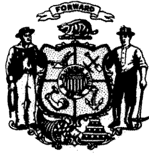
State of Wisconsin



DFI DEPARTMENT OF FINANCIAL INSTITUTIONS

www.wdfi.org

345 West Washington Avenue
Madison, WI 53703

TTY	608-266-8818
Office of the Secretary	608-264-7800
Banking	608-261-7578
Mortgage Banking	608-261-7578
Corporations	608-261-7577
Credit Unions	608-261-9543
Savings Institutions	608-261-4335
Securities	608-266-1064
Uniform Commercial Code	608-261-9548
Wisconsin Consumer Act	608-264-7969

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

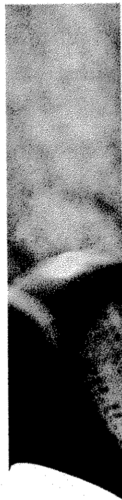
You can file a complaint by writing to:

Department of Financial Institutions
Division of Securities
PO BOX 1768
Madison, WI 53701-1768

DFI/SEC/103P (R 03/00)

Investing

Resolving Disputes



Most brokerage firms and their securities agents (salespersons) deal honestly and fairly with their clients. Sometimes, however, difficulties and disputes can arise and, on rare occasions, fraud and theft may occur. There are several steps you can take to protect yourself.

The best way to avoid becoming a victim of securities fraud or theft is to arm yourself with knowledge. Before you invest, ask the salesperson if he or she is licensed in Wisconsin and if the security being offered is qualified for sale in Wisconsin. You may check the responses, as well as the salesperson's disciplinary history, by calling the Wisconsin Division of Securities.

Do not let yourself be pressured by the salesperson into making a purchase. You may need time to determine if a purchase is correct for you, as well as to verify the salesperson's statements about registration and licensing. Do not fall for extravagant claims. Ask to see a copy of the prospectus which describes the security and the company issuing it. Protect yourself by investigating before you invest.

Resolving Disputes

Aside from clerical errors, there are a number of potentially serious abuses which could occur in a brokerage account and of which you should be aware. Although you may not learn of these unlawful activities until after the fact, being able to recognize them and taking immediate action to rectify them should be your first priority.

Abusive Practices

Unlicensed Activity

All brokerage firms and their sales agents who conduct securities business with persons in Wisconsin must be licensed by the Wisconsin Division of Securities. Selling securities without a license is a serious violation of the securities law.

Unregistered Securities

Every securities offering in Wisconsin must be registered with the Wisconsin Division of Securities, unless the offering qualifies for a specific exemption from the registration requirements. It is against the law to sell unregistered, non-exempt securities in Wisconsin.

Unauthorized Trading

Unless the salesperson has written authority from you, YOU must approve each order to buy or sell before it is entered for your account. Without such authority, the salesperson must not buy or sell securities on your behalf and merely inform you later. The only exceptions are for a customer's failure to pay for purchases or to deliver certificates for securities that the customer has sold.

Unsuitable Recommendations

Brokerage salespersons are required to make investment recommendations to customers based on a reasonable inquiry into the customer's financial condition, investment objectives, and other relevant information. Because not every customer can tolerate the same degree of investment risk, a given security may be appropriate for one customer, but not for another.

Churning

Churning is a pattern of securities trading in which the salesperson makes numerous purchases and sales of securities in order to generate commissions. To identify churning, calculations can be made to determine how many times the dollar value of the account was reinvested, how much commission income was generated for the firm and the salesperson, and what the customer would have to earn, taking those commissions into account, in order to break even or obtain a reasonable return.

Unexecuted Trades

Brokerage firms and their salespersons are required to execute customers' orders promptly, at prices reasonably related to the market at the time the order was received. Salespersons must not ignore your instructions to buy or sell or to seek a specific price in the market.

Failure to Deliver

Delivery of a customer's securities and uninvested funds must be made within a reasonable time of the customer's request.

Unauthorized Transfer of Assets

No funds or securities may be withdrawn from your account without your written authorization. Unauthorized transfers may be detected by closely reviewing your monthly statements to determine that all of your funds, securities, and transactions are accurately reported.

Fraud

Fraud can take many forms. It often consists of the misrepresentation or omission of material facts in the offer and sale of securities. It could also be a type of business practice, such as trading on "inside" information, or manipulating the market price of securities.

Theft

Sometimes, out-and-out theft may take place. Never make checks payable to a salesperson; instead, make them payable only to the brokerage firm or

the issuer of the security, such as a mutual fund. Never give cash or securities to a salesperson. Even if the firm is bonded for losses, it still may be difficult for you to prove that you did, in fact, give cash or securities to the salesperson.

When brought to the attention of regulatory authorities, any of the above activities may result in disciplinary action against the salesperson or firm, including referral for criminal prosecution. Recommending investments that happen to lose money, however, is not a crime or a violation of the securities law. No one can predict or guarantee how a security will perform after its purchase.

Self Defense

Once you have invested, vigilance becomes your best protection. The most important step you can take to protect yourself is to review your purchase and sale confirmation slips and monthly statements as soon as you receive them. If you have a question, ask your salesperson for an explanation. If you find an error, insist that it be corrected immediately. Early

detection may prevent losses from mounting and will show that you do not agree with the actions that took place in your account. The initial contact may be by telephone or letter, but if a telephone is used, follow up with a letter in case proof of the conversation is needed later. Take written and dated notes of your conversations with the salesperson, as well as with anyone else at the firm, regarding the problem.

Save all records of your transactions and copies of your correspondence with the salesperson and the firm. These papers can support your version of the facts if a dispute develops. If you send documents to your brokerage firm or salesperson, send only copies. NEVER part with an original document or letter; it is your most valuable piece of evidence.

If the salesperson is unable or unwilling to resolve your concerns, send a written complaint to the compliance department of the brokerage firm. The letter should include details of your concerns and copies of your monthly statements or other documents which help to explain the problem. Again, DO NOT send your originals. If you cannot resolve your problem with the firm, there are several alternatives you can explore.

Formal Resolutions

The Wisconsin Division of Securities regulates the offer and sale of securities; it also licenses and regulates brokerage firms, their salespersons, and investment advisers. You may send a letter of complaint to the Division detailing your concerns. Be sure to enclose copies of your correspondence with the brokerage firm and copies of all related documents.

The Division of Securities can take disciplinary action against brokerage firms and their salespersons who have violated the law. Although the Division cannot require the return of a customer's funds, resolution of disciplinary proceedings may also result in a firm's repurchase of securities from a customer or other types of reimbursement to a customer.

Securities transactions with brokerage firms and their agents are governed not only by state law, but also by federal

law. Federal securities law is administrated by the U.S. Securities and Exchange Commission. Related business-practice rules are administered by the NASD Regulation, Inc.

Some violations of the Wisconsin securities law, including most of those already discussed, provide grounds for civil lawsuits. Under that law, you have three years from the date of the transaction to file a lawsuit. You can seek a full return of your invested money, interest on that amount at the statutory rate, and reasonable attorney's fees from those who violated the law, including the brokerage firm, salesperson, and any partner, officer, director, or employee who materially aided the transaction. Because other laws may also apply, you should probably seek legal advice before deciding to file a lawsuit.

Most customer brokerage agreements now have a provision requiring arbitration in the event of a dispute. Such a provision currently prevents the customer from filing a lawsuit, even for violations of the securities laws. If the customer agreement form presented to you contains a mandatory arbitration clause, you may ask that, as a condition of your doing business with the firm, such a clause be deleted from the agreement before you sign it.

Arbitration takes place outside the court system and is a less formal process than a court proceeding. It is generally quicker and less expensive than going to court. As with court proceedings, although no lawyer is required, it is recommended that you seek legal advice.

The arbitration process begins when you file a claim with an arbitration service. The filing consists of a completed Uniform Submission Agreement, a Demand for Arbitration, a Statement of Claim, and the required fee. Check the rules of the arbitration service through which you are seeking arbitration to determine if any time limitations exist.

Arbitration cases may be tried by a single arbiter (sometimes referred to as an "arbitrator") or a panel of three arbiters. The size of the panel

depends upon the dollar amount of the dispute and the arbitration service's rules. The panel is selected from the service's list of available arbiters. They will include members of the industry as well as persons with no brokerage affiliation. In most cases, each party to the dispute will have some input into the selection process of arbiters.

Arbitration hearings can be held at most any location convenient to the parties, including the offices of the service, a law firm, or a hotel conference room. There are few formal rules governing either procedure or evidence at an arbitration hearing. Both sides present evidence, and the hearings seldom last more than a day or two. The arbiters are usually given 30 business days to reach a decision. They need not give a reason for that decision, but may state simply who won and the amount of the award.

Although arbitration is generally faster than a court proceeding, in some cases the process can still take well over a year. The decision of the arbiters is final. There is no ability to have it reviewed by a

court, except in exceptional cases of misconduct by the arbiters such as fraud, evident partiality, corruption, or a refusal to apply the relevant law. Because court review is unlikely and no reasons are given for the arbiters' decision, parties to an arbitration proceeding take the chance they will lose and never know the reason.

Five organizations conduct most securities arbitration hearings:

- NASD Regulation, Inc. ("NASDR")
- American Arbitration Association ("AAA")
- New York Stock Exchange ("NYSE")
- American Stock Exchange ("AMEX")
- Chicago Board Options Exchange ("CBOE")

The organization having jurisdiction over your dispute is probably determined by the arbitration clause in your brokerage agreement. If that is not the case, you may choose an arbitration service yourself.

The NASDR also offers another option for resolving disputes prior to a formal arbi-

tration hearing—Mediation. In mediation, the parties discuss their problems and feelings in informal joint and private meetings with the mediator, usually an attorney with securities background. The mediator has no power to dictate a solution but offers suggestions to help the parties find an acceptable resolution.

Unlike arbitration, mediation is not binding. If no agreement can be reached through mediation, you can still pursue arbitration or civil action. In fact, if you have already filed an arbitration claim but have not gotten to the hearing stage, you can request a delay pending mediation. Mediation also is usually quicker and less expensive than arbitration.

Remember...

Your first attempt to resolve any problem or concern with your account should be with the salesperson and the firm. DO NOT WAIT for a matter to correct itself. If a resolution is not forthcoming, do not hesitate to contact a regulatory authority such as the Division of Securities, or to seek legal advice.

Regulatory Agencies

Following is a list of addresses for the Department of Financial Institutions and other agencies regulating brokerage firms and securities agents:

Department of
Financial Institutions
Division of Securities
P. O. Box 1768
Madison WI 53701-1768
1-800-47CHECK
www.wdfi.org

NASD Regulation, Inc.
District 8 Office - 20th Floor
10 S. LaSalle Street
Chicago IL 60603-1002
312-899-4400

U.S. Securities and Exchange Commission
Chicago Regional Office
Northwestern Atrium Center
Suite 1400
500 W Madison Street
Chicago IL 60661-2511
312-353-7390

Arbitration Contacts

Information and forms for arbitration can be obtained by contacting one of the following arbitration services:

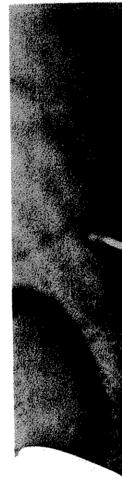
NASD Regulation, Inc.
Arbitration Department
NASD Financial Center
33 Whitehall Street
New York NY 10004

American Arbitration Association
225 N. Michigan Avenue
Suite 2527
Chicago IL 60601

New York Stock Exchange
Arbitration Department
20 Broad Street
New York NY 10005

American Stock Exchange
Arbitration Department
86 Trinity Place
New York NY 10006

Chicago Board Options Exchange
Arbitration Department
400 S. LaSalle Street
Chicago IL 60605



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.

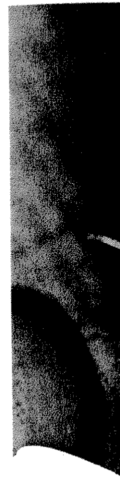
Division of Corporate and Consumer Services - responsible for the Uniform Commercial Code (UCC) filings, and maintaining the state-wide data base of UCC lien filings for secured transactions, and for organizing or licensing domestic and foreign corporations, limited partnerships, limited liability companies,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

www.wdfi.org

State of Wisconsin

DFI DEPARTMENT OF FINANCIAL INSTITUTIONS

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Securities	608-266-1064
Uniform Commercial Code	608-261-9548
Wisconsin Consumer Act	608-264-7969

Financial Education 414-227-4181

Milwaukee Financial Education Center
Governor's Central City Initiative
101 West Pleasant Street, Suite 211
Milwaukee, WI 53212

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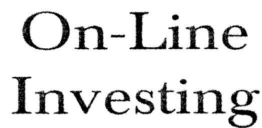
Department of Financial Institutions
Division of Securities
PO BOX 1768
Madison, WI 53701-1768

DFI/SEC/105P (R 03/00)

Investing

On-Line Investing



On-Line Investing

It used to be that "hot tips" about the stock market came from your barber or your Uncle Louie. If you wanted to buy or sell stocks, you went to the big Wall Street brokerage firm office downtown or you called your broker on the telephone and he gave you advice and entered your order. If you wanted financial information about a company, you asked your broker or you pored over back issues of *The Wall Street Journal* or other publications at your local library. But not anymore! As more and more people acquire computers, they also gain access to the Internet. The limits of information and services obtainable through the World Wide Web have yet to be defined. Estimates of the number of on-line trading accounts in 1998 ranged from 5 to 10 million and are expected to triple within five years.

But what kind of information is out there in cyberspace and how can an investor sort the good from the bad? And what are the differences between calling a live broker and trading on-line all by yourself? Here are some answers that may help you navigate through the realm of cyberspace investing. This brochure is not intended to explain the workings of the Internet, websites or web browsers. Rather, it will give you an overview of some types of information available relating to securities and some things to watch out for.

On-Line Brokerage Services

More and more brokerage firms are hosting websites that not only provide information about stock recommendations but also allow you to access your account information on-line and even place orders electronically, without the aid of a salesperson. A brokerage firm can host a website without being licensed in Wisconsin until someone in Wisconsin asks to open an account or the firm contacts an individual in the state about opening an account or purchasing a security. At that point, the brokerage firm must be licensed with the Department of Financial Institutions (DFI) Division of Securities before it opens an account or accepts any orders. Most brokerage firms will inform you that they cannot conduct business in Wisconsin if the firm is not licensed. You may be advised that the firm will notify you when it becomes licensed or you may be advised to check back at a later date to see if the firn. is approved to conduct business in Wisconsin.

Investment Suitability

When you open a traditional brokerage account, the securities agent is required to obtain information about you before trading begins. This information—about your financial situation, your investment objectives, experience, etc.—is vital for your agent to determine which securities are suitable for you. Gathering this background is required by state and federal securities laws and is designed to protect you from being placed in high risk or otherwise inappropriate investments. Because on-line brokerage firms provide minimal advice, they also conduct limited suitability reviews. Many firms will review the information you submit on your initial application only to the extent of verifying that your financial information meets their required minimum levels. If you begin trading in high-risk securities or strategies, the on-line firm will probably not question your activities unless they result in large losses or outstanding debit balances.

If you are not equipped to do your own research on which investments to buy and when, or if you do not feel comfortable in assessing how your personal financial situation would be affected by your trading activities, you should strongly consider using the services of a full service broker until you are in a better position to make those decisions for yourself.

Opening An Account

On-line brokerage services will require you to complete an information form similar to a customer new account information form used by traditional brokers. This form will ask for personal information such as your name, address, social security number, financial information, investment objectives and experience, and often, credit card information. New account forms may have pre-selected or "default" responses entered for certain information. For example, the country may be preset as "USA." These forms can seem long and tedious to fill out. However, you should carefully review any boxes or fields that already

have information entered in them to be sure they are correct for you.

One pre-selected option has been common in complaints received by DFI. Customers did not realize they had opened a margin account, which allows them to purchase securities "on credit" without paying for them in full at the time of the trade. The result has been that customers used the expanded buying power margin trading allows, but got into trouble when the value of their securities fell. The amount of money lost was actually twice as high as it would have been had they not bought the securities on margin.

Just like traditional brokerage firms, on-line firms are subject to the Wisconsin requirement to send a copy of the completed customer new account form to you within 20 days of opening the account. Some firms actually send a paper copy of the completed form to you. **However, please note:** many firms merely advise customers to print out a copy of the completed form and retain it for their records, sometimes in small type buried in the middle of a paragraph where it is not easily noticed.

Save or Print Out Copies

Regardless of the firm's policy, you should always retain a copy of any application you complete in the event you have a problem in the future and need to verify what was submitted when you opened your account. Also, in reviewing website applications of several brokerage firms, DFI has discovered that many of the customer agreements, which are legally a part of the application, can be lengthy and not easy to locate within the site. You should search for and carefully read these agreements for details on payment procedures, interest charges, fees, mandatory arbitration clauses, and other conditions of opening an account. You should immediately download a copy of the agreements for your records also.

Once the account has been approved, you will receive a user name and password to access the actual trading portions of the website. As with any personal identification numbers or passwords, you should protect the secrecy of that information to prevent unauthorized use of your account by others. Remember, YOU are responsible for any trades made using your user name and password. The record of who submits an order will show the user name and password of the account holder—not the e-mail address or other electronic identification information. With an on-line order entry service all errors are your responsibility and you will be liable for any losses incurred in correcting an error.

Quotes and Orders

Many investors believe that the computer provides instantaneous access to quotations and trading desks—no more waiting for a broker to write up an order and walk it to the teletype operator. While it is true that you probably receive more timely trading information via your on-line brokerage connection, you should understand that "real time" quotations do not mean the price you see is the absolute latest price or the price you will receive on your order. Some on-line firms, in not always obvious places, will advise that

quotations may be 5 or 10 minutes behind. This is because traders have to post their trades or quotes and the on-line service then has to update its information. In busy markets, this can mean longer delays. Thus, when your order reaches the trader's desk, several minutes may have passed between when you saw the price on-line and the time the trade actually takes place. Regardless of what you see on your screen or a "ticker" showing trading information, you are only entitled to a price reasonably related to the market price at the time the order reaches the trading desk.

When you enter your order, you are responsible for entering the correct instructions: buy or sell, quantity, symbol, price, and any qualifiers to the order. If you are not familiar with how to use limits, stops or other terms that qualify how your order is to be handled by the trader, you should probably use a full service broker until you have gained more experience. When an order is filled, it is said to be "executed." Remember, once executed, most transactions cannot be cancelled. If an error occurs in the execution of an

order because the order form was improperly completed by you, you remain responsible for whatever costs are associated with correcting that transaction.

On-line brokerage firms have specific procedures to follow if you experience or think there is a problem with an order you have entered. You should understand these procedures—usually found in the customer agreement and/or in the order entry section of the website—before you begin entering an order. For example, the customer hits the "ENTER" key and nothing appears to happen, so the "ENTER" key is hit again. The customer later finds that two orders have been entered instead of one. And, because the customer may not have followed the stated procedure for order entry questions, the customer is liable for both transactions.

Keeping Track of Your Orders

Brokerage firms have different procedures for notifying you of order executions. Most will send you an e-mail response with order execution information detailing the date, time, price and other pertinent information about your trade. Unless you are capable of receiving e-mail at any time of the day and reviewing it immediately, you run the risk of missing information about the status of an order that may require your immediate attention and any delay in reading that mail may mean a loss. DFI has received complaints from on-line investors who entered orders which they were sure would be executed, or for which they even may have received a report of execution, then logged off their computer. When they logged on the following day they found a message correcting an execution or advising that the order was not executed at all. Unlike using a live broker, the electronic system will generate e-mail messages, but will not call you back again or leave a message on your answering machine, and will not send a message to a location other than your main e-mail address. The brokerage firm is not responsible for losses as a result of your not seeing a message until it was too late.

Settling Transactions

Settlement, or paying for the transaction, is subject to the same time frame as any other brokerage account, whether it is done with a live person or via the Internet. Federal law requires purchases to be paid for within three business days of the transaction date. Securities sold must be delivered to the firm in the same time frame, although most on-line firms will not allow sell orders for securities that are not already on deposit in the account. Regardless of whether you receive a formal confirmation or not, the funds or securities are due by the settlement date. Failing to meet this deadline allows the brokerage firm to sell any securities in your account, even if they were not involved in the trade, to cover an outstanding debit or to repurchase shares sold that were not held in the account. No prior notice is required and the decision as to when and what to do is at the option of the brokerage firm.

Technical Difficulties

On-line trading has exploded in the last few years and on-line brokerage firms have struggled to keep pace with the growth. This has recently resulted in computer crashes and massive backlogs on backup telephone lines. When the market is making large movements and volume is heavy, on-line trading activity increases also. While on-line firms are constantly improving their computer hardware and software, delays may occur. Know your firm's procedures for backup order entry or account inquiry.

When such problems occur:

- Try to make printed copies of orders you attempted to enter or of e-mail messages you have sent so you can show exactly what you entered and when.
- Know what telephone numbers to call and expect long delays.
- Have all of your information ready when you do reach someone and be sure to get the person's name and identification number if they have one, and note the time of the call.

Most firms record their telephone conversations, but with 20 to 40 people or more taking calls, it is nearly impossible to find one taped conversation if the customer service representative's name and the time of the call are not known. Follow up frequently to ensure your problem has not been lost in the shuffle and that your account is adjusted.

Day-Trading

The ease of access provided by on-line trading has opened new opportunities to average investors, some potentially more risky than others. Daytrading is one of those glamorous strategies that have lured many investors into high-risk situations that have resulted in significant losses. Daytrading means buying and selling a security the same day. In reality, some purchases may not be closed out until the next morning, but the intent is

very short-term trading in large quantities and small price movements. For example, a person might think ABC Corp. stock is going to experience a fast price increase. The customer buys 5000 shares at 25. Within 15 minutes, the stock increases in price to 25 1/4. The customer enters a sell order and takes a quick $1250.00 profit. Then, the customer might enter another buy order in the hope that the price will continue to increase.

The lure of making big profits in a few minutes is very strong. And many people spend hours tracking potential daytrade stocks and watching their computers for the signal to buy or sell. But just as quickly as a stock can zoom up and create a large profit, it can also go down and create a large loss. The nature of most daytrading requires you to have a margin account and the brokerage firm also may require large deposits to cover the federal margin requirements which permit you to buy stocks many times the value of the funds on deposit in the account. For example, you may be required to maintain a $25,000 balance in your account. On a daytrading basis, that $25,000 may allow you

to buy as much as $250,000 worth of securities without putting up another nickel. Therefore, if you bought 10,000 shares at 25 and the stock dropped to 24 3/4, you would sustain a loss of $2,500.00. It would only take a few such losses to quickly wipe out your deposit or, even worse, put you into a deficit that may be difficult for you to cover from other resources. On top of commissions and any losses you might incur, you will also be charged interest on any debit balances you carry in your account as a result of your trading.

While many firms offer training classes in daytrading, their main interest is earning commissions from your trading and they will provide little assistance should you get into trouble. This is a very high-risk strategy that should not be entered into by those who do not have experience in trading speculative securities and who do not have the financial where-with-all to expose themselves to significant loss potential.

Company Information

From small, start-up companies to corporate giants, the Internet has become a way for businesses to promote themselves, their products and their securities to a tremendous audience. Many corporate websites contain a wealth of financial and business performance information. An investor wanting to do research can start here for a basic outline of the company. In addition, many magazines, newsletters and special websites will have additional information and opinions concerning a company and its securities. You should not rely solely on any one source of information. You should consult multiple sources, looking for several that generally back each other up on the information or recommendations made.

The Internet is Anonymous

Remember, when reading information or recommendations on the web, you probably know little about the person or firm making the recommendations. The anonymity of chat rooms, bulletin boards and websites allows anyone to say anything they wish without any requirement to back up their opinions or statements. Securities regulators have seen a marked increase in the number of sites proclaiming glowing reports about obscure stocks and companies. In the world of telephone and paper communications, someone promoting a particular security would be required to substantiate their claims. However, because communication via the web is instantaneous, and the identity and location of the person making the claim is often difficult or impossible to discover, the likelihood of fraud by misrepresentation or omission is heightened.

If It Sounds Too Good . . .

Claims of having special sources of information on a company may be a sign of two possible types of fraudulent activity. The first, so-called "insider information"—information that is known only to persons inside the company and has not been released to the general public—may be factual or a fabrication. In either event, it is a violation of both state and federal securities laws for anyone to trade on inside information. Should you be discovered to have bought or sold securities on inside information, you could be subject to heavy monetary penalties and forfeiture and possible criminal penalties.

The other possibility, and the more likely one, is that the information is fictitious or the claim of having special information is just a lure to hook you into an investment. Like the boiler room operators who commit telemarketing fraud, those committing cyberfraud make up elaborate stories about their own important place in the securities industry or a company and their

connections to key people in corporations or the financial markets. Name-dropping is a common tactic to add credibility to research reports and tips.

So, if you read about a deal that sounds too good to be true or about information that is secret, there is a good chance that the deal in question is not what it is represented to be.

Another problem identified with stock promotions on the web has been undisclosed relationships between website operators and issuers of securities. The U.S. Securities & Exchange Commission already has investigated a number of website operators who have received undisclosed compensation from issuers for promoting their securities. Investors have no idea whether the recommendations are truly representative of the merits of the security or just hype paid for by the issuer.

Registration Requirements

Many companies offering securities for the first time may decide the web is a cheaper place to attract investors than paying thousands in fees to a brokerage firm to market the securities to the public. Securities offerings must be registered or rely on an exemption from registration with federal and/or state securities regulators in order to be legally sold to the public. Most state securities regulators, including Wisconsin, have taken the position that a website promoting a company and discussing the details of a securities offering does not violate state securities laws. However, they do agree that once a company responds to an inquiry from a potential investor or directs any kind of information or communication on the security to a person in a particular state—Wisconsin, for example—that offering then becomes subject to Wisconsin securities law.

In other words, if you are in Wisconsin surfing the Net and view a page giving information about stock being offered by XYZ Corp., XYZ does not need to take any

action under the Wisconsin securities law. However, if you e-mail XYZ a request for information, before responding with information related to the securities being offered, XYZ must comply with all registration requirements in Wisconsin, whether or not a sale is actually made.

You can call the Department of Financial Institutions Division of Securities at **1-800-47CHECK** to verify whether a security is qualified for sale in the state.

Steps To Take To Avoid Fraud

The steps to take to avoid becoming a victim of cyberfraud are the same ones you would use when dealing with anyone offering investment opportunities.

1 Know with whom you are dealing. Do not assume the person giving advice or recommendations on-line is really who they say they are. Check with the Department of Financial Institutions, Division of Securities for information on the status of licensed securities professionals

or principals of a company. Remember, chat rooms and bulletin boards are not policed to verify contributors' identities or the truth of their statements.

2 Investigate before you invest. Do not be swayed by claims of big gains, inside information or "get in before it's too late" investments. Check out the securities with the Department to see if they are qualified for sale in Wisconsin. Look for information on the company in *The Wall Street Journal*, *Barrons*, *Forbes*, or other reliable financial publications. Also, check the National Fraud and Information Center website for information about on-line scams reported by law enforcement and regulatory agencies throughout the United States. The website address is **www.fraud.org**.

3 Understand on-line investment procedures. Be sure the website operator is a licensed broker-dealer before supplying any personal information to open an account. Call the Division of Securities at **1-800-47CHECK** and verify the licensing status and history of the brokerage firm. We cannot advise you to use or not use a particular brokerage firm, but we can give you information

on where the firm is licensed and on any complaints or disciplinary actions taken against the firm by a regulatory agency anywhere in the country. Also, keep copies of the on-line application you submitted along with copies of any agreements that affect your account, order reports, trade confirmations and account statements.

4 Determine your own risk tolerance. Before you make any investment, you should determine what your investment objectives are and how much risk you are willing to take to reach those objectives. Once you have made those determinations, don't be lured by quick profits or "sure things," or investments that do not match your own investment objectives or that expose you to more risk than you are comfortable with.

5 Beware of unsolicited e-mail messages. These messages have been a gigantic and ever-growing problem. Known by names such as junk mail and "spamming," hidden codes on web pages provide a means of identifying your computer and can either provide solicitors direct access to your own hard drive or send tens or hundreds of unso-

licited messages to you on every subject from investment opportunities to match-making services. If the subject of an e-mail message appears unfamiliar or questionable, you may simply want to delete it. Some Internet access providers will block certain types of e-mail if you request it.

6 Check it out! If you have any doubts about investment information you see on the Internet, or if you think you have been the victim of fraud or deceit in an on-line investment transaction, call the Department's Division of Securities immediately at **1-800-47CHECK**, or contact us via our website at **www.wdfi.org** or by mail at:

DFI Division of Securities
PO Box 1768
Madison, WI 53701-1768

Always Remember...

The Internet can be an invaluable tool to help you with your financial and investment decisions. Like any tool, you must learn how to use it properly. Being able to recognize the dangers of misuse of the Internet will help you avoid becoming lost in cyberspace.

Sources

Some sources of information on investments and on-line trading are:

Wisconsin Department of Financial Institutions:

www.wdfi.org

North American Securities Administrators Association:

www.nasaa.org

U.S. Securities & Exchange Commission:

www.sec.gov

National Fraud & Information Center:

www.fraud.org

Better Business Bureau:

www.bbb.org

National Association of Securities Dealers:

www.nasdr.com

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- 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.
- 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.

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

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

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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.

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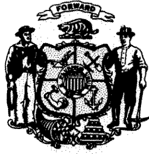
345 West Washington Avenue, Madison, Wisconsin.

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:

www.wdfi.org

State of Wisconsin



DFI DEPARTMENT OF FINANCIAL INSTITUTIONS

www.wdfi.org

345 West Washington Avenue
Madison, WI 53703

TTY	608-266-8818
Office of the Secretary	608-264-7800
Banking	608-261-7578
Mortgage Banking	608-261-7578
Corporations	608-261-7577
Credit Unions	608-261-9543
Savings Institutions	608-261-4335
Securities	608-266-1064
Uniform Commercial Code	608-261-9548
Wisconsin Consumer Act	608-264-7969

Financial Education 414-227-4181

Milwaukee Financial Education Center
Governor's Central City Initiative
101 West Pleasant Street, Suite 211
Milwaukee, WI 53212

You can file a complaint by writing to:

Department of Financial Institutions
Division of Securities
PO BOX 1768
Madison, WI 53701-1768

DFI/SEC/104P (R 03/00)

Investing

Stocks

Stocks

Corporations are usually organized under state laws. Each corporation is authorized by its charter to issue a specified amount of stock. Stock represents partial ownership (equity) in the corporation. The corporation may issue no more stock than the number of shares of stock authorized by its charter. Often a corporation will be authorized to issue more stock than it plans to sell immediately so that it may sell additional shares in the future without amending its charter.

Classes of Stock

Common Stock

A corporation must issue at least one class of stock–common stock–sometimes referred to as common shares, capital shares, or capital stock. Purchasers of common stock are granted specific rights by the issuing corporation's charter and by the chartering state's business corporation law. These rights generally include the right to vote at stockholders' meetings, the right to sell or otherwise dispose of their stock, the right of first opportunity to purchase any additional shares of common stock issued by the corporation, the right to share pro-rata with other common stockholders in any dividends distributed to common stockholders, the right to receive annual reports and to

inspect the corporation's books and records, and the right to share in any assets remaining after creditors are paid, if the corporation is liquidated. Common stocks sometimes have a par value, which is an arbitrary value assigned to them by the issuing companies. The stock may actually be bought and sold at prices greater or less than the par value.

A corporation may be authorized to issue more than one class of stock. A corporation may issue two or more classes of common stock which would then be distinguishable from each other by the rights granted to each class share. For example, one class of common stock might have enhanced voting rights; holders of this class would likely pay a higher price for their shares.

However, it is more likely that, if more than one class of stock is issued by a corporation, one of the classes will be common stock, with any additional classes being designated as preferred stock.

Preferred Stock

Preferred stock gets its name from the preferences granted to its owners. These include a preference as to payment of dividends, and may include a preference in the distribution of assets (after creditors are paid) if the corporation is liquidated. However, preference as to dividends does not guarantee the payment of dividends. Rather, if dividends are declared, the preferred stockholders have the right to receive their preferred dividend before the common stockholders are paid any dividends. On the other hand, preferred stock normally carries no voting rights. Issuing preferred stock enables a corporation to raise additional capital without jeopardizing the controlling interests of the common stockholders. Like common stock, preferred stock may have a par value, and also like common stock, preferred stock may be bought and sold at prices greater or less than par.

Preferred stockholders may be granted some voting rights, but normally those voting rights are limited to matters directly affecting their special rights as preferred stockholders.

If, for example, a company fails to pay dividends for a specified number of consecutive calendar quarters, preferred stockholders may then have the right to elect one or more members of the corporation's board of directors.

Preferred stock may be participating or non-participating, cumulative or non-cumulative, callable, convertible, or some combination of these and other features.

If the company decides to issue non-participating preferred stock, the stockholder is entitled to dividend payments at regular intervals but will not receive any additional dividends, no matter how profitable the company may become.

In contrast, holders of participating preferred stock will receive a share of ordinary dividends distributed to common stockholders in addition to the regular preferred dividend.

If the stock is a cumulative preferred and the company fails to pay a dividend when due, the unpaid dividend obligation will accumulate for the benefit of the preferred stock owners. If the company does not make payments on the cumulative preferred stock

for a number of years, the obligations continue to accumulate during the entire time and must be paid in full before common stockholders receive any dividend payments. In contrast, if a preferred stock is non-cumulative, unpaid dividends may never be received.

Callable preferred stock may be called in for redemption by the company at a price which is set by the company at the time of issuance. The call feature of a preferred stock enables the company to eliminate the high cost of dividends it may be paying on preferred stock. The call price of the preferred stock tends to put a ceiling on the market price of the stock because the company can redeem the stock at any time at the call price.

The stockholder may choose to exchange convertible preferred stock for shares of the company's common stock at a predetermined rate. The conversion usually cannot take place within the first two or three years after issuance, and other conditions may apply. Convertible preferred stock offers the stability and fixed return of preferred stock with the potential to cash in on

an increase in the value of the related common stock. However, once you have converted to common stock, you cannot switch back to the preferred.

Values of Stock

In addition to the par value mentioned earlier, stocks have book value and may have a market value. While par value is an arbitrary value set by the company at the time of issuance, a better approximation of the value of a share of stock is its book value. A share's book value is the total net assets of the company divided by the number of shares outstanding. For example, suppose a company with 1,000 shares of stock outstanding has total assets worth $10,000 and total liabilities of $4,000. Its net assets would then be $6,000. The book value of each of the 1,000 shares of stock therefore would be $6.

However, book value is usually not considered the most accurate measure of a stock's value. Depending on how investors evaluate a company's earnings prospects, they may be willing to pay more or less than book value for shares of the company's stock. The price at which shares of stock can be bought and sold is called the market value. However, not all shares are publicly traded and therefore, some shares have no market value.

Investment Objectives

How Risky?

As you contemplate any kind of investment, one of your primary considerations will be your overall investment objectives. Once you have determined that investing in stock is appropriate for you, you will want to keep your objectives in mind in order to chose the kinds of stock that are right for you.

Stocks are issued by all kinds of companies, from financially sound corporate giants, to established smaller companies looking for capital to expand, to speculative start-up companies with no track record and sometimes no product.

Blue chip stock is common stock of the largest, most financially stable corporations in America, considered leaders in their industries. These stocks have a history of stable or increased dividend payments. The "blue chip" reference comes directly from the poker table, where blue chips are more valuable than red or white ones. An investment in blue chip stocks is generally considered relatively conservative, but any investment in stock carries with it the risk of losing your entire investment.

Growth stocks are purchased by investors willing to take more risk for greater potential price appreciation. These stocks usually have what is referred to as a high price/earnings ratio (P/E). This ratio is obtained by dividing the current market price per share by the company's most recent earnings per share. This ratio is an indication of the market's current opinion about the growth potential of a stock or group of stocks: a high P/E ratio is based on anticipation that the company will do well.

Penny stocks are high risk, low-priced, highly speculative stocks usually issued by new

companies. They are called "penny" stocks because they often sell for under $1 per share, although they may be priced up to $5 per share. They may be offered over the telephone or through the mail by high-pressure salespersons who hope to make substantial profits. These stocks are often issued by struggling companies. While some penny stocks have turned into profitable investments, the failures far outnumber the successes. An investor interested in penny stocks should be aware of the high risk of loss associated with them.

Growth or Income

As already noted, growth stock offers potential for price appreciation. Growth-stock companies typically invest all or most of their earnings in expansion. They are not likely to pay much in dividends. Price fluctuations for these stocks are often larger and more irregular than for income stocks. Other characteristics of growth stocks may include:

1. Earnings larger at each peak of the business cycle

than they were at the previous peak;

2 Average growth rate of 10% or more per year;

3 High product demand with competition not an overriding concern;

4 Earnings growth greater than that of the average business having favorable growth prospects;

5 Good potential for substantial price appreciation over the longer term.

Income stocks, on the other hand, are usually issued by well-established companies with steady earnings but lower potential for price appreciation. These companies are able to turn a large part of their earnings over to shareholders in the form of dividends because they do not choose to use the money for continued expansion.

Dividends and Yields

A company may distribute a portion of its profits or retained earnings, or both, to shareholders in the form of cash dividends. A company may use retained earnings to pay dividends despite the fact that it has not earned a profit from its operations–a practice which may adversely affect its future.

If you want regular income from stocks, you should look for a company that has a history of paying cash dividends on a regular basis. If you are more interested in capital gains (achieved by selling at a higher price than the purchase price), look for a growth stock. Firms with strong growth records generally pay smaller or no dividends because they retain their profits to keep the company growing.

A number of dates relate to payment of cash dividends. They are:

1 Declaration Date. This is the date on which a company's board of directors declares that a dividend will be paid and specifies the amount.

2 Record Date. This is the date specified by the board of directors for determining shareholders who will be paid the dividend. All shareholders listed in the company's records on that date will be paid the dividend whether or not they actually own the stock on that particular date.

3 Payment Date. As the name suggests, this is the date on which the dividend payment is made.

4 Ex-dividend Date. This date comes after the declaration date and is usually three business days before the record date. From the ex-dividend date until the payment date, the stock is traded without the declared but unpaid dividend. This means if a sale is made on or after the ex-dividend date, the seller rather than the buyer, is entitled to the dividend.

Because of the lag in recordkeeping, a person who purchases a stock just prior to the ex-dividend date does not always have the shares issued in his or her name in time to receive the dividend directly from the company. This may

result in the seller actually receiving a dividend check the seller is not entitled to. In that case, the brokerage firm will charge the seller's account for the amount of the dividend and pay it to the buyer.

A dividend is said to be passed when it is expected but not declared. Dividends are passed or omitted when, in the opinion of the company's board of directors, the company's financial condition does not warrant payment or the money is needed for other business purposes. Even the largest firms may pass dividends.

A company may choose to pay a stock dividend, which is a dividend paid in shares or fractions of shares, instead of cash. A stock dividend merely lowers the cost per share of your holdings; it does not change the total value of your holdings. For example, if you owned 100 shares of stock worth $1,000, each share would be worth $10. If a 25% stock dividend were paid, you would then own 125 shares whose total value would still be $1,000. However, each share would then be worth $8.

A stock dividend is usually nontaxable at the time paid

unless the company offers the stockholder the option of receiving the dividend in the form of either stock or cash.

The yield on a stock is the percentage of return on the market value of the stock. It is calculated by dividing the yearly dividend paid by the current market price of the stock–not the purchase price. While your dividend payments on a stock may remain the same every quarter, the yield may change dramatically with changes in the stock's market price. Remember, however, that a company may be paying dividends even though it is not making a profit, and that a company making a profit may elect not to pay dividends. Therefore, you may wish to pay attention to the P/E ratio, discussed earlier, as well.

Stock Splits

When a company believes that investors are shying away from purchasing or holding its stock because the market price is too high or too low, the board of directors may approve a stock split. A stock split is similar to a stock dividend in that new shares of stock are issued to current stockholders.

Stock splits are expressed as ratios such as "2 for 1" or "3 for 2." In a 3 for 2 split, for example, for every 2 shares you currently own, you would receive one additional share so that after the split was paid, you would have 3 "new" shares for every 2 "old" shares you previously held.

As with a stock dividend, while the total value of your holdings remains the same, the value per share will change according to the split ratio. When a stock split takes place, the market price per share will generally be adjusted by the same ratio. Most stock splits result in additional shares being issued and the market price per share being reduced to a more attractive trading level for investors.

In contrast, when the market price of a stock is unusually low, a reverse stock split may be declared. In a reverse split, shareholders are required to send their certificates to the company to be exchanged for new certificates representing a smaller number of shares.

Again, the split is expressed as a ratio, such as a "1 for 10" reverse split. In that example, for every 10 shares you currently own, you would receive a certificate for 1 new share. A reverse split will increase the market price per share by approximately the same ratio. Thus, the total value of your holdings will remain the same, but the market price per share will be approximately 10 times higher.

The four dividend dates previously discussed also apply to stock splits, with one exception: the ex-dividend date normally is the day after payment date. Because market prices are usually adjusted for dividends and stock splits on the ex-date, placing the ex-date after the payment date discourages speculative trading in the stock between the declaration date and the payment date. It does mean, however, that if you sell your stock any time on or before the payment date, you will not be entitled to the split shares.

Stocks vs. Bonds

A brief mention of bonds as contrasted with stocks is relevant before concluding. Whereas a stock represents partial ownership (equity) in a company, bonds represent debt payable by a company to the bondholders.

As part owners, stockholders take on added risk for their investment. If a company must liquidate, stockholders cannot receive anything for their shares until all debts, including bonds, are paid in full. Also, interest on bonds must be paid in good times or bad, like any other debt. In contrast, dividends on stock can be reduced or even eliminated in lean periods. Profits in good years, however, usually mean higher dividends, increased stock prices, and better returns for the stockholder, while interest on bonds remains constant.

Of course, when considering investing in stock, you should carefully evaluate all aspects of a company, weigh your objectives carefully, and investigate before you invest.

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