



KAMARAJ IAS ACADEMY
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Ponzi Scheme

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Why is in news? Money laundering laws will now cover cryptocurrency trade

A Ponzi scheme is an **investment fraud** that **pays existing investors with funds collected from new investors**.

It **works like a pyramid scheme** and generates returns for older investors by acquiring new investors, who are **promised a large profit at little to no risk**.

But in many Ponzi schemes, the fraudsters do not invest the money.

Instead, they use it to pay those who invested earlier and may keep some for themselves.

With little or no legitimate earnings, Ponzi schemes **require a constant flow of new money to survive**.

When it becomes hard to recruit new investors, or when large numbers of existing investors cash out, these schemes tend to collapse.

Ponzi schemes are named after **Charles Ponzi**, who duped investors in the 1920s with a postage stamp speculation scheme.

These are generally **multi-level marketing schemes**, however, **Multi-level marketing itself is not illegal in India** because there is a product being sold. But direct marketing companies cannot promote pyramid or money circulation schemes.

Safeguards against Ponzi Schemes in India:

Ponzi schemes are **banned under the Prize Chit and Money Circulation (Banning) Act, 1978**.

It is a Central Act but the respective State governments are the enforcement agency of this law

These are also dealt with by the **Enforcement Directorate** under the **Prevention of Money Laundering Act, 2002**.

The **Banning of unregulated Deposit Schemes Act 2019** has been enacted to **prevent fraudulent schemes**.

It **provides for severe punishment** ranging from 1 year to 10 years and fines ranging from 2 lakh to 50 crore rupees to act as a deterrent.

It has adequate provisions for disgorgement or repayment of deposits in cases where deposits have been raised illegally.

It mentions that the first claim on the recovered money will be that of depositors.

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