

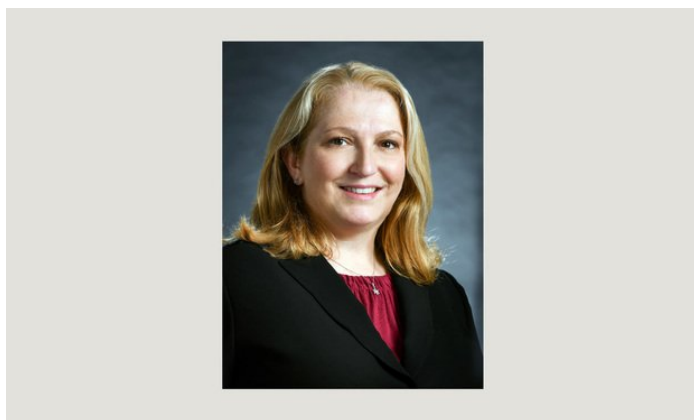
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When Belonging Can Cost You Everything: Affinity Fraud

So, what is affinity fraud? The Securities and Exchange Commission (SEC) defines affinity fraud as “investment scams that prey upon members of identifiable groups, such as religious or ethnic communities, the elderly or professional groups.

By **Nicole McNeil Donecker** | November 19, 2019 at 01:26 PM
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It sounds odd, but I had experience with “affinity fraud” before I knew what it was called. As a forensic accountant I conducted investigations involving members of religious organizations where one member of the group was preyed upon by another member for financial gain—the proverbial “I have an investment deal for you.” Unfortunately, the “investment” was not as advertised, resulting in losses to many participants/“investors.”

So, what is affinity fraud? The Securities and Exchange Commission (SEC) defines affinity fraud as “investment scams that prey upon members of identifiable groups, such as religious or ethnic communities, 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.”

As with other fraud schemes, perpetrators of affinity frauds take advantage of the “trust and friendship that exists in groups of people who have something in common.” Victims of these types of scams often do not report the fraud to law enforcement or pursue other legal avenues; instead members try to “work things out within the group.”

Affinity fraud most often involves a Ponzi or pyramid scheme that necessitates the fraudster’s continual need for new investor funds in order to provide “returns” to earlier investors. The most famous of affinity frauds is Bernie Madoff’s \$50 billion Ponzi scheme. Madoff’s victims were comprised of wealthy members of the Jewish community, Jewish organizations and charitable groups.

Affinity fraud can be investigated as either a civil or criminal matter, with complaints filed by the SEC and the Department of Justice, for example. Often the SEC's involvement is due to the utilization of unregistered securities and investments.

In April 2015, the SEC filed a civil complaint against Leroy Brown Jr. and LB Stocks and Trades Advice. Brown is a former member of the U.S. Army, living in Killeen, Texas, the same town as Fort Hood Military Base. Brown used his tenure in the military to target current and former U.S. military members. Brown and LB Stocks made numerous false statements regarding investment licenses and registrations with applicable government entities. The complaint states that Brown and LB Stocks claimed to “provide investment services for U.S. military and other government personnel, such as ‘Military Deployment and Redeployment Investment Solutions’ and ‘Low Income Family Advice’.”

Brown and LB Stocks “guaranteed” to double or triple the investment in 120 days. Investors could purchase a membership certificate of LB Stocks for \$1,000 per certificate. Brown and LB Stocks purported to invest in underdeveloped land which, upon sale, would double investors' money. In the end, Brown had transferred nearly all of the investor funds into personal accounts. The SEC obtained a temporary restraining order and an asset freeze against Brown and LB Stocks. The SEC complaint seeks civil penalties, disgorgement of ill-gotten gains and permanent injunctive relief.

In March 2016, the Department of Justice filed a criminal complaint against Seng Xiong. Xiong perpetrated an affinity fraud scheme that allegedly promised Hmong elders “10 acres of land, a house and many other benefits in a future country that would be established as a Hmong homeland somewhere in Southeast Asia.” Xiong, a member of the Hmong community who immigrated to the United States from Laos at a young age, was active in

Hmong advocacy groups in his community in the early 2000s. According to court documents, beginning in 2012, Xiong represented to the Hmong community that he was “working with the United Nations and the United States government to establish a new country for the Hmong in South East Asia.” The Hmong community in the United States was eager to return to their home and re-establish their pre-Vietnam War life.

Xiong instructed Hmong elders to deposit \$3,000 to \$5,000 into an account in the name of Seng Xiong through a “returning home registration form.” These deposits were made to Xiong’s account from bank branches in Minnesota, Wisconsin and California. Xiong reached the Hmong community through a conference call line, YouTube channel, a radio broadcast, a website and a personal cellphone number. Xiong was sentenced to 87 months in prison and three years supervised release and was ordered to pay \$1,226,446 in restitution to victims.

Affinity fraud occurs throughout the United States. According to the FBI, Utah has one of the highest rates of white-collar crime in the country. In an article posted by the FBI on Dec. 18, 2017, Special Agent Michael Pickett stated that the FBI is investigating more than \$2 billion of fraud in Utah, with 10 new cases opened in the previous four months.

As the SEC’s definition of affinity fraud includes religious communities, it is no surprise that Utah reportedly has one of the highest rates of fraud in the United States. With over 50% of the population of Utah belonging to The Church of Jesus Christ of Latter-day Saints, the members of the church are often victims of affinity fraud. The church’s website offers resources for its members including multiple articles on the topic.

Utah has become proactive in the fight against affinity fraud and other financial fraud schemes. In 2016, Utah introduced the first-of-its-kind White Collar Crime Offender Registry. An individual who has been convicted in a Utah state court after Dec. 31, 2015, of a second degree felony under eight sections of the Utah Code, including securities fraud, is required to register. The White Collar Crime Registry is part of Stop Fraud Utah, a collaborative initiative between multiple federal and state agencies offering free consumer education seminars to help residents recognize and avoid financial fraud schemes.

The SEC has issued educational materials to assist investors in recognizing affinity fraud and protecting themselves against it. The SEC.gov and Investor.gov websites contain alerts and bulletins on affinity fraud. Additionally, the SEC's Office of Investor Education and Advocacy (OIEA) provides a guide titled "Stopping Affinity Fraud in Your Community, How to avoid investment scams that target groups" to help investors avoid and recognize affinity fraud in their community.

The bulletin includes a graphic from the FINRA Investor Education Foundation identifying five common persuasion tactics used. These red flags should alert investors to either avoid the investment or perform additional research and due diligence before investing:

- The "phantom riches" tactic, which holds the potential of wealth and guaranteed income in front of the investor.
- The "source credibility" tactic, where the fraudster puts themselves out there as being with a big firm, having specialized credentials or having specific experience.
- The "social consensus" tactic, leading the victim to believe that the fraudster, their relatives and their community are also investing.
- The "reciprocity" tactic, where the fraudster will do the victim a favor in return for the investment.

- The “scarcity” tactic, which makes the investment appear exclusive or limited in supply.

When an investment seems “too good to be true” or the investment has little risk but a high return, the SEC recommends the following rules of thumb:

- No risk means low investment returns.
- High potential investment returns typically means high risk.
- Promises of consistent double-digit investment returns are consistently frauds.

Remember, do research when investing and perform due diligence on the person offering the investment. The SEC and other agencies offer resources to help investors protect themselves from scams and frauds. If it seems too good to be true, it probably is.

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