



# PENNY STOCKS

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*Before investing in penny stocks, get the facts. This segment of the market has often been a playground for fraud.*

## **What is a Penny Stock?**

Penny stocks are low-priced stocks that typically start out at less than one dollar per share. They are sold on the promise of significant potential growth.

## **Where do they originate?**

Very often, companies issuing penny stocks are new to the market. They may not have been in business long enough to establish a proven track record or credible financial history. Another characteristic may be an inexperienced management team. These factors undermine market reception and the ease with which penny stocks can be traded. Anyone investing in penny stocks should be aware that when they may want to sell their stock a market may not exist. Penny stocks are priced low for a reason.

## **The risks are high**

Despite their bargain basement price, penny stocks are high risk. Unless you have the financial resources to withstand the loss of your initial investment and target returns, penny stocks are not for you.

## **Get the facts!**

Why is it so important to get the facts? Penny stocks are extremely vulnerable to manipulation. Promoters intent on misleading or defrauding investors are counting on you **not** to do your homework.

A common scam is the pump and dump . In this situation, a promoter accumulates an inventory of penny stocks. Using high-pressure sales techniques, the stock is pitched to clients. Clients (or investors) are found by any means in the interest of making a market. In the course of events, the price of the penny stock will rise (possibly to several dollars per share). As long as the promoter is able to locate new investors or encourage current clients to increase their holdings at a higher price, the scam continues. All the while, the promoter profits. When the scam has run its course, the stock becomes illiquid and the price falls. Hapless investors are left holding the now-worthless stock.

## **Where to go for information**

Unscrupulous promoters are inventive and persistent. Using any means possible, they may spread false information. It pays to double-check their claims through other sources. Corporate information comes in many forms including: annual and quarterly reports, financial statements, and prospectuses. These can be obtained from the public library system, your dealer or adviser, stock exchanges, and SEDAR. The System for Electronic Document Analysis and Retrieval (SEDAR) is a database of documents located at [www.sedar.ca](http://www.sedar.ca). All publicly traded companies are required by securities regulators to report on their business activities. This information (including annual reports and company news releases) is available to the public free of charge.

## **Are penny stocks listed on a stock exchange?**

Stock exchanges have minimum listing requirements that a company must meet before its securities can be traded on that exchange. Among other things, these requirements relate to a company's finances, management, and share ownership. If a company is not able to meet these minimum requirements, they may trade on the over-the-counter market. The over-the-counter markets consist of a network of dealers who trade among each other either on behalf of individual investors or themselves.

## **The Changing Markets**

Traditionally penny stocks trade on junior exchanges or over-the-counter markets. The restructuring of Canada's stock exchanges has resulted in higher levels of listing requirements for companies. These changes saw the Vancouver and Alberta Exchanges and Canada's over-the-counter market (CDN) merge to create the Canadian Venture Exchange, now known as the TSX Venture Exchange. Investors benefit from a well-regulated, fair and accessible market with enhanced protection through uniform regulatory standards, consistent enforcement and improved market information.

## **How will I recognize a penny stock scam?**

There are a few tell-tale signs:

- ✓ **Unsolicited telephone calls.** Be skeptical of an unknown salesperson calling to offer you "a fantastic investment opportunity".
- ✓ **High-pressure sales tactics.** Do not be pressured into making hasty investment decisions.
- ✓ **Promises of a great rate of return.** No dealer or adviser can guarantee an exceptional rate of return, and the law prohibits promises of such future returns.

- ✓ **Claims of little or no risk.** If the projected rate of return is high, the associated risk is likely to be high as well.
- ✓ **Offers to discount commissions.** Commissions that are charged for sales of penny stocks are often at rates higher than normal.
- ✓ **Claims of inside information.** It is illegal to trade on the basis of confidential or inside information. The penalties for insider trading can be severe.
- ✓ **Reluctance to provide shareholder information.** A salesperson should not hesitate to provide you with the information, which may include a prospectus that is necessary for you to make an informed decision.

The Ontario Securities Commission has pursued and shut down long-standing securities firms for conducting pump and dump scams. Whether it's a cold call or a well known firm in the community, get an independent opinion, or do your own research. Regulators are at the forefront of investor protection but you can make a difference by understanding how the market works. Get the facts.

If you have any questions you can contact us in one of the following ways:

**Telephone** 416-593-8314  
**Toll free** 1-877-785-1555

**Fax** 416-593-8122

**e-mail** [inquiries@osc.gov.on.ca](mailto:inquiries@osc.gov.on.ca)

**Or write to**  
Ontario Securities Commission  
Contact Centre  
20 Queen Street West  
Suite 1900, Box 55  
Toronto, Ontario  
M5H 3S8

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