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U.S. Securities and Exchange Commission

## Investor Alert: Beware of Fantasy Stock Trading Websites Offering Real Returns

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*The SEC's Office of Investor Education and Advocacy is issuing this Investor Alert to warn investors about fantasy stock trading and other similar websites that may violate federal securities laws designed to protect investors from abuses in the swaps market.*

*You may come across websites that claim to offer you the chance to make money from publicly traded or privately held companies without actually buying stock in those companies. You (as well as the operators of these sites) should be aware that some of these transactions could fall under a type of security known as a "security-based swap." Transactions on these websites can implicate both the federal securities and commodities laws. **Even when the site presents the transaction as a "fantasy" trading game or competition, and even when it involves only small amounts of money (sometimes called an "entry fee"), you should understand these sites may be violating laws designed to protect investors.***

### Security-Based Swaps

Although you may think that terms like "swap," "security-based swap," and "derivative" include only complicated financial instruments used by sophisticated financial institutions, these definitions are actually much broader. Generally, the legal definition of these products includes any agreement, contract, or transaction whose value is based upon – or "derivative" of – the value or performance of some other financial product, event, or characteristic.

The SEC is in the process of implementing a new regulatory regime for security-based swaps. The anti-fraud provisions of the federal securities laws apply to all transactions in security-based swaps, regardless of the sophistication or wealth of the investors (who are called "counterparties"). In addition, there are a number of laws that were designed to enhance protections in cases involving the offer and sale of security-based swaps to persons who are not "eligible contract participants." The definition of "[eligible contract participant](http://www.cftc.gov/ConsumerProtection/EducationCenter/CFTCGlossary/index.htm#E)" (<http://www.cftc.gov/ConsumerProtection/EducationCenter/CFTCGlossary/index.htm#E>), ("ECP") includes a variety of entities and individuals including, for example, people who have more than \$10 million invested on a discretionary basis. Whenever you are presented with an opportunity on a website that offers the type of financial exposure described in this alert, it will be important for you to understand not only the nature of the product itself, but also whether you qualify as an "[ECP](http://www.cftc.gov/ConsumerProtection/EducationCenter/CFTCGlossary/index.htm#E)" (<http://www.cftc.gov/ConsumerProtection/EducationCenter/CFTCGlossary/index.htm#E>). Whether you qualify as an ECP is an important factor in determining the specific legal protections you are entitled to receive.

### Pay-to-Play "Fantasy" Trading Competitions

There are many different ways that virtual games referencing securities could involve a security-based swap. For example, a website could charge people an entry fee to join an online fantasy stock trading competition in which they would "buy" or "sell" a virtual portfolio of securities and in which they could win a prize. Although any actual situation would need to be analyzed based on the particular facts and circumstances involved, the facts presented in this hypothetical suggest that this website may be offering security-based swaps.

### SEC Action on Security-Based Swaps

- SEC staff have recently observed websites offering many different kinds of financial instruments that may raise concerns under the federal securities laws. *SEC staff continue to investigate other websites, entities, and companies that may be taking investor money without complying with the federal securities laws.*
- The SEC has recently investigated and taken action in a case involving a website that the SEC found illegally offered and sold security-based swaps to people who were not ECPs.

[In the Matter of Sand Hill Exchange, Gerrit Hall, and Elaine Ou](http://www.sec.gov/news/pressrelease/2015-123.html) (<http://www.sec.gov/news/pressrelease/2015-123.html>), the SEC issued a settled cease and desist order against a website operator (as well as its two principals) that claimed to offer anyone an opportunity to realize profits based on the performance of private companies that were not yet publicly-traded (i.e., "pre-IPO" companies). Specifically, Sand Hill offered to sell "contracts" referencing a pre-IPO company. As detailed in the SEC's order, those contracts provided that if a

liquidity event – such as an initial public offering, merger, or dissolution – occurred, then the contract buyer would receive an amount of money that was based on the value of the company at the time of the event.

#### Other Things to Remember

- **Gambling laws are separate from the federal securities laws.** In some cases, a website may assert that its activities are legal because of particular state or federal gaming or gambling laws, such as the Unlawful Internet Gambling Enforcement Act of 2006. *These laws do not override the federal securities laws and do not affect the analysis of whether a product is regulated by the SEC as a security-based swap.*
- **These websites often involve Bitcoins as payments or prizes.** As is the case with many types of online transactions, these websites might allow you to provide your payment or fee (or claim your prize) in Bitcoins or some other type of virtual currency. Don't be fooled – simply denominating a transaction in something other than cash does not make an otherwise illegal offer or sale of a security-based swap suddenly legal.
- **There can be significant consequences for these sites and their operators if they are found to be offering and selling security-based swaps in violation of the securities laws.** In addition to legal action by the SEC, other federal agencies or state securities regulators, and investors may have private rights of action.

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*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.*