

The Villains of Currency

Investors' Excitement Allows Fraudsters To Get Even the Savvy

By Joanna Slater

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Cashing in on the volatile world of buying and selling currencies just became riskier.

Scam artists are increasingly using currency-trading schemes to ensnare even experienced investors, regulators say. The scams take many forms, soliciting individuals over the telephone or wooing them at hotel presentations.

One widespread scheme promises investors fat profits if they jump in on a time-sensitive opportunity to trade currencies. The money then disappears or gets eaten up in unprofitable trades.

ON GUARD

- **The News:** Foreign-currency trading scams have grown rapidly in the past few years, targeting even sophisticated individual investors.
- **The Background:** Historically, such scams targeted ill-informed investors. But rising interest in currency trading, as well as easier trading via the Internet, have broadened the scope of scamsters.
- **What May Help:** Regulators are cracking down. Sometimes opening a savings account in a foreign currency is a safer -- and easier -- way to make a currency bet.

Such frauds exploit a growing awareness among the investing public that the global foreign-exchange market -- worth roughly \$2 trillion a day -- is an important financial arena. They also benefit from a legal loophole: Not all of the people who solicit investors to trade currencies are regulated, making them difficult to monitor.

Schemes like these are "the fraud du jour," says Michael Dunn, a commissioner at the Commodity Futures Trading Commission, the government body responsible for regulating a portion of currency trading. In recent years, foreign-exchange fraud cases have expanded

to take up 28% of the body's current litigation. "This is a real problem out there," says Mr. Dunn.

Over the past five years, more than 25,000 investors have been burned by these frauds, which employ a variety of tactics to lure individuals. Some firms set up booths at investor fairs or rely on printed brochures or pitches over the telephone. Other schemes target particular ethnic groups or spread by word of mouth.

That's how Vicki Myers learned about White Pine Trust Corp., a San Diego foreign-currency fund. Before deciding whether to invest, Ms. Myers visited the company's office. The firm had trading screens, glossy brochures, and, it claimed, an outstanding track record. Impressed, Ms. Myers and her husband invested \$58,000 in retirement funds and other savings.

After the fund's Web site stopped working and no one returned her calls, she drove back to the office in 2004, only to find it abandoned. The money was likely gone, she realized. The fund's founder is now in prison after pleading guilty to wire fraud.

"It made me sick," recalls the 57-year-old, who is a marketing director at a residence for the elderly. She estimates that about half of her husband's retirement savings disappeared in the fraud.

The scams tap into an increasing curiosity among individuals about the world of currencies, long

the domain of banks, companies, and other institutions.

"The strength and weakness in the dollar is being talked about in the headlines on a daily basis," says Muhammad Rasoul, chief operating officer of Global Forex Trading, a registered foreign-exchange firm based in Michigan that caters to individual customers. "You're going to have people trying to take advantage of those who aren't as familiar" with currencies.

To combat such practices, Mr. Rasoul advocates closing the loopholes that allow some currency-market players to escape regulation and help unscrupulous operators to thrive.

Knowing how to identify legitimate foreign-exchange players is particularly important since the number of firms catering to individual investors has exploded in recent years. Increasing numbers of small investors are trying their hand at buying and selling actual money, thanks to electronic-trading platforms that require low minimum investments.

It's a risky proposition that features unpredictable swings in prices that can wipe out gains. The scams rarely mention such hazards. They target not only financial novices and the elderly, but also investors with an advanced grasp of how markets work.

A good example is the con that ensnared Ms. Myers, which managed to solicit more than \$30 million from investors.

The fund's founder, Richard Matthews Jr., pleaded guilty to wire fraud in 2005 in federal court in San Diego, and is in prison while a receiver liquidates the ill-gotten gains from the scam, which included a 12-acre island in Belize, property in California, and a yacht.

Investors in the scheme may recover approximately 20% of their original investment, according to the receiver.

The frauds themselves differ in type and scope. A garden-variety scam might work like this: Fraudsters rent a telemarketing "boiler room" complete with phones and cubicles, and start cold-calling numbers from a list of leads available for purchase. They promise large guaranteed returns, hail their track record, and ask that a minimum investment be wired to a particular bank. If an investor bites, the calls continue, saying more money is needed to take advantage of an urgent trading opportunity.

When the investor asks for the money back, the response is that the market has shifted; then a month or two later the company closes. "The next day they're up and running under a new name," says Mr. Dunn of the CFTC. Florida is a particular hotspot for such schemes, he says.

Another tactic is to target members of a particular community. In San Francisco, for example, a firm placed a classified ad in a local Chinese-language newspaper -- promising well-paid work with health insurance. People who responded to the ad were given a minimal amount of training in how to trade currencies. Then they were asked to invest \$20,000 of their own money and to encourage friends and relatives to open accounts. Nearly all of the \$1.78 million invested by at least 45 people was lost.

One fact that helps to explain the prevalence of such currency scams is that they sometimes slip through the regulatory cracks. The CFTC has the authority to crack down on fraud in futures contracts, which are agreements to buy or sell a given commodity (or in this case, a particular currency) on specific dates. Futures contracts are a basic way to speculate on currencies. In a recent foreign-exchange case, *CFTC v. Zelener*, in the 7th U.S. Circuit Court of Appeals in

Chicago, the judges ruled that although customers were defrauded, the contracts involved weren't explicitly futures. As a result, the judges said the carefully worded contracts in the case put the wrongdoers beyond the mandate of the CFTC. "In effect, it gave a blueprint for fraudsters on how to escape our jurisdiction," says Mr. Dunn of the CFTC.

Last year, Congress examined ways to close the Zelener loophole and is expected to reconsider the issue soon.

Another issue exploited by fraudsters relates to how currency contracts get sold to the average investor. The current law provides a fair degree of latitude for companies selling over-the-counter currency futures: for example, they don't have to register with a regulatory body, as long as they're affiliated with a company that has done so. Their employees can also escape regulatory scrutiny.

The result, at times, is high-pressure sales tactics by people who were previously involved in other forms of commodity fraud, says Daniel Roth, president of the National Futures Association, a self-regulating body for the industry.

"Essentially you have a completely unregulated sales force that is in some cases preying on retail customers," says Mr. Roth. "I can't believe that's what Congress intended."

Some registered firms take steps to protect themselves. Mr. Rasoul of Global Forex Trading says his firm won't take customer referrals from unregulated agents who may be using questionable practices to bring in business. "We're not interested in dealing with people who don't have some kind of responsibility over them," he says.

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Unmasking Fraud...

If you're considering investing in currencies, some resources to protect yourself:

- ❖ Visit the CFTC's currency fraud site: www.cftc.gov/enf/enfforex.htm²
- ❖ Contact the National Futures Association at (800) 676-4NFA and ask if a company is a member of the NFA or registered with the CFTC, and to check the disciplinary record of a particular company or salesperson. The NFA has a site to check a firm's record (www.nfa.futures.org/basicnet³).
- ❖ Check if the company has attracted the attention of other authorities, like your state's securities commissioner (www.nasaa.org⁴) or Attorney General's consumer protection bureau (www.naag.org⁵).

... And Getting Into Forex

There are several ways to invest in foreign-currency movements:

- ❖ **Mutual Funds.** Several "hard currency" funds invest in a variety of currencies. Foreign-bond funds also derive a portion of returns from currency movements. Morningstar's Web site is a resource to research such funds.
- ❖ **Online Accounts.** A large number of companies offer online trading accounts to retail investors where they can speculate directly on currency movements.
- ❖ **ETFs.** Certain exchange-traded funds track the performance of individual foreign currencies against the dollar. Sites such as www.etfconnect.com⁶ offer information.

Sources: CFTC; WSJ data