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Revealing Impact of a Dim Economy:

A Deluge of Recent Ponzi Schemes

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Bernie Madoff's fraud on investors was certainly the largest in history – with actual losses of $18 Billion and estimates of fabricated gains as high as $65 Billion. But time has shown he was not the only one. In the 16 months since Madoff's arrest, a good number of other cases have come to light.

In February 2009, for example, the SEC filed civil charges against R. Allen Stanford and three of his companies for orchestrating a fraud tied to the marketing of $8 Billion in high-yield CDs. Like Madoff, this alleged Ponzi scheme came with financial statements and investment income the SEC has described as "fictional." A few months later, Stanford was arrested by the FBI and indicted on criminal charges. Stanford's personal assets, as well as those of his companies, are currently under court-ordered receivership and his criminal trial is set for January 2011. On the civil side, an investor's committee was formed to pursue actions against third parties to try to recover some of their losses if the court-appointed receiver decides not to sue them himself.

Last April, Art Nadel was indicted on 15 counts of securities, wire and mail fraud based on a Ponzi scheme with his hedge fund, Scoop Management. News of the Madoff case reportedly prompted business associates to demand an audit, which then prompted Nadel to disappear. He was later found and arrested in Florida, though much of the estimated $350 Million has yet to be accounted for.

SoCal investors not immune

In addition to these cases, a number of other suits have garnered national attention. While Madoff and others like him may be little more than folks we read or hear about, the fraudulent investments they have become synonymous with – *Ponzi schemes* – are all too real for more than a few Orange County residents.

One need look no further than the Medical Capital case before Judge Carter in District Court right here in Orange County. Last August, the SEC filed suit alleging fraud on investors based on the wrongful taking of funds and misrepresentations about prior defaults and late payments. The case has since been described as one of the largest Ponzi schemes in Orange County history. While the SEC was able to obtain an emergency order and a receiver has been working to recover what he can for investors, some may fare better with lawsuits against third parties, such as the broker-dealers that sold the notes and others who may bear responsibility, though it remains to be seen.

Also close to home, and even more recently, the SEC filed a case last month over a $14.7 Million Ponzi scheme that targeted pensions of bus drivers in Los Angeles County. According to the complaint, an investment advisor encouraged the drivers to take a lump sum payment from their pensions and roll them into IRA accounts under his management. The drivers were lured by promises of annual returns of 10-15%, which the SEC says were false. The judge in that case has since granted the SEC's request for a temporary restraining order and frozen the assets of the investment advisor and his companies.

Financial meltdown sparks scrutiny

A significant number of other Ponzi lawsuits have also made recent headlines. In addition to all these cases, there are an even greater number of smaller cons, relatively speaking, that most have probably never heard of.

With all these scams of late, one has to ask why. Is it a sign of the times? Are there more swindlers today than in the past? Perhaps the media and Internet have just increased our awareness.


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In fact, some have said the SEC's embarrassment in failing to catch Madoff's scheme has caused the agency to pursue and run press releases for more and more of these cases since they fit the hot topic of the day.

Or perhaps it is the economy. Why not? It is an easy target that has taken blame for just about everything the last two years. But if you stop and think about it, the fact these frauds came to light in or after 2008, a year marked by global market turmoil and the financial sector meltdown, is not just coincidence.

The nature of the Ponzi scheme itself offers some explanation. The SEC defines a Ponzi scheme as an investment fraud involving payment of purported returns to existing investors from funds contributed by new investors. It is named after Charles Ponzi, who ran an international stamp redemption practice in the 1920s that claimed to reap annual net returns of more than a 400%! In Ponzi's case, his scheme grew too big, causing regulators to realize that more than 100 million stamp transactions were needed to substantiate the millions of dollars he raked in. With only 27,000 transactions on the books, something was clearly amiss and Ponzi was arrested and indicted in short order.

Absent government intervention, most Ponzi schemes can continue undetected unless it becomes difficult to recruit new investors or a large number of existing investors ask for the return of their principal. In other words, as long as there is a consistent flow of new money, the scheme has the possibility of forging ahead for a quite a long time, at least until regulators catch on or enough investors try to cash out.

Considering these characteristics, one can see how a declining economy can lead to revealing a fraudulent scheme for what it is.

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After all, when money is tight, existing investors are inclined to look closer at their current holdings. Some who are confident in a bull market may have second thoughts when things turn bear. This rationale can lead to increased liquidation or cashing out of investments, further drying up a fraudster's pool of available funds.

Additionally, in a down economy, there is simply less money to go around. Even those who are capable of investing may choose to sit "on the sidelines." In more difficult times, new investors may also be cautious of less traditional forms of investments, which many Ponzi schemes can be associated with. These factors, in turn, can make the scheme's organizer desperate and more likely to make outlandish promises or solicit unqualified investors, thereby drawing the eyes of regulators.

Beyond Ponzi schemes

Thus, the state of the economy since 2008 has contributed to the revelation of more and more Ponzi schemes. However, it is also important to understand that while the word "Ponzi" has become a popular catch phrase these days, not all cases fit within this category. Beyond Ponzi, investment frauds can range from the simple to the complex, and many can be tied, in part, to some form of legitimate business. Yet whether it is actually a Ponzi scheme or some other type of fraud, investor rights and remedies are usually triggered by some sort of material misrepresentation.

The good news is that regardless of the form of investment fraud, if you have been had, there may be help. You just need to know where and how to look for it. The laws in this area are designed to protect investors, and while every case is different, you will not know all of your options until you seek and find excellent advice.

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