Protecting Senior Citizens from Investment Fraud

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Chairman Kohl, Ranking Member Smith, and Members of the Committee:

I am pleased to be here today to discuss the important work the Securities and Exchange Commission is doing to protect investors, including our nation's senior citizens. Financial fraud against the elderly is a topic that I, my fellow SEC Commissioners, and the SEC staff care about deeply.

Protecting senior investors is one of the most important issues of our time – and I've made it one of my highest priorities since becoming Chairman of the SEC. Some Census numbers released earlier this year give us a sense of the magnitude of this issue. In 2006, there were more than 37 million Americans age 65 and older, accounting for 12% of the total population. There were five million people age 85 and older, nearly two million in their nineties, and over 73,000 Americans age 100 or older. Longevity is now the norm in our country, and for that we can all be grateful – but it also means we need to be prepared. Every year, as medical miracles allow us to enjoy a larger population of senior citizens, the task of protecting retirement nest eggs grows in importance.

In the 21st century, Americans will live significantly longer than their parents – and longer than most of them planned for their retirement. A number of older Americans will face difficulties in making their retirement assets last an extra decade or more. It is estimated that Americans 65 and older hold $15 trillion in assets, an all-time record. Yet nearly a third of that group say they do not have enough money even to meet their basic living expenses. Those with sufficient funds to invest may be tempted to take higher risks with their investments in order to achieve higher returns, instead of switching into low-yield, safe investments like the retirees of yesteryear. That will make them prime targets for scam artists and securities swindlers.

Just as the notorious Willie Sutton described the bank robber's propensity to “go where the money is,” securities fraudsters will follow the money, too. Households led by people over 40 already own 91 percent of America’s net worth, and Americans aged 55-64 have the highest income and the highest net worth of any age group, according to the Federal Reserve’s Survey of Consumer Finances. As the baby boomers continue to age, it will be a very short while before the vast majority of the nation's savings are in the hands of America's elderly.

We have long known that the elderly are especially vulnerable to the financially devastating impact of frauds and scams, and there are several reasons for this. A recent study by a researcher from the Federal Reserve and a professor at the University of Texas is only the most recent of many to suggest that one reason is the declining mental faculties of senior investors, which negatively impacts their personal financial management.[1] And investment fraud hurts seniors more than any other group, because when seniors lose their life's savings, they lack the time to rebuild a nest egg.

Taking care of my own parents' finances, I have grappled with this important issue on a very personal level. Before my mother died a few years ago, she was pestered by a seemingly endless barrage of annuity schemes and mortgage offers. Despite the fact that she was suffering from throat cancer and could barely speak, she received repeated unsolicited sales pitches over the phone and even in person. Even though my father was suffering from Alzheimer's disease, the brokers preyed upon him as well.

The products these brokers were pushing weren't just unsuitable, but affirmatively harmful to anyone in my parents' circumstances. The annuity products they purchased locked up their modest savings with huge penalties. I particularly remember one persistent salesman who called more than a dozen times, pestering my mother to refinance her safe, low-rate 30-year mortgage with a short-term loan that had a balloon and a teaser rate. That would have cost my parents their home when it came due. Even though I personally warned him never to call her again, he continued.

Both during my time in Congress and since I've become Chairman of the SEC, I've heard hundreds of similar stories from constituents and colleagues. It is heartbreaking to see a loved one ripped off by underhanded tactics that may comply with the letter but not the spirit of the law. That's why, at the Commission, we're always doing our best to protect all investors as if they're our own mother or relative.

A Multifaceted Approach

The SEC is the investor's advocate – and when it comes to senior investors, we have a special responsibility. We need to do everything we can to ensure that seniors are well-educated about the important choices they make, and that they are treated fairly and appropriately by brokers, investment advisers, and others in the securities industry. And we need to see that anyone who takes advantage of seniors through investment scams is brought to justice swiftly. Since I became Chairman, we have been attacking the problem from a number of angles – from investor education, to targeted examinations, to aggressive enforcement efforts. In this initiative, we have partnered with other organizations.

[1] Korniotis, George M. and Kumar, Alok, "Does Investment Skill Decline Due to Cognitive Aging or Improve With Experience?" (July 2007). Available at SSRN: http://ssrn.com/abstract=767125

Working Effectively with Partners

Helping our nation's seniors is not a task that can be undertaken solely by the federal government. Efforts by multiple parties are necessary to protect them from investment fraud, as well as to equip them with the necessary skills to identify and avoid possible investment scams. That's why the SEC has initiated efforts to partner with other organizations, such as the AARP, the Financial Industry Regulatory Authority (FINRA), and the North American Securities Administrators Association (NASAA) on seniors-related initiatives.

Working together, we held our first Seniors Summit in July 2006 to coordinate our efforts to protect older Americans from investment fraud and abusive sales practices.

At the 2006 Summit, the NASD Investor Education Foundation unveiled a new study on investment fraud. The study explored the reasons the elderly are victimized by fraud, and offered some very interesting findings. Fraudsters, the study found, use hundreds of sophisticated social influence tactics to get their victims to sign on and often bombard their victims using a combination of these tactics. Among the most common social influence tactics are "phantom fixation" (the con artist dangles the prospect of wealth or prizes to tantalize the victim), "social consensus" (the con artist convinces a victim that peers, neighbors, and other respected people in the community are all making this particular investment), "scarcity" (the con artists makes the investment seem rare so the victim will feel pressured to act quickly), and "reciprocity" (the con artist provides a small favor, such as a free lunch, to induce the victim to return the favor in kind by buying the investment).

At the 2007 Seniors Summit, which will be held next week on September 10th, we will gather even more of the nation's resources to protect seniors. One important part of the event, open to the public, will be a "lunch and learn" program focused on how to combat investment fraud by understanding the persuasion tactics most often used by fraudsters who prey on seniors. This is one lunch seminar that won't be a come-on to deceptive sales tactics.

But to shine a spotlight on how free meals are used as a lure to attract senior investors, we will kick off this year's event with a presentation of the findings of the SEC's examination of "free lunch" sales seminars aimed at seniors, which has been a joint effort among federal and state law enforcement. We will also discuss how best to educate seniors about investments and hear about recent enforcement actions to address fraud on seniors.

Education

A major part of the Commission's program to prevent fraud against seniors is investor education. Indeed, investor education and outreach are critical parts of every aspect of the Commission's work. In this regard, the Commission has sought to arm senior investors with information that they can use to identify and avoid potential fraudulent investment schemes, to deal with aggressive sales tactics, and to assess the financial products available to them. These efforts are aimed not only at seniors, but also their caregivers – as well as pre-retirement workers, who are encouraged to plan for contingencies later in life.

In the last year, we've placed significant emphasis on investor education initiatives directed towards seniors, and partnered with other regulators and consumer organizations, including AARP, to sponsor over 40 events to educate senior investors across the U.S. So far, more than 50,000 seniors have attended.

We have also devoted a portion of the SEC website specifically to the issues facing senior investors (http://www.sec.gov/investor/seniors.shtml). The site provides links to critical information on investments that are commonly marketed to seniors, and detailed warnings about common scam tactics. Realizing that not all seniors are web savvy, and many are unable to read the small print on computer screens, we have also packaged all of our online senior-related materials into a single hard-copy Seniors Guide with large, easy to read fonts. The SEC's Office of Investor Education and Advocacy will mail the 108-page investment fraud guide to any investor, free of charge, upon request.

Earlier this summer, I announced a significant expansion of the Office of Investor Education and Advocacy (OIEA). A new focus for OIEA will be assessing the views and needs of retail investors, including seniors, and ensuring that those views inform the Commission's regulatory policies and disclosure programs. The new Director of OIEA, Kristi Kaepplein, is bringing new energy and ideas to the Commission's longstanding program of protecting seniors and other individual investors.

Targeted Examinations

The SEC's examination program conducts on-site compliance examinations of securities firms to foster compliance with the federal securities laws. Our Office of Compliance, Inspections and Examinations (OCIE) uses risk-based techniques to focus on activities that pose the greatest compliance risk to investors and the integrity of the markets. Last year, as part of our new initiative to help protect senior investors, OCIE joined with state securities regulators in Florida, California, Arizona, Texas, North Carolina, South Carolina, and Alabama, as well as with the NASD and NYSE, in a coordinated series of examinations of financial firms that sponsor "free lunch" sales seminars, often at local restaurants and hotels.

Final and complete results of the OCIE examinations will be released by the SEC, NASAA, and the Financial Industry Regulatory Authority (FINRA) at the second annual SEC "Seniors Summit" next week, and will also be posted on the SEC's website. But even at this point it is clear that we were right to identify these "free lunch" sales seminars as posing serious risks to senior investors. Many of the advertisements and mailers used to solicit seniors to attend these events were confusing or misleading about the intent of the event. Our examinations have found that, despite being advertised as "educational" or touting "nothing will be sold," the purpose of these seminars is to convince attendees to open new accounts with the sponsoring firm – and ultimately, to sell financial products to seniors.

While we can look forward to seeing the full results of these examinations next week, this work is already helping regulators understand how sales seminars are used to target seniors, and how we can better help protect seniors from being victims of unsuitable sales of securities. Our "free lunch" examinations are also a terrific example of what can be achieved when the SEC partners with others, and we thank our partners at NASAA and FINRA for working collaboratively on this important project.

Aggressive Enforcement

Over the past two years alone, the SEC's Division of Enforcement has brought at least 40 enforcement actions involving fraud on seniors. Many of these actions were coordinated with state authorities. In one notable case, *SEC v. D.W. Heath and Associates*, the Commission worked with the Riverside County District Attorney's Office to crack down on a $144.8 million Ponzi scheme that lured elderly victims in southern California to workshops with the promise of free food – and then bilked them out of their retirement money by purporting to sell them safe, guaranteed notes.

In just the past two months we have brought three significant enforcement actions targeting seniors – two of which were emergency actions to halt ongoing activities. First, in July we filed an emergency action against AmeriFirst Funding, Inc., AmeriFirst Acceptance Corporation, and their principals alleging that they defrauded investors of approximately $55 million through the fraudulent offer and sale of so-called Secured Debt Obligations (SDOs). The Commission's complaint alleges that AmeriFirst sales agents lured elderly investors, and others saving for retirement, with advertisements for relatively high-yielding FDIC-insured certificates of deposit, then convinced the investors to purchase the SDOs instead. The complaint further alleges that the defendants misrepresented the safety of the SDOs by falsely asserting, among other claims, that the investment had little or no risk because accounts were guaranteed by a commercial bank, protected by many layers of insurance coverage, and fully secured by collateral. In other words, rather than promising outlandish returns – a common ploy of Ponzi operators – the defendants allegedly played on the conservative nature of retirees and near retirees with low risk thresholds. Defendants also touted the credentials of one of the principals of AmeriFirst, while failing to disclose his long history of financial irresponsibility and securities-related sanctions, including personal bankruptcies and a permanent bar from associating with any broker-dealer. In the AmeriFirst action, we secured preliminary injunctions and asset freezes, but as in too many such cases, much of the money appears to have been spent before we got there.

In another notable case, *SEC v. Earthly Mineral Solutions, et al.*, this July we sued two Nevada companies and their officers for allegedly perpetrating a $20 million Ponzi scheme involving mining interests. Like AmeriFirst, the defendants in Earthly Mineral Solutions allegedly played on the tendency of senior investors to be more conservative and "guaranteed" investors a fairly modest 7% to 9% annual return on their investments.

The Commission's complaint alleges that the defendant's actions convinced a number of investors saving for retirement to liquidate personal IRAs to invest in the purportedly safe mining interests.

Finally, just weeks ago, in *SEC v. Secure Investment Services*, *et al*., we took emergency action to shut down an alleged $25 million Ponzi scheme that targeted hundreds of senior and other investors nationwide who bought fractional ownership interests in life insurance policies. The Commission's complaint alleges that the father/daughter team that operated Secured Investment Services falsely promised investors safe, secure, and profitable interests in life insurance policies known as "viaticals" while failing to disclose the dire financial condition of the investment venture. The defendants allegedly pocketed $700,000 of investor funds for their personal use while the venture was on the verge of collapse.

The SEC's enforcement staff will continue to aggressively investigate and file actions against those who prey upon senior citizens. In particular, the SEC will continue to bring emergency actions to shut down ongoing offering frauds, with the goal of preventing further investor harm.

Fighting Unethical Sales Practices

In addition to coordinating and improving efforts in our current three-pronged approach for protecting seniors against investment fraud, one goal for this year's Seniors Summit is to identify new areas of focus for protecting the financial interests of seniors. One possibility is improving broker-dealer sales practices by identifying principles of conduct to help firms and their personnel establish and maintain high standards in their interactions with investors.

Broker-dealers are already subject to numerous specific sales practice obligations. These obligations are primarily spelled out in the rules of the self-regulatory organizations, particularly FINRA. The rules establish strong baseline standards for sales practices, but good business practices should inevitably lead a firm to even higher standards of conduct in dealing with their customers. The Commission, as well as the self-regulatory organizations and the securities industry, can help firms in this regard as they work to develop principles of conduct with respect to the sale of securities to seniors and with respect to the many other special issues that surround senior investors.

Another important Commission initiative is to consider whether the different regulatory structures applicable to the two main types of securities intermediaries that we regulate – broker-dealers and investment advisers – are confusing to senior investors, and whether they continue to make sense in light of how the securities business has evolved. In 2006, the Commission awarded a contract to the RAND Corporation to conduct factual research and analysis for a major study comparing the levels of protection afforded retail customers of broker-dealers and investment advisers. The study is well underway, and a final report is due at the end of this year. We expect to use the findings of the study as an empirical foundation for evaluating the current legal and regulatory environment for the provision of financial products, accounts, programs, and services to senior investors by broker-dealers and investment advisers.

One particular source of potential investor confusion is the use of "senior" professional designations by brokers, investment advisers, and others – an issue you are rightly highlighting in this hearing. I commend the Committee for raising awareness regarding the use and abuse of senior professional designations. We need to do everything we can to ensure that seniors are well informed about the experience, background, and expertise of financial professionals they use. We also want to ensure that seniors are treated fairly and appropriately by brokers and others throughout the securities industry.

As you know, some financial professionals use designations that imply that they are experts at helping seniors with financial issues. Many seniors, however – and many investors of all ages – don't understand the alphabet soup of initials that may follow the names of these financial professionals. Titles such as "senior specialist" or "retirement advisor" often bespeak nothing but a clever attempt to lure senior investors to purchase questionable investment services.

The education, experience, and other requirements for receiving and maintaining a "senior" designation vary greatly from mere self description to mandatory completion of rigorous exams and work in a designated field for several years. In many cases, even state-approved designations may be relatively easy to obtain in terms of time and effort, even for an individual with no relevant experience.

The SEC does not endorse any particular designation, but we do encourage investors to do their homework with respect to professional designations, and we are looking into whether we, our counterpart regulators in the states, or state legislators and the Congress should do more. In the SEC's online brochure on senior designations (available at www.sec.gov/investor/pubs/senior-profdes.htm), we refer investors to "*Understanding Investment Professional Designations*" on FINRA's website, which provides the education and experience requirements for many professional designations. Our investor education materials also remind investors that understanding a financial professional's designation is just one step investors should take when they evaluate his or her credentials.

Conclusion

Before I conclude, I would like to share a personal story. As I briefly mentioned, my mother passed away several years ago. As hard as it was to accept my mother's death, it was harder still to see my father so vulnerable. So it was nice that it seemed to help both of us to spend some time going through old pictures and mementos in Mom and Dad's apartment.

And in that enjoyable scavenger hunt, I came across a small framed check, made out to my grandfather. It was for $3.36 — representing 56/1,000 of 1% of the hard-earned savings he'd earnestly entrusted, in 1929, to the debentures of Insull Utility Investments.

That was the eventually notorious holding company of Samuel Insull, the Ken Lay of his day — who combined scores of power utilities to create a corporate pyramid.

It all came crashing down in 1932, and hundreds of thousands of investors, including my grandfather, lost their savings as a result. The Insull abuses, which FDR railed against in the 1932 campaign, helped give birth to the Securities and Exchange Commission in 1934.

I have hung that small frame with my grandfather’s check on my office wall. It serves as a reminder that being the investor's advocate means standing up for the little guy. It means never forgetting that the cost of securities fraud is measured not just in accounting losses and diminished stock prices, but in people's lives — in their dashed hopes, and their squandered savings; in retirement dreams that might never materialize, or doctor bills that can't be paid.

As Chairman of the Securities and Exchange Commission, I have had the opportunity to devote myself to the cause of the ordinary investor. I look forward to continue working with this Committee and our many state and federal partners to protect and educate our nation's senior investors.

Thank you again for this opportunity to appear before the Committee. I would be happy to answer any questions you may have.