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In Echoes Of Madoff, Ponzi Cases Proliferate

By STEVE STECKLOW

Federal and state authorities are reporting a growing number of financial scams that echo the alleged Madoff fraud, as strapped investors seek access to their cash amid increasingly hard times.

At least six suspected multimillion-dollar fraud cases have emerged this month alone, many of them alleged Ponzi schemes, in which investors are lured by promises of lofty returns but are actually paid off from new victims' funds.

On Tuesday, authorities arrested Arthur Nadel, the missing Florida hedge-fund adviser, who was accused by federal authorities of defrauding clients of millions of dollars. His arrest came as Spanish banking giant Banco Santander SA said it would offer thousands of its private-banking clients €1.38 billion ($1.82 billion) in compensation for losses arising from investments in Bernard L. Madoff's alleged $50 billion Ponzi scheme, the first financial company to do so.

Todd Foster, a lawyer for Mr. Nadel, says his client voluntarily surrendered to the authorities and is cooperating with them. He says "we aren't in a position to comment on the criminal charges now," adding that investment "losses don't necessarily equate with fraud."

In the latest case to emerge, Nicholas Cosmo, a Long Island, N.Y., investment-firm owner, surrendered to federal authorities Monday. Mr. Cosmo allegedly raised more than $370 million between 2006 and 2008 by promising investors 48% annual returns from funding commercial loans, according to a federal affidavit in support of his arrest.

But little money was lent, and only about $746,000 remains, according to the federal affidavit. According to his attorneys, Mr. Cosmo intends to work with authorities "to allay investors' concerns." A federal judge in New York's Eastern District ordered him held pending a bail hearing Thursday.

The rise in financial-fraud reports preceded the Madoff case's emergence. A review of recent Securities and Exchange Commission civil actions shows an increase in cases in which the agency alleged Ponzi schemes. The agency, which doesn't keep an official count, brought at least 23 Ponzi cases last year, up from 15 in 2007. It has already filed four in 2009. That tally doesn't include actions on the state level, where allegations of securities fraud are routinely pursued. The SEC declined to make anyone available to discuss its Ponzi cases.

More schemes are emerging now, experts say, in part because of the economic downturn. Tough times have prompted people to seek to cash in their investments, only to find out their money is missing. New investment also dries up in slumps, making it harder for fraudulent funds to replenish their coffers and make the payments needed to keep their operations going.

The recent economic boom may have made some investors especially susceptible to Ponzi schemes and other investment frauds, investigators say. That's because legitimate but secretive hedge funds and other investment firms reported years of strong gains, making eye-popping returns seem more plausible.

"When you have serious economic problems, people who have been content with where their money has been sitting sometimes need it," says Bill E. Branscum, a private investigator in Naples, Fla., who has probed dozens of Ponzi schemes. "And in needing it and in finding out that they can't get it, that serves to reveal Ponzi schemes that may have gone unnoticed."

Three weeks ago, the SEC accused a Philadelphia-area investment fund manager, Joseph S. Forte, with running a Ponzi scheme since at least 1995 that claimed returns as high as 38% and raised $50 million. Mr. Forte didn't return phone calls made late in the day.

Meanwhile, Idaho's securities regulators are investigating allegations by investors in Idaho Falls that they lost up to $100 million in an alleged Ponzi scheme by Daren Palmer, a local money manager. No charges have been filed. Mr. Palmer didn't return phone calls made late in the day.

There was also the case of Marcus Schrenker, an Indiana financial adviser who was arrested in Florida earlier this month after allegedly trying to stage his death in a plane crash as investigators probed his businesses. He faces charges in Indiana and Florida; his lawyer has said Mr. Schrenker isn't mentally competent to stand trial in Florida.

The biggest case, of course, is the one allegedly carried off by New York money manager Mr. Madoff, who has estimated inflicting losses of $50 billion on his investors. Mr. Madoff's attorney, Ira Lee Sorkin, declined to comment.

In scale, all of the SEC's other alleged Ponzi cases pale in comparison with Mr. Madoff's alleged scheme, which lasted for decades. The second-largest SEC case last year, one that the agency says primarily targeted Orthodox Jews, totaled about $255 million, according to SEC records. Excluding the Madoff case, the alleged schemes cited in the past 13 months generated more than $1.1 billion from unsuspecting investors, according to SEC records.

The Ponzi scams alleged by the SEC sprung up all around the country: in Texas, where participants, many of them elderly, invested $45 million in a phony hedge fund that supposedly produced annual returns as high as 61%; in a currency-trading scheme in Georgia which promised returns of 10% a month; in Florida, where two companies raised $30 million by allegedly convincing investors they would earn money by exporting gadgets like Apple iPods to South America. The SEC alleges that the companies purchased few electronics and used "newly invested funds to make principal and interest payments to existing investors."

An attorney for the defendant in the Texas case, Rod Cameron Stringer, had no comment. An attorney for the defendant in the Georgia case, James G. Ossie, said his client "hasn't yet responded to the allegations of the government" but that "he's been cooperating with regulators and wants to make restitution to all his clients." The defendant in the Florida case, Andres Pimstein, pleaded guilty last month to related criminal charges of wire fraud "in connection with a multi-million dollar investment 'Ponzi' scheme," according to the Federal Bureau of Investigation. Mr. Pimstein couldn't be reached for comment.

According to SEC filings, many of the alleged victims in the agency's cases believed they were receiving huge returns from exotic investments, including hedge funds, private placements of securities and foreign notes.

Ponzi operators "always need a disguise," says Robert L. FitzPatrick, a Charlotte, N.C., consultant and expert on Ponzi and pyramid schemes, a similar form of ruse in which investors lure other investors. "It normally includes some kind of rather vague description of the way it earns money." He notes that legitimate hedge funds, which are lightly regulated, generally lack transparency.

The Ponzi scheme's namesake, Charles Ponzi, a Boston-based con man, peddled an exotic investment. Mr. Ponzi raised millions of dollars in 1920 by promising 50% returns in 45 days by exploiting exchange-rate discrepancies in international postal coupons, used to buy stamps. But authorities said he wasn't even buying the coupons; he later pleaded guilty to mail fraud.

In many of the SEC cases, the perpetrators allegedly siphoned off money to fund lavish lifestyles. An SEC civil complaint last year accuses a California investment adviser of using millions of his clients' money "to pay for lavish personal expenses, such as upkeep on his Ferrari, limousine services and shopping trips." The defendant, Robert C. Brown Jr., of Hillsborough, Calif., couldn't be reached for comment late in the day.

The SEC has accused South Florida investment adviser Anthony A. James of misappropriating at least $2.4 million in client funds to buy a six-bedroom home, a Porsche and season tickets to the Miami Heat basketball team. In that case, filed in September, the SEC alleges that between 2001 and January 2008, Mr. James, principal of James Asset Advisory LLC, received at least $5.2 million from about 44 clients who were told their money would be invested in stocks, bonds and mutual funds.

The SEC alleges the money never was invested. Instead, the agency says, Mr. James misappropriated at least $2.4 million for personal expenses. They also say that "like a classic Ponzi scheme," he and his company "transferred approximately $2.8 million from new clients to existing clients to repay principal or to create the illusion of profitable trading."

Bruce M. Lyons, Mr. James's attorney in the SEC case, says his client doesn't dispute the allegations and that he's "trying to arrange to make everybody who was involved in the transactions whole."

—Philip Shishkin and William M. Bulkeley contributed to this article.

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