



IT'S TOP TEN TIME AGAIN - REGULATORS IDENTIFY THIS YEAR'S BIGGEST SCHEMES AND SCAMS

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January 27 2004

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It's that time again. State securities regulators have named the "Top 10" investment scams facing investors in 2004. Gone from this year's list are several prominent scams of 2003 - Analyst Research Conflicts, Charitable Gift Annuities, Oil and Gas Schemes, Equipment Leasing, and Viatical Settlements (at least as a separate category). Other scams, featured on the regulators' 2002 list, are back - Ponzi Schemes and Internet. (For a look at last year's Top Ten list see [An Imperfect Ten](#)).

Regulators predict that investors will be confronted with increasingly complex and confusing schemes. "Our fight against fraud never stops because each year con artists discover new ways to fleece the public," stated Ralph A. Lambiase, president of the North American Securities Administrators Association and director of the Connecticut Division of Securities.

Sadly, many of the age-old scams still work to cheat victims of their hard-earned savings as well. It pays to remember that if an investment opportunity sounds too good to be true, it usually is." "Investors lose billions of dollars annually to investment fraud," Lambiase said.

NASAA ranks the top ten scams and schemes in order of prevalence and seriousness, as follows:

1. PONZI SCHEMES. This scam, a perennial favorite that returns to the list after a year's absence, is named for Charles Ponzi, a swindler who took investors for \$10 million in the early 1900s by promising 40 percent returns. A Ponzi scheme promises high returns to investors and uses money from new investors to pay previous investors. The only people who consistently make money are the promoters who set the Ponzi in motion. In Mississippi last year, a Tennessee attorney and a Mississippi securities dealer pled guilty to 58 counts of investment fraud for their role in a Ponzi scheme that bilked 41 investors from four states out of \$10.2 million. Authorities said the victims were told they were investing in a money-trading program that did not exist.

2. SENIOR INVESTMENT FRAUD. State securities regulators said older investors are being targeted with increasingly complex investment scams involving unregistered securities, promissory notes, charitable gift annuities, viatical settlements, and Ponzi schemes all promising inflated returns. Regulators say that volatile stock markets, low interest rates, rising health care costs, and increasing life expectancy, combined to create a "perfect storm" for investment fraud against senior investors. Pennsylvania securities regulators last year shut down a "Ponzi" scheme that targeted seniors, after 13 Philadelphia-area investors lost nearly \$2 million from their pensions and IRAs. In Arizona, a Scottsdale company and four individuals were ordered to return more than \$15 million to mostly senior investors and pay penalties of \$45,000 to the state in a case involving "CD alternatives" earning up to 8.5 percent.

3. PROMISSORY NOTES. These short-term debt instruments often are sold by independent insurance agents and issued by little known or non-existent companies promising high returns - upwards of 15 percent monthly - with little or no risk. They can become a vehicle for fraud when the issuer lacks the capacity or intention to deliver the promised returns. When interest rates are low, investors often are lured by the higher, fixed returns that promissory notes offer. In one recent case, Grammy-nominated polka star Jan Lewan pled guilty to charges that he defrauded investors in 21 states through the sale of promissory notes. Lewan, who defected from Poland in 1979 and has subsequently performed for President Reagan and Pope John Paul II, allegedly offered promissory notes that were supposed to pay an interest rate of 12 to 20 percent. Authorities said investors lost between \$2 million and \$2.5 million. Lewan had previously been banned from selling

securities in Pennsylvania. New Jersey authorities also acted against Lewan in 2003, fining him \$950,000 and prohibiting him from selling securities in the state. Connecticut securities regulators are also investigating Lewan.

4. UNSCRUPULOUS BROKERS. Improper brokerage practices have dominated the headlines in recent years. From misleading research reports to backroom deals with mutual funds, brokerage firms have managed to skirt the rules and the law. Individual brokers have engaged in unlawful practices as well. State securities regulators say they are still receiving a high level of complaints from investors of brokers cutting corners or resorting to outright fraud to fatten their wallets. In October 2003, for example, US Bancorp Piper Jaffray agreed to pay \$2.6 million to settle a complaint by the state of Montana alleging unethical business practices and fraudulent securities dealing by the investment firm and one of its brokers. State regulators accused Thomas J. O'Neill, who was a broker in the firm's Butte office, of making more than 6,000 unauthorized trades for mostly elderly customers between 1997 and early 2001. They said some trades were made for a customer who was in a coma and again after he died. Authorities said O'Neill generated commissions for himself and the firm through the illegal trades that transformed mostly conservative retirement investments into risky portfolios.

5. AFFINITY FRAUD. These frauds bank on the fact that most people tend to trust someone who shares the same heritage, belief, or affiliations. Religious or ethnic identity is a common source for affinity fraud. Scammers often use their victim's religious or ethnic identity to gain their trust and then steal their life savings. In November 2003, authorities arrested five people accused of defrauding evangelical Christians of \$160 million in three years and using the money to live extravagantly. Federal and state investigators charged that a California family promoted an affinity fraud scheme through evangelical leaders and groups, targeting people who shared religious beliefs and common ethnicities. A joint effort involving the FBI, the SEC, the IRS and the Texas State Securities Board, brought criminal and civil charges to halt the scheme, which promised returns of 25 percent within three months.

6. INSURANCE AGENTS AND OTHER UNLICENSED SECURITIES SELLERS. Insurance agents, seeking high commissions, sometimes peddle fraudulent or high-risk investments, such as promissory notes, ATM and payphone investment contracts and viatical settlements. In these cases, the person running the scam typically instructs the independent sales force – usually insurance agents but sometimes investment advisers and accountants – to promise high returns with little or no risk. For example: Arizona securities regulators in 2003 obtained a \$4.3 million final judgment against a Scottsdale company and two insurance agents who fraudulently sold charitable gift annuities to mostly senior investors who were told their money would be invested in secure accounts. Instead it was placed in high-risk, speculative investments while the insurance agents helped themselves to \$1.3 million in commissions. California authorities in 2003 ordered several insurance agents to stop selling viatical investments – interests in the death benefits of terminally ill patients that are always high risk and sometimes fraudulent. The agents promised returns as high as 150 percent in three years, and guaranteed the investment through a “fidelity” bond, but failed to tell investors that the bond was issued by a company incorporated in Vanuatu, South Pacific that is not licensed by to issue bonds in California.

7. PRIME BANK SCHEMES. This one appears on the list year after year. It is perpetrated by con artists who promise investors triple-digit returns through access to the investment portfolios of the world's elite banks – often referred to as “prime banks”. To avoid the onus now attached to these schemes, some of the promoters no longer refer to prime bank, instead selling these investments as “risk free guaranteed high yield instruments” or something equally deceptive. In 2003, five Oklahoma men were convicted on fraud charges stemming from a prime bank scheme in which 5,000 investors lost \$14.6 million.

8. INTERNET FRAUD. According to the Federal Trade Commission, cyber fraudsters took in \$122 million in 2002. The Internet has eased access to information, but it has also offered con artists the opportunity to reach millions of potential victims simultaneously, and at minimal cost. NASAA points out that many online scams are merely new versions of schemes that have been fleecing offline investors for years. In November 2003 various federal, state, local, and foreign law-enforcement agencies targeted cyber fraudsters and netted 125 arrests and more than 70 indictments. Operation Cyber Sweep identified more than 125,000 victims with losses estimated to exceed \$100 million. One widespread con – e-mails purportedly originating from Nigeria or

another African nation that promise the recipient an opportunity to earn millions by providing personal banking information. NASAA's advice is simple. "Don't be dot conned. If you get an e-mail pitching a deal that can't be beat, hit delete," NASAA president Lambiase cautioned.

9. MUTUAL FUND BUSINESS PRACTICES. By now every investor should be aware of the spiraling problems in the mutual fund industry. So far they have ranged from excessive fees and failure to pay discounts, to improper market timing, unlawful late trading, and deals that influence brokerage firms to "push" certain mutual funds ahead of others. State securities regulators, the SEC, NASD, and mutual-fund firms themselves have launched a series of inquiries into mutual fund trading practices. Several of those firms already face federal or state charges.

10. VARIABLE ANNUITIES. NASAA notes that sales of variable annuities have increased dramatically over the past decade, but so have investor complaints. Variable annuities are a legitimate investment product, but they are not for everyone. Regulators are concerned that investors are not being told about high surrender charges and the steep sales commissions agents often earn when they move investors into variable annuities. Some investors also are misled with claims of guaranteed returns when variable annuity returns actually are vulnerable to the volatility of the stock market. The benefits of variable annuities – tax-deferral, death benefits among others – come with strings attached and additional costs. High commissions often are the driving force for sales of variable annuities. Mississippi securities regulators moved last year against a licensed securities broker in the state who earned commissions of approximately \$1 million within a 15-month period largely through sales of variable annuities. Variable annuities are often pitched to senior citizens, who in most cases are not suitable candidates for these investments. "Variable annuities make sense only for consumers willing to invest for 10 years or longer, but they are not suitable for many retirees who cannot afford to lock up their money for a long time," Lambiase said.

NASAA has created an interactive Fraud Center (http://www.nasaa.org/nasaa/news&pa/Fraud_Center.asp) featuring details of the Top 10 scams, schemes and scandals; tips on how to detect con artists and avoid becoming a victim; an Investor "Bill of Rights;" instructions on how to file an investment-related complaint; and contact information for each state securities regulator.

We urge readers to visit the Fraud Center, and take heed of NASAA's advice.

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