

CONFESSIONS OF A SCAM ARTIST

**"You never forget
the day you're arrested"**



pennsylvania
DEPARTMENT OF BANKING
AND SECURITIES



Each year, consumers lose billions of dollars to con artists who make a living by fleecing the public out of their hard-earned money.

The Pennsylvania Department of Banking and Securities' goal is to protect the public from deceptive practices in connection with offers, sales and purchases of securities in Pennsylvania while encouraging availability of equity and debt financing to legitimate businesses and industries in or affecting the Commonwealth.

We hope this booklet and the information it offers help you become a wiser investor.

"He that is of the opinion money will do everything may well be suspected of doing everything for money."

-Benjamin Franklin

Confessions of a Scam Artist



"You never forget the day you're arrested. It was Feb. 12, 1999. A Friday night. I was on my way to dinner."

Eric Stein recalls all too clearly the moment the game was up.

"You never forget the day you're arrested," he says. "It was Feb. 12, 1999. A Friday night. I was on my way to dinner."

That evening marked a turning point in what Nevada's attorney general at the time called "perhaps the largest investment scam in modern [state] history." Stein was the founder and managing director of Sterling Group, a company based in Las Vegas that used TV commercials to sell products directly to viewers. Investors, in turn, were offered the chance to buy stakes in those commercials.

But according to the Federal Trade Commission, Sterling Group and its operations were a Ponzi scheme. In such frauds, money paid in by later investors is used to pay inflated returns to the original investors to attract more funds.

Stein had been a fugitive for almost a year. Four months after his capture, he pleaded guilty to 73 criminal counts, including mail fraud, securities fraud, conspiracy and money laundering. In December 2001, he was sentenced to eight years in prison. When investigators tallied the damages, almost 1,800 investors had lost \$34 million. [At the time of this interview's publication, Stein was 46 years old and incarcerated at Fort Devens Federal Prison Camp in Massachusetts.] Saying he is now "focused on trying to make a bad situation better," he agreed to discuss his scam and its mechanics: how it started, why it worked and how it collapsed.

His comments provide an insider's look at swindles that rob Americans of billions of dollars each year – and help explain why adults approaching retirement currently rank among scam artists' favorite targets.

On a recent morning at Devens – sitting in a small room with large windows and a guard observing nearby – Stein began by talking about ingredients common to most scams: a so-called issuer, the person who comes up with the idea for the scheme itself, and an independent sales office, or ISO, which is a group of people hired to solicit investors.

Here are excerpts from the interview.

THE WALL STREET JOURNAL

(WSJ): Are most of these solicitations done by telephone, or mail or personal visits?

STEIN: Not all ISOs use telemarketing; some use personal visits. If you're in parts of Florida, that's where you [find] a lot of telemarketers – Boca Raton or Fort Lauderdale. In Chicago, where we dealt a lot with ISOs, they don't use the phones. They go and they visit you.

WSJ: Are most, or all, investment scams a Ponzi scheme or some version of a Ponzi scheme?

STEIN: Yes. Someone has got to get paid somewhere along the line. If you don't Ponzi the scam, you won't be able to have references who can tell other investors, "Hey, this is great – I got a check."

WSJ: Most people have heard warnings – repeated warnings – about investment fraud and sales pitches that are too good to be true. And yet we regularly read about new scams and new victims. Why do people continue to fall for these schemes?

"You already know who your target audience is. They're very carefully marketed."

STEIN: Well, there's really several levels. The best way to sum that up is when you're selling an investment scam, you already know who your target audience is. They're very carefully marketed.

WSJ: In what way? How do you know whom to target?

STEIN: Well, in French they call it a "mooch" list. That's a slang term that's used in the industry to describe people who have the [right] personality traits – they've got to have a deal. It's almost like an addiction. And typically, they're people who are in their 50s, or they're entrepreneurs who have accumulated some wealth. You get [their names] from list companies.

WSJ: And where do list companies get the names?

STEIN: [One] technique [is] a mall intercept. If you go to a [shopping] mall, you [are asked to] fill out this questionnaire, and you might win this car.

And in a particular neighborhood, [the list company] might get hundreds of names. People are real interested in getting that car, so they'll answer questions [about

themselves] naively and very honestly. The other way they get names [is] off the Internet. You answer questions for certain free things, and [the list companies] are gathering information from there.

WSJ: How many names would you buy? What did they cost?

STEIN: The names are very expensive. We used to pay \$25, \$50, \$100 a name. We'd buy a thousand at a time. It's a 1-to-10 ratio. For every 10 calls you make, you're going to get one person.

WSJ: What makes a deal tempting?

STEIN: The people that run these scams – the issuers, if you will – they really have strong strategies. They come up with hooks to lead you in, just like a very strategic advertising campaign.

That's the reason why people fall for them. It's not that [the schemes] are all that great. It's just that usually they're timed around things that are current in the marketplace, and everybody wants to be a winner.

Another reason is that many [people] have lost confidence in traditional investment products, like stocks, bonds, and mutual funds. Think Enron and WorldCom. And sellers of fraudulent securities know this.

"Look, you can't trust corporate America. You should have gotten great returns on a particular stock, [and] you didn't because they're manipulating it."

The [sales pitch] that someone might use will be, "Look, you can't trust corporate America. You should have gotten great returns on a particular stock, [and] you didn't because they're manipulating it. [By contrast] this guy here has a general partnership; he's a small-business owner. You can trust him."

And that's how they get you!



SLICK AND SIMPLE

WSJ: Are scams getting more sophisticated, or do they tend to remain the same year after year?

STEIN: They're getting more professional looking. The key to understanding a scam is its believability – how it's packaged, how it looks. If a person receives documentation [in the mail], and it doesn't look like it's reasonable, they say, "This can't possibly be true," and they throw it out. But [if] the person who's developing this scam [can] really work at their computer and create something that just looks brilliant, [that's] really an advantage that they have over the victim.

WSJ: What would a good package of documents look like?

STEIN: It's written very logically. They tend to have limited amounts of charts and graphs and things that might confuse the reader. It's very nicely put together, no spelling errors. It looks professional; it's glossy. It's got a history of who the company is, or it's got a history of who the players are. If it's a start-up which is typically what happens, and you look at it, you go, "This is great. It's a ground-floor opportunity."

WSJ: What would some of these opportunities be?

STEIN: It's got to be something that people can understand – diet pills or television campaigns, auto products. Anything that makes sense to people. Anything that doesn't need a lot of explaining, that can be explained maybe in a two or three minute phone call. If it's some kind of water-treatment plasma plant, people are going to go, "What the heck is this?" They're not going to understand it. But if you say, "Look, we're going to open up a hundred retail stores and sell mattresses," [people] sleep on a mattress every day. They know the cost of a mattress. If you can explain [it] correctly, they're going to go for it.

WSJ: What kind of return do these deals promise?

STEIN: The return on investment has to be very significant – 20% to 25% or more per 90 days.

Truth is, 25% on a quarterly basis is impossible – can't happen. But you're not going to believe that it can't happen. Because you want to believe it can happen, because that's what you want to happen.

► DENTISTS BEWARE

WSJ: Most people probably think that only someone who is uneducated or naive or stupid would fall for these pitches. True?

STEIN: Totally not true. The majority of clients that I dealt with over the years were white-collar types of people. They were people who were already successful. They were people who had cash – had made money – and had worked very hard for it. They were doctors, they were dentists. [That] was a big group we went after – dentists. Dentists love to be loved by people.

WSJ: Dentists?

STEIN: They sure do, because nobody likes going to the dentist. They're the easiest group to sell. There are companies that just sell [investments] to dentists.

WSJ: Who else?

STEIN: Some attorneys, not too many. A lot of car-dealership owners, some golf-course owners, some high-profile restaurateurs. A lot of business owners, mostly entrepreneurs.

WSJ: Why do they bite?

STEIN: All investors ultimately have a common characteristic: They're risk takers. [Some] guys – we call them "hard money" or a "mooch" – just like to play it really big. We know for a fact that he's going to tell his friends that he's in this huge deal, and that they can't come in right now.

We used to call it "golf course talk." So you're playing the psychological aspect as well as the financial aspect.

WSJ: Aren't people skeptical? Don't they ask questions?

STEIN: They're going to ask all kinds of questions. [But] you have to help them along the way. You've got to give them testimonials, you've got to give them references. We had a lot of confederates working for us – other investors we brought in that we paid to give references [about] how wonderful we were. It's all about the packaging and the picture that you paint for them – the image, all about the dream you're making for them.

► WHO'S VULNERABLE?

WSJ: Is there a group that's more vulnerable than most?

STEIN: One of the major players that they go after are the people hitting close to retirement or who have recently retired. They've been hammered in the stock market for the last couple of years, or they've made bad decisions with mutual funds, or whatever. They don't have the business opportunities they had when they were younger, and as they get closer to the time when they really want to sit back and relax – so to speak, as the sand

passes through the hourglass – those are the people that [investment scams] are really hammering the hardest.

WSJ: What about the new limits on telemarketing? Doesn't that reduce the number of sales pitches?

STEIN: The reality of it is: if you're already breaking the law, do you think [a new] law is going to stop you? You're just going to keep on doing it. So [telemarketing



rules] – while they're very good for people being bothered by magazine subscriptions during the dinner hour, which certainly can be very annoying – aren't going to stop the guy that deals in hard money. Quite honestly, he isn't legitimate, he's never been legitimate, [and] he doesn't care.

WSJ: Who are some of those players? How do telephone calls to victims work?

STEIN: An “opener” or “screener” might be one and the same person. If you’re calling names from a list, you want to verify that the person on the list is interested in receiving a package. So you make an initial contact with them. Sometimes screeners are just used to weed through the people on the list. If the person you call says, “No, I’m sorry, I’m not interested,” then, of course, that name gets checked off the list. If the person says, “Yes, I am interested,” the screener then takes on the role of opener, and the opener starts explaining the



opportunity and why it’s important for the person to become involved in it, and ascertains their true level of interest.

From there, it’s either turned over to a “seller,” the person who’s actually doing the selling, or that person may then step into the next role, which is coordinating the sale of the actual investment. If that person who’s doing the selling has a problem and can’t get the victim to come in, they turn it over to a “closer.”

“If the person really has the cash, they’re going to go after them.”

That person is usually presented [to the victim] as the “office manager,” or the “sales manager” or the “vice president of marketing” – whatever they want to call this person. He or she gets on the phone and spends some time talking. That’s determined by the level of liquidity that the victim has. If the person really has the cash, they’re going to go after them.

► RAISING CAPITAL

WSJ: Tell us about your scam. How did you become an “issuer”?

STEIN: Well, the idea came from the fact that I needed money to expand a growing business. I was into the selling of products on television, the direct-response business. I produced 60-second and two-minute spots, and I sold all kinds of products – health products, household products.

I needed about \$5 million, but I was unable to find the venture capital or an angel.

WSJ: Was this a legitimate business?

STEIN: When we started, it was legitimate. We shot commercials, we ran some air time. We realized that we needed more air time, a lot more air time. We thought we could get some investors to join us in a small general partnership. We were in the process of raising the money when I took a vacation. I went to Ensenada, Mexico, for the summer. And while I was there, I met a bunch of telemarketers who were having a great time spending the money that they had fleeced from all these people.

"My kind of project was the perfect project for the telemarketing arena, because margins were huge, the topic was exciting, people loved television, and there were a lot of – as there are today – direct response commercials running on television."

They had lots of cash, and they explained to me that my kind of project was the perfect project for the telemarketing arena, because margins were huge, the topic was exciting, people loved television, and there were a lot of – as there are today – direct response commercials running on television.

WSJ: What was your reaction?

STEIN: I'm just listening to it, not even thinking this is an illegal thing. I had very little knowledge of securities law. I was a marketer; I didn't know about this stuff.

So summer ends, and we come back to California.

And I'm thinking to myself, well, maybe I should try and find a telemarketer – just to talk to somebody – because this would be a great opportunity for the company. We could build it and grow it into something that's huge.

In November of 1996, I was introduced to a telemarketer in Anaheim, Calif., and together we structured a deal. We agreed that we would sell shares in a limited liability company. I designed the prospectus, contracts and created references.

After a few months, we added larger telemarketing companies to sell the deal nationwide.

► THE PITCH

WSJ: What was the specific sales pitch?

STEIN: The potential investor was told that a successful direct-response company was looking for limited funding of only \$5 million. The company was described as sourcing products to sell through late-night

TV commercials in markets located in second- and third-tier cities. Furthermore, that we wrote the scripts, filmed the commercials and bought the media ourselves.

The investors were told that they were buying shares called "media units" in an LLC. The air-time cost was \$25 per commercial spot. So, one \$5,000 "unit" bought the investor 200 commercials.

In turn, we told the investor that a minimum of five products would be sold each time the commercial ran, [and] the investor [would] receive \$7.50 for each product sold through the commercials.

So, 200 [commercial] spots equals 1,000 [products] sold. One thousand sales multiplied by \$7.50 per [item sold] equals \$7,500. Therefore, a \$5,000 short-term investment yielded after 90 days a return of \$7,500.

WSJ: What were some of the products in the commercials?

STEIN: Talking pet tags. A flea trap. A Christmas tree fire alarm. Aqua-bells, those are plastic dumbbells that you fill with water.

WSJ: Was any of that real? Were there any commercials? Any products? Any air time?

STEIN: We filmed some actual commercials, [and] the ISOs made copies of them to send to potential investors with a prospectus. They were mainly used as a selling tool. It legitimized what we were doing. Someone would see [the commercials] and say, "These guys are for real."

The real issue was: How much air time did you buy, and how much product did you sell? Only a fraction of the money we raised – about \$1 million – actually was spent on air time. You didn't have enough air time being bought to support the returns you're giving people.

WSJ: How well did the deal work?

STEIN: Typically, we did about a million dollars-plus a week. One day, we received \$3.8 million.

WSJ: In one day?

STEIN: One day. It boggles the mind when I think about it.

FOLLOW THE MONEY

WSJ: Where did all the money go?

STEIN: A lot of the money went to the investors to get them to put more money back in. That's how Ponzi [schemes] operate. The lion's share of the money went to us for our expenses. [The] telemarketer got almost half. Then we had office expenses and living expenses and lifestyle expenses. Living in Vegas can be expensive.

WSJ: What was your lifestyle like?

STEIN: Lavish. A Rolex for every day of the week. I had 21 suits made to order. I could buy anything I wanted – a Bentley, whatever I wanted.

WSJ: How did the scheme fall apart?

STEIN: Well, you can only play the game for so long with such huge investment returns.

And then you get guys that you don't want to pay.

I wanted to renegotiate with my telemarketers. I wanted to go down to 30% [commission]. They were making 45; they wanted 50 to 55. I said no, so I fired them

all, and started working the clients on my own.

They [the telemarketers] didn't like that, so then they started telling the clients that [the deal] was illegal. Well, of course it was illegal. How are you going to make those kinds of returns on the street? Where are you going to get 25% every quarter? It might happen, but it certainly wasn't happening with me legally.

So, once [the telemarketers] stopped getting paid, the money started running out. In order to work a scam, you have to have huge amounts of money coming in so you can do the payoffs [to investors] – pull off the top, pull off the top. I couldn't hold it together. Complaints started coming in.

When complaints start coming in, you start going under investigation. That's it. It's over.

WSJ: Looking back, was there one particular day or moment when you decided – when you knew – you were going to do something illegal, or was it more of a slippery slope?

STEIN: In the beginning, I was trying to raise money. I knew I was working in the gray – I knew that you shouldn't be selling through telemarketing to people who you don't know. I had every intention of making sure the deal was legit.

I was warned several times by people that knew me and people that cared about me, and I talked with attorneys and I talked with financial advisors – real, certified people – who said, "What you're doing is illegal, you're going to get in a lot of trouble."

I'm like, "It's going to be fine. I'll fix it, I'll fix it." You can't fix it. I was sucked up into the personality of the game. I liked the game, and I was a risk taker.

I just took the risk too far.

WSJ: Are you still facing lawsuits?

STEIN: Civil [lawsuits], sure. I'm responsible for \$34 million of repayment. That doesn't go away.

WSJ: To date, has any of it been repaid?

STEIN: I don't know how much of it has been repaid. I had co-defendants, and I don't know what their financial circumstances are. My intentions are to repay as much of it as I can.

WSJ: Do you still have any of the money?

STEIN: No, the money is gone.

▶ TIME TO REFLECT

"I regret it every day. That's one of the reasons I'm sitting here talking to you."

WSJ: Any regrets?

STEIN: I regret it every day. That's one of the reasons I'm sitting here talking to you.

I think that in the beginning, in the early part of 1999, I didn't have any regrets because I was still in shock. It wasn't until 2001 when I began to realize that I had done this – where I participated in this huge disgrace to the financial community and to many, many investors.

Now, I'm more focused on what I can do to fix it.

My [focus] is really on taking those energies and that creativity that was used to create that scam [and] putting it toward something more positive and trying to repay these people.

WSJ: To be frank, people might find that hard to believe.

STEIN: I can't speak for another person's social responsibilities, but I can speak of my own.

Prison is a very harsh environment, and it really changes your mind-set if you let it. You can change it for the positive.

WSJ: What do you get out of this interview? Do you get any reduction in your sentence?

STEIN: No. [The sentence] is set in stone. What I get out of this interview is knowing that I'm trying to do something – even while I'm in here – to try to make right a very bad wrong.

My interest and my goal [are] to make sure that some kind of warning goes out that's proactive. It's good to know that there are agencies out there that can explain the negative things of a bad project.

But by the time you've reached these organizations, these watchdog agencies, you've already been taken.

If I simply told people about my experiences and explained to them the pitfalls of what to look for – if one person reads this and says, "Hey, this makes sense; I'm going to watch out for this," and then that person hangs onto their money – then that's a good thing.

WSJ: What do you plan to do when you get out of prison?

STEIN: Teaching and some seminar work. That's the goal.

That's what I've done in here [in prison]. I created 37 courses; 22 of those are business courses. I teach employment skills, I teach some motivational kinds of courses, and then I teach separate entrepreneurial courses – how to prepare a business plan, how to start a cleaning service, how to start and manage a lawn-care service.

I probably have taught in the last 2 1/2 years at least 1,200 people. They're open to learning; they just didn't know they had the skills.

It's extremely gratifying.

► TOO GOOD TO BE TRUE?

Eric Stein offered the following advice and observations on how to reduce your chances of falling victim to such schemes.

- Never talk to any financial salesperson on the telephone whom you don't know personally and never discuss any financial materials that you didn't personally request. "Most people try to be polite when they answer the phone. In this case, avoid typical phone etiquette and stick to your guns."
- If someone sends you an e-mail or a brochure through the mail regarding a financial opportunity, and you don't know the person, don't recognize the company name or didn't ask for the information, then don't respond. "If you get something in the mail, there's a chance the people running the scam already know something about you; that's why they're sending the paperwork. Never respond to unsolicited material."
- If you are considering buying stocks or related financial products, purchase these items only through a licensed and registered broker employed by a reputable firm. Verify the broker's background through BrokerCheck® at www.dobs.state.pa.us and click "Investor Education" or call 1.800.PA.BANKS (1.800.722.2657). "Be careful when someone calls himself a 'financial consultant,' or a 'business consultant,' or 'financial advisor.' Anyone can use those labels."
- Never purchase any unregistered securities. "First, they haven't been reviewed by state regulators. Second, there's no open market for these products. You can't call your broker and say, Unload this."
- Be cautious purchasing private placements, general and limited partnerships, and membership units in a limited liability company, or LLC. "These aren't illegal in and of themselves. But scam artists abuse them to raise money."
- Never purchase any financial product that is described as "low risk, high yield," or "safe" because a friend, relative, religious leader or a parishioner has recommended the opportunity to you. "That speaks for itself."
- Never answer any survey or enter a contest while shopping in a mall or while online. "You might let down your guard in a mall or online. They're a source of names and possible targets for scam artists."

► UPDATE ON ERIC STEIN

In 2011, Eric Stein pleaded guilty to one count of mail fraud and one count of wire fraud connected to a new scam, a company called Return-A-Pet LLC.

Stein (who sometimes used the name Robert Philips) claimed to investors that Return-A-Pet provided enrolled pet owners with access to a toll-free number (staffed 24 hours-a-day) and printed on the pet's ID tag. Return-A-Pet was supposed to facilitate the return of lost pets to their owners.

According to Forbes magazine, "Once Stein pocketed the upfront fees, the investors allegedly never received the materials and services promised. On July 9, 2012, Stein was sentenced to 63 months in prison, three years of supervised release, and ordered to pay restitution to his victims in the amount of \$528,000."

BY GLENN RUFFENACH

Staff Reporter of The Wall Street Journal
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