Ponzi Scheme Presentation Outline
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Outline

1. Distinguishing Ponzi business from Legitimate Business.
2. Introducing Charles Ponzi
3. The Traits of Successful Con Artists
4. The Traits of the 'Marks'-- the Victims.
5. The Traits of Investment Schemes.
6. Red Flags to Watch For.
7. The Road to the Fiduciary Concept and Rules.

1. Distinguishing Ponzi business from Legitimate Business

a. **Every business can become a Ponzi scheme.** Businesses pay investors from the profits of the business after deducting the borrowed money. The difference between a legitimate payment and a Ponzi scheme is in where the money comes from: *Does it come from a <u>business; or does it come from other investors</u>*. Legitimate businesses invest in a **business**, Ponzi schemers invest in a story about a business. The Ponzi business has two main components. First is producing a story about a business. Second is selling worthless obligations backed by the story

b. Two important differences between a legitimate business and a Ponzi scheme:

*In contrast to legitimate businesses, Ponzi schemes transfer money from one group of investors to another group and to the con artists. No wealth is created from an earmarked enterprise because none in fact exists.

*The other difference is that investors in legitimate enterprises are not deceived. They receive truthful information that allows them to make an informed investment decision, and they take the risks that they know about for rewards they understand

2. Introducing Charlws Ponzi and his scheme

a. Italian immigrant to the US in the early 1900s

b. In 1919, Ponzi came up with an arbitrage scheme involving stamps.

*The scheme worked as follows: For example, he would **buy 100 stamps for 100 Italian liras** that are worth, say, **20 American dollars**. When the price of the liras would rise, and the value in dollars of the stamps would increase, he would surrender the stamps for the 100 liras. With these 100 Italian liras he

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would buy 30 American dollars. Thus, his 20 dollars would bring 30 dollars, or a gain of 10 dollars

c. He convinced friends and relatives to invest in his notes, promising to pay a return of 10% a month, or fifty percent in 45 days.

d. As the news circulated, new investors clamored to hand Ponzi their money. Within 9 months, Ponzi **collected between $9.5 and $15 million**

e. But, soon there were **un-anticipated problems:**

"The calculations did **not account for long-term** investment

*The calculations did **not account for very large** investments

*And soon the **government ceased to pay cash for surrendered stamps.**

f. When Ponzi realized his plan was no longer viable, **he did not stop.** Instead of stopping the venture, he **continued selling** his 'magic notes' and <u>**used new and rolled-over investments**</u> to pay outstanding obligations

***** **Rumors** began to spread that Ponzi was **bankrupt**, and i**nvestors demanded payback.**

***** The exponential cash flow that was needed to maintain Ponzi's scheme ceased. He did not have all the money.

***** Ponzi paid back his obligations, but **remained $4-$5 million** short

* Ponzi was **arrested, convicted, sentenced,** and upon his release **deported to Italy**

<u>**3.What are the features of successful con artists?**</u>

a. Perceived as 'artists'

* Society gives them <u>**elevated title**</u>—not merely 'charlatans, bandits, or swindlers' but ***artists***

* Perceived as <u>**'winners'**</u> for carrying out a <u>***magician's illusion***</u>

b. They sell more than their schemes

* Sell **themselves**—their **dress** lends credibility to their scheme: .<u>Tailored suits</u> and <u>brief-cases</u> speak to the con artist's occupation and status

* Nice, social, expert-flatterers and salesman

*Sometimes their salesmanship is so good that <u>they themselves</u> get caught up in the fantasy, believing their success rests on a solid foundation

* For example, **when Charles Ponzi realized that he could not repay his investors, he did not flee with the millions he had, but continued to believe persistently that he could find another successful venture**

c. Character of the Ponzi schemers?

Narcissists

*Inflated sense of **self-importance**, **entitlement** <u>**inability to empathize**</u>**.**

<u>***They see only themselves. Others are things.**</u> Self-loathing is counterbalance by **extreme** <u>**self-indulgence**</u>

***Externalize sources of blame**

***Denial.** Denying **wrongdoing** *reduces feelings of guilt and shame.* This allows them to **bury internal conflict and perpetuate their scheme.**

d. **Blame others**

***Blame the government**—for shutting them down when otherwise could have turned business around.

*Anti-government stance often shared by investors. For example **Bank** #439288 operating Ponzi scheme in **Canadian town. That bank had support of town's people** when investigators shut it down

***Blame the victims**—for falling prey to their scheme: **Stupid. Serves them right.**

i. **Believe** that **fraud is fair** because **'everyone does it'**
ii. **Believe** that they are **justified in fraud because they do good elsewhere, by donations and community help**

BUT they spend money on themselves as a means to gain power, control, and respect

iii. As noted: Lack empathy towards victims

4.What are the traits of victims or "Marks"?

a. Perceived as **'greedy and gullible'**

iv. Often they are condemned **for not doing their homework** (especially if they are representatives of institutions and lost others' money); they are viewed as **paying the price for their gullibility.**
v. **The victims have a personal Need' and they Buy into the personal relationships with the schemer** as much as into the scheme itself
vi. Personal relationships or friendships **lend trust and credibility** to incredible business ventures
vii. Fake relationship with schemer fills void of friendship or love in their own life.
viii. Example of Joseph Zirkel, who perpetrated investment scheme **targeting wealthy women,** promising to manage their money, but also **getting romantically** involved with them.

b. Victims may be **sophisticated or unsophisticated**

c. Victims may keep silent. Why? Possible **reasons** to keep silent:

i. Might feel **embarrassed** about being 'taken for a ride'
ii. **Might have suspected** or had reason to suspect the scheme & **invested nonetheless to take advantage** of early profits or recruited others.

iii. They may be **close to bankruptcy** and want to **stop trustee in bankruptcy** from claiming clawbacks

iv. **Might keep silent** because of **affinity to the schemer**

<u>Charles **Ponzi was a hero to the Italian Boston community**</u>

d. **Victims** may be **'Addicted' to excitement of participating in exclusive venture**

i. Ponzi schemers often **sell to each other lists** of the important potential investors-**Marks**. You and **Rockefeller** in the same group!!

5. <u>What are the traits of the investment schemes?</u>

a. High returns

i. Monthly promised return from 10% per month, to 75% within six to eight weeks.

b. **Investment is unique**—Ponzi schemers have sold everything from **bus-stop <u>shelters, tropical islands; synthetic rubies</u>**

i. Has the aura of a '**thrilling *treasure-hunt***'

ii. **BUT** also has **<u>costs and benefits that are hard to evaluate</u>**

c. **Name of the investment** promotes trust.

i. The **note for example might be entitled <u>"Certificates of Deposit"</u>** conveying the safety of <u>bank CDs</u> or say "backed by the **<u>full faith and credit"</u>** of the company to mirror US securities.

ii. Might distribute **<u>statements similar to bank statement</u>**<u>s</u> claiming amount held for investor **payable on demand.**

d. Short-term investments

i. This <u>reduces the perceived risk</u> to investors because enables them 'control' **even if they roll over** their investment month to month

e. Payments were always prompt. Until they ceased altogether.

f. Payments and investments are exclusive

i. <u>Ponzi schemer may reject payments</u> offered by investors or people who want to invest. This renders trustworthiness.

*<u>**Example of British banker who, after he was wined and dined by a con artist**</u>**, without being asked for a line of credit, offered a line of credit himself. <u>Banker had to convince the con artist to take a $2 million line of credit.</u>**

ii. <u>Affinity groups are targets</u>

*It is **efficient to sell to a group because one establishes, <u>trusting relationship</u>** amongst members

* Particularly **vulnerable are** **<u>religious groups</u>**, who transfer **trust in god with trust in con artis**t. And they influence each other even on matter outside of faith.

iii. **Institutional investors** (especially unregulated ones) **are targets.**

g. **<u>High cost of validation of the Ponzi story</u>**

i. **<u>Due to secrecy</u>**

1. The secrecy is both **alluring** for investors and is as part of the **lucrative opportunity**—the **con artist refuses to disclose details** so that others won't know where the '<u>goose laid golden eggs</u>' is.
2. **Secrecy helps con artist establish reciprocal trust** by **disclosing a 'secret.**'
3. **NO.** Example of **Michael Calozza** who was an insurance agent for a mutual insurance company, Sons of Norway. He fabricated a letter from the Sons of Norway to himself, in which the company offered its staff a tax-advantaged high-yield secure investment. He then had clients borrow against their insurance policies and hand the borrowed money to him so he would invest the money in the Sons of Norway investment and pass the returns through to his clients.

ii. **<u>No easily verified information</u>**

1. **<u>Investment are in remote countries</u>**
2. **<u>The documents are forged documents</u>**

h. **<u>Similar to legitimate business nonetheless</u>**

i. Legitimate businesses **<u>refinance,</u> paying old investors with new investor's funds**

ii. Employ **legitimate professionals—lawyers, accountants, sales force.**

iii. **Ponzi payouts to early 'songbirds' attests to the legitimacy** of high returns and prompt payments (**investors** then also act as free **sales force)**.

i. **<u>Borderline between legality and illegality</u>**

i. Ponzi scheme **may start off as a legitimate business**, but turn into a Ponzi scheme when:

ii. Example of **a <u>money manager, who when realized that a large investment would soon default, decided instead to tell the clients that an "unknown company had promised to pay them $160 million</u>** for their future stakes in the nearly dead" investment. Clients did not question the statement, and interest payments continued to arrive. In fact, the government argued, the **clients' money was lent to the company so that the company could pay the clients the promised interest with their own money.**

6. **Four Red Flags**
    a. **Low-risk, high-return investment**
        i. **Red flag** because low risk and **high returns** are **mutually exclusive** in a rational market.
        ii. **It should indicate to investors** that issuer has exhausted other sources of low risk financing, or that he has no intention of repaying
    b. **Secrecy surrounding the business plan**
        i. **Alluring** to investors because of the **secret's exclusive nature**
        ii. **Obscures the source** of important **details**, like the **source of profits.**
    c. **Continuous offering of securities**
        i. **Few institutions** outside large-scale financial institutions need to engage in continuous offering.
        ii. **Investors should raise questions about why continuous offering is needed and where is the raised capital going?**
    d. **The Scheme involves less regulated securities**
        i. For example, Ponzi schemes often **require privately-placed securities** which ***do not require registration.*** **This is exactly when sophisticated investors are expected to take greater care to research the securities being offered**
    e. **Other signals**
        i. **Quick successful rise** of a corporation business and securities prices **may indicate** that **it *is* too good to be true**
        ii. **Heed and listen to warnings from insiders and temporary insiders.** such as employees, investment banks, reporters, and legal advisers
        iii. **Opportunities that require quick-decision, or are open only to members of an affinity group – AVOID them.**
    f. **Note: CASE: Ponzi schemes contaminate any transaction.** The Defendants in s court proceeding were brokers who received transfers [*846] in the form of commissions for the initial sales and for later **renewals** of investment notes.
    g. Quote from a case:

"As the initial transferees of transfers made in connection with a fraudulent Ponzi scheme, the Defendants are liable to the Trustee for all of the commissions received in connection with the Ponzi scheme -- even if they are completely innocent of any wrongdoing, and even if they had no knowledge that the Debtor's investment program was a Ponzi scheme.[2]

7. The relationships of the losing and gaining investors

Since the Madoff Ponzi scheme was exposed, Irving H. Picard, a partner at a New York law firm 9 Baker & Hostetler), was the court-appointed trustee charged with liquidating assets of the Madoff bankruptcy estate. He has recovered billions of dollars for victims. He did well as well in his legal fees. Irinv **Picard was my student.**
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Let me add the contrary to Ponzi schemes by examining fiduciary law. In fact, it reflects by law the animals' genes.

1. Fiduciary law is in fact our human substitute for genetic tendencies in many animals. Note that in the family of the Male lion receives the large share-he is the protector of the family.
2. The female is the hunter. She is small, ferocious, and agile.
3. The bees have a bee queen, the mails that make her fertile and workers.
4. However, when it comes to monkeys the scene changes. Monkeys can cheat, even from childhood, when the little monkey wants something and there have been examples of their taking a greater share.
5. Humans cannot live alone and depend on each other. But heir drive to support others is not full and is sometimes absent. That is when fiduciary duty plays a significant role. Doctors, parents, lawyers, government officials, investment advisers, trustees and others who hold power for the benefit of others are fiduciaries and bear duty to perform their expertise well and avoid conflicting interests with those whom they serve. In the United states brokers have been

[2] In re: McCarn's Allstate Finance, Inc., V. Coyer, National Exchange, Inc., Chapter 7, Case No. 02-19766-8W7, Adv. Pro. No. 03-0566, Adv. Pro. No. 03-0568, Adv. Pro. No. 03-0570, Adv. Pro. No. 03-0682, Adv. Pro. No. 03-0652 UNITED STATES BANKRUPTCY COURT FOR THE MIDDLE DISTRICT OF FLORIDA, TAMPA DIVISION *326 B.R. 843*; *2005 Bankr. LEXIS 1253*; *44 Bankr. Ct. Dec. 275*; *18 Fla. L. Weekly Fed. B 287(2005).*

fighting against a full fiduciary duty even though their sales talk to investors, who have no knowledge of the subject, must be relied on. A surgeon who left the surgery to settle his financial account lost his license for life even though the patient survived. Parents who 100 years ago were owners of their children are now fiduciaries and if they do not perform their parental duties may lose custody of their children. The lines are not clearly drawn and the arguments will continue.

I hope future humans will evolve both trustworthiness and identification with each other, and discover how better their life might be.