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NEWS RELEASE

Financial Literacy Month Tip of the Week

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Twenty-first Century Ponzi Schemes

Lessons from Charles Ponzi, Bernie Madoff and Daren Palmer

Boise, Idaho…Bernard Madoff perpetrated a multibillion-dollar scam that defrauded investors around the world for decades until his arrest in December 2008. Daren Palmer, perpetrator of the largest Ponzi scheme in Idaho's history at more than $60 million in losses, led many Idahoans to financial disaster. The Department of Finance says there are lessons to be learned from these and similar schemes, which have increased significantly in recent years both nationally and in Idaho.

For example, in 2011 alone, enforcement action was taken by the department or another agency in seven cases investigated by the department where there appeared to be elements of a Ponzi scheme. And according to a recent national study, there were 329 "major" (over $1 million in assets) Ponzi schemes uncovered in the United States since 2002 with an estimated 233-percent increase in Ponzi schemes uncovered from 2007 to 2011, largely due to the economic downturn.

Named after Charles Ponzi, his scheme duped thousands of New England residents into investing in a postage stamp speculation scheme in the 1920s. At a time when annual interest rates on bank deposits were paying about 5 percent, Ponzi promised investors a 50-percent return in just 90 days. While Ponzi initially purchased some postage coupons to support the scheme, he quickly switched to paying early investors using the investments of later investors.

For decades, Madoff investors received consistent and steady annual returns through elaborate, fabricated account statements and other documentation provided to investors to convince them that their money had been placed in actual investments. The investments "appeared" legitimate, especially to people receiving payments. But in reality, there were no actual investments and no actual returns. Madoff paid the initial investors "returns" with money provided him by a steady flow of new investors. In 2008, as the global economy began to decline, large numbers of Madoff investors needed money and began asking to cash in their investments. That's when Madoff's Ponzi scheme burst – he did not have enough money to cover his investors' requests and new investor money was hard to be found in the economic downturn.

"What every investor should know is that Ponzi schemes, even as extensive as Madoff's and Palmer's, are not too difficult to detect if you know the warning signs," said Gavin Gee, director of the Idaho Department of Finance. "A few simple actions can help investors sidestep the potentially devastating impact of a classic Ponzi scheme."

In a Ponzi scheme, claims of underlying investments are bogus. Very few, if any, actual physical assets or financial investments exist. As the number of total investors grows and the supply of potential new investors dwindles, there is not enough money to pay off promised returns and cover investors who try to cash out.

Here are tips to protect yourself and your hard-earned savings from a Ponzi scheme:

- **Beware of promises of unrealistic returns.** This is perhaps the easiest way to spot a Ponzi scam. Any legitimate investment involves risk. Guarantees of unrealistically high returns are a clear warning sign. But delivering consistent 10-percent returns for decades, as Madoff purported to do, is unrealistic too, if not impossible. "Too good to be true" should be considered a red flag.
- **Diversify – everything.** Don't put all of your eggs in one basket. Consider diversifying not only your assets but also your money managers, accounts, and financial advisors. Spreading your money around will limit your exposure to the financial problems of any one investment.

- **Don't rely on reputation or word of mouth alone – understand your investment.** Con men often talk a good game, but what they're saying is gibberish designed to make the investor reluctant to ask questions for fear of looking foolish. Don't fall for it! Get your questions answered or skip the investment.
- **Verify the investment details.** Ask detailed questions about the investments and those selling the investments, and get clear and direct answers before you invest.
- **Auditors.** Check the auditor, or ask your financial adviser to check the auditor of any fund or company for you. Auditors sign and certify financial statements of companies and investment funds. Investors rely on these audit reports since auditors are liable for inaccuracies.
- **Background check.** Check with the Department of Finance to determine if the individuals and firms selling the investment are registered in Idaho or check online at http://www.finra.org/Investors/ToolsCalculators/BrokerCheck/ . Most Ponzi schemes do not register or license their sales people as required by state and federal securities laws.
- **Report fraud.** If you're a victim of a Ponzi scheme, call the Department of Finance. It can investigate the matter and your call may help you and others from being victimized by the same or similar scam.

For more information visit the Department's website: http://finance.idaho.gov.

*April is Financial Literacy Month. Department of Finance Press Releases and a list of **free** financial literacy events can be found on the Internet at http://finance.idaho.gov and may be obtained by contacting the department at (208) 332-8000 or Idaho toll-free at 1-888-346-3378.*