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AKADÉMIAI KIADÓ

Pyramid and Ponzi schemes and the repercussions of the differing regulatory approaches Hungarian developments in the light of contemporary global trends

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ABSTRACT

Apart from a few shorter papers inspired by the nomination of a new crime prohibiting the organization of 'pyramid games' by the Hungarian Criminal Code in 1996, the topic of 'pyramid and Ponzi schemes' remained of little interest to Hungarian legal scholars. Internationally, the topic has garnered increased attention due to the grave socio-economic effects of ever newer scheme-collapses, from the high-profile American Madoff (2009) to the myriad less-known cases from emerging systems like the fiasco of the Albanian pyramid schemes in the mid-1990s, pyramid schemes camouflaged as multi-level marketing (MLM) ventures, or their online versions more recently. Comparative works that would juxtapose the pertaining laws and experiences of the United States with those of Hungary are lacking.

To fill the void, this article contrasts a select number of differing regulatory approaches. At one end of the spectrum is the United States (US), which, instead of passing sector-specific laws, mobilized and adapted the enforcement tools of all utilizable branches of law to combat the schemes. While in the US this has been uniquely primed by securities laws, in Hungary the task remains limited to what criminal law and the criminal justice system could offer, coupled with the dominantly *ad hoc* reactions of the Hungarian Securities and Exchange Commission (SEC). Development of tests to distinguish legitimate Multi-Level Marketing (MLM) companies from pyramid schemes disguised as such represents the only segment where significant rapprochement occurred between the US, the European Union (EU) and therefore also Hungary.

For contrast and illustration of the other end of the spectrum, the systems that were forced to react to risks corollary to the schemes by enacting sector-specific laws, the most recent regulatory reactions of India,

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Myanmar, and Sri Lanka had to be resorted to. As the latter two imposed complete bans on all MLMs, it is only the Indian 2019 comprehensive act that attempts to combat the schemes and akin forms of financial fraud relying on a new comprehensive regulatory model.

The Philippines is an interesting mixture made of local and transplants that readily proves that the solutions of the most developed US system could successfully be transplanted into a significantly different socio-economic environment.

KEYWORDS

pyramid and Ponzi schemes, fraud, scam, multi-level-marketing (MLM), capital markets and securities regulations, consumer protection law, prophylactic (ex ante), ex post remedies

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'Maryland and Pennsylvania, both with securities markets as large and active as Wall Street's in the 1820s, allowed companies, and indeed the state government as well, to pay interest and dividends out of new loans and stock issues. That New York State law forbade this Ponzi-scheme financing would be a significant factor in the establishment of Wall Street's dominance in securities trading. [...].'[1]

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'[A] strong emphasis on enforcement by markets at any level of development is the key to market growth and prosperity.'[2]

1. INTRODUCTION

1.1. Why should legal scholarship be interested in pyramid and Ponzi schemes?

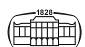
Notwithstanding the heightened attention devoted to the theme of pyramid and Ponzi schemes in the aftermath of the 2008 Madoff scandal,[3] understandably more in the United States (US) than in the rest of the world, the pertaining comparative legal scholarship remains scarce. This applies *a fortiori* to Hungary, where the sheer number of publications from under the pen of legal scholars, no matter whether on local or international developments, in Hungarian or other languages, counts no more than a handful. Sources that would herald global trends to Hungarians, or vice versa, are lacking. The situation is no different in the rest of the region and hence the ensuing should be of equal interest *mutatis mutandis* to lawyers from this niche of Europe.

That this paper aims to be a gap-filler, could be concluded already from these facts. It desires, however, to be an uncommon gap-filler because the horizon within the article's purview stretches beyond Europe and the US, and reaches as far as four Asian countries having faced challenges of the sort more recently, too. Remote from each other, geographically and otherwise, yet any lawmaker that ponders on *de lege ferenda* should find the comparison of these instructive as one can learn also from those countries that solve similar problems with less sophisticated legal tools.

[1] Gordon (1999) 59.

[2] Birdwell (2011) 545.

[3] For a succinct recount of the Madoff Ponzi scheme from one of the leading experts of the field see Frankel (2012).



The pragmatic reason why this peculiar subject matter would deserve more heedfulness is linked to the omnipresence of these kinds of fraud, the threat to the integrity of the financial markets, and the grave socio-economic repercussions their inevitable collapse may generate. These may range from the siphoning off of deposits to unproductive (fraudulent) uses[4] to collapse of the entire governmental system, as it occurred in Albania in the mid-1990s,[5] in addition to the harm caused to often thousands of vulnerable consumer-victims of these.

To better assess the dimensions of the 'topic' it is best to take a look at US experiences, where the SEC not only set the fight against the schemes as a priority after Madoff[6] but it is the country where every year dozens of schemes get detected,[7] investigated and reacted upon. The richness of the related records, public or private,[8] is hardly matched elsewhere and thus much less could be learned about the schemes in other countries. Obviously, this is partly due to the fact that the size, depth and the structure of the US versus European (or other) markets is significantly different, which inevitably results in proportionately larger number of cases in the US.

If the previously low number of cases have failed to alert lawmakers in many parts of the world to the necessity of strengthening their related regulatory responses, as is the case in Hungary and in most of the EU Member States, and save the specific problem of pyramids disguised as multi-level-marketing (MLM)[9] venture, then the threats generated by online versions of the schemes should open the eyes. The reach of these does not stop at the national borders and as a rule are harder to detect.

In light of the above, it should be a legitimate query, what law can do to combat pyramid and Ponzi schemes. By which branches of law and with which legal remedies and tools can the corollary risks best be tackled? This set of questions is not only a genuinely pressing one but there is a lot to be learned from the growing variety of regulatory responses evolving around the world. This study aims to cast a modest light on these with the paraphernalia of comparative law, with a touch of interdisciplinarity; alluding for rethinking rather than unthinking the subject matter in Hungary.

1.2. Comparative terminological and definitional notes

1.2.1. Why is terminology an issue?. Many reasons require commenting on the meaning of our central terms, starting with the fact that for lawyers, especially from countries with fledgling capital markets, this material tends to be little known. *Second,* the connotation, number and breadth of terms used by local languages may differ from the English ones. There is such a difference between the two main jurisdictions of this study: while Hungarian legal terminology operates with a single umbrella term 'piramisjáték' – metaphrased: 'pyramid game' – in the (US) the designation of the very same notion ramifies to the tandem of 'pyramid-' versus 'Ponzi schemes.' Clarifications are needed, *third,* also because certain presumptions are often

[4]Hofstetter, Majía and Rosas (2018) 18–33.

[5]Jarvis (2000). See also Gorezi and Bashari (2009) 52–57.

[6]Khuzami and Walsh (2009).

[7]For the Ponzi schemes investigated by SEC annually since 2009 (collapse of the Madoff scheme) see SEC Enforcement Actions against Ponzi Schemes at Link 1.

[8]See the database of 'Ponzitracker' operated by Jordan Maglich at Link 31.

[9]See, e.g., Epstein (2010) 91.

uncritically subscribed to concerning the theme in the center of our analysis herein. Let us take a closer look at each of these points.

1.2.2. Pyramid and Ponzi schemes defined. Pyramid and Ponzi schemes could be said to be the two sides of the same coin. Although some legal systems do not, at least as yet, distinguish the two as is the case with Hungary, the trend is their notional differentiation. Indeed, they are phenomena sharing some commonalities and yet differing, too, though this may not always be clear due to inconsistent use of terminology. *First and foremost*, they are **forms of financial fraud** prompting regulatory responses for the sake of protecting investors and the integrity of the markets. Besides the general mandate of law to combat all forms of fraud, the narrower underlying rationale, simplified, is that fraud on markets diminishes trust in them, as a result of which investors disappear and the markets decline; or in extreme cases even collapse. Part of the problem is that scams often appear as **financial innovation**, the utility of which is both doubted[10] and believed to be the *sine qua non* of modern financial systems. Cryptocurrencies and the enabling Blockchain technology, as well as the myriad other possibilities the Internet offers for developing and marketing new financial products, are superb contemporary examples. Although banned in some countries, the verdict whether cryptocurrencies are socio-economically advantageous 'creatures', remains inconclusive. At least, this is what the US SEC's opinion in the matter of the collapsed German DAO venture from 2017 suggests.[11] What links these technological advancements to our topic is that they may enable the emergence and collapse of online-pyramid and Ponzi schemes. Even a new term is in circulation now for them: *post-modern* Ponzi schemes.[12]

Second, as **both involve pyramidal organizational structures** that survive until the inflow of new clients stops, the main distinguishing factor between pyramid versus Ponzi schemes is the activity the emphasis is put on. In case of the former, the recruitment aspects are the key: if the venture survives exclusively, or predominantly, from the recruitment efforts of members, they are illicit, entailing criminal liability and the nullity of the underlying contracts. This is the case both in the EU and the US. The ones restricted only to recruitment are suitably named **'naked' pyramid schemes.** Ponzi schemes are rather characterized by fraudulent investment services in which 'money contributed by later investors generates artificially high dividends or returns for the original investors, whose example attracts even larger investments.'[13] Indeed, in case of the Madoff scheme, new investors joined primarily thanks to reputation, word of mouth, rather than through recruitment offering monetary bonuses or other extra benefits for joining.[14]

Third, while in case of pyramid schemes there is often **some economic activity**, like the marketing of cosmetics, other goods or services, Ponzis are limited to *redistribution of the raised*

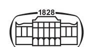
[10]See, e.g., Canova arguing that the extreme level of financial innovation has significantly contributed to the 2008 Credit Crunch. Canova (2015) 63.

[11]SEC, 'Release No. 81207 - Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO' (25 July 2017).

[12]Moore et al. (2013).

[13]Garner (1999).

[14]This can be properly detected also from the related movie 'The Wizard of Lies' (2017), directed by Barry Levinson, Robert de Niro starring Bernie Madoff and Joseph E. Iberti being the producer.



moneys. The formula based on which they operate, the notorious saying 'Rob Peter to Pay Paul',[15] thus suits the latter better. This is the feature that makes Ponzi schemes more exposed during crisis when sources of cash dry up often overnight and payments to earlier generations of investors become impossible. Indeed, the collapse of Madoff might be attributable to such effects of the 2008 Credit Crunch. Similarly, based on the same rational, the COVID19 pandemic could also result in the fall of some so far unnoticed schemes.[16]

Fourth, it is their common denominator as well that they **are doomed to collapse** once the pool of new members or investors dries up. Although their time-span normally is a year or so, some historic schemes have survived unscathed for years: while the Hungarian real property investment cooperatives appeared and collapsed in roughly a year,[17] the Madoff's scheme was in existence for more than a decade. MLM schemes, the activities of which are dominated by income-producing economic activities on top of revenues from recruitment, are exceptions in this respect, as already mentioned above.

Fifth, the schemes are **protean**, **genuine chameleons of finance**, and therefore the 'clothing', the façade in which they appear is extremely varied, which inevitably **makes their detection hard**. Save a few extremes, like the Russian MMM that openly admitted its true nature, most appear in outer forms that not only closely resemble but are identical with the ones regular businesses take on. The reason is simple: to attract new members or investors, to dupe them into joining or investing, they have to look real, otherwise only few people would normally join. No wonder that the true nature of quite a number of known schemes was recognized, neither by investment experts, nor by financial supervisory agencies.

Last, **MLM schemes**, the dominant forms of direct marketing as a novel business model, originating in the US and spreading exponentially to other parts of the globe starting roughly somewhere in the 1970s, generate idiosyncratic problems. Consequently, they represent an integral yet distinct chapter in the overall history of the schemes, by definition being primarily linked to pyramid and less to Ponzi schemes. Given that they also rest on pyramidal structures and yet are engaged also in some income-generating economic activities, typically sales or marketing of some services, the task of determining which versions of MLMs are fraudulent and thus should be weeded out from the system are more complex than is the case with 'naked' pyramid schemes. As it will be seen on the examples of the US, Hungary and even of Myanmar below, due to these reasons, MLMs are subjected to distinct regulatory tests and answers.

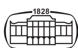
Such blurry boundaries subsisting between pyramid and Ponzi schemes, including pyramids masked as MLMs, is the reason why the observation of the three should not be separated from one another. The rationale of this viewpoint is most visible in US law, for which the efficient protections are of paramount importance, even at the price of deviation from venerable conventions of law: schemes may be of interest both to competition and securities laws, and sometimes there will be no sharp borderline between substantive and procedural laws, a fact that might be unusual to European lawyers trained in the Continental European civil law tradition.

In contrast, much of Europe remains the hostage of a sort of silo thinking not willing to see in the schemes anything but fraud doomed to remain dominantly in the bailiwick of criminal

[15]See, e.g., Lewis (2015) 6.

[16]Bartalos (2020).

[17]See the chronology of events as reported by Hungarian media in Appendix I in Tajti (2005) 196–210.



lawyers. The most important concession so far being recognition of pyramid schemes, naked or those camouflaged as MLM ventures, as phenomena to be tackled by competition law. The more recently unfolding, typically ad hoc-type reactions on online scams, of some national financial supervisory bodies in Europe, however, could only be perceived as signs of hope at the very beginning of a long and winding regulatory path looming on us.

1.2.3. Terminology challenges in comparative context. In this domain, relatively novel to lawyers, comprehension might be obfuscated by the idiosyncratic, or immature linguistic solutions of local languages. Often, for example, non-native speakers of English and yet writing in English, unwittingly employ connotations of key terms borrowed from local languages and then metaphrase them causing thereby unease to those familiar with the commonly used English vocabulary. For instance, some Central European local language designations include *the word 'game'* when speaking of the forms of financial fraud in the center herein. The simplest types of schemes – letter chains or gifting schemes – do deserve to be apostrophized like that, but the overwhelming part of the schemes are anything but *games;* they tend to look like regular financial or business ventures. Some may even set out as genuine businesses that 'turn rogue' only at a later point in time.

In Hungary, one of the few countries that nominated a sector-specific crime instead of relying on the general crime of fraud, the Criminal Code's designation includes the expression 'pyramid game' ('piramisjáték').[18] Interestingly, the second most often used alternative also contains the word 'game': 'pilótajáték' or – metaphrased – 'pilot game'. The vocabulary of investigative journalists and lay people includes also only these expressions. A similarly nominated crime is enshrined into the Austrian Criminal Code as well.[19] The Romanian 'joc piramidal' and the Slovak 'Ponziho hra' could also be added to the list.

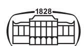
It is striking that the expression 'Ponzi scheme' essentially is still not used, even by the media in Hungary. Consequently, in Hungary, the expression *pyramid-game* extends also to Ponzi schemes.[20] No serious attempt seems to have been made to distinguish the two as yet. Contrary to Hungary, its neighbors seem to have begun to introduce the 'Ponzi scheme' phrase into their local languages, like the Croatian 'Ponzijeva i piramidalna shema,' the Romanian 'schema piramidala e schema Ponzi,' the Serbian 'piramidalna i Poncijeva prevara,' or the Slovak

[18]Section 412 of Act Number C of year 2012 on the Criminal Code ('2012. évi C. törvény a Büntető Törvénykönyvről'). The Hungarian text of the section reads as follows: 'Piramisjáték szervezése - 412. § Aki mások pénzének előre meghatározott formában történő, és kockázati tényezőt is tartalmazó módon való összegyűjtésén és szétosztásán alapuló olyan játékot szervez, amelyben a láncszerűen bekapcsolódó résztvevők a láncban előttük álló résztvevők számára közvetlenül, vagy a szervező útján pénzfizetést vagy más szolgáltatást teljesítenek, bűntett miatt három évig terjedő szabadságvesztéssel büntetendő.

'The English translation is the following: 'Organization of Pyramid Schemes - Section 412. Any person who arranges a scheme based on the collection and distribution of the money of others in a predetermined form and way, which also contains an element of risk, in which the participants joining in a chain-like manner pay cash to, or perform another service for, the participants preceding them in the chain, directly or through the organizer, is guilty of a felony punishable by imprisonment not exceeding three years.' The English translation of the Hungarian Criminal Code made public by the Hungarian government is available at Link 2.

[19]§ 168a of the Austrian Penal Code 1974 (as amended in 2019) ('Strafgesetzbuch') – '*Ketten oder Pyramidenspiele*.' The 'Pyramidenspiele' is the exact equivalent of pyramid-games.

[20]On terminology issues see also Tajti (2019) 21–24.



'Ponziho schèma.' A similar trend is observable in western European countries (e.g., see the French 'système de Ponzi,' the German 'Ponzi-scheme,' the Italian 'schema Ponzi' expressions, or the Spanish 'esquema Ponzi').

As opposed to Hungary, a differentiation is made between pyramid and Ponzi schemes in the US, the Philippines, Canada and other countries that more closely source their inspirations from the US. The same applies also to English-language international legal scholarship though thanks to the real-life dominance of Ponzi schemes, today most sources are devoted to and speak primarily of Ponzis.[21]

The situation is more complicated in the European Union (EU) because the EU has, at least so far, focused only on pyramid schemes as forms of unfair commercial practices and as part of consumer protection and competition laws. The Union's highest court's (EJEU) 4Finance UAB decision from 2014[22] forged even a test, very similar to the US Amway test, to distinguish legal versus illegal MLM schemes; to be discussed below.

Except the mentioned gradual integration of the 'Ponzi scheme' phrase into European local languages, a number of inherited idiosyncratic expressions have also been kept, blurring the picture somewhat. For instance, it is an issue whether the German '*Schneeballsystem*' (metaphrased: avalanche or snowball system) is what Americans mean under Ponzi scheme. As there is a dearth of related German language legal publications,[23] clarification inevitably awaits a future opportunity.

1.2.4. Preconceptions, stigmatization and the need for qualifications. The nature of schemes is sometimes obfuscated by certain common misconceptions, too. A short digression on these, therefore, is unavoidable, whereby *obiter* a light will be shed also on the great diversity of their appearance forms. *First* comes the belief that **the victims of schemes are 'greedy and gullible,'**[24] the resulting moral and regulatory verdict being that they do not deserve regulatory protections. Admittedly, this preconception has proved to be correct in case of many historic collapses. Yet the reasons why certain investors join are much more nuanced.[25] As best exemplified by MLM schemes, especially in frontier markets where thousands live under the subsistence levels with no access to the banking system, MLMs have often been perceived as such new ventures that offer job-like positions and the prospect of a stable income. Similarly, as Lewis put it (though related to only Ponzi schemes):

> [c]ontrary to common perceptions, the attraction in many cases was not so much greed, but safety and security, and peace of mind in having discovered an investment avenue that seemingly offered preservation of wealth and the prospect of a consistent flow of returns delivered by iconic figures.[26]

[21]Bazoian and Rhodes (2012).

[22]C-515/12 - ECLI:EU:C:2014:211 (‚4Finance UAB').

[23]For a rare publication from Germany on Ponzi schemes, see Kilian (2009). The author rightly noted that Ponzis are hardly something from the past and yet one could rarely find anything about them in German legal scholarship.

[24]See, e.g., Lewis (2015) 165.

[25]On this point see generally also Tajti (2021).

[26]Lewis (2015) 166.

Affinity schemes are another example of this point:[27] in their case a religious leader or an iconic figure of a closed group of people promotes, or speaks assuredly to the members of the group about a particular offering, eventually making them join and suffer the consequences.

It is another mistaken assumption that the victims of schemes are invariably 'rich' people, who obviously had money to risk, and thus should not expect spending taxpayers' money on their protection. Numerous examples of schemes being the exclusive 'club' of ultra-rich can be found (e.g., the Madoff scheme); just as cases proving the contrary as well.

As we will see below, notwithstanding these opinions, US law does not leave victims on their own – contrary to many other differently oriented systems. True, the US position may be primarily attributable to the need to protect the integrity of the markets, to maintain trust in them, as well as to defend the financial and economic system, which may be threatened particularly if behemoth schemes collapse. If the 2008 Colombian DRFE Ponzi had 'merely' the effects of diverting savings from productive to unproductive uses and transferring funds to foreign destinations,[28] then the collapse of the Albanian pyramid schemes in the mid-1990s amounted to a genuine systemic risk as a result of which the entire government fell, leading to about two-thousand lost lives.[29]

These days, one can easily find postings also on rampage and devastation left by African schemes. For example, the 2009 Kenyan Report of the Taskforce on Pyramid Schemes[30] listed 271 pyramid schemes camouflaged as cooperative societies with 148,784 consumer-investors. If adjudged based on the data in the related 308 page-long Report, about 90% of the interviewed victims would qualify as vulnerable.[31]

Second, it is often also thought that **recovering the money invested in the collapsed schemes is a hopeless effort** because by the time the bubble bursts no assets are left to be included in the bankruptcy estate and, consequently, victims cannot recoup anything. Whether this is so, depends on a number of factors, among which the efficiency of the applicable bankruptcy regime ranks first. If the bankruptcy system, especially its avoidance laws, works there may be a fair chance for creditor recoveries even in case of fallen pyramid and Ponzi schemes. The problem is that bankruptcy systems are often defunct, not only in emerging legal regimes having introduced modern with bankruptcy law recently, but also in some European countries with considerable legal tradition.

Partly this is due to the devastating effects of the intense bankruptcy stigma making business people and citizens (i.e., consumer-investors) distrust the bankruptcy system.[32] This may include directors and officers of bankruptcy enterprises rejecting or dodging handing over the required financial reports to the insolvency practitioner (administrator or trustee), or creditors failing to participate in bankruptcy proceedings. In Central and Eastern Europe, it is also a wide

[27]SEC (2013) at Link 3.

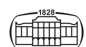
[28]Hofstetter and others (2018) 18.

[29]Jarvis (2000) 1.

[30](Kenyan) Ministry for Cooperative Development and Marketing (2009) 16.

[31]This outcome was based on defining vulnerable households with income below of 30,000 Kenyan Shillings (about 289 USD) per month (proxy recommended by Bankable Frontiers as technical advisor). See also the blog of Jentzsch (2012).

[32]For more on the topic of bankruptcy stigma, its effects and the various regulatory responses from a comparative perspective, with the accompanying bibliography, see Tajti (2018) 1–33.



practice of abandoning insolvent companies instead of filing for opening of formal bankruptcy (insolvency) proceedings.[33]

The 'empty pocket' presumption, however, is not necessarily correct in jurisdictions where the bankruptcy system, and avoidance laws, function efficiently. Again, the suitable example is the US 'Madoff Victim Fund' created in 2013,[34] '*the most successful Ponzi recovery in history*,'[35] which in July 2020 began its fifth round of payouts to victims from the moneys recovered. Avoidance laws play in such contexts a pivotal role because they allow for claw-back of moneys that had been paid out to earlier generations of investors – the net winners.[36] In emerging systems this is nothing more than wishful thinking.

The final point is related to **the technique of 'red flagging**,'[37] or educating and warning consumer-investors about the risks corollary to, and the hallmarks, of pyramid and Ponzi schemes, based on which they could be identified. Red flagging has become a standard technique by now appearing on the online surfaces of regulatory agencies and apparently they are of help. Yet they are far from being foolproof. Rather, they ought to be perceived only as one of the useful elements of the regulatory system; needed but insufficient.

2. THE MATRIX OF REGULATORY RESPONSES

2.1. Why are sector-specific regulatory responses needed?

Unsurprisingly, the perception, the stance on the severity of corollary risks, and consequently the regulatory approaches to pyramid and Ponzi schemes differ around the globe and depend on a variety of factors, from the 'rule of law' index to the existence and depth of the local capital markets, to the quality of enforcement tools that had developed to tackle these as well as other kinds of problems. Thus, the US was not compelled to pass sector-specific regulations because combating financial fraud of all sorts had been on the agenda of policy-makers at least since the Great Depression. Not new statutes, but rather the strengthening of the SEC, and upgrading of other investor-protection tools was needed. Inchoate financial systems, like Myanmar or Sri Lanka, as opposed to the US, were rather forced to enact sectorial laws against system-endangering scams emerging during the first two decades of the 21st century, as they had essentially nothing in place to efficiently combat them with.

What is common to all these systems on our regulatory spectrum is that none of our observed systems relies anymore exclusively on what such classical branches of law, such as contract, tort and criminal law, could offer for the task. Elimination of fraud from the financial markets is of such importance that this mission cannot be left solely to criminal law and the criminal justice system operating primarily *ex post*, after the harm done. Criminal law's

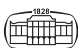
[33]See more on this in Tajti (2019) 21–22.

[34]The website of the Fund is at Link 4. Note that the Madoff bankruptcy case was a SIPA (Securities Investor Protection Act 1970 – codified under 15 U.S.C.A. §78aaa et seq) liquidation case, where the trustee was appointed based on this act. The US Bankruptcy Court for the Southern District of New York administered the consolidated liquidation case.

[35]Madoff Recovery Fund (2018).

[36]See, e.g., Winters (2012) 119.

[37]See, e.g., the US SEC pertaining pages, for pyramid schemes at Link 5.



deterrent effect is obviously to be reckoned with yet it hardly suffices as the continued emergence of ever newer schemes proves. Putting the swindlers behind bars is crucial yet not equal to the compensation of investors. If trust is to be maintained in the markets, more is needed – an axiom long realized by the Americans but not by many others. Similarly, '*the general commercial law (primarily contract law) does not provide an adequate basis for the operation of the investment markets*'[38] either.

Indeed, the ensuing comparison of the regulatory approaches will readily show how this idea has materialized in the US, and how far the other systems have reached in forging and introducing legal tools for combating the schemes and other types of financial fraud.

As in every system the remedies of classical branch of law are given and can potentially be exploited, the distinguishing factor among various regulatory systems is what is offered on top of that against the schemes? And then, what are the additional tools with which the efficient enforcement of such sector-specific laws is to be achieved? If we take the US as the benchmark, as the system that has developed the most varied repository of legal devices to fight fraud, then the extras may come in two main forms.

On one hand, through resort to laws that are dominated by mandatory provisions having *ex ante* (prophylactic) effects, statutory or sub-statutory level, as well as entrusting enforcement to appropriately empowered, financed and staffed agencies based on laws ensuring their independence as well. Today, such laws tend to be known as 'regulations' in a broader sense.[39] Sometimes new sector-specific ones are enacted to react to burning problems; as was the case with the Indian act prohibiting unregulated depositary schemes. At other times the existent ones are exploited, in particular, securities and antitrust (competition) laws. In the US, for example, 'giving teeth' to regulations ensued through constant expansion of the enforcement tools given into the hands not only of the SEC as the guardian of the integrity of the markets and the protector of investors, but also through strengthening the position of investors themselves. This sometimes ensued via legislative interventions or agency rulemaking, at other times by courts using their equity powers and by 'making' law. These avenues of expansion will be more closely examined in the context of reflections on US law below.

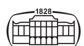
2.2. The matrix of regulatory responses and its limitations

Based on the ensuing comparison of the six legal systems focused upon herein, a seminal matrix with identifiable regulatory models lends to be designed, notwithstanding that there is neither a precise borderline between them, nor are they and their characterizations commonly subscribed to.

The US is most efficient in combating pyramid and Ponzi schemes today, which undoubtedly could be ascribed to it being a **multi-pronged system:** a system that has mobilized the largest number of branches of law for the pursuit of the proclaimed purposes and is

[38] MacNeil (2005) 20.

[39] As formulated by MacNeil: 'The term 'regulation' is nowadays understood more specifically to refer to rules and procedures created by statute and administered by dedicated agencies. [. . .] [M]odern form of regulation started in the United States in the early 1930s, largely as a response to the events that culminated in the Wall Street Crash of 1929.' MacNeil (2005) 20.



thus 'standing on more feet'. The Philippines, quite successfully employing the tools borrowed from the US in a considerably different socio-economic environment, could aptly be posited as the model of a close **benchmark-follower**. Hungary toes the EU line as well, at least as far as the EU's unfair commercial practices law and pyramid schemes disguised as MLMs is concerned, yet it could be best portrayed as a paradigm of a **restrained organic growth regime**, which finds no reason to take a single step ahead if not mandated by the EU.

Myanmar and Sri Lanka stand out as **inchoate regulatory systems limited to narrow, targeted responses** illustrating that fledgling financial systems are especially susceptible to fraud appearing as pyramid schemes disguised as MLMs. As both systems imposed bans on MLMs, they also display that such fledging systems are hardly capable of directly taking over sophisticated regulatory responses of developed benchmark systems. The legal institutions and infrastructure is immature, and for proper comprehension and application of tests known in the US, or the EU, time is needed to properly train judges and the staff of regulatory agencies. The time pressure and the regulatory vacuum, however, inevitably prompted passage of narrow sectoral laws with such easily implementable solutions that may not necessarily guarantee properly balanced solutions.

Although facing similar challenges as Myanmar and Sri Lanka, India is distinct because it had earlier undergone many rounds of tug-of-wars with various financial pathologies appearing on its markets, including naked and pyramid schemes camouflaged as MLMs, as well as Ponzi schemes. India is instructive as an example of how the fraud-spiral unfolds in evolving regulatory systems from MLMs as relatively simple and easily detectable vices mutating into more complex ones by exploiting the regulatory gaps and inexperience. As the most recent Indian formula to tackle all these is through a comprehensive act centered around a single all-encompassing category of 'unregulated deposits,' it may conveniently be referred to as the example of a **blanket anti-financial fraud system** that reaches broader than those of Myanmar or Sri Lanka. In all three systems, the extremely large number of unbanked people that have become victims of these, and the systemic risk posed, make them worthy of attention, too.

We shall now look at these focusing on the main features of each of these regulatory approaches. As the comparison of the US and the Hungarian laws is in the center, the connected elaboration will inevitably be more detailed than the other jurisdictions; impacted also by the shortage of quantitative and empirical data, scholarly analyses, and other types of sources in general.

2.3. The United States: the multi-pronged system

2.3.1. The key regulatory elements. The paradigm country that most vigorously combats the schemes today, is the US. SEC's mission,[40] indeed, extends to protection of investors even against investment offerings that surface in unorthodox forms, which is an approach followed by

[40] As put by the SEC itself, its mission is to 'protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation.' Link 6.

the Canadian provinces[41] and the Philippines, but not by Europeans by and large.[42] Moreover, the long evolutionary path, starting with the New Deal legislation of the 1930s, declaring the 'protect[ion of] investors against fraud'[43] as the central goal has peaked in adding *compensation of investors* falling victims of fraud by now. A brief account of the tools with which these policy choices materialize ensues. Note that US has no sector-specific law focusing exclusively on pyramid and Ponzi schemes: hence what ensues applies to all forms of fraud threatening the capital markets.

2.3.1.1. Sector-specific criminal law? Criminal law remains an irreplaceable solid fundament that has additionally been adapted to more efficiently serve the ultimate policy of deterring and prosecuting fraud in the financial markets in the US; including pyramid and Ponzi schemes. This prong is unique in many respects in the US.

To begin with, unlike Austria or Hungary that introduced a distinct, nominated crime in the hope of making prosecution of the schemes easier, that pattern was not embraced in the US. Here, rather, a multitude of crimes, some general and a few sector-specific, are relied on in practice. Bernard L. Madoff, for example, was charged with nine different felonies.[44] The felony of 'securities fraud,' enshrined in both the 1933 Securities Act and the 1934 Securities Exchange Act using similar language, is the one that could be taken as a sectoral crime; or a crime defined by statutory law outside the criminal statutes. Yet the crime of 'securities fraud' is not limited only to the schemes but is of general application in the securities domain.

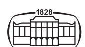
Let us immediately add that notwithstanding the sweeping coverage of the Acts and the substatutory rules to be discussed next, empirical evidence suggests that 'securities fraud' is ***not*** the most frequently resorted to crime by prosecutors in this domain in the US. As expressed by Judge Rakoff in his oft-cited passage: 'To federal prosecutors of white collar crime, the mail fraud statute is our Stradivarius, our Colt 45, our Louisville Slugger, our Cuisinart – and our true love. We may flirt with RICO, show off with 10b-5, and call the conspiracy law darling, but we always come home to the virtues of [general crimes], with [their] simplicity, adaptability, and

[41]In the 1978 judgment of the Ontario Superior Court *Pacific Coast Coin Exchange of Canada Ltd. v. Ontario Securities Commission* (1978), 2 S.C.R. 112, for example, the court declared that the silver coins offered for sale to investors for a fee of 2% was a security and thus subject to registration and disclosure. This outcome was reached by the court, indeed, through the utilization of the US Howey test.

[42]The 2019 ESMA (European Securities and Markets Authority) document titled 'ADVICE – Initial Coin Offerings and Crypto-Assets' (9 January 2019 | ESMA50-157-1391) may denote a change for Europe in this respect. Namely, as per a related 2018 survey conducted in the EU Member States, more types of crypto-assets qualify as MiFID II financial instruments. See section VI on the legal qualification of crypto-assets, Ibid at 18–21. Whether this functional thinking, or approach that looks at the economy rather than on the form, will lead to a shift with respect to pyramid and Ponzi schemes as well remains to be seen.

[43]*Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 203 (1976), 1382.

[44]These included two sector-specific and two general types of fraud: securities and investment adviser fraud, on one hand, and mail as well as wire fraud on the other. Then three versions of money laundering: international money laundering to promote specified unlawful activity, international money laundering to conceal and disguise the proceeds of specified unlawful activity and the general felony of money laundering. The list closes with false statements and perjury. Sarna (2010) 147. Madoff was convicted of operating a $65 billion Ponzi scheme in 2009 and sentenced to 150 years in prison. Quisenberry (2017) 1.



comfortable familiarity.'[45] Put pithily, prosecutors rely on general rather than sector-specific crimes in combating fraud on securities markets, often cumulating them.

The *modus operandi* of the felony of 'securities fraud' otherwise is complex, a fact that has been rightfully criticized.[46] Yet, this complexity obviously was the token of the sweeping coverage readily showing the resoluteness of the policy makers to eliminate fraud from the markets.

Figuratively speaking, although the crime of 'securities fraud' reaches out basically to all provisions of the two acts like the arms of an octopus, the felony actually rests on two main feet. The *first* is encapsulated in Section 24 in the 1933 and Section 32(a) in the 1934 Act,[47] which with similar language[48] proclaim that '**[a]ny person** who willfully[49] violates any provision of this chapter . . . , or **any rule or regulation** thereunder [. . .]' shall upon conviction be fined or imprisoned. [Emphasis added.] It ought to be stressed here also that these sections, titled simply as **'*Penalties*,'** reach not only the provisions of the acts themselves, but also the provisions of *sub-statutory level sources of law* that were promulgated by SEC based on them as we will demonstrate that below on the example of the SEC Rule 10b-5.

The *second* prong that further radically extended the reach of the criminal provisions is contained in another pair of similarly sounding provisions in the two acts: Section 17(a)(2) of the 1933 and Section 10b of the 1934 Act. The latter is, for example, named as '**Manipulative and Deceptive Devices**.'[50] These define the body of crime, the *corpus delicti,* or what behavior qualifies as securities fraud. The texts of these are also filled with the pronoun **'any,'** obviously intended to further extend the horizon of the Acts' applicability and to facilitate the job of federal prosecutors.

Yet to transform this section into an omnipotent weapon – not only in the hands of prosecutors but also of the SEC performing the important function of detecting, investigating and reporting securities crimes to prosecutorial offices, more was needed. The solution, the next step of expansion, appeared in 1942 embodied in Rule 10b-5 promulgated by SEC based on Section 10b of the 1934 Act, and named as **'Rule 10b-5: Employment of Manipulative and Deceptive Practices**.' The Rule was also specifically formulated to further expand the reach of the system, to catch '**any** manipulative or deceptive device or contrivance' in connection with the purchase or sale of any security in violation of the securities laws.[51] The zealousness of the drafters made it also a quite general, if not vague, as a result of what giving content to it was left

[45]Rakoff (1980) 771.

[46]Couture (2019) 694.

[47]See §24 of the 1933 Securities Act regulating the primary market (i.e., issuance of securities) and §32(a) of the 1934 Securities Exchange Act regulating the secondary market (i.e., trading of securities that are already on the market, and all the related issues).

[48]The difference that caused most of the problem is the phrase 'willfully and knowingly' in Section 32(a) of the 1934 Act. See, e.g., *United States v. Dixon* 536 F.2d 1388 (2nd Cir., 1976).

[49]Koets (1997) 457.

[50]Codified as 15 U.S. Code § 78j.

[51]15 U.S.C. § 78j(b) (2013). Court have over time expanded the reach of the securities acts, first by their applicability to 'securities not registered on national exchanges so long as the means of interstate commerce are implicated' and later even if not traded on organized US securities market (for this see Leasco Data Processing Equip. Corp. v. Maxwell, 468 F.2d 1326, 1336 (2d Cir. 1972). Beyea (2010/11) 143.

to courts.[52] No wonder that Chief Justice Rehnquist portrayed Rule 10b-5 as a '*judicial oak which has grown from little more than a legislative acorn*.'[53]

The short and simple provision of Rule 10b-5, recognizing three types of fraud defined by quite wide-reaching language, has been quoted many times. The designation 'Rule 10b-5' itself has become identified with the phenomenon itself: with what fraud on the securities market denotes. The cavalcade of 'any'-s, similarly to the statutory definition of the mentioned sectoral crime of 'securities fraud,' should properly convey the message on its nature, and as such deserves to be quoted. It reads:

> It shall be unlawful for **any** person, directly or indirectly, by the use of **any** means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, to employ **any** device, scheme, or artifice to defraud, to make **any** untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or to engage in any act, practice, or course of business which operates or would operate as fraud or deceit upon **any** person, in connection with the purchase or sale of any security.

Such drafting technique aids the work of SEC as well in its investigative work, which is the top expert body that often learns about fraud on the market first. SEC as a regulatory (administrative) governmental body, to stress again, however, has 'neither authority nor practical control over the decision of a U.S. Attorney [i.e., prosecutor] to initiate a criminal prosecution.'[54] SEC may only 'transmit such evidence . . . to the Attorney General, who may, in his discretion, institute the necessary criminal proceedings [. . .].'[55] Still, Section 10b of the 1934 Act, the most voluminous from all the New Deal securities statutes, covering a significantly larger number of varying threats to the market than the others, became one of the brand symbols of the federal regulatory system as its 'workhorse.' Not without a reason: as the US Supreme Court put it, as a 'catchall' clause, it was intended, 'to enable the [SEC] to deal with new manipulative [or cunning] devices; '[56] besides the more conventional one.

Many of the statutes passed during the last few decades have further augmented several criminal penalties, naturally each targeting that specific form of criminal behavior the act intended to react upon.[57] This amounted to a virtually incontrollable addition of ever newer crimes to the system often without well-justified basis, some of relevance to the securities domain, made US criminal law chaotic. This and other deficiencies notwithstanding,[58] US remains comparably one of the most successful systems as far as prosecution of securities and other crimes exploitable to combat fraud on the capital markets is concerned.

[52]Beyea (2010/11) 143.

[53]*Blue Chip Stamps v. Manor Drug Stores* 95 S.Ct. 1917 (1975) 1926.

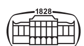
[54]Jennings and others (1998) 1582.

[55]Section 21(d) of the 1934 Act.

[56]*Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 203 (1976) 1385.

[57]The 2002 Sarbanes and Oxley Act (Public Company Accounting Reform and Investor Protection Act, § 1348.), for example, introduced a purportedly new crime named exactly as its kin in the 1933 and 1934 securities acts. For a critique of the practice see Falvey and Wolfman (2002) 1.

[58]See, e.g., O'Sullivan (2006) 632 criticizing the US criminal system for over-criminalization paralleled by repetitions, federal grabbing of areas traditional being in State competence, as well as vagueness.



The last point that ought to be stressed is that what may cause misunderstanding is that Section 10b in tandem with Rule 105-b are also bases for civil causes of action and entitle SEC to conduct administrative proceedings, from investigations, hearings to issuance of measures *sua sponte* when so empowered.[59]Strict separation of securities criminal law, in other words, is not possible, as the US system is of hybrid nature, as it will be further demonstrated below.

2.3.1.2. The open-end, 'economic' definition of 'security' and unorthodox investment vehicles. The open-end definition of security, enshrined in both the 1933 Securities- and the 1934 Securities Exchange Acts with almost identical language, was specifically designed to catch unorthodox investment schemes. As Justice Jackson put it when rejecting the arguments for the strict construction of the definition in the watershed case of *SEC v. C.M. Joiner Leasing Corp.* in 1943:

> In the Securities Act the term 'security' was defined to include by name or description many documents in which there is common trading for speculation or investment. Some, such as notes, bonds, and stocks, are pretty much standardized and the name alone carries well-settled meaning. Others are of more variable character and were necessarily designated by more descriptive terms, such as 'transferable share,' 'investment contract,' and 'in general any interest or instrument commonly known as a security. [. . .]. **However, the reach of the Act does not stop with the obvious and commonplace. Novel, uncommon, or irregular devices, whatever they appear to be, are also reached** [. . .].[60] [Emphasis added.]

Notwithstanding that pyramid and Ponzi schemes do not necessarily appear in unorthodox forms, such structured definition has made it possible to SEC to unmask and investigate quite a number of schemes ever since. This approach – foreign to Europeans – is the expression of one of the pivotal policy choices of the US system, as per which investors and the markets are to be protected even against unusual investment offerings, no matter the designations.

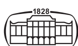
The point is that the 'definition of security' is not merely stating the meaning of the term 'security' (what the function of definitions normally is limited to) but it has an additional practical role: once it is found that an 'investment offer' qualifies as a 'security, all the tools of the securities regulatory system may be mobilized. From this point on, the SEC can not only investigate and impose administrative measures, but it can also obtain court injunctive orders ordering discontinuation of activities and freezing the assets. Besides the juridical entities, the directors and other officers of wrongdoers can also be reached.[61] For many of these ancillary remedies obviously readily available e*x parte* measures are needed to react promptly and without informing the schemers. The importance of these unfortunately is not recognized by some systems; Hungarian civil procedure, for example, is still devoid of them.[62]

[59]The SEC's related powers were expanded especially by the Securities Enforcement Remedies and Penny Stock Reform Act of 1990, which amended the Securities Exchange Act 1934 that had created SEC; as well as the 1933 Securities Act. Under both, SEC may turn to courts and ask the court to prohibit a person to serve as officer or director (disbarment) (Sections 101 for the 1933 Act and Section 201 for the 1934 Act). Yet SEC may itself enter cease and desist orders under both Acts for violation of securities laws (Sections 102 and 203). As far as imposition of money penalties are concerned, SEC may both turn to courts but it may impose them itself though in specific cases.

[60]*SEC v. C.M. Joiner Leasing Corp* 320 U.S. 344 (1943).

[61]Birdwell (2011) 562.

[62]For an overview of the related French, English, Hungarian and US laws see Tajti and Iglikowski (2018).



Courts developed two main tests over time for determining whether an investment qualifies as a 'security' for the purposes of federal securities regulations, first the **Howey test**[63] for equity, and later the **note (or Reves) test** for fixed-income-type unorthodox investment schemes.[64] Although Howey plays the key role in combating fraud, due to its alleged rigidity, even a third, the **'Hawaii Market Center test'**[65] came into existence recently but has seldom been used so far.

Unlike many other contemporary systems, it could be thus claimed that pyramid and Ponzi schemes, as unorthodox investment schemes inherently dominated by consumer-investors, have been within the purview of the US federal securities regulatory system born out of the Great Depression in the 1930s. MLMs have also come within the purview of SEC, though only in the 1970s, thanks to this idiosyncratic approach; just as some franchise systems or such oddities as chinchilla breeding programs.[66]

2.3.1.3. Expanded powers of SEC. SEC has failed to unmask the Madoff Ponzi scheme and has failed on other fronts as well. Hence, it is sometimes legitimately criticized.[67] Yet, if adjudged from abroad, it has unquestionably played a momentous role in enforcing securities regulations, including scoring impressive victories against the schemes as well. This was due to the gradual but steady statutory expansion[68] of the powers given to the agency, from administrative[69] and civil procedural tools to rule-making, a process starting with its creation in 1934. Yet, the period of genuine exponential growth is to be dated from the Securities Law Enforcement Remedies

[63]*SEC v. W.J. Howey Co.* 328 U.S. 66 S.Ct. 1100, 90 L.Ed. 1244. As per the Howey Test an investment contract qualifies as a 'security' if 'first, ... there is an investment of money; second, that the scheme in which an investment is made functions as a common enterprise; and third, that under the scheme, profits are derived solely from the efforts of individuals other than the investors.' Quoted from *SEC v. Koscot Interplanetary, Inc.* 497 F.2d 473.

[64]*Reves v. Ernst & Young* 494 U.S. 56, 110 S.Ct. 945, 108 L.Ed.2d 47.

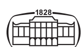
[65]For analysis of the test see Matthew (2020) 2073.

[66]As persuasively expressed by Hazen: 'What do the following have in common: scotch whisky, self-improvement courses, cosmetics, earthworms, beavers, muskrats, rabbits, chinchillas, fishing boats, vacuum cleaners, cemetery lots, cattle embryos, master recording contracts, animal feeding programs, pooled litigation funds, and fruit trees? [...] The answer is that they have all been held to be securities within the meaning of federal or state securities statutes. The vast range of such unconventional investments that have fallen within the ambit of the securities laws' coverage is due to the broad statutory definition of 'security' [...].' Hazen (1995) 28–29.

[67]Mattei and Nader criticized the SEC as follows: 'Today in the USA, the [SEC], as for all administrative agencies in times of neo-liberalism, is still underfunded and understaffed, so it is unrealistic to think that it can handle the tremendous workload of a monitoring and control agency in a complex market.' Mattei and Nader (2008) 175. Indeed, Mattei and Nader are correct in stressing the limits of what SEC, or any administrative agency, can do. Picturing them as omnipotent for this reason, Europe or the US, is therefore mistaken. Obviously, agencies must prioritize according to some criteria, and undoubtedly these may be politically tainted. Yet, if one compares the size and the depth of US capital markets with the parameters of Hungarian (or for that matter, Italian, Austrian or German) markets and the statistics of respective SEC's, the US SEC excels in all respects notwithstanding its weaknesses. See the list of detected Ponzi schemes in the US at Link 1.

[68]Barnard (2010) 403.

[69]Administrative remedies can be resorted to directly by the SEC as an independent administrative agency. The right to investigate, hold hearings and administrative sanctions has been strengthened by adding to the arsenal, for example, money fines and ceases and desist orders.



and Penny Stock Reform Act 1990 (Remedies Act 1990)[70] and the 2002 Sarbanes-Oxley Act (SOX).[71] Though regulatory backpedaling forced by courts, or SEC being sued for improperly performing its statutory mandate,[72] are not unheard of either.

Parallel with the increased powers, SEC's mission has also been expanded to include compensation of the victims of fraud on the capital markets. 'Disgorgement of ill-gotten profits' and 'civil penalties-cum-fair funds' are the main legal categories whereby this has been achieved, and in which the gist of this transformation is encapsulated. Although SEC's explicit disgorgement powers were introduced with the Remedies Act 1990 only, courts did recognize SEC's right to ask disgorgement of ill-gotten profits even before the passage of the Act.[73] Yet, it is the 'FAIR Funds for Investors' Section 308 of the 2002 Sarbanes and Oxley Act[74] that has transformed genuinely the SEC into a real champion of defrauded investors by entitling it to impose penalties and distribute them to defrauded investors through the so-called 'fair funds.'[75] As a commentator put it: 'With this new authority, the SEC's role extends beyond the traditional role of 'enforcing securities law, sanctioning securities laws violators, and deterring future fraud' **to embrace a compensatory role for defrauded investors**.'[76]

As a result of the trend, today, 'the SEC has [even] three main methods of compensating injured investors: distributions by receivers put in place by the SEC, distribution of disgorged profits, and distribution of money collected as civil penalties.'[77] The latest development is enshrined in the *Liu v. SEC* judgment from 2020 in which the US Supreme Court strengthened the investor-compensatory function of disgorgement by declaring it an equitable remedy.[78]

[70]The 1990 Enforcement Reform Act [Pub. L. 101-429 (15 Oct, 1990)] 'dramatically expanded the Commission's enforcement arsenal by adding three significant new tools: civil fines, cease and desist orders; and corporate bar orders. [. . .]. Traditionally the SEC relied heavily on two principal enforcement tools: civil injunctions and administrative proceedings.' Note that for corporate bar orders the SEC has to turn to courts. Quoted from Seligman (1998) 1540. See also Morris (1993) 151–52.

[71]The Public Company Accounting Reform and Investor Protection Act of 2002 (full title) [107 Pub. L. No. 204, 116, Stat. 745] required SEC to 'prescribe minimum standards of professional conduct for attorneys who practice before SEC' and 'adopt rules within one year [. . .] that address the conflict of interests affecting securities analysts.' Coffee and Seligman (2003) 14–15.

[72]For a more recent case in which SEC was unsuccessfully sued specifically for failing to take the necessary steps facing a Ponzi scheme see *Zelaya v. U.S.* 781 F.3d 1315 (11th Cir. 2015).

[73]In the 1971 case *SEC v. Texas Gulp Sulphur Co. [446 F.2d 1301, 2d Cir. 1971]* 'a federal appellate court recognized that the SEC had equitable power to "require [. . .] corporate insiders who traded on material nonpublic information to disgorge their illegal trading profits."' Velikonja (2015) 340.

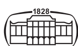
[74]15 U.S.C. § 7246(a). SEC was empowered to regulate and establish a Fair Fund into which it could add civil penalties in addition to disgorged amounts to compensate victims of fraud. Black (2008) 317. See also SEC Rules on Fair Fund and Disgorgement Plans 17 CFR 201.1100 through 201.1107.

[75]Black (2008) 326.

[76]Baird (2014) 388.

[77]Winship (2009) 145.

[78]*Liu* et al. *v. SEC 591 U.S. (2020)*. The Supreme Court held: 'A disgorgement award that does not exceed a wrongdoer's net profits and is awarded for victims is equitable relief permissible under §78u(d) (5)' of the 1934 Securities Exchange Act. The section reads: '(5) Equitable Relief. —In any action or proceeding brought or instituted by the Commission under any provision of the securities laws, the Commission may seek, and any Federal court may grant, any equitable relief that may be appropriate or necessary for the benefit of investors.' As it added: 'the SEC's equitable, profits-based remedy must do more than simply benefit the public at large by virtue of depriving a wrongdoer of ill-gotten gains.' Ibid at 16.



As concrete numbers may be more telling than narration, here are some figures showing the dimensions of SEC's success. In the leading 1996 case *of SEC v. First Jersey Securities, Inc.,*[79] for example, $22,288,099 profits plus $52,689,894 prejudgment interest had to be disgorged (repaid) by the wrongdoers and then were distributed to the investors. As First Jersey was not a case about Ponzi schemes, it ought to be noted that SEC can exert civil penalties and disgorgement also if the schemes are involved – as best illustrated by the Madoff saga. Or, to provide data from the post-SOX era, in the 2006 *SEC v. JT Wallenbrock & Assocs.*[80] case involving sale of unregistered promissory notes, more than $400m ill-gotten profits and $24.3m prejudgment interest were repaid. This was possible thanks to the due-time reaction of SEC quickly obtaining asset freeze, a temporary restraining order prohibiting future violations (later substituted by a preliminary injunction) and appointment of a receiver to gather and guard the assets of the Ponzi scheme involving more affiliated entities.

What may be also interesting is that resort to disgorgement and civil penalties by SEC is not limited to non-bankruptcy context. This is conceivable because of the basic principle of US bankruptcy law according to which '*[t]he Bankruptcy Code embraces the notion that debts incurred through the debtor's malfeasance should not be extinguished in bankruptcy.*'[81] For our purposes, put simply, the money collected by the organizers of pyramid or Ponzi schemes is not dischargeable in bankruptcy, it cannot be written off. Hence, if the SEC or the bankruptcy trustee (administrator) can track down and recoup the scheme's assets, there may be a chance for investor compensation through the application of more sections of the Bankruptcy Code.[82] Moreover, as certain government actions are excluded from the automatic stay (moratorium) that ensues upon filing a petition to open bankruptcy proceedings,[83] the SEC can proceed with enforcement of securities laws but cannot enforce money judgments.[84] In the infamous Madoff case, the SEC also obtained, besides a permanent injunction prohibiting future violation of the anti-fraud provisions of the securities acts and asset freeze – a disgorgement of substantial amounts with interest and imposed civil penalties.[85]

Ultimately, one can say that the entire post-Fair Fund era, indeed, has been characterized by vigorous SEC employment of section 308 to collect funds to compensate defrauded investors. The overarching effect of this paradigm change cannot be overestimated because, as a commentator put it: 'SEC's fair fund distribution is often the only source of compensation for defrauded investors.'[86] The negatively affected industries, moreover, have tried to exploit SEC's success in campaigning against the legitimacy of securities fraud class actions, the most frightening form of private securities litigation, claimed not to be necessary anymore.[87]

[79]*SEC v. First Jersey Securities, Inc.* 101 F.3d 1450 (2d Cir. 1996).

[80]440 F3d 1109 (9th Cir. 2006).

[81]Baird (2014) 388.

[82]See in particular Section 523(a)(19) and 727(a)(4).

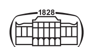
[83]§362(a) et seq. of the US Bankruptcy Code.

[84]Section 362(b)(4) of the US Bankruptcy Code. Black's Law Dictionary defines automatic stay as: 'A bar to all judicial and extrajudicial collection efforts against the debtor or the debtor's property, subject to specific statutory exceptions.'

[85]SEC Litigation Release No. 20834 (19. Dec. 2008).

[86]Velikonja (2015) 391.

[87]Black (2008) 337.



As skeptics may think that the maximum has been achieved with SOX's fair funds and the SEC's position cannot be further strengthened, a mention ought to be made of the subsequent, post-Credit Crunch milestone: the 2010 Dodd-Frank Act.[88] This voluminous piece of legislation 'expanded the SEC's authority to impose civil fines in administrative proceedings against all persons, not just regulated industries.'[89] Linked to that, it also extended the discretionary powers of SEC to decide whether to take a civil case before federal courts or rather before its own administrative judges.[90] Although subtle, these changes further strengthened the strategic position of SEC.

From the perspective of many European and developing regulatory systems, it is a crucial point to note also that these changes enabled going after the assets not only of the juridical entity that defrauded the investors but also after its officers and control-holders; as it happened in the First Jersey case. All this works efficiently because SEC is staffed with experts, is in a better position to gather evidence of fraud on the market, and some of the pleading (proving) standards are less onerous when applied to it as opposed to private claimants – like with obtaining preliminary injunctions.[91] Most of these enhanced investor-protective tools do not exist in Hungary today and in the neighboring region; the repercussions of their lack would undoubtedly deserve closer scrutiny.

Courts, on top of all that, have often heeded the position of the SEC when deciding cases.[92] What makes US law peculiar in this respect, though not limited only to the securities domain, is that the federal Supreme Court, in the 1984 milestone decision *Chevron U.S.A., Inc. v. Natural Resources Defense*,[93] has introduced a two-part test[94] based on which courts are expected to uphold the interpretation of various federal agencies if certain preconditions are fulfilled. This became known after the case as 'Chevron Deference.' Yet even prior to that deference had been given to agency construction of federal statutes the implementation of which the SEC (or other federal agency) was charged with; just on a less formal basis. Named after the 1944 *Skidmore v. SWIFT & Co.*[95] case as 'Skidmore Deference,' courts assessed SEC's interpretation before 1984 against multiple factors [to] determine what weight they should be given,[96] and had often followed it notwithstanding that they had no formal duty.

[88]Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 929p, 124 Stat. 1376, 1862-65 (2010) (codified in scattered sections of 15 U.S.C.).

[89]Velikonja (2015) 339.

[90]See on this topic Zaring (2016).

[91]See, e.g., *SEC v. Unifund SAL*, 910 F.2d 1028 (Court of Appeals, 2nd Cir., 1990). The gist of the SEC-favoring rule, as put by the court was described as follows: 'In our earliest encounters with injunction requests by the Commission, **we relieved the Commission of the obligation**, imposed on private litigants, **to show risk of irreparable injury**.' [Emphasis added.].

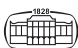
[92]See, e.g., *Board of Trade of the City of Chicago v. SEC* 923 F.2d 1270 (US Court of Appeals, 7th Cir., 1991) the court heeding to SEC's opinion on whether a then novel trading platform is an 'exchange' as defined by the 1934 Securities Exchange Act.

[93]104 S. Ct. 2778 (1984). The case concerned the construction of the term 'stationary source' under the Clean Air Act by the Environmental Protection Agency; the SEC was not involved.

[94]According to the test a court is to 'uphold a federal agency's construction of a federal statute if 1/the statute is ambiguous or does not address the question at issue, and 2/the agency's interpretation of the statute is reasonable.'

[95]*Skidmore v. SWIFT & Co.*, 65 S.Ct. 161 (1944).

[96]*Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 843-44 (1984), judgment, 2793.



It should then not come as a surprise that the SEC, 'having scored a series of impressive litigation victories in the Supreme Court [and having] elevated its ingrained fascination with novel and atypical securities interests virtually to an art form,'[97] has given teeth to the expansive policies exactly based on the mentioned Section 10b of the 1934 Securities Exchange Act, the accompanying Rule 10b-5 and the economic open-end definition of 'security'. The mandate to deal with atypical 'securities' was the driving force for the SEC to investigate, take actions, or file *amicus curiae* briefs in courts hearing private claims involving, among others, pyramid and Ponzi schemes.[98]

2.3.1.4. The stiff sector-specific tort law, express and implied causes of action and the remedial purposes of the securities acts. Similarly to a mosaic picture being made of many indispensable components, the anti-fraud, or tort prong, of federal securities regulations, and the reasons behind its efficiency, rest on more closely interlinked elements. The *first,* albeit less-important, element consists of the few sections providing for *express causes of action* in both the 1933 Securities-[99] and the 1934 Securities Exchange Act.[100] Initially, only these were reckoned with for civil liabilities.[101] Yet, as the empirical evidence suggests, exactly their concreteness and rigidity must have made them of limited practical use. As noted by commentators on one of these, of equal relevance to the rest: 'the Section did not produce a substantial recovery for 30 years. In the past few years [i.e., the 1990s] however, §11 has been used more frequently.'[102]

Yet, only a few years had to pass for courts to realize that express causes of action produce dissatisfactory results. The solution, *the second element,* was found by courts in the concept of *implied cause of action*. The court that proclaimed its birth was the one deciding the 1946 milestone case *Kardon v. National Gypsum Co.*[103] in which the issue was whether there was a right of action under Rule 10b-5 which did not foresee such rights expressly? As the court answered: 'A remedy by civil action lies in favor of stockholders against officers and directors [. . .] **although such remedy is not expressly provided for in the [1934 Securities Exchange] Act.'**[104] [Emphasis added]. Eventually, as the Supreme Court noted in the 2008 Stoneridge Investment Partners, LLC v. Scientific Atlanta, Inc.[105] decision: 'Congress . . . ratified the implied right of action [in the 1995 Private Securities Litigation Reform Act],' though starting with the 1975 *Cort v. Ash*[106] case, it also began limiting its reach.

[97]Pitt and Shapiro (1990) 192.

[98]Pitt and Shapiro (1990) 193. See also the case *SEC v. Yiu Nan Michael Wang,* et al. 2016 WL 115 335 62.

[99]Sections 11 and 12. Section 11 of the Securities Act 1933, for example, lists not only the persons (issuer, underwriter and outside experts like accountants) but also the wrongful acts for which they can be held liable in tort.

[100]Sections 9 (manipulation of the price of a listed security) and 18 (false or misleading statement contained in document filed with SEC).

[101]Black's Law Dictionary defines civil liability as 'Liability imposed under the civil, as opposed to the criminal law.'

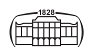
[102]Coffee and Seligman (2003) 849.

[103]73 F.Supp. 798 (E.D. Pa. 1947).

[104]73 F.Supp, point 3, 798.

[105]552 U.S. 148, 169 L.Ed.2d 627.

[106]422 U.S. 66 (1975).



The outcome of the combination of the wide-reaching Rule 10b-5 with implied right of private investors to sue for tort was a rule, similar to the above-canvassed criminal prong, according to which 'disregard of any command of the statute is a wrongful act and a tort.' The synergic effect of their symbiosis forged 'the most frequently used antifraud remedy in the federal securities laws; '[107] applicable against the schemes as well.

The *third piece of the mosaic* that made all these revolutionary investor-protection advancements possible is to be attributed to the **remedial nature of the securities acts**. This operates as a policy, a principle, or a beacon for making or applying securities laws, that has manifested itself in this domain in various forms. It is a very practical materialization of the Latin maxim of '*ubi jus, ibi remedium,'* or '*where there is a right, there must be a remedy*.' In the securities domain, this means that the system must ensure that efficient remedies are made available to protect investors. Appellate- and the US Supreme Court alike have relied on it, among others, to shift the burden of proof for the benefit of employee-investors,[108] to interpret the meaning of the Howey test in the context of MLM schemes so as to ensure adequate protection to consumer-investors,[109] and indeed, it was the justification for the proclamation that there is an implied cause of action under Rule 10b-5.

The already hinted-at private securities litigation comes in addition to these in the form of class,- derivative, and even direct actions,[110] as supplemented by the comparably exact pleading standards idiosyncratic to the US. They are the procedural means whereby defrauded investors can take justice into their hands, or have fairer chances of prevailing litigating in courts of law. As such, they have become extremely useful supplements to SEC enforcement, and in prosecuting securities crimes, too. If class actions allow the concentration of claims of hundreds if not thousands of small investors,[111] and derivative actions for shareholders going after third parties in lieu of 'their' company directors who are unwilling to do that, then properly structured laws on direct actions empower individual investors to litigate and sue for damages if the SEC is unwilling to step in.

This is yet another complex set of topics, made of parts each reaching well-beyond the confines of this work; yet they ought to be listed as each of them, with their strengths and weaknesses, figures as an important supplementary building block of the system guided by the overarching goal of investor protection. Some of these procedural tools, either do not exist elsewhere, or are of a substantially different nature,[112] not providing investors with litigation tools fitting the exigencies of the securities domain.

[107]Coffee and Seligman (2003), note 68 supra, at 971–972.

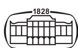
[108]*SEC v. Ralston Purina Co.,* 346 U.S. 119 S.Ct. 981, 97 L.Ed. 1494.

[109]*SEC v. Koscot Interplanetary, Inc.* 497 F.2d 473 (US Court of Appeals, 5th Cir. 1974).

[110]Black's Law Dictionary defines direct actions as '[a] lawsuit to enforce a shareholder's rights against corporation.'

[111]See, e.g., Thompson and Sale (2019) (Claiming that securities fraud class actions operate also as means of regulating corporate governance, disciplining managers in the US.).

[112]As Nagy noted concerning Europe's collective actions, the European versions of class actions: 'While [. . .] surrounded by distrust and suspiciousness, today more than half of the EU Member States have introduced collective actions for damages and, from those who did, more than half chose, to some extent, the opt-out system. [. . .].' Nagy (2019) v.



2.3.1.5. Pyramid and Ponzi schemes as agency priorities. The uncovering[113] of, and the gigantic dimensions[114] of the Madoff Ponzi scheme, gave a further impetus to 'war' on pyramid and Ponzi schemes. This ensued with the arrival of Mary Schapiro as SEC chair and Robert Khuzami – an experienced former prosecutor – to lead the SEC Enforcement Division.[115] Albeit the new teams' achievements were criticized, the results were exemplary in the history of SEC.[116] One of the priorities of the restructured SEC under Schapiro, indeed, was aggressive prosecution of Ponzi schemes. As it was reported in 2010, 'while [p]reviously only a handful of Ponzi scheme cases would be handled during the year; over the past twelve to eighteen months, over forty cases have been brought.'[117]

It is important to note this to realize that by setting their priorities properly, agencies can significantly increase the efficiency of the warfare against the schemes. Obviously, an agency can often achieve much more than private litigators, especially if empowered as the US SEC, starting from easier access to evidence through the power to 'bring a case for programmatic reasons, even if the potential cost – in both litigation expense and internal resources – far exceeds the potential recovery the SEC may conceivable achieve.'[118]

2.3.1.6. Multi-level marketing in the United States It is the US that could be taken as the cradle of MLM, or direct marketing. Numbers properly prove this as about 1,400 MLM companies were registered in the US, for example, in 2018.[119] It should not come as a surprise then that this is also the country which has a rich history with pyramid schemes disguised as MLMs. Yet, instead of banning MLMs, more branches of law were employed to forge tests for weeding out scams. Although investors could get adequate protection from the SEC employing the Howey- or the Reves tests developed to deal with unorthodox investment schemes, it is the FTC that has played the key role in protecting consumer-clients against pyramids camouflaged as MLM schemes.

The FTC's fight against pyramid MLM schemes has a history going back decades. Eventually, the FTC Amway test of whether an MLM business is a banned pyramid scheme or a legitimate business venture was promulgated yet at the price of a number of administrative[120] and court decisions.[121] The test was based on Section 5(a) of the Federal Trade

[113]The SEC filed a complaint against Madoff and Bernard L. Madoff Investment Securities L.L.C. on 11 December 2008. See Complaint, *SEC v. Madoff*, No. 08-10791 (S.D.N.Y. Dec. 11, 2008).

[114]For the estimate of sums that were involved see *In Re* Bernard L. Madoff LLC 654 F.3d 229, 231 (2nd Cir., 2011). As Levmore described, about $36bn went through Madoff's hands, the investors withdrew about $18bn and another $18bn is missing. Levmore (2012) 979. [The author suggest enhanced focus on deterrence instead of on unjust enrichment.].

[115]Mary Schapiro was sworn in as SEC Chairman in January 2009. Barnard (2010) 404.

[116]As it was reported by the SEC, more than 735 enforcement actions were filed in fiscal year 2011 (ending 30 September) – more than ever in SEC history – and '*more than $2.8 billion in penalties and disgorgement [were] ordered in FY 2011 SEC enforcement actions.*' Link 7.

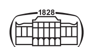
[117]Lowman (2010) 4.

[118]Lowman (2010) 4.

[119]Nuyten (2017).

[120]*See in particular In Re Koscot Interplanetary, Inc.* 86 F.T.C. at 1181 and *In re Amway Corp.*, 93 F.T.C. 618, 716 (1979).

[121]See also *United States v. Gold Unlimited, Inc.*, 177 F.3d 472, 479–82 (6th Cir.1999).



Commission Act on prohibition of unfair and deceptive acts and practices.[122] When applying the test, the presumption is that not all MLMs are illegal. As more recently spelled out in the 2014 *F.T.C. v. BurnLounge, Inc.*,[123] and as refined earlier in the 1996 *Webster v. Omnitrition Int'l , Inc.*[124] case, to determine whether an MLM is an illegal pyramid scheme, 'court must look at how the MLM business operates in practice.' This because, as per FTC's Koscot test, a pyramid scheme is:

> characterized by the payment by participants of money to the company in return for which they receive (1) the right to sell a product and (2) **the right to receive in return for recruiting other participants into the program rewards which are unrelated to sale of the product to ultimate users**.[125] [Emphasis added.]

Then, if the recruitment rather than the sales aspects dominate,[126] the MLM is a banned pyramid scheme. Or, as FTC put it:

> As is apparent, the presence of this second element, recruitment with rewards unrelated to product sales, is nothing more than an elaborate chain letter device in which individuals who pay a valuable consideration with the expectation of recouping it to some degree via recruitment are bound to be disappointed.

The sharpening of the Amway test awaited subsequent litigation. One such question was how to calculate with self-consumption of MLM members in assessing the 'sale v. recruitment' ratio: as part of the members' income from sales, or rather to disregard it? This is a crucial question because in case a large number of MLM members is under-performing on the sales side, the balance might very easily tilt towards the recruitment aspects if the members' own consumption could not be taken into account. On this question the FTC's answer, otherwise, is in the negative in the sense that other factors need to be taken into

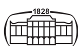
[122] Federal Trade Commission Act (1914) 15 U.S.C. 45(a)(1).

[123] *F.T.C. v. BurnLounge, Inc.* 753 F.3d 878 (9th Cir. 2014). BurnLounge was an MLM online music store from New York City, founded in 2004. It was sued by the FTC in 2007 for being an illegal pyramid scheme. As FTC prevailed on both, first and appellate levels, FTC disgorged to defrauded consumers about $1.9 bn starting in 2015. BurnLounge had two programs, the Retailer and the Mogul Programs; out of which only the second was found to be a pyramid by the first instance court (and was therefore in the purview also of the second instance). One became a Retailer by purchasing one of three packages: '*Basic ($29.95 per year); Exclusive ($129.95 per year plus $8 per month); or VIP ($429.95 per year plus $8 per month). Each package provided the Retailers with access to a ready-made and customizable web page, called a "BurnPage." A BurnPage was the vehicle through which Retailers sold music, music-related merchandise, or packages of music-related merchandise to customers in return for 'BurnRewards.' [. . .]*.' For additional monthly fee of $6.95 one could turn to a Mogul, which could redeem the BurnRewards for cash rather than for music or merchandize.

[124] *Webster v. Omnitrition Int'l, Inc.* 79 F3d 776, 781 (9th Cir. 1996).

[125] *In re Koscot Interplanetary, Inc.*, 86 F.T.C. 1106, 1181 (1975), aff'd mem. sub nom., Turner v. F.T.C., 580 F.2d 701 (D. C.Cir.1978).

[126] See, e.g., the third prong of the summary holdings in the BurnLounge case stating that '[. . .] participants' use of products did not undercut business's recruitment focus.' Contrary to BurnLounge, many of the MLM business emulate the formula developed by Amway to satisfy the expectation, which consists of the following elements: first, the ten percent rule (ten retail customer) policy; second, the 70% rule mandating distributors to sell 70 percent of previously purchased product before reordering, and third, policy to buy back the inventory from terminating distributors. *In re Amway Corp.*, 93 F.T.C. 618, 716 (1979).



account as well to pass the final verdict, because '*the FTC focuses on how the structure as a whole operates in practice.*'[127]

The FTC has also a Business Guidance on its website. The function of it is to warn and educate consumers on the corollary risks; notwithstanding of what thousands of US citizens fall prey to pyramid schemes continually.[128] FTC's pertaining actions were later joined by the SEC primarily through the mentioned Howey 'investment contract' test. Notwithstanding the dual-channel attack on pyramid and Ponzi schemes by FTC and SEC, ever newer forms of schemes continue to emerge, to a great extent because grey areas remain; increasingly due to technological innovations. For example, it was the SEC and not the FTC which has been the first in the world to file a suit for failure to register an offering of a security involving digital currencies.[129]

Given the sophisticated regulatory system of the US, courts that understand the 'economics' behind MLMs are also needed to make the system function properly. Such courts may be lacking in emerging economies. Consequently, although US experiences should be very instructive to other countries as well, transplantation of US solutions should proceed with utmost caution. For example, the outright ban on MLM businesses in Sri Lanka or Myanmar seems to be sensible, at least for the time being, and bearing in mind the embryonic nature of their financial regulatory systems and the relatively low financial literacy of all involved.[130]

As far as America is concerned, the nexus of MLM and pyramid schemes remains a controversial topic. No better example could be mentioned than the short attack on Herbalife Ltd[131] by William Ackman, a US activist hedge fund manager, starting with airing his three-hour power point presentation aimed at exposing Herbalife Ltd. as an '*unsustainable pyramid scheme*'[132] on 20 December 2012. As this had attracted considerable media attention in the US, the price of Herbalife shares on the market began to fall, and

[127]See point 6 of FCT Business Guidance at Link 8.

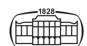
[128]As per an FTC Survey, between May 2002 and 2003 about 1.55 m US adults were victims of pyramid marking schemes. *See* Pareja (2008), note 6, referring to Anderson (2004).

[129]*SEC v. Pacheco*, Case 5:19-cv-00958 filed with the US District Court – Central District of California on 22 May 2019. Text available at Link 9.The MLM business in the case, valued at $26.5m, rested on sale of 'IPro packages', a recruitment-based compensation plan, ability to convert 'points' into digital assets and such 'points' awarded to sales of IPro packages and recruitment.

[130]See, e.g., the brief comments of Gary Langan Goodenow, former senior trial attorney in the SEC enforcement division, titled *the SEC and Multilevel Marketing* on the webpage of MLM Watch – the Skeptical Guide to Multilevel Marketing, Goodenow (2004).Talking of the Amway formula, he noted that whenever he prosecuted a pyramid or Ponzi scheme, the organizers' defense was that '*I set this up just like Amway.*'

[131]As Herbalife Ltd. is described by Wikipedia: 'Herbalife Nutrition is a global multi-level marketing corporation that develops, markets, and sells dietary supplements, weight management, sports nutrition, and personal-care products. The company was founded by Mark Hughes in 1980, and it employs an estimated 8,000 people worldwide. The business is incorporated in the Cayman Islands, with its corporate headquarters located in Los Angeles, California. The company operates in 94 countries through a network of approximately 2.3 million independent distributors. [. . .].' See at Link 10.

[132]Available at Link 11.The site constantly updates the number of number of distributors that drop out from Herbalife. On 4 January 2020 this was indicated: '1 distributor drops out of Herbalife every 16.7 s. Since 2013 alone, 13,241,344 distributors have dropped out.'



presumable would have tumbled to dangerously low levels had it not been for the intervention of Carl Icahn, another well-known high profile investor. Icahn's strategy was to obstruct the short attack of Ackman and to profit from that. This required from Icahn, besides purchasing major blocks of Herbalife Ltd. stock, showing that the business model employed by Herbalife is a healthy one.[133] Eventually Ackman exited the Herbalife short-attack on 25 February 2018 and thus the short selling war was won by Icahn. Thereafter, Icahn also sold portion of its stakes in Herbalife but not all of it. Herbalife's stock began to fall yet again in February 2019 yet apart from that the company survived unscathed and is in continued existence at the beginning of 2020,[134] though anticipating disruptions to come due to the COVID-19 pandemic.[135]

Apart from the fact that the thin dividing line that separates legitimate MLM and prohibited pyramid schemes could be exploited by activist investors, hedge fund managers and short sellers to reap profits, for our purposes it is of much bigger importance that in the Herbalife contest the harm inflicted on vulnerable consumer-investors has also been exposed. So much so that the well-known British-American television host and political commentator, John Oliver, has devoted one episode of his '*Last Week Tonight with John Oliver*' HBO series to the Herbalife saga and the topic of pyramid selling schemes.[136] In it, especially telling is the footage in which former Mexican consumer-investors (called distributors) speak out about their losses and deplorable experiences with MLM of the Herbalife model as well as John Oliver's words pointing to the quintessence of the problem targeted in this paper as well: 'MLMs hold up the hope that if you work hard, you can take control of your life, start your own business, and help your family . . . but how real is the opportunity?'[137] These development could be spoken of as first hand empirical evidences prompting passage of sector-specific regulations.

2.4. Hungary: a restrained organic growth system

2.4.1. The beginnings: the Pre-II WW snowball contracts. Although a comparably advanced banking sector, commodities and securities exchanges were already in place by the end of the 19th century, when the country and thus its markets were much larger within the Austro-Hungarian Empire, this was paralleled by several spectacular financial scandals.[138] It is nonetheless hard to find evidence specifically of 'pyramid games' from those years. The same could be said of the capitalist Hungary between the two World Wars.[139]

[133]See Carl Icahn's statement regarding Herbalife of 25 May 2018 at Link 12.

[134]See the website of the company at Link 13.

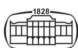
[135]See, e.g., Fine (2020).

[136]See the 'Last Week Tonight with John Oliver' episode entitled 'Multilevel Marketing: Last Week Tonight with John Oliver (HBO)' (7 Nov. 2016) at Link 14.

[137]Last Week Tonight with John Oliver' episode entitled 'Multilevel Marketing: Last Week Tonight with John Oliver (HBO)' (7 Nov. 2016) at Link 14.

[138]See generally Tomka (2006).

[139]For a general overview of the development of the Hungarian legal system see Harmathy (2019).



The exceptions seem to have been the predecessor of contemporary MLMs called, metaphrased, ‘snowball contracts’ (‘hólabda-szerződés’),[140] though the designations ‘avalanche’ (‘lavina szerződés’), ‘hydra’ (‘hydra szerződés’) or ‘sale deed-docketing’ contracts (‘jogosítóbárca szerződés’) were also known. These were also operating based on a pyramidal structure and recruitment into scheme was a *sine qua non* of the contracts though without any payouts specifically for that. The ‘buyer-clients’ had two main obligations to fulfill cumulatively to qualify for receipt of the purchased asset: on one hand, advancement of the purchase price in exchange for certain merchandise sold by the promoter, and on the other hand, recruitment of a predetermined number of new ‘buyer-clients’ into the system.

Both preconditions were more onerous than it is normally the case today with MLMs. On one hand, recruitment meant handing over to the promoter the required number of sales contracts, or purchase orders, concluded with or made by the new clients lured into the system.[141] Here from stems the designation ‘sale-deed docketing,’ an archaic expression not really used in Hungary anymore. On the other hand, if the buyer was not capable of fulfilling the recruitment-prong of the transaction, he lost his advance payment. No matter which alternative materialized, the promoter was winning, either from the advance payment, or from all the benefits new clients brought into the venture. All of that without any payments or efforts coming from his side.[142]

Snowball contracts were deemed unfair not only because the number of potential new clients was mathematically limited (similarly to classical pyramid and Ponzi schemes), and thus the first condition of the contract was often impossible to fulfil, but also because the involved goods were normally sold at a depressed price which ‘lured the customers from those competitors that marketed the goods at non-depressed (normal) prices.’[143] Such contracts were null and void entitling the defrauded buyer not only to recoup his advance but also to claim damages for the expenditures invested by the buyer in finding new clients.[144] Invitation or occasioning somebody to conclude the contract was a petty offence.[145]

[140]These contracts were prohibited already by the Decree No. 70.055 of year 1900 of the Hungarian Minister of Trade, a prohibition that was taken over also by the Act No. V of year 1923 on Unfair Competition (*1923. évi V. törvénycikk a tisztességtelen versenyről*). Section 14 of the latter reads: ‘4. Snowball Contract. §14 It is prohibited to conclude the so-called snowball (hydra-, purchase-deed-docketing-, avalanche-) contracts, based on which the buyer, or the purchaser of certain services, is entitled to acquire the goods or the services, if he manages to gather a predetermined number of buyers or clients making orders for the purchase of such goods or services, and if he fails to achieve that, he will suffer legal detriments. Such contracts, and the further contracts that are concluded by the buyer or the order-maker with third persons are null and void; the advanced purchase price or counter-services must be returned and the seller or the party obliged to perform the service is liable for the damages so caused.’

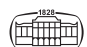
[141]See Meszlény describing this in Hungarian as follows: ‘. . . a vevő az árut csak akkor kapja meg, ha meghatározott számú jogosítóbárcát helyez el. Minthogy ez rendszerint nem szokott sikerülni, a vevő elveszti a vételárat, ha pedig sikerül, az eladó a megfelelő számú új megrendelés birtokába jut ingyen.’ Meszlény (1923) 118.

[142]Meszlény (1923) 118.

[143]Kuncz (1928) 125.

[144]Kuncz (1928) 118.

[145]Meszlény (1923) 120.



Although one of the Hungarian commentators interestingly noted that '[t]he snowball contract's classical home jurisdiction was Switzerland [and] [in Hungary it] never took root,'[146] both the lawmakers and the commentators found it important to deal with them. This cannot be interpreted otherwise than presuming that they were hardly unimportant episodes in real life in those days.

2.4.2. Were socialism and 'pyramid games' really irreconcilable?. As during socialism, lasting roughly from the second half of the 1940s until the early 1990s, the paraphernalia of capitalism were ideological enemies of the system, and as this applied *a fortiori* to the institutions of capital markets being equated with despicable speculation and fraud, securities and investments also largely disappeared from the lives of Hungarians. Bearing this in mind, the logical assumption would be that 'pyramid games' could not have emerged during those decades either. Yet, that was not necessarily the case, as the ensuing anecdote suggests. As far as my recollections go, there was a TV documentary on one of the Hungarian TV channels still during socialism, in the second half of the 1980s, not focused on finances but on the suicides committed because of the collapse of a nation-wide fishing-bait breeding campaign. As part of this, above-the-average returns were promised to citizens in exchange for breeding fishing-bait worms. No word was cast on the financial aspects of the 'campaign' in the documentary presumably because back then there were no regulations that would have treated this as investment, and neither the media-people, nor citizens conceived the offering as investment – something similar to shares or bonds. Consumer law was in its infancy as well in those days and was 'disinterested' in the matter, notwithstanding that the living standard of the populace was low especially compared to the 'West.' Hence, it is justified to presume that most of the 'investors' came from the ranks of vulnerable consumers; some living below subsistence levels. The arrangement was *ex post* looked upon perhaps as a criminal law matter.

In fact, even today such arrangements would qualify as investment contracts within the purview of the securities regulatory system only in the US and the few countries that have been inspired by the 'economic definition' of securities like Canada and the Philippines – hardly in Hungary.

However, the Hungarian fish-worm-bait rearing scheme did closely resemble the various animal breeding programs known to SEC and US securities at least from the 1946 Howey case on, and which have been routinely reacted upon by the tools of the securities regulatory system ever since. In particular, the above-discussed open-end definition of 'security' and the Howey test, designed to tackle unorthodox investment schemes, have played the leading role in protecting investors against these 'securities' in case of which 'the promoter sells the breeding stock to the investors and promises to repurchase the offspring they raise.'[147]

No radical breakthrough occurred in Hungary in respect of unorthodox investment schemes ever since, similarly to Germany, which remains the top regulatory model for Hungarians.

[146]Kuncz (1928) 125.

[147]Jennings and others (1998) 317. See the cases *Smith v. Gross,* 604 F.2d 639 (9th Cir. 1979) (earthworms) or *Continental Mktg. Corp. v. SEC* 387 F.2d 466 (10th Cir. 1967) (beavers).

2.4.3. Synopsys of the socio-economic and legal environment of Hungary after the fall of the Berlin Wall

2.4.3.1. Nomination of a new crime. The transition towards democracy and market economy, beginning in the early 1990s, brought with it a revival of the financial system with a focus on the reestablishment of the Budapest Stock Exchange as well as the consolidation and modernization of the inherited banking sector bleeding from myriad wounds. Hence, such unorthodoxies as pyramid and Ponzi schemes initially escaped attention. They were still perceived as milder forms of fraud, similar to gifting and money-wiring (transfer) arrangements. Some opinions justified that by two factors: on one hand, the participants were communicated up front what was at stake, and on the other hand, the terms and conditions of joining were identical for all the participants.[148] One of the very few commentaries, for example, began by pointing to schemes organized by postcard collectors in the 1960s.[149]

Yet only a few years were needed to realize that the risks these seemingly 'harmless' offerings generate are hardly *de minimis*. So much so that actually it was the banking sector that blew the whistle seeing far too many consumer-investors lose, and only the few at the top of the hierarchy gain, through the ever-newer schemes camouflaged as legitimate business forms or known financial products. It was presumed that nomination of a distinct crime would significantly increase the efficiency of the prosecution of culprits as opposed to the general crime of fraud.[150] The prohibition of the organization of pyramid schemes,[151] metaphrased as pyramid 'games' ('piramisjáték'),[152] was consequently added using this designation to the 1996 Criminal Code.[153]

The only criminal law-related development of relevance ever since has been the refinement and expansion of the reach of the system (effective from January 2018). While initially only the promoters themselves (and the officers of these if companies were targeted) were caught by the system, from 2018 on the agents of these could be reached as well. Moreover, the use of the more recently introduced covert investigative tools (*leplezett felderítési eszközök*), subject to judicial approval, has been specifically allowed related to pyramid schemes as well.[154]

There are no empirical evidences on whether the nomination had significantly increased the number of successfully prosecuted schemes. Still, the criminal justice system remains a stable building blocks of the system for fighting the schemes, modestly but increasingly supplemented

[148] Tóth (1996) 226.

[149] Tóth (1996) 226.

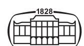
[150] Tóth (1996) 227.

[151] Only pyramid schemes were tackled and there is not mention of anything in lieu of Ponzi schemes. This is the case even today because of why it ought to be concluded that the Hungarian notion of 'pyramid schemes' includes also Ponzi schemes as defined, for example, in the US. There seems to be no source that would discuss this issue or that would propound rethinking of the nomenclature in Hungary.

[152] Not clear wherefrom the expression 'pilótajáték' – metaphrased: pilot game – entered Hungarian language. That the pilot game was something more widely known, not really looked upon as more than a genuine game, is properly reflected in the hard-to-qualify-the-genre booklet from 1988 by Bencsik.

[153] See § 412 of the Hungarian Criminal Code. The new crime was added with the Act No. LII of year 1996 and was enforceable after 15 August 1996. Tóth (1996) 227.

[154] Jogi Forum/MTI (2018). For an overview of the development of Hungarian criminal procedural law see Bárd (2007) 214.



by the administrative measures of the two agencies in charge: the National Bank performing also the function of SEC, and the Competition Law Authority. These will be taken a closer look at in the following.

2.4.3.2. Are the regulators accountable and liable for failing to detect schemes in due time? – a 2003 court case. The collapse of the three largest pyramid schemes labeled 'real property investment cooperatives' ('ingatlan-befektetési szövetkezet') in September 2003, followed soon by the collapse of the remaining twelve, was undoubtedly one of most publicity-generating calamities in the more recent financial history of the country.[155] This made 'pyramid games' yet again a hot topic for the media though only for a limited period time. Once the scars of the collapses have healed, the cooperatives and the fleeced consumer-investors, dominated by pensioners, quickly disappeared from public discourse. No revamping of the law ensued and no lessons seem to have been learned. No governmental agency or official was found culpable, and no governmental office-holder resigned either for failing to detect the cooperative-scams, or for the misfortunes impacted on consumer-investors.

The most reassuring consequence of the debacle was a daring, forward-looking court case filed in 2003 with one of the capital's (Budapest) courts.[156] In the case, the Hungarian SEC was sued by a victim of one of the fourteen cooperatives having lost one million Hungarian Forints.[157] By investing the sum, the plaintiff became a *member* of the cooperative, has received a membership ticket ('célrészjegy') that the cooperative promised to repurchase after three months with a fixed interest roughly being double than the then prevailing bank savings accounts interest rates. In other words, the ticket was a peculiar kind of fixed income equity security, not named as a preferred share (of stock) but a *cooperative membership ticket*. It was indicative as well that the outlook of the related advertisements closely resembled those for bank savings accounts and traditional methods of how the payable interests used to be (and still are today) structured.

The gravamen of the claim was that the cooperative had been illegally providing financial services without holding any license for that. Given that the Hungarian SEC (named: Financial Supervisory Authority) had investigated the cooperative the tickets of which the claimant had purchased before its collapse, yet had failed to detect, and order cessation of the illegal activities, the central issue was whether the authority was liable for the damages so caused?

While in the US, the SEC is quite an active litigant[158] and is sometimes sued,[159] that is conspicuously not the case in Hungary. Direct suits initiated by individuals, which the present one was, are rare in the financial sector. Therefore, the Hungarian case at hand should be

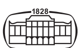
[155]For the short chronology of events see Appendix No. I in Tajti (2005).

[156]BDT2010.2177. The filing number with the Budapest Court of Appeal *(Ítélőtábla)* is 5.Pf. 21 145/2008/5.

[157]One-million HUF in January 2003, for example, was around 4,100 Euros.

[158]In the period 2010–2018, SEC initiated more than eight thousand enforcement actions. Velikonja (2019) 389.

[159]Rubin and Cannon (2009) 45–49. The latest such Supreme Court case is *Liu* et al. *v. SEC 591 U.S. _(2020)* where the Court held that 'A disgorgement award that does not exceed a wrongdoer's net profits and is awarded for victims is equitable relief permissible under §78u(d)(5)' of the 1934 Securities Exchange Act that reads: '(5)Equitable Relief.—In any action or proceeding brought or instituted by the Commission under any provision of the securities laws, the Commission may seek, and any Federal court may grant, any equitable relief that may be appropriate or necessary for the benefit of investors.'



perceived as an invaluable rarity, a precedent that raised a legal question crucial for the proper functioning of the securities regulatory system yet on which the law has no, or inadequately developed answer. None of the implicated courts rejected the claim as inadmissible. It could have been, however, predicted that the claimant was doomed to lose. The main reason, shared by both the first instance and the appellate court, was that 'there was no direct causational linkage between the activities of the defendant [i.e., the SEC] and the damages suffered by the plaintiff.'

Unfortunately, the case did not earn special attention[160] though it properly highlighted why the status, the powers as well as the duties and potential civil liabilities of the supervisory agency are crucial for the efficient functioning of the financial regulatory system, mandated to combat fraud appearing on the capital markets and the financial system of all sorts.

Suing the SEC for the damages caused by it, or its employees, to investors is closely regulated also in the US. This even includes discretionary powers given to the federal government by the Federal Tort Claims Act (FTCA) to set the limits of its own liabilities.[161] Still, US SEC appearing in the shoes of defendants, or respondents, occurs much more frequently than is the case in Hungary what suggest that the pertaining law in Hungary is not fully developed on this front. More precisely, there is no intention to more seriously reckon with private securities litigation.

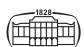
Our central topic desires adding obiter here that in the US litigation against SEC may involve pyramid or Ponzi schemes. In the 2015 case *Zelaya v. U.S.*,[162] for example, SEC was sued for negligently failing to notify SIPC after finding that 'a company, which operated as broker/dealer and investment advisor, **was operating a Ponzi scheme,** and in approving annual reregistration of company as investment advisor.'

In any event, what the above Hungarian case suggests is that while direct suits by individual investors (shareholders, or even holders of unorthodox securities, as the cooperative tickets) are possible in Hungary, the legal superstructures necessary to ensure a level playing field to investors inherently being in a disadvantageous strategic position would require rethinking the pertaining laws. US law and cases showing the nuances of the complex role causation plays in securities litigation – which was the central issue in the Hungarian case commented upon in this section – might be instructive to Hungarians. In particular, as the paucity of related experiences might also be the reason why in Hungary, for the time being, the 'war' on pyramid and Ponzi schemes remains primarily in the bailiwick of criminal lawyers with some ad hoc administrative

[160]Hungary is a continental European civil law system, where codes and statutes as products of legislation are deemed to be the most important sources of law today as it used to be during socialism, too. The general importance of cases, however, has begun to increase in the 21st century. Initially, this was expressed only in the growing number of publicized cases. This process culminated in the official transformation of the system into a 'limited-precedential' ('*korlátozott precedensrendszer*') one in spring 2020. Limited - because only the interpretations of the Hungarian Supreme Court (called Curia) are mandatory and the court deciding a concrete case may depart from the Curia's position if the facts and circumstances of the case would justify that or if the departure is needed to align the decision with the Basic Law (i.e., the Constitution). See §72 of the Law '2019. évi CXXVII. Törvény az egyes törvényeknek az egyfokú járási hivatali eljárások megteremtésével összefüggő módosításáról.' See also Virág and Völcsey (2020).

[161]28 USC Ch. 171: Tort Claims Procedure. As it is stated in the Zelaya case: 'Through the enactment of the FTCA, the federal government has, as a general matter, waived its immunity from tort suits based on state law tort claims; but in offering its consent to be sued, the United States has the power to condition a waiver of its immunity as broadly or narrowly as it wishes, and according to whatever terms it chooses to impose. 28 U.S.C.A. § 1346(b)(1).'

[162]781 F.3d 1315 (11th Cir. 2015).



interventions of the NB and private securities litigation is nowhere in sight: neither as the avenue whereby defrauded investors could get compensation, nor as procedural tools disciplining the participants of the market. The more active competition agency, having passed a relatively larger number of decisions involving MLM companies, stands out primarily.

2.4.3.3. The second decade of the 21st century: organic growth through increasingly activist agencies? The second decade of the 21st century brought with it some visible advancements of relevance to our subject matter. This has been partly under the impetus of the European Union (EU) – where the prestige and importance of securities regulations have increased significantly lately – and partly as a result of autochthonous developments, including the surfacing of new scams. It is not clear whether the integration of the formerly independent Financial Supervisory Authority into the Hungarian National Bank (Hereinafter: NB) effective on 1 October 2013 has had any impact on the modestly intensifying attention to 'pyramid games' as demonstrated by subsequently publicized proclamations and steps taken by this body; the reactions of which nonetheless remain limited.

In Hungary, the Competition Authority was at the forefront of the combat against illegal MLMs. It decided several cases involving at least obiter MLMs. As opposed to MLMs, Ponzi schemes as perceived in the US, remained in the bailiwick of the NB performing also the functions the SEC. These two tracks continue to live in a unique kind of symbiosis resembling the work of the FTC and SEC tandem of agencies in the US. As it is a distinct theme, we will leave the discussion on MLMs to the next section: here we will focus only on the anti-pyramid-games work of the NB.

To start with, very few measures have been taken by the NB since 2013, at least if juxtaposed to the intensity of US SEC's activities. Moreover, the most noteworthy steps ensued with delays and remained limited to the following three major novelties potentially applicable to combat the schemes as well.

First, as prescribed by the EU Market Abuse Directive (MAD II),[163] a whistleblower page was added to the website of the NB.[164] Although not designed specifically for 'pyramid games,' this could be the chain of communication through which the NB could learn about new schemes as well. *Second,* the NB began to implement a red flag policy warning the citizens of problematic financial offerings. *Last,* in May 2018, the NB launched a modest campaign specifically devoted to 'pyramid games' presumably pressed by the unexpected detection of six or seven new schemes during the first months of 2018 alone.[165]

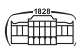
The overall result of the more activist NB is increase of collected fines. In year 2016 alone, for example, 3.7 bn HUF fines have been imposed by it on illegal providers of financial services. True, it is not known how many of these included pyramid and Ponzi schemes (if at all).

It is also indicative, and at the same time also disheartening to consumer-investors, that the NB has found it important to stress in its public announcements what investment forms it is

[163]Directive 2014/57/EU of the European Parliament and of the Council of 16 April 2014 on criminal sanctions for market abuse (market abuse directive). See also recital 74 of Regulation 596/2014 (16 Apr. 2014) on market abuse (the market abuse regulation).

[164]The whistleblower page of the Hungarian National Bank is (in Hungarian) at Link 30.

[165]MTI (2018). See the portal of Portfolio at Link 15.



statutorily ***not*** mandated to investigate,[166] and that the fines imposed by it have nothing to do with, they are distinct, from the losses (potential pecuniary claims) of the investors.[167] Or, put simply, in Hungary investors cannot get compensation from the collected fines. This has two essential repercussions. The *first* is that the Hungarian NB, acting as the SEC as well, is designed as the guardian only of the integrity of the markets but only indirectly is the protector of consumer-investors' interests. *Second*, the panoply of remedies that are available to the US SEC are hardly paralleled in Hungary. It is not comforting to know that this is not much different in the region. Problems seem to exist even in Germany, the economic engine of the EU and the country where Frankfurt is envisioned to take over the throne from London after Brexit – as the recently emerged 'Wirecard' scandal suggests.[168]

In particular, the lack of SEC's disgorgement and penalty powers should be regrettable to Hungarian investors as bankruptcy avoidance laws do not necessarily work, and private securities litigation is underdeveloped as well in the country.

True, in principle consumer-investors can expect some compensation from the state's Investor Protection Fund ('Befektető-védelmi Alap')[169] yet it remains an open question whether investments into the schemes are looked upon by the Fund as scams for which they provide no protections. The Fund's payments additionally are capped. To compare with the US: the myriad investor-protection tools available in the US and spoken about above, all come on top of the compensation available from a similar fund, the Securities Investor Protection Cooperation (SIPC), which however was unavailable to many of Madoff investors due to the restrictions of SIPC's rules.[170]

Ultimately, irrespective of the fact that the underlying regulatory framework is far from being perfect in Hungary, minor positive developments could be heralded. It seems that the NB more routinely files criminal charges with the prosecutors' office for financial fraud or specifically for the crime of organization of 'pyramid games' whenever illegal financial service-providers have

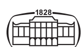
[166]*See*, e.g., the NB's warning concerning the activities of the Austrian (Vienna-based) company *Invia World GmbH* as of 13 April 2018 (in Hungarian), offering services related to crypto-currency mining. The NB stressed that it is not within its statutory duties to investigate the issuance or mining of crypto-currencies notwithstanding of what it found it important to warn the public about the corollary risks. See also the 9 May 2017 communique of the NB on the joint meeting of the NB, police, prosecutors' office and the tax authorities concerning the – as back then named – pyramid scheme-like activities of the *One-Coin* offering investments into crypto-currencies. See Fazekas (2017) It is indicative that neither the Hungarian authorities, nor those of Bulgaria (country of origin of One-Coin) took any concrete step beyond issuing warnings to the public until the servers of the issuer had been seized in a January 2018 raid undertaken at the request of German prosecutors. Hope (2020) 4.

[167]*See, e.g.,* the public communique of 27 Aug. 2018 related to the NB's decision in the case of *Atlantic Global Assets S.A.* (decision No. N-PJ-I-44/2017) whereby it prohibited the company provision of any kind of investment-related services with immediate effect and fined the firm with 91 million HUF upon conclusion of investigations started in February 2017. The firm offered 4–6% WEEKLY! interest in exchange for investing 90–500,000 Euros for a year. As the NB noted: 'it seems that this was nothing but a pyramid scheme.'

[168]Brunsden and Fleming (2020).

[169]The Fund's website (with English pages) is at Link 16. The US also has such a fund, the Securities Investor Protection Corporation (SIPC) established in 1970 based on the Securities Investor Protection Act. Its webpage is at Link 17.

[170]SIPC did not provide protection to investors who invested indirectly, through feeder funds (companies), into the collapsed Madoff company. Baird (2014), note 73 supra, at 385.



been detected lately.[171] However, none of these advancements sufficiently strengthen the position of consumer-investors falling victims of the schemes, who are in desperate need not only of such ancillary remedies as disgorgement and fair funds, but of a more activist and more schemes-focused SEC as well.

2.4.3.4. Pyramid schemes camouflaged as multi-level marketing systems. Like the rest of the region's countries, many of the globally known MLM systems (e.g., Amway, California Fitness), alongside some local and lesser known kin, have been active in Hungary ever since the fall of the previous regime. Some attracted the attention of the financial supervisory authorities[172] and have been investigated, and some have reached the courts as well. When the iron curtain fell, there were no obstacles to entry for such western tested business patterns as MLMs, or leasing, and business format franchise. Several western MLMs became popular within a short time span to a great extent because they offered income opportunities to the local populace. Often, however, as a few Hungarian Competition Authority decisions imposing fines suggest, strange products (e.g., devices with alleged 'magical' healing capabilities),[173] and the false prospects of extraordinary profits, rather than the prospects of a job-like position were the lure to join.

Things began to turn in the right direction thanks especially to the European Court of Justice's '4finance' UAB decision in 2014[174] and the test forged by the court in it for weeding out illegal pyramid schemes. Its common denominator with the US FTC Amway test is that in both the dominance of the recruitment aspect is the decisive factor that tilts the balance towards illegality. A number of interesting Hungarian competition agency and court decisions have seen the daylight thereafter.

For example, the Hungarian Competition Authority imposed a fine on the life-insurance company *CIG Pannónia Életbiztosító Nyrt*. (open joint-stock company) and the *linked Reál-Team Network Kft.* (Ltd.)[175] for running of an MLM-cum-pyramid in which the insurance product – life insurance policy – was combined with benefits for recruiting new clients. A fine was imposed on these affiliated companies because the recruitment aspects dominated the structure by promising substantial payments in return for recruiting new clients. Or, as the court named it, it was a '[recruitment]-commission-based pyramid' ('*jutalék piramis*').

2.4.3.5. The ultimate verdict. All these developments in the domain of MLMs allow characterization of Hungary as a 'loyal soldier' of EU. As far as the other prong, the Ponzi schemes are concerned, the steps taken hardly go beyond what the more developed western European civil law systems do partly because Ponzi schemes are not a priority for the EU for the time being.

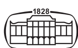
[171]Jogi Forum/MTI (2018).

[172]In 2011, selling of life-insurance policies via MLM were investigated by the local SEC. See the brief blog of Budapest Business Journal (2011).

[173]*See, e.g.,* the case VJ-23/2013 involving certain magnetic healing products, VJ 156/2007 merchandize containing flavonoids and anti-oxidants, or the case VJ/055-191/2014 on cosmetics (Lavylites trademark). The last reached also the Hungarian Supreme Court – the Curia – which confirmed the imposition of significant fines for dishonest trading practices (see case No. Kfv.VI.37.538/2017/11).

[174]See the judgment in the case C-515/12.

[175]Vj/102/2013.



The lack of interest to take a look at the US system of securities law remedies to see how fight against fraud could be enhanced is a grave mistake the price of which undoubtedly negatively impacts trust in the system resulting in less investments, and higher margin the country, or Hungarian companies have to pay above average interest rates to be in the position to raise capital not only on global financial markets but also within the country. As one commentator summarized the situation: '*The government authorities and the securities industry share the same fundamental goals, which are to attract investors, lower the cost of capital, and develop the market. Getting this formula right can unleash the fullest potential of the capital markets, which will create jobs, eliminate poverty, and increase the standard of living for future generations*.'[176] Even if this sentence might sound overly optimistic to the Hungarian ear, which can be forgiven to an American author not knowledgeable in the environment that surrounds the capital markets in Central Europe, even the skeptics should agree that it contains a truth that should be heeded in this niche of the globe, too.

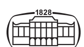
2.5. Lessons on pyramid and Ponzi schemes from Asia: targeted regulatory responses of India, Myanmar, Sri Lanka and the Philippines

2.5.1. What can we learn from Asian experiences?. Contrary to presumptions, as the ensuing elaboration on the selected four Asian countries will show, a lot could be learned from the experiences of countries that are geographically distant, and the socio-economic environment of which is significantly different. Common denominators with non-Asian countries could easily be found, in particular, the realization that no system is immune to pyramid and Ponzi schemes. Idiosyncratic problems exist as well and what casts a distinct light on the topic based on data from these Asian countries is the prohibitive number of vulnerable consumer-victims especially of pyramids disguised as MLMs; often unbanked people living at subsistence levels.

The low financial literacy of large segments of these societies takes its toll as well, a problem that is perhaps more expressed here for a variety of reasons. One of them is that underdeveloped legal systems are less capable of protecting the markets against scams, as judges and the staff of financial supervisory agencies are inexperienced and unqualified to deal with the intricacies of the domain. As best illustrated by Myanmar and Sri Lanka, these together inevitably culminate in a systemic risk requiring drastic yet easily-implementable measures: a complete ban of all kinds of MLMs instead of opting for a sophisticated fact-specific test known in the US. It ought to be added as well that in richer, high-welfare countries the losses generated by collapsing schemes could more easily be absorbed by consumer-investors thanks to various safety-cushions in the form of higher incomes, availability of personal savings, and developed social-security systems.

The Philippines, as a hybrid legal system, stands out as a country that has possessed a working financial regulatory system largely borrowed from the US for the last few decades now. The patterns known from the US seem to have had teeth in this country as well notwithstanding the distinct socio-economic environment. In other words, legal transplantation seems to work here.

[176] Birdwell (2011) 585.



2.5.2. India and its blanket anti-financial fraud system's formula: prohibition of unregulated deposit schemes. India has interesting cases to contribute to the discourse as well. What stands out is the prohibitively large number of vulnerable and unbanked consumer-investors that have fallen victims especially of MLMs. One of the cases from the more recent history of the country, involving mostly '*middle class or retired Indian working class investors who invested their savings*'[177] was the Anubhav teak plantation scam in existence between 1992 and 1998. These consumer-investors could also be accused as being greedy and gullible, given that compared to the 5–7% interest rates paid by banks back then, the Anubhav company group offered as high returns as 21–24%.[178]

Yet if one takes into account the countervailing arguments as well, a much more nuanced picture would unfold in front of us. Namely, while initially teak production and processing was proclaimed by the promoters as their key activity, soon the venture not only expanded to timeshare, finance, and real property business but had thrived as a real corporate group made up of more companies and a foundation with 91 offices, and about 1,800 employees scattered nationwide. All this occurred before the public eye, just as the lavish lifestyle of the central-figure, and the lukewarm reactions of the regulators to a great extent due to defects of the regulatory system.[179]

Yet the 2019 revamping of laws is even more interesting here as it displays similar concerns to those of present day Myanmar or Sri Lanka, pyramid schemes masked as MLMs being in the limelight. Interestingly, although the spreading of early-generation direct marketing, and MLMs, had started in India allegedly already in the 1950s, to a great extent thanks to and as promoted by various international development organizations (World Bank, Oxfam, Practical Action),[180] the comprehensive reform of the regulatory system ensued only in 2019. First by an Ordinance, following what the related bill was approved by the government in July 2019 and reached the parliament the same year.[181] The Banning of Unregulated Deposit Schemes *Act* 2019, repealing the Ordinance, was passed on 31st of July 2019.[182] The legislative action was obviously also an expression of the severity of the problems India has faced in economic life for years, to a great extent because of the defects of the regulatory framework.[183]

The Act extends well-beyond pyramid- and Ponzi schemes: the prohibition targets '**unregulated deposit schemes.**' As the comments to the *Ordinance*[184] already stressed, the aim was

[177]Muthukrishnan (2010).

[178]Muthukrishnan (2010).

[179]Muthukrishnan (2010).

[180]For a non-legal analysis of experiences with the market for off grid solar technology in rural India and the effects of caste primarily in the forms of exclusion and subtle forms of prejudice, or what has been happening 'at the bottom of the [social] pyramid' see Cross (2019) 458–79.

[181]Economic Times (2019).

[182]The text of the Banning of Unregulated Deposit Schemes Act 2019 (No. 21 of 2019, as of 31st of July 2019) in English language is available at Link 18. Section 44 of the Act repeals the Ordinance.

[183]See generally Aggarwal (2015) 387–94.

[184]The text of the Indian Banning of Unregulated Deposit Schemes Ordinance in English is available at Link 19.

not only to protect consumer-investors but also to weed out black market institutions taking 'deposits' in various forms.[185] The Act does not name specifically either MLM or Ponzi schemes. Rather it operates with open ended definitions similarly, for example, to the US Howey economic definition of 'security.' The key category of 'deposit' is defined thus as 'an amount of money received by way of an advance or loan or in any other form, by any deposit taker [. . .].'[186] The ultimate goal is to eliminate all such 'deposit-takings' defined in this extensive sense from the market that are not subject to regulations and oversight by one of the governmental agencies. This is achieved through the definitions of Regulated versus Unregulated Deposit Schemes; the first class being 'deposits' that are already subject to oversight by the Indian Securities and Exchange Board, or other governmental bodies, as enshrined in the First Schedule of the Act. All other instances of 'deposit taking' are deemed to be 'Unregulated'[187] and are prohibited by the Act.

The seriousness of the policy-makers, at least adjudged based on the text of the Act, could be seen from the measures introduced to give teeth to the Act. It will be interesting to see how efficient the Act's implementation will turn out to be as this piece of legislation is undoubtedly idiosyncratic for being sector-specific and for the rich repository of tools it employs to combat, for example, Ponzi schemes on which in many other countries no specific regulations are in place. In particular, appointment of special officers and identification of 'Designed Courts'[188] to handle claims during the implementation of the Act is foreseen, with extensive procedural powers (investigations, search and seizure)[189] of the authorities, including the power to attach deposit-takers assets,[190] impose fines[191] and cash the assets. The Act is also a criminal statute foreseeing significant imprisonment terms for those deposit takers contravening some provisions of the Act.[192] Yet, perhaps most importantly, the act gives the power to the Courts to order disgorgement of profits from 'any person, who has made profit,'[193] including also from *mala fide* transferees.[194]

However, as India is a federal state and the act itself entrusts the federal units with tasks regarding the implementation of the act, though providing them also with a margin that might

[185] Ray (2019). As the sub-title states: 'While protecting small investors is at the heart of the law, it also targets the scourge of black money.' Available at Link 20.

[186] Section 2(4) of the Ordinance.

[187] Section 2(17) of the Ordinance reads that an Unregulated Deposit Scheme is 'a Scheme or an arrangement under which deposits are accepted or solicited by any deposit taker by way of business and which is not a Regulated Deposit Scheme, as specified under column (3) of the First Schedule [of this Ordinance].'

[188] Section 8(1) 2019 Unregulated Deposit Schemes Act.

[189] Chapter Eight of the 2019 Unregulated Deposit Schemes Act.

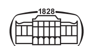
[190] Unregulated Deposit Schemes Act Section 13.

[191] Unregulated Deposit Schemes Act Chapter VI 'Offenses and Punishments.'

[192] Unregulated Deposit Schemes Act Chapter VI 'Offenses and Punishments.'

[193] Unregulated Deposit Schemes Act Chapter VI 'Offenses and Punishments,' Section 18(f). The importance of this ancillary remedy was recognized in the Ordinance as well, just as by the commentators.

[194] Unregulated Deposit Schemes Act Chapter VI 'Offenses and Punishments,' Section 16(1).



lead to differing outcomes,[195] whether the act will outperform its predecessors in rooting out fraud remains to be seen. A lot will inevitably depend on the attitude of the federal units.

That Ponzi schemes have caused problems in India as well and that the Unregulated Deposits Act is also concerned with them, not only with the 'milder' forms of scam as pyramids disguised as MLMs, and that it was perfectly comprehended in the country that the corollary systemic risk is hardly remote, could also be seen from the pages written by Indian columnists. Let us conclude this section with one apt reference hinting at not only Ponzis but also the concomitant systemic risk, as well as a recent Indian scandal in West Bengal:

> Financial frauds cause crisis in financial markets, but in India such frauds can even trigger a constitutional crisis. The recent stand-off between the West Bengal government and the Central Bureau of Investigation in the probe of the financial fraud related to unauthorized deposits reflects how a Ponzi scheme could run from the poorest squirrelling away for a rainy day to thriving millionaires.[196]

2.5.3. Myanmar: inchoate system with a targeted response. Unfortunately, the Myanmar military ('*Tatmadaw*') had committed a *coup d'état* on 1st of February 2021, ending civil and imposing military rule. This was paralleled also by annulment of the November 2020 democratic elections, detaining of President Win Myint and State Counsellor Aung San Suu Kyi, along with ministers, and closing the earlier quite intense communication channels with the external world. Little is known about what is happening on the political scene ever since, let alone the faith of our central theme: pyramid, MLM and Ponzi schemes. Nonetheless, Myanmar's experiences with these should not be discarded as they undoubtedly represent a unique addendum to the global repository of the knowledge on the schemes, and eventually they might serve as a source of information for some better times hopefully to come. The ensuing pages devoted to this ill-fated, but beautiful country with an interesting but short history of schemes, should be read with these caveats in mind. Myanmar (until 1988 Burma)[197] is an example of a country that stepped onto the path of opening towards the world, building democracy and market economy only recently, in 2011, in which nonetheless the first schemes had appeared even before the regime change already in 2006. The regime volte-face was then paralleled by burgeoning of scams surfacing in various guises for what the regulatory vacuum and the low financial literacy of the overwhelming part of the population has proved to be a fertile ground. It was not without a reason that a local English-language paper validly concluded in 2017 that '[...] people continue to fall prey to scammers for a range of reasons, including lack of knowledge, greed and regulatory weaknesses.'[198]

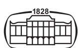
Understandably, the literature related to the schemes, just as generally on the Myanmar legal system and laws, is scarce. Hence, the primary source of information on the schemes are the short writings and blogs of investigative journalists and the affected industries. These, however, do reveal quite a lot about the brief history of Myanmar schemes. The shortage of sources

[195] See, e.g., the definition of 'appropriate Government' in section 2(1) of the Banning of Unregulated Deposit Schemes Act 2019.

[196] Ray (2019).

[197] Crouch and Lindsey (2014) xix.

[198] Kyaw (2017).



denotes also that one can hardly find quality quantitative data, be it on the number of victims or the moneys lost.

For our purposes, the following should in particular be highlighted. *First,* while besides schemes that clearly targeted the richest segments of the populace, some have specifically approached rural areas of the country, like the *Saxon Capital Ltd.* that operated outside cities through local agents.[199] Estimates are that billions of Kyat[200] were lost in this scheme alone.

Second, while some of the schemes and their offerings – often being orchestrated from abroad[201] – admittedly should have been suspicious even to laymen, many (if not most) operated disguised in clothing of regular companies making detection of their real nature hard even for experts.[202]

Third, to the extent one could adjudge based on the few public statements of public officials,[203] initially the prevailing opinion was that the participants of the schemes were rich people who fell prey to their greed, and thus do not deserve special protections from the side of the legal system. This stance only changed sometime in 2016.

Fourth, similarly to some countries of the region, the popularity of MLMs has significantly increased after the regime change. In 2017 sixty MLM schemes were active in the country, some being scams as determined *ex post*. Although three MLM firms were blacklisted in 2009 and 2011 under the 1950 Emergency Provisions Act, their continued mushrooming, the scale of the collapsed ones, as well as the resulting systemic risk, made the government establish the Bureau of Special Investigations in 2017. As a result of these efforts targeting specifically MLMs, things eventually sped up, culminating in the passing of the Notification of the Ministry of Commerce No. 46/2018[204] on 18th of September of the same year,[205] whereby the operation of all MLM schemes was banned with immediate effect. Ever since, consultations are ongoing to decide what the final position on MLMs should be.[206] The opinions seem to heed to the position expressed by one of the members of the parliament, which is that

> [t]he best thing the government could do is totally ban MLM while the education level of people is still low and information flow is still weak in the country. The time is not yet ripe to allow MLM. It

[199]Thiha (2017).

[200]Kyat (MMK) is the national currency of Myanmar. The exchange rate on 14 July 2019 was 1,702.07 MMK for one Euro.

[201]For example, the *'I Glob Ad'* scheme, operating completely via internet, was heralded as worldwide leader in marketing yet which had, neither a webpage, nor presence on social media. All one could determine is that it was registered in the UK in 2016 on the name of a 'Mackenzie Carter.' Kyaw (2017).

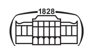
[202]One of the biggest collapsed schemes, the Global Growth Company Ltd. (based on Sakura Tower in the capital, Yangon) formally was engaged in futures trading: investors deposited their moneys that were then allegedly invested in commodities contracts. About 300 people lost in the scheme about 1.5 bn Kyat. Kyaw (2017).

[203]Mr. U Maung Maung, the former deputy minister of finance, concurrently having been also at the helm of the Myanmar SEC, said in an interview to the magazine Frontier about 'Global Growth' (one of the biggest collapsed schemes) in 2015 the following: 'The people who were cheated by the company are not poor people . . . Obviously, if they can invest a lot of money, they must be rich, so it is not problem for them.' Kyaw (2017).

[204]Text of the Notification of the Ministry of Commerce No. 46/2018 in Burmese language is available at Link 21. The Ministry of Commerce banned MLMs under section 4 of the Essential Supplies and Services Law.

[205]Shin (2018).

[206]See, e.g., Irrawaddy (2018) and Nan Kham Mai (2019) 191–204.



should be allowed back only when the education level of people has improved, there is good flow of information, the FDA can properly examine [MLM products], and there are adequate rules and regulations.[207]

No better evidence could be provided on the systemic risk lurking behind the mushrooming schemes in fledgling regulatory systems but this volte-face of the Myanmar government, which obviously was prompted to react by the massive scale of the affected consumers and the grave harm caused. Myanmar, in a sense, therefore is such a clean new page in our album portraying pyramid and Ponzi schemes that perfectly corroborates many of our propositions and claims.

2.5.4. The Philippines: the benchmark follower. The Philippines' experiences and regulatory responses could be a good model to learn from especially by such emerging financial and regulatory systems as Myanmar. Even a brief account here could amply show that. Some of the criminal penalties known in the Philippines, though, could hardly be reconciled, for example, with European standards.[208] The heavy reliance on securities regulations and the SEC,[209] on the other hand, is obviously due to the pervasive impact of US law. Thus, those knowledgeable in US federal securities regulations should easily recognize the role the economic definition of securities plays in both countries (including the Howey test) reaching not only pyramid and Ponzi but also some MLM schemes. Apart from this feature of the Philippine approach, the following needs to be highlighted as well. *First,* having seen above that the main target for Myanmar and Sri Lanka were the MLM schemes leading to the banning of all kinds of MLM schemes, the response in the Philippines to this facet of our subject matter was more nuanced and was introduced already by the 1992 Consumer Act,[210] with further clarifications ensuing in 2002 through an administrative order.[211] Here, instead of a complete ban, the regulators decided to grapple with the complex task of differentiating legitimate techniques of 'direct selling' from pyramid schemes; similarly to the US.

Second, it is a good indicator of the importance attributed to the question of pyramid and Ponzi schemes whether related cases have reached high courts in a country. The Philippines

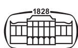
[207]Irrawaddy (2018) opinion of MP Aung Kyaw Kyaw Oo.

[208]Presidential Decree of President Marcos No. 1689 of 6 April 1980 *Increasing the Punishment for Certain Forms of Swindling or Estafa* made of only two sections. While the second makes the decree immediately effective, the first increased punishments to 'life imprisonment to death if the swindling (estafa) is committed by a syndicate consisting of five or more persons formed with the intention of carrying out the unlawful or illegal act, transaction, enterprise or scheme, and the defraudation results in the misappropriation of money contributed by stockholders, or **members of rural banks, cooperative, 'samahang nayon(s)', or farmers association**, or of funds solicited by corporations/associations from the general public.' Text available at Link 22.The phrase in bold indirectly points to the cases and aims to protect, indeed, the most vulnerable types of consumer-investors.

[209]For the laws and regulations, the enforcement of which is entrusted to the SEC of the Philippines see the website of the agency at Link 23.

[210]See Article 4(k) of the Consumer Act of the Philippines [Republic Act No. 7394 of 13 April 1992] defining 'chain distribution plans' or 'pyramid sales schemes' and Article 53 prohibiting their employment in case of sale of consumer goods.

[211]Administrative Order No. 8 series 2002 of the Department of Trade and Industry of the Republic of Philippines.



seems to stand out in this respect as well. In the *People v. Balasa* judgment of the Supreme Court,[212] which is regarded as the landmark case in the Philippines on the subject matter of Ponzi schemes, the court developed the formula on the nature of 'Ponzi stratagems', which was later revisited in other Supreme Court decisions involving pyramid and Ponzi schemes[213] – known in the Philippines also as '*syndicated estafa*' (swindling).

Third, besides the SEC,[214] important roles are played by various associations in the country given that warning and education of consumers plays a pivotal role in the fight against the scams in the center of our observations. Here, the warnings and educational materials of the most directly affected association – the Direct Selling Association of the Philippines[215] – deserve attention. For example, they developed an eight-point test for differentiating between legal 'direct-selling' and illegal pyramiding.[216]

Otherwise, the Philippines has had its fair share of pyramid and Ponzi schemes, too, and many of these, indeed, involved the poorest segments of the society, often unbanked people similarly to the other three Asian countries covered. The forms in which these appeared ranged from conventional types to online schemes more recently. From among the latter the Aman Futures Group connivance stands out, among others, for the relatively swift responses of the Philippine SEC displaying also understanding of the economics of the schemes. Namely, while the company was registered on 22 June 2012, the SEC decision (order) revoking its license dates from 18 July 2013.[217] In the case, the SEC reacted with issuance of a 'cease and desist order' prohibiting all investment activities of the company, after it had investigated the complaints of individuals having lost their investments and having found that the company committed some *ultra vires* acts. In 2019, the assets of another major recent Ponzi scheme, the 'Kapa-Community Ministry,'[218] were frozen by the appellate court upon the initiative of the obviously very pro-active Philippine SEC.

[212]*People v. Balasa, Supreme Court of the Philippines G.R. No. 106357* (3 Sept. 1998). Text at Link 24.

[213]The list includes *People v. Rosario Baladjay G.R. 220458* (26 July 2017) [the SC modified the decision of the regional court, convicted the accused to lifetime imprisonment and imposed damages to be payable by him to a few victims]; *People v. Palmy Tibayan* and *Rico Z. Puerto G.R. No. 209655-60* (14 Jan. 2015) [the SC affirmed the decision of the appellate court and the organizers of the Ponzi scheme – syndicated Estafa – were convicted to lifetime imprisonment and they had to pay damages also to a few of the victims.]. The *SEC v. Oudine Santos G.R. No. 195542* (*18 July 2013*) concerned only the preliminary investigation phase against the alleged ostensible agent of the collapsed subsidiary of the PIPC Corporation (Performance Investment Products Corp.) registered in British Virgin Islands, who according to the SEC induced some of the investors to invest in PIPC.

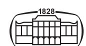
[214]See, for example, the Philippine SEC (2015), Link 25. In the center of this one-page document stands with bold that '*Legitimate Multi-level Marketing companies focus on marketing efforts rather than recruitment*.' They also point to the related presentation (and the above-mentioned eight-point test) of the Direct Selling Association.

[215]Philippine Direct Selling Association's website at Link 26.

[216]See at Link 27.The test contains questions like whether there is a product and whether the product has a fair market value, or are commissions paid on sale of the product instead of on registration (entry)? Only if the answers to all eight criteria are affirmative could a scheme be regarded as a legitimate one.

[217]Philippine SEC Order No. 11-12-164 (EPD Case No. 12-3004) in the matter of *Aman Futures Group Phils Inc.* as of 18 July 2013.

[218]Rivas (2019). Kapa's scheme was simple: 30% return for life in exchange for recruiting new members willing to donate a minimum amount of P10.000.



2.5.5. Sri Lanka: the MLM-centered system. As evidenced by a 2006 Central Bank Pamphlet,[219] the problems generated by pyramids masked as MLMs were not only well-known already at the beginning of the 21st century in Sri Lanka but were reacted upon, too, first by a Presidential Warning and soon thereafter by the passage of the new Anti-Pyramiding Act of 2005.[220] This was preceded by debates, including a high-profile conference devoted to this topic and with participation of the US organization 'Pyramid Scheme Alert'[221] in 2005. The anti-pyramiding steps, in other words, were influenced by an impetus coming from abroad. Interestingly, the Pamphlet, wisely, devoted heightened attention to the misfortunes of the mid-1990s Albanian pyramid schemes.[222] Here, the large number of impacted vulnerable, often unbanked citizens, required regulatory reactions. Similarly to India or Myanmar, in the absence of precise statistics one could assume rather than come forward with hard data on the number of impacted vulnerable consumers, yet it is a fact that a large percentage of the population remains unbanked in Sri Lanka to date. As a recent World Bank country report noted on Sri Lanka, '[while] [e]xtreme poverty is rare [in the country] and concentrated in some geographical pockets, however, a relatively large share of the population subsists on slightly more than the poverty line.'[223]

However, not only consumer-protection considerations urged enactment of the Anti-Pyramiding Act. Namely, siphoning out of the country about $15m in the period 2003 and 2005 by the Hong Kong-based Gold Quest, which purported to be trading in gold and jewelry, drew the attention of the country's national bank that then set the legislative ball rolling.

All this properly corroborate our initial claims, according to which fledgling financial systems are also exposed to the schemes focused upon herein. Moreover, the resulting calamities often amount to systemic risks and require urgent regulatory reactions by sector-specific laws.

3. CONCLUSION

The above, even the skeptics should admit, proves that pyramid and Ponzi schemes do matter, both as legitimate topics for legal scholars, and as forms of financial fraud the emergence of which should optimally be prevented, or alternatively reacted upon forcefully and promptly. Particularly, because it is law that is most capable of, and the function of which is to eliminate and penalize fraud appearing on the market through adequately developed regulatory enforcement systems.

The potential broader economic and systemic implications of whether and with what tools are the schemes reacted upon likewise require heightened attention from the side not only of scholars but a fortiori by policy makers. The beacon should be Gordon's epigraphical quotation

[219]Central Bank of Sri Lanka (2006). Danger Posed by Pyramid Schemes & Network Marketing Programs'.

[220]The text of the 2005 Anti-Pyramid Act is accessible via the website of the US organization Pyramid Scheme Alert webpage at Link 28.

[221]See the related report of Fitzpatrick (2005), the president of 'Pyramid Scheme Alert',' entitled 'the Efforts of Sri Lanka to Combat MLM Pyramid Schemes Mr. Fitzpatrick was also a participant of the related conference held in Colombo on 3 June 2005.

[222]Fitzpatrick (2005) 7.

[223]World Bank in Sri Lanka (12 April 2020 update) at Link 29.

setting the scene at the beginning of this article, according to which if economic growth is conditioned on the existence of deep capital markets, then the precondition for the latter is not only the availability of such 'a robust law enforcement program'[224] with which all kinds of fraud could efficiently be combated but also one with which specifically pyramid and Ponzi schemes could be powerfully tackled as well.

The overarching edification, however, is that no foolproof remedy capable of forestalling the emergence of schemes has been invented as yet. The historic, though notorious, exception was the eradication of all paraphernalia of 'capitalist' law from the face of the Earth characteristic of such totalitarian regimes as communism. Contrary to such nihilistic attitudes, systems that want to profit from investments and other paraphernalia of the world of finance have no other choice but to take cognizance of the risks corollary to capital markets and contemporary financial systems together with the mentioned corollary microand macro-level considerations. They ought to be willing to look out of the box, heed the experiences of others, and do forge policies aimed at strengthening the law enforcement system well in advance of scheme collapses. The unwise wait until a major collapse occurs . . .

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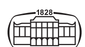

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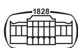

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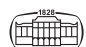

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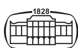

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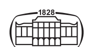

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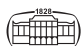

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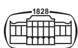

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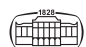

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