

# Investment fraud

Business



Investment fraud is any scheme or deception relating to investments that affect a person or company. Investment fraud includes: illegal insider trading, fraudulent manipulation of the Stock Market and prime bank investment schemes, other which I will also discuss in this research paper.

The term “insider trading” can refer to legal or illegal trades. Insider trading is legal when corporate insiders-officers, directors, and key employees-buy and sell shares of their company. Securities and Exchanges Commissions (SEC) or any authority given that responsibility; keep a record of all trades conducted by corporate insiders. Insider trading, however, becomes illegal when corporate insiders violate their company’s confidentiality and secretly share or sell private information to an outsider. The outsider will use the information not available to the public to buy or sell shares of the company to make a decent amount of profit. Illegal insider trading often gets pinpointed as the cause for the higher cost of capital for securities issuers, thus lowering overall economic growth.

Other types of Stock Market fraud include wash-trading, match-trading, and false prospectus. Wash trading happens when an investor simultaneously buys and sells shares of the same company through two different brokers. Wash trading is done to increase the activity of a stock in hopes of producing the impression that something big is coming. Match trading, is similar to wash trading, but usually a computer is used to pair-up shares of the same value to buy and sell to increase stock activity. At the end of each fiscal year, companies produce a prospectus for prospective buyers summarizing the company’s goals, assets, debts, and financial risks to help buyers decide whether or not they should invest in a company.

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Sometimes companies produce false prospectus misrepresenting risks or losses to influence potential shareholders to invest. Prime bank investment scheme is another type of investment fraud. Prime is a generic term used to describe legitimate financial institutions that issue investments. These schemes often claim false affiliations with organizations like the International Chamber of Commerce (ICC) and International Monetary Fund (IMF) to deceive investors. Offenders using this scheme trick prospective investors to believe that they're participating in an innovative investment program.

Offenders might request investors to sign papers agreeing not to disclose their identities, or any of the transactions made through the programs. Pump and Dump – A highly illegal practice where a small group of informed people buy a stock before they recommend it to thousands of investors. The result is a quick spike in stock price followed by an equally fast downfall. The perpetrators who bought the stock early sell off when the price peaks at a huge profit. Most pump and dump schemes recommend companies that are over-the-counter bulletin board (OTCBB) and have a small float. Small companies are more volatile and it's easier to manipulate a stock when there's little or no information available about the company.

There is also a variation of this scam called the “short and distort.” Instead of spreading positive news, fraudsters use a smear campaign and attempt to drive the stock price down. Profit is then made by short selling. But we have to recognize short selling is a strategy in dealing in stocks but sometimes it can be used with wrong intentions by fraudsters. Off Shore Investing – These are becoming one of the more popular scams to trap U. S.

and Canadian investors. Conflicting time zones, differing currencies, and the high costs of international telephone calls made it difficult for fraudsters to prey on North American residents. The Internet has eroded these barriers. Be all the more cautious when considering an investment opportunity originating in another country. It's extremely difficult for your local law enforcement agencies to investigate and prosecute foreign criminals.

The Internet is a great tool for investors, allowing us to research investments and trade securities with unprecedented ease. Unfortunately, the lack of rules on the ' Net also makes it a perfect place for fraud to flourish. Thus we can claim that technology do it part to encourage investment fraud.

Secondly, most people in the society are hungry for the wealth but they do not want to pay the price to acquire that wealth , thus they tend to use short cuts so they can get what they are supposed to get after long period of investing and working they want to get there within month or even few years , they claim Bill Gate came from being nobody to a billionaire and mark, both yes may seem like became rich overnight but if you are lucky and study their history you will learn that that not what happened they did earn their wealth by working hard and believing in themselves to achieve the they have now. Due to the want of becoming rich syndrome frauders get their victim there and claim to provide them with a way that they can achieve that kind of wealth they only dream of by means of various investment frauds.

While also lack of financial education and knowledge also encourage the fraudster to commit crime of investment fraud because they know very few people do know what goes on when it come to investment. Society may tend to think that it is only rich people, old people or organization that are

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targeted by frauders but that is not the case because recently victims come from even middle class background but they are also looking for ways to get rich but not the price which leads them to pay expensive and painful prices when they discover that they have lost the little they had. What I mean is that everybody is at risk of being targeted by investment frauders and we should be very careful with whom we entrust with our money.

Fraudsters can get punished in terms of jail terms. For example, Madoff's business surfaced as early as 1999 when financial analyst Harry Markopolos believed it was legally and mathematically impossible to achieve the gains Madoff claimed to deliver. According to Markopolos, he knew within five minutes that Madoff's numbers didn't add up, and it took four hours of failed attempts to replicate them to conclude Madoff was a fraud.

Madoff is currently serving his 150-year term and his assets are being auctioned so that the money that will come from that sale will at least be used to compensate the victims of Madoff's fraud. Victims are entitled to compensation but that can only be possible if the authority can access information of where the money went. Like in the case of Madoff, it is believed that about 12 - 20 billion cannot be claimed because nobody knows where Madoff did with it, thus meaning that compensation to the victims will be very hard to accomplish. Society should try and look at their history and understand those who are now enjoying their wealth there doing so after a long time of sacrifice and dedication to their investment, so as society we should change our values, build or learn to acquire new character and also be patient and avoid using shortcuts to achieve wealth. Finally, government is the caretaker of the society; it has already put some measures to discourage

investment fraud in terms of rules and regulation instilled by organization like FBI in this case in USA and other organization like exchange commission , housing commission likes, the only thing government or governments can do is to empower those organization so they can be able to fully deal with investment fraud , because as the days goes by smarter do also frauder get thus need of change on regulations and rules and how to instill that authority. The financial industry, or financial services industry, includes a wide range of companies and institutions involved with money, including businesses providing money management, lending, investing, and insuring and securities issuance and trading services. The following institutions are a part of the financial industry: Banks, Credit card issuers Insurance companies, Investment bankers, Securities traders, Financial planners and in their pursuit to offer service they tend to act as competitors thus leading some of the to indulge themselves in illegal activities which are known as investment fraud which means any scheme or deception relating to investments that affect a person or company.

Investment fraud includes: Affinity fraud, Mortgage Fraud, High Yield Investment Fraud schemes, Corporate Fraud But this research is to find solution of this problem by suggesting ways in which society and government can come together to get lid off those fraudster and teach the young and old how to now an investment fraud&nbsp; but also try to teach younger generation on how to create weal and make them understand that wealth creation is a process that require them to change their habits and mentality toward wealth. Affinity fraud includes investment frauds that prey upon members of identifiable groups, such as religious or ethnic

communities, language minorities, the elderly or professional groups. The fraudsters who promote affinity scams frequently are – or pretend to be – members of the group. They often enlist respected community or religious leaders from within the group to spread the word about the scheme, by convincing those people that a fraudulent investment is legitimate and worthwhile. Many times, those leaders become unwitting victims of the fraudster's ruse.

These scams exploit the trust and friendship that exist in groups of people who have something in common. Because of the tight-knit structure of many groups, it can be difficult for regulators or law enforcement officials to detect an affinity scam. Victims often fail to notify authorities or pursue their legal remedies, and instead try to work things out within the group. This is particularly true where the fraudsters have used respected community or religious leaders to convince others to join the investment. Many affinity scams involve “ Ponzi schemes” or pyramid schemes, where new investor money is used to make payments to earlier investors to give the illusion that the investment is successful. This ploy is used to trick new investors to invest in the scheme and to lull existing investors into believing their investments are safe and secure.

In reality, the fraudster almost always steals investor money for personal use. Both types of schemes depend on an unending supply of new investors; when the inevitable occurs, and the supply of investors dries up, the whole scheme collapses and investors discover that most or all of their money is gone. Affinity frauds can target any group of people who take pride in their

shared characteristics, whether they are religious, ethnic, or professional. Agencies such as U. S.

Securities and Exchange Commission have investigated and taken action against affinity frauds targeting a wide spectrum of groups. Some of the cases include the following: “ Armenian-American community loses \$19 Million”: The SEC’s complaint alleges that this affinity fraud targeted Armenian-Americans with little investment experience, for some of whom English was a second language (Leeds, 56). “ Criminal charges against South Florida man for \$51. 9 million fraud”: African American victims of this investment scheme were guaranteed that their investments would generate a 30% risk-free and tax-free annual return. “ ‘ Church Funding Project’ costs faithful investors over \$3 Million”: This nationwide scheme primarily targeted African-American churches and raised at least \$3 million from over 1000 investing churches located throughout the United States. Believing they would receive large sums of money from the investments, many of the church victims committed to building projects, acquired new debt, spent building funds, and contracted with builders (Porteous, 59).

A Ponzi scheme is a fraudulent investment operation that pays returns to separate investors, not from any actual profit earned by the organization, but from their own money or money paid by subsequent investors. The Ponzi scheme usually entices new investors by offering returns other investments cannot guarantee, in the form of short-term returns that are either abnormally high or unusually consistent. The perpetuation of the returns that a Ponzi scheme advertises and pays requires an ever-increasing flow of money from investors to keep the scheme going. The system is destined to

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collapse because the earnings, if any, are less than the payments to investors. Usually, the scheme is interrupted by legal authorities before it collapses because a Ponzi scheme is suspected or because the promoter is selling unregistered securities.

As more investors become involved, the likelihood of the scheme coming to the attention of authorities increases. While the system eventually will collapse under its own weight, the example of Bernard Madoff's investment scandal demonstrates the ability of a Ponzi scheme to delude both individual and institutional investors as well as securities authorities for long periods: Madoff's variant of the Ponzi scheme stands as the largest financial investor fraud committed by a single person in history. Prosecutors estimate losses at Madoff's hand totaling roughly \$21 billion, as estimated by the money invested by his victims. If the promised returns are added, the losses amount to \$64.8 billion, but a New York court dismissed this estimation method during the Madoff trial.

The scheme is named after Charles Ponzi who became notorious for using the technique in early 1920. Ponzi did not invent the scheme (for example Charles Dickens' 1857 novel *Little Dorrit* described such a scheme decades before Ponzi was born), but his operation took in so much money that it was the first to become known throughout the United States. Ponzi's original scheme was based on the arbitrage of international reply coupons for postage stamps; however he soon diverted investors' money to support payments to earlier investors and himself. Knowingly entering a Ponzi scheme, even at the last round of the scheme, can be rational economically if there is a reasonable expectation that government or other deep pockets

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will bail out those participating in the Ponzi scheme. A pyramid scheme is a form of fraud similar in some ways to a Ponzi scheme, relying as it does on a mistaken belief in a nonexistent financial reality, including the hope of an extremely high rate of return. However, several characteristics distinguish these schemes from Ponzi schemes: a, In a Ponzi scheme, the schemer acts as a “ hub” for the victims, interacting with all of them directly.

In a pyramid scheme, those who recruit additional participants benefit directly. (In fact, failure to recruit typically means no investment return.) b) Ponzi scheme claims to rely on some esoteric investment approach (insider connections, etc.) and often attracts well-to-do investors; whereas pyramid schemes explicitly claim that new money will be the source of payout for the initial investments) pyramid scheme is bound to collapse much faster because it requires exponential increases in participants to sustain it. By contrast, Ponzi schemes can survive simply by persuading most existing participants to “ reinvest” their money, with a relatively small number of new participants.

A bubble is similar to a Ponzi scheme in that one participant gets paid by contributions from a subsequent participant (until inevitable collapse), but it is not the same as a Ponzi scheme. A bubble involves ever-rising prices in an open market (for example stock, housing, or tulip bulbs) where prices rise because buyers bid more because prices are rising. Bubbles are often said to be based on the “ greater fool” theory. As with the Ponzi scheme, the price exceeds the intrinsic value of the item, but unlike the Ponzi scheme, there is no person misrepresenting the intrinsic value. With the greater fool theory in mind, some may invest even though they believe the securities are

overpriced due to a bubble. “ Robbing Peter to pay Paul”: When debts are due and the money to pay them is lacking, whether because of bad luck or deliberate theft, debtors often make their payments by borrowing or stealing from other investors they have.

It does not follow that this is a Ponzi scheme, because from the basic facts set out there is no indication that the lenders were promised unrealistically high rates of return via claims of unusual financial investments. Nor (from these basic facts) is there any indication that the borrower (banker) is progressively increasing the amount of borrowing (“ investing”) to cover payments to initial investors. A pyramid scheme is a non-sustainable business model that involves promising participant’s payment, services or ideals, primarily for enrolling other people into the scheme or training them to take part, rather than supplying any real investment or sale of products or services to the public. Pyramid schemes are a form of fraud. A successful pyramid scheme combines a fake yet seemingly credible business with a simple-to-understand yet sophisticated-sounding money-making formula which is used for profit.

The essential idea is that a “ con artist” Mr. X, makes only one payment. To start earning, Mr. X has to recruit others like him who will also make one payment each. Mr.

X gets paid out of receipts from those new recruits. They then go on to recruit others. As each new recruit makes a payment, Mr. X gets a cut. He is thus promised exponential benefits as the “ business” expands.

Matrix schemes use the same fraudulent non-sustainable system as a pyramid; here, the participants pay to join a waiting list for a desirable product which only a fraction of them can ever receive. Since matrix schemes follow the same laws of geometric progression as pyramids, they are subsequently as doomed to collapse. Such schemes operate as a queue, where the person at head of the queue receives an item such as a television, games console, digital camcorder, etc. when a certain number of new people join the end of the queue. For example ten joiners may be required for the person at the front to receive their item and leave the queue.

Each joiner is required to buy an expensive but potentially worthless item, such as an e-book, for their position in the queue. The scheme organizer profits because the income from joiners far exceeds the cost of sending out the item to the person at the front. Organizers can further profit by starting a scheme with a queue with skill names that must be cleared out before genuine people get to the front. The scheme collapses when no more people are willing to join the queue. Schemes may not reveal, or may attempt to exaggerate, a prospective joiner's queue position which essentially means the scheme is a lottery.

Some countries have ruled that matrix schemes are illegal on that basis (Derrig, 74). Mortgage Fraud, however, is just one component of the recent financial crisis, which has left trillions of dollars of losses in its wake as the Dow Jones Industrial Average fell to 6, 547 in March 2009 from its high of 14, 164 in October 2007. Throughout the past decade, a flourishing market developed for the securitization and sale of assets such as mortgages by financial institutions and other entities who were seeking to alleviate risk, <https://assignbuster.com/investment-fraud-essay-samples/>

increase cash flows and profit from these complex financial products. As underwriting requirements began to erode, sub-prime assets began to make up the majority of asset backed securities. In 2007, the markets for sub-prime asset backed securities began to collapse, which has been credited as one of the primary causes of the financial meltdown. In the wake of this historic economic calamity, the FBI has and will continue to investigate criminal allegations related to the activity that contributed to the financial crisis using all available tools at our disposal.

It is no secret that the financial crisis caused severe damage to both the financial markets and investor confidence. The crisis not only revealed new fraud schemes, such as material misrepresentations in the marketing of asset backed securities, but also exposed established fraud schemes which had been thriving in the global financial system, High Yield Investment Fraud schemes have many variations, all of which are characterized by offers of low risk investments, guaranteeing an unusually high rate of return. Victims are enticed by the prospect of easy money, and a fast turnaround. Another type of High Yield Investment Fraud is Prime Bank Investment Fraud. In these schemes, victims are told that certain financial instruments such as notes, letters of credit, debentures, or guarantees have been issued by well-known institutions such as the World Bank, and offer a risk-free opportunity with high rates of return.

Perpetrators often claim unusually high rates of return and low risk are the result of a worldwide secret exchange open only to the world's largest financial institutions. Victims are often drawn into Prime Bank Investment Frauds because the criminals use sophisticated terms, legal looking

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documents, and claim that the investments are insured against loss.

Corporate Fraud As the lead law enforcement agency investigating Corporate Fraud, the authority has focused its efforts on cases which involve accounting schemes, self-dealing by corporate executives, and obstruction of justice. The majority of Corporate Fraud cases pursued by the authority involve accounting schemes designed to deceive investors, auditors, and analysts about the true financial condition of a corporation. Through the manipulation of financial data, the share price of a corporation's stock remains artificially inflated based on fictitious performance indicators provided to the investing public. In addition to significant financial losses to investors, Corporate Fraud has the potential to cause immeasurable damage to the U.

S. economy and investor confidence. Effects of Investment Frauds Financial crisis from 2007 to the present is considered by many economists to be the worst financial crisis since the Great Depression of the 1930s. It was triggered by a liquidity shortfall in the United States banking system, and has resulted in the collapse of large financial institutions, the bailout of banks by national governments, and downturns in stock markets around the world. In many areas, the housing market has also suffered, resulting in numerous evictions, foreclosures and prolonged vacancies.

It contributed to the failure of key businesses, declines in consumer wealth estimated in the trillions of U. S. dollars, substantial financial commitments incurred by governments, and a significant decline in economic activity. Wealth effects, there is a direct relationship between declines in wealth, and declines in consumption and business investment, which along with <https://assignbuster.com/investment-fraud-essay-samples/>

government spending represent the economic engine European contagion the crisis rapidly developed and spread into a global economic shock, resulting in a number of European bank failures, declines in various stock indexes, and large reductions in the market value of equities and commodities Global effect a number of commentators have suggested that if the liquidity crisis continues, there could be an extended recession or worse. The continuing development of the crisis has prompted in some quarters fears of a global economic collapse although there are now many cautiously optimistic forecasters in addition to some prominent sources who remain negative The financial crisis is likely to yield the biggest banking shakeout since the savings-and-loan meltdown. Some developing countries that had seen strong economic growth saw significant slowdowns. For example, growth forecasts in Cambodia show a fall from more than 10% in 2007 to close to zero in 2009, and Kenya may achieve only 3-4% growth in 2009, down from 7% in 2007.

According to the research by the Overseas Development Institute, reductions in growth can be attributed to falls in trade, commodity prices, investment and remittances sent from migrant workers (which reached a record \$251 billion in 2007, but have fallen in many countries since). This has stark implications and has led to a dramatic rise in the number of households living below the poverty line, be it 300, 000 in Bangladesh or 230, 000 in Ghana. Ethically society is very weary of the opportunities which can be true but seems to be so good to be true, this will affect the players in the financial industry negatively and also make them lose money , socially people tend to enjoy and make merry when there is that feeling of having but when the

society feels it have to protect the little they have that affect them socially too and also those whom may be indicted with frauds tend to have very tough time in life because everyone seem against them for example madoff case. The only solution is society to have basic education on investment and government to empower the body that are given the authority to govern financial industry. Conclusion Investment fraud is to me a crime of high magnitude because it does not only take victim money but need the victim to help in that process of being robbed, which take me to what Edwin Sutherland said and I quote" Within the field of criminology, white-collar crime has been defined as " a crime committed by a person of respectability and high social status in the course of his occupation" (1939). Sutherland was a proponent of Symbolic Interactions, and believed that criminal behavior was learned from interpersonal interaction with others.

White-collar crime, therefore, overlaps with corporate crime because the opportunity for fraud, bribery, insider trading, embezzlement, computer crime, copyright infringement, money laundering, identity theft, and forgery are more available to white-collar employees". To someone who have never be a victim can brush off this information but investment frauds has lead to many death, divorces and many suffering that can not be quantified , so as society we should make sure that put measure that will discourage would be fraudsters and also arm our selves with knowledge of how to create wealth because research have shown that we are very prone to frauders because of our hunger for wealthy or as American call it American dream. I have never heard of someone who hate being rich but can we get that wealth in right way and that statement may vague but what I mean can we acquire our



wealth in a manner that we hurt no one in the process of creating that wealth and also do it according to the rules and regulation.