

The **Art** of Investor Self-Defense

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You are offered an investment that promises to pay a safe and secure return of 10% a year for five years. Do you:

- A. Invest, because 10% annualized returns would really bulk up your retirement account.**
- B. Compare the investment to the yields on essentially risk-free investments such as federally insured certificates of deposit.**
- C. Investigate the company and salespeople offering the investment.**
- D. Ignore the offer and continue investing regular sums into your Employees Retirement System sponsored retirement account or outside IRA.**

Choosing B, C, or D (or all three) would have helped protect investors from fraud. Unfortunately, in 2008 a number of state employees apparently opted for A, because they invested in a scam run by a Houston company called National Life Settlements LLC. The company purported to sell promissory notes based on the death benefits from insurance policies, a business known as life settlements.

National Life Settlements raised \$27 million from more than 300 investors statewide. Because the Texas State Securities Board intervened in the scam early and forced the company into court-ordered receivership, investors ultimately received about 69% of their money back in early 2010. That kind of recovery is unusually high, however.

The principles of NLS, Howard Judah and Gregory Jablonski, are scheduled to go on trial for fraud in Harris County in March. The court-appointed receiver and the State Securities Board have sued NLS sales agents in an effort to recover more money for investors.

As countless defrauded investors can attest, sinking money into a scam is the single most harmful way to undercut years of careful planning and saving. There is little margin for error these days, with investors facing slow economic growth, low yields, and volatile markets.

State employees can count on their Employees Retirement System annuity at retirement, as well as Social Security. There are other retirement savings plans available, such as the Texa\$aver plan offered through the ERS. It's going to take all three of those planks to construct a comfortable retirement.

So how do investors avoid fraudulent companies that disrupt and in some cases destroy the best-laid financial plans? By going through an investor protection checklist:

Are the company, its salespeople, and its investment products registered in Texas?

With few exceptions, registration is required to sell investments in Texas. Virtually all investment fraud stems from the sale of unregistered products by unregistered salespeople.

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Needless to say, the principles of NLS weren't registered, its investments were not registered, and the vast majority of its salesmen – who were insurance agents – were not registered.

Investors sometimes buy securities from a financial professional such as an insurance agent without realizing the agent needs to be registered with the State Securities Board. An insurance agent can no more sell you securities than your plumber can.

In Amarillo, two insurance agents sold nearly \$7 million worth of fraudulent “private annuities” and other bogus financial products to investors. Neither man was registered to sell securities, but the pair used their existing relationship with customers to build trust. The agents, John F. Langford and Jimmy Don King, recently received state prison sentences of 15 years and two years, respectively.

The State Securities Board's main site, www.ssb.state.tx.us, contains links to check on the registration of financial salespeople.

Compare an investment opportunity to “safe” investments



Investment opportunities don't exist in a vacuum. An investment that is supposed to yield, say, 8% to 10% a year – as the Amarillo insurance salesmen promised for their “private annuities” – should be looked at in context.

Compare investment offers to the return on essentially safe investments: A federally insured certificate of deposit, a savings account, or Treasury securities backed by the full faith and credit of the U.S. government. As savers know, the yields on these investments are pitifully low. Even a five-year CD yields about 2.3% a year, less than the historical rate of inflation, which is 3%.

You can check the going rates for these safer investments through Bankrate (www.bankrate.com). The site lists the national averages for CDs, money market accounts, savings accounts, and other basic vehicles for savings. Before committing any money, investors should ask themselves, if federally insured rates of return are so low, how can a promoter offer a “safe” investment that promises much higher yields?

With the low yields today, investors are often tempted to

go for the better offer. The Warr Investment Group LLC of Austin made just that kind of offer: In YouTube videos and other online promotion, CEO James Elton “Jim” Warr touted his “safe, secure savings account” that rewarded investors with an 8% annual yield by putting their money into a real estate program. He quickly raised \$1 million from investors, most of whom, it's fair to say, did not compare his promised 8% return with the low yields on safer investments.

In short, investors “reached for yield” and got burned. Warr was not registered to sell securities. The investments weren't registered either. The State Securities Board and Texas Attorney General's Office seized Warr Investment Group's assets and a court-appointed receiver started to untangle its finances. The receiver recently announced plans to return investors one-third of their money, with the total recovery expected to reach 50 cents on the dollar.

Obtain the regulatory record of your financial professional



You probably wouldn't hire a lawyer who had been suspended and sanctioned for serious ethical violations, so why would you hire the financial equivalent? All states participate in the Central Registration Depository (CRD), a database maintained by the Financial Industry Regulatory Authority.

The State Securities Board provides free CRD reports. The background report provides the following information for a broker, broker-dealer, investment adviser and other categories of registered financial professionals:

- **Work history**
- **Certifications**
- **Customer complaints or lawsuits**
- **Status of those complaints**
- **Civil, criminal, or bankruptcy proceedings**
- **Scores on licensing exam**

Brokers and investment advisers are not notified of requests for their regulatory records. Therefore, your request is confidential.

The CRD system is far from perfect; it depends in large measure on self-reporting by firms and individual registrants. But for the most part it provides enough information for an investor to make a reasoned judgment on hiring a financial professional.

Calculate costs, a huge factor in investment returns



It seems like a straightforward question, but determining the total costs of an investment isn't always easy. Mainstream investments such as mutual funds charge annualized fees as low as 0.10% and as high as 5% and beyond.

There are also sales charges: front-end loads charged when you make the investment, or back-end loads charged when you withdraw money.

More alternative investments might require you to lock up your money for a certain period of time. Regardless of the type of investments, cost can devour large chunks of your return.

Consider two investors. Over the years both have built up a \$100,000 account. Over the next 20 years they will both earn an annualized rate of return of 7% on that sum.

One investor pays a low annualized investment fee of 0.20%. Her money grows to \$372,756 over 20 years.

The second investor pays a 2% fee every year. His money grows to \$265,330, which means his fee cost him \$107,426 more than if he had invested in the low-cost fund.

The State Securities Board's education site, www.TexasInvestorEd.org, has a suite of calculators, including one to determine how much costs are eating into your mutual fund returns.

For alternative investments, make sure to read the prospectus thoroughly, learn all costs and fees, and determine whether you can access your money at any time.

Read more

At www.TexasInvestorEd.org investors can read and download free publications covering many facets of investing and avoiding fraud. Free print copies of the publications are also available upon request from the Investor Education department.

The Texas Investor Protection Guide provides guidance and tools needed to avoid fraud, mitigate investment risk, and check the background of financial professionals. It includes case studies of Texas investment scams; information on finding a financial professional you can trust; a sample brokerage statement; and a glossary of financial and regulatory terms.

The Texas Family Guide to Personal Money Management provides a comprehensive approach to organizing family finances, budgeting, planning for goals such as buying a home and saving for college, and retirement planning.

A Salute to Smart Investing is for members of the military and their families, focusing on scams that target the military and money issues facing troops and their families.

It's Your Financial Life is a guide for young people or anyone who is trying to navigate the often intimidating and confusing world of personal finance. The booklet covers the basics of banking, the benefits and perils of credit, buying insurance, advice on how to build a solid credit history, and the basics of investing, among other topics.

We also offer the Kiplinger's Series on Investing in Stocks, Investing in Bonds, Keys to Investing Success, Mutual Funds and ETFs, and Where to Invest Your College Money.



REGIONAL ALL STATE EMPLOYEE CELEBRATION

January 12, 2012 - Saint Arnold's Brewery, Houston

The All State Employee Celebration continues to grow in numbers and popularity each year, so we're trying something similar in Houston. The celebration is designed to recognize the people who make Texas work by treating them to a fun evening with music, food and drinks. Every Texas state employee and retiree is invited to attend. 6:00 p.m. - 8:00 p.m.

