



# Back to Basics

*Investor awareness is your  
best defense  
against fraud.*



# Back to Basics

## Overview

**Back to Basics** is a new series of investor awareness materials provided by the Investor Education Section of the North American Securities Administrators Association (NASAA). Through a series of one-page briefs, **Back to Basics** is designed to provide readers with an overview of complex investing topics through easy-to-understand language in a simple format. **Back to Basics** will be available on the Investor Education section of the NASAA website at [www.nasaa.org](http://www.nasaa.org).

### Current **Back to Basics** Topics

- Affinity Fraud
- Blind Pool Investment Offerings
- Brokers and How to Check Their Background
- Certificates of Deposit
- Cold Calling and Boiler Rooms
- Commodity Investments
- Early-Stage and Start-Up Companies
- Foreign Exchange Currency Fraud
- Free Meal Seminars
- International Investment Fraud
- Internet Investment Fraud
- Investment Advisers & How to Check Their Background
- Investor Tips for a Down Market
- Microcap Fraud
- Oil & Gas Investment Fraud
- Online Investing
- Ponzi Schemes
- Pyramid Schemes
- Professional Designations & Certifications
- Promissory Notes
- Retirement Investment Schemes

### About NASAA

*The North American Securities Administrators Association (NASAA) is the oldest international organization devoted to investor protection. NASAA is a voluntary association whose membership consists of 67 state, provincial, and territorial securities administrators in the 50 states, the District of Columbia, Puerto Rico, the U.S. Virgin Islands, Canada, and Mexico. State and provincial securities regulators have a long tradition of protecting investors through financial education.*

For more **Back to Basics**: visit: [www.nasaa.org](http://www.nasaa.org)



# Back to Basics

## Affinity Fraud

### *Beware of Swindlers Who Claim Loyalty to Your Group*

Affinity fraud is fraud that is aimed at a group of people who share common characteristics.

Everyone, in some way or another, is connected to a group or association. Our interests, backgrounds, and other factors will naturally lead us to those organizations or affiliations that serve our needs. Race, culture and religious beliefs also play a role in identifying us as members of unique groups that we often come to trust – sometimes to our detriment.

#### **Dangers From Swindlers Within Your Group**

Con artists understand and exploit our natural inclination to trust people who appear to share our common interests or values. This is especially true when it comes to investing money. A person can be influenced to make an investment decision based solely on an emotionally-charged tip or advice received from a trusted acquaintance, especially if that person belongs to the same group as the potential investor.

In some cases, the “trusted” person in the group is the con artist, while in others it is a well-intentioned group member who was fooled into thinking that the investment was sound. By spreading news of the investment through the group, this member becomes an unwitting promoter of the fraudulent scheme. This willingness to trust another member of one’s affinity group leaves an investor vulnerable to falling victim to a scam.

Unfortunately, affinity fraud is often directed at communities of faith. In these cases, scammers prey on and appeal to the religious beliefs of group members.

Once a victim realizes that he or she has been scammed, too often the response is not to notify the authorities but instead to try to solve problems within the group. Swindlers work hard to convince victims to remain silent by telling them that the investments are confidential and that to disclose any details would violate the terms of the deal. They also tell victims that disclosure of the investment to authorities would cause unnecessary bureaucratic “red tape.”

*Tips on How to Avoid Affinity Fraud >>>*

For more **Back to Basics**: visit: [www.nasaa.org](http://www.nasaa.org)



# Back to Basics

## How to Avoid Affinity Fraud

- Beware of the use of names or testimonials from other group members. In a Ponzi scheme, scam artists frequently pay out high returns to early investors using money from later investors. Accordingly, early investors may be wildly enthusiastic about a scheme that may collapse entirely once you've invested.
- Obtain a prospectus or other form of written information that details the risks in the investment and procedures to get your money out.
- Remove emotion from what is essentially a business transaction. Ask a neutral outside expert not in your group – an accountant, attorney or a licensed, registered investment professional – to evaluate the investment.
- Don't take the word of a salesperson. Before investing any money, check out the investment yourself. For more information about an investment or an individual or company offering an investment, contact the securities regulator in your state or province. You can locate contact information by visiting NASAA's website at [www.nasaa.org](http://www.nasaa.org) or by calling (202) 737-0900.



# Back to Basics

## Blind Pool Investment Offerings

Blind pools are investment vehicles that raise capital by selling securities to the public without telling investors what the specific use of the proceeds will be. While the blind pool will usually provide at least some indication of what general industry the funds will be invested in, blank check offerings do not identify any proposed investment intent whatsoever. They are literally “blank checks” that the promoter can use at his whim.

Blind pool offerings are often characterized by an absence of proven managerial and technical expertise among the corporate officers and key employees. They are often undercapitalized, having virtually no assets other than the other money obtained through the offering itself. This lack of funding is especially critical since the primary purpose of many blind pools is to evade regulatory requirements by raising funds to acquire a private firm that wants to go public without complying with the required regulatory steps, including the proper disclosure requirements.

Some promoters have used high pressure “boiler room” telephone sales tactics to sell shares in their pools. The low stock prices lure investors into a totally speculative ventures because they don't feel they have to risk a lot of money to participate.

### ***Avoiding Blind Pool Investment Fraud***

- Before making any investment, always fully read the prospectus.
- Make sure you know the background of the promoters and officers.
- Carefully read the “risk factors” section in the prospectus.
- Remember that all oral statements about the company may be nothing more than a hype to get you to invest.
- Don't allow yourself to be pressured in a quick decision. If the promoter wants your decision now, your answer should probably be “no.” Allow enough time to have the offering reviewed by your attorney, accountant or investment professional.
- As with any speculative investment ask yourself if you can afford to lose your money. Does the return sound too high compared to other investments? Remember, if it sounds too good to be true, it probably is.

### **Protect Yourself**

For questions about an investment or an individual or company offering an investment, contact the securities regulator in your state or province. You can locate contact information by visiting NASAA's website at [www.nasaa.org](http://www.nasaa.org) or by calling (202) 737-0900.

For more **Back to Basics**: visit: [www.nasaa.org](http://www.nasaa.org)



# Back to Basics

## Cold Calling and Boiler Rooms

The North American Securities Administrators Association estimates that unwary investors lose billions a year to investment fraud promoted over the telephone through cold calling and boiler rooms. Investors purchase shares of stocks or interests in companies or investment schemes from unknown companies and unknown callers. Unfortunately, far too many investors fall for the lure of “too good to be true” scams as callers promote investments such as self-employment scams, high-tech or oil and gas schemes, and unknown stocks.

### Unsolicited Phone Calls Often Involve High-Pressure Sales Tactics

- **Salespeople may make repeated calls** and even become abusive, questioning, for example, the intelligence of anyone who would pass up such a “sure thing.”
- **Outrageous promises of extraordinary profit at little or no risk.** The rule is “the higher the return, the higher the risk.” Listen for salespeople who claim it is possible to make extremely high or even “guaranteed” profits without any risk of loss. Most legitimate firms will provide written materials clearly disclosing the potential for loss as well as short- and long-term tax implications.
- **A demand for an immediate decision.** Boiler room salespeople want fast action before you have a chance to develop second thoughts or consult with a professional for advice. As a result, many deals will be “gone tomorrow,” “sold out today,” or have “just one of two remaining openings.”
- **A reluctance to provide information about the sales firm or the investment.** If a boiler room is uncovered, it may be subject to state or federal action. Therefore, some phone scam operators are not forthcoming when asked information about the sales operation and investment.
- **Mumbo-jumbo about “inside information” or “secret” technology.** In order to close a sale, the voice on the other end of the phone may tell you that this is a “sure thing.” A common claim is that celebrities, major corporations, or banks will be investing shortly.
- **Delayed delivery of the product and/or profits.** This is a classic “red flag” of an investment scam. If you don’t have your investment in hand or under control in some other location, you have nothing for your money. Beware of promises involving delays of more than a few weeks for delivery of your investment.
- **Unusual arrangements for collecting funds from investors.** Some con artists try to avoid mail fraud charges by using overnight courier services, such as Federal Express. Other phone scam operations go even further by sending a cab or courier to pick up the check. (over)

For more **Back to Basics**: visit: [www.nasaa.org](http://www.nasaa.org)



# Back to Basics

## Cold Calling and Boiler Rooms

### How to Avoid Becoming a Victim If You Are Contacted

Not all investments promoted over the phone are fraud or scams. A wise investor will use these simple tips when confronted with telephone solicitations:

**Do not make an immediate decision!** First get written information about the firm, the salesperson, and the investment.

**Ask questions!** Even if everything checks out with your securities regulator, don't rely on a company's glossy brochure. Ask about history of the company and any related entities. If the investment is traded, question trading history, the location of trading, and who is making a market in the stock.

**Seek out professional advice** from a lawyer, accountant, or broker before making an investment.

**Avoid investments you do not understand.** The greater your degree of ignorance, the greater the chance you will be swindled.

When hounded by high-pressure tactics, **hang up.**

**Do not give out your credit card number** over the phone to strangers.

For questions about an investment or an individual or company offering an investment, or if you think you may be the victim of investment fraud, contact the securities regulator in your state or province. You can locate contact information by visiting NASAA's website at [www.nasaa.org](http://www.nasaa.org) or by calling (202) 737-0900.



# Back to Basics

## Certificates of Deposit

The volatile stock market can make a certificate of deposit, commonly known as a CD, a safe and appealing investment. However, some CDs are not what they seem. Take the time to do your homework and ask the right questions to avoid disappointment.

### What is a Certificate of Deposit?

Certificates of deposits are savings certificates with a specified fixed interest rate and maturity date. The term of a CD ranges from one month to five years and investors are restricted from withdrawing funds prior to its maturity date or risk incurring a penalty. CDs are generally issued by commercial banks and credit unions, but stock brokers and brokerage firms can also sell them. They are insured by the FDIC.

### Not All CDs are Created Equal

The CDs described above are the most familiar to investors; however, there is another type of CD known as a “callable” CD. A callable CD is similar to a traditional CD, but it has a call feature similar to other fixed-income securities in that it can be redeemed, or “called away,” by the issuing bank prior to its stated maturity date and at a preset call price. For example, you invest in a callable CD offering a 3.5 percent interest rate but interest rates have fallen and now the same CD is paying only 2.5 percent. The issuer would have to pay the higher rate through your CD’s maturity date but has the option of paying a premium to stop paying you the higher rate.

While callable CDs are attractive as they often have higher yields than traditional bank-issued CDs, they do require a 10-, 20- or even 30-year commitment. There are substantial penalties for redeeming callable CDs before their maturity dates. Investors should know that with callable CDs, only the issuer, not the investor, can “call,” or redeem, the CD. Investors who want their money before a callable CD matures risk a substantial loss – as high as 30 percent in some cases. This type of certificate of deposit has resulted in numerous complaints from older investors stating they have been misled into buying a callable CD with up to a 30-year maturity date. Investors should be careful and ask questions regarding a callable CD to make sure they understand the product and have determined whether it meets their investment objectives.

(over)

For more **Back to Basics**: visit: [www.nasaa.org](http://www.nasaa.org)





# Back to Basics

## Checklist and Glossary of Useful Terms

To make your homework easier, NASAA has created a handy checklist with 13 questions designed to help investors distinguish between traditional bank-issued CDs and callable CDs. Before purchasing any CD, the checklist prompts investors to learn its maturity date, where the money will be deposited, the penalties for early withdrawal, any costs associated with selling before maturity, and whether the interest rate is fixed or variable.

Before choosing any investment, it is important to determine how it will fit with your financial goals, income, living expenses, and tolerance for risk. If you're considering purchasing a "callable" or "brokered" CD, become familiar with the following terms:

**Federal Deposit Insurance Corporation (FDIC):** In the event of a bank failure, federal deposit insurance protects deposits up to \$250,000 per depositor that are payable in the United States. You can verify that the bank is FDIC-insured by calling the FDIC hotline, 1(877) 934-3342 (1-877-ASK-FDIC).

**Maturity Date:** Ask to see the maturity date in writing. CDs can have maturity dates of up to 15 or 20 years.

**Issuer:** It is important to know which bank or thrift issued your CD because FDIC coverage is limited to \$250,000 per depositor. If you have existing deposits at an institution and add a brokered CD, it may push your total deposited funds over the \$250,000 limit.

**Deposit Broker:** Typically CDs are sold in banks, but brokerage firms, because they bring a large amount of deposits to a bank, can also offer CDs by negotiating a higher rate of interest. The brokerage firm can then divide the CD into smaller amounts and offer a fractional interest of the CD as a "brokered CD" to customers.

**Interest Rate:** Interest rates may be fixed or variable and are paid on a timetable- monthly, semi-annually or annually. Payments are made by check or an electronic transfer of funds. Variable interest rates can be tied to an index, such as the stock market, and could go down or disappear altogether. When comparing interest rates, make sure to look at the annual percentage yield (APY).

**Step-Up or -Down CDs:** CDs with a "step-up or -down" feature have a fixed interest rate for a period of time, usually one year. "Step-up" CDs have a higher rate in subsequent years while "step-down" CDs have a lower rate in subsequent years.

**Penalties for Early Withdrawal:** If you want to cash in your CD prior to the maturity date, you may have to pay a penalty to withdraw your CD and lose part of your principal. The brokerage firm that sold the CD sets the liquidation price. The firm has no obligation to buy the CD back at its face value, so cashing in the CD prior to the maturity date can often result in a significant loss of the original investment.



# Back to Basics

## Retirement Investment Schemes

There is no such thing as an “IRA Approved”, “IRS Approved” or “IRA Sanctioned” investment.

The IRS does not review, approve or endorse any IRA investments or any IRA investment forms. The IRS does issue letters to IRA sponsors, trustees and custodians certifying that they are complying with the requirements concerning investor rights, account administration and standards for the establishment of documents that allow contributions to be deductible as IRA contributions for tax purposes. Scammers use these letters to claim that the investment they are offering is IRS or IRA Approved, or IRA Sanctioned.

Federal tax laws currently allow a deduction of contributions to an IRA account, within certain limits. It is legal to put almost any investment in a retirement savings plan, such as an IRA. Only a few categories of investments are prohibited from being used for IRA deductions, including art objects, antiques, stamps and other collectibles, including some coins.

IRA Approved labeling has been used largely in connection with investments in new and untested technologies that are more easily sold to investors who may be new to these types of investments and, therefore, are unaware of the enormous risks and uncertainties involved in start-up technology companies. Other investments that have been latched onto by promoters of IRA Approved schemes in recent years are wireless cable, exotic livestock (ostriches/emus), real estate deals (mortgage pools), specialized mobile radio, and, most recently, precious metals.

### ***Protect Yourself***

- **Use extra caution when it comes to making IRA investments.** Take the time to evaluate fully any investment opportunity and, if necessary, consult with a competent tax advisor.
- **Reject any investment labeled as IRA Approved or one claiming to be endorsed by the IRS.** The IRS does not review, approve or endorse any specific investment.
- **Avoid buying an investment based only on a TV “infomercial” or radio advertisement.** Most broadcasters do not check out the accuracy of the advertisements they air. The same is true for many investment-related radio talk show hosts as many do not check out advertisers and may be receiving a payment for their personal endorsements.

(over)

For more **Back to Basics**: visit: [www.nasaa.org](http://www.nasaa.org)



# Back to Basics

- **No-risk, high-return investments don't exist.** The most basic rule of investing is that a higher return means higher risk, period. If someone tells you that you can make 200 or 300 percent on your money in a short period of time and that the chance of loss is low or nonexistent, you have found a deal that is too good to be true!
- **Transfers or rollovers of IRAs should only go to pension fund administrators.** Custodians for IRA accounts must be approved by the IRS or the contributions may not be tax deductible. If your money is sent directly to a promoter, it is not going into a recognized IRA and, even worse, may be gone for good.
- **Examine closely any investment packaged as an interest in a "general partnership" or "limited liability company."** These could be investment schemes in which promoters are attempting to evade the state and federal securities laws that require disclosure of all pertinent facts about themselves and the investment. The promoters may be attempting to conceal personal bankruptcies, previous securities law violations, risks (including lack of expertise), actual marketing costs (like 40-60% commissions for sales people, leaving little or nothing for the actual project), and competing technologies.
- **Beware of claims that the investment being offered is not a security.** Just because a promoter claims that what he or she is offering is not a security, does not make it so! Securities must be registered or exempted from registration in order to be sold in any state. The registration laws require that promoters disclose all pertinent facts to potential investors. If you would consider it important to know before you invest, then they are required to tell you.
- **Approval as a custodian for IRA contributions doesn't mean what you think.** IRA custodians have to follow many IRS rules in handling retirement funds, but they are not obligated to check out the investments chosen by the account holder. The custodian is not "on the hook" if your IRA investment turns out to be a worthless scheme.
- **Educate yourself about IRAs and retirement planning.** The IRS offers "Individual Retirement Arrangements" at no cost to those who call 1-800-TAX-FORM (829-3676). You may also obtain "Planning for Your Retirement," an introductory brochure from the American Association of Retired Persons (AARP) Worker Equity Program, by requesting a copy from: "Planning for Your Retirement," AARP, 601 E Street NW, Washington, DC 20049.

*Check the registration status of any investment and promoter before you invest. For questions about an investment or a company or individual offering an investment, contact the securities regulator in your state or province. You can locate contact information by visiting NASAA's website at [www.nasaa.org](http://www.nasaa.org) or calling (202) 737-0900.*



# Back to Basics

## Commodity Investments

Virtually everything that comes out of the ground - gold, silver, livestock, corn, oil, orange juice - can be classified as a commodity future. Commodity futures contracts are fast-paced, volatile investments through which an investor hopes to earn money from future price changes.

Commodities prices respond to many factors, including inflation, strikes, weather, economic forecasts and reports, politics, foreign events, new technology and even rumors. The events that affect commodities prices can happen at any time.

For the more experienced investor, commodities investing can offer substantial investment returns with very little initial investment. However, the risks associated with commodity investments are substantial.

### ***Dangers of Commodity Investing***

Uncontrollable factors such as inflation, weather, political unrest, foreign events, new technologies and even rumors can have devastating consequences to the price of a commodity. Investors investing in commodities must be able to bear a total loss of their investment.

Speculative risks. The commodities markets, just like the bond or stock markets, are made up of traders whose primary interest is in making short-term profits by speculating whether the price of a security will go up or go down. If you trade commodities, constantly check the pulse of the markets, finding out as much as possible about who the market participants are so that you can distinguish between the commercial users and the speculators.

The risk of fraud in trading commodities. Investors should always watch out for plain and simple fraud. One way to prevent being taken advantage of is to be extremely vigilant about where you're putting your money. Make sure that you thoroughly research a firm before you hand over your money. Unfortunately, there are times when no amount of research or due diligence is able to protect you from fraud — it's just a fact of the investment game.

### ***Watch out for these warning signs***

- Unsolicited, high-pressure phone calls
- Claims of inside information about the performance of the commodity
- "You must act at once!" warnings

(over)

For more **Back to Basics**: visit: [www.nasaa.org](http://www.nasaa.org)



# Back to Basics

- Claims of large and rapid profits
- Claims of little to no risk associated with the investment
- Contracts with names such as “deferred delivery,” “fixed maturity”, or “cash forward” that are not contracts traded through regulated commodities changes.

## ***Ask Questions!***

- Is the dealer registered with the Commodities Futures Trading Commission (CFTC), National Futures Association (NFA) or any other regulatory agency?
- Is the actual transaction to be executed through a regulated commodity exchange?
- Does the firm have literature or written materials explaining the transactions or a risk disclosure statement?
- Does the dealer have or will it obtain the commodity purchased?
- What percentage of the investment will go for fees, commissions or other costs?
- How long has the company been in business and who are its principals and officers?
- Will the company provide a copy of its financial statement?
- Where will the investment funds be held?
- Can independent references be obtained?

The public can obtain information about any firm or individual registered with the Commodities Future Trading Commission (CFTC), including any actions taken against a registrant, through the National Futures Association (NFA) Background Affiliation Status Information Center (BASIC), available on the NFA website at [www.nfa.futures.org](http://www.nfa.futures.org). Investors can also find out if someone is registered by contacting the NFA at (800) 676-4632.

The CFTC’s Division of Enforcement has established a toll-free number, 866-366-2382, to assist the public in reporting possible violations of the commodities laws. In addition, if you think you have been a victim of a commodities scam, you can report it through a downloadable form on the CFTC’s website [www.cftc.gov](http://www.cftc.gov) or by mail at Office of Cooperative Enforcement, CFTC, 1155 21st St. NW, Washington, DC 20581.

For questions about a commodities investment, or if you believe you are the victim of a scam, contact the securities regulator in your state or province. You can locate contact information by visiting NASAA’s website at [www.nasaa.org](http://www.nasaa.org) or by calling (202) 737-0900



# Back to Basics

## Early Stage and Start-up Companies

State laws have been relaxed to make it easier for small businesses to raise start-up and growth financing from the public. Many investors view this as an opportunity to “get in on the ground floor” of emerging businesses and to “hit it big” as these small businesses grow into large ones. Statistically, most small businesses fail within a few years. Small business investments are among the most risky that investors can make.

NEVER MAKE A SMALL BUSINESS INVESTMENT THAT YOU CANNOT AFFORD TO LOSE ENTIRELY.

### Investment risk with new companies

Never let a commissioned securities salesperson or an officer or director of a company convince you that the investment is not risky. Small business investments are generally highly illiquid even though the securities may technically be freely transferable. Thus, you will usually be unable to sell your securities if the company takes a turn for the worse.

Also, just because the state has registered the offering does not mean the particular investment will be successful. The state does not evaluate or endorse the investment. If anyone suggests otherwise to you, it is unlawful.

### Questions to Consider Before Investing

- How long has the company been in business? If it is a start-up or has only a brief operating history, are you being asked to pay more than the shares are worth?
- Consider whether management is dealing unfairly with investors by taking salaries or other benefits that are too large in view of the company’s stage of development or by retaining an inordinate amount of the equity of the company compared with the amount investors will receive. For example, is the public putting up 80% of the money but only receiving 10% of the company shares?
- How much experience does management have in the industry and in a small business? How successful were the managers in previous businesses?

(over)

For more **Back to Basics**: visit: [www.nasaa.org](http://www.nasaa.org)



# Back to Basics

- Do you know enough about the industry to be able to evaluate the company and make a wise investment?
- Does the company have a realistic marketing plan and do they have the resources to market the product or service successfully?
- The Disclosure Document usually used in public venture offerings is the “Form U-7,” which has a question and answer format. The questions are designed to bring out particular factors that may be crucial to the proper assessment of the offering. Read each question and answer carefully. If an answer does not adequately address the issues raised by the question, reflect on the importance of the issue in the context of the particular company.
- Do not let a securities salesperson pressure you into making a premature decision.
- It is generally a good idea to see management of the company face-to-face to size them up. Focus on experience and track record rather than a smooth sales presentation. If at all possible, take a sophisticated business person with you to help in your analysis.
- Beware of information that is different from that in the Disclosure Document or not contained in the Disclosure Document. If it is significant, it must be in the Disclosure Document or the offering will be illegal.

## Protect Yourself

Help protect yourself from fraud by asking questions about an investment or an individual or company offering an investment by contacting the securities regulator in your state or province. You can locate contact information by visiting NASAA’s website at [www.nasaa.org](http://www.nasaa.org) or calling (202) 737-0900.



# Back to Basics

## Microcap Fraud

**Microcap** stocks are shares in companies that are not well-established, have a small amount of shares in public hands (also known as “thinly traded”) and often trade at less than \$5 per share. Many microcap companies are not required to file financial reports, so it’s difficult to get information about the company’s products, services, finances and management.

Microcap stocks often trade in the “over-the-counter” (OTC) market and are quoted on the OTC Bulletin Board or the “Pink Sheets.” They are often too small to be traded on the stock exchanges or Nasdaq and because they are not subject to the listing standards and reporting requirements of an exchange or Nasdaq, public information is often limited.

### Tactics Used in Microcap Fraud Schemes

**Internet fraud.** Promoters hype a stock through the use of company web sites, blogs, social networking sites or online newsletters. They create false press releases or indicate that a company has had a revolutionary product approved by a state or federal governmental agency. After the price sky rockets, the promoter sells to unsuspecting investors and pockets large profits. The stock price eventually collapses after the hype dies down and investors end up holding shares that are worthless. This is known as “pump and dump.”

**Spam e-mail.** Promoters send junk email or “spam” to thousands of potential investors to spread false information quickly and cheaply about a microcap stock.

**Paid spokespersons.** Microcap companies may pay promoters to advertise a microcap stock in infomercials, ads on the radio, ads on television, in print ads, or even in investment newsletters, research reports and unsolicited fax correspondence. These ads claim to be unbiased and independent, when they are actually paid for by the microcap company.

**Unsolicited calls.** Promoters set up “boiler rooms” where a large number of high-pressure salespeople use a room full of telephones to make unsolicited calls to as many potential investors as possible. The callers use scripted sales pitches that tout stocks with outrageous promises.

(over)

For more **Back to Basics**: visit: [www.nasaa.org](http://www.nasaa.org)





# Back to Basics

## Be on the alert for microcap fraud schemes

- Beware of high pressure, unsolicited telephone calls. Never allow yourself to be pressured into making an investment. Don't make an investment that you don't understand and be wary of promises of inside information or "get-rich-quick" schemes. The best advice is to hang up the phone! Use an answering machine to screen cold-calling salespersons.
- Be wary of information on blogs, social networking sites or unsolicited e-mail messages. The person providing the information may be an unscrupulous stock promoter, or an insider who wants to dump their shares.
- Question microcap sales pitches featuring the names of reputable "clearing" broker-dealers. These firms often have no more than a contractual relationship with microcap brokers.
- Check out the promoter and the investment. If you are working with a broker, ask for their CRD number. Call your state or provincial securities regulator to learn if the person you are working with has a disciplinary record and that the investment is properly registered.
- Ask to see a prospectus if it is a recent public offering or other up-to-date information before you invest. Read these documents carefully. Greater caution should be taken if a prospectus is not available. A prospectus must be filed with the Securities and Exchange Commission and/or with a state or provincial securities regulator. Anything that a salesperson says that contradicts disclosures in a prospectus or other offering materials should be a red flag that there is a problem.

### ***Protect Yourself***

Help protect yourself from fraud by asking questions about an investment or an individual or company offering an investment by contacting the securities regulator in your state or province. You can locate contact information by visiting NASAA's website at [www.nasaa.org](http://www.nasaa.org) or by calling (202) 737-0900.



# Back to Basics

## Investment Advisers

The title investment adviser is a legal term that describes a broad range of people who are in the business of giving advice about securities (stocks, bonds, mutual funds, and annuities). They also may use a variety of titles, such as investment manager, investment counsel, asset manager, wealth manager, or portfolio manager.

Investment advisers provide ongoing management of investments based on the client's objectives, typically with the client giving the adviser authority to make investment decisions without having to get prior approval from the client for each transaction.

Investment advisers are subject to a *fiduciary duty*. That means they have to put your interests ahead of theirs at all times by providing advice and recommending investments that they view as being the best for you. They also are required to provide up-front disclosures about their qualifications, what services they provide, how they are compensated, possible conflicts of interest, and whether they have any record of disciplinary actions against them.

Investment Advisers are regulated by either the U.S. Securities and Exchange Commission or by state securities regulators, depending on the amount of assets they have under management.

### How to Check an Investment Adviser's Background

While the vast majority of the stockbrokers, brokerage firms, investment advisers and investment adviser firms are honest and reputable, it pays to remember that just like many other professions, there are those individuals and firms who are not.

State and federal laws require investment adviser firms and their representatives to be registered or licensed. Canadian securities laws require anyone trading securities, or in the business of advising clients on securities, as well as the company they work for to be registered with their provincial or territorial securities commission, unless a registration exemption applies.

Investigate your investment adviser thoroughly by verifying the registration status of an investment adviser, checking employment, complaint and disciplinary history, and, in some cases, requesting copies of any regulatory actions.

**Protect Yourself: Ask Questions >>>**

For more **Back to Basics**: visit: [www.nasaa.org](http://www.nasaa.org)



# Back to Basics

## U.S. Resources:

Using an investment adviser? For background information, contact the securities regulator in your state or province. You can locate contact information by visiting NASAA's website at [www.nasaa.org](http://www.nasaa.org) or by calling (202) 737-0900.

Ask for all materials from the Investment Adviser Registration Depository (IARD). The IARD has information on more than 260,000 investment advisers.

You can also find out information about investment advisers through the U.S. Securities and Exchange Commission's (SEC) Investment Adviser Public Disclosure (IAPD) Program. You can check on an investment adviser's registration status and background information on the IAPD website at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov).

Search the Investment Adviser Public Disclosure (IAPD) website for information on investment adviser representatives and firms registered with state securities regulators and the Securities and Exchange Commission.

## Canadian Resources

The National Registration Search is a web-based tool that provides information about individuals and firms registered with securities regulatory authorities in Canada. Registration information from the Ontario Securities Commission (OSC) is not included in the national registration search, but is available through the OSC Registrant List.

## Protect Yourself: Ask Questions!

- **Is the investment opportunity registered for sale in the state in which you live?** Call your state securities regulator to find out. All investment opportunities must be registered or exempt. If one being recommended to you isn't registered or exempt, consider that a red warning flag to investigate further. Ask for and review carefully written disclosure information.
- **Always stay in charge of your money.** Protect your nest egg. Once you've made an investment, carefully review your account statements. Make sure you know where your money is being held. Generally, you should receive account statements from the custodian of the securities as well as from your investment adviser. Confirm that all transactions are ones you have authorized.
- **Insist on a full explanation of investment recommendations** and don't invest in something you don't understand. If the return on an investment sounds too good to be true, it probably is. A legitimate investment adviser should find out about your financial needs and goals, as well as the level of risk you are comfortable with, then suggest a "suitable investment." Don't allow the promise of high returns cloud your judgment.



# Back to Basics

## Internet Investment Fraud

While the Internet is a valuable tool for investors – providing research and driving down trading costs – it’s also an easy and inexpensive tool for crooks to commit old-fashioned investment fraud. For a few hundred dollars, a criminal can buy literally millions of e-mail addresses of potential victims. That’s one reason why it is important to avoid unsolicited offers that you receive via e-mail or find on the Internet.

### Types of Online Investment Schemes

State and provincial securities regulators have identified the following major online investment scams:

**Manipulation of obscure, thinly-traded stocks.** Since it may be impossible for anyone to know the true identity of anyone else on the Internet, there is enormous potential for manipulation of little-known companies that have a small number of shares on the market. Acting alone or with accomplices, a single company insider, broker, public relations executive or even just a large shareholder can leave numerous messages calculated to spark interest in an obscure stock.

**Misconduct by phony, unlicensed or unscrupulous brokers/investment advisers.** States and provinces are concerned that some investment professionals may be attempting to drum up new business, without the supervision of their employers, by making illegal assurances about the potential for profit in certain investments. An aggressive broker is able to make unsupported comments to hundreds of thousands of investors, sophisticated and unsophisticated, in an online message.

**Undisclosed interests of promoters.** Schemers who promote fraudulent and abusive investment schemes exploit the anonymity of cyberspace. In reading a bulletin board message about a stock, you have no way of knowing if the person involved is a company official, PR representative, or market-making brokerage firm. Has the person hyping the stock been paid to do so and, if so, has that fact been disclosed?

**Promotion of “exotic” scams.** In hundreds of cases, messages have been posted online promoting a wide variety of highly suspect, unregistered investment deals, such as wireless cable television “build-out” schemes, ostrich farming and viatical settlements, as well as flat-out rip-offs including pyramid scams and Ponzi schemes. (over)

For more **Back to Basics**: visit: [www.nasaa.org](http://www.nasaa.org)



# Back to Basics

## Precautions to Take Against Online Investment Schemes

**Don't expect to get rich quick.** The online world is filled with timely and accurate information that can help you become a smarter investor. Unfortunately, it also is home to investment fraud and abuse. Evaluate the information you get online in the same way that you would any news magazine article, television report, or whispered "hot tip."

**Don't assume that your internet service provider polices its investment blogs or bulletin boards.** Most don't. In fact, the vast majority of services take a "hands off" attitude to validating claims made in message postings. The volume of postings, literally millions of messages each month, swamps even the ones that do minimal policing. In the world of the Internet, just about anything goes.

**Don't buy thinly-traded, little known stocks on the basis of online hype.** These stocks are most susceptible to manipulation. Unlike blue chips and other stocks with substantial floats, the price of low-volume stocks can be moved through relatively small strategic trades.

**Don't act on the advice of a person who hides his or her identity.** Don't assume that two or more people talking up a stock are actually two or more different people!

**Don't get fooled by claims made about "inside information," including pending news releases, contract announcements, and products.** Investment bulletin boards and discussion groups are filled with "hot tips" about impending developments sure to send a stock soaring in value.

**Don't assume that just because someone says that he or she has checked something out, he or she has actually done so.** Online stock hypesters make all sorts of claims about visiting companies, inspecting mining operations, and having personal conversations with company officials.

**Watch out for conflicts of interest.** Make sure that you always know why someone is so "high" on an investment opportunity!

**Make sure that an investment opportunity and the person promoting it are properly registered with your state or provincial securities agency.** Laws designed to protect small investors from fraud and abuse do apply in cyberspace. A failure by an issuer or broker to follow regulatory requirements is often a major "red flag" of an investment scam.

For questions about an investment or an individual or company offering an investment, contact the securities regulator in your state or province. You can locate contact information by visiting NASAA's website at [www.nasaa.org](http://www.nasaa.org) or by calling (202) 737-0900.



# Back to Basics

## International Investment Fraud

Complaints about overseas investment scams involving precious metals, oil and gas ventures, mining, coins, currency speculation, special foreign banking instruments, and overseas business opportunities are received by state and provincial regulators on a regular basis.

If you find that you have been a victim of international investment fraud, contact your local securities regulator as soon as possible. Offshore investments make it much more difficult, if not impossible, for you to recover your funds and for law enforcement agencies to investigate and prosecute the scammers.

The complexities of international law and criminal extradition agreements can work for criminals by increasing the burden on U.S. regulatory and law-enforcement authorities. Foreign-based promoters, as well as e-mail and Internet advertising, have made bringing perpetrators to justice all the more difficult. Although your money may be gone for good, reporting the scam to regulators can help shut down the operation and save the money of future investors

### 6 steps to protect investors' interests across the globe

**Don't believe the hype.** If you listen to fellow investors and read the business news columns, it is easy to get the impression that you are missing out on the "hot new investment" of the moment. Don't give in to the pressure to send your dollars overseas or even just across town. First, make sure the investment is appropriate for your financial objectives and, in particular, your ability to take on the risk of losing all of your money. Con artists are quick to pick up on the psychology of the investment climate and create "look alike" investment swindles that mirror "hot" investments in legitimate markets.

**Do your homework.** How are investments regulated in the nation where you are thinking about sending your money? To what extent are investors in this market protected from investment fraud and abuse? What if you have to resolve some sort of dispute related to your investment? Where would you go for assistance in resolving your problem? If you don't have the time or resources to answer these questions, you should hold onto your money.

(over)

For more **Back to Basics**: visit: [www.nasaa.org](http://www.nasaa.org)



# Back to Basics

**Remember: International isn't necessarily better.** Even if investing overseas is one of the "hottest" trends in investing, it doesn't mean that the quality of the investment opportunities in other nations is any better than those in the U.S. In fact, because of enforcement complications, the level of risk in overseas investments – even in mainstream market products – may be considerably higher than it is here, where markets are well regulated. And once your money is gone, it may be impossible to recover, due to the practical difficulties involved in pursuing court action against foreign entities and individuals.

**Take the time to inquire** with your Better Business Bureau (BBB) about the company in question. They may have a record of other customers' experiences with, or government actions against, the company.

**Invest in what you know.** Don't be deceived by slick-produced brochures that may make an enterprise look legitimate. If you don't have the contacts or financial resources to personally inspect your investment, consider carefully before giving up your money. In general, investors are best advised to deal with people they know and in investments they understand. If a stranger calls, pressuring you to invest "right away" in the huge profit potential of some offshore investment, think twice!

**Ignore false claims** that overseas investment promoters are somehow exempt from state and federal securities law registration requirements -- they aren't.

## *Protect Yourself*

Help protect yourself from fraud by asking questions about an investment or an individual or company offering an investment by contacting the securities regulator in your state or province. You can locate contact information by visiting NASAA's website at [www.nasaa.org](http://www.nasaa.org) or by calling (202) 737-0900.



# Back to Basics

## Free Meal Seminars

Many individuals over the age of 50 have received an invitation in the mail offering a free lunch or dinner investment seminar. The invitations usually offer a free gourmet meal, encourage spouses to attend and mention topics such as tips on how to earn excellent returns on your investments, eliminate market risk and grow your retirement funds. These words should be red flags for investors.

Free meal sales seminars are often advertised in local newspapers, through mass-mailed invitations, mass e-mail and on websites. Sponsors of these seminars hold the seminars at upscale hotels, restaurants, retirement communities and golf courses.

### ***Beware of Abusive Sales Practices***

Many free meal seminars are designed to solicit seniors. The bait for many of these seminars is that “income” will be “guaranteed” at a substantially higher rate than the returns someone on a fixed income can expect to get from certificates of deposit, money market investments or other traditional financial products.

Seniors seeking educational insights and information should be aware that the primary goal of the sponsors of these free meal seminars is to obtain new customers and sell investment products.

Promoters of free meal seminars often use the promise of high commissions to lure brokers, insurance agents, investment advisers, accountants and lawyers, some of whom are not licensed to sell securities, into offering products they may know little about, such as variable or equity-indexed annuities, limited partnerships, or promissory notes. Securities professionals must know their customers’ financial situations and refrain from recommending investments that they have reason to believe are unsuitable.

(over)

For more **Back to Basics**: visit: [www.nasaa.org](http://www.nasaa.org)





# Back to Basics

## Foreign Exchange Currency Fraud

The foreign currency exchange market (forex) is a worldwide decentralized over-the-counter financial market for the trading of currencies. It determines the relative values of different countries' currencies.

Forex contracts involve the right to buy or sell a certain amount of a foreign currency at a fixed price in U.S. dollars. Profits or losses accrue as the exchange rate of a specific currency fluctuates on the foreign currency exchange market. Forex markets are among the most active markets in the world in terms of dollar volume.

Participants in the forex markets include large banks, multinational corporations, governments and speculators. Individual traders comprise a very small part of this market. Because of the volatility in the price of foreign currency, losses can accrue very rapidly and may quickly wipe out an investor's down payment.

### Foreign Currency Exchange Schemes

Foreign currency exchange scams often attract investors with sophisticated offers placed in newspapers, radio promotions and on Internet sites (see NASAA Investor Alerts on Affinity Fraud and Social Networking.) Promoters often lure investors into foreign currency exchange scams through the concept of leverage, or the right to "control" a large amount of foreign currency with an initial down payment representing only a fraction of the total cost. Investors are often baited to invest in foreign currency scams through bogus predictions about "inevitable increases" in currency prices and promises that their investments will reap huge returns over a short time with little to no downside risk.

In a typical case, investors may be assured of reaping tens of thousands of dollars in just a few weeks or months with an initial investment of only \$5,000. Often, the investor's money is never even placed in the foreign currency exchange market through a legitimate trader but is stolen for the personal benefit of the con artist.

(over)

For more **Back to Basics**: visit: [www.nasaa.org](http://www.nasaa.org)



# Back to Basics

## Protect Yourself

If you are solicited to invest in a foreign currency exchange program, watch out for these warning signs:

- Be wary of promises that sound too good to be true. Get-rich-quick schemes, including those involving foreign currency trading, tend to be fraudulent.
- Be skeptical about unsolicited phone calls offering investments, especially from out-of-state salespeople or companies that are unfamiliar.
- Be cautious if you have acquired a large sum of money recently or have large amounts of money to invest. Retirees, in particular, may be attractive targets for fraudulent operators.
- Be wary of high-pressure efforts to convince you to send or transfer cash immediately to a firm via overnight delivery or the Internet.
- Be smart when investing. Even when purchased through a reputable and licensed dealer, forex investments can be extremely risky. If you are tempted to invest, make sure you understand the investment and only invest what you can afford to lose.
- Ask for professional advice. Ask your accountant, attorney or registered investment professional to evaluate the investment.

Investors should make sure that anyone offering a forex investment is properly licensed and has a reputable business history. The public can obtain information about any firm or individual registered with the Commodities Future Trading Commission (CFTC), including any actions taken against a registrant, through the National Futures Association (NFA) Background Affiliation Status Information Center (BASIC), available on the NFA website at [www.nfa.futures.org](http://www.nfa.futures.org). You can also find out if someone is registered by contacting the NFA at (800) 676-4632.

The CFTC's Division of Enforcement has established a toll-free number, (866) 366-2382, to assist the public in reporting possible violations of the commodities laws. In addition, if you think you have been a victim of a forex scam, you can report it through a downloadable form on the CFTC's website at [www.cftc.gov](http://www.cftc.gov) or by mail at Office of Cooperative Enforcement, CFTC, 1155 21st St. NW, Washington, DC 20581.

For questions about a forex investment or an individual or company offering an investment, or if you believe you may be the victim of a scam, contact the securities regulator in your state or province. You can locate contact information by visiting NASAA's website at [www.nasaa.org](http://www.nasaa.org) or by calling (202) 737-0900.



# Back to Basics

## Investor Tips for a Down Market

A sharp downward slide of the stock market may make some investors panic and consider making drastic changes. Before making any investment decisions around your stock portfolio, get the facts.

### Important Considerations Before Making a Move

#### *What is a “Real” Loss?*

It can be frightening to watch an investment portfolio decline in value, but remember this is not your “real” loss. A real loss is selling an investment at a price below its purchase price. Yes, it is important to think about how to preserve the value of your assets but don’t let panic drive your decision making.

#### *Should I Cash Out My 401K Early?*

Before you do, make sure you are aware of the consequences. If you cash out before you are 59 ½ and do not roll the proceeds into an IRA or another employer’s plan within 60 days, you may face these consequences:

- You may have to pay federal income tax on the entire amount;
- Your current employer is required to withhold 20% of your account balance to prepay the federal taxes;
- You may owe state and local tax on your distribution; and
- You may also be subject to a 10% early withdrawal penalty tax by the IRS.

(over)

For more **Back to Basics**: visit: [www.nasaa.org](http://www.nasaa.org)



# Back to Basics

## ***Are your accounts insured?***

**Insured:** All deposit accounts at insured banks and savings associations, including checking, NOW (negotiable order of withdrawal - interest bearing checking accounts), savings accounts, money market deposit accounts and certificates of deposit (CDs) up to the insurance limit. The FDIC (Federal Deposit Insurance Corporation) is an independent agency of the U.S. government that protects you against the loss of your deposits if an FDIC-insured bank or savings association fails. FDIC insurance is backed by the full faith and credit of the U.S. government. The protection limit is \$250,000 per bank or savings association (unless the account[s] meet certain requirements), and up to \$250,000 for certain retirement accounts (e.g. IRAs).

**Insured:** The cash and securities, such as stocks and bonds, held by a customer at a financially troubled brokerage firm that is a member of the Securities Investor Protection Corporation (SIPC). SIPC can help when assets are stolen by a broker or put at risk when a brokerage fails for other reasons. Though created by Congress through a Securities Investor Protection Act, SIPC is neither a government agency nor a regulatory authority. It is a non-profit, membership corporation, funded by its member securities broker-dealers. Protection limits for securities in your account at a SIPC member brokerage is up to \$500,000, including a maximum of \$250,000 for cash claims. The SIPC does not insure accounts against losses due to market fluctuation, poor investment decisions or lost investment opportunities.

**Uninsured:** Investments in mutual funds (stock, bond or money market mutual funds) whether purchased from a bank, brokerage or dealer; annuities (underwritten by insurance companies, but sold at some banks); stocks, bonds, Treasury securities or other investment products, whether purchased through a bank or a broker-dealer; and money market mutual funds.

## ***Protect Yourself***

Be sure to ask how your financial services professional gets paid. Does he or she receive compensation via a flat fee, commissions on transactions, or some other method? Does he or she receive compensation on the front end or the back end? Don't rush into signing anything and consider asking a trusted friend or objective family member to help review your decision. Remember, if a professional or anyone else is offering returns that are too good to be true, they probably are. Get more information, be cautious and ask a lot of questions.

If you're considering working with a financial professional to help you get through this financial crisis, it is critical that you check him or her out before entrusting the person with your money. For questions about an investment or an individual or company offering an investment, contact the securities regulator in your state or province. You can locate contact information by visiting NASAA's website at [www.nasaa.org](http://www.nasaa.org) or by calling (202) 737-0900.



# Back to Basics

## *Be wary of insured, 'risk-free' promissory notes*

Promissory notes are documents signed by a borrower promising to repay a loan, also called a note, under agreed-upon terms. Promissory notes are debt instruments that can be used for a variety of different borrowing and lending situations. For example, many mortgages incorporate a promissory note as the debt instrument acknowledging the borrowing of funds for the purchase of real property. Promissory notes are also one method used by companies to raise capital for legitimate business purposes.

### **Why a Promissory Note May Not be a Wise Investment**

Legitimate promissory notes are marketed almost exclusively to sophisticated, corporate or institutional investors that have the resources to thoroughly research the companies issuing the notes and to determine whether the issuers have the revenue and earnings capacity to pay the promised interest and principal.

Promissory notes that are marketed to the general public, however, often turn out to be scams being sold as investments that guarantee above-market, fixed interest rates, while supposedly safeguarding the principal. This is especially true in cases when the promissory notes being sold are issued by an individual, not a company, or by a company that is nothing more than a shell for the owner or issuer.

Even legitimate notes carry the risk that the issuers may not be able to meet their obligations.

### **Protect Yourself**

Help protect yourself from fraud by asking questions about an investment or an individual or company offering an investment by contacting the securities regulator in your state or province. You can locate contact information by visiting NASAA's website at [www.nasaa.org](http://www.nasaa.org) or by calling (202) 737-0900.

For more **Back to Basics**: visit: [www.nasaa.org](http://www.nasaa.org)