

# FRAUD GONE WILD

## Pyramid, Ponzi schemes disguised as valid investment opportunities

By Staff Report

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The people taken in by Bernie Madoff's alleged Ponzi scheme may be seen as greedy, but Robert FitzPatrick, a nationally recognized expert on pyramid and Ponzi schemes as well as other consumer frauds, says that isn't the case with most people taken in by such frauds.

"I've been to meetings where they promote these things, and I don't see a lot of greed in the room," he said. "I see desperation, need, hope.

"Somebody will say the people taken in by these things are greedy and stupid. If that's the case, we're all stupid and greedy, then." FitzPatrick said it is easy to recognize a pyramid scheme.

"What's not easy is to understand why it doesn't work," he said. "Another problem is that they're everywhere. What causes people to 'not get it' is the sheer prevalence of them.

"This is fraud that has gone wild. It's no accident at all that Madoff took some of our smartest people for billions of dollars. There is no one dealing with these things."

He said the pyramid schemes are disguised as "matrix selling" and "cash gifting" opportunities that assert their legality and legitimacy by citing lack of government action.

Madoff's scheme began to unravel when investors wanted about \$7 billion back, and Madoff couldn't pay them.

Securities and Exchange Commission Chairman Christopher Cox blamed his staff for failing to catch the 70-year-old Madoff's scheme until now. He said the



Charles Ponzi is the namesake of the Ponzi Scheme

agency failed to act on “credible, specific” allegations about Madoff dating back to 1999.

“Without regulation, it is not reasonable to expect the average person would be able to know enough to avoid such schemes,” FitzPatrick said.

“We believe that the markets are legitimate and relatively free of utter fraud, that regulators are watching them, and that they have rules that are relatively transparent. But when you pull out the regulation, you still have a public trained to invest,” said FitzPatrick, president of Pyramid Scheme Alert, an international organization formed to expose, study and prevent illegal pyramid schemes.

He said organizers of Ponzi and pyramid schemes will tell people who question their legitimacy that there is such strict regulation in this country, it’s virtually impossible to run a scam.

“The exact opposite is the case, and of course they know that,” FitzPatrick said.

He said pyramid and Ponzi schemes work for a while — a long while in Madoff’s case.

“He was paying consistent double-digit returns when no one else could for 10 years,” he said. “In that plan, nobody could get their money back because he was simply recycling the money. There was no money being made other than that introduced by new investors.”

Investors in Madoff’s hedge fund were largely wealthy individuals or entities who may have lost as much as \$50 billion.

But FitzPatrick said the average person is more likely to encounter a Ponzi or pyramid in a “business opportunity” scheme that requires an investment plus recruiting of new investors — who are rarely called “investors” by the organizer.

“You’ll go to a meeting that’s carefully orchestrated,” he said. “They’re held in nice hotels. The presenter is dressed nicely, and there will be people just like you and me giving testimonials.”

“The question will be asked, ‘If it doesn’t work, how does it keep working?’” FitzPatrick said.

The reason is that 60 percent to 70 percent of the people who are recruited quit every year, without making a dime, and are simply replaced,” he said. “The top people are making money by churning the people under them every year.”

To avoid such schemes, FitzPatrick said, you have to dig deeper and ask lots of questions.

“Do your due diligence like nobody used to have to do,” he said. “In a Ponzi scheme, look at how the organizer pays these extraordinary returns. Probe where the money comes from.”

FitzPatrick said another warning bell in the Madoff scheme was that the statements he sent to clients “basically were unintelligible.”

One investor asked how the fund could be so successful and was told it followed a “split strike conversion” strategy, which involved owning stock and buying and

selling options at the same time, he said, an explanation that makes no sense, either.

“You also may get, ‘I can’t tell you in-depth because then I’d be giving away my secrets,’” he said.

FitzPatrick said Ponzi schemes, unlike pyramid schemes, don’t churn investors.

“They just have to keep growing,” he said. “He had to get new people in or get people who thought they were earning money to reinvest it. But it was all on paper. They weren’t earning anything.” \_\_FitzPatrick said there are other factors that slow detection of Ponzi schemes.

“The whole concept of investing is that you have to trust somebody,” he said.

“And if you’re going to trust someone, why not the former chairman of the Nasdaq stock market (Madoff)?”

### **The difference between the two schemes**

The term “Ponzi scheme” is used primarily in the United States. Other English-speaking countries do not distinguish between this and other forms of pyramid schemes.

In both pyramid and Ponzi schemes, early investors are paid by subsequent ones in an unsustainable model. In a pyramid scheme, the investors recruit new investors, while in a Ponzi scheme, the organizer does the recruiting.

### **Ponzi scheme origin**

The Ponzi scheme is named after Charles Ponzi, an Italian immigrant who ran a scam in New England in the early 1900s that promised investors in postal reply coupons a 40 percent return on their money in just 90 days. He planned to use the difference in the exchange rate between the dollar and foreign currencies to buy and sell the international mail coupons at a profit.

His company, Securities Exchange Co., and the scheme collapsed around 1920, however, when people started calling for their money amid a growing investigation.

Ponzi had been paying the high return to early investors (and himself) with money paid in by subsequent investors, rather than from the profit from any actual business. The system is doomed to collapse because there are little or no underlying earnings from the money the promoter gets.

Ponzi actually bought only about \$30 in mail coupons.

### **A couple schemes dissected**

Canada has become a feasting ground for pyramid schemes, says Robert FitzPatrick, founder of Pyramid Scheme Alert and co-author of “False Profits: Seeking Financial and Spiritual Deliverance in Multi-Level Marketing and Pyramid Schemes.”

“The Canadian government is completely compliant of these things,” he said. “It becomes an endorser by means of doing nothing.”

Case in point is a Ponzi scheme disguised as a pigeon-breeding business called

Pigeon King International. The organizer claimed he had a plan to save the family farmer, and lured more than 1,000 such farmers from the United States and Canada into the scheme.

Most lost all their investment.

The company is now bankrupt and closed. Returns were obtained from the investments of later investors. The operator had no external market for the pigeons. He sold breeding pigeons and then contracted to buy the offspring at agreed-upon prices. The selling prices of the breeding pairs and purchasing prices of the offspring were arbitrary but promised very high rates of return.

He lied to investors about markets and future sales of the pigeons and inflated their values.

Federal prosecutors in St. Louis recently have alleged that a securities firm there defrauded customers of more than \$4.5 million in what they called a Ponzi scheme.

Rate Search Inc. claimed it was able to find the best return on certificates of deposit by searching nationwide, and made its money by taking a percentage of the interest.

But the company and its owner faked account statements to hide missing money and soothe investors, while in fact it never bought some of the CDs customers thought they owned, federal authorities said.

<http://www.sj-r.com/business/x1647203252/Pyramid-Ponzi-schemes-disguised-as-valid-investment-opportunities>

Staff writer, [Chris Dettro](#) can be reached at 217-788-1510,