

STUDY OF THE MECHANISM FOR THE IMPLEMENTATION OF CRIMES RELATED TO PYRAMID SCHEMES AND METHODS OF THEIR PREVENTION

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ABSTRACT

The objectives of scientific work are to conduct a detailed analysis of the mechanism of implementation of pyramid schemes, their classification, and features, which provides an opportunity to highlight methods of prevention and search for methods to reduce the level of such criminal activity. These objectives of the study can be achieved thanks to methodological approaches that reveal theoretical and practical aspects of the work. Such methodological approaches should include theoretical, dialectical, and formal-legal, as well as methods of deduction, induction, synthesis, and others. In the course of the study the mechanism for the implementation of the pyramid schemes, and the current state of the pyramid schemes were considered. The authors study the regulations of the activities of financial pyramids on the territory of several countries. The article listed the risks of crowdfunding and its impact on economic security and the economic system as a whole. In addition, shortcomings in criminal procedure legislation were highlighted. The specificity of the commission of this type of crime lies in its detection and avernment, based on which recommendations were made to improve the legislation, as well as the methods and ways of crime prevention related to the pyramid schemes.

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1. INTRODUCTION

Modern conditions of society provide an opportunity for the development of the world market effectively and on a large scale. This is due to the emergence of a large number of private companies, enterprises, and organizations that are difficult to monitor and track their activities. In recent decades, quite a number of crimes related to the financial pyramids have been solved, but even so, people continue to invest money in doubtful companies and organizations. The concept of a “pyramid scheme” should be interpreted as a system of providing the parties of the structure with income by attracting the funds of new participants. This means that the money is paid to the first participants of the pyramid scheme by receiving the funds of subsequent participants¹. As a result of the activities of such financial pyramids as “MMM”, “Russian House of Selenga”, “Haper-invest”, “Sovereign” and many others, financial damage was caused more than 1.6 million. More than 1000 criminal proceedings have been initiated in connection with the activities of the pyramid². In the current circumstances, the pyramids have changed the way they are implemented, but not the principles of work performance. They tend to adapt to constant changes in financial market trends, the emergence of new financial sector services and economic infrastructure, as well as digital financial technologies. The principle of activity, however, remains the same – pyramid schemes do not carry out real economic activities, attracted funds do not participate in the money turnover, and payments for parties of the pyramid scheme are made at the expense of money, introduced by new participants³.

In other words, pyramid scheme activities involve income generation by attracting money from new participants to the pyramid scheme. A factor contributing to the emergence of these criminal organizations is the relatively low financial awareness of the population. The activities of these structures pose a threat to public safety, as the participants in the financial pyramids and their illegal schemes are a large number of participants from various segments of the population. They fall under the influence of fraudsters, who in

¹ Chemodanova, Yu.V. et al.: Ponzi schemes as one of the types of economic crimes in the monetary investment market, *Science Integration*, 8 2018, p. 281.

² Bondarenko, V.V., Guseva, E.S.: Modern Russian financial pyramids: countermeasures, *Service Sector: Innovation and Quality*, 54 2021, p. 103.

³ Cunderlik, L.: Fraudulent Schemes in the Financial Market (Financial Pyramids) –Detection and Prevention, *Financial Law Review*, 21(1) 2021, p. 16.

various ways and methods promise scam victims income on a quick and easy basis. Most of the criminal cases related to pyramid schemes are investigated for the embezzlement of citizens' funds through the organizational and legal norms in the form of private limited companies, public joint stock companies, joint-stock companies, etc., or consumer credit cooperatives⁴. The dynamics of these crimes are increasing every year, and at the same time, the number of victims and the amount of damage suffered is increasing. The peculiarity of pyramid schemes is the compensatory nature of their activities. Its essence lies in the fact that the reattached money raised by the new parties of the structure will compensate the money of those participants who joined the earlier stages. This allows us to characterize the essence of the pyramids in the legal and economic spectrum⁵.

Based on the above stated, it is of particular importance to examine the mechanism for the implementation of these crimes to provide a more detailed analysis and assessment of the criminal aspects of criminal activities related to the pyramid investment scheme. This can be achieved by studying the concept of "a pyramid scheme", highlighting its main characteristics, principles of action, features, as well as ways of carrying out this unlawful activity. Equally important is the aspect that contributes to the study of methods for the prevention of crimes related to pyramid schemes. In particular, such as the involvement of the mass media, the study of ways to increase financial awareness of the population, as well as other methods to reduce the incidence of these crimes and prevent the risk of fraud abuse, will have a significant impact on the legal and economic spheres.

2. MATERIALS AND METHODS

Various methodological approaches have led to scientific research on the criminal aspects of crime related to pyramid schemes posing a significant risk to society. The first such approach is the system analysis, which provides a holistic mechanism of the criminal act connected with the pyramid schemes, as a set of its elements based on the identified characteristic interconnected features of the implementation of this type of crime. Based on the deduction

⁴ Milyakina, E.V.: Economic and legal approach to the systematization of methods for committing crimes related to the organization of financial pyramids, *Scientific Portal of the Ministry of Internal Affairs of Russia*, 1(53) 2021, p. 87.

⁵ Lv, F., Huang, J., Wang, W., Xin, G., Wang, B.: Detecting pyramid scheme accounts with time series financial transactions, in: *2018 IEEE Third International Conference on Data Science in Cyberspace (DSC)*, The Institute of Electrical and Electronics Engineers Inc., Piscataway, 2018, pp. 722-728.

method, it is possible to provide elements characterizing this criminal phenomenon on the basis of a holistic mechanism. The method of concretization helps to establish the identified theoretical aspects in the form of their practical implementation by providing a scheme for the implementation of this type of criminal act. In studying the criminal limbs and the legislation regulating criminal liability for crimes related to pyramid schemes, mention should be made of the importance of using the formal dogmatic method. This method considers these aspects and norms as a system of fundamental rights and legal conviction, means, and methods of legal regulation through the prism of prevention of this type of crime.

The dialectical methodological approach involves a comprehensive and complete study of the functioning of crime related to the pyramid schemes; an analysis of the existing links between its characteristic elements; study of possible contradictions by analyzing and synthesizing the identified aspects in the context of the transition from theoretical components to their practical implementation. The comparative analysis method will assess international experience in preventing crimes related to pyramid schemes, namely the experience of the United States of America (USA), China, the Netherlands, the Russian Federation, and others. The synergistic method would, in turn, make it possible to study the criminal limbs of the crime as self-organizing systems.

Thus, the authors of this work highlight the following stages in the scientific work. The first stage reveals the theoretical component of the article, namely the analysis of the concept of “pyramid scheme” and consideration of the features of this type of crime. Crimes related to the use of the pyramid scheme have also been described. This provides an opportunity to analyze in more detail the mechanism for the implementation of these crimes. The second stage includes an analysis of the legal framework, which makes it possible to highlight the provisions criminalizing particular crimes. This will make it possible to describe the criminal limb of the study. Also at this stage, the delimitation of this type of crime with illegal business activity, illegal banking activity, and other types of crime in the economic domain is considered. The third and concluding stage of the study, based on the theoretical and practical aspects and methods of the implementation of this type of criminal activity, identifies methods and ways for the prevention of crimes related to pyramid schemes and reduces the crime rate incidence of this type of criminal activity.

3. RESULTS AND DISCUSSION

3.1. MECHANISM FOR THE IMPLEMENTATION OF CRIMES RELATED TO FINANCIAL PYRAMIDS AND THEIR FEATURES

The danger to the public of the pyramid schemes consists in the dismantlement of the foundations of the proper functioning of the banking system, the withdrawal of a significant amount of cash from tax and financial control into the shadow economy, the growth of indicators of social strain, as well as the loss of public confidence in the financial institutions of the state. Therefore, of particular importance is the examination of the mechanism of the pyramid schemes for a better understanding of this type of fraud. In general, the pyramid scheme is an unstable business model, where several stricture members at the “top” of the pyramid are engaged in finding and attracting new members who will pay the prepaid expenses in chain order to the persons who attracted them to such a structure. Based on how new participants will submit new reports, some of the subsequently attracted funds will also go “up the chain”. Often, financial pyramids can also be called “pyramid fraud” and in many states such activity is illegal⁶.

The name of the “pyramid scheme” stems from the fact that this structure as a whole resembles the structure of the pyramid, which begins with its founders in the person of one or more subjects. Then the number of participants in the pyramid gradually increases, but at the same time, the status of participants based on each new wave of such participants gradually decreases⁷. In this way, the people at the top of the structure receive funds, and the people who occupy the lower niche lose funds. Considering the main features that characterize the pyramid scheme, it is necessary to highlight the promise of a high percentage of profitability, the lack of official registration or the statute for the legal implementation of this activity, declaration by the founders of the pyramid investment scheme of minimum risks. It is also noted the presence of combative advertising, and payment at the expense of receipt of funds from new participants, creating the illusion in the form of thoughtful implementation of this kind of activity and its validity. Next, we emphasize the rapid and maximum attraction of new participants in the pyramid structure, the promises of get-rich-quick, the financial damage to depositors of such a structure, and the

⁶ Feng, P., Sun, D., Gong, Z.: A case study of pyramid scheme finance flow network based on social network analysis, *Sustainability*, 11(16) 2019, p. 4370.

⁷ Rastuti, T.: The empowerment of communal and socio-cultural value in pyramid scheme dispute settlement, *Journal Sampurasun: Interdisciplinary Studies for Cultural Heritage*, 2 2018, p. 108.

actual high risk of investment of finance. As a result, it provides bankruptcy of the pyramid scheme or termination of activity for other reasons⁸.

Thus, analyzing these features of the structure of the pyramid scheme, it should be noted that to maximize the attractiveness of the structure and its maximum expansion, the organizers provide an imaginary return on investment of investors above the market. As the pyramid scheme expands, the possibility of clawback of funds is diminishing. This results in the logical outcome being the collapse of a structure in which investment investors are left without promised money or other capital investment assets. The founders of the pyramid scheme hide with misappropriated funds. An important aspect is also the identification of the main fraudulent activities in the form of the pyramid investment scheme. So, first of all, noted projects that do not hide the structure of their activities and often operate under the guise of “network marketing”. Next, the pyramid structures are identified, which carry out activities under the guise of microfinance organizational structures. They also note pyramids that operate with the expectation of borrowers who have been denied access to other financial institutions. Consider organizational structures whose activity is aimed at offering refinancing services or co-financing of debts of individuals to banks or other lending institutions. Also identified are pseudo-professional financial market participants whose activities are aimed at providing trade services in the foreign exchange market⁹.

The peculiarities of the crimes related to the pyramid schemes are characterized by careful, goal-oriented preparatory activities, most of which are often carried out openly and coincide with legal activities. Considering the modus operandi of criminals on the basis of the pyramid investment scheme, it is noted as a set of goal-oriented and deliberate acts committed by the guilty(s) and the victims, which are taken in as active, and passive or abused to obtain the object of the criminal infringement, in this case – money. Thus, the founders of the pyramid scheme organize the fundraising and obtaining money, while masking the activity. Methods of embezzlement of depositors’ money consist of a set of methods, which are often used by the organizers of investment pyramids¹⁰. Thus, the methods used by the organizers of financial pyramids are

⁸ Sachkov, A.N.: Differentiation of the composition of the organization of financial pyramids with other crimes in the field of economic activity, *Legal Culture in Modern Society*, 8 2021, p. 369.

⁹ Bosley, S.A., Bellemare, M. F., Umwali, L., York, J.: Decision-making and vulnerability in a pyramid scheme fraud, *Journal of Behavioral and Experimental Economics*, 80(June) 2019, p. 1.

¹⁰ Gavrilin, Yu.V.: Expert research methodology for the activities of consumer credit cooperatives and other financial market organizations that have signs of “financial pyramids”, *Pro-*

as follows. There is the reception of attraction of money of individual persons; the acceptance of their disguise; and the acceptance of embezzlement. Considering these methods, it is worth mentioning the choice of the organizational and legal form of the legal entity, which will subsequently accept money. This makes it possible to create a simulation of activities that provide income from cash, and the embezzlement is carried out through the execution of fictitious transactions.

The next method used in the operation of the pyramid scheme is to make a decision that determines the scale of activity, and the disguise in this case is the insurance of the invested money, the embezzlement is effected by paying for works and services of a fictitious nature. It is further noted the development of conditions under which the acceptance of funds will be realized, which is disguised under the guise of privacy measures, and the received money – through their offshore. No less important is the next step, which carries out the procedure of registration of funds received from individual persons, which is disguised under the guise of registration of the organizational structure in offshore areas or as a front person. Received money in such a case is possible due to embezzlement of the raised funds under the guise of collection. Such an admission as the attraction of new participants in the structure of the pyramid schemes is possible due to the provision of partial payments to the members of the structure due to the receipt of funds from new members of the structure, and cash inflow is processed as fictitious loans in behalf of shareholders. Also important is the use of such a method as the organization of advertising and popularization of this project. This is disguised due to bribery, and the procuring of a receipt – due to the investment of income in affiliated structures¹¹. These methods used in the implementation of the pyramid schemes should be characterized in terms of their economic and legal orientation. This conclusion is based on the fact that each method used is based on economic rationality and is decked out in an organizational legal form. Economic relations constitute the content of the relevant legal rules, which have a significant impact on the development of the economic sector.

Thus, the key methods constituting the evidentiary basis of embezzlement using pyramid investment schemes are the use of the received funds from depositors to pay dividends, exceeding the number of depositors in the structure of the pyramid over the recipients of income in a multiple amount, as well as the formation of a fund of cash at the expense of three types of source. There

ceedings of the Academy of Management of the Ministry of Internal Affairs of Russia, 3 2021, p. 148.

¹¹ Medikov, E.V., Rostokinskiy, A.V.: International aspects of the fight against financial pyramid schemes, *Education and Law*, 1 2021, p. 155.

is the receipt of monetary funds from offshore companies, deposits of cash from individual persons, and contributions of founders to capital or capital assistance. Having formed an idea of the mechanism for the implementation of crimes related to pyramid schemes, it is necessary to conduct an economic and legal characterization of the methods used by the founders of pyramid schemes. This allows us to form an aggregate picture of the components and modus operandi of crime.

In Kazakhstan until the adoption of the new Law of the Republic of Kazakhstan No. 292-VI ZRK “On amendments and additions to certain legislative acts of the Republic of Kazakhstan on improving criminal, criminal procedure legislation and strengthening the protection of individual rights”¹² the establishment and management of a financial (investment) pyramid scheme (para. 3 par. 2 art. 217) was a corruption criminal offense. But this criminal offense has now been removed from the list of corruption criminal offenses. At present, the creation and management of the financial (investment) pyramid is envisaged art. 217 Criminal Code of the Republic of Kazakhstan¹³. According to data for the second half of 2021, more than 400000 Kazakhstanis for 417 billion tenge suffered from pyramid schemes between 2020 and 2021. The total number of victims was 40833 people, and the established amount of damage was 417 billion tenge. In his recent message to the people of Kazakhstan, President Kassym-Jomart Tokayev instructed the Prosecutor General’s Office to strengthen measures against fraud and pyramid schemes, as the problem is urgent and carrying a large financial loss¹⁴.

3.2. INTERNATIONAL EXPERIENCE IN COUNTERING PYRAMID SCHEMES

To improve the prevention of criminal acts connected with the activities of pyramid schemes, it is worth noting the world’s experience in countering this phenomenon. Thus, in considering the policy of the United States of America, it is worth mentioning that the organizer of the pyramid scheme may receive a prison term of more than 100 years due to judicial judgment, with full confiscation of his property, including that of his property, which is registered to the relatives of the convicted person. As a result, the organizer is a life-term

¹² Law of the Republic of Kazakhstan No. 292-VI ZRK “On amendments and additions to certain legislative acts of the Republic of Kazakhstan on improving criminal, criminal procedure legislation and strengthening the protection of individual rights”.

¹³ Criminal Code of the Republic of Kazakhstan, (Art. 217).

¹⁴ https://total.kz/ru/news/finans/svishe_400_tisyach_kazahstantsev_postradali_ot_finansovih_piramid_date_2021_09_15_13_14_39,07/06/2023.

prisoner and his relatives are poverty-stricken. As an additional measure to counter these crimes, the United States of America policy has provided for the establishment of an appropriate office. Its purpose is fraud prevention and is regulated on a special website. Citizens have the right to fill in a special electronic form with the notification of economic crime, as well as to get acquainted with recommendations regarding personal security and economic security¹⁵. Furthermore, German policy provides for life imprisonment for the organizers of the pyramid scheme. Also, the legislation provides a ban on the “recruitment” of participants in the structures, where income is generated by the receipt of funds from new participants. The law carries a punishment of two years imprisonment or a penalty for such a crime. Equally important, German law also criminalizes attempts to create a structure¹⁶.

China’s policy in this case is to criminalize not only the organizers of the pyramid scheme but also all persons involved in recruiting new members of the structure, who benefit from a percentage of other participants. Depending on the damages awarded, the death penalty may be awarded for the establishment of the structure. Also, an additional measure to prevent this phenomenon is the appropriation of funds to destroy the pyramid schemes on the online platform, in parallel with the search for evidence of illegal activities of the members of the structure in real life¹⁷. The Competition Act also characterizes the policy of a State such as Canada. The goal of this act is to prevent the development of pyramid schemes. In the event of resistance or non-fulfillment of legal provisions of the act participants in pyramid schemes are required to charge such persons with fraud, imposition of fine to \$200000, or imprisonment for one year. If there is the existence of a pyramid scheme in an unlawful act, the term of deprivation may be increased to five years¹⁸.

Article 172.2 of the Criminal Code of the Russian Federation¹⁹ provides for responsibility for the organization of fundraising activities. That is, in the case of the pyramid scheme, the end of the crime is moved to an earlier stage. According to the legislative structure, the organization of the activities of the pyramid schemes is sufficient to bring the criminal act to an end. In practical application, it is possible that the organization of the activities of the pyramid scheme is not suppressed and fund-raising activities are implemented. In this case, the criminal act may fall under the characteristics of the objective parties

¹⁵ USA Criminal Code.

¹⁶ Criminal Code of Germany.

¹⁷ Criminal Code of the People’s Republic of China.

¹⁸ Model Law on Competition.

¹⁹ Criminal Code of the Russian Federation.

to both components of crime. This related nature of the rules granted makes it necessary to compare the rules on the organization of the activities of pyramid schemes and the wrongful act provided for in article 172.1 of the Criminal Code of the Russian Federation, which includes the falsification of documents of a financial nature in the form of records and financial activity reports. In analyzing established practice in applying the law, we can conclude that pyramid scheme activities in some cases involve the importing of invalid data in financial documents. Therefore, based on the fact that the above-mentioned rules provide for liability for different acts, if the components of both crime acts are found to constitute crimes simultaneously, the relevant rules will be applied together.

It is also worth mentioning that the pyramid scheme is a form of illegal business activity. Since the organization of the pyramid scheme does not include a permit for such activities, it may also fall under the components of a crime, which is regulated by the provision of Article 171 Criminal Code of the Russian Federation, so the conduct of illegal business activities. According to the authors, the implementation of activities related to the pyramid schemes is always illegal business activity. However, the activities of the pyramid schemes should be qualified only according to the provisions, regulated in Article 172.2 Criminal Code of the Russian Federation. Based on the analysis of the legal provision providing for the responsibility for the organization of the pyramid scheme and their correlation with other legal provisions that have similar components of the crime, the study of crime prevention related to financial pyramids and methods of prevention such unlawful acts is an important aspect.

Thus, systematizing international experience in the prevention of crimes related to the pyramid scheme, improving national legislation, financial awareness, and public awareness are common features. It is also worth mentioning the coordination of the work of federal and regional structures to suppress criminal activities related to the pyramid schemes, the development of common methods of judgment proceedings in cases of pyramid schemes, and the organization of additional investigative actions in this field. It is also important to develop and introduce special applications that have in their arsenal the functions of information analysis to identify the commission of unfair acts and misbehavior in the open market. The main factors that may reduce the effectiveness of crime prevention related to the activities of pyramid schemes in the territory of the country lie in the legislative framework and the low financial awareness of the population. Of particular importance is the question of increasing exposure to educational materials to increase financial awareness and public awareness. For example, the placement of video materials on exhibition stands throughout Kazakhstan, on the streets, in public transport, as well as in other crowded places, and, in particular, in physical proximity to financial

institutions, the target allocation of which is to raise money from clients²⁰. It is also necessary to tighten supervision over the activities of organizations that are registered in offshore zones, Internet organizations, and newly established organizational structures, whose activities may correspond to the features of structures acting on the principle of pyramid schemes. There is also a need to criminalize those who engage new entrants into the pyramid scheme.

When analyzing international experience in improving financial awareness, it is worth mentioning, for example, the Dutch Authority for the Financial Markets, which maintains a list of victims of fraud at the hands of crime bosses, communicates with victims of unlawful acts personally, conducts appropriate explanatory talks aimed at avoiding and preventing re-entry into the pyramid scheme. A representative of the Authority for the Financial Markets appears in television programs devoted to financial fraud, where the organization plays a key role in the prevention of this criminal element²¹. Some organizations distribute information aimed at improving financial awareness on social networks, for example, on Twitter or Facebook. These platforms are in high demand and are often used for the rapid transmission of information to warn the population about existing threats to financial security²². An interesting method of the public awareness about financial fraud is the use of a mobile application. It provides users with information and tools for the immediate identification of licensed organizations in the financial market and provides means of ensuring contact with relevant regulatory authorities²³. Another interesting way to increase financial awareness is the creation of a mobile game by the Ontario Securities Commission called “Cranial Cash Clash”²⁴. This mobile game provides multiple-choice questions on the financial topic, including the topic of fraud. Mobile game users can learn more about fraud in general, as well as about pyramid schemes, which are carried out through the use of various tips, links to sources of information, and various advices.

²⁰ Bondarenko, V.V., Guseva, E.S.: Modern Russian financial pyramids: countermeasures, *Service Sector: Innovation and Quality*, 54 2021, p. 103.

²¹ Bekee, S.Y., Osuagwu, O.E.: Intelligent agent-based fraud detection and Prevention model for financial Institutions, *West African Journal of Industrial & Academic Research*, 20(2) 2019, p. 4.

²² Preetha, S.: *Proceedings of International Conference on Cyber Security and Ethical Hacking in Blockchain Technology (ICCSEHBT)*, SCMS School of technology and management, Kerala, 2021, p. 39.

²³ Wackernagel, M.: Is the Global Economy Running a Pyramid Scheme?, in: Wilderer, P.A., Grambow, M., Molls, M., Oexle, K. (eds.): *Strategies for Sustainability of the Earth System*, Springer, Cham, 2022, p. 191.

²⁴ <https://www.getsmarteraboutmoney.ca/tools/cranial-cash-clash>, 06/06/2023.

Thus, having analyzed the mechanism for the implementation of criminal acts on the principle of pyramid schemes, it is worth noting that the suppression of this type of activity is one of the priority directions in modern policy. It was possible to prevent such crimes by increasing financial awareness and strengthening national legislation. At this stage, the structure of the pyramid schemes is attracting more victims and material damage to the victims. Also, the prevention of crime related to the financial pyramids will strengthen the economic status of the country, thus ensuring the economic security of the state.

4. CONCLUSION

A study on the prevention of crimes related to pyramid schemes concluded that the current level of the prevention of this phenomenon was not sufficiently effective. This poses a national danger and has a significant impact on the economic status of the state. In that regard, recommendations have been made to raise awareness of the phenomenon, based on international experience. When considering the mechanism of functioning of the pyramid schemes, it is first of all worth mentioning that this structure is a supporting system, where the income generation of the members of the structure is carried out by fundraising from new participants. This means that the money is paid to the first participants of the pyramid scheme by receipt of funds from subsequent participants. The main features of the pyramid scheme include the promise of a high percentage of profitability, the lack of official registration or charter for the legal implementation of such activities, the declaration of the founders of the pyramid investment scheme of minimal risks, the presence of combative advertising and other considered features.

No less important is the analysis of the provisions that regulated criminal liability for the establishment of a pyramid scheme, which allows a more detailed description of the activities of the structure of the pyramid scheme. When studying international experience in the prevention of crime related to pyramid schemes, they should be systematized based on characteristics. These include the improvement of national legislation, the enhancement of financial awareness and public awareness, and the coordination of national and regional structures for the suppression of criminal activities, related to pyramid investment schemes. The note is taken of the development of a common method of proceeding in cases of pyramid investment schemes and the organization of additional investigative actions in this field, and, equally important, the development and introduction of special applications with functionality, allowing the analysis of information for the presence of unfair factors and misbehavior in the open market.

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