



## How to Avoid a Ponzi Scheme

During the 64-day period between January 8 and March 12, 2009, the Commodity Futures Trading Commission charged 11 people with running Ponzi schemes to the tune of \$212 million. The headlines prove that it can happen to anyone, but there are steps that can be taken to minimize the risks. First, learn what a Ponzi scheme is and look for red flags that are consistent with every Ponzi scheme.

### **Ponzi Scheme?**

A **Ponzi scheme** is a fraudulent investment operation that pays returns to investors from their own money or money paid by subsequent investors rather than from any actual profit earned. Participants are told they are investing in financial instruments such as mortgage-backed securities or financial investments they don't really understand. Very rarely, however, does any commercial investing activity actually take place. Typically a few of the beginning investors are paid "returns on their investments" which are actually paid with money from new investors, not money made from investments. If a Ponzi operator can continually draw in new investors and keep a few older investors happy with occasional small payouts, a scheme can be perpetuated for years.

### **Am I Susceptible to a Ponzi Scheme?**

In 2006, the Financial Industry Regulatory Authority (FINRA) Investor Education Foundation issued an Investor Fraud Study Final Report that was designed to determine why older Americans tend to be more regularly victimized by fraud schemes. Investment victims typically are:

- older men
- married
- college educated
- more affluent (level of income greater than \$30,000)
- more financially literate
- more likely to have experienced negative life events (i.e., serious illness, limited physical abilities)
- more likely to rely on their own experience and knowledge when making investment decisions
- more likely to listen to sales pitches
- optimistic about the future
- unwilling to report fraud or admit to being scammed

If you recognize anyone who fits this profile -- yourself, a relative, or a friend -- pay close attention to the red flags and suggestions offered below.

### **Red Flags**

A number of red flags are associated with all Ponzi schemes:

1. Is the rate of return being offered better than what is being offered in the marketplace?
2. Are they guaranteeing the investment performance?
3. Does the investment record look too steady over the long term?
4. Is the promoter particularly aggressive in wanting you to invest (i.e., there are only a few opportunities left)?
5. If you ask questions or request detailed information in writing, is the promoter reluctant or unable to comply?
6. Are you encouraged to continually reinvest instead of taking a payout?

7. Does the promoter want complete control over your money, and do they ask for checks to be made out to them or a company they control?
8. Is there any information on the Internet regarding the investment company or the promoter themselves?
9. Does the investment company have a legitimate Web site with investor credentials and licensing information?
10. Are the invested funds held separately at a firm regulated by FINRA and backed by the Securities Investor Protection Corporation?
11. Can you get your statements directly from the broker and not the promoter?

If you can answer yes to any of the first seven questions, or no to questions eight through eleven, then you should be concerned that the investment opportunity may be a Ponzi scheme.

### **Get a Little Help from FINRA**

FINRA ([www.finra.org](http://www.finra.org)) is the largest independent regulator for all securities firms doing business in the U.S. Their role is to protect investors by maintaining the fairness of the capital markets.

In February 2009, FINRA introduced two new, interactive tools on its Web site to help investors avoid fraudulent schemes. The tools are free.

- **Scam Meter** is a series of four questions that predicts the likelihood that a potential investment might be a scam.
- **Risk Meter** is a series of twelve questions to help investors determine if they are at risk of becoming scammed.

Another section explains how to check out an investment professional to make certain they are legitimate. If they are a broker, you can confirm their licensing and registration with FINRA's **BrokerCheck**, which will also list any history of complaints. The FINRA Web site also lists where to check on other types of investment professionals.

Before you turn over your life savings to someone you don't know, do some background work and remember. "Just because everyone else is doing it, doesn't make it a good idea," and "If it sounds too good to be true, it probably is!"