Anatomy of a "Ponzi" Scheme

Ponzi schemes are a type of illegal pyramid scheme named for Charles Ponzi, who duped thousands of New England residents into investing in a postage stamp speculation scheme back in the 1920s. Ponzi thought he could take advantage of differences between U.S. and foreign currencies used to buy and sell international mail coupons. Ponzi told investors that he could provide a 40% return in just 90 days compared with 5% for bank savings accounts. Ponzi was deluged with funds from investors, taking in $1 million during one three-hour period-and this was 1921! Though a few early investors were paid off to make the scheme look legitimate, an investigation found that Ponzi had only purchased about $30 worth of the international mail coupons.[1]

Decades later, the Ponzi scheme continues to work on the "rob-Peter-to-pay-Paul" principle, as money from new investors is used to pay off earlier investors until the whole scheme collapses.

Viaticals (viaticated insurance policies): financial transactions in which a company purchases life insurance policies from the terminally ill at less than their face value; they then sell the policies (or a "share" of the policies) to investors.[2]

In the mid-1990's, Financial Federated Title & Trust (FinFed) was formed with the stated purpose of purchasing life insurance policies from terminally ill AIDS patients and selling the policies to investors (viaticals). Here's how it worked:

1. AIDS patients with life insurance policies would be contacted by various marketing methods.
2. If they were determined by a medical examination or a review of medical records to be "terminally ill" with a life-expectancy of 2-3 years, FinFed would agree to "purchase" their life insurance policy and would receive the death benefits when the patient died.

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[1] Securities and Exchange Commission (SEC); http://www.sec.gov/answers/ponzi.htm

[2] Definition from Dictionary.com (December 2008)

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3. FinFed located investors through a network of insurance agents to sell “shares” in the policies to raise money to purchase the policies and administer the paperwork.

The breakdown purportedly worked like this:

40-50%	to the patient
20-25%	to FinFed for administration and commissions to the agents
30-40%	to the investors

FinFed required two elements to make the plan work: AIDS patients with valid life insurance policies, and investors with money to purchase the policies. Investors were promised a 30-40% ROI for their money. Independent insurance agents began selling the “investments” to their clients, from lone investors to groups, and even to a large pension administrator.

Three problems began to develop with the scheme:

1. AIDS patients were living longer, due to significant advances in medical treatments (the “AIDS cocktails”);
2. The “shares” in the policies were actually securities, which should have been registered with the Securities and Exchange Commission (SEC);
2. FinFed wasn’t purchasing enough (or any) policies!

When the principals of FinFed were later charged in federal court in the Southern District of Florida[3] with a wide variety of wire, mail and securities fraud counts, testimony revealed that the bulk of monies collected, nearly $130 million, went directly to the principals of FinFed, who spent millions on expensive cars and jewelry, luxury vacations, and large homes in the Florida Keys and Stowe, Vermont.[4]

As in all classic Ponzi schemes, the initial group of investors were paid “dividends” on their investments, but the “dividend” was actually money from new investors. Only a few hundred policies were ever purchased, and then only when the SEC began their investigation did a serious effort begin to locate policy holders. What started the SEC investigation was a report that shares of the viaticated insurance policies were being sold as unregistered securities. It was later discovered that one of the principals of FinFed was a convicted felon.[5]

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[3] United States v. Brandau, Balsam, *et al*, 99-CR-08125-Hurley, Southern District of Florida

[4] Ibid.

[5] Ibid.

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The scheme unraveled in 1998 when disclosures about FinFed began coming out in the media, and new investor money stopped coming in. Several of the people at the top levels of the company were convicted at trial and received sentences of up to fifty years; even a local lawyer went to prison for several years.

Some early indicators of problems:

- "secretive" or poorly conceived investment strategies
- small staff to handle million dollar investments
- claims of returns greater than the market average
- failure to conduct "due diligence" on the principals
- failure to register securities with the SEC and state agencies

Five Rules for Safe Investing:

1. Are the seller and the investment licensed and registered in your state?
2. Has the seller given you written information that fully explains the investment?
3. Do you understand the business of the company you are investing in?
4. Does the rate of return sound reasonable, in light of your knowledge of the company and its management?
5. Does the investment fit in with your *personal* investment strategy?

Remember, any investment decision should be discussed with a licensed, knowledgeable, and trusted financial professional. Call us at **561-687-8381** or visit us at www.radioinvestigator.com for more information about investment frauds and schemes, and to learn more about ways to protect yourself and your company from fraud, embezzlement and theft.

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