

## THE DEPARTMENT OF BUSINESS REGULATION IDENTIFIES TOP INVESTOR TRAPS

August 5, 2010 – The Department today released its annual list of traps that cautious investors should avoid when seeking to jump-start their investment portfolios as the impact of the financial crisis and increased market volatility continues to reverberate along Main Street.

Deputy Director Maria D'Alessandro said investors rebuilding nest eggs damaged by the market collapse as well as those frustrated with low interest rates, are particularly susceptible to speculative investments that most often turn a promise for profit into thin air.

“Knowledge, attention to detail and a healthy sense of skepticism are a triple threat to fight investment fraud,” D'Alessandro said. “State securities regulators provide detailed background information about those who sell securities or give investment advice, as well as about the products being offered. The more you are prepared, the better your chance of sidestepping a trap that can leave you in a financial hole for many years.”

### Top 10 Investor Traps

The following products and practices deserve special scrutiny:

#### Products

- **Exchange-Traded Funds (ETFs).** While ETFs resemble mutual funds in many respects, some, such as leveraged and inverse ETFs, may contain hidden traps and complexities, and may consist of highly leveraged bundles of exotic financial instruments, including options and other derivatives. Given their potential for volatility, leveraged ETFs may not be suitable for most retail investors. These types of ETFs are primarily designed for short-term trading (such as day-trading), and not for buy-and-hold strategies. Also be aware that some ETFs are thinly traded and may not always be liquid.
- **Foreign Exchange Trading Schemes.** Currency trading and foreign exchange (forex) trading schemes can be particularly harmful to unsuspecting investors. Trading in foreign currencies requires resources far beyond the capacity of most individual investors. Promoters profit by charging high commissions or selling investment strategies assuming that trades are actually made. In some instances, salespeople and promoters who claim to have complex algorithms or propriety software programs which allow them to beat the market are actually just running Ponzi schemes. Too often, state regulators have encountered situations where there are no trades; the money is simply stolen.
- **Gold and Precious Metals.** High gold prices have trapped some investors in gold bullion scams in which a seller offers to retain “purchased” gold in a “secure vault” and promises to sell the gold for the investor when it gains in value. In many instances the gold does not exist. Investors have also been harmed by promoters pitching investment pools in precious metal commodities and gold mines.
- **Green Schemes.** Investment opportunities tied to the development of new energy-efficient “green” technologies are increasingly popular with investors and scammers alike. Scammers also exploit headlines to cash in on unsuspecting investors, whether from investments related to the clean-up of the Gulf of Mexico oil spill or the rising national interest in environmental innovations tied to “clean” energy, such as wind energy, wave energy, carbon credits and other alternative energy financing.
- **Oil & Gas Schemes.** Regardless of the price at the pump, fraudulent energy promoters continue to capitalize both on interest in the commodity and on oil and gas as investment alternatives to the stock market. Oil and gas investments tend to be highly risky and unsuitable for traditional, smaller investors who cannot afford the risk. Securities investments offering profit participation in oil and gas ventures

can be legitimate, but even when the underlying project is genuine, any revenues realized can be absorbed by high sales commissions paid to the promoter and dubious “expenses” skimmed off by the managing partner. Some promoters, many of whom have had past run-ins with regulators, have attempted to structure their “joint ventures” or “general partnerships” to avoid securities regulation and deprive investors of important protections.

## **Practices**

- **Affinity Fraud.** Scam artists have found it lucrative to abuse membership or association with an identifiable group to convince a potential investor to trust the legitimacy of the investment. Typical affinity groups include religious, ethnic, professional, educational, language, age and any other group with shared characteristics that allow investors to trust members of the group. Rather than trusting a person or company due to a common affiliation, investors should seek further information about the investment from an unbiased, independent source and review both the promises and risks.
- **Undisclosed Conflicts of Interest.** When obtaining investment advice about securities, investors need to know that not all advice is given with their best interest at heart. Some salespeople can receive lucrative commissions when they sell a product that is risky or inappropriate for an investor, but don't have to disclose that financial incentive. Investors should demand that anyone giving advice or recommendations disclose how they are compensated.
- **Private or Special Deals.** Some investors encounter investment opportunities or deals couched as “private” or only for “special” clients. While securities laws do offer businesses the opportunity to raise capital by selling securities to a relatively small number of investors in a non-public offering, these securities are not subject to the same review as others. Many state securities regulators have seen continued or increased abuse of fraudulent private offerings made under federal exemptions or not regulated at all. Although properly used by many legitimate issuers, private offerings have become an attractive option for con artists looking to steal money from investors by promoting the special or private nature of these schemes and by making false and misleading representations.
- **“Off the Books” Deals.** “Off the books” sales are an increasingly common threat to investors. Be cautious if your broker offers an investment on the side instead of one sold through his or her employer. These “off books” investments may not only be illegal, but they can also be especially risky without the oversight and supervision of the broker's employer.
- **Unsolicited Online Pitches.** Promoters of fraudulent investment schemes are moving beyond e-mail and turning to social media and online communities, such as Facebook, Twitter, Craigslist and YouTube to solicit unsuspecting investors. Some may use these sites to spread misinformation to artificially inflate the value of stock before selling in a “pump and dump” scheme. Others may promise high-yield, tax-free returns from investments in offshore markets. Once the money is sent to another country and is in someone else's control, investors may not be able to get it back. In many cases, these offers turn out to be Ponzi schemes. Investors should approach any unsolicited investment opportunity with suspicion.

D'Alessandro cautioned investors to familiarize themselves with the warning signs of investment fraud and independently verify any investment opportunity as well as the background of the person and company offering the investment. “Investors should do business with licensed brokers and advisers and should report any suspicion of investment fraud to their state securities regulator,” D'Alessandro said. “One call can protect your financial security and might prevent others from becoming victims.”

For more information, contact the Securities Division (401) 462-9527