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## FINRA Submits Proposed Rules to the SEC to Address Financial Exploitation of Seniors

*By Erin Ardale Koepfel and Curtis S. Kowalk*

Last Thursday, the Financial Industry Regulatory Authority (“FINRA”) submitted proposed rules to the United States Securities and Exchange Commission (“SEC”) designed to address “financial exploitation of seniors and other vulnerable adults.”<sup>1</sup> In recent years, battling the financial exploitation of vulnerable persons has become a top focus for regulators such as FINRA and the Consumer Financial Protection Bureau, as well as state legislatures. FINRA has been particularly active in this space. In April 2015, it launched its Securities Helpline for Seniors, designed to be a “go-to” resource for senior investors with securities-related questions and concerns.<sup>2</sup> Then, in October 2015, FINRA issued Regulatory Notice 15-37, in which it sought public comment on the proposed rules that it has now submitted to the SEC.<sup>3</sup> And, late last week, FINRA and the Securities Industry and Financial Markets Association (“SIFMA”) came together to co-host a highly anticipated and long-planned “Senior Investor Protection Conference” in Washington, D.C., which covered a variety of topics relating to the protection of elderly investors, such as identifying a client’s potential cognitive decline, marketing and communicating to senior investors, and best practices for developing policies and procedures relating to senior investor protection.<sup>4</sup>

FINRA’s activity in this area has the potential to benefit senior investors in important ways. It may also have significant impact on regulated firms, requiring them to evaluate and modify their business practices. This alert briefly addresses the issue of senior financial exploitation, the various approaches currently taken by state and federal authorities, the scope of FINRA’s proposed rules, and possible considerations for securities firms and broker-dealers seeking to responsibly address this important issue.

### The Issue

As members of the “Baby Boom” generation continue to reach retirement age, their significant assets have made them prime targets for financial exploitation. Elder financial exploitation, broadly defined as the illegal or improper use or conversion of funds or resources of an older person, is a growing problem in the United States, impacting an estimated one in five American citizens over the age of 65.<sup>5</sup> Despite its prevalence, financial

<sup>1</sup> Press Release, FINRA, “FINRA Files Rule Proposal With SEC to Protect Seniors and Other Vulnerable Adults From Financial Exploitation” (Oct. 20, 2016), <http://www.finra.org/newsroom/2015/finra-solicits-comment-proposed-rules-addressing-financial-exploitation-seniors>.

<sup>2</sup> FINRA, “Report on the FINRA Securities Helpline for Seniors” (December 2015), [http://www.finra.org/sites/default/files/Securities\\_Helpline\\_for\\_Seniors\\_Report.pdf](http://www.finra.org/sites/default/files/Securities_Helpline_for_Seniors_Report.pdf).

<sup>3</sup> See “FINRA Regulatory Notice 15-37: Financial Exploitation of Seniors and Other Vulnerable Adults” (October 2015), [http://www.finra.org/sites/default/files/notice\\_doc\\_file\\_ref/Regulatory-Notice-15-37.pdf](http://www.finra.org/sites/default/files/notice_doc_file_ref/Regulatory-Notice-15-37.pdf); Press Release, FINRA, “FINRA Solicits Comment on Proposed Rules Addressing Financial Exploitation of Seniors” (Oct. 15, 2015), <http://www.finra.org/newsroom/2015/finra-solicits-comment-proposed-rules-addressing-financial-exploitation-seniors>.

<sup>4</sup> FINRA and SIFMA, “Senior Investor Protection Conference” (Oct. 20–21, 2016), [http://www.finra.org/sites/default/files/2016\\_sipc\\_agenda.pdf](http://www.finra.org/sites/default/files/2016_sipc_agenda.pdf).

<sup>5</sup> 2010 Investor Protection Trust Elder Fraud Survey, [investorprotection.org/downloads/EIFFE\\_Survey\\_Report.pdf](http://investorprotection.org/downloads/EIFFE_Survey_Report.pdf).

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exploitation also tends to be underreported for a number of reasons, including victims' feelings of shame and embarrassment.<sup>6</sup> In recent years, high profile cases,<sup>7</sup> as well as aggressive advocacy by senior groups, have made combating financial exploitation a top priority for federal and state authorities.

### Current Regulatory Landscape

Currently, there is no federal statute specifically addressing the financial exploitation of seniors. The Older Americans Act,<sup>8</sup> passed in 1965, requires the Administration on Aging to administer formula grants to states for purposes of elder abuse awareness and prevention, and the Elder Justice Act,<sup>9</sup> included within the Affordable Care Act, requires the Department of Health and Human Services and the Department of Justice to study the issue of senior financial abuse, provide grants to state and local authorities, and provide training and support programs. Neither of these statutes, however, has a criminal justice component, by which financial exploitation of seniors would be specifically addressed.

Federal regulators have tried to fill this void via task forces,<sup>10</sup> inter-agency guidance,<sup>11</sup> and other initiatives,<sup>12</sup> but these efforts have focused on research, education, and the promotion of best practices, rather than the establishment of criminal liability for perpetrators.

Because there is no federal statute directly addressing the financial exploitation of seniors, the matter has been left to the states. Though each state has laws outlawing financial fraud and exploitation generally, very few states specifically target the financial exploitation of seniors. It is in this context that the North American Securities Administrators Association ("NASAA") drafted model state legislation in 2015.<sup>13</sup>

The NASAA Model Act, aspects of which have already been adopted in some form by several states,<sup>14</sup> prescribes a certain course of conduct when qualified individuals (e.g., broker-dealer agents; investment adviser representatives; independent contractors; and

<sup>6</sup> See, e.g., Richard Eisenberg, "Why Elder Financial Abuse Is Such A Slippery Crime" *Forbes* (Feb. 13, 2015), <http://www.forbes.com/sites/nextavenue/2015/02/13/why-elder-financial-abuse-is-such-a-slippery-crime/#7cabf4447734> (last visited Oct. 25, 2016).

<sup>7</sup> E.g., Russ Buettner, "Appeals Exhausted, Astor Case Ends as Son Is Sent to Jail" *The New York Times* (June 21, 2013), [http://www.nytimes.com/2013/06/22/nyregion/astors-son-his-appeals-exhausted-goes-to-prison.html?\\_r=0](http://www.nytimes.com/2013/06/22/nyregion/astors-son-his-appeals-exhausted-goes-to-prison.html?_r=0); "The Brooke Astor Case: 'An Appalling Set of Circumstances,'" *American Bar Association Commission On Law And Aging* (2011), [http://www.americanbar.org/content/dam/aba/administrative/law\\_aging/2011/2011\\_aging\\_mar18\\_ea\\_brkastr\\_mono.authc heckdam.pdf](http://www.americanbar.org/content/dam/aba/administrative/law_aging/2011/2011_aging_mar18_ea_brkastr_mono.authc heckdam.pdf).

<sup>8</sup> Older Americans Act of 1965, Pub. L. No. 89–73, 42 U.S.C. § 3001 et seq (2012).

<sup>9</sup> Elder Justice Act, Pub. L. No. 111–148, §§ 6701-6703, 124 Stat. 119 (2010).

<sup>10</sup> E.g., Elder Justice Task Forces, United States Department of Justice, information available at <https://www.justice.gov/elderjustice/task-forces>.

<sup>11</sup> Press Release 2013-195, "Interagency Guidance on Privacy Laws and Reporting Financial Abuse of Older Adults" (Sept. 24, 2013), <https://www.sec.gov/News/PressRelease/Detail/PressRelease/1370539837338>.

<sup>12</sup> Press Release 2015-67, "SEC Staff and FINRA Issue Report on National Senior Investor Initiative" (Apr. 15, 2015), <https://www.sec.gov/news/pressrelease/2015-67.html>.

<sup>13</sup> NASAA Model Act to Protect Vulnerable Adults from Financial Exploitation, North American Securities Administrators Association, <http://serveourseniors.org/about/policy-makers/nasaa-model-act/> (last visited October 25, 2016).

<sup>14</sup> NASAA Model Legislation or Regulation to Protect Vulnerable Adults from Financial Exploitation, NASAA (hereinafter, "NASAA Model Act") (Jan. 22, 2016) ("Since publication of the Model Act, two states – Alabama, and Indiana, have enacted statutes that contain provisions similar to those found in the Model Act including mandatory reporting to state securities regulators along with APS offices. Additionally, Vermont has adopted the Model Act by regulation. A fourth state, – Louisiana – has passed legislation that protects voluntary disclosures"), <http://serveourseniors.org/about/policy-makers/nasaa-model-act/commentary/background/> (last visited Oct. 25, 2016).

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supervisory, compliance, or legal personnel)<sup>15</sup> reasonably believe that an elderly customer may be susceptible to financial exploitation. Under the Model Act, qualified individuals would be obligated to report suspected financial exploitation to the state's Adult Protective Services and the state securities regulator,<sup>16</sup> would be allowed to disclose concerns to trusted third parties that had been designated by the elderly investor,<sup>17</sup> and would be permitted to delay disbursement of customer funds for up to 25 business days in certain situations.<sup>18</sup>

### FINRA Proposal

FINRA's proposed rules, submitted to the SEC on Thursday, October 20, 2016, include amendments to FINRA Rule 4512, as well as the adoption of a new FINRA Rule 2165. The FINRA proposal is largely consistent with provisions in the NASAA Model Act — FINRA explained that even though the proposed rule change and the Model Act are not identical, the two organizations worked together “to achieve consistency where possible and appropriate.”<sup>19</sup> One notable difference is that the NASAA Model Act requires governmental disclosure in certain circumstances, while the FINRA proposal has no such mandatory governmental reporting requirements.<sup>20</sup>

### *Amendments to Rule 4512*

Currently, FINRA Rule 4512 (“Customer Account Information”) requires firms to maintain certain information relating to customer accounts, such as the customer's name and residence, whether the customer is of legal age, and the names of any associated persons responsible for the account. The Rule would be amended to require that firms also make reasonable efforts to obtain the name and contact information of a “Trusted Contact Person” for each non-institutional customer account. In FINRA Notice 15-37, FINRA explained that the Trusted Contact Person is intended to “be a resource for the firm in administering the customer's account and in responding to possible financial exploitation.”<sup>21</sup> A member may elect to inform an individual that he or she was chosen to be a Trusted Contact Person, but this is not required.<sup>22</sup>

<sup>15</sup> *Id.* at Section 2.

<sup>16</sup> *Id.* at Section 3.

<sup>17</sup> *Id.* at Section 5.

<sup>18</sup> *Id.* at Section 7. Disbursements may be delayed initially for up to 15 business days, and this period may be extended upon request by Adult Protective Services or the commissioner of securities for another 10 business days.

<sup>19</sup> FINRA Proposed Rule Change, SR-FINRA-2016-039, at 77 (filed Oct. 20, 2016) (hereinafter, “FINRA Proposal”), <http://www.finra.org/industry/rule-filings/sr-finra-2016-039>. FINRA further noted that “[b]oth the proposed rule change and NASAA model would apply to accounts of natural persons age 65 and older and would permit temporary holds of up to 25 business days, including the initial and subsequent periods. Proposed Rule 2165 also would incorporate the concept of a temporary hold being terminated or extended by a state regulator or agency or court of competent jurisdiction.”

<sup>20</sup> Compare FINRA Proposal at 72 (“The proposed rule change does not require that members report a reasonable belief of financial exploitation to a state or local authority”) and NASAA Model Act, Section 3 (“If a qualified individual reasonably believes that financial exploitation of an eligible adult may have occurred, may have been attempted, or is being attempted, the qualified individual shall promptly notify Adult Protective Services and the commissioner of securities”).

<sup>21</sup> FINRA Regulatory Notice 15-37: Financial Exploitation of Seniors and Other Vulnerable Adults (October 2015).

<sup>22</sup> FINRA Proposal at 58.

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### *New Rule 2165*

FINRA has also proposed a new Rule 2165 (“Financial Exploitation of Specified Adults”). This Rule would permit, but not require, members to place temporary holds on disbursements of funds or securities from the accounts of “Specified Adult” customers where there is a reasonable belief that these customers are experiencing “financial exploitation.”<sup>23</sup> The proposed Rule defines a “Specified Adult” as: (1) a natural person age 65 or older;<sup>24</sup> or (2) a natural person age 18 or older who the firm reasonably believes has a mental or physical impairment that renders the individual unable to protect his or her own interests.<sup>25</sup> Finally, the Rule would define “financial exploitation” as either:

1. the wrongful or unauthorized taking, withholding, appropriation, or use of a Specified Adult’s funds or securities; or
2. any act or omission by a person, including through the use of a power of attorney, guardianship, or any other authority, regarding a Specified Adult, to:
  - a. obtain control, through deception, intimidation or undue influence, over the specified adult’s money, assets or property; or
  - b. convert the specified adult’s money, assets or property.<sup>26</sup>

In its initial 2015 draft proposal, FINRA permitted only a “Qualified Person” to enact a temporary hold,<sup>27</sup> but the version filed with the SEC eliminated that defined term and instead would permit “members” generally to place holds on disbursements. This change stemmed from industry concern regarding how to determine whether an associated person served in a supervisory, compliance, or regulatory capacity that is “reasonably related” to the account.<sup>28</sup> FINRA modified the rule to allow a member to place the hold, but added a requirement that the member develop written supervisory procedures that identify the titles of those employees authorized to place temporary holds and noted that any such person must serve in a supervisory, compliance, or legal capacity for the member.<sup>29</sup>

While the proposed Rule would not establish an affirmative requirement to withhold funds, it would create a safe harbor for firms that elect to do so under the following circumstances: (1) there is reason to suspect financial exploitation of a customer; (2) the firm has notified the Trusted Contact Person of the hold, as well as all parties authorized to transact business on the account;<sup>30</sup> and (3) the firm immediately undertakes an internal review of the facts and circumstances. Specifically, any firm enacting a temporary hold on disbursements under Rule 2165 would be provided safe harbor from FINRA Rules 2010 (“Standards of

<sup>23</sup> Rule 2165 only applies to disbursements of funds, but FINRA noted in its submission to the SEC that it “may consider extending the safe harbor to transactions in securities in future rulemaking.” FINRA Proposal at 40.

<sup>24</sup> FINRA Proposal at 414, Exhibit 5.

<sup>25</sup> *Id.*

<sup>26</sup> *Id.*

<sup>27</sup> “Qualified Person” was defined as “an associated person of a member who serves in a supervisory, compliance or legal capacity that is reasonably related to the Account of the Specified Adult.” FINRA Regulatory Notice 15-37: Financial Exploitation of Seniors and Other Vulnerable Adults (October 2015).

<sup>28</sup> FINRA Proposal at 37–38.

<sup>29</sup> FINRA Proposal at 416-17, Exhibit 5.

<sup>30</sup> The Trusted Contact Person need not be informed of the hold if he or she is believed to be involved in the suspected financial exploitation of the Specified Adult. Notably, in response to customer privacy concerns, FINRA eliminated a proposed requirement that the member contact a Specified Adult’s immediate family member in the event that it suspects the Trusted Contact Person to be engaged in financial exploitation. See FINRA Proposal at 64–66.

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Commercial Honor and Principles of Trade”), 2150 (“Improper Use of Customers’ Securities or Funds”), and 11870 (Customer Account Transfer Contracts”).<sup>31</sup> The temporary disbursement hold may last up to 15 business days, unless extended by a state regulator or agency or court of competent jurisdiction.<sup>32</sup> If, after conducting an internal review of the facts and circumstances, a member reasonably believes that financial exploitation has occurred or is occurring (or has or will be attempted), the member can extend the hold for up to another 10 business days.<sup>33</sup>

Although disbursement holds are discretionary, Rule 2165 would require FINRA members to “establish and maintain written supervisory procedures reasonably designed to achieve compliance” with the Rule, including “procedures related to the identification, escalation and reporting of matters” related to financial exploitation. Additionally, as noted previously, these procedures must identify the titles of those persons authorized to place temporary holds.

The Rule would also require that members retain records relating to instances of potential financial exploitation and the member’s subsequent actions,<sup>34</sup> and develop training policies or programs designed to ensure compliance with the Rule.<sup>35</sup>

### Considerations for Securities Firms and Broker-Dealers

FINRA’s focus on financial exploitation of seniors, coupled with an increased sensibility that financial services firms should protect vulnerable citizens from being victimized by financial criminals, suggests that broker-dealers may wish to consider proactive steps, even before the SEC determines whether or not to approve the proposed rules. Among these possible steps is the identification of trusted contact persons for each customer account. Even if the proposed FINRA requirement is never implemented, such “trusted contact” designations may reflect a growing and best industry practice and provide firms with a resource they can engage if financial exploitation is suspected.

To the extent that have not already done so, firms may also consider instituting financial exploitation training programs for account-level employees, as well as supervisory, compliance, and legal personnel. Such training would enable employees to better identify potential instances of financial exploitation, inform them of their statutory and regulatory obligations, and demonstrate to federal regulators and FINRA that the firm takes this topic seriously. Furthermore, firms may consider potential plans of action or internal review protocols for situations of suspected financial exploitation. Firms should give thought to policies that define relevant responsibilities of various employees, including with respect to regulatory reporting, internal escalation and internal reviews of instances of suspected financial exploitation, client communication, and potential holds on disbursement of funds.

<sup>31</sup> FINRA Proposal at 417, Exhibit 5.

<sup>32</sup> *Id.* at 416.

<sup>33</sup> *Id.* Note that this 10-day extension was reduced from FINRA’s original 15-day proposal set forth in Regulatory Notice 15-37.

<sup>34</sup> Specifically, the Rule would require records of: “(1) request(s) for disbursement that may constitute financial exploitation of a Specified Adult and the resulting temporary hold; (2) the finding of a reasonable belief that financial exploitation has occurred, is occurring, has been attempted, or will be attempted underlying the decision to place a temporary hold on a disbursement; (3) the name and title of the associated person that authorized the temporary hold on a disbursement; (4) notification(s) to the relevant parties pursuant to paragraph (b)(1)(B) of this Rule; and (5) the internal review of the facts and circumstances pursuant to paragraph (b)(1)(C) of this Rule.” FINRA Proposal at 417, Exhibit 5.

<sup>35</sup> *Id.*

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Consistent with FINRA guidance, member firms should consider developing an internal understanding of “red flags” that may identify potential financial exploitation. FINRA specifically identified the following circumstances as indicating a need for further investigation: “(1) attempts to transfer money to engage in commonly known fraudulent schemes (e.g., foreign lottery schemes); (2) uncharacteristic attempts to wire securities or funds, particularly with a customer who is unable to explain the attempts; (3) when a caretaker, relative, or friend of the customer requests disbursements on behalf of the customer without proper documentation; (4) abrupt increases in disbursements, particularly with a customer who is accompanied by another person who appears to be directing the disbursements; (5) attempted forgery of the customer’s signature on account documentation or a power of attorney; and (6) a customer’s unusual degree of fear, anxiety, submissiveness or deference related to another person.”<sup>36</sup>

Regardless of the ultimate fate of FINRA’s proposal, firms should expect this issue to continue to garner more attention in the future, both from FINRA and other regulators. Accordingly, firms should consider the elements of the proposals and the degree to which they have systems and procedures reasonably designed to safeguard the interests of vulnerable clients.

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### Authors:

#### Erin Ardale Koeppel

erin.koeppel@klgates.com  
+1.202.778.9420

#### Curtis S. Kowalk

curtis.kowalk@klgates.com  
+1.202.778.9397

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<sup>36</sup> *Id.* at 31–32.