How to Protect Insureds from Private Investment Fraud

If you hear the phrase "investment fraud" and immediately think of handcuffed embezzlers, defunct crypto currency exchanges, get-rich-quick pyramid schemes, and internet scammers targeting little old ladies, you aren't alone.

Investment fraud tends to conjure visions of headline-grabbing scenarios where unwitting investors are robbed of their lifesavings by shady fraudsters and mustache-twirling scoundrels.

And while we all might like to think we could spot these criminals miles away and steer clear, the sad reality is that investment fraud can occur under the radar through the misdeeds or misconduct of seemingly reputable financial advisors.

As a trusted insurance agent, you are in a unique position to help your insureds uncover and avoid private investment fraud. It is not uncommon for small business owners, or athletes or entertainers, to seek the counsel of an insurance agent about non-insurance financial matters.

While you might not be qualified to provide investment advice, you can help guide your clients toward finding a suitable investment advisor by educating yourself and them about fraud avoidance and investment theft insurance.

CONTACT

To learn more about how Amwins can help you place coverage for your clients, reach out to your local Amwins broker.

LEGAL DISCLAIMER

3.23

Common Types of Investor Fraud

Investment products or services (stocks, private equity funds, securities, annuities, etc.) are typically sold by brokers and/or investment advisors who are certified, licensed, and registered with the Securities and Exchange Commission (SEC).

While most of these brokers are ethical professionals working for firms that uphold their legal obligations toward clients, it is not unheard-of to encounter advisors or brokerages who engage in misconduct that can result in significant financial losses for clients.

For fiscal year 2022, the SEC filed a total of [760 enforcement actions and recovered a record $6.4 billion in penalties] and disgorgement on behalf of the investing public. Illegal conduct ran the gamut from insider trading to fraudulent market manipulation, to advisor misconduct like undisclosed conflicts of interest or failure to divulge risks.

For example: A global investment firm (and three portfolio managers) settled charges for a fraudulent scheme to conceal the downside risks of a complex options trading strategy which caused billions of dollars in losses to more than 100 institutional investors, including pension funds for teachers, clergy, bus drivers, and others.

Most, if not all, of these investors would have assumed they were "safe" from fraud and insured for losses because they were invested with a firm that is required to comply with securities laws and provide insurance as a member of the Securities Investor Protection Corporation (SIPC).

The reality, however, is that the SIPC insurance covers losses (only up to $500,000) in the event that a brokerage fails financially. Most financial theft losses are a result of an individual within a firm acting maliciously. Investment theft insurance can offer protection for the investor regardless of whether the brokerage fails, which is a very rare event.

So, barring a successful SEC investigation, litigation, and settlement, these investors would have had to sue the brokerage and the advisors on their own—without any guarantee of recouping their losses.

What Can Savvy Investors do to Protect Themselves from Losses?

1. Check a Financial Advisor's Credentials

Before investing with anyone, check to make sure he or she is currently licensed, registered, and in good standing with the SEC. This can be done on sites like Investor.gov or brokercheck.finra.org. FINRA is the Financial Industry Regulatory Authority, a government-authorized non-profit organization that oversees U.S. broker-dealers.

Searching by an individual's name will reveal licenses held, current and previous registrations and disclosures such as customer complaints, regulatory actions, employment terminations, bankruptcy filings and certain civil or criminal proceedings to which they were party.

2. Check for Imposters Posing as Credentialed Advisors

In July 2021, the SEC and FBI published an Investor Alert warning against fraudsters posing as investment advisors. FINRA has posted an article with visual guides to help investors spot fake websites and imposter documents. Check any documents you receive from a financial advisor against the information you collect yourself from the SEC, FINRA and/or state registrations.

Do a Google search on the advisor, the firm, and/or the investment opportunity to see if there are any scam alerts, news reports or unfavorable client reviews.

3. Question Investment Strategies and Returns

Heed the adage "if it sounds too good to be true, it probably is." A reputable financial advisor will be able to discuss both the advantages and disadvantages of a recommended investment strategy and won't promise unrealistic returns.

Ask questions and if the advisor is unclear or dismissive of your concerns, seek another opinion before investing. The advisor might not be a scammer, but you should feel comfortable that you are making the right investments for your situation.

4. Understand Fee Structures

You should know how your advisor is compensated. Is it by commission, assets under management or a fee schedule? A professional advisor is required to provide new and existing clients with a current SEC Form ADV which clearly outlines the types of advisory services offered, fees and costs for services, and conflicts of interest, among other information. If the advisor is cagey about how he or she gets paid, that is a huge red flag for fraud.

5. Purchase an Investment Embezzlement, Theft and/or Misappropriation of Funds Insurance Policy

Sometimes, no matter how much you try to avoid it, you can still fall victim to fraud. Just ask the investors who entrusted Bernie Madoff with their money. Sure, now we associate his name with one of the largest financial frauds of modern-day history, but before 2008 he was a well-respected money manager.

The former chair of the Nasdaq, Madoff appeared to have a legitimate investment strategy that ran for decades, yielding high, but not unrealistic, returns. In reality, it was a ponzi scheme that defrauded thousands of investors out of tens of billions of dollars.

Today, private investors can protect themselves from theft losses by purchasing confidential Investment embezzlement, theft and/or misappropriation of funds insurance policy that names the specific investment firms, asset managers, trust companies, etc. involved in the financial transactions. The policy then protects those investment funds from embezzlement, theft and/or misappropriation by any of the named money managers.

Some policies not only recover the embezzlement, theft and/or misappropriation of assets, but also provide funds for legal representation and a periodic review of the registered investment professionals listed on the policy.

Takeaway

Investment fraud is a growing concern, and yet many private investors may not realize some of their largest assets are not protected against potentially huge losses. As a trusted advisor to your insureds, you are in a unique position to educate your clients about the risks they face when investing and the insurance protections available to them.

The experts at Amwins Access have an exclusive partnership with Capital Shield to offer a variety of coverage options for savvy private investors.

For additional information on this product contact Kevin Madden at kevin.madden@amwins.com or 561.656.6174.