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NASAA: State Securities Regulators' Views On Top Emerging Enforcement Issues

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At the North American Securities Administrators Association (NASAA) Annual Conference earlier this week in Indianapolis, the NASAA Enforcement Section gave a preview of the results of its annual survey of securities administrators. In that survey, state securities regulators identified binary options, marijuana-related investments, stream of income investments and the cybersecurity of digital currency as the primary emerging enforcement concerns.

Binary options.

Described by one regulator as “the flavor of the week in terms of investor fraud,” these options, with a fixed expiry time, are all-or-nothing investments. If the option expires in-the-money, the investor gets a fixed amount of cash; if it expires out-of-the-money, the investor gets nothing. Because they are easy to understand and do not require any leverage, state regulators believe relatively unsophisticated investors are attracted to these investments. The regulators’ main concern, however, is that many of the promoters are offshore. They reported getting complaints about promoters not paying on the in-the-money options, promoters “cooking” the odds to favor the “house,” and identity theft.

Marijuana-related investments.

With medical marijuana legal in over 20 states, more marijuana-related business enterprises – growers, dispensaries, and suppliers of more items necessary to the business such as grow lights – are looking for investors. State regulators expressed concern about what they described as the “Breaking Bad Effect” – consumers being convinced that there is lots of money to be made in the drug business, particularly the legal (at least as far as the states go) drug business. Meanwhile, state securities divisions had several concerns about the companies in which investors were putting their money. First, despite the Department of Treasury and DOJ memos described in [Mark Stuaan's earlier post](#), marijuana-related businesses are having trouble accessing the banking system, so all the transactions – sales of product, payment of wages, payment of taxes, etc. – are in cash, making it difficult, if not impossible, to verify any financial statements. Second, regulators perceive that many in the industry come from, as one regulator put it, a “culture of non-compliance,” or simply have no idea about securities laws. As an example of this, the Colorado Securities Commissioner noted that, in the months after legalization of recreational marijuana in that state, there were over 50 ads on Craigslist by Colorado marijuana-related businesses, looking for investors. The states’ also are concerned that, even if the companies’ securities offerings comply with the law, their shares are traded in the micro-cap space – in other words, they trade in the penny-stock world that is rife with “Wolf of Wall Street” type fraud. Indeed, the states have already taken action on two alleged pump-and-dump schemes in the area.

Stream of income investments.

These investments involve the participation in assigned disability, pension or similar income streams. A retiree receives an up-front, lump-sum payment in exchange for assigning a certain amount of his or her future pension payments. Those lump sum payments are funded by investors who receive in turn part of those future payments.

[The GAO released a report earlier this year](#) on these transactions, focusing on the pension advance side of the transactions. The state securities commissions are obviously more focused on the pension investment side of the equation, and voiced concerns that these investments were being represented as low risk transactions, without adequate disclosures regarding what they view as some fairly significant risks.

Cybersecurity of digital currency.

Bitcoin and other digital securities were on the list of emerging enforcement issues last year as well, but the focus was on the volatility of those currencies. This year, in the wake of the [cybertheft of Bitcoins from Mt. Gox](#), the state commissioners are worried about the threats of similar cybercrime.