When people fall victim to a scam and lose their investments, 20/20 hindsight often has the rest of us scratching our heads and wondering, "How the heck did they fall for that?"

We all have our circles, and when one person in that circle trusts someone, it becomes easier for the rest of us to trust that person. We assume that someone we know did the due diligence and now we don't have to.

Let's hope that after being inundated with news about Bernie Madoff's alleged $50 billion Ponzi scheme -- perhaps the scam of our lifetimes -- we're a little less smug about who falls for a scam and who doesn't.

1. Keep your eyes wide open
Each person who hands money to an adviser or a firm to invest must do so with his eyes wide open. Check out the adviser's credentials, get references and use a search engine or news service to see if anything's been reported or blogged about the adviser. Make sure the adviser understands your goals and financial needs. And know how your money will be invested, and get it in writing.

But if your best efforts aren't enough and you learn that some or all of your money is gone either through fraud, bad advice, inappropriate investments or a bankrupt brokerage, you may find yourself relying on various agencies to recover your funds.

2. SIPC gives limited protection
Just as the Federal Deposit Insurance Corp., or FDIC, protects the money you have in deposit accounts in member banks and savings institutions, the Securities Investor Protection Corp., or SIPC, affords some protection for cash, stocks and bonds in your brokerage account. But it's a mistake for investors to think that SIPC coverage is as strong and broad as FDIC coverage.

Investor protection tips

1. Keep your eyes wide open
2. SIPC gives limited protection
3. Stingy with the payout
4. No protection against fraud
5. Excess coverage from brokerage
6. Get your plan in writing

"SIPC is very tight with the dollar. They operate almost like a private-sector insurance company in terms of not wanting to pay claims," says Mark Maddox, a securities and investment fraud attorney with Maddox Hargett & Caruso in Indianapolis.

Maddox, a former Indiana securities commissioner, says that when you look into the SIPC, you'll see it's nothing like the FDIC.

The FDIC and SIPC both protect you when an institution fails. If the money you have in a deposit account -- checking, savings, CDs, money market account -- is within the FDIC coverage limits, you'll receive your money promptly, no questions asked.

3. Stingy with the payout
The SIPC protects cash, stocks and bonds up to $500,000 per customer at member brokerages. That includes a $100,000 limit on cash. Mutual funds are not covered by the SIPC.

"SIPC always has been a tough place to get money out of," Maddox says. They'll deny claims. They'll say you don't qualify for this reason or that reason. They'll put investors through a gauntlet, and only those people who have the time and energy and resources to survive the gauntlet will get any money
You're at the mercy of people who are making insurance-type decisions. You're often involved in litigation and then one or two levels of appeals. Very often you'll need to employ an attorney on a one-third contingency fee to help you through the process. Then at some point you're really just trying to cut your losses.

4. No protection against fraud

From its inception in 1970 through December 2007, the SIPC paid investors only $508 million from its reserve fund. SIPC coverage comes into play only when an institution fails and assets are missing from an investor's account. If a brokerage is in business and you believe assets are missing from your account due to fraud, the SIPC will not help you. You'll have to hope that the brokerage can determine what happened and reimburse your account, or perhaps you'll need to turn to the Securities and Exchange Commission.

"In the past I've always said that, all things being equal, (an investor) is better off with a large firm, a major name, than a small firm," says Stuart Meissner, a securities arbitration attorney in New York and former prosecutor with the New York State Attorney General's Office.

"Usually, the supervision is much better as far as overseeing brokers and the enforcement of compliance standards. Secondly, if there is a problem and you need to file a claim, generally you can be confident that the firm will be around to pursue a claim against. That enables you to get an attorney to take on your case. When you have a no-name firm, you may not even get to the point of seeing if the firm can pay. However, in the past year and a half, that has somewhat gone out the window with Lehman Brothers (LEHMQ.NaE)," says Meissner.

5. Excess coverage from brokerage

Most large brokerages have what's called "excess SIPC" coverage and will reimburse customer accounts when it is determined that funds were removed from your account through unauthorized transaction through no fault of your own. Often the coverage extends into the millions of dollars. Fidelity, for example, has no limit on its stock and bonds coverage, although there is a $1.9 million cap on cash.

Meissner advises investors who opt for small brokerages that don't have excess SIPC to make sure the firm is covered by errors-and-omissions insurance. This is comparable to malpractice insurance. If you end up suing the brokerage, you want to know that there is money to pay your claim.

"A lot of small firms talk about SIPC, and that's misleading -- it (can) give a false sense of comfort to investors. Ask the firm if they have errors-and-omissions insurance, and ask to see a copy of the policy. If they don't want to tell you or they don't know, it may be a sign to go elsewhere," says Meissner.

6. Get your plan in writing

Meissner also says having an investment plan in writing is crucial.

"There's a distinction between an investment advisory firm and a brokerage firm. The advisory firm isn't covered by SIPC. With anyone you deal with, ask for a plan, in writing, that shows how they are going to invest your funds and how the plan meets your objectives. Later, down the road, if they don't do what was in the plan, it's a pretty straightforward case of comparing what was in the plan and what happened -- or looking at the plan in the beginning and saying this isn't suitable for your needs."

As mentioned, the SIPC doesn't cover mutual funds, but that doesn't mean you should shy away from them in your investment account. Vanguard, the giant mutual fund company, carries a fidelity bond to cover its funds, says spokeswoman Rebecca Cohen.

"We have a fidelity bond that covers in excess of SIPC on the brokerage side of the business, and we have a fidelity bond on the mutual fund side of the business that covers fraud and illegal acts, but our funds also have insurance against negligence and pricing errors. Most of the errors we see are clerical and can be easily remedied."

There are four entities -- the FDIC, the SIPC, the SEC and the Financial Industry Regulatory Authority, or FINRA -- that every saver and investor should know about. Knowing what protections are afforded you is just as important as being vigilant about your accounts on a routine basis.