

12 Steps To Avoid Ponzi Schemes & Investment Frauds



By Christopher T. Marquet
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It has been two and a half years since the largest Ponzi scheme in history came to light with the collapse of Bernard L. Madoff Investment Securities, LLC in late November 2008 – now estimated to be about \$20 billion. Since that time, numerous other major Ponzi schemes and investment frauds have been revealed, including infamous Madoff runners up: R. Allen Stanford and his Stanford Group entities (\$7.2 billion); Thomas J. “Tom” Petters and his Petters Worldwide Group (\$3.65 billion); Paul Greenwood and his Westridge Capital Management (\$1.3 billion); Joel Steinger and his Mutual Benefits Corp. (\$1.25 billion); Scott W. Rothstein and his Rothstein Rosenfeldt Adler (\$1.2 billion); and Nevin K. Shapiro and his Capitol Investments, USA (\$880 million). These are all massive frauds that have shaken investor confidence around the globe. Calls for stricter oversight and regulation abound and special criticism of the Securities & Exchange Commission has mounted for its apparent failure stop these frauds.

Nevertheless, greater investor awareness, due diligence efforts and increased enforcement actions – already underway – should help prevent future schemes from getting so destructive. Sadly, this will not stop the seemingly bottomless cesspool of con-artists who perpetuate investment fraud schemes. While it appears that Ponzi schemes have proliferated in recent years – and the numbers from our upcoming *Marquet Report on Ponzi Schemes* seem to support this theory, get-rich-quick investment fraud schemes have always been around. Indeed, these invasive weeds will continue to germinate with the allure of fast money and riches, lavish, celebrity lifestyles and the accoutrements that come with it all. The question is, can these weeds be squelched before they do too much damage?

Inevitably, all Ponzi schemes and other investment frauds such as pyramid schemes, collapse under their own weight. It is simply impossible to deliver high rates of return – universally implied or explicitly promised in Ponzi schemes – by using investors’ funds while continuing to attract additional investors. The collapse or revelation is only a matter of time. Unfortunately for those investors burned by the schemes, they will typically only see pennies

on the dollar recovered. Claw-backs may also take back earlier returns derived from fraudulent schemes.

Some practical strategies for investors to help them avoid investment frauds and Ponzi schemes include, but are not limited to, the following:

- 1. Do your due diligence** – thoroughly check out prospective investment advisors, money managers, hedge fund operators, private equity funds and any other individual or entity to be entrusted with your hard earned investment funds. As *The Marquet Report on Ponzi Schemes* has demonstrated, a significant percentage of Ponzi scheme operators (at least 1 in 8, according to our research) have prior criminal, fraud accusation or regulatory censure in their histories. Others are not even registered with the appropriate regulatory bodies. Nearly 5% of the investment frauds we reviewed in this report involved the sale of completely phony securities. Make sure outside auditors are reputable. In some cases they have been completely phony.
 - *Regulatory & professional checks* - The SEC requires investment adviser representatives and investment advisor firms to register by filing an “Independent Adviser Public Disclosure” called a “ADV Form”. These can be searched directly on the SEC’s web site [here](#). The SEC site can also be searched for regulatory actions, litigation notices, enforcement actions and other sanctions. The Financial Industry Regulatory Authority (“FINRA”) maintains a searchable disclosure called “BrokerCheck” which includes files on registered brokers, including affiliations, qualifications and regulatory actions (see [here](#)). Each state has a securities regulating body that can be contacted. A useful listing can be obtained at the North American Securities Administrators Association, [here](#). Other professional associations can be checked as well, including [The Financial Planning Association](#), [The National Association of Personal Finance Advisors](#), and the [Certified Financial Planner Board of Standards](#).
 - *Background checks* – for deep digging conduct a thorough background check on the individual(s) to be entrusted with investment funds. This would include a thorough vetting of credentials, employment history, educational background, as well as independent civil and criminal checks, searches for liens, judgments and bankruptcies and the aforementioned regulatory bodies. Media coverage, business affiliations and online Internet profiles should all be checked. Identify “non references” – individuals who have had dealings with the subject in the past, but may not be listed as a client reference. Such individuals may be former business partners, former employees, current or former clients, industry analysts and others. Finally, a “lifestyle check” can also be conducted. As we have seen, most Ponzi schemers live a fairly opulent or lavish lifestyle. While not a conclusive indicator

of fraud, it is certainly a common theme. Independent investigatory firms like [Marquet International](#) and other reputable outfits provide this kind of service.

- *Talk to people* – it is not good enough to just “ask around” or talk to references provided. No one gives out bad references. Some fraudsters actually manufacture fraudulent references. Speak to actual longtime clients. Speak to “non” references. This latter category can be identified by asking the actual references for others to speak to or through the background investigation outlined above.

2. **If it sounds too good to be true, it probably is** – as we have seen Ponzi schemers induce prospective investors with the promise of higher than market returns – often sky high or extraordinary returns. The upcoming *Marquet Report on Ponzi Schemes* analysis shows that the higher the promised returns the shorter the life of the Ponzi scheme. Still, that is cold comfort for those who get burned. Any investment program that purports to deliver significantly higher than market rates of return should be an immediate yellow, orange or even red flag, depending upon how incredible they are. That, in fact, is the proper word for it – incredible – meaning “so extraordinary as to seem impossible,” “not credible,” “hard to believe,” “unbelievable,” “farfetched,” “astonishing,” and “preposterous,” according to dictionary definitions.
3. **Be skeptical of exotic financial products** – if you cannot understand what the investment is and how it works, you probably should not invest in it. Ponzi schemers do not like to have to explain their programs with too much specificity and therefore often make them appear highly complex or simply describe their trading program as “proprietary” or an “exclusive” program.
4. **Be skeptical of “once in a lifetime claims”** – as in the case of typical pyramid schemes, prospective investors are given a “once in a lifetime” opportunity to “get in on the ground floor”.
5. **Be highly skeptical of “guaranteed” returns or “risk free” investments** – as previously noted, no legitimate investment advisor can or will guarantee returns and no investments are risk free. Since all investment involves risk, higher returns necessarily means higher risk. Also avoid investments described as “sure things” or “special” or “exclusive” access.
6. **Be skeptical of investment programs targeted at specific “affinity” groups** – as our upcoming *Marquet Report on Ponzi Schemes* determined, elderly or retired individuals are the most common affinity group targeted by Ponzi schemers. Other common affinity groups include Religious sects and Ethic groups. Ponzi schemers sometimes attempt to create an exclusivity mystique about their investment “opportunity.” Be

concerned if your investment advisor claims you are now a member of an “exclusive” club.

- 7. Be skeptical of flimsy disclosures and statements** – Many Ponzi schemers provide little disclosure information (naturally) upfront and provide fraudulent or completely fabricated statements to investors. Examine the statements, be sure they are detailed and regular, ie. monthly. Statements should come from the custodian of funds, not the investment advisor.
- 8. Be wary of too regular returns, especially in a volatile market** – it is impossible for real securities investments to make consistent returns, month after month, year after year. This was Madoff’s hook (and tell), by providing stability of returns. Likewise, if promised returns or dividend payments are not forthcoming, investigate. Be sure your liquidation options are open.
- 9. Be skeptical of new or unknown investment firms/advisors** – It is much less risky to work with a well-established reputable outfit than someone new or unknown.
- 10. Be skeptical if your investment advisor is also not the custodian of your investment** – the adjunct is also valid: be wary if the custodian is an affiliate of the investment advisor. The custodian has direct access to your investment funds.
- 11. Avoid high pressure sales tactics and Internet solicitations** – you can be sure than many of these are fraudulent.
- 12. Diversify your investments** – Many investors lost their life’s savings in the recent spate of Ponzi schemes. That is because they put all of their eggs in one basket. If the basket rots through, a diversified investor will at least have many other baskets to place their eggs.

Ponzi schemes can be avoided with the proper amount of due diligence and a healthy dose of skepticism.

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