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Regions Wealth Podcast

Episode 22: From Friend to Fraud: Spotting the Signs of an Investment Scam

When it comes to investment fraud, we typically only hear about big, billion-dollar schemes like the Madoff investment scandal. However, the reality is that investment fraud is quite common. Research has found that one in ten investors fall prey to investment fraud at some point in their lives. In this episode of Regions Wealth Podcast, Area Investment Executive Scott Krogmann joins us to discuss what investors can do to protect themselves against fraud, and what warning signs they should look out for.

Episode Transcript

Sarah Fister-Gale:

Welcome to Regions Wealth podcast, the podcast that tackles life's challenges with financial experience. I'm your host, Sarah Fister Gale.

When it comes to investment fraud, we typically only hear about those big billion dollar schemes, like the Madoff investment scandal. However, the reality is that investment fraud is quite common. And while some might assume that only millionaires are at risk, research has found that older active investors of all income brackets are vulnerable. So what can investors do to protect themselves against fraud? And what warning signs should they look out for?

Joining me remotely is Scott Krogmann. He's the Area Investment Executive for Regions Bank. Scott, thanks for joining us today.

Scott Krogmann:

It's great to be with you today.

Sarah:

In this episode of Regions Wealth Podcast, we're discussing investment fraud. We've taken some frequently asked questions and developed a character who needs your help. Let's listen.

Donna:

"Hi. My name is Donna. My husband Jim and I are recently retired. We each have a pension, but didn't want to rely solely on that in retirement. We worked hard to save and invest our earnings during our working years, and built up a very nice retirement fund. We envisioned this as our big opportunity to move downtown and enjoy city life, travel the world… do all of those exciting things we couldn't really do while we were both working demanding jobs and raising a family. Unfortunately, we ran into a situation that really altered our plans.

A few years before he retired, Jim's colleague — we'll call him Ned — approached him with a stock tip. He claimed this was a <u>big</u> opportunity… one that had a pretty low risk. He promised us that if we invested immediately — as in, that very day — we'd double our money. Now in retrospect, I know how that sounds, but we'd become close friends with Ned and his wife Linda. We'd even gone on a trip to Italy together! We trusted him. And Ned was big into investing, constantly boasting about his latest big success. I have to admit, the bragging was a bit much, but he and his wife were incredibly well off, so we had no reason to doubt his claims."

Sarah:

So let's pause here for a second. What red flags are you seeing in this particular scenario?

Scott:

Now, when anyone shares a hot stock tip, I'm reminded of the axiom, if it sounds too good to be true, it probably is. And when you add the time pressure on top of everything else that she's described, it makes it worse, and certainly is reason enough for me to raise a red flag. Anytime that you put a time component in place, it clouds our judgment. That should make anyone want to pump the brakes and reconsider if the decision you're making is based on fact or emotion.

Sarah:

That makes a lot of sense. So, most of us would probably be wary of someone we didn't know called us up and clued us in to a hot stock tip. But in this case, the tip's being shared by a close friend. You're saying that, even when your close friends offer you investment advice, you should still be leery?

Scott:

When I want to try a nice wine, or go to a new restaurant, I will often lean on my friends for advice. When it comes to things that are truly imperative in my life, whether that's fixing my car, repairing a hole in my roof, or getting to retirement, I'm always going to want to lean on a professional. And leveraging a financial planner is always going to be a more appropriate answer than a friend that perhaps doesn't have the amount of schooling, experience, and training necessary to adequately address your specific concerns.

Sarah:

That's a great way to put it, Scott. OK, let's listen to a bit more of Donna's story.

Donna:
“Now, by this time, Jim had been managing our portfolio for several months under Ned’s tutelage, and we were doing quite well. So when Ned advised Jim to really double-down on this particular stock, we went for it. We invested a big chunk of our money. In the end, we lost A LOT. At first, we wrote it off as bad luck, but eventually we realized it was all a scam.”

Sarah:

Before we go into specific types of investment fraud, let's start with the basics. How common is investment fraud?

Scott:

A study that was done by the Pension Research Council, back in 2016 estimated conservatively that one in 10 investors will be victimized by investment fraud at some point in their lives. This typically happens at a point at which an investor is particularly vulnerable, when they're facing a turning point event in their life, whether that is the sale of a home, reception of inheritance, a rollover of an IRA, or in this case as we're nearing retirement. We tend to be very emotional about our financial decisions. And when we're at these key points, we tend to be even that much more emotional. We don't make decisions necessarily based on fact so much as emotion.

Sarah:

So, when it comes to investment scams, most of us probably think of Bernie Madoff and Ponzi schemes. However, I was surprised to learn that there’s a pretty wide range of investment scams. Could you walk us through some of the most common types?

Scott:

I'd be happy to. The type of fraud that is being described here is known as affinity fraud. Now, there are as many types of fraud, as there are consumers. Affinity fraud, in particular, is anytime someone perpetuates fraud by leveraging their relationship with someone, be that personal, professional, through a hobby, or a group that a client belongs to, and utilizing that to leverage the relationship for nefarious means.

High yield investment programs is another type of fraud. The guarantee of a high yield, a better rate of return if you will, in the hopes to have people use emotion to make a decision that otherwise they might recognize as not a realistic rate of return, not a realistic investment.

Pump and dump is another very common type of fraud, in which the person perpetuating the fraud owns the investment and they convince others to make a similar investment in the same exact holding. Anytime that you purchase investments in large amounts it tends to artificially inflate the value of the investment, which allows the fraudster to then sell at that inflated price, leaving you holding the bag.

Sarah:
Now Scott, I'm curious: We see all kinds of consumer fraud being perpetrated over social media. When it comes to investment fraud, does social media ever play a role?

Scott:

In this age of internet and social media, it is just that much easier for us to be able to recognize opportunities, some of which are for nefarious purposes. And so, I would remind people of the importance of taking opportunities that you may see over internet or social media with a grain of salt.

Sarah:

I love that, because you're right, there are opportunities out there, but there's also a lot of fraudsters. So, what question should Donna and Jim have asked before taking Ned's advice?

Scott:

My first question would be to ask what Ned's experience level is, specifically, what licenses and what registrations does he carry, and which financial firm is holding those licenses for him? As a registered financial professional, you're expected to carry licenses and designations. Fortunately, we have the ability to look those licenses up. The Financial Industry Regulatory Authority, or FINFRA, provides a website, brokercheck.FINRA.org, that allows you to look up any advisor, past or present, what licenses they carry, as well as any designations. You can also find out about their past work history, where they have worked, and in which states they are licensed to do business. These are important things to know about someone you're entrusting your financial decisions to. I would hope that Ned would be happy to provide that information upfront. And if he doesn't, that would be a big red flag for me.

Sarah:

So Scott, when conducting research on the BrokerCheck site, what sort of licenses should we be checking for?

Scott:

Financial advisors are required to carry a Series 7 license, which allows the advisor to buy and sell investments on a client's behalf. A Series 66 or 65 license is also known as the Financial Planner's License. It confirms that an advisor is working on the client's behalf, first and foremost. A new regulation deemed Regulation Best Interest, put into place at the midpoint of 2020, in fact forces, through the SEC, all advisors to work in client's best interest before they work in their own best interest. While that seems natural, one of the reasons that fraud continues to be prevalent is those advisors that don't put a client's needs before their own.

Sarah:

So you should ask the questions. Is there any other sort of due diligence that needs to be done prior to making an investment like this one?

Scott:

Any advisor is obligated to provide you with their background. And if an advisor is hesitant to do so, or they refer to their investing as a hobby, something that they do for themselves and no one else, that would be a red flag.

Sarah:

Okay. What about the investment itself, what kind of due diligence should an investor do to make sure it's viable?

Scott:

If Donna and Jim are absolutely tied to Ned's advice over any other professional, I would recommend that they dive deeper into what securities and protections are tied to this investment. What makes this investment work, and how does it protect Donna and Jim as clients trying to get to retirement? What's going to protect them in the event that Ned's advice doesn't go the way that we planned it?

Sarah:

So, should investors do the same level of due diligence when working with a fully registered and licensed advisor?

Scott:

It's perfectly acceptable to ask more about a specific recommendation, and even to explain it back to the advisor to make sure that you are clear, not only what that investment does, but why it's important that you utilize it. If it's not something that you're comfortable with, it's okay to ask for a second option, or a third option, until you are comfortable.

Sarah:

So in other words, don't be afraid to self-advocate. That's excellent advice, Scott. Okay, let's listen to the last portion of Donna's story.

Donna:

"We chalked the whole thing up to a difficult life lesson and didn't report it. We kissed our lost money goodbye and moved the remainder of our investments into a savings account, and wound up having to delay some of our retirement goals. But now, it's been eight years. Jim and I are thinking about reinvesting what's left — it's just not getting as nice of a return in savings — but we're understandably a bit gun-shy. The advisor we worked with for decades leading up to the whole Ned incident has since retired, and we're just really hesitant to trust anyone else. Our biggest fear is that we'll make another big mistake and lose what's left of our nest egg."

Sarah:

OK, so Donna and Jim *didn't* report the incident. Now Scott, why is it so important to report incidents like these, even in instances where the money is as good as gone?

Scott:

It's definitely important that they record any possible securities fraud for investigation, not only for themselves as investors, but to help other investors. The SEC provides a number of different ways to report possible securities fraud. Their website, SEC.gov, allows you to fill out a form and record your instance of possible securities fraud. If you don't utilize the internet, you can call them at 1-800-732-0330. These also provide a great resource for the different types of fraud that we've discussed today, so that you can be a little bit more aware of potential fraud.

Sarah:

Jim and Donna are now thinking about investing again. As they said, they're understandably gun shy. What best practices should they keep in mind when it comes to finding a new investment advisor?

Scott:

I would tell them both to find an advisor that will learn about you. What are your hopes? What are your expectations, your concerns, and your goals? Not just about what your account balance is. Donna and Jim aren't willing to take on as much risk now as they once did. And a qualified advisor should recognize that fact and tailor the solutions to meet the client's needs.

Sarah:

How do you go about finding someone like that? How can you make sure you're going in the right direction?

Scott:

We certainly talked about BrokerCheck and your ability to do research on any advisor. You can utilize that. I would tell you to lean into the other financial professionals that you may have in your life. Banking institutions and lending institutions should reasonably be able to steer you towards reputable advisors that you can use in planning your own financial future.

Sarah:

So, don't just ask your neighbor if he's got a guy?

Scott:

Ask your neighbor about a good wine, not about how to plan for retirement.

Sarah:

Fair enough. So Scott, at the end of each of these episodes, we like to ask for some key takeaways, some insights people can share with their friends. What are the key things individuals should keep in mind prior to making an investment?

Scott:

Working with a licensed advisor, as we've mentioned, leveraging BrokerCheck as a means to understand an advisor's background, is an important component. But working with a licensed advisor that you're comfortable with and who cares about your long term goals, someone who can clearly articulate their process to meet your needs. Every advisor should have a process that's easy for them to explain. Frankly, anything less is like asking your fishing buddy for dental surgery advice. Utilize a professional, making sure that you check their background. You want to make sure that the advisor you're working with helps you take the emotions out of the equation. A financial plan removes the emotion from the equation that will route you to your ultimate goals.

Sarah:

We hear that advice time and time again on this podcast: take emotion out of the equation. Scott, any final takeaways to help our audience avoid fraud?

Scott:

Sarah, for as long as investments have been in existence, we've had people that have tried to perpetuate fraud as a means to circumvent the system, a way to get rich quick, if you will. It's important that we try, as consumers, to minimize the amount of fraud that takes place. We have plenty of official organizations in the form of FINRA and the SEC that do a very good job of regulating in an effort to minimize fraud, but we have a responsibility, as consumers, to make sure that we trust but verify, that we continue to check to make sure that what sounds good is good, and what sounds too good to be true doesn't end up being too good to be true.

Sarah:

Well, Scott, thank you so much for your time today. This was Scott Krogmann, area investment executive for Regions Bank.

Scott:

Thank you, Sarah.

Sarah:

And thank *you* for joining us. In our next episode, we'll be talking to Private Wealth Planner Wyeth Greene about estate planning, so be sure to check back, or visit Regions.com/WealthPodcast for updates.