CFP BOARD'S

Consumer Guide to Financial Self-Defense

What you must know and do to prevent financial abuse

CERTIFIED FINANCIAL PLANNER
BOARD OF STANDARDS, INC.

Reviewed by Federal Citizen Information Center, U.S. General Services Administration

WELCOME

It should surprise no one that Certified Financial Planner Board of Standards, Inc.—whose core mission is to serve the public—would publish a "self-defense guide."

At CFP Board, we take the responsibility to protect American savers and investors very seriously. It is why we insist that CERTIFIED FINANCIAL PLANNER™ professionals adhere to a fiduciary standard of care, which requires them to put the interests of the client first. It is also why we uphold the CFP® certification as the standard of excellence for personal financial planning.

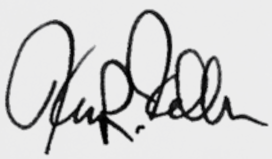
As the CEO of CFP Board, I have found recent events particularly disturbing. Fraud and mismanagement by financial professionals have undermined consumer confidence. CFP Board is in an ideal position to advance the protection of consumers from fraudulent, unethical practices that can put their financial futures at risk.

CFP Board's consumer advocate, Eleanor Blayney, CFP®, has written this guide as a first line of defense for consumers who may be vulnerable to the minority of financial advisors who do not practice according to the highest ethical standards. It is written in dedication to those who have been hurt by, or victims of, financial fraud and mismanagement.

In these pages, CFP Board's consumer advocate alerts consumers to some of the common behaviors that warn of fraudulent or unethical practices on the part of a financial advisor. She describes these "red flags" and their potential consequences, lists the things that consumers should do to protect themselves, and provides information on how to file an official complaint if unethical or incompetent practices are suspected. I encourage you to use this guide as a tool to protect yourself and your loved ones.

This guide, however, is just a starting point. To truly protect your financial status, seek the advice of an advisor who will put your interests first. A list of CERTIFIED FINANCIAL PLANNER™ professionals in your area is available on CFP Board's Web site (www.CFP.net). The site also offers a wealth of financial planning information specifically designed to protect and educate consumers.

I wish you success in your pursuit of financial well-being.



Kevin R. Keller, CAE
CEO, CFP Board

CAUTION: RED FLAGS AHEAD

Check the news on any given day, and you'll likely run across another sad tale of financial fraud. Even the most sophisticated investors can fall prey to it, as the Bernie Madoff saga clearly demonstrates.

But you don't have to run in Madoff's circles to encounter financial abuse. A 2009 survey of CERTIFIED FINANCIAL PLANNER™ professionals found that:

- 60% of respondents knew a consumer who had experienced fraud or abuse at the hands of another advisor.
- The most likely targets of financial fraud or abuse were senior citizens, aged 61-75. (According to the Elder Financial Planning Network, seniors have lost $2.6 billion to financial mismanagement or abuse.)

These numbers leave us with serious questions. Whom can we trust? Where do we turn for guidance? What red flags can warn us of potential trouble?

That's why CFP Board has produced this Consumer Guide to Financial Self-Defense. Here you'll find a series of "red flags," taken from a CFP Board survey of situations reported by CFP® professionals where a consumer had been taken advantage of by a financial advisor. Each of these red flags:

- Identifies a common situation where consumers may be victimized.
- Describes the warning signs of fraud or abuse.
- Shares real-life situations in which consumers were abused.
- Shows you what you can do to protect yourself.

CFP Board is in a unique position to offer this booklet. As an organization created to serve the public, CFP Board holds CERTIFIED FINANCIAL PLANNER™ professionals to rigorous ethical standards that put the client's interest first and foremost.

You *can* protect yourself from shady operators. Use the tips in this booklet as your first line of defense.

Eleanor Blayney, CFP®
Consumer Advocate, CFP Board

"We've known him forever. I'm sure you can trust him."

DID YOU KNOW?

60% of CFP® certificants know a victim of fraud or abuse at the hands of another advisor.

Source: CFP Board 2009 and 2010 Surveys

DO YOUR HOMEWORK

Maybe he's lived next door for years. Perhaps your kids play together, you golf in the same foursome, or a close friend recommended him. Whatever the details, he claims to be a financial advisor. Why not just go with him?

To be sure, you want an advisor you can trust. But knowing someone as a person doesn't mean you know him as an advisor. People take it on faith that the advisor is who he appears to be—that the credentials on his business card are legitimate. Yet blind trust often begets disaster.

SPOT THE RED FLAG

- An advisor fraudulently claiming to be a CERTIFIED FINANCIAL PLANNER™ professional holds a power of attorney for a client's account and steals $1 million.
- An advisor gets business by claiming to be retired military, a CFP® professional, and even a Director of the CFP Board's Board of Directors. Clients discover that none of these claims are legitimate only after they've been taken advantage of.

YOUR SELF-DEFENSE MOVES

- Ask your advisor to provide services with the "duty of care of a fiduciary." This obligates them to base their recommendations on the client's best interests, fully disclosing any conflicts of interest (actual, potential, or perceived). If the advisor avoids the question or doesn't understand the term, go elsewhere.
- Trust, but always verify. You can't board a plane without verifying your identity and passing security checks. With your very livelihood and future security at stake, you can't afford to hire a financial advisor without a background check.
- Ask your prospective advisor to identify the organizations that license or supervise him. Brokers are regulated by FINRA; investment advisors by either the SEC or a state securities regulator; insurance agents by the state insurance commission in states in which they do business; CFP® professionals by CFP Board. Use these organizations' Web sites to check the advisor's background and disciplinary history, if any. (See the reference list at the back of this guide for links to these organizations.)

"Just sign here. I'll take care of the rest."

DID YOU KNOW?

Never sign any loan documents that contain "blanks." This leaves you vulnerable to fraud.

Source: FBI Financial Crimes Report to the Public, FY 2009

FILL IN ALL THE BLANKS

Financial planning involves a lot of paperwork. To make the process easier, many advisors offer to complete the forms for you, using the information they have on file. But that can lead to trouble. Any advisor can get your information wrong; an unethical advisor might falsify data. Either situation can invalidate your contract.

SPOT THE RED FLAG

- An advisor fills out an investor profile for a client. The profile incorrectly describes the client as eligible for an investment. As a result of the misinformation in the profile, the client was put into an investment that was not suitable for the client's income or net worth. When the investment proved to be worthless, the loss was particularly damaging to the client.
- An advisor completes a form to roll over his client's retirement plan to an IRA. The advisor incorrectly describes the client as no longer working for the employer who set up the plan. The mistake renders the transfer ineligible for rollover, and the client may be required to pay income tax on the account balance.
- While filling out a life insurance application, an advisor asserts that his client has no history of alcohol abuse, even though her driving record includes an alcohol-related charge. When the client dies in a car accident, the insurance company discovers the false statement and refuses to pay benefits to her beneficiaries.

YOUR SELF-DEFENSE MOVES

- Regardless of the paperwork burden, do not leave blanks that someone else could fill in without your knowledge or consent.
- Ask your advisor to send you copies of the final, submitted documents. These should be clearly marked with the word final (or as submitted) and the date the document was completed. That gives you hard evidence should a discrepancy arise later.

“This is just for my special clients.”

DID YOU KNOW?

There are no “secret” markets in which banks trade securities. Representations to the contrary are fraudulent.

Source: US Treasury Department, 2010

BEWARE OF ROGUE ADVISORS

Your advisor presents you with a "private" or "exclusive" investment opportunity. Her letter looks different somehow: maybe it's not on her employer's stationery, or it even bears the logo of another company. And though you've always done business at her office, this time she asks you to meet at a local café.

Look out. Your advisor could be "selling away"—offering you an opportunity that her employer does not know about or supervise. That could hurt you in two ways: not only could your money be going into unsuitable or fraudulent investments, but if they don't work out, you may have no legal recourse against the employer.

SPOT THE RED FLAG

- A broker uses the logo and "guarantee" of his former employer, an insurance company, to sell a tax-free corporate bond returning 32% a year. (If the mention of a former employer doesn't send up red flags, the promise of a 32% return on a tax-free corporate bond should!)
- An advisor "sells away" an interest in a private partnership to a client. The client loses her $4 million and has no recourse to sue the employer.
- An advisor offers a client an opportunity to earn a preferred interest rate. The catch: the "opportunity" involves lending money to the advisor himself.

YOUR SELF-DEFENSE MOVES

- Ask your advisor to verify—in writing—that his employer or company supervises the investment.
- Ask the employer or company directly whether it approves and supervises the investment.
- If your advisor is a sole practitioner, verify that she carries professional liability insurance.
- Remember that investments should always be regulated or supervised by third parties, with the risks and possible conflicts of interest fully disclosed.

"I'll send you all the investment reports."

DID YOU KNOW?

Thirty million Americans ages 18 and older, or 13.5% of the U.S. adult population, were victims of consumer fraud during a one year period.

Source: Federal Trade Commission's Fraud Forum, 2009

MAKE SURE IT ALL ADDS UP

What if your advisor's reports are the only reports you get? Even worse, what if you receive no regular reports at all? This happened to Bernie Madoff's clients, and we know how that turned out. Madoff's reports showed account balances that had long since disappeared into his boats, mansions, and cars.

SPOT THE RED FLAG

- An advisor asks a 71-year-old woman to transfer accounts to his new firm. From then on, she receives no statements showing her accounts or the value of her investments.
- A client receives statements only from his advisor. Later, he is horrified to learn that the advisor is going to prison for fraud.
- An advisor accepts money from a client for a specific investment, but the client never receives written confirmation of the investment purchase. The advisor is later found guilty of running a Ponzi scheme.

YOUR SELF-DEFENSE MOVES

- Make sure you receive regular statements from independent third-party sources. Usually, these sources are the custodians of your assets—either a brokerage firm or a trust company. Reconcile the statements with reports you receive from your advisor, and ask about any discrepancies.
- If you invest in limited partnerships, real estate, or non-traded securities—any investment not valued frequently or held by a separate custodian—verify that the investment manager is audited annually by a reputable independent accounting firm.

“Make the check payable to me...”

DID YOU KNOW?

Complaints to the SEC of “Theft of funds or securities” more than doubled from 2008 to 2009 to 1,238. This was the largest increase among the complaint categories.

Source: U.S. Securities and Exchange Commission FY 2009 Annual Complaint Data

DON'T GIVE AWAY THE KEYS

You've met with an advisor, liked what you heard, and decided to buy a financial product. Then, when you get out your checkbook, the advisor says, "Just make it payable to me. I'll make sure it gets invested." Or he tells you to leave the payee line blank. At best it's unethical. At worst it's fraud.

SPOT THE RED FLAG

- An advisor deposits a client's check, made payable to himself, into his own account for his own use. He then issues fraudulent statements, leading the client to believe that the funds have been invested.
- An advisor talks a client into lending her money. Later she declares bankruptcy, and the client has little chance of collecting the debt.
- An advisor persuades a client to give him $100,000 for an "advanced premium deposit fund" that will pay off her $2 million life insurance policy. When the client asks for her money back, she discovers that the advisor is using the funds for his own purposes.

YOUR SELF-DEFENSE MOVES

- Never make a check payable to an advisor. Never leave the payee line blank. If you pay a fee for the advisor's services, always make the check payable to the advisor's business.
- Refuse any request for a personal loan.
- Question any situation that gives an advisor unlimited access to money intended for investment (or money actually invested). That includes giving the advisor a full power of attorney for your accounts.

"I know it's a difficult time, but you need to decide."

DID YOU KNOW?

When the economy falters, it's a prime time for scams. Con artists target people who are desperate for quick help with their money problems.

Source: Consumer's Union, July 14, 2009

STEP BACK

Your life has turned upside down. Perhaps you've lost a spouse, are going through a difficult divorce, or lost your home. In the face of events like these, we often feel vulnerable and lack perspective—not the best time to make big decisions. Unscrupulous advisors know this and may swoop in with "opportunities," pressing you for a decision before you can think straight.

SPOT THE RED FLAG

- An advisor convinces a recent widow to invest her $350,000 death benefit in a variable life insurance policy. Her greatest need, however, is not insurance but cash—cash that's now tied up in the insurance policy.
- A victim of Hurricane Katrina receives a loan from the Small Business Administration to rebuild his business. An advisor presses him to purchase an annuity with the funds instead—an annuity he can't touch for 10 years without significant surrender fees.
- A woman visits the local funeral home to make arrangements for her mother's funeral. An advisor meets her there with paperwork to move the mother's investments to the bank he represents. Only later does the woman discover that he not only moved the investments, but sold them without her knowledge.

YOUR SELF-DEFENSE MOVES

- Be suspicious of pressure tactics or sales pitches during a major life change. It's best not to make important decisions for at least a year or two after a personal loss.
- Find an advocate—a trusted family member or friend—to help you with truly urgent matters, such as meeting tax or reporting deadlines.

"This one's a no-brainer. You can't lose."

DID YOU KNOW?

An analysis of Madoff's returns versus the S&P 500, showed that he only had three down months versus the market's 26 down months during the same period, with a worst down month of only –1.44% versus the market's worse down month –14.58%.

Source: SEC investigation report against Madoff, August 31, 2009

LOOK FOR THE DOWNSIDE

No risk, high return. If it sounds too good to be true, that's because it is. A fundamental principle of investing is "there's no free lunch." If an advisor tells you otherwise, take your business elsewhere.

SPOT THE RED FLAG

An advisor consistently sells variable annuities to seniors with the promise of no loss of the funds invested and a high return. Seniors hear all the advantages—an income stream they can't outlive, guaranteed death benefits, high yield—and sign up. The advisor, however, doesn't tell them about the steep surrender charges and limited options for distribution. More often than not, the annuity turns out to be a bad fit for the investor.

YOUR SELF-DEFENSE MOVES

- When your advisor recommends a fund, insurance contract, or retirement strategy, listen carefully for a fair, complete discussion of the pros and cons. Write them down. If you're hearing only pros, you're not getting the full story.
- Ask the advisor under what circumstances the investment will not perform as projected. Consider economic events—such as inflation or rising interest rates—as well as your personal circumstances. What happens if you need money for an unexpected event? What happens if you die early or outlive the income stream?
- Make sure the advisor focuses on your specific needs as much as on the investment.
- Ask for a description of the investment in writing, with a clear statement of its benefits and risks. In this document, you'll see that such words as—always, guaranteed, and completely—are absent, even if they were used frequently in the verbal presentation.

"This offer is good for today only."

DID YOU KNOW?

The "Scarcity Tactic," or implying that something is rare or scarce, is one of the most common persuasion tactics used in investment fraud.

Source: "Outsmarting Investment Fraud" by the SEC, AARP and FINRA

DON'T LET YOURSELF BE PRESSURED

The bigger the decision, the more time and care it deserves. After all, the choices you make today can have consequences for years to come. Ethical advisors know this—so they give clients plenty of space for making smart choices, urging action only when chronic indecision has hurt the client's interests in the past.

Unethical advisors see things differently. They might push a deal to meet sales quotas or earn bonuses. For them, the fast decision trumps the right decision.

SPOT THE RED FLAG

- An advisor visits her clients at home, seeking a signature or a check. Ethical advisors may also make home visits, but only for the convenience of clients; unethical advisors invade the client's personal space to gain an emotional advantage. (One client, visited six times by a persistent advisor, considered signing the deal as a way to make the visits stop.)
- An advisor invites clients to a free dinner and seminar. The resulting sense of social obligation created an implied pressure to sign up for the advisor's "limited time only" investment.

YOUR SELF-DEFENSE MOVES

- Give yourself plenty of time to mull over an investment before you decide. Don't act until you fully understand what is being offered.
- Speak up when you feel pressured. Any feeling of pressure is reason enough to delay making a decision.
- Know how the advisor earns her pay, and consider this as you evaluate her advice. An advisor who practices as a fiduciary will disclose upfront whether her compensation is tied to a specific product or recommendation. If she doesn't mention how she is paid, ask.
- Use your "free look" period. Contracts for insurance policies and annuities often give you this period—usually 30 days—during which you can back out without incurring penalties.

"I can replace that with something better."

DID YOU KNOW?

"Churning" refers to the excessive buying and selling of securities in your account by your broker, for the purpose of generating commissions and without regard to your investment objectives. Churning can be a violation of SEC Rules and other securities laws.

Source: SEC 2009, April 15, 2009

FOLLOW THE MONEY

Better for whom? Ethical financial advisors are always on the lookout for ideas and investments that make their clients' lives better. In contrast, unscrupulous advisors typically base their buy/sell decisions on the size of their commission or fee. Because selling sometimes feels like admitting a mistake, a suggestion to sell for "something better" can be a powerful motivator for investors—and a recipe for trouble in the hands of a scam artist.

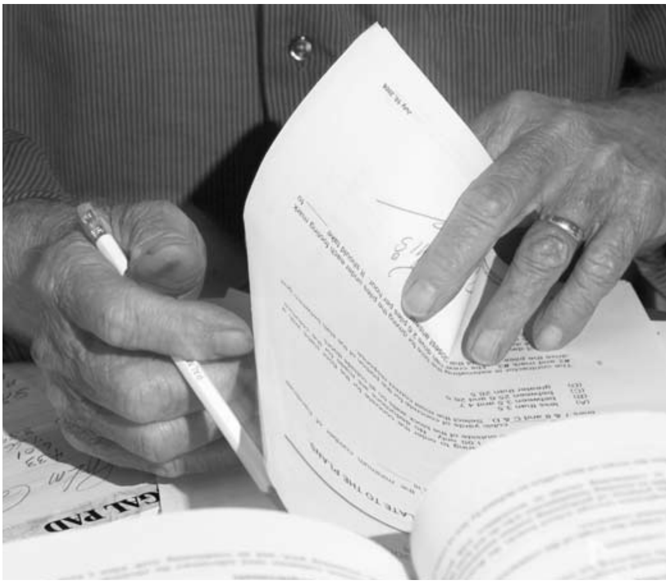
SPOT THE RED FLAG

- An advisor convinces a client to replace a variable annuity as soon as its surrender charges have expired, telling the client that this is a "tax-free" transaction. The advisor makes $80,000 in undisclosed commissions on the replacement annuity. The client now faces a renewed period of surrender charges.
- At the suggestion of his advisor, a client buys an insurance policy with an extravagant premium—nearly half the client's annual income! The client has no beneficiaries and doesn't need the insurance for estate planning. What triggered the decision to buy? The advisor recommends the policy as a "tax-free investment" likely to perform better than other investment options.

YOUR SELF-DEFENSE MOVES

- Whenever you are presented with a proposed transaction, ask, "What does this cost me?" In particular, ask about surrender charges, loads, commissions, internal expenses, or other transaction charges. (The existence of charges isn't an abuse; not being told about them is.)
- Always ask your advisor, "What do you get from this transaction?" Third-party payment or commission isn't a red flag all by itself. But if the benefits for you aren't enough to justify that commission, look for other investment options.
- Consider whether the timing of proposed transactions is motivating the recommendation. Too frequently, new annuities are sold just as the surrender charges on existing annuities have disappeared, or an advisor suggests a replacement insurance policy or financial product just as she moves to a new firm.

"It's very complicated. No need to bother you with all the details..."



DID YOU KNOW?

Financial abuse costs elders more than $2.6 billion annually, though four in five cases are not reported.

Source: MetLife Mature Market Institute Study, March 2009

ASK, ASK AND ASK AGAIN

Financial matters are complicated. That's why we rely on advisors in the first place. Unfortunately, lack of financial expertise—or other issues, such as dementia—can make clients vulnerable to fraud.

SPOT THE RED FLAG

- An elderly client asked her bank for a better rate on her CD. She walked out with an annuity that could not be surrendered for more than 10 years without a steep sales charge. The client had no idea that her new investment worked very differently from her old one.
- A client had never heard of the companies he held as individual stocks in his advisor-managed portfolio. He discovered this only after incurring substantial losses.
- A client was unaware that his brokerage company had been named as the trustee in his estate planning documents—and that the named trustee could not be replaced.

YOUR SELF-DEFENSE MOVES

- Tell your advisor when you don't understand something. Ethical advisors will be happy to explain: they know that the best clients are well-informed clients. If you don't understand the explanation, ask again.
- Forget about handing over your financial decisions to a professional because you don't want to be bothered. At a minimum, you must be able to assess whether your advisor is helping you.
- If necessary, get a second opinion on your advisor's recommendations or approach. The cost of another set of eyes is trivial compared with the potential cost of fraud or abuse.
- Plan for the possibility that you may not be able to handle your own affairs. Give power of attorney to a trusted friend, relative, or professional to make financial decisions in the event that you cannot act on your own behalf.

REMEMBER...

TO PREVENT FINANCIAL ABUSE:

- Trust, but always verify. Ask your advisor to provide services with the "duty of care of a fiduciary." Identify the organizations that license or supervise him (see the reference list on the next page), then check their Web sites for his background and disciplinary history, if any.
- Never leave blanks on paperwork, and always ask for final or submitted copies (with the word final or submitted stamped right on them).
- Ask whether your investments are regulated or supervised by third parties.
- Make sure you receive regular statements from independent third-party sources—not just from your advisor.
- If you invest in limited partnerships, real estate, or non-traded securities, verify that the investment manager is audited annually by a reputable independent accounting firm.
- Always make your checks payable to the advisor's business or custodian—not the advisor herself. Question any situation that gives your advisor unlimited access to your money.
- Take your time before any decision—and don't make major decisions just after a life change, like a divorce or the death of a loved one. Find a trusted family member or friend to help in reviewing or making the decision.
- Ask your advisor to list the pros and cons of each investment idea. If you hear only the pros, you're not getting the full story.
- Understand how your advisor earns her pay. She should disclose any conflicts of interest—actual, potential, or perceived—that might affect her recommendations.
- Before agreeing to any transaction, carefully consider the charges you'll incur and the timing involved.
- Understand your investments. Ask if you don't understand, and get a second opinion if necessary.
- Designate a trusted friend or relative to handle your investments in case something happens to you.

RESOURCES AND USEFUL LINKS

TO FIND A FINANCIAL PLANNER OR ADVISOR IN YOUR AREA...

- www.CFP.net/search
- www.fpanet.org/PlannerSearch/PlannerSearch
- www.napfa.org (click "Find An Advisor" on the left navigation panel)

TO CHECK THE BACKGROUND OF A FINANCIAL PLANNER OR ADVISOR...

Some of these resources may also tell you about your advisor's employment history, disciplinary record, and registrations.

- www.CFP.net/search
- www.finra.org/brokercheck
- www.adviserinfo.sec.gov

TO FILE A COMPLAINT...

Start by taking your complaint directly to the advisor and the management of your advisor's broker-dealer or investment advisor. If you fail to get a satisfactory response, then contact the agencies below.

If the complaint is about:

- a broker or securities product (such as stocks or mutual funds), contact:
  - The Financial Industry Regulatory Authority (FINRA): www.finra.org/Investors/ProtectYourself/p118628
  - Your state securities regulator: www.nasaa.org/QuickLinks/ContactYourRegulator.cfm
- an insurance salesperson or product (such as insurance policies or annuities), contact:
  - Your state insurance commissioner: https://eapps.naic.org/cis/fileComplaintMap.do
- an investment adviser or investment advice, contact:
  - The U.S. Securities and Exchange Commission (SEC): www.sec.gov/complaint.shtml
  - Your state securities regulator: www.nasaa.org/QuickLinks/ContactYourRegulator.cfm.
- a CFP® certificant, contact:
  - CFP Board: www.CFP.net/learn/complaint.asp

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