NSCP NATIONAL SOCIETY OF COMPLIANCE PROFESSIONALS Currents February 2020

Finding the Right Balance: Meeting the Needs of Senior Investors Amid Heightened Regulatory Priorities

By Daniel Hetzel

Senior Investors

The aging of America's population is placing increasing numbers of seniors at risk for Alzheimer's disease and other forms of cognitive impairment making this segment of the population more vulnerable to various forms of financial exploitation. This article explores how those in the financial services industry can implement best practices to protect elderly clients from financial exploitation. This article also discusses regulatory efforts to protect elderly investors and examines issues which those in the financial services industry face when trying to comply with various rules and regulations designed to protect elderly customers

In May 2019, the SEC's Office of the Investor Advocate published an article entitled: "How the SEC Works to Protect Senior Investors" which contains a number of surprising statistics. On average, for example, 10,000 baby boomers retire each day in the US. By 2035, there will be 78 million people in the US aged 65 or older. Up to 20% of people over age 65 have some form of cognitive impairment – and more than half of people older than 85 have Alzheimer's or another form of dementia. Nearly 1 in 5 Americans age 65 or older have been affected by elder financial abuse. Seniors lose an estimated $2.9 billion annually from fraud or financial abuse, according to the Senate Special Committee on Aging, and a mere 5% of victims partially or completely recovered the items or funds taken from them.

Regulatory Guidance

The SEC announced the prevention of financial exploitation of seniors as a major priority for 2019 and conducted an extensive public education and outreach program that year. Although the SEC's recent examination priorities letter for 2020 did not explicitly identify 'financial exploitation of seniors' as a priority, the SEC's Office of Compliance Inspections and Examinations ("OCIE") did announce that it will "again emphasize the protection of retail investors, particularly seniors and those saving for retirement." The SEC made protecting seniors a priority in risk-based exams of broker-dealers, investment advisers and other entities in 2019 – and the same can be expected in 2020. For example, in the first quarter of 2019, the OCIE conducted a national initiative focused on more than 200 investment advisers who had significant exposure to senior clients and reviewed the policies, procedures and practices that these firms had in place with respect to senior clients. These exams focused on issues including: whether senior clients were providing investment advisers with the name of 'trusted contacts' on account opening documents; how investment advisers were dealing with concerns about senior clients' diminished capacity; what practices were in place for handling client requests for changes in beneficiaries on investment products; and what training was provided to associated persons on elder financial exploitation and protecting senior investors.

During the course of these exams, the SEC found that: (1) many investment advisers lacked written policies and procedures which define criteria – such as age, retirement status, or other factors – for determining which clients count as seniors; (2) most firms were not training employees on issues related to senior clients, even if they had written policies and procedures in place; (3) the policies and procedures which were in place to protect seniors at many firms lacked specificity and – for example - escalation policies did not identify any concrete steps that representatives should take if they suspect elder financial exploitation; (4) firms need to give representatives specific guidance on how to recognize signs of diminished capacity; and (5) it was important to have procedures that address the handling, monitoring and supervising of clients' requests to change the beneficiaries listed for their accounts. These procedures should not be limited to specific products or accounts like insurance products, IRAs or retirement accounts, but should specify how accounts flagged for suspicious changes should be supervised and monitored. Broker-dealers and investment advisers would be wise to take note of the above, especially since the OEIC has announced the protection of senior investors and those saving for retirement as a priority in risk-based exams for 2020.

About the Author
Daniel Hetzel is Partner at Kaufman Dolowich & Voluck LLP. He can be reached at dhetzel@kdvlaw.com.

Suspicious Activity Reporting Requirements

Banks, broker-dealers, mutual funds and other financial institutions are required to file Suspicious Activity Reports ("SARs") – and these forms were updated in 2013 to include a specific box to check if the filer suspected that the case involved elder financial exploitation. Since then, financial institutions have reported more than 180,000 suspicious activities specifically targeting older adults. The yearly dollar amount of suspicious activity reported for elder financial exploitation has also continued to increase each year – which indicates an increased financial threat to the elderly. For example, according to a December 2019 FinCen Financial Trend Analysis: (1) in 2014, the total suspicious activity amount reported for elder financial exploitation was $2.2 billion; whereas (2) from January to August 2019 alone, the total amount was $5 billion.

Financial institutions have reported more than 180,000 suspicious activities specifically targeting older adults.

FINRA Rules

In February 2018, two FINRA rule changes became effective that were designed to give broker-dealers new tools to protect senior investors. FINRA Rule 4512, entitled "Customer Account Information", requires firms to make reasonable efforts to obtain the name and contact information for a trusted contact person when a retail customer's account is opened and when the account information is updated. However, customers are not required to provide this information, and if they decline to do so, the firm can still open the account.

This Rule is designed to facilitate communication between a firm and a customer's trusted contact to address possible financial exploitation. As discussed in Section .06 of the Supplementary Materials to FINRA Rule 4512, associated persons are authorized to contact the trusted contact person and disclose information about the customer's account to address possible financial exploitation and to confirm the specifics of the customer's current contact information, health status or the identity of any legal guardian.

FINRA Rule 2165, entitled "Financial Exploitation of Specified Adults", permits broker-dealers to place a temporary hold on disbursements of funds or securities from the accounts of certain customers if the broker reasonably believes that financial exploitation of the customer has occurred, is occurring, has been attempted or will be attempted. This Rule covers customers: (1) who are 65 and older; and (2) customers who are 18 and older and who the broker-dealer reasonably believes have a mental or physical impairment which prevents them from protecting their own interests. Although not a requirement, FINRA Rule 2165 allows broker-dealers to place a hold on disbursements if they suspect financial exploitation. If the firm places a hold on a customer's account, the firm must notify the trusted contact within two business days, unless the firm reasonably believes that the trusted contact is engaged in the financial exploitation. Broker-dealers are allowed to place an initial hold of up to 15 business days on customer funds and may extend this hold for another 10 business days to conduct an additional review.

FINRA Rule 2165 does not currently provide for broker-dealers to place a temporary hold on securities transactions – but instead only allows for a temporary hold on the disbursements of cash and securities. In August 2019, FINRA issued Regulatory Notice 19-27 to seek comment on whether FINRA should expand the temporary hold to cover securities transactions.

Federal and State Laws

In May 2018, Congress passed and the President signed into law the Senior Safe Act of 2018. The Act provides various financial institutions with immunity for disclosing the suspected exploitation of seniors to certain agencies, including state securities and insurance regulators and state or local agencies responsible for administering adult protective service laws. This law applies to credit unions, banks, investment advisers, broker-dealers, insurance companies and transfer agents. To receive the immunity, financial institutions must provide training on: (1) how to identify and report the suspected exploitation of a senior internally and, as appropriate, to government officials or law enforcement, including common signs that indicate the financial exploitation of a senior; and (2) the need to protect the privacy and respect the integrity of each individual customer.

In addition to FINRA's rules, the U.S. Congress and a number of states have also adopted laws to ensure that financial institutions protect seniors. For example, as of January 13, 2020, New Jersey became the 27th state to adopt laws and regulations that would permit certain financial firms to pause disbursements when financial exploitation is suspected. These state-level regulations tend to be patterned on the Model Act to Protect Vulnerable Adults From Financial Exploitation, which was adopted in January 2016 by an association of state securities regulators named the North

American Securities Administrators Association ("NASAA"). While FINRA rules apply only to broker-dealers, the NASAA's Model Act is meant to also apply to federally covered and stated registered investment advisers. An increasing number of states' report and hold laws include transactional holds as well as a pause on disbursements.

States are, in fact, becoming increasingly proactive with legislation designed to protect seniors. For example, the Ohio Elder Justice Act requires bank employees, accountants, real estate brokers and financial advisers to alert adult protective services if they suspect elder abuse or exploitation. Per O.R.C. 5101.61, any of the above 'mandatory reporters' who have reasonable cause to believe that an adult is being abused, neglected or exploited shall immediately report to the County Department of Jobs and Family Services and there are enhanced penalties for anyone who attempts to financially exploit a person over the age of 65. Similarly, as of January 2020, California requires broker-dealers and investment advisers to report suspected financial abuse and exploitation. See Section 15630.2(b)(2). These state-level regulations designed to protect seniors – which can differ from federal law, can differ from the rules of SROs like FINRA and can vary significantly from state to state and – comprise yet another layer of rules with which firms must remain in compliance.

How should national firms implement firm wide policies and procedures when only certain states require the reporting of suspected financial exploitation? Some believe that more stringent reporting requirements necessarily better protect senior investors and firms should therefore embrace mandatory reporting even when it is not required. However, the various articles which advocate for mandatory reporting across the board fail to cite any empirical evidence that mandatory reporting of suspected elder abuse really does deter or prevent elder financial exploitation more than discretionary reporting.

At a minimum, firms should revise their policies and procedures to focus on states in which they conduct business which now require mandatory reporting – and should provide associated persons with access to materials which discuss the nuances of these different state laws. This could be done in a similar manner to many existing firm policies and procedures which identify those specific states which have very stringent concentration limits on the amount of non-traded alternative investments that customers of those states can purchase. Firms should think carefully, however, before adopting mandatory reporting as a firm policy across the board because adopting this higher standard could increase the potential exposure of firms and their associated persons. For example, under a mandatory reporting regime, firms and their associated persons face increased potential exposure to liability if elder financial exploitation does occur and they do not report their suspicions about it soon enough. On the other hand, as discussed in greater detail below, if firms are over-zealous about reporting and/or reacting to suspected elder financial exploitation when it has in fact not occurred, firms face increased potential liability in the form of lawsuits from the very investors and/or family members they are trying to protect.

Three Potential Issues for Broker-Dealers and Investment Advisers

When it comes to protecting senior investors, broker-dealers, investment advisers and other firms dealing in securities face multiple challenges. First, broker-dealers need to carefully monitor the accounts of senior investors to ensure that registered representatives cannot be accused of exploiting these customers by recommending unsuitable investments which result in an overconcentration of high-commission, risky and illiquid investments like non-traded REITs, oil and gas investments or other Reg. D. private placements. In addition to facing the standard claims for unsuitability and failure to supervise in FINRA arbitrations, registered representatives and firms engaged in this type of investment activity are increasingly being accused of elder abuse and are facing claims under various state elder protection statutes which provide for heightened penalties such as statutory interest and attorneys' fees. Investment advisers face these same risks in the context of customer-initiated arbitrations.

Second, it is not easy to strike the proper balance between protecting seniors while also respecting their rights and autonomy – and an adviser who wants to do the right thing can still face the risk of litigation from those same clients or their families and friends. For example, in 2017, Fidelity Investments became concerned that an elderly client in the Atlanta area was suffering from diminished mental capacity and was being taken advantage of by a neighbor. To protect her, Fidelity froze her accounts, which totaled $1.02 million. Fidelity, however, soon found itself facing a lawsuit from this 71 year-old widow claiming that the firm's actions were unwarranted. Without access to her money, the widow

Second, it is not easy to strike the proper balance between protecting seniors while also respecting their rights and autonomy – and an adviser who wants to do the right thing can still face the risk of litigation from those same clinets or their families and friends.

claimed that she was unable to pay for her medical care, pay her electric bill, visit the dentist or take her dogs to the veterinarian. The widow also claimed that, due to a broken water pipe, she was forced to use a portable toilet in her home. This case reflects the fact that there is no easy way for firms to adopt policies and procedures which strike the right balance across the board and that the appropriate response to suspected financial abuse will often vary depending on the specific facts and circumstances of each situation. Perhaps the best advice that firms can give to their associated persons is to know their elderly customers, actually meet with them in person more than once or twice a year, trust their instincts and remain vigilant for any indications of financial exploitation.

Third, broker-dealers and investment advisers (who are not subject to FINRA rules, but who are subject to federal and/or state securities laws depending on the amount of assets under management) should be aware that the various regulations designed to protect senior investors at the federal, state and self-regulatory level are not perfectly harmonized and can contain different standards and conflicting requirements. For example, FINRA Rule 2165 and the NASAA's Model Act both contain a safe harbor which permits financial professionals and firms – under certain conditions and for a limited time – to refuse to honor the explicit request of a client to withdraw his or her money or securities. Many states (including Delaware, Kentucky, Tennessee and Texas) also have laws that permit transaction holds, but require mandatory reporting of suspected elder financial exploitation if a firm chooses to hold a transaction. These are example of a policy choice that places a priority on protecting the elderly from suspected financial exploitation, even if it comes at the expense of the individual's autonomy.

However, FINRA and the NASAA took different paths on the question of mandatory reporting. NASAA chose mandatory reporting. The Model Act requires firms to promptly notify the state securities regulator and/or Adult Protective Services if they have a reasonable belief that financial exploitation of an eligible adult may have occurred or is being attempted. This requirement applies whether or not the firm elects to pause the disbursement. FINRA, on the other hand, decided against imposing mandatory reporting to state or federal authorities – and FINRA Rule 2165 simply requires firms to notify a client's trusted contacts if the firm pauses a disbursement. In light of the above, firms need to be clear about which regulations govern their professional relationship with senior customers and should err on the side of caution in terms of complying with regulations at the federal, state and self-regulatory level which are inconsistently harmonized.

However, FINRA and the NASAA took difficult paths on the question of mandatory reporting.

Training

In order to execute policies and procedures effectively, associated persons and their supervisors need to develop the ability to recognize signs of potential financial exploitation. Associated persons can develop and improve these skills through continued efforts to 'know their customer' and, for example, and having regular (documented) phone calls with elderly customers on at least a quarterly basis and by having in-person meetings on at least an annual basis. However, firms should also try to provide associated persons with employee training programs (preferably, live in-person training) that prepare them for identifying and reporting elder financial abuse. NASAA, for example, offers the Senior$afe training program whereby broker-dealers and investment advisers can contact securities regulators in their jurisdiction to request n presentation on how to protect senior investors. AARP also offers a BankSafe interactive course which is designed to help those on the 'frontlines' of the financial services industry to prevent financial exploitation, empower family caregivers and help those with dementia. Similarly, the Independent Community Bankers of America offers the Community Banker University's Elder Financial Abuse Course that teaches procedures to frontline staff to detect and prevent elder financial abuse.