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# THE EMERGENCE OF PONZI SCHEMES IN GHANA "A RAISING CONCERN"

## INTRODUCTION

Investment fraud can plague financial markets regardless of their level of development. It encompasses all types of actions aimed at obtaining a financial gain from investors based on deception. Such fraud can take many different forms from very simple schemes such as outright theft where none of the investor's money is returned, to more complex schemes such as Ponzi and pyramid schemes. Schemes can be regulated or unregulated entities and can take different legal forms, from joint stock companies to hedge funds or simple pools of assets.

In a Ponzi scheme, returns may be paid to investors out of the money paid in by subsequent investors rather than from genuine profits. These schemes usually offer higher returns than any legitimate business activity could plausibly sustain, in order to lure investors. Ponzi schemes usually have to attract new investments at an exponentially growing rate to sustain payments to existing investors, and inevitably collapse when the new investment needed exceeds the size of the target market. At that point, most investors lose most or all of their investment, while early investors including the scheme's founders may have obtained high returns. Thus, it can be a matter of plain luck and timing whether an individual turns out to be a victim or a beneficiary of the fraud. Ponzi schemes are insolvent from the moment that they take in money from investors. Their liabilities to investors exceed their assets as the value of liabilities increases at the inflated rate of return, while assets may be depleted by the running costs of the scheme or possibly suffer from other depredations.

As the experience of different countries has shown, the “business opportunity” advertised to lure investors into putting their money in a Ponzi scheme can vary in nature, from straightforward investments in stocks or bonds, to less traditional financial sector products such as currency trading, to investments in nonfinancial assets, such as real estate, cars, and helicopters. These business opportunities are only limited by the imagination of the perpetrator and the gullibility of the investor.

As indicated above, Ponzi schemes can be perpetrated by unregulated entities, through informal sector vehicles that operate in the shadow of formal financial institutions. In other cases, they are perpetrated by regulated entities, which abuse their regulated condition to lure investors.

The types of investor lured into these schemes vary. Many times, the schemes will have drawn in or specifically targeted as investors individuals from amongst a specific group or community sharing a common affinity, such as ethnicity, religion, or profession. In many instances the perpetrators promote their schemes through leaders of the affinity group. In some cases, investors are given an explicit incentive to recruit new investors (Box 1). The damage when such schemes reach their inevitable end can be widespread amongst populations with limited income and means to absorb the eventual losses. The resulting combination of anger, betrayed trust, recriminations and sheer loss of wealth and income can also have significant political and social repercussions.

The experiences of different countries show that the exponential growth rate needed to sustain schemes can lead to large-scale economic and institutional damage. The negative consequences include:

• Undermining confidence in financial markets;

• Diverting savings from productive to unproductive uses and, in some cases, from the domestic economy to foreign destinations, with a balance of payments impact;

• Incurring fiscal costs, if bailouts occur;

• Diverting deposits from banks and increasing non-performing loans if loan proceeds were diverted into schemes;

• Causing swings in consumption driven by paper profits or early withdrawals;

• Causing socio-economic strife if a sufficiently large number of households are suddenly exposed to losses; and

• Undermining the reputation of political authorities, regulators, and law enforcers for failing to prevent open frauds and to address money laundering or support of other illegal enterprises by schemes' operators.

**Pyramid Schemes Versus Ponzi Schemes**

The labels Ponzi scheme and pyramid scheme are often used interchangeably to describe specific forms of investment fraud where sustainability depends on the influx of new “investors” to the scheme. However, from a technical perspective, there are differences in the way the two types of schemes operate.

Pyramid schemes are a form of fraud where the expected benefit to members depends primarily on the number of individuals they recruit, which is not necessarily the case in a Ponzi scheme. For instance, each member may be required to recruit five others who each recruit five more, and so on to get the reward, creating a pyramid in which payments flow upward to earlier members—and not necessarily to a central pool of funds, as in a Ponzi scheme. While the large reward draws in members, the number of recruits required to be rewarded grows exponentially, and inevitably exceeds the target population. At that point, the flow of rewards up the pyramid stops, and most members receive nothing in return for their membership fee, as they are unable to recruit new members. Ponzi schemes often grow larger than pyramid schemes as they can take in unlimited amounts from a single individual and can continue to operate indefinitely, as long as payments demanded by investors from the scheme do not exceed payments by investors into the scheme.

A pyramid scheme may attempt to masquerade as a multi-level marketing (MLM) arrangement, which is a legitimate business activity in many jurisdictions. MLM members are salesmen who sell a legitimate product but also receive commissions on sales by their recruits, their recruits’ recruits, and so on. The distinction between a legal MLM arrangement and an illegal pyramid may be difficult to establish. A hypothetical MLM arrangement in which members must buy an initial inventory of products which they neither consume nor sell would be an illegal pyramid scheme in many jurisdictions.

There are a number of similarities between the life-cycles of pyramid schemes and Ponzi schemes. Both types of schemes typically proceed through the following stages: initiation; validation, when large and easy rewards earned by initial members generate strong word of mouth publicity; expansion, when a large number of people join or massive investments are received; and collapse, when defaults occur, the inflow of new funds or members stops, and the promoters may seek to abscond with money.

The schemes are inherently likely to collapse and default on most members. Pyramid schemes grow exponentially for a given rate of recruitment until they exhaust the pool of potential members. Inflows in a Ponzi scheme must also grow exponentially, if investors do not reinvest all earnings.

In practice, schemes may incorporate elements of both pyramid schemes and may be difficult to classify. For instance, several of the Caribbean schemes described below appear to have characteristics of both types of schemes.

**GROWTH OF PONZI SCHEMES IN GHANAIAN FINANCIAL SECTOR.**

Over the past two decades, there have been several Ponzi schemes in Ghana. The most dramatic case in Ghana were Pyramid and R 5 schemes in 1995, where authorities such as Bank of Ghana, Ghana Police CID and BNI faced difficulties in dealing with the schemes. In Ghana, institutions and financial regulators lacked the appropriate enforcement tools such as the ability to freeze assets, shut down the schemes at the early stage. The growth of schemes such as CB Net Marketing Concept in 2013, E Finance and More, Diamond Investment Ltd, Global Coin Community, Fine Fort, TCL Savannah Investment Ltd in 2016 and Menzgold Ltd could be attributed various factor such as gullibility, regulatory and institutional gaps, poor coordination and cooperation among financial regulators, lack of independence of financial regulators, lack of specialization and speedy disposition by courts, lack of authority to investigate and prosecute unregulated schemes and lack of the necessary enforcement tools, resources and political independent to cope with financial misconduct including the operation of Ponzi schemes.

- Gullibility was contributed to the growth of Ponzi scheme over the past decade. Gullibility is a sub-type of foolishness. foolish is defines as an act "one where someone goes ahead with a sociably or physically risky behavior in spite of danger signs, or unresolved questions which should have been a source of concern for the actor. theory of gullibility explains the success of Ponzi schemes in Ghana. Gullibility also explains the lacked of clear thinking on the part of the investors who participate in such Ponzi schemes. Individual Ghanaians have a high IQ yet they still remained gullible, because impulse and intuition driven by emotions led them to irrational decision over among the most intelligent Ghanaians.
- Affinity fraud is another possible explanation for the success of some schemes such as Pyramid and Mensgold. Affinity crime has been defined as those victims share some sort of bond, and this could be ethic, religious, club, workers in the same business, people living in the same vicinity or people who travel in the same social circles. These common bonds gave the victim a reason to trust the schemer. The common belief was that someone from such a background would never cheat. In the case of NAM 1, the majority of his investors were from his inner circle, social group.

- The lack of strong regulatory and institutional responses, with under developed financial institutions have allowed Ponzi schemes such as Mensgold to develop and continue to operate until 2018 even after many red flags have been issued by the Bank of Ghana since 2013, and this is true reflection of a broader problems that challenged the credible enforcement of both Ghana Police Service, BNI and Economic Crime Agency.

**RECENT COUNTRY EXPERIENCE**

The recent country experience in the Mensgold saga has shown that institutions and the regulatory agencies were too reactive and also failed to act quickly and decisively when the scheme was established in Kasoa – Central region in 2013.

The lack of broad authority to investigate and prosecute unregulated schemes has inflated damage on most investors and also diverted savings from productive investments. The experience in Ghana over the past decade has suggested serious gaps in both institutions such as the Police (CID), Economic Crime Agency, BNI and financial regulators such as Bank of Ghana and Securities and Exchange Commission as well as defects in the legal and regulatory framework governing enforcement of financial laws and anti-money laundering acts which had been a key factor in Crime Agencies and financial regulators' inadequate response to various Ponzi Schemes over the past decade. There were four key elements lacking in poor responses to the Ponzi Schemes:

1. There was no clear provision to prosecute the Ponzi schemes
2. The lack of broad investigative authority, especially to 'trace and track the money' through the accessing banking information.

3. Undefined authority to impose administrative penalties such as financial penalties as well as the withdrawal of license and the inability to charge the owners of such schemes with speed and alacrity within existing laws.
4. The lack or non-existent of broad authority to cooperate and exchange information among both the Security Agencies and financial regulators have contributed to the growth of Ponzi Schemes in Ghana over the past decade. Ponzi schemes like any other money laundering schemes, constitute a violation under several financial laws such as AML ACT 2008, ACT 749 as amended. Amendment Act 2014 Act 874 could have been pursued by the collaboration between Crime Agencies, Financial Intelligence Centre, Bank of Ghana and Securities and Exchange Commission.

   A close dialogue between the criminal authorities and financial regulators could have led to more effective enforcement. Criminal Authorities i.e. Police CID, Economic Agency and Financial Regulators should have effective and proactive mechanism for the exchange of information and serious corporation to curb and unlicensed and regulated Ponzi Schemes. The need for multilateral memorandum of understanding by Criminal Authorities and Financial Regulators should become an important tool to curb this menace in the society especially in the rural communities and the villages.

   In addition, it will be crucial that the financial regulators, Bank of Ghana, Securities and Exchange Commission, National Pension Regulatory Authority and National Insurance Commission keep the public informed, through warnings regarding the methods used to defraud the unsuspecting investors and the need to question potential investment financial viability, and only invest through licensed and regulated entities.

5. The lack of specialized court and speed disposition by the courts in Ghana might have contributed the emergence of Ponzi schemes in Ghana over the past decade. Because many decisions have to be taken by both criminal authorities such as the Police Service (CID) and financial regulators to stop Ponzi schemes like Menzgold which were subjected to judicial approval or review by the Attorney General Department, it would be crucial and critical for judges and the court systems to have the necessary expertise and competencies and that would enable them to give priority to such financial matters, in particular for those that involved emergency action.

   Without the necessary skills and competencies, it would be difficult to expedite actions on those who perpetrated such financial crimes. For example, Menzgold was able to continue operating for 5 years while the Criminal authorities and Financial Regulators could not obtain court's cease and desist orders while the Ponzi schemes continued to operate bank account with some commercial banks.
6. The public lacked of financial information and education on those unregulated schemes. The Ministry of Finance, Ministry of Information and the Financial Regulators should have a broad financed literacy programs in urban and rural arears to help stop these Ponzi schemes in the society.

## ADDRESSING UNREGULATED INVESTMENT SCHEMES: KEY POLICY LESSONS

Ponzi schemes appeared to have mainly flourished in the form of "unregulated investment schemes". As demonstrated by the experience of the countries, such type of schemes can undermine investor confidence in financial institutions. The longer that they operate, the more damage they are able to inflict. Thus, the main policy lesson that can be extracted from countries’ experiences with Ponzi schemes is the need for a rapid and early response from financial regulators and law enforcement authorities to identify and stop the schemes and protect investors’ interests.

However, responding swiftly has proven to be a challenge in many Ghana. Other policy lessons involve tackling the social dimensions of the phenomenon by means of programs to enhance financial literacy and personal financial responsibility amongst members of the public. In the case of Ponzi schemes operated by regulated entities such as offshore banks, the lessons point more simply towards the dangers of weak regulatory frameworks and inadequate supervision. The recent Ghanaian experience has heightened the awareness of regulators and potential investors to the risks associated with unregulated investment schemes. However, awareness alone will not prevent a recurrence, and the experience shows that fraudulent schemes will emerge on a regular basis even in financial markets with strong regulatory frameworks. Thus, it is necessary that countries work together in enhancing their legal and regulatory frameworks.

**Preconditions**

As was indicated earlier, taking comprehensive actions to stop Ponzi schemes has proven to be challenging for many countries. Analyzed altogether, the cases show that regulatory response is influenced by a set of preconditions. When these preconditions are present, regulators are more prone to be proactive and act quickly and decisively. In their absence, regulatory responses come, at best, with significant delay.

These preconditions are:

1) independence of financial regulators;

2) broad authority to investigate and prosecute unregulated schemes;

3) effective mechanisms for domestic and international cooperation;

4) adequate resources for enforcement; and

5) speedy courts with the requisite skills and experience.

**Independence of financial regulators**

In many of the cases studied, political and even popular support for regulatory actions to stop the schemes has been absent. Such lack of support has been the result of a complex set of factors, including limited understanding of the nature of the activities carried out by the schemes and thus of the danger that their unchecked operations may entail for individuals and the financial sector as a whole. In some cases, the lack of support can be attributed to direct or indirect contributions by the schemes to governmental or social causes. sports, beauty contests, charities, political campaigns that make them popular with politicians and the public. In this type of environment, it is critical that the financial regulators have sufficient independence to be able to carry out their mandate without the need for any additional approval from the government and even in circumstances where the schemes may have the tacit support of members of the government.

It is also critical that the regulatory framework contains adequate provisions to protect staff and commissioners against law suits arising from the exercise of their duties. In the absence of such provisions, regulators might not feel completely free to take rapid and strong actions against the schemes given that they might end up causing them personal liability which, even if they expect to be vindicated by the courts, exposes them to the uncertainty of lengthy and expensive litigation in their personal capacities.

**Broad authority to investigate and prosecute unregulated schemes**

The experience of many developing countries suggests that gaps in the legal and regulatory framework to enforce financial laws and regulations have been a key factor in the lack of an adequate response by financial regulators to Ponzi schemes.

Four elements are important:

(i) clear provisions to prosecute the schemes;

(ii) broad investigative authority;

(iii) authority to seek or impose civil/administrative remedies; and

(iv) authority to seek emergency relief.

**Clear provisions to prosecute the schemes**

the ability of Ghana to combat Ponzi schemes that operate as unregulated investment schemes is the existence of clear provisions that prohibit and punish the undertaking of certain financial activities without a license/registration from a financial regulator. Such provisions should apply to deposit taking, securities intermediation, and public offering of securities and collective investment schemes. Depending on the definition of such financial activities in a particular jurisdiction, it might be necessary to include additional “catch all” provisions, for example, prohibiting the collection of money from the public without authorization. In addition, the legal framework should contain provisions that directly prohibit and punish investment fraud.

## Investigative authority

Statutes should provide financial regulators with the authority to investigate breaches to financial laws and regulations, including the breaches of the licensing provisions. While that authority is usually given to financial regulators, in many developing and emerging markets they have limited powers to request information, in particular from unregulated entities. Thus, it is necessary that statutes provide financial regulators with broad authority to request information, including subpoena powers. Particularly important to combating Ponzi schemes and other types of investment fraud is the ability to "follow the money," for which the regulatory agencies should be empowered to access banking information.

## Administrative sanctions and criminal sanctions

The authorities should have at their disposal a wide range of remedies (sanctions) available to combat Ponzi schemes, including both criminal and civil/administrative sanctions. However, as the cases indicate, in some developing and emerging markets, the financial regulators lack the authority to directly impose a broad range of civil/administrative sanctions. As a result, financial regulators lack the authority to prosecute such offenses and have to rely entirely on the criminal authorities. Experience shows that the criminal authorities have other competing priorities and, that in practice they do not pursue all cases. Also, the burden of proof for criminal offenses is significantly higher than that required at the administrative or civil level. Thus, to be most effective, financial regulators need to be empowered to prosecute this type of misconduct as a civil/administrative breach, irrespective of the fact that the same misconduct constitutes a criminal offense also under the jurisdiction of the criminal authorities. However, as will be discussed below, coordination between the two authorities is critical for an efficient and effective use of enforcement powers.

Empowering regulators with sanctioning powers can be achieved in different ways depending on the legal tradition and culture.  for example, the securities regulator has the authority to investigate and prosecute (litigate) all violations of securities laws, including investment fraud, but the imposition of sanctions is done either by an administrative tribunal or by the civil courts (for example in United States). In others, investigation, prosecution (litigation) and the imposition of sanctions is done by the financial regulator (for example, the Ontario Securities Commission in Canada).

Another problem that some countries face is that actual penalties that can be imposed are not sufficiently serious to have a deterrent effect.

**Adequate resources for enforcement**

A strong legal enforcement framework is necessary but not sufficient to ensure adequate handling of Ponzi schemes. In Ghana where the problem of Ponzi schemes has just started to be tackled, the lack of experienced personnel has proven to be an important challenge to taking prompt action.

**Specialization and speedy disposition by the courts**

As part of the due process of law, many decisions that a financial regulator takes to stop Ponzi schemes are subject to judicial approval or review. As a result, it is critical that judges have the necessary expertise in financial matters. In addition, it is important that financial matters, in particular those involving emergency relief, be given priority.

However, experience shows that this is a key challenge in developing and emerging market countries, Ghana not exception. addressing challenges of adequate expertise and speedy disposition of financial matters by courts requires special attention by governments since it is not easily achieved in the context of the overstretched and under-funded judicial systems commonly found in Ghana. training and specialization of judges is key, as well as the development of expedited procedures for these types of actions.

**Impact of Ponzi schemes on the Ghanaian Economy**

Most of these Ponzi schemes are disasters in waiting because, they take money from one person and give to the other (robbing peter to pay Paul and vice versa) without adding any real value to the economy as records of these transactions are not kept and made open to regulatory authorities.

The negative effects are mostly minimal and go largely unnoticed except by the economist. It is advisable to curb the activities of ponzi schemes to avoid undesirable returns and horrible economic impact. Ponzi schemes have played a major role in the life of some Ghanaian by enabling them earn quick money even without engaging in a productive venture. This increased the disposable income of some Ghanaians and has aided a rise in demand for products and services that these individuals wouldn’t have been able to afford on a normal day.

**Direct effects of ponzi schemes on the economy**

They kill creativity, gradually destroy work ethics and cause a decline in social services by encouraging greed and laziness.

Energies that would have been invested in productive ventures is stolen or diverted into ponzi schemes, causing a decline in the overall productivity and possibly slows down the gross domestic product (GDP) growth.

Although ponzi schemes may temporarily alleviate poverty, they will not curb inflation because a decline in production reduces availability of goods for purchase and demand becomes higher than supply.

Another direct effect is the reduction in consumption expenditure; the poor people who lost money in ponzi schemes suffered the most as they have been forced to reduce their expenses even on basic amenities and this reduced the effectiveness of demand especially in rural areas where most of these people reside.

**Indirect effects of ponzi schemes on the economy**

Many people have lost so much money in ponzi schemes and this has reduced their capability to access means of livelihood, health facilities and other necessities. Money lost by investors has created a loop hole in the financial system of the country because many Ghanaians withdrew their life savings from banks while some borrowed money and injected into these schemes. The loss of these monies may signify loss of capital formation which slows down economic growth but like mentioned earlier, this effect is minimal.

**Loss of Credibility**

every well-functioning financial system is built on credibility, trust and integrity. Ponzi schemes have undermined the confidence of many Ghanaians.

In a bid to meet up with pressing needs, Ghanaians are likely to spend more than they save because of high expectations and trust in the ability of Ponzi schemes to deliver high rates of returns. When these schemes fail, they are left with little savings which translate to little investments and the very unlucky ones are left with nothing.

**In conclusion**

ponzi schemes inevitably inflict financial damage on most of their investors and divert savings from productive investments. If these schemes are not checked, they grow exponentially and cause broader macro-economic instability and damage the reputation of institutions such as the Registrar General, Companies Registry, as well as the security agencies (Ghana Police Service; BNI and Economic and Organized Crime Office) and also undermine the confidence of the financial regulatory agencies such as Securities and Exchange Commission and Bank of Ghana. In other jurisdictions, ponzi scheme lead to both political and social instability like Albania in 1996.

Awareness and public education on these schemes must put in place in rural and urban areas. Broad financial literacy programs by District and Municipal councils can help to these unregulated schemes. It is crucial that government keep the public informed through general and specific warnings regarding the methodologies used by these fraudsters to defraud innocent investors in villages, towns and cities.