You might ask, what's a Ponzi scheme? You’ll never hear an investment promoted with that name, but there are many of them around.

Ponzi schemes can be well-disguised, but they tend to share some common characteristics. If you know what to look out for, you can avoid them. The pitch is often elaborate and inventive; the promise is always very high returns over a very short time. The promise of high returns keeps new money flowing in to the scheme to pay the early investors. But all the money coming into the scheme flows right out like water through a leaky bucket, with the promoter raking off plenty for personal luxuries. Once the money stops, the investors lose all.

How Ponzi Schemes Work
The con artists who run Ponzi schemes constantly come up with new window dressing for their pitches. In Joan’s case, it was a foreign currency hedge fund, but it could be bogus mutual funds, business franchises, commercial real estate, low-cost housing projects, resale of federal reserve notes, oil exploration, unregistered securities, assigned equipment leases—anything that might sound promising, but not too specific.

For example, the Securities and Exchange Commission (SEC) shut down an Internet Ponzi scheme in which people were told that if they paid money to a certain company, then viewed ads that came up automatically on their Web browsers, they would receive money from ad revenues. They were promised a return of 44 percent in just 12 days. Some early participants were paid money invested by later participants, but most investors simply lost their money. According to the SEC, 300,000 people worldwide were bilked out of more than $50 million in this scam.

Ponzi schemes, named for a 1920s con artist, are a kind of pyramid scheme. Investors are lured with promises of unique opportunities producing high returns, and for a while they may get those returns. But what they don’t know is that their money is not really being invested in anything at all. The interest they receive is money being paid in by later investors. As long as more investors sign on, which they will because of word-of-mouth advertising about the “great returns,” everything seems fine. Early payouts can be as promised. As the word spreads, others grab at the chance to share in the riches. But since no real investments are being made, it can’t last long. The promoter is only collecting money from new participants to pay off earlier investors, so the scheme will inevitably fail. Either the con artists pocket the investors’ money and disappear, or authorities get wind of the scheme and start investigating. When they find no money where it should be in the books, or that the investment promoters are not licensed, the scheme folds.

When Joan, a retiree living in Santa Fe, heard from a financially successful friend that an investment he’d made was getting returns of over 20 percent, she gave his broker a call. She wasn’t sure she completely understood details of the “foreign currency hedge fund” he was urging her to invest in, but it was hard to argue with the returns it was producing. In fact, it looked like such a good deal that she convinced her sister and father-in-law to invest as well. Over the next few months, statements from the investment company arrived regularly, and the results were just as good as promised. So Joan eagerly reinvested her returns.

But after a while, the statements and the payments stopped coming. Her calls to the broker weren’t answered. And then it all came tumbling down—she read in the newspaper that the broker wasn’t really a broker at all, and that she and many others had been snared by a scam—a “Ponzi scheme.” All of the $80,000 she’d invested was gone.
As with other scams, the con artists running Ponzi schemes may try to find their victims over the telephone, through the mail, with advertisements, or in face-to-face meetings (perhaps arranged through friends or relatives who have been taken in). Of course, the Internet provides fertile ground for all kinds of fraudulent investment promotions.

**Red Flags**

Although the product and approach may vary, there are warning signs that many Ponzi schemes and other investment scams have in common. Look out for:

- Unexpected telephone calls, letters, emails or even personal visits from strangers—or even friends—who offer quick profit schemes requiring an immediate investment from you.
- Promises that you can double your money within a short time.
- A description of the investment that is somewhat vague or out of the main stream that you really don't understand. The original Ponzi scheme was based on the international exchange of postal reply coupons.
- An investment that is based on insider connections or secret tips that “can't go public yet.”

**Alarm Signals**

There are some early warnings that you may be in a Ponzi scheme.

- Interest payments or statements become irregular or suddenly stop.
- The seller stalls, frequently with elaborate explanations or requests to invest more heavily, when you ask to withdraw your investment.
- Phone calls are not returned.
Your To-Do List:

- **Take your time.** Most people get caught up in Ponzi investments because they get swept along with the excitement generated by strong early returns. A genuinely sound investment will be around tomorrow. A Ponzi investment is guaranteed to fail so don’t be in a rush to lose your money. Be ready to say, “I’m not making a decision today.”

- **Watch for promises** of very high returns over a very short term. When Ponzi schemes get started, the returns can be great. The word gets out about the high returns, drawing more people in, just as Joan convinced her family to invest. But in reality, money is just being transferred from new investors to old investors.

- **Read everything you can.** Get on your computer or go to the library and look up articles about the product being offered and the person offering it. Get some independent advice about the investment’s worthiness.

- **Contact your state regulator.** You can find how to contact your regulator on the North American Securities Administrators Association (NASAA) website at www.nasaa.org/QuickLinks/ContactYourRegulator.cfm.

- **Ask your state regulator** about the license of the person recommending the investment. Most Ponzi schemes involve some form of security or investment. People selling most secured investments must be licensed by state regulators. You want to make sure that the person giving the investment advice is licensed to sell the investment offered.

- **Learn more from your state regulator.** You can also get information about complaints, disciplinary actions, education, and previous employment of brokers in the Central Registration Depository (CRD). Information about investment advisers is found in their Form ADV. Your state regulator can help you access all this information. Because some investment advisers and their representatives are also brokers, you may want to check both the CRD and Form ADV.

- **Check the FINRA website.** The Financial Industry Regulatory Authority also has BrokerCheck, an online resource to check the background of your investment professional, www.finra.org/InvestorInformation/InvestorProtection/ChecktheBackgroundofYourInvestmentProfessional/index.htm.

- **Check the product.** Before sinking your money into any investment, no matter how promising the returns, always make sure the offering is registered with your state securities regulator.

- **Read more about pyramid schemes** from the SEC. The SEC shows how the pyramid scheme builds and then folds, taking investors for a fall, www.sec.gov/answers/pyramid.htm.

- **Read Joseph Conrad’s book, Chance,** to resist the irresistible. In his 1914 classic, Conrad sets up a scheme that rivals Ponzi, long before Ponzi hatched his plan.