

Contracts For Difference

A contract for difference (CFD) is offered as an alternative to traditional financial instruments used to speculate on financial markets. These types of investments generally are available only to very high net worth individuals or institutional investors. CFDs may be marketed to retail investors by scammers looking to make a quick profit.

What are contracts for difference and how do they work?

A CFD is a type of derivative contract between a buyer and a seller where the parties to the contract speculate on what the price of an underlying asset will be at a specific time. If the value of the asset increases at contract time, the seller pays the buyer the difference. If the value of the asset falls at contract time, the buyer pays the seller the difference.

An example of a CFD:

Jane is a trader with more than \$10 million in investable assets who has been speculating on rising palm oil prices. She thinks she can make a profit based on the favorable trend. She is confident that the prices will rise by a margin of 12% in the next year. The current market price is \$500 per unit, and she believes it will rise to \$560. She approaches her CFD brokers, who buy 2,500 units on her behalf. Therefore,

Jane expects in a year's time, her \$1.25 million investment will grow to \$1.4 million should the per-unit cost reach \$560. The palm oil market, however, takes a plunge as demand for coconut oil surges. Jane acts fast to limit her losses and exits the contract at \$480 per unit. Therefore, Jane lost only \$50,000.

How to recognize a CFD scam?

If you are solicited by a company that claims to trade in CFDs and asks you to invest funds, you should be very careful. Watch out for the following warning signs:

Sounds too good to be true: Get rich schemes, including those involving CFDs, tend to be scams.

Heavily promoted: CFD scams are promoted as an "exciting opportunity" to speculate in the market. Usually these ads appear in newspapers and on radio, TV or online. The ads may look legitimate, but what usually

happens is that your money is not invested in anything. It is simply stolen by the scam artist.

Promises of high returns: The scam offers to pool your money in a fund that will be managed by expert currency traders. They guarantee little or no risk and high investment returns. You may not have been told that the investment is very risky and you're likely to lose some, or all, of your money.

Training: Promoters will try to get you to sign paperwork, attend trading seminars, or buy software that will unlock the mysteries of CFDs. When you respond, sellers or their affiliates may encourage you to invest in a CFD opportunity.

Wire money: Once promoters provide you with a contract, they encourage you to wire your money offshore. Be aware that once you transfer funds to a foreign firm, it may be difficult or impossible to get your money back.

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How to **Protect Yourself**

CFDs are high-risk investments that can cause investors to lose most, or all, of their investment quickly. Fraudsters often promote CFD offerings that promise unrealistic returns.

1. Be skeptical about unsolicited phone calls offering investments, especially those from out-of-state salespersons or companies that are unfamiliar.
3. Be especially cautious if you have acquired a large sum of cash recently and are looking for an investment vehicle. In particular, retirees with access to their retirement funds may be attractive targets for fraudulent operators. Getting your money back once it is gone can be difficult or impossible.
4. Be wary of high-pressure efforts to convince you to send or transfer cash immediately to the firm, via overnight delivery or the Internet.
5. Be smart about the money you put at risk. Even when purchased through the most reputable dealer, CFDs are extremely risky and you could lose some, all or more than your initial investment.

The **Bottom Line**

If you have been solicited to purchase CFDs, you need to know how to spot a CFD scam. Before making any financial decisions, ask questions, and do your homework. Contact us to learn more about top investor threats and the Red Flags of Fraud.