

2009-2010 Top 10 Investor Traps

Natural Resource Investment Scams.

The Kentucky Department of Financial Institutions (DFI) expects to continue to see a rise in energy and precious metals scams promising quick, high returns. Investors may 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.

Ponzi Schemes. Despite the heightened awareness of Ponzi schemes following Bernard Madoff's 150-year prison sentence for multi-billion dollar fraud, 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. Beware of investment opportunities promising high and steady rates of return.

Leveraged Exchange-Traded Funds

(ETFs). This relatively new financial product has been offered to individual investors who may not be aware of the risks. 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. These volatile funds typically are not suitable for most retail investors.

Real Estate Investment Schemes. State securities regulators have noted a rise in scams disguised as offers to help homeowners "save" their homes or "fix" their mortgages, usually in exchange for a fee paid in advance. Advance-fee offers only generate a quick profit for the con artist and provide no benefit to the consumer. And while reverse mortgages are legitimate lending products, some unscrupulous salesmen try to convince consumers to inappropriately invest the funds.

Private Placement Offerings. Private placements allow businesses to raise capital by selling securities to a relatively small number of investors instead of a public offering made through national securities markets. Regulators have observed a 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 an unlimited amount of money without registering the offering as long as they meet certain standards. Although properly used by many legitimate issuers, the exemption has become an attractive option for con artists and those barred from the securities industry.

Short-term Commercial Promissory

Notes. Short-term commercial promissory notes that are nine months or less in duration 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.

Life Settlements. The rising popularity of life settlements, or viaticals, 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 seniors. 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.

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.

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

Speculative Inventions and New Products.

New products are for venture capitalists who know how to assess the risks. They are not good retirement investments, even though they may promise high returns.

Contact the Department of Financial Institutions' Securities Division at 800-223-2579 with any questions about an investment product, broker or adviser before investing.

