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Starting Your Investment Program With $1 to $1,000

Lesson Eight: How Do I Protect My Nest Egg?

Lesson Handout

Nothing But the Blue Sky

Think back to the days of Jesse James when lawlessness ran thick as bison over the prairies. Scoundrels like James weren't the only thieves on the prowl. These clever crooks looked professional, sounded honest and claimed to represent solid companies with legitimate investment opportunities.

What trusting investors got was nothing more than a piece of the blue sky. The so-called "investments" were worthless. The money usually disappeared into thin air along with the salesperson. You don't want your hard earned money to disappear when you are trying to save it for the future. You can take these steps to protect your nest egg:

- Choose to invest with someone who can make a profit for you that fits your risk tolerance style.
- Investigate before you invest
- Recognize and protect your self from fraud and abuse when saving and investing
- Know who to contact if you have a problem.

How Kansas Drove Out a Set of Thieves

The State of Kansas took action. In 1911, Kansas became the first state to enact a law to protect its citizens from worthless securities and dishonest salespeople. The new "Blue Sky" law established three requirements:

1. Companies issuing securities had to register their offerings with the State before soliciting investors. They had to prove that the company was in good financial standing and the investment was fair and equitable.

2. People selling securities had to obtain a license from the State before soliciting investors; and

3. Companies and salespeople had to be honest and ethical. False and misleading information intended to defraud investors was not allowed.

Other states soon passed similar laws. The U.S. Securities and Exchange Commission was created in 1934 to regulate the national securities market. We now have a system of state, federal, and industry regulation. There is a securities regulator in each of the 50 United States, the District of Columbia, Puerto Rico, Mexico and the Canadian provinces and territories.

State regulators are often the first to detect illegal and unethical activity through investigations and customer complaints. States may suspend and revoke securities licenses, order fines and sanctions and pursue criminal prosecution in a court of law. States also work to obtain restitution for investors. Securities laws are still known as blue sky laws today.

What is a security?

When people hear the word “security,” they most likely think of stocks, bonds and mutual funds. Even if you don’t trade on the major stock exchanges, you might still be investing in securities. Other securities include:

- Leases in oil and gas wells;
- Farming and ranching operations;
- Sale and leaseback agreements for pay telephones, ATM machines, kiosks, and similar equipment;
- Viatical settlement contracts and “senior life settlement” contracts;
- Charitable gift annuities;
- Coins;
- Art; and
- Pyramid schemes.

There are many others. Any type of passive investment is probably a security. A passive investment is one in which the investor relies on another person to make a profit. Choose to invest with a financial service provider that you can trust to manage your money to make a profit for you.

Assessing Your Risk Tolerance

Risk tolerance is one way to gauge whether or not a particular investment is right for you. It shows how well you handle the potential loss of money from your investments and change as your life circumstances change. When you determine your risk tolerance, you take into account your personality, personal goals, current investing style and your "gut reaction." When you assess your risk tolerance level, there aren't any right or wrong answers. The correct answer comes from your assessment of what risk level you are comfortable with and then choosing investments to fit your comfort level. Investors are classified in three general investment styles:

● Aggressive: These investors are after big returns and are willing to take the necessary risks in order to get them. They might like to gamble or invest in capital ventures (brand-new companies just out on the market) or international and high-growth stocks.

● Moderate: These investors understand there are risks involved when a person invests. They don't mind taking some risk, as long as they know there's a pretty sure bet their initial investment will still be there when they need it. They tend to do a lot of thinking before they invest and prefer solid, blue chip companies and maybe indexed mutual funds as well.

● Conservative: These investors are also known as "risk-averse investors." They want to ensure their money is still there when they need it. They don't want any potential for loss and prefer secure investments like bonds and government-issued securities to investing in the stock market.

Investigate Before You Invest

Many different professionals offer financial products or services that involve securities. You have the right to know what qualifies that person to sell you that product. Before you put money into an investment, check it out.

Contact your state securities regulator to:
- Make sure the salesperson is properly licensed;
- Make sure the investment is registered (if it is not exempt);

- Find out if the person or firm has a history of complaints or regulatory violations.

State securities regulators rely on a system of nationwide databases to track licensing, registration and disciplinary actions. That means that if a person or company outside the state in which you live solicits you to invest, you can check them out.

Investors who request background checks also alert state securities regulators to people or companies who are operating illegally. This helps protect others from getting scammed.

Before you invest,
- Get everything in writing.
- Make sure you understand the risks.
- If you do not understand how an investment works, avoid it.

After you invest,
- Keep good records of your accounts.
- Stay in touch with your financial adviser.
- Make sure you are receiving regular statements and reports.
- Check your statements for inaccurate information.
- Report problems immediately.

Recognizing Fraud and Abuse

Look for common themes and red flags to alert you to potential problems with an investment.

- **Unlicensed Salespeople and Unregistered Securities**

This is a common tactic used to defraud investors. Always verify that the salesperson is licensed and authorized to sell securities. Make sure the investment is properly registered before you invest.

Note: Certain exemptions from licensing and registration are permitted. If a person or company tells you that they are exempt, they must be able to tell you why. Follow up with a call to your state securities regulator to verify this information.

- **Unsuitable Investments**

Brokers and investment advisers are required to make appropriate recommendations based on factors such as your age, net worth, and risk tolerance. Tell your broker your needs and goals.

- **Misrepresentation**

The people selling investments must tell investors the truth about the risks and terms of an investment. Beware of buzz words like "guaranteed," "safe as a CD," "risk-free," and "sleep at night."

- **Unauthorized Trades/Churning**

Check your statements for any unauthorized trades. Watch out for "churning". Excessive churning is trading to generate sales commissions.

- **Theft of Client Funds**

Investors trust that their money will be used as specified when they invest it. Get receipts for all deposits. Never pay in cash or make a check payable to the salesperson's personal account.

If You Have Problems

- Act quickly.
- Communicate in writing.
- Gather your records and receipts.
- Keep copies of everything for your self.
- Notify your state securities regulator.

If the problem is with the salesperson or an investment you already have…
Send a letter describing the problem to the branch manager or compliance officer of your broker-dealer or investment adviser. Use information from your account statements and reports to support your claim. If the problem is not corrected, contact your state securities regulator to file a complaint.

Questions to Ask When You Are Thinking About Buying a Security

Is the SECURITY registered?
Is the SALESPERSON licensed and authorized to sell securities?
Are there any disciplinary actions against the salesperson or company?
Do you understand the investment?
Do you understand the risks?

If you suspect a scam…

Notify your state securities regulator immediately.

Privacy Issues

In order to process your financial account information, your advisor must obtain detailed information about you, including bank account numbers, social security numbers, credit card numbers, birth dates and other identifying information. They must collect this personal information in order to comply with the U.S. Patriot Act and the Gramm-Leach-Bliley Act. You should obtain and read a copy of their privacy policy to find out with whom your information will be shared.

Conctact
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Financial Industry Regulatory Authority (FINRA)
The Financial Industry Regulatory Authority (FINRA), is the largest non-governmental regulator for all securities firms doing business in the United States. FINRA oversees nearly 5,000 brokerage firms, about 173,000 branch offices and more than 677,000 registered securities representatives.

Created in July 2007 through the consolidation of NASD and the member regulation, enforcement and arbitration functions of the New York Stock Exchange, FINRA is dedicated to investor protection and market integrity through effective and efficient regulation and complementary compliance and technology-based services.

FINRA touches virtually every aspect of the securities business—from registering and educating industry participants to examining securities firms; writing rules; enforcing those rules and the federal securities laws; informing and educating the investing public; providing trade reporting and other industry utilities; and administering the largest dispute resolution forum for investors and registered firms. It also performs market regulation under contract for The NASDAQ Stock market, the American Stock Exchange, the International Securities Exchange and the Chicago Climate Exchange.

FINRA has approximately 3,000 employees and operates from Washington, DC, and New York, NY, with 15 District Offices around the country.

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Federal Deposit Insurance Corporation (FDIC)
The Federal Deposit Insurance Corporation is an independent agency of the United States government. It was founded in 1933 in response to consumer needs in the face of a failing banking system. Since the start of FDIC insurance in 1933, no depositor has ever lost a single-penny of FDIC-insured funds. The FDIC protects funds depositors place in banks and savings associations. FDIC insurance is backed by the full faith and credit of the United States government. Credit unions are not insured by the FDIC. They have their own organization, the NCUSIF, which provides insurance for credit union deposits up to $250,000 per insured institution.

FDIC insurance covers all deposit accounts, including checking and savings accounts, money market deposit accounts and certificates of deposit. FDIC insurance does not cover other financial products and services that banks may offer, such as stocks, bonds, mutual fund shares, life insurance policies, annuities or securities.

The standard insurance amount currently is $250,000 per depositor. The $250,000 limit is permanent for certain retirement accounts (includes IRAs) and is temporary for all other deposit accounts through December 31, 2013. On January 1, 2014, the standard insurance amount will return to $1000,000 per depositor for all deposit accounts except certain retirement accounts, which will remain at $250,000 per depositor.

Savings accounts, checking accounts, certificates of deposit and other deposit accounts, when combined, are insured up to $100,000 for each covered institution. Covered institutions include banks and thrifts. Credit unions are not insured by the FDIC. They have their own organization, the NCUSIF, which provides insurance for credit union deposits up to $100,000 per insured institution.

The FDIC insures deposits only. Mutual funds, annuities, stocks bonds, treasury securities and the contents of safety deposit boxes are not covered by FDIC insurance. Separate insurance may be available for IRA funds that are deposited at a bank or thrift.

The FDIC is funded only by the institutions that pay premiums to have their deposits insured, and receives no funding from Congress. The FDIC insures more than $3 trillion in deposits in virtually every bank and thrift in the country. It has 5,200 employees. The main offices are in Washington, DC. There are six regional offices throughout the country.

Securities Investor Protection Corporation (SIPC)
The SIPC was created by Congress in 1970 to protect the interests of investors when a brokerage firm fails or enters bankruptcy and works in these cases to return customers' cash, stock and other securities. It is not the FDIC; it does not work with banks but with brokerage firms. The SIPC offers coverage up to $500,000, including $100,000 in cash for consumers dealing with covered firms. It is important to note that the SIPC does not protect against fraud; they are concerned with recovering assets that may be missing when a brokerage firm fails.

Not every type of investment is covered by the SIPC. Commodity futures, currency futures and contracts and limited partnerships not registered with the Securities and Exchange Commission (SEC) are not covered. Not every investor is covered by the SIPC, either. Those who are not covered included partners, managers or owners of failed firms and third-parties who have a controlling influence over the management or the policies of the failed firm.

Employee Retirement Income Security Act (ERISA)
ERISA is a law that was passed by Congress in 1974. ERISA sets standards for most voluntarily established pension plans to provide protection for the individuals who rely upon these plans. Because of ERISA, employers must provide information to participants about the status of their plans and responsibility for managing these plans wisely. ERISA laws assure participants that the plans are being managed in the participants' best interests, not those of the corporation or the managers of the plan.

ERISA allows for a grievance process so that participants can get benefits from their plans and take action when the best interest of participants is not carried out. The organization that assures compliance with ERISA is the Employee Benefits Security Administration, a division of the U.S. Department of Labor.

Pension Benefit Guaranty Corporation (PBGC)
The PBGC is a federal corporation that was created by the passage of ERISA. Its mission is to protect the retirement incomes of American workers covered by defined benefit plans. The PBGC is not funded by tax revenues, but by premiums paid by employers who sponsor insured pension plans, and returns earned from

investing these premiums. When a pension plan fails or terminates, the PBGC takes over that fund and its assets and pays the beneficiaries of the plan.

Protecting Yourself against Identity Theft

Each individual owns the primary responsibility for his or her future. You can secure your financial future by understanding how investments work, managing your retirement plans wisely, and understanding the risks and regulations associated with each. It is also important to guard against Identity Theft.

What is Identity Theft?

Identity theft is a crime. Someone wrongfully obtains and uses another person's personal information in a way that involves fraud or deception, usually for economic gain. Identity theft has been a crime since 1998 when Congress enacted the Identity Theft and Assumption Deterrence Act. Victims of identity theft may spend years and thousands of dollars restoring their identities and credit ratings. In the meantime, victims may lose job opportunities, be refused housing loans and in extreme cases, be arrested for crimes they did not commit.

How to Avoid Identity Theft

You are your own best resource for securing your financial information and safeguarding against identity theft. The Federal Trade Commission in their document "Take Charge: Fighting Back Against Identity Theft" recommends taking the following steps:

- Place passwords on your credit card, bank and phone accounts. Avoid using easily available information like your birth date, the last four digits of your Social Security number, your phone number or even your mother's maiden name.
- Secure personal information in your home, especially if you have roommates or have work done in your home.
- Ask about information security procedures in your workplace or at businesses, doctor's offices or other places that collect your personal information. Know where you information is, what it is being used for and who else might have access to it.
- Don't give out personal information over the phone, through the mail or over the Internet unless you have initiated the contact or know who you are dealing with.
- Treat your mail carefully. Deposit your outgoing mail at the post office rather than in your mail box. If you are planning to be away from home contact the post office and have your mail put on hold.

- Treat your trash carefully. Identity thieves pick through garbage to get personal information. Invest in a document shredder to shred sensitive documents. Shred credit card statements, utility bills, investment statements, bank statements, insurance forms, and physician statements. Shred anything else that might include personal information, including offers for credit cards.
- Safeguard your Social Security number. Do not carry your card with you. Leave it in a safe place. Only give out your SSN number when absolutely necessary. Offer to substitute another number.
- Carry only the identification information and the credit and debit cards that you actually need.
- Computers and the Internet create new levels of security need.
  - Install virus protection software and update it on a regular basis. Update your operating system and other software programs.
  - Do not open files sent to you by a stranger. Don't click on hyperlinks or download programs from people you don't know.
  - Be careful about using file sharing systems.
  - Use a firewall program, especially if you use a high-speed Internet connection such as cable, DSL or T-1 that leaves your computer connected to the Internet 24 hours a day.
  - Try not to store financial information on your laptop unless absolutely necessary. If you do, protect it with a strong password. Use both numbers and letters that will not be obvious to anyone trying to hack your system.
  - Before you dispose of a computer, delete all the personal information you have stored. Use a "wipe" utility to overwrite the information rather than simply using the keyboard or mouse commands, or reformatting the hard drive. Information can still remain on a hard drive even though the pointers to it have been erased.

Protect yourself. When someone asks you for personal information such as your Social Security number, ask the following questions:
- Why is this information needed?
- Is there an acceptable substitute for this information?
- How will this information be used?
- How will you protect my information?
- What will you do if my information is compromised?

If a business or service provider is reluctant to discuss these questions with you, you may want to decide if you really need the service or benefit that they are providing.

What to Do if You Are a Victim
If someone has used your personal information, the Federal Trade Commission advises the following:

1. Place fraud alerts on your credit reports and review their current status.

   You will need to call one of the following companies to place a fraud alert on your credit report. The company you contact is required to inform the other two, and they will place alerts on your reports
   - **Equifax:** 1-800-525-6285; www.equifax.com
   - **Experian:** 1-888-397-3742; www.experian.com
   - **TransUnion:** 1-800-680-7289; www.transunion.com

2. Close the accounts that you know, or believe, have been tampered with or opened fraudulently.
   - Call and speak with someone in the security or fraud department of each company. Follow up in writing and include copies of supporting documents.
   - When you open new accounts, use new Personal Identification Numbers and passwords. Avoid easily available information.
   - Once you have resolved your identity theft dispute with a company, ask for proof. Ask for a letter stating that the company has closed the compromised accounts and discharged the fraudulent debts.

3. File a report with your local police or the police in the community where the identity theft took place.
   - Be sure and get a copy of the report and the report number.
   - If the local police are reluctant to take a report, ask to file a "Miscellaneous Incidents" report or try a higher jurisdiction, such as your state police.

4. File a complaint with the Federal Trade Commission (FTC).
   - The FTC offers a clearinghouse for information regarding identity theft. The information that you share about your incident may help them resolve a larger issue.
   - The FTC has several resources regarding identity theft, including forms for filing reports and strategies for organizing your case.

Summary

You have worked hard to earn the money you are saving and investing. You can take these steps to protect your nest egg so it can grow for you:

- choose to invest with someone who can make a profit for you that fits your risk tolerance style.
- investigate before you invest
- recognize and protect yourself from fraud and abuse when saving and investing
- know who to contact if you have a problem.