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Re: Citizen's Proposal for Inclusion of Small Investor Fraud Module in Utah Higher System of Education American Institutions Required Courses

Ms. Giani, Mr. McTighe, Ms. Hitch and Mr. Phillips:

I am writing you to propose that the Utah Department of Commerce (UDOC) and the Economics Department of the University of Utah (University) jointly develop and test a one hour instructional module on small investor fraud for implementation in Utah System of Higher Education (USHE). The module would be implemented in USHE required undergraduate American Institutions courses. The recipients of this letter are governmental members of the Utah Securities Task Force (Giani and McTighe) and educators (Hitch and Phillips). That Utah has a significant small investor fraud problem is not a new issue. Since Ms. Hitch and Mr. Phillips may not have the same background on this matter as compared to Ms. Giani and Mr. McTighe, I include a brief review of the national and Utah historical small investor fraud problem.

1 Summary of proposal

Pursuant to USHE Policy 470-3.1 [1], all Utah public education undergraduates are required to complete one of four courses: Economics 1740 (United States Economic History), Political Science 1100 (American Political Institutions), or History 1700 (American Civilization). The module would be incorporated in each course under the topic of the role of *caveat emptor* in the American economic system. The anti-fraud module suggested here would be a long-term supplement to the Utah Securities Task Force's 2009 anti-fraud public education program marketed under the "Fraud College" [2] trademark and the Utah Division of Securities Ponzi scheme website [3]. "Fraud College" directly targets the primary victims of small investor fraud - the elderly with significant assets.

2 The proposal is needed.

Utah needs the proposal to reduce the victimization rate of the elderly from investor fraud. In a 2010 survey, the non-profit Investors Protection Trust found 20% of the elderly self-reported being victimized by some form of fraud. Twenty-years of enforcement intervention through direct elderly anti-fraud public education have proven to be only partially effective at reducing rates of victimization. Barnard (2010) and Friedman (1998) separately noted that because cognitive abilities decline with age, many elderly persons cannot be reached by direct education [4, 5]. Utah's unique cultural values also make the state's elderly more susceptible to investment fraud [6]. Educating the children of the future elderly, who will be interested and responsible caretakers of their parents, can be an effective second line of defense against elderly fraud [4]. 91% of Americans aged 65 or older have at least one living child [7]. The required USHE American Institutions courses concentrate young adults whose parents are high-income earners, and those young persons are also likely to accrue significant future wealth. Deploying an anti-fraud education module among young college-educated adults holds promise for reducing the long-term incidence of Utah investor fraud victimization.

The proposal would also help reduce the fraud rate among young adults with high future earning potential, who are also susceptible to consumer and investment fraud. While affinity and investment fraud are often associated with the elderly, persons over 65 are 32% less likely to be victims of other types of consumer fraud such as mass-marketing and weight-loss schemes [8, at S3 to S4], [9, at 68]. In 2005, the FTC found that 13.5% of all United States adults were victims of some form of fraud [8, 10]. One mechanism that may contribute to the higher suspectiblilty of young adults are their extensive use of internet social networks. Higher use of internet social networks provides relatively more opportunities for young adults to form more, albeit less deep, social bonds. For investment fraud victims of all ages, 49% where introduced to the scheme through a "friend, neighbor, co-worker or family" and 73% of first-time victims report that personal trust was the primary factor in their decision to invest. [11]. A secondary effect of consumer fraud on both the elderly and the young is avoiding future investment, which can reduce their adequately saving for retirement. In a 2010 study for the Canadian Securities Administrator, the Innovative Research Group found for investors of all ages, suffering consumer fraud involving less than $10,000 made 64% of victims less likely to make future investments [11]. Suffering an investment fraud loss of $10,000 or more made victims 77% less likely to make future investments.

Utah needs the proposal to support economic development. As discussed below, the state has a historical reputation as an incubator for small investor frauds. That reputation reduces the ability of the state to attract investment capital and new businesses. Implementing this proposal is a starting point for correcting that perception of Utah.

3 History of significant Utah small investment frauds from 1980 to 2010

Before the 1980s, Utah had a reputation for penny stock fraud associated with the Salt Lake Stock and Mining Exchange. In 1980, the Wall Street Journal labeled the Utah securities market as "a place with its own enterprise zone for financial chicanery" [12,13]. Utah's reputation continued through the 1980s to mid-2000s due to a number of notable small investor fraud scandals.

Discovery and prosecution of small investor frauds are cyclical; the frauds are linked to recessionary cycles. Small investor frauds profilerate during economic upswings but before a recessionary downturn. Economic upswings allow Ponzi fraud schemes to lure new investors, who are flush with accrued profits, sufficient to sustain interest payments to initial investors, but when an economic downturn starts, new investors dry up and the Ponzi pyramid collapses.

Between the 1980s and the present, several high-profile Utah fraud cases came to light in the wake of economic downturns: The Grant Affleck-AFCO and the Independent Clearinghouse cases followed the 1980 recession [12, 14, 15], the Deseret Federal Savings and Loan collapse followed the mini-recession of 1983, and the Pacific Bonneville alternative energy investment Ponzi scheme followed the 1991 recession [12, 13]. The Wynn Co. auto loan investment scam followed the 2001 recession and was accompanied by a doubling of criminal convictions by the Utah Securities Division [12, 16]. The Attorneys Title Guaranty scheme came to light in 2007 [17]. In 2007, at the end of the expansion phase of the current economic cycle, according to FTC tracking of consumer complaints, Utah dropped from its historical national number one fraud ranking with 193.2 fraud complaints per 100,000 persons to second position behind Colorado [18].

The reduced rate of discovered consumer fraud in the late 2000s was short-lived both nationally and in Utah. Because of the Great Recession, by 2009, the Associated Press found that the national number of media reported Ponzi and other significant small investor scams quadrupled over prior years to 150 cases involving alleged losses of 16.5 billion USD [10, 19]. The FBI reported a 25% one-year increase in its securities and commodities fraud caseload [20]. Utah was not an exception to this national pattern. In 2010, the Utah Securities Task Force (including participation and leadership by Giani, McTighe and Utah Securities Division Director Keith Woodwell, among others) reported that the Task Force had pending small investor fraud investigations involving 4,400 victims and alleged potential losses of 1.4 billion USD [21, 22]. Because those matters were still under investigation, the Task Force did not identify alleged wrongdoers.

Table 1 compiles media reports from late 2009 through March 4, 2011 about suits filed in Utah state and federal courts that concern Ponzi schemes and mass marketing fraud. I assume that the media reports listed in Table 1 concern alleged fraud matters that are included in the June 2010 Utah Securities Task Force announcement of active investigations:

Table 1: *Alleged Utah Ponzi schemes and mass-marketing frauds - investigations and trials 2010-2011 per media reports - by descending date media reported a matter*

Entity	**Month Rept'd.**	**Refs.**	**Investors No.**	**Loss USD Mil.**
Johnson, J.; IWorks	2011-02	[23]	-	59.0
Morris, W.; E&R Holdings; Wise Fin.	2011-01	[24]	90	60.0
Hammons, W.*; Vescor	2011-01	[25–28]	800	52.0
Hoover, G.L.; Sinola Gold	2011-01	[29]	-	1.3
Wright, T.; Waterford	2011-01	[30, 31]	184	167.0
Filiaga, F. Jr.*; PT Group	2010-12	[32]	-	2.0
Taylor, R.E.; PFS; Ascendus	2010-12	[22]	45	9.7
Udy, R.D.*; Strategic Assets	2010-08	[33]	1,500	20.0
Mowen, J.	2009-12	[34]	-	18.0
Koerber, C.; Founders Capital	2009-05	[35–37]	-	100.0
Total			**2,619**	**489.0**

Notes: Source: Media reports per "References." Table includes persons and events that are alleged to have committed wrongdoing and the table includes claims that have not been fully adjudicated. "*" means media reported that the individual has been criminally convicted of fraud related to the loss. Estimates of the number of injured investors and loss are based on media accounts, are rough approximations and are not reported for all matters. Types of alleged fraud vary in each matter and include stock, investment and mass marketing fraud.

Although both the 1.4 billion USD in fraud and the 0.489 billion USD in fraud losses represent a recession driven spike, those losses are significant compared to Utah's state gross domestic product. For each year between 2007 through 2009, Utah's GDP measured in billions of dollars was: 2007 - 109.27, 2008 - 112.73, and 2009 - 112.67 [38]. From 2007 to 2009, state GDP grew by 3.4 billion USD, and the 1.4 billion USD in potential losses being investigated by the Task Force are equal to 40% of that total, but only 1.2% of state GDP. In 2010, Utah's GDP shrank by 54 million USD, and losses compiled in Table 1 are about 900% of that annual change (*id*).

Taking the 1.4 billion USD as a maximum recession driven spike in fraud cases that only involved 1.2% of total state economic activity, one reasonable interpretation is that small investor fraud is not a significant problem that requires governmental response. The current spike is an abberation that market forces adequately control during the growth phase of the business cycle. This economist view looks at all economic activity neutrally, including fraud, as a positive contributor to state GDP. That view discounts fraud's non-economic losses and secondary effects. For the elderly victim, secondary effects can include the need to rely on increased public assistance, intergeneration transfers of income from children or an induced health crisis. As noted above, for both the elderly and the young, being the victim of small consumer fraud involving losses under $10,000 significantly deters consumers from making future investments, thus increasing the rate of inadequate saving for retirement. The view that market forces adequately respond to fraud also ignores our culture's basic social contract that white collar criminal wrongdoing should be equally prosecuted. Crimes against the person, like assault, or against property, like auto theft, also are perpetrated by a small 1% minority of the population, but no reasonable person suggests that those crimes should be left to resolution through private market insurance.

4 Feasibility of the proposal

The proposal is *feasible* because it can reach its intended target population. American Institutions courses within the Utah System of Higher Education uniquely concentrate young adults in an education context of learning about the American economic system. USHE Policy 470-3.1 creates a bottle-neck of students in those courses [1]. That student concentration is unique in that students are only likely to be exposed to concepts of consumer fraud, business fraud and Ponzi schemes if they pursue a major in business or economics. Taking the University of Utah as representative of other colleges in the USHE, the University Office of Budget and Information Analysis reports that during the 2009-2010 academic year only about 10% of all undergraduate credit hours accrued in departments where those advanced fraud topics might be encountered (61,103 undergraduate credit hours out of 587,057 hours) [39].

The proposal is *acceptable* because the instructor-student time commitment is small. If a pilot program proves successful, the proposal requires reallocating a one hour lecture within four courses of American Institutions curriculum. The proposal involves a small incremental change. The proposal is acceptable because teaching small investor fraud can be incorporated within teaching the existing concepts of *caveat emptor* within the existing American Institutions curriculum. The proposal does not substantively change the existing emphasis on neo-classical free-market principles taught within the Economics Department.

The proposal's *cost* is affordable, even in the current constrained higher education budget. Because this is a preliminary proposal, a formal budget is not included. I estimate developing a module would require University resources of totaling about 150 hours: 20 hours expended by a full-time professor, 20 hours expended by an associate professor, 100 hours expended by a graduate student, and 10 hours of secretarial time. Potential grant sources include the non-profit Investor Protection Trust (`http://www.investorprotection.org/grant/`) or FINRA Investor Education Foundation (`http://www.finrafoundation.org/grants/`).

The effects of the proposal can be easily *assessed* in the short-run by existing course evaluation forms.

In the 2011 general session, the Utah legislature implemented the *alternative solution* of increasing state statutory penalties for affinity fraud by passage of three bills introduced by Utah Senator McAdams [40, 41]. S.B. 101 sub. increases affinity fraud penalties where the wrongdoing exploits a trust relationship. S.B. 101 sub. provides whistleblower protections to employees of companies that engage in investment fraud. S.B. 151 sub. repeals exemptions from state securities regulation for fractionalized real estate investments - the subject of the Kroeber listed described in Table 1. The governor is expected to sign these new bills, but these measures do not address increasing anti-fraud education targeted to young adults.

Other *alternative solutions* to the proposal are unlikely to produce the same effects. The no-action alternative of pursuing existing education models will not optimally address the need for fraud education by targeting the adult children of future fraud victims. This "no action" alternative is my primary motivation for making the proposal, and I have a unique education and employment background that enables me to speak to the "no action" alternative. After working as a paralegal in various law firms for 30 years, in the summer of 2010 I began freshman studies at the University of Utah. My early paralegal career involved assisting attorneys on the Affleck case (in a minor tangential role), on Deseret Savings collapse, and for two years on the Independent Clearinghouse matter. As a civil litigation paralegal, I assisted on one single investor securities fraud case involving damages in excess of one million dollars. My later career included assisting attorneys for four years on one large trust matter and six years in antitrust enforcement.

In 2010, I took the University of Utah's 1070 American Economic History course which used the course text Heilbroner and Singer (1999) [42]. Heilbroner and Singer do not educate young adults on investment fraud risks, and because of the text's legitimate emphasis on neo-classical free-market economics, the course text had the opposite effect of increasing a young student's susceptibility to future investment fraud. Heilbroner and Singer (1999) do not mention Charles Ponzi or define what a Ponzi scheme is. Baumol and Blinder (2010), the course text in Microeconomics 2010 that I am presently taking, provides a more balanced view of neo-classical economics, but similarly does not educate young adults on the risk of small investor fraud or Ponzi schemes [43].

Existing courses likely to be encountered by a broad range of University of Utah undergraduates do not discuss fraud risks, and the proposal would not be duplicative of current curricula.

5 Conclusion

In conclusion, I propose that the University of Utah and the Utah Securities Task Force consider developing an anti-small-investor fraud module, test the module during the spring 2011-2012 University of Utah semester, and, if successful, implement that module throughout USHE American Institutions required courses. The proposal seeks to reduce the elderly and young adult fraud rate in Utah through education targeted at young college adults. If acceptable, I suggest as a first step that the Utah Securities Task Force invite Ms. Hitch and Mr. Phillips, or his designated representative, to a future non-privileged portion of a Task Force meeting to discuss the merits of this proposal. Please feel free to contact me with any questions regarding this proposal via email at `fisherka@csolutions.net`.

Sincerely,

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