FRAUD FACTS

Fraud Advisory Panel

Issue 7 December 2010 INFORMATION FOR INDIVIDUALS

Ponzi schemes

A Ponzi scheme is a type of investment fraud that pays returns to initial investors from money brought in by new investors. The scheme collapses when new investors cannot be recruited or earlier investors try to withdraw their principal investment.

Introduction

Investors can be attracted by promises of high returns with little or no risk. But investments that seem too good to be true usually are. Many types of investment fraud entice potential investors by promising unrealistic returns.

Investment fraud is big business and can take many different forms.

One well-known form of investment fraud is the Ponzi scheme, named after Charles Ponzi, who conned thousands of investors out of millions of dollars in Boston during the 1920s. There have since been many variations of the scheme, including the recent Bernie Madoff investment scandal in the United States.

One of the most successful UK-based Ponzi schemes in recent years has been KF Concept, which defrauded investors of £34 million through various gambling and other activities.

What is a Ponzi scheme?

A Ponzi scheme is an investment fraud that uses funds raised from new investors to create returns for earlier investors.

Investors are often lured by the prospect of high rates of return with little or no risk or by consistent returns at times of economic uncertainty.

The scheme collapses when no new investors can be found or when earlier investors try to withdraw their principal investment. Most investors lose their money.

Ponzi vs pyramid schemes

A Ponzi scheme is different from a pyramid scheme.

A Ponzi scheme will often appear to present a real investment opportunity for the individual, whereas a pyramid scheme will typically only offer individuals a right to returns if they pay a fee to join the scheme and are then able to successfully recruit other members – such as friends and family – to the scheme.

Both types of scheme are camouflaged as a legitimate company that invests, or sells or manufactures products, but the funds contributed by investors are rarely, if ever, used for valid purposes.

Thinking about investing?

Before you invest it is important that you understand exactly what it is you are buying. While there are many types of legitimate investments available, there are also many which are fraudulent. But by doing some research and looking for common warning signs you will be able to avoid being scammed.

Always check that any stockbroker or firm offering stocks and shares for sale is authorised by the Financial Services Authority (FSA) to conduct investment business in the United Kingdom. Otherwise you will not be able to access complaints procedures or compensation through the Financial Services Compensation Scheme if things go wrong.

The warning signs

Be aware of the warning signs of a Ponzi scheme:

- **High returns at low risk:** All investments have some degree of risk, which should be reflected by the expected returns. If the promised returns seem out of line with the risk of the investment, be wary. If it sounds too good to be true, it probably is.
- **Complex investment strategy:** This can apply to other investment frauds as well as to Ponzi schemes. If you cannot get a straightforward explanation of how the investment scheme works, you should not invest.
- **High-pressure sales pitches:** Because greater numbers of investors must be recruited to generate returns, sales pitches can become high-pressure. You may find it harder to resist if you have been introduced to the scheme by a friend or acquaintance, but do not be pressured into something you are unsure of.
- **Difficult-to-get-in sales pitches:** Confusingly, some Ponzi schemes purport to be very difficult to join. You may be tantalised by rumours about high investment returns, while the scheme operator appears *un*-keen to extend these 'benefits' to you. This was a characteristic of the Madoff fraud.
- **Incentives for investor recruitment:** As the Ponzi scheme requires more and more investors in order to stay afloat, many schemes offer rewards or incentives to recruit new members.

If you encounter any of these issues – proceed with caution! Investigate further and seek advice from an independent professional financial advisor.

Reporting fraud

If you think you may have become the victim of an investment fraud, report it to your local police station or to Action Fraud by calling 0300 123 2040 or visiting the website www.actionfraud.org.uk.

Recovering your money

In most cases reporting the matter to the police or to Action Fraud will represent the most realistic prospect of recovering any money lost.

For victims who have lost a significant sum of money, it may be possible to pursue civil recovery proceedings to recover losses. To maximise the prospects of success it is important to act immediately upon discovery of the fraud and seek professional legal advice.

How to protect yourself

DO:

- ✔ Seek professional and independent financial advice.
- ✔ Ask questions! Make sure you understand what type of asset you are investing in and the investment strategy behind it.
- ✔ Compare the market to see whether the return you are being offered is realistic and consistent with those offered by other similar investments.
- ✔ Review historic returns and ensure that these are in line with the market.
- ✔ Check the FSA register to see whether the individual or business is authorised to conduct investment business in the United Kingdom.
- ✔ Know who you are dealing with. Look the company up on the Companies House website to see whether it is a registered company and review its annual report and accounts.
- ✔ Take your time to make an informed investment decision.
- ✔ Report an investment fraud to Action Fraud.
- ✔ Remember, if it sounds too good to be true, then it probably is.

DO NOT:

- ✗ Believe everything you are told.
- ✗ Buy investments from unauthorised individuals or businesses. The FSA publishes warnings about unauthorised firms (based in the UK and overseas) offering financial products to UK investors on their website (see 'warnings and alerts').
- ✗ Be pressured to invest by cold-callers, friends, family or acquaintances.
- ✗ Invest in schemes that promise returns based on recruiting new investors.
- ✗ Agree to make an investment in a high-pressure meeting or presentation.
- ✗ Invest in a multi-level marketing plan or investment without professional and independent financial advice.
- ✗ Invest in a scheme that has a secretive strategy or is too complex to understand.
- ✗ Send money or give your bank account details to cold-callers without having first checked whether the caller and investment are legitimate.
- ✗ Forget that you can say no to an investment opportunity.

Further information

Helpful websites for making informed investment decisions.

Action Fraud
www.actionfraud.org.uk

Companies House
www.companieshouse.gov.uk

Consumer Direct
www.consumerdirect.gov.uk

Financial Services Authority (Register)
www.fsa.gov.uk/register/home.do

Fraud Advisory Panel
www.fraudadvisorypanel.org/

National Fraud Intelligence Bureau
www.nfib.police.uk

The Law Society
www.lawsociety.org.uk

The Law Society of Scotland
www.lawscot.org.uk

US Securities and Exchange Commission
www.sec.gov

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