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## INTERNATIONAL POPULARIZATION OF FINANCIAL PYRAMIDS: THEORETICAL AND PRACTICAL ASPECTS

### LA POPULARIZACIÓN INTERNACIONAL DE LAS PIRÁMIDES FINANCIERAS: ASPECTOS TEÓRICOS Y PRÁCTICOS

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#### ABSTRACT

At present, the financial and economic sector is one of the most imperfect and vulnerable areas of public relations, which are subject to enhanced protection. The development of financial relations in the world requires constant adjustment of legal regulation in this area of public relations, especially in the context of modern legal integration, globalization and the global financial crisis. In modern conditions, the instability of the global economy, in general, and the crisis economic phenomena in Russia, in particular, including the growing influence of the negative consequences of the sanctions policy towards our country in 2014-2015. Highly specialized studies on the problems under consideration are clearly insufficient, the urgency of the majority is lost in connection with the mega-dynamic development of public relations, the change in state policy.

**Keywords:** financial pyramids, economic security, bankrupt, criminal cases.

#### RESUMEN

En la actualidad, el sector financiero y económico es uno de los sectores más imperfectos y vulnerables de las relaciones públicas, que están sujetos a una mayor protección. El desarrollo de las relaciones financieras en el mundo requiere un ajuste constante de la regulación legal en este ámbito de las relaciones públicas, especialmente en el contexto de la integración jurídica moderna, la globalización y la crisis financiera mundial. En las condiciones modernas, la inestabilidad de la economía global, en general, y los fenómenos económicos de crisis en Rusia, en particular, incluida la creciente influencia de las consecuencias negativas de la política de sanciones hacia nuestro país en 2014-2015. Los estudios altamente especializados sobre los problemas considerados son claramente insuficientes, la urgencia de la mayoría se pierde en relación con el desarrollo mega-dinámico de las relaciones públicas, el cambio en la política estatal.

**Palabras clave:** Pirámides financieras, seguridad económica, quiebras, causas penales.

## INTRODUCTION

Currently, the search for new, optimal time-based models for the prevention of economic crimes is underway. On the one hand, states should react to facts of illegal actions of citizens and legal entities, and, on the other hand, the state must provide an opportunity to develop domestic business, is interested in increasing foreign investment in the Russian economy.

According to the Russian Interior Ministry, in 2014, more than 160 organizations operating in the Russian Federation with the signs of “financial pyramids”, whose illegal activities suffered more than 9,000 citizens, and the amount of damage caused amounted to 1.7 billion rubles. In connection with the existence of the damage already caused, more than 200 criminal cases were initiated under Article 159 of the Criminal Code of the Russian Federation. The scale of activities of such organizations (associations of citizens) is a real threat to the economic security of the state, as it hinders the flow of money into the real sector of the economy, undermines the citizens’ confidence in legal financial instruments that are legally guaranteed, and also generates social conflicts.

In view of law enforcement practice accumulated by law enforcement agencies (including foreign ones), it is necessary to create, together with self-regulating organizations, effective legal and organizational barriers that prevent unlicensed activity in attracting people’s money. Currently, the draft law on criminal punishment for the creation of financial pyramids has been approved and amendments are being made to the Criminal Code and the Code of Criminal Procedure of the Russian Federation. A financial pyramid is a legal entity or an association of individuals that systematically attracts individuals’ funds by promising a property benefit if payments or other property to persons making monetary contributions is made from money received in the form of contributions from other persons, with the exception of Legal entities that have the right, in accordance with the legislation of the Russian Federation, to attract funds of the population on a permanent basis. When reading this definition, a number of questions arise. First, the activity in the form of organizing a financial pyramid is not entrepreneurial, because it is, first of all, not a risky activity, but simply a collection of money, and not an activity at all. Accordingly, the question arises whether the financial pyramid can be declared bankrupt. Secondly, the phrase “monetary contributions, carried out at the expense of money received in the form of contributions from other persons” should include the phrase “exclusively or in the overwhelming case.” In this case, there should be no real investment activity. Thirdly,

the phrase “legal entities that have the right, in accordance with the legislation of the Russian Federation, to attract funds of the population on a permanent basis”, as well, is required to clarify. Not all legal entities involved in unlicensed banking activities are financial pyramids and the emphasis in this case should be made not on the source of money but on payment terms.

## DEVELOPMENT

International practice and foreign legislation on different approaches to the content of the concept of financial pyramids. So, the state of California defines the pyramids as an “endless chain” and prohibits them on the basis of the law on illegal lotteries. The state of Illinois practices a slightly different approach and classifies pyramids as a criminal act in the form of deception directed against property. Some states, such as Georgia, prohibit pyramids in the framework of legislation regulating business activities and multilevel marketing. The US Federal Trade Commission (hereinafter referred to as the Commission) institutes cases against the pyramids on the basis of the Federal Trade Commission Act, which generally prohibits “fraudulent or deceptive acts or activities in the conduct of commercial activities or affecting it.” Some countries in the world, such as Japan, allow for legislative activities to create and operate pyramid schemes, the Japanese deliberately invest their money and knowingly understand the risk they incur. In November 2013, in the first reading, the Verkhovna Rada of Ukraine passed a law banning financial pyramids. The law was drafted on behalf of President Viktor Yanukovich by the government and the National Commission for the Regulation of Financial Markets. According to this law, the organizers of financial pyramids, both in the real world and in the virtual one, expect penalties from 1.7 to 3.4 thousand hryvnias (200-300 dollars) and imprisonment for a term of 3 to 8 years. In the event that the organizers were several or the people were harmed by a “large sum”, the punishment could be more severe with the confiscation of property. This law defines the concept of a “financial pyramid” - this is a method of attracting financial assets of pyramid participants in exchange for the opportunity to get financial benefits by redistributing financial assets attracted from other participants in the pyramid. The law also contains one exception: the structures that obtained licenses for financial activities in the National Financial Service do not belong to the pyramids. In part 3 of Art. 177-1 of the Criminal Code of the Republic of Kazakhstan defines “*the creation and (or) management of the financial (investment) pyramid, committed by an organized group, a person authorized to perform public functions, or equivalent to him if they are*

*associated with the use of his official position, as well as attracting money or other property on a particularly large scale”.*

International practice and foreign law distinguishes Ponzi schemes and financial pyramids. Ponzi schemes promise high financial returns or dividends that are inaccessible through traditional investments. Instead of investing victims' money, scammers pay dividends to primary investors at the expense of subsequent investors' money. The scheme usually falls apart after the organizer runs away with all the money or when it becomes impossible to find a sufficient number of new investors to continue paying "dividends". This type of fraud is named after its creator - Charles Ponzi from Boston, Massachusetts. He was in the early 1900's. Launched a scheme that guaranteed investors 50% of the return on their investment in mail coupons. Although he was able to pay the original participants, his scheme collapsed after it became impossible to pay to subsequent investors.

As with the Ponzi schemes, money from the financial pyramid collected from new victims is paid to their predecessors to preserve the appearance of legitimacy. In the pyramids, however, the victims themselves are encouraged to attract new victims by paying commissions for recruitment. In the narrower sense of the word, pyramids are fraud in the sphere of investment or marketing, in which a person is offered a distribution or a franchise to promote a certain product. The real profit is obtained not from the sale of the product, but from the sale of the status of the distributor. The emphasis on selling a franchise instead of the product itself ultimately leads to the moment when the flow of new investors stops and the pyramid collapses. Each pyramid as a rule is based on the fact that new participants can return their investments by attracting two or more persons to it. Promoters do not inform future participants that all of them mathematically can not do it, as some members leave, and others exit, returning their investments.

It is necessary to distinguish the concepts of the financial pyramid, Ponzi schemes and legal multi-level marketing schemes. Multilevel marketing programs (hereinafter - MMP), unlike the pyramids and Ponzi schemes, have real goods for sale. More importantly, MMPs actually sell their goods to the end user, without requiring additional contributions or joining the program. MMPs can pay commissions to a long chain of distributors, but they are paid for the actual sale of goods, and not for attracting new members.

## CONCLUSIONS

Pyramids damage not only consumers. In many cases, they affect the current operations of banks and damage the reputation of the banking industry. Many organizers of the pyramids display their schemes as a more perfect alternative to traditional banks and investments. Defendant in the case of the Commission against the company International Loan Network Melvin Ford stated that his company's bonus program was "the most powerful financial system since the invention of banks." At the height of his popularity, Charles Ponzi claimed that he would form a new banking system and share profits equally among investors and shareholders. In *FTC v. Cano* Commission directly considered the influence of the pyramids on the banking system and individual banks. In this case, the Commission pursued the proposed scheme of the Internet pyramid, operating under the banner of Credit Development International. For an initial contribution of \$ 130 and subsequent monthly payments of \$ 30, consumers could join the "Credit Development International" platinum program and become a participant in its "strengthened matrix three by seven." This structure presupposed a seven-level commission of depth, which required participants to bring only three new members. The company said that under this program, participants can earn up to 18 thousand dollars a month. In addition to promises of high profit, the attraction of Credit Development International was the issue of unsecured Visa or MasterCard with a credit limit of 5 thousand dollars at 6.9% per annum. This offer was especially attractive for consumers with a bad credit history, which the company attracted with slogans: "Guaranteed approval without a security deposit! No credit check and solvency! The old bankruptcy is not a problem! ". Representatives of Credit Development International claimed that they could afford such a profitable offer, since they have a special marketing relationship with a large foreign bank Banque Nationale de Paris. According to the record of the meeting with potential clients, the company hinted that American banks are in a conspiracy to not provide the same favorable conditions. A representative of Credit Development International argued that "normal banks do not want people to know about the possibility of getting a credit card at 6.9%." The company presented itself as an alternative to an ordinary bank, stating that "our goal is to become the largest credit union in the world". In fact, according to the evidence of the Commission, Credit Development International did not have any business relations with Visa, MasterCard or Banque Nationale de Paris, nor with any bank wishing to issue credit cards to its members. In the future, the defendants were obviously deceived by one of the banks with whom they had relations. When investors paid the entrance fee by

credit card, the defendants processed not through Credit Development International, but through a front company with a VISA trading account. Accordingly, the defendants substituted their bank in case of a risk of repayment of payments to disgruntled investors by the VISA system. Eventually, members of Credit Development International did not receive their credit cards and according to the calculations of the Commission's economist, 89% of them would never have been able to obtain sufficient income to compensate for the initial installment. The commission was able to obtain a temporary injunction, a court order and a decision to freeze the assets of defendants from Credit Development International. The Commission estimates that over five months of Credit Development International's activity, more than 30,000 consumers from the US, Europe, Australia and South-East Asia lost between \$ 3 million and \$ 4 million as a result of this fraud.

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