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AAll Meeting Research Triangle Chapter

Lori J. Schock, Director
Office of Investor Education and Advocacy
U. S. Securities and Exchange Commission

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Three Key Messages for Investors

- Avoid Fraud
 - Investor Protection Campaign
 - Recent Investor Alerts
- Impact of Fees
 - Recent Investor Bulletin
 - Fund Analyzer
- Manage Risk
 - Current Environment
 - Interest Rate Risk
 - Need for Diversification



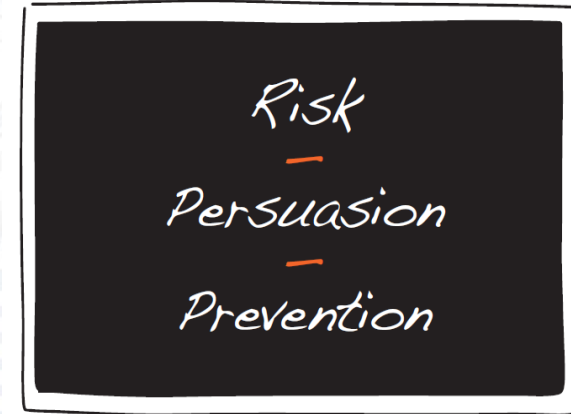
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Investor Protection Campaign

▶ Outsmarting Investment Fraud

- Understanding Fraud **Risk**
- Recognizing **Persuasion** Tactics
- **Preventing** Investment Fraud



- ▶ Incorporates moderated presentation, videos, and learning activities & exercises
- ▶ Call to Action: Deputizes participants to warn others



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Preventing Fraud – Ask and Check

- ▶ Those who counter-argue and actively question a communication are less persuaded.
- ▶ Interviews of cons reveal that they do not like to be questioned.
- ▶ Ask and check the registration status of the professional and investment.
 - ▶ ASK if they are licensed to sell the investment and if the product is registered.
 - ▶ CHECK that they are licensed and the product is registered.



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Investor Alerts on Fraud



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INVESTOR ALERT

Binary Options and Fraud

The SEC's Office of Investor Education and Advocacy and the Commodity Futures Trading Commission's Office of Consumer Outreach (CFTC) are issuing this Investor Alert to warn investors about fraudulent promotion schemes involving binary options and binary options trading platforms. These schemes allegedly involve, among other things, the refusal to credit customer accounts or reimburse funds to customers, identity theft, and manipulation of software to generate losing trades.

Binary Options

Binary options differ from more conventional options in significant ways. A binary option is a type of options contract in which the payout will depend entirely on the outcome of a yes/no proposition.

The yes/no proposition typically relates to whether the price of a particular asset that underlies the binary option will rise above or fall below a specified amount. For example, the yes/no proposition connected to the binary option might be something as straightforward as whether the stock price of XYZ company will be above \$9.36 per share at 2:30 pm on a particular day, or whether the price of silver will be above \$33.40 per ounce at 11:17 am on a particular day. Once the option holder acquires a binary option, there is no further decision for the holder to make as to whether or not to exercise the binary option because binary options exercise automatically. Unlike other types of options, a binary option does not give the holder the right to

purchase or sell the underlying asset. When the binary option expires, the option holder will receive either a pre-determined amount of cash or nothing at all. Given the all-or-nothing payout structure, binary options are sometimes referred to as "all-or-nothing options" or "fixed-return options."

Binary Options Trading Platforms

Some binary options are listed on registered exchanges or traded on a designated contract market that are subject to oversight by United States regulators such as the SEC or CFTC, respectively, but this is only a portion of the binary options market. Much of the binary options market operates through Internet-based trading platforms that are not necessarily complying with applicable U.S. regulatory requirements. The number of Internet-based trading platforms that offer the opportunity to purchase and trade binary options has surged in recent years. The increase in the number of these platforms has resulted in an increase in the number of complaints about fraudulent promotion schemes involving binary options trading platforms.

Much of the binary options market operates through Internet-based trading platforms that are not necessarily complying with applicable U.S. regulatory requirements and may be engaging in illegal activity.



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INVESTOR ALERT

Private Oil and Gas Offerings

The SEC's Office of Investor Education and Advocacy is issuing this alert to educate individual investors about certain risks and possible fraudulent activity involving private offerings of securities for oil and gas ventures.

The number of fraud cases related to private securities offerings for oil and gas ventures has increased over the last few years. From few in 2005 and 2006, the number of SEC cases has averaged more than 20 per year since. State securities regulators have experienced a similar increase in cases over the past five years. All investing involves varying degrees of risk. *Investing in private offerings, however, carries unique risks, and private oil and gas offerings have additional risks to consider.*

What should I do first?

If you are asked to invest in a private oil and gas offering, you should first consider and investigate who exactly is asking you to invest and think carefully about whether the investment is appropriate for you.

Is the person recommending the investment registered? Most people offering you securities must be registered as a broker with the SEC and must be a member of the Financial Industry Regulatory Authority, or FINRA. You can find out if someone is registered and obtain information about a registered broker by visiting FINRA's [BrokerCheck](#) website or calling FINRA's BrokerCheck hotline at (800) 289-9999. If you are

working with a registered investment adviser, you may be able to obtain information about the adviser by visiting the SEC's [Investment Adviser Public Disclosure \(IAPD\)](#) website. You can also check with your state securities regulator regarding the person soliciting your investment.

What if I'm not working with a registered broker or investment adviser? If someone who is not registered solicits your investment, that person may be violating the law. One exception from broker registration is available to employees of the company offering the securities and who engage in strictly limited sales activities. If you aren't consulting a registered broker or adviser, you should consider doing so. A registered broker or adviser that is familiar with the oil and gas industry and not connected to the offering can help you analyze the investment. *Most importantly, working with a registered broker or investment adviser affords you certain legal protections.*

Even if you are working with a registered broker or adviser, it is not a seal of approval. Oil and gas offerings present many investment risks, and working with a registered individual is not a guarantee that the offering is a sound investment. Ask about any prior history of selling oil and gas offerings and if those offerings failed, the vetting or due diligence process for such offerings, and the risks of the particular investment you are considering.



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New Product, Old Scam



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INVESTOR ALERT

Ponzi Schemes Using Virtual Currencies

The SEC's Office of Investor Education and Advocacy is issuing this investor alert to warn individual investors about fraudulent investment schemes that may involve Bitcoin and other virtual currencies.

Ponzi Schemes Generally

A [Ponzi scheme](#) is an investment scam that involves the payment of purported returns to existing investors from funds contributed by new investors. Ponzi scheme organizers often solicit new investors by promising to invest funds in opportunities claimed to generate high returns with little or no risk. In many Ponzi schemes, rather than engaging in any legitimate investment activity, the fraudulent actors focus on attracting new money to make promised payments to earlier investors as well as to divert some of these "invested" funds for personal use. The SEC investigates and [prosecutes](#) many Ponzi scheme cases each year to prevent new victims from being harmed and to maximize recovery of assets to investors.

As with many frauds, Ponzi scheme organizers often use the latest innovation, technology, product or growth industry to entice investors and give their scheme the promise of high returns. Potential investors are often less skeptical of an investment opportunity when assessing something novel, new or "cutting-edge."

Look Out for Potential Scams Using Virtual Currency

Virtual currencies, such as Bitcoin, have recently become popular and are intended to serve as a type of money. They may be traded on online exchanges for conventional currencies, including the U.S. dollar, or used to purchase goods or services, usually online.

We are concerned that the rising use of virtual currencies in the global marketplace may entice fraudsters to lure investors into Ponzi and other schemes in which these currencies are used to facilitate fraudulent, or simply fabricated, investments or transactions. The fraud may also involve an unregistered offering or trading platform. These schemes often promise high returns for getting in on the ground floor of a growing Internet phenomenon.

Fraudsters may also be attracted to using virtual currencies to perpetrate their frauds because transactions in virtual currencies supposedly have greater privacy benefits and less regulatory oversight than transactions in conventional currencies. Any investment in securities in the United States remains subject to the jurisdiction of the SEC regardless of whether the investment is made in U.S. dollars or a virtual currency. *In particular, individuals selling investments are typically subject to federal or state licensing requirements.*

The S.E.C., for its part, has been warning investors of the danger of "potential investment scams" involving bitcoin and other virtual currencies. In one case, it has [charged Trendon T. Shavers](#), a Texas man, with running a bitcoin-based [Ponzi scheme](#) with the promise of vast riches.

"Con men read the headlines like everyone else," said Lori Schock, director of the S.E.C.'s Office of Investor Education and Advocacy.

"Bitcoins sound sexy and new, but at the end of the day, if they're making claims about limitless wealth from unregistered investments it comes down to an old-fashioned Ponzi scheme."

Excerpt from New York Times article, A Bitcoin Puzzle: Heads, It's Excitement. Tails, It's Anxiety. By JEFF SOMMER

Published: November 23, 2013



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Impact of Fees: Investor Bulletins and Cost Calculators



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INVESTOR BULLETIN

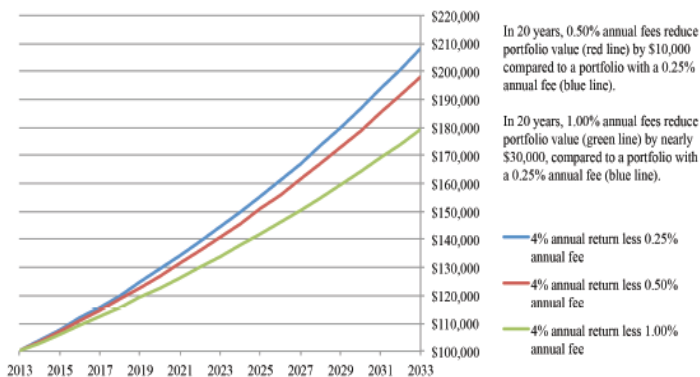
How Fees and Expenses Affect Your Investment Portfolio

The SEC's Office of Investor Education and Advocacy is issuing this bulletin to educate investors about how fees can impact the value of an investment portfolio.

As with anything you buy, there are fees and costs associated with investment products and services.

These fees may seem small, but over time they can have a major impact on your investment portfolio. The following chart shows an investment portfolio with a 4% annual return over 20 years when the investment either has an ongoing fee of 0.25%, 0.50% or 1%. Notice how the fees affect the investment portfolio over 20 years.

Portfolio Value From Investing \$100,000 Over 20 Years



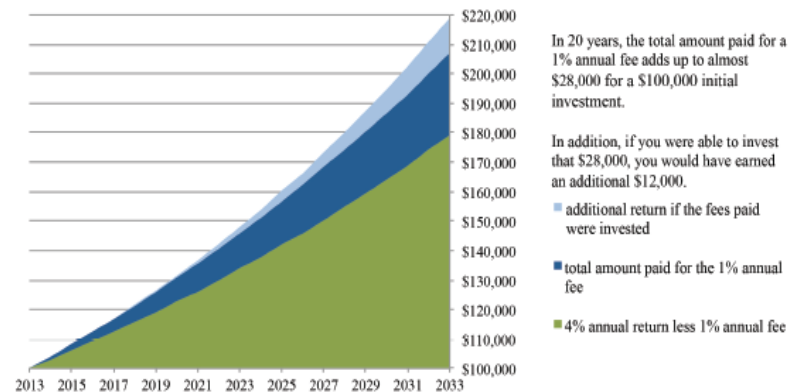
How do ongoing fees affect your investment portfolio?

Ongoing fees can also reduce the value of your investment portfolio. This is particularly true over time, because not only is your investment balance reduced by the fee, but you also lose any return you would have earned *on* that fee. **Over time, even ongoing fees that are small can have a big impact on your investment portfolio.** The chart above illustrates the effect of different ongoing fees on a

\$100,000 investment portfolio with a 4% annual return over 20 years.

The chart below illustrates the impact of a 1% ongoing fee on a \$100,000 investment portfolio that grows 4% annually over 20 years. As the investment portfolio grows over time, so does the total amount of fees you pay. Because of the fees you pay, you have a smaller amount invested that is earning a return.

Illustration of Ongoing Fees Over 20 Years





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Manage Risk



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INVESTOR BULLETIN

Interest Rate Risk — When Interest Rates Go Up, Prices of Fixed-Rate Bonds Fall

The SEC's Office of Investor Education and Advocacy is issuing this Investor Bulletin to make investors aware that market interest rates and bond prices move in opposite directions—for example, when market interest rates go up, prices of fixed-rate bonds fall.

You may have noticed articles in the media about investors "chasing yield," the so-called "bond bubble," or predictions about declines in bond prices. Some of these warnings about a drop in bond prices relate to the potential for a rise in interest rates. Interest rate risk is common to all bonds, particularly bonds with a fixed rate coupon, even U.S. Treasury bonds. (Many bonds pay a fixed rate of interest throughout their term; interest payments are called coupon payments, and the interest rate is called the coupon rate.)

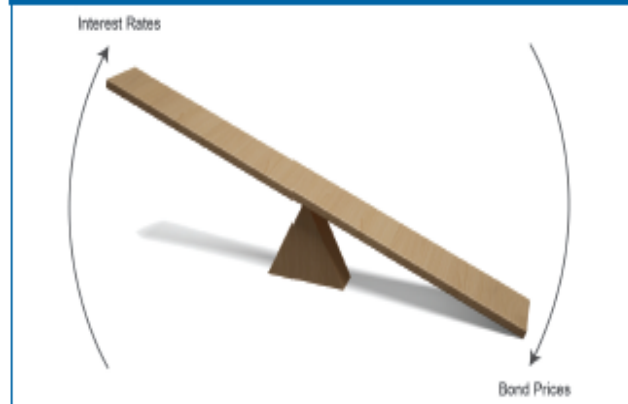
The purpose of this Investor Bulletin is to provide investors with a better understanding of the relationship among market interest rates, bond prices, and yield to maturity of Treasury bonds, in particular, although many of the concepts discussed below generally apply to other types of bonds as well. This Investor Bulletin is a companion piece to our Investor Bulletins on [Corporate Bonds](#), [High-Yield Bonds](#), and [Municipal Bonds](#). For a basic explanation of how bonds operate and their terminology, please see our Investor Bulletin on [Corporate Bonds](#).

The Effect of Market Interest Rates on Bond Prices and Yield

A fundamental principle of bond investing is that market interest rates and bond prices generally move in opposite directions. When market interest rates rise, prices of fixed-rate bonds fall. This phenomenon is known as *interest rate risk*.

A seesaw, such as the one pictured below, can help you visualize the relationship between market interest rates and bond prices. Imagine that one end of the seesaw represents the market interest rate and the other end represents the price of a fixed-rate bond.

Market Interest Rates and Prices of Fixed-Rate Bonds Move in Opposite Directions



Higher market interest rates → lower fixed-rate bond prices

Lower market interest rates → higher fixed-rate bond prices

A bond's yield to maturity shows how much an investor's money will earn if the bond is held until it matures. For example, as the table below illustrates, let's say a Treasury bond offers a 3% coupon rate, and a year later market interest rates fall to 2%. The bond will still pay a 3% coupon rate, making it more valuable than new bonds paying just a 2% coupon rate. If you sell the 3% bond before it matures, you will probably find that its price is higher than it was a year ago. *Along with the rise in price, however, the yield to maturity of the bond will go down for anyone who buys the bond at the new higher price.*

EXAMPLE 1: If Market Interest Rates Decrease by One Percent

Financial Term	Today	One Year Later ↓
Market Interest Rate	3%	2%
Coupon Rate (semi-annual payments)	3%	3%
Face Value	\$1,000	\$1,000
Maturity	10 years	9 years remaining
Price	\$1,000	\$1,082
Yield to Maturity	3%	2%

Lower market interest rates → higher fixed-rate bond prices → lower fixed-rate bond yields



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Media Coverage – July 20, 2013 by Jeff Sommer of the New York Times



If You're a Bond Investor, Beware of the Seesaw

THE Securities and Exchange Commission issues frequent bulletins about what it calls "investment frauds and scams" — a frightening taxonomy of plots and stratagems aimed at separating investors from their money.

The agency's alerts range from warnings of Madoff-style Ponzi schemes to "pump and dump" operations intended to temporarily inflate a stock price. They also include cautionary notes about polite offers of assistance from predators posing as government regulators.

Lately, though, the S.E.C. has been giving a warning of a different sort. Bearing the general title "Interest Rate Risk," this latest bulletin is a cry for understanding. It's about bonds, and for most people, the subject is confounding.

The problem isn't a new scam but a lack of knowledge about how bonds work, which can be dangerous in a time of rising interest rates. In its bulletin, the agency points out that investors need to understand that when rates rise, bond prices generally fall. This inverse relationship is a fact of life in the bond market. Like gravity in the physical world, it's constant, powerful and important.

But outside trading floors, business

schools, banks and brokerage firms, bond dynamics are fairly obscure, surveys find. That's troubling in a time like this, said Lori Schock, director of the agency's Office of Investor Education and Advocacy. "We're not predicting what's going to happen to interest rates or when," she said, "but we do know that rates can't go much lower. And we know that they can go a lot higher."

If interest rates do go higher, most people don't understand how that will affect bonds. A 2012 financial literacy survey by the Finra Investor Education Foundation asked this question: "If interest rates rise, what will typically happen to bond prices?" Prices will fall, but only 28 percent of adult Americans in the survey answered correctly. Finra ran the same survey in 2009 and got the same results.

The Finra survey found that financial literacy levels were generally very low. On its Web site, it offers a five-question quiz, with questions drawn from the survey — none requiring computations, just an understanding of basic concepts. Only 14 percent get them all right, it says. (The average number of correct answers is between 2 and 3.)

As far as bonds go, Ms. Schock said, one way to visualize the relationship of interest rates and prices is to think of

what she calls "a teeter-totter." She's from Indiana. In Queens, where I come from, we call it a seesaw. Whatever you call it in your playground, imagine interest rates sitting on one side of a plank and bond prices clinging to the other. When one side rises, the other falls.

That's just the way seesaws work, and it may be enough explanation. But suppose you want to go a little deeper: Why do interest rates and bond prices move like this?

Here's one way to understand it: When you buy a fixed-rate bond, you are making a loan. In return, you get your money back, plus interest. When market interest rates rise, the bond drops in value. That's because, under current conditions, anyone making the same loan will expect more interest than you've gotten. If you want to trade the old bond for a new one, the old one will have less value. And when something sold in the marketplace has less value, its price usually falls.

There are exceptions to every rule, of course. If the bond's interest rate isn't fixed, and instead readjusts as market rates change, the seesaw analogy doesn't hold. And the prices of different kinds of bonds shift differently. But the seesaw captures the basic idea.

It's important right now because interest rates have risen since the spring, and, therefore, prices have fallen. If you don't understand the relationship between prices and rates (often called yields) you could hurt yourself "by reaching for yield, buying bonds that you think are going to pay you more interest, only to see rates go up further, so the value of your bonds will fall," Ms. Schock said.

Many people are in danger of getting hurt this way. "We're concerned that many people might mistakenly think that there's safety in investing in bonds," she said, "when there's actually a fairly good chance of running into trouble with interest rate risk now."

EVEN Treasury bonds are affected by interest rate risk, although the federal government backs these bonds and will pay all the principal and interest if you hold them to maturity. Such high-quality bonds are safe in many ways, especially in comparison with other assets.

Bond prices are generally less volatile than stock prices, and a major bond market decline is likely to be much less severe than a major fall in the stock market. Bonds can provide steady income and — whether held individually

or in a mutual fund — can play an important role in a diversified portfolio, buffering against stock fluctuations.

But when market rates rise, you'll run into a pricing problem if you need to sell a bond — or if you hold Treasuries in a mutual fund, where they are priced daily. All things equal, your mutual fund will fall in value as yields rise.

Interest rates on Treasuries — and a range of other bonds — have already risen sharply, and a broad consensus of market analysts says they are likely to rise further in the years ahead. Historically, rates are still relatively low, largely in response to the policies of the Federal Reserve. The Fed has been buying \$85 billion of bonds a month, but is considering an end to those purchases.

Bond yields gyrated last week in response to congressional testimony by Ben S. Bernanke, the Fed chairman, who said Fed action was "by no means on a preset course." If the economy strengthens, he said, the Fed will ease its bond-buying. That could result in higher interest rates.

If you hold your bonds until maturity — or keep them as a buffer — you may tolerate such swings. But it's better if you understand what's going on. Remember the seesaw: When yields rise, prices fall. □



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Dodd-Frank Wall Street Reform and Consumer Protection Act



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A Member of the Financial Stability Oversight Council





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Jurisdiction over Advisers to Hedge Funds



Requires advisers to register with the SEC,
provide information about their trades and portfolios



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Oversight of Credit Rating Agencies



Enhanced enforcement tools, additional ability to sanction and deregister, a new office, more disclosure, and expert liability



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Fiduciary Duty: Investors see no difference ... Should the law?



Investment Adviser



Broker-Dealer



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Skin in the Game ... Requiring companies selling asset-backed securities to retain 5% of the risk





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Municipal Securities



Adopt permanent rules for the registration of
municipal advisors



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Investor Advisory Committee Meeting Friday, January 31, 2014

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Jumpstart Our Business Startups Act (JOBS Act)



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JOB Act of 2012 – IPO On-ramp



Emerging growth companies have reduced regulatory burdens when going public and for up to the first five years of being public



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General Solicitation



The general public will see broad advertising for offerings that are limited to high income or high net worth investors



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General Solicitation – Accredited Investor



Accredited investors are deemed to be investors that can “fend for themselves” and bear the risk of investing in private offerings



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JOB Act of 2012 – Revised Regulation A



Revised Regulation A provides two exemption “tiers” for companies to sell securities to the public with less regulatory requirements



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JOBs Act of 2012 – Crowdfunding



New financing alternative that will allow businesses to raise relatively small sums from large numbers of individuals by leveraging the Web and social media



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Websites:	www.sec.gov www.investor.gov
Telephone number:	(202) 551-6500
Twitter:	@SEC_Investor_Ed
Mail:	U.S. Securities and Exchange Commission 100 F Street, NE Washington, DC 20549
Name:	Lori J. Schock, Director Office of Investor Education and Advocacy
Email:	SchockL@sec.gov