

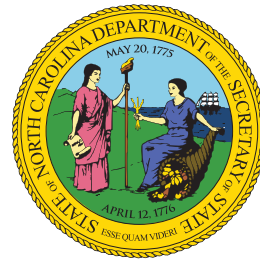
5. **Ask for detailed information in writing.** Ask for information on the company, its officers and its financial track record. If a product is involved in the deal, ask for documentation of its cost, fair-market value, and existing and potential markets. If a promoter is reluctant to provide information, consider it a red flag of a potential Ponzi scheme.
6. **Verify the promoter's claims.** In one scam, promotional materials indicated that a commodities pool operation was licensed by state and federal governments, that losses were limited to 50 percent of an investor's funds, and that the pool traded more than \$100 million in commodity futures contracts in each of the past five years. None of the claims was true.
7. **Seeing is believing.** Be skeptical of deals that can't be checked out in person. Be particularly leery of claims that all banking transactions and bookkeeping are handled in remote cities or countries, or "offshore."
8. **Resist pressure to reinvest without seeing your "profits."** Promoters often try to keep Ponzi schemes alive by convincing initial investors to roll over their profits for even better returns. While it often makes sense to stick with a legitimate investment over time, be suspicious of promoters who are reluctant to let you cash in your gains.
9. **Look for unbusinesslike conduct or disruption of services.** An investor in one scam received a handwritten receipt bearing the words, "Received With Thanks." Reluctant to have their schemes exposed, few Ponzi operators enlist much office help, if any. They may answer the phones and mail themselves. This hastens the collapse of the scheme, as one person finds it more and more difficult to keep up with all the required interest payments and investor contracts.

Want to be kept in the know?

Read about the latest scams and fraud prevention tips by subscribing to our monthly e-newsletter. Visit:
<http://www.sosnc.gov/sec/SubScribeEmail.aspx>.

North Carolina Department of the
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NORTH CAROLINA DEPARTMENT
OF THE SECRETARY OF STATE
SECURITIES DIVISION

PONZI SCHEMES



Very few swindlers are remembered beyond their lifetimes. Charles Ponzi, however, has staying power.

Perhaps you know little or nothing about the Italian immigrant who first arrived in Boston in 1903 at the age of 20, but you're probably familiar with his legacy: the investment scam known as a "Ponzi scheme."

After traveling up and down the East Coast between Canada and the Deep South looking for easy business ventures, Ponzi eventually resettled in Boston in 1917. It was there that he devised the fraudulent investment plan that bears his name even today.

“Ponzi schemes continue to rob an army of Peters to pay only a handful of Pauls.”

Ponzi noted that International Postal Reply Coupons, an internationally recognized form of pre-paid postage, could be bought for one or two cents abroad and redeemed for six cents in the United States. In 1921, he opened his Securities and Exchange Company in Boston and began telling investors that he could provide a 100% return in just 90 days compared with the 5% return banks were offering on their savings accounts. Ponzi was deluged with funds from investors, taking in \$1 million during one three-hour period. Though a few early investors were paid off to make the scheme look legitimate, an investigation conducted by the *Boston Post* and law enforcement eventually exposed Ponzi by showing that there weren't enough of the postal coupons in circulation to support the returns he promised. They found that Ponzi had purchased less than \$50 worth of the international mail coupons, but had fleeced investors of about \$10 million. He was imprisoned in Massachusetts and later deported to Italy. He eventually died in a Brazilian charity ward in 1949.

Thanks to the explosion of financial services and investment opportunities available to the public today, Ponzi schemes continue to rob an army of Peters to pay only a handful of Pauls.

HOW PONZI SCHEMES WORK

A classic Ponzi scheme depends upon a steady stream of new investors with get-rich-quick desires. The promoter advertises a plan that promises large returns for little or no effort on the part of the investor. Without disclosing it, the promoter pays early investors above-market rate returns with the money collected from new investors. To keep the scheme alive, the promoter relies on the power of positive word-of-mouth advertising from early investors to attract new investors. Without new investors, the scheme will eventually collapse under its own weight — that is, if the swindler hasn't already disappeared with the investments.

ELEMENTS OF A PONZI SCHEME

Like all good con artists, Ponzi scheme operators prey on the weaknesses of their victims. Victims are urged to cash in on a quick, speculative scheme rather than invest for the future, usually on the false promise that the investment is risk-free. Promoters often concentrate on specific cities, types of investors, family members, church groups, professionals, and social acquaintances. Initial victims unwittingly aid the swindler by lining up their friends, relatives, and professional associates as new victims. (For more information, see our brochure entitled *Affinity Fraud*) Initial investors are paid off handsomely, often at higher than promised rates. This is the "proof" shown to skeptical investors.

Inevitably, all Ponzi schemes are doomed to fail because the number of new investors needed to pay off earlier investors becomes impossible to sustain. Unfortunately, investors are slow to admit that they've been swindled for fear of public embarrassment for having fallen victim. Frequently, there's a fear that public exposure will create a run on the promoter and make matters worse. And, as the scheme relies on a sense of community, there's a fear that others will ostracize the first investor who breaks ranks within the professional or social circle.

“...all Ponzi schemes are doomed to fail because the number of new investors needed to pay off earlier investors becomes impossible to sustain.”



Finally, investors frequently cling to the faintest hopes that everything will work out for the best. Even after Charles Ponzi was exposed, investors pressed funds on him under the belief that everything would work out — and even blamed the government for "victimizing" Ponzi!

AVOIDING PONZI SCHEMES

Don't Get Scammed! Here are some basic rules to follow:

1. **Beware of promises of high, guaranteed profits.** This is perhaps the easiest way to spot a Ponzi scheme. Any legitimate investment involves a degree of risk that makes it impossible to promise profits, much less astronomical returns.
2. **Avoid promoters who won't provide clear and detailed explanations of their investment vehicles.** Don't listen to promoters who tell you that it is impossible to explain their deal in layman's terms.
3. **Check out the promoter's background.** The Securities Division of the North Carolina Department of the Secretary of State can tell you whether a person is legally allowed to sell securities in the state and whether any complaints or regulatory actions have been filed against the seller. One quick call to the Division at 1-800-688-4507 could prevent you from falling victim to a fraud.
4. **Get information on the offering.** As most Ponzi schemes involve securities known as "investment contracts," they should be registered as securities offerings with the Securities Division. Contact the Division at 1-800-688-4507 to see if the offering has been properly registered. Your local Better Business Bureau also may have information about the investment program or the promoter.