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Ignoring the warning signs

You don't need to be an investment professional to spot signs of fraud

Numerous and significant investment frauds have been percolating for some time, and, with a sluggish economy, many are crumbling. As fraud is revealed, many elderly investors are left without life savings.

Victims usually have placed tremendous faith in the person who has defrauded them. For this and other reasons, they didn't discern and act on warnings that would have allowed them to avoid the situation. In many cases, a gentle warning to the investor from a family member or professional adviser would have averted financial tragedy.

POINT OF VIEW

Will Terpening

Lawyers, financial planners, accountants and other professionals are trusted to guide clients through a wide range of problems and decisions. Over time, clients come to value their counsel. This relationship raises two observations when it comes to our work with elderly or financially unsophisticated investors, or with individuals who are connected to these investors.

First, even those of us whose counseling does not extend to investment advice are in a position to warn our clients and their loved ones about fraud. Pastors, accountants and lawyers come to mind. As a means of adding value, we might consider spending a moment discussing fraudulent schemes and their warning signs with the elderly.

Second, as a criminal-defense lawyer, I have noticed many financial professionals who are accused of fraud either were acting in good faith or gradually slipped into misconduct through a series of seemingly minor ethical or tactical slips. As professionals, we can never acquire too much training regarding our ethical and fiduciary duties.

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A commonly encountered elderly victim of investment fraud is a widow who might never have handled financial matters before the death of her spouse. The fraudster tends to be a disarming individual who promises to help the widow meet financial goals without worrying about the details. Sometimes, the fraudster is elderly as well, creating a demographic affinity with the victim. Family members are reluctant to interfere, even if they have concerns about the relationship. Quite often, the investment professional and individual are introduced through a church relationship; the victim relies on the perceived imprimatur of the investment professional's family loyalty or faith.

What are some warning signs for investment fraud in the context of elderly, unsophisticated or otherwise vulnerable investors? Although some of the following may appear obvious, I'm routinely shocked that many are overlooked, even by third-party professional counselors:

•The fraudster doesn't generate regular statements with investment positions in detail.

•Investment materials include references to trading in currencies, precious metals and over-the-counter or "pink sheet" stocks.

•If such statements are generated, they do not appear to be on formal letterhead. Instead, they appear to be simple Excel spreadsheets.

•The fraudster can't satisfy promptly client requests for details.

•The fraudster isn't reachable by phone or in person for extended periods.

•Statement figures do not add up from month to month.

•The fraudster guarantees an improbable rate of return, or promises the investment principal can't be lost.

•The fraudster isn't associated with a firm whose reputation can be verified by third parties, such as the client's other professional counselors.

•Marketing materials are glossy but contain typographical errors.

•The investment was solicited by phone, and the client feels pressure to invest.

•The fraudster does not work in an office, or changes addresses frequently.

•The fraudster encourages the client to move investment funds in and out of high-commission investments such as annuities with frequency and without clear rationale.

•The fraudster has an unusually close relationship with the client, attending social events, or helping her complete significant transactions for the purchase of automobiles or homes, or attempting to obtain direct access to bank accounts.

•The fraudster aggressively promotes reverse mortgages or refinancings.

•The investment involves promissory notes for loans to the fraudster or his company.

•The investment is unsuitably risky for an elderly client on a modest, fixed income.

Of course, these warning signs do not indicate fraud by themselves. As the investing public becomes more aware of fraud, even ethical and honest investment professionals should seek to avoid misunderstandings with clients by maintaining a record free of red flags. Efforts to disclose and explain investment activities for clients will help avoid problems.

Will Terpening is a Charlotte-based attorney at the Anderson Terpening law firm.