

Popular Scams for 2009

Securities Sales/Offers Involving Products and Professionals Without Proper Registration or License Credentials.

Most of the people convicted in Alabama for violations of the Alabama Securities Act were not licensed to sell investments or to charge a fee for investment advice or financial planning in Alabama. Also, the product they offered was not registered or exempt from registration in Alabama. State law mandates that any business or individual who offers or sells securities within, into or from Alabama must be licensed/registered with the ASC (unless exempt). Before any Alabama citizen agrees to purchase an investment product or service, they should contact the ASC to inquire about the company or person making the offer, as well as the registration status of the product being offered for sale. The ASC will conduct a free background check and provide details concerning enforcement actions, negative business activities and will verify required licensing and registration.

Affinity Fraud. Con artists are increasingly targeting religious, ethnic, cultural and professional groups. Some may be members of the group or pretend to be members in order to gain trust. Con artists often recruit a respected member or official of a community or religious congregation to promote their schemes by convincing them that a fraudulent investment is legitimate. In many cases, even the leaders become victims of what turns out to be a Ponzi scheme. Remember: Investigate before you invest – no matter who is selling. Social networking websites have recently created an environment ripe for affinity fraud, where scammers can take advantage of freely shared information with both their real and ‘virtual’ friends by posting it to their profile.

Ponzi Schemes. Named for swindler Charles Ponzi, who in the early 1900s took investors for \$10 million by promising 40 percent returns, these schemes are a perennial favorite among con artists including the now infamous Bernie Madoff. The premise is simple: promise high returns to investors and use money from previous investors to pay new investors. Inevitably, the schemes collapse and the only people who consistently make money are the promoters who set the Ponzi in motion. Con artists typically attribute government intervention as the reason why new investors didn’t get their promised returns.

Promissory Notes. For sophisticated or corporate investors, promissory notes can be a good investment, providing a reasonable reward for those who are willing to accept the generally higher than average risk. However, promissory notes that are marketed broadly to the general public often turn out to be scams. Promissory notes are sold as instruments that guarantee above-market, fixed interest rates, while safeguarding their principal. When interest rates are low, investors may be enticed by the higher, fixed returns that promissory notes offer. These notes, however, can become vehicles for fraud when the issuer of the note has no intention or capability of ever delivering the returns promised by the sales person; leaving the note worth less than the paper on which it is printed.

Sale of Unsuitable Products. State and provincial securities regulators continue to see the sale of complex hybrid financial products, such as variable and equity-indexed annuities, to investors for whom they are not suitable—typically seniors or people who do not realize that risk is involved and there may be penalties for early withdrawal of the principal. These products frequently contain features so complicated that even licensed financial professionals are not adequately trained to understand them.

Self-Directed Pension Plans. Many types of securities fraud require the victim to remove funds from legitimate investments such as stock brokerage accounts, mutual funds, insurance policies, deferred compensation plans and mutual funds so that they can be invested in a worthless scam. This scam may begin with advice to convert an employer-sponsored pension into a self-directed pension plan. While these plans may serve legitimate investment purposes, all too often they only serve to benefit the scam artist.

Prime Bank Schemes. These schemes often promise high-yield, tax-free returns that are said to result from “off-shore trades of bank debentures.” Investors are told that only very wealthy people can get the benefit of these programs but the promoter is able to make it available to the victim. Sometimes the victim is required to execute a “confidentiality agreement” in order to invest and is told not to consult an attorney, accountant or financial planner because they keep these programs for the “big boys” and will deny that they exist. There are no such programs, no such debentures and no such high-yield trades. These prime bank schemes are the securities equivalent of a purse snatch. Once the seller has your money, it’s gone “off shore” forever.

Private Security Offerings. Con artists are turning increasingly to private securities offerings under Rule 506 Regulation D of the Securities Act of 1933 to attract investors without having to go through the full registration process. Although sometimes legitimate, these offerings are often associated with fraud. Also, proceed with caution when encouraged to invest in “general partnership” or “limited liability companies.” Speculative deals often are packaged as such in an attempt to evade the consumer protection requirements of state and federal securities laws.

Real Estate Investment Schemes. As the housing market continues to reel from the subprime lending crisis, schemes promising large returns from various types of real estate-related investments also are increasing. Some real estate alternatives may actually be worthless real estate investments that promoters are trying to dump off to unsuspecting retail investors. State and provincial securities regulators also note that “reverse mortgages” pose several risks: they may not be appropriate for a given investor; if the homeowner chooses the option of accepting the funds all at once in a lump sum it may create a sudden supply of cash that may be diverted into other bad investments; and they enable promoters to gain access to a senior citizen’s entire financial profile. Such disclosure of other assets can lead to yet more scams—and losses.

Oil and Gas Investment Fraud. High oil prices mean oil and gas scams will continue to attract victims. Oil and gas deals are complicated investments that generally require a significant investment, often requiring a minimum deposit of thousands of dollars. Increasingly, these deals are being promoted via the Internet with claims of attractive tax advantages. Sales materials with “official-looking” surveyor maps and “geologist” opinion letters touting the likelihood that the “managers” of the drilling enterprise will hit pay dirt are sent regularly to prospective investors more than 1,000 miles from the region being “prospected.” Overall, these deals are highly risky, but the lure of high profits often proves irresistible to investors.

Sale and Leaseback Contracts. In an attempt to avoid the investor protections of securities laws, some investments are structured to resemble the sale of a piece of equipment such as a payphone, ATM machine or Internet booth located at a remote venue where the investor cannot service and maintain the equipment and must enter into a servicing agreement. In order to make the deal more attractive, investors are told that after a given period the equipment can be sold back to the seller at the investor’s original purchase price. The investor is also promised a specific rate of return. In a variant of this scheme, a real estate interest such as a long-term lease in a resort community is sold instead of physical equipment. Frequently the equipment or property does not exist and the seller lacks the financial capacity to keep the promise of repurchase.

Pump and Dump Schemes. Unethical broker-dealers frequently “pump” up the value of low-priced securities traded on the NASDAQ “pink sheets” and then “dump” the stock after naïve investors have purchased the stock at inflated prices. The balloon breaks when the promoters no longer maintain the myth that there is value in the shares and investors are left holding worthless shares. These schemes frequently appear through unsolicited e-mail messages. [Hundreds of millions of dollars have been lost by U.S. citizens in penny stock, micro cap and related pump and dump scams and Alabamians have lost millions of dollars.]

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, to report suspected fraud or to obtain consumer information.