



# MADOFF—A 21ST CENTURY PONZI SCHEME

**B**ernard Madoff perpetrated a multibillion dollar scam that defrauded investors around the world for decades until his arrest in December 2008. Madoff's fraud led many to financial ruin and his name is now synonymous with what many consider one of the largest Ponzi schemes in history. What every investor should know is that Ponzi schemes, even as extensive as Madoff's, are not too difficult to detect if you know the warning signs. A few simple actions can potentially help investors sidestep the financially devastating impact of a Ponzi scheme.

## What is a Ponzi Scheme?

The "Ponzi Scheme," named after the 1920's swindler, Charles Ponzi, is a ploy where earlier investors are paid with funds given by subsequent investors. In a classic Ponzi, claims of underlying investments are bogus; very few, if any, actual physical assets or financial investments exist. As the number of total investors grows and the supply of potential new investors dwindles, there is not enough money to pay off promised returns and cover investors who try to cash out. A Ponzi bubble bursts when the con artist simply cannot keep up with the required payments. In many cases, the perpetrator has spent investment money on personal expenses, depleting funds and accelerating the bursting of the bubble.

## The Madoff Case

For decades, Madoff investors received consistent and steady annual returns through elaborate, fabricated account statements and other documentation that were provided to investors to convince them that their money had been placed in actual investments. The investments "appeared" legitimate—especially to the people who received payments. But in reality, there were no actual investments and no actual returns. Madoff paid the initial investors "returns" with money provided him by a steady flow of new investors.

As the global economy began to decline in 2008, large numbers of Madoff investors needed money and began asking to cash in their investments. That's when Madoff's web of deceit began to unravel since he did not have enough money to cover his investors' requests, and new investor money was hard to be found in the economic downturn.

### ***Free Investor Resources***

*For more information on wise investing and other investment products, visit the Investor Resource Center, [www.azinvestor.gov](http://www.azinvestor.gov). To request a presentation for your group call the Investor Education Coordinator at 602-542-0428 or email at [info@azinvestor.gov](mailto:info@azinvestor.gov).*

## How to Protect Yourself Against Ponzi Schemes

- **Beware of promises of unrealistic or overly consistent returns.**

This is perhaps the easiest way to spot a Ponzi scheme. Any legitimate investment involves risk. Guarantees of unrealistically high returns are a clear

warning sign. But delivering consistent investment returns for decades, as Madoff purported to do, is unrealistic too, if not impossible. Beware of any investment that sounds "too good to be true" as it probably is.

- **Diversify—everything.** Avoid putting all of your eggs in one basket. Diversify not only your assets but also your money managers, accounts, and financial institutions. Spreading your money around will limit your exposure to the financial problems of any one institution. Victims in the Madoff case who were financially stable after the scam were the ones who invested only a portion of their assets with Madoff, not their entire life savings.
- **Don't rely on reputation or word of mouth alone.** Con artists are experts at building networks of trust, making investors think they are getting an “inside” track on a hot investment. Many of Madoff's victims invested because people they knew and trusted, such as friends and even family members, encouraged them to do so. If someone gives you an “inside” tip, avoid handing over your money until you or an objective third party thoroughly conducts some due diligence on the investment opportunity.
- **Verify the investment details.** From those who are selling the investments, ask detailed questions how the investments make money, and get clear and direct answers before you invest. In the Madoff case, clients were told that the investment strategy was
- **Check out auditors.** Check the auditor, or ask your financial adviser to check the auditor of any fund or company for you. Auditors sign and certify financial statements of companies and investment funds. Investors rely on these audit reports since auditors are liable for inaccuracies. A legitimate investment company managing multibillion dollars of assets under management would use a reputable, nationally known auditing firm.

In the Madoff case, with over \$50 billion in purported funds, the fact that the auditor was unknown, hard-to-locate and had only three purported employees responsible for reviewing such an extensive portfolio, which should have been a red flag to investors.

- **Do a background check.** The Arizona Corporation Commission's Securities Division urges investors to determine if the individuals and companies selling the investment are registered to offer and sell securities and do not have a disciplinary history. Remember, anyone selling a security is subject to registration with the Securities Division. If the promoter claims a registration exemption, follow up with the Securities Division to speak with a duty officer. You can also check the promoter's disciplinary history when you call.

---

## How to Report Fraud

If you are a victim of a Ponzi scheme or any other investment fraud, contact the Investigator on Duty of the Commission's Securities Division at **602-542-0662** or toll free, **1-866-VERIFY-9**, or email [info@azinvestor.gov](mailto:info@azinvestor.gov) to request a complaint form. Also, you can download the complaint form at the “Ask and Check” section on the home page of [www.azinvestor.gov](http://www.azinvestor.gov). Note that your inquiry or complaint is confidential and may help others from being victimized by the same scam.

**Before you invest, ask and check!**

