Texas State Securities Board

Regulating the securities industry and protecting investors since 1957

SELF-DIRECTED IRAs: MORE CHOICES, MORE RISK

Investing for retirement usually means buying stocks, bonds, and mutual funds through a workplace retirement plan like a 401(k) or in your own Individual Retirement Account (IRA).

If you want to buy riskier assets for your retirement account – things like precious metals – then you will likely have to open a *self-directed IRA*. Pay close attention to that "self" part, because it's the part that makes it a risker way to save for retirement.

All IRAs provide investors with tax benefits for retirement savings, and all IRA accounts are held for investors by custodians. Most IRA custodians limit holdings in IRA accounts to firm-approved investments such as stocks, bonds, mutual funds, and certificates of deposit.

Self-directed IRAs, however, are held by custodians that allow investments in a broad range of riskier "alternative assets" such as real estate, promissory notes, cryptocurrencies, tax lien certificates, interests in energy projects – from oil and gas to solar – and private placement securities.

Self-directed IRA custodians have only limited duties to make sure the alternative assets – and the promoter selling them – are legitimate.

The problem is that the more unconventional the assets, the harder it is to understand them, their costs and fees, and their tax consequences. According to a 2016 U.S. Government Accountability Office report, a decision to invest in alternatives through a self-

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- Making Investments Control risk and costs as you build a portfolio
- Investing for Retirement Using tax-sheltered accounts, from 401(k)s at work to personal IRAs
- Choosing a Financial Professional The right adviser to fit your needs
- Scams and Unsuitable Investments Bad investments and worse promoters

directed account "increase the owners' responsbilities in ways they may not understand – and mistakes can trigger taxes and penalties."

Unscrupulous investment promoters may exploit self-directed IRAs because they permit investors to hold riskier assets, including those that are not registered as securities.

Texas Securities Commissioner Travis J. Iles recently took action against a precious metals firm that was accused of using self-directed IRAs in its scheme to convince elderly investors to liquidate their securities in registered firms and invest in precious metals.

According to the May 1 **Emergency Cease and Desist Order**, representatives of Metals.com are advising potential investors to sell their securities and invest in precious metals through a self-directed IRA. The Metals.com sales pitch focuses on the supposed riskiness of stocks, bonds, and mutual funds held at registered firms.

In another case, the State Securities Board assisted in the 2017 prosecution and conviction of an Austin promoter of real estate investment programs who encouraged investors to transfer their funds to a self-directed IRA that was secretly controlled by his daughter.

There are numerous other ways investment promoters try to exploit self-directed IRAs to entice potential investors. Among them:

Misrepresentations regarding custodial responsibilities. Fraud promoters can misrepresent the responsibilities of self-directed IRA custodians to convince investors that their investments are legitimate or protected against losses.

Fraud promoters often claim that self-directed IRA custodians investigate and validate any investment in a self-directed IRA. In fact, self-directed IRA custodians are responsible only for holding and administering the assets in a self-directed IRA. They generally do not evaluate the quality or legitimacy of any investment in the self-directed IRA or its promoters.

We Want to Hear from You

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Submit a tip or complaint to the Enforcement Division:

(512) 305-8392 or
enforceinfo@ssb.texas.gov

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 retirement accounts that carry a financial penalty for prematurely withdrawing money before a certain age. This penalty may induce self-directed IRA investors to keep funds in a fraudulent scheme longer than those investors who invest through other means.

Lack of information for alternative investments. Unlike publicly traded securities, financial information necessary to make a prudent investment decision may not be as readily available for alternative investments. Even when financial information is available, it may not

Examples of Alternative Assets in Self-Directed IRAs

ENERGY	Oil and gas interests, solar, biofuels, wind energy
FOREIGN-BASED ASSETS	Foreign exchange currency and overseas property
PRECIOUS METALS	Gold, silver, platinum, and palladium bullion and certain coins
PRIVATE EQUITY	Private company stock, interests in LLCs and limited partnerships
PROMISSORY NOTES	A form of debt, either secured (backed by collateral) or non-secured, in which borrower promises to return lender's funds and make fixed-income payments
REAL ESTATE	Interests in real property options such as rental housing, commercial buildings, and undeveloped land.
TAX LIENS	Investments in liens imposed on tax-delinquent real property or personal property
VIRTUAL CURRENCY	Bitcoin and other cryptocurrencies and cryptocurrency-based investment programs

Source: "Improved Guidance Could Help Account Owners Understand the Risks of Investing In Unconventional Assets," U.S. Government Accountability Office report GAO-17-102 to the U.S. Senate Committee on Finance be audited. Furthermore, self-directed IRA custodians usually do not investigate the accuracy of this financial information.

Ways to Avoid Fraud With Self-Directed IRAs

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. You should be aware that none of these valuations necessarily reflects the price at which the investment could be sold, if at all.

Avoid unsolicited investment offers. Investors should be very careful when they receive an unsolicited investment offer. Whether from a total stranger or from a friend, trusted co-worker, or even family member, investors should ask themselves, "Why would anyone tell me about a really great investment opportunity they can keep to themselves?"

Ask questions. Always ask if the person offering the investment is licensed and if the investment is registered, then check out the answers with the Texas State Securities Board.

Be mindful 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. Low risk generally means low yields, and high yields typically involve higher risk. Fraud promoters often spend a lot of time trying to convince investors that extremely high returns are "guaranteed" or "can't miss."

Ask a professional. For complex investment opportunities, particularly those which involve the opening or creation of a new account outside a traditional financial institution or recognized broker, investors should consider getting a second opinion from a registered investment professional, attorney, or certified public accountant.

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