent account statement from BLMIS to a client in New York.

He also transmitted and caused others to transmit via wire transfer \$2 million from investors from Bloomington to New York. Bernie Madoff took money from individuals, hedge and pension funds, trusts, banks and charities. Those who were affected were not only from the U. S but from other countries in the world. Although the list of those who lost is long there are some who suffered huge losses compared to others like Fairfield Green Group, Rye Investment Management and Kingate Global Fund Ltd in Britain.

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Fairfield Greenwich Group is believed to have suffered the highest losses in the Madoff fraud saga.

Out of the \$17 billion invested with Madoff, \$7.5 billion belonged to Fairfield Green Group. Following Madoff's arrest and prosecution, assets belonging to Fairfield Green Group were frozen with the exception of business and normal living expenses. As a result, it is on the verge of losing some of its client. For instance; Benedict Hentsch who had recently agreed to form a merger with Fairfield is now trying to break the deal. In 2010 Fairfield Green group would have collected \$135 million in fees from clients from South America Asia and the Middle East.

Another big loser in the United States was Rye Investment Management which is part of Massachusetts Mutual Life Insurance's Tremont Capital. It is estimated to have incurred a loss of \$3 billion. This \$3 billion included all the money belonging to its clients because Madoff was the firm's sole fund manager. Therefore like Fairfield, the assets belonging to Rye Investment management could also be frozen. Kingate Global Fund Ltd which is a hedge fund run by Kingate Management Ltd incurred losses amounting to \$2.8 billion (Shaoul, 2008). Ponzi schemes usually take a toll on a country's economy.

According to court records, in 2002, such schemes caused a total of over \$9.6 billion in losses. Businesses could have been safeguarded from these devastating events if the government had enforced the existing laws in time. The federal officials are charged with the responsibility of conducting comprehensive and regular examinations of broker-dealers, money managers and investment advisers. If the federal officials had conducted

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these official duties in time, they could easily have identified discrepancies in the operations carried out by Madoff and his investment firm.

A second safeguard could have been transparency. Transparency is carried out with the voluntary disclosure from the industry and regulatory investigation. Nonetheless this seems to have been overlooked in the case of Madoff. Therefore, his fraudulent deals could easily have been uncovered in a situation where transparency existed (CFA Institute, 2010). Private investors have a responsibility to protecting their businesses and money from risks. In the case of the Bernie Madoff Ponzi scheme, there are some key strategies that the investors could have used as espoused by Levitz, 2010.

The first one is checking the background of their financial adviser. In the United States, there are several government and regulatory organizations such as Financial Industry Regulatory Authority, Certified Financial Planner Board of Standards, state insurance and security departments which usually keep the records of the disciplinary history of financial planners and advisers. From the information the investors and even potential investors would have known the qualifications and any disciplinary history of Madoff and his investment firm.

As a result they would have been in a position to make informed decisions about their investments. The secondly safeguard is asking questions about the risk factors involved. Information about the risks involved when investing is available in a fund prospectors. However, it is often presented in a complex way which makes it hard for approximately 70% of investors to

understand. Therefore the investors ought to have sought clarification in much simpler language regarding the risks and benefits of their investment.

For any portfolio allocation strategy being pitched, the investors should have asked the firm to conduct a miniresstest if at all the investment risks were worthwhile. This would have been impossible for Madoff since he was not investing his clients' funds. Eventually his schemes would have been uncovered before they escalated to the heights that they did (Levitz, 2010). Finally, identifying any conflict of interest in the firm is important. The federal law requires financial advisers to act in the best interest of their clients.

However in the case of Madoff, he over-extended his mandate and put his own interest ahead of those of the clients. Those who invested with his firm could have asked questions in a bid to identify whether there would arise the possibility of potential conflict of interest in the long run. Conclusion Madoff's fraudulent activities were a global scheme that trapped charities, individuals and hedge funds and caused financial losses of billions of US dollars and also life as some of those who had invested with his firm committed suicide.

Therefore he eleven counts of fraud for his involvement in the Ponzi scheme. The criminal legal actions taken against him included the scheme to defraud, perjury, money laundering whereby he solicited funds from investors but never invested them As a result he was jailed for 150 years. References CFA Institute. (2010). Investment Fraud. Retrieved June 7, 2010 from [https://www.cfainstitute.org/about/press/release/Pages/01212009\\_16348.aspx](https://www.cfainstitute.org/about/press/release/Pages/01212009_16348.aspx) Management Ethics. (2010). Investment Scandal by Madoff. Retrieved June 7, 2010 from <http://www.>

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