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NEWS RELEASE

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STATE SECURITIES REGULATOR RELEASES "TOP 10" INVESTMENT SCAMS, SCHEMES AND SCANDALS

(BOISE) January 14, 2004 – Gavin Gee, Director of the Idaho Department of Finance, 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 in 2004. New to this year's list are mutual fund practices, senior investment fraud, and variable annuities.

"Investors face a complex maze of scams, schemes and scandals," said Gee. "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."

Investors lose billions of dollars annually to investment fraud, Gee said. "All securities regulators, whether local, state, or federal, share the common goal of protecting investors," he said. "I urge legislators to help us continue to do our jobs by ensuring that regulators have sufficient resources to protect our citizens."

The Idaho Department of Finance, a member of the North American Securities Administrators Association (NASAA), also announced a new interactive Fraud Center on the NASAA website (www.nasaa.org). The center features 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. "Education and awareness are an investor's best defense against fraud," Gee said.

The following ranking of scams, schemes and scandals for 2004 is based on a survey of state securities regulators conducted by NASAA. The list is based on the order of prevalence and seriousness as identified by state securities regulators: 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 Business Practices, 10) Variable Annuities.

Top 10 List of Scams, Schemes and Scandals

(based on a survey of state securities enforcement officers and regulators)

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 previous investors to pay new investors. Inevitably, the schemes collapse and the only people who consistently make money are the promoters who set the Ponzi in motion. Con artists typically blame government intervention as the

reason why new investors didn't get their promised returns.

2. **SENIOR FRAUD.** 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. 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. To learn more, visit NASAA's Senior Investor Resource Center at <http://www.nasaa.org/nasaa/sirc/sirc.asp>.
3. **PROMISSORY NOTES.** A long-time member of the Top 10 list, 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. 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 sales person.

For instance, in April, 2003, the State obtained a judgment against Galaxy Financial Services, Inc. and Robert Swick, Las Vegas, Nevada, and several related entities and individuals, for selling "high yield promissory notes" that were not registered for sale in Idaho. Investors were told the notes were very safe, fully secured against loss and were "excluded from any legal action, including Chapters 13, 7 and 11." Investors were not, told, however, that Swick might use corporate funds to pay personal "gaming markers" and that investment collateral might be promised to more than one investor.

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. "I give credit to the increasing numbers of investors who are giving their brokerage statements a closer look and asking the right questions about unexplained fees, unauthorized trades or other irregularities," Gee said.

The State completed a case against one such broker in October, 2003. Nampa securities and insurance agent Delbert Gray of Nampa misappropriated and converted client funds to his own use as part of a Ponzi-type scheme, resulting in losses to victims of approximately \$1.5 million. Gray was also the subject of a criminal prosecution for his actions and was sentenced to the maximum term of 57 months in prison and ordered to pay restitution.

5. **AFFINITY FRAUD.** Con artists know that its only human nature to trust people who are like yourself. 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.
6. **INSURANCE AGENTS AND OTHER UNLICENSED SECURITIES SELLERS.** 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. "Scam artists continue to entice independent insurance agents into selling investments they may know little about," Gee said. 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.
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.

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 cyberfraudsters took in \$122 million in 2002, according to the Federal Trade Commission. "The Internet has turned from an information superhighway to a road of ruin for victims of cyber fraud," Gee said. "Many of the online scams regulators see today are merely new versions of schemes that have been fleecing offline investors for years." Gee also warned investors to ignore e-mail offers from individuals representing themselves as Nigerian or West African government or business officials in need of help to deposit large sums of money in overseas bank accounts. "Don't be dot.conned. If you get an e-mail pitching a deal that can't be beat, hit delete," Gee cautioned.

A local example In May, 2003, the State obtained a Consent Order to Cease and Desist in an internet scheme originating in North Idaho. A 20 year-old Coeur d'Alene resident operated an internet business called Sonic Universal Investment Club from a computer in his parents' bedroom. The website, which opened in August of 2002, fraudulently claimed the company had been in business for 7 years, was located in New England and was paying between 20 and 50% returns as the result of trading stock options. Restitution and fines were ordered in this case.

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 funds and mutual fund employees have either pleaded guilty, been charged or settled with state regulators. "These inquiries raise questions about the fundamental unfairness and a betrayal of trust that hurts Main Street investors when special opportunities are created for certain privileged mutual fund shareholders and insiders," Gee said.
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 and 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" Gee said.

The Idaho Department of Finance urges Idaho residents to make sure that the investments and investment professionals with whom they deal are registered. To check out an investment or salesperson, investors can contact the Department at (208) 332-8004 or toll free within Idaho at 888-346-3378.



Department of Finance Press Releases and other information can be found on the Internet via the worldwide web at <http://finance.state.id.us> and may be obtained by contacting the Department at (208) 332-8004 or Idaho toll-free at 1-888-346-3378.