From Ponzi to Madoff:

How to Teach Your Students About Fraud and Scams

... and hopefully have some fun in the process!

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The Maine Office of Securities

The Office of Securities regulates the securities industry in the State of Maine and welcomes consumer complaints and questions, including questions about investments, financial professionals, and securities laws.

The Office also educates Maine investors on how to identify red flags for financial fraud and provides resources addressing how to protect yourself from fraud and scams.

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DEPARTMENT OF PROFESSIONAL & FINANCIAL REGULATION
Office of Securities
STATE OF MAINE

In the Classroom

- What is Securities Fraud?
- Top Ten Financial Con Men
- Red Flags & How to Protect Yourself
- Group Activity

Securities Fraud

- Investment fraud, also known as securities fraud, is the violation of the securities laws when **investors are induced to make purchase or sale decisions on the basis of false information**, frequently resulting in losses.
- Securities include stocks, bonds, investment contracts, and promissory notes among other things.
- Investment fraud can take many forms including:
  - unsuitable investments
  - fraudulent offerings (e.g., Ponzi schemes)
  - unregistered products
  - unlicensed advisers/ brokers
  - theft or misappropriation of funds

Pyramid or Ponzi Scheme?

	Pyramid Scheme	Ponzi Scheme
Typical "hook"	Earn high profits by making one payment and finding others to become distributors of a product. The purported product may not exist or it may be "sold" only to other people who also become distributors.	Earn high investment returns with little or no risk; often the investment does not exist or only a small percentage of incoming funds are actually invested.
Payments	Must pay a participation fee and recruit new distributors to receive payments.	No recruiting necessary to receive payments.
Interaction with original promoter	Sometimes none. New participants may enter the pyramid scheme at different levels.	Promoter generally interacts directly with all participants.
How the scheme works	Funds from new participants are used to pay recruiting commissions to earlier participants.	Funds from new investors are used to pay purported returns to earlier investors.
Collapse	Fast. An exponential increase in the number of participants is required at each level.	May be relatively slow if existing participants reinvest money.

Top Ten Scam Artists:

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Charles Ponzi 1882-1949

Ponzi was the infamous swindler who paid out returns with other investors' money; the "Ponzi scheme" is named after him.

Ponzi figured out a way to capitalize on the difference in market prices for stamps. Ponzi would send money to agents working for him in other countries, who would buy IRCs and send them back to the United States. An IRC is a coupon that can be exchanged for postage stamps in other countries. Ponzi would then exchange the IRC for stamps worth more than he paid for them, and sell the stamps. Ponzi reportedly made more than 400% on some of these sales, but needed investors to increase his profits. He promised investors outrageous returns of 50% in 45 days, or 100% in 90 days. Ponzi paid these investors using money from other investors, rather than with actual profit. The scheme collapsed when a newspaper investigation resulted in investors demanding their money back. Estimates vary, but his investors lost about **$20 million dollars.**

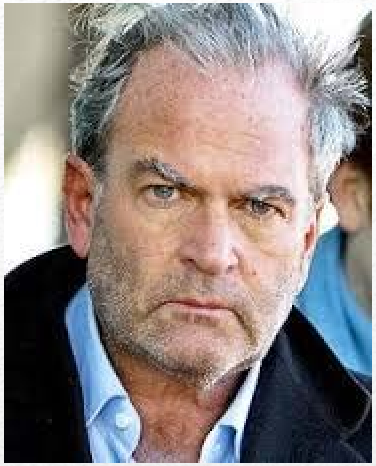
Victor Lustig 1890–1947

The man who scammed Al Capone and sold the Eiffel Tower… twice.

In May of 1925, while reading the newspaper, Lustig noticed an article about the dilapidation of the Eiffel Tower. At the time, the Eiffel Tower had become an expensive nuisance left over from the 1889 Paris Exposition. The tower had fallen into disrepair, and Parisians lobbied for its removal. Lustig saw an opportunity and forged government credentials to call together a small group of scrap metal dealers. He explained that the city wanted to sell the Eiffel tower for scrap, but that officials wanted to keep the plans a secret to avoid backlash from citizens.

One of the dealers bought the story and put down a cash bid to tear down the tower. Yet when he went to city officials to cash in on the deal, they had no idea what he was talking about. The dealer realized he was duped, and was so embarrassed that he refused to go to police. A month later, Lustig repeated the scam.

Marc Stuart Dreier



Yale University and Harvard Law School graduate steals millions

Dreier was a New York lawyer who orchestrated an elaborate fraud scheme that bilked hedge funds and other investors out of **$700 million** through the sale of fake promissory notes. He created phony financial statements and accounting documents, and paid people to impersonate others to trick prospective investors into believing the notes were genuine. His fraud unraveled when he was arrested after trying to impersonate an employee of the Ontario Teachers' Pension Plan in an attempt to sell a fake note for millions of dollars. Dreier had used the proceeds of his scheme to finance a lavish lifestyle. He owned a luxury apartment on the Upper East Side, properties in the Hamptons, a valuable art collection, expensive cars, and an $18 million yacht. He was sentenced in July 2009 to 20 years in prison.

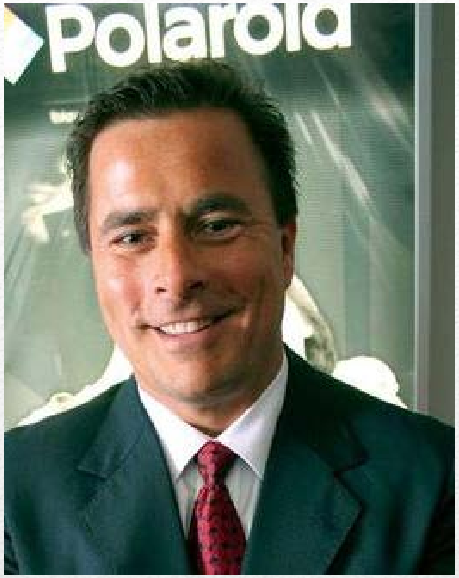
Billion Coupons Investment & Marvin Cooper, CEO

Affinity fraudster to the Deaf community

Hawaii-based Billion Coupons, Inc. ("BCI") and its CEO Marvin R. Cooper raised **$4.4 million** from 125 investors starting in 2007 and specifically targeted members of the Deaf community in the United States and Japan. BCI and Cooper told investors that their funds would be invested in the foreign exchange ("Forex") markets, that investors would receive returns of up to 25% per month from such trading, and that their investments were safe. They claimed that the number of investors was limited and not open to public investors. BCI and Cooper actually used only $800,000 of investor funds for Forex trading, and they lost more than $750,000 of it. Cooper misappropriated at least $1.4 million in investor funds to pay for a new home and other personal expenses. Because BCI and Cooper failed to generate sufficient funds from their Forex trading to pay the promised returns, they operated as a Ponzi scheme by paying returns to existing investors from funds contributed by new investors. The scheme collapsed when a potential investor got suspicious and reported the scheme to state and federal regulators and BCI's assets were seized.

Tom Petters

Polaroid owner sentenced to 50 years in federal prison



Minnesota businessman Tom Petters was the founder, CEO and sole owner of Petters Group Worldwide. He boasted billions in revenue and ownership of 150 companies including Polaroid and Sun Country Airlines. His reputation helped bring in billions of investment dollars from people around the world. Petters sold promissory notes through his firm Petters Company Inc., offering returns of 15 to 20 percent. Investors believed PCI was dealing in electronics and consumer goods to be sold to companies such as Costco and Sam's Club. But there was no real merchandise bought and sold, nor any profits. Petters was running a con; Petters and a small group of employees covered up the scam by forging documents on fake deals and channeling investor funds between failing companies. Law enforcement had no idea what Petters was up to until an employee turned him in and his **$3.7 billion** Ponzi scheme was revealed. More than a dozen people tied to the scheme went to prison.

Allen Stanford

“Sir Allen” spent $12M lengthening his yacht by just 6 feet

The Texas-bred Stanford built an offshore financial empire in the Caribbean and was knighted in 2006 by the government of Antigua. Acting through a network of financial advisers working for a company he owned, Stanford’s Antiguan-based bank sold approximately **$8 billion** of so-called "certificates of deposit" to investors by promising improbable and unsubstantiated high interest rates. These rates were supposedly earned through the bank's unique investment strategy, which purportedly allowed it to achieve double-digit returns on its investments for the past 15 years. CD purchasers were told that their deposits were safe, monitored by a team of 20-plus analysts, and subject to yearly audits by Antiguan regulators. In fact, Stanford channeled investor funds into a luxurious lifestyle (including his own professional cricket team and stadium on the West Indies island), a Swiss bank account, and various business deals that almost never succeeded. Mr. Stanford was sentenced to 110 years in federal prison in June of 2012.

Sean Nathan Healy

A $500,000 home theater system at the expense of investors

In July 2009, Healy was charged with taking as much as **$20 million** from about 50 investors by promising to use the money to trade in securities and commodities on their behalf. He operated under the name Sand Dollar Investing Partners and claimed to have access to “restricted” shares not available to the public. In reality, Healy did not invest any of the money, but used it to buy a $2.4 million home, more than 10 luxury cars (including a Porsche, Lamborghini, and several Ferraris), $1.4 million in jewelry, and pay for about $2.3 million in home renovations, according to the SEC. To keep investors from asking questions, Healy made payments to old investors from new funds, but when that money ran out, investors filed complaints. During the investigation into his activities, Healy lied to federal investigators and his own attorney by providing forged bank records and affidavits. In the end, Healy pled guilty and was barred from the commodities industry. Hewas sentenced to just over 15 years in prison.

Michael E. Kelly

Mexican time share scam falls apart

Through various companies and a network of salesmen, Kelly fraudulently obtained approximately **$500 million** from about 8,000 investors for the sale of promissory notes and interests in universal leases, which had a 25-year term and purported to relate to time shares at Mexican hotels operated by Kelly. In fact, Kelly used a significant portion of the funds raised from investors for his own personal benefit, including the purchase of hotels, businesses, homes, boats, automobiles, an airplane, a nightclub, and an interest in a real estate development project in Cancun. Many investors were guaranteed a return as high as 11%, regardless of whether the time share room was actually rented. Many of the investments were sold to retirees who found the promised high fixed rates of return, coupled with the reported safety to be an attractive investment. Kelly's ability to pay these returns, however, depended on continually raising funds from new investors and using those funds to pay earlier investors. Kelly was sentenced to five years in prison and passed away in 2013.

Greater Ministries International & Gerald Payne

Through his church ministry, Payne created an investment plan that claimed to double the "blessings" that people invested through nonexistent investments in precious metals and successful gold and diamond mines. To the outside world, GMI seemed to be a well-meaning church that helped the homeless; however, the church was running a massive Ponzi scheme. Claiming to accept money only from active Christians, Payne said that God had modernized the multiplication of the loaves and fishes and asked him to share the secret. Because the initial investors were being paid off with funds from subsequent investors, there were many investors to spread the word. The church and Payne collected approximately **$448 million** from investors. When state regulators in Colorado shut down the bank where GMI had deposited much of its money for unrelated reasons, Payne was forced to suspend payments to all donors. Even though new funds continued to come in, the loss of the bank deposits caused the scheme to begin collapsing. By the time the bankruptcy trustees were able to step in, there was only a few million left for victims. Payne was sentenced to 27 years in prison in 2001.

Bernard Madoff

The modern day Ponzi

In March 2009, Madoff pled guilty to charges including running a decades-long Ponzi scheme that he perpetrated on advisory clients of his firm; estimates of his fraud are close to **$65 billion.** Madoff's clients included stars such as Steven Spielberg and Kevin Bacon, and Madoff Investment Securities grew famous for its reliable annual returns of 10% or more, regardless of the market's performance. Madoff had an impressive reputation, in part because he helped found the NASDAQ stock exchange and served a term as its chair. Madoff falsified documents supporting his firm's astonishing returns and had clients beating down his door. Although some investors were suspicious of the firm's success, no one wanted to ask too many questions. The scheme fell apart when, confronted by his sons, Madoff admitted that a branch of his firm was actually an elaborate Ponzi scheme. The next day Madoff was arrested and charged with securities fraud. He was ordered to serve 150 years in prison, which was the maximum sentence allowed.

Warning Signs of a Scam

- **Promise no risk with high rewards/returns**
- Spelling and grammatical errors
- **Offer is for you only or a “select group”**
- High pressure sales techniques
- “Cash only” or checks made out personally
- Promises to provide paperwork “later”
- Ask you to sign blank forms or documents
- Inability to contact an independent company representative
- **Offers that are too good to be true**

Why Are Scam Artists So Successful?

- People are generally friendly and want to help
- The economy has left some desperate to rebuild their savings
- **Affinity fraud**
- Underreporting
- **Source credibility**
- Many people *want* to believe that their luck has finally turned around

How to Protect Yourself

- ***Reduce Your Exposure*** – Attending free lunch seminars, responding to HYIP solicitations, or entering prize giveaways may place you on a mailing or phone list.
- ***Be Skeptical*** - Assume that the great-sounding deal is probably not what it seems, even when the salesperson claims it is a sure thing. Ask "what is in it for them?"
- ***Slow Down*** - Before clicking on that link, sending money, or providing personal information, take some time to think about it.

How to Protect Yourself

- ***Create a Paper Trail*** - Anytime you consider investing, ask for business cards or other information that lists the name and firm of the individual who wants to sell you something.
- ***Check it Out*** – Contact your allies in Maine state government to find out if an investment is legitimate.
- ***Ask Questions*** - Any legitimate financial professional will be able to answer your questions and should welcome the opportunity.
- ***Hang up!*** - If an unknown caller is trying to sell you something, you have no obligation to talk to them.

Group Activity

Break up into small groups and create your own scam!

You are a scam artist trying to make some money, so you need to figure out your scam. Based on the techniques we have discussed, how would you design your product or service to lure in investors?

- Who is your target market?
- How are you going to convince Mainers to invest?