



## **CONTACT:**

Research Section  
1000 Technology Drive, Suite 2130  
Fairmont, WV 26554  
Ph: 877-628-7674  
Fax: 304-366-9095  
Web: [www.nw3c.org](http://www.nw3c.org)

## **Telemarketing Fraud (October 2009)**

Telemarketing fraud is a term that refers generally to any scheme to defraud in which the persons carrying out the scheme use the telephone as their primary means of communicating with prospective victims and trying to persuade them to send money to the scheme.<sup>1</sup> This may include any plans, programs, mail outs, solicitations, or campaigns to entice the purchase of goods, services, or charitable contributions through false representation; fraudulent schemes in which telemarketing is an integral component of the marketing effort including Internet marketing, offers over the telephone, infomercials, and targeted mailings; and using one or more telephone lines or any other telecom medium for false representation.<sup>2</sup>

### **How It Happens**

Telemarketing is the marketing of goods and services through telephonic contact. In 2004, the Direct Marketing Association reports that sales revenue from direct and interactive marketing topped \$2.3 trillion.<sup>3</sup> Although outbound teleservices generate an enormous sum of money in legitimate sales, there is conversely a large sum of consumer income that is swindled by fraudulent telemarketers.

Telemarketing victims are targeted in a variety of ways including cold calling. This method is not as popular as in the past. Today, it is much easier to target potential hits through the purchase of lead lists/mooch lists from lead brokers, including e-mail addresses. Some leads are generated by combing the obituary pages for senior death notices looking for the "survived by his wife of 60 years" red flag. Additional means of targeting include credit card applications and contest entry forms. And many marketers are entering the television world of infomercials and commercials which reach a very large and varied audience.

Traditionally, fraudulent telemarketers have operated out of boiler rooms. This term originated in the 1920's and is used to describe the highly charged atmosphere generated by the sales staff. A typical boiler room operation would involve sparsely furnished rented offices filled with banks of telephones. The more complex rooms may even be computer-networked. The salespeople, including fronters [first level callers], closers [sales reps who seal the deal], and verifiers [responsible for confirming the sale] use high-pressure tactics to pitch [the specific solicitation], via a script [the printed document used to sell the promotion], investment offers, charity donations, and low cost long distance telephone plans, just to name a few.

The big boiler room operations of yesterday is being replaced by smaller rip and tear operations that can more easily avoid detection. Rip and tear telemarketers utilize various locations that essentially function as mobile offices from which they conduct their activities including hotel rooms. The use of rented mailboxes, disposable cell phones, and prepaid calling cards is also very popular. The object is to collect as much money as possible in a short period of time and then relocate before being identified. Keep it short in duration and simple in design.

The schemes and scams are many and varied, but they are largely variations of traditional sales frauds. They typically involve elements of high pressure sales tactics, often encouraging the consumer to "act now or risk losing out on the once-in-a-lifetime offer".

Fake check scams have become the most popular form of telemarketing fraud in the past two years. The check scam can operate in a variety of ways. Usually, an individual is contacted from the scammer and is either awarded a check for a "prize" they have supposedly won, an offer to purchase an item they have for sale, or to serve as a holder for large sums of money from a foreign country. A check is then sent to the individual for the agreed upon amount, which they can cash, contingent that the individual pay a handling fee or a "prize insurance" fee to the scammer. The fraud results in the scammer receiving the fee from the victim, but the check is counterfeit, which leaves the victim responsible for resolving the debit from their account. According to The National Fraud Information Center, fake check scams via telemarketing accounted for 58% of all complaints of 2007, the most of any type of telemarketing fraud for two years running. Average loss to those involved was \$3,854. The former number one telemarketing scam, prize/sweepstakes scams, remained in second for as many years and accounted for another 14% of all complaints with an average loss of 6,601.<sup>4</sup>

Phishing is another recent phenomenon, and while it is more common on the internet, fraudulent telemarketers can adapt the scam to their operations easily. Credit and other financial consumers are usually the target for this scam. Individuals will receive a call claiming to be from a representative of their financial institution. After this introduction they inform the consumer that he/she has been the victim of fraud and it is imperative that they verify their account information for security purposes. In order to prevent any fraudulent activity, the victim willingly hands over this information, only then to be victimized by those claiming to protect them. Phishers can claim to be anyone in a position of authority from the government, law enforcement, or other public office. Vishing is the telephone version of phishing. Many times scammers will use recordings claiming to be from a financial institution calling to verify account information. It is important that requests for personal information not be given out over the phone unless you have previously verified their legitimacy.

Telemarketing fraud through charity solicitation can be an especially egregious form of preying upon consumers' generosity. Recall the large number of charities that evolved as a result of 9/11. Often, names deceptively similar to organizations that are easily identified with legitimate charities are used: Fraternal Order of Police versus the Police Fraternal Order, for example. Some fraudulent telemarketers solicit in the name of an actual group without that group's consent. It may be stated that all money collected will be used to purchase bullet proof vests when in fact only one vest will be purchased and the remaining money will be pocketed by the telemarketing entity. It may be that only 10% of your donation is actually deposited into the charity fund and the remaining 90% is for administrative costs. That's typically not what the consumers intended to be done with their money.

Credit repair companies offer to improve or fix credit history for a fee. To the family mired in credit card debt, this can be an extremely attractive opportunity. They will send an application fee to a "company" that will search for a low interest card for which the family can qualify. But as is usually the case, no credit card is ever identified. Secured credit cards require payment of a sizeable fee for a low interest card and it may not be disclosed to the consumer that they must keep an amount of money that may be equal to the credit line in an escrow account. This is not necessarily fraudulent, but the lack of disclosure of the secured nature of the card is the sticking point. In Canada, credit card rooms are using shell companies to cover illegitimate businesses offering low interest Visa® or MasterCard® cards. These sophisticated operations use account debiting agencies to obtain the victims' current card information. The company will mail out worthless packages with victims often providing their personal information for lower interest cards. A twist on this scam is the credit card protection scam. This scam is predominantly run by loan telemarketers and other crime groups with many of these rooms located in Toronto and south western Ontario. This type of operation is often connected with other rooms in the United States, Montreal, and Vancouver which often have acquired the services of United States lawyers to facilitate the transactions on the American side.

Investment scams are many and varied. Typically investors are promised quick, high value returns on any size investment, whether it be in foreign currencies, gas futures, vintage wine, or gold and rare coins, just to list a few. Even in times of stock market volatility, the con artists' message to consumers is that there is plenty of money to be made in the market. But the importance is identifying the "safe alternatives" which will yield the highest returns. NASAA (North American Securities Administrators Association) publishes an annual top 10 investment fraud list. Their top 10 for 2006 were Deficient Disclosure, Energy Scams, Online

Affinity Fraud, Prime Bank Schemes, Private Securities Offerings, Promissory Notes, Pump & Dump Schemes, Real Estate Investment Schemes, and Unsuitable Sales.<sup>5</sup>

## Costs and Statistics

Consumers do not as readily report fraud victimizations to law enforcement as they do personal or property crime victimizations. The lack of reporting is typically due to a variety of reasons including shame, embarrassment, disbelief, self-doubt, self-blame, or simple unawareness that a crime has been committed. This lack of reporting makes it extremely difficult to measure the scope and impact of telemarketing fraud.

It has been reported that 92% of adults in the United States say that they have received fraudulent telephone offers.<sup>6</sup> While the overall reporting frequency remains low, according to the National Fraud Information Center, the frequency of telemarketing fraud complaints has increased significantly to 4,587 in 2005, compared to 2,814 in 2004.<sup>7</sup> In terms of costs to consumers, the data available is mixed. In 2007, the average loss was \$3,091 which is up 50% from the 2006 average loss of \$2,036 per victim.<sup>8</sup> However, a 2009 report by the National Consumers League suggests that losses may be on the decline as the reported average consumer loss to telemarketing fraud in 2008 was \$1697.<sup>9</sup> In a mid-year report for 2009, the National Consumers League has stated that the economic crisis has affected fraud activity and anticipates an increase in complaints and losses for 2009.<sup>10</sup>

A report from the Consumer Sentinel complaint database<sup>11</sup> states that in 2008 complainants lost more than \$1.8 billion total to fraud with a median loss of \$440 per complaint.<sup>12</sup>

According to the National Fraud Information Center, the top telemarketing scams in 2007 included fake check scams, general merchandise over the internet, prize/sweepstakes, phishing, Nigerian money offers, internet auctions, advanced fee loans, lottery/lottery ticket buy clubs, sweetheart swindles, and magazine sales.<sup>13</sup> The average reported dollar loss was \$1507. Bank debits are increasingly being utilized for payment by consumers.<sup>14</sup> This is of particular concern due to the ever-increasing instances of identity theft.

## Examples/Case Studies

- The first major illegal telemarketing company, or a boiler room, was 50 States Distributors. They began operations in the late '70s in Las Vegas, with offices throughout the West. 50 States was eventually shut down by the FBI and the U.S. Postal Service, but former managers and salespeople spread out across the country and started their own scam operations.<sup>15</sup>
- In August 2006, former HSBC Bank vice president Raymond Payne plead guilty to conspiracy to commit wire fraud and mail fraud in connection with his participation in a massive telemarketing fraud scheme conducted out of Montreal, Canada. Payne served as a relationship manager on an account held by the First Choice telemarketing company in Montreal. First Choice would allegedly "cold call" low income households with poor credit and offer "guaranteed" credit cards for a fee of \$249 to \$299. Victims gave First Choice personal banking information, which in turn was used by First Choice to initiate automatic transfer of funds from the victims' HSBC accounts. Payne claims that in April 2003, he became aware of this conduct, but chose to actively hide the scheme from bank management at HSBC. The charges claim that although some victims did receive a manual on repairing their credit, none of the victims received a credit card. More than 100,000 individuals were victimized in the U.S., with approximately \$30 million dollars in proceeds being run through the HSBC bank. Payne's charge carries a maximum 20 year prison sentence and a maximum fine of \$250,000.<sup>16</sup>
- In July 2009, Bernard Fromstein was sentenced 2 years jail time for perpetrating a decade long telemarketing scheme that bilked US and Canadian businesses out of \$158 million dollars. Fromstein's telemarketers, all trained by the company, would contact customers in Canada and the U.S. claiming they were updating business listings for a directory the company had already ordered. The scam

targeted mostly non-profit and small businesses, which paid \$399 for a directory they didn't order. The Competition Bureau of Canada says that future scammers will face stiffer charges due to amendments made to the Competition Act in 2009.<sup>17</sup>

- In June 2006, telemarketers Nathan J. Matalon and George Francis Kunkel, Jr. were sentenced to lengthy prison terms for their involvement in a telemarketing scam. Matalon was sentenced to 7 years and Kunkel sentenced to 11 years in prison. In 2005 the two men were indicted for soliciting customers throughout the United States to purchase payphones from Kunkel's company Public Telephone Corporation (PTC), customarily offering a package of seven payphones for \$15,000. The indictment also charged that the two men misappropriated \$2 million from customers by making false statements and omissions concerning the expected profits from the payphone business opportunity. The men also misrepresented themselves by stating that they were in partnerships with American Telephone & Telegraph (AT&T) and that a well-known Wall Street firm commented supported their claims of profitability. Additional charges also included conspiracy to commit wire fraud and mail fraud.<sup>18</sup>
- In May 2006, Geoffrey Gallagher was sentenced seven and a half years in prison for assisting in the operation of a telemarketing scam that offered to sell "collectibles" for huge profits. The scam was part of West Coast Gallery, a collectible gallery in Covina, CA. Gallagher and other telemarketers would typically call elderly individuals to invest in collectibles, such as authentic political or celebrity artifacts. Gallagher made false statements to the victims, such as stating that all investments were very safe, typically yielding a return of 28% to 150% profit. He would also state that they would be refunded if the item did not sell for a profit within 30 days. West Coast gallery had few actual collectibles, which were typically bought from eBay and then auctioned for a skyrocketed price. In total, West Coast Gallery collected over \$3.5 million from over 150 victims.<sup>19</sup>

## The Response/Current Efforts

In response to the growing problem of telemarketing fraud and in an effort to protect consumers, many states have enacting "no call" laws and registries. The federal government followed suit in 2003 and, while it applies in all states, exists side-by-side with state legislation in some.<sup>20</sup>

Law enforcement agencies, securities regulators, private partners, and advocacy and senior groups have also joined together to create task forces to combat telemarketing crime. Through use of reverse boiler rooms,<sup>21</sup> agencies are arming targeted consumers with information, education, and strategies to help them resist high-pressure sales tactics.

- In Operation GLOBAL CON (2006), more than 565 people in North and South America and Europe were arrested. The operation was the most far reaching multinational virtual taskforce assembled to seek mass-marketing fraud schemes. Bureau officials executed 447 search warrants in five countries. The operation concluded with arrests of 139 American individuals, and an additional 426 arrests in Canada, Costa Rica, the Netherlands, and Spain. The schemes included a variety of methods, such as telemarketing, internet, and mass mailings. A total of 96 separate U.S. investigations in this operation led to a discovery of more than 2.8 million victims, who suffered losses totaling more than \$1 billion.<sup>22</sup>
- Operation Tele-PHONEY (2008) was announced by the Federal Trade Commission in May. The operation files over 180 actions that represent 500,000 victims, and over \$100 million in damages. The sweep includes actions against a variety of telemarketers, ranging from companies that offered fraudulent goods to false tax rebates or prescription drug plans. A partial listing of companies named in these cases can be found online at <http://www.networkworld.com/community/node/27967>.<sup>23</sup>
- SENIOR SENTINEL (1993-95) began as an innovative way to obtain tape recordings of fraudulent telemarketers' pitches utilizing citizen volunteers. At the outset of SENIOR SENTINEL, the Iowa Attorney General's staff transferred the telephone numbers of telemarketing fraud victims to their office. Staff, posing as elderly victims, answered these numbers and recorded the conversations.

Fraudulent telemarketing calls immediately flooded these phone lines, and the staff obtained irrefutable evidence of misrepresentations made during those calls. Iowa's telemarketing fraud enforcement program proved so successful that search warrants executed on illegal boiler rooms throughout the United States repeatedly uncover instructions to fraudulent telemarketers not to call into Iowa. BI then replicated Iowa's taping program on a national scale. Undercover Agents and citizen volunteers, many of whom were referred by the American Association of Retired Persons (AARP), set up and staffed telephone lines. Telemarketers would contact the volunteers, believing that they were soliciting people whom other telemarketing schemes had previously victimized. Agents and volunteers recorded these conversations in which the telemarketers used false and misleading statements in soliciting funds from the would-be "victims" to participate in the scams. Investigators and prosecutors then used those recordings to prosecute the telemarketers for various fraud offenses.<sup>24</sup>

- On December 7, 1995, United States Attorney General Janet Reno announced the takedown of Operation Senior Sentinel, in which 38 FBI field offices, 12 United States Attorney's Offices, more than a dozen state attorneys general offices, and the Fraud Section of the Criminal Division of the Department of Justice had participated. As of July 31, 1996, SENIOR SENTINEL had resulted in the conviction of 598 persons for telemarketing fraud-related offenses, execution of 104 search warrants, and the investigation of 180 telemarketing "boiler rooms". Many federal and state telemarketing investigators now commonly use the "SENIOR SENTINEL technique" to obtain incriminating statements from unsuspecting con artists.<sup>25</sup>
- Operation DOUBLE BARREL (1995-1998) was a nationwide operation that combined the SENIOR SENTINEL technique of consensual recordings, the increasing willingness of federal and state authorities to work together in combating telemarketing fraud and the availability of "backyard" and "victim" venue prosecution. DOUBLE BARREL involved the conduct of simultaneous and coordinated federal and state prosecutions of telemarketing boiler rooms. State Attorneys General prosecuted victim venue cases involving subjects of telemarketing fraud schemes, relying primarily on the FBI's investigation of those subjects in the location where they were operating. FBI Agents conducted their typical telemarketing investigations, trying to identify victims from those states participating in the initiative. The results of the investigations were forwarded to United States Attorneys' offices and the state offices for coordination of prosecutions. Thus, telemarketing schemes faced federal prosecutions involving backyard venue cases, and state prosecutions in victim venue cases. Department of Justice policy permits the pursuit of federal and state prosecutions against the same fraudulent scheme in a manner consistent with constitutional protections such as the Double Jeopardy Clause.<sup>26</sup> During Operation DOUBLE BARREL, federal authorities charged 795 individuals in 218 federal criminal cases, and 14 state Attorneys General charged 194 individuals in 100 state criminal investigations. In the various states, 255 civil complaints were lodged against 394 individuals.<sup>27</sup>

## **“For More Information” Links**

- AARP (previously known as the American Association of Retired Persons) <http://www.aarp.org/research/frauds-scams/>
- Better Business Bureau - <http://www.bbb.org>
- Consumer Sentinel - <http://www.ftc.gov/sentinel/>
- Department of Justice - <http://www.usdoj.gov/criminal/fraud/telemarket/>
- FBI-Economic Crimes Unit: Financial Crimes Report to the Public - [http://www.fbi.gov/publications/financial/fcs\\_report2007/financial\\_crime\\_2007.htm](http://www.fbi.gov/publications/financial/fcs_report2007/financial_crime_2007.htm)
- Federal Trade Commission (FTC) - <http://www.ftc.gov/bcp/menus/consumer/phone.shtm>
- FCC Do Not Call Registry - <http://www.fcc.gov/cgb/donotcall/>

- Internet Crime Complaint Center - <http://www.ic3.gov>
- National Association of Attorneys General - <http://www.naag.org/>
- National Consumer Law Center-What To Do If You Become A Victim Of Telemarketing Fraud - [http://www.consumerlaw.org/initiatives/seniors\\_initiative/telemarketing\\_fraud.shtml](http://www.consumerlaw.org/initiatives/seniors_initiative/telemarketing_fraud.shtml)
- National Fraud Information Center - <http://www.fraud.org/telemarketing/teleset.htm>
- National Hispanic Council on Aging - Telemarketing Fraud - [http://www.nhcoa.org/telemarketing\\_fraud.htm](http://www.nhcoa.org/telemarketing_fraud.htm)
- North American Securities Administrators Association (NASAA) - <http://www.nasaa.org/>
- Office for Victims of Crime (OVC) - <http://www.ojp.usdoj.gov/ovc/publications/infores/fraud/welcome.html>
- PhoneBusters - <http://www.phonebusters.com>
- Privacy Rights Clearinghouse: Fact Sheet on Telemarketing - <http://www.privacyrights.org/fs/fs5-tmkt.htm>
- Telemarketing and Consumer Fraud & Abuse Prevention Act - <http://www.lectlaw.com/files/stf02.htm>

*Maintenance and revisions: Jason Boone, NW3C Research Assistant*

## Endnotes

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<sup>8</sup> National Fraud Information Center (2008). Con Artists Prey on Consumer Vulnerability, Lurk Online, Make Deceptive Pitch via Phone, Email. Retrieved on May 15, 2008 from [http://www.nclnet.org/news/2008/top\\_ten\\_scams\\_02222008.htm](http://www.nclnet.org/news/2008/top_ten_scams_02222008.htm).

<sup>9</sup> National Consumer League (2009). NCL's Fraud Trends January – December 2008. Retrieved on August 1, 2009 from <http://www.nclnet.org/news/2009/2008%20fraud%20stats.pdf>.

<sup>10</sup> Consumer Affairs. (2009). National Consumers League Warns Of Recession-Fueled Fraud. Retrieved on August 1, 2009 from [http://www.consumeraffairs.com/news04/2009/07/recession\\_fraud.html](http://www.consumeraffairs.com/news04/2009/07/recession_fraud.html).

11 Consumer Sentinel is a complaint database that catalogs fraud and identity theft complaints. Leading partners and data contributors include the Federal Trade Commission, National Association of Attorneys General, PhoneBusters, National Consumers League, Internet Fraud Complaint Center, Better Business Bureau, and others. For additional information on Consumer Sentinel go to <http://www.ftc.gov/sentinel>.

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21 An effective prevention technique whereby the tactics employed by callers in fraudulent boiler room operations are utilized by volunteers, generally seniors, who call potential victims and provide prevention tips.

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<sup>23</sup> Network World (2008). FTC unfurls largest-ever telemarketing fraud sweep. Retrieved on May 21, 2008 at <http://www.networkworld.com/community/node/27967>.

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26 Ibid.

27 Department of Justice (1998). Federal And State Law Enforcement Snare Hundreds Of Dishonest Telemarketers In Nationwide Undercover Operation. Retrieved on July 1, 2005, from <http://www.usdoj.gov/opa/pr/1998/December/596cr.htm>.