Trust, Gullibility & Greed
Ponzi and Beyond

Allan Bachman, CFE
Education Manager
Association of Certified Fraud Examiners
Austin, Texas
Agenda

▲ Evolution
▲ Where does this begin?
Where Did it Start?  
Who knows?

▲ In existence in some form for long before 1900  
▲ “borrowing” from Peter to pay Paul

▲ Charles Dickens’s 1857 novel *Little Dorrit* described the fraudulent dealings (a pyramid-type scheme) of a banker, Mr. Merdle.

Ponzi did not invent this type of fraud
Pyramid Scheme

▲ Investment strategy based on a hierarchical setup.
   ▲ Greater focus on recruitment than on product sales.
   ▲ New recruits make up the base of the pyramid

▲ Initiated by recruiting investors with an offer of guaranteed (high) returns

▲ Earliest investors receive the promised high rate of return

▲ New wealth is generated by promising higher-than-average returns to new recruits
   ▲ Liabilities always exceed the assets
Doctrine of Utmost Good Faith

▲ **Minimum standard** in most financial transactions

▲ Requires the *buyer and seller to act honestly* toward each other and to *not mislead or withhold critical information*

▲ In a Ponzi scheme this is the *first thing violated*

▲ Fundamentally: *Trust*
Guilt-Edged Investment

▲ A transaction that makes money by unethical means

▲ Not *necessarily* using illegal practices

▲ Examples:
   ▲ Bucket Shop
   ▲ Churning
   ▲ Circular Trading
   ▲ Front Running
   ▲ Pump and Dump
The Requirements to Being “Taken In”

▲ The tendency of humans to model their actions on the behavior of other humans
  ▲ Especially true when dealing with matters they don’t fully understand

▲ The twin mechanisms of:
  ▲ Many people *making big profits* on their investment and
  ▲ *Telling others*

▲ Makes the investment seem *safe* and at the same time *too good to pass up*
Gullibility and Greed

▲ Gullibility is often equated with trust

▲ Some level of emotion enters into virtually every gullible act

▲ The single emotion that motivates gullible behavior can be a strong wish to increase and protect one’s wealth

▲ Critical in a Ponzi Scheme

▲ In some individuals, this takes the form of greed
Robert Shiller, an American Nobel Laureate, economist, academic, and best-selling author coined the phrase saying:

“…that others have made a lot of money appears to many people as the most persuasive evidence in support of the investment story associated with the Ponzi scheme…”

...evidence that outweighs even the most carefully reasoned argument against the story”
Ponzi Scheme Pyramid

Pyramid schemes can become impossible to sustain, as shown in the pyramid.


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Required Elements

▲ Trust
  ▲ Key attribute to the early investors
  ▲ The necessary structure builds on trust

▲ Precision / Complexity
  ▲ Some “black box” mechanism which is overly complex

▲ Spin
  ▲ How it is sold: “The story”

▲ Greed
  ▲ Investors
Ponzi Scheme: Mechanics

▲ Investing fraud involving *promise* to investors *of high rates of return with little risk*

▲ Generating *returns for early* investors by *acquiring new investors*

▲ Investment yields promised returns to investors only as long as there is a *constant supply of new investors (i.e. new money)*
How They Succeed

▲ Active Salesmanship
▲ Diverted Skepticism
▲ Carefully Refined Pitches
▲ Ready Answers
▲ “Industry Expertise”

*Despite potential red flags, investors will be “blindly” attracted to “too-good-to-be-true” returns*
Why They Succeed

▲ There is no upside to finding them

▲ Exposure requires convincing people of what they do not want to believe

▲ *Each element* taken in a vacuum *could be possible*

▲ High rates of return are the enticement to keep true due diligence at bay
Affinity Fraud

▲ Investment scam which targets members of an identifiable group
   ▲ Race, age, religion, social status, etc.

▲ Fraudster either is, or pretends to be, a member of the group

▲ Leverages and exploits the inherent trust within the group
   ▲ Enlists the help of the leader to spread the word, abetting the fraudulent scheme
Ponzi Scheme: Downfall

▲ Collapses when the new investments slow or stop

▲ Outflow > Inflow

▲ In the long run: *will not and cannot succeed*
Exit Strategy

▲ There is none...
Agenda

▲ Evolution

▲ Mechanics

▲ History
  ▲ Ponzi brands a fraud scheme
Carlo Pietro Giovanni Gugliemo Tebaldo Ponzi
“Charles” Ponzi Brief Pre-History

▲ Born Italy 1882

▲ Arrived in Boston November 1903

▲ Worked as a waiter, fired for shortchanging customers and theft

▲ Moved to Montreal 1907; teller, then manager at Banco Zarossi

▲ Arrested and imprisoned in Canada for forgery

▲ Spent 3 years in St. Vincent-de-Paul Federal Penitentiary
“Charles” Ponzi Brief Pre-History

▲ Released in 1911 attempted to return to USA
▲ Caught in a scheme to smuggle immigrants into US
▲ Convicted; spent two years in Atlanta prison
▲ Returned to Boston
▲ Married in 1918
▲ Started companies and other ventures which were failures
Everyone Knows What a Ponzi Scheme Is

But do you know what Ponzi’s fraud was?
“Why should I worry about money?
The money is always around to be had.

The main thing is to have an idea.
A plausible idea which can be dressed up and sold.”

Charles Ponzi
Spring 1919 Ponzi establishes an import/export business

January 1920 creates *The Securities Exchange Company* selling investments in International Reply Coupons
International Reply Coupons
International Reply Coupons

▲ $1 in USA could purchase 20 5¢ IR Coupons

▲ $1 (US) in Rome could purchase 66 5¢ IR Coupons
  ▲ A total value of $3.30 (66 x 5)
  ▲ Post WW1 currency deeply devalued

▲ Profit of $2.30 for every dollar invested
Ponzi’s Plan

▲ Purchase IR Coupons in bulk overseas with investors’ money

▲ Redeem them in the USA

▲ Pay investors

▲ Pocket the difference
“It might have looked economically unsound as an investment. But it was extremely attractive as a gamble.”
Ponzi’s Scheme

▲ January 1, 1920: Investment opportunity offered:
   ▲ Promised 50% return in 45 days

▲ 18 initial investors for a total of $1,770
   ▲ Average investment: $98.33

▲ February 15, 1920: paid $2,478
   ▲ Average return $137.67
Ponzi’s Scheme

▲ Investment opportunity offered to the public:
    ▲ Promised 50% interest in 90 days

▲ By July 1920
    ▲ $10,000,000 in cash invested
    ▲ $15,000,000 in notes issued
    ▲ 30 New England branch offices

▲ Took advantage of the public’s unfamiliarity with:
    ▲ Postal regulations
    ▲ International exchange rates
“I knew [investors] would either come back or send their friends.”

“Confident that the coupons were on the way, I had redeemed a number of my notes with cash derived from the issuance of new notes.”

July 1920
Ponzi Sees the Writing on the Wall

“When the coupons failed to arrive, I found myself in the position where I could not have met all my outstanding notes in full.”

“Not only couldn’t I pay the promised 50% return. But I couldn’t even refund the principal at more than $0.75 on the dollar.”
The Wheels Come Off

▲ William H. McMasters hired by Ponzi to handle public relations

▲ July 24, 1920—Adverse newspaper publicity begins
  ▲ Audits and investigations begun
  ▲ Ponzi makes his promises

▲ August 2—*Boston Post* claims Ponzi is insolvent
  ▲ Article written anonymously by McMasters

▲ August 12—Charles Ponzi turns himself in
DECLARÉS PONZI IS NOW HOPELESSLY INSOLVENT

Publicity Expert Employed by "Wizard" Says He Has Not Sufficient Funds to Meet His Notes—States He Has Sent No Money to Europe Nor Received Money from Europe Recently

NEW MOVE TO FOIL MANNIX

Hold Soldier for Murder

Money in Banks Taken from Investors

Tell of Visits to Official Last Monday

PUBLICITY EXPERT EMPLOYED BY "WIZARD"

"WIZARD" SAYS HE HAS NOT SUFFICIENT FUNDS TO MEET HIS NOTES—STATES HE HAS SENT NO MONEY TO EUROPE NOR RECEIVED MONEY FROM EUROPE RECENTLY

NEW MOVE TO FOIL MANNIX

POISON AS ANTIDOTE FOR LOVE

LOW BALTIC LIBERATOR TO BE SENT FROM LIVERPOOL TO SOUTHBOSTON

CAMERON DEVOS, SERGEANT IDENTIFIED BY WIFE OF SOUTHBOSTON POLICE COMMISSIONER

WOMAN KILLED FROM MERIDIAN

FOREIGN EXCHANGE

HANOVER TRUST CO.

HD

METROPOLITAN TRUST CO.

5% INTEREST AND SECURITY

HANOVER TRUST CO.

5% INTEREST AND SECURITY

TOMORROW SATURDAY

HARBOURGHER, KUHN & CO.

43 TREMONT ST., BOSTON, MASS.

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The Next Chapter

▲ Federal charges
  ▲ Pled guilty: sentenced to 5 years
  ▲ December 11, 1920, begins sentence
  ▲ Released in 1924

▲ State charges
  ▲ Three trials
    ▲ November 1922: Not Guilty
    ▲ November 1924: Hung Jury
    ▲ February 1925: Conviction
      ▲ Sentenced to 7–9 years
“…nothing deters a man from evil more than the certainty or a strong possibility of being caught and punished for it.”
The Final Chapter

▲ February 1927 - Ponzi is extradited from Texas to Massachusetts
▲ February 1934 - he is released
▲ October 1934 - he is deported
▲ 1949 – dies in Rio de Janeiro

Ponzi spent 31 years in North America more than half of that in prison
Agenda

▲ Evolution

▲ Mechanics

▲ History
  ▲ Ponzi brands a fraud scheme
  ▲ Madoff takes it to the next level
Madoff’s Ponzi

▲ Delivered consistent returns of 1 – 1.5% per month for more than 20 +/- years

▲ Black box investment strategy
  ▲ “a proprietary option collar strategy…meant to minimize volatility”

“I was not willing to have them…do the due diligence… I absolutely refused to do it.”

“You don’t like it, take your money out, which of course they never did.”

Bernie Madoff
The Wheels Come Off

December 10, 2008, three months after the stock market cratered, Madoff told senior employees at BLMIS:

“It's all just one big lie
...basically, a giant Ponzi scheme.”

Turned into the FBI
Arrested
December 11, 2008
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**Due 2/12/2009**

2/12/2009

**DIV**

FIDELITY SPARTAN

U.S. TREASURY MONEY MARKET

DIV 11/12/08

FIDELITY SPARTAN

U.S. TREASURY MONEY MARKET

DIV 11/19/98

FIDELITY SPARTAN

U.S. TREASURY MONEY MARKET

DIV 11/19/98

CONTINUED ON PAGE 3

**Please retain this statement for income tax purposes**
Where is Bernie Madoff?

▲ Pled guilty to all 11 counts:
  ▲ Securities fraud, wire fraud, mail fraud, money laundering, making false statements, perjury, theft from an employee benefit plan, and making false filings with the SEC
  ▲ Sentenced June 29, 2009 by Judge Denny Chin
  ▲ Called Madoff’s conduct “extraordinarily evil”
  ▲ Judge felt: “The benefits of giving him hope [to get out someday] were far outweighed by all of the other considerations.

▲ Serving 150 years in Federal Correction Institution Butner, NC. Inmate # 61727-054
  ▲ Madoff: “[Judge] was anything but fair, with zero understanding of the industry”
Co-Conspirators & Accomplices

▲ Peter B. Madoff, Chief Compliance Officer
▲ David G. Friehling, CPA
▲ Frank DiPascali: Madoff “Right-Hand Man”
▲ Enrica Cotellessa-Pitz: Controller
▲ Annette Bongiorno: Madoff personal secretary
▲ Joann Crupi: Madoff portfolio manager
Co-Conspirators & Accomplices

▲ Daniel Bonaventure: Director of Company Operations and Accountant
▲ Jerome O’Hara: Computer programmer
▲ George Perez: Computer programmer
▲ David Kugel: Trader
▲ Eric Lipkin: Payroll Manager
▲ Irwin Lipkin: Former controller
Immediate Family Members?

▲ Ruth Alpern
   ▲ Denies knowing of any Ponzi scheme
   ▲ Legally changed to maiden name
   ▲ Living in seclusion in Florida
   ▲ Never interviewed by investigators

▲ Andrew
   ▲ Denied knowing of any Ponzi scheme
   ▲ Sued by trustee for $73,800,000
   ▲ Died of cancer September 2014

▲ Mark
   ▲ Denied knowing of any Ponzi scheme
   ▲ Estate sued by trustee for $81,300,000
   ▲ Committed suicide Dec. 11, 2010
“The man who is admired for the ingenuity of his larceny is almost always rediscovering some earlier form of fraud”

John Kenneth Galbraith
December 11

Carlos “Charles” Ponzi
1920 Enters Federal prison

Bernard Madoff
2008 Turns himself in to the FBI

Victor Lustig
1935 Starts prison term
Sold the Eifel Tower

Twice
Questions?

Allan Bachman, CFE
(512) 276-8158
ABachman@ACFE.com
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Thank You

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Education Manager
Association of Certified Fraud Examiners
Austin, Texas