WOLF POPPER LLP

PRESENTATION TO:

Illinois Public Pension Fund Association Midwest Training Conference

IPPFA

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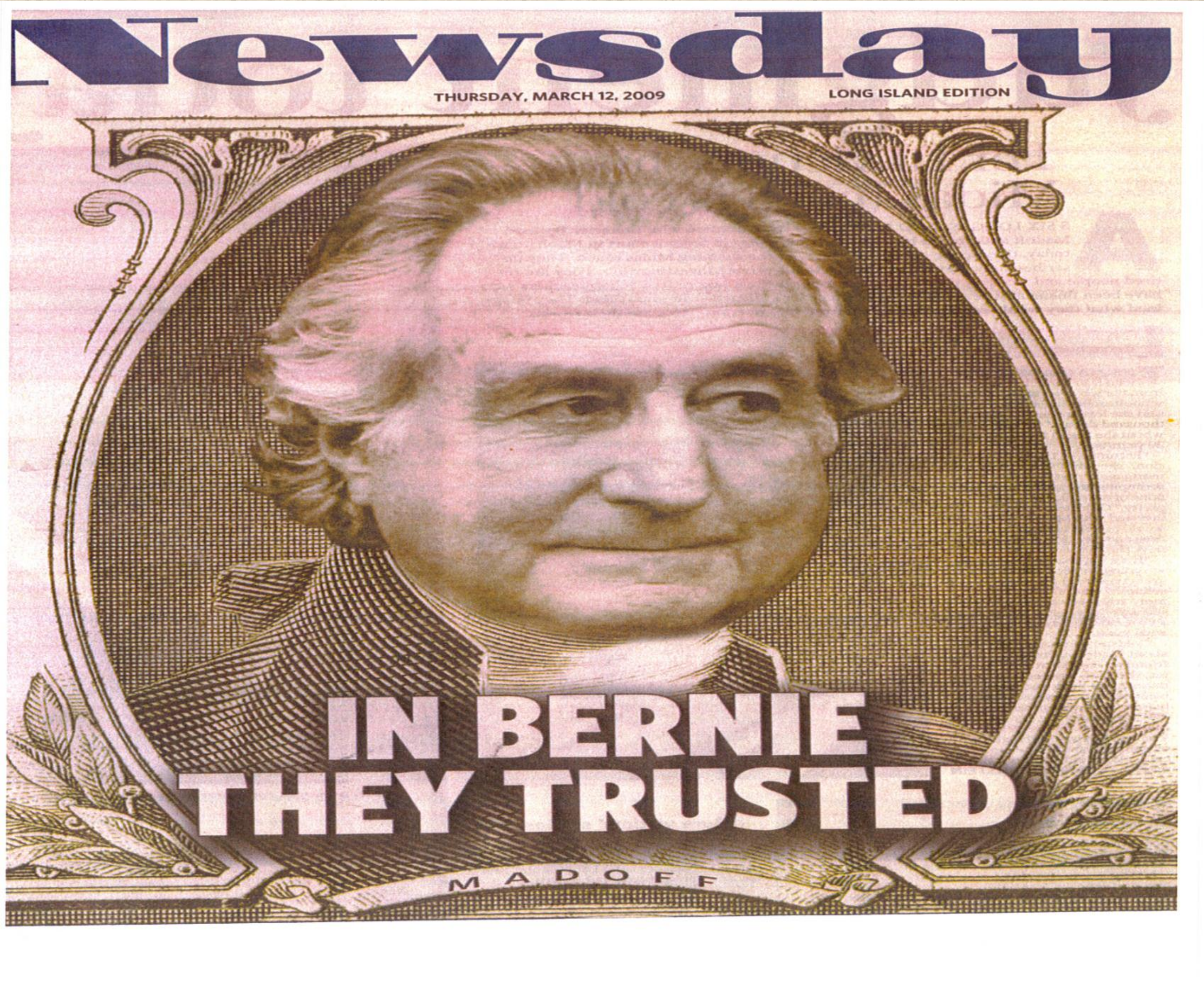
October 8, 2009

Investment Fraud
How Bernie Madoff Made Off With The Money



Who is Bernie Madoff?

- Today's global disgrace was a revered titan on Wall Street
- Madoff helped kick-start the NASDAQ Stock Market in the early 1970s
- He was Chairman of the NASDAQ for 3 years
- His brother – Peter Madoff – was Vice Chairman of the NASDAQ

Who is Bernie Madoff?

- Madoff owned a brokerage firm: Madoff Securities
  - Madoff Securities was involved in 2 primary areas:

1. Market making
2. Investment advisory services

Who is Bernie Madoff?

- <u>Market Making</u>

– Madoff Securities was 3d largest market maker in NASDAQ stocks and active in European and Asian equity markets

– Had 600 major brokerage clients including Charles Schwab, Fidelity Investments, and numerous discount brokers

– It was a billion dollar legitimate business

Who is Bernie Madoff?

- <u>Investment Advisory Services</u>
  - Managed money for wealthy investors and others directly
  - Managed money for “feeder” hedge funds and fund-of-funds
  - This is where ponzi scheme occurred

What is a Ponzi Scheme?

– An investment swindle in which some early investors are paid off with money put up by later investors in order to encourage more and bigger risks.

– Needs ever increasing amounts of new money flowing in the door to pay off old investors as well as the perpetrators of the scheme.

How Did The Madoff Ponzi Scheme Work?

- Madoff attracted investors through direct marketing by himself and his brother, as well as through feeder funds
- Attracted and kept investors through reported “incredible” steady return streams with unusually low volatility
  - Between 1990-2001 Madoff reported positive returns for every year for his largest feeder fund (between 11% – 27%)
  - He reported only 3 down months out of 87 months v. S&P which was down 28 months of the same 87 months
    - Equivalent to a major league baseball player batting .966 over a career
  - Always doing well under all market conditions = impossible
- Sent investors monthly reports showing securities he “purchased” for their accounts during that month

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Madoff Securities I
Mayfai

ENTERED

PERIOD ENDING: 11/30/08

YOUR ACCOUNT NUMBER:

YOUR TAX PAYER IDENTIFICATIO: ******8979

DATE	BOUGHT RECEIVED OR LONG	SOLD DELIVERED OR SHORT	TRN	DESCRIPTION	PRICE OR SYMBOL	AMOUNT DEBITED TO YOUR ACCOUNT
				BALANCE FORWARD		112,319.88
11/12	1,596		1194	WELLS FARGO & CO NEW	29.800	47,623.80
11/12	1,140		1696	HEWLETT PACKARD CO	34.900	39,831.00
11/12	988		5520	WAL-MART STORES INC	55.830	55,199.04
11/12	646		6022	INTERNATIONAL BUSINESS MACHS	87.270	56,401.42
11/12	2,394		9846	EXXON MOBIL CORP	72.880	174,569.72
11/12	2,622		10348	INTEL CORP	14.510	38,149.22
11/12	1,254		14674	JOHNSON & JOHNSON	59.580	74,763.32
11/12	1,710		18999	J.P. MORGAN CHASE & CO	38.530	65,954.30
11/12	912		23325	COCA COLA CO	44.660	40,765.92
11/12	532		27651	MCDONALDS CORP	55.370	29,477.84
11/12	988		31977	MERCK & CO	28.550	28,246.40
11/12	3,610		36303	MICROSOFT CORP	21.810	78,878.10
11/12	1,824		40629	ORACLE CORPORATION	17.300	31,627.20
11/12	722		53607	PEPSICO INC	56.410	40,756.02
11/12	418		54109	APPLE INC	100.780	42,142.04
11/12	3,078		57933	PFIZER INC	16.940	52,264.32
11/12	722		58435	ABBOTT LABORATORIES	54.610	39,456.42
11/12	1,368		62259	PROCTER & GAMBLE CO	64.080	87,715.44
11/12	494		62761	AMGEN INC	59.160	29,244.04
11/12	950		66585	PHILLIP MORRIS INTERNATIONAL	43.600	41,458.00
11/12	2,280		67087	BANK OF AMERICA	21.590	49,316.20
11/12	760		70911	QUALCOMM INC	33.770	25,695.20
11/12	2,470		71413	CITI GROUP INC	12.510	30,997.70

CONTINUED ON PAGE 2

What Marketing Strategies Did Madoff Use To Attract Investors?

- Dazzled them with smoke and mirrors
- Played hard to get (aura of exclusivity)
- Promised low fees (too good to be true)
- Created aura of trust

Dazzled Them With Smoke And Mirrors

- Showed targets “incredible” steady investment results
- Claimed results came from his use of a “Split-Strike Conversion Strategy”
  - This “Hedge” strategy includes 3 components:
    1. Purchase basket or grouping of stocks (e.g. Coca-Cola, Intel, GE) for stock appreciation and dividends.
    2. Sell call options on a comparable # of shares to generate income.
       - An option to buy the shares at a fixed price at a future date
    3. Buy put options (a right to sell shares at a fixed price at a future date) to protect stock portfolio from market price decline.

    Puts and calls create a floor on losses and a ceiling on possible profits.

Dazzled Them With Smoke And Mirrors

- Madoff marketed this “strategy” because most people wouldn’t understand it and would be embarrassed to admit their ignorance.
- In fact, a Split-Strike Conversion Strategy as described was not capable of beating the typical percent return on U.S. Treasury bills less fees and expenses.
- It would have been impossible to employ this strategy with the billions of dollars ultimately invested with Madoff.
  - Not enough OEX index options in existence for the strategy to work
- If questioned about strategy Madoff responded “It’s a proprietary strategy. I can’t go into great detail” and if pressed further “sorry, you need to invest with someone else.”

Played Hard To Get

- Created aura of “exclusivity”
  - He turned away some investors and kicked out others who asked too many questions
  - A new investor had to know someone to be able to invest with Madoff

Promised Low Fees

- Madoff Securities charged **no management fees**!
  - Made money off of commissions from buying and selling securities for investors' accounts

Created Aura Of Trust

- Bernie and Peter Madoff joined numerous wealthy country/golf clubs in the New York City area and Florida and mingled with members creating familiarity and earning trust
- Madoff was extraordinarily wealthy (nearly a billionaire) – penthouse apartment in Manhattan, shares in 2 private jets, and yachts on the French Riviera and in Palm Beach, multiple homes
- Preyed on the Jewish Community (i.e. “we’re one of you”)

How Did Madoff Pull Off The Scheme For So Long?

- The Madoff Ponzi Scheme started in the 1990s
  – Lasted over a decade

. . . How?

1. In typical ponzi scheme style, early investor redemptions were paid out with later investors' money

2. Madoffs were adept at constantly raising new money to keep the scheme going

3. He controlled his auditor. The auditor for Madoff Securities – Friehling & Horowitz - had only **3** employees:

   - A secretary
   - An 80-year old "semi-retired" accountant based in Florida
   - 1 full-time auditor (recently indicted)
     – Auditor was paid approximately $150,000 per year for "audits"

How Did Madoff Pull Off The Scheme For So Long?

4. Clients and feeder funds had no online access to their accounts

5. Madoff claimed to clear his own trades with no external custodian

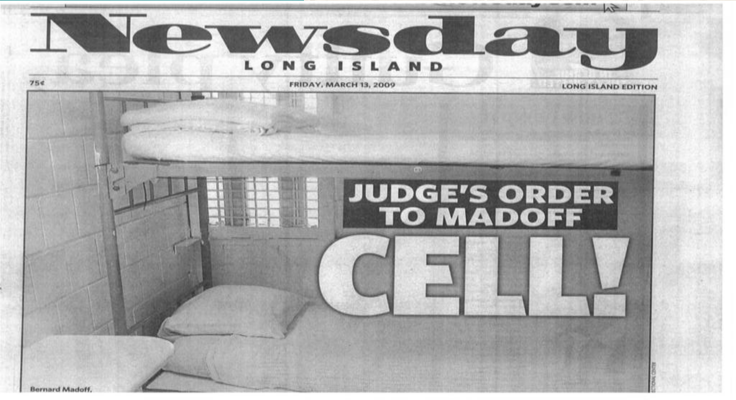
6. Madoff Securities was not registered as an “investment advisor” with SEC until 2006 (only because it agreed to do so after an SEC investigation) meaning its investor advisory services business went unregulated from the 1960s until that time

The Fraud Unravels

- Ironically, the faltering U.S./global economy led to Madoff's downfall
- The ponzi scheme failed when too many investors asked to redeem their money at the same time which brought house of cards down: Madoff ran out of cash
- In December 2008, Madoff "confesses" and turns himself in for what some have called the "most complex and sinister fraud in American History."

Results Of The Fraud

- At the time he turned himself in Madoff allegedly told the FBI his scheme caused losses of **$50 billion!**
- It is now believed that approximately **$20 billion** is more accurate estimation of losses from the scheme
- Notwithstanding the incredible amount of money Madoff raised:
  - Never used the “split-strike conversion strategy” or any other strategy
  - Never purchased any securities; the cash he didn’t steal stayed in a Chase Manhattan Bank account
    - The monthly statements he sent to his customers were completely fabricated and showed bogus transactions



Guilty Plea

- On March 12, 2009, Madoff pled guilty to all 11 counts he was charged with including:
  - fraud
  - perjury
  - theft from an employee benefit plan
  - 2 counts of international money laundering
- The 71-year old Madoff was sentenced to **150** years in prison on June 29, 2009.

Who Were The Victims Of The Scheme?

- Individuals
  - Scheme evaporated life fortunes (some 100% invested)
  - Elderly Retirees
  - Famous people: Stephen Spielberg, Kevin Bacon, Kyra Sedgwick, Elie Weisel
  - At least 2 reported suicides
- Charitable Organizations
  - Columbia University
  - Children's Medical Fund of N.Y.
  - Howard Hughes Medical Institute
  - Police Athletic League
  - Many charities wiped out (i.e. Elie Weisel Foundation)

Who Were The Victims Of The Scheme?

- Trusts
  - Employee Profit Sharing Plans
  - Defined Benefit Plans
- Pension Funds
  - Taft Hartley Funds
  - Public Pension Funds

http://media.miamiherald.com/smedia/2009/02/05/08/MadoffList.source.prod_affiliate.56.pdf

Madoff's Victims / A list of reported victims and their exposure

$7.50 billion	**Fairfield Greenwich Advisors,** an investment management firm
$3.30	**Tremont Capital Management,** the fund-of funds business run by Tremont Group Holdings
$2.87	**Banco Santander SA,** Spanish bank
$1.80	**Ascot Partners,** Hedge fund founded by billionaire investor, philanthropist and GMAC Chief J. Ezra Merkin
$1.40	**Access Intl. Advisors,** a New York-based invest-ment firm
$1.35	**Fortis Bank Neder-land NV,** Dutch bank
$1.00	**Union Bancaire Privee,** Swiss bank
$1.00	**HSBC,** British bank
$0.56	**Natixis SA,** a French invest-ment bank
$0.55	**Carl Shapiro,** the founder and former chairman of apparel company Kay Windsor Inc. and his wife
$3.59 billion	**Other Known Victims**

The Feeder Funds

- Feeder funds did not necessarily disclose to investors that Madoff was managing the Funds' money.
- Feeder funds were paid incentive and other fees to perform **due diligence** and keep an eye on their money manager (i.e. Madoff) which they did not do.
- Fairfield Greenwich alone made more than **$500** million in fees from money given to Madoff.
- Public funds and other investors in Fund-of-Funds unknowingly invested tens of billions of dollars with Madoff and got burned.
- These hedge funds were unregulated.
- Investors have now sued these feeder funds for false statements in offering materials and breaches of fiduciary duties.

What Lessons Can Be Learned From The Madoff Scandal? Can You Avoid Similar Frauds And Prevent Your Fund From Being Caught In The Trap?

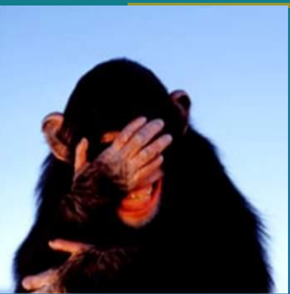
- Madoff scandal teaches numerous lessons to trustees, consultants and other fiduciaries who are charged with investing pension funds.

Lessons — Clichés

1. Don't put all your eggs in one basket.
   – Diversifying portfolio is crucial
2. If it looks too good to be true it probably is.
   – Look out for promises, or "reported" historical results, of steady above-average yields (low volatility in all circumstances)

3. Where there is smoke there usually is fire.
   – Numerous red flags indicating something was amiss with Madoff
   – E.g., if a money manager won't share its investment strategy because it is "proprietary" even if your fund agrees to a confidentiality agreement, pass

Lessons



4. When considering an investment, if you do not understand information being given to you, ask questions. Do not be embarrassed.

5. Beware of exclusive "special" opportunities just for you and your fund.
   - An investment supposedly "closed to others"
   - "Once in a lifetime opportunity"

6. Follow the money
   - Does fee structure create conflicts of interest for your consultants/advisors?

Lessons

7. Do not rely on the Government to stop frauds.

   – The regulatory structures, procedures and institutions in place to prevent crimes like the Madoff ponzi scheme failed.

- As early as May 2000, the S.E.C. was provided evidence that should have caused a detailed investigation of Madoff.

  – SEC was continually provided with information during an 8-year period, including a detailed memo setting forth 29 “red flags” of how Madoff had to be running a ponzi scheme, from a competitor.
  – SEC actually investigated Madoff Securities, found certain technical violations, and forced it to register as an investment advisor in 2006. No other penalty.

- It is now learned that:

  – Madoff was very close with several SEC officials as a Wall St. fixture.
  – Former Chairman of the SEC occasionally turned to Madoff for advice as to how the market functioned.
  – Madoff’s niece, his firm’s compliance lawyer, married a former member of the SEC team that had inspected Madoff’s market-making division’s books in 2003.
  – Madoff also used multiple sets of books to fool regulators.

Lessons

8. If your Fund is investing in an unregulated investment, fiduciaries need to exercise a **heightened** sense of duty requiring extra due diligence.

   – The hedge funds that invested with Madoff were largely unregulated by the government.

   – Fiduciaries must make decisions on an informed basis.

     - Know what you are investing in
     - Know who you are investing with
       – Do a background check (e.g. Agape Worldwide)
     - Use experts who can give you unbiased advice
     - Document all steps you took before you authorized the investment so you can later demonstrate in Court you acted prudently
     - Evaluate the performance of the investment regularly after it has been made

Other Recently Uncovered Frauds

BIOPURE

Lied to investors about its product
- Ex-Exec faked cancer to duck the SEC

Stanford
- Robert Allen Stanford accused of an **$8 billion** investment fraud scheme

BruceKramer/Barki LLC
- Accused of a $40 million ponzi scheme involving foreign currency trading

Agape World Inc.
- A convicted felon engaged in a $400 million + scheme which purportedly went to financing real estate bridge loans aimed primarily at blue collar workers on Long Island, N.Y.

Chinese Warren Buffet
- Toronto-based hedge fund ran a $75 million ponzi scheme targeting members of the Chinese-American community

Bayou Group LLC
- $450 million ponzi scheme

WHAT IS THE SECURITIES FRAUD NETWORK?

- It is a <u>**Free**</u> Service Provided by Wolf Popper LLP for IPPFA Members Only; Endorsed by the IPPFA;
- Wolf Popper **Investigates Potential Legal Claims** Network Members May Have Arising Out of Securities and Accounting Frauds;
- The Network Provides Services to **Help** Your Fund **Recover Losses** From Corporate and Accounting Frauds;

- May **Litigate** on Member's Behalf on a **Contingent Fee** Basis;
- Wolf Popper Will Aid Network Members in Filling Out **Proof of Claim Forms**;
- Wolf Popper Advises Network Members of **Corporate Governance Matters** that May Impact the Holdings of the Securities Network Members' Funds.

What Does Your Fund Need to Do to Join the Securities Fraud Network

1) Sign the agreement to join the IPPFA Securities Fraud Network at no cost. The services provided by Wolf Popper pursuant to the agreement are also free.

2) Obtain from Wolf Popper, and then sign, a confidentiality agreement which ensures that information about your fund's securities holdings remain private.

3) Sign the authorization which allows your securities custodian to give Wolf Popper the data it needs to monitor your fund's portfolio to detect corporate and accounting fraud, as well as relevant corporate governance developments.

SECURITIES FRAUD NETWORK
MEMBERSHIP/RETENTION AGREEMENT

_____________________, 2009

____________________ Fund
____

This letter will confirm that the _____________________ Fund (the "Fund") agrees to have the Fund's securities portfolio monitored for potential legal claims or relevant corporate governance matters. In this connection, the Fund expressly retains Wolf Popper LLP for purposes of providing the aforementioned securities portfolio monitoring services and to be the Fund's securities litigation counsel.

The Fund agrees to arrange for Wolf Popper LLP to receive the last three years of statements reflecting the securities transactions engaged in by, or on behalf of, the Fund. Additionally, the Fund agrees to arrange for Wolf Popper LLP to receive such statements on a monthly or more frequent basis going forward.

The Fund and Wolf Popper LLP have agreed that Wolf Popper LLP will provide the portfolio monitoring services described above free of charge. If the Fund wishes to pursue any litigation or corporate governance matter in the future, Wolf Popper LLP and the Fund will agree to the form of compensation for such services at that time. However, Wolf Popper LLP agrees that if securities litigation is brought and it is retained, Wolf Popper will work on a wholly contingent basis with respect to all legal fees and will advance the litigation-related expenses.

This agreement may be terminated by either party upon 60 days written notice to the other party.

If you agree to the above, please sign your name where indicated below and return this letter to me.

Sincerely,

Chet B. Waldman

AGREED TO ON BEHALF OF THE FUND

By:________________________

CONFIDENTIAL INFORMATION AGREEMENT

The undersigned acknowledge and agree that disclosure of the information relating to the Securities/Trading Portfolio of the _____________ Pension Fund (the "System") to be provided by the System to Wolf Popper LLP ("Wolf Popper") is proprietary. Wolf Popper hereby agrees that the information that the System discloses shall be confidential and for a limited purpose, and that said disclosed information shall not be used nor disclosed to third parties outside of Wolf Popper without first obtaining the Fund's written permission. In connection with its retention, Wolf Popper agrees that those employees at Wolf Popper monitoring the Fund's Securities/Trading Portfolio will consist solely of the attorneys, paralegals and necessary staff of Wolf Popper, and that any and all information shall be kept confidential and used for no purpose other than in connection with the work of Wolf Popper for the System.

Dated: ________________, 2009

________________ Pension Fund
[Address]

By:________________________

Dated: ________________, 2009

WOLF POPPER LLP
845 Third Avenue
New York, NY 10022

By: ____________________
Chet B. Waldman

CUSTODIAN AUTHORIZATION

____________, 2009

TO:

[Custodial Bank]______________
____
[Address]__________________
____

On _________, Wolf Popper LLP was formally retained by the Fund Board of Directors (the "Board") for the purpose of having Wolf Popper perform portfolio monitoring services and act as securities litigation counsel to the Board and the Fund (the "Fund"). The purpose of this letter is for the Board to give the Fund's [Custodial Bank] written authorization for [the Bank] to provide Wolf Popper with access to the Fund's securities portfolio so that its employees can provide the services to the Board Wolf Popper was retained to perform. Accordingly, please either (i) send Wolf Popper (electronically) the Fund's securities portfolio statements on a periodic basis (*i.e.*, daily, weekly or monthly) – Wolf Popper's address is 845 Third Avenue, New York, N.Y. 10022, attn. Chet B. Waldman – or otherwise; (ii) contact either Chet Waldman at (212) 451-9624 or Yuu Kinoshita at (212) 451-9641 so that a link-up between the custodial bank and Wolf Popper can be established.

Thank you.

Sincerely,

_________________ Fund

By:____________________

Title:___________________

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