

## Online Investment Scams Tutorial

<http://www.investopedia.com/university/scams/>

Thanks very much for downloading the printable version of this tutorial.

As always, we welcome any feedback or suggestions.

<http://www.investopedia.com/contact.aspx>

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### Introduction

To: investor@aol.com

Subject: This is your lucky day!!!

*I don't usually send out stuff like this, but what I have to tell you is just too good. For the last 6 months I've been developing the ULTIMATE TRADING PROGRAM. I've figured out exactly how to pick the next Microsoft. In fact, over the last year I've had a 3000% return on my investment!!!*

*In my investing program there is absolutely NO RISK. In fact, it's such a SURE THING that we'll guarantee you cannot lose your investment. Thing is, if you want a part of the action, you'll have to send me \$499.95 today. There are just too many other investors who want to get in on this...*

Ever find a scam like this in your e-mail? We sure get enough of them in the Investopedia inbox.

The Internet is a great tool for investors, allowing us to research investments and trade securities with unprecedented ease. Unfortunately, the lack of rules on the 'Net also makes it a perfect place for fraud to flourish.

In this tutorial, we look at the ins and outs of Internet investment fraud. We examine different scams, see how they are carried out, and discuss how to avoid them.

## Different Types Of Scams

Very few of the scams on the Internet are new. Most of the swindling techniques we see today originated long ago as telemarketing, direct mail, or even door-to-door selling schemes. But the Internet adds another troubling dimension to these old tricks. For example, a fancy Web site can create the illusion of a large and reputable company, especially if it provides links to legitimate sites.

Here are some of the largest and most successful investment scams:

- **Ponzi Scheme** - A type of pyramid scheme, this is where money from new investors is used to provide a return to previous investors. The scheme collapses when money owed to previous investors is greater than the money that can be raised from new ones. Ponzi schemes always collapse eventually.
- **Pump and Dump** - A highly illegal practice where a small group of informed people buy a stock before they recommend it to thousands of investors. The result is a quick spike in stock price followed by an equally fast downfall. The perpetrators who bought the stock early sell off when the price peaks at a huge profit. Most pump and dump schemes recommend companies that are [over-the-counter bulletin board](#) (OTCBB) and have a small [float](#). Small companies are more volatile and it's easier to manipulate a stock when there's little or no information available about the company. There is also a variation of this scam called the "[short and distort](#)." Instead of spreading positive news, fraudsters use a smear campaign and attempt to drive the stock price down. Profit is then made by [short selling](#).
- **Off Shore Investing** - These are becoming one of the more popular scams to trap U.S. and Canadian investors. Conflicting time zones, differing currencies, and the high costs of international telephone calls made it difficult for fraudsters to prey on North American residents. The Internet has eroded these barriers. Be all the more cautious when considering an investment opportunity originating in another country. It's extremely difficult for your local law enforcement agencies to investigate and prosecute foreign criminals.
- **Prime Bank** - This term usually describes the top 50 banks (or thereabouts) in the world. Prime banks trade high quality and low risk instruments such as world paper, [International Monetary Fund](#) bonds, and

[Federal Reserve](#) notes. You should be very wary when you hear this term- it is often used by fraudsters looking to lend legitimacy to their cause. Prime bank programs often claim investors' funds will be used to purchase and trade "prime bank" financial instruments for huge gains. Unfortunately these "prime bank" instruments often never exist and people lose all of their money.

## Bulletin Boards

There are literally hundreds of investment boards where anyone can rant, rave, or post BS. Online bulletin boards (BBs) come in various forms, including newsgroups, usenet, or web-based boards. Some of the larger BBs, like those found on sites such as [Raging Bull](#), [Boards on Yahoo! Finance](#), and [Silicon Investor](#), see thousands of messages posted on an hourly basis.

While there are many valid and useful posts on these boards, a large number of tips turn out to be bogus. Fraudsters most often use a [pump and dump](#) scheme on BBs by pretending to reveal inside information about big upcoming announcements, great new products, or lucrative contracts. The opposite can be done too. If fraudsters hold a [short](#) position in a company, they will try to spread negative rumors in the hope that investors will panic and push prices down.

Here's the tricky part about BBs: anonymity. You don't know for sure who you're dealing with and how credible they are. People claiming to be unbiased observers who've carefully researched a company may actually be company [insiders](#), large shareholders, or paid promoters. A single person can easily create the illusion of widespread interest in a small, [thinly-traded](#) stock by posting a series of messages under various aliases.

In the aftermath of the dot-com [bubble](#), bulletin boards experienced a dramatic drop in traffic. Thankfully, many investors realized they couldn't believe everything they read online. But that's not to say there is no valuable information on BBs. Before Enron went bankrupt, posts were made online that revealed many of the fraudulent practices taking place at the energy giant. Regrettably, at the same time, there were countless posts that were bullish on Enron. It's nearly impossible to sort out the valuable posts from the fake ones.

## Newsletters

Almost every stock pick site offers a newsletter that is supposedly full of useful insights and great stocks. There are many good newsletters out there, but some are just promoting stocks under the guise of presenting investors with "free unbiased information."

In fact, many companies hire employees or pay people to write online newsletters to promote their stock. In theory, this practice is not illegal. But federal securities laws require newsletters to disclose who paid them, the amount paid, and the type of payment. Most fraudulent newsletters fail to provide this information. Instead, they lie about the income they receive, their independence, their research, and their historical results. They stand to profit handsomely if they convince investors to buy or sell particular stocks. Newsletters also use the [pump and dump](#) technique discussed earlier. With enough people on the list, it is possible to create movement in the price of small stocks.

Even worse is junk e-mail or "spam." As spam costs next to nothing to create, it has become the tool of choice for many fraudsters. Often these messages consist of "get-rich-quick" schemes and offer "guaranteed results." If the sender is unfamiliar to you or the message is addressed generally (great investment tip) it is likely a scam. Brokers and traders don't give away good tips to random people for free. Besides, no reputable company would spam to get their name out. The smartest thing you can do is hit your delete button.

Identifying these shady e-mails isn't tough. Besides promising huge results with no risk, look for CAPITALIZED LETTERS WITH MANY EXCLAMATION MARKS!!! FOR SOME REASON SCAM ARTISTS THINK YOU'LL LISTEN IF THEY WRITE LIKE THEY ARE SCREAMING AT YOU!!! Another clue is when the e-mail comes from free e-mail providers such as yahoo.com or hotmail.com. Spammers use these addresses to hide where the original message comes from. Below are some examples of e-mails to watch out for. These are real, uncut, uncensored, spam scams sent to our Inbox at Investopedia:

[Stock spam example 1](#)

[Stock spam example 2](#)

[Stock spam example 3](#)

## **Dealing With Investment Fraud**

If you come across or are the victim of an investment scam, the best thing to do is report it to the [SEC](#). They have online forms to contact them at their complaint site: <http://www.sec.gov/complaint.shtml>.

You can also write them at:

Securities and Exchange Commission  
Office of Investor Education & Assistance  
450 Fifth Street, N.W.  
Washington, D.C. 20549-0213  
Fax: 202-942-9634

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You can forward spam or copies of fraudulent message board postings to: [enforcement@sec.gov](mailto:enforcement@sec.gov).

When contacting the SEC, you only need to give as much personal information as you wish. However, the more information you give them, the better they will be able to help you. Include specific details of how, why and when you were defrauded with any contact info you have on the fraudulent person or company you are reporting.

## **Conclusion**

Now that you're familiar with the various kinds of online investment scams, we hope you'll be prepared for anything the fraudsters throw at you. We'll be happy if this tutorial saves one person from being scammed out of their hard-earned money.

To recap:

- Many scams on the 'Net aren't new at all. They're just variations on classic Ponzi schemes, pump and dump scams, and offshore investing scams.
- Bulletin boards are especially dangerous because you don't know the identity of who is posting. Take all posts with a grain of salt.
- Newsletters are often written by paid promoters. Always be skeptical: if things sound too good to be true, they probably are.
- Spam isn't even worth the second it takes to hit delete.
- If you encounter a scam, contact the SEC.