



# Lessons from PFGBest scam

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# The fraud

- Russell Wasendorf owner of a brokerage firm Peregrine Financial group Iowa admitted to stealing \$200M of customer funds over 20 years
- He had been cooking his books for 32 years and showing higher bank balance in customer accounts to the Regulators than what was really available
- This was to hide losses he made in the part of Peregrine that sold commodity options and futures.
  - One more firm which has burnt itself in the options and futures arena.



# The man

- 64 years old
- A Pillar of his community
- Corporate jet
- Lavish lifestyle
- Many homes
- PFGBest's headquarters a \$18 million complex that included day-care, a four-star cafeteria and state of the art geothermal climate control.
- Charitable contributions galore!

# MODUS OPERANDI

- SIMPLE forging/ fudging of bank statements !
- Made himself the sole point man for all bank documents
- Received bank statements himself; no one ever saw the real statements!
- He used computer software, scanners and printers to "make very convincing forgeries of nearly every document that came from the bank," including statements, letters and other correspondence. He made them very fast too!
- Rented a Cedar Falls postal box and told NFA Regulator, National Futures association) it belonged to US bank
- NFA/Auditors mailed confirmation requests to postal box (!)
- He would take the forms and fill in fake nos and send them back!
- He showed that bank accounts had hundreds of millions of dollars -(he said he had \$225M but actually he had around \$5M)

# How did the fraud come to light?

- NFA pressed Peregrine to adopt electronic reporting
- That meant he could no longer do doctor statements and confirmations!
- He decided to commit suicide and wrote a note; hooked a tube to the tail pipe of his car
- He did not succeed
- He was found unresponsive in his car in which he had attempted suicide
- Arrested in hospital

# Even extra vigilance after MFglobal did not help!

- In January 12 the CFTC and the National Futures Association (NFA) conducted an industry-wide review of the 70 largest futures commission merchants to reassure futures customers.
- The CFTC/NFA found no "material breaches of customer funds protection requirements."
- This was not a full blown audit though (Done by NFA)
- CFTC admitted it had limited funds to do a proper supervision

# Interesting parallels to Bernie Madoff fraud

- Done for many years
- Both were virtually one-man companies with blunt total authority
  - Their way was one way – what is called ‘my way or the highway’
- Like in Madoff case, his own family did not know about this though employed in the Company
  - Wasendorf's son, Russ Wasendorf, Jr., the company's president and chief operating officer did not know himself!
- Both were pillars of their small community and very well respected
- Both were geniuses at deception- Madoff used to use different color pens to give the impression the paper work was done by different people at different times
- Both had small time auditors- PFG Best auditor address was a modest home and he was a one man show as was the case in Madoff case
- Big EGO made it impossible for them to take corrective action so they continued on and on

# Interesting parallels to Parmalat/Satyam

- Bank statements and confirmations were forged in all these frauds
- Photoshop, scanners and laser/ inkjet printers have been handy tools to provide authentic looking statements/confirmations
- All were **paper** based statements/ confirmations
- Were able to fool authorities/ auditors for many years!

# Regulations in the offing /being looked at after MFGlobal

- Brokers will be prohibited from conducting 'in house' repurchase transactions
- Restriction on investing customer moneys in foreign sovereign debt
- Margins to be held customer by customer making it easier to bail out companies that have disasters
- Separate records to be kept of the cleared swaps of each individual customer and relevant collateral- CFTC looking to apply that model to futures too
- The model of European regulators who give customers the option of varying levels of segregation being looked at
- Also being looked at is creation of fund for futures customers similar to Securities Investor protection corp. which guarantees customer investments up to \$500k

# Lessons from PFG Best

- Text book case of ‘Management override of controls’
- Any place where the CEO/Chairman personally shows too much interest in concentrating many crucial things to himself or his cronies should raise a red flag –as it happened in Satyam too
- Once you start manipulating it is like ‘riding the tiger’ (a famous Raju quote in Satyam)- there is no stopping
- Unknown auditor is a sure red flag especially for a \$500M company–PFG Best auditor was a firm named “**Veraja-Snelling Company**”!
- Most frauds are not new –some version of them has happened before somewhere in the world
- But no lessons are learnt!

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