

# Investment Scams and Fraud

## Common Investment Threats

We've all heard about investment scams and fraud. And most of us think: "that couldn't happen to me" or, "I'd never fall for that", but it does, and we do. Who is the typical victim of investment scams and fraud? Here are the statistics:

- Individuals 45 to 70 years-old
- Most of these victims are financially literate and educated
- Most have above-average incomes
- Generally inquisitive and confident

## The Approach

Scam artists typically approach their targets either directly, individual-by-individual, through referrals, or through affinity groups such as clubs, associations, or places of worship. Affinity group scams are successful because of the potential for peer influence and the false belief that if other people I know are investing, it must be okay.

## Scam Tactics

Scam artists have highly-developed skills for communication and persuasion. Couple that with a friendly and disarming personality, and you may just "fall for it." The tactics they use include:

- Persistence. Whether subtle or high-pressure, they literally wear you down – without you even realizing it.
- Creating scarcity and the need for immediacy.
- Getting to know you personally. In doing so, they identify your strengths, your weakness, and where you're vulnerable.
- Plain-old sweet persuasion through a disarming demeanor.

With your good judgment suspended and your defenses down, you "fall for it." It's common for victims of fraud to comment after the fact: "I still can't believe it. I thought they were my friend."

## Common Investment Schemes

### Real Estate Investment Schemes

Schemes related to new real estate development projects or buying, renovating, flipping or pooling distressed properties are popular with scam artists. While legitimate real estate investments can be an important part of a diversified investment portfolio, there are substantial risks. Regulators have seen problems with non-traded real estate investment trusts (REITS). REITS properties offer promises of investment funds being secured by an interest in real property; however the property in question is already highly leveraged and has no remaining equity. As with all investments, careful vetting and due diligence is a must with real estate investments.

### Pyramid Schemes

Scammers promise sky-high returns in a short period of time for doing nothing other than handing over money and getting others to do the same. Despite their claims to have legitimate products or services to sell, these deceivers spend much of the money on themselves and simply use money coming in from new recruits to pay off early stage investors. Although the products sold may be

legitimate, eventually the pyramid will collapse. At some point the schemes get too big, the promoters cannot raise enough money from new investors to pay earlier investors, and many people lose their money.

### **“Ponzi” Schemes**

A type of illegal pyramid scheme named for Charles Ponzi, who fooled thousands of New England residents into investing in a postage-stamp speculation scheme back in the 1920s. Ponzi schemes continue to work as money from new investors is used to pay off earlier investors. Ultimately the scam will collapse leaving investors with nothing to show for their trust. Ponzi schemes have similar characteristics:

- Promise of incredibly high return coupled with low risk
- A reasonably plausible explanation of why the investment is so good
- A scam artist with credibility will often base claims of holding false credentials or being part of a particular group or organization.

One way to protect yourself is to ask questions and when you think you have asked all the questions you have, ask more questions. Bernie Madoff, the king of Ponzi schemes, once said he only turned people away when they asked too many questions.

### **Risky Oil and Gas Drilling Programs**

Investors exploring alternatives to traditional securities may be attracted to the lucrative returns often associated with investments in oil and gas drilling programs. Unfortunately, energy investments generally prove to be a poor substitute for traditional retirement planning. Promoters will conceal risk, using high pressure sales tactics and deceptive marketing practices to peddle worthless investments in oil wells to the investing public. Investors should conduct thorough due diligence and assess their own tolerance for considerable risk when considering the purchase of interests in oil and gas programs.

### **Proxy Trading Accounts**

Be wary of individuals who claim to have trading expertise and offer to set up or manage a trading account on an investor's behalf. Allowing an unlicensed individual to have access to the username and password for your brokerage account or worse, allowing an unlicensed individual to set up a brokerage account in your name, is a recipe for disaster. Investors should check with the Michigan Department of Licensing and Regulatory Affairs (LARA), Corporations, Securities and Commercial Licensing Bureau at 517-335-5237 to confirm that anyone offering to manage your accounts is properly registered and has a clean background. Financial professionals who make the commitment to be properly registered also commit to act ethically and honestly.

### **Digital Currency**

Consumers now are able to purchase goods and services with virtual money such as Bitcoin, PP Coin and other digital currencies. Unlike traditional coinage, these alternatives typically are not backed by tangible assets, are not issued by a governmental authority and are subject to little or no regulation. The value of Bitcoins and other digital currencies is highly volatile and the concept behind the currency is difficult to understand even for sophisticated financial experts. Be aware investments that incorporate abstract money systems present very real risks, including the possibility of leaving an investor broke.

### **Get-Rich-Quick Self-Employment Scams**

This scam promises a sure path to financial independence through work-at-home scams and pyramid schemes. The scam also assures certain income in return for an initial and sometimes recurring

investment. It may also include a variety of other phony business and franchise opportunities.

This scam targets individuals needing to supplement their income. If you are an unemployed worker, suddenly in possession of a large severance package; or retired with a sizable pension, you may be a prime target. Scam artists often locate their victims through trade shows, telephone solicitations, television, radio, print advertisements, and the Internet. They tell the prospective purchaser that interest by the public or a specific market niche is very high and that the window of opportunity will soon close. These promoters pressure investors to make a quick decision and hand over their money.

## Tips to Protect Yourself from Scam Artists

Invest wisely online and offline. Here are some important tips you should keep in mind when you are considering purchasing investment products and for protecting those investments once you have them:

- Beware any money manager who wants total control of all your money or who deliberately overemphasizes his trustworthiness and honesty.
- Choose everyday investments that can be bought and sold through well-known brokerage firms or mutual fund companies. Make sure your statements come from your brokerage firm, not the individual money manager.
- Beware promises of high or unusually steady rates of return. If a money manager can't easily explain his or her investment process, that's a red flag.
- Take your time when making investment choices. Don't be hurried or bullied into making a decision.
- Be careful of "act now" or "before 'it's too late'" statements.
- Say "no" to anybody who tries to pressure you or rush you into an investment.
- Always ask for a written explanation of any investment opportunity and then shop around and get a second opinion.
- Make checks payable to a company or financial institution, never an individual.
- Retain and maintain account statements and confirmations you receive about your investment transaction.
- Document all conversations with financial advisers.
- Seek independent, third-party advice. Have a licensed investment professional, attorney or accountant review the investment opportunity. Most of the money lost to scams and fraud is just that: lost; and often difficult to recover from both financially, and emotionally.
- Take immediate action if you detect a problem. Time is critical, so do not be afraid to complain.
- Don't let embarrassment or fear stop you from reporting financial exploitation or investment fraud.
- Don't put all your eggs in one basket- divide your investments among different asset categories, such as stocks, bonds, and cash held in federally insured deposit accounts.

The following are resources you can contact to check on a broker or to obtain investment information:

- Department of Licensing and Regulatory Affairs (LARA) - Corporations, Securities and Commercial Licensing Bureau – 517-335-5237 or [www.michigan.gov/securities](http://www.michigan.gov/securities).
- Financial Industry Regulatory Authority (FINRA) – FINRA Broker Check Hotline at 800-289-9999 or [www.finra.org/investor](http://www.finra.org/investor)
- Securities and Exchange Commission (SEC) – 800-732-0330 or [www.sec.gov/investor](http://www.sec.gov/investor)
- National Futures Association (NFA) – 800-621-3570 or [www.nfa.futures.org](http://www.nfa.futures.org)
- Commodity Futures Trading Commission (CFTC) – 202-418-5000 or [www.cftc.gov](http://www.cftc.gov)

## Other Ways to Protect Yourself

When presented with any investment opportunity that you're unfamiliar with, suspicious of, or "sounds too good to be true," use this quick and easy check list to help protect yourself:

1. Confirm that the investment is registered with the state's securities regulator or the state's insurance regulator.
2. Confirm that the salesperson is properly licensed and registered with state's regulators. For insurance products, and insurance salespersons in the State of Michigan, call the Michigan Department of Insurance and Financial Services (DIFS) at 877-999-6442. For other types of investments, and for the salespersons who pitch them, call the Michigan Department of Licensing and Regulatory Affairs – Corporations, Securities, and Commercial Licensing Bureau at 517-335-5237.

We're all potential victims of investment fraud and scams. The skills of the criminal are not used to sell the features and benefits of a bogus investment. The investment is only a prop. Their skills are used for one purpose: to get you to turn over your money. They do this by disarming you and lulling you out of your natural skepticism and better judgment. And when that occurs, any one of us could "fall for it."