Investor Alerts and Bulletins

Investor Alert: Self-Directed IRAs and the Risk of Fraud

Aug. 8, 2018

The SEC's Office of Investor Education and Advocacy is issuing this Investor Alert to warn investors of risks associated with self-directed Individual Retirement Accounts (self-directed IRAs).

Self-directed IRAs allow investment in a broader—and potentially riskier—portfolio of assets than other types of IRAs. While a broader set of investment options may have appeal, investors should be mindful that investments in self-directed IRAs raise risks including fraudulent schemes, high fees, and volatile performance.

Investing through Self-Directed IRAs

An Individual Retirement Account (IRA) provides investors with certain tax benefits for retirement savings. Some common examples of IRAs include the traditional IRA, Roth IRA, Simplified Employee Pension (SEP) IRA, and Savings Incentive Match Plan for Employees (SIMPLE) IRA. All IRA accounts are held for investors by custodians. Custodians may include banks, trust companies, or any other entity approved by the Internal Revenue Service (IRS) to act as an IRA custodian. Most IRA custodians limit the holdings in IRA accounts to firm-approved stocks, bonds, mutual funds, and CDs.

A *self-directed* IRA is an IRA held by a custodian that allows investment in a broader set of assets than is permitted by most IRA custodians. Custodians for self-directed IRAs disclaim most duties to investors, and may allow investors to invest retirement funds in "alternative assets" such as real estate, promissory notes, tax lien certificates, and private placement securities. *Investments in these kinds of assets may have unique risks that investors should consider. Those risks can include a lack of disclosure and* liquidity *-- as well as the risk of fraud.*

Certain self-directed IRAs allow investment in so-called "digital assets," which include crypto-currencies, coins, and tokens, such as those offered in so-called initial coin offerings (ICOs). *Fraudsters may use the allure associated with ICOs and other digital assets to entice self-directed IRA investors with the promise of high returns.*

While it is possible that digital assets may provide fair and lawful investment opportunities, they may also be conducted without SEC registration or a valid exemption from registration, and may not provide complete or accurate information to aid investors in making informed decisions. In addition, many of the trading platforms for these digital assets refer to themselves as "exchanges," which may give investors the misimpression that they are regulated by the SEC. For more information on the risks associated with ICOs and other digital assets, please check out our Spotlight Page on Initial Coin Offerings and Digital Assets. F*or more information on the risks associated with trading platforms for digital assets, please check out the Divisions of Enforcement and Trading Markets' "*Statement on Potentially Unlawful Online Platforms for Trading Digital Assets."

Self-Directed IRAs and the Risk of Fraud

Fraudsters may be more likely to exploit self-directed IRAs because custodians or trustees of these accounts may offer only limited protections. Custodians and trustees typically have only limited duties to investigate the assets or the background of the promoter.

There are a number of ways that fraudsters may try to use self-directed IRAs to perpetrate a fraud on unsuspecting investors. For example:

- **Misrepresentations Regarding Custodial Responsibilities –** Fraudsters may misrepresent the duties of self-directed IRA custodians to deceive investors into believing that their investments are legitimate or protected against losses. For example, fraudsters often claim or suggest that self-directed IRA custodians investigate and validate any investment in a self-directed IRA. However, unlike custodians for other types of IRAs, self-directed IRA custodians are responsible only for holding and administering the assets in a self-directed IRA. *Self-directed IRA custodians generally do not evaluate the quality or legitimacy of any investment in the self-directed IRA or its promoters.* Furthermore, most custodial agreements between a self-directed IRA custodian and an investor explicitly state that the self-directed IRA custodian has no responsibility for investment performance.
- **Exploitation of Tax-Deferred Account Characteristics** – Self-directed IRAs are tax-deferred accounts that carry a financial penalty for prematurely withdrawing money before a certain age. The prospect of an early withdrawal penalty may encourage an investor to take a passive approach to managing the account, which may result in a lesser degree of oversight than a managed account might receive, allowing a fraudster to perpetrate his fraud longer.
- **Lack of Information About Alternative Investments –** Self-directed IRAs allow investors to hold alternative investments that, unlike publicly traded securities, may have limited financial and other information available. Even when financial information for these alternative investments is available, it may not be audited by a public accounting firm. Furthermore, as noted above, self-directed IRA custodians usually do not investigate the accuracy of any financial information that is provided.

*The SEC continues to bring cases related to fraud involving SDIRAs. For more information, see **Securities and Exchange Commission v. Hoplon Financial Group et al., and Securities and Exchange Commission v. Lucita A. Zamoras.***

Ways to Avoid Fraud with Self-Directed IRAs

Despite the risks presented by self-directed IRAs, there are a number of steps that investors can take to reduce the risk of fraud.

- **Verify information in self-directed IRA account statements.** Alternative investments may be illiquid and difficult to value. As a result, self-directed IRA custodians often list the value of the investment as the original purchase price, the original purchase price plus returns reported by the promoter, or a price provided by the promoter. If possible, take steps to independently verify information—such as prices and asset values—provided in account statements.
- **Avoid unsolicited investment offers.** Investors should exercise extreme caution before investing in an unsolicited investment offer that promotes the use of a self-directed IRA. Fraudsters may attempt to lure investors into transferring money from traditional IRAs and other retirement accounts into new self-directed IRAs.
- **Ask questions.** Always ask if the person offering the investment is registered or licensed, and if the investment itself is registered. Then check out the answers with an unbiased source, such as the SEC or your state securities regulator. The SEC has a short publication called "Ask Questions" that discusses many of the other questions investors should ask of anyone who wants them to make an investment, including about the background and history of the promoter. Please take a look at it before making any investment decisions.
- **Be wary of "guaranteed" returns.** Every investment carries some degree of risk, and the level of risk typically correlates with the return an investor can expect to receive. Lower risks generally correspond to lower yields (or returns). By contrast, higher yields typically involve higher risk. Fraudsters often spend a

lot of time trying to convince investors that extremely high returns are low risk by calling them “guaranteed” or “can't miss” opportunities. Be extremely wary of such claims. High returns typically represent potential rewards for investors who are willing and financially able to take big risks.

- **Consult a professional.** For investment opportunities like alternative assets in self-directed IRAs, investors should consider getting a second opinion from a licensed, unbiased investment professional or an attorney. This is especially important if an investor is opening or creating a new account outside a traditional financial institution or well-recognized broker-dealer.

Recourse for Fraud Victims

If you have lost money in a fraudulent investment or scheme involving a self-directed IRA or a third-party custodian, or have information about one of these scams, you should:

- Contact the SEC Complaint Center.
- Check out the SEC’s Resources for Victims of Securities Law Violations.
- Contact your state securities administrator. You can find links and addresses for your state regulator by visiting the North American Securities Administrators Association’s website.

You also can read our Investor Bulletin: How Harmed Investors May Recover Money for general information on ways victims may recover money from fraudulent scams.

Additional Information

For additional educational information for investors, see the SEC’s Investor.gov website. For additional information related to avoiding fraud, also see:

- Questions You Should Ask About Your Investments
- How to Avoid Fraud

For additional information regarding IRAs, please see the Internal Revenue Service’s IRA Online Resource Guide.

The Office of Investor Education and Advocacy has provided this information as a service to investors. It is neither a legal interpretation nor a statement of SEC policy. If you have questions concerning the meaning or application of a particular law or rule, please consult with an attorney who specializes in securities law.

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