Don’t Be the Next Victim of Financial Fraud

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- New financial frauds are exposed every day, frequently by repeat tricksters.
- Fraudsters typically prey on our greed. Examples show how.
- We can protect ourselves by following some straightforward practices.

You’d think that the notoriety of the Madoff Ponzi scheme would have sensitized investors to fraudsters, but investors get scammed all the time, and frequently by repeat offenders. According to **The Market for Financial Adviser Misconduct**, a research study by Professors Mark Egan of Harvard, Gregor Matvos of the University of Texas and Amit Seru of Stanford :

> *Seven percent of advisers have misconduct records, and this share reaches more than 15% at some of the largest advisory firms. Roughly one third of advisers with misconduct are repeat offenders. Prior offenders are five times as likely to engage in new misconduct as the average financial adviser. Firms discipline misconduct: approximately half of financial advisers lose their jobs after misconduct. The labor market partially undoes firm-level discipline by rehiring such advisers. Firms that hire these advisers also have higher rates of prior misconduct themselves, suggesting "matching on misconduct." These firms are less desirable and offer lower compensation. We argue that heterogeneity in consumer sophistication could explain the prevalence and persistence of misconduct at such firms. Misconduct is concentrated at firms with retail customers and in counties with low education, elderly populations, and high incomes. Our findings are consistent with some firms "specializing" in misconduct and catering to unsophisticated consumers, while others use their clean reputation to attract sophisticated consumers.*

In other words, the bad guys keep preying on the unsophisticated wealthy (who says money makes you smart?), and affiliate with firms that foster misconduct. You’d suppose that these offenders get better with practice, so we should not underestimate their cleverness. We are all vulnerable.

In the following we share some examples of fraud to guard against: advance fee fraud, regular fraud, and Ponzi schemes. We provide a recent incidence of each, and conclude with recommendations to protect ourselves. Don't let fraud happen to you.

Advance Fee Fraud

In **Directly from the SEC: Fraud Warning**, attorney John Lohr describes:

> *Advance fee fraud gets its name from the fact that an investor is asked to pay a fee up front – in advance of receiving any proceeds, money, stock, or warrants – in order for the deal to go through. The bogus fee may be described as a deposit, underwriting fee, processing fee, administrative fee, commission, regulatory fee or tax, or even an incidental expense that fraudsters may guarantee to repay later. Sometimes, advance fee frauds brazenly target investors who have already lost money in investment schemes. Fraudsters also often direct investors to wire advance fees to escrow agents or lawyers to give investors comfort and to lend an air of legitimacy to their schemes.*

Mr. Lohr provides the following example.

- Perpetrator: Brett A. Cooper, and his companies
- People impacted: Investors in New Jersey
- Losses: $7 million
- The "Pitch": 3 different schemes involving prime bank transactions and overseas debt instruments requiring fees to open special accounts.
- Warning flags: Advance fee fraud schemes may try to fool investors with official-sounding websites and e-mail addresses.
- Discovery: Department of Justice examination of mass mailing schemes

Regular Fraud

Be wary of schemes that purport to create big tax savings. This gimmick cost the financial advisor $12 million and 7 years in jail.

- Perpetrator: Henry Brock, president of Utah-based Mutual Benefit International Group
- People impacted: Wealthy people in Utah
- Losses: $ 4 million in phony tax deductions

- The “Pitch”: Generate business losses through a subsidiary Brock owned
- Warning flags: Too good to be true
- Discovery: IRS audits

Ponzi Schemes (aka Pyramid Schemes)

Ponzi schemes are the most common form of fraud. The scamsters promise extraordinary returns, and deliver those with new investor monies, until the flow of new investors ends. Methods abound. For example, there’s a recent case involving 5 financial advisors who pocketed $102 million before they were caught.

- Perpetrators: 5 advisors across the country in Rochester NY, Ocala FL, San Antonio and Orville OH
- People impacted: More than 600 investors
- Losses: $ 102 million
- The “Pitch”: Guaranteed double-digit returns and dividends
- Warning flags: Any “Guarantee” is a warning. Too good to be true.
- Discovery: SEC

Protecting Ourselves

The SEC maintains and updates a website to protect investors at www.investor.gov. Its guidance and news are very helpful.

Attorney John Lohr, mentioned above, offers the following recommendations:

- Does it sound too good to be true? If it sounds too good to be true, it (probably) is.
- Is the investment offering registered with the SEC and my state securities agency? Where can I get more information about this investment? Can I get the latest reports filed by the company with the SEC: a prospectus or offering circular, or the latest annual report and financial statements?
- Research the background of the individuals and firms offering and selling you these investments, including their registration/license status and disciplinary history.

- Do I understand what I am agreeing to? Make sure you fully understand any investment or business agreement that you enter into, or have the terms reviewed by a competent attorney.
- Can I locate the business or person with whom I am dealing? Be wary of businesses that operate out of post office boxes or mail drops and do not have a street address. Also, be suspicious when dealing with persons who do not have a direct telephone line and who are never in when you call, but always return your call later.

Conclusion

Sociopathic fraudsters like Bernie Madoff are keen to capitalize on our complacencies and greed. As Michael Douglas says in the movie ***Wall Street*** "Greed is good" ... for con men. Like Madoff, many fraudsters are no garden variety bandits. Many appear to be honest and trustworthy beyond reproach. So some say that the important lesson from these frauds is that no amount of due diligence can protect us from being had. The smarter approach is to "trust but verify" rather than resolving to be tricked by the next Madoff.