International Journal of Social Science Research and Review

http://ijssrr.com
editor@ijssrr.com
Volume 5, Issue 10
October, 2022
Pages: 339-345

Ponzi Scheme: Risk and Regulation in Indonesia

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http://dx.doi.org/10.47814/ijssrr.v5i10.599

Abstract

This study aims to determine the historical crime of the Ponzi Scheme. The benefits of this research arecan be a study for other authors, including universities, other educational institutions and the public against the crime of the Ponzi Scheme. The research method uses qualitative by collectingdescriptive data which later the results of the research will contain data excerpts to provide an overview of the presentation in the study. The results show that the Ponzi Scheme created by Charles Ponzi caused enormous damage to both the financial industry and the general public.

Keywords: *Ponzi Scheme; Investment; Finance*

Introduction

Investment is an agreement based on a number of funds or other resources with the aim of obtaining future profits. Continuous investment will increase the level of the economy as well as great job opportunities, as well as increase national income and prosper economic prosperity. An investment activity originates from 3 important functional roles, including (1) investment activities can create an increase in aggregate demand, Gross Domestic Product, and adequate employment opportunities; (2) The increase in capital goods by producing an increase in product capacity caused by investment; (3) Technological development has a big share in an investment.

In the current era of industry 4.0, technological developments are increasingly advanced. In the world of economy, the most noticeable effect of technological progress is the ease of online transactions. With online transactions, it is easier for people to make payment transactions. A few examples, with the emergence of various digital investment platforms, public knowledge about investment is getting easier. That way, when knowledge about the importance of investing has been formed, it is very easy for people to start investing through the digital platform. However, with the presence of digital investment, not a few people have felt the bad impact.

There are various kinds of crimes in the economic world, one of which is the ponzi scheme. In 2022, Indonesia was shocked by a crime case committed by Indra Kenz as Binomo Trading Affiliate. Indra Kenz was proven guilty of fraud in the form of fraudulent investments. Indra Kenz as an affiliate and Binomo as a trading platform with a binary options system, offer the Indonesian people an investment with quick profits. Indra Kenz exemplifies himself as a person who has succeeded in making money through trading binomo. With the existence of social media, Indra Kenz gains more advantage in convincing the Indonesian people by showing a glamorous life, owning a luxury car, and abundant wealth thanks to binomo trading.

Indra Kenz's case is similar to that of a ponzi scheme. A ponzi scheme is a crime in the form of fraud committed by someone by offering an investment product where the profits from the investment are very tempting. Crimes under the ponzi scheme in Indonesia have emerged since the 1990s by offering fraudulent investments by several companies, including PT. Qurnia Subur Alam Raya (QSAR), Golden Traders Indonesia (GTI) Syariah, Virgin Gold Mining Corporation (VGMC).

The author observes how crimes using ponzi schemes are very dangerous for the wider community. The reason is, many people do not know about the background of ponzi schemes and how the crimes of ponzi schemes work. Although Ponzi schemes have been around for over 80 years in one form or another, and they are one of the easiest scams to detect. According to the Securities Administrator of North America, the Ponzi scheme ensnares many investors who have large sums to invest and who are considered experienced and financially sophisticated. The reason is the growth of financial services and sometimes confusing new investment instruments available to the public. In fast-changing financial markets.

Method

The method used in this research is qualitative. Where this research will be carried out by collecting descriptive data which later the results of the study will contain data excerpts to provide an overview of the presentation in the study. So that the research results can be used to interpret the existing phenomena, it is necessary to approach using analytical techniques which in this case is a critical reasoning approach. Next, the analysis technique of this research involves interpretation using a qualitative approach (critical reasoning).

The types and sources of data come from literature books and related journals inductively. This inductive analysis is used to find plural facts as contained in the data and can describe the background in full.

Results and Discussion

Ponzi schemes, although dating back to the 1900s, have recently damaged society at an alarming rate. In just six years from 2008 to 2013, more than 500 different Ponzi schemes (not counting Madoff) collectively took over $50 billion. On average, a Ponzi scheme was exposed or broken every four days in just those six years (Maglich). Since its inception, the Ponzi Scheme has antagonized and deceived humanity, stealing hundreds of millions and sometimes even more than billions of dollars in the process. The Ponzi scheme has developed into a convoluted masterpiece in its appearance that has shaped not only the financial world but also legal and societal aspects.

The Ponzi scheme has really grown and developed into a very big con. However, it does not change drastically in its pure chemical makeup. To begin with, the mechanics of a Ponzi scheme is that people are offered the opportunity to invest in businesses that are suspected of exploiting some kind of financial loophole – in exchange for unusually large and fast profits. These early investors get every dollar promised; they usually earn big enough to make them brag about it to everyone they know. Other people rush into the business to receive the same returns, sometimes pleading with the perpetrators to take their money. In fact, in a true Ponzi scheme, there is no underlying business and no actual investment is made; nothing but money in and money out. Until the scheme collapses, investors are paid with funds received from investors later. Generally, a large number of these investors reinvest their profits that would otherwise be returned to the business. On paper, they can get rich, but only on paper. This scheme can last as long as new investors continue to turn in their money so that old investors can be paid.

The key aspect is that actors promise investors to put their money into certain investments that provide an annual return, providing a sense of legitimacy. The way a Ponzi scheme actually works is not a complicated thief tool. On the contrary, they are quite simple. Fraudsters offer investments that promise very high returns with apparently very low risk from businesses that don't exist or emerge from secret ideas. High returns and low risk is a gold mine for any investor. If an investment can generate positive returns with minimal risk of losing the initial investment, the product will fly off the shelves.

Historically, the name of the scheme was with Charles Ponzi, but the real creator of the con man was a man from Brooklyn named William Miller in 1899. Decades before the scheme was labeled Ponzi, William Miller ran a crooked business that scammed without knowing the investors of their money. As all such planners do, Miller claims that he has several "windows into the way a profitable business works", but in reality, he only scammed his investors from $1 million to more than $25 million. After Miller, the real name of the scheme was in the national spotlight. Although not the creator of the scheme, Charles Ponzi's scam was so widespread and lucrative that it attracted national attention. As Miller did, Charles Ponzi promised a sizeable profit to his investors. In reality, Ponzi pocketed a large sum of money. Collectively, Ponzi investors lost about $20 million, which totaled about $280 million.

Because of Charles Ponzi, the term "Ponzi Scheme" has come under worldwide scrutiny. Before Ponzi, fraudulent investors were relatively rare, at least for the general public. While fraudsters like William Miller do exist, they are far less widespread and more importantly far less identified. After all, ponzi brings this type of scam into the spotlight. While Ponzi eventually became the face of the scheme, no other con artist was more notorious than Bernard Madoff. The modern face of financial crime is Bernie Madoff who was convicted in 2008 of running a $50 billion Ponzi scheme.

Like Charles Ponzi, Madoff used investor confidence and credentials to gain trust and promise his investors an average annual "return" of 10.5% over two decades. In reality, the "return" Madoff followed was nothing more than the money his newest client was seeking and believed to have invested. There are major similarities to be found in all three men, along with all Ponzi schemes in general. Gaining the trust of investors is the main aspect that a planner must have. Without trust, there is no scheme. Madoff, as well as others, used a concept called "affinity fraud," in which con artists target potential victims who share a common bond, such as religion, to build trust. Although the scheme itself has a simple framework, it can really expand due to the concept of affinity fraud. Link affinity is an important determinant in the success of a Ponzi scheme. Leveraging affinity's links helps in building the trust needed to solve scams. When it comes to Charles Ponzi, he raised $9.8 million in 8 months in 1920, most of which came from three quarters of the Boston Police Force.

Similarly, Madoff used his religion to take advantage of his fellow Jews. The ability to locate a specific target group allows the scheme to be initiated. After that, strong trust becomes the glue that binds investors and prevents them from leaving. The reason affinity schemes target people with similar affiliations is trust; no one thought any of them would fool them, not when they could fool so many others.

Common to all Ponzi schemes is a scam to trick investors into believing a business is using a secret idea. It is through this idea that investment plans can be initiated and generate exorbitant profits. Of course, in reality, this whole strategy was a complete fallacy. As seen in the history of this scheme, Charles Ponzi promised very high returns from investing in postal coupons, while the actual postal system was substantially short of the amount of money he handled. With Ponzi, 160 million coupons must be in circulation to cover investments made by Ponzi companies, when in reality there are only 27,000 according to the US Postal Service. Likewise with Bernie Madoff who promises returns on his split-strike conversion strategy which historically has never been able to produce the returns he provides for his clients. Of the total $9 billion put options on the Chicago Board Options Exchange that Bernie Madoff claims to have exercised, he will need more than $65 billion at various times to protect his investors' money.

Instead of acting lawfully, the fraudster helps himself with the investor's money and pays the high return promised to the previous investor on the money handed over by the next investor; the scheme ends when there is no more money from new investors. Basically, when the market is doing well, more investors come in. However, when the market is in trouble, or furthermore when new investor funds cannot supply the money needed to pay old investors, the scheme collapses. With Bernie Madoff, in the United States in 2008 and 2009, 190 Ponzi schemes collapsed. Prior to 2008, the market was in fairly good shape. Once global markets started teetering in the midst of a recession, investors both new and old in Ponzi schemes began to withdraw their money,

Before the scheme collapses and the amount of money is lost, there must be some form of intervention that prevents this catastrophe from happening. Thus, regulators need to do a better job of prevention. One of the main watchdogs is the Securities and Exchange Commission or SEC. The US SEC has a three-part mission: Protect investors, Maintain fair, regulated, and efficient markets, and Facilitate capital formation. In 1933 and 1934, Congress passed the Securities Act and the Securities Exchange Act. In turn, the main purpose of this law is for those who sell and trade securities – brokers, dealers and exchangers to treat their investors fairly and honestly . Thus, the Ponzi scheme violates the basis of these two laws and in turn, there should be no problem to arrange and sue. But in reality, fraudsters often last until the cheater himself, sometimes several years into the future.

Herein lies the problem. The SEC highlights Ponzi schemes as a "red flag" which is a common indicator and warning sign. To highlight the pair, the SEC pointed out that overly consistent returns coupled with secretive and/or complicated strategies are the main red flags of a Ponzi scheme. This type of behavior raises alarm bells, but it is exactly the type of behavior exemplified by the notorious Bernie Madoff. An article written on May 7, 2001, published during Madoff's initial SEC investigation, was entitled: Don't Ask, Don't Tell. The secondary title reads: Bernie Madoff is so secretive, he even asks investors to keep mum. The article stated, “What Madoff told us was, 'If you invest with me, you must never tell anyone that you're invested with me. It's no one's business what goes on here' says an investment manager here' said an investment manager). The sheer amount of secrecy that exists within Bernard L. Madoff Investment Securities LLC should not only raise a “red flag”, it should sound a red siren. You must not tell anyone that you are investing with me. It's nobody's business what happens here' says one investment manager). The sheer amount of secrecy that exists within Bernard L. Madoff Investment Securities LLC should not only raise a “red flag”, it should sound a red siren. You must not tell anyone that you are investing with me. It's nobody's business what happens here' says one investment manager). The sheer amount of secrecy that exists within Bernard L. Madoff Investment Securities LLC should not only raise a “red flag”, it should sound a red siren.

The incompetence of the US Government and its subsidiary regulators, such as the SEC, has allowed Ponzi schemes to continue to slide under the radar. Most of the public became skeptical of Madoff's leaps and bounds before regulatory authorities did. This SEC incompetence provides an opportunity for fraudsters to steal millions. Thus, increased regulations and innovative policies across the board need to be implemented to thwart these counters years before they collapse on their own. To do so, the SEC must emphasize collaboration and camaraderie among regional offices, hiring and placing the right employees in the right positions, and being much more proactive in pursuing and enforcing.

Bernie Madoff remains the most notorious financial con artist in history. Madoff shows off every aspect of his Ponzi scheme and uses his personality to hide it. What allowed Madoff to steal as much as he did as long as he did was simply because of who he was and what he represented. Simona Suh, an SEC enforcement staff attorney during the mid-2000s, admitted that staff had been skeptical of the fraud claims at Madoff because she didn't fit the profile of a Ponzi conman.

Madoff Investment Securities LLC, is one of the most successful broker-dealers on all of Wall Street. In fact, during the early 1990s Madoff Securities LLC alone accounted for nearly 10% of daily trading on the New York Stock Exchange. The company's immense influence on the market made Madoff extremely wealthy and enabled him to become one of the most respected people in the entire industry. When Madoff's name was spoken, there was a certain aura surrounding him. To add to his resume, Madoff markets himself as a co-founder of the NASDAQ and has served as its chairman; he was a prominent philanthropist in New York and a member of various industry and private board committees; Bernie Madoff is the King of Wall Street. So, to claim and, furthermore, proving Madoff ran one of the greatest Ponzi schemes in history is nearly impossible. No one wanted to believe Madoff was lying. Not even the government.

Through his guise, Bernie Madoff was able to deceive not only investors but also some of the best and brightest. Because of who he is and what he has accomplished so far in his career, attracting investors is quite simple. Bernie Madoff's alleged strategy is referred to as a split strike conversion. Simply put, Madoff claims that he will buy the stock, but will also buy the put option to limit losses along with selling the call option which essentially places an upper limit on profits. To explain further, in Madoff's strategy, he could buy shares for $50. He would then buy a put option that would allow him to hedge his stock price at the $35 floor. This put option is a hedge if the stock purchased for $50 drops below $35, allowing Madoff to keep selling the stock for $35. Lastly, Madoff will sell call options for $65. This will allow the call owner to exercise the option and buy Madoff stock for $65 if it rises to $65 and above, hoping to continue rising.

Regardless, while this is a valid strategy, it will not result in the returns that Madoff gives his clients. Illegitimacy comes into play because, in Madoff's case, the problem is that he continues to report month-to-month profits even when the market is making negative returns. While this strategy is used to limit losses, it certainly cannot eliminate them. As with Madoff, however, the returns have always been consistent. Madoff has only reported a three-month decline in more than seven years. For example, in 1993 when the S&P 500 returned 1.33%, Bernie returned 14.55% to investors; in 1999 the S&P was back at 21.04% and there was Bernie at 16.69%. The market fluctuates and does so quite often, that's how it is and always will be. For Bernie, his returns never fluctuated. The returns that Bernie makes are always good, but rarely spectacular. However, the returns are not a red flag factor as many other funds produce similar, if not better, returns. The worrying thing is that even after the market yields a few months down, Madoff will always turn a profit. No mathematical model can explain this consistency other than deception. The worrying thing is that even after the market yields a few months down, Madoff will always turn a profit. No mathematical model can explain this consistency other than deception. The worrying thing is that even after the market yields a few months down, Madoff will always turn a profit. No mathematical model can explain this consistency other than deception.

While Bernie Madoff continues to baffle many in the industry with his consistent returns, hardly anyone talks about him. Whether people believed the absurd explanations behind his strategy, or they saw the invalidity, no one said anything. Edward Thorp, a respected and well-known hedge fund manager, glimpsed the scams that Madoff committed in 2004. Thorp conducted due diligence on behalf of other investment institutions. Due diligence, as it relates to investments, involves investigating the intricacies of a company's strategy, ensuring its practices are lawful and legal. Thorp pointed out that he had obtained some of Madoff's trading tickets and compared them to OPRA tapes. OPRA is the Option Price Reporting Authority, which is the authority responsible for keeping a permanent record of each trade. What Thorp found was that, when comparing Madoff's trading tickets to those on OPRA, he found several discrepancies.

Proved to be a fraud, Madoff fled, his trading ticket would never match the one held in OPRA. Madoff doesn't trade at all. Instead of bringing this important information to the relevant authorities, while Thorp simply advised his clients and anyone in his network to stay away from Madoff, he took it no further. In the United States, the deregulation movement began in the 1970s and was based on the belief that markets are self-regulating, even to the extent of self-repairing market failures. The American public's point of view holds that the market is self-regulating and should be left alone. Thus, the US Government and the SEC took this into account. From 1970 to the 2008 Recession, the market was left to self-regulate.

As evidenced by the actions of Ed Thorp, self-regulation is almost non-existent. In turn, if industry practitioners fail to report suspected fraud, or have no meaningful incentive to do so, and if government agencies do not have systems in place to receive, evaluate, and investigate whistleblower tips, then self-regulation will never work. As shown, when illegal practices are discovered, many practitioners simply shy away from getting involved, but that's all they do. Likewise, the agency tasked with handling illicit practices when reported is inadequate. While it is true that many in the industry have turned a blind eye to skeptical practices, there are many others seeking justice. However, due to the incompetence of the regulatory authorities,

Closing

Ponzi schemes have been around since the late 19th century causing enormous damage to both the financial industry and the general public. Despite a simple form of financial theft, the scheme made famous by Charles Ponzi has gone from defrauding investors of $1 million in its early years to more than $50 billion. The scheme itself is not complicated. Fraudsters entice customers to invest in their businesses using covert techniques. With essentially no risk, the investment will yield large and fast returns. Actually, there is no special technique, the scammers just pay the old investors with the new investors' money and the sequence of events continues in this way. The problem is that when people start withdrawing their money during tough economic times, or the new funds are not enough to pay off debts to old investors, the scam collapses on its own. A scheme can last a day, or as proven by the most famous con artist of all time, Bernie Madoff, it can last more than a decade. The longevity of a Ponzi scheme depends on the skills, as well as the rewards of the fraudster.

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