

# Two New FINRA Rules for the Protection of Senior Investors

John E. Clabby and Michael A. Gross – July 10, 2018

The protection of senior investors continues to be a priority for the Financial Industry Regulatory Authority (FINRA), from both an examination perspective and an enforcement perspective. In fact, FINRA detailed how seniors are one of its major areas of concern in the last three editions of its *Annual Regulatory and Examination Priorities Letter*.

Certain rule changes that took effect February 5, 2018, have equipped FINRA members with new tools to protect senior and other vulnerable investors from financial exploitation. First, members may now place temporary holds on disbursements from accounts when they reasonably believe that financial exploitation has occurred, is occurring, or has been, or will be, attempted. Second, members must now solicit a trusted contact person for each retail customer account, and they may contact that person to address possible financial exploitation.

This article discusses the new rules and provides insight on how members might expect the rules to affect examinations, enforcement actions, and customer claims.

## **FINRA's Role in Protecting Senior Investors**

Many constituencies play a role in protecting senior investors, including investors' relatives, friends, and advisors; members and their associated persons; law enforcement; federal and state regulatory agencies; and FINRA. As detailed below, FINRA's role in detecting and preventing the exploitation of senior investors has three principal components.

First, FINRA detects and deters bad actors in the securities industry through review of customer complaints, tips, and trade data; routine and cause examinations; and enforcement of its rules and certain federal securities laws. FINRA's use of enforcement actions to protect senior investors has focused, in large part, on the suitability of recommended investment products, particularly, complex and high-yield products. These matters have focused on whether investment recommendations were suitable given a senior investor's financial profile, including his or her age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, and risk tolerance. The poor judgment of one registered representative becomes a significant problem for a firm when FINRA inquires into the rep's recommendations and the firm's supervision and training to detect and prevent the rep's improper sales practices.

Second, FINRA gathers and publicizes information on senior investors, both to protect them and to educate its members and their associated persons. Its Securities Helpline for Seniors is a powerful resource for senior investors and their advocates. The Helpline allows FINRA to collect information on potential issues with members and registered representatives, as well as industry trends, and then raise awareness about particular issues and schemes, including through *Investor Alerts* and other publications. These have included, in the last two years, those schemes that have targeted senior and other vulnerable investors with speculative energy-

based investments, non-traded real estate investment trust (REITs), and, most recently, cryptocurrency stock scams.

Third, FINRA has encouraged and, with the new rules, empowered members to act to protect their senior and other vulnerable customers from financial exploitation. Consider a registered representative who suspects that a senior investor has fallen under the improper influence of a long-lost niece or a new accountant and who has now requested an outbound transfer of funds or securities to the suspected exploiter. The new rules concern this third role for FINRA, and the rules encourage—if not conscript—members to detect and prevent financial exploitation in real time.

### **Temporary Holds on Disbursements: New FINRA Rule 2165**

FINRA Rule 2165 applies to “Specified Adult(s),” which is defined as both “a natural person age 65 and older” and an adult of any age “who the member reasonably believes has a mental or physical impairment that renders the individual unable to protect his or her own interests.” R. 2165(a)(1). This definition follows the definition of similar terms in financial elder abuse in many state codes, in that it includes not just investors of a certain age (here, 65) but also adults of any age with a particular impairment. The rule does not take the further restrictive step that some states have enacted in limiting elder abuse to instances where the victim is over a statutory age *and* is actually suffering from infirmities of aging, such as demonstrated mental dysfunction.

The rule permits—but does not require—members to place a temporary hold on disbursement of funds or securities from the account of a “Specified Adult” if the member “reasonably believes that financial exploitation of the Specified Adult has occurred, is occurring, has been attempted, or will be attempted.” R. 2165(b) (1)(A). The rule does not permit members to place a temporary hold on the purchase or sale of securities in an account; it covers disbursements only.

To place a hold on disbursements, members must take two further steps: (1) within two business days after placing the hold, notify all authorized parties to the account and the “trusted contact person” (explained below), unless the member reasonably believes one of those persons has engaged in the exploitation; and (2) “immediately initiate[] an internal review of the facts and circumstances” of the suspected financial exploitation. R. 2165(b) (1)(B) & (C).

Time frames on the hold are tight. The hold expires “not later than 15 business days” after first being placed, unless the “internal review” supports an additional extension of no longer than 10 business days. R. 2165(b)(2) & (3). The hold may be extended by a state regulator or agency, as well as a court. R. 2165(b)((2) & (3). Although the terms “state regulator or agency” are undefined, they presumably include state law enforcement and adult protective services, as these agencies are often the first responders in cases of suspected financial elder abuse.

Members who implement a temporary hold must have written supervisory procedures (WSPs) reasonably designed to achieve compliance with the rule, including procedures related to the identification, escalation, and reporting of matters related to the financial exploitation of specified adults as defined in the rule. The WSPs also must identify the title of each person authorized to place, terminate, or extend a temporary hold. The rule further requires that such persons be associated persons of the member who serve in a supervisory, compliance, or legal capacity. Members who use the rule also must develop and document training policies and programs reasonably designed to ensure compliance with the rule.

The rule also imposes record-keeping requirements on members who implement it, including the maintenance of records regarding (1) the subject disbursement requests, (2) the finding of a reasonable belief of financial exploitation underlying the decision to place the temporary hold, (3) the name and title of the person who authorized the hold, (4) evidence of notification of the hold to the requisite persons, and (5) the aforementioned internal review.

Apart from its direct authorization for such a hold, the rule provides members and their associated persons who follow it with a “safe harbor” from other FINRA rules, specifically Rule 2010 (the “catchall” provision for unethical conduct); Rule 2150 (barring “improper use” of customers’ securities or funds); and, perhaps most important, Rule 11870 (requiring members to “expedite” certain customer requests to transfer securities).

#### **Trusted Contact Person: Amendments to FINRA Rule 4512**

FINRA Rule 4512 specifies what customer account information members must maintain for each account. The amendment to Rule 4512 adds section (a)(1)(F), requiring, for noninstitutional accounts, the maintenance of information of “a trusted contact person age 18 or older who may be contacted about the customer’s account.” By its terms, this amendment is not limited to aged or otherwise impaired customers. If the customer or prospective customer fails to identify such a contact person, members may still open the account if they have made “reasonable efforts to obtain the name of and contact information for a trusted contact person.” R. 4512.06

Members are required to disclose, in writing at the time of account opening, that they may contact the trusted person if they suspect financial exploitation:

[T]he member or an associated person of the member is authorized to contact the trusted contact person and disclose information about the customer’s account to address possible financial exploitation, to confirm the specifics of the customer’s current contact information, health status, or the identity of any legal guardian, executor, trustee or holder of a power of attorney, or as otherwise permitted by Rule 2165.

FINRA Supplementary Material 4512.06.

Members need not seek to obtain trusted-contact information for existing accounts until they update the information for the accounts, either in the course of their routine business or as

otherwise required by applicable laws and rules. The innovation of this rule is that members now have an avenue to discuss account information with a customer's trusted third party without violating any privacy laws.

### **Examination and Enforcement of the Rule Changes**

Sophisticated members have been focused on protecting senior investors for some time. Some larger members even have units dedicated to handling seniors' issues. But even for them, these rule changes require new infrastructure, policies, procedures, and training. For the last year or so—since at least the Securities and Exchange Commission's approvals of the rule changes in February 2017—members have been developing these procedures and processes and further educating employees and partners on elder abuse and how to implement the new requirements.

The near-term focus of examinations will likely be on members' development of WSPs to achieve compliance with the temporary hold rule and on whether members have established recordkeeping procedures and training programs reasonably designed to ensure that associated persons comply with both rule changes.

On January 8, 2018, FINRA pushed its *Annual Regulatory and Examination Priorities Letter*. As it did last year, FINRA focused its discussion of elder abuse on enforcement against intentional bad actors in the industry rather than on firms that fail to implement or properly empower registered representatives to detect third-party fraud. Accordingly, enforcement for "missed opportunities" to detect third-party fraud may be the subject of examinations for the near to medium term. The letter notes new Rule 2165 and the amendment to Rule 4512, describing them as "tools to protect senior investors from these types of schemes." Further, FINRA "remind[ed] firms of their obligation to file a Suspicious Activity Report (SAR) for illicit activity involving the exploitation of senior investors."

These temporary holds and the ability to call a trusted contact person are significant additional tools that FINRA likely is expecting members to actually use. Members should think carefully about potential liability in enforcement actions and customer arbitrations for financial exploitation that reasonably could and should have been detected and prevented using these new tools or otherwise. In this respect, note that while Supplemental Material 2165.01 clarifies that the rule "does *not require* members to place temporary holds on disbursement of funds or securities . . ." (emphasis added), members will, in essence, be required to implement such holds. That is, if there are warning signs of financial exploitation, members need to take action. There is no safe harbor from customers' lawyers asserting claims that members failed to place a temporary hold, as they were permitted to do and should have done.

There likewise is no safe harbor from customers' lawyers asserting claims that members wrongfully placed a temporary hold. Therefore, members should follow the rule and follow it carefully. Documentation of the implementation of the new rules will be important to defend against customer objections and complaints to a hold. As noted above, record retention is specified in the rule. Further, because the hold will be at the direction of an associated person

who “serves in a supervisor, compliance or legal capacity for the member” (R. 2165(c)(2)), standardization of records practices should be easier than if the hold could be initiated at the level of customer interaction only.

Members may also want to reexamine whether and how to investigate, verify, and then document suspicions of abuse of senior investors. “Reasonable belief” to support such a hold may be based on “the facts and circumstances observed in the member’s business relationship with the natural person.” Supplementary Material 2165.03. While the rule contemplates that this “reasonable belief” can be documented at the time of the decision to initiate the hold (see R. 2165(d)), often suspicion arises outside the context of a request for disbursement of funds or securities. This could include the addition of an authorized person to an account or comments from, or abnormal behavior by, a senior during a regular phone call or meeting. How to capture this information and what to do about it then, rather than just when a disbursement has been requested, should be a part of the planning.

It is expected that elder abuse will continue to grow as both an unfortunate practice and as an enforcement priority, as the number and percentage of investors continue to age, particularly with the ongoing retirements of the baby boomer generation. How much action FINRA and other regulators will require to detect and prevent financial exploitation of senior and other vulnerable investors remains to be seen. Benjamin Franklin’s famous quote that “an ounce of prevention is worth a pound of cure” rings true in addressing matters of possible financial exploitation.

### **Conclusion**

The two new FINRA rule changes encourage well-meaning members and their associated persons to take proactive steps to protect their senior and other vulnerable customers from financial exploitation. FINRA’s examination and enforcement likely will focus on the procedural, training, compliance, and record-keeping requirements attendant to the new rules.

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