

# CITY SECURITIES WEALTH ADVISORS

Your Life. Your Goals. Your Advisors.

June 23, 2009

Earlier this month I had the unique experience of being interviewed and filmed by the Discovery Channel for an upcoming show. Their question: How can an investor avoid the kind of fraud and scams that have recently been widely reported by the media? The answer is that there are a lot of things you can do to avoid getting swindled. While there is no single silver bullet, doing some or all of these things will greatly minimize the chances. So let's explore them.

There are usually up to five people or entities involved when you invest your money – you, your advisor, the custodian, the money managers, and the securities themselves (stocks, bonds, funds). Here is what to look for with each:

## You

Of course you really can't swindle yourself, but your behavior may make you more susceptible. Be sure you understand the things you invest in. It is okay to trust someone, but never be afraid to ask tough questions and enough of them for you to fully understand your investments. If you get any resistance to this or avoidance of your questions, take your money elsewhere. Also, be involved after you've invested. Read your statements and inquire about any activity or holdings you don't understand. Finally, never forget the cliché "If it sounds too good to be true, it probably is." This simple rule works.

## Your Advisor

Whether you are working with a CFP, broker, investment advisor, or insurance agent, it is pretty easy to check out your advisor. Look for history including regulatory trouble, client complaints, and personal bankruptcy – it's all public information. At [www.cfp.net](http://www.cfp.net), you can see the status of a CFP's certification and any disciplinary history; go to the BrokerCheck link at [www.finra.org](http://www.finra.org) to search the history of any advisor that holds securities licenses; [www.sec.gov](http://www.sec.gov) can provide a detailed document about any Registered Investment Advisor (RIA) firm; and your state's insurance department can help you check out the licensing and background of an insurance agent. Be sure to ask your advisor questions about what you learn from these sources.

## The Custodian

Your custodian is the entity that actually holds your money and investments, and they are responsible for producing the statements you receive, despite the fact that your advisor's logo and address usually appear on the statements. The important thing is that you have a reputable custodian that is separate from your advisor (your advisor can tell you the custodian they use, and it is usually printed on the bottom of the statements as well). If your advisor directly holds your money, there is easy opportunity for fraud. A separate custodian will help ensure that withdrawals are sent only if authorized by you, provides you a detailed and audited accounting of all activity that would be very difficult for anyone to tamper with, and often has sophisticated signature verification tools and extensive procedures and controls to ensure the safety of your money.

Both your advisor and custodian may provide various types of insurance to further protect you against fraud and mistakes involving your money. With both entities, ensure everything is always transparent...no secrets or hard to find data. Transparency is usually found in the form of detailed

statements coming directly from your custodian, and online access to view your assets and activity on a daily basis.

### The Money Managers

Bernie Madoff was a money manager – so how do you avoid seeing your money disappear with a headline like he created? It is not very common for investors to hire a money manager directly. This is usually done through an advisor; so you will be working with and relying on your advisor to help you avoid the Mr. Madoffs of the world. First, diversify! It is usually best to work with one qualified and trusted advisor, but to place all of your money with one money manager is just crazy. I was amazed at how many people and institutions trusted Bernie Madoff with everything. You and your advisor should be hiring many money managers to build a broadly diversified portfolio. Second, transparency is critical. When asked by the analysts at SEI Investments several years ago, Mr. Madoff refused to disclose the current and past investment positions that resulted in his fantastic reported performance, so he wasn't hired. Any manager that will not provide this kind of transparency should never be hired – no matter how good the returns are. Most managers are registered with the SEC; so, like your advisor, they can be checked out at [www.sec.gov](http://www.sec.gov). Finally, the returns the manager is claiming should be independently audited, and if they aren't consistent with the types of investments being purchased by the manager, then we are back to the "if it sounds too good to be true" philosophy.

### The Securities

Most of the securities (stocks, bonds, and mutual funds) that you, your advisor, or your money managers purchase will be well-known and registered with the SEC. With these, normal due diligence, knowing what you are buying, and good ol' diversification will largely keep you out of trouble. Where fraud usually comes into play is with lesser-known and/or unregistered securities. These stories usually sound like this... "You have a friend whose uncle knows this guy that is starting a new company selling widgets. He needs investors right now, and you can get in for \$20,000. \$50,000 is even better. But you better get in quickly because the company will go public next year and that \$50,000 will be worth \$1 million." Right. I've heard this story lots of times, and without even blinking I immediately ask for a financial statement. I've never received one. Demanding transparency is critical.

To boil this all down, here are the key things to keep in mind for avoiding investment fraud:

- Check the background of your advisor
- Understand what you are investing in
- Have a separate custodian
- Require transparency
- Diversify
- If it sounds too good to be true...

I hope you have a great week. As a reminder, if there are others you know who would benefit from these letters, I would be happy to include them.

All the best,



Kenneth R. Klabunde, MS, CFP®