

AN ANALYSIS OF THE IMA PONZI SCHEME

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ABSTRACT

Financial scams are one of the most prevalent crimes in India. And one such scam is a Ponzi scam, where gullible investors are given false assurances of high returns with minimal or no risk involved. A good example of such a scam is the recent I Monetary Advisory (IMA) Ponzi scam. This research paper will deeply explain the evolution of the Ponzi scam and how companies make investors fall prey to such scams. This research paper will further explain the IMA Ponzi scam and how its strategy to lure investors was different than usual. Legislations introduced by the Government of India to combat such scams will also be discussed. Finally, this research paper will suggest some red flags which are to be considered by an investor before investing in a scheme and also how to identify whether a scheme is likely to be a Ponzi scheme.

KEYWORDS: IMA, Ponzi scheme, investors, money, government.

INTRODUCTION

Investors are mistrusted by businesses with their structures that guarantee tremendous benefit at reduced risk. One such scam is the Ponzi scam. This scheme was founded by Carlo (“Charles”) Ponzi (1882-1949)¹. He was born on March 3, 1882, in Lugo, Italy. The scam was later on named after him. Ponzi scheme is an fraudulent scheme wherein investors are promised higher returns at low risk of investment. Such companies focus all their attention on attracting new clients to make investments². This method is similar to the pyramid scheme where returns are created for existing investors who, through seeking new investors, have been promised enormous returns with low risk.

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¹ Kaushik Babu, “*The Ponzi economy*”, Vol. 310, Scientific American, pp. 70-75 (2014).

² James Chen, Ponzi Scheme, Investopedia (July 28, 2020, 11:13 PM) <https://www.investopedia.com/terms/p/ponzisceme.asp#:~:text=A%20Ponzi%20scheme%20is%20a,to%20pay%20the%20earlier%20backers.>

One such scam happened in India as well. I Monetary Advisory (IMA) was a company based in Bangalore. It was alleged that the company lured investors by promising higher returns with minimal risk involved using Islamic ways of investment³. It had investments from India and the UAE. The company was founded by Mohammad Mansoor Khan in 2013 and was presented as an Islamic banking company. The company later diversified into other businesses like jewelry (IMA Jewels), real estate (IMA Builders and Developers), hospitals (frontline multispecialty hospital), and many more.

In this research study, the author will describe the Ponzi scheme, how it got this name, and how companies do it. Later, the author will talk about IMA and how it lured investors into this scheme and how the investigation into this probe was done. Further, the author will discuss the aftermath of this scam. Finally, the author will discuss the approach of Indian laws towards the Ponzi scheme.

METHODOLOGY OF RESEARCH

To write this research paper, the author has adopted the “qualitative doctrinal method research methodology”. Analysis is conducted using secondary sources of information, such as comments, news article, government records, and databases, etc., under this approach. Unlike other research methodologies, and this methodology does not include any fieldwork. This research methodology is also known as the armchair methodology of research.

This research work is doctrinal. The author has analyzed and made use of secondary sources like newspaper articles, research papers, and search engines to perform this research work. The articles or research papers are also cited wherever required.

RESEARCH OBJECTIVES

The objective behind researching on this topic is as follows:

³ IMA scam: all you want to know about Ponzi scam in Bengaluru, Times of India, (July 29, 2020, 10:03 AM) <https://timesofindia.indiatimes.com/india/ima-scam-all-you-want-to-know-about-ponzi-scam-in-bengaluru/articleshow/72950311.cms>

- To briefly describe the Ponzi scheme and how it got its name
- How investors fall prey to such scams.
- To depict the same scam done by I Monetary Advisory (IMA)
- To show how was the investigation done regarding the same by the concerned authorities.
- To provide the aftermath of this scam.
- Ponzi scheme in the Indian laws.
- To give some recommendations that can be considered to stay away from such scams.

LITERATURE REVIEW

James Chen, Ponzi scheme, Investopedia: this news article describes everything about the Ponzi scheme. The author gives a brief comparison of the Ponzi scheme with the pyramid scheme. He describes that both are fraudulent arrangements based on a false promise of returning higher profits to the investors. Both schemes generate returns for older investors by procuring money from new investors. Apart from this, the author describes the origin of the scheme, which happened back in the 1920s, and how it has changed with the development of the technology. The author explains this by giving a historical precedent regarding the same, that is, a Ponzi scheme that happened back in 2008. Finally, the author gives some warnings o as to identify whether a particular investment scheme is a Ponzi scheme or not.

Kaushik Babu, “The Ponzi economy”, Vol. 310, Scientific American, pp. 70-75 (2014): the author of this research study highlights the history and the origin of the Ponzi scheme and how it brought many innocent investors under its net by the citing the example of Bernard Madoff, who was put into jail for running such scheme. The author further states by showing Bernard as an example, that how a Ponzi scheme is a get-rich-quick scheme, which will flourish the market until the reality comes out. The functioning of the scheme with a numerical example is also given. Finally, the author cites the various example of the Ponzi scheme happening and how it is changing with the rapidly changing technology as well.

“IMA scam: all you want to know about Ponzi scam in Bengaluru”, Times of India: this news article talks about the investigation part of the scam and how CBI approached the matter. Further, the news article describes how this matter came into the light and later, talks about the founder, Mohammed Mansoor Khan, and his investment strategy, which focused primarily on Muslims. So far as the probe is concerned, the agency had found that more than four thousand crore rupees of deposits were raised from four lakh innocent investors. Khan was arrested by the ED and is currently under judicial custody.

“Bill introduced in Lok Sabha to check the Ponzi scheme”, Economic Times: this news article briefly discusses the bill recently passed by the parliament, that is, the banning of unregulated deposits schemes bill, 2019. The intention with which the bill was introduced in the Lok Sabha was to protect innocent investors from the Ponzi scheme. The bill seeks to handle the fiasco of illegal deposits taking activities in the country. Such activities exploit regulatory gaps in the country. This bill aims to lay out a thorough technique to ban the unregulated deposits schemes, except the deposits taken in the ordinary course of business. It provides harsh punishments of imprisonment ranging from one to ten years or a fine from two lakh to fifty crores.

Prathima Nandakumar, “Was the Ponzi scam an open secret in political circles?” The Week: this news article describes the political link of the IMA Ponzi scheme, which prevented it from getting exposed in the public. The author described the modus operandi of this particular scheme which involved local politicians. IMA used to rope in local politicians, community leaders, and also moulvis to make people believe that they are the shareholders of the company and they will get higher returns upon investments. The company used to make prompt payment initially, which would create hype around the company. However, this did not last long and the company failed to make payments. The influence of this company in the political circle was an open secret, but fearing backlash from the community and because of the election going on, nobody tried to expose the scam.

HISTORICAL BACKGROUND OF PONZI SCHEME

There are several schemes available in the market which is sold with a tag of “assured returns” to the investors. The latter, who are not bothered with the mechanism, involved in the scheme which makes such bizarre claims blindly, invest their hard-earned money in such schemes. And unfortunately, fall prey to what is called as investment fraud. There are various types of investment fraud. Offshore scams, pump-and-dump, advance fee fraud, pyramid schemes, etc. just to name a few.⁴ One of such fraud which an investor for prey to is the Ponzi scheme

A Ponzi scheme is an investment scam that promises investors with huge returns with minimum or no risk involved. So far as the origin of the term is concerned, the “Ponzi scheme” was coined after a fraudster named Charles Ponzi in 1919. It is a “get-rich-quick” scheme that can successfully be executed with a good marketing strategy.⁵ But it is to be taken with a pinch of salt as this is a short term money generating scheme and it is bound to collapse. Notwithstanding the above fact, the origin of this practice can be traced back to the 1800s. In Germany, it is believed to be first mobilized by Adele Spintzeder and in the United States, by Sarah Howe.⁶ The method which is used in a Ponzi scheme was described by Charles Dickens in his two different novels, that is, “*Martin Chuzzlewit*”, published in 1844 and “*Little Dorrit*” in 1857.⁷

The initial plan of Charles Ponzi in 1919 was based on the US Postal Service.⁸ In those days, foreign reply coupons were established by the postal service, enabling a sender to pre-purchase and include postage in their correspondence. The receiver will take the coupon to a nearby post office and exchange it for a reply to the appropriate priority airmail postage stamps. Arbitrage is called this procedure because it's not illegal. Ponzi, however, became greedy and decided to expand his reach. Under the banner of his company, he assured to generate returns of 50% in forty-five days or 100% in 90 days. Because of his initial success in the postage stamp scheme, investors lured to invest money. Meanwhile, Ponzi just redistributed the amount collected to the investors under the banner of profit which the investors earned. This scheme lasted until late 1920, after which, The Boston Post began

⁴ “Types of investment fraud”, SAVE AND INVEST.ORG (30 Sep. 2020, 5:07 PM) <https://www.saveandinvest.org/protect-your-money-spot-and-avoid-fraud/types-investment-fraud>

⁵ Supra note 1.

⁶ Supra note 2.

⁷ *Id.*

⁸ Supra note 1.

investigating the company. As a consequence of which, Charles Ponzi was arrested by the authorities on the 12th of August, 1920. He was accused of several counts of mail fraud.⁹

Ponzi schemes are prevalent today. Thanks to the ever-advancing technology, such scams happen at an even larger scale. An example of this can be found back in the year 2008 when Bernard Madoff was declared guilty of operating a Ponzi scheme.¹⁰ With the help of the technology, he was able to falsify trading reports which assured the client that his investment is bearing fruit. But actually, such investment was never made by the company and hence, the investment never existed.¹¹

HOW COMPANIES LURE INVESTORS INTO THIS SCHEME?

The companies running such schemes first will have to attract investors. This is achieved by making false claims, with little to no risks involved, of guaranteed high returns. Such companies divert all their attention and energy to attract new investors on regular basis. This is an important step that is to be done so that money obtained from new investors is used to be paid to existing investors. This process of borrowing money from new investors to pay off existing investors goes on until the scam is busted by the authorities.

The target audience of companies running such schemes are people who are new to the stock market, who are afraid of the unpredictable existence of the equity market, or those who are not happy with the returns provided by bank fixed deposits. The need to make money quickly is so strong that it overwhelms the financial wisdom of investors several times. Despite the unnatural business model of less well-known firms, they are drawn to promises of hypothetical returns made by them.

Someone is to ask this question that what is the modus operandi followed to operate a Ponzi scheme. First, they attract investors by assuring high returns and offer to pay in instalments. The first few batches of instalments are properly paid by the company to the existing investors. This creates word of mouth publicity which helps them to attract more new investors.

⁹ *Id.*

¹⁰ “SEC Charges Bernard L. Madoff for Multi-Billion Dollar Ponzi scheme”, U.S Securities and Exchange Commission (30 Sep. 2020, 7:13 PM) <https://www.sec.gov/news/press/2008/2008-293.htm>

¹¹ *Id.*

Most of the Ponzi schemes operate under the banner of a plantation or a multi-level marketing (MLM) company¹² An MLM is a sales strategy wherein an agent is remunerated for not only selling products but also recruiting new salespeople for the company. This in return creates a hierarchy of salespersons. They represent themselves to be a company registered under the Companies Act and some even flaunt their ISO certification. But in reality, most of these certifications are fake and don't even have the approval to collect deposits from the public. They target rural or semi-rural areas, as financial awareness in such places is lower as compared to urban areas. This is done with the help of aggressive marketing strategies. For getting this done, companies hire agents, by offering them a high commission. As said earlier that these companies focus on expanding their network and creating a hierarchy, it often becomes a challenge for regulatory agencies to catch hold of each agent.

The basic premise of this scheme is to receive a continuous flow of money. This will happen if the company can find out new investors regularly. If they aren't able to find a sufficient number of investors, the inflow of money would be disturbed, ultimately putting an end to such schemes.

In 2017 alone, 63 companies that were involved in "chit fund/MLM/Ponzi activities" have been assigned to the Serious Fraud Investigation Office (SFIO) for scrutinized examination.¹³ Both the authorities at the central and state level are taking have been making attempts to curb such kind of schemes.

THE IMA PONZI SCHEME

As mentioned in the previous chapter that there are various ways by which a company may lure investors and make them invest a heavy amount in them. But I Monetary Advisory (IMA) came out with a different approach to attract investors. This company made investors invest money by playing the religion card.

¹² Dipak Mondal, "Be wary of investment schemes with high returns", BUSINESS TODAY, (30 Sep. 2020, 7:46 PM) <https://www.businesstoday.in/moneytoday/cover-story/accounting-fraud-investment-schemes-ponzi-scheme-high-returns/story/22665.html>

¹³ "Ponzi Scheme: All you want to know", TOI (30 Sep. 2020, 9:28 PM) <https://timesofindia.indiatimes.com/business/india-business/ponzi-scheme-all-you-want-to-know/articleshow/66542589.cms>

I Monetary Advisory was a company headquartered in Bangalore founded in 2008¹⁴. The company was a successor of the company called Iliyas-Mansoor Advisory which was dissolved in 2006.¹⁵ The latter company was founded in 2006 by Mohammad Mansoor Khan, a management graduate, along with his business partner named Iliyas. I Monetary Advisory (IMA) was founded by Mohammed Mansoor Khan and he decided to keep the same initials as the name.¹⁶ This company purported itself as Islamic banking companies and had investors both in India and the United Arab Emirates (UAE). When the company was first launched in 2006, it came out as a business that promised to deliver a return of 7% to 8% on investments.

Khan, to finance his projects, roped in several local *Netas* and local *maulvis* to talk for him, as far as his investment strategy is concerned.¹⁷ All his employees were always in white *kurta* pyjama to flaunt the Muslim identity of his business, grew long beards and read *namaaz* in the office. He donated some amount of money to masjids and madrassas. Each investor was given a copy of the Holy Quran as a gift. Just like in any other Ponzi scheme, all the initial investors were given back handsome cheques. This created word of mouth publicity which encouraged more and more investors to invest money. Khan's enterprise expanded in many industries let it be in infrastructure, jewelry, education, healthcare, etc. soon, his name became a household name amongst the Muslim community. Using his Islamic identity added another feather on the cap.

The scheme was going well, at least from the perspective of Mansoor Khan until the investor's faith in Khan started to cripple after 2017. The company seemed to be backing off from its claims of an assured 7% to 8% return. The returns started to shrink, from an overwhelming 9% to 5%, and then soon to a negligible 3% from mid-2018. The returns went further down to 1% in February and further, it slipped down to zero in May. This continuous downfall panicked investors. They tried to approach various offices of the company, only to realize that the offices were shut. Khan was flooded with investment withdrawal requests, but didn't bother to attend them and went underground.

¹⁴ Ram Theja, "Tracing the meteoric rise of IMA jewels scam Kingpin Mansoor Khan", THE NEWS MINUTE (30 Sep, 2020, 10:07 PM) <https://www.thenewsminute.com/article/meteoric-rise-i-monetary-advisory-and-its-founder-mansoor-khan-103843>

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ Supra note 3.

INVESTIGATION AND AFTERMATH OF THE SCAM

It was too late when all the investors realized that they had been duped by the company. This severe agitation amongst the investors leads to an investigation lead by CBI. This matter got attention when Khan fled to Dubai and left a video behind that says that Khan is going to commit suicide because there is massive corruption in the state and central government.¹⁸

In its investigation, CBI found that more than Rs.4000 crore was raised illegally by the company from lakhs of innocent investors. But still, the state CID gave a clean chit to the company and its director.¹⁹ Finally, on July 21, 2019, Mansoor Khan was arrested by Enforcement Directorate (ED) upon his arrival in Delhi. Before handing over the case to CBI, the Karnataka state government set up a special investigating team (SIT). As of 24th December 2019, some Rs.3,000 crore were outstanding in the form of principal amount and interest in respect of 76,000 investors.²⁰

From this whole episode, it can be interpreted that this scam operated by the company was thriving on its political connections. The modus operandi in a Ponzi scheme includes roping in agents, who help the company create a hierarchy. The same happened in this scam as well, but rather than agents, the company roped in local *maulvis*, politicians, and community leaders. This helped the company to create a network faster as these people already had a set of loyal followers. The political connection of the company made the investors assume that the company is genuine and give returns as promised.

This scam bought out a large political and criminal nexus with the company as it survived for 13 years despite an alert from RBI in 2015 along with a forfeiture notice by the state government. Even though RBI warned the state government that the IMA scheme was a “scam-in-the-making”, no heed was paid to it and no action was taken by the state police. The courtesy goes to “High connections” of the company with the state government. Rather than taking action, the state responded that “the funding was under Limited Liability Partnership (LLP)” and as per the Karnataka Protection of Interest of Depositors in Financial

¹⁸ Supra note 3.

¹⁹ *Id.*

²⁰ *Id.*

Establishments (KPID) Act, the investors were investing as “partners”, not “depositors”, and hence, no action could be taken.²¹

It was evident that this scam was openly known in the political circles. But fearing the political connections with the company and also the backlash from the community during elections, this matter was kept under the carpet.²²

The total loss to the investors was estimated to be around Rs.2,500 crore.²³ After an analysis done by ED of 105 bank accounts related to IMA, it is believed that Mansoor received around Rs.4,000 crore.²⁴ Mansoor diverted the money in over 14 different companies and the total losses to these companies are estimated to be around Rs.5,000 crore with a loss to IMA alone at Rs.2,500 crore.²⁵

PONZI SCHEME FROM THE PERSPECTIVE OF INDIAN LAWS

It is because of such schemes; gullible investors fall prey to them and invest their life savings on such schemes, just to realize that they have lost all the money invested. Such people not only lose their hard-earned money but also lose their trust in the financial market. This is especially detrimental to the economy because if people stop investing money fearing such losses money would leak out of the economy as it won't be channelized towards meaningful investments. The government of India, to curb this menace, introduced a bill in Lok Sabha to save investors from Ponzi schemes.

In 2019, the government passed the Banning of Unregulated Deposits Schemes Bill, 2019.²⁶ This bill aims to create a system by which such depositors can be compensated and also deal with the menace of illegal deposits.²⁷ Such activities are exploiting the regulatory gaps and

²¹ Prathima Nandakumar, “Was IMA Ponzi scam an open secret in political circles?” THE WEEK, (30 Sep. 2020, 11:45 PM) <https://www.theweek.in/news/india/2019/06/13/was-ima-ponzi-scam-open-secret-political-circles.html>

²² *Id.*

²³ K.V. Bhardwaj and Imran Gowhar, “IMA Ponzi scam: The unraveling of an investment fraud”, THE HINDU, (30 Sep, 2020, 11:54 PM) <https://www.thehindu.com/news/national/the-unravelling-of-an-investment-fraud/article28213945.ece>

²⁴ Rajiv Kalkod, “IMA scam: ED slaps notice, minister says ready to answer all questions” TOI, (30 Sep. 2020, 11:59 PM) <https://timesofindia.indiatimes.com/city/bengaluru/ima-scam-ed-slaps-notice-minister-says-ready-to-answer-all-questions/articleshow/69995241.cms>

²⁵ *Supra* note 25.

²⁶ “Bill introduced in Lok Sabha to check Ponzi Schemes”, THE ECONOMIC TIMES, (1 Oct. 2020, 10:23 AM) <https://economictimes.indiatimes.com/news/politics-and-nation/government-introduces-bill-to-check-ponzi-schemes-in-lok-sabha/articleshow/70296479.cms>

²⁷ *Id.*

weak administrative measures. It was introduced in the lower house by the Finance minister Nirmala Sitharaman.

This bill has got adequate provisions to punish those companies who illegally raise deposits from the public. The mechanism which it intends to put in place will facilitate repayment of depositors without delay by attaching the assets of the company in which they had invested. However, it ensures that the provisions mentioned will not apply to those deposits taken in an ordinary course of business so that it can be ensured that other business organizations carry on their work by taking deposits in the ordinary course of business without facing trouble.²⁸ This legislation draws a line between those organizations that are illegally raising money from the public and those organizations that are genuinely raising money during the ordinary course of business. This had to be done so that it can be ensured that there's no hardship faced by genuine businesses, and also those individuals who are facing a tough time financially and are borrowing money from friends and relatives.²⁹

So far as the penalties and punishments are concerned, the bill mentions about punishments ranging from 1 to 10 years of imprisonments and fines ranging from Rs.2 lakh to Rs.50 crore, as the case may be.³⁰

CONCLUSION AND RECOMMENDATIONS

People investing rather than saving is something very beneficial for an economy, as it ensures the money flowing in the economy. The government should incentivize people to invest. But because of such fraudulent practices happening, people lose their hope in investing. The government should create awareness regarding this and should warn its people that investments promising abnormal returns in a shorter span of time may never give fruitful results.

Companies involved in such malpractices always try to find new ways to fool people into investing their savings. IMA, in this case, made people invest under the banner of religion. Religion may be very sensitive to an individual; there is always a chance that such individuals may be exploited in the name of religion. In such instances, people, rather than dwelling on emotions of their religion and investing on an emotional basis, should

²⁸ *Id.*

²⁹ *Id.*

³⁰ *Id.*

consciously think before investing in such schemes. After all, it's their hard-earned money and no one is as concerned as they should be.

This case also brought out the political connection of the company into the limelight. Even though the government introduced legislation to curb such fiascos from happening is a welcoming move, the government should also ensure that these political connections of a company are in check.

Below are some recommendations which can be considered before investing to remain safe from Ponzi schemes:

- If a company is ensuring abnormally high returns on investment, do take it with a pinch of salt. Because it is obvious that returns are directly proportional to risk, the more risk one is willing to take, the higher the rate of return one may expect. So, therefore, no investment can assure guaranteed returns. Such investment opportunities are signs of fraud in the making.
- Usually, Ponzi schemes ask for a higher initial investment from investors. That's the reason why people who fall for it invest their life savings in it. The reason behind demanding a higher investment is because these companies do not have a fixed source of income. So to pay its initial investors along with the interest promised, they are obliged to ask higher initial investment. A genuine company will always ask for a reasonable amount of initial investment.
- It was mentioned earlier that to raise money from the public, a company is supposed to receive a certification from authorities like SEBI or RBI. So to make sure that the money is going in safe hands, do ask for these certifications.
- Before investing in any company which claims to give abnormal returns, do go through the business model of that company. Invest money only if it is found to be satisfactory. Never invest in those companies which say that their business strategy is a secret or too complex to explain.
- One should go through the terms and conditions of the investment which a company offers. A genuine company will have a refund or exit policy, but if a company has no refund or exit policy, better refrain from investing in it.
- An investor has a right to ask for financial statements from the company and should exercise it on regular basis. A genuine company will provide its investors with their



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financial statements at regular intervals, maybe monthly, quarterly, or annually. But if a company fails to provide so, then there may be something wrong going on.

