Testimony of Karen Tyler

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and

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Before the

United States Senate Committee on Banking, Housing, and Urban Affairs

“Shopping Smart and Avoiding Scams: Financial Literacy During the Holiday Season.”

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Chairman Dodd, Ranking Member Shelby, and members of the Committee,

I'm Karen Tyler, North Dakota Securities Commissioner and President of the North American Securities Administrators Association, Inc. (NASAA). [1] I am honored to be here today to assist you in alerting consumers to steps they can take to avoid financial scams this holiday season.

The holiday season is a time of generosity and giving. Unfortunately, it's also the time of year when scam artists aggressively exploit this spirit of goodwill. This predatory conduct, combined with a convergence of financial challenges - higher gasoline prices, a volatile stock market, lower housing values, and general economic unrest - may lead individuals to make hasty, ill-informed decisions in the pursuit of higher returns on their investments. NASAA urges investors to be especially vigilant in protecting their assets from internet, telephone and in-person promotions for alternative investment opportunities.

State Securities Regulatory Overview

The securities administrators in your states are responsible for enforcing state securities laws, the licensing of firms and investment professionals, registering certain securities offerings, examining broker-dealers and investment advisers, and providing investor education programs and materials to your constituents. Ten of my colleagues are appointed by state Secretaries of State, five fall under the jurisdiction of their states' Attorneys General, some are independent commissions and others, like me are appointed

[1] The oldest international organization devoted to investor protection, the North American Securities Administrators Association, Inc., was organized in 1919. Its membership consists of the securities administrators in the 50 states, the District of Columbia, the U.S. Virgin Islands, Canada, Mexico and Puerto Rico. NASAA is the voice of securities agencies responsible for grass-roots investor protection and efficient capital formation.

by their Governors and Cabinet officials. We are often called the "local cops on the securities beat," and I believe that is an accurate characterization.

Financial Education Role of State Securities Regulator

Recognizing that education is a key weapon in the fight against investment fraud, the NASAA Investor Education Section was created in 1997 by the NASAA Board of Directors to help support the financial education efforts of our members. The Investor Education Section, along with a network of professionals from across the NASAA membership, is responsible for developing, coordinating, delivering, and supporting financial education initiatives that can be utilized by state securities regulators in their ongoing endeavor to improve the level of financial literacy in their jurisdictions. Currently, the Section has five focus areas: Youth Outreach, Senior Outreach, Affinity and Military Outreach, General Education Program Coordination, and a new area dedicated to working adults (pre-retirees) and their families called The Sandwich Generation.

Most state and provincial securities regulators have established investor education departments or divisions within their agencies. The result is an effective network of dedicated professionals delivering financial education at the grassroots level. Over the past 12 months, NASAA members have reached nearly 180,500 consumers through 1,100 investor education presentations. Our financial education professionals can be found at work in such venues as the classroom, the workplace, senior centers, and at trade and professional organization events. They partner with teachers, employers, and peer-based volunteer groups to deliver financial education to our constituents of all ages.

Investment Fraud Does Not Take a Holiday

Securities regulators know first hand that investment fraud does not take a holiday. Last year, state securities regulators reported significant increases in the number of enforcement actions, money ordered returned to investors, and years of incarceration for securities law violations.

For the most recent reporting period, NASAA members reported 3,635 enforcement actions (including administrative, civil and criminal), up from 2,964 during the previous reporting period. More than one-quarter of all enforcement actions involved the financial exploitation of seniors. While we are currently in the process of updating these statistics, preliminary results show that investment fraud against seniors continues to grow, with nearly half (44 percent) of all investor complaints received by state securities regulators coming from seniors, up from 28 percent in 2005.

Clearly, investment fraud is a year-round problem. But it really hits home during the holiday season, when consumers may face a financial crunch with increased expenses from holiday gifts and travel. Others may be considering end-of-year investment or tax-savings opportunities. Still others, including seniors alone for the holidays, may be invited to a free holiday lunch or dinner investment seminar. For many, these situations can give rise to unsuitable product recommendations or a pitch for “get-rich-quick” investment scams.

The good news for investors is that there are four key defensive actions they can use to protect themselves and their money from financial predators this holiday season.

First, never give your Social Security number, date of birth or credit card numbers in response to unsolicited e-mail messages or “cold callers” over the phone – no matter how good the sales pitch sounds.

When registered professionals in the securities industry make sales calls, they must call only between 8:00 a.m. and 9:00 p.m. These time restrictions do not apply if you are already a customer of the firm or you have given them permission to call you at other times. Cold callers must also promptly tell you their name; their firm’s name, address, telephone number; and that the purpose of the call is to sell you an investment.

Investors should remember that every securities firm must keep a “do not call” list. If you want to stop sales calls from that firm, tell the caller to put your name and telephone number on the firm’s “do not call” list. If anyone from that firm calls you again, get the caller’s name and telephone number. Note the date and time of the call, and complain to the firm’s compliance officer, your state’s securities regulator, or the SEC.

The Internet also has made it simple for criminals to reach millions of potential victims at minimal cost. They no longer need to spend money setting up boiler rooms, making phone calls [or sending mailings]. We recognize that the Internet is an important tool for legitimate business purposes, such as direct offerings of securities through company websites and online brokerage services. Yet we continue to see online investors targeted with increasingly complex investment scams involving unregistered securities, promissory notes, charitable gift annuities, viatical settlements, and Ponzi schemes all promising inflated returns.

State securities regulators urge investors to beware of Internet and e-mail fraud, particularly with the busy holiday season. Recently, the Florida Office of Financial Regulation has noted an increase in the number of e-mail fraud attempts, known as “Phishing” sent to financial institution customers and credit union members. “Phishing” is a form of online identity theft that lures consumers into divulging personal financial information. Consumers must remain ever vigilant in order to protect their identity and property, including their financial accounts.

It starts with an e-mail asking the recipient to click on a link to verify their financial account information. If the recipient proceeds to do so, the link directs them to a fraudulent website and asks for their financial account number and PIN, along with other personal information. The customer, unaware that they have linked to a fraudulent site, provides the information, thereby enabling the “phisher” to steal personal financial data.

The “phisher” then can use the information to clean out the victim’s financial account and commit other forms of identity theft.

Financial institutions will never ask their customers or members for such personal information through e-mail. Anyone who receives an e-mail that appears to be from a financial institution asking for account information should consider it to be a fraudulent attempt to obtain their personal account data for an illegal purpose.

Second, state securities regulators caution against making quick and risky investment decisions based upon sales pitches that refer to great deals that will be offered for only a short time or those that offer year-end tax advantages. The end of the year is a favorite time for criminals to roll out various income-tax avoidance schemes. Investors should resist the temptation to file for nonexistent financial returns, such as Social Security advances or to speak with anyone offering to file a claim on their behalf for an upfront “fee.”

Each of these scenarios is a red flag that often signals a criminal at work. A well planned and systematic investing approach, over the long-term, usually will produce greater returns than a get-rich-quick scheme. It pays to remember that if it sounds too good to be true, it usually is.

Third, even though the holidays are busy and everyone is pressed for time, investors should find the time to research any investment opportunity – and those who offer them – before even considering investing their hard-earned dollars.

State securities regulators advise investors to ask for – and read – the prospectus of any investment proposal before deciding to invest. It is important to remember that just because you receive literature about an investment, you should not assume that the investment is legitimate. And, even if the investment is legitimate, it may not be suitable given an investor’s age, tolerance for risk, and overall financial profile.

The fourth defensive action comes once an investor has read the prospectus and independently researched all information concerning an investment opportunity. This step is perhaps the most important to help avoid getting scammed during the holiday season, or anytime, especially for investors who have been approached through an unsolicited contact pushing an unfamiliar investment alternative. This defensive move takes only a simple call to your state securities regulator to check the disciplinary background of the broker or investment adviser offering the investment. Almost anyone selling an investment product in any state must be registered with that state's securities regulator, and the product being sold must be registered, unless exempt by law.

Investors also should discuss their rights and responsibilities with their broker or adviser and understand whether the individual has a legal obligation to put the needs of investors before their own. It is important to remember that investment services providers not only offer different types of services and charge for them differently, they are also subject to different federal and state regulatory requirements and have different legal obligations to their customers.

For example, investment advisers are subject to a fiduciary duty. That means they must put the interests of investors ahead of their own at all times, by providing advice and recommending investments that they view as being the best for their customers. Investment advisers also are required to provide up-front disclosures about their qualifications, what services they provide, how they are compensated, possible conflicts of interest and whether they have a record of disciplinary actions against them. Brokers are generally not considered to have a fiduciary duty to their customers, [although this standard may apply in certain limited circumstances.] Instead, brokers are required to know your financial situation well enough to understand your financial needs and to recommend investments that are suitable for you based on that knowledge. They are not required to provide up-front disclosures of the type provided by investment advisers.

I'd like to turn now to an unfortunate, but very real, aspect of the holiday season. The holidays can be a lonely time for those away from their loved ones, especially many of our nation's seniors. Unscrupulous sales people may exploit this fact, inviting seniors to free lunch or dinner financial education seminars, providing them with an appealing diversion during a difficult time. But instead of unbiased financial education, seminar attendees may be fed a hard sales pitch for investment products that are often unsuitable. Although this is troubling year-round, it is especially offensive during the holiday season when fraudsters prey on those who may be lonely, especially the elderly.

Recently, state securities regulators, the Securities and Exchange Commission and the Financial Industry Regulatory Authority released the findings of a year-long examination of 110 free meal seminars. Our joint examinations found that while many free meal financial seminars were advertised as "educational," or "workshops," 100 percent of the "seminars" were instead sales presentations; 50 percent featured exaggerated or misleading advertising claims; and one-quarter involved possibly unsuitable recommendations to attendees.

Many in this room have been invited to that "free" lunch or dinner investment seminar that we just "can't afford to miss." The invitation I'm holding in my hand is filled with the recurrent themes that typically appear in these enticing ads: a free gourmet meal, tips on how to earn great returns while eliminating market risk, and a warm welcome to spouses of the invitees.

Many invitations use words such as "guaranteed," "can't lose principal," or "no-risk investment." Nothing will be sold, they say, and there is no cost or obligation. The high-pressure sales pitch usually comes in a follow-up telephone call a few days later.

The troubling violations our examinations uncovered range from outright lies and the conversion of investor funds, to more sophisticated forms of abuse. In many cases, the salesperson recommends that the senior liquidate the investments they currently own and use the proceeds to purchase equity indexed or variable annuities, products that are often flagrantly unsuitable for seniors and often reward the seller with a high sales commission.

Additionally, these recommendations often constitute the dissemination of financial advice for compensation without an investment adviser license, which is a violation of state securities law.

For the past four years, since we first determined that the abusive targeting of seniors was a growing problem, national in scope, state securities regulators have focused on aggressively investigating and bringing enforcement actions to mitigate the investment fraud and misconduct facilitated by the free meal seminar mechanism.

Criminals count on people opening not just their hearts but also their wallets during the holidays. To help investors protect themselves this holiday season, NASAA today has issued an investor alert and podcast (audio broadcast) offering a series of resolutions for safe investing.

For example, resolve to investigate before you invest. The holiday season brings out phony investment schemes and scams promoted by high pressure criminals seeking to fleece investors for all they’re worth. Take the time you need to understand what you’re investing in.

Resolve to make safe investing a family affair. Take the time to check-in with your parents or family members and don’t be shy about discussing personal finances. Make fraud prevention a family affair.

Resolve to check out your broker or investment adviser before investing. It just takes one call to your state securities regulator to get a quick history on your broker or investment adviser, but that call will pay dividends with the knowledge you’ll gain.

Resolve to fight fraud. Whether it's taking the time to read your monthly statements and ask questions if you notice anything suspicious… make fraud detection part of your routine. And be sure to call your state securities regulator if you suspect you have been the victim of investment fraud. A list of state securities regulators is on the NASAA website at www.nasaa.org.

Conclusion

The holidays can be a perilous time for investors. My office and other state securities administrators will continue to play an active role in protecting investors throughout the year through a nationwide network of highly trained, unbiased, non-commercial experts in financial services, products and fraud avoidance.

I thank the Chairman and each member of this Committee for allowing me the opportunity to appear today. I look forward to answering any questions you have and providing additional assistance to you in the future.