

Investor Education

Securities Division, Maryland Attorney General's Office

Pyramid Schemes: Investor Beware!

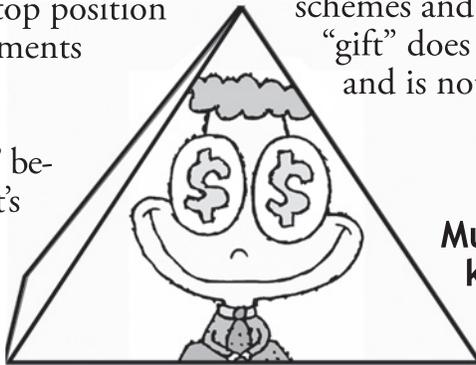
Many people are looking for ways to earn extra money. Some are attracted to “pyramid schemes” that promise impressive profits for little effort. However, pyramid schemes are risky, and they are **illegal** in Maryland and every other state.

In a typical **pyramid scheme**, a person pays a set amount to the promoter to join the pyramid and then convince others to do the same. Each person supposedly will have the opportunity to advance to the top position in the pyramid and receive payments from numerous other persons.

These scams are called “pyramids” because part of each new participant’s investment goes to other earlier investors. There are often several levels of investors, with only a few investors at the top level, and an increasing number of investors in the newer, lower levels. In order for everyone in a pyramid scheme to profit, there would have to be a never ending supply of new participants who are willing, ready and able to pay money into the scheme. Inevitably, however, the scheme runs out of potential participants, leaving a large number of investors empty-handed.

Anyone who establishes, promotes or advertises a pyramid scheme in Maryland is committing a criminal offense that may result in a fine of up to

\$10,000 or a prison sentence of up to one year. Pyramid schemes can take a variety of forms. One example is a Gifting Club or Network. These clubs are structured to pay off early investors with money coming in from later investors. Often, these gifting clubs are promoted among friends, neighbors, co-workers, and even church groups. Because there is no source of funds other than money from new investors, and because the number of new investors eventually dries up, these gifting clubs are pyramid schemes and eventually collapse. A legitimate “gift” does not come with strings attached and is not an investment opportunity.



Multilevel or Network Marketing Plans

Pyramid schemes also may try to pass themselves off as multilevel marketing plans, or network marketing plans. These plans are a way of selling goods or services through distributors who earn commissions both from their own sales and from the sales of others they recruit into the plan. Multilevel marketing plans usually promise to pay commissions through two or more levels of recruits, known as the distributor’s “downline.” A multilevel marketing plan is an illegal pyramid scheme, however, if participants earn money **primarily** from the recruitment of others into the plan, rather than from the sale of a product or service.

It may be difficult to determine in advance whether something calling itself a multilevel marketing company is in reality a pyramid scheme. Here are some warning signs of a pyramid scheme:

- The plan offers a product or service to disguise its true nature, but the product or service may be overpriced, useless, or have no established market. Examples include exotic vitamins, health tonics, diet aids, miracle cosmetics, new inventions, financial “secrets,” and precious coins or gems.
- The company employs hard sell tactics or group psychology to pressure new recruits to sign up as distributors. Seminars and meetings may resemble old time revivals with stories of great wealth and promises of easy money for all, with very little effort required.
- New distributors are required to pay substantial initial fees or are told to purchase a large amount of product inventory up front.
- The purchasers for the plan’s products or services seem primarily to be new and existing plan distributors, rather than the general public.
- Distributors must commit to receiving shipments of product each month, whether or not distributors need the inventory.
- The company advertises the multilevel marketing plan as a “job” in the help wanted sections of newspapers or on Internet employment search sites.
- The company or promoters represent that the plan has been approved or registered by a government agency. In Maryland, no governmental agency approves or registers any multilevel marketing plan.

- The terms and conditions of membership, the compensation plan or the refund policy are hard to understand.
- The company or promoters show off large commission checks or luxury items earned by other participants
- Promoters suggest that distributors can earn significant “residual income” for little or no effort.

If you are thinking about joining a multilevel marketing company, watch out for these signs. The plan may be nothing more than a pyramid scheme. If you join, you may not only lose your money, you also may be violating the law.

For more information, or to check on any investment opportunity, contact the Maryland Attorney General’s Office, Division of Securities by calling (410) 576-7042 or e-mailing securities@oag.state.md.us.

