

The Ponzi Scheme: Don't Get Snared

By [Matthew Jarrell](#)

Money comes somewhere behind food, water and shelter as a basic necessity. Money alone isn't a bad thing. But the worship of money or greed cause some tragedies. [Financial advisors](#) should be understanding when addressing questions and apprehensions regarding the impropriety that has precipitated a firm distrust for financial professionals everywhere. 'White Collar Crime' is just a fancy way of saying 'upscale thievery.' By the time you see the bad guy on the front page of the paper, it's too late. What's so curious is how much these charlatans are able to collect from an unsuspecting investor.

If you're an advisor, you know how difficult it can be to win new clientele to your practice. "Stupefied" — that's the word that describes my feeling when I learn another investor was duped into delivering their hard earned financial nest egg to the latest [Ponzi scheme](#) ... hook, line and sinker. It seems as though the most conservative investors have an affinity for finding these predatory posers. The reason why: it's the *promise*.

INNOVATION IN SWINDLING

Italian-born immigrant [Charles Ponzi](#) swindled the equivalent of about \$225 million in today's dollars through a so-called investment that promised as much as 50% return in just 45 days by using money from one investor to pay those promised returns to a previous investor. The scheme was initially exposed by a William H. McMasters, who worked briefly as Ponzi's publicist. Ponzi was tried and convicted of mail fraud in U.S. Federal Court and served 3.5 years in prison. Shockingly, his sentence served did little to dissuade his appetite for financial swindling; he would serve additional time in prison for committing similar type fraud before being deported in 1934.

The effects of being taken to the cleaners financially by a financial predator can be devastating not only financially but personally as well. Just ask Terry H., a small business owner in Kalamazoo, Mich. A man named [Alex Sualim](#) defrauded Terry and other investors out of more than \$13 million. Terry's share taken by a very persuasive Sualim, a.k.a Lennie Grant, was \$400,000. Sualim posed as a businessman, with multi-million dollar contract, urgently needing a U.S. supplier for a sensitive semiconductor material called silicon-germanium which turned out to be nothing more than packing in boxes with no promise of delivery or payment. Terry was asked to advance money for the delivery from China then deliver to a fictitious company in Canada. Terry immediately notified the FBI when he sensed foul play. But by then, it was too late. Terry spent the next few years chasing leads and conducting his own investigation and closely following the FBI's investigation. In a letter penned to the U.S. Attorney's office, Terry's emotion defines palpable:

"And although I understand that I am not the only victim in this case and the amount of money he stole from me was "only" \$400,000 (which represents but a small portion of the total) it may as well have been 4 million dollars to me because the money I invested was nearly everything I had saved for retirement! In fact, this situation has also caused such a division between my wife and I that she recently filed for divorce as well, so Mr. Sualim's lies and premeditated deceit have not only caused me great harm financially, but personally as well!"

Sualim was arrested in Nevada and was tried in U.S. Federal Court. Sualim has been ordered to repay victims every penny. We wish Terry well in recovering his financial assets. (To learn more, see: [How to Avoid Falling Prey to the Next Madoff Scam.](#))

WATCH THE WARNING SIGNS

[Bernie Madoff](#). It's probably not necessary to write anything more. Bernard L. Madoff Investment Securities stole approximately \$15 billion where investors were promised high returns from a fund that reportedly [never made a trade](#).

[Foundation for New Era Philanthropy](#). John G. Bennett, Jr stole approximately \$135 million from charities and non-profits in the same manner by promising to double the money invested over a six- to nine-month period. Here in Michigan, one of the more than 1,100 organizations affected was Spring Arbor College. Enter Accounting Professor, Albert Meyer, who was kind enough to give this writer an interview:

MJ: Why was John Bennett of New Era so convincing?

AM: He networked with influential people. Consequently, people would argue that if so-and-so is involved then it has to be legit. He also projected the image of a very religious person. So, the Christian community fell for that. I called the Christian Coalition and told them that Bennett was running a Ponzi scheme and defrauding their constituents. They told me that Mr. Bennett was a good Christian man and I had no right to make these accusations. Bennett called the seminars he ran for the not-for-profits (to help them fill in applications to obtain grants from the government and other foundations) The Templeton Institute. He told people at these seminars that a very wealthy individual, who wants to remain anonymous, is providing the matching donations. They instinctively assumed that [Sir John Templeton](#) is backing the scheme. (For related reading, see: [What is a Pyramid Scheme?](#))

MJ: How long did it take you to convince someone in an authoritative position that New Era was a Ponzi scheme?

AM: It is hard to tell. I expressed my misgivings to the v.p. of business affairs at Spring Arbor College in the summer of 1993. I told the external auditor that he has a duty to protect his client and do due diligence on New Era. He told me that the v.p. for development (fund raising) told him not to rock the boat. I told him he was certified to rock boats. I think Steve Stecklow (an investigative journalist) started to take me seriously by about February 1995. The dean of the business school also believed me by that time and some others in the business faculty. Nobody in the administration believed me. In fact, they met with the board to discuss how they could fire me. Bennett called the president, after Steve Stecklow called him, and told the president to fire me otherwise the college would be excluded from the scheme. I told the president to tell Bennett that if he returns the one million dollars I would resign and then once I'm gone, he could reinvest the one million dollars. I was confident that the scheme would collapse before the president could have time to return the cash to New Era. Instead, the college sent another million dollars. (For more, see: [Affinity Fraud: No Safety in Numbers.](#))

MJ: How can the individual investor avoid being taken to the cleaners by a financial predator?

AM: Firstly, don't place any of your cash in someone else's bank account.

Secondly, if you break this rule, because you consider the amount to be insignificant, remind yourself that once you receive the promised "exceptional" return on the capital, you would be encouraged to commit more funds and before you know the "insignificant" amount would turn into a substantial amount.

Thirdly, only [registered investment advisors](#), brokers and other investment professionals are licensed to solicit individuals with investment opportunities. So-called sophisticated investors, those with a [high-net worth](#), are not protected from unlicensed charlatans. High-net worth individuals are more prone to be targeted by unlicensed promoters, but they ought to know better, hence the licensing and regulatory regimes are not designed to protect them, and quite rightly so.

Fourthly, don't make the false assumption that if your best friend, or even someone you admire greatly, is going along with the scheme that it is legitimate. If serious money is at stake, and you have doubts, as you should if it entails placing your money in another person's bank account (or even a hedge fund — Madoff ran a hedge fund), pay a professional ([CPA](#) or lawyer) a fee to do due diligence on your behalf. You'll have recourse to the professional indemnity insurance policies of these professionals if they failed to recognize your investment opportunity as a Ponzi scheme.

Fifthly, don't forget the old adage, if it is too good to be true it probably isn't. There is no easy road to riches. Be skeptical at all times.

MJ: Why is integrity so important in life?

AM: Integrity is really all one has when all is said and done. [Warren Buffet](#) is very wealthy, but he has proven himself to be a man of great integrity. (He has his detractors, but they are just a bunch of soreheads.) Bill Gates is also a man of integrity. Bennett lost his integrity when he compromised his principles and values, as did Dennis Kozlowski at Tyco, Shilling and Fastow at Enron ... and the list goes on. No amount of money can buy back lost integrity. (For more, read: [Fiscally Challenged? Wise Up to Financial Fraud.](#))

Albert Meyer is the President and Founder of Bastiat Capital in Plano, Texas. He is credited with exposing not only New Era Philanthropy but also fraudulent accounting practices of Tyco and [The Coca-Cola Co.](#) Harvard Business School formed several case studies on his research of Coca-Cola and eBay Inc.

THE BOTTOM LINE

The important thing for the individual investor is to know and understand the capabilities of the person they're dealing with professionally. Don't give your money away to person or organization that isn't registered to transact securities. It baffles me that this happens, yet it does. Advisors should allow each client ample time to make an educated decision. Investors should ask questions. Investors should never — and I repeat — never invest in something they're uncomfortable with. Investors can utilize resources like [Finra's brokercheck](#) to inquire whether your professional is properly registered. For business transactions, hire an accountant to check into the company you're doing business with. Beyond all else, never underestimate your personal and professional obligation to properly report suspicious activities to your state Insurance Administrator or Securities Administrator, and of course, the U.S. Department of Justice. (To learn more, see: [Investopedia's Tutorial on Investment Scams](#).)

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