

State of Wisconsin



Investing

Getting Started

**DFI** DEPARTMENT OF FINANCIAL INSTITUTIONS

[www.wdfi.org](http://www.wdfi.org)

345 West Washington Avenue  
Madison, WI 53703

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Financial Education

Madison Center 345 West Washington Avenue Madison, WI 53703	608-261-9555
Milwaukee Center 101 West Pleasant Street, Suite 211 Milwaukee, WI 53212	414-227-4181

**You can file a complaint by writing to:**

Department of Financial Institutions  
Division of Securities  
PO BOX 1768  
Madison, WI 53701-1768  
800-472-4325 (800-47-CHECK)





## Getting Started

More than 47 million Americans invest in securities and every one of them had to make the same basic decisions to get started. For example, there are many ways of investing—in bank certificates of deposit, in mutual funds purchased directly from an investment company, and in stocks and bonds purchased through a brokerage firm. Even though you may be starting small, there may come a time when your total investments will represent a sizable amount of money. You should be clear about your investment goals and take at least as much care investigating and choosing someone to handle your investments as you would when buying a home or an automobile.

Choosing a stockbroker to handle your investments requires more than looking up a name in the yellow pages. This brochure contains information on how to select a stockbroker, what kinds of services you can expect from a stockbroker, and what to consider before making investments in any securities.



## Investment Goals

Your first step should be to determine what you want to accomplish through your investments. Do you want capital growth (increase in the value of your investment); income (periodic cash return); profits through speculation (by frequent trading or trading in high-risk securities); safety of principal (stability of the value of the investment); or some combination of these? These terms are commonly called "investment goals" or "investment objectives."

There are many kinds of investment objectives, although brokerage firms may use different names for the same goals. Only you, the customer, can determine what goals are right for you. Four basic investment objectives are:

**Safety** – very conservative investment with little risk of loss of your investment dollars, while perhaps providing some income benefits.

**Income** – investment for receiving regular income payments. Tax-free income is a common consideration. However, the market value of income securities may rise and fall as interest and dividend rates on newly issued investments change. For example, an existing bond bearing 5% annual interest will decrease in market value if new bonds currently being issued bear a 7% interest rate; in contrast, the existing 5% bond will increase in market value if newly issued bonds bear a 3% interest rate.

**Growth** – investment for a long-term increase in market value. Because growth securities are more likely to increase in market value than are income and safety securities, they also carry a higher risk of decreasing in market value. Growth investments generally provide little or no dividend income.

**Speculation** – investment for price appreciation in short-term trading. Speculation carries a high risk of losing part or even all of your

investment. There is also a greater possibility of higher and/or faster market appreciation. Usually, little or no dividend or interest income is derived from investing in these securities.

These four basic objectives can be refined or combined so that they more accurately express your investment goals. For example, you can choose to have both income and growth securities in your investment portfolio.

When deciding what your investment objectives are, remember that the more money you want to make, the more risk you must be willing to take with your investment dollars. When evaluating risk, you should also consider the length of time you can afford to leave the funds invested, the proportion of your assets you can commit to securities investments, and how much you can afford to lose.

Although securities may be part of a suitable investment program, potential investors should make sure that they are protected against a financial crisis before they begin; for example, by having adequate life insurance and bank savings. Here are some things to consider before you invest:

**1** DO have a money reserve set aside for emergencies before you invest.

**2** DO remember that there is risk in any investment and select your securities according to how much risk you can afford to assume.

**3** DO be sure you have knowledge, before you buy, of the terms, characteristics, and quality of the investments that interest you.


**4** DO ask for facts and advice from a licensed salesperson and be honest with your salesperson about your finances, goals, and investment knowledge.

**5** DO be selective. There is no such thing as investing in the market as a whole. Choose very carefully securities that fit your investment objectives.

**6** DO understand the type of order your salesperson proposes to place for you.

**7** DO have a sensible investment plan that you and your salesperson fully understand and follow.

**8** DO NOT invest in common or preferred stocks, mutual funds, or long-term bonds with money you may need on short notice.

 **TO DO-  
OR NOT DO-  
WHEN  
INVESTING**

**9** DO NOT disregard quality for the lure of higher yield unless you are prepared to take the risk.

**10** DO NOT invest in a company merely because it is in a successful industry. Each company should be considered on its own merits.

**11** DO NOT invest on the basis of tips or rumors. They are usually not trustworthy.

**12** DO NOT be afraid to say NO to the suggestions of a salesperson if you are not convinced the investments are right for you or if you do not understand them completely. Ask your salesperson to explain further.



## The Search

Securities can be bought and sold through hundreds of different brokerage firms. Many brokerage firms have offices in Wisconsin and many more conduct their business from outside the state by mail and over the telephone. Wherever the firm or salesperson is located, all brokerage firms and their sales agents doing business with the public in Wisconsin are required to be licensed by the Wisconsin Department of Financial Institutions. Although licensing does not guarantee good performance, it does provide to the Department the opportunity to review applicants' qualifications and compliance with operational and sales practice regulations.

Individual salespersons are called by many names: agents, registered representatives, account executives, financial consultants, and so forth. Although their titles may differ, their functions and knowledge requirements are the same. The State of Wisconsin requires securities agents to take and pass a number of examinations that test the agent's knowledge of securities products, sales practices, and state and federal securities laws. Passing an examination or using

an impressive-sounding title does not ensure a particular level of investment expertise, however.

Brokerage firms can be classified into three basic types: full service, discount, and limited products.

A full-service brokerage firm will provide you with the most complete package of investment services. It can provide individual service by an assigned salesperson, make recommendations on securities, provide research materials, and offer a wide variety of investment options. It usually has a varying commission schedule based on the type of security and the amount of the investment. A full-service firm is often the best choice for those who are just getting into the market or who do not have the time or desire to do their own investment research.

A discount brokerage firm can also provide you with access to a wide variety of securities products but, in most cases, you are not assigned to one salesperson. Salespersons at a discount brokerage firm are usually order-takers only and thus not allowed to give any advice, make recommendations, or provide research materials. Because of the limited service provided by such a firm, it can offer large discounts from

full-service commission rates. A discount firm which provides no investment advice should be used only by those persons who are familiar with investing in securities and are capable of doing their own investment research.

Some brokerage firms specialize in a limited number of securities products. For example, some firms may sell only mutual funds or limited partnerships or certain types of bonds. Therefore, the recommendations made by the salespersons will be geared toward the specialized type of security the brokerage firm offers. Commissions will vary depending on the individual brokerage firm.

Most salespersons are paid a part of the sales commission charged by their brokerage firm on securities transactions. There may be other fees for special transactions such as exchange offers, bond redemptions, stock transfers, custody charges (charges for holding your securities if your account does not generate a minimum amount of commissions each year), and charges for opening, maintaining, and closing IRA accounts.

## Background Information

One of the best ways to begin your

search for a broker is to ask friends or family members about their investment experiences and if they would recommend a particular firm or salesperson.

The Wisconsin Department of Financial Institutions can tell you when the firm and the salesperson were licensed in Wisconsin, how long they have been in the securities business, if any complaints have been filed with the Department by Wisconsin investors, and if any state or federal regulatory or law enforcement agency has taken any disciplinary action against them. To check on a firm or salesperson, call 1-800-47-CHECK and ask for a licensing background check. The Department cannot, however, tell you if any firm or salesperson is "reputable," nor can it make any recommendations.

Disciplinary information on firms and salespersons is also available from the National Association of Securities Dealers, Inc. by calling 1-800-289-9999.

The Better Business Bureau may have information as well.

## Opening an Account

After you decide which brokerage firm and salesperson to work with, the salesperson will prepare a number of forms

to open your account. The first is a new account form. This lists your name, address, social security number, employment information, credit references, investment experience, net worth, annual income, and investment objectives. The form may also include information relating to automated money-fund purchases, transfer instructions, and check requisitions. Many firms will not require you to sign this form. However, the salesperson must sign the form and have it reviewed and approved by the branch manager. The brokerage firm must then provide a copy of the completed form to you within 20 days of your opening the account. You should review the form carefully for accuracy and request that the form be corrected if necessary, and that a corrected copy be sent to you.

Many firms are now combining a number of forms to simplify their recordkeeping. You may find other forms combined with the new account form: for instance, a W-9 form, a customer agreement, a joint account agreement, a margin agreement.

The W-9 form relates to federal tax withholding on all dividends, interest, and proceeds of securities sales or redemptions

collected by the brokerage firm for your account.

The customer agreement establishes the rules by which the account will be operated—for example, when payments are due. It will also likely include an “arbitration clause” which is a requirement that any dispute between the customer and the brokerage firm be settled by arbitration rather than in court. You should read every agreement carefully before you sign.

A joint account agreement sets forth the division of ownership of an account created in the name of two or more individuals.

A margin agreement describes the rules relating to purchasing securities on credit.

Also, depending on the type of account or the type of trading you expect to engage in, you may have to sign other specialized forms such as an option agreement or a trading authorization. Most brokerage firms will allow trading activity to begin before receiving the completed and signed agreements. However, the brokerage firm will restrict further activity in your account if you do not return the completed forms by the deadline imposed by the firm. In any event, Wisconsin



sin law requires the brokerage firm to provide you with a copy of each agreement within 20 days of the date you signed it.

Some salespersons may provide you with brochures that describe their firm's services. However, they must also disclose to you in writing any fee for retirement accounts, for holding securities in your account, and for special services such as bond redemptions, exchanges, and transfers.

Brokerage firms may hold customer securities in "street name," which means that the securities are registered in the name of the brokerage firm. Having securities held in street name makes it easier to sell securities for your account and provides a way to safeguard your securities without the expense of a safe deposit box. However, you should also be aware that you may not be able to participate in a dividend reinvestment program for street name shares and that many brokerage firms are beginning to levy a custody charge on accounts not generating a minimum amount of commissions each year. If you do not intend to trade frequently, you should be sure you know how much the custody fee will be. To avoid any custody fees,

you may want to have the certificates delivered to you instead.

## Suitability

State and federal securities laws require

salespersons to make a reasonable inquiry about a potential customer's financial condition and investment objectives and to seek any other information which would provide the salesperson with sufficient knowledge to make suitable investment recommendations. The agent must collect this information to enable him or her to recommend an investment strategy compatible with the investor's goals and other pertinent factors. Wisconsin law further requires that each salesperson learn the customer's net worth, annual income, and investment objectives and to record this information on the customer new account form.

Annual income refers to how much money you earn during the year, including spousal income if the account will be a joint account. Net worth is the value of all cash, bank accounts, securities (all sometimes referred to as liquid assets), property, and other assets of saleable value, less total indebtedness.

This information is vital to your



salesperson in helping you to assess your ability to accept varying levels of risk and in determining the suitability of recommendations. You do have the right to refuse to provide this information but you should understand that by doing so, you restrict the salesperson's ability to make recommendations regarding your investment activity.

Having the financial capability to engage in a particular investment strategy is not the only basis for determining its suitability. You should also understand the nature of the securities being recommended and be able to evaluate how their performance may affect you. Investing in any security includes an element of risk. You need to determine the degree of risk that is acceptable to you in exchange for the hoped-for return. The answer lies in your assessment of your "human capital," an intangible but important consideration when deciding on an investment strategy.

Human capital includes such things as your future earning capacity as you progress in your career, how many income-earning years you have ahead of you, what future financial commitments you can expect (for

example, having children, paying for college educations, buying a home, and so forth), what your retirement needs will be, and any personal needs.

Your income, net worth, and human capital affect the types of risks you are willing and able to accept and how much of your assets you are willing to expose to risk at a given time.

## Transactions

When you discuss a purchase or sale with your salesperson, remember that unless you have given the salesperson specific written authority to use his or her own discretion in making investment decisions for your account, each purchase and sale in your account requires your prior specific authorization. Once you have given an order to your agent, even orally, it becomes a binding contract. If you change your mind for any reason, and the trade has already been executed, the chances are slim that the salesperson will be able to cancel it. You are then responsible for payment for securities purchased or delivery of securities sold. If you fail to complete the transaction, the brokerage

firm will sell out or buy back the security at the then-current market price and you will be liable for any loss.

When a transaction is made for your account, two dates are relevant. "Trade date" is the date the purchase or sale was executed. "Settlement date" is the date the funds or certificates must be received by the brokerage firm and the date on which the firms representing the buyer and seller exchange cash and securities to "settle" the trade. It is also the first day that proceeds of sales of securities are available to be paid to you. Normal settlement is currently three business days after trade date. Option transactions and U.S. government securities transactions generally settle on the next business day following trade date.

According to Federal Reserve regulations, payment for purchases is due by settlement date; however, in most instances, the regulations provide a two-day grace period. The brokerage firm may apply for an extension of time for such payment (up to five additional business days) if the reason for the delay meets the applicable extension criteria.

If an extension is not granted or if funds are not received by

the expiration of the extension, the brokerage firm is required to sell sufficient securities in the account to cover the amount owed. This can be done without specific authorization of the customer and may include selling not only the security purchased, but also any other securities in the account if necessary.

Upon settlement, the proceeds of a sale will be available to you if the securities were in street name or you delivered certificates to your brokerage firm in "good delivery form" (properly signed and not requiring any legal papers, such as estate papers or residency documents).

You should never place with one brokerage firm, an order to sell a security that you have on deposit with another brokerage firm. You may be unable to make delivery of the securities to the selling brokerage firm in the allotted time. You would thus be required by the selling brokerage firm to repurchase an equal number of such securities, at the then-current market price, in order to cover the sale. You would also be liable for any commissions, fees, or losses incurred.

Always inform your salesperson of the location of your securities before placing an order to sell. Your brokerage firm may have procedures that will allow the sale to take place immediately, but those procedures must be started before the order is entered.

If within a week after settlement date you do not receive payment for securities sold, check with your salesperson. Sometimes there are problems with the transfer or in the accounting which are not your salesperson's fault. If you are not satisfied with the answer you get from your salesperson or his or her supervisor, contact the Wisconsin DFI.

You should receive a written "confirmation" of each trade executed for your account. A confirmation is not a bill. Brokerage firms do not issue bills; payment or delivery is due for a transaction on settlement date whether you receive the confirmation or not. You should contact your salesperson to find out what you owe if you have not received the confirmation.

## Through the Years

You will receive a monthly or quarterly statement from the brokerage firm which shows all the trades and other activity in your account. If there were no trades in your account during a particular month, you may not receive a statement for that month. Trades are usually listed by settlement date. Other entries, such as for funds received or securities delivered, are listed by the date on which they actually occurred. You should review your account statement carefully, question anything that does not look quite right, and take notes of the explanations given to you. Be sure to keep the statements and your notes in case any problems arise so that you will have them handy as a ready reference source.

Should the brokerage firm you are dealing with cease to do business or experience a financial failure, the Securities Investor Protection Corporation (SIPC) will often take control and liquidate the firm. Arrangements will be made to transfer customer accounts to another brokerage firm, deliver customer funds and securities



directly to the customers, or replace any securities or funds up to a value of \$400,000 in securities, and \$100,000 in cash, per account. However, SIPC does not insure against losses resulting from trading or poor recommendations.

There are many more aspects to dealing with a stockbroker than we can cover here. Other brochures available from the Wisconsin Department of Financial Institutions can provide additional information on a variety of specific subjects. However, the key points to remember before Getting Started in securities are:

- Carefully assess your investment needs;
- Do some checking before deciding on a brokerage firm and a salesperson; and
- Maintain communication with your salesperson so each of you knows and understands what is expected from the relationship.

If problems develop, try to work them out with the salesperson, the branch manager, or the brokerage firm's compliance officer.



## About the State of Wisconsin Department of Financial Institutions

**DFI** provides financial education through our *Your Money Matters* program including:

- Website access to a wide range of business and financial information from DFI, and the *Your Money Matters* event calendar.
- Informational brochures on Investing, Credit, Financing and Entrepreneurship.
- Education Centers featuring on-line access in Madison and Milwaukee.
- Seminars for the public on current financial topics.
- Speakers for meetings and seminars, conventions, professional and civic groups, high school and college classes, and other audiences of 30 or more.
- E-News automated e-mail notification system that informs subscribers of activities or developments relating to specified areas of interest.



**DFI** regulates the following:

**Division of Banking** - regulatory responsibility for state-chartered banks, mortgage bankers and licensed financial service providers.

**Division of Corporate and Consumer Services** - responsible for the Uniform Commercial Code (UCC) filings, and maintaining the state-wide data base of UCC lien filings for secured transactions, and for organizing or licensing domestic and foreign corporations, limited partnerships, limited liability companies, and limited liability partnerships.

**Office of Credit Unions** - supervision of state-chartered credit unions.

**Division of Savings Institutions** - supervision of savings and loans, and savings banks.

**Division of Securities** - regulates offerings of securities including mutual funds; franchise offerings; broker-dealers and securities agents; investment advisers and investment adviser representatives.

**Wisconsin Consumer Act** - Counsels consumers and merchants regarding their rights and responsibilities under the Act, which governs consumer credit transactions and the collection of consumer debt.



## More About DFI

**DFI** is a self-supporting agency funded by fees charged to those it regulates.

**DFI** is here to serve you!  
Visit us at:

**345 West Washington Avenue,  
Madison, Wisconsin.**

Office hours are Monday through Friday, 7:45 a.m. to 4:30 p.m.

**DFI** To learn more about us  
visit our Website at:

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Investing

# Investment Fraud





## Investment Fraud



Your telephone rings....  
A voice on the other end of the  
line introduces itself as a repre-  
sentative of a company offering  
you the chance to invest in the  
opportunity of a lifetime:

"Tired of low interest rates  
on savings accounts? Tired  
of losing money in the  
stock market? Want to  
make a lot of money?  
Want to get in on the  
ground floor of an invest-  
ment that will triple your  
money? Well, we have a  
great opportunity for you!"

Since the invention of the tele-  
phone, "get-rich-quick artists"  
have telephoned large num-  
bers of people for fraudulent  
promotions. Over the years

their sales techniques have  
become polished and sophisti-  
cated. As the schemes have  
become more complicated, the  
true nature of the "invest-  
ments" has become deeply hid-  
den, but fraud against investors  
is still the real goal.

The Wisconsin Department  
of Financial Institutions regu-  
lates the offer and sale of secu-  
rities under the Wisconsin Uni-  
form Securities Law and pur-  
sues actions against individuals  
and firms engaged in securities  
fraud. This brochure will help  
you to recognize the difference  
between legitimate salespeople  
and those promoting frauds,  
and help you to protect your-  
self BEFORE you invest.

# Definitions

The following terms are critical to a basic understanding of the investment industry. Learning them will help you to distinguish between legitimate securities offerors and those operating outside the law.

SECURITIES, as defined by Wisconsin law, include stocks, bonds, promissory notes and other evidences of indebtedness; shares in mutual funds; stock options; limited partnership interests; interests in oil and gas, mining, or real estate ventures or leases; certificates of deposit; some commodity contracts; and, "investment contracts" (a catch-all term for certain kinds of unusual investment arrangements in which the investor is to rely on the efforts of others for some essential managerial activities).

BROKER-DEALERS are firms which market investments to the public. Broker-dealers and their sales agents who contact persons in Wisconsin seeking to sell them securities must be licensed by the Department of Financial Institutions.

SECURITIES REGISTRATION is a process in which an issuer files

securities offering materials with the Department of Financial Institutions. The Department reviews the materials to determine whether they meet minimum standards as to disclosure of facts investors should know. The materials must disclose the background of those making the offering, their financial condition, the risk factors in the offering, and the investors' ownership rights and obligations under the offering. If those standards do not appear to be met, the securities are not registered. Every securities offering in Wisconsin must be registered with the Department of Financial Institutions before being offered for sale to persons in Wisconsin, unless it qualifies for an exemption from the registration requirement.

If you are contacted by a telephone salesperson, you should ask whether the investment offered is registered for sale in Wisconsin. You should also ask whether the person and his or her firm are licensed by the Department of Financial Institutions BEFORE you agree to anything. Legitimate broker-dealers and agents will gladly provide this information to you. If you are in any way uncertain, you should double-check their answers by contacting the Department.



## Boiler Room Schemes & Scams

Boiler Room and Ponzi Schemes are some of the

terms used to describe the sale of questionable investments. They can all be summarized by one term: SECURITIES FRAUD. Many approaches have been used to entice persons in Wisconsin to send money to a company that is really a "boiler room."

BOILER ROOMS are locations where a number of people use telephones to sell interests in a company or product to investors. The term boiler room describes the heat and high pressure generated by the callers as they try to convince investors to send in their money. In most cases, either the company or product does not really exist, or it does not operate as represented. Often, private courier services [such as Federal Express or UPS] are used in attempts to evade the U.S. postal-fraud laws. Here are just a few examples of recent boiler-room schemes:

PONZI SCHEMES use the money of later investors to pay off earlier investors. Early investors receive what appear to be high dividends or interest on their investments. Reports of these high returns are then used to entice new investors.

In reality, there is no underlying business. The early investors are simply being paid off with funds received from the later investors. When the scheme collapses, as it always does, current investors lose their money and the promoters walk away rich.

AFFINITY SCHEMES use a common connection between you and the salesperson to establish trust. This is simply a ploy to get you to drop your defenses so that you can be separated from your money. Because you are members of the same group, he or she wants you to believe that you would never be defrauded. The fact that the salesperson is of your race, religion, ethnic or other similar type group does not make the investment legitimate.

TELECOM FRAUD uses recent news stories about the revolution in telecommunications and the use of the internet. Scam artists concoct schemes that, at first glance, seem possible. However, check to see how much of your money actually goes toward the investment. Very often as much as half of your investment goes for fees of one kind or another. The more of your money that goes into "up front" fees, the lower any return on your invest-

ment would be, if there is any legitimate business operation at all. In addition, the systems are often not built or are of substandard quality. The fact that there are high "front end" fees is almost always an indicator that fraud is the case. Legitimate operations rarely build such front-end profits for themselves into the price.

REAL ESTATE SCHEMES AND OIL AND GAS VENTURE SCAMS come in many forms. Most are designed to convince you to invest in some kind of property or mineral rights at a location that neither you nor other investors have ever seen. Statistical reports and glowing projections are produced to entice you to invest in the hope of becoming an oil baron or a real estate magnate. In fraudulent promotions, even if the property or oil well does exist—which is often not the case—the proposed income-producing activity either does not exist, or does not operate as represented.

**T**he schemes described above are just a few examples of the fraudulent offers made to persons in Wisconsin every month. You work hard for you money; **DO NOT** allow a smooth-talking caller to take it away from you. If

you receive an unexpected telephone call from someone who tries to convince you to send money so that you can take advantage of a great investment opportunity: ASK if the firm and salesperson are licensed with the Department of Financial Institutions to do business in Wisconsin. ASK if the investment is registered with the Department for sale in Wisconsin. CONTACT the Department's Division of Securities at 608-266-1064 if you wish to verify the answers. Many of these schemes claim that what is being sold is not a security. Some sellers falsely claim that promissory notes or the like are not securities. Or, the interests they are selling are labeled "general partnership interests" or "limited liability membership interests" or the like. If they are doing the essential managerial work and you are mostly just giving them money, then they are selling a security and it must be registered with the Department unless otherwise exempt from such registration. People offering and selling fraudulent investments normally do not even attempt to register them under the securities laws, because of the factual disclosures they must

make in order to get the securities registered. That is why you should always check to see whether the investments being offered to you are registered.

## Rules to Remember

DO NOT give out personal information such as your social security number, your financial condition, your past investment history, or your bank, credit union, or savings and loan accounts unless you feel confident about dealing with the salesperson and the firm. And, you should not deal with any securities dealer or its representative unless you know that both the firm and the representative are licensed under the Wisconsin securities law. If you give a caller such information, a claim may later be made that you did authorize a transaction; otherwise, why would you have given the caller such information?

INSIST that written information about the investment be sent to you—before you make any invest-

ment decision—by U.S. mail, not by a private courier service [such as Federal Express or UPS]. After you receive the information, seek the opinion of a local brokerage firm, accountant, attorney, or someone you trust who is knowledgeable about making investments.

NEVER let a salesperson use high-pressure or hard sell tactics to coerce you into agreeing to make a purchase. Boiler-room callers are experts in using language that sounds "right." They use all the current industry slang and will, if necessary, invent more to sound as though they really know more about the investment than you will ever need to know. A boiler-room caller will often tell you to "trust me." DON'T!

MAKE NO PROMISES, regardless of what the salesperson says. Wait until you receive all the information you requested by U.S. mail, and have had time to evaluate it before giving the caller any indication of possible interest.

DO NOT be afraid to hang up the telephone if someone continues to pressure you. You do not owe this type of salesperson any explanations or courtesies.



Those who market investment fraud rely on the telephone as their primary sales tool. Legitimate investment firms and their salespersons use the telephone to identify new customers. You can use the information in this brochure to help you distinguish between them. The key is to investigate before you invest!



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