Pending bank settlement raises questions of timing ; Court documents show Republic executives suspected fraud 17 months before alerting regulators: [FINAL Edition]

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Abstract (summary)

[William Rogers] came to Republic from Prudential Securities, where he handled some of [Martin Armstrong]'s accounts. At Prudential, Rogers allegedly conducted unauthorized trades and lost money in Armstrong's accounts over a 2- to 3-year period, according to transcripts of tape- recorded conversations between Armstrong and Rogers, which Armstrong was compelled to turn over to regulators.

Heavy trading in Armstrong's Prudential accounts triggered a review. Prudential's background check turned up Armstrong's personal bankruptcy records and his long-running clash with the Commodity Futures Trading Commission (CFTC), among other questionable activities, according to a letter Armstrong sent to Prudential responding to its allegations. Armstrong gave a copy of the letter to USA TODAY.

His marketing materials included his resume, which embellished his qualifications. It said, "Armstrong . . . has been studying market behavior since 1962." In fact, he was 13 years old in 1962. It also said, "Armstrong holds a degree in Computer Science and Engineering." In fact, Armstrong completed a 2-year program at RCA Institute, a technical school in Cherry Hill, N.J. His resume also stated, "He was chairman of the foundation for the Study of Cycles." Under Armstrong's watch, from 1993-98, the foundation's endowment was depleted, and Armstrong was sued for taking the foundation's research collection and other assets and refusing to return them.

Full Text

NEW YORK -- The U.S. Attorney's office and HSBC Bank USA are expected to announce soon one of the biggest corporate criminal settlements in history, as potentially damaging details come to light in one of the largest securities fraud cases ever, people familiar with the situation say.

HSBC, the giant bank that acquired Republic National Bank of New York 2 years ago for $10 billion, is finalizing an agreement in which the bank is expected to pay more than $700 million in restitution to Japanese investors who were allegedly defrauded by one of Republic's largest customers, a market guru named Martin Armstrong.

David Brodsky, a lawyer for HSBC, says, "Discussions (are ongoing) to resolve the regulatory and U.S. Attorney's investigations and may encompass a settlement of some of the" claims filed by Japanese investors. "There has been progress in those discussions, but there is no assurance that a resolution will be achieved."

It has been widely known for 2 years that Armstrong is accused of using his accounts at Republic to defraud Japanese investors out of $1 billion.

What hasn't been public, until now, is that federal investigators have been gathering evidence that Republic executives suspected the scheme 17 months before they alerted regulators and the FBI raided Armstrong's money management firm, Princeton Economics International.

Meanwhile, HSBC is clearly preparing for a settlement. Wednesday, it reported a third-quarter loss of $167 million -- largely because of a $575 million reserve to pay for an "anticipated resolution" of the regulatory and criminal investigations and a class-action investor lawsuit. Last year, the bank put $79 million in reserve.

Now, Armstrong -- who was jailed in January 2000 for defying a court order to turn over gold coins, antiques and other corporate assets -- could face additional charges of money laundering, Steve Glaser, an assistant U.S. attorney, said in a summer court hearing.

Armstrong raised more than $3 billion from Japanese firms by selling them bondlike investments, prosecutors say, promising to put the money in separate accounts at Republic and invest it in U.S. government-backed bonds. Instead, prosecutors allege, he made risky bets on gold, currencies and stocks. As he lost money, he used new investors' cash to pay back old investors, prosecutors say.

Alarms at Republic first sounded in April 1998. An internal review of Republic's securities division focused on Armstrong's accounts, which had sustained $330 million in losses. Investigators found "incorrect practices of combining margin account balances" for separate accounts and "documentation errors" in opening accounts for Armstrong's investors, according to a copy of the review filed in U.S. District Court.

Looking at the accounts, which represented 90% of Republic's securities business, Peter Kimmelman, chairman of the credit review committee and a director of the bank, said he was "skeptical and suspicious of the whole set up. It looks like a Ponzi scheme," according to minutes of an October 1998 committee meeting.

Almost a year later, as Armstrong's financial empire was under siege by regulators in Japan and the USA, Kimmelman sent a handwritten note to the chairman of Republic, saying that it appeared Armstrong "commingled and used client money to 'goose up' fixed income returns promised to Japanese. I suspect that when markets went against him, it was converted into a pyramid scheme. . . . His structure of running several hundred entities as explored by our Credit Review Committee in spring 1998 can only be understood in the context of a pyramid."

Kimmelman, now a director at HSBC and head of New York money management firm Kimmelman Asset Management, did not return calls for comment.

But Brodsky says, "We disagree with (the investors') characterization of the facts" portrayed in these recently filed court documents.

Red flags at Prudential

Republic might never have heard of Armstrong or Princeton Economics if the bank hadn't hired William Rogers in 1995 as a manager in its securities division.

Rogers came to Republic from Prudential Securities, where he handled some of Armstrong's accounts. At Prudential, Rogers allegedly conducted unauthorized trades and lost money in Armstrong's accounts over a 2- to 3-year period, according to transcripts of tape- recorded conversations between Armstrong and Rogers, which Armstrong was compelled to turn over to regulators.

"I owe you at least 50 grand, right?" Rogers said in one conversation, adding, "I get (sic) myself into a hole and then I got deeper in it. . . . And then I thought maybe if I, I told you everything I was doing, we could work it out. A thousand dollars a day or something I could bang out and make it up that way, but you, you didn't want to go that way." Rogers and his attorney declined to comment for this article.

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A spokeswoman would only say that Prudential asked Armstrong to take his business elsewhere. So Armstrong's accounts and Rogers moved to Republic.

Armstrong's history is full of inconsistencies and contradictions. In dozens of interviews with USA TODAY, Armstrong's conversations blurred fact and fiction.

Armstrong, 51, was born and raised in New Jersey. His father was a lawyer, and his mother was a homemaker. His first job was at a gold coins and bullion shop, where he became fascinated by rare coins and stamps. He boasts he became a millionaire at age 15 by selling rolls of rare Canadian pennies for $600 apiece.

A few years later, his business practices came under fire when he started selling rare postage stamps. In 1972, when Armstrong was 23, he was expelled from a prestigious stamp collectors' group, the American Philatelic Society, because customers complained he did not fill their mail orders or refund their money.

He disputes that, saying he was expelled because he was "running a business and I wasn't 21."

Armstrong went on to write three stamp-collecting books, then turned his love of coins and precious metals into a commodities-forecasting newsletter.

But in 1985, the Commodity Futures Trading Commission, the federal agency that regulates commodities markets, filed a complaint against Armstrong because he wasn't a registered commodity advisory. Two years later, the CFTC filed another complaint against him, charging him with receiving kickbacks.

"They hit me with that subpoena to force me to turn over all my lists of clients, worldwide, which I denied," Armstrong says. "Then they went to the FBI and accused me of mail fraud, saying that I was selling subscriptions and not giving them to some. I was then raided by . . . FBI agents." He calls the claims of mail fraud "total BS." He was never prosecuted for mail fraud.

About the same time, the state of New Jersey went after him for failing to collect sales tax on gold bullion sales, and the IRS raided his offices for not keeping records on bullion purchases and sales over $10,000.

In September 1987, Armstrong had $4.4 million in debt, including $2.7 million in unpaid taxes; he was about to lose his home through foreclosure. He filed bankruptcy, claiming his only assets were $350 in cash, a gold ring and worthless stock in his company.

While Armstrong's estate was liquidated, he continued to fight the CFTC. Blacklisted by the agency, Armstrong incorporated his company in the Turks and Caicos Islands to avoid many U.S. laws and taxes and started selling bondlike products to Japanese investors, mostly small and midsize companies.

His marketing materials included his resume, which embellished his qualifications. It said, "Armstrong . . . has been studying market behavior since 1962." In fact, he was 13 years old in 1962. It also said, "Armstrong holds a degree in Computer Science and Engineering." In fact, Armstrong completed a 2-year program at RCA Institute, a technical school in Cherry Hill, N.J. His resume also stated, "He was chairman of the foundation for the Study of Cycles." Under Armstrong's watch, from 1993-98, the foundation's endowment was depleted, and Armstrong was sued for taking the foundation's research collection and other assets and refusing to return them.

Armstrong says he has never seen the resume.

Financial woes did not appear to slow Armstrong.

In 1993, 3 months after Armstrong emerged from bankruptcy, he used a newly minted company named Princeton Economics to buy a $1.2 million house on the New Jersey shore. He also used company funds to purchase rare coins, antiques and gold bars. Princeton Economics paid for his car, a car for his son and a horse for his daughter, both of whom worked at the firm, according to company records filed by a court-appointed receiver.

Armstrong's live-in girlfriend also worked as his secretary and bookkeeper. Although the girlfriend was a paralegal by training and had no prior financial experience, she was responsible for keeping track of hundreds of investor accounts and billions of dollars.

Armstrong claims his computer model, based on centuries of cyclical data on everything from gold prices to weather patterns, could forecast the economy and commodity and stock prices. So powerful were its predicting powers, even the FBI wanted to get its hands on it, Armstrong says.

But something went wrong. Between November 1997 and August 1999, he lost $368 million gambling on moves in the Japanese yen and the Standard & Poor's 500-stock index, according to prosecutors.

Japanese investors heard rumors of the losses and began to get nervous. That's when, prosecutors allege, Armstrong tried to hide his losses. Armstrong sent investors letters, signed by Rogers, then- president of the futures division at Republic, that falsely stated the amounts in the accounts and claimed the money was invested in safe, U.S. government-backed bonds.

Kankaku Securities, for example, received a letter on Republic letterhead dated April 1998, saying the value of one of its accounts was $4,229,603. The actual balance was $3,786,636, court documents say.

Armstrong blames Republic for the discrepancies between the amounts in the accounts and in the letters. "I wasn't really involved in (sending those letters). I was on the road most of the time," he says. "I do know they (Republic) screwed up the accounting very significantly." HSBC's lawyer declined to comment.

A 10-day gap

In May 1999, a huge international bank, HSBC (known in the early 1990s as Hong Kong & Shanghai Bank), struck a deal to acquire Republic. Today, Republic is owned by HSBC's U.S. subsidiary.

Two weeks after the deal was announced, Japanese regulators raided Armstrong's Tokyo offices. As they combed through boxes of records and interviewed employees, they became increasingly concerned.

On Aug. 18, 1999, they sent a letter to James Sweeney, chief executive of Republic's securities division and Rogers' boss. They asked if the Japanese investments were safe and in separate accounts.

Before alerting the U.S. Attorney's office, Republic took almost all of the cash left in Armstrong's accounts to cover his trading losses, according to documents filed in the SEC's case. In the end, only $58 million remained to repay investors, court records say.

Ten days after receiving the letter from Japanese regulators, Republic alerted U.S. regulators.

The FBI raided Armstrong's offices in Princeton, N.J., and quickly charged him with securities fraud.

The scandal threatened to derail the HSBC acquisition. So the late founder of Republic, Edmond Safra, cut his asking price by $450 million to cover potential liabilities for HSBC.

Now, almost 2 years later, Armstrong sits in jail and HSBC is close to a deal that will pay back Japanese investors. But the questions about what Republic executives knew, and when, remain unanswered.

TEXT OF INFO BOX BEGINS HERE

Timeline of events involving Martin Armstrong, investment questions

1991: Armstrong begins marketing investments to Japanese investors.

1995: Prudential Securities closes Armstrong's accounts after heavy trading in the account triggered a review. Armstrong takes his business to Republic National Bank's securities division.

April 1998: An internal review at Republic raises red flags about Armstrong's $330 million trading losses, as well as "incorrect practices of combining margin account balances" for separate accounts and "documentation errors" in opening accounts for Armstrong's investors.

October 1998: The chairman of Republic's Credit Review Committee, after reviewing Armstrong's accounts, says he is "skeptical and suspicious of the whole set up. It looks like a Ponzi scheme," according to minutes of a committee meeting.

January 1999: Armstrong starts sending letters to worried Japanese investors assuring them that their money is safe and held in separate accounts at Republic. The letters are signed by William Rogers, president of Republic's futures trading.

May 9, 1999: HSBC announces a deal to buy Republic for $10 billion.

May 24, 1999: Japanese securities regulators raid Armstrong's offices in Japan.

Aug. 18, 1999: Japanese regulators send a letter to Republic Bank requesting information about the safety of the money Japanese investors gave to Armstrong.

Aug. 24 and 25, 1999: Republic uses almost all the remaining cash in Armstrong's accounts to cover the losses in his other accounts, according to court documents filed by the Securities and Exchange Commission.

Aug. 28, 1999: Republic alerts U.S. regulators that Armstrong may be running a Ponzi scheme.

Sept. 1, 1999: Republic suspends Rogers, president of its futures trading, and James Sweeney, chief executive of its securities division.

Nov. 8, 1999: To close the deal with HSBC, Republic's founder, Edmond Safra, cuts his asking price for the bank by $450 million to help offset any liabilities HSBC may face as a result of Armstrong's alleged scam.

Dec. 3, 1999: Safra is killed, allegedly by his male nurse, during a mock robbery of his Monaco estate.

Dec. 31, 1999: HSBC's acquisition of Republic closes.

Jan. 13, 2000: Armstrong is put in prison for contempt of court.

Nov. 14, 2001: HSBC USA reveals $575 million charge to cover the anticipated resolution of Japanese investors' lawsuit.

Illustration
PHOTO, Color, Todd Plitt, USA TODAY; PHOTO, B/W; Caption: Martin Armstrong, once a jet-setting financial adviser, is accused of orchestrating one of the largest securities frauds in history as the single-biggest client of Republic National Bank of New York's securities division. He has been in prison since January 2000 for defying a court order to turn over gold and antiques that he allegedly purchased with money from his now-defunct company, Princeton Economics International.Minutes: From a meeting of the Republic New York Credit Review Committee.