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WHO'S GUARDING THE HENHOUSE?

While Madoff pulled off the heist of the century, who was watching?

By Julius (Jay) Wachtel. The widow was in disbelief. Her entire trust fund of $29.2 million wiped clean, she had only fond memories of that "lovely" and "thoughtful" New York financial magnate, an honored member and occasional visitor to the ultra-exclusive Palm Beach country club, founded a half-century ago to accommodate those whose ethnicity kept them from getting in anywhere else.

Bernard L. Madoff's business occupied three floors of Manhattan's Lipstick Tower. On the eighteenth and nineteenth floors platoons of traders chugged away buying and selling securities. But the real action was on the secretive seventeenth floor. That's where the former NASDAQ chairman and his assistant, Frank DiPascali, ran an exclusive investment business that earned their well-heeled clients returns of ten to twelve percent year-in and out, as predictably as the tick-tocking of a fine Swiss watch.

On December 11, 2008 two FBI agents appeared on Madoff's doorstep and asked whether he had an "innocent" explanation for the improbable accusations leveled against him by his sons, both principals in the brokerage side of the house. That's when the Baron of Wall Street soulfully admitted, "there *is* no innocent explanation."

Investigators were stunned. Of the seventeen-plus *billion* that should have been in client accounts only three-hundred million remained. Madoff said that everything else had been lost in a decades-long Ponzi scheme in which principal from new suckers was used to pay existing investors. Now that the economy had tanked and withdrawal requests were skyrocketing the jig was up. Madoff's best guess of the total loss? Fifty *billion*, or twice what GM and Chrysler are pleading for to avoid bankruptcy.

Madoff's victims are everywhere. Big losers in Southern California include L.A.'s Jewish Community Foundation, down $6.4 million, and Steven Spielberg's *Wunderkinder*, a charity to which the acclaimed director reportedly contributed $1 million per year. Many Hollywood notables used money managers who invested with Madoff. One, Stanley Chais, faces a multi-hundred-million dollar lawsuit for failing to do due diligence. A respected philanthropist who served with Madoff on several charity boards, Chais complains that he, too was snookered.

In the East the roster of victims includes the Elie Wiesel foundation, named after the Nobel laureate and Holocaust survivor, which lost $37 million, and the JEHT foundation, which supports a host of non-profits including Cardozo law school's famous Innocence Project. (JEHT was wiped out and closed its doors.) Yeshiva University, where Madoff was treasurer of the Board of Trustees and director of the business school, got whacked for a cool $100-125 million. Many New York real estate projects financed or secured by funds entrusted to Madoff are also imperiled. But by far the biggest losers are several externally-owned "feeder funds" that had Madoff manage their assets. One, the Fairfield-Greenwich Group, lost $7.5 *billion*. Another, Ascot Partners, lost $1.8 billion.

And that's not all. Madoff's tsunami also swept through Europe, leaving banks from Spain to Great Britain to Switzerland reeling with losses totaling billions.

How could it happen? All along there were whispers that it was a con game. As early as 1999 a respected Wall Street executive concluded that Madoff's sterling results were bogus and turned him in to the S.E.C. Most who suspected something was amiss guessed, it now seems incorrectly, that Madoff's unusually consistent performance was due to "front-running." If he knew what securities the brokerage side of the house was about to buy, he could acquire them for his investors first, thus temporarily increasing their value. Then when the brokerage placed its bid he could sell the stocks at the inflated price, generating a tidy profit for his clients and a commission for himself.

That's insider trading and illegal as heck. It would have required his sons' help, but so far it seems that they're in the clear. In an interview for a 2001 article, "Madoff Tops Charts; Skeptics Ask How", Madoff denied any improprieties. He attributed his success to a unique system of hedging stock purchases that sharply reduced the effects of market fluctuations. Why didn't he set up his own fund and really rake it in? Um, he was happy working for commission and didn't want to bother.

Shift gears to the violence-ridden decades of the eighties and nineties when LAPD was recovering ten-thousand guns a year. Many were recently purchased. It turned out that some licensed retailers were making big bucks pushing guns out the back door. How could that be? Dealer records were rarely reviewed. And even when inspectors showed up they never compared the books against distributor invoices, allowing unscrupulous sellers to accumulate large quantities of unrecorded guns for illegal resale.

No, guns aren't stocks but the principle is the same. Decades of deregulation have taken the bite out of the dog. In recent Congressional testimony, former S.E.C. Chairman Arthur Levitt complained that politicization and budget cuts curtailed enforcement and demoralized employees. In what the *New York Times* characterized as a "mea culpa," Christopher Cox, the S.E.C.'s current head, angrily accused these same employees of ignoring a decade of warnings about Madoff. Rather than investigate they simply "relied on information voluntarily produced by Mr. Madoff and his firm." Like the ATF inspectors, they accepted the books at face value.

What else might they have done? They could have verified how much capital Madoff really held. Or they could have visited "Friehling & Horowitz," the obscure auditing firm responsible for examining his books. Private financial researchers who did so ran into a middle-aged accountant and a secretary working out of a tiny office in remote New City, New York. That was one of the many reasons they advised their clients to steer clear of Madoff.

No one in the S.E.C. has the power to arrest. That's why an FBI agent signed the criminal complaint. In contrast with ATF, DEA, Customs and Immigration, which house regulatory and criminal investigation functions under the same roof, the FBI and S.E.C. work separately, creating a distance that inevitably inhibits the free exchange of information. Had it been otherwise a savvy agent might have learned of the scheme before it turned into an international catastrophe. In any case, we would be far better served if our battalions of highly-paid auditors and special agents spent their time aggressively ferreting out crime rather than picking up the pieces after the fact. It's simply not good enough to put up a fence after a fox cleans out the henhouse.