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Ponzi Schemes and the London Riots: from White-Collar Crime to City Grime

By Howard Silverstone and Jonathan Silverstone

A review of online postings following last summer's London riots made interesting reading to those of us in the world of forensic investigations. One of the most interesting was posted on Americablog.com:

"Fine, round up the thugs, but why don't we ever see such determined action when it's Wall Street? The last time I checked, they caused a lot more damage and the costs aren't even close. The bankers have looted the global economy and smashed the middle class and poor to pieces but that is OK apparently. Somehow it's only ok to crack down on crime when it's not white-collar crime."

While this statement perhaps does not consider Sarbanes-Oxley and other measures put in place to counter the more high-profile white-collar crimes, it does make one think a little deeper about the respective crimes and the effort by authorities to counter them. So let's go back in time to start our discourse and try to understand if there really is any link between covertly stealing money and overtly stealing consumer products.

In 1920, an Italian immigrant from Boston advertised astronomical rates of return for investors in a new company that promised interest anywhere from 50 to 100 percent of an initial investment. In August 1921, just nine months after his plan's commencement, Charles Ponzi was jailed for running a fraudulent scheme that has carried his name for ninety years and has been promulgated in many countries across the globe—most recently with the largest fraud operation ever conducted by a single individual, Bernard Madoff. With almost a century gone since the genesis of such a means of committing fraud, the question remains: why does the Ponzi scheme still plague international enterprise today despite its prevalence throughout history and the examples it has made globally of greedy financiers and unsuspecting investors?

The financial setup for the Ponzi scheme resembles a broadly defined pyramid: the top comprising early investors, whose eventual dividends come from later investors rather than any legitimate financial instrument as was advertised—eventually culminating in the departure of the manager of the Ponzi scheme with all of the invested money or the complete demise of the scheme due to its unmanageable size. The initial structure of the Ponzi scheme itself explains the omnipresence of this type of fraud even after nearly a century of victims: the apparent primary success of this operation lures both new investors and retains earlier ones who had received the promised returns. A scam that does not produce desired results can quickly fade, but the dividends made by early investors, and the almost unbelievable glamour of the way the operation is sold to its victims, couple to form an intricate web of anxious investors who have continually fallen prey to the Ponzi scheme.

The ultimate lasting cause of the long existence of the Ponzi scheme is the vulnerability of the modern consumer: from the appeal of the promised investment opportunity, to the economic climate during which the scheme is implemented, to the seemingly (and in reality) unreal returns it produces. Those who commandeer the Ponzi scheme range from someone who has a substantial financial background, establishing a level of credibility suitable for substantive investment to those who are relative novices, but somehow garner immediate attention.

One can look no further than Madoff to see the superstar status that can be the driving force

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in drawing a sufficient tiered pool of investors. The idea of taking part in a new investment strategy piloted by such a well-established member of the financial services industry is enough to sway even the most prudent of investors. The time period during which a disguised scheme presents itself plays an important role in the attraction of an investor base. An economic downturn will foster desperation rather than incredulity, and thus reels in those who view the Ponzi scheme's façade as a means of finding a path out of financial troubles during a recession. When the economy flourishes, those with a now booming cash flow seek ways to capitalize on their heightened earnings—leading many unsuspecting investors to a Ponzi scheme. Therefore one can observe that the economic climate influences the mentality of those who ultimately make the decision to invest in a financial venture that disguises a Ponzi scheme, yet the presence of the fraud is independent of economic climate. The recession in 2008 serves as a microcosm for the omnipresent nature of the scheme: a lengthy list of Ponzi schemes bears examples of the fraudulent manipulation of unknowing investors both before and after the global economic downturn.

While the development of a Ponzi scheme lies in the hands of the white-collar thieves who pilot them, the lasting continuation of this type of fraud lies with those who make the decision to invest. The Ponzi scheme still plagues international enterprise today because of the exploitation of an international consumer base that does not have the proper preparation to recognize and evade Ponzi schemes. In order to end the funding of these sometimes gargantuan fraudulent stratagems, we must make a better effort in providing the necessary tools to identify the factors that intimate the existence of a Ponzi scheme. The veneer of perfection and exclusivity is, after all, just a veneer.

So from 1920, we now move forward to 2011 and the streets of London—where the cognitive background of looting sheds light on the psychological foundation of such white-collar crimes as the Ponzi scheme. Riots, apparently stemming from a police shooting, led to more widespread instances of looting and the theft of goods in open sight of hundreds of onlookers and even more on television and across the Internet. But such open channel vision did not deter even the youngest members of the mobs from partaking in the behavior. Just as the followers of mob violence do little to hide their act as they smash the windows of betting shops and electronics retailers, the followers of Charles Ponzi who furtively obtain their ill-gotten gains come into direct contact with the "investors" whose funds they plunder.

Dr. Lance Workman teaches in the School of Social Sciences where he is head of Psychology at Bath Spa University. He told the BBC, "Humans are the best on the planet at imitating. And we tend to imitate what is successful. If you see that people are walking out of a shop with a widescreen TV and trainers (sneakers), a certain kind of person thinks why shouldn't I do that?" This proclivity to copy the tours de force of others often accounts for the repetition of large scale corporate crimes, despite the fact that a sizable portion of them end in the perpetrator being led away from a city building by the police with his or her hand desperately trying to block the lenses of all the newspaper and television cameras documenting this specific crime's demise. The same logic behind thousands of rioters in more than one neighborhood in London and later in more cities, explains Ponzi schemes' repeat execution, no matter how risky.

Dr. James Thompson, honorary senior lecturer in Psychology at University College London told the BBC, "Morality is inversely proportional to the number of observers. When you have a large group that's relatively anonymous, you can essentially do anything you like. Part of that is down to safety in numbers. There may only be 20 or 30 people who are leading the trouble but the presence of several hundred onlookers makes it far less likely they'll get caught." This actually presents a paradox, as Dr. Thompson's comments in this context are the opposite of what forensic accountants tell their business clients. The more safeguards you put in place to watch people, and the more they know they are being watched, the less likely they will be in a position to steal from you.

Another observer of the London riots said that for most, the motivation is the thrill, with the "free stuff" just a bonus. This is an interesting observation in the context of Ponzi schemes and other white-collar crime. White-collar criminals typically steal because of some kind of need (usually financial); or through sheer greed; or they have the opportunity; and their expectation of being caught is low (usually because they are not being watched). However, some have justified their actions as pure intellectual challenges, which are akin to doing it for the thrill, something potentially at the heart of the actions of some of the London looters.

While rioting marred the image of one of the international community's most prominent cities, Prime Minister David Cameron called upon the parents of the young rioters to take responsibility and prevent their children from continuing the ongoing destruction. As forensic accountants, it is our responsibility to determine the causes of fraudulent schemes and set the foundation for future prevention by our clients. The most brilliant of criminals shares characteristics of the hooded thieves plaguing the global media, no matter the size of the amount to be illegally gained or the manner by which it is ransacked. After all, whether white-collar or blue-collar, Multinational Corporation or a London newsagent, it's all looting.