The Motley Fool
Fool.com

Previous Page

A Simple Plan: How Allen Stanford Stole $7 Billion

http://www.fool.com/investing/general/2012/07/06/a-simple-plan-how-allen-stanford-stole-7-billion-.aspx

Matt Koppenheffer
July 6, 2012

This is part two of a four-part series on the crimes of global financier Allen Stanford. For part one of the series, click here.

If Ponzi scheme mastermind R. Allen Stanford manages to live to 169 years old, he may see the world as a free man again.

As far as Ponzi schemes go, Stanford's was massive. To put it in perspective, the fraud's namesake, Charles Ponzi, ran a con in 1920 that cost investors around $20 million -- or roughly $225 million in today's dollars. That's small potatoes. In the late 1990s, a $1.2 billion Ponzi scheme failure in Albania led to riots and lawlessness across the country. More recently, Petters Group Worldwide founder Tom Petters had a good run with his $3.7 billion fraud that unraveled in 2008.

And Stanford's rake? A cool $7 billion. That puts him right up there with the much-despised Bernie Madoff as one of the worst financial felons of all time.

A simple plan

For such a staggeringly large fraud, Stanford's scam itself wasn't anything out of the ordinary. It was actually dead simple. Promise high returns on a no-risk investment. Justify the rates with a plausible story. Create fake financial reports to hide the fraud. Rinse, repeat.

Through the various U.S. and global affiliates of Stanford Financial Group, Stanford's legions marketed certificates of deposit from Stanford International Bank, the group's Antigua-based bank and the seat of the fraud. Stanford CDs offered the promised-land combination of rock-solid security and above-market returns. To supercharge sales, Stanford Financial lured investment advisors with big books of business by paying 1% commissions based on the face value of their CD sales.

Stanford Financial marketing materials claimed that the investors' CDs were backed by safe, secure investments. The bank was supposedly able to pay out above-market rates because it was in a low-tax haven and maintained minimal overhead. With help from James Davis, Stanford's college roommate, and others, Stanford backed up these claims with fudged financial statements.

But where did investors' money actually end up? According to the Department of Justice's indictment of Stanford, about 9% of the $8 billion in assets was in cash and highly liquid investments. Another 10% was invested with private equity and other managers outside of Stanford International Bank. The rest, however, was reported as part of the "Tier III" assets that were managed directly by Stanford and Davis. Around $3.2 billion of that was sunk into what the government termed "artificially valued real estate" and another $1.6 billion consisted of loans to Sir Allen Stanford. As for the rest of the $2 billion-plus supposedly in the Tier III assets, well, it's unclear exactly where that ended up.

An offshore drilling

If there was any twist of genius in Stanford's execution, it was planting the heart of his international fraud in lightly regulated Antigua. Leroy King, the former head of Antigua and Barbuda's Financial Services Regulatory Commission, may have been of particular help in keeping Stanford International Bank out of hot water by turning a blind eye to management's misdeeds. He is currently fighting extradition to the U.S. over bribery accusations.

However, it's a wonder that bribery was even necessary.

Stanford was so powerful and well regarded that when Antigua wanted to reform its banking laws in the 1990s it put him in the driver's seat. When the new rules were written, Stanford was named to the very regulatory body charged with overseeing his bank. By 2004, the Antiguan government had loans outstanding from Stanford Financial to the tune of $87 million and it had helped bankroll a new hospital complex for the island. More broadly, Stanford's presence in Antigua was singlehandedly changing the economic trajectory of the small island.

Then there was cricket -- the Stanford Cricket Ground, the Stanford Superstars, and, of course, the millionaire-maker Stanford Super Series.

It wasn't just Antigua that was on the receiving end of Stanford's funny money. In the 10 years prior to being indicted, Stanford spent $7 million on lobbyists and campaign contributions in the U.S. as he sought to ply members of Congress and loosen U.S. regulation of offshore banks. Senators John McCain and Chris Dodd were among the top recipients of Stanford's largesse.

In fact, so sold were American politicians on Stanford that then-President George W. Bush sent a letter to Stanford Financial Group that praised the company's efforts: "To protect their future well-being and that of their families, it is important for individuals to give careful thought to strengthening their financial security. By providing investment and wealth management services, companies like yours are helping more Americans build a solid foundation for the future."

We know now that what Stanford was actually doing was the exact opposite -- he was cheating American families and robbing them of their financial future. In fact, while Madoff's massive fraud largely targeted wealthy individuals and institutions, Stanford's scheme preyed on many less-well-off, working-class families and retirees. And it was all possible through an unbelievable failure by the U.S. Securities and Exchange Commission. To continue with part three of the series, click here.

Previous Page