Early Retirement Seminars 101:

Smart Tips for Spotting Retirement Scams

For many Americans, retirement can be an alluring stage of life—a time when many hope to finally have the time to try new hobbies or travel. But retiring comfortably and being able to do the things you dream about requires a steady stream of income that lasts as long as you do. The earlier you retire, the more important it is to manage your retirement assets wisely.

Unfortunately, some financial "experts" tout early retirement schemes that promise more than they can deliver. This Fact Sheet will help you avoid being misled by flawed or even fraudulent retirement pitches, particularly those that dangle the prospect of early retirement with little or no reduction in income compared to your working years. It describes real-life examples of fraudulent early retirement pitches, provides tips on how to recognize and avoid these sorts of pitches and tells you where to turn for help.

What This Document Does Not Cover

Understand that this Fact Sheet does not cover early retirement packages that may be offered by the federal government. For employer-sponsored retirement programs, the best source of information will be your agency's Benefits Officer.

Real-Life Example

Employees of a major corporation attended free seminars near their place of employment where a broker pitched a strategy which recommended that they:

- Retire earlier than they might otherwise have done;
- Cash out of their 401(k) plan or take a lump-sum payment for the cash value of their pension; and
- Open a traditional Individual Retirement Account at the broker's firm and invest in securities that carried substantial risk and high fees.

During the seminars, the broker represented that these investments would generate aggressive annual returns as high as 18 percent. Little mention was made of the risks associated with such an aggressive growth scenario. The most obvious risk being that the value of the investments goes up and down with changes in market conditions. The pitch also failed to adequately explain that the overall return on the investments would be reduced by various fees and expenses associated with the purchase and ongoing administration of the investments.

Furthermore, the strategy recommended annual withdrawal amounts generally starting at 7.5 percent to 9 percent of the initial investment. While materials given to individual employees in one-on-one meetings portrayed these rates as being sustainable for more than 30 years, they assumed returns of 11 to 14 percent.

The reality is that these rates proved unrealistic and were not achievable. Employees who followed the broker's program could not maintain the recommended withdrawal amounts without depleting their retirement accounts to levels that threatened their retirement security. By the time many of the employees realized this, they had lost a significant portion of their retirement nest egg.

Be Skeptical of Early Retirement Investment Claims

Because the allure of a leisurely retirement can be very tempting, and those who promote early retirement schemes can be extremely persuasive, it's critical to think carefully before you act.

Signing on to an early retirement investment strategy presents risks. It only makes sense if you have saved enough to begin with, make smart investment choices during your retirement years and withdraw money at a rate that does not deplete your savings too early.

How much is enough? This depends on many factors, including other sources of income, such as your Federal retirement benefit, rate of return on your investments and how long you live. You likely will need a savings nest egg that is many times your current yearly earnings to provide enough income to live comfortably in retirement. For an approximate estimate of how much savings you will need to accumulate, use the **Federal Ballpark E$timate calculator** at *www.opm.gov/benefits*.

Be skeptical if you hear:

- **Everyone can retire early!** The reality is that many employees simply do not have the resources to do so. Early retirement is not feasible for many people and is particularly risky for workers who haven't saved enough for an extended retirement and who have limited opportunities for other employment.
- **You can make as much in retirement as you can by continuing to work!** Promises like this usually hinge on unrealistically high returns on investments and unsustainably large yearly withdrawals.
- **You can expect returns of 12 percent or more!** First of all, no one can predict what an investment will do from one year to the next—and even if an investment performed well in the past, this is no guarantee it will do so in the future. Second, any return over 9.6 percent exceeds the historical long-term returns for the stock market (assuming all dividends were reinvested rather than spent), and greatly exceeds long-term returns for less risky investments such as bonds, for which the average annual return over the long term is less than 6 percent. Finally, the stock market is inherently volatile—it goes up, and it goes down. Over the past 80 years, there have been many short term periods that produced returns well below the historical average of 9.6 percent.
- **You can withdraw 7 percent or more and never run out of money!** While there is no perfect consensus on what this withdrawal rate should be, the uncertainty of return, market fluctuations and increased life expectancies among other factors argue for being conservative with your withdrawals, especially during the first years of retirement. Many experts recommend withdrawal rates between 3-5 percent per year, especially in the first years of retirement.

Scam Psychology 101

Some early retirement and investment pitches are outright scams. The common thread that binds investment fraud is the psychology behind the pitch.

We've all heard the timeless admonition "If it sounds too good to be true, it probably is"—which is great advice, but the trick is figuring out when "good" becomes "too good." There's no bright line. Investment fraudsters make their living by making sure the deals they tout appear both good and true. Fraudsters are masters of persuasion, tailoring their pitches to match the psychological profiles of their targets. They look for an Achilles heel by asking seemingly benign questions—about your health, family, political views, hobbies or prior employers. Once they know which buttons to push, they'll bombard you with a flurry of influence tactics, which can leave even the savviest person in a haze.

1 The Employee Benefit Research Institute (EBRI) suggests you will need target multiples of at least 12 times your current household earnings, and in some cases much more, to obtain a 90 percent chance of having adequate retirement income to cover basic expenses plus non-covered health care costs throughout retirement. EBRI Issue Brief, June 2006,"Measuring Retirement Income Adequacy: Calculating Realistic Income Replacement Rates." Jack VanDerhei, Temple University and EBRI Fellow.

Some of the most common tactics include:

- **The "Phantom Riches" Tactic—**dangling the prospect of wealth, enticing you with something you want but can't have. "These gas wells are guaranteed to produce $6,800 a month in income."
- **The "Source Credibility" Tactic—**trying to build credibility by claiming to be a reputable expert. "Believe me, as a senior vice president of XYZ Firm, I would never sell an investment that doesn't produce."
- **The "Social Consensus" Tactic—**leading you to believe that other savvy investors have already invested. "This is how ___ got his start. I know it's a lot of money, but I'm in—and so is my mom and half her church—and it's worth every dime."
- **The "Reciprocity" Tactic—**offering to do a small favor for you in return for a big favor. "I'll give you a break on my commission if you buy now—half off."
- **The "Scarcity" Tactic—**creating a false sense of urgency by claiming limited supply. "There are only two units left, so I'd sign today if I were you."

If these tactics look familiar, it's because legitimate marketers use them, too. However, when we are not prepared to resist them, these tactics can work subliminally. Little wonder that victims often say to regulators after they have been scammed, "I don't know what I was thinking" or "it really caught me off guard." That's why an important part of resisting these common persuasion tactics is to understand them before encountering them.

Red Flags of Fraud

To stay on guard and avoid becoming drawn into a scam, look for the warning signs of investment fraud:

Guarantees: Be suspect of anyone who guarantees that an investment will perform a certain way. All investments carry some degree of risk.

Unregistered products: Many investment scams involve unlicensed individuals selling unregistered securities—ranging from stocks, bonds, notes, hedge funds, oil or gas deals, or fictitious instruments, such as prime bank investments.

Overly consistent returns: Any investment that consistently goes up month after month—or that provides remarkably steady returns regardless of market conditions—should raise suspicions, especially during turbulent times. Even the most stable investments can experience hiccups once in a while.

Complex strategies: Avoid anyone who credits a highly complex investing technique for unusual success. Legitimate professionals should be able to explain clearly what they are doing. It is critical that you fully understand any investment you're seriously considering—including what it is, what the risks are and how the investment makes money.

Missing documentation: If someone tries to sell you a security with no documentation—that is, no prospectus in the case of a stock or mutual fund, and no offering circular in the case of a bond—he or she may be selling unregistered securities. The same is true of stocks without stock symbols.

Account discrepancies: Unauthorized trades, missing funds or other problems with your account statements could be the result of a genuine error—or they could indicate churning or fraud. Keep an eye on your account statements to make sure account activity is consistent with your instructions, and be sure you know who holds your assets. For instance, is the investment adviser also the custodian of your assets? Or is there an independent third-party custodian? It can be easier for fraud to occur if an adviser is also the custodian of the assets and keeper of the accounts.

A pushy salesperson: No reputable investment professional should push you to make an immediate decision about an investment, or tell you that you've got to "act now." If someone pressures you to decide on a stock sale or purchase, steer clear. Even if no fraud is taking place, this type of pressuring is inappropriate.

What the IRS Says About Early Withdrawals from Your Retirement Plan

In addition to the income tax you pay on most retirement plan withdrawals, Section 72(t) of the Internal Revenue Code imposes an additional tax of 10 percent on distributions from qualified retirement plans—including traditional IRAs—made before age 59 ½. The IRS does, however, allow you to avoid this 10 percent penalty if the distributions from your retirement plan "are part of a series of substantially equal periodic payments."

These payments must last for five years or until you reach age 59 ½, whichever is longer, and IRS rules govern how you calculate the amount of the payments. For more information on Section 72(t) and methods for calculating payments, see the IRS's FAQs regarding Revenue Ruling 2002-62 at *www.irs.gov*.

Tips to Avoid Being Taken In

Don't let the promise of easy money lure you into an early retirement you weren't otherwise considering. Before you quit your day job (or night job) and invest your retirement savings, follow these tips:

- **Be skeptical of "free lunch" seminars.** Even if those events take place at or near the workplace, don't assume that your employer is behind the event.
- **Be wary of early retirement pitches based on little-known loopholes.** While IRS Section 72(t) is a "little-known loophole" that allows you to access your retirement funds early, there's a lot more to a successful early retirement than avoiding a 10 percent tax penalty.
- **Know your current plan.** The federal government allows former employees and uniformed service members to leave personal and matching contributions that were paid into the **Thrift Savings Plan (TSP)** at *www.tsp.gov* in the TSP. Before moving your TSP assets, take time to understand the current plan. Because of the extremely low costs associated with the TSP, you will likely find that staying put is a sound and less costly option. The TSP also offers a life annuity option as one of the full withdrawal options available once you leave the Federal Government or uniformed services. This option provides guaranteed payments for as long as you live, or you may elect an annuity that pays benefits to a survivor or joint annuitant. Note that this annuity is separate from payments you may receive as part of the pension component of the Civil Service Retirement System (CSRS), Federal Employees Retirement System (FERS) or military pension.
- **Understand the tax bite.** Before quitting and cashing out of the TSP, do a little math. Remember that even if you avoid the 10 percent early withdrawal tax penalty, you won't be able to spend every penny. Instead, you will have to pay ordinary income taxes on your withdrawals. Be sure to ask a tax professional about any other potential tax consequences of your decision.
- **Figure out the unintended consequences of early retirement.** You may also wish to consult an attorney about any other unintended consequences, especially if you are in debt or owe child support or alimony. Depending on the laws in your state, cashing out of your retirement plan may mean that your creditors can collect against that payment you receive—even if you're rolling the assets to a traditional IRA.
- **Understand the difference between classes of mutual fund shares.** Keep in mind that Class A mutual fund shares may be the best choice if the investment amount is large enough to qualify for a discount on front-end sales loads that may be offered for larger mutual fund investments and usually starts at $50,000, but sometimes can be as low as $25,000. Use FINRA's **Fund Analyzer** at *www.finra.org/fundanalyzer* to compare and calculate mutual fund expenses.
- **Consider the costs associated with variable annuities.** Be aware that most variable annuities have sales charges, including asset-based sales charges or surrender charges. In addition, variable annuities may impose a variety of fees and expenses when you invest in them, including mortality and expense fees, administrative costs, and investment advisory fees.
- **Check the speaker's credentials.** Find out whether the person offering you investments is registered with FINRA, which regulates brokers. Use **FINRA BrokerCheck** at *www.finra.org/brokercheck* or call the FINRA Hotline at (800) 289-9999. If he or she is registered, be sure to check out any red flags raised by employment or disciplinary history. To check out an investment advisor, use the Securities and Exchange Commission's **Investment Adviser Public Disclosure website** at *www.adviserinfo.sec.gov* or contact your **state securities regulator** at *www.nasaa.org* or call (202) 737-0900.
- **Get a second opinion.** Before committing to an early retirement strategy, consult with a financial professional of your choosing before taking the advice of someone who "found you."

Keep in mind that your retired life may be as long as, or longer than, your working life. Take the time to research your retirement options carefully—before you leave the working world behind.

If a Problem Occurs

If you have questions or wish to file a complaint about an early retirement pitch that involves investments, be sure to file a complaint with FINRA or the Securities and Exchange Commission:

FINRA Complaint Center	*www.finra.org/complaint*
SEC Office of Investor Education and Advocacy	*www.sec.gov/complaint/select.shtml*

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