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FOUNDERS OF MCGINN, SMITH & CO., INC. INDICTED ON ADDITIONAL FRAUD CHARGES

Superseding Indictment Alleges Defendants Improperly Diverted Nearly$1 Million and Directed False Accounting Entries Regarding These Transactions

Albany, New York —United States Attorney Richard S. Hartunian, Acting Special Agent-in-Charge Toni Weirauch, Internal Revenue Service, Criminal Investigation, New York Field Office, and Clifford C. Holly, Special Agent-in-Charge, Federal Bureau of Investigation, Albany Division announced that a grand jury sitting in the Northern District of New York returned a superseding indictment today charging TIMOTHY M. McGINN, age 63, of Clifton Park, New York, and DAVID L. SMITH, age 66, of Saratoga Springs, New York, with (1) one count of conspiracy to commit mail and wire fraud; (2) nineteen counts of mail and wire fraud; (3) six counts of securities fraud; and (4) three counts each of filing a false income tax return. The superseding indictment also includes an $8 million money judgment forfeiture allegation.

The original indictment was returned on January 26, 2012, and a trial is scheduled for November 13, 2012. MCGINN and SMITH were arraigned today before the Honorable Randolph F. Treece, United States Magistrate Judge, at the Federal Courthouse in Albany. The defendants were released on conditions pending trial.

The superseding indictment contains new allegations that the defendants improperly diverted nearly $1 million; directed false accounting entries regarding those transactions in response to a document request from the broker-dealer's regulator, Financial Industry Regulatory Authority, Inc. ("FINRA"); and caused the false accounting entries to be submitted to FINRA. The newly alleged improper diversions fall into two categories: (a) the improper diversion of more than $473,000 of investor money from an escrow account to pay preferred clients who had unrelated investments (between May 15, 2008 and July 8, 2009); and (b) the improper diversion of $525,000 from bank accounts for three unrelated investments to pay the broker-dealer's employees (between November 14, 2008 and April 15, 2009). The superseding indictment also alleges that the defendants improperly used a corporation to conceal and disguise the true nature of the payroll diversions by passing the money from the three unrelated investments through that corporation and then to the broker-dealer. Finally, the superseding indictment alleges that the defendants misled FINRA about the preferred client diversions and the payroll diversions by (a) directing the creation of false accounting entries to conceal the true nature of these transactions in response to a document request from FINRA; and (b) causing the submission of these false accounting entries to FINRA. The new counts – counts 8 and 9 – charge the defendants with two additional counts of mail fraud related to the improper diversions of investor money to pay preferred clients.

The superseding indictment also contains all of the counts included in the original indictment. Count 1 charges the defendants with conspiracy to commit mail and wire fraud. The superseding indictment alleges that the purpose of the conspiracy was to mislead investors and FINRA regarding the safekeeping and use of investor money raised by 17 trusts, one corporation, and other entities; the risks of the trust offerings; the performance of the underlying income streams; the source of investor payments; and the improper diversion of investor money in order to obtain money from investors and enrich themselves. As a result of the defendant's conduct, the investors were not aware that the defendants had diverted approximately $4.1 million in connection with transactions related to the trusts for their own benefit and the benefit of another person. If the defendants are convicted of Count 1, the maximum potential penalties they face include imprisonment for 30 years, to be followed by supervised release for 5 years, and a fine of the greater of $1,000,000 or twice the gross pecuniary gain or loss.

Counts 2 through 20 charge the defendants with mail and wire fraud. The maximum potential penalty for each of Counts 2 through 20 is imprisonment for 30 years, supervised release for 5 years, and a fine of the greater of $1,000,000 or twice the gross pecuniary gain or loss. Counts 2 through 6 and 10 through 13 relate to the Firstline Series B Trusts, which raised money from investors in connection with a loan of $2.4 million to Firstline Security, Inc., a company that generated alarm contracts. The superseding indictment alleges that the defendants knew that Firstline was facing litigation with its dealer, but did not disclose that to investors, or tell them when Firstline filed for bankruptcy and defaulted on loans. Instead, the defendants directed that investors receive $2 million of lulling payments by transferring money from other entities controlled by McGinn and Smith, and their firm sold approximately $600,000 of one of the Firstline investments without any disclosure of the bankruptcy or defaults.

Counts 7 and 14 relate to the Integrated Excellence Trusts, for which the defendants raised about $1.2 million from investors in connection with a loan to benefit Integrated Excellence, Inc., which generated alarm contracts. The superseding indictment alleges that the defendant knew that the payments received from the loan were not sufficient to pay investors, but they directed that investors receive lulling payments by transferring money from other entities controlled by McGinn and Smith.

Counts 15 through 18 and 20 are wire fraud charges related to the misuse of investor money held in escrow accounts. Counts 15 and 16 involve the diversion of approximately $142,000 of investor money from an escrow account to make payments to investors in other trusts. Counts 17, 18, and 20 involve approximately $115,000 that McGinn and Smith took directly from escrow accounts holding investor funds. These transactions violated their duties as officers and owners of the company acting as the trustee for the Trusts, and they failed to disclose these transactions to investors.

Count 19 is a wire fraud charge related to approximately $230,000 McGinn took from McGinn Smith Transaction Funding Corp. between August 22, 2008 and July 8, 2009. McGinn repaid $100,000 of the money. When Smith discovered that McGinn had taken this money, he directed that a false accounting entry be made to conceal it.

Counts 21 through 26 relate to the failure to disclose improperly diverted fees to investors in violation of federal securities laws. Counts 21 and 22 relate to $100,000 in fees paid in connection with TDM Verifier Trust 08, and counts 23 through 26 relate to approximately $855,000 in fees paid in connection with Fortress Trust 08. All of these transaction fees were paid with investor money. The maximum potential penalty for each of Counts 21 through 26 is imprisonment for 20 years, supervised release for 3 years, and a fine of $5,000,000.

Counts 27 through 32 are tax charges arising from the failure of McGinn and Smith to declare the improperly diverted money on their personal tax returns for 2006 through 2008. McGinn and Smith later described the money as "loans," but did not list them as such on personal financial statements. When FINRA discovered the false loan accounting entries for the diverted money, the defendants misled FINRA by directing the creation of backdated promissory notes. The maximum potential penalty for each of Counts 27 through 32 is imprisonment for 3 years, supervised release for 1 year, and a fine of $100,000.

This case is being investigated by the Internal Revenue Service, Criminal Investigation and the Federal Bureau of Investigation. This case is being prosecuted by Assistant United States Attorneys Elizabeth C. Coombe and Richard D. Belliss.

The charges are merely accusations and the defendants are presumed innocent until and unless proven guilty.

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