

Investing and the Internet  
How to Avoid Cyber-Fraud





# INVESTING

## Investing and The Internet How to Avoid Cyber-Fraud

The Internet can be an invaluable tool for investors and offers a wealth of information about financial markets and investing. News services, government agencies, stock exchanges, mutual fund companies, securities issuers and securities dealers and 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 fraud-artists who want nothing more than to separate you from your hard earned money. Securities 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.



# IRAD

## Unregistered trading

The Québec *Securities Act* and the *Act respecting the distribution of financial products and services* require that people in the business of trading or advising in securities in this province be registered (licensed) with the Commission des valeurs mobilières du Québec or the Bureau des services financiers, depending on registration category. This registration requirement also exists in the other Canadian provinces and territories. Increasingly, dealers and advisers from Canada and abroad are advertising their services over the Internet, which is, in itself, perfectly legal. However, it is important to know that these firms can only accept clients and conduct business in the province where they are registered.

## Online 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<sup>1</sup>. 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. The abuse of insider information (that has not yet been made public on the market) is prohibited by the *Securities Act*. *What these 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. Securities 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 securities dealers or advisers who do not take the same care in preparing electronic communications as they would in preparing an official filing for securities regulators.

## Manipulation

Through 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 the shares in question are held by a small group of people who are behind the manipulation.

As investors rush to the market to “get in on the ground floor”, the cyber-schemers cash in, selling their cheap shares into the rising market. When the hype-fueled share price falters, the instigators of the hoax may inflict even more damage on victims by urging them to “average down” by buying additional shares as the price drops. The security often

<sup>1</sup> Consult the glossary at the end of this document for definitions.



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.* In fact, the Internet is simply an alternative mode of communication, just like the phone or fax, except that it has a global reach! Be very careful when you are solicited through the Internet.

### **Illegal distributions**

The power of the Internet has tempted many new ventures to try to sell securities to the public illegally. In Québec, as well as elsewhere in Canada and in other countries, the general rule is that securities can be distributed to the public only after the securities regulators have vetted the company’s prospectus. Even then the securities must be distributed through a dealer registered with the appropriate regulator. 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 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 that’s on the Internet**

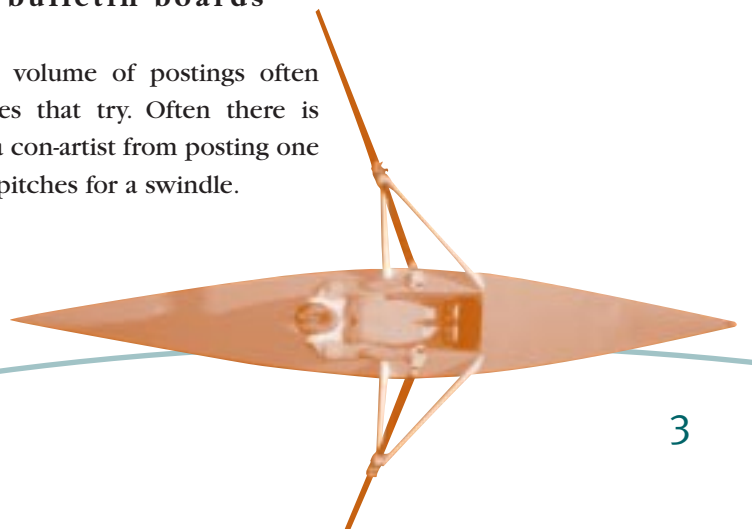
Evaluate the information you get online in the same way that you would a whispered hot tip from a stranger. Exercise healthy skepticism and remember how easy it is for people to disguise their identity online. *Keep in mind that investment schemers often talk up projects in remote corners of the globe 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**

Online 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 screens 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.



# INTERNET

## **Don't buy thinly traded, unknown securities on the basis of online information**

These are the securities most susceptible to manipulation. Unlike large blue chip stocks, the price of thinly traded, low priced shares can be moved significantly through relatively small strategic trades. This online practice 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 securities dealer or adviser (see our brochure *"Your Securities Broker or Financial Adviser - Choices for a Bright Future"*).

## **Don't get suckered by claims made about "inside information"**

Online investment bulletin boards and discussion groups are riddled with supposed hot tips that are sure to send some stocks 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 Québec and elsewhere 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 do apply in cyberspace, just as they do to more traditional modes of communication. The failure of companies, or dealers or advisers to comply with regulations is often a red flag highlighting a potential investment scam. The securities regulator in your province or territory 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 regulator wherever they do business. Registered dealer or adviser representatives must have appropriate education and experience and comply with capital and conduct requirements. You can check a person's registration by contacting the securities regulator in your province or territory. In Québec, this information is available at the Commission des valeurs mobilières du Québec or the Bureau des services financiers, depending on the registration category.

**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 Québec. Again, you can contact the Commission des valeurs mobilières du Québec or the Bureau des services financiers, depending on the registration category, to find out if a dealer is registered.

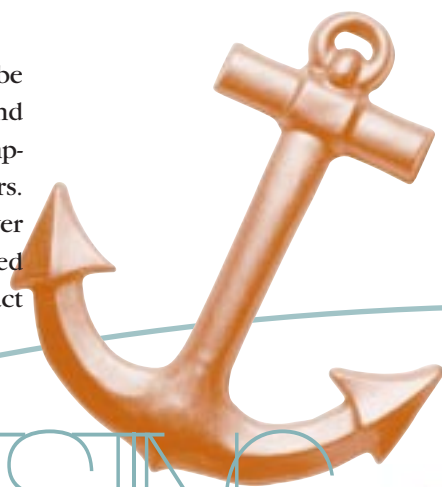
**Can I invest in securities via the Internet?**

Yes, but only if you are investing through the Internet site of a securities dealer that is registered to trade securities in Québec. Keep in mind that the Internet is simply an alternative mode of communication to the telephone, for example. In fact the growing popularity of trading securities on the Internet is due to the desire of customers to reduce their brokerage fees.

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

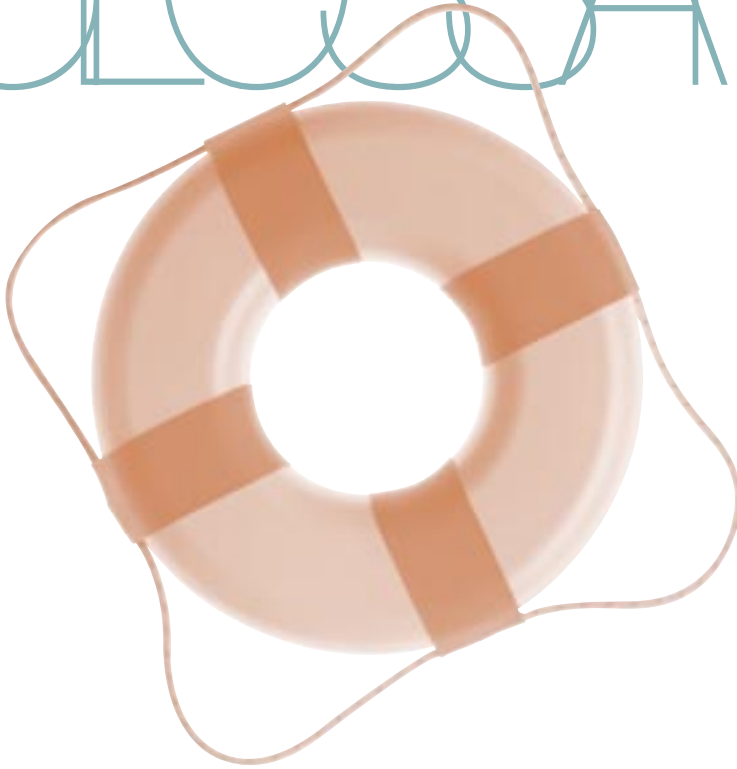
Only if the company meets some very specific legal requirements. To sell its own securities to the public, a company must have filed and obtained a receipt for a prospectus and it must be registered to trade its own securities.

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 adviser representative, or contact your provincial securities regulator.



# GLOSSARY

## Glossary



***Over-the-counter market:*** A market for securities made up of securities dealers who may or may not be members of a recognized stock exchange. Over-the-counter is mainly a market conducted over the telephone, on which shares, bonds and money market securities are traded (i.e. short-term instruments such as treasury bills).

***Prospectus:*** A prospectus is a disclosure document prepared by an issuer — a company that wants to distribute securities to the public — which is distributed to potential investors. The prospectus must contain very specific information about the company issuing the securities. It describes the company and its business sector and contains the company's articles of incorporation, its history, a list of its directors, its financial statements, a description of the issue and the risk factors associated with the investment. Before it can be distributed to investors, the prospectus must be issued a receipt by the Commission des valeurs mobilières du Québec indicating that it complies with the requirements of the *Securities Act*.

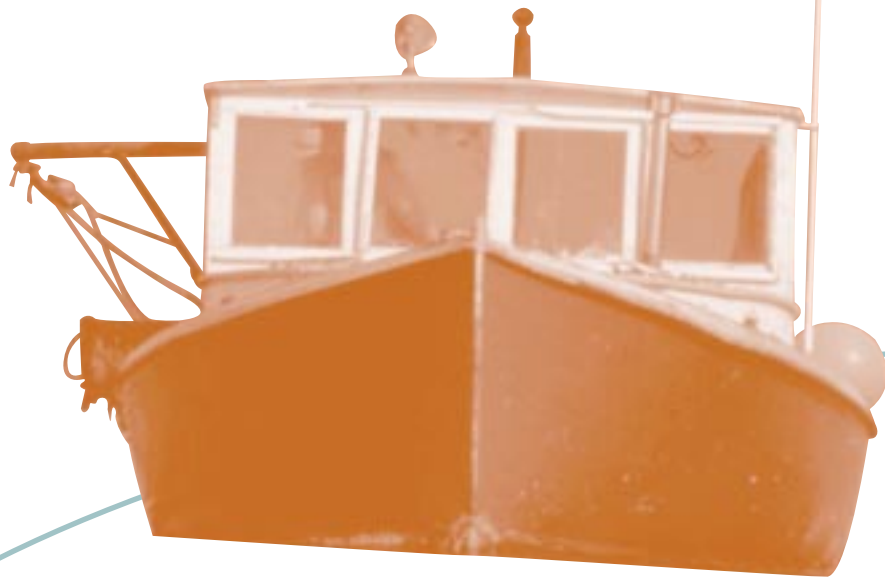
***Representative:*** There are securities dealer representatives and securities adviser representatives. In both cases the representative is the individual acting on behalf of the firm for which they work. A representative may be registered with only one securities adviser.

***Securities:*** Investment products such as stocks, bonds, mutual fund units, etc.

***Securities adviser:*** A firm that advises the public with regard to the purchase or sale of specific securities, either directly, through publications or otherwise. An advisor may also have discretionary management authority over a securities portfolio. The adviser must be registered with the securities regulator of the province or territory in which it does business.

**Securities dealer:** A firm that acts as intermediary in securities transactions. It carries out various functions relating to the transfer of funds between investors (e.g. an individual investor) and those who use the funds (e.g. the company issuing shares). The dealer may act as investment adviser, execute trades for institutional or individual investment accounts, and assist companies or governments in raising funds through share issues. The dealer must be registered with the securities regulator of the province or territory in which it does business.

**Thin market:** A market in which there are comparatively few bids to buy or offers to sell, or both. The phrase may apply to a single security or to the entire stock market. In a thin market, price fluctuations between transactions are usually larger than when the market is liquid. A thin market in a particular stock may reflect lack of interest in that issue, or a limited supply of the stock.



This brochure was produced courtesy of the Canadian Securities Administrators.

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Web Site: [www.cvmq.com](http://www.cvmq.com)  
E-mail: [courrier@cvmq.com](mailto:courrier@cvmq.com)

## ALBERTA

### Alberta Securities Commission

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Calgary, AB T2P 3C4  
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## MANITOBA

### Manitoba Securities Commission

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#### Government of Newfoundland and Labrador

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Telephone: (709) 729-4189  
Fax: (709) 729-6187  
Web Site: [www.gov.nf.ca/](http://www.gov.nf.ca/)

## NORTHWEST TERRITORIES

### Registrar of Securities Department of Justice Government of Northwest Territories

P.O. Box 1320  
Yellowknife, NT X1A 2L9  
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Fax: (867) 873-0243

## NOVA SCOTIA

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## NUNAVUT

### Nunavut Legal Registries Government of Nunavut

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Publications: (416) 593-8117  
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