



Benefits Administration Letter

Number 11 - 107

Date: August 16, 2011

Subject: Fact Sheets on Retirement Scams

The purpose of the Benefits Administration Letter (BAL) is to transmit two Fact Sheets jointly developed by the Office of Personnel Management (OPM), the Securities and Exchange Commission (SEC) and the Financial Industry Regulatory Authority (FINRA). The publications contain tips for spotting early retirement scams.

Last year the SEC charged the estate of the recently deceased Kenneth Wayne McLeod, his benefits consulting firm, Federal Employee Benefits Group, Inc. (FEBG), and his registered investment adviser, F&S Asset Management Group, Inc. with fraudulently soliciting government employees to invest in a government bond fund that didn't exist.

According to the SEC's complaint, McLeod lured many of his investors through retirement benefits seminars he gave at government agencies nationwide. He raised at least \$34 million since 1988 from an estimated 260 investors around the country. The security of the government bonds was a key element of McLeod's deception but he never purchased any bonds. Instead, he used the investors' retirement savings to conduct a Ponzi scheme, to pay himself and to pay for lavish entertainment.

OPM, SEC and FINRA have developed the two attached Fact Sheets to help benefits officers and employees avoid investor fraud.

The Fact Sheet, *Help your Employees Achieve Their Retirement Dream*, provides benefits officers with valuable information to help spot early retirement fraud. The fact sheet describes steps benefits officers can take to help ensure employees receive sound financial information in a seminar and how they can check that a firm or individual proposing to provide retirement seminars for employees is in compliance with SEC and FINRA requirements.

The Fact Sheet, *Early Retirement Seminars 101*, helps employees avoid being misled by flawed or fraudulent retirement pitches, particularly those that dangle the prospect of early retirement with little or no reduction in income. The fact sheet describes common tactics in retirement scams and warning signs of investment fraud. It also gives employees tips to avoid being taken in by investment fraud and where to turn for help.

William Zielinski
Associate Director
Retirement Services

Attachments



Early Retirement Seminars 101:

Smart Tips for Spotting Retirement Scams

For many Americans, retirement can be an alluring stage of life—a time when many hope to finally have the time to try new hobbies or travel. But retiring comfortably and being able to do the things you dream about requires a steady stream of income that lasts as long as you do. The earlier you retire, the more important it is to manage your retirement assets wisely.

Unfortunately, some financial “experts” tout early retirement schemes that promise more than they can deliver. This Fact Sheet will help you avoid being misled by flawed or even fraudulent retirement pitches, particularly those that dangle the prospect of early retirement with little or no reduction in income compared to your working years. It describes real-life examples of fraudulent early retirement pitches, provides tips on how to recognize and avoid these sorts of pitches and tells you where to turn for help.

What This Document Does Not Cover

Understand that this Fact Sheet does not cover early retirement packages that may be offered by the federal government. For employer-sponsored retirement programs, the best source of information will be your agency’s Benefits Officer.

Real-Life Example

Employees of a major corporation attended free seminars near their place of employment where a broker pitched a strategy which recommended that they:

- ▶ Retire earlier than they might otherwise have done;
- ▶ Cash out of their 401(k) plan or take a lump-sum payment for the cash value of their pension; and
- ▶ Open a traditional Individual Retirement Account at the broker’s firm and invest in securities that carried substantial risk and high fees.

During the seminars, the broker represented that these investments would generate aggressive annual returns as high as 18 percent. Little mention was made of the risks associated with such an aggressive growth scenario. The most obvious risk being that the value of the investments goes up and down with changes in market conditions. The pitch also failed to adequately explain that the overall return on the investments would be reduced by various fees and expenses associated with the purchase and ongoing administration of the investments.

Some of the most common tactics include:

- ▶ **The “Phantom Riches” Tactic**—dangling the prospect of wealth, enticing you with something you want but can’t have. “These gas wells are guaranteed to produce \$6,800 a month in income.”
- ▶ **The “Source Credibility” Tactic**—trying to build credibility by claiming to be a reputable expert. “Believe me, as a senior vice president of XYZ Firm, I would never sell an investment that doesn’t produce.”
- ▶ **The “Social Consensus” Tactic**—leading you to believe that other savvy investors have already invested. “This is how ___ got his start. I know it’s a lot of money, but I’m in—and so is my mom and half her church—and it’s worth every dime.”
- ▶ **The “Reciprocity” Tactic**—offering to do a small favor for you in return for a big favor. “I’ll give you a break on my commission if you buy now—half off.”
- ▶ **The “Scarcity” Tactic**—creating a false sense of urgency by claiming limited supply. “There are only two units left, so I’d sign today if I were you.”

If these tactics look familiar, it’s because legitimate marketers use them, too. However, when we are not prepared to resist them, these tactics can work subliminally. Little wonder that victims often say to regulators after they have been scammed, “I don’t know what I was thinking” or “it really caught me off guard.” That’s why an important part of resisting these common persuasion tactics is to understand them before encountering them.

Red Flags of Fraud

To stay on guard and avoid becoming drawn into a scam, look for the warning signs of investment fraud:

Guarantees: Be suspect of anyone who guarantees that an investment will perform a certain way. All investments carry some degree of risk.

Unregistered products: Many investment scams involve unlicensed individuals selling unregistered securities—ranging from stocks, bonds, notes, hedge funds, oil or gas deals, or fictitious instruments, such as prime bank investments.

Overly consistent returns: Any investment that consistently goes up month after month—or that provides remarkably steady returns regardless of market conditions—should raise suspicions, especially during turbulent times. Even the most stable investments can experience hiccups once in a while.

Complex strategies: Avoid anyone who credits a highly complex investing technique for unusual success. Legitimate professionals should be able to explain clearly what they are doing. It is critical that you fully understand any investment you’re seriously considering—including what it is, what the risks are and how the investment makes money.

Missing documentation: If someone tries to sell you a security with no documentation—that is, no prospectus in the case of a stock or mutual fund, and no offering circular in the case of a bond—he or she may be selling unregistered securities. The same is true of stocks without stock symbols.

Account discrepancies: Unauthorized trades, missing funds or other problems with your account statements could be the result of a genuine error—or they could indicate churning or fraud. Keep an eye on your account statements to make sure account activity is consistent with your instructions, and be sure you know who holds your assets. For instance, is the investment adviser also the custodian of your assets? Or is there an independent third-party custodian? It can be easier for fraud to occur if an adviser is also the custodian of the assets and keeper of the accounts.

A pushy salesperson: No reputable investment professional should push you to make an immediate decision about an investment, or tell you that you’ve got to “act now.” If someone pressures you to decide on a stock sale or purchase, steer clear. Even if no fraud is taking place, this type of pressuring is inappropriate.

What the IRS Says About Early Withdrawals from Your Retirement Plan

In addition to the income tax you pay on most retirement plan withdrawals, Section 72(t) of the Internal Revenue Code imposes an additional tax of 10 percent on distributions from qualified retirement plans—including traditional IRAs—made before age 59½. The IRS does, however, allow you to avoid this 10 percent penalty if the distributions from your retirement plan “are part of a series of substantially equal periodic payments.”

These payments must last for five years or until you reach age 59½, whichever is longer, and IRS rules govern how you calculate the amount of the payments. For more information on Section 72(t) and methods for calculating payments, see the IRS’s FAQs regarding Revenue Ruling 2002-62 at www.irs.gov.



Help Your Employees Achieve Their Retirement Dream:

Tips for Spotting Early Retirement Scams

Federal agencies offer retirement benefits to help their employees lay the groundwork for financial independence when they leave the workplace. As a Benefits Officer, there is one more thing you can do for your employees, especially those nearing retirement—help ensure they do not fall prey to early retirement scams that may wipe out years of savings and benefits.

You have partners to help you spot and fight these scams, including the Office of Personnel Management, the Securities and Exchange Commission and the Financial Industry Regulatory Authority (FINRA), the largest non-governmental securities regulator. Keeping federal employees safe from financial fraud is a team effort.

This Fact Sheet contains valuable information to help you spot early retirement fraud. It is best used in conjunction with a comprehensive fraud-fighting resource—the FINRA Investor Education Foundation's Outsmarting Investment Fraud Toolkit. The research-based Toolkit includes a fully-interactive Outsmarting Investment Fraud curriculum and a cinema-quality "Tricks of the Trade: Outsmarting Investment Fraud" DVD that walks you through the "psychology of a scam." Understanding how scammers think and act—and why investors fall for their tactics—is a valuable part of fighting financial fraud. Additional online resources are available at www.saveandinvest.org/55Plus.

Be on the Lookout

Your agency may host financial education fairs, seminars or other meetings to educate your employees about retirement planning, or the agency may permit third party providers to conduct seminars for your employees. Most third-party provided retirement planning seminars offer valuable information that is free of sales pitches. But you will want to be on the lookout for inappropriate content, particularly information that promotes voluntary early retirement and contains investment strategies that include misleading assumptions about investment returns, suggest risky withdrawal strategies or lead to outright fraud. Such tactics can derail years of employee savings and sound retirement readiness efforts on the part of your agency.

Review

- ▶ **Seminar Content:** Ask to see seminar materials in advance. Information, both in the main text and footnotes, should be clear and complete. Materials should provide a sound basis for evaluating the products or services offered.
- ▶ **Performance Projections:** Seminar materials should not project the performance of investments. They should not suggest that past performance is an indication of future performance. Explanations of mathematical principles such as compounding or how tax-deferral works are acceptable. Any examples should indicate that they are hypothetical and not indicative of any specific investment may perform.
- ▶ **Disclosure of Risks:** All investments carry some risk. Presentations of products or investment strategies should include a balanced discussion of benefits and risks. Be wary of statements suggesting that an investment or strategy will lead to stability, safety or peace of mind without explaining the risks. Without the downside, you do not have a balanced presentation.
- ▶ **Promissory Images:** Look for pictures or graphics that suggest investments will always be successful – dollar signs, money trees, cornucopias, pots of gold, bank vaults. FINRA rules prohibit this kind of imagery.
- ▶ **Firm Identification:** The firm sponsoring the seminar needs to identify itself clearly and prominently in the materials distributed to participants.

Refer

Protect Employees: If you are not satisfied with the timeliness or detail of the answers to your questions or you are concerned about the content of the seminar materials, you can make a referral of the seminar materials to FINRA for review.

How to Refer Seminar Materials to FINRA for Review

Please forward the seminar materials with the following information:

- ▶ Your agency name and address
- ▶ Contact person at your agency and telephone number
- ▶ Name of the firm(s) sponsoring the seminar
- ▶ Name of the individual(s) conducting the seminar
- ▶ Short description of your concerns

Mall to:

FINRA Investor Education
1735 K Street, NW
Washington, DC 20006-1506

If you have questions, call us at (202) 728-6964.

When FINRA gets your referral, we will:

- ▶ Acknowledge receipt of the materials;
- ▶ Review according to FINRA rules and procedures and, if our review uncovers a problem, take appropriate action, including contacting the firm and/or individuals as necessary; and
- ▶ Refer the matter to the appropriate regulator if FINRA has no jurisdiction.

Please understand that, as a regulator, FINRA typically does not confirm or deny publicly what regulatory action we are taking. That means that once you make a referral to FINRA you might not hear anything further from them. That said, you may contact FINRA at (202) 728-6964 to discuss any questions or additional concerns.

You should know that not all retirement seminar sponsors or the individuals conducting them are registered with FINRA. FINRA has jurisdiction over virtually all brokerage firms, their employees and associated persons. Registered Investment Advisers may be registered with the Securities and Exchange Commission or the state securities regulator where they conduct business. Insurance agents are licensed and regulated by state insurance commissions.