



LET'S TALK ABOUT...

FINANCIAL LEXICON EDITED BY THE SWISS ASSOCIATION OF ASSET MANAGERS

Ponzi Scheme

(Part Two) Attracting investors through very high returns and alluring proposals, retaining them thanks to their constant flows, whatever market conditions, making them feel comfortable in face of competing placements: but such yields being not the result of regular investments but just the shift of new clients' money towards the old ones. These are the main features of a Ponzi scheme, a fraudulent structure which has been constantly present throughout the financial history, named after the story of Charles Ponzi in the 20's. Later other major scandals have arisen, as the one designed by Nicholas Cosmo, who promised short-term returns of 50 to 80%, or Joseph Forte's fund, recently charged by the SEC-Security and Exchange Commission, until the very famous and current Madoff *affaire*, the "big one" amounting to about 50 billion US dollars, also involving a huge number of investors, a lot of funds, banks and other financial institutions. Other Ponzi schemes are surely to emerge, also because during the periods of financial crisis, such fraudulent temptations tend to increase. However a clarification applies, because the idea of Ponzi Scheme is sometimes linked to financial cases which are to be rather viewed as just speculative bubbles, in that there is no specific design aimed at using fresh money to pay old participants. If an investor is attracted by the surging value of an asset, due to its increasing demand and "fashion effect", so fueling a speculative spiral up to unsustainable levels and subsequent cracks, that is not a Ponzi scheme indeed. On the contrary a sceptical mind could see certain bad-balanced pension structures in which current workers pay for retired persons as sorts of "good faith" Ponzi schemes, not to say of the many bailouts and support plans which use taxpayers' and "innocent" savers' money to recover the losses and damages created by speculative and unrestrained investors and managers. But that is another story. *(end)* GLT

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(Part One) Among the many news of market downturns, difficulties in trading sorts of securities, blocks of redemptions, postponed payments, not to mention daily bankruptcies and bailouts, fraudulent situations are also emerging, some of which are labelled as "Ponzi schemes". A Ponzi scheme is a type of investment, or better pseudo-investment, that attracts investors by promising high returns, usually much higher than market averages for similar placements. But such returns do not come from real profits, but out of the fresh money of new investors. For the scheme to work over time, if not suddenly interrupted by supervision or legal authorities, two major necessary conditions are the continuous contributions of new clients and the absence of huge redemptions by old ones. Of course a good deterrent against redemptions is the high level of returns which allure the clients to hold on. Moreover the scheme is often supported by a system of fees and rebates in favour of persons and institutions which, consciously or not, feed the scheme at different levels. The operation's promotor benefits from management and administration fees, even if in some cases there is no investment activity at all, and funds are just shifted from new clients to the old ones, less the fees for the management and the network's actors. Ponzi schemes may be found throughout the financial history at all times and in all countries, but the scheme is actually named, in financial literature and the media, after Charles Ponzi, who emigrated to the United States from Italy in 1903 and during the 20's involved about 40,000 people in a famous financial fraud related to postage stamps, by promising 50% returns for very short term investments. Since then many other Ponzi situations have come out or are just under assessment and investigation, as the very cited Madoff *affaire*, which involves much bigger figures than the Charles Ponzi's one, both in terms of number of investors and amount of the fraud itself, likely amounting to \$50 billion. *(to be continued)* GLT

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