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Editorial: Lawmakers should reject fund for FRM victims

By
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It is not the responsibility of state taxpayers to make victims of the $33 million FRM Ponzi scheme whole. The Senate should reject Senate Bill 180, a proposal by Republican Senate President Peter Bragdon and Democratic Sen. Lou D'Allesandro to create a "recovery fund" that would use $3 million per year in tax dollars to compensate the scam's 250 investors. That's $3 million that would not be available to meet a host of pressing needs.

It's true, as claimants contend and repeated investigations concluded, that the state regulatory agencies involved – the Department of Banking, the Bureau of Securities Regulation and the attorney general's office – did not acquit themselves admirably when it came to the scheme operated by Scott Farah and Donald Dodge. They acted like the "see no evil, hear no evil, speak no evil" monkeys and failed to heed repeated signals that what Farah was running was not a legitimate investment vehicle but a con game.

The bill's sponsors believe that the state's bungled response to FRM's violation of banking rules means that the state should reimburse the victims. We disagree. Government entities, and the people they employ, make mistakes and by law aren't liable for them when made in the course of carrying out their official duties.

Governments wrongly deprive people of their liberty, and sometimes of life itself. They fail to perfectly protect the food citizens eat and the medications they take. They surely didn't protect the tens millions of people who lost vast sums due to lax federal oversight of the financial industry.

Ponzi schemes are perennial. A website run by Los Angeles lawyer Kathy Bazoian Phelps, theponzibook.blogspot.com, lists dozens of recent similar scams. And just this week, the Boston Globe reported on an alleged multi-million-dollar scam a couple is charged with running out of offices above their West Roxbury ice cream store. The people bilked in such schemes are invariably investors who are willing to accept a high degree of risk to receive high returns. It should not be up to taxpayers to cover the bets when gamblers lose. Doing so would also create a "moral hazard," an increased willingness to make risky bets that betters can lose and taxpayers can't win.

It's common for the victims of Ponzi schemes to sue regulators for missing warning signs they should have seen, hoping for similar compensation – but these are not winning cases. Last month, the federal Ninth Circuit Court upheld a lower court ruling denying victims of Ponzi schemer Bernard Madoff the right to sue the Securities and Exchange Commission for failing for more than two decades to stop the scheme. Even under the federal Tort Claims Act, which permits some lawsuits against government, agencies are protected from suit for negligence, incompetence or simply being wrong when carrying out discretionary duties, the court said. Federal agencies should have caught on to Madoff far sooner, but they used their discretion when deciding who, if anyone, merited a closer look. The same was true with state officials and FRM.

There will be more Ponzi schemes, and the problems the FRM debacle brought to light still must be addressed. Financial instruments have become more complicated and opaque, making it hard to determine just which agency should regulate them. Combining the banking, securities regulation and insurance regulatory functions under a single agency would allow better communication, a concentration of expertise and a decreased likelihood that future FRMs will occur. That's the kind of legislation lawmakers should be working on instead of an investor bailout.

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