A Wolf in Sheep’s Clothing: Enacting Statutes Enhancing Criminal Penalties for Affinity Fraud

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The following note reviews a new form of sentencing enhancement under the security fraud statutes of two states. The sentencing enhancement is imposed on individuals who are found guilty of affinity fraud. Indiana passed its affinity fraud bill in 2009, and soon thereafter, Utah state legislature adopted its own affinity fraud sentencing enhancement statute. New Jersey, although introduced a similar bill in 2010, has as of date not passed the bill.

Other states are likely to follow the examples of Indiana and Utah and enact similar affinity fraud penalty enhancement statutes aimed at deterring and punishing culprits. This note compares and contrasts Indiana’s and Utah’s current affinity fraud statute, and New Jersey’s proposed affinity fraud bill. The note also discusses some of the issues that courts might encounter when dealing with their analysis of whether or not a particular fraudulent scheme encompassed an affinity relationship so as to render it eligible for the sentencing enhancement.

Table of Contents

Introduction ..........................................................................................................................1
Affinity Fraud ..................................................................................................................5
Enhanced Punishments For Affinity Fraud .................................................................14
Affinity Fraud Statutes ....................................................................................................22
Potential Issues From Affinity Fraud statutes .........................................................28
The Right Ingredient ....................................................................................................32
Enhanced Penalties Are Not Enough ........................................................................36
Conclusion .....................................................................................................................42

I. Introduction

What is the difference with the following two scenarios?

(1) Joe Black comes up to you and proposes a new investment opportunity that will yield a 20 percent return on your investment, every month, for 12 months. You met Joe last week at a small business conference you attended. At your request, Joe shows you paperwork that confirms 20 percent return, for the past several months, on the investment deal. After a week of
deliberating on the idea, you decide to invest most of your life savings, $100,000 dollars, with the hopes of making extra money for when you finally retire. Six months later, Joe is indicted for running a Ponzi scheme.

(2) Joe Black comes up to you and proposes a new investment opportunity that will yield a 20 percent return on your investment, every month, for 12 months. You have known Joe for five years now, you attend the same church and many of your fellow churchgoers have already invested with Joe. You decide to invest most of your life savings, $100,000 dollars, with the hopes of making extra money for when you finally retire. Six months later, Joe is indicted for running a Ponzi scheme.

The above scenarios narrate a form of securities fraud. A person entices you to invest in a new investment opportunity, guaranteeing a 20 percent return on your investment. You invest, hoping to make extra money, but ultimately getting scammed. There is, however, one major difference between the two scenarios, the type of relationship between the parties.

In the first scenario, Joe is a person you just met. Although his investment proposal is enticing and you are inclined to invest, you do not know him. So you request documents to verify all is true. You put in due diligence to make sure your money is in safe hands.

In the second scenario, however, Joe is a person you have known for five years. He attends your church and many of your fellow churchgoers have also invested with him. He

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1 The above scenarios are a form of pre-planned fraud—a scheme created for the sole purpose of defrauding investors. A second type of fraud is sometimes called intermediate fraud—when businesses start out as legitimate, but eventually commit fraudulent acts. Wayne E. Baker & Robert R. Faulkner, *Diffusion of Fraud: Intermediate Economic Crime and Investor Dynamics*, 41 CRIMINOLOGY, no. 4, 2003, at 1173, 1174. [hereinafter *Diffusion of Fraud*]. Affinity fraud can take the form of both pre-planned and intermediate fraud, although majority of such fraudulent schemes are pre-planned.
seems trustworthy, and because of this trusting relationship—with very little or no due diligence
to verify the legitimacy of the offer—you decide to invest.

The second scenario is so prevalent in our society it has a name of its own—Affinity
Fraud. Affinity fraud has many definitions, but the underlying rationale is that people tend to be
more trusting and, thus, more likely to invest with individuals they have a connection with—
religious, ethnic, social, or professional. Most classes of securities markets are susceptible to
affinity fraud, but such fraud is more common in Ponzi style investment schemes.

Ponzi scheme derives its name from a well known fraudster from the 1920s, Charles
Ponzi. Mr. Ponzi, an Italian immigrant to the United States, figured out that he could purchase
International Postal Reply Coupons from other countries for pennies and redeem them for cash at
a fix rate in the United States. ² Mr. Ponzi offered his investors a profit of 40 percent within 90
days.³ By the time Mr. Ponzi was finally charged, he owed more than three million dollars to
investors.⁴ A vast amount of literature exists describing the life and the notorious scam
perpetrated by Mr. Ponzi, but what most of the literature neglects to emphasize is that Mr.
Ponzi’s scheme would not have instigated without the use of affinity fraud. “The initial investors
were not turned out in black suites with ample waistcoats anchored by gold watch chains; rather,
coming mostly from Boston’s North End, they were the same simple immigrants that Ponzi
understood and had victimized in the past.”⁵

² 2 CHARLES ELLIS & JAMES VERTIN, WALL STREET PEOPLE: TRUE STORIES OF THE GREAT BARONS OF

³ Id. at 163.

⁴ Id. at 165.

⁵ Id. at 163.
During the 90 years since Mr. Ponzi’s scheme, investors have lost billions to affinity type fraud. One of the more recent security fraud cases—dramatically effecting U.S. investors—also dealt with affinity fraud. Namely, Bernard Madoff’s ponzi scheme that cost investors over $50 billion. In the beginning, and throughout his scheme, Madoff—a prominent Jew—targeted the Jewish community. In an NPR interview, Dean Cass, of Boston University Law School, recognized the strong influence that affinity fraud played in the Madoff Ponzi scheme. “He was clearly targeting people who were Jews because he’s Jewish. . . . [I]t’s the circle that is going to be most trusting of him…. [I]t’s not any accident that Mr. Madoff … sought out as clients many, many prominent Jews.”

Affinity fraud has been around for a very long time, but with the advent of the internet and the recent recession in the United States economy, affinity fraud is on the rise. The North American Securities Administrators’ Association (NASAA) has expressed alarm over the rise of affinity fraud schemes as a result of the ease of internet access and many of the online social networks that bring people—who share a common attribute—together. Furthermore, during economic recessions, “[f]inancial scams of all types proliferate…but affinity fraud seems to…”

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8 NASAA is an organization comprised of state regulators, http://www.nasaa.org/.

9 NASAA Cautions Investors About Social Networking Fraud, NASAA (Sept. 7, 2011), http://www.nasaa.org/5572/nasaa-cautions-investors-about-social-networking-fraud/ (noting that the rise in “popularity of websites such as Facebook…and other online social networks and communities has made it easier for con artists to quickly establish trust and credibility”).
grow[ ] faster simply because it’s unusually effective....[t]he con artist is able to tailor the pitch to the weaknesses and worries of th[e] specific group and sway people who are normally not gullible.”  

The need to deter such fraudulent schemes is at its greatest.

Part one of this note unravels the intricacies of affinity fraud; how it is different from other types of fraud, who the main targets are, and how this type of fraud is harming society. Part two discusses whether there is a need to have specific laws aimed towards deterring affinity fraud architects, and enhanced penalties for those who commit affinity fraud. In part three, I compare and contrast affinity fraud penalty enhancement statutes in Indiana and Utah, and look at New Jersey’s affinity fraud bill introduced in 2010. Part four focuses on the legal complications of affinity fraud statutes and what steps legislators can take to minimize potential issues. In the final section, I recommend incorporating investor education, group leadership involvement, and whistleblower incentives, to further shield investors.

II. Affinity Fraud

The definition of affinity fraud varies slightly from source to source, but the underlying idea remains the same. Black’s Law Dictionary defines affinity fraud as “fraud in which the perpetrator tailors the fraud to target members of a particular group united by common traits or interests that produce inherent trust.” The Securities and Exchange Commission has defined affinity fraud as “investment scams that prey upon members of identifiable groups. . .[t]he fraudsters who promote affinity scams frequently are—or pretend to be—members of the


11 I will be using the words affinity fraud architect, fraudster and scammer interchangeably.

The National American Securities Administrators Association states that affinity fraudsters use statements such as, “[y]ou can trust me…because I’m like you. We share the same background and interests. And I can help you make money.”

a. The Vulnerable Prey Of Affinity Fraudsters

Affinity fraud “prey[s] upon members of identifiable groups, such as religious or ethnic communities, the elderly, or professional groups.” Looking around, we see that “[e]veryone, in some way or another, is connected to a group or association. Our interests, backgrounds, and other factors will naturally lead us to those organizations or affiliations that serve our needs.”

When we share a common bond, or high-trust relationship, with another individual, we tend to believe that the individual is similar to us in other aspects. That is, knowing we would never run an illegal investment scheme, we assume that persons similar to us, or part of our “in-group”, would not either. But with so many things to consider in our everyday lives, we are prone to take shortcuts whenever possible. This opportunity arises every time we interact with someone

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15 How to Avoid Scams, supra note 13.

16 Swindlers, supra note 14.

17 High-trust refers to the level of trust we have with close friends or family members. See Thao Phuong Ngoc Tran, Essays on Social Preferences, iii (May 3, 2010) (unpublished Ph.D. dissertation, Harvard University), UMI Number: 3415386 (“[A] high trust individual is more likely to be trusted because his having high trust for other people induces a higher expectation of his trustworthiness and also greater altruism towards him.”)

18 Id.
from our “in-group”. We tend to lower are guard, take shortcuts, and base our decisions on the
likeability and trust we have of that person, rather than verifying the authenticity of their
statements.

(1) Religion. Affinity fraud is most common among religious groups. Fraudsters appeal
to people’s altruistic ideals, generosity and God–like aspirations. The Oracle Trust Fund Ponzi
scheme illustrates this.\footnote{Oracle Trust Fund, Lit. Rel. No. 16355, (modified Nov. 17, 1999), \textit{available at}
http://www.sec.gov/litigation/litreleases/lr16355.htm. Even with the promise of exorbitant and unrealistic returns,
victims—blinded by the affinity relationship—carelessly invest. \textit{Commission Files Emergency Action Against
Abraham L. Kennard and Two Corporations in Ongoing Affinity Fraud}, Lit. Rel. No. 17827 (modified Nov. 5,
2002) (describing a religious based Ponzi scam that promised that each investment of $3,000 would pay a return of
$500,000), \textit{available at} http://www.sec.gov/litigation/litreleases/lr17827.htm.} This scheme targeted members of Christian churches in rural Kansas,
Nebraska and Missouri. The defendants used Biblical names for their investment schemes
(Jubilee Trust Fund, Oracle Trust Fund and Elkosh Trust Fund), and “proclaimed their status as
so-called ‘born-again’ Christians and suggested that the investment would fulfill a religious
‘duty’ or ‘prophecy.’”\footnote{Id.} The fraudsters guaranteed that investors would receive a monthly return
of 20\% for 12 to 18 months, by supposedly trading in high-yield foreign bank instruments.\footnote{Id.} In
reality, the defendants operated a ponzi scheme, paying initial investors with money received
from later investors. In the end, nearly 125 members of various Christian churches lost roughly
$7.4 million.\footnote{Id.}
(2) Race/Ethnicity/Nationality. Race, ethnicity and nationality can create a strong trusting relationship and identifiable group among members. Roy Fluker, Jr., and his two children honed in on this mindset in their fraud scheme that cost thousands of African-American investors millions of dollars. One of Fluker’s fraudulent schemes, an educational and financial program, called, Spend and Redeem Program, pledged that investors would receive an education through their investments, and 25 percent yield on their investment every month for 12 months. This affinity fraud scheme targeted exclusively the African-American community, and the companies were purposely named “All Things in Common, LLC” and “More Than Enough, LLC”. “[T]he group challenged African-Americans to empower themselves by putting their money in the black-run investment program.” By the time authorities caught on and stopped the scheme, “[m]ore than $18 million was collected between 2005 and 2008 from about 2,000 investors….”

Immigrants are also easy targets of affinity fraud. When individuals immigrate to a new country, with very little language skills and cultural awareness, they form strong bonds with other, former and current, immigrants, who speak their language, have gone through similar situations, and understand their culture. Melkon Gharakhanian took advantage of this ethnic bond when he scammed investors in the Armenian-American community out of more than $5

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million, during late 1999 through 2001. Gharakhanian promised investors that “he would use their money to purchase various securities for their accounts….”26 He instead used the money for his own personal benefit. Gharakhanian targeted “members of Glendale’s large Armenian-American community, many of whom had never invested in the stock market.”27

(3) Elderly. The elderly are an obvious target for affinity fraud. The elderly victim, frequently, has a large savings through many years of work. Many elders are often defrauded by individuals they have a high-trust relationship with—close friends, caregivers, and family members. A recent affinity fraud scheme targeted elderly victims from Jehovah’s Witnesses congregations.28 According to the SEC complaint, the Commission charged Ronald Nadel and Joseph Malone with raising over $16 million from roughly 190 elderly investors nationwide between 1999 through 2004. The defendants promised 10% to 25% return on their investments,


27 Id.; See e.g., SEC Halts $23 Million Ponzi Scheme, Affinity Fraud Targeting Haitian-American Investors, Lit. Rel. No. 2008-306 (Dec. 30, 2008), http://www.sec.gov/news/press/2008/2008-306.htm (discussing an emergency action taken by the SEC to halt an alleged Ponzi scheme carried out by George L. Theodule against Haitian-American investors.) Theodule’s company, Creative Capital, guaranteed a 100 percent return on investments within 90 days. The fraudster also promised that the company’s profits “were being used to fund new business ventures, including some to benefit the Haitian community in the U.S., Haiti, and Sierra Leone,” although all along defrauding investors out of more than $23 million. Id. Linda Chatman Thomsen, Directof the SEC’s Division of Enforcement correctly identified the underlying opportunity for the fraud by focusing on the fact that the “Ponzi scheme preyed upon unsuspecting members of a close-knit community, attempting to take advantage of the trust they had in each other….” Id.

and sent out fictitious quarterly account statements showing profits. The fraudsters—pretending to be part of the Jehovah’s Witnesses—committed a classic affinity fraud scheme.

(4) Professional Organization. Affinity fraud can infiltrate many different types of professional organizations—labor unions, retired bus drivers, Ferrari owners, and even NBA Alums. Similar to other identifiable groups, individuals in this category have something in common and that commonality is what creates the trust and friendship that affinity fraudsters prey upon. In 2011, prosecutors in New Jersey charged Tate George, a former New Jersey Nets and Milwaukee Bucks player, with wire fraud. George ran a Ponzi scheme from 2005 through 2011, targeting former pro athletes just like him. George was able to raise over $2 million from investors by appealing to the commonality of their pro athlete affiliation.

b. Difficult to Detect

In an ordinary fraudulent investment scheme, the fraudster presents documentation and other material to overcome an investor’s suspicion and apprehension to invest. With affinity

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29 Union Outreach Program Launched As Part Of Fraud Prevention Month, NEW BRUNSWICK SEC. COMM’N (Mar. 2, 2011), available at http://www.nbsc-cvmnb.ca/nbsc/news_content_display.jsp?news_id=262&id=24&pid=4 (“Unions are especially at risk of affinity fraud because they have influential leadership that affiliated members listen to and trust….”).


33 Id.
fraud, investors lower their guard because of the relationship they have with the fraudster.\textsuperscript{34} Although many investors would normally disconnect a telephone call offering some form of questionable investment, these same investors let their guard down when approached by individuals who seem similar to them or belong to their social groups.\textsuperscript{35}

As time goes on, many victims refuse to believe that someone they trusted would scam them, and so they allow the situation to continue, hoping for the big pay-off that their trusted comrade has promised. Further exacerbating the situation, “victims often fail to notify authorities or pursue their legal remedies, and instead try to work things out within the group.”\textsuperscript{36} Not only are victims of affinity fraud in denial, but such fraud is also difficult for regulators or law enforcement officials to detect on account of the “tight-knit structure of many groups.”\textsuperscript{37}

For these reasons, an affinity fraud scheme tends to stretch out for a longer period of time.\textsuperscript{38} The scheme can go on for years, with investors reinvesting more of their hard earned

\textsuperscript{34} Wayne E. Baker & Robert R. Fulkner, \textit{Social networks and loss of capital}, 26 SOCIAL NETWORKS 91, 104 (finding that there is “only a 23\% probability that an investor who used within-network exchange also conducted due diligence, compared with a 60\% probability for an investor who did not use social ties.”) [hereinafter \textit{Social Networks}].


\textsuperscript{36} \textit{How to Avoid Scams, supra} note 13.

\textsuperscript{37} \textit{Id.}

\textsuperscript{38} A counter argument is that because of the close-knit relationship, group members are more likely to figure out relatively quickly that they were defrauded because group members talk to one another and relate their suspicions, worries and outcomes of the investment. \textit{See Diffusion of Fraud, supra} note 1, at 1182. However, investors tend to stay in denial—that they have been defrauded by a trusted friend or loved one—for a long period of time, allowing the fraud to continue.
money, sinking deeper into the inevitable black hole they agreed to blindly jump into. Daren Palmer, a man who has been called a rural Western version of Bernard L. Madoff, was able to operate his affinity scheme for nearly six years before the SEC filed complaints. Palmer, a resident of Idaho Falls, seemed like the average humble neighbor and friend—except for the fact he was a multimillionaire. He solicited clients to invest in his company, promising them upwards of 20 percent return. Palmer was able to acquire over $75 million from 68 investors, and in the end, he lost more than $20 million. Palmer is a prime example of affinity fraud; not only did he scam his neighbors and fellow churchgoers, but he also scammed his own father and brother-in-law.

**c. Affinity Fraud Harms Society**

Judge Denny Chin, the presiding judge for Bernard Madoff’s notorious fraud, correctly described Madoff’s conduct as “extraordinarily evil.” The fraud carried out by Madoff is incomparable, it is in a league of its own—never has such fraud been carried out against so many individuals and caused such a devastating impact. We should not, however, be quick to judge

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whether one fraudulent scheme is more evil than another. Affinity fraud, intrinsically, is extraordinarily evil, whether it harms one individual or thousands.

Developed, independent and democratic economies, such as the United States, depend on trust—both social trust among citizens and citizens’ trust in their governmental entities—to prosper. A key ingredient for prosperity is the free flow of capital. The free flow of capital requires stable investments in the financial markets. Individuals who trust one another are more likely to invest in the financial market. Unfortunately, affinity fraud erodes the trust needed for such investments to occur and to foster our economy.

In addition, “[o]ur culture values people’s willingness to make charitable donations, a kind of generosity that is important to the prosperity of society in general.” Affinity fraud impairs the social trust and generosity that our economy depends on. Victims of affinity fraud lose the freedom to trust both strangers and loved ones. They experience a form of financial prison with a life-term sentence. As one of the Madoff’s victims stated during Madoff’s sentencing hearing, “[h]e took from us the freedom that we held so preciously close to our lives, the very

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thing I always valued and never took for granted. In a sense, I would like someone…to tell me how long is my sentence.”46

The negative consequences of affinity fraud are significant. Victims, having lost their ability to financially support themselves, need to rely on government support, which is an extra cost for an already overburdened treasury. Also, having lost trust in others, victims are less likely to invest in the market, diminishing the free flow of capital in our economy. Affinity fraud harms all of us—whether directly or indirectly—and unlike a typical thief that pickpockets unsuspecting individuals, “a person who violates trust may well do serious damage to the ties that bind us together in [our] complex society.”47

III. Enhanced Punishments For Affinity Fraud

a. Rationale

Losses from securities and commodities fraud are estimated to total approximately $40 billion per year.48 Victims include individual investors, financial institutions, public and private companies, government entities, and retirement funds.49 Moreover, between 2004 though 2009,

46 Id.

47 United States v. Isaacson, 155 F.3d 1083, 1087 (Fernandez, J., dissent) (describing the reasons for the federal sentencing guidelines).


49 Id.
fraud investigations increased by 33 percent.\textsuperscript{50} Although affinity fraud is a small sub-part of the whole scheme of securities fraud, the consequences on victims and the economy are vast.

Our society is built around relationships of trust—we trust family members, friends and people from certain groups or organizations. “In a world of increasing complexity, many people feel the need for a short-hand way of knowing who to trust.”\textsuperscript{51} When this trust is violated and destroyed, it has both psychological and physical effect on us.\textsuperscript{52} The justifications for enhanced penalties for perpetrators of affinity fraud are plenty. Professor Lisa Fairfax summed up the main justifications, stating:

\begin{quote}
[M]any forms of affinity fraud prey upon the victim’s generosity. Because our society values charitable impulses, we should impose harsher penalties on those who exploit these impulses. Second, many forms of affinity fraud involve relationships of high trust. The law generally imposes greater responsibility and more severe consequences on people who violate such relationships because participants in special trust relationships are less cautious and, therefore, more vulnerable and because these relationships enable their participants to commit crimes that are more difficult to detect and resolve. Additionally, some relationships of trust serve important economic functions that deserve legal protection through heightened penalties for their violations.\textsuperscript{53}
\end{quote}

The idea for enhanced penalties for violating a position of trust is neither novel nor shocking. Legislators have recognized many different types of crimes—involving violation of trust—requiring enhanced punishment due to the culpability and severe repercussions of the crime. These types of crimes create a twofold harm; (1) the crime itself, and (2) the harm of

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\begin{itemize}
  \item \textsuperscript{51} Swindlers, supra note 14.
  \item \textsuperscript{52} Madoff Sentencing, supra note 45, at 10 (victim Maureen Ebel stating that her emotional toll is devastating and her health deteriorated rapidly after she found out about the fraud).
  \item \textsuperscript{53} Fairfax, supra note 44, at 90.
\end{itemize}
being violated by someone one trusts. Defendants, abusing a position of trust, have received enhanced penalties in sexual offense cases, cases where fiduciary duty is established, as well as cases outside the traditional fiduciary relationship. The rationales for enhanced penalties for affinity fraud are similar to those of other crimes.

The goals of criminal law are to deter, incapacitate, rehabilitate, and render just punishment. As a society, we find that certain crimes deserve extra punishment. Society, in general, views crimes that are perpetrated within a position of trust especially shocking, shameful, and outrageous.

What is more, securities and investment fraud are extremely harmful to the victims as well as society at large. Oftentimes, one’s life savings and retirement accounts are completely wiped out by the fraudulent scheme. One victim of Madoff’s scheme said, “not only have I lost the inheritance of my father who worked for his entire life so that his children and his children’s children can live a better life, I have lost our retirement accounts and funds in trust for our children.”

Other than material possessions, investors also lose confidence in their government. “I have lost my life savings because our government has failed me and thousands and thousands of

54 Dena M. Gromet & John M. Darley, Punishment and Beyond: Achieving Justice Through the Satisfaction of Multiple Goals, 43 LAW & SOCIETY REV., no. 1, 2009, at 1, 2 (“[I]nvestigations have demonstrated that people respond to intentional wrongdoing not as instrumentalists (concerned with deterrence and fears of victimization) but with a moral reaction (concerned with offenders receiving their ‘just deserts’ and the moral health of society.”)

55 Id. at 3 (noting that society uses retributive justice to “send a message to community members that wrong-doing is not tolerated within the boundaries of the community, as well as to show support for the community values that were violated.”).

56 Madoff Sentencing, supra note 45, at 18–19 (victim Burt Ross).
other citizens….the Securities & Exchange commission, by its total incompetence and criminal
negligence, has allowed a psychopath to steal from me and…the world.” Less confidence
means fewer investments, which in turn causes less capital to flow through the markets. As
mentioned in section II(c), social trust and trust within ones government is what makes a strong
democracy. Many of the consequences of affinity fraud are felt instantly, but the long lasting
effects are plenty, harming generations to come.

b. The Need For Explicit Affinity Fraud Penalty Enhancement Statutes

The academic community has offered the idea of expanding the penalties of certain well
established laws to allow enhanced penalties for affinity fraud. Professor Fairfax, in particular,
has advanced several ideas to allow enhanced punishments for this particular type of fraud. Professor Fairfax has suggested that we look to fiduciary-like principles, and the current federal
sentencing guidelines to create a nexus for enhancing penalties for affinity fraud.

Section IV discusses the enactment of penalty enhancements statutes specifically tailored for
affinity fraud; however, to better explain and clarify the need for such statutes, it is important to
briefly discuss the limitations of the proposed alternatives.

(1) Fiduciary Duty

Fiduciliaries, namely those individuals that hold some form of trust or confidence, are
found in different contexts and industries. Due to the high degree of trust in such relationships,

57 Id. at 8–9 (victim Maureen Ebel).

58 See FAIRFAX, supra note 44 and Lisa M. Fairfax, The Thin Line Between Love And Hate: Why Affinity-
Affinity Hate Crime].

59 See FAIRFAX, With Friends Like These, supra note 44, at 100–111.

the law imposes higher obligations on fiduciaries. The rationale for imposing greater responsibility on a fiduciary relationship and, therefore, greater punishment for those that abuse such a relationship is similar to the rationale for enhanced penalties for affinity fraud.

Individuals in such relationships place high-trust and confidence in one another and we want to protect this trusting relationship and punish those who abuse it. However, “not every misuse of a fiduciary relationship will subject a defendant to the enhancement; he must either occupy a ‘formal position of trust’ or create sufficient indicia that he holds such a position that it is appropriate to hold him so accountable.”

Hence, the difficulty of extending fiduciary duty penalties to affinity fraud stems from the principle that there needs to be some sort of “formal position of trust”, and courts are reluctant to find formal position of trust in affinity fraud schemes.

(2) United States Federal Sentencing Guidelines

The U.S. Federal Sentencing Guidelines (the “sentencing guidelines”), enacted as part of the Sentencing Reform Act of 1984, advises courts in determining an appropriate sentence for offenders of different crimes. Three specific sections of the guidelines provide an increase in

61 United States v. Koehn, 74 F.3d 199, 201-202 (10th Cir. 1996) (quoting United States v. Queen, 4 F.3d 925, 929 n. 3 (10th Cir.1993)).

62 See Drinkard v. Walnut Street Securities, Inc., 2009 WL 1322591 *3 (“Although the Court is not prepared to hold that this sort of affinity fraud necessarily involves the creation and breach of a fiduciary duty, the allegations in the instant case detailing that Defendant’s alleged agents actively exploited religious connections to establish trust and confidence, are sufficient to state a claim for breach of fiduciary duty.”). The court was cautious not to extend an affinity type relationship to a fiduciary duty realm, but was willing to find a fiduciary duty in this particular case because the defendant was licensed under the state securities laws.

the length of a defendant’s sentence for criminal acts similar to acts performed in affinity fraud schemes. (1) Abusing a position of trust for the advancement of a crime,⁶⁴ (2) perpetrating crimes against vulnerable individuals,⁶⁵ and (3) misrepresenting to individuals that one is acting on behalf of a charitable, educational, religious, or political organization, or a government agency.⁶⁶

(1) §3B1.3 increases a sentence level by two points if the defendant abuses a “position of public or private trust, . . . in a manner that significantly facilitated the commission or concealment of the offense.”⁶⁷ The sentencing guideline commentaries offer the following example to illustrate a violation under this section: an “offense [that] involved theft or embezzlement from a labor union and the defendant was a union officer or occupied a position of trust in the union…”⁶⁸

(2) §3A1.1 allows an increase in sentencing by two to four points for perpetrating a crime against a vulnerable victim. The clause “acknowledge[s] that, while most crimes are committed for other motives, in many instances defendants know or should know of their victim’s particular vulnerability and are therefore more blameworthy for knowingly or even negligently harming them.”⁶⁹ A vulnerable victim is identified as a “person who is a victim of the offense of

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⁶⁴ USSG §3B1.3 (2010) (providing a two level increase in sentencing when defendant uses a position of private or public trust to carry out the crime).

⁶⁵ USSG §3A1.1 (2010).


⁶⁸ Id.

⁶⁹ United States v. Cruz, 106 F.3d 1134, 1139 (3d Cir. 1993).
conviction and any conduct for which the defendant is accountable under §1B1.3 (Relevant Conduct) and who is unusually vulnerable due to age, physical or mental condition, or who is otherwise particularly susceptible to the criminal conduct.”

Also, a defendant will receive an additional two point increase if the offense involves a large number of vulnerable victims.

(3) §2B1.1(b)(8) adds a two level increase to offenses that involve a “misrepresentation that the defendant [is] acting on behalf of a charitable, education, religious, or political organization, or a government agency,” but in reality, the defendant intends to divert all or part of the proceeds for his or her personal use.

Although a fraudster could potentially receive penalty enhancements under §3B1.3 for an affinity type fraud, courts are inconsistent in their application of the sentencing guidelines for such fraud. §3B1.3 does not define what is meant by a position of trust; courts find that “[d]etermining what constitutes a position of trust…is not a simple task.” While some courts might define a position of trust broadly, the majority hold that “as a general matter, a position of trust is characterized by ‘access or authority over valuable things.’” Furthermore, courts are

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72 *United States v. Iannone*, 184 F.3d 214, 222 (3d Cir. 1999) (internal citations omitted) (stating that three factors will determine whether a defendant “occupies a position of trust for the purposes of §3B1.3: (1) whether the position allows the defendant to commit a difficult-to-detect wrong; (2) the degree of authority which the position vests in the defendant…; and (3) whether there has been reliance on the integrity of the person occupying the position.”).

73 *United States v. Dorsey*, 27 F.3d 285, 289 (7th Cir. 1994) (quoting *United States v. Boyle*, 10 F.3d, 485, 489 (7th Cir. 1993); *United States v. Lamb*, 6 F.3d 415, 421 (7th Cir.1993)). *See also, United States v. Ward*, 222
reluctant to broaden the definition outside of a traditional fiduciary style trust.\textsuperscript{74} In \textit{United States v. Mullen}, the defendant abused a position of trust when he implemented a Ponzi scheme against members of his country club.\textsuperscript{75} The court concluded that there was no “evidence suggesting that [the defendant] had a… fiduciary relationship, with any member of the country club that significantly contributed to his ability to perpetrate or conceal the Ponzi scheme.”\textsuperscript{76}

Courts are also hesitant to use §3A1.1—vulnerable victim—to enhance penalties for affinity fraud. The Ninth Circuit, in \textit{United States v. Castellanos}, considered whether a Ponzi scheme—directed mainly towards Hispanic individuals—could fall under §3A1.1.\textsuperscript{77} The court acquiesced that “Spanish-speaking individuals are more likely to become victims of a fraud perpetrated by a Spanish-speaking defendant than would English-speaking persons,”\textsuperscript{78} nonetheless, the court held that this is not enough “to support a finding of particular susceptibility under §3A1.1.”\textsuperscript{79} The court’s rationale was that “criminals will always tend to

\textsuperscript{74} \textit{United States v. Mullens}, 65 F.3d 1560 (11th Cir. 1995).

\textsuperscript{75} \textit{Id}.

\textsuperscript{76} \textit{Id.} at 1566.

\textsuperscript{77} \textit{United States v. Castellanos}, 81 F.3d 108 (9th Cir. 1996). USSG §3A1.1 defines vulnerability as either unusual age, physical or mental condition, or if the victim is particularly susceptible to the criminal act. In \textit{Castellano}, the district court found the victims vulnerable under the latter definition, but the appeals court was worried that a broad reading of the statute would potential render most defendants eligible for the penalty enhancement. \textit{Id.} at 111.

\textsuperscript{78} \textit{Id.} at 110

\textsuperscript{79} \textit{Id.}
target their victims with an eye towards success in the criminal endeavor. Thus, the chosen victims are usually more susceptible than the general population to the criminal conduct.”

Enhanced penalties under fiduciary duty laws and federal sentencing guidelines are insufficient to deter and punish affinity fraud architects. Courts acknowledge that affinity type fraud is very harmful, yet as the above cases demonstrate, courts are reluctant to apply these laws to enhance the punishment for those who commit affinity fraud.

IV. Affinity Fraud Statutes

Within the last three years, three separate states—Indiana, Utah, and New Jersey—have introduced bills to specifically deal with enhanced penalties for affinity fraud. The Indiana and Utah bills became law. New Jersey introduced its affinity fraud bill in 2010, but the bill has not been enacted as of date. Each state crafted its affinity fraud statute differently. The following section will analyze the statutes introduced by each state and will compare and contrast the differences between each statute.

a. Indiana

Indiana, in 2009, amended its securities act to include penalty enhancements for affinity fraud and fraud against seniors. “Unfortunately, this is a type of crime we’re seeing more and more of in Indiana,…[and so] we aggressively pushed for these stricter penalties,” stated Todd Rokita, Indiana Secretary of State. In recent years, Indiana has faced several devastating affinity fraud schemes, costing hundreds of Hoosiers millions of dollars.

80 Id.

81 News Release, More Severe Penalties For Egregious securities Violations Take Effect In Indiana, INDIANA SEC. DIV. (July 8, 2009), http://www.in.gov/sos/securities/2726.htm.

Prior to the change, IC §23–19–5–8 read as follows:

Sec. 8. (a) A person who knowingly violates this article, or a rule adopted under this article, except section 4 of this chapter or the notice filing requirements of IC 23–19–3–2 or IC 23–19–4–5, commits a Class C felony.

In 2009, Indiana House Bill No. 1646 added two specific provisions to the current statute.

Sec. 8. (a) A person who knowingly violates this article, or a rule adopted under this article, except section 4 of this chapter or the notice filing requirements of IC 23–19–3–2 or IC 23–19–4–5, commits a Class C felony.

(b) A person who knowingly violates section 1\(^{83}\) of this chapter commits a Class B felony if the person harmed, defrauded, misled, or deceived by the violation is at least sixty (60) years of age.

(c) A person who knowingly violates section 1 of this chapter:

(1) while using or taking advantage of; or
(2) in connection with;

a relationship that is based on religious affiliation or worship commits a Class B felony.\(^{84}\)

Reeves and his sons created a Ponzi an elaborate ponzi scheme, which “targeted victims through their faith, and then exploited their religious convictions in order to hide …[the] scheme from potential investors.”).

\(^{83}\) Section 1 is the general fraud provision (IC §23–19–5–1):

It is unlawful for a person, in connection with the offer, sale, or purchase of a security, directly or indirectly:

(1) to employ a device, scheme, or artifice to defraud;
(2) to make an untrue statement of a material fact or to omit to state a material fact necessary in order to make the statement made, in the light of the circumstances under which they were made, not misleading; or
(3) to engage in an act, practice, or course of business that operates or would operate as a fraud or deceit upon another person.

\(^{84}\) The need to create a separate offense tailored specifically against fraud through religious affiliation is understandable, because of the high prevalence of this type of fraud. See Julia Levy, *Putting faith into investments: ‘Affinity fraud’ scams growing in United States*, NATIONAL POST, Aug. 8, 2001, at C8 (statement by Deborah Bortner, NASAA’s president and the director of securities for the state of Washington) (“I’ve seen more money stolen in the name of God than in any other way.”).
In effect, the new amendment to the statute enhances the criminal penalty from a Class C felony (a fixed minimum term between two and eight years)\textsuperscript{85} to a Class B felony (a fixed minimum term between six and twenty years).\textsuperscript{86}

b. Utah

Some have dubbed Utah as the nation’s fraud capital.\textsuperscript{87} One explanation for this is that Utah residents are “quick to trust, [and] quick to make friends…,”\textsuperscript{88} explained Sen. Ben McAdams, D-Salt Lake City, who sponsored the bill. “I’m outraged there are people who would take our best qualities and use them against us.”\textsuperscript{89}

On March 25, 2011, Utah Senate Bill No. 101—enhancing criminal penalties for affinity fraud—was adopted by the state legislature.\textsuperscript{90} The bill took “months of work to perfect and gain support among lawmakers,” but in the end, due to a “growing recognition of the extent of financial fraud in Utah,” the legislature passed the amendments.\textsuperscript{91}

\textsuperscript{85} IC § 35–50–2–6 ((a) A person who commits a Class C felony shall be imprisoned for a fixed term of between two (2) and eight (8) years, with the advisory sentence being four (4) years. In addition, the person may be fined not more than ten thousand dollars ($10,000)).

\textsuperscript{86} IC § 35–50–2–5 (A person who commits a Class B felony shall be imprisoned for a fixed term of between six (6) and twenty (20) years, with the advisory sentence being ten (10) years. In addition, the person may be fined not more than ten thousand dollars ($10,000)).


\textsuperscript{89} Id.

\textsuperscript{90} UT ST § 61–1–21.

\textsuperscript{91} GEHRKE, supra note 88.
§ 61–1–21 discusses the penalties for violating the statute. Under ordinary securities fraud, an individual is guilty of a third degree felony if the crime committed was worth less than $10,000 and is guilty of a second degree felony if the committed crime was worth more than $10,000.\textsuperscript{92}

With the added amendments, an individual is now guilty of a second degree felony when the crime committed is worth less than $10,000 and is (1) an investment by a person over whom the violator exercises undue influence; or (2) an investment by a person that the violator knows is a vulnerable adult.\textsuperscript{93} And for those crimes that are worth $10,000 or more, the individual is guilty of a second degree felony and shall be imprisoned for not less than three years and more than 15 years.\textsuperscript{94}

To clarify what is meant by ‘undue influence’ and ‘vulnerable adult’, the statute was amended to include the definition of these words.\textsuperscript{95}

\textbf{(hh) “Undue influence” means that a person uses a relationship or position of authority, trust, or confidence:}

(i) that is unrelated to a relationship created:

(A) in the ordinary course of making investments regulated under this chapter; or

(B) by a licensee providing services under this chapter;

(ii) that results in:

(A) an investor perceiving the person as having heightened credibility, personal trustworthiness, or dependability; or

(B) the person having special access to or control of an investor's financial resources, information, or circumstances; and

(iii) to:

(A) exploit the trust, dependence, or fear of the investor;

(B) knowingly assist or cause another to exploit the trust, dependence, or fear of the investor; or

(C) gain control deceptively over the decision making of the investor.

\textsuperscript{92} UT ST § 61–1–21(1) and (2).

\textsuperscript{93} UT ST § 61–1–21(3).

\textsuperscript{94} UT ST § 61–1–21(4).

\textsuperscript{95} UT ST § 61–1–13.
(ii) “Vulnerable adult” means an individual whose age or mental or physical impairment substantially affects that individual's ability to:
   (i) manage the individual's resources; or
   (ii) comprehend the nature and consequences of making an investment decision.

c. New Jersey

In March of 2010, a bill was introduced to supplement chapter 21 of Title 2d of the New Jersey Statute. The legislators found that it is “necessary to establish the crime of ‘affinity fraud’ to enable more efficient prosecution of criminally culpable persons who knowingly, or with criminal recklessness, submit false or fraudulent statements of material fact relating to an investment opportunity to a targeted identifiable group.” Although the bill did not become law during that session, it is worth analyzing the proposed components of the bill.

The bill defined affinity fraud as:

[M]aking, or causing to be made, a false, fictitious, fraudulent, or misleading statement of material fact in, or omitting a material fact from, or causing a material fact to be omitted from, any written securities or investment document, that a person attempts to submit, submits, causes to be submitted, or attempts to cause to be submitted to an identifiable group, such as a religious or ethnic community, the elderly or professional group, which group was targeted because of a dominant or identifiable characteristic of the group.

A person found guilty of affinity fraud will receive enhanced criminal penalties in the following manner:

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98 To minimize unnecessary verbiage, I will refer to the New Jersey bill as a statute, instead of proposed bill.

99 Assemb. Bill 2419 at 3.

100 Id.
a. A person who, is registered or regulated by the NJ Bureau of Securities, knowingly commits affinity fraud is guilty of a second degree.
b. A person who, is registered or regulated by the NJ Bureau of Securities, recklessly commits affinity fraud is guilty of a third degree.
c. A person, unregistered or unregulated and not subject to the provisions of subsection a or b, is guilty of third degree if that knowingly commits affinity fraud.
d. A person, unregistered or unregulated and not subject to the provisions of subsection a or b, is guilty of fourth degree if that person recklessly commits affinity fraud.

**Let’s Compare!**

The above three statutes were introduced for the same reasons—to deter and punish affinity fraud architects—yet each is slightly different from one another. The following diagram helps separate the important distinctions of each statue.

<table>
<thead>
<tr>
<th>States</th>
<th>Who can be a victim?</th>
<th>Who can be charged under this statute?</th>
<th>Mens Rea</th>
<th>Penalties if found guilty of Affinity Fraud under the provisions set forth</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indiana</td>
<td>1. Anyone at least sixty years of age. or 2. Relationship based on religious affiliation.</td>
<td>Any individual that violates the Act. (Includes individuals registered or regulated by the Indiana Bureau of Securities).</td>
<td>Knowingly</td>
<td>Enhancement from a Class C to a Class B felony. Fixed term of between six and twenty years, with the advisory sentence at ten.(^{101})</td>
</tr>
<tr>
<td>Utah</td>
<td>1. Anyone experiencing an <strong>Undue Influence</strong> from a relationship or position of authority, trust, or confidence. or 2. <strong>Vulnerable adult.</strong></td>
<td>1. The relationship cannot be created in the ordinary course of making investments regulated or by a licensee providing services. 2. Any individual.</td>
<td>Willfully</td>
<td>Enhancement from Third to Second degree felony when victim’s losses are less than $10,000. Second degree felony plus an enhancement</td>
</tr>
</tbody>
</table>

\(^{101}\) IC § 35–50–2–5 (Class B felony).
No specific age, mental or physical impairment is stated. (Includes individuals registered or regulated by the Utah Bureau of Securities).

<table>
<thead>
<tr>
<th>New Jersey</th>
<th>Any identifiable group.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>As long as the group was targeted because of a dominant or identifiable characteristic of the group.</td>
</tr>
<tr>
<td></td>
<td>1. Individuals registered or regulated by the NJ Bureau of Securities face second or third degree convictions.</td>
</tr>
<tr>
<td></td>
<td>2. Individuals unregistered or unregulated, face third and fourth degree convictions.</td>
</tr>
</tbody>
</table>

V. Potential Issues For Affinity Fraud Statutes

There are many good reasons to enhance penalties for security and investment fraudsters that prey upon the high-trust relationship of friends and loved ones.\textsuperscript{102} As with any law, however, issues are bound to arise when the law is applied. Prosecutors, public defenders and even courts are likely to encounter ambiguous and superfluous wording, unclear statutory intent, and possible constitutional issues. The following section discusses the likely issues to arise and provides recommendations to minimize the problem.

\textsuperscript{102} See supra part III.A.
a. **What’s the point of enhanced penalties?**

A federal public defender, Benji McMurray, during the discussion of the Utah affinity fraud bill, expressed his concern that we should not “mak[e] laws that sit on top of other laws[.]”

States currently have criminal and civil penalties for individuals who commit securities fraud, what makes affinity fraudsters different, to justify enhanced penalties?

The federal sentencing guidelines shed some light on the above question. In constructing enhanced punishments for violation of trust under §3B1.3, the federal sentencing guidelines justified the enhancement for the need to “punish insiders who abuse their positions [of trust] rather than those who take advantage of an available opportunity.”

Similar to sentence enhancements under §3B1.3, sentence enhancements for affinity fraud are created to punish and deter those that abuse their high-trust relationship with the victim.

b. **How do we make sure the right person is given the penalty enhancement?**

McMurray further expressed the concern that even legitimate investments “where someone who does business with a fellow churchgoer is running the risk of an enhancement.”

In drafting affinity fraud statutes, legislators need to make sure that the “net thrown by the [affinity fraud] bill [does not] entangle legitimate businesspeople.” Such a scenario, however, is unlikely to occur. Before one can receive an enhanced penalty for affinity fraud, the court has to first find the individual guilty of ordinary securities or investment fraud.

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105 **PETE RSON**, *supra* note 103.

106 Id.
Moreover, for those individuals that are found guilty of securities fraud, legislators can minimize the chances of non-affinity related fraudsters receiving a penalty enhancement by crafting well defined and unambiguous affinity fraud statutes. Furthermore, sentencing courts should construe a narrow interpretation of high-trust relationships, to “be careful not to be ‘overly broad in imposing the enhancement for abuse of a position of trust or ‘the sentence of virtually every defendant who occupied any position of trust with anyone, victim or otherwise’ would receive…[the] enhancement.”

**c. What constitutes trust and who is a vulnerable victim?**

Courts have been inconsistent in their analysis in determining whether a high-trust relationship was the main ingredient that allowed the fraudster to carry out the fraudulent scheme. Case law dealing with § 3A1.1(b) and § 3B1.3 of the federal sentencing guidelines help demonstrate the confusion, ambiguity, and inconsistency in court decisions involving sentencing enhancements for violation of trust.

In *United States v. Luca*, the district court enhanced Luca’s sentence by two point pursuant to the vulnerable victim provision of § 3A1.1(b), after finding him guilty of running a Ponzi scheme against members of the church where he held a leadership position. Pursuant to a pre-sentencing report, the district court concluded that Luca’s victims were vulnerable based on their age and their membership in the church. On appeal, the Ninth Circuit remanded the case to the trial court, because “the district court made [no] factual findings sufficient to support the

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107 *United States v. Ghetler*, 605 F.3d 1256, 1264 (11th Cir. 2010) (quoting *United States v. Garrison*, 133 F.3d 831, 837 (11th Cir. 1998)).


109 *Id.*
The court held that “[t]he government is correct that a finding by the district court that a specific victim was unusually vulnerable due to age is enough to support a §3A1.1(b) enhancement….age standing alone, however, does not establish someone as a specific victim.” What was missing from the pre-sentence report was the actual age of Luca’s victims; the Ninth Circuit found it insufficient to rely on the report, which merely stated that the victim’s were vulnerable due to advanced age.

Courts—in analyzing facts to determine whether a position of private and public trust was violated for the purpose of enhancing an offender’s sentence under §3B1.3—maintain that “[i]n every successful fraud the defendant will have created confidence and trust in the victim, but the sentencing enhancement is not intended to apply in every case of fraud.” Ergo, “[t]he determination of whether a defendant occupied a position of trust is extremely fact sensitive.” It is not enough to say there was trust, the government must show that “the position of trust must have contributed in some substantial way to facilitating the crime and not merely have provided an opportunity that could as easily have been afforded to other persons.”

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110 Id. at 1026.

111 Id.

112 Id. at 1028.

113 United States v. Koehn, 74 F.3d 199, 201 (10th Cir. 1996) (affirming sentence enhancement for violation of a position of trust because defendant controlled escrow account and had a fiduciary duty to the victim).

114 United States v. Louis, 559 F.3d 1220, 1225 (11th Cir. 2009) (applying the three factors mentioned in §3B1.3—professional judgment, discretion, and deference—to find that a federal firearms licensee does not hold a position of trust and district court erred in applying the abuse-of-trust sentence enhancement).

115 United States v. Lilly, 37 F.3d 1222, 1227 (7th Cir. 1994) (holding that defendant, a church pastor, did abuse his position of trust—because he “was the Church’s pastor and spiritual leader, his congregation undoubtedly trusted him to further the Church’s religious mission.”).
In *United States v. Hall*, the court noted that “it [is] the government’s burden during sentencing, to show, by a preponderance of the evidence, that [the defendant] occupied a position of trust with respect to his victims.” Haywood Hall, a pastor for Greater Ministries International Church (GMIC), along with six co-defendants, promoted a fraudulent investment scheme. During sentencing, the court applied a two point increase to Hall’s sentence pursuant to § 3B1.3 for abuse of position of trust due to his status as a pastor. The Eleventh Circuit noted that it was error for the sentencing court, relying solely on Hall’s status as a pastor, to find a position of trust and enhance Hall’s sentence. The court, in determining whether Hall occupied a position of trust, looked to the victims presented at trial and found that “[n]one of the[ ] victims came to the roadshows for spiritual guidance; rather, all of them testified that they came to invest money, not because Hall was a pastor, but because they wanted to ‘double their money.’”

A state can minimize the issues that arose under *Luca* and *Hall*—when requesting affinity fraud sentencing enhancements for an offender—by producing, during trial, sufficient and particular evidence showing the victim’s particular vulnerability or the existence of the victim’s reliance on the high-trust relationship with the defendant.

**VI. The Right Ingredients**

The States of Indiana, Utah, and New Jersey have recognized the need to employ a mechanism to decrease the disproportionate rate of affinity fraud that is occurring within each respective state. Affinity fraud, however, is not indigenous to the above three states; many states are suffering from affinity fraud. As other states decide to follow in the footsteps of Indiana and

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117 *Id.* at 1321.

118 *Id.* at 1325.
Utah, by enacting their own affinity fraud penalty enhancement laws, they need to be cautious when drafting the statute’s language.

a. Relationship Element

“We know it when we see it, but actually putting words to describe it is very difficult.”119 During the floor debates for Utah’s affinity fraud penalty enhancement bill, many of the concerns regarding the bill were how to make sure to punish the right person and not just everyone that forms a trusting relationship during the ordinary course of investing.

Utah’s statute deals with this concern by explicitly carving out those individuals that create a relationship during the ordinary course of making investments regulated under the securities laws and by any licensee providing services under the securities laws. Reading the section carefully, this does not preclude licensed and registered investment advisors from receiving the penalty enhancement, it simply distinguishes the types of relationships and precludes penalty enhancements when the relationship is not based on affinity. Indiana took a different approach to minimize the above concern, by narrowing the liability to only those relationships that are based on religious affiliation.

New Jersey’s bill, although not enacted as of date, is notably broad. The definition of affinity fraud, within the bill, makes no mention of a relationship or position of trust.120 Under this proposed statute, any individual that defrauds an identifiable group is guilty of affinity fraud. The SEC’s definition of affinity fraud states that the “fraudsters who promote affinity scams


120 See supra note 99.
frequently are - or pretend to be - members of the group.” 121 New Jersey’s proposed bill for affinity fraud does not mention or require any form of trust or relationship in perpetuating the scheme. Under New Jersey’s definition, any fraudster—that targeted an identifiable group—could potentially be found guilty of affinity fraud, whether or not he or she was part of the group or had any sort of relationship among the group members.

b. Victim Element

“Affinity fraud refers to investment scams that prey upon members of identifiable groups, such as religious or ethnic communities, the elderly, or professional groups.” 122 A state is free to craft its affinity fraud statute any way it pleases, mindful of constitutional parameters. Indiana recognized only two types of victims in its affinity fraud statute; those over the age of sixty and relationships based on a religious affiliation. Utah took the opposite approach, not specifying an identifiable group or age, but assessing liability on those who defraud vulnerable adults or utilize undue influence on their victims. New Jersey’s proposed bill punishes those that defraud an identifiable group, as long as that group was targeted because of a dominant or identifiable characteristic of the group.

The wording of the statute will determine who is or is not a victim. Legislators should be cautious that the proposed bill does not focus on the particular character traits of an identifiable group. Sentencing courts, likewise, should not base their sentence on any particular character traits. “It would violate the Equal Protection Clause for a State to base enforcement of its criminal laws on ‘an unjustifiable standard such as race, religion, or other arbitrary

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121 How to Avoid Scams, supra note 13.

122 Id.
Therefore, sentencing enhancements for affinity fraud should not be based on whether the fraudster targeted a particular race, religion or other identifiable group, but should focus on the reasons why the individual targeted that particular group, namely, the trust and close-knit relationship of the individuals.

In *United States v. Holmes*, defendant, who was African American, targeted other African Americans for his fraudulent scheme. The court, during sentencing, added four levels from the sentencing guideline; two for abuse of a position of trust under § 3B1.3 and two for vulnerable victim under § 3A1.1(b). On appeal, Holmes “argued that the district court sentenced him at the top of the applicable Guideline range because his victims were black.” The Fourth Circuit looked over the language used by the district court during its decision to add the enhancement levels, and held that the “[l]anguage in no way demonstrates that the district court sentence Holmes to the maximum ‘because his victims were black.’”

c. Sufficient Factual Findings

In the previous section, both *Luca* and *Hall* illustrated that “it [is] the government’s burden during sentencing, to show, by a preponderance of the evidence, that [the defendant] occupied a

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124 United States v. Holmes, 60 F.3d 1134, 1135 (4th Cir. 1995).

125 Id. at 1137.

126 “It is a disturbing crime. It's obviously made more disturbing because of the particular relationship that this defendant attempted to create with his clientele. He appealed to, I think, a racial minority.... [T]hough I don't use that for the enhancement purposes under [the vulnerable victim provision] ... I think it does show a part of his crime that makes it more despicable and more distasteful than your normal fraud.”

127 Id.
position of trust with respect to his victims,” or that the victims were particularly vulnerable. “[I]nsufficient evidence to support the district court’s finding that [the defendant’s] victims’ [high-trust relationship or age] made them ‘otherwise particularly susceptible to the criminal conduct’” would result in overturning the sentence enhancement.

To minimize the inconsistency in sentencing enhancements under an affinity fraud statute, legislators should consider adding the requirement that, in order to enhance penalties, a court must specify the factual findings that support the enhancement.

Specifically, when determining whether a victim is considered vulnerable for a penalty enhancement, the judge must “[first] determine whether one or more of the victims belong to a class that is particularly vulnerable to the criminal activity in question….” And to enhance a penalty, for abuse of a high-trust relationship, the judge should consider whether “the position of trust…contributed in some substantial way to facilitating the crime and not merely…provided an opportunity that could as easily have been afforded to other persons.”

VII. Enhanced Penalties Are Not Enough

“This [bill] won’t put an end to fraud…it’s a mechanism for us to say that it is outrageous, we will not tolerate it, and we will fight it with enhanced penalties and enhanced fines.” While an affinity fraud statute is a useful tool, it should not be the only tool. As other

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128 Hall, 349 F.3d at 1325.

129 Luca, 183 F.3d at 1026 (quoting United States v. Randall, 162 F.3d 557, 560 (9th Cir. 1998)).

130 United States v. Luca, 183 F.3d 1018, 1025 (9th Cir. 1999).

131 Lilly, 37 F.3d at 1227.

132 Past Audio Floor Debates, supra note 119 (statement by Sen. McAdams) (Senate day 19, time 10:00 to 11:30).
states decide to enact their own affinity fraud statutes, they should look to other “tools” they can utilize to minimize affinity fraud.

It is always better to stop a potential crime from occurring then to subsequently punish the transgressor. Public education regarding affinity fraud is fundamental to decreasing the opportunities for affinity fraudster to perpetrate such schemes. Another tool is to prepare group leaders with the information they need to effectively warn their members about affinity fraud. Finally, as victims of affinity fraud are more reluctant to come forward and expose a loved one, friend or trusted confidant, providing some sort of incentive for potential victims to expose the fraudulent scheme will further help decrease the longevity of the scheme.

a. Public Education

The extent of public education about affinity fraud, in most states, is limited to merely reposting a warning published by the SEC or by NASAA onto their own state securities websites. Some states might draft their own warnings regarding affinity fraud, but again, these

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133 Researchers have found that the probability of loss of capital decreases dramatically when investors put in due diligence ex ante to investing. See Social Network, supra note 34, at 104 (“[I]nvestors who use only [their social ties] have a higher probability of loss of capital (39%) than investors who use within-network exchange and still conduct due diligence (14% probability of loss)”). See e.g., Edward Change, Structural Laws and the Puzzle of Regulating Behavior, 100 Nw. U.L. Rev. 655, 662 (2006) (discussing two options for structuring laws to minimize crimes—either by increasing deterrence through increased penalties, or by decreasing the opportunity for the crime to occur through “architectural design [of the law], a greater involvement of citizens and nongovernmental actors, and other similar mechanisms”).

states merely post the warning on their state’s securities website, with no further action. This strategy is inefficacious for affinity fraud schemes. Potential victims of affinity schemes lower their guard and disregard uncertainties because they have a high-trust relationship with the fraudster. Victims, therefore, are less likely to put in due diligence to look up the warning publications.

Public education campaigns, through community outreach efforts, are more likely to inform investors of the dangers of affinity fraud. The New Mexico Regulation and Licensing Department Securities Division launched a community outreach program targeting affinity fraud in 2007. “We want to alert people to the risk they run in blindly trusting someone simply because of a shared connection through membership in an organization,” stated Bruce Kohl, Securities Division Director, while explaining the reasons for the campaign. The program offers a 30-minute presentation to church congregations, social clubs and civic groups around the state.

Another effective educational service for communities is a Fraud College. On June 30th, 2010, Utah organized a conference on fraud prevention and awareness for local residents as well as experts in the field. One of the features of the conferences was a “panel comprised of leaders and representatives from many religions across communities...[that would]


discuss[...] affinity fraud...” Brent Baker, a board member of Fraud College, summed up the need for this valuable service, stating, “[i]n this era of deceptive investment schemes...Fraud College promises to help the community speak with one voice to support and educate the public at large.”

Lastly, it looks like we can learn a thing or two from our neighbors in the north. British Columbia’s Securities Commission, on October 11, 2011, announced that the province will launch a three year “Be Fraud Aware” campaign to deal with securities and investment fraud. The campaign will focus on educating different ethnic groups during the three years. The first year, the campaign will “focus on the Chinese and South Asian communities, the two biggest ethnic groups in BC....” The campaign will use both traditional advertising and social media, running “television ads in Mandarin, Cantonese and Punjabi, supplemented with full and half page newspaper ads. Radio spots will be run in Mandarin, Cantonese, Punjabi, Hindi and Urdu.” Cautioning investors in more than one language, especially when possible victims speak very little English, is an effective way to reach a broader audience.

b. Warning From Individuals In Leadership Roles

Individuals in leadership roles and other positions of trust need to recognize the need to inform individuals under their responsibility or influence about the dangers of affinity fraud. The New Brunswick Securities Commission (NBSC) launched a union outreach program to

138 Id.
139 Id.
141 Id.
142 Id.
“remind unions and their members to research all investment opportunities.”  

Rick Hancox, Executive Director of the NBSC, stated that “[u]nions are especially at risk of affinity fraud because they have influential leadership that affiliated members listen to and trust….”  

To better facilitate the information to union members, “[l]eaders within organized labour are being invited by the [NBSC] to participate in [this] new program to fight investment fraud and to promote informed investing.”  

Religious leaders should also address the dangers of securities and investment fraud to their congregation. An Ensign article, a magazine for members of the Church of Jesus Christ of Latter Day Saints, forewarned church members that “cases of fraud are becoming more common and are a concern for everyone, including Church members.”  

Although not directly using the word ‘affinity fraud’, the article warns investors that “there are no set characteristics of someone promoting fraudulent investments. In fact, they may be typical acquaintances from work or church, family members, or close friends….”

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144 Id.

145 Id.


147 Id.; See, e.g., Amy Frykhom, Affinity Fraud, 126 Christian Century 12, 12–13 (Aug. 25, 2009) (quoting treasurer of the Evangelical Lutheran Church in America, saying that “preventing fraud…begins with setting a ‘tone from the top.’”).
c. Whistleblower Incentives

In typical investment schemes, fraudsters intimidate their investors into silence, by threatening that the investor might not recover his investment if the authorities are informed. In affinity fraud cases, the same intimidation is present, but with greater apprehension from the investor. Investors are reluctant to accept the fact that someone they trust has defrauded them, and so are less likely to inform authorities of the fraudulent scheme. Enacting a whistleblower incentive “gives possible victims the economic incentive they need to come forward early to speak against fraud…”\textsuperscript{148}

Indiana added their whistleblower economic incentive provision, § 23–19–6–12, in 2010.\textsuperscript{149} The law allows the commission to “award, from any amount imposed as a penalty…and recovered by the securities division, a percentage, not to exceed ten percent…of the amount recovered, to any person who provide information leading to imposition of the penalty.”\textsuperscript{150} Utah took a similar approach and introduced a new whistleblower amendment, § 61–1–107, that may “award to one or more whistleblowers who voluntarily provide original information to the commission or division that leads to the successful enforcement of a covered judicial or administrative action.”\textsuperscript{151} The amendment limits the award amount to “(i) the balance in the fund


\textsuperscript{149} IC § 23–19–6–12

\textsuperscript{150} \textit{Id.}

as of the date the awards are determined; or (ii) 30% in total, of what is collected of the monetary sanction imposed in the judicial or administrative action.”\textsuperscript{152}

Including an economic incentive for possible victims to come forward and reveal a fraudulent investment or securities scheme would allow state officials to be more effective in stopping the scheme before its growth and better compensating the victims.

\textbf{VIII. Conclusion}

With the current downturn of the economy, neither states nor citizens can afford the negative consequences of affinity fraud. Senator McAdams, in discussing the need to fix Utah’s fraud economy, stated that “if we put…[in the] energy into shrinking [such] fraud, it will not only have a positive impact on [people’s] lives, it will also have an economic impact-with money not going into fraud, it will go into legitimate activities.”\textsuperscript{153}

Affinity fraud is a major national problem; states are likely to follow the examples of Indiana and Utah and enact similar affinity fraud penalty enhancement statutes aimed at deterring and punishing culprits. States should be mindful, however, that enhanced penalties, alone, are insufficient to solve the problem. Investor education campaigns, incentives for possible victims to come forward, and condemnation from group leaders, are also important and useful tools to help fight affinity fraud.

\textsuperscript{152} \textit{Id.}

\textsuperscript{153} \textit{PETERSON, supra note 148.}