

The Seduction of a Ponzi Scheme

By Pamela Zschoche CFP®

You work hard. You've been fortunate enough to be able to put aside some savings for retirement. You are depending on those savings for retirement, and cannot risk losing what you have worked so hard to accumulate. Investing in the stock market seems risky during the economic crisis, and rates on CDs are below the rate of inflation.

Then you meet a man at church who introduces himself as a financial advisor. He tells you about a strategy he uses to smooth out the ups and downs by trading in and out of large cap stocks, buying options, and investing in treasuries when there doesn't seem to be an opportunity in equities. You are smart. You have investing experience. It makes sense to you. He understands your vulnerabilities and knows all the right answers.

This is the scenario of a case that occurred in the Kansas City area. The perpetrator was tried and convicted. Where and how you meet a person, particularly in a "trusted environment," can influence your level of trust. So, how do you know for sure whether the investment is legitimate?

Initially, the most obvious clues would include:

- The words "no risk" to describe the investment. Generally, the higher the return, the higher the risk.
- A feeling of urgency is often created to make a person feel that they must act now, or, that the investment will only be available for a limited time.
- Watch out for verbal or written documentation of remarkably consistent returns, especially in a turbulent stock market environment. According to the Wall Street Journal, a client of Mr. Madoff said when she discussed her investment with a friend who was suspicious, she thought he was probably just jealous that her investments had grown 10% every year for 15 years.
- Promises that seem unrealistic usually are. One such investment might be called a High-Yielding CD, with a return three times what a CD at your local bank is paying. Further research may indicate that this is not a FDIC insured investment. Instead, there might be a statement that the investment is "insured against loss."

- No prospectus is offered. If one is, be aware: not everything written is true. Instead, legal looking documents using sophisticated terms may be offered.
- Be wary of “Special Purpose Corporations” and “Prime Bank Notes”, frequently used in a fraudulent manner.
- Is a recommendation made without regard for your risk tolerance or investment goals?

If you learn of an investment, and you are interested, but not sure the investment is legitimate, what can you do? The first step would be to read the prospectus. As it is possible to create phony documents, try to get information on the internet. Ask someone whose financial advice you trust. Check out unfamiliar companies with your local consumer protection agency, Better Business Bureau, state Attorney General, or the National Fraud Information Center. It is unwise to respond to an offer you don't understand thoroughly.

What if you fear that you might already have some questionable investments? Talk to a financial expert you trust before seeking legal advice or filing a complaint. What are some clues?

- Unprofessional or “unofficial” looking statements. Legitimate statements will have a brokerage/clearing house name and phone number clearly displayed. Call the number to verify that the account actually exists.
- Frequent trades for which you have never received trade confirmations, or a prospectus. The statement should also include information on the trade date, quantity, and price.
- New investments on your statement that you have never heard of, and again, did not receive a prospectus. Ask your advisor (broker) if they have “discretion.” This is not necessarily a bad thing, but it does mean that you have given permission allowing them to place trades in your account without your knowledge or prior approval. If you don't remember giving permission, ask to see the form with your signature. This permission should be in writing.
- Do you have the ability to view your account via your broker's website?

Anyone can become a victim. The Associated Press reported that nearly four times as many Ponzi schemes collapsed in 2009 (150) as compared to 2008 (40). Experts give the reason for such a large increase as investors having less money to risk. Money decisions can be emotional for most of us. Skeptical objectivity is helpful. Or, as Warren Buffet has been quoted to say, "Pessimism is your friend, euphoria is the enemy."

To get more information, or to file a complaint, go to:

www.fbi.gov

www.Consumeraction.gov

www.ksc.ks.gov

www.sos.mo.gov/securities

www.LooksTooGoodToBeTrue.com

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