

## ***THE MANY FACES OF PONZI***

Charles Ponzi, born c.1882, emigrated, from Italy in 1903. At first he went to Canada where he was convicted of forgery in 1909. He served a brief prison term there and almost immediately upon his release he was arrested for smuggling aliens into the United States. He was convicted and did time in an Atlanta prison.

In 1920, Ponzi developed his postal coupon scheme which, it is purported, had collected nearly \$10,000,000 from around 10,000 investors. The scheme, according to the N.Y. Times, July 30, 1920, page 1, column 7, went something like this.

Ponzi claimed that he was considering publishing an export magazine. He communicated with a man in Spain regarding this magazine. The man sent him an international exchange coupon that he was to redeem for American postage stamps and he was to use these stamps to forward a copy of the magazine to Spain. Ponzi found out that the coupon in Spain cost the equivalent of about one-cent in American money for which he got six cents in stamps here. He claimed that he furtherly investigated the rates of exchange of "coupon-for-stamps" in other counties, as well, and because those rates were also favorable, he began his "investment program" in a small and limited way. He offered his program to some of his friends; \$150 return in ninety days for every \$100 invested. Although he promised a return in ninety days he began paying in forty-five days.

Ponzi officially opened his postal coupon business in December 1919, by establishing his company "***The Securities Exchange Company***". Through his company he issued notes of different colors to thwart problems he was having with forgers. These notes appeared with the following text:

*The Securities Exchange Company, for and in consideration of the sum of exactly \$1000 of which receipt is hereby acknowledged, agree to pay to the order of \_\_\_\_\_, upon presentation of this voucher at ninety days from date, the sum of exactly \$1500 at the company's office, 27 School Street, room 227, Boston, Massachusetts or at any bank.*

*The Securities Exchange Company*

*Per Charles Ponzi*

Ponzi borrowed \$200 from Joseph Daniels, a furniture dealer, in order to start his Securities Exchange Company. Although Ponzi repaid Daniels in full, Daniels insisted that he was to share one-half of all future profits as part of the loan agreement. Later when Ponzi refused to acknowledge Daniels as a fifty-percent partner, Daniels retained an attorney and was quite successful in establishing legally his partnership/relationship with Ponzi. Although Ponzi eventually settled with Daniels, it became obvious to the authorities that Ponzi had been outsmarted by Daniels and his attorney. Daniels was paid off (around \$50,000) by Ponzi and was not held responsible or accountable for the

activities of the Securities Exchange Company. The humorous phrase used after Ponzi was imprisoned was, "*Daniels got off Scott-free and Ponzi got the Scott tissues*".

Ponzi's success was almost instantaneous and with leaps and bounds he had expanded a one-man operation to about 30 or more employees. Plus, he purchased a home for \$35,000 in historic exclusive Lexington, at Banker's Colony. Just as quickly as he had ascended the ladder of success by July 1920, he had plummeted and one month later he was arrested for his postal coupon scandal.

It has been long debated as to whether Ponzi ever realized any profits from his dealings with postal reply coupons. More importantly, is the concept he put into practice, a concept that to this day still bears his namesake, "***Ponzi Scheme***".

***This is the concept.*** Early investors are paid with money coming entirely out of money paid into the scheme from later investors. Although Ponzi schemes are similar to pyramid schemes they differ in that Ponzi schemes are promoted and operated by a central company or person. Usually there is one person or company that is collecting the money from all new investors and they use this money to pay back the old or earlier investors the exorbitant returns promised on their investments. Ponzi schemes usually do not have the hierarchical structure that pyramids have.

***This is the lure.*** Investors are drawn into the Ponzi by the promise of tremendously high rates of interest being paid with the guarantee of "*no risk*" return on their investment. They usually convince the investors that this is a special opportunity for them, similar to that which is made available to the proverbial "insiders" of investment folklore.

***This is the function.*** Funds are collected from an initial group. They are promised exceptional returns on their investment. They are, in fact, paid the returns promised. The initial group invites others to invest with them. They, too, are paid the exceptional returns with no risk. The group expands and the returns continue to roll in. This procedure is self-perpetuating until the source of potential new investors dwindles and the Ponzi collapses.

***This is the reality.*** Funds are never invested. There is no significant source of income other than that derived from the money of new investors. Although investors believe that the yields are coming from investments it is really the re-distribution of capital.

Now remember Ponzi schemes do work. They pay the dividends and returns promised. ***Only*** the early investors enjoy these fat returns. They are happy and invite others to join with them. All those that get in on the "bottom floor", so to write, will realize returns greater than they could have reaped from any other legitimate investments. What makes the Ponzi scheme so insidious is that they can actually pay off for a short time. The person behind the scheme generally takes the money from the forth or even the fifth tier of investors and actually pays some of it back to the previous investors. This cycle will continue until the source of new investors ceases.

Timing is the key to success of the Ponzi scheme. It works in at least two ways. First, they create a sense of urgency on the potential victim so he must “hurry” to take advantage of this “chance of a life time” opportunity. Second, just before the source of new investors dries up the sense of urgency is upon the promoter and he absconds with all the investors’ funds.

Again, remember that Ponzi schemes are pure re-distribution of money that comes from later investors to pay earlier investors. No funds are ever invested! It is an investment swindle which promises and delivers high profits from fictitious sources to earlier investors from funds that are raised from later ones. When the source of new investors dries up so does the Ponzi scheme.

There are two basic types of Ponzi schemes. The first is where the promoter invites you to invest in a **High Yield Investment Program (HYIP)**. He clearly states that there will be an exorbitant rate of return with no risks.

Following are some of the more common pitches he will throw at you:

### ***Some of the Faces of Ponzi.***

- Investment opportunity is part of a “secret market”.
- Enormous “secret secondary market”
- Project invests in “prime bank” notes or “prime bank” instruments.
- Group invests in discounted “standby letters of credit” or “bank guarantees”, “medium term notes” (MTN’s), “bank debentures”, “bankers’ acceptances”, “discounted cashiers’ checks”
- Top European banks are involved with these transactions
- These are specialized “roll programs”.
- Program is endorsed by The Federal Reserve Bank, Federal Reserve System, Federal Deposit and Insurance Corporation (FDIC), the United Nations (UN), International Chamber of Commerce (ICC), the Federal Bureau of Investigation (FBI), the Securities and Exchange Commission (SEC), World Bank, Bank of England, Commission for Under Developed Nations and a host of other names they will drop to convince you of the authenticity and legitimacy of the program
- References to certain trusts that carry part of the name of a very well known or famous bank, such as, Credit Swiss Foundation for the Poor, Bank America’s Trust Foundation for the Under Privileged, Swiss Bank’s Trust Management Fund, or to Pension Funds... or to any other creatively convincing title of a well known foundation.
- High Yield Investment Programs (HYIP) with no risk

### ***Be Alert to the Following***

- Any investment program that does not provide clear and detailed explanations of their investment vehicles

- The program is too difficult to explain in layman's terms
- Lack of available detailed information on the company, its officers and audited copies of its financial track record
- Any offer that cannot be checked out in detail
- Be leery of claims that this is part of "secret" market and records are kept in remote cites or foreign countries
- Insistence that you reinvest without seeing your profits.
- Inability for you to visit the office facilities of the promoter and ask questions of the staff.
- Be alert to any gaps in the service being offered or absence of the promoters for any periods of time without secretarial services.
- Exercise caution of "one-man or one-woman" operations handling thousands or millions of dollars.
- Question the veracity of promoters claiming to be "connected to insiders"
- Be careful of a "chance-of-a-lifetime" opportunity
- Promoters will only accept cash

The second type is where the promoter does not specifically mention the kinds of instruments that will be invested in on your behalf. Rather he obscures his role by saying that he is part of a trust, foundation or consortium that will pool funds from many sources, and in blocks of 10 to 100 million dollars will invest them in a secret, secondary market, so secret that even your own banker will not know of it.

***The scenario goes something like this:***

The players: Mr. X (the promoter of the Ponzi scheme)  
 Mr. Y (the innocent catalyst being used by Mr. X)  
 Group Z (the group organized by Mr. Y)

Mr. X approaches Mr. Y (a friend of a friend) and offers him a "*chance of a life time*" investment opportunity. He asks Y if he and some of his friends (ten total) could invest \$10,000 each in a high yield no risk project. Y responds that he thinks so. X then sets the trap. He offers to each investor who puts in \$10,000, \$1000 interest per week plus at the end of six months the original \$10,000 will be worth \$20,000. So, in reality \$10,000 will "earn" \$26,000 (\$1000 for each week for 26 weeks), plus an additional \$10,000 at the end of the 26<sup>th</sup>. week – total: \$36,000 + the original \$10,000 investment.

He asks Y to form a group of ten investors and they are to meet next Thursday at his apartment, which incidentally is elaborately furnished.

Y rounds up the group and they meet at X's apartment.

X is very cordial, offers them hors d'oeuvres, and the very best beverages. He quickly gets down to business and explains the program just as he had explained it to Y earlier.

Once he is convinced that they are serious about his investment program, he gets a verbal commitment from them and then says, "My consortium has advised and authorized me to give each of you your first week's interest on the \$10,000 each of you will bring next Thursday." He then proceeds to give each of them \$1000 in 100-dollar bills neatly placed in an envelope. He tells them to enjoy the beverages and if there were any questions he would be pleased to address them.

### ***Week One***

The following Thursday the group meets again. Assuming that each of them has their \$10,000 he immediately hands each of them an envelope with their \$1000 for next week's interest (in advance) on their investment. (Of course, he is developing a quasi fraternal comfort level with his potential victims as he plays on each individual's greed factor.

So by evening's end he will have taken in \$100,000 and paid out \$20,000 in interest. His profit so far: \$80,000.

### ***Week Two***

On Thursday of next week they meet again and he gives them \$1000 each. His profit now is \$70,000.

### ***Weeks Three and Four***

When they meet the following week he stirs them a little. He explains that he will be away the next week meeting with his consortium. He gives them his cellular phone number to ease their suspicion and then says, because he will not be there on next Thursday he will be giving them this week's interest plus next week's interest in advance.

So to date he will have paid out \$50,000 and will be holding \$50,000.

Before the two weeks are up he calls another meeting explaining that he has returned earlier than expected and has great news from his consortium. During the meeting he tells them that if they can come up with another \$20,000 each he can put this new money into a new consortium trust and they will now be "earning" \$1000 per week from the original investment of \$10,000 (from which they each will have already received \$5000 back in interest), plus \$2000 per week interest for 26 weeks on their new investment of \$20,000, and, the new \$20,000 will be worth \$40,000 at the end of 26 weeks. Invariably they will agree, and on their word(s) he gives them \$2000 each in advance of the \$20,000 they will bring next week.

He will now be holding \$30,000 after he gives them their \$2000 interest on next week's investment (\$50,000 minus \$20,000).

## ***Group's Rationale***

The group's thinking will be something like this. Each of us has gotten \$7,000 return on our original investment of \$10,000, and this was only in a matter of less than four weeks.

On Thursday they arrive with their new \$20,000 investment. X already has two envelopes for each investor: one with \$1000 representing interest on the original \$10,000 investment and \$2000 for the "second" week's interest for the \$20,000 which they have not given him – yet.

X has now given back \$10,000 to each investor (\$100,000 total) and he now is holding \$200,000.

One need not get any mental exercise by jumping to conclusions, but you can be well assured that when the group arrives at his apartment next Thursday Mr. X will have evaporated with their collective \$200,000, never to be heard from nor seen again. Furthermore, it is conceivable that Mr. X had more than one group working at the same time.

Now, there are many variations on a Ponzi theme (or is that scheme?). The introduction is clearly stated. The motifs are well developed. There are adequate contrasts in each section and anticipation of the "coda" is foreordained.

Charles Ponzi was a legend in his own time and is emblematic in ours. He served time during his lifetime and promoters of his schemes continue to borrow time from ours.

## ***Some of the Many Faces of Ponzi***

The United States Securities and Exchange Commission has a web site that lists official Litigation Release cases. You may want to visit their web site at: <http://www.sec.gov/index.htm>, then click on Litigation Releases Federal Court Actions.

Randomly selected are the following Litigation Release Cases: LR16927, 16929, 16934, 16940, 16942, 16950, that dealt with Ponzi-like schemes. After reading those you might want to scroll to the bottom of the page and view these additional cases that were also Ponzi-schematic:

January 5, 1998 – March 31, 1998 Litigation Release Cases: LR15612, 15622, 15636, 15686;

April 2, 1999 – June 30, 1999 Litigation Release Cases: LR16154, 16168.

Reading these randomly selected cases should give you an indication of the prevalence of Ponzi schemes being perpetrated today by fraudsters.

Could Arthur Schopenhauer, the philosopher, have portended the role of a future Ponzi victim, who would believe in what a fraudster described rather than what the reality actually was had he been able to see for himself when he wrote, *"My desire is for wisdom, not for the exercise of the will. The exercise of the will is the strong blind man who carries on his shoulders a lame man who can see."*

Rarely is there anything more irritating than clichés. Albeit the following are apropos:

*"Robbing Peter to pay Paul"..."Paying the earlier comers out of the contributions of later comers".*

Yet, the poet, Johann Schiller, seems to have said it well for those that stand in awe of Charles Ponzi's creativeness, *"It is rascally to steal a purse, daring to steal a million, and a proof of greatness to steal a crown. The blame diminishes as the guilt increases."*