Investing and the Internet

Be Alert to Signs of Fraud

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Canadian Securities Administrators
Autorités canadiennes en valeurs mobilières

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The Internet can be an invaluable tool for investors and offers a wealth of information about financial markets and personal investing. News services, government agencies, stock exchanges, mutual fund companies, securities issuers and financial advisers have established literally hundreds of World Wide Web sites that provide up-to-date information on investing and investment products. With just a few keystrokes, an investor with a computer and modem can have access to more educational materials and current market data than ever before.

Investors who venture into the online world, however, should keep in mind that the power of the Internet is also being exploited by investment con-artists and fast-buck operators who want nothing more than to separate you from your hard earned money. Regulators in Canada and the United States have mounted important new programs to stop cyber-fraud, but there are still many places on the Internet for swindlers to set up shop. This does not mean that cyberspace should be avoided, but it does mean that investors should be alert to signs of fraud.

Unregistered Trading

The law in Canada requires that people in the business of trading or advising in securities be registered (licensed) in each province and territory in which they do business. Increasingly, dealers from Canada and abroad are advertising their services over the Internet and the World Wide Web and are accepting clients and conducting business in jurisdictions where they are not registered.

Online Touts and Promotions

Online bulletin boards, news groups and discussion groups dedicated to investment topics can be effective forums for investors to share ideas about personal finance. Unfortunately, some con-artists have used these forums to tout specific securities for their own enrichment. Frequently using aliases, these con-artists post messages calculated to spark interest in a security, usually one that is traded on a venture capital or over-the-counter market. The messages sometimes take the form of testimonials or fake conversations. They often include unsupported share price predictions or 'hot tips' about important news that has not been publicly disclosed. What the messages do not disclose is that the person is hyping the security only for personal gain.

Misrepresentations

That information appears on a computer does not mean it is true. Regulators are receiving an increasing number of complaints about misrepresentations in investment information distributed through the Internet or by e-mail. Often the misinformation has been posted anonymously or through an alias, making it difficult to determine its origin. In other cases, the misstatements are made by companies or financial advisers who do not take the same care in preparing electronic communications as they would in preparing an official filing for regulators.

Manipulation

Through anonymous online touts, misrepresentations and puffery, cyber-schemers have used the Internet to help them artificially run-up the price of thinly traded securities. Unwary investors read about hot tips, huge potential profits and limited risk, but they aren't told that the vast majority of shares are held by a small group of people who are behind the hype and promotion. As investors rush to the market to 'get in on the ground floor', the inside group cashes in, selling their cheap shares into the rising market. When the hype-fueled share price falters, the promoters may blame unnamed short sellers and may inflict even more damage on victims by urging them to 'average down' by buying additional shares as the price drops. The security often disappears from sight soon after, and investors are left to post plaintive messages: "Whatever happened to Company X?" These manipulative schemes have been played out for decades, but the Internet makes it easier for fraudsters to reach a wide audience of unsuspecting investors.

Illegal Distributions

The power of the Internet has tempted many new ventures to try to sell securities to the public illegally. In Canada and in many other countries, the general rule is that securities can be distributed to the public only after the regulators have vetted the company's prospectus. Even then, the securities must be distributed through a registered dealer. New schemes are being uncovered regularly in which companies are advertising and selling securities to the public via the Internet without having filed a prospectus and without fulfilling the legal requirement to provide investors with detailed information about the company and its securities.

Protecting Yourself Against Online Fraud

Some of the abusive investment schemes in cyberspace are indistinguishable from those that have been used elsewhere for decades. The online world, however, represents an enormous advance in the ability of con-artists to victimize the unwary. Some simple precautions can keep you from becoming a victim.

Don't believe everything you read.

Evaluate the information you get online in the same way that you would a whispered hot tip from a stranger. Exercise healthy skepticism and remember how easy it is for people to disguise their identity online. Keep in mind that investment schemers will often talk up projects in remote corners of the globe that can't be easily checked out, or use endless technical jargon that can only be debunked by experts.

Don't assume you know whom you are talking to.

Bulletin board and discussion group participants may not be who they say they are. Those who recommend specific securities may have no investment qualifications and may well have ulterior motives.

Don't assume that your online service provider polices its investment bulletin boards.

Most don't. The volume of postings often swamps the ones that try. Often there is nothing to stop a con-artist from posting one or one hundred pitches for a swindle.

Don't buy thinly traded, little known securities on the basis of online information.

These are the securities most susceptible to manipulation. Unlike blue chip stocks, the price of thinly traded, low priced shares can be moved significantly through relatively small strategic trades. This is why online hype usually concerns little known junior companies. Always take the time to do your own research based on reputable information sources, and seek the advice of a qualified, independent financial adviser (see our brochure *Choosing Your Financial Advisers*).

Don't get suckered by claims made about 'inside information'.

Investment bulletin boards and discussion groups are riddled with supposed hot tips that are sure to send some stock soaring in value. Ask yourself, "If this is such great news, why are they telling me?" These hot tips are seldom, if ever, true. Besides, even if they are true, trading on inside information is illegal in Canada.

Be on the lookout for conflicts of interest.

Some of the people who analyze and recommend securities online are being paid by the company whose shares they are recommending. Some disclose this fact, while others make no mention of their conflict of interest. Make sure you know why someone is enthusiastic about an investment opportunity.

Make sure that the security has been qualified for sale and is being sold by a person properly registered with your securities regulator.

Securities regulations designed to protect investors from fraud and abuse do apply in cyberspace. The failure of companies, dealers or advisers to comply with regulations is often a red flag highlighting a potential investment scam. Your securities regulator can tell you whether an individual or company is registered to trade or advise in your area and whether the company selling the securities has filed a prospectus.

Other Common Questions

Should I accept investment advice offered over the Internet?

Common sense would suggest that you don't take investment advice from anyone you don't know and trust, particularly if they don't know you and understand **your** investment needs and objectives. In Canada, every person who is in the business of advising in securities must be registered with the securities regulators wherever they do business. Registered advisers must have appropriate education and experience and comply with capital and conduct requirements. You can check a person's registration by contacting your securities regulator.

Can I open an Internet trading account with a dealer in another province, territory or country?

Not unless that dealer is properly registered to trade in your province or territory. Again, you can contact your securities regulator to find out if a dealer is registered.

Can I invest in securities via the Internet?

Yes, but only if you are investing through the Internet site of a securities dealer that is registered to trade securities in your area.

A company is offering to sell its own securities over the Internet. Can I buy them?

Only if the company meets some very specific legal requirements. To sell its own securities to the public, a company must have filed and obtained a receipt for a prospectus and it must be registered to trade its own securities. In certain circumstances, a company may be exempt from the prospectus and registration requirements, but those exemptions seldom allow sales to public investors. Be wary. Before you buy any securities over the Internet, you should speak to a registered dealer or your securities regulator.

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