Madoff Video Transcript

Segment 1 (0:00)

Bernard Madoff managed to make $50 Billion of investors' money from around the world and make it vanish into thin air.

Lipstick Building, NY: The scam took place here, in New York.

But Madoff wasn't always so affluent.

Far Rockaway, Queens: His career began as a lifeguard in 1960.

Here he made $5,000 ($35,000 today), which he used to start trading stocks.

Miami Beach: Madoff made his way to richer areas… to attract richer clients with more cash.

The Pink Sheets:

Madoff's new business dealt with the National Quotation Bureau.

This business was no competition to those trading on the New York Stock Exchange.

To beat his competition Madoff made use of computer technology.

This technology eventually became the foundation of the modern NASDAQ Stock Exchange.

(1:01)

Segment 2 (1:02)

Investment: Madoff invested money in stocks.

Profits: When the stock price increased he made a profit.

Losses: But when the stock prices fell he lost money.

Madoff wasn't making the big money he wanted.

Palm Beach: So Madoff chose rich Country Clubs to find richer investors.

He became part of these clubs' close community, and befriended them to gain their trust.

Clients fell for his charisma and charm.

…and handed over large sums of money, on Madoff's promise of 10% profit every year.

Hedge Fund: this was the beginning of Madoff's *hedge fund*.

10% Consistently: Madoff gave clients 10% back on their investment every year, without fail.
This was incredibly attractive, and impressive, given the instability of the *stock market*.

Collar: Madoff said he achieved this consistency using a "collar" method to limit gains and losses.

Rights to Buy and Sell:
By selling and purchasing the rights to buy and sell stocks at a fixed price
…the gain and loss due to fluctuations in the actual price of the stock can be constrained.

But This Didn't Add Up:
Even using this collar method there was no way Madoff could achieve the consistent 10% gains.
(2:23)

Segment 3 (2:24)
Secrecy:
Madoff's *Hedge Fund* was shrouded in secrecy.

The 17th Floor:
Operating from the 17th floor of the Lipstick Building, only a dozen employees were involved.
The floor was isolated from the rest of the company.
And the computer producing the statements was an old IBM in the corner.
It wasn't connected to the rest of the company network.
And to avoid leaving a digital footprint all the client's statements were printed on paper only.

So What Was Madoff Doing?
Well there'd be only one way of providing consistent 10% returns.

Imagine if a client gave Madoff $1,000,000.
Madoff could now just give back $100,000
But after 10 years, he'd have given the investor back all his money.
And in the 11th year, he has no more money to make the yearly payment.

Withdrawals:

Worst of all, when the client asks for his $1,000,000 back (which he can do at any time)…
Madoff would have to admit that it no longer exists…
As he's used it up to make the client's own yearly payments!

The Scheme Would Make No Profit:
…despite lasting for 10 years undiscovered.
(3:44)

Segment 4 (3:45)
So Madoff used a classic trick…
To be able to continue to make the payments year after year.
…Madoff would require further income from alternative sources that would cover this expense.

Question: Where might this income come from?
Answer: Another Investor.

The cash coming in from another investor…
Could be used to make the payments to the first investor.

Question: But how do you make the yearly payments to the second investor?
Answer: Yet another investor.
And to pay him a further one.

In this scheme, the cash from each new investor is used to pay back the older investor.
100% of everyone's money is being used to pay everyone's 10% yearly "return."
Each investor's 10% "gain" is another investor's 10% loss. All the money is slowly burnt up.

Ponzi Scheme:
This is known as a Ponzi Scheme.
But such schemes usually collapse after one year.
(4:50)

Segment 5 (4:51)
So how did Madoff keep his Ponzi Scheme going for 20 years?
To keep a Ponzi Scheme going you need…

Avoid Withdrawals: Avoid investors who are going to want their money back soon.

Continual Investment: lots of investors willing to keep investing.

Don't Get Caught: Don't let any financial authorities work out your game.

Madoff achieved the latter by using a small, unknown company to do his auditing.

Friehling and Horowitz did not need to register as auditors as this law was not present in New York.

Madoff's secrecy also prevented detection.

Indeed, Madoff refused clients who asked too many questions.

"Velvet Rope": This built up a sense of "elite" that attracted investors to Madoff's fund.

Communities: Combined with his focus on clubs and communities, this ensured a steady stream of new investors.

Charities: Last, Madoff focused on investment from charities, such as that of Steven Spielberg. Due to the financial structure of a charity, they very rarely needed to make withdrawals.

The Credit Crunch: Then came 2009, the global economic downturn, and the beginning of the end for Madoff.

Huge numbers of Madoff's investors needed to make withdrawals due to the economic climate.

But of course, their money wasn't there.

$50 Billion had been vaporized.

...and Madoff once chairman of the NASDAQ…was finished.

(6:25)