

Is enough being done to prevent the next Ponzi?

By now most of us have heard of ponzi schemes and the names Bernie Madoff, Barry Tannenbaum and Grahame Whitehead. The word 'ponzi' originated from Charles Ponzi, a US postal coupon system fraudster who emigrated from Italy to the US in the early 1900s and who was significant enough to have a specific financial scam named after him. Maddoff's ponzi scheme, exposed in December 2008, seemed to set the ponzi ball rolling with Whitehead following hot on his heels in April 2009 and Tannenbaum close thereafter in June.

The common denominator and underlying strategy of a ponzi scheme is the offer of unrealistic returns, encouraging hungry investors to part with substantial amounts of money to fulfill their financial dreams. However, the actual investments used to lure investors do not often exist and the money received is more than often banked in a single bank account and used instead to fund the fraudster's lavish lifestyle. The offender continues to find more and more investors and uses the most recent deposits to make interest payments to the previous investors thereby building confidence with his clients who very often invest even more once they receive their initial substantial interest payments. Schemes of this nature involve an ongoing effort to keep up appearances and maintain investor satisfaction which some fraudsters seem to manage to do for years without detection. However, in a volatile market, this façade is almost impossible to uphold unless the fraudster has swift access to enough funds to cover both his investors capital and the substantial interest payments promised. In some cases, ponzi swindlers say they initially started out with a legitimate business and no intention to run a ponzi scheme. However, this clearly changed once they found the 'rob Peter to pay Paul' way of doing business far too attractive.

With any investment or scheme, the adage 'if it sounds too good to be true, it probably is' should be the simple yardstick used before parting with substantial funds. The devastation felt with the loss of money will be long felt by, not only direct investors, but their families and very often charities and foundations that placed their trust in these financial masterminds. Many pensioners will never have the opportunity of recovering from the loss of their funds and will not be able to spend the rest of their days enjoying the lifestyle they should be entitled to. In the Madoff case, suicides of affected investors have been reported and it is almost impossible to ascertain quite how much damage has incurred as a result of his illegal doings.

All of this, of course, begs the question of whether enough is being done locally and internationally to prevent fraud before it has the ability to reach this scale. In the case of Tannenbaum, some reports say that Rand Merchant Bank (RMB) reported "suspicious activity" to the FIC as far back as 2007. This has not been confirmed by the FIC although they did release a statement on 14 June 2009 confirming they were investigating the matter and appealing to all investors to provide any information that could possibly assist investigators.

In Madoff's case, the US Securities and Exchange Commission (SEC) came under much fire for not investigating him thoroughly as apparently questions were raised around his activities as early as 1999. Even more alarming, considering the duration of his fraud, is that Madoff Securities LLC was investigated at

least eight times over a 16-year period by the SEC and other regulatory authorities. And, in fact, the media, including the Wall Street Journal who apparently declined to print a story questioning Madoff's returns and quoting a leading financial analyst as far back as in 1999, had been alerted on several occasions to the suspicious behaviour surrounding Madoff's firm.

In South Africa, some feel that the Finance Intelligence Centre (FIC) Act needs strengthening and complain that the bureaucratic process involved in investigating suspicious transactions is arduous and could possibly hinder the effectiveness of these investigations. Additionally, the FIC needs to follow up on any reports as and when they happen and take action when they are notified of potential wrongdoings. Authorities will no doubt continue to be under pressure to ensure that regulations are adhered to and that fraud of this type becomes a problem of the past, particularly in the wake of these three high profile ponzi schemes alone. On 02 December 2009, the FIC released a further statement saying it "continues to show a significant contribution in the fight against money laundering and crime in general" and its 2009 Annual Report shows that cases with a combined value of R6 billion during the 2008/2009 financial year, have been referred to law enforcement agencies for further investigation. This figure represents a 195% year-on-year increase on their previous financial year.

By the same token, investors need to be more vocal to South Africa's FIC if there is the slightest suspicion of any wrong-doing or obvious criminal behaviour as investor awareness is crucial in fighting this crime and stopping it in its early stages. Once the South African Revenue Service (SARS), the Reserve Bank (SARB), the Serious Economic Offences Unit and the National Prosecuting Authority are involved, the major damage is usually done and measures should have been taken long before this stage.

Ponzi schemes have historically been difficult to detect given the complexities of tracing multiple victims and witnesses who could be scattered all around the globe, hence the FIC's request for investors to come forward. In October 2009, Edward Nathan Sonnenbergs' (ENS) forensics department also released a statement asking for investors in Whitehead's scheme to come forward to assist. ENS has completed a report on their investigation so far and a criminal docket has been transferred to the Serious Economic Crimes Unit in Pretoria and a prosecutor assigned to the case. Whitehead's case in the UK has subsequently been postponed until February this year. Often though, it is difficult to encourage investors to come forward, possibly because they are reluctant to highlight investments they have perhaps not notified SARS of or have used 'hot' money to take part in these schemes.

Madoff's hefty 150-year sentence came from the court's desire to show how seriously they take these crimes and the same stance needs to be considered worldwide. Madoff's reluctance to assist with information, which led the courts to believe he did not operate alone, did not do him any favours either. Either way, a zero tolerance policy, with sentences to match, needs to be implemented both here and internationally.

While it can be said that greed is very often a motivator for some investors, it does not preclude the fact that these schemes are fraudulent and shouldn't mean investors lose their capital, no matter what their reason for investing is. It makes sense that an extraordinary investment opportunity with exceptional returns, no paper

trail and based mainly on trust, is a sure red flag to any would-be investor. Again, if it sounds too good to be true, it probably is.

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ENS (Edward Nathan Sonnenbergs) is based in South Africa and is the largest full-service law firm in Africa.

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