PYRAMID AND PONZI SCHEMES AND THE PRICE OF INADEQUATE REGULATORY RESPONSES: A COMPARATIVE ACCOUNT OF THE DIVERGING REGULATORY RESPONSES OF CHINA, EUROPE, AND THE UNITED STATES

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Abstract

The perception and regulation of pyramid and Ponzi schemes, as specific forms of investment fraud, vary significantly around the globe today. Although no jurisdiction is immune from them, in some jurisdictions, they are among the top targets of financial supervisory agencies (e.g., United States), in others they are rather crimes perceived to be primarily in the bailiwick of public prosecutors (e.g., Germany). This difference is then reflected in the publicized records of detected cases.

Special concerns apply to emerging financial systems that not only lack efficiently functioning sector-specific regulations and properly empowered agencies that could react in due time, but because of the comparatively lowest financial literacy of the populace – the potential investors – are also the most vulnerable to these types of financial pathology. It is not only that in these countries disgorgement of illegally obtained profits, fair funds or anything similar is unheard of, but typically no recovery could be expected in the often equally dysfunctional bankruptcy proceedings either that normally follow the schemes’ collapse. The systemic risk that may be generated by schemes of magnitude similar to the Albanian pyramid schemes comes on top of all that. China, faced with the consequences of the recent Ezubao scheme, is only now to decide which path to take, though unfortunately the same could be said also as to many of Central and Eastern European jurisdictions as well.

In light of these considerations, this paper aims to show that comparative law has what to offer in this domain by sketching a select number of schemes from China, Europe, and the United States together with their characteristic regulatory solutions. The central argument is that combating pyramid and Ponzi schemes cannot be left only to such classical branches of law as criminal, tort or contract law. Rather, they should directly be targeted by financial regulations, be in the purview of adequately empowered agencies and their investigation and prosecution ideally be entrusted to a specialist body (e.g., the UK Serious Fraud Office). Training of staff of these is inevitable as well because detection of schemes requires specialist expertise in finance as no scheme could be sold unless it looks like a legitimate business; a task that hardly could be entrusted to prosecutors trained to prosecute conventional crimes and to be adjudicated by generalist judges. Education of the investing public on top of that is as well a must. These tested tools notwithstanding, as sketched by the article, even some developed financial systems lack adequate regulatory responses, let alone the emerging ones.
“[R]egulation alone can never be enough, given the behavioral biases and psychological pitfalls to which all of us, even the most clever and celebrated, are subject. Regulators are not immune from these influences either.”

I. Pyramid and Ponzi Schemes: Terminology, Definitions, and Legal Scholarship

In English publications, both terms – pyramid and Ponzi Schemes – are used, sometimes interchangeably yet perhaps with preponderance of the latter especially in writings, coming from the United States (U.S.) and other common law jurisdictions. Even a cursory look at the related US literature could corroborate that. As opposed to that, in Continental Europe, it is rather the designation ‘pyramid scheme’ that is more frequently resorted to, both in local languages and in English language publications of authors from these countries. Though the Ponzi-variant seems to be spreading as well. The European Union’s (E.U.) Unfair Commercial Practices Directive, on the other hand, uses the phrase ‘pyramid promotional scheme, with respect to what it leaves open—whether the two fully or rather only partially overlap.

Some languages, like German, have their own idiosyncratic term(s), concretely “Schneeballsystem” (metaphrased: “avalanche system”), in addition to the ones known in the English language as well (“Pyramidensystem” and “Ponzi-system”). Some German sources use also the ‘Ponzi-trick’ variant (“Ponzi-Trick”). The list of remote, imprecise attributes (rather than alternative designations) include also the very unofficial, German-Jewish ‘bubble company’ (“Luftgescheft”). In the Hungarian language, two variants, both alluding that the schemes are ‘games,’ are in use, which metaphorically mean ‘pyramid game’ (“piramissjaték”) or ‘pilot game’ (“pil6tajaték”).


4. A few examples might prove the above. For example, while in French it is “système de Ponzi,” the Italian expression is “schema Ponzi.” The Slovak variants are similar to the already mentioned ones but besides the “Ponziho schéma” and the “pyramidova schéma,” the ‘game-versions’ are also known i.e., “Ponziho hra.” On the Balkans, the ‘pyramid scheme’ is as well more widely used but the expression ‘Ponzi scheme’ is also spreading. For example, while the Croatian expressions are “Ponzi jeva i piramidalna shema,” the Serbian is “piramidalna i Poncijeva prevara.” In Romanian language, the two established phrases are “joc piramidal” (pyramid game) and “schema piramidală.”


7. See BTK. § 412 (The exact designation of the crime in the Hungarian Criminal Code is ‘Organization of a Pyramid Game’ (“Piramissjaték szervezése”). While the ‘pyramid game’ is the legal designation of the phenomenon, the phrase ‘pilot game’ is part of the vernacular. Although no legal or
If departing from the nomenclature of the U.S., which is one of the few systems that makes clear distinction between the two, the key difference is that in the case of pyramid schemes "a participant pays for the chance to receive compensation for introducing new persons to the scheme, as well as for when those new persons themselves introduce participants." No such ‘participatory’ prerequisite applies to Ponzi schemes, in case of which normally there is no actual economic activity whatsoever (or it is extremely minimal) but rather solely a collection of investments and their distribution to a few of early-generation (luckier) investors; if not exclusively to insiders. Colloquially, they are based on the concept of ‘rob-Peter-to-pay-Paul.’ As the Black’s Law Dictionary defines, a Ponzi scheme is “[a] fraudulent investment scheme in which money contributed by later investors generates artificially high dividends for the original investors, whose example attracts even larger investments.”

As the borderline between the two is thin and there is some overlap, the refinements formulated by U.S. courts may be instructive even outside the U.S. In the seminal case of Rieser v. Hayslip, this test was applied for the plaintiff to prove the existence of a Ponzi scheme:

1) deposits were made by investors; (2) the Debtor [i.e., Ponzi perpetrator] conducted little or no legitimate business operations as represented to investors; (3) the purported legitimate business operations of the Debtor produced little or no profits or earnings; and (4) the source of payments to investors was from cash infused by new investors.

The definition of the U.S. Securities and Exchange Commission (SEC) reads similarly:

[a] Ponzi scheme is an investment fraud that involves the payment of purported returns to existing investors from funds contributed by new investors. Ponzi scheme organizers often solicit new investors by promising to invest funds in opportunities claimed to generate high returns with little or no risk. In many Ponzi schemes, the fraudsters focus on attracting new money to make promised

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payments to earlier-stage investors and to use for personal expenses, instead of engaging in any legitimate investment activity.  

The differentiation between the pyramid and Ponzi schemes is, however, of little relevance for our discussion here given that both represent similar if not equal threats to investors and to the integrity of the financial systems and thus require as well similar if not identical treatment. Hence, we may conveniently use the phrase ‘pyramid and Ponzi schemes’ or simply just ‘Ponzi scheme’—given that the reading audience of this paper may be accustomed to one or the other only. Terminology clarification, however, is crucial because the mismatches in usage may lead to misunderstandings. For example, a researcher from a Continental European system accustomed to the ‘pyramid scheme’ variant may easily disregard sources on ‘Ponzi schemes’ if not aware that in fact, two sides of the same coin are at stake. This notwithstanding, whether different regulatory solutions should be forged for pyramid and Ponzi schemes is a topic that would deserve separate in-depth analysis; which, however, goes beyond the confines of this paper.

Talking of etymology, the twin of pyramid schemes "... takes its name from Charles Ponzi, who in the late 1920s was convicted for fraudulent schemes he conducted in Boston," as noted by the Black’s Law Dictionary itself. His ‘trick’ was, otherwise, described in the U.S. Supreme Court case Cunningham v. Brown as “buying international postal coupons in foreign countries and selling them in other countries at 100 percent profit...” His justification—the ‘bait’—was that his returns were based on “excessive differences in the rates of exchange following the war.”

From the list of various references to these phenomena one should not leave out economists and finance scholars either, in the vocabulary of whom pyramid and Ponzi schemes are ‘bubbles.’ This term, however, reaches much farther as it refers to any “significant, usually rapid, increase in asset prices that is soon followed by a collapse in prices and typically arises from speculation or enthusiasm rather than intrinsic increases in value...”


13. See, e.g., LEWIS, supra note 3, at 165. (concluding by stating that “Ponzi schemes differ markedly from pyramid schemes and Ponzi finance not only in their operation but also because...[t]hey follow a distinct life cycle”).

14. See http://content.time.com/time/specials/packages/article/0,28804,2104982_2104983_2104992,00.html (last visited on March 7, 2018) (claiming Charles Ponzi was 3rd among the top 10 all-time swindlers).

15. 265 U.S. 1, 7-9, 44 S. Ct. 424, 425-26, 68 L. Ed. 873 (1924).

16. Id.


18. See id.
Before embarking on the elaboration of the substance, a brief comment and caveat on legal scholarship are needed. As in many countries pyramid and Ponzi schemes are, neither directly targeted by banking and financial regulations (or any other branch of law), nor are they focused on by legal scholars, they are lacking from law school curricula and from the pages of law reviews as well. A comparatist trying to research the topic would have hard times not only because of the different terminology but also because of the scarcity of pertaining publications. As this applies especially to emerging financial systems, including a few European ones as well, the reader is well-advised to bear in mind that if no scholarly paper has managed to attract the attention of the editors of any law review in one’s jurisdiction (or elsewhere) that should not directly lead to the conclusion that pyramid and Ponzi schemes are either unknown there or are phenomena with no relevance to law or to regulators. The scholarly vacuum, interestingly, equally applies to some major legal systems and economic-financial centers of our contemporary world as well, like Germany. To these, the topic of pyramid and Ponzi schemes remains to be largely a ‘no issue’ up until today. This paper aims to put forward reasons why that should not be so.

II. Famous and less-known yet telling examples

A. Developed systems

1. Germany

Germany, as one of the financial centers of Europe and one of the countries with the highest rule of law index, is not devoid of pyramid and Ponzi schemes either. What makes this country peculiar is that it is hard to find reported court cases, or case studies, involving these types of financial pathology, let alone papers stemming from under the pens of legal scholars. As Stefan Theil aptly put it in the magazine Newsweek in an article reporting on the fall of a major German bank (Bankgesellschaft Berlin - BGB) – purportedly involving a Ponzi scheme or practices resembling that – in Germany the response “has been tepid [amounting] to a deliberate effort to enshroud the case in ’extreme secrecy’ . . .”

It is telling, however, that a leading member of the parliamentary investigation committee, depicted it as a ‘gigantic pyramid scheme.’


Otherwise, little detail is known about the operation of the BGB bank. As the scarce sources reveal, the bank has faced the growing losses, first tried to “sell” a portion of problematic real-estate investments to a shell company created in the Cayman Islands from the bank’s money somewhere in the year 2000. When this became known thanks to the media, the value of the bank’s shares plummeted leading to a situation in which “the bank was mainly doing business with itself.”  

The aired reactions could reveal a lot about what the German society, lawmakers and scholars think about various forms of financial pathology, including pyramid and Ponzi schemes, as shown in the following.

First, when attempting to understand what went wrong and how the downfall of BGB could have been prevented, Theil came to the conclusion that in fact, pyramid schemes (and thus also the kin Ponzi schemes) have never really been in the focus of German regulatory agencies. They represent radically different financial pathology for the U.S. SEC and for the German Federal Financial Supervisory Authority (BaFin). This seems to have remained a valid distinguishing feature of the two systems up until today.

Secondly, Theil did point to two important features of related German policy choices: the “continuing immunity of large state-protected sections of the German economy” and German confidentiality laws making it “extremely difficult even for official investigators to penetrate white-collar crime.”

As far as the first source of criticism is concerned, the city of Berlin, holding 56% of BGB’s equity, had to infuse about two billion Euros into the bank in order to save it from being closed down by regulators in early summer 2001. Confidentiality and data protection laws, on the other hand, are commonly known to be meaningfully broader compared to similar U.S. laws, and thus inevitably make the job of regulatory agencies and investigators more difficult. In that respect, suffice to point to the special data protection arrangements of the E.U. and U.S. had to make because of the increasing

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21. See id.
stiffness of European data protection laws: to wit, the Safe Harbor scheme that was replaced in 2016 by the EU-US Privacy Shield.\textsuperscript{25}

Thirdly, talking of future threats in the form of major financial calamities, including pyramid and Ponzi schemes, as well as the need to comprehend why a more meaningful shift toward \textit{ex-ante} legal tools is necessary—as proposed by this paper— the words of Stefanie Wahl, a senior scholar at the Institute for the Economy and Society in Bonn, may be telling. In her opinion, the “[German] ethic of protecting society from future harm is not very developed.”\textsuperscript{26} (emphasis added).

The above, however, should not lead to the conclusion that cases involving, and thus evidencing German pyramid and Ponzi schemes could not be found. The two following brief accounts will show that they do emerge in Germany, that some peculiar legal issues do arise connected to them, and that the responses may not necessarily be identical with what, for example, those to which U.S. federal regulations would lead. The small-scale \textit{Phoenix Kapitaldienst GmbH} case, for example, involved an investment company that transformed into a Ponzi scheme and went bankrupt in 2005.\textsuperscript{27} As the bankruptcy administrator refused to transfer to a former investor (investments were made in 2002)—the claimant in the case—a portion of monies foreseen to be repaid as part of normal bankruptcy distributions, litigation reaching even the German (federal) Supreme Court (SC) arose; the Court ordered the effectuation of the transfers within a strict short deadline.\textsuperscript{28} In another recent case, the (SC) adjudicated that those monies that stem from a Ponzi scheme yet which have been transferred to a separate account of the investor by the schemer, are not to be returned based on fraudulent conveyance laws.\textsuperscript{29}

Finally, a 1985 case deserves mention because of the unique combination of an investment scheme proclaimed to be a franchise, yet which in fact operated as a pyramid scheme.\textsuperscript{30} Here, the investors were lured into the scheme by the image of the franchise as a new success-business model and the luxury goods (perfumes and leather products) purported to be marketed by the system.\textsuperscript{31} The underlying contract contained clauses with elements that are traditional corollaries of business format franchises.\textsuperscript{32} This included for the investor-franchisee a meaningful entry-fee, obligation to purchase a certain quantity of products allegedly marketed by the system, and

\begin{itemize}
  \item \textsuperscript{25} Theil, \textit{supra} note 19.
  \item \textsuperscript{26} Theil, \textit{supra} note 19.
  \item \textsuperscript{27} Bundesgerichtshof [BGH] [Federal Court of Justice] Sep. 20, 2011, BGHZ XI ZR 434/10.
  \item \textsuperscript{28} \textit{Id.}
  \item \textsuperscript{29} Bundesgerichtshof [BGH] [Federal Court of Justice] Mar. 29, 2012, BGHZ IX ZR 207/10.
  \item \textsuperscript{30} Oberlandesgericht [OLGZ] [Higher Regional Court] Sep. 12, 1985, No. 5 U 4430/85.
  \item \textsuperscript{31} \textit{Id.}
  \item \textsuperscript{32} \textit{Id.}
\end{itemize}
the obligation to recruit newcomers to the scheme.\textsuperscript{33} In return, however, except for promised future training, essentially nothing was to be provided by the organizers of the scheme—named as franchisors.\textsuperscript{34} The court adjudicated the scheme as immoral and as such void.\textsuperscript{35} The recruitment of new members was especially problematic in the eye of the Court because it was thought to be nothing else but a pyramid scheme.\textsuperscript{36} As the court said, “in fact, the investors would have been paid those money [if satisfying all the preconditions and being successful in recruiting new members] that they contributed initially.”\textsuperscript{37}

2. United States

The US has presumably the richest reported history with Ponzi schemes in recent times. For example, The Ponzi Book lists forty-two “more recent and larger American Ponzi scheme cases”.\textsuperscript{38} The overwhelming number of them have not reached the media, let alone the pages of law reviews outside the U.S., and thus, remain almost entirely unknown to the outside world though they could be very instructive for other jurisdictions as well. The high number may be explained by the depth of the U.S. capital markets. While Ponzi schemes remain unreported in other jurisdictions and consequently it is hard to compare, it may be hypothesized that there is a positive correlation between the number and variety of Ponzi schemes, on the one hand, and the level of development of a country’s capital markets U.S. authors tend to find the explanation for such frequency of Ponzi schemes primarily in the psychology of victims as the primary culprits.\textsuperscript{39} As one source noted, “the American public is better educated and better informed than ever. But here’s a paradox: The more people know; the dumber and more careless they seem to get about their investments.”\textsuperscript{40} The story, unfortunately, seems much more complex and the red flags that seem to be as conspicuous as put forward by some authors, in fact, are not that easy to spot and comprehend. As a U.S. court put it in 2010, “Lest one think Ponzi schemes are too simple and obvious to bamboozle the financially savvy, an oil-drilling swindle in the 1970s duped top executives at Pepsico, Time, and General Electric, as well

\begin{itemize}
  \item[33.] Id.
  \item[34.] Id.
  \item[35.] Id.
  \item[36.] Oberlandesgericht [OLGZ] [Higher Reg’l. Court] Sep. 12, 1985, No. 5 U 4430/85.
  \item[37.] Id.
  \item[38.] PHELPS & RHODES, supra note 12, at § 1.04.
  \item[39.] See, e.g., TAMAR FRANKEL, THE PONZI SCHEME PUZZLE: A HISTORY AND ANALYSIS OF CON ARTISTS AND VICTIMS (Oxford University Press 2012) (focusing on explaining Ponzi schemes through the prism of the schemers (called ‘con artists’) and their victims).
  \item[40.] Richard L. Stern & Lisa Gubernick, The Smarter They Are, The Harder They Fall, FORBES, May 1985, at 38.
\end{itemize}
as the chairman of U.S. Trust, the president of First Boston Corp., and an author of several books on Wall Street finance.\(^{41}\)

Besides these factors, the increased role of technology and the exploitation of connected financial innovation play in devising the scams cannot be denied either. Blockchain technology\(^ {42}\) and the mushrooming cryptocurrency market may be the best examples. Amidst the surrounding truly global hype, experts speaking of unparalleled opportunities offered by cryptocurrencies, along with the consequent race to attract tech-companies expert in cryptomarkets, it should not come as a surprise that various national regulators are extremely cautious how and whether to react at all.\(^ {43}\) Although a number of cryptocurrency schemes have already collapsed, the industry seems to have already coined a new name for Ponzi Schemes in this novel, the extremely technology-dependent niche of the market: PonZICOs.\(^ {44}\) While clearly paving the path, the SEC’s cautious reaction, reflected in the SEC Report on the German DAO blockchain scheme from July 2017,\(^ {45}\) should be illustrative of the complexity and delicacy of the situation. Moreover, notwithstanding SEC warnings,\(^ {46}\) the sums lost by investors are estimated to be enormous. The problem in this respect is that due to the fact that these systems tend to operate non-transparently through the internet, it is often next to impossible to determine not only the extent of losses but even to locate the participants (both, promoters and organizers as well as the investors).

The fact that the U.S. SEC reported the highest number of enforcement actions against Ponzi schemes in recent years, however, was not only the product of the agency’s policy choices. Namely, what should not go unnoticed is that no other jurisdiction affords such a wide panoply of legal

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41. United States v. Treadwell, 593 F.3d 990, 993 n. 2 (9th Cir. 2010).
42. See, e.g., Ronald L. Chichester, Wide Open Spaces, 80 Tex. B.J. 228 (April 2017).
43. Compare, for example, the language and stance of ESMA – the European Union’s financial authority – as expressed in its 7 February 2017 Report with that of SEC to see that the positions of the regulators are far from being the same, ESMA being more lenient and focusing more on the benefits that may stem from use of blockchain technology. The ESMA Report titled the Distributed Ledge Technology Applied to Securities Markets can be downloaded at https://www.esma.europa.eu/sites/default/files/library/dlt_report_-_esma50-1121423017-285.pdf. (last visited on Mar. 7, 2018).
44. This designation is identical with the name of one such offerings, the website of which is at <https://ponzico.win> (last visited on Mar. 7, 2018); see also Matt Levin, Bloomberg View columnist, commenting on PonziCO, at https://www.bloomberg.com/view/articles/2017-05-16/hedge-fund-pay-and-trade-les (last visited Mar. 7, 2018); see generally David Gerard, Attack of the 50 Foot Blockchain: Bitcoin, Blockchain, Ethereum & Smart Contracts (CreateSpace Indep. Publ. Platform, UK, 2017) (discussing Ponzi schemes related to blockchain technology and cryptocurrencies).
protections for the forestalling of and sanctioning perpetrators of Ponzi schemes, as well as remedies for victims of this peculiar form of financial fraud, as the U.S. Suffice to mention disgorgement of profits or the fair funds system, which are such powerful remedies efficiently protecting the interests of defrauded investors that most other legal systems hardly could parallel.\(^47\) In other words, what makes U.S. peculiar is that—unlike many other jurisdictions—these pathologies have always been within the purview of regulators in this country, even if with fluctuating intensity.

From the forty-two cases mentioned by The Ponzi Book, for our purposes here, mention should be made only of the two most famous schemes: that of Charles Ponzi and the more recent Madoff saga.

Besides what has already been said about the first hereinbefore, it should be added that Charles Ponzi cost investors in America about $20 million in the early 1920s; which according to Sama, would be around $300 million today.\(^48\) His scheme was built around postal reply coupons.\(^49\) The idea was born from the realization that the coupons could be purchased at a huge discount in his home country, Italy, due to high inflation looming large in the post-WWI era and then they could be cashed at face value in the U.S. Today, this trading technique is known as arbitrage.\(^50\) Charles Ponzi eventually founded his own securities company, which promised abnormally high returns in order to expand and to lure in new investors.\(^51\) The system operated for about a year, essentially until the lavish pay-outs to the earlier generation investors attracted a sufficient number of newcomers.\(^52\)

Bernard Madoff's scheme, that collapsed in 2008, caused approximately $18 billion in losses to investors (i.e., these money are simply missing) and involved about $170 billion of cash flowing through the accounts controlled by him.\(^53\) These numbers make the Madoff scheme presumably the largest modern time Ponzi scheme, not only in the U.S. but also worldwide. Madoff was charged with 11 felonies for which 150 years of imprisonment were imposed.\(^54\) Madoff's scheme was nothing more than a pure, yet carefully orchestrated Ponzi scheme, which was supported by "detailed monthly statements purportedly showing many transactions," and which could go unnoticed because no one doubted or checked them.\(^55\) As Irving Picard, the trustee liquidating Madoff's investment firm, confirmed:

\(^{47}\) See infra section 3.2.
\(^{48}\) See David E. Y. Sarna, History of Greed: Financial Fraud from Tulip Mania to Bernie Madoff (2010), at 146.
\(^{49}\) Id.
\(^{50}\) Id.
\(^{51}\) See Thomas L. Friedman, The Lexus and the Olive Tree (2000), at 156.
\(^{52}\) See Jarvis (2000), page 7.
\(^{53}\) See Sarna, supra note 34, at 147.
\(^{54}\) See Sarna, supra note 34, at 147–48.
\(^{55}\) See Sarna, supra note 34, at 152.
no security whatsoever was purchased on behalf of customers for at least thirteen years. Renowned auditing firms trusted and accepted Madoff’s reports without properly checking them. This was possible due to the fact that Madoff was “a legend on Wall Street for nearly 50 years, with an enviable reputation,” plus he was a former chair of National Association of Securities Dealers’ Automated Quotations (NASDAQ). However, some other features of his tactics are noteworthy. For example, Madoff turned down some investors and thus, it was impolite to raise questions by those who made it into his exclusive club. Last but not least, the returns were “at the outer end but within the realm of believable.”

Talking of the victim’s gullibility and countering the argument the red flags are so conspicuous and self-explanatory, it was also telling that the list of Madoff’s clients included undoubtedly financially-knowledgeable entities such as “investment management firms, foreign banks, hedge funds, brokerage firms, pension funds, companies, charities, universities, and insurance companies” as well as wealthy individuals.

Thanks to Madoff, the SEC was restructured and the fight against Ponzi schemes was afforded top priority with the arrival of the then-new chair, Mary Shapiro (serving as chair from 2009–2012). One commentator, characterized these years as the era of “aggressive prosecution of Ponzi schemes” in 2010: while “[p]reviously, only a handful of Ponzi scheme cases would be handled during the year; over the past twelve to eighteen months, over forty cases have been brought[,] [which] has required an amazing shift of resources and focus.” The point that ought to be added here—if these numbers would seem modest—is that the number of countries which could at least remotely match the U.S., as far as the number of detected and reacted upon Ponzi schemes are concerned, is no more than a few.

B. Emerging Financial Systems

1. Albania – Systemic-Risk Pyramid Schemes

56. See id.
57. Id.
58. See Frankel, supra note 39, at 5
59. See SARNA, supra note 34, at 161.
Albania, one of the poorest post-socialist countries on the Balkans, had its encounter with pyramid schemes soon after it began its transition to a market economy in one of the worst possible forms known to the history of these investment frauds. Namely, the pyramid scheme crisis of 1996-1997 caused not only huge monetary losses to citizen-investors, but was also the direct cause of the downfall of the entire economic and political system and the deaths of about 2,000 people. The rise of the schemes began already in 1991-1992 though a major push was given to them by the introduction of the United Nation’s (U.N.) embargo against the neighboring rump Yugoslavia (Serbia and Montenegro) in 1992, when some of the pyramid schemes could have ripped extra profits from smuggling gasoline to the embargoed neighbor; a fact never proved but “they were generally believed to be involved.” As Friedman succinctly described, “[s]o well established were these Ponzi schemes in Albania that one of the most brazen of them even sponsored an Italian race-car team, as though it were MasterCard International.” Yet when the embargo against rump-Yugoslavia (at least, the gasoline supply) was lifted in 1996, that meant the beginning of the end.

Besides the ability to profit from the U.N. embargo, of key importance were three more factors: the financial illiteracy of the population, the inadequacies of the formal financial system and the involvement as well as the passivity of the incumbent government. As a result, during the heydays of the pyramid schemes, not a few but even seventeen banks and companies profited lavishly from the new “business model.” Strangely, they were all properly licensed entities, which, however “were never audited, nor do they appear to have paid profit taxes” ever. As in early 1996, unexpectedly newer participants appeared on the market offering even higher interests rates on deposits, frenzied competition broke out; triggering no reaction whatsoever from the side of any of possibly competent governmental bodies — including the National Bank of Albania. This lead to the collapse of the first scheme that then had a domino effect bringing down the rest very soon.

The lesson Jarvis drew based on this saga, of relevance, not only to Albania, is that the best panacea against pyramid and Ponzi schemes is early detection and prevention of unfolding the schemes. This obviously includes also the mobilization of all the suitable tools law could offer, in particular,
those with prophylactic effects. In this respect, as already hinted at, US law
conspicuously stands out. In fact, the whole post-Great Depression
development of US federal capital markets and securities regulations was
about constant strengthening the position of the SEC as well as of the
investors, from the court-developed sector specific anti-fraud laws to the
enrichment of the repository of tools available to the SEC to enforce
regulations.\footnote{See id. (discussing Wang Zhendong's death sentence).
See Rakesh Sharma, Online Lender Ezubao a $7.6B Ponzi Scheme: China Says (Feb. 1, 2016),
http://www.investopedia.com/articles/investing/020116/ezubao-chinese-online-lender-accused-
ponzi-scheme.html?utm_source=term-of-the-day&utm_medium=email&utm_campaign=TOP-
1/4/16&utm_term=term-of-the-day.
Id.
Id.}

2. China – from ant farm investments to online peer-to-peer lending
Ponzi schemes

Not too many cases from China have been reported by international
media so far. Yet the ant-sales scheme from the north-eastern province of
Liaoning has reached the pages of western media already in 2007.\footnote{Id.}
Except for the stiff fraud penalties and having ants in the center of the underlying
“business idea,” the case properly corroborates the findings discussed in this
paper.\footnote{Id.} It superbly illustrates the high level of exposure to emerging markets
to pyramid and Ponzi schemes. Yet even the idea of building a scheme around
animal breeding programs is hardly something new. Suffice to take a look at
US cases involving breeding programs with “earthworms, beavers, muskrats,
rabbits, chinchillas . . .”\footnote{Id.} which have already been reacted upon and handled
by the regular tools of federal capital markets and securities regulations there.
Instead, in China, criminal law played the central role obviously with
questionable outcomes for investors having lost often their life savings.

The scheme was built around purportedly rare ants the excretion of
which had traditionally been used to make medicines and wine in that part of
mainland China.\footnote{Id.} At the outset, investors got two boxes full of ants for
$10,000 Yuans (about $1,300 in 2007), which they were supposed to raise
for the schemer company and which were repurchased by it every month for
about $52 (i.e., $624 per annum or 40% return).\footnote{Id.} As it happens in case of
Ponzi schemes, the scheme eventually collapsed in about two years, making
36,700 citizens of 12 towns lose about $400 million, many their life savings.\footnote{Id.}
However, the success of the scheme, as the sources suggest, could not be attributed solely to the gullibility and greed of citizen-investors. Namely, the central figure, the schemer (Mr. Want Zhendong), was parallel running a purportedly successful group of companies with 10 subsidiaries and 800 employees, was engaged in philanthropic activities reported on local media, and has not infrequently been photographed with politicians. These were such key factors which gave the image of genuineness and legitimacy; factors that have played a role in the development of schemes elsewhere, too.

For a more recent Chinese Ponzi scheme, the fame of which has reached foreign media as well is the case of an online peer-to-peer lending platform named ‘Ezubao’.\(^{78}\) Little is known about it because the case is still unfolding and access to data is restricted. It is clear, however, that this scheme dwarfs all the earlier ones in China because according to the initial reports, about 900,000 investors were defrauded of approximately $7.6 billion (RMB 50bn).\(^{79}\) The system allegedly offered up to 15% annual returns.\(^{80}\) The founder is claimed to have plowed new investors’ capital into its own real estate projects together with some 1,200 accounting books, which had to be excavated by the police.\(^{81}\) As reported, this scheme and the excesses of online lending has already threatened the financial system, in the opinion of the ruling Chinese Communist Party.

Although only two Chinese schemes were briefly canvassed, they properly show that no system is immune to pyramid and Ponzi schemes as peculiar types of investment fraud and financial pathology. Notwithstanding that China has proved to be eager to learn from the experiences of the most developed western legal systems in the last decade or so, the US approach to Ponzi schemes has so far not been properly heeded there. Time will tell what consequences will ensue from such a stance.

3. Hungary – schemes disguised as real property investment cooperatives

\(^{78}\) Id.


\(^{80}\) See Tom Mitchell, Chinese Police Need Diggers to Unearth ‘Ponzi Scheme’ That Took alleged $7.6bn, FINANCIAL TIMES (Feb. 2, 2016), at 1.

\(^{81}\) Id.
Pyramid and Ponzi schemes are hardly meaningful interest to legal scholars in Hungary and thus the rule is that very few court or agency decisions and scholarly publications focus on these. Although some schemes have emerged and collapsed in the post-1990 period, they failed to invoke much attention among legal scholars; instead, they emerged only in reports of investigative journalists. The fact that the author of this paper has tried not only to analyze the phenomenon from the point of view of the adequacy of the responses of the legal system but has also tried to chronologically list all the developments from the founding of cooperatives through the collapse–cum-their ripple effects is very exceptional. The case, nonetheless, is very instructive of the problems incomprehension, ill-suited regulatory responses and gaps in the system may cause. In that case, nothing suggested the involvement of bribery or other forms of corruption. The main highlights were the following:

Altogether fourteen such cooperatives were founded roughly at the same time and each one of them collapsed as well almost simultaneously. In the biggest one, named as Baumag, about 12,000 individuals, out of which quite a number were pensioners, have lost their life savings. The offerings of the cooperatives were publicly advertised without any restraints on the streets on show-boards and in widely circulated newspapers, including freely circulated ones in the metro (subway). The financial supervisory authority found


84. The CEO of the cooperative was charged and found guilty for embezzlement and for the crime of bankrupting the cooperative. See Baumag-ügy: a Kuria fenntartja a másodfokú ítéletet, report of the daily newspaper Magyar Nemzet. Downloaded from: <https://www.mno.hu/gazdasag/baumag-ugy-a-kuria-fenntartja-a-masodfoku-itetet-1249163>. Last visited on 7 March 2018.

85. Tajti, Definition of Security, supra note 54, Appendix I listing the events in chronological order.

86. Tajti, Definition of Security, Id. at 209. In the proceedings lasting more than ten years, the 12,000 thousand small (consumer) investors of Baumag Cooperative are claiming twenty-billion Hungarian Forints. (1 USD was exchange for 245-250 Hungarian Forints on 7th of March 2018).

87. Gyu la T. Máté, A Wonder-Investment Opportunity or a Pyramid-Game? in: Magyar Hirlap (Hungarian language daily), (March 26, 2003 issue) at 9, advertising the offer of KPMH Cooperative. The offer was 14% for investment lasting 3 months, 17% for 6 months and for a year – 23%. At the same time, the interest rates paid by banks on savings accounts and on government-securities were slightly above 6%. Moreover, as the newspaper noted, the No. 1 fund manager in Hungary in year 2002 has achieved “only” 12.9 % in that year.
nothing irregular primarily because the cooperatives did not qualify as ‘banks or financial organizations’ and, therefore, were not subject to registration and licensing with it. Consequently, the authority (as it proclaimed) had no powers to take any steps in the case. Only the police did some investigations while the schemes were still in operation but found nothing illegal either. Part of the cooperatives’ ‘trick’ was that the structure, formulation and generally the outlook of the cooperative advertisements resembled very closely those of traditional savings accounts-related ones of commercial banks.\textsuperscript{89} For the money paid in, in fact, the investors got membership-stakes, which were promised to be repurchased by the issuing cooperatives upon the expiry of the agreed upon period of time (3, 6 or 12 months).\textsuperscript{90} As this represented equity and not debt, in the bankruptcy proceedings that ensued after the collapse of the cooperatives, the investors’ claims ranked last, after all the creditors. In other words, the chances of getting back anything from their investments were close if not equal to zero from the inception.

The cases properly illustrate and corroborate that pyramid and Ponzi schemes could hardly be efficiently fought without a regulatory system that directly targets these schemes and possesses adequately empowered expert enforcement bodies with properly trained staff. The gathered media reports corroborate this as they readily prove that none of the governmental bodies seem to have understood what was concretely at stake and consequently inappropriate responses were made by them. As a result, the collapse of the cooperatives occurred exactly as suggested by the pertaining theories.\textsuperscript{91}

The issue that remained unanswered in Hungary was related to the possible liability of banking and financial regulatory bodies, or of the state itself, for having failed to detect and prevent the schemes emerging or escalating in due time. This is an issue that may come up actually in case of any country where a scheme emerges and the responses, as a rule, depend on the gravity and magnitude of the calamities caused by a scheme. In the case of the cooperative, one of the investors, indeed, did sue the Financial Supervisory Authority for the failure to prohibit the activities of the cooperatives in due time as in the opinion of the claimant the sale of cooperative memberships amounted to financial activities subject to licensing by the Authority. While in the U.S. such a claim would have had quite solid chances of success, for the Court of Appeal of the Capital Budapest it was not proven that “there was a proximate cause between the actions of the Authority and the damages of the plaintiff [i.e., investor].”\textsuperscript{92}

\begin{itemize}
\item \textsuperscript{89} Tajti, \textit{supra} note 54, at 117, Appendix I.
\item \textsuperscript{90} See Tajti, \textit{Definition of Security}, \textit{supra} note 54, at 117; Tajti, \textit{Definition of Security}, \textit{supra} note 54, at Appendix I.
\item \textsuperscript{91} \textit{Id}.
\item \textsuperscript{92} Decision of the Court of Appeal of the Capital Budapest No. BDT2010.2177.
\end{itemize}
4. Romania – the Caritas saga

The proclaimed mission of the most famous recent Romanian scheme—Caritas, a limited liability company founded in 1992, was “helping Romanians cope with the hardships of the transition from a centralized to a free market economy.”  

Similarly to Albanians, the citizens of Romania had as well no experience with and knowledge about investing at that time. Moreover, no working capital market existed in those years, and thus the only avenue of making any money above the comparatively low wages was either winning on lottery or bank savings deposit accounts. In such a milieu, then it came as a tempting opportunity to deposit money with Caritas and receive the exorbitant 800% interest after three months. As Caritas was a duly registered company and it did pay taxes, no governmental body interfered, especially as some government officials became privileged depositors of Caritas by having a chance for faster returns for the price of a 10% commission. Part of the story is that no proper financial regulation was in place in those days in the country. At its peak period, it was estimated by the governor of the National Bank of Romania that about one-third of Romania’s banknotes were in the hands of Caritas.

Besides being a typical Ponzi scheme, a money-collecting, and distribution machine from an emerging system at the outset of its transitory process, the case likewise illustrates how important it is to have appropriate regulations and expert enforcement bodies trained in financial law. Moreover, as soon as possible when embarking on the development of local capital markets and linking to the global financial system. This is the token of early detection of the pyramid and Ponzi schemes. Although Romania now has a developed regulatory system similar to most other Central European countries, a number of smaller schemes have emerged after the eventual collapse of Caritas in 1993. Thus, the thoughts enshrined in this paper have not lost their relevance in this country either.

5. Russia – the MMM Scheme

94. Id.
96. Id.
The MMM scheme, organized in the form of an open (i.e., public) stock company, the mastermind and the controller of which was Mr. Sergei Mavrodi, was much more than mere money collection-cum-distribution.98 First, at the start of operations, it issued stocks approved by the Ministry of Finance, what – after failure to obtain approval for the issuance of the next series of shares – was followed by the formation of various funds and raising money by the issuance of the so-called ‘MMM Tickets’ in 1994. These were a sort of fixed income instruments. As these were not sold on organized markets, their price was fixed by Mavrodi and other insiders, which allowed for a showing of constant growth; increasing the trust of investors in the scheme. Allegedly, so much cash was piled up in the offices of the firm during the heydays of the scheme ($50 million per day) that could not escape the attention of the authorities.99 Additionally, they acquired 8% of Gazprom and other oil and gas companies; another thorn in the eye of politicians. Mavrodi was arrested in 1994, a path eventually leading to the bankruptcy of the company in 1997.100

As one may assume, all this was possible because Russia had in those days, either no, or inadequate capital market and securities regulation in place.101 In fact, the first generation of post-communist Russian regulations was passed as a response to MMM.102 Concretely, Presidential Decree No. 1233 of June 11, 1994 “On the Protection of the Rights of Investors,” Presidential Decree No. 2063 of November 4, 1994 “On Measures of State Regulation of the Securities Market in the Russian Federation,” and Federal Law No. 208-FZ of December 26, 1995 “On Joint-Stock Companies.”103 Furthermore, these were the years of ‘voucherization,’ a governmental effort to “create broad-based equity ownership in formerly state-owned firms [and to distribute vouchers] to ‘every man, woman, and child in Russia’ . . .”.104

Although the citizenry was, similarly to the other CEE countries mentioned herein, quite inexperienced in financial matters and yet exuberant to make a fortune via investing, there was one more momentum that made the MMM scheme special. Namely, the defrauded public perceived the

98. The acronym of MMM is made of the first letters of the founders, Mavrodi, Sergey, Mavrodi, Vyacheslav and Melnikova, Olga, notwithstanding of what, as all sources confirm, all controls were in the hands of Sergey Mavrodi.

99. Id.


101. See id.

102. See id.


104. See Greg Lumelsky, Does Russia Need a Securities Law?, 18 NW. J. INT'L. L. & BUS. NO. 1, 111-164 (Fall 1997) at 111.
scheme “as its ally and the interdicting state as its enemy. Indeed, the arrested owner, Sergei Mavrodi, was elected to the Russian Duma from his jail cell, his defiant supporters insisting that MMM’s crash was the government’s fault.”\(^\text{105}\) As a final brief gloss: although not yet proven Mavrodi, seems to have been later behind the biggest Internet-based Ponzi scheme, known as the ‘StockGeneration,’ operating various virtual exchanges via the Internet between 1998 and 2000 from a Caribbean Island.\(^\text{106}\) While in Russia MMM was brought to an end to a great extent by the involvement of politics, the expatriate scheme was closed due to the intervention of U.S. SEC.\(^\text{107}\) Recently, reports have appeared that speak of MMM’s appearance in Africa.\(^\text{108}\)

C. On the nature and typology of pyramid and Ponzi schemes

1. Ponzi schemes: the fraudulent Chameleons of finance

Undoubtedly, one of the key characteristics of pyramid and Ponzi Schemes is the wide variety of façades, the “clothes” in which they could emerge. Sometimes old patterns get repeated, typically in somewhat altered form, though as technology and business methods develop, the employed patterns may follow the suit as well. As it was put forward in a recent article from the US - “The Ponzi scheme of the future will be reinvented and remarked to the unwitting public. Please be forewarned.”\(^\text{109}\) As such, they are risks of ‘known unknown’ type because one could reckon with their emergence yet not necessarily knowing exactly in what form and in which niche of the financial world or economy.\(^\text{110}\)

As we are interested herein about what bankruptcy law could offer to victims of Ponzi schemes as opposed to penal and regulatory law, it should also be added that what the schemes offer may differ as far as their legal nature is concerned. Given that for bankruptcy law the key line of differentiation are creditors and equity holders, it ought to be added

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105. Verdery, supra note 90, at 667.
106. See COLLEN CROSS, ANATOMY OF PONZI SCAMS PAST AND PRESENT (Slice Pub’g 2017).
pertaining to the variability of the schemes that they can, indeed, be
differentiated into those offering debt (fixed income) versus equity-types of
pay-outs to investors. For example, the Madoff and the Hungarian real
property investment cooperatives are examples of the latter sub-types of
schemes. If extreme-variability argument is subscribed to, that should lead
to two quintessential conclusions. On the one hand, rigid, closed-end
definitions, trying to pin down the entire universe of pyramid and Ponzi
schemes for good, could hardly work. Such an approach would rather cripple
the governmental agencies entrusted with enforcement of the laws.
Lawmakers should instead perceive these forms of financial pathology as
objects of constant metamorphosis notwithstanding that “Ponzi schemes
[tend] to repeat the patterns of their predecessors.” The role of the open-
end definition of ‘security’ plays for US federal capital markets and securities
regulation may be a good model.

On the other hand, given their variable nature, hardly could one think of
a better panacea against them but appropriately trained, highly expert and
properly empowered independent regulatory agencies, or special
prosecutor’s office of the UK Serious Fraud Office type, as timely detection
and prevention of their unfolding is of key importance. Yet, as the
experiences of the US SEC show, sometimes even the agencies fail. As
noted by Lewis, although SEC was “established to protect investors against
misrepresentation and fraud in the issuance and sale of securities, by
enforcing securities laws . . . it signally failed to recognize several Ponzi
schemes at an early stage over the last decade.” For example, Madoff was
turned in by his sons, SEC overlooking important red flags. The variability
may occasionally mean also that in case of some Ponzi schemes the “schemer
sets out believing it has a legitimate business, but it either it could not get the
business off the ground as planned or the legitimacy of the business was lost
in the wake of the fraudulent scheme.” More often than not, however, they
are fraudulent from the very inception without the schemers ever intending
to engage in any kind of legitimate business activity.

The schemes, at any event, must look real, as if being engaged in
legitimate business activities with a legitimate business façade; else they

(assuming the U.S. Bankruptcy Code does not allow claw back of interest payments from Ponzi scheme
investors in general because of affirmative defense afforded to transferees who take payments in good
faith and for value).
112. See Bazoian & Rhodes, supra note 12, at 1-11.
113. See Tajti, supra note 53 (Definition of Security).
114. See Lewis, supra note 3
115. See Lewis, supra note 3, at 149.
116. See Lewis, supra note 3
117. See Phelps & Rhodes, supra note 12, at 1-11.
118. Id.
hardly could be sold to investors. Consequently, "[f]or their scheme to work, Ponzi schemers must make their offerings and trustworthiness as public as possible and for as long as possible. Their scheme depends on incessant advertising and rising reputation to continuously attract new investors." They have a sort of "double-image," the schemers "must know what they are actually doing, and be publicly well-known for what they seem to be doing."

Detecting and unraveling of schemes are hard especially in case of "affinity Ponzi schemes," in which the perpetrator reaches out to some specific inner circles, as it was in case of Madoff. Such schemes are veiled with mystique and secrecy, information spreads by word of mouth rather than by public advertisements and being part of the circle is deemed to be a privilege. While in the first step, the schemer "reaches out to people in his circle who he trusts and who trust him, and persuades them to invest in the scheme," later generation investors are already lured in by the new investors typically from the same affinity group. Given their increased frequency in the U.S. recently, the SEC found it important to warn and educate the investing about these under the rubric of "affinity fraud," or "investment scams that prey upon members of identifiable groups, such as religious or ethnic communities, the elderly, or professional groups."

It should be added that, historically, schemes that did not hide their true nature were also known. It seems that the previously mentioned Russian MMM scheme was, at least at some point of that sort, since the schemers publicly proclaimed themselves a pyramid scheme. These are, however, the exceptions.

2. Should pyramid and Ponzi schemes be treated solely as crimes?

Notwithstanding the variety of pyramid and Ponzi schemes, many jurisdictions deem such schemes as nothing more than crimes, and they are therefore dealt with exclusively by the paraphernalia of penal (criminal)

120. See FRANKEL, supra note 39, at 57.
121. Id.
124. Id.
127. Id.
Some jurisdictions have specific crimes against pyramid and Ponzi schemes, while others prosecute them based on general crimes such as fraud. The U.S. experiences clearly suggest that the criminal justice system is crucial yet insufficient. As aptly summarized by Frankel:

"Some people believe that the criminal justice system ought to protect them from fraud. Others believe that once fraud has occurred, the criminal justice system can do very little. It is unclear whether potential prison sentences deter addicted con artists [i.e., schemers]. Nonetheless, the frauds that were discovered after the crash of 2008 have shaken the public, regulators, and Congress. Con artists are discovered and jailed. The Securities and Exchange Commission is vigorously pursuing perpetrators of securities fraud. But no one believes that this is enough to stem the tide of fraud."

As these experiences show, not only of the US but some other countries relying exclusively on the criminal law as the solution is problematic for a number of reasons. In the former, the related discourse revolves around rethinking the additional remedies, which compared to the other systems, excels. Regardless, it makes sense to raise the criminal versus other remedies question in the context of all the civil law jurisdictions covered herein.

First, such ways of thinking indirectly presume that all investors in pyramid and Ponzi schemes are gullible irresponsible speculators, if not gamblers, who do not deserve protection through financial regulation. Although it has not been articulated in either top ranking law review articles or expert analyses, this seems to still be the case in emerging regulatory systems. However, empirical evidence shows that quite a number of reputable schemes were dressed up as legitimate business ventures that raised no suspicion, even in the eyes of experts, surviving virtually undetected until their collapse. If so, then investors in such schemes could hardly be stigmatized as gullible and greedy, yet they should bear all the negative

129. Id.
130. FRANKEL, supra note 39, at 189.
131. See, e.g., Saul Levmore, Rethinking Ponzi-Scheme Remedies in and out of Bankruptcy, 92 BOSTON L. REV. 969, 990 (2012) (vouching for “less focus on unjust enrichment and more on deterring misbehavior and social waste.” This, in the context of bankruptcy law, should mean that the withdrawing of Ponzi schemes should rather be encouraged, “in order to hasten the collapse of fraudulent enterprises”).
132. Id.
133. See generally Tajti, supra note 78 (Definition of Security).
134. Id.
135. Id.
consequences.\textsuperscript{136} Often, however, the sweeteners that drove them to invest in a scheme, when compared to similar financial products, are not necessarily offerings with abnormally high returns.\textsuperscript{137}

A suitable example is the Hungarian real property investment cooperatives.\textsuperscript{138} Their advertisements closely resembled those of bank savings deposits offered by duly registered businesses and even though they offered higher returns than average, the returns were not drastically higher than those paid on bank savings accounts at the time.\textsuperscript{139} Moreover, this occurred in an economy with high-interest rates and frequently fluctuating interest rates being the rule of the day.\textsuperscript{140}

Secondly, the determinative push to invest is often generated by the inaction, or minor reactions of governmental agencies, such as the police and public prosecutors.\textsuperscript{141} Such an attitude may then generate the false image of legitimacy that may be the final push for laymen-investors wanting to make a slightly higher return compared to what commercial bank saving deposits would yield.\textsuperscript{142} This has occurred, for example, not just in case of the Albanian schemes, but also in the case of the mentioned Hungarian real property investment cooperatives, though the fact that the Madoff scheme was so long-lived could partially be attributed to this factor, too.\textsuperscript{143}

Now, if in a jurisdiction only criminal law is entrusted with helping investors, including investors in pyramid and Ponzi schemes, all the tools developed over time developed to aid investors to recover as part of the burgeoning branch of law known as capital markets and securities regulations, or simply financial regulations will be unavailable.\textsuperscript{144} Indeed, if one mechanically compared the number of tools available under the US federal regulatory system, that play a central role in protecting investors and the integrity of the market, one would easily recognize that many of them are simply lacking even in some of the developed economies.\textsuperscript{145} For example, while registration, and disclosure, as well as regulation of financial service providers, could be said to have become a standard prerequisite of modern regulatory systems, the role the ‘economic’ definition of ‘security’ or the

\begin{itemize}
  \item \textsuperscript{136} \textit{Id.}
  \item \textsuperscript{137} \textit{Id.}
  \item \textsuperscript{138} \textit{Id.}
  \item \textsuperscript{139} \textit{See generally Tajti, supra note 78 (Definition of Security).}
  \item \textsuperscript{140} \textit{Id.}
  \item \textsuperscript{141} \textit{See, e.g., Richard W. Jennings, Harold Marsh, Jr., John C. Coffee, Jr. & Joel Seligman, SECURITIES REGULATION (Foundation Press, New York).}
  \item \textsuperscript{142} \textit{Id.}
  \item \textsuperscript{143} \textit{Id.}
  \item \textsuperscript{144} \textit{Id.}
  \item \textsuperscript{145} \textit{Id.}
\end{itemize}
sector-specific stiff antifraud law—coupled with private cause of action or corporate bar orders—is still hardly paralleled elsewhere.\textsuperscript{146}

Perhaps the most telling example is the remedy of \textit{disgorgement of profits}, lacking from many systems and not only underdeveloped ones.\textsuperscript{147} As one Swiss author—suggesting as well study of pertaining US law—recently claimed, “the legal framework available under Swiss law to disgorge undue gains is surprisingly limited.”\textsuperscript{148} Needless to say, what applies to Switzerland as a financially developed system, applies a fortiori to less mature ones like China, Hungary or Romania. Disgorgement is not only a powerful legal remedy but also a tool to serve justice and regain the trust of investors in the system.\textsuperscript{149} Namely, if a properly empowered expert agency makes use of it, be it in the context of Ponzi schemes or any other financial fraud, often it is the only way to ensure that illicit profits are returned from the hands of fraudsters and the victim-investors would recoup some of their losses. The importance of having such a remedy, however, has other beneficial effects as well.\textsuperscript{150} As it was stated in the US leading case of \textit{SEC v. First Jersey Securities, Inc.}, (1996), “[t]he primary purpose of disgorgement as a remedy for violation of the securities laws is to deprive violators of their ill-gotten gains, thereby effectuating the deterrence objectives of those laws.”\textsuperscript{151}

If US law and the uniquely large spectrum of legal tools employed to combat Ponzi schemes in the US are observed, it is conspicuous that the system relies besides the protections afforded by classical branches of law (criminal, contract and tort law) also on burgeoning sector-specific regulations increasingly perceived as a distinct branch of law.\textsuperscript{152} More than a handful of reasons explain why this is crucial. Yet, apart from what has been said above, perhaps the key distinguishing feature of these regulations is that while the mentioned classical branches of law are characterized predominantly by remedies with \textit{ex-post} effects, regulations are rather of \textit{prophylactic} nature, relying on remedies with \textit{ex-ante} effects. Figuratively speaking, the quintessential outcome of the above hinted at differences as far as the available investor-protections and remedies are concerned is that while in the U.S. in this domain the maxim ‘\textit{Ubi jus, ibi remedium}’ is materialized in real life, in emerging systems—ironically more vulnerable to financial

\begin{flushleft}
\textsuperscript{148} Id.
\textsuperscript{149} Id.
\textsuperscript{150} Id.
\textsuperscript{151} Id.
\textsuperscript{152} See generally \textit{SEC v. First Jersey Securities, Inc.}, 101 F.3d 1450 (2nd Cir. 1996).
\end{flushleft}
pathologies of pyramid and Ponzi scheme sort – it remains a dead letter on law school textbooks.\textsuperscript{153}

Thirdly, such a criminal law-focused approach is problematic also because prosecutors are normally trained to prosecute classical crimes and are not necessarily equipped with expertise for detecting and unraveling pyramid and Ponzi schemes. The same applies to generalist judges that adjudicate cases with financial fraud even in the U.S.\textsuperscript{154} The sticky point, is whether the prosecutors, as well as the judges, could understand the very phenomena of the pyramid and Ponzi schemes? It is not without reason therefore that in the U.K. “a specialist prosecuting authority tackling the top level of serious or complex fraud, bribery and corruption” was created in 1988 under the Criminal Justice Act 1987.\textsuperscript{155} This office has already successfully prosecuted also some major Ponzi schemes in the UK.\textsuperscript{156} This seems to be one of those patterns from the UK that should be closely looked at by emerging systems.

Lastly, more research would be needed on many points hinted at above. For example, it might be worthwhile to explore whether it helps the prosecution of pyramid and Ponzi schemes if specific crimes exist or rather the general crime of fraud (or any other general crime) is sufficient? The fact that, for example, Hungary has a specific crime ‘prohibiting organization of pyramid schemes’ is not much of a help because the number of prosecuted cases is conspicuously greater in the U.S., where the literature firmly puts forward that three ‘general’ federal crimes are commonly relied on in this context: to wit, mail fraud, wire fraud, and money laundering.\textsuperscript{157}

3. The impact of dysfunctional and emerging bankruptcy systems

Ponzi schemes, as a rule, collapse once the pool of potential investors dries up. While most of them go bust quickly in a matter of a year or so, longer-lasting schemes have also been known (e.g., the Madoff scheme). The collapse means also that many ends up in bankruptcy proceedings; “many” and not “all” because in jurisdictions with dysfunctional bankruptcy system the defrauded investors do not even bother to file for bankruptcy as they presume that it is of little avail. While the conclusion that is fully valid for the US according to which “without some system of orderly liquidation [which in fact are liquidations proceedings offered by the Bankruptcy Code

\textsuperscript{153} Id.
\textsuperscript{154} Id.
\textsuperscript{155} Id.
\textsuperscript{156} See generally SERIOUS FRAUD OFFICE, About Us, https://www.sfo.gov.uk/about-us/.
\textsuperscript{157} See PHELPS & RHODES, supra note 12, § 16.02, at 16–4.
in its Chapter 7] and distribution to claimants, Ponzi victims are essentially left to a feeding frenzy, which stands to generate much inequity and disappointment, while doing little that will actually make the victims of the scheme whole,” in systems with dysfunctional bankruptcy systems even the benefits that court-run orderly liquidations may generate is unavailable.

Interestingly, however, it seems to be characteristic primarily to U.S. bankruptcy scholarship to perceive Ponzi schemes as one class of bankruptcy crimes for this specific reason. Yet, of greater importance is that whether the victims of schemes will get some compensation, besides the existence of remedies similar to the U.S. disgorgements, depends on whether the bankruptcy system works efficiently in a country? The answer to this question, then, depends on many more technical details from the powers of the bankruptcy trustee through such questions as who else could be sued by the trustee besides the schemer. While it is far from being unheard of in the U.S. that those who “knowingly helped to perpetrate the fraud” have been found liable besides the schemer, such way of thinking might be foreign to others. It may be even more surprising elsewhere that not only receivers of gifts could be caught by U.S. rules but also those investors who have received payments from the scheme, or who have helped to recruit new investors (feeders and helpers).

Unfortunately, as it is commonly known, the bankruptcy system is often dysfunctional or suffers from serious defects exactly in emerging systems, where pyramid and Ponzi schemes emerge the most easily and where there is, either no properly functioning financial regulatory system with an expert agency at its helm, or to which pyramid and Ponzi schemes are of little or no concern. Regrettably, this applies also to some European jurisdictions, including even some Member States of the European Union, where the way the bankruptcy system works is far from being satisfactory.

Perhaps the most critical role from that perspective is played by avoidance laws, or the laws that make tracking and reclamation of investments from fraudsters possible both within and outside bankruptcy proceedings. This because if avoidance laws work, the payments not only to

160. See PHELPS & RHODES, supra note 12, at § 17.02 (discussing that per U.S. law, for example, civil contempt proceedings may be utilized to make the Ponzi perpetrator or third parties repatriate assets to the US. As opposed to that, “Criminal contempt may also be utilized, although its purpose is to punish disobedience with a court order rather than to compel compliance.” Civil contempt in the US involves either imposition of fines (per diem fine for each day) or detention of an individual until compliance with court order).
161. Id. at 177-78.
the Ponzi perpetrators, and other insiders to the schemes, but the distributed money to the first and some later generations of investors could also be reclaimed. To differentiate, U.S. bankruptcy law distinguishes ‘initial’ and ‘subsequent transferees,’ both having some though not fully identical defenses. The more transfers (money) are repaid, the more there will be available for distribution to creditors and other claim-holders. Now, if avoidance laws remain largely dead letters on paper in a jurisdiction even in conventional bankruptcy cases, then the chances that they may work better if Ponzi schemes are at stake must inevitably be worse.

The sheer number of U.S. reproduced cases with trustees successfully using avoidance laws should be telling that in this country this particular branch of law is working. The maturity of bankruptcy and fraudulent transfers laws, therefore, should be instructive to all jurisdictions pondering how the law can help the investors recover (increasingly known as “clawbacks”). This because, although many of the defrauded Ponzi investors end up being net losers, that must not be so always. A brief look at the ‘Madoff Recovery Initiative’s webpage might show that. The lesson one should draw is that where bankruptcy law works (e.g., U.S. or U.K.), with a functioning bankruptcy system there is a real hope that something may be recovered even by victims of Ponzi schemes. In countries lacking an efficient bankruptcy regime that is nothing more than wishful thinking.

A few tips borrowed from US law should properly illustrate how the law and courts, indeed, could aid the trustee or the investor-claimants in Ponzi schemes-related court proceedings. First and foremost, let us mention the so-called ‘Ponzi scheme presumption’ of U.S. law according to which “the mere existence of a Ponzi scheme is sufficient to establish actual intent [to hinder, delay or defraud],... a presumption [that] can be a powerful tool in a Ponzi scheme case, as it eliminates the need to prove actual intent to hinder, delay or defraud...” This, in other words, means that in the US, Ponzi schemes are deemed to be fraudulent per se once their existence has been established.

162. Id. (stating that the initial transferee may assert three defenses to a fraudulent transfer claim: 1) the good faith value defense (§548(c) of the US Bankruptcy Code), 2) the ‘stockbroker defense (if the Ponzi perpetrator was engaged in buying and selling securities), and 3) the ‘mere conduit’ defense “asserting that it was not the actual recipient of the property.” Subsequent transferees have besides these some additional defenses under § 550 of the US Bankruptcy Code).

163. See, e.g., Miriam A. Cherrv and Jarrod Wong, Clawbacks: Prospective Contract Measures in an Era of Excessive Executive Compensation and Ponzi Schemes, 94 Minn. L.Rev. 368 (Dec. 2009). (The authors promote the idea of adding clawbacks that would operate prospectively directly into investment contracts to better equalize winning and losing investors.)


165. See PHLPES & RHODES, supra note 12, § 2.03, at 2-6. (citing Bear, Stearns Sec. Corp. v. Gredd (In Re Manhattan Fund, Ltd.), 397 B.R. 1, 8 (S.D.N.Y. 2007) and Barclay v. Mackenzie (In Re AFI Holding, Inc.), F.3d 700, 704 (9th Cir. 2008) (quoting Hayes v. Palm Seedling Partners – (In Re Agric. Research & Tech. Grp. Inc.), 916 F.2d 528, 534 (9th Cir. 1990); SEC v. Res. Dev. Int'l, LLC, 487 F.3d 295, 301 (5th Cir. 2007)).
The important consequence of that, as the leading authority reads, is that all transfers “made by Ponzi perpetrators in the course of a Ponzi scheme, whether as gifts, charitable contributions, or returns to investors, will likely be construed to have been made with fraudulent intent.” Furthermore, fifteen distinguishable factors were identified through cases that “weigh in favor of applying a presumption of fraud in a Ponzi case.”

One does not have to go to the other end of the rainbow to realize that such a presumption and tests at hand significantly ease the trustee’s burden of proof. It should not come as a surprise then that in the US a significant portion of clawbacks, generally and also in case of Ponzi schemes, is returned to the debtor’s estate and thus becomes available for distribution to creditors and investors. This is due exactly to the efficiently functioning bankruptcy system and avoidance laws. Where such rules are lacking, the job of the trustee, or an investor-claimant, is far from being easy, especially with generalist judges not trained in finance.

The token of efficiency, however, often is in such mundane factors as the motivation of bankruptcy administrators (trustees): if they are not motivated to go after as many voidable transactions as possible or the system is corrupt and they could pocket more by refraining from pursuit of their statutory duties, bankruptcy law would remain impotent. If such an image of the bankruptcy system becomes the prevailing one on the market that would generate further negative consequences. For example, creditors and investors would simply not be interested to participate in bankruptcy proceedings, what would be a further blow because the controlling functions bankruptcy systems entrusts creditors’ committee in the bankruptcy process with would not be effectuated.

The interface of bankruptcy law and Ponzi schemes is a complex one and therefore the above lines are nothing more than the tip of the iceberg only. Many more legal issues should be raised and comparatively analyzed to get a fuller picture. The above brief account should, however, be sufficient to make the reader realize: bankruptcy law has a significant role to play in this domain as well.

Moreover, outside of the US, quite a number of other areas of law – some linked to bankruptcy, others not necessarily – have escaped attention as well. The notable examples include the role of contempt proceedings and

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166. See Phelps & Rhodes, supra note 12, § 2.01.
167. See Phelps & Rhodes, supra note 12, § 2.03, at 2-8. (discussing one such factor was that the Ponzi perpetrator had no legitimate business operations to which its alleged investment program was linked. See on that the cases Scholes v. Lehmann, 56 F.3d 750, 757 (7th Cir. 1995) and Wyle v. C.H. Rider & Family (In Re United Energy Corp.), 944 F.2d 589, 590 n1. (9th Cir. 1991)).
various prejudgment remedies\textsuperscript{168} in recovering and freezing assets\textsuperscript{169} in the hands of Ponzi scheme perpetrators or transferees, the possibilities offered by tort law (e.g., the tort of deepening insolvency),\textsuperscript{170} reliance on constructive trusts\textsuperscript{171} (primarily in common law systems), US forfeiture proceedings and victim compensation through the criminal process (or equivalents in other systems, if any).\textsuperscript{172} Or the options available based on such \textit{lex specialis} as the US Racketeer Influenced and Corrupt Organizations Act (RICO).\textsuperscript{173}

D. Why should pyramid and Ponzi schemes be targeted by regulations and be within the purview of regulatory agencies?

1. Micro-level reasons

The central argument for a sector-specific regulatory response to the pyramid and Ponzi schemes rests with the adequate protection of – typically yet not only consumer – investors. Two aspects of this regulatory goal should be distinguished; the first was already touched upon earlier.

On the one hand, besides what criminal, contract or tort law may offer, independent and expert regulatory agencies equipped with a wide panoply of legal tools should exist. This, in particular, because the mentioned classic branches of law predominantly offer remedies with \textit{ex-post} effects and prevention in this specific domain is more important. While schemers (fraudsters) may be in-jailed and a judgment ordering payment of damages in tort law, or for breach of contract could be obtained, that would be of little avail to investors given that pyramid and Ponzi schemes always end with bankruptcy – very often with no assets available for distribution.\textsuperscript{174} Moreover, if investors into such schemes are treated as equity holders, they are paid after the first-priority administrative costs and after all the secured and unsecured creditors.\textsuperscript{175} In fact, financial regulations have been “invented” exactly to fill the void left by classic branches of law, by being in the position to act rather than react. While all this may sound as often reiterated

\textsuperscript{168} See Phelps & Rhodes, supra note 12 (Explaining that prejudgment remedies can primarily be used to prevent dissipation of Ponzi scheme assets); FRCP 64 (allowing the use of every such remedy available under the state law where the court is located); FRCP 65 (temporary restraining orders and preliminary injunctions); FRBP 7064-65 (available to bankruptcy trustee).

\textsuperscript{169} See Phelps & Rhodes, supra note 12.

\textsuperscript{170} See Phelps & Rhodes, supra note 12, § 8.01.

\textsuperscript{171} See Phelps & Rhodes, supra note 12, § 6.01, at 6-2 (listing the three scenarios where a constructive trust may be claimed).

\textsuperscript{172} See Phelps & Rhodes, supra note 12.

\textsuperscript{173} See Phelps & Rhodes, supra note 12, § 10.03, at 10-42; see also Bridge v. Phoenix Bond & Indem. Co., 553 U.S. 639, 647 (2008).


\textsuperscript{175} Id. at 1593-98.
commonality, the matter of fact is that significant differences exist in the perception and regulatory responses to this issue even among the leading financial regulatory systems.

On the other hand, adequate protection presumes, as realized on both sides of the Atlantic, education of the investing public. It should not come as a surprise therefore that meaningful emphasis is put on this task by the US SEC\textsuperscript{176} and the UK Financial Supervisory Authority\textsuperscript{177} - agencies of the world’s two leading financial centers. In the UK more organizations have added Ponzi schemes to their agendas, like the Fraud Advisory Panel\textsuperscript{178} or the UK Police-linked ‘ActionFraud’ – the latter running a webpage where fraud could be reported (whistleblowing).\textsuperscript{179} Besides defining the phenomena, these agencies and organization have come forward with a list of ‘red flags’ (in the UK, ‘warning signs’), which they recommend reckoning with prior to investing. While these apply generally, they may be an invaluable panacea against Ponzi schemes as well. The list includes such indicia as the promise of unreasonably high returns with little or no risk, word of mouth marketing, overly secretive investment strategies, little or no documentation or secrecy.\textsuperscript{180}

As opposed to these Anglo-Saxon examples, much less attention seems to be devoted to the warning of investors specifically against pyramid and Ponzi schemes by the European Union’s bodies or by such developed civilian legal systems as Germany. The German agency (BAFIN) mentions pyramid schemes, for example, under the heading of “Not Serious Investment Offers” (“Geldanlage – Wie Sie unsériöse Anbieter erkennen”).\textsuperscript{181} As opposed to these, a search on the webpage of the European Securities and Market Authority (ESMA) yielded results neither for ‘pyramid’ nor for ‘Ponzi’ schemes.\textsuperscript{182} These undoubtedly give a proper hint at the priorities the various agencies attribute to the central topic of this paper.

A final point ought to be added. Namely, notwithstanding the efforts aimed at education of investors, typically, the general public condemns the victims even in countries with the most developed financial systems. As Tamar Frankel aptly summarized the U.S. perspective,

\begin{itemize}
  \item \textsuperscript{178} See https://www.actionfraud.org.uk/.
  \item \textsuperscript{179} Id.
  \item \textsuperscript{181} See European Securities and Market Authority https://www.esma.europa.eu/search/site/pyramid (last visited May 2, 2017).
\end{itemize}
[a]lmost invariably, the first reaction of people at the mention of Ponzi scheme victims is to blame the victims. The victims of risky investments are deemed 'greedy' because they are drawn to enticing offers that are too good to be true; they are gullible and stupid because they ignore investment risk and the risk of possible fraud. Therefore, the victims got what they deserved.182

Needless to say, the opinions do not differ, save some specific exceptions, in emerging financial systems either. The key difference, however, is that in the U.K. and the U.S. this is not the officially subscribed to position and investors in the pyramid and Ponzi schemes are not left alone by the system, as already highlighted above by a few examples from these jurisdictions.

2. Macro-level reasons

Three main macro-level reasons justify direct targeting and a pro-active stance as to pyramid and Ponzi schemes. These are, firstly, the threat of systemic risk, secondly, the investors' loss of trust in the system and in the markets, and thirdly, a potential blow to the image of the jurisdiction hit by the Ponzi scheme negatively affecting its position in the global competition for investors as well as in the process of regulatory competition. A brief comment on each of these points ensues.

3. The Threat of Systemic Risk

Although Albania is at the moment still outside the European Union, it was important to make mention of its unhappy encounter with pyramid schemes because of the sheer magnitude of the harm and damages these caused to the economy, the citizenry, and eventually the entire constitutional and governmental system. If compared to the economic strength of the country, the pyramids were devastating. In other words, Albania is the case proving the severity of systemic risk inherent to behemoth pyramid and Ponzi schemes, or more precisely, the aggregate effect the collapse of a multitude of schemes could generate.

For scholarly examples of schemes generating systemic risk, one should point also to the above-mentioned Romanian Caritas and the Russian MMM. Suffice to reiterate only one fact related to the former to make the reader realize that, indeed, the entire Romanian financial system was threatened by Caritas.183 Namely, as hinted at above, in autumn 1993, the President of

182. See FRANKEL, supra note 39, at 167.
Romania’s National Bank estimated that one-third of all banknotes of the country was held by Caritas.  

The losses, harm, and damages could be astronomical in developed systems as well, even if not necessarily endangering the entire economic system – as illustrated by the Madoff saga.  

While some quantitative data seems to be available from Western Europe, they can more easily be found on the other side of the Atlantic. The data on the losses caused by U.S. Ponzi schemes, brought forward by Tamar Frankel, professor of law and internationally renowned expert of the field, during her testimonials before the U.S. Congress, were the following:

1976, 1990 and 1996 the losses caused by Ponzi schemes exceeded $1 billion per annum;

in 1995 and 1997 the sum reached $1.6 billion,

in 2002 it would aggregate $9.6 billion.  

Yet all these were overshadowed by Madoff involving “cash floating through the accounts of $170 billion.” Undoubtedly, these numbers should properly speak for themselves.

4. Loss of trust in the system and in the markets

The second consequence of fallen pyramid and Ponzi schemes may be investors’ loss of trust in the system and in the markets. Trust, as a key factor to economists and financial experts and a stranger to lawyers attuned rather to justice-related explanations, is said to be the sine qua non, the catalyst of financial markets. The basic axiom suggests that if there is no trust in the market, there is no investment either. Essentially, all the building blocks of contemporary financial regulatory systems, be it the disclosure system or the rules against insider trading, aim at creating, maintaining and restoring trust (the last: after crises and bubbles). Or, as Alan Greenspan aptly put it through reaching more broadly, “Our market system depends critically on trust – trust in the word of our colleagues and trust in the word of those with whom we do business.”

184. Id.
186. SARNA, supra note 34, at 127.
187. Id.
The real question is whether such an agenda is subscribed to in a
country? Whether investors' money is reckoned with in the economy or
rather investments are perceived as mere speculation or gambling for big
money by taking big risks? In Albania, for example, as almost every family
had someone having lost fortunes in the schemes, the trust of the citizenry in
the institutions of the system radically fell for the post-collapse decade or so.
The distrust affected essentially all segments of the state, from courts to
government, through the completely bankrupted financial system with all of
its building blocks. 189

5. Negative impact on regulatory competition

Two aspects of regulatory competition that may be negatively affected
by the fall of pyramid and Ponzi schemes deserve brief commenting: the
perspective of emerging financial systems and the perspective of rival
financial centers.

The regulatory responses to pyramid and Ponzi schemes should be
important for emerging markets for the following reasons. On the one hand,
emerging markets, as a rule, compete with each other to attract foreign and
local investors as access to finance at favorable terms and conditions is the
token of economic growth, competitiveness, and eventually of social
welfare.190 In order to be attractive, however, it is not enough only to borrow
the best available regulatory solutions and international practices, blackletter
law is important but clearly insufficient as the world of finances—as already
stressed above—thrives only if trust exists.191 Trust, however, can be built
only if fraud gets exposed efficiently, is reacted upon by competent agencies
adequately, and the investors are provided with appropriate remedies,
including the chance of recoupment of losses. While no system is immune to
financial pathology of various forms, the pivotal difference between efficient
and inept systems is that in the former, there is normally a reaction from the
side of the system, which—even if not in each and every case—provides for
some sort of compensation to investors.192 In crippled systems, investors are
doomed from the beginning to losing their investments.

(quotting Federal Reserve's Second Monetary Policy Report for 2002: Hearing Before the S. Comm. on
Banking, Hous. and Urban Affairs, 107th Cong. 44 (2002) (statement of Alan Greenspan)); see also
Ronald J. Colombo, Trust and Financial Regulation 34-56 (Hofstra U. Sch. Legal Studies Research Paper

189. See Arnisa Gorezi & Evgjeni Bashari, Enforcement of Contracts in Albania— Overcoming
Dilemmas in an Emerging Market, in MESSMANN & TAJTI, CASE LAW OF CENTRAL AND EASTERN
190. See Ajit Singh, Competition and Competition Policy in Emerging Markets: International and
Developmental Dimensions, UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT G-24
191. FRANKEL, supra note 39, at 57.
The resulting formula is likewise simple: where the system is inefficient, there is no trust and thus, investors largely bypass such a system. To add to this simplified train of thought that additionally, the trust of local investors may be a positive, encouraging signal also to the foreign ones. Suffice to compare the treatment of pyramid and Ponzi schemes in any of the emerging systems and the U.S. to realize that there is, indeed, a causational link between what happens to pyramid and Ponzi schemes and the maturity and level of development of the market and the financial system in a country.¹⁹³ This should also explain why the U.S., possessing the most tested contemporary financial regulatory system has, in its modern history placed such an emphasis on pyramid and Ponzi schemes, at least since the beginning of the modern day financial regulatory system, the cradle of which was the Great Depression of the 1930s.¹⁹⁴ The U.K., with London as another contemporary center, could be the other suitable example, especially since the establishment of the U.K. Serious Fraud Office.

The conclusion that lends itself to be formulated therefore is that it should not be irrelevant for those contemporary financial centers either what the treatment of pyramid and Ponzi schemes is which are nowadays trying to catch up, like China. This is a quintessential question, especially as the attention afforded to pyramid and Ponzi schemes are far from being equally intense in all present-time financial centers.

Yet, if the figures on the losses Ponzi schemes caused to the U.S. compiled by Tamar Frankel are insufficient to back up the suggestion that pyramid and Ponzi schemes need to be directly and forcefully targeted by all available tools of the legal system, let us add the quite far-reaching suggestion of John Steele Gordon, who in his book on the history of the Wall Street claimed the following: “[t]hat New York State law forbade . . . Ponzi-scheme financing [was] a significant factor in the establishment of Wall Street’s dominance in securities trading when, in 1837, the boom came to an inevitable end.”¹⁹⁵ In other words, the fact that Wall Street has become the number one financial center of the U.S. and eventually of the world and not a street somewhere in either Maryland or Pennsylvania – which had in those days as large and as active securities markets as New York – is to a significant extent because of New York’s timely and proper reaction to Ponzi schemes.

III. Conclusions and Implications

This paper aimed to show that the consequences of inadequate regulatory responses to the pyramid and Ponzi Schemes could be devastating,

¹⁹⁵. See supra section 3; see also JOHN STEELE GORDON, THE GREAT GAME 59 (Simon & Schuster, New York 1999).
as illustrated by the cases from both developed and emerging financial systems. Although no country seems to have been historically capable of completely forestalling their emergence, the price to be paid drastically differs depending on a system’s preparedness to combat these peculiar forms of investment fraud, both from the perspective of the affected national economies and from the perspective of individual investors.\footnote{See e.g., Ann T. Coughlan, Anti-Pyramid Scheme Bill Will Protect Consumers And Support Entrepreneurs, \url{https://www.forbes.com/sites/realspin/2017/10/12/anti-pyramid-scheme-bill-will-protect-consumers-and-support-entrepreneurs/#55756da7bd7a} (last visited Oct. 12, 2017).} Resorting to comparative law should, exactly for that reason, be helpful given that by juxtaposing the various historical cases and the employed regulatory tools it becomes possible not only to evaluate the comparative advantages of the observed systems but also to learn what price might be paid for not heeding the experiences of others. Although the latter observation applies primarily to emerging systems, regulatory competition and other considerations should make developed systems interested as well.

What makes the above elaboration novel, however, is that as opposed to the overwhelming part of publications on pyramid and Ponzi schemes focusing typically on a single jurisdiction, this paper tried to draw conclusions based on the experiences of three—from the perspective of financial law—important parts of the contemporary world: China, Europe, and the United States. Based on such a tripartite model, commenting on six of the most important findings is desirable here on the concluding pages.

Firstly, the experiences of the U.S., as the most tested financial regulatory system of our times, evidence that it is crucial to tackling pyramid and Ponzi schemes by all legal tools developed to protect the integrity of the financial system and the investors. The high priority afforded to and a large number of Ponzi schemes that have been exposed and reacted upon in this country should speak for themselves.\footnote{See \textit{SECURITIES AND EXCHANGE COMMISSION}, \textit{What is a Ponzi Scheme?} (Jun. 2, 2014) \url{https://www.sec.gov/spotlight/enf-actions-ponzi.shtml} (stating “curtailing Ponzi schemes and holding accountable the individuals responsible for these scams is a vital component of the SEC’s enforcement program.” The records of major examples of SEC enforcement actions against Ponzi schemes show that while in 2014 there were only three such cases, the numbers for 2013 were ten, thirteen for 2012, fifteen for 2011, and so on. No comparable data seems to exist for most other systems).} The other conclusion that one should draw from the U.S. approach is that pyramid and Ponzi schemes should not be reacted upon by ad hoc solutions. Deaf ears, characteristic to many financial systems today, might turn out to be a too risky strategy. Instead of waiting, “a critical mass of public outrage is reached” as a consequence of the burst of a bubble, and instead of precipitous ad hoc regulatory responses, “calm deliberation and pursuit of sensible resolutions” in peacetime is needed.\footnote{See Erik Luna, \textit{The Curious Case of Corporate Criminality}, 46 AM. J. CRIM. L. No. 1, 1507, 1516-} The U.K. approach, albeit differing in nature from the U.S. one, points in the same direction.
Moreover, the same conclusions ought to be reached also towards such bank-based systems as Hungary and the similarly structured Central European economies, where pyramid and Ponzi schemes have caused enormous harm in the post-1990 period. This conclusion stands, notwithstanding that in the equally bank-centered Germany or France—which still are looked upon as the top legal models by Central European jurisdictions—the topic of pyramid and Ponzi schemes seems to have almost completely escaped the attention of legal scholars and regulators alike. Yet, the scholarly vacuum does not mean that in Germany, for example, no pyramid or Ponzi scheme has ever emerged.

Secondly, the spectrum of regulatory approaches varies significantly today, notwithstanding the cross-fertilization and some rapprochement among the jurisdictions hosting the most developed financial centers of the world today. Undoubtedly, the U.S. should be placed at the intensive end of the spectrum for it reacts to Ponzi schemes forcefully with presumably the widest panoply of legal tools, classical and novel sector-specific ones as well. At the opposite end are “zero-reaction” regimes, which neither take account of, nor react to Ponzi schemes by sector-specific regulations, but leave investors at their own. In these jurisdictions, as often the bankruptcy and the penal system are dysfunctional and no remedies are offered by other branches of law either, the defrauded investors routinely remain empty-handed. All the other systems are in-between the two extremes depending on whether criminal and other classical branches of law are exclusively or overwhelmingly expected to deal with the schemes. The more a legal system entrusts to sector-specific financial regulations and regulatory agencies, the more such system comes closer to the U.S.-end of the spectrum. Continental European jurisdictions and more recently China seems to be the examples of clear mezzanine classes, characterized by strong penal prongs and less by powerful agencies. The price of this, as one could

17 (Fall 2009).
200. Id.
202. See, e.g., Coughlan, supra note 196.
203. Id.
205. See Coughlan, supra note 196.
conclude even in the lack of ample empirical data, is very concrete: while in
the U.S. investors are disgorged, at least to a portion of their investments, in
these jurisdictions typically no investor gets compensated in any form.

Thirdly, it should come as natural from this that the linked legal
scholarship is the richest as well in the U.S. In Europe, especially empirical
case studies that would allow lifting the veil from various schemes from their
inception to their collapse in order to identify the "business model" are
lacking. At the moment, however, this topic is a "no topic," both for the
E.U., and for most of the European national legal systems and their scholars.
Consequently, very few countries find it important to inform and educate not
only the potential citizen-investors but also the future prosecutors, judges,
and regulators specifically about the pyramid and Ponzi schemes. However,
the strategy of "when I'll see it, I'll recognize" could hardly work in practice
given that typically, once the pyramid or Ponzi scheme-bubble has burst it is
already too late.

Fourthly, even the above admittedly eclectic and limited selection of
schemes should confirm that no country, developed or emerging, is immune
to pyramid and Ponzi schemes. Consequently, the fact that the legal or
financial scholarship of a country fails to cover the domain should not
uncritically be taken as the proof that the country, therefore, has neither faced
nor is exposed to pyramid and Ponzi schemes.

Fifthly, it should also be evident from the above that the magnitude of
some pyramid and Ponzi schemes is prohibitive and may amount to systemic
risk, endangering not only some localizable niche markets or groups of
individuals (religious or affinity groups) but sometimes the entire financial
system of a country (e.g., Albania). Given the significance of the risk, it
remains a mystery why the topic is neglected in such developed economies
and major legal systems such as that of Germany. This question is a
legitimate one despite that admittedly the question of whether a bank-based
regulatory system is a way to prevent the emergence of pyramid and Ponzi
schemes seems to have remained unanswered as of yet. In any event, the
answer from those bank-based systems from where empirical evidence are
available (e.g., Hungary and much of post-socialist Central European
systems) is negative. Moreover, the same conclusion could be drawn also
with respect to the U.K., a system that is normally classified as a mixture of
bank- and market-based systems and which, thus, shares certain features with
the prototype bank-based system of Germany, as best illustrated by the fact
that Ponzi schemes are among the targeted financial pathologies of the UK
Serious Fraud Office.

Sixth, a word should be cast on presumably the most contentious
issue—the attitude to the individual investor who typically invests into
pyramid and Ponzi schemes. The stance is of major importance because the
answer to the quintessential regulatory dilemma of what types of protections and remedies should be afforded to them depends on this. This is a key policy issue as, even if not expressed publicly, in quite a number of jurisdictions, the answer seems to be that investment into pyramid and Ponzi schemes are the worst kind of speculation and consequently, such investors deserve no protections by the law in any form.

The gist of this dilemma is, indeed, whether the taxpayers’ money should be spent on such investors by covering the costs of the regulatory system. This paper, just like the leading systems of the U.K. and U.S., vouches for an affirmative answer. As stated in the Economist recently, “[i]t is easy to claim that bubbles are irrational. They seem to represent a deviation of prices from fundamental values—and they contradict the basic economic theory. But there has been little attempt to understand how speculation actually works. The example of tulipmania shows the importance of doing that—rather than relying on lazy quips about ‘animal spirits’ or irrationality.”

Although this quotation is related to the Seventeenth century Dutch Tulipmania, which was a different sort of financial pathology, given that contrary to Ponzi schemes, no one was in the center of the scheme to control it and to decide about distributions, but the comment equally applies to investors in pyramid and Ponzi schemes as well. The increased presence of technology in finance corroborates this “because technology has given scam artists [i.e., schemers] a greater range of vehicles and opportunities to perpetrate a scam, to add to the traditional door-to-door method.”

Seventh, the ultimate lesson for emerging financial systems such as China is that financial fraud of the pyramid and Ponzi schemes variant deserves utmost attention by lawmakers, regulators and others safeguarding the integrity of the markets from the very beginning of the road hoped to lead towards robust capital markets. It would make sense, however, to study the experiences and the different answers and solutions not only of developed systems but also the ones of such transitory countries as Hungary or Romania. The efforts would pay, given that more than nickels and dimes are at stake, as the still-unfolding Ezubao and many other cases from other parts of the world show.

Last but not least, from the perspective of comparative law, this paper attempted as well to nudge comparatist scholars to elevate the topic of the pyramid and Ponzi schemes higher on their research agendas, focusing their attention also on such exponentially developing financial systems as that of present-time China or the post-transitory Central European systems. Admittedly, this advice should be heeded more exactly by scholars and lawmakers from emerging financial systems as it is not without a reason that

209. See Kate Nash, Up In Smoke, ADVERTISER 61, (Apr. 22, 2003).
210. See id.
the U.K. and the U.S.—the most developed financial centers of our time—are those regulatory systems that devote the most attention to and react the most forcefully to these pathological phenomena today.

The multi-million dollar question that remains open is, therefore, why is it that the two most developed financial systems of our times that realize that the price to be paid for regulatory failure in this domain is significant and could be devastating and the most vulnerable and exposed emerging financial systems fail to do that? It is honestly hoped that this brief transnational account on the pyramid and Ponzi Schemes here at the end of the second decade of the 21st century properly substantiated how gravely mistaken such neglect is.