



CONTACT:

Research Section
1 Huntington Way
Fairmont, WV 26554
Ph: 800-251-3221 Fax: 304-363-4312
Web: www.nw3c.org

Securities/Investment Fraud

(Last updated July 2017)

Definition

The term “Securities Fraud” covers a wide range of illegal activities that involve the deception of investors or the manipulation of financial markets.¹ A security is a catch-all term for many kinds of investments such as stocks, bonds, mutual funds, and similar investment strategies. One trick is to think of a security as an intangible investment. For example, buying gold bars is not a security, but the purchase of stock in a precious metal fund is a security. Also, securities do not include tangible assets like a car or a home.² The two primary laws that govern the securities industry and serve to protect investors are the Securities Act of 1933 and the Securities Exchange Act of 1934.

The Securities Act of 1933 (known as the “truth in securities” law) was established to, “require that investors receive financial and other significant information concerning securities being offered for public sale” (disclosure) and to, “prohibit deceit, misrepresentation and other fraud in the sale of securities.” *The Securities Exchange Act of 1934* was established to empower the U.S. Securities and Exchange Commission (SEC) with broad authority over the securities industry. Specifically this act, “identifies and prohibits certain types of conduct in the markets” and requires, “periodic reporting by companies with publicly traded securities.”³

In addition to these federal laws, each state has related statutes and rules that govern securities transactions. The securities industry also has regulatory requirements imposed by membership organizations such as the National Association of Securities Dealers (NASD), the New York Stock Exchange (NYSE) and the American Stock Exchange (AMEX).

How it Happens

Typically a small collection of techniques and investment products are used to defraud investors. Common techniques include Ponzi or pyramid schemes, pump and dump schemes, internet fraud and affinity fraud. Investments that are commonly used in fraudulent schemes are internet fraud, insider trading, microcap fraud, accountant fraud, mutual fund fraud, short selling abuses, Ponzi schemes and various types of corporate fraud such as corporate misconduct and the use of dummy corporations. As this paper examines these various types of securities fraud, it is important to be aware that often combinations of these variations are used together to carry out the fraud. Affinity

fraud may involve a Ponzi or Pyramid Scheme directed at a group in which the perpetrator uses a particular relationship with the victim in order to carry out the fraud.

Pyramid or Ponzi Schemes

In the classic "pyramid" scheme, participants attempt to make money solely by recruiting new participants into the program. The hallmark of these schemes is the promise of sky-high returns in a short period of time for doing nothing other than handing over your money and getting others to do the same.⁴ Despite the claims of pyramid scheme promoters, whose goal is to convince would-be investors that they have legitimate products or services to sell, these fraudsters simply use money received from new recruits to pay off early stage investors. Eventually they run out of investors and the scheme collapses. This benefits early investors, but later investors suffer considerable losses. The scheme collapses once the promoter fails to raise enough money from new investors to pay earlier investors.

Similarly, a "ponzi" scheme is an investment fraud that involves the payment of professed returns to existing investors from funds contributed by new investors. Ponzi scheme organizers often solicit new investors by promising to invest funds in opportunities claimed to generate high returns with little or no risk. In many ponzi schemes, the fraudsters focus on attracting new money to make promised payments to earlier-stage investors to create the false appearance that investors are profiting from a legitimate business.⁵

Pump and Dump Schemes

A "pump and dump" scheme is slang terminology for deliberate stock price manipulation. Pump-and-dump often occur on the internet where it is common to see messages posted that urge readers to buy a stock quickly, to sell before the price goes down or a telemarketer will call using the same sort of pitch. Often the promoters will claim to have special inside information about an impending development, or they claim to use an infallible combination of economic and stock market data to pick stocks. In reality, they may be company insiders or paid promoters who stand to gain by selling their shares after the stock price is "pumped" up by the buying frenzy they create. Once these fraudsters dump their shares and stop hyping the stock, the price typically falls, and investors lose their money.⁶

The most common method for carrying out this scheme was telemarketing, or a "boiler room" operation. Since 1996; however, the internet has become the most common venue for the pump and dump (see below Internet Fraud). The stock used in the scheme may be entirely fraudulent and have no company existing to support the stock. It may also be a legitimate stock of a legitimate company (usually a micro-cap stock and a relatively small company. In either case, the information used to hype the stock and artificially increase the stock's price is false information that misrepresents the potential value of the investment.

Internet Fraud

The Internet is particularly appealing to fraudsters as a tool for investment fraud because of the huge number of potential victims online and the minimal expense required to develop and maintain a fraudulent scheme. The before mentioned SEC warns that, "it's easy for fraudsters to make messages look real and credible, but nearly impossible for investors to tell the difference

between fact and fiction.”⁷

One of the most common forms of internet fraud is the pump and dump (see Pump and Dump Schemes). In addition, the internet is used to execute pyramid schemes (see Pyramid or Ponzi Schemes), off-shore frauds and so-called “risk-free” opportunities. Off-shore frauds may involve fraudulent opportunities in currency exchange or inheritance investments. “Risk-free” investment scams often involve fraudulent opportunities in high-tech or exotic-sounding ventures. Three of the most frequently used methods of communicating fraudulent information on the Internet are:

- (1) online investment newsletters,
- (2) online bulletin boards, and
- (3) “spams,” or mass e-mails.

The SEC warns investors, “Never make an investment based solely on what you read in an online newsletter or bulletin board posting, especially if the investment involves a small, thinly-traded company that isn’t well known.”⁸

Insider Trading

“Insider trading” refers generally to illegally buying or selling a security while in possession of material or nonpublic information about the security. This type of information usually is attained from someone inside a corporation knowledgeable about an upcoming merger that will affect the stock price of the corporation. This information allows that person to take unfair advantage of the information for self-gain, or to avoid losses with their holdings. An insider trading violation can also occur when the person buying or selling is not the actual insider, but is acting on the insider tip from someone with knowledge.

Examples of SEC insider trading cases include:

Corporate officers, directors, and employees who traded the corporation's securities after learning of significant, confidential corporate developments;

Friends, business associates, family members, and other "tippees" of such officers, directors, and employees, who traded the securities after receiving such information;

Employees of law, banking, brokerage and printing firms who were given such information to provide services to the corporation whose securities they traded;

Government employees who learned of such information because of their employment by the government; and

Other persons who misappropriated, and took advantage of, confidential information from their employers.⁹

Affinity Fraud

“Affinity Fraud” refers to scams in which the perpetrator uses personal contacts to swindle a specific group, such as a church congregation, a rotary club, a professional circle or an ethnic community. The fraud may take the form of any of those already discussed, and may be carried out either in person or over the internet. Most affinity frauds are Ponzi schemes, in which money from new investors is used to repay old ones, or is siphoned off by the promoters.¹⁰

Mutual Fund Fraud

A “mutual fund” is a collection of some kind of investment, usually stocks that are extremely popular. Anyone with a 401k or other such savings arrangement with their employer is investing in a mutual fund. You pick a fund you like (e.g., growth, value, technology, international, etc.), buy shares of the fund, and let a money manager pick the stocks they believe will yield the best return. The mutual fund managers collectively pool the investors’ monies in order to purchase different stocks (or other types of assets such as bonds). In exchange for this diversification and the brokers’ expertise, an annual fee is paid. The concept behind the mutual fund is that the expert money manager selects a range of investments (low risk, moderate risk, high risk) and encourages a group of investors choose a portfolio that may provide a level of security from the fluctuations of the market and the economy overall.

Mutual Fund fraud can take a number of forms.¹¹

- The brokerage firm or fund issuer can mischaracterize the types of investments in which the fund will invest. Again, this mischaracterization may take the form of pump and dump (discussed above) to falsely inflate the price of the price of the investment.
- A fund manager or investment firm may recommend a particular investment because it pays a higher commission or carries incentives for brokers rather than the potential for investor profit.
- The fund manager engages in “churning” or switching an investor’s money from fund to fund in order to generate fees for themselves rather than properly looking after the welfare of the investors they are paid to service.

Microcap Stock Fraud

“Microcap stock” are stocks of public companies whose worth is relatively low in comparison to major companies typically traded on national exchanges. The term microcap stock applies to companies with low or “micro” capitalizations, meaning the total value of the company’s stock. A typical definition would be companies with a market capitalization of less than \$250 or \$300 million.¹² Microcap stocks are normally traded on stock exchanges that do not require minimum standards such as minimum amount of net assets or stock holders. Often, the biggest difference between a microcap stock and other stocks is the amount of publicly available information about the company. Most large public companies file reports with the SEC that any investor can get for free from the SEC’s website.¹³ Many microcap stocks are traded “over-the-counter” as opposed to the major exchanges. They are somewhat more prone to market volatility than stocks from more well established companies. It is not uncommon to see these companies fail for whatever reason, and go out of business. Microcap stocks are often referred to as penny stocks which the SEC defines as a security that trades or less than \$5.00 per share, and are not listed on the national exchanges.

Micro stocks are susceptible to Pump & Dump schemes as well as ‘dump & dilute’ schemes in which the company engages in multiple stock issuances, usually to company insiders. The

insiders then exercise the option to sell their shares on the market which dilutes the value of shares held by outside customers transferring the value to the company insiders.

Microcap stocks are also susceptible to “Bait and Switch” schemes in which a fraudster will advertise during investment seminars, or on the internet to showcase exaggerated and false claims about profitability, discounted brokerage rates and other sales schemes to attract investors. In the bait and switch the scam operators may even sell fictitious shares in non-existent companies.

Dummy Corporations

A “Dummy Corporation” is created solely for the purpose of insulating an individual or another corporation from liability in either contract or import.¹⁴ Dummy corporations may be created by fraudsters to create the illusion of being an existing corporation with a similar name. In some cases dummy corporations, are set up to appear as legitimate. They have web sites and real employees, but do not sell or manufacture anything. The establishment of an official looking web site helps to even fool the prospective investor trying to do legitimate research. The corporations are used to sell false investment opportunities to the unsuspecting. A dummy corporation also be used as a strategy to hide the true financial status of a company. While the use of dummy corporations is not inherently illegal, the usage of these corporations can go against the ethics of the parent company, which can in turn spark controversy between the organization and the public.

Short Selling Abuses

The process of short selling is somewhat speculative. Engaging in short selling usually requires that the individual participating in the short sale, have some sort of brokerage account in which they have an established amount of equity to cover potential losses. Speculators use short selling to capitalize on a potential decline in a specific security.¹⁵ The idea is to identify stocks that are likely to decline in value, borrow them using equity in a brokerage account as security should the anticipated decline in value not happen, sell them at market price, let the price decline and then buy them back and return them to the borrowed source. The difference in price between the original sale of the borrowed stock and the price repurchased after the price decline represents the profit.

Let’s assume you short 100 shares of hypothetical stock ABC at \$10 per share; after a period of time, the stock has declined to \$5, at which point you buy it back. Your gross profit on this short sale is thus \$500 ($[\$10 - \$5] \times 100$ shares). Your net profit will be lower, owing to the costs involved with short selling.¹⁶ Short sale fraud is like the pump and dump in reverse. Rather than using information to artificially stimulate interest in a stock driving up demand and in turn the price of the shares, they use information to stimulate holders of the stock shares to ‘run scared’ and sell off their investments in the company, driving down the value of the stock so the speculators can then engage in short sales with more certainty that their speculation will pay off.

By cluttering message boards and forums with lots of negative messages, short seller con artists try to make it as difficult as possible to find positive information regarding a particular security. They say things like, “Get out before it all comes crashing down”. And imply they are looking out for investor’s best interests by highlighting stocks that will go to zero in price causing a complete loss for anyone

holding the stock.¹⁷

Exempt Security Scams

“Exempt Securities”, on their own are not scams. They are sold by companies that are allowed to sell the securities without filing a prospectus. To qualify to legitimately trade in this type investment, due to its high level of risk the individual must be able to establish that they have the wealth to participate. The scam usually starts when someone receives an unsolicited pitch to invest in a promising business that is about to offer shares to the public. The victim may be told that the investment is only available to very wealthy people, but an exception can be made and the victim is urged to sign paperwork. This paperwork usually involves lying about the victim’s income so as to qualify the purchaser to take the risk. Exempt securities are risky, and victims can lose all of their investment. Falsifying real investment abilities means taking an unaffordable risk.¹⁸

Unregistered Products/Unlicensed Salesmen

Fraud threats to investors can change from year to year, depending on a number of factors. According to the North American Securities Administrators Association, the top threat for the 2015-16 year was the offer of securities by an individual without a valid securities license. This scam took the number one spot in terms of regulatory enforcement. Con artists try to bypass stringent state registration requirements to pitch unregistered investments, usually with promise of no risk and high returns.¹⁹

Costs and Statistics

With the Dow Jones industrial average near its record high, slightly more than half of Americans (52%) say they currently have money in the stock market, matching the lowest ownership rate in Gallup's 19-year trend.²⁰

In fiscal year 2015, there were 218 securities and investment fraud offenders sentenced in federal courts. The number of securities and investment fraud offenders decreased by 22.7% from fiscal years 2013 to 2015. The median loss for these offenses was \$3,454,756.

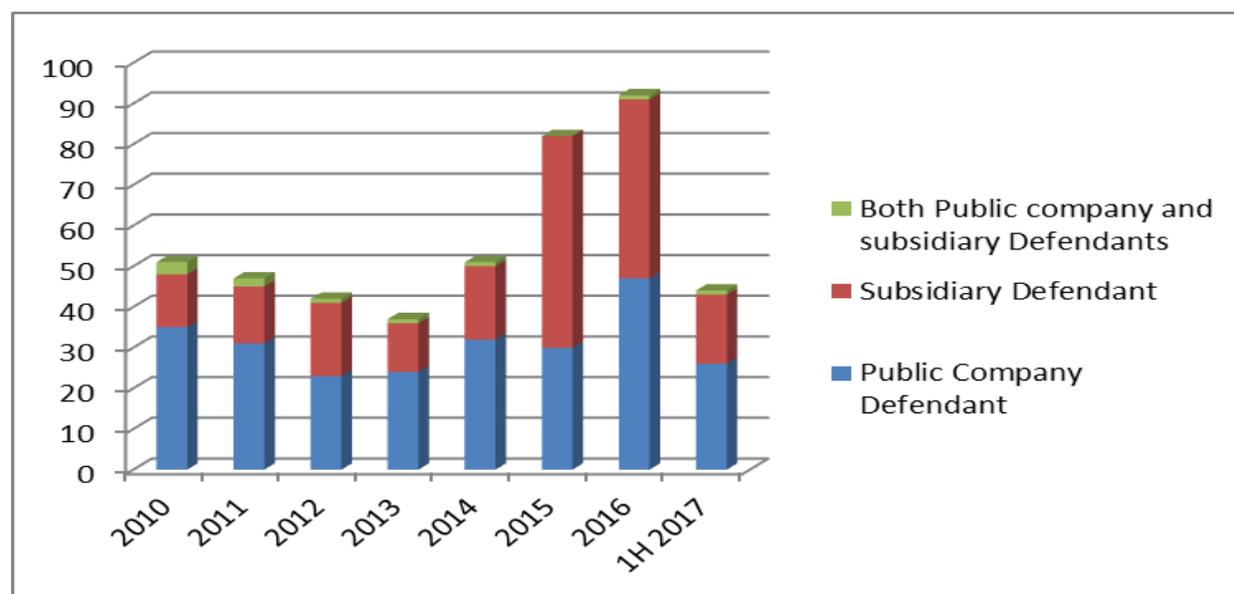
- ◆ 32.6% of securities and investment fraud offenses involved loss amounts greater than \$7 million.
- ◆ 21.1% of securities and investment fraud offenses involved loss amounts of \$400,000 or less.²¹

Not all securities and commodities fraud cases are handled through the criminal system. Many times the government will decide to handle enforcement in the civil arena. According to the latest published statistics on civil settlements, there were 80 securities class action settlements approved in 2015 (the most recent year for which statistics are available) representing a 27% rise in the number of settlements over 2014 and the highest since 2010. Total settlement dollars in 2015 increases substantially over the 2014 historic low of \$3 billion and were 9% higher than the average for the prior 5 years. In 2015 there were eight mega settlements (more than \$100 million),

up from just one in 2014. The average settlement size climbed from \$17 million in 2014, to \$37.9 million in 2015 (an increase of 23%), while the median amount (typical settlement) remained relatively flat (\$6.0 million in 2014 compared to \$6.1 million in 2015).²²

Enforcement Cases Initiated by the SEC ²³

	Both Public Company and Subsidiary defendants	Subsidiary Defendants	Public Company defendants
2010	3	13	35
2011	2	14	31
2012	1	18	23
2013	1	12	24
2014	1	18	32
2015	0	52	30
2016	1	44	47
First Half 2017	1	17	26



High Profile Examples/Case Studies

In recent years, violations of disclosure rules and fraudulent accounting practices by public corporations have been the most widely publicized of SEC actions. Included among these are

sanctions against Morgan Stanley & Co., Goldman, Sachs & Co., and Latour Trading LLC for violations of the market access rule, which requires firms to have adequate risk controls in place before providing customers with access to the market, sanctions against Deloitte & Touche LLP and eight auditing firms for various brokerage firms for violating independence rules and charged two Merrill Lynch entities with using inaccurate data in executing short sale order.²⁴

June 29, 2017: The U.S. Commodity Futures Trading Commission (CFTC) announced today that it entered into non-prosecution agreements with **Jeremy Lao (Lao)** of New York, New York, **Daniel Liao (Liao)** of Minato-Ku, Japan, and **Shlomo Salant (Salant)** of New York, New York. In their non-prosecution agreements, Lao, Liao, and Salant each admits that he engaged in the unlawful disruptive trade practice of “spoofing” (bidding or offering with the intent to cancel the bid or offer before execution) in U.S. Treasury futures markets while trading for Citigroup Global Markets Inc. (Citigroup) in 2011 and 2012. The non-prosecution agreements set forth how each trader employed a spoofing strategy that involved entering a large brief order (with the intent to cancel the large order before execution) on the opposite side of a smaller order (that each wanted to trade) in the same or a correlated market. Lao, Liao, and Salant used the spoofing strategy to get their smaller orders filled (and filled more quickly) at the prices they wanted. The agreements also detail numerous incidents of unlawful conduct at Citigroup, to which the traders admitted. For example:

- On January 31, 2012, one of Liao’s spoofing orders traded before he could cancel it and resulted in a \$60,000 loss. Shortly thereafter, Liao called members of Citigroup’s U.S. Treasury desk to report the loss and the circumstances around it. Specifically, Liao told the head trader on the desk that he had “offered 4,000 contracts in [ten-year futures] hoping I’d get hit in some [ten-year cash Treasuries].” The head trader responded, in part, “cool, sounds like it didn’t cost too much, so that’s cool.” At this point, another senior trader got on the phone and asked about what happened. The head trader responded, “He offered [ten-year futures] in the screens and got lifted,” to which the senior trader responded, “Oh! you were [screwing] around and got jacked.” In a subsequent call, the senior trader told Liao not to stress about the incident and reminded Liao that because he is in Tokyo, “when you do that, people know what you are doing. There’s no liquidity anyway, you’re on the offer for like umpteenth size, clearly, clearly guys know you want to buy. Yeah, don’t pick up bad habits from us.”²⁵

May 12, 2017: A federal jury convicted former professional baseball player Douglas DeCinces of insider trading charges for using non-public information to purchase stock in an Orange County company in transactions that netted him \$1.3 million in profits. At trial, prosecutors argued that DeCinces obtained the insider information from James V. Mazzo, 60, a neighbor of DeCinces in Laguna Beach, who was the CEO of the Santa Ana-based Advanced Medical Optics, Inc. Mazzo is accused of telling DeCinces that his company was going to be acquired by Abbott Laboratories. The jury that convicted DeCinces and Parker was unable to reach a unanimous verdict on the charges against Mazzo, and Judge Guilford declared mistrial on these charges. Mazzo allegedly provided DeCinces with confidential information in advance of Abbott’s January 2009 acquisition

of Advanced Medical Optics (NYSE: EYE). DeCinces and his associates, including Parker, used the non-public information to purchase shares of EYE, which increased from approximately \$8 to \$22 as a result of the acquisition. The evidence presented at trial showed that DeCinces liquidated his diverse stock portfolio of investments at Merrill Lynch – suffering approximately \$80,000 in losses – to obtain approximately \$160,000 that he used to purchase EYE stock. DeCinces ultimately purchased a total of 90,700 shares of EYE stock, which he sold soon after Abbott’s tender offer for the company was publicly announced, and realized approximately \$1.3 million in profits. DeCinces gave information on the acquisition of EYE to Parker. After purchasing EYE shares and selling them following the acquisition, Parker realized illegal profits of nearly \$350,000.²⁶

June 23, 2016: The Securities and Exchange Commission today announced that Merrill Lynch has agreed to pay \$415 million and admit wrongdoing to settle charges that it misused customer cash to generate profits for the firm and failed to safeguard customer securities from the claims of its creditors. An SEC investigation found that Merrill Lynch violated the SEC’s Customer Protection Rule by misusing customer cash that rightfully should have been deposited in a reserve account. Merrill Lynch engaged in complex options trades that lacked economic substance and artificially reduced the required deposit of customer cash in the reserve account. The maneuver freed up billions of dollars per week from 2009 to 2012 that Merrill Lynch used to finance its own trading activities. Had Merrill Lynch failed in the midst of these trades, the firm’s customers would have been exposed to a massive shortfall in the reserve account. According to the SEC’s order instituting a settled administrative proceeding, Merrill Lynch further violated the Customer Protection Rule by failing to adhere to requirements that fully-paid for customer securities be held in lien-free accounts and shielded from claims by third parties should a firm collapse. From 2009 to 2015, Merrill Lynch held up to \$58 billion per day of customer securities in a clearing account that was subject to a general lien by its clearing bank and held additional customer securities in accounts worldwide that similarly were subject to liens. Had Merrill Lynch collapsed at any point, customers would have been exposed to significant risk and uncertainty of getting back their own securities. In addition to the Customer Protection Rule violations, Merrill Lynch violated Exchange Act Rule 21F-17 by using language in severance agreements that operated to impede employees from voluntarily providing information to the SEC.²⁷

July 1, 2015: The Securities and Exchange Commission charged Deloitte & Touche LLP with violating auditor independence rules when its consulting affiliate maintained a business relationship with a trustee serving on the boards and audit committees of three funds it audited. Deloitte agreed to pay more than \$1 million to settle the charges. According to the SEC’s order:

- Deloitte Consulting acquired a proprietary brainstorming business methodology from Boynton in 2006 and collaborated with Boynton to implement it and serve both internal and external firm clients through 2011.
- As a member of the three funds’ boards and audit committees, Boynton was required to complete annual trustee and officer (T&O) questionnaires designed in part to identify conflicts of interest. Boynton did not identify his business relationship with Deloitte Consulting in response to a question calling for identification of his “principal occupation(s) and other positions.” Relying on his understanding that Deloitte Consulting was a separate legal entity from Deloitte, Boynton also did not identify the business

relationship in his responses to a question added to the questionnaire in 2009 inquiring whether he had any “direct or material indirect business relationship” with Deloitte.

- ALPS contractually agreed to assist the funds in discharging their responsibilities yet failed to adopt sufficient written policies and procedures as required to prevent auditor independence violations. The funds’ audit committee charter addressed auditor independence generally, but the T&O questionnaires did not expressly cover business relationships with the auditor’s affiliates. The funds also did not have sufficient written policies and procedures to prevent other types of auditor independence violations, nor did they provide sufficient training to assist board members in the discharge of their responsibilities related to auditor independence.²⁸

May 12, 2015: The Securities and Exchange Commission announced fraud charges against ITT Educational Services Inc., its chief executive officer Kevin Modany, and its chief financial officer Daniel Fitzpatrick. According to the SEC’s complaint filed in the U.S. District Court for the Southern District of Indiana, the underlying loan pools had performed so abysmally by 2012 that ITT’s guarantee obligations were triggered and began to balloon. Rather than disclosing to its investors that it projected paying hundreds of millions of dollars on its guarantees, ITT and its management took a variety of actions to create the appearance that ITT’s exposure to these programs was much more limited. Over the course of 2014 as ITT began to disclose the consequences of its practices and the magnitude of payments that ITT would need to make on the guarantees, ITT’s stock price declined dramatically, falling by approximately two-thirds. The SEC’s complaint alleges that ITT, Modany, and Fitzpatrick engaged in a fraudulent scheme and made a number of false and misleading statements to hide the magnitude of ITT’s guarantee obligations for the PEAKS and CUSO programs. For example, ITT regularly made payments on delinquent student borrower accounts to temporarily keep PEAKS loans from defaulting and triggering tens of millions of dollars of guarantee payments, without disclosing this practice. ITT also netted its anticipated guarantee payments against recoveries it projected for many years later, without disclosing this approach or its near-term cash impact. ITT further failed to consolidate the PEAKS program in ITT’s financial statements despite ITT’s control over the economic performance of the program. ITT and the executives also misled and withheld significant information from ITT’s auditor.²⁹

The Response/Current Efforts

Very often, a securities or investment scam targets investors who have little or no experience in the markets and involves a product that is unregulated or ambiguously regulated. That is, inexperienced investors are often victims of fraudulent investment scams in hedge funds, foreign currency exchange, business ventures, or some other investment that may not be directly regulated by the SEC or state securities regulators. In some cases, these investments are not clearly regulated by any government agency. For this reason, state and federal regulators have developed initiatives to educate investors and to caution investors not to invest in anything that they do not understand. Fraudsters target inexperienced investors and use non-traditional investment products because inexperienced investors are often too embarrassed to admit that they do not understand the details of the investment and fail to ask questions about things that seem unclear.

The laws and rules that govern the securities industry in the United States derive from a simple and straightforward concept: all investors, whether large institutions or private individuals, should have access to certain basic facts about an investment prior to buying it, and so long as they hold it. To achieve this, the SEC requires public companies to disclose meaningful financial and other information to the public. This provides a common pool of knowledge for all investors to use to judge for themselves whether to buy, sell, or hold a particular security. Only through the steady flow of timely, comprehensive, and accurate information can people make sound investment decisions. The SEC oversees the key participants in the securities world, including securities exchanges, securities brokers and dealers, investment advisors, and mutual funds. Here the SEC is concerned primarily with promoting the disclosure of important market-related information, maintaining fair dealing, and protecting against fraud.³⁰

Investment advisors and securities brokers must be registered with state regulators, the SEC and/or some internal regulatory organization. This registration process allows for regular monitoring of conduct and violations. Verification of registration and review of previous professional conduct alone cannot assure an investor that investments offered by an advisor or broker are not fraudulent, research of this kind, including research of specific investments, can significantly reduce an investor's chances of losing money from a fraudulent scheme.

In addition to disclosure and conduct rules of the SEC, the NASD, and other regulatory organizations, additional rules pertaining to conflicts of interest among corporations, brokerage firms and accounting firms have been recently developed and expanded in response to the disclosed fraudulent practices of public corporations such as Enron.

Rules specifically criminalizing securities fraud were also included in the Sarbanes-Oxley Act of 2002. Securities fraud has long been prosecuted under mail and wire fraud statutes, sec. 807 of the Act is significant in that it removes the need to demonstrate that a particular activity, involving the purchase or sale of a security, constitutes a fraud and was "willfully" committed. Instead, violation requires only the knowing execution of a fraud "in connection with any security." These differences seem subtle, the application of the new language could have significant effects on the processes of investigation and prosecution in securities fraud cases.

Following the 2016 settlement mentioned above with Merrill Lynch, whistle blower protections have been extended and strengthened to help encourage the active participation of employees of organizations dealing in investments, to help further the process of monitoring from within, for unethical investment practices that inordinately disadvantage investors.

"For More Information" Links

- Securities and Exchange Commission (SEC) - <http://www.sec.gov>
- Financial Industry Regulatory Agency <http://www.finra.org/>
- North American Securities Administrators Association (NASAA) - <http://www.nasaa.org>
- Federal Trade Commission (FTC) - <http://www.ftc.gov>

- Commodity Futures Trading Corporation (CFTC) - <http://www.cftc.gov>
- United States Postal Inspection Service (USPIS) <https://postalinspectors.uspis.gov/>
- Fraud.org, a division of the National Consumers League - <http://www.fraud.org>

Author: Gerald Cliff, Ph.D., NW3C Research Director NW3C



This project was supported by Grant No. 2015-BE-BX-0011 awarded by the Bureau of Justice Assistance. The Bureau of Justice Assistance is a component of the Office of Justice Programs, which also includes the Bureau of Justice Statistics, the National Institute of Justice, the Office of Juvenile Justice and Delinquency Prevention, the Office for Victims of Crime, and the Smart Office. Points of view or opinions in this document are those of the author and do not necessarily represent the official position or policies of the U.S. Department of Justice.

The National White Collar Crime Center (NW3C) is the copyright owner of this document. This information may not be used or reproduced in any form without express written permission of NW3C. NW3C™ are trademarks of NW3C, Inc. and may not be used without written permission. ©2017. NW3C, Inc. d/b/a the National White Collar Crime Center. All rights reserved

Endnotes

¹ Securities Fraud Awareness and Prevention Tips, by published by the Federal Bureau of Investigation, retrieved June 28, 2017 from; <https://www.fbi.gov/stats-services/publications/securities-fraud>

² Investing 101: What is a Security? From LearnVest Investment Knowledge Center, located at; <https://www.learnvest.com/knowledge-center/investing-101-what-is-a-security/>

³ U.S. Securities and Exchange Commission. (2000, August 8). *The laws that govern the securities industry*. Retrieved June 28, 2017, from <https://www.sec.gov/answers/about-lawsshtml.html#secexact1934>

⁴ U.S. Securities and Exchange Commission, fast answers, *What is a Pyramid Scheme?* Retrieved June 28, 2017 from; <https://www.sec.gov/fast-answers/answerspyramidhtm.html>

⁵ U.S. Securities and Exchange Commission, fast answers, *What is a Ponzi Scheme?* Retrieved June 28, 2017 from; <https://www.sec.gov/fast-answers/answersponzihtm.html>

⁶ U.S. Securities and Exchange Commission, fast answers, *What is a Pump and dump Scheme?* Retrieved June 28, 2017 from; <https://www.sec.gov/fast-answers/answerspumpdumphtm.html>

⁷ U.S. Securities and Exchange Commission. *Internet fraud: How to avoid Internet investment scams*. Retrieved June 28, 2017, from <http://www.sec.gov/investor/pubs/cyberfraud.htm>

⁸ Ibid. U.S. Securities and Exchange Commission. *Insider Trading*, retrieved June 28, 2017 from; <https://www.sec.gov/reportspubs/investor-publications/investorpubscyberfraudhtm.html>

⁹ U.S. Securities and Exchange Commission. *Insider Trading*. Retrieved June 28, 2017, from; <https://www.sec.gov/fast-answers/answersinsiderhtm.html>

¹⁰ *Fleeing the Flock*, published 1/28/12, in *The Economist*, retrieved June 28, 2017 from; <http://www.economist.com/node/21543526>

¹¹ Page Perry Law Firm web page, *The Investors' Watch Dog*. Retrieved June 28, 2017, located at; <http://www.pageperry.com/mutual-fund-fraud>

¹² U.S. Securities and Exchange Commission, *Microcap Stocks: A Guide For Investors*, published 9/18/13, retrieved 6/29/17, <https://www.sec.gov/reportspubs/investor-publications/investorpubsmicrocapstockhtm.html> located at;

¹³ Ibid. Securities and Exchange Commission (above)

¹⁴ Definition of 'Dummy Corporation' provided by Duhaime's Law Dictionary, retrieved June 30, 2017, located at; <http://www.duhaime.org/LegalDictionary/D/DummyCorporation.aspx>

¹⁵ *Short Selling Tutorial*, by Elvis Picardo CFA, published April 28, 2017, published in Investopedia, retrieved June 29, 2017, located at; <http://www.investopedia.com/university/shortselling/>

¹⁶ Ibid. *Short Selling* from Investopedia.

¹⁷ *Short and Distort Stock Scams*, on *Fraud Guides*, *Investment Schemes, Internet Scams and Consumer Fraud*, Retrieved, June 29, 2017, located at; <https://www.fraudguides.com/investments/short-distort-stock-scams/>

¹⁸ *Protect Your Money, Avoiding Frauds and Scams*, published by the North American Securities Administrators Association, Retrieved on June 30, 2017, located at; http://www.securities-administrators.ca/uploadedFiles/General/pdfs/Protect_your_money-ENG.pdf

¹⁹ *Top Investor Threats for 2015-16*, published in the North American Securities Administrators Association, yearly report, retrieved June 30, 2016, located at; <https://indd.adobe.com/view/b13ecd85-191e-45d2-9eb6-2e7aac6ecfce>

²⁰ *Just Over Half of Americans Own Stocks, Matching Record Low*, published 4/20/16 by Gallup Poll, retrieved June 29, 2017, located at; <http://www.gallup.com/poll/190883/half-americans-own-stocks-matching-record-low.aspx>

²¹ U.S. Sentencing commission Quick Facts, *Securities and Investment Fraud Offenses*, retrieved June 30, 2017, located at; http://www.ussc.gov/sites/default/files/pdf/research-and-publications/quick-facts/Securities_Fraud_FY15.pdf

²² *Securities Class Action Settlements 2015 Review and Analysis*, P. 3 published by Cornerstone Research, NYU Pollack Center for Law and Business, retrieved June 30, 2017, located at; <https://www.cornerstone.com/Publications/Reports/Securities-Class-Action-Settlements%E2%80%94942015-Review-an>

²³ *Securities Enforcement Empirical Database*, published by NYU Pollack Center for Law and Business, retrieved June 30, 2017, located at; <http://www.law.nyu.edu/centers/pollackcenterlawbusiness/seed>

²⁴ *SEC Announces Enforcement Results for FY 2015*, retrieved June 30, 2017 from U.S. Securities and Exchange Commission Web Site, located; <https://www.sec.gov/news/pressrelease/2015-245.html>

²⁵ Press Release pr7581-17. CFTC Enters Into Non-Prosecution Agreement with Former Citi-Group Global Markets Inc. Traders Jeremy Lao, Daniel Liao, and Shlomo Salant, retrieved from the U.S. Commodities Futures Trading commission web site, June 30, 2017, located at; <http://www.cftc.gov/PressRoom/PressReleases/pr7581-17>

²⁶ U.S. Department of Justice, press release, May 12, 2017, retrieved June 30, 2017, located at; <https://www.justice.gov/usao-cdca/pr/former-mlb-player-doug-decinces-and-associate-found-guilty-insider-trading-offenses>

²⁷ SEC Press Release 2016-128. Merrill Lynch to Pay \$415 Million for Misusing Customer Cash and Putting Customer Securities at Risk. Retrieved June 30, 2017 from <https://www.sec.gov/news/pressrelease/2016-128.html>

²⁸ SEC Press Release 2015-137. SEC Charges Deloitte & Touche With Violating Auditor Independence Rules. Retrieved June 30, 2017 from; <https://www.sec.gov/news/pressrelease/2015-137.html>

²⁹ SEC Announces Fraud Charges Against ITT Educational Services. May 12, 2015 Press Release, retrieved June 30, 2017 from; <https://www.sec.gov/news/pressrelease/2015-86.html>

³⁰ U.S. Securities and Exchange commission, “What We do” retrieved June 30, 2017 located at; <https://www.sec.gov/Article/whatwedo.html>