The Essential INVESTMENT GUIDE

What every investor should know before and after losing money in the market

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A special thanks to Daniel Ferreira, Esq. for his contribution to this investor guide.

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Disclosure:

This guide does NOT provide any investment recommendation or legal advice, for educational purposes only. The information contained herein does not reflect the opinions of Napoli Bern Ripka Shkolnik, LLP or any of its employees. If you have additional questions or would like to speak with our Securities and Commercial Litigation Department, please give the head of our department, Adam J. Gana, a call at 1-866-381-2434.

INTRODUCTION

One of the great advantages of accumulated wealth is its ability to grow through investing. Whether an individual, a family, a corporation, or other entity, the appropriate and effective allocation of monetary resources can help generate income and affords people the opportunity of accomplishing many of the goals they set up for themselves. Sometimes, however, investors can be the victims of securities violations by their brokers, brokerage firms, or the firms who develop, market, and sell investment products.

Essential to protecting investors' legal rights from such violations is an understanding of the fundamental characteristics of the securities markets and investment products, the most common legal claims and defenses, and the legal framework through which disputes are most commonly resolved. The purpose of this guide is to help clients gain insight into their legal rights and remedies and also help investors better understand the securities markets.

Before delving into these topics, let us first answer some of the most frequently asked questions we receive from our clients.

When should you contact an attorney?

You should seek legal advice from an attorney:

- When your account loses money because your broker failed to warn of the risks of a particular investment product they recommended for purchase

- When your broker refuses to follow your instructions in relation to your account, e.g. order to sell or purchase an investment

- If your broker concentrates your account in just one investment or type of investment

- If there is excessive trading activity in your account given your investment objectives and financial situation

How can an attorney help you?

Consulting an attorney can be very helpful. Their experience and legal analysis will assist in:

- Determining whether the loses suffered are the result of a violation of your rights

- Deciding what the best strategy is for recovering your loses

- Providing assistance in pursuing your legal rights by administering the adjudication and providing legal representation

How much will it cost me?

How much you will spend depends on the firm you choose to represent you. Napoli Bern Ripka Shkolnik, LLP does not charge any fees for its services unless the firm recovers money for you. Our Securities and Commercial Litigation Department works entirely on a contingency basis.

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REGULATORY FRAMEWORK

The financial & securities markets in the United States are regulated by multiple entities that cooperate to oversee various aspects of financial institution and broker/dealer conduct and enforce Federal and State securities laws. The main goals of these regulations are to prevent cases of market manipulation (such as insider trading), ensure competence of providers of financial services, protect clients, investigate complaints, and help maintain confidence in the financial system.

The institutions entrusted with these essential tasks include the Federal Reserve System (Fed), Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Administration (NCUA), the U.S. Securities and Exchange Commission (SEC), the Commodity Futures Trading Commission (CFTC), as well as the self-regulatory organization Financial Industry Regulatory Authority (FINRA). While some of these entities help regulate the monetary system, others assist with controlling the securities markets.

Monetary System

The Fed is the central banking system that conducts the nation's monetary policy, supervises and regulates banking institutions, maintains the stability of the financial system and provides financial services to depository and government institutions. The OCC assists the

Fed in chartering, regulating, and supervising all national banks and the federal branches and agencies of foreign banks in the United States.

The FDIC is a government corporation that insures the safety of deposits in member banks, currently up to $250,000 per depositor per bank. The NCUA is the United States independent federal agency that supervises and charters federal credit unions, which are institutions where members who have accounts are the owners and elect their board of directors in a democratic vote.

Securities Markets

The SEC is the United States federal agency with primary responsibility for enforcing the federal securities laws and regulating the securities industry, the nation's stock and options exchanges, and other electronic securities markets in the United States. In addition to working with various SROs such as the New York Stock Exchange (NYSE) and the FINRA, the SEC also works with other federal agencies, state securities regulators, international securities agencies and law enforcement agencies.

Currently, the SEC is responsible for administering seven major laws that govern the securities industry. They are: the Securities Act of 1933, the Securities Exchange Act of 1934, the Trust Indenture Act of 1939, the Investment Company Act of 1940, the Investment Advisers Act of 1940, the Sarbanes-Oxley Act of 2002 and most recently, and the Credit Rating Agency Reform Act of 2006.

The enforcement authority given by Congress allows the SEC to bring civil enforcement actions against individuals or companies alleged to have committed accounting fraud, provided false information, or engaged in insider trading or other violations of the securities law. The SEC also works with criminal law enforcement agencies to prosecute individuals and companies alike for offenses, which include a criminal violation. In addition, the CFTC assists the SEC as an independent government agency specifically regulating the futures and options markets.

FINRA

The Financial Industry Regulatory Authority (FINRA), on the other hand, is a private corporation that acts as a self-regulatory organization (SRO) and is the largest independent regulator for all securities firms doing business in the United States. FINRA is the successor to the National Association of Securities Dealers, Inc. (NASD) and was created when the NYSE and the NASD consolidated their regulatory functions. FINRA's activities touch virtually every aspect of the securities business including registering and educating industry participants, enforcing industry rules and the federal securities laws, informing and educating the investing public, providing trade reporting, and administering the largest dispute resolution forum for investors and registered firms.

FINRA has regulatory oversight over all securities firms that do business with the public not regulated by another SRO, such as the Municipal Securities Rulemaking Board. FINRA dispute resolution offers all investors a relatively expeditious recourse to enforce their rights when any FINRA member or Associated Person, e.g. registered representatives, violates those rights.

Chapter Two

FINRA ARBITRATION PROCESS

What You Should Expect

Securities brokerage firms require all potential clients to complete new account forms prior to opening a brokerage account. In virtually every new account form is a mandatory arbitration clause to resolve disputes. That is, if a conflict arises, clients cannot sue the brokerage house in court, but instead must file an arbitration claim. Consequently, the overwhelming majority of actions brought against brokerage firms are FINRA arbitrations (although other arbitral forums are sometimes incorporated into the client agreement). The arbitration process has both advantages and disadvantages. A brief explanation of the arbitration process is described below.

Starting the Arbitration Process

The claimant, i.e. the person bringing the action against the brokerage firm, files a Statement of Claim (similar to a Complaint) with FINRA. FINRA then serves the Statement of Claim on the brokerage firm or individual broker (respondent). The respondent is then given 45 days to file a response to the claimant's allegations. In its response, the brokerage firms must provide affirmative defenses as to why it should not be found liable for the investor's losses.

Costs of Filing Arbitration

The cost of filing a FINRA arbitration claim depends upon the amount of money the claimant is seeking in damages. The initial filing fees usually range from $500 to $1,800. Additional costs may be incurred in relation to motions or other actions requiring FINRA participation or arbitration panel action.

If the arbitration claim goes to hearing, many times it is necessary to hire an expert witness to give testimony regarding the technical issues of the case. There are also hearing session fees. Nonetheless, following the completion of the arbitration, the arbitrators can assess those arbitration fees against the Claimant, the Respondent, or both.

Arbitrator Selection

Presently, if the amount in dispute is less that $100,000, one arbitrator will preside over the arbitration. All controversies involving more than $100,000 are appointed three arbitrators. Shortly after the formal response of the respondents is filed, FINRA will send both parties a list of arbitrators from which to choose. When a three-member arbitration panel is necessary, FINRA provides a list of ten public chairpersons, ten public arbitrators, and ten brokerage industry arbitrators.

FINRA also includes resumes for each arbitrators, disclosures regarding associations or conflicts, lists of the arbitrator's currently active cases, lists of awards the arbitrator has previously rendered, and any additional background information the arbitrator wishes to share. Both parties are given the opportunity to request copies of the award documents. Either party can remove any arbitrator from the list, although only a certain number of strikes are available to each party for each category. Any arbitrator properly struck by either party cannot be appointed by FINRA. The parties then rank the remaining arbitrators. FINRA tabulates the ranking and chooses the arbitrators ranked highest by both parties.

Recently FINRA has initiated an All-Public Panel rule that allows claimants an opportunity to choose only non-industry arbitrators when the arbitration is presided over by a three-person panel. Under this rule a claimant may strike up to all of the potential Non-Public Arbitrators. It is important to note that either party may still challenge any appointed arbitrator for good cause, e.g. bias.

The Pre-Hearing Conference

Several months after filing the statement of claim, FINRA holds a pre-hearing conference. The conference is held via telephone and it is at this time Arbitration hearing dates are selected after the parties accept the composition of the panel. The parties establish all of the necessary dates and acceptable modes of communication with the appointed arbitrators. The arbitrators also remind the parties that FINRA promotes dispute resolution through mediation.

Mediation

Mediation is a non-binding process where a neutral mediator holds an informal settlement conference to discuss the possibility of settling the claim. Mediation can be conducted during the arbitration process without interfering or delaying the scheduled arbitration hearing. FINRA statistics reveal that four out of every five cases brought before a mediator are resolved. When the parties agree to mediate, they do not give up any rights to arbitrate if the mediation is not successful.

The Discovery Process

The parties are required to exchange documents during the discovery process (beginning as soon as the respondents file an answer). FINRA provides a list of general documents that each party should exchange in discovery. The discovery guideline suggests that in Claimants produce:

- Federal and State tax returns from 3 years prior to the transaction(s) at issue up until the most recent year
- Updated resumes; If no resume exists, a description of both educational and professional background is also acceptable
- Documents, correspondence, or notes (e.g. diaries/calendars, etc.) related to the accounts maintained with the respondent firm, and statements or confirmations from other investment accounts
- All prior complaints made by you, or on your behalf, involving the matter at issue, any civil or securities litigation you were a party in

The Arbitration Hearing

Arbitration hearings generally follow a pattern: both parties are given the opportunity to describe their cases during an opening statement. Next, they present their evidence and may call witnesses. Each side also has a chance to cross-examine opposing witnesses before making their closing arguments designed to summarize their cases. The process has many similarities to a court trial but has more relaxed rules governing the process.

After the Arbitration Hearing

After the hearing, the arbitrators will review the facts of the claim, the legal standards propounded by each side, and weigh all of the details as well as the veracity of the witnesses in reaching their. The decision is generally released within 30 days of the final hearing date. The decisions generally do not contain an explanation of the decision, although one can be requested for an additional charge. The decision of the arbitrators is binding and there are very limited grounds for appeal.

SELECTING A PROFESSIONAL INVESTMENT ADVISOR

Before you entrust your money to an investment professional, make sure you know more than just their name and professional designation. There are several steps you can take to find an investment professional that can meet your financial needs, including:

- Think about your financial objectives and know what type of financial services you need. There is a wide variation in the range of products and services that investment professionals offer. Knowing what you need will not only help you find the professional that's right for you, but prevent you from paying for services you don't want. Some professionals can provide financial statement preparation and analysis, investment planning, tax planning, estate planning, retirement planning, education planning, and risk management services. Other professionals may only be able to recommend a limited number of investment products depending on the licenses they hold.

- Trust is very important when it comes to relying on an investment advisor. Get names of professionals from friends, neighbors, family or business colleagues. If you receive a name of an investment professional from an individual or group that you don't know, be certain to ask for several references.

- Interview several professionals before making a decision. The more advisors you speak with the better your chances of understanding what each brings to the table. Meet them face-to-face in their offices, if possible. Ask them about their:

  Areas of specialization

  Professional designations

  Registrations or licenses

  Education

  Work history

  Investment experience

  Products and services

  Disciplinary history

- Understand how you will compensate them for their services. There is no legal requirement that investment advisors be paid in any specific manner. Investment professionals are typically paid in one (or more than one) of the following ways:

  An hourly fee

  A flat fee

  A commission on the investment products they sell you

  A percentage of the value of the assets they manage for you

  A combination of fees and commissions

- Ask whether they receive any additional compensation or financial incentives based on the products they sell. Sometimes investments professionals and their firms receive additional compensation for selling a particular mutual fund or other investment product, which can create a conflict of interest.

- Make sure that the investment professionals and their firms are properly registered with FINRA, the SEC or a state insurance or securities regulator and learn about their professional background, business practices, and disciplinary history. Most investment professionals need to register as investment advisers, investment adviser representatives or brokers (registered representatives). Others may only be licensed to sell insurance. FINRA's BrokerCheck can help you find registration and other background information on these professionals.

- Check out any professional designation by contacting the issuing organization and determining whether they are currently authorized to use the designation and whether they've been disciplined. The criteria used in granting professional designations for investment professionals vary. While some require formal certification procedures including examinations and continuing professional education credits, others may merely signify that membership dues have been paid.

- If the investment professional will sell you investment products, ask if the firm they work for a member of the Securities Investor Protection Corporation (SIPC). SIPC provides limited customer protection if a firm becomes insolvent. Ask if the firm has other insurance that provides coverage beyond the SIPC limit. SIPC does not insure against losses attributable to a decline in the market value of your securities.

Remember, part of making the right investment decision is finding the investment professional that best meets your financial needs. Do not rush. Do your background investigation. Resist investment professionals that urge you to immediately hire them and always make sure that you inform your advisor about your investment goals and risk tolerance in writing.

How to Check Out Your Broker or Brokerage Firm

Conducting a background check of your broker or investment firm is worthwhile as that simple step could save you both money and future litigation. The Central Registration Depository system ("CRD") is a source that you can turn to for this kind of information. The CRD is a computerized database that holds licensing and registration information on over 600,000 registered representatives and over 6,000 brokerage firms throughout the country. Every state securities regulator can access the CRD database.

In most cases, a stockbroker or any other person who wants to sell securities must be licensed or registered to do so. Also, some states may require insurance agents who sell variable annuities or variable life policies to be licensed. Therefore, these individuals' records will be maintained on the CRD. The CRD will tell you about your stockbroker's past, including:

- Employment history for the past 10 years
- Securities examination scores
- Licensing or registration status
- Disciplinary history

As an investor, you can also request a public report of background information on any stockbroker or brokerage firm. Depending on the state jurisdiction, this report can be obtained either free of charge or for a nominal fee. In addition to employment and examination history, the CRD report will contain the following types of securities- or commodities-related disciplinary history, if applicable:

- Final disciplinary actions that have been taken by federal, state, and foreign securities regulators as well as self-regulatory organizations

- Civil judgments and arbitration decisions disputes involving public customers
- Criminal convictions or indictments against registered or licensed brokerage firms and their associated persons
- Settlements of $10,000 or more among the parties to arbitrations, civil suits, and customer complaints
- Employment terminations after allegations were made involving violations of investment-related statutes or rules, fraud, theft, or failure to supervise investment-related activities
- Bankruptcies filed within the last 10 years and outstanding liens and judgments
- Pending disciplinary actions taken by industry regulators
- Pending arbitrations and civil proceedings
- Pending written complaints alleging sales practice violations and compensatory damages of $5,000 or more.

How to Request a CRD Report

In order to obtain a CRD report; simply call your local state securities regulator or FINRA. As a matter of practice, stockbrokers and brokerage firms are not advised of your request. Keep in mind, however, that FINRA does not report certain types of information that may be available through your state securities regulator.

This information is easy to obtain and the securities regulators want you to make informed decisions prior to investing your hard-earned dollars. A vast majority of the stockbrokers and brokerage firms are honest and reputable. However, like many professions, there are those individuals and firms who are not. One phone call may save you from sending your money to a bad broker or disreputable brokerage firm.

Chapter Four

INVESTMENT SAFETY

Key Investment Concepts

In order to reach your investment goals it is also important to prepare yourself by understanding the fundamental concepts and terms within the securities industry. Although the following terms are not an exhaustive list, it does provide useful information in planning and making informed investment decisions.

Return

What you get back on an investment you make. Ideally, the return will be positive, your initial investment or principal will remain intact, and you will end up with more than you invested. However, investing sometimes involves risk and you can wind up with less money than you initially invested (which is described as a negative return).

Investment Objective

The financial goal or goals of an investor. An investor may wish to maximize current income, maximize capital gains, or set a middle course of current income with some appreciation of capital. Defining investment objectives helps to determine the investments an individual should select. Investors must inevitably sacrifice a degree of safety if they want to increase their yields. This is the inverse relationship between safety and yield: as yield increases, safety generally goes down, and vice versa. Some of the typical investment objectives used in the securities industry include:

- *Capital Appreciation* – If the main outcome you want from investing is growth, then you would look for investments with capital appreciation as the main objective. This objective seeks to grow the principal value of your investments over time and is willing to invest in securities that have historically demonstrated a moderate to above average degree of risk of loss of principal value to pursue this objective. Focusing on long-term growth, it is generally content to let investment value grow within the portfolio while reinvesting dividends to purchase more shares.

- *Current Income* – This objective seeks investments primarily focused on the continued receipt of income while recognizing and accepting market and issuer risks inherent in investments of this type. This strategy can be used to create an income stream that never touches the principal, yet provides cash for certain current needs (college, for example). It is interested in securities that pay a consistent and high dividend such as stocks, top-quality real estate investment trusts (REITs), and highly-rated bonds.

- *Capital Preservation* – Those investors with this objective are seeking complete protection of the investor's principal. This objective is good for investors seeking to maintain the principal value of investments, and interested in investments that have historically demonstrated a very low degree of risk of loss of principal value. Investors who use capital preservation tend to invest in bank CDs, U.S. Treasury issues, and savings accounts.

- *Speculation* – This objective usually seeks a significant increase in the principal value of your investments and is willing to accept a corresponding greater degree of risk by investing in securities that have historically demonstrated a high degree of risk of loss of principal value to pursue this objective. Because speculation is interested in quick profits, it accepts maximum risk through advanced trading techniques like shorting stocks, trading on margin, options and other special equipment.

Risk Tolerance

The degree of uncertainty that an investor can handle in regard to a negative change in the value of their portfolio. An investor with a high-risk tolerance is likely to invest in securities, such as stocks in startup companies, and is willing to accept the possibility that the value of his/her portfolio will decline. An investor with a low risk tolerance, on the other hand, tends to invest predominantly in stable stocks and/or highly graded bonds. One's risk tolerance is subjective and may vary according to age, needs, goals, and even personal dispositions.

Time-Horizon

The length of time over which an investment is made or held before it is liquidated. Time horizons can range from seconds, in the case of a day trader, all the way up to decades for a buy-and-hold investor. Knowing your time horizon is extremely important when it comes to choosing the type of investments you want and your asset allocation. All things being equal, you can afford to be more aggressive with a longer time horizon.

For example, most advisors would recommend that the asset allocation of a 30 year old be more heavily weighted in equities than that of someone who is close to retirement. That said, age isn't the only determinant of time horizon. A 30 year old who is saving money for a down payment on a house in one year would be investing with a one-year time horizon, despite the fact that retirement is years away. Given the short time frame, it would be prudent to invest more conservatively because there is little time to make up any losses.

Liquidity

The degree to which an asset or security can be bought or sold in the market without affecting the asset's price. Liquidity is characterized by a high level of trading activity. Assets that can be easily bought or sold are known as liquid assets. It is generally safer to invest in liquid assets than illiquid ones because it is easier for an investor to get his/her money out of the investment.

Diversification

Reducing risk by investing in a variety of assets. If the asset values do not move up and down in perfect synchrony, a diversified portfolio will have less risk than the weighted average risk of its constituent assets, and often less risk than the least risky of its constituents. Therefore, any risk-averse investor will diversify to at least some extent, with more risk-averse investors diversifying more completely than less risk-averse investors.

Net Worth

In personal finance, net worth (or wealth) refers to an individual's net economic position; similarly, it uses the value of all assets (long term assets) minus the value of all liabilities. Liquid net worth, on the other hand, refers to the part of an individual's net worth that can be readily turned into cash. Liquid net worth includes investments such as stocks and mutual funds, but does not include assets that are difficult to readily convert, such as real estate or cars.

Volatility

The tendency of the price of investments to fluctuate. Not all investments are equally volatile. For instance, stock and stock mutual funds tend to change price more quickly than bonds. And the prices of smaller or newer company stocks may fluctuate faster and more dramatically than those of larger, well-established companies—sometimes known as blue chips.

Systematic Risk

Risks that you can predict will occur—though not when they will happen—are known as systematic risks. These risks are part and parcel of investing in the financial markets. While learning to accept risk as a normal part of investing is necessary, there are various ways to minimize the impact of systematic risks on your portfolio including diversification, laddering (timing your purchases so that investments mature at different times).

Nonsystematic Risk

A risk that lies with the individual investment rather than with shifts in the investment market or asset class as a whole. One way to mitigate nonsystematic risk is by buying different securities in the same industry and/or by buying securities in different industries. Another way to avoid nonsystematic risk is by thoroughly researching potential investments before committing your money.

Account Types

Depending on your position in life, your family makeup, or your ability to monitor and manage your investments, the type of investment account you choose to open can have a significant impact on the way it is administered. Below are descriptions of the most common types of investment accounts available. It is important to note accounts may fall into multiple categories discussed.

Cash-Management Account

This is the most basic kind of brokerage account into which investors place money in order to make trades. It combines the ability to trade securities while earning money market interest with the ability to write checks and make deposits. A “CMA” often requires a minimum initial deposit amount. There must be enough money in the account to cover the trade at the time of its execution (including both the price of the security and the commission), or the investor must be able to pay for the trade within three days (which is called the settlement date). Some brokerage firms accept credit cards to fund cash accounts, but the most require cash or a personal check.

Traditional Brokerage Account

An account set up with a licensed brokerage firm that allows you to buy and sell stocks, bonds, mutual funds and other investments. Also known as a “full-service account,” a traditional account offers a wide variety of services including retirement planning, tax

strategies, and experienced investment research. They will walk you through the process and help you build a customized portfolio designed to meet your objectives.

Discount Brokers Account

An account that offers lower commissions to effect trades by limiting the services provided. In contrast to a "full service broker," discount brokers are geared toward the do-it-yourself investor. Generally, they will not offer investment advice. They will simply execute orders once you've decided to buy or sell an investment. Furthermore, instead of executing transactions through a broker assigned to your account, you will do most of your trading online, or if you decide to call in your order, with the first available broker.

Margin Account

A more sophisticated brokerage account that allows investors to make trades with money borrowed from the brokerage firm. The securities and cash collateralize the loan in the account. If the value of the stock drops sufficiently, the account holder will be required to deposit more cash or sell a portion of the stock. The important thing to understand about margin is that it has consequences. Margin is leverage, which means that both your gains and losses are amplified. Margin is great when your investments are going up in value, but the double-edged sword of leverage really hurts when your portfolio heads south. Because margin exposes you to extra risks, it's not advisable for beginners to use it. Margin can be a useful tool for experienced investors, but until you get to that point, play it safe.

Individual Retirement Account

A tax-deferred retirement account for an individual that permits individuals to set aside money each year, with earnings tax-deferred until withdrawals begin at age 59 1/2 or later (or earlier, with a 10% penalty). The exact amount depends on the year and your age. IRAs can be established at a bank, mutual fund, or brokerage. Only those who do not participate in a pension plan at work or who do

participate and meet certain income guidelines can make deductible contributions to an IRA. All others can make contributions to an IRA on a non-deductible basis. Such contributions qualify as a deduction against income earned in that year and interest accumulates tax-deferred until the funds are withdrawn. A participant is able to roll over a distribution to another IRA or withdraw funds using a special schedule of early payments made over the participant's life expectancy.

Joint Account

A brokerage or bank account that is owned together (jointly) by two or more people. A joint account agreement is typically needed to open such an account. This agreement will detail whether transactions require the signatures of all parties or whether one party can take actions on his/her own.

Non-Discretionary Account

A brokerage account in which the client ultimately makes all the trading decisions. However, the client may give very limited discretion to the broker or account executive. This limited discretion is in terms of price or time. However, an order as to whether to buy or sell, quantity and exact instrument is required to be given.

Discretionary Account

Sometimes called a “managed account,” this type of account allows a broker to buy and sell securities without the client's consent. The client must sign a discretionary disclosure with the broker as documentation of the clients consent.

The next chapter will discuss the basic characteristics of a variety of investment products.

Chapter Five

UNDERSTANDING INVESTMENT OPTIONS

Investments come in many varieties, each with their own advantages and risks. Before beginning to invest, it is important to review and understand the basic characteristics of various types of investments so you can make an informed decision about what kinds of investments will be most suitable to your needs and objectives.

Many financial investments - including stocks, bonds, and mutual funds, as well as ETFs that invest in these types of assets - are legally considered to be securities under the Federal securities laws. Securities tend to be widely available, easily bought and sold, and subject to federal, state, and private-sector regulation.

However, investing in securities carries certain risks. That's because the value of your investment fluctuates as the market price of the security changes in response to investor demand. As a result, you can make money, but you can also lose some or all of your original investment. The following is a cursory overview of common types of investments, and if you have interest in a particular kind of security you should conduct a more thorough investigation before investing.

Bank Products

Banks offer two main products: Transaction accounts, better known as checking accounts, which allow you to transfer money by check or electronic payment to a person or organization that you

designate as payee. Deposit accounts, also known as savings accounts, which pay interest on your money in those accounts. In contrast to these bank products, securities investments such as stock, bonds, and the mutual funds that invest in them are not insured or guaranteed by the FDIC.

Stocks

Purchasing stocks means you are buying shares in a company and your return will depend on the subsequent success or failure of the company. All publicly traded companies issue common stock. Some companies also issue preferred stock, which exposes you to somewhat less risk of losing money, but also provides less potential for total return. Each of these types of stock come with particular advantages and disadvantages.

One way to generate income from these investments is a positive change in price between the time when an investor purchases a stock to the time when they sell that stock, which is called a capital gain. In addition, companies may periodically distribute dividends to shareholders, and this provides another way that investors can generate income by investing in stocks. In the case of preferred stock, the holders are usually guaranteed a fixed dividend

Besides internal factors, the performance of individual stocks is also affected by what happens in the stock market in general, which is in turn affected by the economy as a whole. That is why it is important to keep abreast of the big picture as well as the developments within a company when investing in the stock market.

Mutual Funds

A mutual fund is an investment company that pools money from many investors and invests based on specific investment goals. Mutual funds raise money by selling shares to investors and then purchase a portfolio of stocks, bonds, other securities or assets (or some combination of these investments).

The holdings of a mutual fund are known as its underlying investments, and the performance of those investments, minus fund fees, determine the fund's investment return. Each share represents an ownership slice of the fund and gives the investor a proportional right, based on the number of shares he or she owns, to income and capital gains that the fund generates from its investments. In addition, because a mutual fund can invest in various types of securities they can offer built-in diversification in addition to professional management, which is why they are a very popular way to invest these days.

You can find all of the details about a mutual fund including its investment strategy, risk profile, performance history, management, and fees in a document called the prospectus. You should always read the prospectus before investing in a mutual fund.

Bonds

Bonds are debt investments. They represent a loan you make to an institution—a corporation, government, or government agency—in exchange for interest payments during a specific term plus the repayment of your principal when the bond comes due. Because the income you receive from a bond is generally fixed at the time the bond is created, bonds are often considered fixed-income investments.

There are several major categories of bonds that are available that you may own directly or through bond mutual funds or exchange traded funds.

- *Corporate bonds* - issued by companies to raise capital for their business activities. A company may have a host of reasons for choosing to issue bonds rather than sell stock, including retaining ownership, obtaining capital at less cost, or preventing dilution of the value of existing stock.

- *Municipal bonds* - issued by municipalities, i.e. local governments at the state, county, or city level, either to

supplement tax revenues or to pay for public projects, such as building a new facilities or maintaining roads or bridges. A "muni," as they are sometimes called, is repaid either from tax revenues or from fees collected by the government that issues the bond. It is important to understand how the interest earned is treated depending on the terms of the bond.

- *Treasury securities* - debt offerings issued by the United States Treasury Department and backed by the full faith and credit of the U.S. government. "Treasuries" are considered to have essentially perfect credit and come as short-term bills, mid-term notes, and long-term bonds. While you do have to pay federal income tax on the interest from Treasuries, you do not pay state and local taxes on that income.

- *Asset-backed securities* - loans, accounts receivables or other assets that are securitized, i.e. packaged into bond offerings. These securities make it possible for you to invest in these debt markets by buying the bonds, while making the money you lend available to borrowers who want to finance their purchases. Asset-backed bonds are called pass-through securities because the payments of interest and return of principal that these borrowers make are returned to the bondholders.

Exchange-Traded Funds (ETFs)

Exchange traded funds, or ETFs, are pooled investments that combine aspects of mutual funds with those of individual stocks. Like a mutual fund, each ETF owns a group of investments, sometimes described as a basket, which reflects the composition of the index that the ETF tracks. But like a stock, an ETF is listed on an exchange and trades throughout the day, so that an order you place to buy or sell is executed at the current trading price.

Real Estate Investment Trusts (REITs)

Real estate investment trusts are corporations that sell shares to raise money for investments in real estate or, less often, a portfolio of real estate mortgages. Equity REITs offer you a way to invest in real estate indirectly, without the responsibility of paying direct capital to buy them. One of the advantages of owning real estate is that it adds to your investment mix an asset generally with a low correlation to stocks, bonds, and the funds that invest in them.

This chapter reviewed various types of investments and their basic characteristics. The products discussed above are relevant to understanding how to approach investing depending on the objectives you are trying to achieve. It is important, however, that you consult you investment advisor and discuss the particular advantages and risks of any investment before you decide to make a purchase. The next chapter will discuss the most common types of legal claims made in relation to investment losses.

COMMON LEGAL CLAIMS

Many investors who suffer losses in their brokerage accounts are the victims of a limited number of violations. The most common legal claims in the context of securities are suitability, unauthorized trading, misrepresentations and omissions, churning, breach of fiduciary duty, and failure to supervise. Although every case must be analyzed on an individual basis, the fundamental character of these claims are set forth below.

Suitability

Financial advisers are obligated to make suitable recommendations to their clients and must abide by the suitability rules imposed by FINRA and the New York Stock Exchange ("NYSE"). Thus every broker is required to conduct a suitability analysis when recommending particular investments to their clients.

A suitability analysis is the determination of whether an investment is appropriate for a specific individual in terms of their willingness and ability (personal circumstances) to take on a certain level of risk. A violation of this requirement alleges that the broker recommended investments or strategies that were not appropriate for the customer's account given their investment goals, financial circumstances, age, or investment objectives or, more generally were not reasonably appropriate for the investing public.

According to NYSE 405 and FINRA Rule 2310, a financial advisor must have a reasonable basis for making an investment

recommendation. The case law sets forth two separate suitability requirements under FINRA Rule 2310, namely reasonable suitability and client specific suitability.

The reasonable-basis suitability analysis determines whether the product is appropriate for any investor and can only be undertaken when a member understands the investment products it sells. Accordingly, a member must perform appropriate due diligence to ensure that it understands the nature of the product, as well as the potential risks and rewards associated with the product.

The broker must then understand how the product is appropriate for the specific person given the client's risk tolerances and investment objectives. In addition, the broker should take into account the customer's marital status, the number and age of his dependents, his earnings, the amount of his savings and life insurance, and his security holdings and other assets. Only once the broker has conducted both types of analysis and made the determination that the investment is indeed appropriate can they make a recommendation that a client purchase a particular investment.

Although unsuitability is one of the most common allegations, it is also one of the more difficult to prove due to its subjective nature. The claimant alleging unsuitability sets forth the fact that the broker knew, or should have known, that the recommendation was inconsistent with the customer's planned objectives, etc. Account documentation is critical in arbitrating these types of claims as they likely contain a risk profile of some sort defining the customer's risk tolerance, objectives, and/or time horizon.

Misrepresentations And Omissions

When a broker, firm, or underwriter makes material misrepresentations or omits material information relating to an investment product they may be found liable for this type of claim. This type of violation essentially says a false statement of fact made (or the failure to make a pertinent statement of fact) by one party to another party, which in turn affects that party's decision in relation to an investment purchase or strategy. Often the misrepresentations or omissions disguise the risk associated with a particular investment. This is important because brokers have a duty to fairly disclose all of the risks associated with an investment.

Depending on the state of the occurrence, a victim of this type of violation alleges that the broker intentionally, recklessly, or negligently misled him or failed to disclose a material fact about an investment. Misrepresentation and omission claims can be unique to the individual (such as when a broker makes verbal misrepresentations to individual customers) or common to a large group (such as when there are written misrepresentations in offering documents or sales materials).

Unauthorized Trading

In a non-discretionary account, a broker is required to obtain authorization whenever they make a purchase or sale of a security in a client's account. FINRA Rule 2310-2(b)(4)(iii) and NYSE Rule 408(a) both prohibit a broker from making trades in a customer's account on a discretionary basis (that is, without first discussing the trade in detail prior to the entry of the order). In addition, many state securities regulations also prohibit such activity and make the trade rescindable, if it is established that the trade was unauthorized.

If you have a margin account, however, and the value of the account falls below your firm's requirements, your broker may be able to sell your securities without consulting you first. This would not be an unauthorized transaction if your account agreement allows your broker to sell your securities, even without notice to you.

Breach Of Fiduciary Duty

Brokers are fiduciaries in relation to their customers and occupy a position of trust and confidence, owing the highest degree of loyalty and fidelity to their customers. The specific nature of these duties depends in part on the nature of the account. Discretionary accounts, for example, impose even higher standards in relation a broker’s actions. In this type of claim, the customer alleges that the broker failed to meet this standard and should be held accountable.

While breach of fiduciary duty overlaps some of the other claims described, negligence may suffice to find the breach, and since the claim is not premised on fraud, the customer's burden of proof is lower, and the claim is therefore easier to prove. Further, state laws differ as to when a broker is a fiduciary and the level of conduct necessary to constitute a breach of the fiduciary duty.

Churning

This type of claim refers to when a broker purchases and sells securities within an account solely to generate commissions without regard to the customer's investment objectives or goals. In the typical churning case, the customer must show: 1) that the broker had ‘de facto’ control of the account; 2) that the trading was excessive in light of investment objectives; and 3) that the broker acted willfully or recklessly with the intent to defraud the customer.

In other words, just proving excessive trading is not sufficient evidence to claim churning, especially if the customer was instigating the trades. While there are many opinions on how much trading is excessive, four to six times turnover has been recognized as an excessive amount in some court cases.

Negligence

A claim for negligence in relation to investment accounts is best described as a claim for broker malpractice. Essentially, a claim for negligence alleges the broker failed to use reasonable diligence in handling the affairs of the customer, and did not act as a reasonable and prudent broker would have acted. Like breach of fiduciary duty, negligence claims do not necessarily require any proof that the broker acted maliciously, or even intentionally.

Even if a broker doesn't have actual knowledge as to the falsity of statements he makes, his activity may constitute negligent misrepresentations. There may also be negligent management of an account, for example by failing to properly diversify a portfolio. Another example of negligence involves negligent supervision by the firm in failing to implement or enforce supervisory and compliance procedures. Like churning, a certain amount of control needs to be present for negligence to take place. If the advisor controlled a significant number of trades and was negligent in execution, security selection, etc., then the case will have a basis.

Negligence and failure to supervise are not as frequently used, due to their subjectivity, but they can be strong components if proven. They tend to go hand-in-hand: if allegations of negligence are proved, there is usually a manager who has failed to act dutifully to supervise his or her employees.

Failure To Supervise

All broker-dealers, registered representatives and individuals that trade securities or act as brokers for traders are subject to Federal and State Securities regulations. In addition, Brokerage firms are required to train and supervise their brokers in handling clients' accounts. When an individual broker is negligent or acts in an unlawful manner against the interests of the client and that client suffers damages as a result of such wrongdoing, the firm may be held liable for the investor's losses.

The duty to supervise imposed on FINRA member firms is a critical component of the securities regulatory scheme and affirmative responsibilities are placed on those who have a duty to supervise. While the violation of these Rules don't independently give rise to a private right or cause of action cognizable under the broad construction of the antifraud provisions of SEC Rule 10b-5 as an "omission" in the failure to disclose that the broker was unsupervised.

Chapter Seven

COMMON DEFENSES

The investor pursuing a securities claim may be confronted with a number of affirmative legal defenses. The basic premises for these defenses is that the investor failed to take appropriate action, understood the consequences of the investment decisions they were making, or that the brokerage firm or broker is not responsible for the losses sustained by the investor. Below is a brief description of each of the common defenses employed by firms and brokers seeking to avoid liability.

Statute of Limitations

Legal recourses virtually always have a time limit, which is called a Statute of Limitations (“SOL”). If an investor who loses money fails to bring a legal action within the allotted time period, they will be barred from seeking recovery. The purpose of these statutes is to allow people and companies to avoid having to litigate claims whose evidence is difficult to obtain or interpret. This is why it is important when you suffer losses related to your investments to contact legal counsel and determine what recourses are available and take action promptly.

Under the FINRA rules, for example, a claimant has six years from the date the violation occurred to bring an arbitration claim. The statute of limitations for common law fraud claims, on the other hand, is generally four years. The limitations statute for a cause of action for fraud or negligent misrepresentation begins running when the conduct occurs, unless the defendant has

concealed it from the plaintiff. Then, in most jurisdictions, the statute of limitations is tolled until the plaintiff either discovers the wrongful conduct or, through the exercise of reasonable diligence, should have discovered it.

Ratification

Ratification is the adoption or confirmation, by a party with knowledge of all material facts, of an earlier act that did not at the time legally bind that party and that the party, therefore, had a right to repudiate before the ratification. This argument says that the customer took, or failed to take, action in relation to a particular transaction that confirms their intent that the transactions take place.

Sometimes, Respondents argue that unauthorized trades, churning, unsuitable securities and all manner of other conduct was "ratified" by the investor, thus eliminating any liability on the part of the broker. To prove the claimant ratified a broker's conduct, a respondent must show that the plaintiff had full knowledge of the respondents allegedly fraudulent or negligent acts at the time of ratification and nevertheless intentionally chose to ratify those acts in spite of the alleged fraud or negligence.

Sophisticated Investor

An affirmative defense to suitability claims designed to persuade the panel the customer-claimant has an appropriate level of knowledge and experience to be capable of evaluating risks associated with investing and was able to properly evaluate the risks of any particular disputed transaction.

Disclaimer

The defendant may argue that the transaction included a disclaimer that protects it from liability. Typical disclaimers include an assertion that the seller (or defendant) relies solely on third

parties for the truth and completeness of the representations made to the investor. But these disclaimers protect the seller only to the extent that the information is true. They will not protect the seller if it knows that the third-party statements are false, because the seller is then a party to the fraud.

Lack of Causation

The defendant may assert the lack of proximate causation – that the actions of a third party are the sole proximate or independent intervening causes of the plaintiff's damages. However, if the defendant could have reasonably foreseen the intervening cause, the chain of causation between the defendant's negligence and the alleged damages is not broken, and the defendant is not relieved of liability for the plaintiff's losses.

Market Defense

There are many factors that affect the prices of particular investments or types of assets. In addition certain events also affect the entire market. These fluctuations in the market generally are sometimes employed by firms or brokers seeking to evade liability. The argument rests upon the implication that it was not the broker’s actions that cause the loss, but rather that events outside the control of the broker forced a decrease in the price of the investment.

CONCLUSION

Hopefully the information provided in this guide has helped you to understand better about investing and about your legal claims. Armed with this knowledge you should be much better prepared to take on the task of the best strategy to reach your investment goals, helping your money work for you, and protect yourself from being taken advantage of by unscrupulous individuals and firms, and to pursue your legal rights.

Nevertheless there is still the possibility that no matter how well you prepare, your rights may be violated by your broker, brokerage firm, or the underwriters of the products you purchase. If you think that is the case, you should contact an attorney to help you evaluate the facts and circumstances of your losses and determine what recourses are available to you in seeking recovery.

Our lawyers at Napoli Bern Ripka Shkolnik, LLP, have represented an array of clients who have found themselves victimized by investment fraud. We have extensive experience in the areas of complex commercial litigation and securities arbitration and litigation. Our securities and commercial litigation department is run by Adam J. Gana who has handled hundreds of various securities claims recovering millions of dollars for investors. We employ seasoned attorneys with a track record of achieving client goals.

We understand that you have probably suffered a significant financial set back as a consequence of following the ill considered advice of your financial advisor or from an institution's misrepresentations inducing you to place money in the wrong hands. The common theme among our clients is that their financial security and life goals have been placed in peril due to the trust placed in an advisor or an institution. At Napoli Bern Ripka Shkolnik, LLP, we understand your cause and are dedicated to standing up for your rights.

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