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Alabama Securities Commission Announces Top 10 Investor Traps

MONTGOMERY, ALABAMA (August 18, 2009) With a new school year about to begin, the Alabama Securities Commission (ASC) reminds investors to take stock of their financial education and arm themselves with the knowledge to sidestep this year's Top Ten Investor Traps.

ASC Director, Joseph Borg, said that investors under pressure from the struggling economy need to resist the lure of sales pitches to rebuild their savings. "An educated investor should be alert at all times, but especially when money is tight. Falling into an investment trap makes it harder to get back on solid financial ground," Borg said.

Many of the traps identified by the North American Securities Administrators Association, of which ASC is a member, promise high returns to cash-strapped investors but provide little if any disclosure of risks and offer high commissions to aggressive sales forces.

"When it comes to investing, verify everything and everyone before you part with your money," Borg said. "Education and information are an investor's best defense against investment fraud. State and provincial securities regulators provide detailed background information about those who sell securities or give investment advice, as well as about the products being offered. Investors should always be wary of unsolicited financial advice or investment opportunities."

Top Investor Traps

The traps below are listed in numerical order, the order of traps are most common to less common according to recent complaints and securities enforcement actions in the State of Alabama.

1. Ponzi Schemes. Despite the heightened awareness of Ponzi schemes following Bernard Madoff's multi-billion dollar fraud and 150-year prison sentence, these scams continue to trap investors. The Ponzi scheme is a house-of-cards swindle in which high returns are paid to initial investors out of the funds of later investors, who end up losing all or most of their money to the promoter. Borg urged investors to beware of investment opportunities promising high and steady rates of return. "While some Ponzi investors may have a slight chance of realizing a return on their investment, most investors have from the outset no hope of recovery. Ponzi schemes are the securities world's equivalent of a purse snatch," Borg said.

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2. Private Placement Offerings. Private placements offer businesses the opportunity to raise capital by selling securities to a relatively small number of investors as opposed to a public offering made through national securities markets. State securities regulators have observed a steady and significant rise in the number of private placement offerings that are later discovered to be fraudulent, especially those made under a federal registration exemption (Regulation D, Rule 506). Companies using this exemption can raise large amounts of money without registering the offering with the SEC as long as they meet certain standards. Although properly used by many legitimate issuers, the exemption has become an attractive option for con artists, as well as individuals barred from the securities industry and others bent on stealing millions of dollars from investors through false and misleading representations.

3. Short-term Commercial Promissory Notes. Many seniors have lost their life savings by investing in short-term commercial promissory notes that are nine months or less in duration. These notes may be touted as being "insured" or "guaranteed," but the insurance companies generally are located outside of the United States, are not licensed to do business in the United States, and lack the resources necessary to deliver on the promised guarantees. Unlike publicly advertised promissory notes, promoters of these notes usually attempt to use commercial paper exemptions as a basis for selling the products without registration. The commercial paper exemptions apply only to high-grade commercial paper traded by major corporations – not to these risky notes pushed to the public by a sales force paid with extremely high commissions.

4. Real Estate Investment Schemes. State securities regulators have noted a rise in scams disguised as offers to help homeowners caught up in the turbulent housing market "save" their homes or "fix" their mortgages, usually in exchange for a fee paid in advance. "Most of these advance-fee offers only generate a quick profit for the con-artist and provide no benefit to the consumer," Borg said. Some homeowners, particularly seniors, may be attracted to reverse mortgages, which are a legitimate lending option. However, the resulting lump sum home equity payment makes them an attractive target for unscrupulous salesmen, who may attempt to direct these funds toward worthless or unsuitable investment products.

5. Gold Bullion and Currency Scams. With the high price of gold, investors should beware of gold bullion scams in which the seller offers to retain "purchased" gold in a "secure vault" and promises to sell the gold for the investor as it gains in value. In many instances the gold does not exist. Similar are the many forms of foreign exchange (forex) trading schemes. 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 many instances there are no trades; the money is simply stolen.

6. Natural Resource Investments. ASC expects to continue to see a rise in energy and precious metals scams promising quick, high returns. Investors anxious to recover losses quickly likely will be hooked by oil and gas schemes, as well as fraudulent offerings of investments tied to natural gas, wind and solar energy, and the development of new energy-efficient technologies.

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7. Speculative Inventions and New Products. New products are for venture capitalists who know how to assess the risks. They are not good investments for your retirement money even though they may promise high returns.

8. Leveraged Exchange-Traded Funds (ETFs). This relatively new financial product has been offered to individual investors who may not be aware of the risks these funds carry. The funds, which trade throughout the day like a stock, use exotic financial instruments, including options and other derivatives, and promise the potential to provide greater than market returns as the value of the underlying assets rise or fall. Given their volatility, these funds typically are not suitable for most retail investors.

9. Life Settlements. State securities regulators long have been concerned about life settlements, or viaticals, and the rising popularity of these products among investors has prompted a recent congressional investigation. While life settlement transactions have helped some people obtain funds needed for medical expenses and other purposes, those benefits come at a high price for investors, particularly senior citizens. Wide-ranging fraudulent practices in the life settlement market include Ponzi schemes; fraudulent life expectancy evaluations; inadequate premium reserves that increase investor costs; and false promises of large profits with minimal risk.

10. Entertainment Investments. These unregistered investments, encompassing a variety of products including movies, infomercials, internet gambling and pornography sites, promise high returns while offering little disclosure of risk.

The ASC cautions potential investors to thoroughly scrutinize and research any investment opportunity or offer. Contact the ASC with inquiries concerning securities broker-dealers, agents, investment advisers, investment adviser representatives, financial planners, registration status of securities and debt management programs, to report suspected fraud or to obtain consumer information. The ASC provides free investor education and fraud prevention materials in print, on our website and through educational presentations upon request.

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For more information visit the ASC website at **www.asc.alabama.gov** or contact Dan Lord, Education and Public Affairs, Manager at 1- 800-222-1253 or 334-353-4858.

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