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Each semester when I explain to students how a Ponzi scheme operates, someone in the class invariably comments that surely no-one would be stupid enough to fall for such a scheme. Sadly, in reality, many people do. For example, up to December 2008, more than 15,000 investors (among whom were celebrities, prominent businessmen, charities and universities) believed that they had made an excellent investment through the company Bernie L Madoff Investment Securities LLC (BMIS) – in fact, many of them were about to hear that they had lost all or most of their investments in what was the largest Ponzi scheme ever. Collectively, it is likely that the investors in this scheme lost around US$50 billion (the final figures still have to be calculated).[1]

So what is a Ponzi scheme?

Before we look at Bernie Madoff's scheme, let's first consider what a Ponzi scheme is. A Ponzi scheme is essentially a fraudulent financial investment scheme, where the interest paid to investors is taken from the investments made by other (later) investors.[2] The operator of the scheme, after retaining a certain percentage of each investment as personal profit, does not make any investments or purchases with the investment income from investors, but simply pays interest to earlier investors out of investment income received from later investors. The operator often promises a high rate of return on investments, and ensures that interest is paid promptly, as promised, to generate valuable personal word-of-mouth advertising from satisfied investors. As money flows in from new investors, the scheme remains prosperous, but once there are no further investors, the operator can no longer pay interest on investments, and cannot repay the investments themselves, and the scheme falls over.

An excellent table that demonstrates how a simple Ponzi scheme operates can be found on the ASIC website.[3]

A number of factors determine the possible life-span of a Ponzi scheme. The scheme will run dry sooner if the interest promised and paid is too high, if the operator retains too much as personal income, or if too many investors demand a repayment of their investment. Once there are no new investors, the scheme comes to an end very quickly.

Why is it called a Ponzi scheme?

This scam is named after Carlo Ponzi, an Italian immigrant to the United States of America, who in 1919, saw an opportunity to use international postal reply coupons as a way to earn money.[4] Ponzi started a financial scheme in which he undertook to earn investors handsome profits (of some 50% in 45 days[5]) through arbitrage in international postal reply coupons.[6] In reality, Ponzi simply paid early investors a 'profit' out of later investments. Nevertheless, his popular scheme meant that over a period of 6 months he received about US$15 million in 'investments' before the scheme then collapsed.[7] He was prosecuted and convicted of fraud, and this type of fraudulent investment scheme now carries his name.

So what did Bernie Madoff do?

Bernie Madoff's scheme started in the early 1990s and ended in December 2008 – it is incredibly unusual for a Ponzi scheme to last this long. Madoff started the scheme as an investment advisory service through his company BMIS. In the early 1990s the US was in a recession, leaving investors generally with little return on their investments.[8] Madoff had received some investment commitments from institutional clients and he 'felt compelled to satisfy [his] clients' expectations, at any cost.'[9] Madoff simply deposited all investments received from investors in Chase Manhattan Bank, and paid interest to earlier investors from money deposited by later investors. To give the scheme some legitimacy, he claimed to employ a 'split strike conversion strategy', and undertook to invest clients' money in a basket of high-quality common stocks hedged by option contracts related to those stocks.[10] He also indicated that he would time the stock market and would purchase government securities when stock prices dropped.[11] In this manner he created the impression that he had a legitimate investment strategy, and had provided for the normal ups and downs in the market.

In reality, no such investments were made, no stocks were purchased, and no option contracts were bought or sold, although Madoff generated impressive-looking statements showing investments that were in fact never made. These statements were sent to all investors. The statements were printed using an old computer[12] housed on the 17th floor of the Lipstick Building in Manhattan where BMIS occupied 3 floors. The activities of the scheme on the 17th floor were separate from the legitimate business conducted on the other floors, and it is said that only a select few staff members had access to the 17th floor.

Madoff's scheme demonstrated many of the characteristics of a classic Ponzi scheme:

Robbing Peter to pay Paul: As no real investments were made, the only source of income for the scheme was money received from new clients and effectively the money of one victim would be used to pay 'interest' to other victims.

Exclusivity: Only certain investors were given the opportunity to invest in this fund – thereby ensuring that the fund had a reputation for being exclusive.[13] It is said that Madoff selected investors carefully to ensure that they would not be of the type that would ask too many questions. Madoff created the impression that he was hesitant to accept an investment from a new investor, making those persons who were given the opportunity to invest, feel special, almost chosen.[14] Madoff relied on word-of-mouth advertising, and certain feeder funds and other intermediaries to feed clients into his scheme. Madoff also only agreed to provide investment services to hedge funds on condition that he would not be named as an investment advisor in the prospectus. In this manner a veil of secrecy surrounded the business.

Affinity fraud: Many of Madoff's investors were from the Jewish community, and also from the country clubs of which he was a member. People are often more willing to trust 'one of their own' – in this case a highly respected member of the Jewish and Wall Street communities.

Consistency: For a fraudulent scheme to be successful, it has to consistently deliver on its promises to retain existing investors and attract new ones. Madoff's scheme in fact consistently outperformed many other funds, yielding profits that were impossible for legitimate funds to achieve.

A secret component: When asked how he managed to maintain consistently high returns when no other funds could do so, Madoff's responses were allegedly vague. Although he touted his 'split strike conversion' strategy in his marketing material,[15] he was not forthcoming in any explanations. This behaviour is typical of a fraudster who will often claim to have some powerful or secret weapon, or some kind of 'secret ingredient', making the investment even more exclusive and attractive to the gullible.

Perceived legitimacy: The detailed, legitimate-looking investment statements provided to clients created the impression that actual investments had been made with clients' money. Madoff's excellent personal reputation in the market, and the fact that the 'investment advisory' business had been operational since the early 1990s, put new investors at ease.

Confidence – the conman: Madoff was an excellent conman who convinced investors to invest in his scheme.[16] Like many other conmen, Madoff required that his victims trust him implicitly and not ask too many questions. Madoff's impeccable reputation as a founder and former chairman of NASDAQ (the American Stock Exchange), a former advisor of the US Securities and Exchange Commission (SEC), a philanthropist, a board member of numerous charities, a 'pillar of the New York and Florida Jewish community'[17] and a 'pillar of finance and charity'[18] made it easy for him to engender confidence and trust. Madoff maintained the confidence of his victims by meeting commitments, making payments, and by sending out legitimate looking statements.

How did Madoff's scheme come to an end?

During the Global Financial Crisis (GFC), a larger than usual number of Madoff's victims withdrew their funds.[19] Madoff had to pay back their principal 'investment' plus any interest to protect the scheme and he was therefore under pressure to obtain new investors at a time when the GFC had

hit the US hard. Some people were less willing to invest in all kinds of financial instruments, and some just simply did not have the spare funds to invest. The fatal flaw of all Ponzi schemes caused Madoff's demise – the scheme ran out of new victims and even a loan from a friend in the amount of US$250 million could not prevent the scheme from collapsing.[20]

Madoff eventually confessed to his two sons, who were senior employees in BMIS, that his investment advisory business was a Ponzi scheme, after they had queried an unusual decision of Madoff to pay bonuses in December not February. His sons then handed the matter over to the authorities.

Prosecution and conviction

Madoff pleaded guilty to all charges including various counts of fraud, money laundering and perjury. In his plea allocution, Madoff admitted that he operated a Ponzi scheme, and that he knew that it was fraudulent.[21] At the age of 71, Madoff was sentenced to 150 years in jail. He is currently serving this jail sentence.

It seems so obvious – why did no one discover that it was a fraudulent scheme?

With hindsight there were clearly many clues that should have alerted victims, employees of BMIS, managers of feeder funds and the government regulators to the fact that Madoff was operating a Ponzi scheme, such as those characteristics discussed above. Other factors that should have sounded alarm bells include the fact that the 'investment fund' was managed in a suspiciously secretive manner, using an inexplicably outdated computer. Also, the accountant for the multibillion-dollar 'fund', Friehling & Horowitz, employed only three people and was operated from small premises. Of all of those who may have doubted the legitimacy of Madoff's 'investment fund', Harry Markopolos was the most vocal and visible whistleblower.

Harry Markopolos and the SEC

As long ago as 1999, Harry Markopolos, a financial analyst and 'math whiz',[22] who had no personal grudge, interest or motive,[23] alerted the SEC on more than one occasion that Madoff might be operating a Ponzi scheme. As a whistleblower, he also did not stand to gain financially.[24] Markopolos arrived at his conclusion based on his financial and mathematical analysis of Madoff's stated strategy – the results were 'not merely improbable but impossible'.[25] Although he suggested to the SEC that Madoff was either practicing front-running[26] or operating a Ponzi scheme, the SEC's investigation focussed on possible front-running (which Markopolos deemed unlikely) and not a potential Ponzi scheme. Markopolos alleges that the SEC's staff members with whom he had dealt, did not have the mathematical or statistical competence to understand his arguments. Consequently, the SEC's investigations were superficial, and at times performed without proper forensic skills. In an uncanny fashion, many of the SEC's investigations stopped just short of discovering evidence of a fraud, often because different internal organisational units of the SEC were involved, and critical information fell through the proverbial cracks.

The SEC's position

As the responsible government regulator, the SEC has endured harsh criticism for failing to discover the fraud over a period of almost 20 years, especially after having been provided with detailed and repeated warnings. In his testimony before the House Financial Services Subcommittee in February 2009, Harry Markopolos described the SEC as 'a group of 3,500 chickens' that had to 'catch foxes' that were 'faster, stronger and smarter' than they were, and also argued that Bernie Madoff 'had to turn himself in because the chickens couldn't catch him even when told exactly where to look.'[27] In the SEC's own investigative report into its failures in the Madoff scandal, it is admitted that the SEC had received more than sufficient detailed and in-depth information over many years on the basis of which a comprehensive examination and/or investigation into Madoff's operations should have been made. There was however, no such comprehensive investigation or examination, even though about five smaller ones were embarked upon, notwithstanding the fact that there was sufficient information for the regulator to be suspicious.[28]

The SEC has also been criticised for the perceived inappropriately close ties between the SEC and Madoff, although no evidence has been presented that any particular individual at the SEC tried to protect Madoff.[29] This has been confirmed by the SEC as well.[30] It has also been alleged that because employees of the SEC may later seek employment in Wall Street, they may be hesitant to investigate (and potentially expose) a Wall Street individual with the reputation of Madoff.[31] In its report, the SEC also acknowledged that the failure by the SEC to follow basic forensic procedures contributed significantly to the failure of the SEC to discover the scheme.[32]

Is the criticism of the SEC justified?

From the point of view of the SEC, Madoff's fraud may have been less obvious than what it is to us now.[33] If an SEC enforcement official was confronted with the claim that Madoff must either be front-running or operating a Ponzi scheme in order to generate the consistent 'profits' that he was assuring his clients they were earning, the official would likely have believed that it would be highly unlikely that Madoff would be operating a Ponzi scheme, as Ponzi schemes tend to have a very short lifespan. Also, Madoff had strong ties to Wall Street – in terms of business, family and personal wealth, and commitments – and he would not have any way out if it was a Ponzi scheme and the scheme failed. Also, in view of the fact that Madoff had built up a successful and apparently legitimate trading firm, one cannot reasonably imagine that he would be willing to take a risk and run a Ponzi scheme.[34] All these factors together would make a scam seem unlikely and it would not have been unreasonable for an SEC manager to request a preliminary or superficial investigation by more junior staff, and then to abandon further investigation if everything appears in order.[35]

Although debatable, it is also possible that the SEC may have considered that the sophisticated clients of Madoff were in a position to fend for themselves. As it turns out, they were not! It is worth noting who some of the clients/victims of Madoff were: BNP Paribas (a large European bank), Royal Bank of Scotland (a large British bank), HSBC (a major international bank), Elie Wiesel (famous holocaust survivor and author) and his charity, the Foundation for

Humanity, New York's Yeshiva University, Technion City (a prestigious university in Israel), Steven Spielberg (a famous filmmaker), Eric Roth (a famous screenwriter), Kevin Bacon (a famous actor), Zsa Zsa Gabor (a famous actress) and Larry King (the well-known CNN talk-show host).[36]

One must also bear in mind that with about 3,600 employees, the SEC has limited resources, yet is charged with the oversight and monitoring of millions of transactions and more than 10,000 registered brokers and financial advisers in a complex legal and regulatory framework.[37]

Many investors and writers have blamed not only the SEC, but also Swiss private banks, and capital introducers for facilitating Madoff's scheme.[38] The structure of the SEC has also been criticised and is currently under review.

So why do people fall for a Ponzi scheme? Why did people invest with Madoff?

Whilst many persons who invest in Ponzi or other fraudulent schemes are accused of being greedy to the point of being wilfully blind to the dangers of a scheme, the investors on Bernie Madoff's list hardly fall into that category. Many victims were already independently wealthy, and there were also a number of institutions such as universities and charities that invested with Madoff. These investors should nevertheless have been alerted to possible wrong-doing by the fact that the return on investment was significantly better than that of other 'similar' funds and unrelated to market movements. Some managers of feeder funds have since been accused of negligence in failing to perform a proper due diligence on behalf of their clients before channelling legitimate investors towards Madoff. In fact many simply trusted Madoff, and were fooled by the legitimate-looking statements, and perhaps thought that Bernie Madoff could not be running a fraudulent scheme because he was too well respected. Also, the investment fund had been running for quite some time. Whilst one can never rule out the possibility that some investors wilfully closed their eyes to warning signs, or were greedy, the majority of investors probably clearly fell into the category of the duped – the unlucky victims.

Did Madoff act alone or is anyone else apart from Madoff to blame?

Although Madoff initially claimed that he worked alone, that was not quite true, and other individuals have also been charged in connection with Madoff's scheme. Some of his key accomplices include David Friehling of the accounting firm Friehling & Horowitz, who has pleaded guilty to a variety of charges including securities fraud.[39] Mr Friehling was also one of Madoff's investors and he therefore lacked the required independence.[40] Another important accomplice, one of Madoff's employees and right-hand man, Frank DiPascali, also admitted to all charges put to him. He was instrumental in the operation of the secretive 'investment scheme' run on the 17th floor of Madoff's business premises. Two computer programmers, Jerome O'Hara and George Perez, also faced charges of conspiracy and falsifying documents for creating computer-coded and random algorithms to create false statements for clients for over 15 years.[41] Criminal investigations are also underway against individuals such as money managers who channelled millions of dollars of investors into Madoff's schemes.[42] Madoff's sons, and his brother and his niece, who worked in the 'legitimate' arm of Madoff's business, and who have consistently denied any involvement with and knowledge of Madoff's scheme, have been sued by the trustee for failure to execute their professional duties properly.[43] The trustee has also sued Madoff's wife for US$44 million that she had allegedly received improperly from the firm.[44]

Where did the money go?

As a Ponzi scheme, a large percentage of the money received from victims was used to pay other victims. Madoff however also used funds to support what has been described as a 'lavish lifestyle,'[45] which included a Manhattan penthouse, houses in Montauk, New York, Palm Beach, Florida, and in France, as well as a fishing boat. His personal wealth is estimated to be in the region of US$200 to 300 million.[46] After the demise of the scheme, Madoff's wife, Ruth, was also stripped of most of her wealth, and she had to move out of the expensive Manhattan penthouse that was to be sold.[47] It is proving difficult to trace Madoff's assets and wealth and although a trustee has identified US$21.2 billion in real losses in customer accounts, he could only locate about US$1.5 billion thereof.[48]

Why are Ponzi schemes illegal?

Ponzi schemes are illegal, and operators and their accomplices may face various criminal charges, including fraud, as they knowingly making false representations with the intention to deceive. Ponzi schemes can also be unlawful because they may involve acceptance of deposits through the taking of 'investments' into the scheme. Generally deposit-taking institutions need to be licensed. For instance, in Australia, deposit-taking institutions have to be authorised by the Australian Prudential Regulatory Authority (APRA) and are subject to the regulation and supervision of APRA.[49] Investment advisers also need to be licensed by the Australian Securities and Investment Commission (ASIC). In Australia, consumers are also protected against false representations and the misleading and deceptive conduct by providers of financial services (which may include investment services) through the ASIC Act, which has provisions prohibiting the making of false and misleading representations.[50]

A 'Madoff' in Australia?

Ponzi schemes are illegal in Australia and ASIC has the authority to investigate and initiate proceedings against operators of Ponzi schemes.[51] The ASIC website is an excellent source of information on Ponzi schemes.[52]

ASIC is well placed to deal with Ponzi scheme operators and has a wide scope of powers. Recent structural changes in ASIC were aimed at preventing and correcting the kind of organisational structural flaws that prevented the SEC from discovering the Madoff scam.[53]

Whilst enforcement may be effective, Australia generally has shorter sentences than the US justice system, and it could be argued that the deterrent effect of Australian punishment may not be as effective.[54] Also, in the US the SEC may launch its own cases, whilst ASIC in Australia provides a brief of evidence to the Director of Public Prosecutions (DPP) who decides whether or not to launch a case. Professor Michael Adams of the University of Western Sydney believes that the American court system deals with things more quickly than the Australian system, and that whilst the US system settles most big corporate cases within 2 years, the time lag in Australia is about 4 to 5 years.[55] He also believes that the DPP is more risk averse and requires a higher level of evidence. ASIC has also been accused of a reluctance to use criminal sanctions where there have been instances of serious misconduct in the corporate world.[56] ASIC can however ban an entity from holding an Australian Financial Services Licence and prevent them operating. ASIC has successfully stopped many fraudulent schemes in the past.

What is the role of the law? What can the law do about Ponzi schemes?

The role of the law is to regulate society. Most legal principles in laws and regulations are quite general in nature, and it is impossible to draft legislation and regulations to cater for each and every possible situation. One's first response may be to suggest that governments make more laws, and more specific laws – for instance explicitly outlaw Ponzi schemes. Many criminals however perpetrate crime knowing that their actions are illegal – more laws may not stop Ponzi schemes. Another suggestion may be to make more detailed and specific laws, which would close loopholes. Again, one has to consider that the law has limits, and that it is not possible to cater for all eventualities – and criminal schemes can be quite creative![57] Another suggestion may be that the law should impose heavier penalties, which should deter people from criminal behaviour. The so-called 'deterrence' theory has however statistically been proven that harsh sentences have only limited success in preventing crime. Another suggestion may be that law enforcers should be so vigilant that it is impossible for crimes to go undetected. They should be both quick to detect and stop wrong-doing. The success of this suggestion would however depend on the resources (manpower, money and skill) available to law enforcement agencies, and may suffer from some practical constraints.[58] From a pragmatic perspective, the education of the public may, along with the existing legal framework, be the best weapon against would-be perpetrators of fraudulent schemes. Whilst it is a function of the law and law enforcement agencies to protect persons against fraudulent schemes, the intricacy of certain schemes, and the inevitable lag in law enforcement, are persuasive arguments that individuals should be educated to take proper care of themselves to prevent them from becoming the unlucky victims of a scam in the first place.

References

1 See Donald J Furman and John S DeJoy, 'Before and After Bernie: Ponzi Regulation or Lack Thereof?' (2009) 5 *International Review of Business Research Papers* 63.

2 Although the words 'investment' and 'investor' are used, the money paid into a Ponzi scheme is not a true investment, and cannot be compared to an investment made, for instance, with a bank, and the 'investors' are essentially victims.

3 See Australian Securities and Investment Commission, *10% per month (120% per year) – where do you get it? Ponzi schemes* (2009) <http://www.fido.gov.au/fido/fido.nsf/byheadline/10+per cent+per+month+%28120+percent+per+year%29+-+where+do+you+get+it%3F?openDocument> at 22 February 2010.

4 International postal reply coupons were included by senders in mail, in much the same way that a sender would nowadays include a prepaid return envelope, thereby saving the recipient the cost of posting a reply.

5 Steven Anderson, 'Ponzi Redux: Madoff Scandal Reveals the Continuing Risk of Falling Victim to an Age-old Swindle' (2009) *Inside Counsel* 44, 44.

6 Furman and DeJoy, above n 1, 65. Given that the Italian currency had at that stage been devalued against the American dollar, international postal reply coupons could be purchased cheaply in Italy and then sold in the USA at a higher price.

7 Anderson, above n 5, 44.

8 Bernard L Madoff, Plea Allocution, 2, <http://www.scribd.com/doc/13219846/Bernard-Madoffs-Plea-Allocution> at 22 February 2010.

9 Madoff, above n 8, 2.

10 Madoff, above n 8, 2-3.

11 Madoff, above n 8, 3.

12 James Bandler and Nicholas Varchaver, *How Bernie did it* (2009) CNN, <http://money.cnn.com/2009/04/24/news/newsmakers/madoff.fortune/index.htm?postversion=2009042406> at 3 February 2010. The computer was an old IBM server from the 1980s that sometimes required operators to key data in by hand. It was nevertheless central to the fraud because it created the statements of trades that were never made.

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14 Ibid.

15 Donald C Langevoort, 'The SEC and the Madoff Scandal: Three Narratives in Search of a Story' (Working Paper No 1475433, Georgetown Law Faculty September 2009), 11.

16 The word conman is derived from 'confidence man' – ie a trickster who obtains the confidence of the victim.

17 'Progress slow a year after Madoff arrest', *New Zealand Herald,* (Auckland), 12 December 2009 <http://global.factiva.com.ezproxy.bond.edu.au/ha/default.aspx> at 19 January 2010.

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19 Stephen Jewell, 'How Madoff led his lambs to the slaughter', *New Zealand Herald* (Auckland), 29 November 2009 <http://global.factiva.com.ezproxy.bond.edu.au/ha/default.aspx> at 19 January 2010.

20 Peter Sander, *Madoff Corruption, Deceit, and the Making of the World's Most Notorious Ponzi Scheme,* (2009) 119.

21 Madoff, above n 8.

22 Sander, above n 20, 96.

23 Michael Lewis and David Einhorn, 'The End of the Financial World as We Know It', New York Times (New York), 4 January 2009 <http://www.nytimes.com/2009/01/04/opinion/04lewiseinhorn.html > at 22 February 2010.

24 Sander, above n 20, 102.

25 Lewis and Einhorn, above n 23.

26 Front-running is the process where an investment advisor, expecting that a client would be interested in purchasing a sizeable number of certain shares, buys some of those shares at a reasonable rate, and then benefits from the sale of those shares later when the client in fact buys those shares.

27 Harry Markopolos, 'Testimony of Harry Markopolos, CFA, CFE, Chartered financial analyst, Certified Fraud Examiner, before the US House of Representatives Committee on Financial Services, 4 February 2009' (Testimony delivered at the US House of Representatives Committee on Financial Services, Washington D.C., 4 February 2009) 35.

28 U.S. Securities and Exchange Commission Office of Investigations, United States of America, *Investigation of Failure of the SEC to Uncover Bernard Madoff's Ponzi scheme – Public Version – Report No. OIG-509* (31 August 2009), 20- 21.

29 Langevoort, above n 15, 6. Madoff for instance had close personal ties to chairman Arthur Levitt.

30 See U.S. Securities and Exchange Commission Office of Investigations Report, above n 28.

31 Langevoort , above n 15, 6.

32 See U.S. Securities and Exchange Commission Office of Investigations Report, above n 28.

33 Langevoort, above n 15, 9.

34 Ibid 9-10.

35 See U.S. Securities and Exchange Commission Office of Investigations Report, above n 28.

36 See generally Sander, above n 20, 141-169.

37 Sander, above n 20, 86- 87

38 Corgentum Consulting LLC, *The Madoff Identity: A New*

Operational Due Diligence Paradigm in a Post-Madoff world (2009), < http://corgentum.com/research-madoffidentity.html> at 22 February 2010, 2.

39 Furman and DeJoy, above n 1, 67.

40 It is estimated that Mr Friehling and his family had invested more than US$14 million with Madoff.

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43 The trustee has sued Madoff's sons as well as his brother and his niece for inappropriate use of company funds. The trustee also alleged that they knew of the fraud because of their positions in the firm and their own investments in the scam.

44 Associated Press, *'Trustee sues Madoff's wife over 'life of splendor''* (2009) MSNBC, <http://www.msnbc.msn.com/id/32205316/ns/business-us_business> at 22 February 2010.

45 'But Madoff's cash harder to find', *New Zealand Herald* (Auckland), 12 December 2009 <http://global.factiva.com.ezproxy.bond.edu.au/ha/default.aspx> at 19 January 2010.

46 Sander, above n 20, 35.

47 'But Madoff's cash harder to find' above n 45.

48 Ibid.

49 Sheelagh McCracken and Anna Everett, *Everett and McCracken's Banking and Financial Institutions Law* (7th ed, 2009), 59-60.

50 Australian Securities and Investments Commission Act 2001 (Cth), s 12DB(1). *The Australian Securities and Investments Commission Act* (ASIC Act) also contains numerous other consumer protection measures.

51 ASIC Act s 13. Under the ASIC Act a person can also be compelled to appear (s 19) and ASIC is also authorised to inspect the books of a company under its supervision (s 29).

52 See generally Australian Investment and Securities Commission <http://www.fido.gov.au/fido/fido.nsf/byHeadline/Ponzi%20schemes> at 22 February 2010.

53 Malcolm Maiden 'A lesson for our times: how the SEC failed to uncover Bernie Madoff's Ponzi scheme', *Sydney Morning Herald* (Sydney), 3 November 2009 <http://global.factiva.com.ezproxy.bond.edu.au/ha/default.aspx> at 19 January 2010.

54 Stuart Washington, 'Going soft and slow on big failures', The Age (Melbourne), 6 July 2009 <http://global.factiva.com.ezproxy.bond.edu.au/ha/default.aspx> at 19 January 2010.

55 Ibid.

56 Vicky Comino, 'The Challenge of Corporate Law Enforcement in Australia' (2009) 23 *Australian Journal of Corporate Law* 1, 3.

57 In the USA it has for instance been identified that there are gaps in the legislation dealing with the liquidation of fraudulent schemes and it is difficult to assess the different claims made by the victims. It has been decided by a US court that the relevant legislation dealing with the liquidation of a brokerage does not apply when the securities or investments were fictitious or non-existent. A question that arises is on what basis the victims should be compensated – should their losses be based on what they had paid into the scheme, or what they had expected to earn out of the scheme based on shares and securities that they thought they owned, but never did? See Michael A Conley, 'Statement before the Capital Markets, Insurance and Government Sponsored Enterprises Subcommittee, United States House of Representatives' (Statement before the Capital Markets, Insurance and Government Sponsored Enterprises Subcommittee, United States House of Representatives, Washington D.C., 9 December 2009), 2-3.

58 See Joel Seligman, 'The SEC in a Time of Discontinuity' (2009) 95 *Virginia Law Review* 682. He argues that it would be difficult for a government to address issues such as the coordination of inspection, examination, conduct and trading rules, and also the enforcement of private rights of action. Difficult questions are raised, for instance whether or not the same approach and rules should be used in all financial industries.

Think about this…

Should whistleblowers be paid? Will rewarding whistleblowers reduce white-collar crime? Should this be a suggestion for what the law can do to prevent Ponzi schemes?

Should Ponzi schemes be legal, provided that the operator advertised the scheme as a Ponzi scheme and all investors knowingly participated in a Ponzi scheme? It may be useful to consider this question from different moral perspectives.

Visit the ASIC website and look at the 'Pie in the Sky Awards' given annually by ASIC to the most imaginative (and successful) financial schemes and scams. Would you have fallen for any of those schemes? See:

http://www.fido.gov.au/fido/fido.nsf/byHeadline/Pie%20In%20The%20Sky%20Awards%20 .

How can one spot a Ponzi scheme? What advice would you give to prospective investors?