Understanding and Combating Investment Fraud

Pension Research Council Symposium – May 6, 2016
Protecting Consumers from Fraud

Growing Body of Research

- Victim Profile
- Risk Behavior
- Psychological Biases
- Susceptibility
- Impact of Self-Reporting Error
- Individual Differences
Fraud Prevalence and Impact

More than 8 in 10 solicited for potentially fraudulent offers

$50 BILLION per year lost to fraud

Financial fraud prevalence is hard to measure. Estimates vary from about 4 to 14 percent.

Fraud Weapon – Social Influence

- Scam pitches are tailored to the “hot buttons” of targets
- An investment fraud pitch is full of influence

Average # Total Tactics per Transcript

Red Flags of Fraud

**Phantom Riches**
Dangling the prospect of wealth, enticing you with something you want but can't have.

**Source Credibility**
Trying to build credibility by claiming to be with a reputable firm or to have a special credential or experience.

**Social Consensus**
Leading you to believe that other savvy investors have already invested.

**Reciprocity**
Offering to do a small favor for you in return for a big favor.

**Scarcity**
Creating a false sense of urgency by claiming limited supply.
Investment Fraud Victim?

Fraud victims are stupid, naïve, gullible, greedy, mentally deficient, elderly, and easily-led.
The Demographics of Fraud

- No single victim stereotype
- Age and fraud victimization
- Beyond age
  - Gender
  - Income
  - Education
The Psychographics of Fraud

- Risk tolerance
- Perceptions of debt
- Impulsiveness
- Financial literacy
The Role of Targeting

- Two kinds of vulnerability
  - Falling victim once targeted
  - Likelihood of being targeted
- Examine the role of demographics, psychographics and targeting on investment fraud
The Role of Targeting

Demographic Model

- Age (10-yr): 1.3
- Income > $50K: 1.6
- Male: 1.7
- College: 1.4

Source: Authors’ calculations based on data from the Fraud Susceptibility Study (2013) and the National Financial Capability Study (2012).
The Role of Targeting

Demographic and Psychographic Model

- Age (10-yr): Odds Ratio = 1.4
- Income > $50K
- Male
- College
- Financial Literacy: Odds Ratio = 1.4
- Too Much Debt: Odds Ratio = 1.1
- Risk Tolerance: Odds Ratio = 1.2

Source: Authors’ calculations based on data from the Fraud Susceptibility Study (2013) and the National Financial Capability Study (2012).
The Role of Targeting

Demographic, Psychographic and Targeting Model

- Age (10-yr)
- Income > $50K
- Male
- College
- Financial Literacy
- Too Much Debt
- Risk Tolerance
- Solicitations

Odds Ratio for Likelihood of Investment Fraud Victimization

Source: Authors’ calculations based on data from the Fraud Susceptibility Study (2013) and the National Financial Capability Study (2012).
Who Tends to Get Targeted?

Older

Male

Higher Income

College Educated
Challenges to Preventing Fraud

Psychological Barriers
► Illusion of invulnerability (I can’t be taken.)
► Reactance (You’re not the boss of me.)
► Threats to self-esteem (I am not stupid.)
► Too much information (I can’t remember what you taught me.)

Systemic Barriers
► Scams everywhere (how do you warn against so many different frauds?)
► Scale (how do you reach a critical mass of consumers?)
► Proving a negative (how do you show when something doesn’t happen?)
► Persistence (if you can show a preventative effect, does it last?)
Investor alerts and warning campaigns have limited focus.

Warning Campaigns
- Specific
- Reactive
- Short-term
- Information-based

Educating Campaigns
- Generic
- Proactive
- Long-term
- Skills-based

Investor Protection Strategy

► Ground in research
► Build partnerships
► Teach Investors to:
  • Know that they are vulnerable
  • Recognize persuasion techniques
  • Take simple, highly protective steps ("Ask and Check")
Field Testing a Curriculum

Those who had been to the OIF seminar responded positively to the fraud appeal 50% less frequently than those who had not.

Percentage of Respondents who Agreed to Receive Information

Source: FINRA Investor Education Foundation
Questions?

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