

2020 SIFMA C&L CONFERENCE
“Diminished Capacity for Investors” Panel¹

I. INTRODUCTION/WHAT DO WE KNOW?

A. We know that the population is aging.

1. An average of 10,000 Americans are turning 65 every day and that will continue at that rate until 2030. By then, one in five persons in the United States will be 65 or older and will total 74 million people.²

B. We know that the aging population has funds to invest.

1. The combined net worth of households in the US over the age of 55 is more than \$77 trillion.³

C. We know that diminished capacity in that population is a reality.

1. Cognitive abilities are impacted as people age

a) Dementia

(1) At least 1 of 10 people in the United States 65 and older has dementia.

(2) The Alzheimer’s Association estimates that by 2050 the number of people with the disease may approach 14 million.

(3) Every 65 seconds, someone in the United States develops Alzheimer’s.⁴

b) Is Dementia the Only Problem?

(1) Research has demonstrated that, even in otherwise healthy adults, age-related changes can lead to a decline in executive decision-making, notably financial decision-making.⁵

¹ This outline was drafted for the 2020 SIFMA Compliance and Legal Annual Seminar by William E. White, a partner at Allen & Overy LLP.

² Pew Research Center, Fact Tank, *Baby Boomers Retire*, December 29, 2010, <https://www.pewresearch.org/fact-tank/2010/12/29/baby-boomers-retire/>; Alzheimer’s Ass’n, *2019 Alzheimer’s Disease Facts and Figures* p. 24 (2019), <https://www.alz.org/media/Documents/alzheimers-facts-and-figures-2019-r.pdf>.

³ Federal Reserve, *Distribution of Household Wealth in the U.S. since 1989*, <https://www.federalreserve.gov/releases/z1/dataviz/dfa/distribute/table/#quarter:120;series:Net%20worth;demographic:age:population:all;units:levels>.

⁴ Alzheimer’s Ass’n, *2019 Alzheimer’s Disease Facts and Figures* at p. 17.

⁵ National Endowment for Financial Education, *Early Warning Signs: Impact of Aging on Financial Decision Making*, pp. 3-7, <https://www.nefe.org/images/research/Early-Warning-Signs-Impaired-Financial-Skills/Early-Warning-Signs-Impaired-Financial-Skills-Executive-Summary.pdf>; Stephen Deane, Securities and Exchange Commission, *Elder Financial Exploitation: Why is it a concern, what regulators are doing about it, and looking ahead*, June 2018, <https://www.sec.gov/files/elder-financial-exploitation.pdf>.

D. We know that financial exploitation of the elderly is ongoing --- with or without dementia or other cognitive issues.

1. Some experts have called out financial exploitation of the elderly as a burgeoning public health crisis and a virtual epidemic. In a recent White Paper, the SEC cites a series of studies that show that the prevalence of financial exploitation in a given year was up to 6.6% of the elderly population. The White Paper points out that these numbers are surely understated.⁶

2. Estimates of loss to seniors each year range as high as \$39 billion.⁷

E. We know that relevant organizations have been focusing on these issues and providing a wealth of information.

1. SIFMA <https://www.sifma.org/explore-issues/senior-investors/>

a) Senior Investor Tool Kit and collection of additional resources.

2. SEC <https://www.sec.gov/investor/seniors.shtml>

a) Collection of materials related to fraud scams and educational meetings.

3. FINRA <https://www.finra.org/rules-guidance/key-topics/senior-investors>

a) Overview of Financial Exploitation and discussion and guidance on FINRA Rules.

4. NASAA <https://www.nasaa.org/industry-resources/senior-issues/>

a) Discussion of Model Act and training information.

5. AARP

https://assets.aarp.org/www.aarp.org_/articles/money/financial_planning/financial_professional.pdf

a) Guide for financial professionals.

F. We know that you should you focus on these Key Takeaways.

1. If you do not have a robust senior program or you think you lack the capacity to have one, do not panic. There is a lot of information and help available to assist you in developing the key steps that should be taken to deal with diminished capacity and elder abuse.

⁶ *Id.* at p. 8.

⁷ Tobie Stanger, *Financial Elder Abuse Costs \$3 Billion a Year. Or is it \$36 billion?*, Consumer Reports (Sept. 29, 2015), <https://www.consumerreports.org/cro/consumer-protection/financial-elder-abuse-costs--3-billion----or-is-it--30-billion->

2. Train advisors to be proactive in discussions with investors. Get ahead of the issues by advisors conducting routine conversations with investors in their early 60s about diminished capacity and the issues that can arise; estate planning; identifying a trusted contact (child or children or other); involving children or heirs in the investment planning and review process; establishing a Power of Attorney; and re-evaluating senior investor's suitability.
3. Develop an easy to follow escalation policy so that the right people get the right information at the right time.
4. Develop a culture of the advisor, compliance, legal, and others collaborating to respond to issues of diminished capacity or elder abuse.
5. When dealing with seniors, train your advisors to document both investment discussions (as they likely already do) and discussions that relate to the investor's capacity (which they may not be doing).

II. WHAT IS DEMENTIA?

A. According to Alzheimer's Association, dementia is a term for a decline in daily function due to memory loss or a decline in thinking skills caused by physical changes in the brain.⁸

B. Alzheimer's disease is the most common cause of dementia in persons more than 65 years old, representing about 60 or more percent of all dementias. Others include vascular dementia (typically after a stroke); Parkinson's disease; Huntington's disease; and Mild Cognitive Impairment (MCI).⁹

1. Symptoms of Dementia: impairment of at least two core mental functions
 - a) Memory
 - b) Communication and Language
 - c) Ability to Focus and Pay Attention
 - d) Reasoning and Judgment
 - e) Visual Perception
2. Common Red Flags
 - a) Behavioural
 - (1) Appears fearful, distressed or submissive

⁸ Alzheimer's Ass'n, *2019 Alzheimer's Disease Facts and Figures* at p. 17.

⁹ *Id.* at p. 9; Kathleen Fifield, AARP Health, *Dementia vs. Alzheimer's: Which is it?*, June 25, 2018, <https://www.aarp.org/health/dementia/info-2018/difference-between-dementia-alzheimers.html>.

- (2) Increased anger and irritation
- (3) Becomes distrusting or withdrawn
- (4) Develops alcohol or drug abuse
- (5) Expresses grief
- (6) Becomes depressed
- b) Memory/Confusion
 - (1) Confusion with simple concepts
 - (2) Is forgetful or has memory loss
- c) Unusual or Unexpected Conduct
 - (1) Unexpected requests or transactions client cannot explain
 - (2) Displays poor judgment
 - (3) Appears disorganized and disorientated
 - (4) Changes their normal routine
 - (5) Changes their appearance or personal hygiene
- 3. Cognitive Decline Can be exacerbated by Common Underlying Issues
 - a) Cardiac disease (including high blood pressure)
 - b) Endocrine dysfunction (diabetes)
 - c) Autoimmune disorders
 - d) Pulmonary dysfunction
 - e) Smoking
 - f) Excessive alcohol consumption
 - g) Lack of exercise
 - h) Social isolation
 - i) Depression/Anxiety

III. FINRA RULES 2165 AND 4512

A. FINRA Rule 2165¹⁰

1. FINRA Rule 2165 permits a member firm to place a temporary hold on a disbursement of funds or securities from the account of a “specified adult” customer when the firm reasonably believes that the customer is being financially exploited. Diminished capacity can make an individual especially susceptible to financial exploitation and Rule 2165 can be used to address these situations.

B. FINRA Rule 4512¹¹

1. FINRA Rule 4512 requires members to make reasonable efforts to obtain the name of and contact information for a trusted contact person upon the opening of a non-institutional customer’s account or when updating account information for a non-institutional account. The rule thus facilitates the firm to discuss the customer’s health status with the trusted contact person. This could include discussing suspicions or a diagnosis of Alzheimer’s disease, dementia or other forms of diminished capacity.

2. The rule does not prohibit members from opening and maintaining an account if a customer fails to identify a trusted contact person, as long as the member makes reasonable efforts to obtain the information.

C. Issues from the Retrospective Review

1. In August 2019, FINRA launched a retrospective review to assess the effectiveness and efficiency of our rules and administrative processes that help protect senior investors. In *Regulatory Notice 19-27* kicking off the review, FINRA sought feedback on whether Rule 2165 should be amended.¹²

a) Some commenters supported extending Rule 2165 to situations where a firm has a reasonable belief that the customer has an impairment, such as diminished capacity, that renders the individual unable to protect his or her own interests, even though there is no evidence of financial exploitation. However, other commenters expressed concerns that such an extension would give firms too much discretion or that firms are not well-positioned to determine if a customer is suffering from such an impairment.

b) Another area that some firms have expressed concern is whether or not the 15 or even 25 days provided for the temporary hold in Rule 2165 is sufficient. Many firms would like this time period expanded.

¹⁰ <https://www.finra.org/rules-guidance/rulebooks/finra-rules/2165>

¹¹ <https://www.finra.org/rules-guidance/rulebooks/finra-rules/4512>

¹² <https://www.finra.org/rules-guidance/notices/19-27>

c) FINRA is soliciting additional feedback on these issues, as well as other issues raised in the retrospective review, via a survey to membership. FINRA is particularly interested in learning about how firms currently address suspected diminished capacity as there may be opportunities to share effective practices with the membership as a whole.

IV. KEY FEDERAL LAW

A. The Senior Safe Act, enacted on May 24, 2018, applies to individuals who are “not younger than 65 years”.

1. For investment advisers and other “covered financial institutions,” the Act “provides immunity from liability in any civil or administrative proceeding for reporting potential exploitation of a senior citizen.” It includes individual as well as institutional immunity, and specifically describes that the immunity “can be helpful when a firm wants to report potential exploitation but fears that the report could violate a privacy requirement.” Employees who serve in a supervisory, compliance, or legal function in a covered financial institution are also eligible for immunity.

2. To obtain immunity, two requirements must be met: 1) employees must first receive appropriate training on how to identify and report exploitation before a report is made, and 2) reports of potential exploitation must be made “in good faith” and “with reasonable care.”

3. The Senior Safe provision does not preempt or otherwise limit applicable state law.

B. Is More Federal Legislation Required?

1. The Senior Safe Act only provides immunity for contacting a “covered agency,” such as a Federal or state regulator, FINRA, or a state or local Adult Protective Services agency. It explicitly omits protection for conversations with third parties. Trusted friends or family members may be ideally positioned to team up with you and your client as your client’s condition deteriorates. This means the Senior Safe Act alone may not be enough to support financial advisors who want to involve other family members.

2. The Senior Safe Act defines seniors as age 65 or over. What if your client has dementia, but is not yet a senior citizen? Approximately 5% of people who develop Alzheimer’s do so before age 65. For them, the advisory firm would need other/additional policies and procedures to protect them beyond the limited scope of the Senior Safe Act.

V. UPDATE ON STATE REPORT-AND-HOLD LAWS

A. Update

1. 25 jurisdictions now have enacted report and hold laws. These are based on the WA state law which was enacted in 2011.¹³ These laws generally give financial institutions and

¹³ Information on NASAA’s Model Act and a list of the states that have enacted legislation or regulations based on the Model Act are available at <https://www.nasaa.org/industry-resources/senior-issues/model-act-to-protect-vulnerable-adults-from-financial-exploitation/>.

their employees immunity for taking proactive steps to delay disbursements and report suspected elder financial exploitation to the appropriate authorities. Since then, the following states have enacted laws and/or regulations based upon this first law: Alabama, Alaska, Arizona, Arkansas, California, Colorado, Delaware, Indiana, Kentucky, Louisiana, Maine, Maryland, Minnesota, Mississippi, Montana, New Hampshire, New Mexico, North Dakota, Oregon, Tennessee, Texas, Utah, Vermont, Virginia.¹⁴

B. The Model Act Provisions

1. The Model Act requires broker-dealers and state-registered investment advisers to report suspected financial exploitation of senior and vulnerable investors to state agencies. The Model Act also permits firms to temporarily withhold the disbursement of funds when exploitation is suspected.

2. In addition, the Model Act allows firms to communicate with a contact person designated by the customer, when needed, as part of its investigation into the suspected exploitation. States that have adopted report and hold laws have frequently modified the provisions of the Model Act depending upon individual statewide considerations.

C. Key points of opposition

1. Privacy laws

2. Not enactment friendly in certain jurisdictions due to existing legal regime.

VI. TRAINING & EDUCATION

A. Training is paramount in dealing with the issues of diminished capacity and elder abuse, not the least of which is that training is a prerequisite to obtain relief under the Senior Safe Act and FINRA Rule 2165.

B. Key Topics for Training in Identifying Issues and Responding

1. How to identify diminished capacity.

a) See Section II above.

b) In addition, focus on key questions to the investor in a financial setting to determine if the customer is:

(1) Taking longer to complete financial tasks.

(2) Missing key details in financial documents.

(3) Experiencing difficulty with everyday math.

¹⁴ Information on NASAA Model Act and a list of the states that have enacted legislation or regulations based on the Model Act are available at <https://www.nasaa.org/industry-resources/senior-issues/model-act-to-protect-vulnerable-adults-from-financial-exploitation/>.

- (4) Showing decreased understanding of financial concepts.
 - (5) Identifying risks in investment opportunities.¹⁵
2. How to identify potential financial exploitation
 - a) Dementia can create the perfect opportunity for elder financial abuse which spans a broad spectrum of predatory behavior.
 - b) Common Red Flags
 - (1) A new, particularly close friend or “sweetheart.”
 - (2) Client is being isolated.
 - (3) Is regularly accompanied by a caregiver or family member who will not allow the client to speak without them being present.
 - (4) Appears/sounds like they are being “coached” by another individual.
3. How to follow the escalation protocol where customer shows signs of diminished capacity
 - a) Every firm should develop an escalation process for diminished capacity and financial abuse issues.
 - b) Financial professionals need to be trained to escalate questions to compliance, legal, and others in any evaluation of diminished capacity and elder abuse.
 - c) Financial professionals are not medical professionals but training and working together as a team can help achieve the right results, protect the customer, and protect the firm.
4. Create a user friendly roadmap for advisors so they can easily follow the escalation process.
 - a) In order for a firm’s system to work, advisors must be provided with an easy to follow and use road map that tells them where they can go inside the firm for help.
 - b) Without this, it is likely that the right steps will not be taken at the right times.
5. Documentation

¹⁵ National Endowment for Financial Education, *Early Warning Signs: Impact of Aging on Financial Decision Making* at p. 9.

- a) It sounds simple but in practice it is not.
- b) Firms should train advisors to appropriately document conversations with older customers, including not just problematic conversations but conversations which help establish that there is not a diminished capacity issue.

C. Key Topics for Training to Get Ahead of Diminished Capacity

1. Training should help prepare advisors for conversations with clients over 60 long before any signs of diminished capacity emerge to include a discussion of:

- a) Diminished capacity and the issues that can arise
- b) Estate planning
- c) Identifying a trusted contact (child or children or other)
- d) Involving children or heirs in the investment planning and review process
- e) Establishing a Power of Attorney
- f) Re-evaluating Senior Investor's Suitability

D. Timing of Training

- 1. At hiring.
- 2. Yearly refresher.
- 3. As new policies are adopted.

VII. KEY TAKEAWAYS

- A. If you do not have a robust senior program or you think you lack the capacity to have one, do not panic. There is a lot of information and help available to assist you in developing the key steps that should be taken to deal with diminished capacity and elder abuse.
- B. Train advisors to be proactive in discussions with investors. Get ahead of the issues by advisors conducting routine conversations with investors in their early 60s about diminished capacity and the issues that can arise; estate planning; identifying a trusted contact (child or children or other); involving children or heirs in the investment planning and review process; establishing a Power of Attorney; and re-evaluating senior investor's suitability.
- C. Develop an easy to follow escalation policy so that the right people get the right information at the right time.
- D. Develop a culture of the advisor, compliance, legal, and others collaborating to respond to issues of diminished capacity or elder abuse.
- E. When dealing with seniors, train your advisors to document both investment discussions (as they likely already do) and discussions that relate to the investor's capacity (which they may not be doing).