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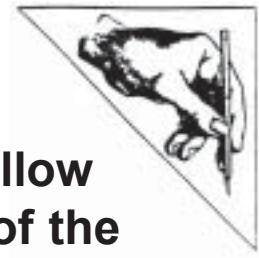
Lee C. Buchheit
Member of the Pennsylvania and District of Columbia Bars



How to Make the Other Fellow Happy,or the Technique of the Phoney Deal

Anyone who offers you a long-term, low-interest, fixed-rate $1 billion loan will put his points in the same clear way, and reply to your points in the same incomprehensible jargon. Here's the practitioner's textbook

October 16, 1981, 11:47 am. A lawyer from London is on a British Airways flight to Madrid. He is reading, for the third time, a promissory note issued by the International Chamber of Commerce, which doesn't issue promissory notes. The rather baroque border on the original document hasn't photocopied well. The text is a promiscuous compilation of words and phrases from legal and financial documents. The lawyer regrets that the author has not been able to work in "*per stirpes*" "usufruct", or "the rule in Shelley's case".

His client explained on the telephone several days ago the proposal that this promissory note be used in connection with a $1 billion, 20-year loan; bullet repayment: 11% fixed-rate interest; with "prime bank guarantees". The client expressed skepticism, which the lawyer did not discourage. Nevertheless, human nature being what it is, and $1 billion being what it is, and the lawyer being who, or what he is, here he is, at his client's request, on his way to Madrid to meet a Spanish-speaking Dutch intermediary claiming to represent a mysterious Amsterdam company acting on behalf of unnamed "Middle-East trusts" with assets lodged somewhere in the Caribbean.

The ensuing events in Madrid were not much out of the ordinary like any other negotiation for a long-term low-interest, fixed-rate $1billion loan. At the hotel the lawyer and the client met a predictable collection of leisure-suited, cigar smoking, gold-braceleted intermediaries from a Latin American labor union, together with a blonde young woman (whose role was never made entirely clear). There were the customary meetings in hotel lobbies and smoky conference rooms rented by the hour. There was the predictable matter of the $5

million payable-on-demand letter of credit which the client was expected to open in favor of the intermediary six days before the disbursement of the loan matter of such small significance that it had understandably been overlooked in all previous communications regarding the deal. The lawyer was subjected to the customary criticisms that his character was blighted by a disgusting cynicism and lack; of trust in his fellow man.

The lawyer, despite his youth, had been exposed to similar transactions several times. These involved subjects as outwardly dissimilar as phoney loans, phoney certificates of deposit, phoney Petromin oil contracts and phoney introductions to Middle-East defense ministers. The lawyer now realized that the individuals promoting these had all negotiated in much the same way. Could there, he wondered, be a guidebook, a manual available only to the worshipful company of phoney deal-makers?

For an hour or more the lawyer carefully watched his counterpart in Madrid. Sure enough, the intermediary often did refer to a small, black, leather-bound book whenever the negotiations became sticky, and it is this document that the lawyer, at great personal and professional risk, abstracted and photocopied. It was written in a dense, impenetrable code which, after several years of drafting syndicated loan agreements the lawyer found childishly easy to decipher.

His translation is published here for the first time; and all things considered, it seems unlikely that anyone will step forward to allege a copyright infringement.

A GUIDE FOR THE NOVICE PRACTITIONER

Phoney deal-making is an old and venerable activity and those engaged in this profession (hereinafter, "practitioners") make a vital contribution to the health of any society They are skilled in the art of making tantalizingly imminent what would, under a crasser light be dismissed as totally fanciful. Think of how inestimably poorer mankind would be if it had never been allowed to nurture dreams of Ponce de Leon's Fountain of Youth, El Dorado, or the alchemist' panacea. Think how cruel it would be in our own time to deprive people of their beliefs in the possibility of a balanced national budget or the physical benefits of Vitamin E.

The successful practitioner of the phoney deal must be gifted with an instinctive understanding of human psychology. He also needs to learn the rules. A phoney deal is a highly stylized art form which, if properly performed, should contain certain predictable elements, like a Greek tragedy, a Japanese tea ceremony, or a first date.

YOUR BEST FOOT FORWARD

There are two cardinal rules for describing yourself and your role in the phoney deal:

You are not yourself a principal in the transaction but only a representative, and unfortunately, circumstances will not permit you to disclose the identity of your principals, except in the most general terms.

Never concede that this amounts to deception. It is, rather, comparable to the discipline of priests and doctors in protesting the confidences of their penitents and patients.

As for your own background, this should be revealed only in a series of calculated slips. Your place of birth must be somewhere that most people have heard of but no one has ever really been such as Bosnia, Herzegovina, or southern New Jersey. It often helps to have been exiled from your beloved homeland by a repressive political regime, which 1) if you're talking to an American, is backed by the communists. 2) if you're talking to a non-American, is backed by the Americans, or 3) if you're talking to a Frenchman, is backed by an Anglo-American alliance. As an exile you will not be expected to produce character references from your own country.

Wherever you come from, you will describe it as a land rich in traditions of honesty and fair dealings among businessmen. You will be able to recall how your father tirelessly instructed you that a man would never attain Heaven, Nirvana, or the Harvard Business School (delete as appropriate) if he ever betrayed a person with whom he had once eaten a meal, ordered martinis or shared a cab (delete to reflect the activity of you and the listener at the time of recounting the story). Distrust was virtually unknown in business dealings in the region of your upbringing and you never cease to be shocked when reminded of its prevalence in the wider world.

Your English is regrettably not perfect. It will be much better in explaining the merits of the deal than it will be in answering detailed questions about it. Under close interrogation, you will often have recourse to lengthy idiomatic expressions in Farsi, Serbo-Croat or Texan, for which there is no accurate rendering in English.

CHARACTER REFERENCES

Every practitioner must expect at some time or other to be asked for character references. It goes without saying that this is an offensive question, showing the questioner's deplorable lack of manners. Nevertheless, we live in a time of ever-decreasing civility, and the practitioner must be ready with one of three types of response.

First response: After the question is asked, pause in silence for at least 15 seconds while looking at the table in front of you and then:

Allow a wave of injured disappointment to sweep over your face;

Sigh deeply;

Begin repacking your briefcase (slowly);

Say: "Even your asking such a question reveals your basic lack of trust in me. I am trying to arrange a deal worth hundreds of millions of dollars to you and you treat me like a candidate for a job as your housekeeper. Obviously I have seriously misjudged your competence to engage in transactions of this size and importance. And to think I assured my principal that you were the type of person he could do business with! But, despite my certain embarrassment in front of my principal, I don't hold this against you. If ever I have a very small, routine sort of transaction, perhaps I will keep you in mind."

This response should bring an apology if the script is delivered with just the right disappointment and resignation in the face of human frailty. Study the tone of a mother explaining to her son that she will understand completely if he chooses not to send home a single letter or postcard during his entire four years at the university his parents have worked very hard their whole lives to send him to. If the word "references" does come up again, try the next method.

Second response: Recoil, shudder, raise your arm as though blocking out a hideous phantom; repeat "References?" and then take a moment to compose yourself, carry on with the conversation as though you were overlooking an unfortunate indiscretion. You practice the arm-raising movement while watching Christopher Lee as Dracula reacting to the sight of a crucifix.

Third response: furiously shout "*My* references! *I'm* offering the money/contract/introduction (delete as appropriate). The important question is where are *your* references?" The practitioner will find that the question of his own references gets lost in the blizzard of annual reports. Standard & Poor's ratings and Princeton Club membership cards which this response calls forth from the other party.

FIRST PRINCIPLES ABOUT PRINCIPALS

Principals are non-existent and hence allow a refreshing scope for the exercise of the Practitioner's imagination. There must always, however, be good and sufficient reasons why the identities of your principals cannot be disclosed. Be imaginative. The only prerequisites for a principal in a phoney financial transaction are Incalculable wealth and a plausible reason why the money cannot be invested under more usual circumstances. Too many practitioners have limited themselves to the Middle East. Why not let slip enough information to permit the

deduction that your principal is, for example, the descendant of a White Russian *emigre* who made his fortune selling off looted icons; a nominal communist who is in fact making a personal fortune by lending out otherwise idle funds held in the Soviet Treasury; or perhaps the "friend" of a Greek shipping tycoon investing the proceeds of her career?

Your principals are people who have become impatient with the petty bureaucracies of banks and tax authorities, which hinder the entrepreneurial spirit. They seek as their business counterparts people of a similar temperament to whom the endless niggling of bank managers/lawyers/accountants/ tax collectors is equally distasteful. After all (you ask) could they have risen to their present position if they were people of timorous dispositions, crippled by a dependence on legal documentation, verifications, notifications and the rest of that rigmarole? A haughty laugh will suffice to give the answer.

DETAILS OF THE DEAL

A guidebook cannot specify the nature of your phoney deal. It may involve oil, money, influence or securities, according to your imagination and the particular avarice of the other party. You should not lose sight of the fact that the other party's willingness even to entertain the thought of discussions with you usually betrays his desperate condition. For example, the other party may be a state-owned utility company buying oil at inflated spot prices and looking for a long-term supply contract; or a private company sinking under the interest cost of its external debt searching for a source of below-market fixed-rate funds; or an arms manufacturer unable to break through the bureaucracy of a Middle-East country looking for a favorable introduction to the local defense minister.

Whatever the deal may be, keep the following points in mind when you describe it:

1. The transaction should always be of mind-boggling size -nowadays, not less than $100 million. Large numbers tend to stun and anesthetize the hearer. Moreover, by showing your easy familiarity with such large figures, you will be adding to your own credibility. Human nature will induce the other party to ape your casual approach to immense sums and this may help to shame him into controlling an undignified squeal when you mention the odd few million dollars that will be necessary to move the deal along.

2. For as long as possible in the discussions, avoid letting on that any money or negotiable instruments or discountable pieces of paper will change hands until the transaction is satisfactorily completed. No question will so vex the other party and be so helpful in undermining his professional advisers' cynicism as: "But what can he hope to get out of it if it is a fake?" At the last possible moment, when the other party has unwisely allowed himself to indulge in an

expectation that the deal will go forward, mention in passing the small matter of the "advance fee", or the "expense money" or the payable-on-demand letter of credit, or the separate (but legally binding) "commission agreement", which must be arranged just a couple of days prior to closing.

3. Aside from love, no human emotion is so useful in unseating sound judgment as greed. Do what you can to cultivate it in the other party.

HANGERS-ON

Under the genus of "hangers-on" in these transactions there are two species: a) helpful and b) unhelpful.

a) Helpful hangers-on: From the standpoint of the practitioner, it is often desirable to have the other party surrounded by people who appear to give dispassionate advice but who are in fact interested (monetarily) in the deal. It is best to flatter such helpful hangers-on by referring to them as "facilitators" or "arrangers" of the deal. With any luck, they will reciprocate by using their position as an adviser to the other party to commend the practitioner's patience and honesty. Encourage them to drift freely between you and the other party's camp during gaps in the negotiations. They may be able to give you advance warning if the substance known colloquially as the "cold light of day" ever begins to creep into the other party's thinking. This will allow you to take timely remedial action by stoking the embers of greed.

b) Unhelpful hangers-on: The practitioner must expect that the other party will occasionally be accompanied by unhelpful hangers-on, such as professional advisers who have no personal interest in the transaction (and who thus tend to see it in a very prejudiced Light). These hangers-on can be of several kinds — bankers, financial consultants, accountants or lawyers.

There is only one effective technique to counteract the baleful influence of a lawyer on his client. You must open the client's eyes to his lawyer's hopelessly terrestrial outlook on life in general and this deal in particular This is best done by getting the lawyer annoyed at you while remaining serenely calm yourself.

HOW TO UPSET A LAWYER

Try the following techniques: 1) For the first half hour of your meeting, refer to the lawyer repeatedly as the other party's accountant; for some mysterious reason this drives them blue with rage.

2) Stare quizzically at the lawyer's business card. Ask questions like: " 'Shearman & Sterling', what sort of company is that?"; or "Then are you Mr. Shearman or Mr. Sterling?"; or "Oh I see, you work for them do you?" There-

after, continually refer to the lawyer as an "agent" and his organization as a "company" this will invariably prompt him to correct your description and thus reveal his basically quibbling nature.

3) During a pause in negotiations (but in front of the client), mention in an off-hand way that your sister's son went to law school. He is now living in obscurity in Delaware. You try to remember to send him money every [Christmas], [Ramadan] [time he pleads for it] (delete for maximum irritating effect).

4) If the lawyer is English, mention the fact that the title "solicitor" denotes a different, but somewhat similar, profession in your country. Try to get the lawyer to admit that he will, if asked, quote a rate for one-half hour of his time.

5) Ask the lawyer how many of these transactions he has done in the past. If you have thought up a particularly imaginative deal, his spontaneous honesty will prompt him to say "none" (or a long string of defensive lawyers' words to that effect). This will then allow you to say: "Well, if you don't know how these deals are customarily done, why have you come along?"

The effect of these techniques will be to enrage and prejudice the lawyer against you in a way that should be perfectly apparent to his client. When the lawyer leaves the room for a moment, you can then shake your head and say to his client that you have never been able to understand why lawyers are such an ill-tempered lot. "And this one . . . " Mention the general subject of lawyers' fees—this will no doubt be met by an effusive expression of sympathy from the client. Then suggest that future discussions should be carried out exclusively among "principals" (a highly emotive and flattering word) or their direct representatives and away from disagreeable and expensive "technicians" (also a highly emotive word).

OBLITERATING LANDMARKS

The venue for the negotiation of the phoney deal must be chosen with great care. Ideally, the venue should contribute toward the other party's sense of disorientation, while appearing to reinforce the practitioner's legitimacy. Under no circumstances, however, should a venue for negotiations be chosen which may allow the practitioner to be located after the deal fails to materialize.

It is usually desirable to separate the other party from every landmark (physical, emotional and professional) which might help him to appreciate the true character of the negotiations. Try to have the negotiations last for as long as possible. Human beings lose their perception (indeed, even their memory) of the world as being a familiar, friendly place with incredible quickness when thrust into strange environments. The immediate result is usually bewilderment and emotional vertigo but this will lead ultimately to loss of judgement and docility.

Study this interesting phenomenon by spending time in hospital waiting rooms or on crowded train platforms.

If the practitioner is particularly skilled, he may even find during a prolonged negotiation that the other party develops a psychological need to be accepted in this unfamiliar world. Once the practitioner begins to reward "acceptable" behavior with compliments and reassurances, the other party will be reluctant to incur his displeasure by unreasonably withholding the money, signatures, bank instructions and the like.

Fatigue in the other party is a great ally for the practitioner. Try to arrange the venue to maximize the discomfort to the other party in reaching it. If possible, switch the venue at the very last moment after he arrives at the place originally selected for the negotiations.

Arrange to rent a conference room for a few hours in an outwardly respectable office or a bank. Leave an envelope with the receptionist and tell her that if someone doesn't pick it up within an hour, she is to interrupt your meeting and return it to you. When she does, this will confirm everyone's impression that you are known and belong to those offices.

If possible, select a venue in which the other party will not speak the local language. His dependence on you will be greatly increased by having to rely on you to order the meals. One added benefit is that, by recommending certain items of the native cuisine, you can render a foreign alimentary canal impatient of prolonged negotiating sessions. This is also a useful last resort technique for depriving a client of his lawyer's presence during the critical periods of the negotiations.

People instinctively *need* to believe in the truth of what other people say. While they may flirt with distrust for short periods, extended exposure to the emotion is generally intolerable. They will repeatedly give the benefit of the doubt to someone else (even strangers) regardless of how often or how outrageously they have been lied to in the past. This fundamental truth lies at the basis of all television advertising. It gives the practitioner an immense advantage which can only be surrendered with great difficulty.

The practitioner's role will obviously require a certain mastery of the art of mendacity. Keep in mind the following hints:

Separate lies, like Volkswagens in casino parking lots, stand out. Therefore lie continuously, lavishly and comprehensively.

Many people (including all Americans) identify fluency with lying. They equate a faltering, disjointed verbal delivery with rustic straight-talking.

The practitioner must therefore learn to affect a stumbling, strained way of talking. Interrupt your sentences frequently in a painfully obvious effort to search for words; this will help negate any suspicion that you gave the sentence some

forethought. Give the impression that naive truth is struggling hard to free itself from the constraints of your unsophisticated tongue. Study this by watching old Sandy Dennis movies or the interviews with professional football players after games.

THE IMPORTANCE OF COMMISSIONS

The practitioner will often find that the representatives of the other party sent to negotiate a transaction will either be low level figures (vice-presidents or financial directors), or underpaid (accountant), or both (lawyers). This tendency presents a marvelous opportunity for the Practitioner to mention in passing that the "commission" on a transaction of this size will obviously allow for a generous sharing among all those who have labored to move the deal along. Naturally, your own efforts as primary intermediary will be rewarded by the largest share of the commission (say $5 million), but you would certainly not begrudge a small recognition being made for the services of the other party's facilitators or advisers in the deal, say $250,000 each.

Now you must expect that the hangers-on (or some of them) will initially reject such a suggestion as improper and unthinkable. Lawyers, whose lack of imagination has already been noted, are particularly given to this. Don't allow yourself to be put off. With practice, you will quickly learn to distinguish whether the representative suffers from a genuine liking for poverty or whether his response is a *pro forma* rejection which really masks a keen interest. If the impolite expression "pay off" enters the conversation, however, look shocked and ask rhetorically whether your father's son would ever insult his business colleagues by suggesting such a thing. Besides, the figure mentioned ($250,000) is obviously too trivial to be mistaken by mature men for a pay off of any kind.

If the representatives are still unpersuaded, mention to them individually the fact that in your country it is perfectly customary and proper for a small token of this kind to be given to those people who work on a deal, particularly a deal of this size and innovative character. This practice is comparable to inviting everyone to a closing dinner, or presenting them with an engraved pen or plastic cube, which you understand to be customary in some other places. Surely, you will ask, the representatives employers do not object to such tokens? No, the representative will then have to admit (after remembering the dozens of cubes which litter his colleagues' desks), they don't. At this point you should notice that the subjunctive mood begins to creep into the representative's subsequent statements about the treatment of commissions.

Allow the matter of commissions to simmer overnight. You will be astounded at how many vice-presidents or even fifth-year associates at law firms have

mortgages that could benefit from a cash payment of $250,000. By the next morning you should find the meat much more tender.

It does not hurt at this juncture to remind the representative that as it now stands he must have faith in your promise to share with him the eventual commission along the lines discussed yesterday. The prospect of trusting you in this regard is bound to prompt the representative to suggest that perhaps the fee-splitting understanding be documented in some way. Far from taking offense when this proposal is made, you welcome the opportunity to prove your good faith. A simple letter agreement signed by both of you is called for and quickly executed (This is an exception to the general rule that you never sign anything.)

HARSH WORDS AND NARROW MINDS

If you are fortunate enough to achieve this, the prospects for your phoney deal will have improved greatly. The hapless representative will too late, but soon, realize that your copy of the commission agreements constitutes practically incontrovertible proof of his cupidity, dishonesty and disloyalty to the organization that sent him to negotiate with you. His copy of the letter may suggest something slightly disreputable about you, but he can hardly denounce you to your unknown (and nonexistent) principal.

In subsequent caucuses of the other side's negotiating team, your new colleague will begin to find that the deal "makes a lot more sense than we thought at first". If this revelation fails to creep over his horizon, mention casually that you could certainly understand how harsh and unwarranted words like "betrayal" "double-crosser", "Judas" and "dismissal" might spring to his employers' minds if they ever saw a copy of the letter agreement (although, of course, you and he know that such words could not be further from the truth). Anyway, you say lightheartedly, even if his employers were to evidence such narrow-mindedness, you are sure there must be plenty of other jobs for a person with his qualifications and background - no doubt many of them with even better pension schemes than the one he will be leaving behind.

HOW TO KEEP YOUR FAITH

Finally, the young practitioner of the phoney deal must prepare himself for the fact that many people will cling to their money with an unseemly obstinacy. No matter bow imaginative your deal, no matter how unspeakable the rudeness and discomfort which you may have inflicted on the other party, no matter how successful you may have been in convincing the other party to economize on the fees of unhelpful professional advisers, you must expect that many people

will be unable lo overcome their covetous nature and reward your efforts as they deserve.

Fortunately, the practitioner need be rewarded only infrequently to remain in the profession. Even if 95% of the people you encounter exhibit that same distasteful venality which prevents them from remunerating you, there will always be a few to justify your faith that human beings can still, even in this day and age, trust one another.

A FRAUDSTER'S POINT OF VIEW OF BANK INSTRUMENT FRAUD

A STUDY WRITTEN & PREPARED BY

PAUL RENNER

To understand the ways a Fraudster uses the financial/banking system to their advantage it is advisable to place oneself through their viewpoint. This article is therefore written to show the various techniques, methods, thought processes and key words that various career criminals have used and are still using to successfully reward themselves.

WHAT IS INVESTMENT?

A dictionary definition of "Investment" is the act of investing money. "To invest" is to lay out (money or capital in an enterprise) with the expectation of profit. All investors want to invest their capital with a view to increasing it. However, there are two emotions that govern the judgement of investing – Fear and Greed. Each emotion pulls the investor in opposite directions. Thus, for example, in the stock market, when the price of a share declines, the fear of loss of capital, makes the investor sell his investment. When the price of a share increases, the greed of the gain in his capital makes the investor buy more of the investment.

This is where the art of the Fraudster comes into play. By identifying these two emotions he plays on them by offering the "perfect investment" called HYIP (High Yield Investment Program). It is explained that the investment is "riskless"; therefore the fear of loss is removed. The emotion of greed is fulfilled by the staggering returns of the investment – 10% per week program; 5% per trade, three trades a day program; 30 day program sanctioned by the FED paying 100%; a UN program paying up to 1000% per year.

IDENTIFYING THE VICTIM

All fraudulent investment schemes involve a victim and a lot of thought is gone into identifying a potential victim with certain parameters. The following are the issues the Fraudster looks for:

1. *Money.* This is the most interesting part for the Fraudster. The sums involved can be from a few thousand dollars to a few million. The Fraudster prefers to deal with less than $10 million, as investors above this figure are more likely to have investment advisors. Even though programs talk of hundreds of millions of dollars or in some cases billions, this is part of the "smoke and mirrors" tricks used to make the investor feel his "small amounts" are inferior and more likely to give up control of his funds. (See setting the scheme/ investment program up below)

2. *P.O.F. (Proof of Funds).* All investment programs require a proof of funds. This is to filter out who really has money available. Also it shows the Fraudster the route the investor has taken to reach him. A lot of POF's are sent by fax and the Fraudster reads the message header to see who is in the market and how many brokers and intermediaries have been used in the chain.

3. *Letter of Intent (LOI).* This is requested to safeguard the Fraudster by stating that they did not solicit the investment. By making an investor write a LOI it is psychologically used to make the investor look up to the "program manager" (Fraudster), as a superior person or entity and that the investor is lucky and/or privileged to have his funds accepted when so many are turned away.

4. *The Broker / Intermediary Chain.* This is the preferred route to finding investors for the simple reason that the Fraudster does not like to have a direct contact with the investor. This is part of the "Barrier Technique" – by isolating each broker and investor, when things go wrong, he believes that the investor will have to initiate a criminal or civil claim against the broker / intermediary. Another reason is the more brokers out fishing for funds, the easier the Fraudster can pick and choose the investor most likely to be scammed of their money.

5. *Using Banking & Financial Terms.* The use of banking and financial terms that don't exist is a smokescreen to filter out those who are too knowledgeable about investing.

Example: When someone talks of a "Letter of Credit" transaction and an investor agrees he knows what that is, the Fraudster would be unsure if the investor was knowledgeable or not. However, if the Fraudster talks of SLC 3036, or SLC 3039, "Letter of Credit, London Short Form", or "Letter of Credit, London Long Form" transactions, there would be the following possible scenarios:

(i) The investor admits he doesn't know what these transactions are – the Fraudster "helps" him by explaining how the transactions work.

(ii) The investor admits he knows or thinks he knows and understands what these transactions are – the Fraudster knows that the investor is ignorant and can be fooled

(iii) The investor says they are scams – the Fraudster replies by saying the investor is ignorant.

Of the above scenarios *(i) + (ii)* results in the Fraudster accepting the Funds. Scenario *(iii)* tells the Fraudster to decline the funds. However, in some cases the confidence and showmanship of the Fraudster results in scenario *(iii)* being convinced that he was mistaken and his viewpoint is changed into scenarios *(i) + (ii)*.

6. *The Myth of HYIP.* The myth that these programs work is so pervasive that even Fraudsters believe they are real but have yet to find the proper trading group. Therefore from a Fraudster point of view it may be preferable to steal from a fellow con artist or minor crook, as there is a great likelihood of getting away with the funds. Contrary to popular belief, there is NO honour among thieves.

Use of Banks/Insurance Companies/ Financial Institutions

The use of financial institutions is important to the Fraudster for without the above there would be NO possible way of scamming any investors.

1. *Bank Statements*. The investor must produce a bank statement in the form of a Proof of Funds (POF).

Consider the following example:

Mr. Andrew Smith, an investor asks his bank, "The Bank of Security" for a letter showing he has $1.5 million on deposit and the following wording:

The above tells the Fraudster several things:

(i) Andrew Smith has $1.5 million;
(ii) The date when Andrew Smith had $1.5 million in the account;
(iii) Andrew Smiths' bank account name, number & location;
(iv) Andrew Smiths' mailing address – home or business?
(v) Who Andrew Smith deals with: David Mason & Susan Philips;

The Bank of Security
Main Office
123 Street
London, England
Telephone No. 44 123 456
Facsimile No. 44 123 457

(Today's Date)

Mr A Smith
8, Rich Avenue
Mayfair, W1
London

Dear Mr. A Smith,

Re: account no A-123-456-89
Account Name: Mr Andrew Smith

At your request the Bank of Security irrevocably confirms with full bank responsibility that the amount of US $1,500,000 (One million five hundred thousand United States Dollars), free and clear of all encumbrances or liens, is available to you and guarantee delivery of these funds as good, clean, clear funds of non-criminal origin upon your order.

Yours truly,

David Mason
Manager
Commercial Accounts

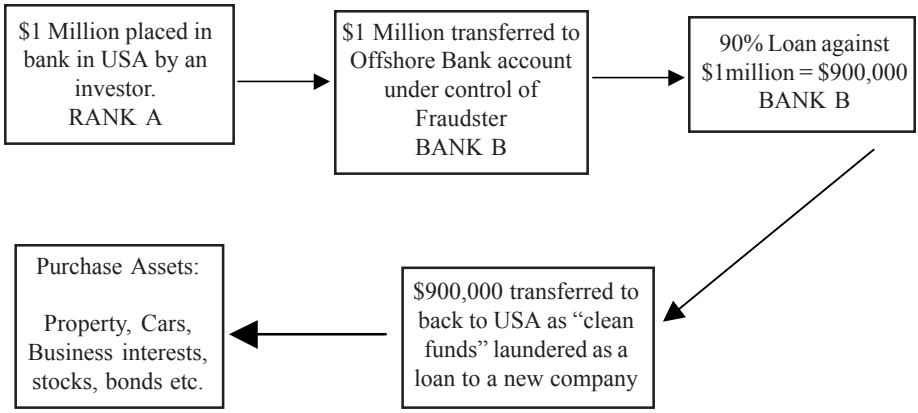
Susan Philips
Customer Service Officer

(vi) Copies of David Mason & Susan Philips signatures for file;

(vii) Ignorance of the bank officers for producing such a letter and that the officers want to help Andrew Smith who must be a good client.

By using the phrase "good, clean, clear funds of non-criminal origin" the Fraudster is looking to see how compliant Andrew Smith's bank is and how eager Andrew Smith is to invest. Since no informed banker would produce such a POF, it tells the Fraudster that he has found naïve/ innocent bankers or ones who may be possible to corrupt into his schemes.

2. *Money Laundering*. The Fraudster needs financial institutions to launder his "profits"; for without the banking system he would not be able to use his ill-gotten gains. By playing one institution against another he can pass funds through different countries and jurisdictions, making the tracing of funds difficult if not impossible.



The above example is a simplification of money laundering but shows how financial institutions can be used in a fraudulent scheme. An investor might put $1 million in funds in Bank A and the Fraudster through his scheme manages to transfer the funds, under his control, to Bank B in an offshore jurisdiction. In the eyes of Bank B, the Fraudster has assets of $1 million. Using the assets as collateral, the Fraudster asks for a loan for his new company of $900,000. Being fully securitized, Bank B is happy to loan against the funds in its bank. Now, the Fraudster can transfer the funds back to the USA through various financial intermediaries, such as banks, brokerage houses, insurance companies, etc. and purchase assets.

3. *Familiarity.* The use of household names such as Citigroup, Chase, Bank of America, HSBC, Barclays, UBS, Credit Suisse and others gives a comforting and reassurance level to an investor. The Fraudster's talk of dealing with the top banks and insurance companies in the world makes it easier for the investor to be deceived. Investors would not feel safe putting their money in the "Bank of Conmen and Crooks International Ltd.", or the "Swindle Life Insurance Company" but by using well known companies the intent of the Fraudster is to place himself in control of the investors funds using such devices as: Powers of Attorney, sub-accounts, joint venture accounts etc.

4. *Rogue or Corrupt Bankers*. Fraudsters try and place part of their team inside financial institutions or if failing that to try and corrupt personnel already working there. A vice-president or a branch manager of a small town bank may be used to legitimise transactions by confirming details of "programs", giving references for the major players, as well as giving reassurance about the security of funds. Investors, not realising that the "banker" is part of the Fraudster's team, might unwittingly give up control of their funds, feeling confident that they are secure, when in reality there may be no safeguards. In return for helping the

Fraudster, the rogue banker may receive commissions far in excess of any money the banker may earn in his career.

5. *Clients.* Surprisingly, the Fraudster finds clients for his schemes from bank officials who believe "trading programs" work but have yet to find a real trader. When a banker hears of options, futures, commodities, swaps and other financial terms, he may have no knowledge of how the mechanics of them really work. However, the banker hearing of the huge returns from other departments within the organisation wants to impress and keep his clients by offering something higher than a standard deposit account. The Fraudster uses the unfamiliarity of the financial terms to convince the banker to tell his clients about a "real trader" who makes higher than normal returns without risk.

6.*Offices.* The offices of banks have been used as meeting places for fraudsters and their potential victims. The reassurance of meeting in the "program bank" lowers the resistance and sceptical nature of the potential investor. Also, with rogue bankers (see point 4) present the scheme suddenly becomes more real.

SETTING THE SCHEME / INVESTMENT PROGRAM UP

First let me clarify two types of scheme. A Ponzi scheme is a system of making payouts to old investors from the influx of new funds from new investors. A Pyramid scheme is a system in which old investors recruit new investors into the "program" for some type of remuneration. Fraudsters use either or both methods in their investment schemes using certain parameters as discussed below.

1. *Complex Nature of Transactions.* The Fraudster makes his transactions complex so that he can deceive the investor. As an analogy, let us examine the following two equations:

(i) $A + B = C$

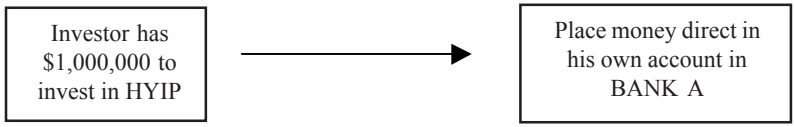
(ii) $A + (((A^2/B^2 \times B^2/A^2) - 1)) \times (C\text{-}D/E+F))) + B = C$

In a transaction (i), it is simple to work out what C is, when we know what values A and B are. In transaction (ii), the equation looks more complex with the addition of D, E, F. However the answer to find C is exactly the same as transaction (i) because the part of transaction (ii) $[(((A^2/B^2 \times B^2/A^2) - 1)) \times (C\text{-}D/E+F)))] = 0$, leaving A+B=C.

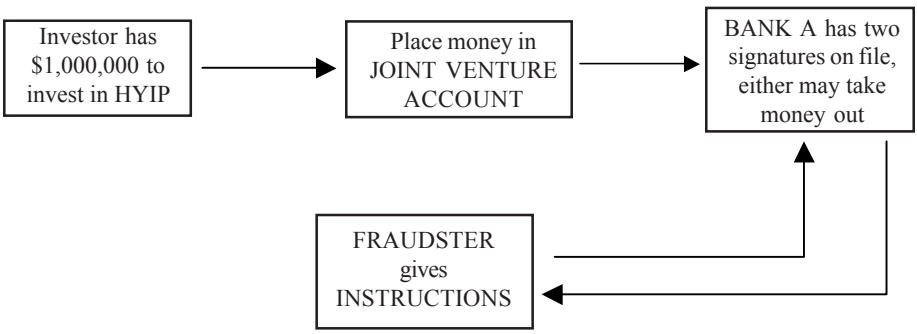
In the same way a Fraudster makes a transaction complex to confuse the investor by giving him variables, which the investor might not understand. In this way the Fraudster is trying to protect himself later, by stating that the investor did not follow the instructions properly and has therefore defaulted on his part.

2. Loss of Control of Funds. There must be some loss of control of funds in the chain so that the Fraudster can steal and convert the funds for his own use. The Fraudster achieves this by putting barriers between investors and financial institutions.

SECURE METHOD



INSECURE METHODS



As can be seen before, the insecure methods result in the ability of the Fraudster to remove the Investor's funds, using the barrier method, without the investor's knowledge.

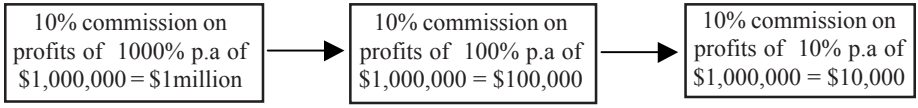
3. *Dealing with Brokers / Intermediaries.* As discussed before the Fraudster prefers to deal with brokers. In this way if a civil or criminal complaint arises the Fraudster knows that the broker will be blamed first. In many cases, the Investor is unaware of the Fraudster's role in his loss of money and will blame the party who took his money. If the broker has brought funds from many clients to the Fraudster, the Fraudster knows that only the broker has the ability to make a complaint against him, as the Fraudster did not have a contract with the Investor. The Fraudster playing on this fact feels that the investors

would have to give up their rights to the broker to sue on their behalf to recover the funds. This situation is highly unlikely, as the investor feels he has been scammed by the broker and is unwilling to give up his rights to, in his mind, a participant in the scheme.

4. *Commissions.* Commissions bring in funds to further the scheme. In the mind of the Fraudster, he appeals to the greed of brokers and anticipates their "share of profits". Even though he has no intention of paying the commissions over the lifetime of the contract, he uses the lure of huge sums of money to capture the interest of brokers and through them their clients.

For example, if a Fraudster knows there are 3 brokers in a chain he will adjust the profits so all brokers have a chance of making huge commissions.

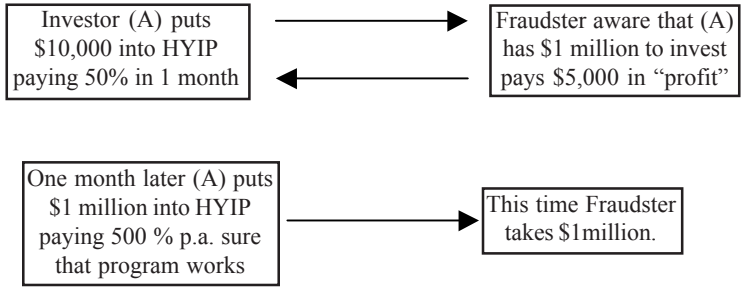
1000% HYIP Offered over 1 year.



Broker 1 would receive $1,000,000
Broker 2 would receive $100,000
Broker 3 would receive $10,000

Because the money flows from broker 3 to 2 to 1 to the Fraudster, he is also putting up 3 barriers to the Investor to find out where his funds are.

5. *Upfront Commissions / Profits.* Sometimes after reviewing the paper-work of potential investors, it makes sense to pay a small commission or profit on a lower sum invested to induce a further investment later in time.



The Fraudster in setting up the scheme to steal $1million promises the Investor that he can pay 50% in one month on $10,000. Exactly one month later the Investor receives his $10,000 plus a "profit" of $5000. Now confident, a sum of $1 million is invested in a 500 % year program. This time the Fraudster takes all the money – not bad an investment for the Fraudster, $5,000 into $1 million in a little over a month!!!

In the same way a good faith commission is paid to brokers to show that the Fraudster is "wealthy and performing", when the reality is to induce inflow of investment funds.

6. *$100 million Programs.* The talk of programs in the $100 million or more range is a subtle trick for various reasons. Firstly, few people are aware, even in banking circles what is possible or achievable with this sort of funds. This then sets a benchmark for the "perfect investment". The Fraudster can talk of meeting the right people in the bank, security house, trader, etc. IF the investor had the full $100 million. Since this investor doesn't have this sum available the Fraudster can remove certain comforting conditions to investment.

If the investor has $10 million to invest, the funds can be placed with the Fraudster's "trader" until such a time as the full $100 million is pooled together. This can act as a delay tactic, while at the same time the Fraudster has use of the interest on the bank account.

For amounts lower than $10 million the Fraudster is doing a "favour" for the investor. If $100 million has the perfect conditions then each time under the money limits: $10 million; $5 million; $1 million; $500,000; $100,000 and less; the Fraudster can remove certainties which gives confidence to the investor if they had invested at a higher amount. The less secure the funds the easier to steal them.

7. *Confidential Nature of Transaction.* The use of Non-Circumvention and Non-Disclosure (NCND) provisions in a contract help the Fraudster by confirming their secret nature only available to the select few. The NCND achieves two things: First, it reassures "brokers" they will be protected and in the process a barrier is put in place by the Fraudster. Secondly, the Fraudster or the brokers cannot talk about "real" transactions that have worked before, as they would be liable for damages for disclosing such confidential information.

8. *Use of International Organisations.* The naming of the FED, IMF, UN, ICC in contracts, is used to reassure the investor that they are dealing with

only the best organisations in the world. Most investors will not check to see if the information is correct! Also the use of false resumes of the Fraudster instil confidence and the use of titles and educational qualifications such as Lord, Sir, Dr, Professor, MA, etc.

9 *Third Party Contracts.* The Investor normally has a contract with the Fraudster. The contract normally will name third parties to the contract, e.g. an accountant, an attorney, a bank, or a securities house that will have specific duties to perform. However, in many cases the third party does not sign the agreement and is either not duty bound by the terms or is simply unaware of its "forced" obligations.

As an example, Contract (A) between Investor and Fraudster below shows some conditions, which rely on third party representations.

CONTRACT A BETWEEN INVESTOR AND FRAUDSTER

CONDITIONS:

i)	Funds will remain in account at all times unless securities of higher value are deposited in exchange.
ii)	Funds to be placed in a sub-account under control of attorney/ securities house/ bank officer
iii)	Funds used to purchase MTNs, Bonds, Securities, LCs, etc only from the Top 25 banks.
iv)	Attorney will escrow the funds until trading begins.
v)	Bank will give a safe custody receipt.
vi)	Securities House will confirm return of investment at end of one year.
vii)	Trader will confirm trading has taken place and will issue monthly statements.
viii)	X% of profits will go to the Humanitarian project, run by the "Commitment Holder".
ix)	X% per year will be guaranteed by the bank with a bank endorsed pay order.
x)	The Investors funds are secured by the guarantee of the bank/ attorney/ securities house

None of the ten conditions above have any value unless the third parties named in the contract are also signatories to the contract. Even then the third party may be involved in the scheme and appropriate due diligence is necessary (see Diligization below)

10. *Bait & Switch Technique.* The Investor is lured into the investment by being promised one thing (*the bait*) and at the last moment, due to "new" unforeseen problems, a solution (*the switch*) is found.

Examples include:

i) 6 month program is changed into a new 9 month program with different conditions; ii) A bank guarantee is to be replaced with an insurance guarantee (usually by an unknown insurance company).

iii) The "trading" bank to be used is changed from a known one to a small unknown bank or branch. (Because the trader "prefers" the anonymity of the small branch)

iv) A Bank safe custody receipt is issued instead by a small security house. (The security house officer may be easier to corrupt.)

v) Bank Financial Instruments issued from a small branch where originally the main office was promised. (Easier to corrupt the small office or to counterfeit, therefore less stringent checks.)

11. *The One (1) Year Program with forty (40) trading weeks.* Since there are 52 weeks in a year and some days will be holidays the Fraudster tells the Investor that he trade only 40 weeks in the year. A story will be spun that says it takes a few weeks to pool the funds for the "$100 million program", a few more weeks before the trading starts and then the accounting periods are calculated and profits to be paid. One simple reason that there is talk of 40 weeks trading in a year, is to delay the investor by 12 weeks (3 months) before he can legally ask for his funds to be returned. The Investor has signed a contract, which states he will be paid 40 weeks within one year of 52 weeks – it doesn't say when those "paying" weeks are!!

12. *Blame it on someone/ something else.* A very good technique of the Fraudster is to have many reasons ready for the delay of payment of profits later in his scheme. The Fraudster will always say there are profits waiting to be distributed but because of certain reasons they cannot be paid yet. The delays are always temporary.

Examples:

i) The FED, UN, IMF are in the process of reorganising their books.

ii) Bank mergers have delayed the traders.

iii) Another investor has complained to the bank and therefore trading has been "temporary" suspended.

iv) There is an SEC inquiry or regulatory inquiry from another country.

v) The Humanitarian project was in a third world country and unfortunately, the war has started again and the commitment holders have decided to reorganise trading mechanism.

vi) The Election of the new President has caused a temporary suspension of trading.

vii) The stock market/ bond market has crashed and there are no buyers at present for the Bank Instruments.

The list can be endless but it is strange that the Fraudster promised the Investor there was no risk and this is the first time the trading has been delayed!

13. *Leasing of Funds Scam.* This involves the Investor paying a sum of money to lease funds (e.g. Treasuries, Bonds, Stocks, Options etc.) with the intention of leveraging the original investment into a much larger amount. The Fraudster may offer $100 million for 3% per month. The Investor therefore pays $3 million for a month hoping to find a real trading program to invest the $100 million. However, as always, there are conditions to be met. For example, the funds can only be moved if a guarantee is produced from a financial institution. This guarantee will never be found and the investor eventually loses his funds for non-performance.

14. *The Internet*. It is becoming more frequent for the Internet to be used to set up the scheme as well as protect the Fraudster. The workings of the "bank debenture market" and "trading" can be posted on the Internet for the world to see. This can cause a myth to expand greatly. How much more real trading programs seem when one can read the history and examples of huge profits made. An exhibit (EXIHIBIT A) of the bank debenture market taken from an Internet site is given at end of this document.

15. *Offshore Payments*. Some programs offer the possibility of payment offshore via a company or trust, with an offshore credit / debit card. This entices many investors who would prefer to be paid without informing their countries tax departments. Unfortunately, the Fraudster will use this against the Investor later. He knows the Investor will be unlikely to complain due to tax evasion and the Fraudster will keep most of the funds.

16. *Joining the Elite.* The promise of joining a "special" club of the world's financial elite is hard to resist for some Investors. The prestige of being better than the "average" person plays on the inferiority complex and can induce an Investor into a scheme. The mention of politicians and well known celebrities involved in the scheme also enhances its "reality".

USE OF ADVISORS

The use of advisors involved with the Fraudster is a reassurance technique, which helps dispel any scepticism of the scheme. The following groups of advisors can be naively or actively involved in the fraudulent scheme.

1. *Bankers.* As mentioned previously, a banker who is involved in the scheme can reassure an Investor by confirming the legitimacy of a "trading program".

2. *Lawyers.* As part of the team of the fraud, the lawyer can reassure an Investor that funds will held in escrow, not be moved, or give confirmation of "trading program" working, even though this may well turn out to be false. Lawyers have been known to draw up contracts that help the Fraudster in achieving his scam. Fraudsters will also use the Attorney bank accounts to co-mingle different investor funds, making the tracing and recovery of funds very difficult.

3. *Accountants.* They can be used to prepare fraudulent trading statements showing profits made when in fact no trading has ever taken place. Investors should be aware that small accounting firms are used.

4. *Insurance Brokers.* Insurance guarantees are sometimes issued by brokers to confirm the scheme paying a percentage of profits over the life of a contract. Also, default guarantees are issued confirming of the return of funds in case of non-performance. Checking with the head office of the insurance company should confirm the accuracy of the guarantees.

5. *Security Houses / Traders.* The mention of "traders" in securities houses lulls the Investor into thinking the schemes are real, when in fact the trader may be involved with the Fraudster.

PROTECTING THE FRAUDSTER

The Fraudster relies on certain criteria to protect himself against prosecution and eventually imprisonment with the following techniques:

1. *Different Jurisdictions.* Business Customs, laws and legal process vary from jurisdiction to jurisdiction and most of the Courts that hear such cases are likely to be uninformed about the techniques or practises of the Fraudster. The Fraudster will prefer to deal therefore in different jurisdictions. As an example,

one "trading" company may be in Ireland, an "administration office" in France, the contract signed in the UK and the Investor funds to be transferred to the US. One can understand the complexities of unravelling the flow of funds and which judicial body would have the power or the willingness to prosecute.

2. *Many Players.* If an Investor dealt directly with the Fraudster only, it would be simple to understand and litigate a case. However, the Fraudster will deal with other parties, such as: bankers; lawyers; accountants; security houses; brokers and others as a way making the claims against him harder to prosecute. Using the "*Blame Technique"* and *"Third Party Contracts"* the Fraudster will deflect his role to a minor one.

3. *Changing a Criminal Case into a Civil Case.* The Fraudster would prefer a simple "civil case" with the outcome of a fine to a "criminal case" where he would be looking at jail time and criminal penalties. Therefore, the Fraudster will try to say the agreement was a "private" arrangement or contract between two business people. The contract may be revoked, rewritten, or an entirely new contract drawn up in a different jurisdiction to escape an impending criminal case. The other benefit for a civil case to the Fraudster, is his claim that the "deal" didn't work out and unfortunately he had to file for bankruptcy. Since there will be no assets left after the bankruptcy hearing, the Investor has no motive to litigate.

4. *Different Banks / Money Laundering.* The use of many companies such as Ltd., LLC., Corp., Trusts, and Anstalts etc. is used to put a barrier between the Investor and the Fraudster as well as disguise the real owner of assets to financial institutions. Funds can then be laundered via the banking system using a variety of different company names and locations.

5. *Ponzi Paying.* Once the funds have been laundered it will be difficult to for the law enforcement agencies to work out where the investors funds ultimately are. Now, the Fraudster will use some of the laundered funds to pay either "profits" to the Investor or use the funds to induce further investment from a new Investor (i.e. *Ponzi Paying*). The effect from the Fraudster point of view is to delay litigation as well as keeping the Investor quiet for a few weeks or months.

6. *Non Co-operation with Authorities.* When there is an investigation by the authorities (e.g. SEC, FSA, COB), the Investor may be contacted as a warning that something illegal may be taking place. The Fraudster will try to comfort the Investor by telling him that "they are trying to close our program

down and we want to pay out the profits to you now." The Investor is told to explain to the authorities that he is satisfied with the "program" and does not wish to make a complaint. Again, the effect is to cause delay in litigation and in apprehending the Fraudster.

7. *The Humanitarian Project.* The Investor may have been told that he had to invest part of his profit in a Humanitarian Project. Once the Fraudster has the Investor's funds he may ask for full plans of the project, administration as well as accounting details. This will cause delay for the Investor. When the paperwork is eventually presented the Fraudster will complain it was not as originally described and there will have to be further modifications. In the case of a "leasing of funds scam" the contract will be cancelled causing the forfeiture of the "performance guarantee", deposit or funds.

8. *Hope.* The Fraudster will use delay tactics on he Investor, knowing that the Investor hopes everything will work out. The promise of payment "next week, next month, next Friday…" or " the trading bank has been changed and we need to rewrite the contract" causes the investor to believe, but mostly hope that he is in a real trading situation. Why should the Investor complain to the authorities today when there is the hope and promise of payment tomorrow?

9. *Litigation by Fraudster.* To delay matters or scare the Investor, the Fraudster will threaten litigation by stating that the Investor has "damaged" his business mechanism, by either contacting the bank, securities house or any of the parties within a NCND agreement. There can be a hundred and one reasons to sue for damages. The damages will often run in the many millions of dollars and will have the effect to dampen down the enthusiasm of the Investor to complain to authorities.

10. *Special Agencies.* The Fraudster says he has aligned himself with special agencies such as the CIA, MI5, Mossad, NSA, etc., and telling the Investor that the money has been taken by them to fund their black ops (undercover work). Since the "special agencies" have now got the money it would be dangerous for the Investor to complain for fear of his life. Again, there is no truth to these statements but they are used as a means of protection for the Fraudster.

WAYS TO PROTECT AGAINST THE FRAUDSTER

After reading the above, the Investor should be aware of the various techniques, that the Fraudster uses to relieve the Investor of his funds. There have

been many regulatory warnings worldwide about the non existence of trading programs with the warning "If it looks too good to be true it probably is." However there will still be investors looking for the Holy Grail of finance. Telling them not to look will have no effect, so this section goes to show them how proper due diligence will protect them from Fraudsters.

DILIGIZATION – THE PROCESS OF DUE DILIGENCE.

1. *Budget.* Firstly, the Investor must decide on a budget for the diligization methods and evaluation of the financial investment programs. A businessperson that wishes to buy or sell a business would spend considerable costs on evaluating whether there was any feasibility in investing in or selling that business. Likewise, in the HYIP "business" it makes sense to have a budget before one undertakes any decision to invest in one of these schemes.

2. *Time Frame.* The Investor must decide how much of his time he wishes to invest in looking for the "Holy Grail". The regulators in the world tell us this business does not exist and spending months, if not years looking for something that does not exist becomes frustrating and exhausting. Secondly, once the Investor feels he has found a "real" program he must decide how long he will wait for it to work (i.e. get paid) or give up as another false program.

3. *Filtering Offers*. Once the investor has begun his search and has offers he must learn to filter out the "fraudulent" offers from the "has a possibility to invest". The Investor would continuously ask questions from those offering the program. These would include:

1. Who are you?
2. Where are you from?
3. What licenses do you hold?
4. What is the track record of your company?
5. How long has your company been in business?
6. What risks are associated with this investment?
7. Do you have any civil law suits or any criminal charges pending against you and/or your company?
8. Can we speak to any past investors who will verify receiving profits from an earlier successful investment?
9. If the Investment group can make so much money quickly why do they need an Investor?
10. If there is a connection with the ICC, FED, US Treasury or any government or regulatory agencies can the Investor speak with someone to confirm the existence and performance of the Investment?

4. *Continuing Diligization.* The Investor would have to investigate the following as part of the diligization process:

1. Are the offerers a large corporate entity, as they claim, with large corporate offices, or are they just con-artists?
2. Do they work from a physical address, or just a mail drop (Mail Boxes, Etc.), or from a "serviced office" that is rented on a monthly basis?
3. Are they well known and established in the financial community, with licensure, bonding, references, history of past completed transactions?
4. Are they merely criminals, and/or defendants in numerous civil law suits, with many past victims?
5. Are they in the process of filing bankruptcy?
6. What is the current financial status of the company (if they are a reputable business they should have a good credit history)?

. . . and other extremely important pieces of information.

The Investor should find out the truth about the agents and their offers BEFORE the Investor loses his precious time and/or hard-earned money.

5. *Legal Research.* The Investor should hire an attorney who is knowledgeable in securities law, banking law and international law. The Attorney would read and evaluate the information received from the Investor. If there were any concerns he would amend the investment contract between the Investor and the offerers, until the contract was the most beneficial for the Investor. Because of the possibility of the "trading program" failing, the Attorney would take all the necessary precautionary steps to make sure the Investor worked within the laws of the countries of the contract and did not violate them.

The Attorney would make sure that the Investor never transferred and/or gave control of the funds to the program providers, without adequate securities or guarantees.

WHAT THE HECK IS A 'PRIME BANK' NOTE?

THE FEDS SAY IT'S A SCAM USED TO CON EVEN SOPHISTICATED INVESTORS
BUSINESS WEEK, JUNE 13, 1994

When Lawrence Gerschel received his M.D. in 1978, his grandfather, legendary financier Andre Meyer, couldn't have been prouder. The Lazard Freres & Co. chief and adviser to the rich and famous, including the late Jacqueline Kennedy Onassis, admired great physicians and donated huge sums to medical research. In 1979, Meyer died at the age of 81, leaving a fortune conservatively estimated at $90 million to his wife, Bella, Lawrence, and three other grandchildren. About three years later, Gerschel, then reputedly worth at least $30 million, chucked his medical career for the business world. If Meyer knew what regulatory and law enforcement authorities allege about his grandson, he might turn over in his grave.

BUSINESS WEEK has learned that the Securities & Exchange Commission and the Manhattan District Attorney's office have launched investigations into Gerschel's New York-based Trust Group, which he set up in 1991 with two partners. Sources close to the D.A.'s probe say that a grand jury has recently issued subpoenas to Gerschel and his partners to determine whether the firm has trafficked in the netherworld of phony "prime bank" instruments, including notes, debentures, and guarantees.

MUSHROOMING. The sale of prime bank instruments, according to authorities, is a mushrooming but little-publicized financial scam that has hoodwinked hundreds of investors, many of them financial professionals. The instruments are marketed by promoters as debt or similar obligations purportedly issued by the "world prime banks," as some offering materials put it. They promise often outlandish, risk-free returns – typically 25% or more per year. Accompanying documents look official and often use the letterheads of real banking institutions, particularly foreign ones, such as Deutschebank and Barclays.

In fact, authorities say, documents purporting to represent such investments are bogus, with no connection to any bank. After selling the paper and perhaps making a few interest payments, promoters usually move the money offshore - where investors can't retrieve it - and disappear.

In recent months, the Comptroller of the Currency, the SEC, and other U.S. and foreign agencies have issued many warnings to financial institutions about "illegal or dubious schemes" involving prime bank instrument, as one release put it. James E. Byrne, a law professor at George Mason university, estimates that over the past few years, investors worldwide have lost $500 million or more in these transactions, which he believes are being perpetrated by as many as 1,000 "hard-core pushers."

Promoters often assure would-be investors skeptical about the high returns that prime bank investments are a secret wholesale market to which only governments, big banks, and other insiders normally have access. Even reputable institutions have been taken. Numerous investors lost hundreds of millions of dollars in a scam involving $1.2 billion in bogus prime bank guarantees issued by the Czech Republic's Banka Bohemia. That episode triggered the April collapse of the bank and left the national Council of Churches $8 million poorer. The Salvation Army in Britain and the government of Nauru lost millions in earlier swindles. "We've only seen the tip of the staggering losses we'll see in the next couple of years," says Byrne.

The Trust Group's activities, authorities say, show how some prime bank schemes operate. They are looking into a recent transaction where they claim the Trust Group nearly duped officials of several counties in Kentucky and their advisor, then known as Shearson Lehman Brothers, out of as much as $150 million. The Trust Group, they say, hoped to move the money to Fossbankin, a small, now defunct bank in the Faeroe Islands, a semi-autonomous territory of Denmark in the North Atlantic.

"FRAUD." The Trust Group, which operated out of a modest Manhattan apartment, has not been charged with any wrongdoing. But John Shockey, special assistant to the Comptroller of the Currency, referring to prime bank instruments, says: "I've never seen any evidence that they engage in any legitimate buy-sell transaction." A spokesperson for Deutschebank - which Trust group Managing director Jeffrey M. Moritz cited in a deposition as a prospective issuer - says: "We don't have a product like that. Those things are a total fraud." Moritz denies that either he or the Trust Group committed any wrongdoing.

In promoting themselves, say authorities, Trust Group officials liberally played on Gerschel's involvement. Authorities believe that Gerschel, who relatives and acquaintances say is naive about financial matters, may have been

seduced by those involved with the Trust Group into letting them exploit his name and fortune. Gerschel, 45, who is the Trust Group's senior partner, denies any illegal actions: "I know by any stretch of the imagination I've behaved well, and I don't have to justify that to anybody." He also denies that the Trust Group committed any wrongdoing.

The Trust Group's prime mover, say authorities, was Sandi Kalez, a self-described securities trader who once arranged car loans, acquaintances say. According to Moritz's deposition, she convinced Gerschel and Moritz, a lawyer and former tennis instructor who had been Gerschel's business partner, to move into the prime bank business, in which she claimed, according to documents at U.S. District Court in Frankfort, KY., to have achieved great success. Kalez did not respond to repeated telephone messages.

An account of the Trust Group's Kentucky deal, which would have been the firm's largest, can be pieced together from the court records. In late 1991, through intermediaries, the Trust group contacted James M. Hatfield, a former college basketball coach and a broker in Shearson's Lexington (Ky.) office. One of his clients was the Kentucky Association of Counties (KACO), which administered a huge pool of cash for most of the state's 120 counties. Says a Smith Barney Inc. lawyer: "The attempted transaction happened over a year before Smith Barney acquired the retail offices of Shearson. As a result, we're not prepared to comment on the specific facts of the attempted transaction."

One of the intermediaries was Denver Attorney T. Robert Hughes, who sold Hatfield and KACO on the Trust Group's "rolling trades" program. According to court records, the pitch went this way: Using KACO's money, the Trust Group, through intermediaries, would buy tranches of $10 million face value of "prime bank guarantees" yielding 7.5%, at a discounted price of $8.3 million. The Trust Group would then sell them for $8.9 million to unspecified buyers, generating for KACO a gross profit of 1% of the face amount for each trade. Documents show that the Trust Group represented to KACO that it could execute at least four transactions per month for each tranche, implying a minimum annual return of 48%. Hatfield later said in a deposition that he was satisfied that the program assured that the "risk is zero." Hughes replies: "I do not believe that the Trust Group committed any wrongdoing or that the KACO transaction was fraudulent or in any way illegal."

In July, 1992, the first slug of about $32 million began moving to Shearson's account at Chemical Bank in New York. The Trust Group hoped that KACO's investment would balloon to as much as $150 million over the next few months. Court documents indicate that the money was to move to an account at a branch of Sanwa Bank California and then possibly to Fossbankin, where it would have been beyond KACO's reach.

Fortunately for KACO, a clerical glitch at Shearson stopped the money flow, Hatfield says. A Shearson manager, according to his deposition, became alarmed when he learned of the transaction. Unable to find an authorizing letter from KACO, he halted the deal. KACO executive Fred Creasey says the prospect of what might have happened to KACO's money "scares me to death."

DISARRY. The glitch precipitated a complex flurry of legal battles. The Trust Group sued KACO for default in U.S. District Court in Frankfort. The case moved to arbitration, and - in another surprising twist - the American Arbitration Assn. in Los Angeles awarded the Trust Group $625,000 in lost profits plus legal expenses. KACO is challenging the award. The arbitrators issued no reason for its ruling and declined to discuss the case. But court records and interviews with participants indicate that the arbitrators apparently did not consider evidence of the possible illegality of the prime bank instruments. The arbitrators also refused to consider information from KACO lawyers that the SEC was investigating the Trust Group. Said KACO attorney Phil Williams, "Until we learned of the SEC investigation and became aware of some of the bulletins the federal regulators were putting out, we were unaware that all of these types of transactions were fraudulent on their face." Hatfield now has second thoughts about the deal: "I've not been able to find one person who believes [prime bank instruments] exist."

Despite the award, the Trust Group has fallen into disarray, mainly because of intensifying local and federal probes. Moritz says the firm is no longer "an operating company." Indeed, Gerschel, Moritz, and Kalez appear to have gone their separate ways.

In a luncheon interview, a visibly distressed Patrick Gerschel, a New York investor and former partner at Lazard Freres, reflected on his brother's predicament. "People who are motivated by money usually breathe it 24 hours a day. That's not the Larry Gerschel I grew up with," he said. "[Larry] should have stayed a doctor."

By Phillip L. Zweig in New York