

JAILBIRD: Wasendorf was put on suicide watch and placed in a thick nylon anti-suicide tunic after his arrest.
REUTERS/LINN COUNTY JAIL

BROKING BAD

As exposure of his fraud loomed, futures broker Russ Wasendorf sparred with his son and went on an epic shopping binge.

Peregrine falls from the sky

BY P.J. HUFFSTUTTER, ANN SAPHIR, TOM POLANSEK AND DAVID SHEPPARD

BROKING BAD PEREGRINE FALLS FROM THE SKY



FINAL RECKONING: Wasendorf pleaded guilty to mail fraud and embezzlement last week in federal court in Cedar Rapids, Iowa. **REUTERS/JEFF HAYNES**

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The year 2007 brought one of the biggest scandals in memory to hit the futures community. Brokerage Sentinel Management Group collapsed in what prosecutors later said was a fraud by its chief executive and its head trader, leaving customers out hundreds of millions of dollars.

That December, one of the leaders of the industry, Russell Wasendorf Sr., warned authorities that beefing up policing in response would be overkill.

“The regulators missed on this one, but fraud is not easily detected,” Wasendorf wrote in an editorial in *Stocks, Futures and Options*, or SFO, an industry magazine he published. “Those who set out to line their own pockets have ways of hiding it, at least for a while.”

He knew what he was talking about. Unbeknownst to regulators, Wasendorf had been stealing from his customers' accounts for years – a fact he confessed after he tried to asphyxiate himself in a car outside Peregrine's headquarters in July. The dramatic end to his career came amid the implementation of electronic monitoring by regulators of Peregrine's accounts – a step Wasendorf had resisted.

Interviews with former employees, colleagues and associates, as well as an examination of court filings and company docu-

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Russ Wasendorf Sr
SFO Magazine

ments seen by Reuters, paint a picture of an entrepreneur who, by using relatively simple tools, was able to keep regulators off the scent for years. He did this even as his behavior grew increasingly showy and erratic.

As the financial shocks of 2008 savaged his business, Wasendorf went on a multiyear shopping binge, finishing an eco-friendly \$24 million headquarters, opening a gourmet Italian restaurant in Cedar Falls, breaking ground on a second kitchen nearby, and installing a wood-fired pizza oven in his backyard.

Wasendorf pleaded guilty to mail fraud, embezzlement and lying to regulators last week. He remains in solitary confinement and under suicide watch inside an Iowa jail.

His confession left key questions unanswered: how much money he ultimately stole from customers; whether he acted

alone, as he claims; how regulators missed red flags over the years; and why they waited so long to subject the prominent broker to significant scrutiny.

Federal prosecutors say Wasendorf stole approximately \$200 million from customer accounts over the years. The 64-year-old pleaded guilty to embezzling at least \$100 million.

Wasendorf was riding high in 2008. But as the design plans for his new headquarters were finished and the land was purchased, the economy weakened and trading diminished. An investment he made in Romanian property, once valued on paper at \$150 million, collapsed as a bubble there burst. Most painfully, the Federal Reserve slashed interest rates to near zero, crippling Peregrine's ability to profit off interest.

By this point, Wasendorf had given up any hope of repaying whatever money had been taken, according to Linda Livingston, his pastor.

On the surface, the good times rolled on. In Iowa, Wasendorf Sr. set the rules at Peregrine headquarters, pampering his staff. In Chicago, where his son - Peregrine president Russell Wasendorf Jr. - spent half his work week, competition with rival firms intensified. Peregrine brokers in Chicago handled trades; new accounts were opened through a call center in Cedar Falls.

Russ Sr.'s temper flared regularly. He tore up a contract in front of a furniture supplier who missed a delivery date by a matter of hours. He yelled at architects when he felt the plans for the new headquarters were not up to snuff, according to Rick Young, whose company installed the building's climate systems.

LIVING LARGE

The new \$24 million headquarters - a glass building on a wooded lot next to a country club - opened in 2009. The same year, Peregrine seized on another chance to top up the client funds that Wasendorf was raiding, acquiring \$80 million in cus-

“If one thing wasn't right, there was hell to pay. But ... he signed the paychecks, so we all just sucked it up.

Jack Nees
bartender



IOWA EPICURE: Wasendorf's popular eatery served herbs from his organic farm and sent staff to Italy to learn medieval sausage-making techniques. [REUTERS/MYVERONA.COM WEBSITE](http://REUTERS/MYVERONA.COM)

tomor accounts held by Alaron Trading.

A year later, the Commodity Futures Trading Commission revealed that Alaron had let a customer run up a \$4 million deficit without collecting the funds to back the losses, and the regulator stripped the unit of its license. But by then, Peregrine had control of Alaron's former accounts, and Alaron was not doing business as a futures brokerage.

Things still looked good on the outside: By its peak in early 2011, Peregrine was overseeing more than \$500 million in segregated client funds, according to regulatory data, making it one of the country's 10 largest independently owned brokers.

Wasendorf lived the part. Among his passions was food. At the glass-walled cafeteria at his new Cedar Falls headquarters, gourmet meals were provided free.

Wasendorf took his private jet to Chicago to catch Bears football games from his private box. He traveled to Europe and Asia; he bought fine wine and photography equipment. He scouted properties in Cedar Falls, snapping up prime space for a restau-

rant, then a second, then a third site for a commercial kitchen, according to property and tax documents at Black Hawk County in Iowa.

For the crew building a U-shaped pool at his Cedar Falls home - complete with locker rooms, saunas, glass house and retractable roof - Wasendorf sent workers on a tour of Italy to see how a special coating on the pool should look when applied.

His Cedar Falls restaurant, myVerona, debuted in 2009 to strong reviews. Chefs used herbs harvested from Wasendorf's own seven-acre organic farm. Wait staff had assistants. Wasendorf footed an all-expenses-paid trip to Europe for the close-knit restaurant staff, including the busboys, to sample wines and learn medieval sausage-making techniques.

“If one thing wasn't right, there was hell to pay,” said Jack Nees, a bartender who worked at one of Wasendorf's restaurants. “But the money was so good. He signed the paychecks, so we all just sucked it up.”

The pay was premium, too, said rival restaurateur Darin Beck. “He was paying everyone there 10 to 20 percent more than every other restaurant in town, and staffing twice as many people than anyone else for a restaurant that size,” Beck said.

Tensions mounted between the CEO and his son. Russ Jr. kept asking whether such investments were wise, said Nicholas Iavarone, Russ Jr.'s attorney and a lawyer for Peregrine for nearly 20 years.

Russ Jr., now 42, talked about leaving Peregrine and venturing out on his own. Russ Sr. didn't plead with his son to stay, Iavarone said. Instead, he voiced anger about other employees who had gone to other firms. He called them disloyal.

By 2010, Wasendorf's marriage to Connie had splintered. The reason is not known. In December, they divorced. Connie moved out of the family home and into a modest, one-story house a few blocks away from Russ Jr. and his family. Connie Wasendorf declined to comment.

In January 2011, Wasendorf Sr. began dating Nancy Paladino, 48. That summer, the couple decided to marry, according to Livingston, Wasendorf's pastor. The courtship further strained the relationship between father and son, Iavarone said, though a person close to the family disputes that account.

Around this time, Wasendorf narrowly avoided disclosure of his scam. He had been hiding his fraud by forging statements from one of his main banks, U.S. Bank, and using a post-office box to intercept correspondence from regulators.

In May 2011, Peregrine's compliance officer, Susan O'Meara, requested that an officer at U.S. Bank send a letter confirming the balance of Peregrine's account to the National Futures Association. The request appears to have been part of a routine annual check.

The bank officer, Hope Timmerman, sent a statement to both O'Meara and the NFA auditor, Lauren Boehm. The document showed that Peregrine's account held \$7.2 million.

That was on a Friday. The following Monday, the NFA received a faxed document, showing a "corrected" balance of \$218.7 million, according to a written account of the interaction by NFA chief Dan Roth to U.S. Sen. Tom Harkin.

Before the NFA received that fax, a woman identifying herself as Timmerman contacted regulators to tell them the document she had sent was "erroneous" and to expect the "corrected" document, according to a civil lawsuit Russ Wasendorf Jr. filed against U.S. Bank earlier this month, alleging his father may have had help in covering up the fraud.

Roth's account of the incident doesn't mention a phone call. An NFA spokeswoman declined to comment beyond Roth's letter. Timmerman did not return a call seeking comment.

A U.S. Bank spokesman said its employees did nothing wrong and that Wasendorf Jr.'s lawsuit, filed in Iowa state court,

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Nicholas Iavarone

attorney for Russ Wasendorf Jr.

is without merit. Harris Kay, O'Meara's attorney, declined to comment. Iavarone, Wasendorf Jr.'s attorney, said that his client was not aware or involved in the fraud.

By late 2011, father and son were barely speaking, Iavarone said. Russ Jr. felt his father had cast his family aside. Peregrine's revenues had plummeted, and the company was fighting for profitability.

"He began to get frustrated dealing with Russ Sr.'s mood swings and, at some point, disrespect," Iavarone said.

This spring, in Chicago, Russ Jr. was telling employees and brokers that he was running the day-to-day operations of Peregrine, said Tim Rea, a trader-client who won a trip to visit the Chicago office as part of an annual contest sponsored by Peregrine. Russ Sr., the son told Rea, was taking a step back and focusing on other businesses.

"He was really clear. Junior was the man in charge, the one running the show," Rea said.

In Iowa, Russ Sr. reminded people that he was Peregrine's sole shareholder.

Wasendorf's troubles mounted. The company had received \$1.24 million in loans, forgivable loans and tax incentives under a five-year contract with Iowa's Economic Development Authority. That was coming to an end.

State officials had reviewed personnel documents and toured Peregrine headquarters. They found that the company had failed to keep its pledge to hire at least 74 workers for jobs that paid \$19.74 an hour or more.

Peregrine only created 25 jobs that fit the bill, said authority spokeswoman Tina Hoffman. Officials demanded back some of the \$1.24 million, per the agreement, said Hoffman.

This May, Wasendorf hosted his annual brokers meeting in Cedar Falls. Brokers from across the country descended on the town, dining on beef Wellington and enjoying an open bar at myVerona.

Most insiders knew by now the company was in trouble: Employees had been told they would face a 10 percent pay cut in June and another 10 percent cut in July, according to employees and firm memos. Segregated client funds Peregrine was supposed to be holding had fallen by more than a fifth, to less than \$400 million, adding to the pressure.

Even so, Wasendorf boasted to local media and rival restaurant owners that he was expanding his culinary holdings. Architects were coming up with design ideas to build myVerona 2 in nearby Waterloo. There were plans to eventually open a pizza joint in Cedar Falls, near the University of Northern Iowa.

Construction crews were gutting a storefront he had bought in Cedar Falls on East Third Street, too, and installing equipment to bottle the restaurant's sauces for retail sale. Nancy, he told people, would manage it and a small staff. Out at his house, workers put the final touches on an outdoor pizza oven and outdoor kitchen, and polished the new copper roof built on the extension over the kitchen.

Russ Jr. had decided to leave the company, said Iavarone. He was spending long stretches in Sydney, leasing an office in the Australian metropolis to work with Chinese investors interested in foreign currencies, and scouting for a home for his family. When in Iowa, Russ Jr. spent his time quietly lining up replacement candidates.

The invitations went out for the August wedding of Nancy and Russ Sr. The staff at myVerona, where one of two receptions



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was to be held, began drawing up the menu.

At Peregrine, NFA investigators had launched a regular yearly audit of the company. But for the first time ever, the agency told Wasendorf that its auditors required an electronic, direct look at his bank accounts, said the NFA's non-executive chairman, Chris Hehmeyer.

The NFA had just begun using this new auditing system in late 2011, and was phasing it in with every new audit it did.

On the weekend of June 30, after telling a handful of friends and family, Russ Sr. and Nancy flew to Las Vegas and married at the Bellagio Hotel. It was a private getaway for the couple, both of whom had divorced in recent years, said a person familiar with the family, and a way to get the paperwork out of the way before the big ceremony and reception back home. But the elopement - revealed only after Wasendorf's suicide attempt - came as a surprise to many in Cedar Falls.

On July 3, Russ Sr. signed over power of attorney to Russ Jr., without his son's knowledge, according to Iavarone.

A few nights later, Russ Sr. dined at myVerona, say people who were there. When a couple at a nearby table was debating which wine to order, he walked out back and returned to give them a pair of expensive vintages from his 300-bottle personal collection, free of charge.

That Sunday, July 8, he agreed to open up the electronic bank accounts to NFA inspectors. The disclosure would soon reveal to auditors a balance some \$200 million less than what he had reported.

Wasendorf didn't go home that night, according to a person close to the family. In the early hours of July 9, family and friends searched Peregrine headquarters but he couldn't be found.

At some point before 8 a.m. that morning, Wasendorf slipped behind the wheel of a silver Chevrolet Cavalier and drove into a

\$200 million

Shortfall in Peregrine customer accounts

Source: U.S. Attorney's Office, Northern District of Iowa

wooded area next to his headquarters.

Peregrine employees spotted the idling car. A tube, connected to the exhaust pipe, snaked through the passenger-side window. A worker called 911. Others rushed outside. Russ Sr. was incoherent, a bottle of vodka in the car and as much as two months-worth of sleeping pills in his stomach.

In Russ Jr.'s office was a copy of the four-page confession letter and a personal apology note from his father. "Your mistake was that you trusted your Father, nothing more," he wrote.

His confession letter, meanwhile, left a lot of unsolved mysteries, including what exactly happened to the missing cash. "I know the question remains, what did I do with the money?" the letter states. Most of it, he claimed, went to "maintain the increasing levels of Regulatory Capital to keep PFG in business and to pay business losses."

But capital is a routine feature of the industry. Regulators require a brokerage to have it on hand to anchor a firm: The more customer assets it has, the higher the required capital. The CFTC and the NFA are trying to reconstruct Peregrine's finances as far back as possible to determine how much customer money really was parked there, a person close to the investigation said.

Today, Peregrine is shut and has filed for bankruptcy. Wasendorf's other companies are closed. Hundreds of people are out of work. Tens of thousands of customers are scrambling to recoup money from Peregrine accounts; their first payout looks to be barely a third of their balances.

Nancy filed for an annulment; she has said she is still committed to her husband, but is acting to shield herself from possible litigation from a scandal she knew nothing about. Russ Jr. and his family left Iowa for their home inside a gated golf-course community in Orlando, Florida. He is looking for a job.

"My father will now rightfully have to endure the consequences of his actions which caused so much turmoil to PFG's customers and the tremendous pain that he inflicted on so many loyal PFG employees," he said in a statement after Russ Sr. agreed to plead guilty.

Wasendorf spent the summer in a solitary jail cell, wearing only a thick nylon and Velcro tunic to prevent suicide. He is not allowed underwear, dental floss, or paper and pen, according to Livingston. He is cooperating with investigators and the bankruptcy receiver charged with selling his assets, according to the receiver and the U.S. Attorney's office.

In a handwritten letter submitted in the criminal case, grade-school friends Dennis and Michelle Burgess told the court that Wasendorf feels his life finally has a purpose: "He has told us of plans for writing a book and of helping others less educated."

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