Doron F. Eghbali Securities Law

Why Should You Be Extremely Cautious About Private Placement Securities?

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Private placement securities are bonds, stocks or other instruments issued by a corporation to outside investors. These investments tend to be very risky partly because the issuers are usually under no obligation to register them with the Securities and Exchange Commission. The problem arises when investors are not told of the dangers looming and do not know enough about the corporation, the broker or other intermediaries' records and credentials to make an informed decision.

WHERE COULD THE PROBLEM PARTIALLY LIE?

The problem partially could lie in the regulatory structure that has not kept pace with the mounting complexity of these instruments. In fact, the law allows the issuers to bypass close scrutiny of regulatory agencies if such securities are sold to super wealthy investors called Accredited Investors whose net worth exceeds $1 million or who earn as little as $200,000 a year.

Senator Christopher Dodd of Connecticut, as part of the financial regulatory overhaul, in the latest draft of the bill had recommended Accredited Investors' regulation be left to states. In addition, Senator Dodd's bill sought to raise the net-worth threshold for such investors to account for inflation. However, critics allege such regulations would further add to complexity of the game and make it harder for start-up companies to raise much-needed funds in the continuing market freeze.

SOME OF THE CONCERNS WITH THESE INVESTMENTS

- **Brokers Play Down the Risks:** Not surprisingly, investors should be on the lookout and understand what they are getting into. Potential investors should ask lots of questions and if the broker seems to play down most of the risks and instead focus on the potential yield, then you should walk away.
- **Too Good To Be True Deals:** It is vitally important, if a deal looks too good to be true, then it is too good to be true. This axiom was painfully proved in the heat of financial crisis.
- **Insufficient Regulatory Scrutiny:** Since the financial regulatory structure is not devised to meticulously scrutinize such investments, investors should be their own guardians. This is important to note, even if, there were laws on the books, the potential for abuse and fraud was still high as Bernard Madoff could evade the law for so long.

SOME DUE DILIGENCE BEFORE INVESTING

- **Contact Your Securities State Regulator:** Contact your securities state regulator and ask about the broker, the brokerage firm or person selling the security. Ensure they are licensed to do business and if they have any records.
- **Finra-Registered Brokers or Brokerage Firms:** Check Finra's BrokerCheck to determine if such people or firms have had problems. To check out Finra, http://www.finra.org/Investors/ToolsCalculators/BrokerCheck/index.htm.

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