

## Retrospective Rule Review

### FINRA Requests Comment on Rules and Issues Relating to Senior Investors

Comment Period Expires: October 8, 2019

#### Summary

FINRA is conducting a retrospective review to assess the effectiveness and efficiency of its rules and administrative processes that help protect senior investors from financial exploitation. The protection of senior investors is a top priority for FINRA. As such, FINRA is interested in whether additional tools, guidance or changes to FINRA rules or administrative processes are appropriate to further address suspected financial exploitation and other circumstances of financial vulnerability for senior investors.

This *Notice* outlines the general retrospective rule review process, summarizes the rules and administrative processes that most directly apply to financial exploitation of senior investors, and seeks responses to a number of questions related to addressing financial exploitation.

Questions regarding this *Notice* should be directed to:

- ▶ James S. Wrona, Vice President and Associate General Counsel, Office of General Counsel (OGC), at (202) 728-8270;
- ▶ Jeanette Wingler, Associate General Counsel, OGC, at (202) 728-8013;
- ▶ Lori Walsh, Deputy Chief Economist, Office of the Chief Economist (OCE), at (202) 728-8323; or
- ▶ Dror Y. Kenett, Economist, OCE, at (202) 728-8208.

August 9, 2019

#### Notice Type

- ▶ Request for Comment

#### Suggested Routing

- ▶ Compliance
- ▶ Legal
- ▶ Operations
- ▶ Registered Representatives
- ▶ Senior Management

#### Key Topics

- ▶ Customer Accounts
- ▶ Financial Exploitation
- ▶ Lending Arrangements
- ▶ Positions of Trust
- ▶ Reporting
- ▶ Senior Investors
- ▶ Temporary Holds
- ▶ Trusted Contact Persons

#### Referenced Rules & Notices

- ▶ FINRA Rule 2010
- ▶ FINRA Rule 2150
- ▶ FINRA Rule 2165
- ▶ FINRA Rule 3240
- ▶ FINRA Rule 4512
- ▶ FINRA Rule 4530
- ▶ FINRA Rule 5310
- ▶ FINRA Rule 11870

## Action Requested

FINRA encourages all interested parties to comment. Comments must be received by October 8, 2019.

Comments must be submitted through one of the following methods:

- ▶ Emailing comments to [pubcom@finra.org](mailto:pubcom@finra.org); or
- ▶ Mailing comments in hard copy to:  
Jennifer Piorko Mitchell  
Office of the Corporate Secretary  
FINRA  
1735 K Street, NW  
Washington, DC 20006-1506

To help FINRA process comments more efficiently, persons should use only one method to comment.

**Important Notes:** All comments received in response to this *Notice* will be made available to the public on the FINRA website. In general, FINRA will post comments as they are received.<sup>1</sup>

## Background & Discussion

FINRA's rules are designed to protect investors, and FINRA places a particular emphasis on protecting vulnerable investors like seniors, many of whom are living on fixed incomes and budgets without the ability to offset significant losses over time or through other means. Recent evidence suggests that financial exploitation of seniors has been increasing, in terms of both magnitude and impact.<sup>2</sup> Although studies indicate that financial exploitation of seniors is often perpetrated by strangers, family members and caregivers—rather than by broker-dealers or other financial services organizations—broker-dealers and other financial services organizations have an important role to play in protecting senior investors.<sup>3</sup>

To this end, FINRA is commencing a retrospective review of its rules and administrative processes that help protect senior investors from financial exploitation. The review will assess the effectiveness and efficiency of these rules and administrative processes and consider whether additional tools, guidance or changes are appropriate to further address suspected financial exploitation and other circumstances of financial vulnerability for senior investors.

### Retrospective Reviews

FINRA periodically reviews its rule sets<sup>4</sup> to determine whether they are meeting their intended objectives by reasonably efficient means. These reviews encompass not only the substance and application of a rule or rule set, but also FINRA's processes to administer the rules. The reviews also can explore whether FINRA can provide additional resources to help member firms' compliance efforts or otherwise further the regulatory objectives of the rules. Among other things, FINRA uses this process to determine whether there are gaps in FINRA's rules that need to be addressed.

In conducting the review of rules relating to financial exploitation of senior investors, FINRA staff will follow a similar process to that of previous retrospective rule reviews. In general, the review process consists of an assessment and an action phase. During the assessment phase, FINRA will:

- ▶ evaluate the efficacy and efficiency of the rule or rule set as currently implemented, including FINRA's internal administrative processes;
- ▶ seek input from both external and internal stakeholders;
- ▶ draw on the expertise of its advisory committees and other subject-matter experts inside and outside of the organization; and
- ▶ seek out the views and experiences of other stakeholders, including industry, member firms, investors, investor advocates, interested groups and the public.

Upon completion of this assessment, FINRA staff will consider appropriate next steps, which may include some or all of the following: modifications to the rules, updated or additional guidance, administrative changes or technology improvements, additional tools, educational materials or other resources, or additional research or information gathering.

The action phase will then follow. To the extent action involves modification of rules, FINRA will separately engage in its usual rulemaking process to propose amendments to the rules based on the findings. This process will include input from FINRA's advisory committees and an opportunity for comment on specific proposed revisions in a *Regulatory Notice* or rule filing with the Securities and Exchange Commission (SEC), or both.

## Request for Comment

### Protecting Senior Investors

FINRA has prioritized protecting senior investors and addressed financial exploitation of senior investors in numerous ways, including:

- ▶ identifying senior investor issues as an examination priority;<sup>5</sup>
- ▶ launching the dedicated FINRA Securities Helpline for Seniors® (Helpline)—available at (844) 57-HELPS—to provide senior investors and their family members with a supportive place to get assistance from specially trained FINRA staff related to concerns they have with their brokerage accounts and investments;<sup>6</sup>
- ▶ creating national standards that give member firms tools—including permitting firms to place temporary holds on disbursements when they have a reasonable belief of financial exploitation and requiring firms to request information from customers about a trusted contact—to address suspected financial exploitation of senior investors and other vulnerable adults (*i.e.*, FINRA Rules 2165 (Financial Exploitation of Specified Adults) and 4512 (Customer Account Information));<sup>7</sup>
- ▶ collaborating with the North American Securities Administrators Association (NASAA) and the SEC to address senior investor protection, including issuing a Senior Safe Act Fact Sheet designed to raise awareness among member firms, investment advisers and transfer agents about the Act and its immunity provisions;<sup>8</sup>
- ▶ issuing alerts and articles educating investors about important issues and highlighting risks facing senior investors;<sup>9</sup>
- ▶ conducting and funding research on senior investors and financial fraud, and engaging with national, state and grassroots partners to develop and distribute fraud prevention resources, educate consumers, and provide training for law enforcement professionals, victim advocates and other people on the front lines of fighting financial fraud;
- ▶ issuing *Regulatory Notices* emphasizing member firms' obligations to senior investors and providing guidance on how to fulfill those obligations;<sup>10</sup> and
- ▶ bringing disciplinary actions for misconduct against senior investors.<sup>11</sup>

### Related Rules and Administrative Processes

FINRA is interested in whether additional tools, guidance or changes to FINRA rules or administrative processes are appropriate to further address financial exploitation and other circumstances of financial vulnerability for senior investors. To that end, FINRA is requesting comment on the functioning of its rules and administrative processes that most directly apply to financial exploitation of senior investors. An overview is set forth below. FINRA recognizes that other FINRA rules and administrative processes not listed here affect member firms' ability to address suspected financial exploitation and FINRA welcomes comment on them as well.

### **FINRA Rule 2165**

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 financial exploitation of that adult has occurred, is occurring, has been attempted or will be attempted.<sup>12</sup> Rule 2165 provides member firms and their associated persons with a safe harbor from FINRA Rules 2010 (Standards of Commercial Honor and Principles of Trade), 2150 (Improper Use of Customers’ Securities or Funds; Prohibition Against Guarantees and Sharing in Accounts) and 11870 (Customer Account Transfer Contracts) when member firms exercise discretion in placing temporary holds on disbursements of funds or securities from the accounts of specified adults consistent with the requirements of the rule.

#### **Application to Transactions**

While placing a hold pursuant to Rule 2165 stops funds or securities from leaving a customer’s account, the rule currently does not apply to transactions in securities by or for the senior investor.<sup>13</sup> Customers can be exploited through transactions as well as disbursements. However, extending Rule 2165 to transactions may raise complicated issues, such as the possibility of changes in a security’s price during the hold and complying with a member firm’s best execution obligations.<sup>14</sup>

#### **Application When No Indication of Financial Exploitation**

Rule 2165 provides member firms with a useful tool in protecting a senior investor’s assets from financial exploitation by a third party. However, some member firms have requested that FINRA extend the temporary hold provision 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, irrespective of whether there is evidence that the customer is the victim of financial exploitation by a third party.

#### **Length of Time of Temporary Holds**

Rule 2165 allows a member firm to place a temporary hold on a specified customer’s account for up to 25 business days if the criteria in the rule are satisfied. The rule also provides that this period may be extended by a state agency or a court. A number of member firms have indicated that 25 business days is not a long enough period in some instances to resolve the matter and that it can be difficult to obtain an extension from a state agency or a court. These member firms have asked that FINRA extend the period in the rule or create a different mechanism for receiving an extension.

### Reporting Requirements

FINRA Rule 4530 (Reporting Requirements) requires member firms to report specified events to FINRA. Although FINRA considers whether a member firm or associated person had acted consistent with Rule 2165 when assessing reported information about a hold on a disbursement, Rule 2165's safe harbor does not extend to reporting requirements pursuant to Rule 4530. For some situations, FINRA has developed problem codes for use in reporting pursuant to FINRA Rule 4530 to provide clarity regarding the reportable event. To date, FINRA has not developed a dedicated problem code for Rule 2165-related reporting.

Form U4 (Uniform Application for Securities Industry Registration or Transfer), which is used by member firms to register associated persons with FINRA and the appropriate jurisdictions, and Form U5 (Uniform Termination Notice for Securities Industry Registration), which is used by member firms to terminate the registration of associated persons with FINRA and the appropriate jurisdictions, require disclosing customer complaints that meet specified criteria. Rule 2165's safe harbor does not extend to complaints about an associated person whose actions were within the safe harbor that may be reportable on Forms U4 or U5. Rather, whether a complaint is reportable depends on the criteria for reporting under Forms U4 or U5.

### FINRA Rule 3240 (Borrowing From or Lending to Customers)

Lending arrangements between registered persons and customers is an area of interest for FINRA because of the potential for misconduct. Rule 3240 provides a regulatory framework to give member firms greater control over, and supervisory responsibilities for, lending arrangements between registered persons and their customers. Furthermore, member firms may choose to prohibit all or some types of lending arrangements between registered persons and their customers.

Rule 3240 prohibits registered persons from borrowing money from or lending money to their customers unless the member firm has written procedures allowing the lending arrangements and: (1) the customer is a member of the registered person's immediate family; (2) the customer is engaged in the business of lending money and is acting in the course of the business; (3) the customer and the registered person are both registered persons of the same firm; (4) the lending arrangement is based on a personal relationship outside of the broker-customer relationship; or (5) the lending arrangement is based on a business relationship outside of the broker-customer relationship. With the exception of lending arrangements described in (1) and (2) above, Rule 3240 requires that registered persons notify the member firm and the member firm pre-approve in writing the lending arrangements.

FINRA has brought disciplinary actions against registered persons for violating Rule 3240 involving lending arrangements with senior investors. For example, FINRA brought an action against a registered person who entered into lending arrangements with several senior customers contrary to Rule 3240 and firm procedures.<sup>15</sup> In another example, FINRA brought an action against a registered person who attempted to mischaracterize a loan from a senior investor as proceeds from the sale of farm equipment.<sup>16</sup> FINRA also has learned of other instances where registered persons have attempted to avoid the rule's obligations by having another registered person handle the account or by listing a spouse on loan documents.

### **FINRA Rule 4512**

Rule 4512 requires member firms 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 in existence prior to the effective date of the amendments (existing account). The trusted contact person is intended to be a resource for the member in administering the customer's account, protecting assets and responding to possible financial exploitation. Member firms are not prohibited from opening and maintaining an account if a customer fails to identify a trusted contact person as long as the member firm makes reasonable efforts to obtain the information.

### **A Registered Person Being Named a Beneficiary, Executor, or Trustee or Holding a Power of Attorney or Similar Position**

Many registered representatives develop close and trusted relationships with their customers, which in some instances have resulted in the customer naming the registered representative as the customer's beneficiary, executor, or trustee or holding a power of attorney or a similar position. These positions of trust may present significant conflicts of interest, and FINRA has taken steps to address misconduct in this area.<sup>17</sup>

To further address these potential conflicts of interest, FINRA intends to consider rulemaking to explicitly prohibit or limit the ability of registered persons to be named a beneficiary, executor, power of attorney, trustee or similar position of trust on the account of a non-family member customer. Any such proposed rulemaking would be published for comment in a separate *Regulatory Notice*.

### **Sanction Guidelines**

FINRA's *Sanction Guidelines* provide both general principles that apply to the overall process of determining sanctions for every case and specific recommendations of a range of sanctions for particular rule violations. The *Sanction Guidelines* familiarize member firms with a wide variety of typical securities industry rule violations, and the range of disciplinary sanctions that may result from those rule violations. The goals of the *Sanction*

*Guidelines* are to assist FINRA's adjudicators in determining the appropriate sanctions in disciplinary proceedings and to provide consistency in the imposition of sanctions. The Sanctions Guidelines include some "principal considerations" to be considered when determining appropriate sanctions. Although the exercise of undue influence and level of sophistication are principal considerations, the customer's age or physical or mental impairments are not currently principal considerations.<sup>18</sup>

### Request for Comments

FINRA seeks answers to the following questions with respect to addressing financial exploitation and other circumstances of financial vulnerability for senior investors:

#### Rule 2165

1. Should Rule 2165's safe harbor be extended to apply to transactions in securities, in addition to disbursements of funds and securities? If so, how should changes in security prices be addressed (*e.g.*, where a hold is terminated: (i) by a state regulator or agency of competent jurisdiction or a court of competent jurisdiction; or (ii) upon a determination that there is not financial exploitation)? Are there other implications of extending the safe harbor to transactions?
2. Should Rule 2165's safe harbor be extended to apply where there is a reasonable belief that the customer has an impairment that renders the individual unable to protect his or her own interests (*e.g.*, a cognitive impairment or diminished capacity), irrespective of whether there is evidence that the customer may be the victim of financial exploitation by a third party? What burdens would be placed on member firms and their registered persons if the safe harbor were extended in this way?
3. Should FINRA extend the temporary hold period in the rule or create a different mechanism to obtain an extension? If so, for how long? How frequently has your firm placed a temporary hold pursuant to Rule 2165 and what has been the duration of any holds? When a hold was placed, did the firm's internal review find support for the reasonable belief of financial exploitation that prompted placing the hold?
4. Has your firm identified any unintended consequences when placing or attempting to place a temporary hold on disbursement of funds or securities from an account under Rule 2165?

#### Rule 4512

5. To gain a better understanding of the effectiveness of the trusted contact provision in Rule 4512: what methods have firms used in seeking to obtain trusted contact person information? What methods have firms found most helpful in obtaining such information? What have been the response rates from new and existing customers in providing the trusted contact person information?

6. Has your firm suspected financial exploitation of a customer, but not had the trusted contact person information? If so, what did your firm do, if anything? Has your firm sought assistance from trusted contact persons, and, if so, was this outreach constructive?

#### **Reporting Requirements**

7. Should FINRA develop a dedicated Rule 2165-related problem code for use in meeting reporting requirements pursuant to FINRA Rule 4530?
8. Is guidance needed to address when complaints related to placing a temporary hold pursuant to Rule 2165 should be reported on Forms U4 and U5? To what extent have registered persons received complaints in situations relating to disbursement holds, and have they been reportable complaints?

#### **Rule 3240**

9. Has Rule 3240 been effective in addressing potential misconduct in lending arrangements between registered persons and their senior customers? Has Rule 3240 been effective more generally as an investor-protection measure?
10. Should the types of permissible lending arrangements in Rule 3240 be modified or should the rule cover a broader range of lending arrangements or relationships?
11. Should the rule address borrowing and lending arrangements that were entered into prior to the existence of a broker-customer relationship?
12. Should Rule 3240 apply for a specified period following an individual ceasing to be a customer (colloquially, a cooling-off period) of the firm or where a customer is reassigned to a different registered representative?

#### **Sanctions Guidelines**

13. Should FINRA amend the Sanctions Guidelines to add as a principal consideration the fact that a victimized customer is a “specified adult” (*i.e.*, a person 65 or older or a person 18 or older who the member reasonably believes has a mental or physical impairment that renders the individual unable to protect his or her own interests)?

#### **General Effectiveness, Challenges and Economic Impact**

14. Has each rule (mentioned above) effectively addressed the problem(s) it was intended to mitigate? To what extent has the original purposes of, and the need for, a rule been affected by subsequent changes to the risk environment, the markets, the delivery of financial services, the applicable regulatory framework, or other considerations? Are there alternative ways to achieve the goals of a rule that FINRA should consider?

15. What has been your experience with implementation of Rules 2165, 3240, 4512 and 4530 related to senior investors, including any ambiguities in the rule or challenges to comply with it?
16. What have been the economic impacts, including costs and benefits, of the rules mentioned above? To what extent do the costs and benefits have a disproportionate impact on firms based on size and business model? Have the rules led to any negative unintended consequences?
17. Should FINRA require additional disclosure or heightened supervision for any particular product or investment strategy that is marketed to senior investors?
18. Can FINRA make rules, guidance or attendant administrative processes related to senior investors more efficient and effective? If so, how?
19. What additional guidance, tools or resources would be helpful to firms or the investing public to address suspected financial exploitation and other circumstances of financial vulnerability for senior investors? Are there areas where FINRA or the FINRA Investor Education Foundation should conduct additional research or publish additional materials to promote greater awareness and education?
20. Are there other approaches, policies, rules, programs or partnerships not discussed herein that are within FINRA's jurisdiction and mandate that would further benefit senior investors?

In addition to comments responsive to these questions, FINRA invites comments on any other aspects of the rules that commenters wish to address. FINRA further requests any data or evidence in support of comments. FINRA welcomes input not only as to whether or not the current rules are effective and efficient, but also specific suggestions as to how the rules should be changed. As discussed above, FINRA will separately consider during the action phase specific changes to the rules.

## Endnotes

1. Persons submitting comments are cautioned that FINRA does not redact or edit personal identifying information, such as names or email addresses, from comment submissions. Persons should submit only information that they wish to make publicly available. See *Notice to Members 03-73* (November 2003) (Online Availability of Comments) for more information.
2. See, e.g., Consumer Financial Protection Bureau, Office of Financial Protection for Older Americans, [Suspicious Activity Reports on Elder Financial Exploitation: Issues and Trends](#) (Feb. 2019). The Report found that suspicious activity report (SAR) filings on elder financial exploitation quadrupled from 2013 to 2017, with financial institutions filing 63,500 SARs reporting elder financial abuse in 2017. The Report also states that these SAR filings likely represent only a tiny fraction of the actual 3.5 million incidents of elder financial exploitation estimated to have happened that year. As covered in the Report, financial institutions that must file SARs include banks, casinos, money services businesses, brokers or dealers, insurance companies, mutual funds, futures commissions merchants and introducing brokers in commodities, loan or finance companies, and housing government-sponsored enterprises.  
  
In addition, a number of recent studies indicate that the vast majority of elder financial exploitation is perpetrated by strangers, family members and caregivers, rather than by broker-dealers or other financial services organizations. See, e.g., Consumer Financial Protection Bureau's Office of Financial Protection for Older Americans, [Suspicious Activity Reports on Elder Financial Exploitation: Issues and Trends](#), at 18 (Feb. 2019); [Statistics and Data on Elder Abuse, The National Center for Elder Abuse, Who are the Perpetrators?](#).
3. See *id.*
4. A rule set is a group of rules identified by FINRA staff to contain a similar subject, characteristics or objectives.
5. See [2019 Risk Monitoring and Examination Priorities Letter](#) (January 2019).
6. See [www.finra.org/investors/highlights/finra-securities-helpline-seniors](http://www.finra.org/investors/highlights/finra-securities-helpline-seniors).
7. See *Regulatory Notice 17-11* (March 2017).
8. See the [Seniors Safe Act Fact Sheet](#).
9. See, e.g., articles such as [Protecting Seniors from Financial Exploitation](#); Investor Alerts such as [Power of Attorney and Your Investments—10 Tips, Plan for Transition: What You Should Know About the Transfer of Brokerage Account Assets on Death](#), and [Seniors Beware: What You Should Know About Life Settlements](#); and FINRA's [Retirement](#) webpage for investors.
10. See, e.g., *Regulatory Notice 07-43* (Sept. 2007) (reminding member firms of their obligations relating to senior investors and highlighting industry best practices to serve these customers); *Regulatory Notice 09-42* (July 2009) (reminding member firms of their obligations with variable life settlement activities); *Regulatory Notice 11-52* (Nov. 2011) (reminding member firms of their obligations regarding the supervision of associated persons using senior designations); *Regulatory Notice 16-12* (April 2016) (providing guidance on member firm responsibilities for sales of pension income stream products); *Regulatory Notice 17-11* (Mar. 2017) (discussing new senior rules and potential financial exploitation of seniors).

11. *See, e.g., John W. Cutshall*, Order Accepting Offer of Settlement, Case ID 2014041590801 (April 11, 2019); *Steven Anthony Olejniczak*, Letter of Acceptance, Waiver and Consent, Case ID 2016050107901 (May 8, 2017).
12. The definition of “specified adult” in Rule 2165 covers those investors who are particularly susceptible to financial exploitation. A “specified adult” is (A) a natural person age 65 and older or (B) a natural person age 18 and older who the member reasonably believes has a mental or physical impairment that renders the individual unable to protect his or her own interests. *See* Rule 2165(a)(1). Supplementary Material .03 to Rule 2165 provides that a member’s reasonable belief that a natural person age 18 and older has a mental or physical impairment that renders the individual unable to protect his or her own interests may be based on the facts and circumstances observed in the member’s business relationship with the person.
13. For example, Rule 2165 would not apply to a customer’s order to sell his shares of a stock. However, if a customer requested that the proceeds of a sale of shares of a stock be disbursed out of his account at the member firm, then the rule could apply to the disbursement of the proceeds where the customer is a “specified adult” and there is reasonable belief of financial exploitation.
14. *See, e.g.,* FINRA Rule 5310 (Best Execution and Interpositioning).
15. *See, e.g., Michael Mendenhall*, OHO Decision, Case ID 2009020489901 (July 25, 2012) (where the registered representative violated Rule 3240 in receiving inappropriate loans from several senior customers).
16. *See, e.g., Katherine Ann White*, OHO Decision, Case ID 2015045601401 (April 7, 2017) (where the registered person claimed that the receipt of a \$10,000 cashier’s check (plus \$600 profit over the following six months) from a senior investor was not a loan but represented the purchase price for the sale of farm equipment that was never delivered to the customer).
17. *See, e.g., Robert Torcivia*, Letter of Acceptance, Waiver and Consent, Case ID 2015044686701 (Sept. 26, 2018) (finding, under the facts of the case, that the registered representative violated Rule 2010 in relation to accepting beneficiary designations and having powers of attorney for senior customers and failing to inform the firm of these arrangements).
18. *See* [FINRA Sanction Guidelines \(March 2019\)](#).