

Schemer

by

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The *Wall Street Journal*, *New York Times* and *Business Week* labeled the Bernard Madoff swindle as the largest Ponzi Scheme on Wall Street. Former Presidential candidate Rick Perry and columnist Charles Krauthammer described Social Security as a Ponzi Scheme. On September 16, 2011 the *Cincinnati Enquirer* reported that federal prosecutors made a deal to recover \$2.6 million lost by dozens of retirees and working people in one of the largest Ponzi Schemes in the region in years. Bernie Madoff, in an interview recounted in the February 27, 2010 issue of *New York Magazine*, given from jail where he is serving a 150 year sentence, called the whole federal government a Ponzi Scheme.

Ponzi, Ponzi, Ponzi

What the devil is a Ponzi Scheme and who the H___ is Ponzi?

The Securities and Exchange Commission definition:

“A Ponzi scheme is an investment fraud that involves the payment of purported high returns to existing investors from funds contributed by new investors. Ponzi scheme organizers solicit new investors by promising high returns with little or no risk.”

Perhaps it is better explained in a down to earth way by a cartoon which shows one guy saying to his friend:

“If I’m the first one in and the first one out,
Ponzi schemes can be lucrative.”

Thus, a Ponzi Scheme is a scam that pays early investors high returns from the fraudulently obtained investments of later investors.

Carlo Pietro Giovanni Guglielmo Tebaldo Ponzi was born March 3, 1882 in Italy and emigrated to the US in 1903 at age 21. The word from Parma, Ponzi’s hometown in Northern Italy, was that relatives, weary of paying his fines for gambling, petty theft and forgery, had to put up the money to get the young man out of the country.

Ponzi boarded the SS Vancouver with \$200 bound for Boston - -but by the time the ship arrived in Boston harbor a card sharp had relieved Ponzi of all but \$2.50.

Later, Ponzi stated:

“I arrived in this country with \$2.50 in cash and
\$1 Million in hopes
and those hopes never left me”

“Carlo” Ponzi became “Charles” after entering the US.

Ponzi’s initial job in America was as a dishwasher in a restaurant. He was promoted to waiter but he was fired for short changing customers and theft,

After a series of odd jobs, Ponzi moved to Montreal, Canada, and became an assistant teller in newly opened Banco Zarossi, a bank established by Luigi “Louis” Zarossi to service Italian immigrants to that city.

Zarossi paid 6% interest on bank deposits - -double the going rate at the time. The bank was therefore growing exponentially. Zarossi was funding the high interest payments to existing depositors by using money deposited in newly opened accounts. The bank failed and Zarossi fled to Mexico with a large portion of the bank’s money. Banco Zarossi was obviously a Ponzi Scheme before Charles Ponzi even had a scheme!

Broke and desperate, Ponzi walked into the offices of Canadian Warehousing, Ltd. and, finding no one there, he wrote himself a check for \$423.58 in a company checkbook, forging the signature of the Director of the company. The Montreal police, having noted Ponzi’s large expenditures after the forged check was cashed, confronted Ponzi who held out his hands wrist up and said “I’m guilty”. Ponzi was sent to prison for three years.

In October, 1908 Ponzi wrote the following letter from his prison cell to his Mother back in Italy:

“Dearest Mother,

Your son has at last stumbled upon excellent fortune in this country. I have taken a position as special assistant to the warden of this institution who can well use my fluency in language in conversing with some of the inmates. It is a three year contract, darling Mother, and during that time I shall not have to worry where my next meal or warm bed is to come from.”

After his release from the Canadian jail in 1911 Ponzi got involved in smuggling Italian illegal immigrants into the US. After being captured and tried, Ponzi was sent to Federal prison in Atlanta. (An aside- this Atlanta Federal Prison was where George Remus of Cincinnati, Ohio, the King of the Bootleggers, was sent in the 1920's for violations of the prohibition of alcohol laws and the subject of an earlier paper.)

Anyway, while in the Atlanta Federal Prison, Ponzi became a translator for the warden who was intercepting letters from criminal Ignazio “Lupo the wolf” Saietta. Ponzi became friends with Lupo and with Charles W. Morse, a prisoner who fooled the prison doctors during medical exams, poisoning himself by eating soap shavings that left his body quickly. Morse got out of prison early because the doctors thought he was sick.

After Ponzi was released in Atlanta, he went to Boston where he met Rose Maria Gnecco and fell in love. Despite receiving a letter from Ponzi's mother describing Ponzi's shady past, Rose married Ponzi.

Ponzi eventually found a way to get rich quick through a vagary of the postal system. At that time it was common for letters from abroad to include an International Reply coupon - - a voucher that could be exchanged for postage back to the country from which the letter was sent. The purpose of the International Reply Coupon was to allow someone in country A to send it to a person in country B who could use it to pay postage on a reply letter.

International Reply Coupons were priced at the cost of postage in the country A but could be exchanged for stamps in country B. If the values were different, there was a potential profit, an arbitrage.

On December 26, 1919 Ponzi established the Security Exchange Company with a \$200 loan. He sought deposits, allegedly to make large profits through arbitraging International Reply Coupons. Ponzi initially promised depositors a 50% return in 90 days. He later sweetened the deal by offering a 50% return for 45 day deposits. (I can't even calculate the return percentage if you annualize these numbers!)

Within months Ponzi's company had two offices in Boston and dozens of employees.

A feeding frenzy ensued. Thousands of people bought Ponzi Promissory Notes ranging from \$10 to \$50,000. There were lines of would be depositors at the door. Some Boston policemen became “sales agents” earning commissions for bringing in depositors.

Ponzi’s company took in millions of dollars per week. Desk drawers, file cabinets, and closets were filled with the suckers’ (oops..I mean depositors’) cash.

People were mortgaging their houses and investing their life savings. Most did not take their profits but reinvested.

As long as the money kept flowing in, existing investors could be paid their out sized returns with new money.

Ponzi was now living the good life. He brought his mother over from Italy in a first class cabin on the ship. He bought a mansion with a heated swimming pool, purchased a “Locomobile” automobile. Ponzi carried a gold tipped cane. He was riding high.

The *Boston Post* newspaper hired Clarence Barron (who started Barron’s financial paper-still in existence today) to investigate Ponzi’s meteoric rise. Barron found that to cover the investments made with Ponzi’s company, 160 million International Reply Coupons would have to be in circulation. However, only 27 thousand actually were issued. The US Post Office stated that these coupons were not being purchased in quantity in the US or abroad. Ponzi’s prior criminal record came to light. Ponzi never used the depositors’ money to buy International Reply Coupons. He just utilized the money from new depositors to pay off the old - - - - what we now call a Ponzi Scheme.

Then the house of cards collapsed. Depositors wanted their money back. The “investors” lost more than 70%.

Ponzi was charged with and convicted of 86 counts of mail fraud and sent to federal prison. While locked up by the feds, Ponzi was tried for larceny by the Commonwealth of Massachusetts and sentenced to 7-9 years in state prison.

Ponzi was released from Federal prison after four years and was desperate to avoid yet another jail sentence. He fled to Florida, adopted a disguise and fake name, and launched a pyramid scheme selling real estate that was literally under water.

After faking his suicide Ponzi got a job on a ship bound for New Orleans. He might have escaped but couldn't keep his big mouth shut; he revealed his identify to a fellow waiter. After he was arrested, Ponzi sent a telegram to President Coolidge asking to be deported. However, his deportation did not occur until he served seven years in a Massachusetts jail.

Ponzi was deported to Italy in 1934 and worked as an English translator. Benito Mussolini offered Ponzi a job with the Italian airline where he served as manager of the Rio de Janeiro office from 1939-1942.

Ponzi died January 18, 1949 in the charity ward of a Rio hospital, age 67. He was buried in an unmarked pauper's grave.

Before he died Ponzi gave an interview with an American reporter and said:

“Even if they got nothing for it, it was cheap at that price.

Without malice aforethought I had given them the best show

that ever was staged in their territory since the landing

of the Pilgrims! It was easily worth fifteen million bucks

to watch me put the thing over.”

In conclusion, as long as humans are subject to greed and laziness and want something for nothing, there will always be Ponzi schemes.

Apropos that, on September 15, 2011 ABC World News reported that Monroe Beachy, a 77 year old Amish man from Sugarcreek, Ohio, was accused of running a Ponzi Scheme. He was charged with mail fraud after allegedly scamming thousands of people, mostly Amish, of \$16.8 Million. The press labeled Beachy as: the “Amish Bernie Madoff”.

It never ends.