

WHAT'S NEW



90-Day Archive
 All Current Articles
 For Your Business
 FYI
 Products & Sweet 16
 Specials
 Partners & Services

For Your Business -

PV/BV, tax, legal & regulatory info, important updates, corrections & more.

[▲ Previous](#) | [Next ▼](#)

Ponzi Schemes information

First in a series of articles addressing important business and consumer issues

"Ponzi Schemes: Protect Yourself" is the first in a series of articles addressing important business and consumer issues.

Origin of the Ponzi scheme

In the 1920s, a con man, Carlos Ponzi, created an investment opportunity to buy foreign stamp coupons and sell them in the United States for large profits. He recruited over 40,000 investors and raised some \$15 million dollars with promises of huge returns on short-term investments.

In the beginning, people were making money and racing to get in on the action. However, the plan was fraudulent, in which Ponzi used money from new investors to pay off old investors to create the illusion of success. Eventually, the scheme failed, along with a few banks and the money of many investors. From that time forward, such activities have been called Ponzi schemes.

Reemergence of the Ponzi scheme

With the Internet comes unprecedented opportunities for communicating information to individual investors, who now can manage their investments without professional advisors. The number of legal investment vehicles being developed and offered is as vast as it is complex.

Unfortunately, along with the good, some bad has resulted. The climate that has produced access for individuals to create wealth and receive information on investing and actually invest on their own has also created a fertile environment for con artists to engage in many investment scams, including breathing new life into the Ponzi scheme.

How a Ponzi scheme works

Here's how a typical Ponzi scheme unfolds.

1. The organizer – the promoter – recruits an investor to give him money in exchange for a promise to repay both the principal invested as well as a high level of interest within a short period of time. The promoter makes similar promises to other investors at the same time. He then begins receiving investment principal from numerous Investors.
2. At the end of the time period, the promoter pays the investors their principal along with the promised interest from the money he has collected from the other investors.

The Latest Products

3. The promoter invites the investor to reinvest the money for another time period. The investor is confident of the legitimacy of the scheme because he got what he was promised, and so he will usually invest the money as well as more money. Often, the investor will unwittingly help spread the scheme by telling friends, family, and others about his success and inviting them to share in his good investment.
4. The promoter is then able to collect a pool of money that he can use to pay those investors who wish an immediate return on their money.
5. If things go well, the promoter can continue the scheme, creating a very large pool before it is necessary to pull the plug.

Ponzi schemes cannot survive indefinitely because the money being paid out is money that has been collected from the investors; there is no significant source of income to generate money to cover the interest on the principal. Because each investor adds not only to the pool of money but also the amount of money that is supposed to be paid out, the bigger the scheme gets, the faster it will fail. When it does begin to fail, the investor will pull the plug by disappearing with the money or announcing that the investment failed and money was lost. Then everyone who has money invested will lose the investment.

Examples of Ponzi cases

Oil Prospecting

One promoter implemented his schemes by creating a series of limited partnerships, which as explained in respective partnership prospectuses, was to acquire rights in various oil- and gas-producing properties, allegedly located in Texas, Ohio, Louisiana, Mississippi, Oklahoma, or Belize. The monies raised from the limited partner investors for units purchased were supposedly held in trust until sufficient funds were acquired for the purchase of the prospective oil and gas property. The monies were also to be used solely to acquire and manage the oil and gas properties and for no other non-partnership purpose.

In fact, very little of the \$150 million raised was actually invested in oil and gas properties. Rather, in an undisclosed pattern of self-dealing, the great bulk of monies were actually commingled and diverted for the promoter's own use and benefit to sustain lavish lifestyles and to pay fictitious "dividends" to earlier investors in other limited partnerships.

The deception was carried out in a variety of ways:

- The promoter was aided and abetted by a company that generated false and misleading geology reports, which were used to placate existing investors and to induce new limited partners to invest.
- The promoter also fraudulently misrepresented the true financial condition of the investment and refused reasonable requests for access to the books and records of the limited partnerships.
- In addition, the promoter deliberately promoted a false sense of financial well-being by sending periodic letters and brochures to reassure the limited partners. However, these communications omitted the fact that the actual proceeds from real oil and gas properties were only a minute fraction of the amounts paid out as partnership dividends, and that the periodic payments were sustained only from the sale of new units to an ever-widening circle of victims.

Advertising Pool

A Washington, D.C.-based promoter used so-called wealth-building seminars as well as publications, fliers, letters, and other promotional efforts to tell investors that their funds would be used to advertise the company's 900-number lines and to promote other profit-making business activities. Claiming to provide office equipment leases to governments, the club even sold investments to banks.

By the end of its run, the business was raking in \$2 million a week, and the overall take was

\$50 million from 6,000 investors. When it finally closed down, the company did not have anywhere near enough money to keep paying off its promissory notes that promised a doubling of one's investment every three months. The courts discovered that the promoter had only about \$2.7 million in the bank yet was obligated to pay the investors more than \$50 million over the next three months.

Because the company made no profits from any legitimate business activity, the promoter would have had to raise this \$50 million from new investors. It would have been virtually impossible for him to pull in such an enormous amount of money from new investors by the next payment date. But even if the promoter had found a way, he then would have owed those new investors over \$100 million in a further three months. The doubling would have continued every three months, and there was no way for him to get out of it without defaulting. Like all Ponzi schemes, the "advertising pool" was doomed to fail and leave thousands of investors empty-handed.

Most of the pool was paid out to earlier investors who saw their money double. In a bid to lure others, they arranged to give payout checks to existing investors at promotional seminars. The doubling was only made possible with the money of later investors. The promoter spent approximately \$1.2 million of the investors' money on a house, pool, cars, trust funds for his children, and more. He also made "loans" of \$1.2 million to various people, many of who were his friends and company insiders, and then made little or no effort to get back the principal or any interest.

Basic rules to avoid Ponzi schemes

1. If it sounds too good to be true, it probably is. Beware of promises of high or guaranteed profits.
2. Avoid promoters who do not give a clear and detailed explanation of the investment they are promoting. Often the promoter will say it is too complicated to explain in layman's terms or that they cannot mention names because the individuals behind the investment want to remain anonymous.
3. Check out the promoter's background and credentials through reliable sources like the Securities Exchange Commission ("SEC"). Typically, individuals have to be licensed to offer investments like those used in Ponzi schemes. Verify explanations as to why the promoter says he does not have to be licensed with the SEC.
4. Ask for detailed information in writing. Obtain information relating to the company that is either doing the investing or in which you are investing, as well as its officers and financial track record. If the promoter makes claims that the investment or company is registered with a government agency or has the stamp of approval of a particular trust company, verify the information with a governmental agency or the trust company. Reluctance to provide detailed information should be a red flag.
5. Be on the alert for any kind of unbusinesslike conduct by promoters, especially the inability to reach them by mail or telephone. Few Ponzi schemes enlist much, if any, office help. Additionally, when promoters become very hard to reach, it is often a sign that the scheme is about to collapse.
6. Resist pressure to reinvest without receiving your profits. Ponzi schemes are often kept going by promoters who convince investors to "roll over" their profits to obtain even greater returns. While it may make sense to stay with a legitimate investment over time, be very suspicious of promoters who are reluctant to let you cash in on your gains.
7. You are not alone! When in doubt, contact the SEC, your State Attorney General's office, an attorney, or even the Better Business Bureau. All are resources to give guidance and aid in not becoming a victim of a Ponzi scheme.

[Back to For Your Business](#)