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Madoff: Layers and Layers of Players

How a far-flung cadres of unregulated securities firms, investment managers—even doctors and lawyers—helped pull unwitting investors into the disgraced money manager's orbit

By Matthew Goldstein and Peter Burrows

The alleged fraud of Bernard Madoff has put the heat on so-called feeders, the giant hedge funds that funneled more than $20 billion to the now-disgraced money manager. But it turns out those players depended on another group of smaller funds and individuals to gather money in what looks like the Wall Street equivalent of a Russian nesting doll. The largely unregulated crowd, including accountants, lawyers, investment managers, even doctors, opened the exclusive world of hedge funds to more investors—and charged exorbitant fees for the privilege.

The sprawling network of individuals and tiny funds, which operates across the entire hedge fund industry, presents a challenge for securities regulators as they consider crafting new rules for this huge slice of the investment world. It's not merely a matter of keeping tabs on 10,000 hedge funds but also on the myriad players on the margins—a far more costly and onerous task. "Sometimes there's no better place to hide than in plain sight," says Bill Singer, a lawyer and former regulator.

The supporting cast in Madoff's alleged scheme is an extreme example of the industry's excess. Everyone wanted a piece of the action. A caddie in the Jupiter (Fla.) area purportedly referred golfers for a fee to firms that invested with Madoff. Donna McBride, a Boca Raton (Fla.) retiree, sank $700,000 into a fund managed by two practicing lawyers in White Plains, N.Y., Joel Danziger and Harris Markhoff. Many investors had no idea what they were buying since marketing documents rarely mentioned Madoff by name. A spokesman for the lawyers says the fund operated independently of their firm.

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The system allowed investors to gain entrée to Madoff with far fewer dollars, thereby expanding his clientele beyond big institutions and billionaires to wealthy individuals of more modest means. Consider the $175 million FutureSelect Prime Advisors II, which plowed its assets into Tremont Group's Rye family of funds, which channeled money to Madoff. Investors in FutureSelect needed to pony up only $250,000, compared with the $500,000 required by Rye and most large feeder funds. Over the years, some firms lowered that bar to as little as $50,000. "A lot of small investors got exposure to Madoff through subfeeders," says Reed R. Kathrein, a lawyer who's representing alleged victims of Madoff. FutureSelect didn't return calls for comment.

Fees were collected at every level. Here's one feeding chain: Commonwealth Financial Network, a group of