



COMMISSION NEWS

ARIZONA CORPORATION COMMISSION, 1200 W. WASHINGTON, PHOENIX, AZ 85007

TO: EDITORS, NEWS DIRECTORS
FOR: IMMEDIATE RELEASE

DATE: July 1, 2004
CONTACT: Heather Murphy (602) 542-0844

INVESTOR ALERT: REGULATORS RELEASE UPDATED TOP 10 LIST OF SCAMS, SCHEMES & SWINDLES

PHOENIX – The Arizona Corporation Commissioners today forecast that investors will be challenged with increasingly complex and confusing investment frauds and identified the Top 10 schemes investors are likely to see over the next 12 months. New to this year’s list are mutual fund practices, senior investment fraud and variable annuities. The Top 10, ranked in order of prevalence and seriousness, are:

1. [Ponzi Schemes](#)
2. [Senior Investment Fraud](#)
3. [Promissory Notes](#)
4. [Unscrupulous Broker/Dealer Representatives](#)
5. [Affinity Fraud](#)
6. [Insurance Agent Securities Fraud](#)
7. [Prime Bank/High-Yield Investment Schemes](#)
8. [Internet Fraud](#)
9. [Mutual Fund Sales Practices](#)
10. [Variable Annuities](#)

“Investors face a complex maze of scams, schemes and scandals,” said Commission Chairman Marc Spitzer. “Our fight against fraud never stops because each year con artists discover new ways to fleece the public. 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.”

Nationally, investors lose billions of dollars annually to investment fraud. Securities regulators at the local, state and federal level work together to crack down on fraud and keep the investing marketplace free from con artists

and scammers.

The following ranking of scams, schemes and swindles for 2004 is based on a survey of state securities regulators conducted by the North American Securities Administrators Association. The list is based on the order of prevalence and seriousness as identified by state securities regulators, with a focus on Arizona cases. The schemes are explained in detail below.

Investors with questions or concerns about the array of investment options can get helpful information on the Commission's website at www.azinvestor.gov or call the Securities Division at 602-542-4242 from the Phoenix metro area. The Commission also has a new toll-free line for Arizona residents outside the metro area: 1-866-VERIFY-9.

- 1. PONZI SCHEMES.** Named for swindler Charles Ponzi, who in the early 1900s took investors for \$10 million by promising 40 percent returns, these schemes are a perennial favorite among con artists. The premise is simple: promise high returns to investors and use money from new investors to pay previous investors. Inevitably, the schemes collapse because it becomes impossible to recruit enough new investors to pay high returns to all the early investors. The only people who consistently make money are the promoters who set the scheme in motion. When regulators shut down these schemes, promoters even go so far as to blame investors' losses on government intervention – rather than admit their own deceptions.
- 2. SENIOR FRAUD.** Volatile stock markets, low interest rates, rising health care costs, and increasing life expectancy, combined to create a perfect environment for investment fraud against senior investors. Since Arizona has a high population of retirees, the Commissioners focus a lot of attention on investor education so seniors do not become victims at the hands of unscrupulous promoters. Older investors are being targeted with increasingly complex investment scams involving unregistered securities, promissory notes, charitable gift annuities and viatical settlements – all promising inflated returns.

“As a senior citizen who lives in a popular retirement community, I take very seriously my duty to protect seniors from fraud and punish those who pull con jobs,” Commissioner Mike Gleason said. He lives in Sun City West.

- 3. PROMISSORY NOTES.** A long-time member of the Top 10 list, these short-term debt instruments are often 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. When interest rates are low, investors often are lured by the higher, fixed returns that promissory notes offer. These notes, however, can become vehicles for fraud when the issuer of the note has no intention or capability of ever

delivering the returns promised by the salesperson.

On June 25, 2004, the Commission entered into a settlement with an Arizona man who, along with his associates, sold \$3.5 million worth of unregistered promissory notes to 83 investors. The issuer of the notes, CapitalPro, declared bankruptcy and investors lost a substantial portion of their investments, despite attempts by the salesman to recover the funds.

- 4. UNSCRUPULOUS BROKERS.** Despite the stock market's rebound in 2003, 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.

“Since January 2004, we have filed actions against or entered into consent orders with four securities salespeople,” Commissioner Kristin Mayes said. “Even the people who are supposed to know better – who are supposed to know the rules and regulations governing what they promote – are engaging in unlawful activity.”

- 5. AFFINITY FRAUD.** Con artists know that it is human nature to trust people with whom you have common interests. That's why scammers often use their victim's religious or ethnic identity to gain their trust and then steal their life savings. No group seems to be immune from fraud.

In a scheme that involved 11,000 investors and nearly \$550 million in church notes and bonds, the Baptist Foundation of Arizona was the largest securities fraud case in Arizona's history and ultimately resulted in the largest nonprofit bankruptcy in United States history. The scheme was shut down by the Arizona Corporation Commission's Securities Division in August 1999. Through a large settlement with its auditor and through the sale of tangible assets, Arizona officials were able to secure funds to repay investors more than 75 percent of their original investments. As a result of this case, church bond offerings in Arizona must now be registered with the Securities Division.

- 6. INSURANCE AGENT SECURITIES FRAUD.** While most independent insurance agents are honest professionals, too many are lured by high commissions into selling fraudulent or high-risk investments, such as promissory notes, ATM and payphone investment contracts and viatical settlements. The person running the scam instructs the independent sales force – usually insurance agents but sometimes investment advisers and accountants – to promise high returns with little or no risk.

In 2003, Arizona securities regulators 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. Since the start of 2004, the Commission has taken action against seven other insurance agents.

- 7. PRIME BANK SCHEMES.** Another perennial favorite of con artists who promise investors triple-digit returns through access to the investment portfolios of the world's elite banks. The negative publicity attached to these schemes has caused promoters in recent cases to avoid explicitly referring to prime

banks. Now, it is common to avoid the term altogether and underplay the role of banks by referring to these schemes as “risk free guaranteed high yield instruments” or something equally deceptive.

In 2002, two Arizona men and five companies were convicted on fraud charges stemming from a prime bank scheme in which [102 investors lost \\$4.5 million](#). In another case, two California men were sentenced to prison for the role in a prime bank scheme that [cost more than 30 victims approximately \\$3.45 million](#). In March, the FBI announced it had targeted 100 people involved in prime bank scams that had [cheated investors out of \\$500 million](#).

- 8. INTERNET FRAUD.** With the Internet becoming a common part of daily life for increasing numbers of people, it should be no surprise that [con artists have made cyberspace a prime hunting ground for victims](#). Internet fraud has become a booming business. The most recent figures show cybercons took in \$122 million in 2002, according to the Federal Trade Commission.

“Powerful graphic design packages and a little marketing savvy can be a dangerous combination for the devious mind,” explained Arizona Corporation Commission Chairman Marc Spitzer. “The same tools that are used to promote legitimate products and convey credibility can be used to fool investors. Online scams and thinly traded stocks promoted through bulletin boards and spam messages are an every day reality and investors should be wary.”

In November 2003, various federal, state, local and foreign law-enforcement agencies targeted cybercons 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. Regulators warn investors to ignore e-mail offers from individuals representing themselves as Middle Eastern or African government or business officials in need of help to deposit large sums of money in overseas bank accounts.

- 9. MUTUAL FUND BUSINESS PRACTICES.** Although mutual funds play a tremendous role in the wealth and savings of our nation, ongoing scandals throughout the industry clearly demonstrate that some in the mutual fund industry are putting their own interests ahead of America’s 95 million mutual fund shareholders. State securities regulators, the SEC, NASD and mutual-fund firms themselves have launched a series of inquiries into mutual fund trading practices. To date, more than a dozen mutual funds are under investigation and several mutual fund employees have either pleaded guilty, been charged or settled with state regulators.

“These investigations demonstrate a fundamental unfairness and a betrayal of trust that hurts Main Street investors while creating special opportunities for certain privileged mutual fund shareholders and insiders,” Commissioner Bill Mundell said. “We will actively pursue inquiries into mutual fund improprieties and are committed to aggressively addressing mutual fund complaints raised by investors.”

- 10. VARIABLE ANNUITIES.** Sales of variable annuities have increased dramatically over the past decade. As sales have risen, so too have complaints from investors. Regulators are concerned that investors aren’t 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. Often pitched to seniors through investment seminars, regulators say these products are unsuitable for many retirees.

“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,” Commissioner Jeff Hatch-Miller said. “Variable annuities are considered to be securities under federal law and the laws of 17 state jurisdictions, including Arizona.”

###