



**Testimony**

**of**

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**Before the**

**Committee on Aging**  
**United States Senate**

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## **Introduction**

Mr. Chairman and Members of the Committee: NASD is grateful to the Committee for inviting us to testify about NASD's work to protect senior investors and for allowing us to submit this statement for the record.

NASD is committed to protecting investors of all ages through a wide range of programs. Our work in two areas is especially relevant to today's hearing topic: our investor education programs aimed at older investors and the work of our regulatory staff in combating fraud targeted at seniors.

Most recently, we have joined with the staff of the Securities and Exchange Commission (SEC) and the Florida Office of Financial Regulation in a new initiative focused on sales seminars. In this new initiative, we will conduct examinations of firms to determine whether they are complying with applicable rules in conducting sales seminars and adequately supervising this activity, including the sales literature used. In addition, this initiative will have an investor education component to make seniors more aware that they may be targets of problematic sales seminars and that investment opportunities may be recommended to them that are highly risky or inappropriate for them, in light of their age, net worth, overall investment experience, income and investment objectives

Our testimony today will focus on both NASD's investor education and its examination and enforcement roles.

## **NASD**

Founded in 1936, NASD is the world's pre-eminent private-sector securities regulator. In 1939, the SEC approved NASD's registration as a national securities association under authority granted by the 1938 Maloney Act Amendments to the Securities Exchange Act of 1934. We regulate every broker-dealer in the United States that conducts a securities business with the public—about 5,200 securities firms that operate more than 108,000 branch offices and employ about 664,000 registered representatives.

NASD rules regulate every aspect of the brokerage business. Our market integrity and investor protection responsibilities include rule writing, compliance examinations, enforcement, professional training, licensing and registration, dispute resolution and investor education. NASD examines broker-dealers for compliance with NASD rules, Municipal Securities Rulemaking Board (MSRB) rules and the federal securities laws, and we discipline those who fail to comply. Last year, NASD filed 1,399 new enforcement actions and barred or suspended 740 individuals from the securities industry. NASD has a nationwide staff of more than 2,400 with an operating budget of more than \$530 million and is overseen by a Board of Governors, more than half of whom are not in the securities industry.

## **NASD Investor Education**

Awareness, prevention and education are major deterrents to investment fraud. Unless seniors are armed with educational tools necessary to actually identify and thus avoid attempts at financial exploitation, they can more easily fall prey to fraud. NASD educates seniors and other investors about how to invest wisely and avoid investment fraud through its own investor education program and through the NASD Investor Education Foundation.

With results of a 2003 survey showing that an overwhelming 97 percent of investors realize they need to be better informed about investing, NASD has responded with an expanded array of resources. These include maintaining a prominent investor portion of our Web site, [www.nasd.com](http://www.nasd.com), which features investor alerts and other publications directed to individual, retail investors. NASD also reaches investors directly through investor forums and other events around the country.

### *Investor Alerts and Other Publications*

NASD has issued a number of investor alerts that warn people about potential problem products or practices. A number of these alerts focus on products that often are targeted for sale to seniors. These include alerts on:

- Equity-Indexed Annuities
- Variable Annuities
- "Stretch" IRAs

In one of our alerts on variable annuities, we focused on the marketing efforts used by some variable annuity sellers to target seniors. For example, as we noted in our alert, one scare tactic that has been used with seniors is the claim that a variable annuity will protect them from lawsuits or seizures of their assets. Claims like this one are not based on facts, but nevertheless help convince older citizens to buy the recommended product.

Other NASD educational publications contain materials of particular interest to investors who have retired or are contemplating retirement. For example, our 401(k) Learning Center contains valuable information about withdrawals from that critical retirement-funding vehicle. Many seniors may find our Bond Learning Center very helpful since they may typically invest a greater percentage of their assets in fixed income investments, such as corporate or government bonds. The Bond Center covers all types of bonds, from savings bonds, to municipals, to treasuries and agency bonds, as well as information about bond funds, including a risk report card for each bond category.

### *NASD BrokerCheck*

A critical first step when doing business with an investment professional is knowing who you are doing business with. NASD's BrokerCheck Program gives investors convenient access to information about brokerage firms and individual brokers, which, like other NASD tools for retail investors, is available free of charge. We encourage investors to use this valuable resource to learn about the disciplinary history, professional background, business practices, and conduct of brokerage firms and brokers with whom they invest. Through the Web at [www.nasdbrokercheck.com](http://www.nasdbrokercheck.com) or a toll free hotline (1-800-289-9999), investors may obtain employment and registration information and request a disclosure report. NASD obtains this information from the broker, NASD member firms, the SEC and state regulators as part of the securities industry's registration and licensing process.

Not only is BrokerCheck an essential first step in selecting a broker or firm, but it also is a resource that individuals should use periodically to keep tabs on their broker or firm. BrokerCheck tells you the states in which a broker is registered to do business. It tells you their employment history and whether they have had any disciplinary problems, such as certain types of criminal actions, enforcement actions by NASD and other regulators, customer complaints and certain investor-initiated arbitrations

We urge investors to make use of BrokerCheck to learn about their investment professionals BEFORE they invest. Investors can also contact their state securities department to obtain information about brokers and to lodge complaints. Each state has a separate securities department that regulates the securities industry within its boundaries.

### *Professional Designation Database*

The North American Securities Administrators Association recently urged seniors to carefully check the credentials of individuals holding themselves out as "senior specialists," noting that individuals use these designations to create a false sense of comfort among seniors. NASD's Professional Designation Database, [http://apps.nasd.com/investor\\_Information/resources/designations/](http://apps.nasd.com/investor_Information/resources/designations/), is the only tool available to investors that helps them to sort through the list of professional designations and to better understand what education and experience requirements are necessary for a designation. This tool allows investors to see whether the granting organization mandates continuing education, offers a public disciplinary process, provides a means to check a professional's status, and otherwise ensures that a professional designation is more than just a string of letters.

### **NASD Investor Education Foundation**

The NASD Investor Education Foundation (NASD Foundation or Foundation) is a natural outgrowth of NASD's long-standing mission to protect investors and uphold the integrity of the markets. Investors need a better sense of what they are doing and why.

Through the Foundation, we meet this need by funding innovative research and educational projects aimed at segments of the investing public who could benefit from additional resources.

NASD established the NASD Foundation in December 2003 in response to both the current environment in the markets and a survey conducted by NASD that showed that investors still have a number of fundamental questions and misunderstandings about important investment issues. The Foundation awards grants to fund educational programs and research aimed at segments of the investing public who could benefit from additional resources.

One of the NASD Foundation's grant making priorities has been to better prepare older Americans for handling their finances during retirement. In its first two years of grant making, the Foundation has funded two grants that focus particularly on older Americans. One of those grants is funding development of an interactive game-based educational program to provide investor education with an emphasis on retirement planning, primarily for 45 to 60 year old women. Funding provided by another grant is being used to conduct a series of focus groups and surveys with victims of investment fraud and non-victims to learn more about why the elderly are more frequently victimized by investment fraud. The grantee will use these findings to determine if a fraud vulnerability profile exists for seniors and, if it does, develop practical marketing messages to increase investment fraud awareness among seniors. The project is to be completed in collaboration with AARP. We anticipate that the project will be completed in May 2006.

### **Investor Complaints and Dispute Resolution**

NASD's goal is not only to be a source of critical information for individual investors so that they can make better-informed decisions, but also to take direct action to protect them. Despite our best efforts to protect investors, however, problems do occur. What recourse do investors have if they feel that they've been treated unfairly or misled?

In addition to contacting the securities firm's compliance department to discuss a broker's unfair or improper conduct, an investor may also lodge a complaint directly with NASD. Investigating complaints from investors is a significant function of NASD, and we look into all complaints that we receive. Alert investors have helped NASD successfully discipline many firms and brokers that have violated NASD rules or the federal securities laws. To report a problem, investors may submit complaints online via our Web site or send a letter to the NASD Complaint Center.

Although the vast majority of investors will never need to resolve an investment-related problem, all investors should know that NASD operates a dispute resolution forum, which handles 90% of securities arbitrations and mediations in the country. To get more information, or the forms needed to begin such a process, investors may visit our Web site or contact one of the NASD Dispute Resolution offices. By clicking on the

Arbitration and Mediation tab at the NASD Web site, investors can access a list of the Dispute Resolution regional offices and hearing sites.

### **NASD Regulatory Work to Protect Seniors**

As noted above, NASD protects investors by adopting appropriate rules to govern the conduct of the securities industry; examining securities firms to determine whether they are complying with those rules, both on a periodic basis and in response to customer complaints and other red flags; and disciplining firms and brokers who fail to comply--imposing sanctions ranging from censures to fines, suspensions and expulsion from the industry. In our routine examinations of broker-dealer firms, NASD focuses on sales practice issues, including suitability, the requirement that a recommendation of a securities transaction be appropriate for the particular investor to whom it is made. Misconduct by firms with respect to the accounts of older investors is identified in several different ways, including our sales practice reviews, customer grievance reviews and advertising/sales literature reviews.

Mr. Chairman, NASD is particularly concerned about possible sales practice abuses in the distribution equity indexed annuities. Equity indexed annuities guarantee the purchasers a minimum fixed rate of return, but also provide an added opportunity based upon the performance of a stock market index. The status of these products is unclear under federal law. Some equity indexed annuities may qualify as securities, in which case they can be sold only by a broker-dealer subject to NASD oversight. However, most sales of equity indexed annuities are treated as insurance sales and are not made by brokers subject to NASD oversight. NASD issued a notice to broker-dealers, urging them to consider adopting more complete supervisory procedures with respect to these products regardless of how they are treated. Moreover, NASD and the Minnesota Department of Commerce have scheduled a roundtable this spring to bring together insurance and securities regulators, industry representatives, and consumer advocates, to discuss whether all of us can do more to protect investors in equity indexed annuities and other annuity products. We hope that the roundtable will represent a significant step toward more effective supervision and sales practice compliance with respect to insurance products.

In addition to these policy initiatives, NASD often conducts sweeps, a series of targeted examinations, involving particular products and the specified products frequently are investments that are sold to the elderly. For example, we recently commenced a sweep focusing on the suitability of recommendations to exchange, withdraw funds or take other distributions from variable insurance products in order to fund investments in equity indexed annuities and the associated supervision of this activity.

Another area on which we have focused our attention and resources is sales seminars, which are often attended by retirees and the elderly. These seminars, with titles like "Asset Protection for Seniors," "Common Sense Retirement Strategies," "Six Mistakes Retirees Make with Their Finances" and "Striking it Rich in Retirement" are of concern because they may combine high-pressure sales tactics under the guise of a free lunch or

dinner. These seminars have been run by the broker-dealers we regulate, as well as other entities we do not regulate, including investment advisers.

Most of the seminars, although not explicitly targeted at seniors, cover topics that would be of interest primarily to seniors and retirees, including asset protection, estate planning and taxes. Other topics covered at seminars include “Tax free IRA/401 K Withdrawals” and “CD Alternatives,” as well as real estate investments. The advertisements for such seminars sometimes mention a specific product, most commonly annuities (variable and equity indexed), followed by insurance, REITs (real estate investment trusts) and mutual funds. As noted earlier, NASD is joining with the SEC and Florida securities regulators to review these seminars.

### *Advertising Regulation*

Broker-dealers use a variety of communications in presenting seminars. For example, they may advertise in local newspapers or magazines, or on the radio, and they may use direct mailings or mass emails. A variety of communications are used in presenting a seminar, including outlines, scripts, PowerPoint slides and notes, handouts, workbooks, worksheets and brochures. NASD reviews these communications on a routine basis and in the course of special investigations and sweeps.

Like any other public communication by a broker-dealer, seminar presentations must adhere to the content standards of NASD Rule 2210. The rule generally prohibits false, misleading or exaggerated statements or claims. The rule requires broker-dealer communications to be balanced and to provide a sound basis for evaluating the facts with respect to the product or service offered. These standards apply to scripted and extemporaneous presentations as well as any collateral material provided (for example, handouts, slides or worksheets).

In addition to the content standards of Rule 2210, sales materials of any kind used by a broker-dealer in connection with a seminar (including advertisements, invitations, scripts and outlines) must be approved prior to use and in writing by a registered principal of that securities firm. This material may also be subject to filing with NASD depending upon its content. Firms must file any sales materials pertaining to mutual funds, variable annuities, variable life insurance, unit investment trusts and public direct participation programs. They must also file certain seminar materials related to government securities, collateralized mortgage obligations and options.

### **Enforcement Cases**

NASD has commenced enforcement actions involving a wide range of abuses perpetrated on senior citizens. The abuses typically include making unsuitable recommendations of variable annuity purchases; inappropriately switching elderly customers from one variable annuity product to another; recommending speculative securities and use of margin; facilitating the use of home equity to obtain investment funds; excessive trading and churning; misrepresentations and omissions; forgery;

unauthorized transactions in customer accounts; fraud such as Ponzi schemes; customer harassment; and abuse of the arbitration process.

The sanctions and relief obtained in NASD settlements and decisions have been wide ranging, including suspensions, restitution for customers, disgorgement of ill-gotten gains and expulsion of firms and individuals from the securities industry. NASD has also pursued actions against individuals who have failed to pay arbitration awards obtained by seniors. Such actions have either resulted in payments to the individual customers/claimants or suspensions from the industry for those who fail to honor their claims. A few examples follow.

#### *Harassment/Arbitration Abuse*

In one recent case, NASD censured and fined Sigma Financial Corporation and its President, Jerome Rydell, \$135,000 for making frivolous filings in Michigan state court to harass and intimidate elderly customers (a husband and wife) who had obtained an arbitration award against Sigma. Rydell also was subjected to a 10-business-day suspension in all principal capacities and Sigma agreed to reimburse the elderly couple the \$110,000 in attorney's fees and costs they incurred over three years defending themselves against the firm in the Michigan court litigation.

#### *Unsuitable Recommendations*

In a case involving unsuitable sales of variable annuities and mutual funds, a registered representative, John S. Blount, was barred from association with any NASD-regulated firm and ordered to pay more than \$1.5 million in restitution plus interest to 10 customers. In one instance, where the customer was a 62-year-old retiree who wanted to keep his principal safe and anticipated the need for funds within a few months, Blount convinced the customer to invest almost all of his liquid assets in a variable annuity contract with high-risk sub-accounts and a six-year period during which substantial penalties would be imposed if the customer surrendered the contract. Later, the customer was forced to borrow against his home to purchase a car and make home repairs.

#### *Fraud/Ponzi Schemes*

In July 2001, Patrick Anthony, through his broker-dealer firm Camden Securities, solicited \$80,000 from two elderly investors (ages 79 and 64), purportedly to invest in a new start-up company. The deal was a fraud; Anthony diverted much of the money to his failing firm, himself and to family members. NASD charged Anthony with violations of NASD Rule 2120 and SEC Rule 10b-5. In the settlement, NASD suspended Anthony from the industry for two years, barred him from serving in a principal capacity with any NASD-regulated firm, fined him \$10,000 and ordered him to pay restitution totaling \$77,400 plus interest to the two customers.

Another fraudulent scheme involved a registered representative named Francisco Galvan, who recommended that a 59-year-old retired nurse purchase stock of Internet



Ventures, Inc. (IVI) and Rockwindow Television Network, Inc. (Rockwindow) for \$25,000 and notes issued by IVI and The Diligent Group for \$305,000. Not only did the retired nurse invest all of her liquid assets, but at Galvan's suggestion, she used her credit cards to finance \$26,250 of the \$30,000 she invested with The Diligent Group. Although she received a 60-day promissory note from the Diligent Group reflecting that she would be paid \$45,000 plus the cost of obtaining the funds from her credit cards, she received nothing. Apparently, she had intended to use the interest earned to surprise her husband by paying off the motor home that they owned. Mr. Galvan was barred from the securities industry as a result.

### *Misleading Advertising*

A case based on misleading advertising involved a registered representative named Dennis L. Marlowe, who was barred for use of misleading advertisements, including seminar advertisements. Another case involved a representative named Cynthia M. Couyoumjian who received a 31-day suspension and a \$20,000 fine for seminar ads and a seminar workbook that, among other problems, promoted equity indexed annuities using misleading and unbalanced statements and claims.

In addition to these formal actions, NASD has issued numerous Letters of Caution to firms for use of problematic seminar materials. In addition, NASD has referred five matters to Florida and California state regulators relating to retiree seminars where NASD had no jurisdiction.

### **Conclusion**

Thank you for giving us the opportunity to testify on these important topics and for your important work on this issue. America's elderly deserve honesty and integrity from those who sell them financial products. NASD will continue its work to protect all investors, including seniors. Mr. Chairman, we encourage every investor, and especially seniors and those who care for them, to look to NASD and for answers, information and help so that they can make informed investment decisions.