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The Madoff/Ponzi scheme — Part 2

Those lucky enough to invest early in a Ponzi scheme typically receive the promised returns. Consequently, their promotion of the investment comes across as genuine and



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instills an almost irresistible urge in friends and family members to invest as well.

Since the early investors have become effective marketing tools,

the investment founder no longer needs to promote the investment. At this point, the cash really begins flowing in, and the investment promoter's lifestyle typically escalates to the level of extravagant.

Ostentatious houses, luxury cars, designer clothes and exotic vacations all contribute to the illusion that the investment promoters are successful business people.

Rather than viewing the extravagant lifestyles of the investment promoters as the

red flags they are, investors tend to view them as possibilities for themselves in the not-so-distant future. In other words, greed overwhelms reason and logic.

Another reason the scheme is so effective is that the investment promoters do not have to pay out very much money since those who were paid the promised returns tend to reinvest their money in it.

Thus, the promoters must simply send paper statements to investors showing how much they have earned on their investment, which is typically much higher than any alternative investments available to them.

Inevitably, one of three things will happen:

- The investment promoters disappear, taking any remaining investment money with them.

- The scheme collapses of its own weight as the economy sours and investor recruiting slows, which makes it increasingly difficult for the promoters to pay out the

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promised returns and, as the word spreads, more people start asking for their money and create a run-on-the-bank situation.

- The scheme is exposed when regulators examine the accounting records of the business and discover the majority of the listed assets do not exist.

In the end, the promoters — if they can be apprehended — go to jail and the investors lose most or all of their money. In retrospect, most investors will berate themselves for being so gullible and greedy.

Unfortunately, many investors are wiped out financially and never fully recover.

Word to the wise

According to the Better Business Bureau, Ponzi-style

investment schemes are “the biggest single fraud threat confronting American investors.”

The SEC reports that Ponzi schemes cost U.S. investors billions of dollars every year. To avoid falling victim to a Ponzi scheme, do the following before investing your money in that “fantastic” or “exclusive” investment opportunity:

1. **Be skeptical of investments that promise extraordinary returns** at little or no risk, even if your family and friends claim they have received the promised returns.

2. **Do not invest in anything you don't understand.** If the promoter cannot explain the investment strategy in simple enough terms for you to understand, do not invest in it.

3. **Do not invest anything or sign any contracts in a high-pressure situation.**

Tell the promoters you need time to do research and think about the investment opportunity.

4. **Carefully research the investment claims** as well as the backgrounds of the investment company along with its promoters. Make sure the investment offering is registered with state securities regulators and the promoters are licensed by state regulators.

In summary, I propose a revised version of an age-old adage: “If it sounds too good to be true, prepare to be scammed.”

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