



INVESTMENT FRAUD



**SPOT THE RED FLAGS.
TAKE ACTION!**



What do victims of investment fraud have in common?

They believed an investment opportunity was legitimate and did not see the warning signs.

This booklet outlines the red flags of fraud and provides action steps you can take to protect yourself.

WHAT MAKES AN INVESTMENT LEGITIMATE?

What legitimate investments have in common is that their issuers and the individuals who sell them operate within the rules of securities law. The SEC and the states regulate many investments to protect investors, including requiring the issuing companies be registered and the people selling them to be registered and licensed. Investment issuers must provide enough information to allow you to make an informed decision about whether to invest.

How common is investment fraud? According to the FTC, investors reported losing more than \$3.8 billion to fraud in 2022.

In some cases, an investment may qualify for an exemption from registration. Be sure to check to make sure that an exemption applies either by using the SEC's EDGAR database or by checking with your state securities regulator.

TAKE ACTION: CHECK REGISTRATION

1. Make sure the issuer is registered with the SEC or your state regulator.
2. Make sure the salesperson is registered and licensed on BrokerCheck.org.
3. If the investment is not registered, verify that it qualifies for an exemption.

TYPES OF LEGITIMATE INVESTMENTS

PUBLICLY TRADED SECURITIES

Traditional publicly traded investments include stocks, bonds, mutual funds, exchange traded funds, and options and futures.

As an investor, you should be aware that if investment markets overall are losing value, as they do from time to time, many if not most of the investments in those markets will lose value too. Although stocks of publicly traded companies may decline in value, these types of investments have the advantage of being liquid. That means you can generally sell your investment when you need to.

EXEMPTIONS FROM REGISTRATION

Some investment assets may be sold legitimately in private transactions, which do not require SEC registration.

These investments are often sold to raise capital for a business venture. Examples include certain alternative investments, private equity funds, shares in start-up companies, limited partnerships, and real estate. Generally, these types of investments are illiquid, which means you may not be able to sell your holding easily, if at all. They may also expose you to greater risk than traditional investments and may require that you have a certain net worth or annual income to invest.

Before investing in non-publicly traded securities, make sure you investigate the company and salesperson, understand the investment's offering memorandum, know that your money may be tied up for a very long time, and can afford to lose the capital you invest.

COMPLEX STRATEGIES

Do not invest because you are afraid of missing out on the latest investment opportunity, even if the product is sold by a registered broker-dealer and receives lots of media attention. For example, if you do not understand how self-directed IRAs, binary options, and leveraged ETFs work, they are probably not for you.

A SEPARATE ACCOUNT FOR HIGH-RISK INVESTMENTS

If you really want to try your hand at some very volatile, high-risk investments, you should only use a limited amount of money that you can afford to lose. You could open a separate account for unregulated investments like crypto, where losing your entire investment is a very real possibility. If you choose to open a small separate account, do not keep it a secret from your spouse or financial adviser. At tax filing time, you will have to report income from all of your accounts.

TYPES OF FRAUDULENT INVESTMENTS

Fraudulent offerings often involve the same types of promises and guarantees as prior frauds, even though the details about the investment products or business ventures change to keep up with the news headlines and current events.

An investment offering may be fraudulent for several reasons, including:

- Misrepresentations about what the

business is, who the owners are, and the risks it poses

- Misuse of investment funds for personal expenses, not legitimate business expenses
- Non-existent companies, with funds from later investors used to pay earlier investors
- False claims that the company owns valuable patents and proprietary products

WATCH FOR THESE RED FLAGS OF INVESTMENT FRAUD

Recognizing the red flags of investment fraud is essential to protecting yourself against being snared by a fraudulent investment. Any one of

these flags should tell you there's something wrong. A combination of them should be a signal to walk away.



Promise of High Rate of Return

The promise of a higher than average rate of return with no risk is a promise that can't be kept. Anyone—or any ad—that makes this claim should be immediately suspect.



Claims of Consistent Returns Over Many Years

You should be careful if a company reports that the investment is making the same return over many years, even if the reported return seems reasonable and not overly high. One of the largest financial frauds in history, run by Bernie Madoff, reported positive returns every year, even

during stock market lows and economic downturns.



Pressure to Act Immediately

Being told you must act quickly to take advantage of an investment opportunity or that the investment is available only if you invest immediately are signs of fraud. If you get this pressure during a phone call, in an email, or on social media, end the interaction.



Insistence on Silence or Secrecy

Requests or warnings to keep the investment opportunity secret are a signal of fraud. Claims that information cannot be provided to you because the investment is proprietary are suspect. Even more suspicious is being instructed not to contact a lawyer or a state or federal agency, with the explanation that if you do the opportunity will disappear.



Lack of Contact Information

Be wary of salespeople who resist providing full contact information for themselves and the company. Claims that the company does not have a physical office, or that everyone works from home, or that checks and mail should be sent to a P.O. box are signs of fraud.



Errors and Inconsistencies in Offering Documents

Offering documents may have different titles: Investment Contract; Promissory Note; Private Placement Memorandum; Investment Agreement; and others. Regardless of the title, if the documents contain spelling errors or use poor grammar, beware. Inconsistencies are also signs of fraud. For example: "Company ABC, LLC" is used in the title, but later in the document, it is "ABC Co" or "Company ABC".



Claims of Exemptions

If a promoter claims that the company is exempt from registration requirements, government filing requirements, or any other licensing or regulatory requirement, be sure to investigate the claims.



A History of Problems

An issuer's or salesperson's history of bankruptcies, lawsuits, liens, enforcement actions and convictions is a bad sign. If you research and find that the owners, managers, or salespeople of a company have a checkered past, be wary of investing.



Testimonials

A company that relies on testimonials of individuals claiming to have made remarkable returns with little work is a big warning sign. Be wary

RATE OF RETURN

The average annual rate of return for the US stock market for the 20 years ending in June 2023 was 9.752% as measured by the S&P 500 index of large company stocks. For the 30 years ending in December 2022 it was 9.64%. Those are good benchmarks against which to measure a promised return.

of the testimonials you see in videos or hear at conferences and meetings where the investment is pitched.



Requests For More Money

A fraud may begin with a request for a small investment. Later, the investor receives a letter or an update on the investment with a request for additional funds, either claiming that the investment is doing so well that it's time to invest more, or stating that the company is in a financial bind and needs more money to keep going. Don't invest more money in a failing investment.

BEYOND RED FLAGS: TAKE ACTION AND INVESTIGATE

Before you consider making any investment you should find answers to these five questions.

1. Is the person promoting the investment registered?

You can check a broker's and salesperson's registration and professional history, including problems, at BrokerCheck.org.

If you can't find a record in any of these places, or if the record shows a history of bad actions, don't ignore the potential for fraud.

2. Has the company offering the security registered with the SEC or filed for an exemption?

Verify with the SEC or your state securities regulator that the company filed all necessary exemption filings and is in fact exempt from registration. You can look up registered companies on the SEC's EDGAR database and by conducting an online search.

3. Is there an offering document describing the investment?

Most securities issuers are required to provide an offering circular or private placement memorandum (PPM) that explains important details about the offering.

The offering documents should describe the company's business, names and experience of the partners and executives, risks of the business, and potential liabilities.

4. Is the salesperson's pitch different than what is in the documents?

You want to pay particular attention to how clearly the offering document or PPM describes the risks that are involved, what the fees are, and how liquid the investment is.

If the salesperson downplays any of your concerns or says the details in the document are there because "the lawyers made us put them in," that should be a signal there are serious problems.



5. Do you have copies of all the paperwork?

When you open an investment account, you should be sent copies of all the completed paperwork. You should also have access to regular investment statements showing how much you've invested and the current value of your account.

The statement should also show commissions, sales charges, and other fees. When you review the statements look for discrepancies including unauthorized trades or missing funds.

TYPES AND EXAMPLES OF INVESTMENT FRAUD

Investment scams sometimes follow recognizable patterns that have been around for a long time. Others are constantly evolving, based on new investment products and new investment technologies.

Some classic types of fraud that continue to attract victims include:

Promissory Note Schemes

Many scams involve the issuance of a promissory note. Although promissory notes are legitimate in many business transactions, be wary of investments involving promissory notes, especially those that promise a high, fixed-rate or guaranteed returns. Do not fall for the pitch that you can enforce the promissory note in court to get your money back. If the fraudster spent all investment funds and is bankrupt, or worse, disappears, you are not likely to get your money back.

Ponzi Schemes

In this type of scheme, fraudsters prey on investors by promising strong investment returns. The victims may receive regular investment reports from the scammer showing how their account value is increasing. They are also able to withdraw from their accounts. But the liquidity

that supports those withdrawals is created by the money invested by the next round of victims. Ultimately the scheme collapses.

Affinity Fraud

This type of fraud occurs when the fraudster uses an affiliation with a specific group, such as a social club, support group, charity, or house of worship, as a way to capitalize on trust to persuade investors to buy into a fraudulent investment. Often, part of the pitch is that the investment is a special opportunity that is being offered only to members of the group.

Advance Fee Schemes

Fraudsters using this type of scam trick their victims into parting with their money by requiring an upfront payment before they can receive the stock or other investment they intend to purchase. The fee, which may be referred to as a commission or down payment, is never returned, and the investment is never delivered.

Free Lunch or Dinner Seminars

Although many financial seminars that offer a free meal are offered by legitimate companies, some are run by individuals who are not properly licensed and want to induce you to

invest with them by offering a free meal. The salesperson may display credentials or certificates to establish legitimacy. Make sure you verify registration on [BrokerCheck.org](https://www.brokercheck.org) and always feel free to eat the food and walk away from the pressure to have a one-on-one future meeting.

Some types of investment fraud that have evolved more recently include:

Fake Websites

Using phony sites, dishonest salespeople can manipulate returns to make it appear that the unsuspecting investor is realizing high returns quickly. Investors are urged to make additional deposits based on the perception that they are making money. In some cases, investors may even be encouraged to make small withdrawals to give the impression of liquidity. Eventually, having bilked enough to make the effort profitable, the perpetrators shut down the site.

Changing Platforms

Reaching potential investors through a social media account, the scammer mentions an investment opportunity, and then sends you to a fake investment exchange or platform. Sometimes, the offering is made through a legitimate platform, but with instructions to pay using a different, fraudulent site.

Testimonials and Endorsements

Investment offerings that rely heavily on testimonials from celebrities or influencers may be paying for the endorsements, or may have provided investment income to these individuals. By the time regular investors

invest, the company may not be profitable.

Liquidity Mining

In this type of cryptocurrency fraud, investors are promised a percentage of the profits earned by crypto trading if they contribute some of their current crypto assets into an app that provides liquidity for future transactions. The scammer contacts the victims using a variety of online sources, including dating apps, and stays in touch for a time to build confidence. Then, when the victim's assets have been transferred, the scammer moves those assets into his or her digital wallet and disappears.

Alternative Investments

Investments that are an alternative to traditional investments, such as stocks, are suitable for some investors who can handle risk and losing some of their investment funds. However, some alternative investments are fraudulent because there is no product, or the seller misrepresents the value of the product. Be careful with investments in assets such as real estate, equipment leasing, loan obligations, art and valuables, and NFTs, making sure you understand how the investment works. You should also verify that the assets exist and are valued accurately, though it may be difficult to do so.

Check Registration of an Individual:
BrokerCheck.org

Check Company Registration and Filings:
SEC.gov

Recognizing the red flags and schemes outlined in this booklet will help protect you from becoming the victim of investment fraud. Always investigate before you invest, and contact your state securities regulator if you believe you have been offered or sold a fraudulent investment.



To contact the Alabama Securities Commission (ASC),
visit **www.asc.alabama.gov**
or call 1-800-222-1253