# The Evolution and Impacts of the Ponzi Scheme and Governmental Oversight

## An Honor's Senior Thesis Project on the Intricacies of Ponzi Schemes and its Regulating Authority

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**Table of Contents**

*Abstract*

Ponzi schemes are not complex tools of thievery. In fact, they are quite simple. To formulate one is simple, but to identify and classify one is not. Or is it? Since its creation back in the 1900's, the con has duped unknowing investors into handing over their money under the guise it would be placed into some form of investment to earn a return. Given this is a scam, the money is never invested, yet the "returns" do in turn happen. The question to be asked is not how do these returns result, as the rest of this paper delineates, but how do people, especially the very regulators in charge of preventing this scam, let it happen? A Ponzi scheme takes advantage of the financial system to embezzle millions, or even billions, of dollars from unbeknownst investors blind to the fraud. Some are ill-advised hardworking normal citizens, some are financial gurus simply perplexed at the workings of the person running the scheme, and others are regulators that are ignorant and unable to recognize the fraud for what it truly is. The comprehensive research of various resources has enabled this paper to delve into what a Ponzi scheme is and why governmental agencies are unable to thwart them from continuously occurring. Due to major governmental oversight and the inability to do its job, agencies like the SEC have been oblivious to this type of fraud even when it has been blatantly in front of them. The solutions within this paper describe possible solutions to this incompetency.

## *I. Introduction, History and Background*

Ponzi schemes, although dating back to as early as the 1900's, have recently ravaged society at an alarmingly increasing rate. In just the six-year span from 2008 to 2013, over 500 different Ponzi schemes (excluding Madoff) collectively took over $50 billion; that is billion, with a "b" (Maglich). On average, a Ponzi scheme was uncovered or busted every four days in just that six-year period (Maglich). Since its inception, the Ponzi Scheme has antagonized and cheated humanity, stealing hundreds of millions and sometimes even upwards of billions of dollars in the process. The Ponzi scheme has developed into a convoluted masterpiece in its appearance that has shaped not only the world of finance, but also aspects of law and society as well.

The Ponzi scheme has truly developed and evolved into a con of great magnitudes. It has not, however, altered drastically in its pure chemical makeup. To begin, the mechanics of a Ponzi scheme are:

"People are offered an opportunity to invest in a business that supposedly exploits some kind of financial loophole – in return for unusually large and rapid profits. These initial investors get every dollar they were promised; they usually earn a profit large enough to make them boast about it to everyone they know. Other people rush to get into this business to receive the same kind of returns, sometimes begging the perpetrators to take their money. In fact, in a true Ponzi scheme, there is no underlying business and there are no actual investments being made; there is nothing except the cash coming in and the cash going out. Until the scheme collapses, investors are paid with funds received from later investors. Generally, a substantial number of these investors reinvest their supposed profits back into the business. On paper, they can become wealthy, but only on paper. The scheme can last as long as new investors continue to hand over their money so old investors can be paid" (Markopolos 49-50).

The key aspect is that the perpetrator promises investors to place their money into certain investments of which provide an annual return, providing a sense of legitimacy. The true workings of Ponzi schemes are not complex tools of thievery. Instead, they are quite simple. The con artist offers investments that promise often very high returns at seemingly very low risk from a business that does not in fact exist or arises from a secret idea (Lewis). High returns and low risk are goldmines to any investor. If an investment can post a positive return with minimal risk in having the initial investment lost, the product will fly off the shelf.

Historically, the namesake of the scheme resides with Charles Ponzi, but the true creator of the con was a man from Brooklyn by the name of William Miller back in 1899. Decades before the schemes became labeled Ponzi, William Miller ran a crooked business swindling unknowing investors of their cash. As all such schemers do, Miller claimed that he had some "inside window into the way that profitable businesses worked", but in reality, he simply defrauded his investors out of $1 million – a sum of over $25 million in today's money (Skarda). After Miller, the true namesake of the scheme strolled into the national spotlight. Although not the creator of the scheme, Charles Ponzi's con was so extensive and lucrative that it attracted national attention. As did Miller, Charles Ponzi promised his investors sizable profits, when, in reality, he pocketed a large sum. Collectively, Ponzi's investors lost an estimated $20 million, which totals roughly $280 million in today's money (Grossman).

Due to Charles Ponzi, the term "Ponzi Scheme" has become a household phrase. Before Ponzi, defrauding investors was relatively uncommon, at least to the general public. Although swindlers like William Miller did exist, it was much less widespread and more importantly far less identified. Ponzi, however, brought this type of con into the spotlight. While Ponzi eventually became the face of the scheme, no other swindler has more notoriety than Bernard Madoff. The modern face of financial evil is Bernie Madoff who was convicted in 2008 of running a $50 billion Ponzi scheme (Carbone).

Like his fellow schemers before him, Madoff used investor faith as well as his personal credentials to gain trust and promise an average 10.5% annual "return" to his investors for two decades (Carbone). In reality, the "return" that Madoff followed through with was nothing more than the money his newest clients sought and believed to be invested. There are major similarities that can be found in all three aforementioned men, along with all Ponzi schemes in general. The gaining of investor trust is a major aspect that the schemers must have. Without trust, there simply is no scheme. Madoff, as well as the others, utilized a concept called "affinity fraud", in which fraudsters target potential victims who share a common bond, such as religion, to build a trust (Gurun). While the scheme itself has a simple framework, it truly is able to thrive due to the concept of affinity fraud. Affinity links have been shown to be an important determinant in the success of Ponzi schemes (Gurun). Utilizing affinity links helps build the trust necessary to complete the scam. When it came to Charles Ponzi, he accumulated $9.8

million in the span of 8 months in 1920, of which mostly came from three-quarters of the Boston Police Force (Lewis). Similarly, Madoff utilized his religion to take advantage of his fellow Jewish people. The ability to find a certain group to target allows for the scheme to commence. After that, a strong trust provides the glue that seals investors in and discourages them from getting out. The reason affinity schemes target people with similar affiliations is trust; nobody thinks one of their own is going to cheat them, not when they can cheat so many others (Markopolos 114).

Along with a concrete investor trust, paying off old investors with new investor money is found in virtually every Ponzi scheme. As long as new investors continue to come, those investors that came before would earn lucrative profits. This mode of action, however, is the very reason that such schemes collapse. While the duration of a Ponzi scheme varies, the inevitable downfall occurs when new investor funds cannot pay off the old investors. Once markets hit a rut and investors withdraw, the whole scheme collapses like a house of cards (Altman). Once that house of cards implodes, millions and sometimes even billions of dollars have been lost.

Also prevalent in all Ponzi schemes is the con of swindling investors into believing there is a business utilizing a secret idea (Lewis). It is through this idea that the investment plan can commence and return exorbitant profits. Of course, in reality, this entire strategy is a complete fallacy. As seen in the history of this scheme, Charles Ponzi promised exorbitantly high returns from investing in postal coupons, while the actual postal system substantially lacked in quantity of the amount of money he dealt with. In accordance to Ponzi, 160 million coupons would have had to be in circulation to cover the investments made by Ponzi's firm, when in reality there were only 27,000 according to the US Postal Service (Markopolos 51). Similarly, Bernie

Madoff promised returns on a split-strike conversion strategy that historically could never produce returns that he provided for his clients. Of the total $9 billion of put options in existence on the Chicago Board Options Exchange that Bernie Madoff claimed to be utilizing, he would have needed upwards of $65 billion at various times to protect his investors' money (Markopolos 41-42).

Instead of acting legitimately, the con artist helps himself to the investors' money and pays the promised high returns to earlier investors from the money handed over by the later investors; the scheme ends when there is no more money from new investors (Lewis). Essentially, when the markets are doing well more investors roll in. However, when the markets hit a rut, or further when new investor funds cannot supply the money necessary to pay old investors, the scheme collapses. Along with Bernie Madoff, in the United States in 2008 and 2009, 190 Ponzi schemes collapsed (Lewis). Prior to 2008, the markets were in fair condition. Once the global markets began to teeter amidst the recession, investors both new and old within Ponzi schemes began pulling their money, and that is when this scam comes to fruition.

In turn, before the scheme collapses and exorbitant amounts of money are lost, there must be some form of intervention that prevents this catastrophe from occurring. Thus, regulators need do a better job in prevention. One major overseer is the Securities and Exchange Commission, or SEC. The U.S. SEC has a three-part mission: Protect investors, Maintain fair, orderly, and efficient markets, and Facilitate capital formation (Investor.gov). In 1933 and 1934, Congress passed the Securities Act and the Securities Exchange Act. In turn, a major purpose of these laws is intended for those who sell and trade securities – brokers, dealers, and exchangers – to treat their investors fairly and honestly (Investor.gov). Thus, Ponzi schemes clearly violate the very basis of these two laws and in turn should have no problem being both regulated and prosecuted. In reality, however, fraudsters often last up until the con collapses in on itself, sometimes several years down the line.

Herein lies the problem. The SEC highlights Ponzi scheme "red flags", of which are common indicators and warning signs. To highlight a couple, the SEC indicates that overly consistent returns coupled with secretive and/or complex strategies are major red flags of a Ponzi scheme (SEC.gov). Clearly this type of behavior throws up a red flag, yet this is the exact type of behavior that the notorious Bernie Madoff exemplified. An article written on May 7 of 2001, published during an early investigation of Madoff being conducted by the SEC, is titled: Don't Ask, Don't Tell. The secondary title reads: Bernie Madoff is so secretive, he even asks investors to keep mum (Arvedlund). Similarly, the article stated, "What Madoff told us was, 'If you invest with me, you must never tell anyone that you're invested with me. It's no one's business what goes on here' says an investment manager" (Arvedlund). The amount of secrecy that occurred within the Bernard L. Madoff Investment Securities LLC should not only have raised a "red flag", it should have blasted red sirens.

The inability of the U.S. Government and its subsidiary regulators, such as the SEC, has allowed for Ponzi schemes to continually slide under the radar. Much of the public grew skeptical of Madoff leaps and bounds before any regulating authority did. This incapability by the SEC provides defrauders the chance to steal millions. Thus, enhanced regulation and innovative policies across the board need be put in place to thwart these cons years before it collapses in on itself. To do so, the SEC must emphasize collaboration and comradery amongst regional offices, appropriately hire and place employees into proper positions, as well as become much more proactive in pursuit and enforcement.

## *II. Bernie Madoff*

To date, Bernie Madoff remains the most notorious financial fraudster in history. Madoff exhibited every aspect of a Ponzi scheme and utilized his persona to conceal it. What allowed Madoff to steal as much as he did for as long as he did simply was due to who he was and what he represented. Simona Suh, an attorney on the enforcement staff of the SEC during the mid-2000s, admitted that the staff had been skeptical of any fraud claims on Madoff because he "didn't fit the profile of a Ponzi schemer" (Markopolos 157). Anyone who worked in the financial industry, if even for just a short time period, knew the name "Madoff", if not also his background.

The company that he founded, Madoff Investment Securities LLC, was among the most successful broker-dealers on all of Wall Street. In fact, during the early 1990s Madoff Securities LLC alone accounted for almost 10 percent of daily trades on the New York Stock Exchange (Markopolos 26). His company and the magnitude of which it impacted the markets made Madoff immensely rich, and enabled him to become one of the most respected men in the entire industry. When the name Madoff was spoken, there was a certain aura that surrounded it. To add to his résumé, Madoff marketed himself as a cofounder of NASDAQ and had served as its chairman; he was a prominent New York philanthropist and a member of numerous industry and private boards committees; Bernie Madoff was a Wall Street King (Markopolos 26). Thus, to claim and, even further, prove Madoff to be running one of the largest Ponzi schemes in history was virtually impossible. No one wanted to believe Madoff was running a lie. Not even the government.

Through his brand name and his guise, Bernie Madoff was able to dupe not only investors, but some of the best and the brightest. Because of who he was and what he'd been able to accomplish thus far in his career, attracting investors was quite simple. Bernie Madoff's alleged strategy was referred to as a split-strike conversion. Simply put, Madoff claimed that he would purchase stocks, but also would purchase a put option to limit losses along with selling a call option that essentially places a ceiling on profits. To explain further, in Madoff's strategy, he could purchase a stock for $50. He then would purchase a put option that allows him to protect his stock price at a floor of $35. This put option is protection if the stock bought for $50 falls below $35, allowing for Madoff to still sell that stock for $35. Lastly, Madoff would sell call options for $65. This would allow for the owner of the call to exercise the option and purchase Madoff's stock for $65 if it rises to $65 and above, hoping it continues to rise.

Regardless, while this is a valid strategy, it would not have produced the returns of which Madoff was providing his clients. The illegitimacy comes into play, because in Madoff's case, the problem was that he was continuing to report gains on a month-to-month basis even when the markets yielded negative returns (Gaffen). While this strategy is employed to limit losses, it most certainly cannot eliminate them altogether. As it pertained to Madoff, however, his returns were always consistent. Madoff only reported three down months in more than seven years (Markopolos 33). For example, in 1993 when the S&P 500 returned 1.33 percent, Bernie returned 14.55 percent to investors; in 1999 the S&P returned 21.04 percent, and there was Bernie at 16.69 percent (Markopolos 33). Markets fluctuate and do so quite often, that is the way it has been and the way it will always be. For Bernie, his returns never fluctuated. The returns Bernie produced were always good, but rarely were they spectacular. However, his returns were not the factor throwing up red flags as many other funds produce similar, if not better, returns. The concerning aspect is that even after the markets produced numerous down months, Madoff always would yield a profit. There was no existing mathematical model that could possibly explain that consistency (Markopolos 33). Nothing, of course, other than fraud.

While Bernie Madoff continued to baffle many within the industry with his consistent returns, close to none spoke out about it. Whether people believed his absurd explanations behind his strategy, or they saw the illegitimacy, no one said anything. Edward Thorp, a respected and well-renowned hedge fund manager, caught a glimpse at the fraud that Madoff was doing back in 2004. Thorp conducted due diligence on behalf of another investment institution. Due diligence, as it pertains to investing, involves investigating the ins and outs of a company's strategy, ensuring their practices are both legitimate and legal. Thorp indicated that he had gotten ahold of some of Madoff's trade tickets and compared them to OPRA tapes. OPRA is the Option Price Reporting Authority, which is the authority in charge of keeping the permanent records of every trade. What Thorp discovered was that, when comparing Madoff's supposed trade tickets to those on OPRA, he found some "discrepancies" (Markopolos 75).

In reality, due to the scam Madoff was running, his trade tickets would never match up to those housed in the OPRA; Madoff was not making any trades at all. Instead of taking this crucial information to a regulating authority, Thorp simply advised his clients and anyone in his network to stay away from Madoff, but he did not take it any further (Markopolos 75). During this time period in the United States, self-regulating markets were encouraged. The deregulation movement began in the 1970s and was based upon the belief that markets are self-regulating, even to the extent of self-repairing market failures (Thoma). A common viewpoint of the American public was an ideology that markets are self-regulating and best left alone. Thus, the U.S. Government and the SEC took this into consideration. From 1970 up until the 2008 Recession, markets were left to regulate themselves. This posed a major problem.

As evidenced by the actions of Ed Thorp, self-regulation hardly occurred. In turn, if industry practitioners fail to report suspected fraud, nor have any meaningful incentive to do so, and if government agencies lack the systems set up to take in, evaluate and investigate whistleblower tips-then self-regulation can never work (Markopolos 75). As shown, when illegitimate practices are discovered, many practitioners simply shy away from involvement, but that is the extent of their actions. Similarly, the agencies in charge of dealing with illegitimate practices when reported have been inadequate. Although true that many in the industry have turned a blind eye to skeptical practices, there have been plenty others seeking justice. However, due to the incompetency of regulating authorities, those that wish to speak up and whistle-blow have time and again been ignored.

## *III. The SEC*

The incompetency of the SEC continuously allows for Ponzi schemes and fraud to occur. Some have gone so far as to label this regulating authority as corrupt, but even that would be giving this organization too much credit. To be corrupt one must show a willingness to act in a dishonest way, often for monetary gain. These allegations could be substantiated by a claim that Harry Markopolos provides which was actually made by Bernie Madoff. Madoff concludes, derisively and accurately, that "'These guys, they work for five years at the [SEC], then they become a compliance manager at a hedge fund'" (Markopolos 159). Markopolos goes even further to substantiate this by saying that Madoff knew this was true because every time an SEC investigator came to his office he or she would ask for an employment application (Markopolos 159). Quite clearly, this sheds a very skeptical light on the employees that work at the SEC. However, to call this type of action corrupt is an unfair accusation. Working for this organization is a great way for these employees to get their foot in the door to Wall Street and meet with its well-known industry gurus.  Thus, applying to work for one of the most renowned investors on Wall Street is not condemnable.

Nevertheless, to ask for an employment application while investigating that very same firm is nonsensical.  While the argument over the degree to which the SEC is corrupt can go back and forth, the ineptitude of this agency is a stern fact.  Even the Federal Bureau of Investigations feels this exact same way.  Markopolos notes an interesting conversation he had with an FBI agent who discusses a common view of the SEC.  The agent said to Harry Markopolos, "'The [SEC] was conducting an investigation for two years and never even figured out there was a seventeenth-floor that Madoff worked on; that's how dumb they were.  You really shouldn't give them any more of your cases.  Your quality of work is way beyond the SEC's capabilities.  From now on when you have a case, just give us a call'" (Markopolos 158).

In relation to the Madoff case, Madoff used the 18th floor of his building for Bernard L. Madoff Investment Securities and the 19th floor for stock-trading.  The SEC failed to go to this alleged 17th floor where the entire Ponzi scheme operation took place.  As the FBI agent notes, the SEC simply is too dumb.  Also, the fact that the FBI urged Markopolos not to give his cases to the SEC shows the true ineptness of the SEC.  If the very regulator for this type of scam cannot handle cases involving this very type of fraud, then what is even the point of having them at all?  The answer is that there is none.  The SEC has shown a lackluster inability to regulate markets.  It is not that this agency is corrupt, it is simply that they are unable to do their job.

Ponzi schemes are not complex scams, but rather quite simple.  One cannot go so far as to say that they are rather easy to identify, but some are much easier than others.  When a Ponzi scheme run by one of the most well-known financial advisors in the nation's history totals upwards of $50 billion, it calls into question the people in charge of regulating. The underlying issues in the case involving Bernie Madoff falls unquestionably at the feet of the SEC. While the people investing and involved with Madoff were more or less oblivious to what he was doing, the SEC was blind. When the media published two articles questioning the validity of Madoff, the SEC remained inattentive. When Harry Markopolos and his team handed countless submissions to various SEC departments, the SEC preferred ignorance. Thus, to label the SEC corrupt would be to claim that this agency had the proper knowledge of and awareness to the situation. The SEC had no such knowledge and had no such cognizance. When the media published the articles, the SEC never even read them. When Markopolos brought hard evidence to support his claims, the SEC ignored him. By the time of his last submission, there were a total of twenty-six “red flags” that signaled Madoff was running a Ponzi scheme. Even with these key indicators, the SEC viewed them simply as “theories” and that they were not and could not be used to bring a lawsuit; they had to be tested and substantiated (Markopolos 156). These words came from the assistant director of enforcement, the one in charge of enforcing the very acts that prevent this type of con from occurring. If this person was not going to enforce the regulations, then no one would.

Along with the close-mindedness that the SEC employs, the agency also lacks a sound inner structure. The SEC is made up of regional offices within different jurisdictions, much like various other governmental organizations. Unlike how police departments work cooperatively over state lines, the SEC lacks this cohesive ability. It is not that they are discouraged or forbidden to work across jurisdictions and offices, it is simply that they choose not to. The question this raises is how can a national organization work productively and efficiently if it is deficient in collaboration? The very obvious answer is that it merely cannot. To substantiate these claims, it is important to discuss the issues Harry Markopolos encountered while attempting to bring the Madoff scandal to national attention.

Markopolos resided in New England, Massachusetts, meaning he would report his fraud submissions to the SEC office located in the New England region. The importance herein lies with the fact that Madoff operated in New York, an entirely different SEC regional office. To most, this would seem inconsequential; Markopolos' submissions would simply be sent from the New England office to the New York office and the investigation would continue. Unfortunately, as history shows this case playing out, it did not occur like this. Thus, we must delve into and seek to find why this, what appears to be normal, sequence of events never unfolds.

Instead of the files being sent to and accepted by the New York office, the case hit a tragic standstill. Harry Markopolos notes that Grant Ward, New England Regional Director of Enforcement at the time, divulged that there was not a lot of respect between the Boston and New York offices for one another (Markopolos 65). Apparently, the two offices are very competitive and the chances of the New York office warmly embracing a case handed to them by the Boston office were limited (Markopolos 65). This in and of itself is shameful. This type of behavior hinders the government's ability to regulate the financial markets and protect the public from fraud, the sole reason it exists in the first place. Competition generally is beneficial, in that it drives opposing forces to be better than the other. However, competition between the same entity is entirely counterproductive. This is comparable to one branch of a TD Bank sabotaging another branch in order to outperform and look better. Overall, the company suffers and these types of actions could cause the total business to go bankrupt. In turn, both branches would no longer exist. The same principle applies for the SEC: if one office ignores the other, the whole system fails.

## *IV. Solutions*

The SEC is an extremely significant entity for the U.S. stock market. Created in 1934, the SEC's purpose was to restore confidence back in the markets after the Great Depression. Since then, due greatly to this organization, the U.S. is viewed as the most sophisticated and popular stock exchange in the world (Amadeo). A major aspect of the SEC is maintaining a transparency that travels from companies to investors. This greatly aids in sustaining investor confidence as this transparency allows investors to obtain accurate and up to date information on prospective companies (Amadeo). As seen in the early 2000s, the SEC has played its role in prosecuting fraudulent acts by companies looking to hide things from the public. For example, in 2001 this governmental agency prosecuted Enron for falsifying SEC submissions (Amadeo). This was a major case for both the markets and the public that the SEC got involved with.

While the SEC has proved to be a significant entity in prosecuting fraud after the fact, it has failed to catch and stop any fraud still ongoing. While prosecuting after the fact is an important action to take, thwarting fraud early before a great deal of money is lost holds much more importance. Although prosecuting the Enron fraud is beneficial, law enforcement made somber statements about how they were taking steps to make sure this kind of fraud ($2 billion) could not happen again, and what they were doing to protect investors (Markopolos 129). Important to note, at the exact same time law enforcement was making these statements, Bernie Madoff was busy stealing upwards of $50 billion.

The problem with the SEC is that its employees lack the drive and incentive necessary to be successful.  Throughout Markopolos' involvement, he noted that Chief Meaghan Chung and other executives in her office spent their time investigating minor frauds and getting an occasional conviction and headline (Markopolos 141).  This is the major issue: these people were going after the inconsequential cases.  Markopolos writes, "In the world of the SEC, a case is a case, and going after a hard target like Madoff counts the same as going after some tiny retail broker…there are no bonuses for the big cases that require a tremendous amount of work" (Markopolos 141).  Quite clearly, the types of employees hired by this organization needs vast improvement.  The purpose is to protect investors and maintain a transparent and just market, but instead it has prosecuted just enough to scamper by.

Due to the numerous deficiencies exhibited by the SEC, dramatic, yet fairly simple, changes need be instituted.  Because the SEC has performed unsatisfactorily and has demonstrated its inability to successfully do its job, enhanced regulation along with innovative policy changes must be put into place.  As discussed, the SEC lacks the necessary cohesion that governmental agencies require.  Being that this regulator operates via various regional offices, cohesion is key.  To lack this aspect undoubtedly results in failure, and in fact that is exactly what the SEC has exemplified.  The SEC has repeatedly failed and its lack of collaboration is paramount in causing this.  Competition is a difficult barrier to overcome, but it is one that should not exist between offices that require coalescence.  However, the fervent competition already exists and thus must be dealt with accordingly.  In turn, emphasizing unity and encouraging teamwork is a necessity.  Of course, this is easier said than done.

Thus, a way to counteract this issue is to provide incentives.  Some form of incentivizing, either through added vacation days or via year-end bonuses for successful collaboration in cases would motivate its employees to work together. As seen in the Madoff case, pertinent information was ill-received when transmitted from one regional office to the other simply due to competition between offices. Due to this, the case hits a standstill and the fraud continued for several years. Instead, to make things run more smoothly, providing incentives to its employees could drastically change their attitudes. While the competition will likely still remain, it could alternatively be directed towards completing cases in order to capitalize on incentives. If a pair of rival offices, such as the two that hindered the Madoff case from being properly investigated, could positively channel their competitive natures it could yield immensely positive benefits. As opposed to one office ignoring crucial information from another, the implemented incentives would allow for the offices to, if even reluctantly, work together to properly do its job. While incentives do not come free of charge, the alternative is far more costly. Had this system been in place, Madoff's $50 billion fraud, and countless others hindered by similar issues, could have been prevented. Due to cases like Madoff's, the SEC has come under intense fire from the public and its legitimacy is constantly under question. In hindsight, the cost of incentives for its employees would undoubtedly be worth preventing the loss of billions of dollars.

In conjunction with providing incentives to employees, the types of people employed by the SEC becomes greatly significant. In the past, SEC employees have acted questionably in the way they have presented themselves. Thus, providing an incentive-program to the types of workers previously employed would have little impact. Admittedly, hiring is never an easy task as you can never truly foresee the way a person will act and operate until on the job. Nonetheless, making the hiring process a crucial endeavor is extremely important for this regulating authority. Hiring people who are looking for a short-stay, as seen previously in the SEC, is not the type needed for such a significant entity. Instead, the SEC needs to look for driven and motivated individuals looking to better society. Also, the SEC's requirements for work experience and exam quality standards were below par for the tasks the SEC deals with. The SEC's capital markets work experience requirements were way too low and the exam quality standards were abysmally low (Markopolos 140). Along with finding those individuals with high aspirations at the SEC, the procedure for evaluating the potential employees also needs improvement. The hiring process must be constantly updated to suit financial markets of the current time, as well as be conducted in a serious manner.

Supplementary to hiring determined individuals, placing employees in the correct jurisdictions is monumental. Even if the proper individuals are hired, it reaps no benefits when these people are placed in the wrong positions. The SEC could have the best and brightest attorneys in the world, but if they are the only ones put in charge of a case dealing with Ponzi schemes it makes no such difference. The inner workings of proving fraud to be a Ponzi scheme are quite complex. It deals with derivatives, mathematical formulas, and many other intricacies. While the Ponzi scheme itself is simple, proving it can be quite difficult. For the Madoff case in particular, those in charge of the investigation were the New York Branch Chief Meaghan Cheung and Assistant Director Doria Bachenheimer; two highly qualified professionals. Although qualified professionals, neither of the two had ever investigated a Ponzi scheme before (Markopolos 140). Solely placing attorneys at the helm of this investigation is unfitting. The reason being, Cheung and Bachenheimer have never dealt with a Ponzi scheme before and would truly have no idea as to what to look for. They may have a few tools at their disposal, but they are placed at a supreme disadvantage having no prior knowledge as to how to go about the investigation. Hence, the importance of placing employees in the right positions emerges. To not have a professional with experience in Ponzi schemes and fraud at the helm is irrational and must be corrected. In the future, employee placement should become a critical component for the SEC.

While the proposed solutions can greatly impact the SEC, being proactive in pursuit and enforcement of current regulations is crucial. Being proactive is truly in conjunction with hiring the right types of people and encouraging collaboration between offices. However, these are not enough by themselves. Being proactive is a necessity for a regulating authority. The role of the SEC is to enforce current regulations in order to prevent or stop fraud in its tracks. Throughout the Madoff case, this type of behavior was lacking, but more accurately it was nonexistent. When Harry Markopolos submitted his findings to the SEC, Cheung and Bachenheimer were skeptical. Markopolos provided a detailed list of countless “red flags” he discovered concerning Madoff’s potential fraud. Instead of utilizing this information, Bachenheimer labeled them as “theories” that had to be tested and substantiated (Markopolos 156). Markopolos then indicates that Bachenheimer explains her reasoning as, “It’s very challenging to develop evidence that something is going wrong until the thing actually falls apart (Markopolos 156). Mr. Markopolos makes sure to note that this is a word for word quote from the inspector general’s report.

Clearly evidenced, the type of proactivity needed within the SEC does not exist. Instead of making use of the detailed reports provided by an experienced finance professional, the SEC ignored the information and sat back in wait. This cannot be the case. In its place, the SEC must become a proactive organization. This entails utilizing pertinent information and embracing tips from potential whistleblowers, not ignoring them due to a questionable motive. A major tool of the SEC is to utilize its assets; those within the industry who deal in its workings on a daily basis. As the agency in charge of enforcement, for the prosperity of the markets, it is vital for this authority to take a much more hands-on approach and impose itself to show it has zero tolerance for fraudulent behavior. The significance is that it sends out a certain message to the public when those in charge are dismissive to those that truly just wish to help.

## *V. Conclusion*

Ponzi Schemes, although dating back as far as the late 19th century, continue to crop up and cause exorbitant amounts of damage to both the financial industry as well as the general population. Although a rather simple form of financial thievery, the scheme made notorious by Charles Ponzi has escalated from swindling investors of $1 million in its early years to upwards of $50 billion in the present. The scheme itself is not complex: The perpetrator of the fraud entices customers to invest in his business that utilizes a secret technique. With essentially no risk, the investment will return a large and rapid profit. In truth, there is no special technique, the fraudster simply pays off old investors with new investor money and the sequence of events is continuous in this way. The problem is, when people begin pulling their money during hard economic times, or new funds are not sufficient to pay off those owed to old investors, the con collapses in on itself. A scheme can last a day, or as evidenced through the most notorious fraudster of all time, Bernie Madoff, it can last the better part of a decade. The longevity of a Ponzi scheme is reliant on the abilities, as well as the accolades of the swindler.

As evidenced through Bernie Madoff, he used his high status, padded resume and personability to trick not only his investors, but also the government. The type of swindling prevalent in Ponzi schemes is an art in a sense. There is much more to the scheme than simply cooking books, as the need for building a trust with clients and emitting the aura of legitimacy to regulators make this con into a charade.  In turn, the problem becomes seeing through the façade and labeling this "business" as exactly what it is: fraud.

To the normal investor who knows little about the intricacies of the industry, this con likely appears to be a perfectly legitimate business.  However, to those that have occupations within the industry, whether it be through a business of their own or as the regulating authority, there are numerous red flags that should send out highly questionable signals.  The problem is and has been in the ability of the public and the government in recognizing and thwarting these cons dead in their tracks.

Although both segments are at fault, the major onus must be placed on the Securities and Exchange Commission, whom has failed immensely.  Pertaining to the Madoff case, the SEC was notified several times over the span of a decade about Bernie Madoff's questionable business practices.  This agency was handed detailed documents delineating abundant instances of fraud.  Similarly, there also were various news stories published by the media that portrayed a growing skepticism about Bernie Madoff.  The SEC ignored both the tips and the media.  Thus, in looking back at the Madoff case which lost investors $50 billion, this type of ignorance calls this organization into question.  Many question this agency's ability prevent this type of fraudulent behavior and in turn its ability to protect investors.

The Securities and Exchange Commission has exhibited incompetence and an inability to effectively do its job.  Due to this ineffectiveness, significant changes need be instituted by the SEC in order to become successful.  One major transformation must be the SEC's improvement of the cohesion across regional offices.  Competition amongst offices can and has been counterproductive to this agency.  To prevent this, motivating its employees through various work-incentives that further regional collaboration can lead to an increase in not only cooperation, but also productivity.

In order to also improve cohesion, the types of employees and their placement into proper positions can have major benefits. It has been found that the requirements for SEC employees are subpar and need substantial improvement. Also, evident within the SEC is that its employees have lacked the professionalism necessary for this organization. In turn, making the hiring a more involved and significant process should become paramount. While it is a difficulty to know the true character of a potential employee during an interview, it should be stressed that the types of individuals the SEC seeks to hire are driven and committed. Similarly, placing the right people in the right places cannot be disregarded. At multiple points in the Madoff case, highly intelligent people were placed to lead the investigation, yet these individuals had never dealt with nor really knew much about Ponzi schemes. In the end, these employees and the SEC in general were placed at a monumental disadvantage.

In conjunction with hiring the right people and improving cohesion, becoming a proactive governmental agency is a necessity. The role of the SEC is to enforce the regulations that prevent and/or stop fraud. Throughout the Madoff case, the SEC consistently ignored highly beneficial and legitimate findings from a viable source. This is something that simply must not occur. In its place, the SEC must become proactive and utilize good Samaritans that whistle blow. The intent of whistleblowers is more often than not for the betterment of society. As opposed to ignoring them, as seen throughout the SEC's history, this organization need trust and utilize them. Otherwise, its greatest assets, those professionals that constantly deal in the industry, will become alienated and disappear.

Ponzi Schemes have certainly left its imprint on both the financial industry and those within it. While this con is unlikely to stop ravaging anytime soon, people are beginning to further their understanding for how to not only recognize the scam, but also thwart it. By making major changes and improvements to itself, the SEC can go from an incompetent overseer, to an enforcer of the law and an intimidating watchdog for investors.

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Section II defines Ponzi schemes, distinguishes them from pyramid schemes, and describes the case for policy intervention against them. Section III describes the recent experience of the Caribbean with UIS, while Section IV presents policy recommendations. Annex I provides background on the experience in the United States, Colombia, Lesotho, and Albania. A Ponzi scheme is a fraudulent investing scam which generates returns for earlier investors with money taken from later investors.Â  Similar to a pyramid scheme, the Ponzi scheme generates returns for older investors by acquiring new investors, who are promised a large profit at little to no risk. Both fraudulent arrangements are premised on using new investors' funds to pay the earlier backers. Companies that engage in a Ponzi scheme focus all of their energy into attracting new clients to make investments. 5 Impact of Ponzi schemes. 6 Measuring gains and losses. 7 Evolution over time. 8 Measuring payment inequality. 9 Conclusions. Appendix A Appendix: general charts. Dissecting Ponzi schemes on Ethereum: identication, analysis, and impact. $ Massimo Bartolettiâˆ—, Salvatore Carta, Tiziana Cimoli, Roberto Saia.Â rules of the scheme, but all Ponzi schemes have in common that, to redeem their investment, one has to make new users enter the scheme. A more authorita-tive denition of Ponzi schemes comes from the U.S. Securities and Exchange Commission (SEC):1. â€œA Ponzi scheme is an investment fraud that involves the payment of pur-ported returns to existing investors from funds contributed by new investors.