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Is Your Investment Fund a Ponzi Scheme?

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Law360, New York (July 08, 2014, 10:42 AM ET) --The Second Circuit Court of Appeals has defined a Ponzi scheme as:

a scheme whereby a corporation operates and continues to operate at a loss. The corporation gives the appearance of being profitable by obtaining new investors and using those investments to pay for the high premiums promised to earlier investors. The effect of such a scheme is to put the corporation farther and farther into debt by incurring more and more liability and to give the corporation the false appearance of profitability in order to obtain new investors. *Hirsch v. Arthur Andersen & Co.*, 72 F.3d 1085, 1088 n.3 (2d Cir. 1995).[1]

No reasonable investor would purposely invest in a fraud, yet many times even sophisticated investors are unable to recognize the signs that an investment opportunity may in fact be a Ponzi scheme. In reality, Ponzi schemes are more prevalent than most realize and many investors often simply abide by the theory that "it won't happen to me." According to Ponzi Tracker:[2]

- At least 67 Ponzi schemes were exposed in 2013
- The average Ponzi scheme was approximately \$44 million
- Over 1,000 total years of sentences were handed down in 2013 to at least 117 individuals involved in Ponzi schemes
- Males were the predominant perpetrators, constituting approximately 90 percent of the individuals sentenced and,
- The total dollar amount of all Ponzi schemes in 2013 exceeded \$13 billion

Butzel Long attorneys Regina Alter and Joshua Abraham with Neil Steinkamp, Managing Director in the Dispute Advisory & Forensic Services Group at Stout Risius Ross provide insight to sophisticated investors by discussing the hallmarks of a Ponzi scheme, review recent enforcement activity, discuss the risks sophisticated investors often face in investing in a Ponzi scheme,

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and look at a case study illustrating the challenges of identifying a Ponzi scheme and the red flags often associated with them.

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