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How to Guard Against Investment Fraud

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Host:

Robert C. Novy, Esq., Managing Partner of Novy & Associates

Featured guest:

John Marinan, Esq., Attorney and Investment-Fraud Specialist

Prior to graduating from Pace University law school, John Marinan was a 10-year veteran of the Middletown Township police department. When opening his own practice, he decided to focus on key areas of interest, including case investigation and fraud detection. He was an arbitrator with the New York Stock Exchange dispute-resolution section, as well as with the National Association of Securities Dealers (NASD, the predecessor to FINRA). His firm specializes in securities arbitration, commercial litigation, fraud investigation, and litigation to recoup embezzled funds.

The Greatest Generation made many sacrifices for this country. Thanks to them, we Americans live in a free and mighty nation. They also worked hard, accumulated assets, and sadly, are now a primary target for investment fraud. Unscrupulous brokers, financial advisors, and other so-called professionals are preying on senior citizens and other vulnerable populations, hoping to get a piece of their hard-earned savings. And the economic environment of the past few years has only fueled the fire.

Historically, investment fraud has been an industry phenomenon, whereby registered brokers, financial consultants, or independent investments advisors act in self-serving ways—and not in the best interest of their clients. Examples include churning, overconcentration, and making decisions that are inappropriate for the client's investment style.

Now, according to attorney and investment-fraud specialist John Marinan, we're starting to see fraud outside the industry. Unqualified individuals claiming to have financial expertise are surfacing with get-rich-quick stunts and Ponzi schemes. Their tantalizing offers appeal to those who feel squeezed by the economic reality of rising living expenses, steep medical costs, skyrocketing gas prices, and hefty real estate taxes.

Moreover, senior citizens who benefited from the high interest-rate yields of the 80s and 90s—with CDs earning upwards of 12 to 14 percent—now find themselves eking out a meager 1.5 to 2 percent. Trying to generate investment income off these historically low rates is challenging, to say the least.

Beware the “Snake-Oil Salesman”

It makes sense then, says Marinan, that when a “snake-oil salesman” knocks on the door with investment opportunities that “guarantee” a 15 percent interest rate, people will bite. However, he warns, such results are wishful thinking. “If it sounds too good to be true, 99.9 percent of the time it is, and the investment will backfire,” Marinan says.

Before you hand your savings over to anyone, it’s critical that you perform your due diligence. Remember, this is your money and you ultimately control it. Never be intimidated into an investment product or strategy you’re not comfortable with. For starters, make sure your prospective broker or advisor is legitimate.

Here is a checklist of things to keep in mind:

- Be certain he or she is a broker/dealer or affiliated with a broker/dealer
- Ask for his or her CRD (Central Registry Depository) number, which is assigned by FINRA (Financial Industry Regulatory Authority), the largest independent regulator for all securities firms doing business in the United States
- Do a background check on FINRA – Go to www.FINRA.org, click on “Broker Check,” and search by CRD number or broker/advisor name; you’ll find the person’s complete licensing history, along with disciplinary action that may have been taken and any pending or settled claims against him or her; if you see numerous regulatory actions or arbitration awards or settlements, that is a red flag, and you should not to business with that person
- If the broker/advisor recommends you liquidate your assets, make sure you understand what tax consequences could result from such a move
- Don’t feel pressured into making a decision on the spot; if you feel bulldozed into signing an agreement—or if the person appears to be withholding information or refuses to give you a prospectus—that is your signal to leave
- Speak to your accountant before signing on with a broker/advisor to discuss the tax advantages and pitfalls of your prospective investment
- Once you select a broker/advisor and you are paying him or her an annual advisory fee, request a meeting in which you can develop a mission statement and spell out your investment goals and objectives; both you and the advisor should sign the

document and revisit it regularly to make sure you are on track and/or to revise it as needed (remember, your goals may change over time)

- ❑ Be sure any trades the broker/advisor makes have had your authorization; review the confirmation statements carefully, noting if the trade was solicited (a registered representative contacts you with a specific investment recommendation) or unsolicited (you place the trade request with your broker/advisor)

Specific to annuity investments:

- ❑ If the person is offering to sell you annuities, make sure he or she is licensed by the N.J. Department of Banking and Insurance (NJDBI); the state requires anyone who sells fixed or variable-rate annuities to be licensed through NJDBI
- ❑ Assuming the necessary designations are in place, find out what the interest rate for the annuity is, and for how long that rate is guaranteed; there are often “teaser rates” of 4 or 5 percent offered up front, but these may expire, leaving you with a paltry rate of return in the end
- ❑ Ask if there is a backend or penalty charge imposed if you opt to cash in your annuity before it matures or expires; if so, you could be looking at sizable fees of 10 percent or higher

What to Do if You Suspect Fraud

If you believe you’ve been defrauded by an investment scheme, you have two courses of action, depending on the type of broker/advisor you’ve hired:

#1 – Arbitration Through FINRA

The first is to seek redress through the arbitration process. When you open an account with a broker/dealer, there is an arbitration provision in your account-opening agreement. That means if you have a dispute with the broker/dealer over a trade or a product, you can bring your claim to the dispute-resolution office at FINRA.

The arbitration process, while similar to litigation, is far more streamlined and cost effective. In this scenario, you file a “Statement of Claim,” which outlines your story, including how the losses occurred and where you believe the broker/dealer went wrong when dealing with your account. You will also be asked to pay a filing fee.

If your claim is between \$25,000 and \$100,000, you can choose to have a panel of at three arbitrators, which will consist of two public arbitrators (both are unrelated to the financial sector) and one industry arbitrator (i.e., someone who works in the financial industry). You can also opt for a single public arbitrator. If your claim is less than \$25,000, you will automatically get a single public arbitrator.

Forum (hearing session) fees are usually split 50/50 between parties, but you can request from the panel that the brokerage firm pay these fees. Arbitration panels act as a court of equity, and they are free to determine restitution claims, compensation claims, attorneys' fees, and forum fees. Generally, whatever damages are awarded may be appealed.

#2 – Superior Court Claim

Real tragedies occur when investments are sold outside the purview of a registered broker/dealer. These people are not regulated by FINRA; therefore, you don't have the option of pursuing the FINRA arbitration process. Instead, you can file a claim at law within the Superior Court. But be aware that many of these "professionals" are uninsured and their operations aren't regulated—so chances of recouping your loss may be slim. New Jersey has a phenomenal securities regulatory agency, the N.J. Bureau of Securities, but like many state agencies, they are overworked, undermanned, and deluged with requests. You must be patient to go this route.

A Final Word of Caution

There is a troubling trend lately in which unsuspecting seniors are being duped into signing irrevocable trusts. Shady advisors finagle their way into becoming trustees of their clients' accounts, and they start investing in risky instruments that contradict their clients' wishes. If your advisor (or a prospective advisor) makes this suggestion, it is probably time to leave. Never sign an irrevocable trust without first consulting an attorney and fully understanding the ramifications and costs of this document (Novy & Associates will gladly walk you through this process). An irrevocable trust is exactly that: irrevocable. Once signed, it is extremely difficult to go back.

A Healthy Partnership

The bottom line for preventing investment fraud is doing your homework before handing your lifelong savings over to a stranger. Get recommendations from friends, perform Google searches, and do background checks on FINRA.

Find an advisor who is a good listener, an excellent communicator, and is sensitive to your financial needs and goals. You are partners in this process, and as in any relationship, you should have a good rapport and mutual respect.

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