



SEC

OFFICE of INVESTOR
EDUCATION and ADVOCACY

Stopping Affinity Fraud *in Your Community*

How to Avoid Investment Scams
that Target Groups

Information is an investor's best tool

When a friend, family member, or co-worker encourages you to invest your money in an opportunity guaranteed to pay a return of 10% or more per year, what will you do?

The SEC's Office of Investor Education and Advocacy believes it is important to raise awareness regarding investment scams that target groups. In this guide, you will learn key strategies for protecting yourself and your community from the potentially devastating impact of affinity fraud.

AFFINITY FRAUD

Affinity fraud refers to investment scams that prey upon members of identifiable groups, often religious or ethnic communities. The fraudsters who promote affinity scams frequently are – or pretend to be – members of the group. They often enlist respected leaders from within the group to spread the word about the scheme, by convincing those people that a fraudulent investment is legitimate and worthwhile. Many times, those leaders become unwitting victims of the fraudster's ruse.

These scams exploit the trust and friendship that exist in groups of people who have something in common. Because of the tight-knit structure of many groups, it can be difficult for regulators or law enforcement officials to detect an affinity scam. Victims often fail to notify authorities or pursue their legal remedies, and instead try to work things out within the group. This is particularly true where the fraudsters have used respected community or religious leaders to convince others to join the investment.

COMMON TRAITS, COMMON TACTICS

Many affinity scams involve “Ponzi” or pyramid schemes, where new investor money is used to make payments to

earlier investors to give the false illusion that the investment is successful. This ploy is used to trick new investors to invest in the scheme and to lull existing investors into believing their investments are safe and secure. In reality, the fraudster almost always steals investor money for personal use. Both types of schemes depend on an unending supply of new investors. When the inevitable occurs, and the supply of investors dries up, the whole scheme collapses and investors discover that most or all of their money is gone.

TARGETS OF AFFINITY FRAUD

Affinity frauds can target any group that takes pride in their shared characteristics. The SEC has investigated and taken quick action against affinity frauds targeting a wide spectrum of groups, including:

- Ethnic communities;
- Religious groups;
- Professional groups;
- Members of the military; and
- Seniors.

HOW TO AVOID AFFINITY FRAUD

Many victims of affinity fraud simply trust the judgment of a friend, family member, or co-worker. Others research the investment opportunity by talking with the promoters or others who have invested in the scheme.

But the key to avoiding affinity fraud or any investment fraud is using independent information to

evaluate financial opportunities. We see too many investors who might have avoided trouble and losses if they had asked questions from the start and verified the answers with reliable information from sources outside of their family, community, or group.

Before you hand over your money for an investment opportunity, consider these questions:

Is the seller licensed?

Smart investors check out the background of anyone promoting an investment opportunity – even before learning about opportunity itself. Why? Research shows that con-artists are experts at the art of persuasion, often using a variety of influence tactics tailored to the vulnerabilities of their victims. Even a little information about your family, interests, or job can help a skilled con-artist swindle your money.

Fortunately, it's easy to find information that can help you protect your investment dollars. Federal and state securities laws require investment professionals and their firms to be licensed or registered, and to make important information public. Be sure to ask anyone promoting an investment opportunity if he or she is licensed and then check out the answer with an independent source. Just one phone call or visit to a web site may save you from sending your money to a con artist, a bad financial professional, or disreputable firm.

To check out the background of an investment professional, visit www.investor.gov or call the SEC's toll-free investor assistance line at (800) 732-0330.

Examples of Common Persuasion Tactics

The “Phantom Riches” Tactic—dangling the prospect of wealth, enticing you with something you want but can’t have. “These gas wells are guaranteed to produce \$6,800 a month in income.”

The “Source Credibility” Tactic—trying to build credibility by claiming to be with a reputable firm or to have a special credential or experience. “Believe me, as a senior vice president of XYZ Firm, I would never sell an investment that doesn’t produce.”

The “Social Consensus” Tactic—leading you to believe that other savvy investors have already invested. “This is how ___ got his start. I know it’s a lot of money, but I’m in—and so is my mom and half her church—and it’s worth every dime.”

The “Reciprocity” Tactic—offering to do a small favor for you in return for a big favor. “I’ll give you a break on my commission if you buy now—half off.”

The “Scarcity” Tactic—creating a false sense of urgency by claiming limited supply. “There are only two units left, so I’d sign today if I were you.”

Source: FINRA Investor Education Foundation

Is the investment registered?

Smart investors always check whether an investment is registered with the SEC by using the SEC's EDGAR database or contacting the SEC's toll-free investor assistance line.

Any offer or sale of securities must be registered, or exempt from registration. Registration is important because it provides investors with access to key information about the company's management, products, services, and finances.

The mere fact that a company registers or files reports with the SEC does not make the company a "good" investment or immune to fraud. Conversely, the fact that a company does not file reports with the SEC does not mean the company lacks legitimacy. The critical difference is that you assume more risk when you invest in a company about which little or no information is publicly available.

If an investment is not registered with the SEC, find out if it is registered with your state securities regulator. If you can't find any record that it is registered with the SEC or your state, or that it's exempt from registration, call or write your state's securities regulator or the SEC immediately with all the details. You may have come face to face with a scam.

HOW DO THE RISKS COMPARE WITH THE POTENTIAL REWARDS?

The potential for greater returns typically comes with greater risk. Understanding this crucial trade-off between risk and reward can help you separate legitimate opportunities from unlawful schemes.

“Too Good To Be True” Investment Opportunities

If you’re not sure if an investment opportunity is “too good to be true,” consider these rules of thumb:

Low risk generally means low yield. If you are offered a “no risk” investment opportunity, compare its potential return with a financial choice that is truly guaranteed, such as a federally insured savings account. If the potential return of the investment opportunity is significantly higher, it could be fraudulent or contain risks you haven’t considered.

High yields typically involve high risk. The stock market, which has produced large investment gains as well as huge losses from year to year, has provided an average annual return of approximately ten percent since the Great Depression. Any investment opportunity that claims you’ll get substantially more could be highly risky.

Promises of consistent double-digit returns are consistently frauds. Investments seeking high returns tend to be volatile. For example, it’s actually quite rare for the stock market to return its historical ten-percent average in any given year; larger gains or losses are more common.

Investments with greater risk may offer higher potential returns, but they may expose you to greater investment losses. Keep in mind every investment carries some degree of risk and no legitimate investment offers the best of both worlds.

Many investment frauds are pitched as high return opportunities with little or no risk. Ignore these opportunities or, better yet, report them to the SEC.

DO I UNDERSTAND THE INVESTMENT?

Many successful investors follow this rule of thumb: *Never invest in something you don't understand.* Sometimes, even the simplest sounding products or investment opportunities can be pretty complex. Always read an investment's prospectus or disclosure statement carefully. If you can't understand the investment and how it will help you make money, ask a trusted financial professional for help. If you are still confused, you should think twice about investing.

WHERE TO GO FOR HELP

Whether checking out an investment professional, researching an investment, or learning about new products or scams, unbiased information can be a great advantage when it comes to investing wisely. Make a habit of using the information and tools on securities regulators' websites. If you have a question or concern about an investment, please contact the SEC, FINRA, or your state securities regulator for help.

U.S. Securities and Exchange Commission

Office of Investor Education and Advocacy

100 F Street, N.E.

Washington, D.C. 20549-0213

Telephone: (800) 732-0330

Fax: (202) 772-9295

Web: www.investor.gov

Online complaint form: www.sec.gov/complaint.shtml

Financial Industry Regulatory Authority (FINRA)

FINRA Complaints and Tips

9509 Key West Avenue

Rockville, MD 20850

Telephone: (301) 590-6500

Fax: (866) 397-3290

Web: www.finra.org/investor

Online complaint form: www.finra.org/complaint

North American Securities Administrators Association

750 First Street, N.E., Suite 1140

Washington, D.C. 20002

Telephone: (202) 737-0900 Fax: (202) 783-3571

Web: www.nasaa.org

ORDERING COPIES OF THIS PUBLICATION

To order free copies of this publication to share with your friends, family members, or others in your community, please visit www.pueblo.gsa.gov. To order by phone, call the Federal Citizen Information Center at (888) 878-3256, Monday-Friday from 8 AM to 8 PM ET.



SEC

OFFICE of INVESTOR
EDUCATION and ADVOCACY

1-800-732-0330

www.investor.gov