

Ponzi schemes: here to stay

There is a dearth of protections available to the victims of Ponzi schemes at the international and domestic level.

Ponzi schemes are large-scale frauds often spanning multiple jurisdictions. Their thirst for new customers means they often cross borders. They lure customers in with promises of higher returns than other schemes. In reality, these returns are paid using investors' own money, or money paid in by subsequent investors.

When a Ponzi scheme implodes, it raises a number of difficult issues. These range from regulatory responsibility, a myriad of different proceedings, and the tracing of assets across various jurisdictions.

At the international level there are two regimes designed to provide procedural harmonisation and efficiency in multinational insolvency. These are the UNCITRAL Model Law on Cross Border Insolvency and the EU Insolvency Regulation.

However, reality is more complex. Experience shows that once a Ponzi scheme comes to light, most of the money is gone. There is little for financial regulators and interested parties to recover.

As such, the challenge is preventing Ponzi Schemes, as well as improving relief for interested parties.

In this morning's session, a panel of speakers from America and Europe will address their direct experiences of how a Ponzi scheme is treated in their jurisdictions, as well as the multinational implications. The Insolvency Section's Insolvency Legislation Co-Chair, Oscos Abogados' Dario U Oscós Coria tells the *IBA Daily News*, "we will explore how best we can use the legal tools available to enact effective protection and recovery for the investments of investors".

Speakers will address their experience in Ponzi scheme cases with multi-national implications. Kennet M Kryš from KRYŠ Global Grand Cayman will talk about the Bernie Madoff, Fairfield \$65 USBM investment scandal. Jenner & Block's Ronald Peterson will outline the cross-border insolvency implications of the US Chapter 15 UNCITRAL Model Law. Ralph Janvey from Kragge & Janvey will address the Stanford Ponzi scheme case. McGuireWoods' Dion Hayes will speak about the Scott Rothstein Ponzi scheme, and Ilona Karppinen from Castren & Snellman will talk on the WinCapita case.

Despite increased regulatory and governmental vigilance Ponzi schemes continue to persist. As



SESSION NAME

When red flags fly: anatomy of a Ponzi Scheme

TIME/PLACE

**Tuesday 8th October,
9.30am-12.30pm,
Room 304, Third level**

Key takeaways

- There is a dearth of protections available to the victims of Ponzi schemes at the international and domestic level;
- Regulators are very much limited by resources and difficulties in overseeing private transactional relationships;
- Pursuing criminal enforcement as well as private civil remedies is a drawn-out process, which can see recoveries diluted by lawyer's fees and costs.

BLG's Ira Nishisato, Vice-Chair of the Litigation Committee explains, no matter how well thought through rules are they are only effective to the extent they are enforced. "Enforcement is very much limited by resources and difficulties in overseeing private financial and transactional relationships," he says.

Again, this is something that varies from jurisdiction to jurisdiction.

Moreover, the perpetrators of the most creative Ponzi schemes tend to be one step ahead of the regulators. Litigation Committee vice-chair Castren & Snellman's Ilona Karppinen tells the *IBA Daily News*, schemes may be set up in industry 'blind-spots' where regulatory control is inadequate or non-existent. "The WinCapita scheme in Finland was enacted in the foreign currency exchange business, which fell out of the bounds of financial regulators' direct supervision," she says.

As such, while regulatory reform will continue to be important in preventing Ponzi schemes, it has its limitations. Private civil remedies and criminal actions will continue to be crucial in enabling victims to pursue recovery when regulators do not act.

And yet, it is a drawn-out process, which can see recoveries diluted by lawyers' fees and costs.

While the pursuit of private civil remedies by investors against alleged 'aiders and abettors' has produced significant recoveries, for example the \$1.2 billion Rothstein Ponzi scheme in Florida, more generally the pursuit of such actions tends to delay investor

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recoveries without an appreciable increase in net recoveries.

In insolvency situations, the insolvency estate representatives frequently pursue claw-back actions against investors – including even 'net losers' – thus redistributing money among the investor body but not reducing (and sometimes increasing after dilution for administrative costs) the net aggregate investor loss.

In such scenarios the pressure can mount on governments to step in.

Ponzi schemes can lead to thousands of people pouring their life savings into what turn out to be phantom accounts. Recovery rates for such schemes sit at around five percent, making them particularly harsh for individual investors.

However, governmental responsibility varies from jurisdiction to jurisdiction.

As Nishisato speaking from Canada explains, "while investors will always look to the state to provide compensation in the face of a regulatory failure, there is no legal obligation to do so".

"Under existing law, liability for regulatory negligence is difficult to prove and in my view this is unlikely to change," he says.

Nonetheless, governments can ease the burden on victims of Ponzi schemes by introducing efficient and low-cost procedures to recover losses.

"In Finland the WinCapita Ponzi Scheme evoked new procedural legislation for victims' claims", says Karppinen. "The objective of this legislation was that victims of fraud are not damaged further by unreasonable difficulties in seeking recovery."