# Ponzi Schemes – Due Diligence

Since Ponzi schemes typically occur in private securities transactions, the burden is on the investor to ensure their investment is legitimate. To assist you in performing the due diligence so that you do not invest in a Ponzi scheme, you may contact the Division's Licensing Section or use the Division's online resources.

***Key Questions to Ask the Issuer, Promoter, or Salesperson Before Investing***

- **What type of security is being offered?**

  Companies raise capital through debt or equity financing. You may be issued an equity interest (e.g. partnership interest, stock, or interest in a limited liability company) for your investment and may receive dividends or a share of profits. Your investment may also be a loan, or debt, to the company (e.g. promissory note, bond) that is to be repaid according to certain terms that may include payments of interest. Debt may also be secured or unsecured.

- **Is the security properly registered with the Utah Division of Securities or federal government?**

  If the company is properly registered, you should be able to find the company in the **Division's online database** or the **S.E.C.'s Edgar database**. If the company says it is exempt, they should be able to provide you with a legal citation of the law that they are relying upon for exemption. If they cannot, the security is likely illegitimate and you should not invest.

- **Does the company provide a disclosure document, like a Private Placement Memorandum?**

  To help you perform the proper due diligence before investing, you should be provided a private placement memorandum, private offering memorandum, or some other document that fully details information about the fund, including: its managers, its financials, its track record, its investment strategy or business plan, and the risks associated with that strategy or plan. Like a mutual fund's prospectus, a hedge fund's disclosure document should be substantial in length (typically 30 to 60 pages).

- **Does the company provide audited financials?**

  Generally, audited financials are reviewed to assess the financial status of the company, including outstanding liabilities.

- **Will the managers use the monies to invest in other companies or securities? If so, what types of investments with the fund manager make?**

  With pooled investor dollars, the managers of the company may invest in many types of investments each of which carry their own particular risks. If the company will make investments with investor dollars, it is acting as an investment fund and the fund manager needs to license as an investment adviser. Additionally, the fund should disclose in writing the types of investments it will make and the risks associated with those investments. If the fund cannot or will not disclose what types of investments it will make with your money, you should not invest.

- **If the managers use the monies to invest in other companies or securities, are the fund managers licensed as an investment adviser?**

  Fund managers are required to license as investment advisers in most instances. To verify whether the fund manager is licensed, please **contact the Utah Division of Securities** or use the **Verify a License** tool.

- **Does the company's business plan (or the fund's investment strategy) make sense?**

  If you cannot understand how the company (or investment fund) is supposed to earn money, do not be surprised if you lose your money. Some business plans and investment strategies may be complicated, but they should ultimately make sense. Some fund managers may say their business plan or investment strategy is proprietary, but that shouldn't apply to the overall business strategy, which should be disclosed in writing.

- **Does the fund's history of returns seem to be too good to be true?**

  The risk/reward principal dictates that the higher the return, the greater risk. Historically, a good rate of return is 7-8 percent per year (above inflation), but some hedge funds boast rates of return as high as 10 percent per month. While such returns are suspect on face, even if they were accurate, they would reflect serious risks. In short, if it's too good to be true, it probably is.

- **What experience do the managers have?**

  Every industry has its specific challenges, so the question is not only whether the business plan or investment strategy is solid, but also whether the managers have the expertise and skill to execute the plan or strategy. While experience is not a requirement, it is definitely something to consider. The experience of all principals of the company (or investment fund) should be fully detailed in the disclosure document and you should **contact the Utah Division of Securities** for further information.

- **Have you researched the company and managers?**

  Before investing you should research the company and its management. The first step may be a simple search on google.com or bing.com to find any information, but you should **contact the Utah Division of Securities** to see if the company or its managers have any derogatory information. You may also use the Division's resource tool **Check Out An Investment Opportunity**. You may also search with other regulators, such as real estate or insurance. Greater due diligence may require looking for any court records for criminal or civil matters.

***Key Question to Ask Yourself Before Investing***

- Is this investment too good to be true?
- Do I understand the investment?
- Why does the company need **my** money?
- Can I afford to lose my investment?
- Have I spent sufficient time researching the company and its managers?