



FINAL REPORT

MARCH 31, 2005

Eron Mortgage Study

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Finally, I would like to thank the many Eron investors who gave so freely of their time to meet in focus groups, and to respond to surveys and telephone interviews. I particularly want to thank James Tindle for his time, his support of this project and his thoughtful advice. I can only hope that this product will ultimately help to diminish the likelihood that future investment frauds will find favour in the capital markets.

Neil Boyd
April 2005

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EXECUTIVE SUMMARY

This is the first systematic study of a single investment fraud, focussed on responses drawn from more than 2,200 Eron Mortgage investors. After reviewing relevant research literature and the specific findings of the B.C. Securities Commission in Eron, the research team held focus groups and developed a pilot questionnaire, mailed to 520 randomly selected Eron investors in December of 2004. After compilation of the results from this initial instrument and presentation of an interim report, the questionnaire was revised and a final version was mailed to 1,765 Eron investors. In addition to drawing upon the information gained from these two questionnaires, the research team conducted telephone interviews with 180 individual Eron investors, and conducted face-to-face interviews with regulators, legal counsel, accountants, and others with expertise in securities regulation and investor fraud.

We received a total of 559 valid responses from Eron investors; a random sample of 559 investors taken from a total population of 2,800 investors in the Eron Mortgage fraud yields a margin of error of plus or minus 3.3 per cent, 19 times out of 20. We found that about 60 per cent of the Eron investors were male, and that they were older than the average Canadian investors; most were in their mid 50s or older at the time of their initial investment. The Eron investors were no better educated and no more affluent than the average British Columbian of a similar age. They were not particularly wealthy – approximately two-thirds reported total annual household incomes of less than \$75,000, and with an average age of 55, their net worth was approximately \$200,000.

The purpose of the Eron investment was, for the overwhelming majority of investors, to fund retirement. These were men and women who were approaching retirement without adequate resources, and we learned that the majority of the investors took their existing retirement funds, borrowed money, and mortgaged their homes in order to invest in Eron. Additionally, we found that those who described themselves as highly knowledgeable investors – typically affluent middle-aged men – lost more than twice as much as the other Eron investors. Finally, we learned, contrary to some assumptions about returns in Ponzi schemes, that those who invested early in Eron (between 1993 and 1995) lost about twice as much as those who invested in 1996 and 1997.

The effects of the Eron Mortgage losses were literally devastating to hundreds of the Eron investors. More than half of those who lost more than \$50,000 reported extreme or major harm to their emotional well-being, their current financial situation, and their retirement security. Between 20 and 30 per cent of these investors also reported extreme or major harm to their marital relations, friendships and physical health.

The report suggests two possibilities in the realm of regulatory reform. First, in order to protect investors in the private or so-called exempt capital market, all principals in businesses which seek to raise capital could be required to obtain a third party credit check, disclosing the relevant business backgrounds of the principals, and thereby providing some measure of protection to potential investors. Additionally, we question the logic of an exemption from the need for an offering memorandum, when that exemption is based on personal trust. One of the hallmarks of investment fraud is that it operates on the basis of exploitation of existing trust. It is not clear that there is any compelling evidence to suggest that being a family member, close friend or close business associate of the principal provides an increased protection for investors in the private markets.

Significantly, the report cites three challenges for investor education, posed specifically by the experiences of Eron Mortgage. First, it is critical that the public, our courts, and our law and policy makers understand the very considerable consequences of securities fraud. In both civil and criminal contexts the penalties imposed do not adequately reflect the harms created by such activity. The deliberateness of the conduct of the principals and the devastating consequences upon hundreds of individuals stand in stark contrast to much violent crime, criminal activity which receives considerably more attention, and attracts much more substantial penalties.

Second, this report identifies two kinds of vulnerable investors in investment frauds – pre-retirement investors, approaching retirement without adequate resources, and desperate to find a way to maintain a dignified lifestyle beyond their working years. As the baby boomers approach retirement in the coming decade, investor education for these individuals will become a more pressing problem. The other type of vulnerable investor is the affluent middle-aged male, assumed to be highly knowledgeable about investments; a carefully focussed and creative set of approaches to investor education will be necessary to reach this individual.

Finally, we learned that the Eron investors did not know that the B.C. Securities Commission has no legal responsibility to check the qualifications of investment principals, to disclose who is under investigation, to evaluate the risk of investments, or to recover investors' money. There is a clear and pressing need to make clear to investors in the private capital markets that they are essentially on their own: the principle of caveat emptor is paramount. The best protection for an investor is that his or her decision to invest take place with skepticism, and with a clear understanding of the risks of the private market. It is the well-informed and skeptical investor who will ultimately be least likely to be victimized by the fraudulent dishonesty of men like Brian Slobogian and Frank Biller.

FINAL REPORT

Eron Mortgage Study

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My wife and I were really good about that...we went to the Better Business Bureau and they all said...that's a good company. We checked with the lawyer, and he said everything looks okay. So we went to one of those speeches, and I said, well let's try one project, and it paid off for about 4 months, and more and more....That's how they get you – they draw you right in. It's the biggest con you ever saw. — AN ERON INVESTOR

In the summer of 1920 Charles Ponzi was the talk of Boston. His seven month old business, The Security Exchange Company, was taking in more than a million dollars a week from investors. He had guaranteed them 50 per cent interest on their principal in 45 days – an astonishing rate of return. The mechanism for generating this wealth was an international reply postal coupon, a device for facilitating international business. Ponzi told his prospective purchasers that he could buy a postal coupon in Spain for about one cent and when he cashed it in America, he could buy six one cent stamps. His plan was to convert on a grand scale – buy millions of dollars of coupons in foreign countries and convert them into five and ten times their value in America. It was all legal – and lauded by some commentators as a brilliant plan.

The scheme appeared to work. Early investors did see 50 per cent returns on their money and, as a consequence, investments grew exponentially through the spring and summer of 1920. But Ponzi was simply using the money from new investors to enrich himself and pay off earlier obligations; he had created a new variation on the longstanding pyramid deception – a variation that is now termed a “ponzi” scheme. The Boston Post questioned the legitimacy of Ponzi’s approach in July of 1920: Who, after all, would buy the millions of dollars of stamps that Ponzi was said to be collecting? In response to increasing media criticism, Ponzi allowed an auditor to examine his books, and his abrupt decline began. The newspaper learned that Ponzi had previous convictions for forgery and smuggling and had spent time in prison in both Canada and the United States; his books quickly revealed his latest deception. He was convicted of fraud, and sent to jail for 14 years, leaving thousands of Americans in financial ruin.¹

Eron Mortgage is a contemporary, albeit more sophisticated, version of Charles Ponzi’s scheme. Like the postal reply coupon, the high returns on investments promoted by Eron Mortgage – real estate developments in Canada and the United States – seemed plausible to investors at the time. Like Charles Ponzi, the principals of Eron Mortgage did not actually carry out the plans that they enthusiastically described to their willing contributors, though their businesses

¹ Mitchell Zuckoff, *Ponzi: The Man and his Legendary Scheme*, Boston, Random House, 2005.

were widely praised by many media commentators. And in both cases, after questions were raised about their businesses, their books were examined and their frauds discovered. But for both Ponzi's investors and the investors of Eron Mortgage, it was too late; the businesses had crashed, their money was gone, and little could be done to retrieve it.

THE ERON MORTGAGE STUDY: OVERVIEW

This is the first detailed empirical study of a single investment fraud. The study has had three key components: 1) two systematic surveys of a total of 2,285 individuals known to have invested in various Eron properties and corporations between 1993 and 1997; 2) thorough interviews with a sample of 180 of these investors; and 3) an examination of what can be learned from the fraud itself, revealed through the records of the fraud, interviews with key investors, and with experts in the realms of

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regulatory law, accounting, and investment fraud. The purpose of the study is to use these three sources of information to help us understand how the Eron fraud was perpetrated. We are following two lines of inquiry: How can we help investors to protect themselves through the delivery of better investor education? And what steps might regulators take to increase investor protection?

More specifically, through careful analysis of the data, we will put forward suggestions that we hope will diminish the likelihood that Ponzi schemes such as Eron Mortgage will find favour in the capital markets.

METHODOLOGY

We have conducted a through empirical documentation of the Eron Mortgage fraud. This is a unique kind of study, one that has, to date, not appeared in the relevant research literature. Most accounts of investment fraud have instead relied on the anecdotal evidence of a few key participants and stakeholders, and not on a detailed statistical analysis of the how and why: the process through which victims become prey to the dishonesty of the perpetrators.

The study involved the following steps:

- A review of the relevant research literature regarding investment fraud
- A review of the decisions of the B.C. Securities Commission in Eron Mortgage et al., most notably the findings of November 26, 1999 and the decision of February 16, 2000
- Focus groups with Eron investors who have substantial knowledge of the fraud
- Design of a survey questionnaire for the Eron investors, developing a profile of age, education, gender, income, net worth, process of involvement, extent of loss, and perceptions of responsibility and possibilities for prevention
- Pilot testing of the survey, mailed to 520 randomly selected Eron investors
- Pilot testing of telephone interviews with 30 randomly selected Eron investors
- Interim data analysis of survey responses and interviews
- Presentation of an Interim Report, discussing preliminary findings
- Refinement of the survey design and mail-out to the remaining 1,765 Eron investors
- Data entry and analysis of survey responses
- Refinement of interview techniques and completion of an additional 150 interviews
- Detailed interviews with Eron investors and brokers
- Detailed interviews with regulators, legal counsel, accountants and others with expertise in securities regulation and investment fraud
- Completion and presentation of a Final Report (this document)

Review of Research Literature and Eron Mortgage Decisions

At the outset of this study, we conducted a thorough review of existing literature in the field of investment fraud, with a particular emphasis placed on the victimology of such frauds. We also were given access to all of the publicly available documentation held by the Commission in relation to Eron Mortgage; we canvassed these materials, paying particular attention to the findings of the Commission in relation to the Eron Mortgage fraud.

Our review of the existing research literature revealed that there has been no similar systematic analysis of an investment fraud; our study represents an entirely novel approach to understanding the dynamics of victimization. What the existing research literature does tell us is that frauds are most likely to be successful if the victim knows or knew of the offender, and if the initial contact was in person, through a third party, or through television or the media (as opposed

to by telephone or mail).² Further, we have evidence that the harms produced by investment fraud may parallel the harms produced by violent victimization. Ganzini et al. surveyed 77 victims of three different Ponzi schemes in Oregon and found significantly higher levels of depression, suicidal ideation and generalized anxiety disorder among the victims, relative to a matched control group.³

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Research also tells us that while investment frauds are much less common than many other kinds of fraud (automobile repair, “free” prizes, charity subscriptions and credit card/identity theft), they are correlated with the most significant financial losses. More specifically, Titus et al. report that the mean loss from investment fraud is five times greater than the loss from any other kind of fraud.⁴

Finally, we know that individuals who are susceptible to fraudulent investments often have less knowledge of investments, less experience in investing and an inclination towards risk-taking.⁵ But the literature also points to “mid-career higher income men with very busy lifestyles and some propensity to take risk” as particularly vulnerable to securities fraud – individuals who do not appear to fall under the category of those with little experience in or knowledge of investing.

Focus Groups

Our initial task was to find individual investors with substantial knowledge of the Eron fraud. Through a variety of means – discussion with Commission staff, with members of the Eron Mortgage Lenders Committee, and with legal counsel for the Eron Committee – we assembled two focus groups in October. These two groups of about 10 individuals each met on two evenings. The discussion was transcribed and formed a starting point for the construction of a survey questionnaire.

Survey Design

Based on data gathered to date, and transcriptions and analysis of the focus groups, the research team worked through November and into December to design the pilot survey. McAllister

² Richard Titus, Fred Heinzelmann and John Boyle, *Victimization of Persons by Fraud*, 41(1) *Crime and Delinquency* 54-72, 1995.

³ Linda Ganzini, Bentson McFarland and Joseph Bloom, *Victims of Fraud: Comparing Victims of White Collar and Violent Crime*, 18 (1) *Bulletin of the American Academy of Psychiatry and the Law* 55-63, 1990.

⁴ Titus, R., and A. Gover, *Personal Fraud: The Victims and the Scams*. In G. Farrell and K. Pease (eds.), *Repeat Victimization, Crime Prevention Studies*, Vol. 12. Monsey, N.Y.: Criminal Justice Press, 2001.

⁵ Kroll Associates, *Assessing Vulnerability to Investment Fraud Among Youth*, Ontario Securities Commission, April, 2001.

Opinion Research, specialists in survey design and analysis, ensured that the questions could be appropriately coded and that the data could be usefully analyzed within a reasonable time frame.

Pilot and Final Phase Survey Methods: Specifics

The pilot survey (Appendix A: Eron Mortgage Survey Pilot) was mailed to 520 Eron investors, randomly selected from a list of approximately 2,800 names in December of 2004; this list of 2,800 names was obtained from the Eron Lenders Committee and the Commission. The database was analyzed to remove duplicate names, incomplete addresses and corporate addresses which did not refer to an identifiable individual. After our analysis we were left with 2,285 unique names and addresses for the Eron investors. Our final survey of the Eron investors took place between February 4th and March 10th, 2005; we mailed out 1,765 surveys during this period of time (Appendix B: Eron Mortgage Survey, Phase 2).

In late January and early February of 2005 we met to make changes to the survey used in the Interim Report. We had two objectives: we wanted to retain as many useful questions as possible, in order to permit the construction of a single database for the final report, and we wanted to gather new information, the need for which was prompted by some of the findings of the pilot survey. More specifically, for our final report we wanted to know more about the origins of the investments made by Eron investors: that is, what was the main source of their investments? We also wanted to improve our understanding of the specific losses suffered by investors – to be able to be more accurate in our calculations of loss. We wanted to improve our understanding of the personal consequences of their losses, and we wanted to know more about their knowledge of the legal roles and responsibilities of regulators – the current legal framework of investor protection.

We used “Voiceshot” technology prior to mailing to investors and at periodic intervals in the survey process, for both the pilot and the final surveys. Voiceshot is a sophisticated new survey tool, not yet widely used by pollsters or market researchers. It both improves survey response rates and eliminates respondents whose telephone numbers are no longer in service. The technology enabled simultaneous telephone contact of the pool of 2,285 investors, and allowed us the ability to leave a short voice message from the principal researcher for each investor. The message explained that a survey would be arriving in the mail within the next few days and that the point of the research is to try to make it less likely that future investment frauds will be successful.

Pilot and Final Phase Interview Methods: Specifics

Again, we used Voiceshot technology to contact interview subjects, randomly selecting individuals from our list of investors, and leaving a voice message that encouraged them to call us if they were interested in providing an interview about their experience in Eron Mortgage. In Phase 2 we also used direct telephone contact of investors willing to grant interviews, as Voiceshot alone could not produce sufficient responses. The telephone interviews in both the pilot and Phase 2 employed the survey as a basis for questioning, but essentially created a narrative of the individual's involvement in Eron. The interviews in Phase 2 also asked three specific questions: Was the person interviewed a “sophisticated” or “accredited investor”? If so, what was the definition of these terms? Was the person interviewed willing to testify against the principals? If so, what was the motivation? If not, what was the source of the reluctance? The interviews from the pilot and Phase 2 were then transcribed, coded and analyzed to determine consistent themes within the narratives, and consistent themes in response to these specific questions.

Interim and Final Phase Data Analysis: Approach

McAllister Opinion Research, an independent market intelligence firm, was responsible for the methodology of data design and analysis. McAllister specializes in state-of-the-art field and analytic techniques that are well-suited to the highly sensitive subject matter of this study. To ensure the integrity and validity of the data, McAllister, working with senior field researchers from Simon Fraser University, employed the following field, data, and analytical procedures for both the pilot and Phase 2.

The data were entered twice by different data entry teams and then electronically cross-checked for consistency. Qualitative responses were coded thematically by content and context using N-Vivo textual analysis software. Multiple response data were coded categorically to preserve sequence of response. Computational procedures were also created to crosscheck and validate the consistency of financial and other numerical data. For example, the total amount lost by an investor (not including interest) was considered invalid if it exceeded total amount invested, and the total invested was considered invalid if it was not equal to the sum of the total lost and total recovered.

Financial data entries were checked against number of projects, income, net worth and source of funds. To preserve the integrity of the data and facilitate certain computational procedures, missing or inconsistent data for certain variables like year of birth, year of investment and investment were substituted with means, medians or probabilistic estimates. In a few intractable cases, the data were simply recoded as missing. One outlier (an individual investment of \$10 million) was excluded

from the calculation of means. New variables like age at time of investment were calculated from existing data (e.g., year of initial investment minus year of birth).

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FINAL REPORT RESULTS

This report presents data based on the results of two mail surveys of a total of 559 investors involved in the Eron Mortgage fraud, the initial pilot survey and Phase 2. The report also provides results from 180 telephone interviews conducted during both the pilot and final phases of this research project. The results of the survey are summarized in the Topline Report, Phase 2, March 2005 (Appendix C). The results of the interviews are summarized in Eron Mortgage Study, Final Thematic Analysis (Appendix D). A more comprehensive set of data tables is also provided in the Eron Mortgage Study: Final Tabular Report, March 17, 2005 (Appendix E).

Of the 2,285 surveys mailed out during Phases 1 and 2 of the study, 438 (19 per cent) had an incorrect address and were returned to us by Canada Post. As a result, 1,847 individuals received surveys, and 576 responded. Within the total of 576 returns we received responses from 7 investors who declined to participate, and 10 further responses which were either incomplete, invalid, or duplicates. As a

Our final analysis is based on 559 completed and valid surveys, a response rate of 30 per cent. A random sample of 559 respondents taken from a population of 2,800 investors in the Eron Mortgage fraud would yield a margin of error of plus or minus 3.3 per cent, 19 times out of 20.

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Can we form conclusions about the investors in Eron Mortgage on the basis of the findings from our two surveys? Or put differently, are those who responded to our surveys representative of all Eron investors? We believe that they are representative for a number of reasons. First, there is a significant depth to the range of loss among our respondents, from less than \$1,000 to more than \$1 million. The mean loss of the investor responses is very similar to the mean losses reported to date from the Eron fraud – approximately \$58,000. Further, our sample of 559 investors reveals a solid cross-section of early and late investors, both male and female, from all age and income groups and representative of a full spectrum of investment experience.

Second, a comparison of week-by-week questionnaire returns for both Phases 1 and 2 suggests that if there is any bias, it is in the direction of a slight overrepresentation of those who invested earliest (1993-95) and lost the most money. While these investors constitute the smallest portion of the responses to date, they are slightly overrepresented and were the most prompt in returning their questionnaires – suggesting that this class of investor was the most motivated to respond. Later investors (1996-97) lost less and tended to take a little longer to return their surveys, suggesting slightly less motivation to respond. We should note that hearing from slightly more of those respondents with the greatest degree of engagement with Eron – the early investors who lost the most – is probably an asset in this type of study. This class of investor typically has the most in-depth knowledge of the subject at hand. Regardless, however, the overall composition of respondents in the study is consistent with known characteristics of the Eron investor population.

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Demographic Portrait of the Eron Investors

Age and Gender

Our data provide, for the first time, a demographic portrait of who the Eron investors were. The data indicate that most Eron investors were male (about 61 per cent) and working at the time of their investment. Only about one in every five of the investors was retired at the time of first investment. The age profile of Eron investors appears to differ quite dramatically from the age profile of the typical Canadian investor, as described by an Angus Reid survey in 1999.

The average age of the Eron investors at the time of first investment was approximately 55. The chart below shows that 64 per cent of the 559 Eron investors were over the age of 45 when they made their first investment in the fraud. In contrast, only 47 per cent of typical Canadian investors are over the age of 45.⁶ These findings have relevance to the current impact of Eron on the lives of those who invested. In 2005, 88 per cent of the Eron investors are now over the age of 45, in contrast, again, to 47 per cent of typical Canadian investors.

AGE OF INVESTORS				
Eron Investor Age	Time of Investment (1993-97)	Time of Collapse (1997)	Current Age (2005)	Typical Canadian Investor*
Under 45	25	24	10	52
45-54	25	28	18	17
55-64	25	28	31	15
65+	14	18	39	15
DK/NA	11	2	2	1

* These figures are taken from a 1999 Angus Reid survey of Canadian investors and refer to the typical Canadian investor at the time of the Eron collapse.

NOTE: Figures in all tables and charts are percentages, unless otherwise indicated.

⁶ These figures are taken from a 1999 Angus Reid Survey of 1,500 Canadian investors.

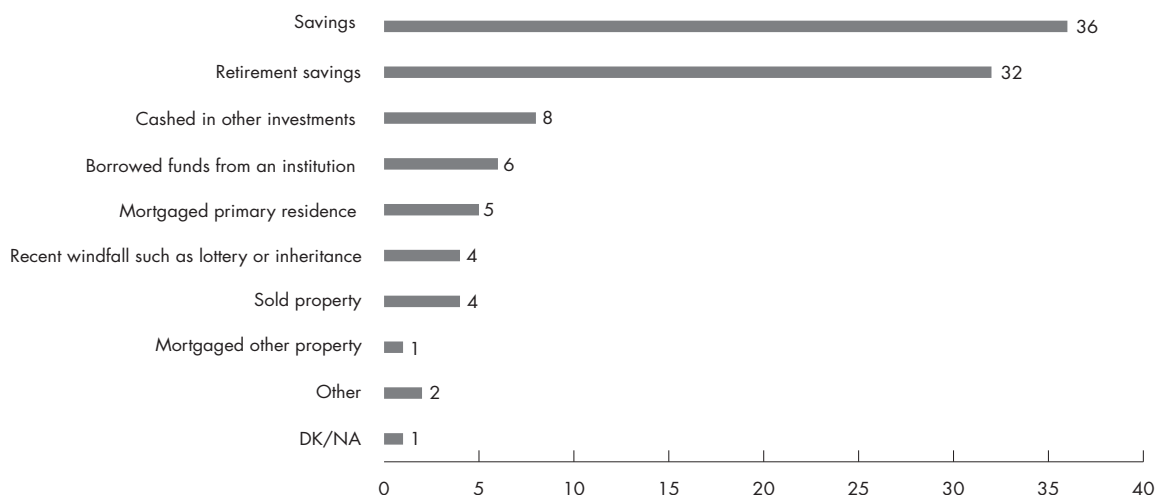
Purpose of the Eron Investment

It is very significant that a majority of the Eron investors committed themselves to these fraudulent real estate projects at a time in their lives when they needed to build retirement income. We know this from their responses to the question of why they invested in Eron in the first place. As can be seen from the table below, extracted from Phase 2 data, the overwhelming majority of investors became involved in Eron primarily to fund their future retirement; only 19 per cent said that they were investing to enhance their current lifestyle.

WHAT WAS THE MAIN PURPOSE OF YOUR ERON INVESTMENT? Check only one.

Fund future retirement	58
Enhance current lifestyle	19
Income for basic needs	12
For children/grandchildren	3
Extra income	3
Diversify investment portfolio	2
Higher rate of return than other investment	1
Other	1
DK/NA	1

We also found that Eron investors not only dipped into their existing retirement savings to fund their Eron investments; they also mortgaged their own homes, borrowed money from financial institutions and mortgaged other property in order to invest. When we asked investors in Phase 2, “What was the main source of money you put into Eron?” we found that only 36 per cent used their savings to fund their investments. The majority took money from their retirement savings accounts, cashed in other investments, mortgaged their homes, borrowed funds, or sold property. When we combine the chart below with the finding that Eron investors were largely investing for retirement, we can see that a significant number of the investors jeopardized their financial security because of their apparent concerns for their financial futures.

SOURCE OF ERON INVESTMENTS *Check only one.**Education and Income*

The Eron investors were no better educated and no more affluent than the average British Columbian of a similar age. About one in every three of the Eron investors indicated that they had graduated from university, and a further one in three had some college or post-secondary training. The remaining third of investors were high school graduates or did not complete secondary education. This profile closely resembles the profile of British Columbians aged 35 or older.

This was also not a particularly wealthy group of investors. At the time of their investment, approximately two-thirds had total annual household incomes of less than \$75,000; only 12 per cent reported annual household incomes of more than \$100,000 – no different from the typical Canadian investor.

Approximately 60 per cent of these investors had a household net worth of less than \$250,000; a little more than 30 percent reported a net worth of more than \$250,000. When compared with the typical Canadian investor, Eron investors appear, at first glance, to be three times as likely to have a household net worth of over \$250,000. But when we cross-tabulate the data with the variable of age we find that the Eron investors are very similar to the average British Columbian with a median age of 55: they have a net worth of a little less than \$200,000, excluding principal residence.⁷ The universe of all investors is typically skewed in the direction of youth; the universe of more affluent investors is typically skewed in the direction of age. The younger investor has simply had less time to accumulate assets.⁸

⁷ R. Sauve, *People Patterns Consulting, The Dreams and the Reality: Assets, Debts and Net Worth of Canadian Households*, Ottawa, Vanier Institute for the Family, 2002.

⁸ One in two typical Canadian investors is under the age of 45, compared to just one in five Eron investors.

ANNUAL HOUSEHOLD INCOME	Eron Investors	Typical Canadian Investors
Under \$25,000	10	10
\$25,000 to just under \$50,000	27	30
\$50,000 to just under \$75,000	27	25
\$75,000 to just under \$100,000	16	13
\$100,000 to just under \$150,000	8	9
\$150,000 to just under \$200,000	2	2
\$200,000 and over	2	2
DK/NA	7	9

HOUSEHOLD NET WORTH (Excluding principal residence)	Eron Investors	Typical Canadian Investors
Under \$25,000	6	28
\$25,000 to just under \$50,000	10	18
\$50,000 to just under \$100,000	19	15
\$100,000 to just under \$150,000	8	9
\$150,000 to just under \$250,000	17	8
\$250,000 and over	32	10
DK/NA	8	12

Summary

The demographic portrait that emerges of the Eron investors is one of quite average men and women who were closer than most investors are to retirement. They earned no more than the average British Columbian of any age and had no more wealth than did those of a comparable age; they were, overwhelmingly, using Eron as a means to provide for their retirement.

The Investing Behaviours of Eron Investors: A Self-Profile

Most Eron investors described themselves as somewhat conservative investors prior to Eron, although this description was much more likely to be preferred by women than it was by men. A little more than 60 per cent of the women who invested described themselves as very conservative or somewhat conservative in their approach, in contrast to 41 per cent of the male investors. Similarly, 35 per cent of the Eron men described their investment style as somewhat or very aggressive, in contrast to 22 per cent of the Eron women.

INVESTMENT APPROACH	Total	Eron Investors		Typical Canadian Investors
		Male	Female	
Conservative – Combined Total	48*	41	61	35
Very conservative	33	27	42	24
Somewhat conservative	16	14	19	11
Moderate	20	23	15	24
Somewhat aggressive	16	18	12	14
Very aggressive	14	17	10	27
Aggressive – Combined Total	30	35	22	41
DK/NA	2	2	2	–

* Some totals reflect addition of decimals.

Only 22 per cent of the investors agreed with the proposition that they were “very knowledgeable of the securities market and mortgage investments” at the time of their investment. At the same time, almost 30 per cent said that they were, and are, comfortable with making all their own investment decisions. There is a slight disconnect here; while 22 per cent claim to be very knowledgeable, almost 30 per cent make all their own investment decisions. The Angus Reid survey of 1,500 Canadian investors, cited above, found that only 17 per cent of this larger group is comfortable with making all their own investment decisions.

INVESTMENT DECISION	Eron Investors	Typical Canadian Investors
Make all my own decisions	28	17
Consider advice of financial advisor	44	56
Rely on my financial advisor	26	26
DK/NA	2	1

When asked if they qualified as a “sophisticated” investor, 17 per cent said that they did, 58 per cent said that they did not, and 25 per cent indicated that they were not familiar with the term. Sophisticated investors, as defined by provincial securities legislation, must have at least \$1 million in financial assets, independent of real estate, or an annual individual income of at least \$200,000.

We were able to cross-reference the responses of Eron investors to this question – to link their identification of themselves as “sophisticated” with their reported incomes and net worth. We found significant contradictions: 18 per cent of those with a family income of less than \$30,000 described themselves as sophisticated investors, as did 18 per cent of those with a net worth between \$100,000 and \$400,000. We do not know whether this represents an attempt by a minority of investors to appear more knowledgeable than they are, a fundamental

misunderstanding by this minority of the meaning of the term, or both. Our telephone interviews suggest that it is likely that both factors are at work. In our Phase 2 interviews 18 per cent of respondents identified themselves as sophisticated investors. However, when the meaning of the term was then explained to them, not a single investor saw themselves as meeting the relevant criteria.

Investors' Perceptions of Risk in the Eron Investment

The most seductive feature of Eron was, not surprisingly, the high guaranteed rates of return. Although a majority of the investors (62 per cent) considered Eron to be either a no risk or low risk investment, 38 per cent perceived, at the time of their investment, that it was a medium or high risk commitment. This is a very interesting finding, as it suggests that while many investors thought Eron was a no risk or low risk proposition, a significant number were aware of the level of risk at the outset. Men were more likely than women to have seen Eron as higher risk: 43 per cent of male investors said that they perceived Eron to be medium or high risk when they first put their money in, in contrast to 31 per cent of female investors.

Those with higher incomes also appeared to be more likely to have initially judged Eron to be a high or medium risk proposition. Forty-five per cent of those with household incomes of more than \$75,000 saw the investment as high or medium risk, in contrast to 30 per cent of those with household incomes of less than \$50,000.

Younger investors and better educated investors – those under 45 and those with a university degree – were also significantly more likely to have viewed Eron as a medium or high risk proposition. It was the less affluent, older and less educated investor who was most likely to have invested in Eron, with the perception that no risk was involved. Eron investors had two key reasons for thinking that Eron was a low risk proposition. First, they believed that there was security in real estate. Second, Eron's business appeared legitimate, based on, among other things, the fact that Eron had been in operation for three years with apparently stellar earnings for its clients.

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Many Eron investors did not see themselves as investors: 34 per cent thought that they were not investing, but lending money – providing a loan with a guaranteed rate of return. There were no significant age, gender or income differences in perceptions of whether Eron was a loan or investment, but those who viewed themselves as lenders lost almost twice as much

as those who viewed themselves as investors: an average of about \$76,000, in contrast to an average of \$43,000. This finding has implications for investor protection. Although such a perception might be characterized as a rationalization of loss, or an indication of a profound misunderstanding of the nature of a security in the capital market, there is also a sense in which it might be fair to accept that the Eron investors were lending money for real estate projects, within the context of a syndicated mortgage. But the language of “loan” and “investment” also raises

But the language of “loan” and “investment” also raises critical questions of risk. When individuals lend money, typically to family and friends, they do so on a very different basis than when large institutions, such as banks or credit unions, lend money. The practice of lending money for profit is not typically associated with an average person, seeking to secure income for retirement. The practice of investing money is, however, more typically associated with this average person.

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How Did Investors Become Involved In Eron?

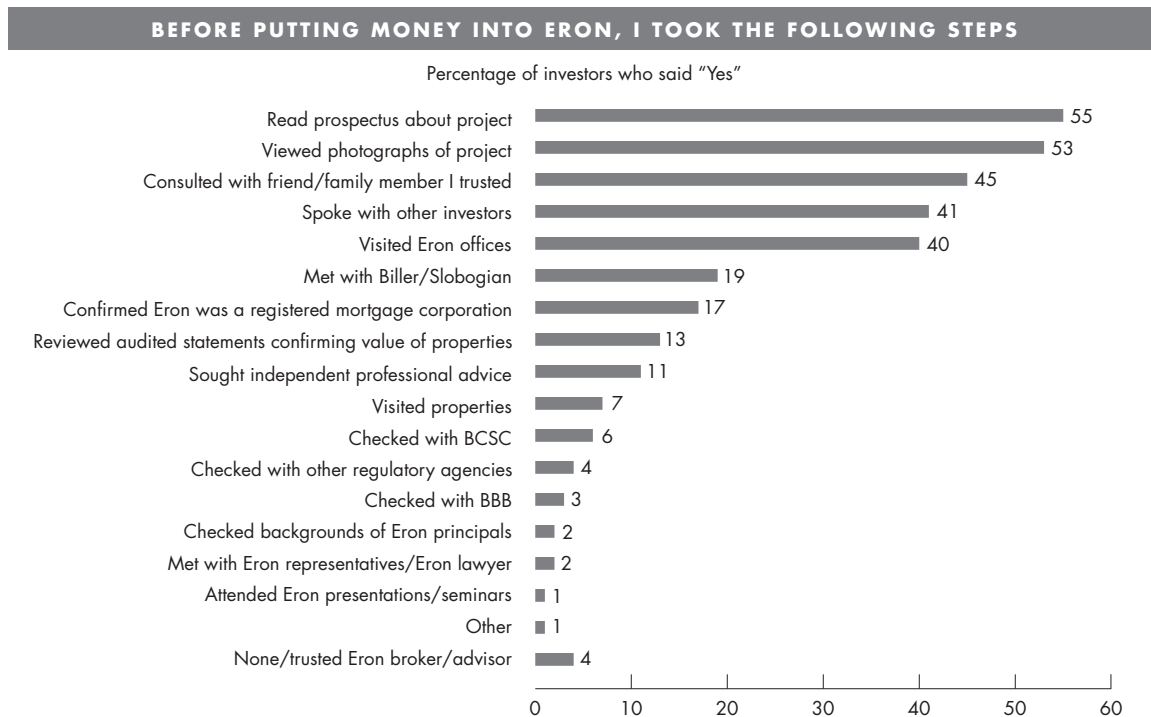
It made sense to me. Joe Blow has a piece of property but can't proceed, because of not having capital to proceed. Therefore he borrows money at higher interest until he gets the infrastructure together for this project that he's hoping to have happen. As soon as he's got something, the banks or someone else can mortgage it for him, and he would pay back the high interest loan.

A friend of a friend had told me about Eron, and at that time I was a struggling single parent, and he encouraged me and an awful lot of others to invest in this... so I invested all the savings I had – about \$14,000. All I remember is that I was a single parent and was struggling. I know that to some people the \$14,000 wasn't much, but it was disastrous to me.

Most investors heard about Eron through family or close friends, but also important were the Eron brokers, the Eron seminars, and newspaper and television advertisements. A slim majority of investors took one of two steps before their initial investment: they read a prospectus about the property, or viewed photographs. A little more than 40 per cent either spoke with other investors or visited the Eron offices.

It is critical to look carefully at the steps that investors took. Fifty-five per cent of the investors actually read a prospectus about the property, but it is not clear whether this real estate prospectus was an honest statement. In any event, it was certainly not a prospectus for investors as defined by the *Securities Act*; such a document would have set out detailed financial information regarding the circumstances underlying the investment. There is no evidence that Eron Mortgage ever filed a prospectus of this kind with the Securities Commission.

It is also not clear that the other steps taken by 25 per cent or more of the investors – speaking to other investors, viewing photographs, consulting with family members, or visiting the Eron offices and its principals – could have been useful steps, in part because Eron was a fraudulent enterprise, and in part because these steps may not have significant value in and of themselves. It is a concern that only 13 per cent of the investors reviewed audited statements confirming the value of the properties, only 11 per cent sought independent professional advice, only 7 per cent visited the properties, and only 6 per cent checked with regulatory agencies. All of these are potentially more meaningful endeavours, but the specifics of the Eron fraud also call into question how useful these steps actually were, or could have been. In retrospect, both visiting the properties to ascertain progress and seeking specifically focussed independent professional advice could have been useful strategies. We will say more about this issue in the commentary that concludes this report.



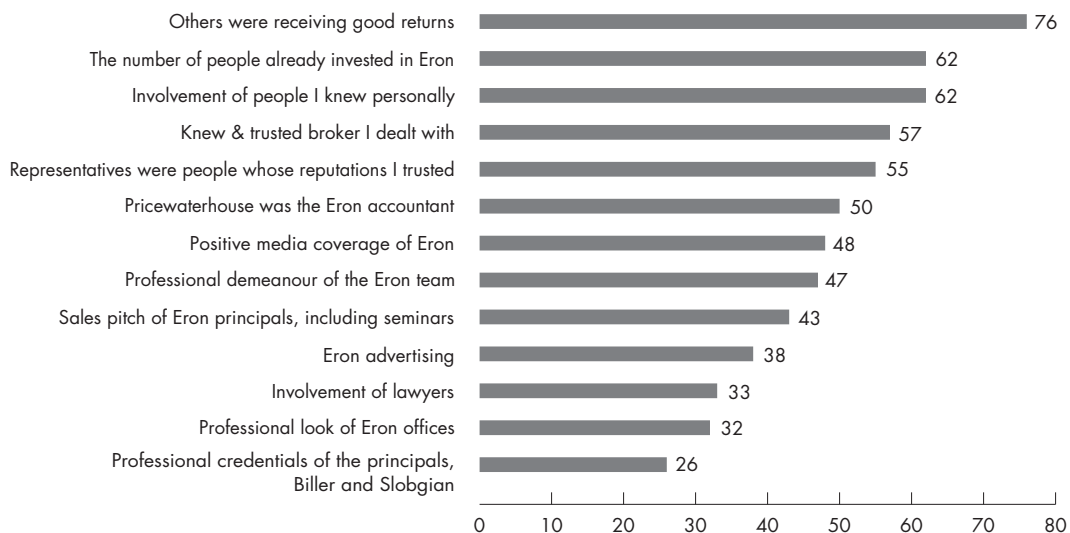
The chart that follows indicates how investors determined whether Eron was a legitimate business. Investors indicated that the key factors behind their investment were, in descending

order of importance: the fact that others were receiving good returns, the number of people already invested, and the involvement of family and close friends – people they knew personally. The investors did not view the professional credentials of the two principals, Biller and Slobogian, as critical issues.

It is understandable that investors became involved in Eron because of their personal connections, because of relationships of trust, and because of the apparent track record of Eron Mortgage, but their perceptions of the relative lack of importance of the credentials of the principals is an important finding. We know that both Biller and Slobogian had been bankrupt prior to this venture, and had a trail of failed businesses; a greater knowledge of the principals might have dissuaded many from investing. This finding points to two possibilities: a need for investors to try to find out more about the principals in private market investments, and a need for the market itself to provide more information about the financial backgrounds of these principals. This is an issue that will be explored in the concluding commentary of this report.

PERCEPTION OF ERON AS A LEGITIMATE BUSINESS

Percentage who said this was "Most Important" or "Very Important"

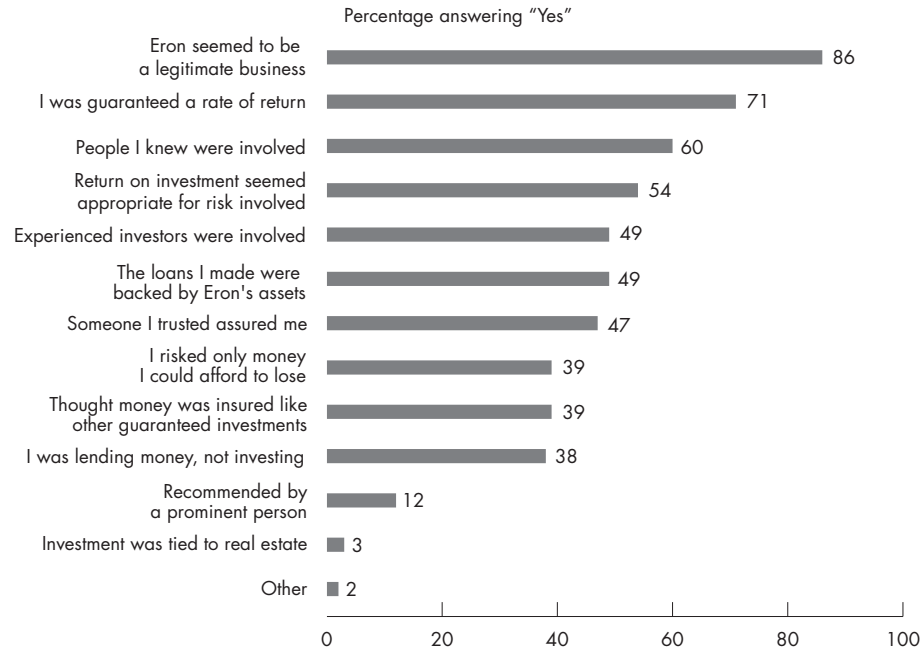


When investors were asked why they thought that the projects in the Eron portfolio represented a reasonable risk, they cited their perception that Eron appeared to be a legitimate business, their guaranteed rate of return, the involvement of friends, associates and experienced investors, and the fact that Eron's loans were backed by assets in the form of real estate.

What is striking about the responses to this question is that investors' perceptions of risk were based on the fact that people they knew and trusted were involved. Bonds of family, friendship, and trusted business commitments were central devices in the expansion of this fraud.

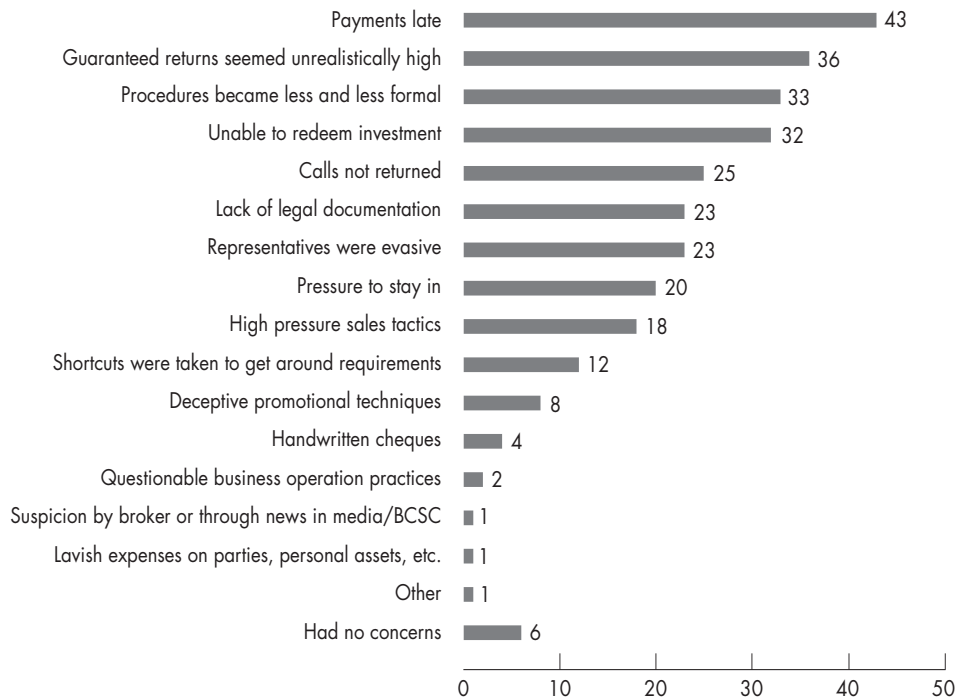
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REASONS THAT INVESTMENT IN ERON APPEARED TO BE A REASONABLE RISK



When asked to point to red flags – issues that could be seen as causing concerns about the Eron investment – the investors pointed to a range of possibilities, with late payments, guaranteed returns, informal procedures, and an inability to redeem their investments as the most critical issues.

ISSUES THAT CAUSED CONCERN DURING INVOLVEMENT WITH ERON



Financial Losses

You know we lost \$250,000 in three months. That took me 40 years to make – 40 damn years of working when I could have been home with my kids. These other people who financed their houses. My husband suggested we do that, and never ever in a million years – not for anything. You always hear “all the money that’s sitting in your home, not earning anything, not doing anything”. Maybe it’s the wise thing to do, but no thank you. My kids don’t even know how much we lost. That’s their inheritance. Most of all we were embarrassed that we were taken, and I said why should we be? There were doctors, lawyers, accountants – people who were far better educated than us.

Early Investors Suffer Greater Losses: Considering the Dynamics of the Eron Ponzi Scheme

The typical perception of a pyramid or Ponzi scheme assumes that early investors enter the marketplace, take their profits and get out, leaving the large majority of later investors with worthless investments. The website of the B.C. Securities Commission notes of Ponzi or pyramid schemes, “these swindles promise high returns, but each participant is encouraged to bring in new investors. The only people who make money are the people who started them. Money from previous investors is used to pay new investors.” While this is an accurate statement, Eron Mortgage has an empirical dimension of loss that has not been explored.

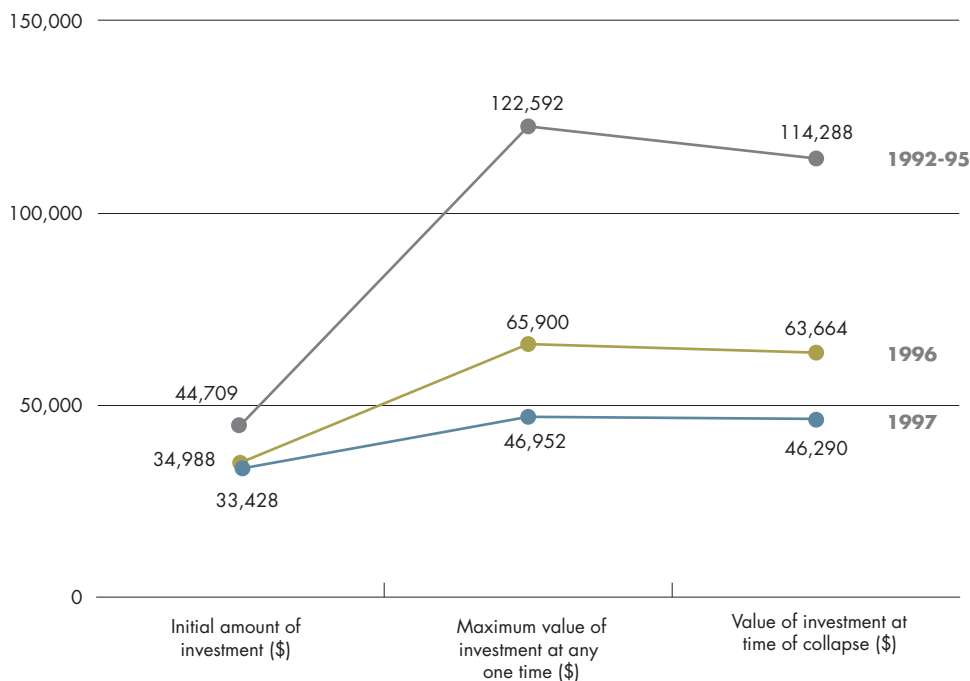
As is the case with most Ponzi schemes, the majority of investors in Eron were late investors; they committed their funds not long before the scheme collapsed. While Eron operated for almost five years, over two-thirds of Eron investors became involved in the year before the collapse, in either late 1996 or 1997.

However, our data tell us that the earlier the investment in Eron Mortgage, the greater the loss, a finding that may be contrary to common understanding of how Ponzi schemes operate. The chart below, “The Trajectory of Investment and Loss” makes this finding clear. We can see that the initial investment in Eron was, on average, about \$40,000, generally irrespective of the year of first investment. But those who invested early – between 1992 and 1995 – made many additional investments, averaging

But those who invested early – between 1992 and 1995 – made many additional investments, averaging more than \$120,000 in total investments. As a consequence, they lost a lot more – an average of about \$115,000, in contrast to slightly more than \$60,000 for those who invested in 1996, and less than \$50,000 for those who invested in 1997.

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THE TRAJECTORY OF INVESTMENT AND LOSS: According to Year of Initial Involvement



The key point of this finding is that the majority of investors never tried to take their money out of Eron, though about one in five did attempt to do this, almost always within three months of the collapse, because of concerns about the investment. Investors who tried to take their money out for this reason generally indicated that they did so because payments were late, there were rumours of instability, they had developed a lack of trust, and representatives were evasive. Our data indicate that only four per cent of those who invested in Eron ever tried to take their money out simply because they had met their investment goals, or because the term of their loans had expired. The initial investors had seen consistent interest payments, and in the wake of these payments they continued to invest more capital, unaware that Slobogian and Biller were simply “taking from Peter in order to pay Paul”.

Generally speaking, those with a greater net worth lost more – about three times as much – as all other investors. Those who lost more substantial amounts also tended to be older; investors under the age of 45 lost about one half of the amount lost by investors over the age of 65. This differential, and net worth differentials, may simply suggest that those who could afford to invest more capital lost more capital. Indeed our data suggest that those with less net worth lost proportionately more of their net worth than did more affluent investors. But it is also

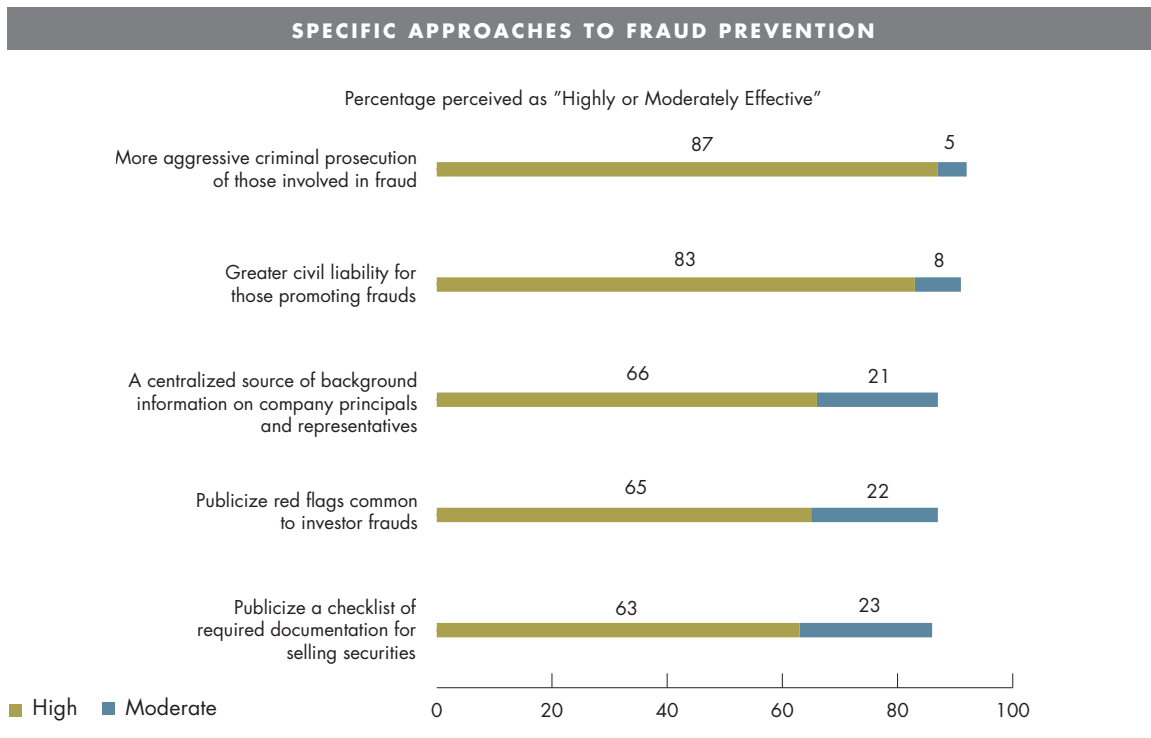
true that those who lost more, in absolute terms, suffered more significant losses, in a variety of important contexts; this finding is discussed below.

Ironically, those who described themselves as having a high degree of knowledge of the securities markets also lost about 75 per cent more than those who indicated that they had little knowledge of the markets. This finding raises important questions about the profile of the vulnerable investor in the capital markets, and about strategies that might be employed to educate the relatively affluent and apparently knowledgeable middle-aged male investor. The data do tell us, additionally, that those with a net worth of more than \$250,000 were three times more likely than all other investors to describe themselves as knowledgeable.

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Perceptions of Responsibility and Prevention:

Eron investors saw tougher penalties – both criminal and civil – as effective means of preventing investment fraud. They also cited improvements in government regulation, better access to information for investors, and more public education as effective approaches, albeit somewhat less effective than changes in criminal and civil penalties. When they were asked about specific approaches, they tended to see all possible choices as having the potential to be highly effective, albeit to varying degrees.



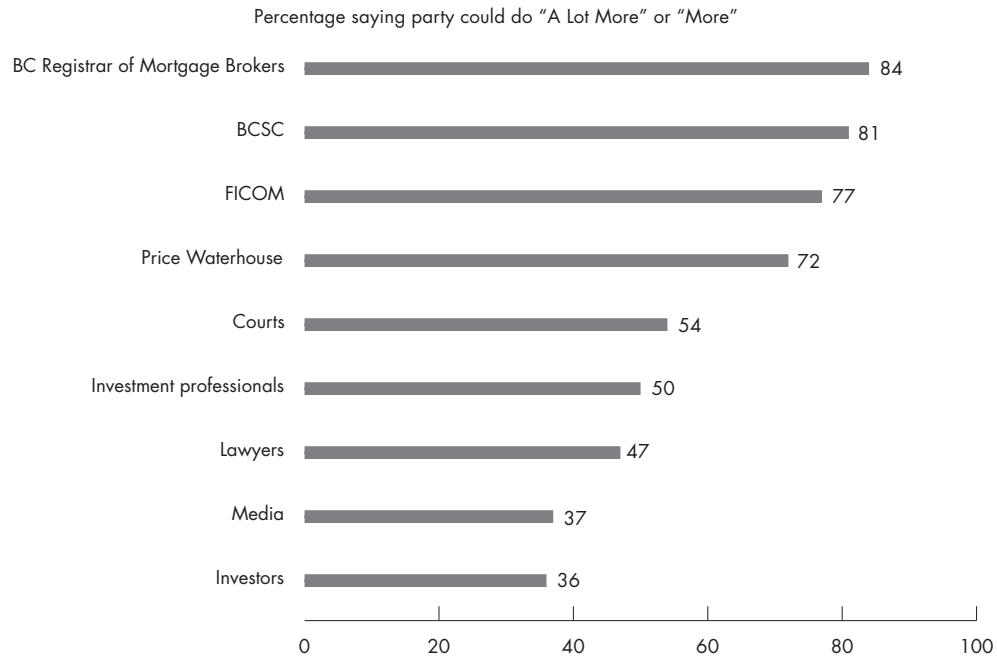
We found that only 26 per cent of Eron investors viewed the backgrounds of principals Slobogian and Biller as “important” or “very important” to their initial decision to invest – and that only two per cent actually checked on the backgrounds of these individuals. And yet more than 80 per cent now perceive that a centralized source of background information on company principals could be effective in the prevention of future investment in fraudulent schemes such as Eron. It appears that their experience with Eron has taught them of the importance of gaining more knowledge about company principals prior to investment.

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Investors placed the greatest degree of responsibility for Eron losses on government regulators, specifically the Registrar of Mortgage Brokers, the B.C. Securities Commission and the B.C. Financial Institutions Commission, and they also indicated that all of these agencies could have done much more to prevent Eron losses. More specifically, 84 per cent said that the Registrar of Mortgage Brokers could have done a lot more than they did, and 81 and 76 per cent made the same judgment about the Securities Commission and the Financial Institutions Commission respectively. At the same time, however, investors also saw themselves as having some responsibility for their losses, and the ability to do more to prevent a fraud of a similar kind. More than 35 per cent of investors indicated that they could do a lot more or more to prevent a recurrence of this loss. It should also be noted, however, that investors who lost substantially more capital were not less likely to blame themselves for their losses; 40 per cent of those who invested more than \$70,000 indicated that investors could have done more or a lot more to prevent this fraud.

Those who lost the greatest amounts in Eron were most likely to place responsibility on the regulators – 92 per cent of those who lost more than \$50,000 said that the Registrar of Mortgage Brokers could have done a lot more or more to prevent the fraud, and 89 per cent made a similar comment regarding both the Securities Commission and the Financial Institutions Commission.

PERCEIVED ROLE IN PREVENTING FRAUDS LIKE ERON IN THE FUTURE



Perceptions of the Legal Responsibilities of Regulators

These responses raise a number of important questions. Our interim data from Phase 1 prompted us to ask a series of questions of the investors during Phase 2. What assumptions do investors have about the legal mandates and responsibilities of the B.C. Securities Commission? When they say that BCSC could do “more” or “a lot more” to prevent frauds such as Eron, are they basing this assertion on informed knowledge of the legal mandates of the Commission? In our revised survey we asked the Eron investors of their knowledge of the roles and responsibilities of BCSC and other regulatory agencies. Specifically, we asked them if the regulators can (a) recover investors’ money, (b) evaluate the risk of investments, (c) disclose who is under investigation, (d) insure investments, (e) approve investment documents, (f) register individuals who sell investments, and (g) check the qualifications of investment principals. We wanted to examine the extent to which investors understand their own responsibilities – to determine the extent to which there may be misperceptions of the roles of government regulators in protecting investors within the capital markets.

The chart below sets out our findings. It is clear that there is substantial misperception of the roles of regulators within the capital markets. The Eron investors are generally not aware of the reality that no regulator has the legal responsibility to recover investors’ money, to evaluate or insure the risk of investments, to check the qualifications of investment principals, to approve

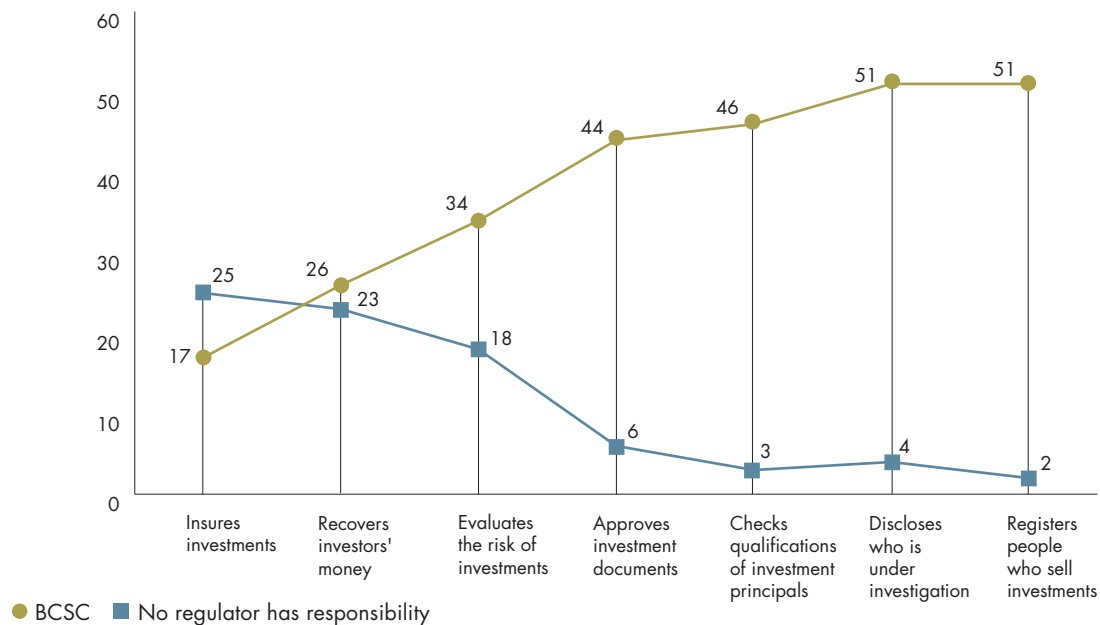
investment documents, or to disclose who is under investigation. They are typically likely to falsely attribute these responsibilities to the B.C. Securities Commission.

More specifically, only three per cent of the investors were aware that no regulator has a responsibility to check the qualifications of investment principals and only four per cent knew that no regulator has a responsibility to disclose who is under investigation. Further, only 18 per cent knew that no regulator has the responsibility to evaluate the risk of assessments, and only 23 per cent knew that no regulator has the responsibility of recovering investors' money. These findings point to a substantial challenge for investor education. It is significant that the pool of respondents for this survey is not a random sample of the general public, but more than 500 investors who have already lost substantial amounts of capital in a fraudulent securities scheme.

More specifically, only three per cent of the investors were aware that no regulator has a responsibility to check the qualifications of investment principals and only four per cent knew that no regulator has a responsibility to disclose who is under investigation. Further, only 18 per cent knew that no regulator has the responsibility to evaluate the risk of assessments, and only 23 per cent knew that no regulator has the responsibility of recovering investors' money.

PERCEPTIONS OF THE LEGAL RESPONSIBILITIES OF REGULATORS

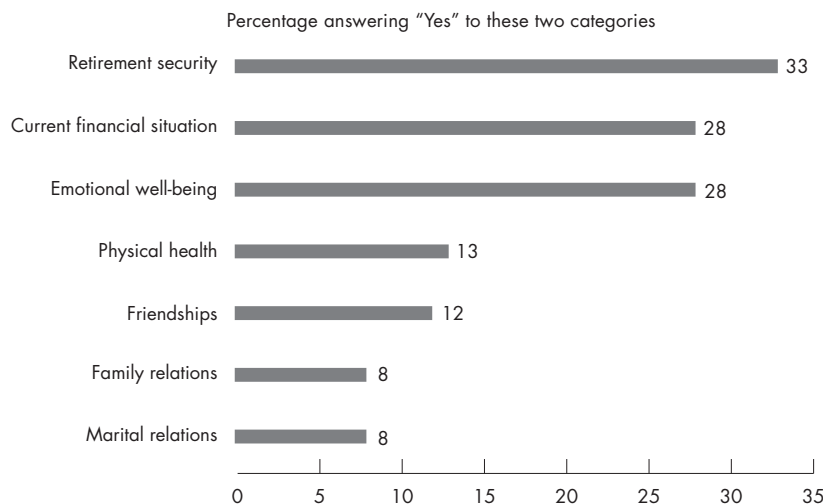
Percentage indicating that (A) the Securities Commission Has Responsibility, and (B) No Regulator Has Responsibility



Effects of Eron Mortgage: The Consequences of Securities Fraud

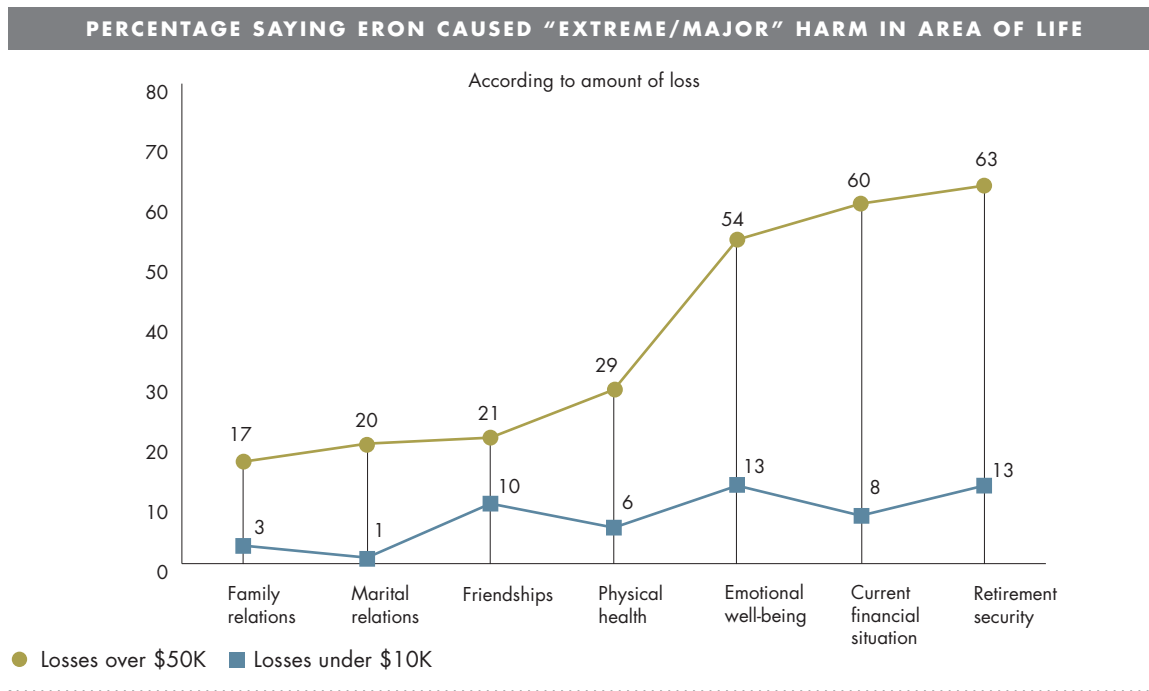
In the introduction to this report we cited evidence suggesting that the personal consequences of investment fraud parallel the consequences of victimization by violent crime. In Phase 2 of our data collection we asked the Eron investors of the personal consequences of their investment in this fraud. More specifically, we asked them of the degree of harm that Eron has caused in various areas of their lives, from extreme to major to moderate to minor, to none. Our variables of concern: retirement security, emotional well-being, current financial situation, physical health, friendships, family relations, and marital relations. The chart below sets out the results of this question.

PERCENTAGE SAYING ERON CAUSED "EXTREME/MAJOR" HARM IN AREA OF LIFE



When we drilled further into the data we found that these consequences varied considerably with the extent of capital loss. The chart below demonstrates the considerable harm reported by investors who suffered more than \$50,000 in losses. The majority of these investors – who we estimate to represent approximately 25 per cent of all Eron investors – report extreme or major harm to their emotional well-being, their current financial situation and their retirement security. Further, almost 30 per cent of this group report extreme or major harm to physical health, and 20 per cent report extreme or major harm to friendships and marital relations. These findings raise important questions about the extent to which both current criminal and civil penalties for investment fraud adequately reflect the harms imposed by this conduct.

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CONCLUSION

Education and Regulation: The Essentials of Investor Protection

In the quotation that opens this report, an Eron investor speaks of the steps that he took prior to investment: consulting the Better Business Bureau, seeking legal advice, and attending an Eron seminar. The investor believed that he exercised some degree of due diligence, but his actions did not protect him from becoming a victim of this fraud.

At the time of his investment all that he could see of Eron was that the company was making regular interest payments to its investors, and that it was in the process of developing a substantial number of real estate projects. Further, Eron purported to be *guaranteeing* interest rates that were typically better than the average returns in the equity markets, and two or three times better than returns from the guaranteed income certificates offered by established banks and credit unions.

But Eron was not in a position to guarantee any kind of return; its claim was fundamentally false. An investment in Eron was an investment in a speculative real estate venture, entirely

different from an investment in the kind of guaranteed income certificate offered by banks and credit unions. Secondly, it was a mistake for investors to have thought that their investment was more secure because they were lending money. They were not lending money; they were investing. Banks, credit unions, and other large financial institutions lend money; individuals are typically borrowers. And mortgage brokers – the individuals who were asking them to make these so called “loans” – usually work with individual borrowers to secure the most attractive mortgage rate possible. This reversal of the usual role of the mortgage broker should have been a red flag for investors; loans are made either by friends, or, as a calculated risk, by institutions with considerable assets. The Eron investors could only have appropriately seen themselves as lenders if they saw their economic situations as similar to that of a large financial institution.

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Additionally, while only a few investors saw the backgrounds of the principals as critical to a decision to invest, the personal business histories of Brian Slobogian and Frank Biller were, in fact, highly relevant and, if known, that information should have signalled extreme caution. These were not men whose investment proposals could be seen as similar in kind to those offered by long-established financial institutions. And, finally, as our data have revealed, investors lacked knowledge of the regulatory framework that governed Eron Mortgage and other similar kinds of investments. They either did not know or misperceived the roles of regulators, and clearly did so to their detriment.

Eron Mortgage: The Regulatory History

Eron Mortgage came to life in the mid 1990s, at a time when annual returns in the markets for guaranteed investment certificates were in the range of 6 per cent for a one-year term. In this context, Eron’s plans to guarantee returns of 18 to 24 per cent were very much out of step.

It was also initially not clear to the public and even to some regulators whether Eron Mortgage would be regulated by the B.C. Securities Commission. From the outset, the sale of these syndicated mortgages was regulated by the B.C. Registrar of Mortgage Brokers, working under the umbrella of the Financial Institutions Commission. The Eron brokers were, therefore, not

registered as sellers of securities by the Securities Commission, but were viewed as brokers, and, therefore, regulated by the Registrar of Mortgage Brokers. The B.C. Securities Commission began to investigate Eron after concerns were raised by the Financial Institutions Commission, and after the Securities Commission, in turn, became suspicious of Eron's practices.

Eron was a private company, and as such was not required to disclose information on its operations and financial situation to regulators or to the general public. Private companies were and are, however, required to provide an offering memorandum to prospective purchasers. This memorandum must contain a detailed explanation of the business, audited financial statements, information about the risks of the investment, and an indication of how the company plans to use investors' capital. There were and are a few exceptions to the need for an offering memorandum: a sale to a close relative, a close personal friend or business acquaintance, an "accredited" or "sophisticated" investor – an individual with an annual net income of more than \$200,000, or an individual investing \$97,000 or more, provided that the investment opportunity has not been advertised.⁹

The critical exception for Eron was one that no longer exists – that of investment in a syndicated mortgage. Eron argued at its hearing that it was not required to file an offering memorandum, as the company had been asking potential investors to invest in specific mortgages. The Commission noted that there was a distinction to be made between the Eron investments that were secured by interests in mortgages on real property and the Eron investments that were secured by promissory notes. The Commission concluded, however, that irrespective of whether Eron was entitled to an exemption for mortgage investments, investments in promissory notes were clearly not exempt from the Act:

The respondents Eron Mortgage, Slobogian and Biller were all registered under the *Mortgage Brokers Act*. No evidence was produced to suggest that with respect to the mortgages the exemptions provided in section 46(e) and section 75(a) were not available to the respondents. However, we have found below that the respondents raised funds from investors for particular mortgages that exceeded the value of those mortgages. This at least raises the question of whether in those circumstances the respondents were entitled to rely on these exemptions, particularly with respect to funds raised after the amount secured by the mortgage was reached. However, this issue was also not alleged in the notice of hearing and therefore was not addressed by the parties, so we make no finding as to whether the respondents were entitled to rely on these exemptions.

With respect to the promissory notes, the Commission concluded that Eron was clearly in violation of the *Securities Act*:

⁹ British Columbia Securities Commission, *Taking Stock of Start-Ups*, Investor Alert.

...all of the notes were sold by brokers operating under the auspices of Eron Mortgage. None of these respondents has ever been registered under the Act. None of the exemptions to section 34 applies. Notes were sold to many investors in amounts less than \$97,000, so the exemption in section 45(2)(5) of the Act was not available. There is no evidence of offering memoranda having been prepared or investor acknowledgements having been signed, so the exemption in section 89(b) of the Securities Rules was not available. None of the other exemptions are applicable. We therefore find that each of these respondents traded securities without being registered, contrary to section 34 of the Act.

Eron Mortgage clearly did not follow the rules prescribed by the B.C. Securities Commission. Although one-third of those responding to our survey indicated that they had been provided with an offering memorandum, there is no evidence that Eron ever actually filed an offering memorandum with the Securities Commission.

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Finally, Form 45-901F, currently available on the B.C. Securities Commission website, indicates that an offering memorandum for syndicated mortgages must disclose whether the principals in the prospective business have been subject to bankruptcy in the five years preceding the venture. This specific requirement was not put in place by the Commission until September, 2002, in the wake of Eron. But even today this requirement would not have captured Brian Slobogian's 1985 bankruptcy; there remains no legal responsibility to disclose previous bankruptcies to prospective investors, provided that they occur more than five years before an individual seeks to raise capital in the private markets.

Possibilities for Regulatory Change

In the course of this study many investors and those with industry expertise have proposed regulatory solutions to the problems created by the Eron Mortgage fraud. The Securities Commission has, in the wake of Eron, removed any doubt about whether an Eron-style syndicated mortgage is a security; it clearly is. More specifically, such an investment no longer constitutes an exemption from the Act, and all those who would sell syndicated mortgages are now subject to the rules set out in Form 45-901F, Offering Memorandum for Syndicated Mortgages.

Additionally, in the mid 1990s systematic investor education by regulators simply did not exist in Canada. There were no significant initiatives of this kind at the B.C. Securities Commission until 1998; the first of the Commission's investor education seminars began in 1999, well after the Eron collapse. The Disciplined Persons List, a Securities Commission website compilation of the names and offences of the more than 650 individuals who have been disciplined by the BCSC since 1987, is also a post-Eron development. Further, until 2002 there was no requirement that an offering memorandum be accompanied by a "risk acknowledgement form", a form which, when signed by the investor, acknowledges risk – acknowledges an understanding that all of the capital invested could be lost.

Some have urged more ambitious changes in the wake of Eron: the creation of a legal responsibility for the Commission to disclose when individuals are under investigation, and the disclosure of the existence of complaints to the Commission, in a manner similar to the Better Business Bureau. We have considered both of these possibilities carefully and have concluded that neither is workable. The disclosure of the names of individuals or companies under investigation would unfairly jeopardize an individual or business, prior to a determination of any wrongdoing; this would also represent an unwarranted invasion of the privacy interests of the individual or business. At the point that action is warranted, the Commission will necessarily take action; whether the Commission acted as promptly as it could have in the circumstances of Eron is not a subject that has been, or could properly be considered in this report.

With respect to the issue of whether a simple disclosure of complaint could provide protection for consumers, again, there seems little evidence to support such an approach. The Better Business Bureau model only discloses the existence of complaints, and it is not clear that this information would be useful to potential investors. It may be that the larger investment companies would have more complaints, simply because of their size, and the corresponding number of investors that they deal with. Further, as one regulator noted, such a scheme could be an invitation to mischief, inviting some participants in the capital markets to take action against competitors, or to wreak havoc upon an individual or company for a variety of personal reasons. There would be no legal obstacle to such a scheme, but it is not clear that there are corresponding benefits for investor protection.

The Background of the Principals

A more intriguing suggestion for regulatory reform flows from the idea of affording better protection to those who invest in securities in private companies. Although it is anticipated that revisions to current securities law in the province of British Columbia will require the principals of companies to disclose personal bankruptcy, penalties and sanctions within the

previous 10 years, the existence of such a requirement itself might not have been sufficient to prevent Eron's entry into the capital markets. All principals in private businesses which seek to raise capital could be required to obtain a third party credit check indicating the absence of bankruptcy, or other penalties or sanctions within the previous 10 years; this third party credit check could then become a necessary part of disclosure to any investor. The third party credit check could essentially disclose the relevant business backgrounds of the principals, providing some measure of protection to potential investors.

Although it is not clear that this requirement would have protected many Eron investors, given that few requested or knew of the relevance of an offering memorandum, a third party check may have protected some investors – and knowledge of the financial histories of Biller and Slobogian may have become both more easily detected and more widely known. We must remember that the principals of private companies come to the exempt market without the need for any prior regulatory scrutiny, and ask for capital from the public. Is it not reasonable to ask that they establish – through a third party – that they are individuals who are deserving of such trust? It is important to stress that although those who raise capital in the private markets must file an offering memorandum with the Commission, there is, as a matter of law and policy, no process of review or scrutiny of this memorandum.

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Personal Trust and Investment Fraud: Rethinking the Logic of Exemptions

Finally, we want to make a few observations about the current exemptions to the requirement of an offering memorandum for private investments. These exemptions – for a close relative, a close friend, or close business acquaintance – actually worked against the interests of the Eron investors. The principal – and the mortgage brokers, whether advertently or not – were able to take advantage of friendships, relationships, and business associations. Indeed, one of the hallmarks of this investment fraud is that it operated on the basis of the exploitation of existing trust. Family and friends were encouraged to commit their retirement savings. Close friends – longtime brokers and business associates – talked of Eron as a safe investment.

It is curious, then, that exemptions to the need for an offering memorandum are based on these categories of relationship. Is there any compelling evidence that being a family member, close friend or close business associate of the principal provides an increased protection for investors in the private markets? Our point is not that Biller and Slobogian relied upon this exemption in order to perpetrate their fraud, but that the fraud itself raises the issue of personal trust and its relevance within the current regulatory regime. It seems reasonable to question the logic of the assumption that interpersonal trust warrants an exemption from regulatory provisions. Would it be more prudent to remove these exemptions – to require that all investors in private companies be provided with an offering memorandum prior to the decision to invest?

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Investor Education: The Challenges Posed by Eron Mortgage

As noted above, investor education is a relatively recent development; this is true not only within British Columbia, but within the mandate of all securities regulators within Canada. This study, as the first systematic inquiry into the characteristics of the victims of investment fraud, has revealed some key challenges for investor education.

The Harms of Securities Fraud: The Need to Increase Awareness

It is clear from this study that securities fraud produces harms that are not fundamentally different from the harms produced by violent victimization. Our data tell us that literally hundreds of the Eron investors suffered “major” or “extreme” harm to their retirement security, their emotional well-being, their physical health, their friendships and their marital relationships.

It is critical that the public, our courts and our law and policy makers understand the consequences of securities fraud. There is no doubt that these actions are difficult to prosecute in criminal courts: the burden of proof is more onerous than in the administrative context, the defendants often have substantial legal resources, and it is also extraordinarily costly and time consuming to provide evidence to establish the evil intent – the mens rea – of the crime.

But in both civil and criminal contexts it is appropriate to ask whether the current penalties adequately reflect the harms created by such activity. For example, the typical homicide involves two people who know each other well, often making tragic mistakes in desperate circumstances, fueled by alcohol and other drugs. Their crimes are appropriately punished, but the deliberateness of their conduct and its impact on the wider community is often much less significant than the actions of those who engage in investment fraud. The principals in Eron appear to have demonstrated little remorse, though the consequences of their actions were literally devastating to hundreds of investors. And yet the civil and criminal penalties imposed are, in relative terms, quite minimal.

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Eron: The Vulnerable Investor

The target of investor education is, understandably, the person who is most likely to be deceived by a fraudulent investment scheme. We have learned that in Eron this person was an average British Columbian, slightly older than most other investors, working but concerned about a rapidly approaching retirement, and about their ability to adequately fund this period of life. This is a portrait of vulnerable individuals, people who are approaching retirement with the sense or conviction that they will not have enough to provide for themselves. We must remember that a majority of these individuals took the money for Eron from their existing retirement funds, borrowed from banks and credit unions, and mortgaged their own homes. The Eron Mortgage fraud makes clear for the first time that the pre-retirement investor should be a critical target of investor education.

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We have further learned that affluent middle-aged males, assumed to be highly knowledgeable about the securities market, can also be victims of such frauds, in part because they did not exercise due diligence with respect to their investments, and in part because they wrongly relied upon family and close friends. This finding expands on data from a recent study by Kroll and Associates, cited at the outset of this report. Their suggestion that middle-aged affluent men are particularly prone to taking economic risks conforms with our finding that they are susceptible to investment fraud – and suggests that efforts should be made to reach this group. These efforts will likely require a very carefully focussed approach.

Understanding the Legal Framework of Regulation: The Road Ahead

It is clear from our study of the Eron investors that most of these individuals do not have a sound understanding of the legal framework that governs investments in private businesses – and it is within this realm that most fraudulent investments occur. Further, this lack of knowledge still exists some seven years after being significantly victimized by an investment fraud.

The overwhelming majority of the Eron investors did not know that the B.C. Securities Commission has no legal responsibility to check the qualifications of investment principals, to disclose who is under investigation, to evaluate the risk of investments, or to recover investors' money. There is a clear and pressing need to make clear to investors in the private marketplace that they are essentially on their own: the principle of caveat emptor is paramount. The Commission can provide enforcement after a fraud has taken place, but it does not have the resources for any prior scrutiny of this market. Investors cannot protect themselves if they do not understand their own obligations and the corresponding obligations of regulators.

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One regulator contrasted the decision to invest in a security with the decision to buy a new car. In the latter case we go to the car lot, we test drive the vehicle to make sure that it fits us, we consider the warranty, we know the brand name and the comparable choices within a similar realm; we even bargain over the price, and whether we will lease or purchase. We are skeptical and typically very knowledgeable purchasers. In contrast, decisions to invest often take place without a corresponding base of knowledge and, most important, without a correspondingly critical analysis. We can make improvements to regulatory law so that it better protects investors, but it will ultimately be a well-informed and skeptical investor who is least likely to be victimized by the fraudulent dishonesty of men like Brian Slobogian and Frank Biller.

