

Dealing with Vulnerable Investors and Financial Exploitation

Unfortunately, financial exploitation is a significant and growing area of concern, particularly with elderly investors or those with diminished capacity. Investment advisers are facing a client base who is increasingly older, and with that comes the increased likelihood of an investment adviser encountering possible financial exploitation. This article provides information to assist investment advisers to prepare for, identify, and react to vulnerable investors and potential incidences of financial exploitation. The article references the North American Securities Administrators Association Model Act, which has been adopted, either in part or whole, by a majority of states.

Who Is Vulnerable, and What Is Financial Exploitation?

As a start, it is important to understand who is a senior or vulnerable investor and what exactly constitutes financial exploitation. Senior investors are those over the age of 65, while vulnerable investors are those with diminished capacity or subject to a state's adult protective services law.¹ Financial exploitation is the wrongful or unauthorized taking, withholding, appropriation, or use of money, assets, or property of an eligible adult or any act or omission taken by a person, including through the use of a power of attorney, guardianship, or conservatorship of an eligible adult, to:

- i) Obtain control, through deception, intimidation, or undue influence, over the eligible adult's money, assets, or property to deprive the eligible adult of the ownership, use, benefit, or possession of his or her money, assets, or property or
- ii) Convert money, assets, or property of the eligible adult to deprive them of the ownership, use, benefit, or possession of their money, assets, or property.²

General Policies and Procedures for Identifying and Dealing with Possible Vulnerable Investor Exploitation

With that in mind, the first thing an investment adviser must do is develop policies, procedures, and training programs to educate employees (particularly those interacting regularly with clients) on how to recognize signs of cognitive decline, diminished capacity, or financial exploitation.

¹ Vulnerable investor or diminished capacity is generally understood to mean a person 18 years of age or older who, because of incapacity, mental illness, mental deficiency, physical illness or disability, advanced age, chronic use of drugs, chronic intoxication, fraud, confinement, or disappearance, is unable to meet the person's own needs or to seek help without assistance.

² NASAA Model Legislation or Regulation to Protect Vulnerable Adults from Financial Exploitation. January 22, 2016.
<http://serveourseniors.org/wp-content/uploads/2015/11/NASAA-Model-Seniors-Act-adopted-Jan-22-2016.pdf>

For example:

- Include a Trusted or Emergency Contact form for clients to fill out once they reach the age of 65. As discussed later, a designated third-party contact is a vital tool allowing the investment adviser to notify a trusted individual if there is an issue or concern regarding diminished capacity or abuse by a third party.
- Encourage clients to self-identify as retired if applicable, which will allow for easier identification of a client in the distribution phase of life for reporting purposes.
- Enhance supervisory oversight for accounts when there is suspicion a client may be vulnerable to financial exploitation.
- Increase the frequency of communication with clients as they age to remain informed of changes in their financial and life circumstances, including their health, living situations, and employment status.
- In connection with the above, document communications with vulnerable clients in case they have trouble remembering and to avoid future misunderstanding. This will also be helpful in the event there are any disputes in the future regarding any protective measures you take on the client's behalf.
- Create escalation procedures. It is important to have a policy in place that indicates to whom and at what stage the matter should be escalated.
- Stay up-to-date regarding popular scams, including phone, email, and online (such as IRS impersonation and

sweepstakes scams).

Finally, remember the investment adviser is often the first line of defense against financial exploitation. Establishing a close relationship and fostering open communication with clients and their families allows investment advisers to more readily identify early signs of vulnerability and deal with the issue before it becomes a problem.

Warning Signs of a Potentially Vulnerable Investor

Correctly identifying warning signs is a key line of defense in protecting clients from financial exploitation. Here are some general signs a client may be vulnerable. This is by no means a definitive list, but some things to look for are:

- **An inability to process simple concepts**, such as a decline in the ability to do simple math, difficulty in understanding core aspects of the account, checkbook mismanagement, and confusion regarding basic financial terms and concepts, such as mortgages and annuities.
- **Erratic behavior**, including speech impairment, memory loss, an inability to recognize the consequences of decisions (such as withdrawal penalties), disorientation concerning time or location, or an uncharacteristically unkempt appearance.
- **Impaired judgment regarding investments or the use of money**, such as uncharacteristic anxiety regarding the

extent of their wealth, making decisions at odds with their stated long or short term goals and commitments, failure to pay bills or paying the same bills twice, and interest in get rich quick schemes.

Identifying Red Flags of Financial Exploitation

Firms should always keep an eye out for signs of a potentially vulnerable investor, but it is just as important to be able to detect and recognize the red flags indicating financial exploitation may be taking place. Again, this is not an exhaustive list, as warning signs may be different for each client. Establishing and maintaining a close and open client relationship puts investment advisers in the best position to protect their clients.

- Repeated unusual cash withdrawal or wire transfers.
- Appearing with unfamiliar new associates, friends, or relatives.
- Difficulty communicating directly with the client, without interference or screening by others.
- Atypical signs of anxiety or nervousness when visiting the office or on the phone.
- Unexpected transactions, such as closing an account.
- Large withdrawals and a disregard for the transaction penalties.
- Unexplained windfalls and a reluctance to provide information regarding its origins.
- Sudden changes to financial documents, including powers of attorney, will, trusts, or account beneficiaries.

What to Do if You Suspect a Client May be Vulnerable or a Victim of Financial Exploitation

Privacy Considerations

Firms should remember the privacy and individual integrity of each client is very important. Financial information and even the fact someone is client is protected as non-public personal information under Regulation S-P (for SEC-registered advisers)³ or corresponding state privacy laws (for state registered advisers). Sharing such information without prior consent can subject an investment adviser to liability. However, for SEC registered investment advisers,

newly passed revisions to Dodd-Frank under the Senior Safe Act 2018 provide immunity from administrative and civil liability for disclosures made to a covered agency as long as:

- i. The disclosing individual was employed by the covered financial institution at the time of the disclosure as a registered representative, investment adviser, or in a supervisory, compliance, or legal function;
- ii. Before the time of the disclosure, the individual received training in identifying and reporting senior

exploitation; and

- iii. The disclosure was made in good faith and with reasonable care.⁴

Trusted or Emergency Contact Form

Investment advisers should establish and train their employees on the policies and procedures for dealing with situations involving vulnerable investors. One key piece of advice is to consistently apply the investment adviser's policies and do so as early as possible in the client relationship. This will help prevent clients from feeling singled out

³ Final Rule: Privacy of Consumer Financial Information (Regulation S-P) <https://www.sec.gov/rules/final/34-42974.htm>

⁴ Senior Sage Act Fact Sheet <https://www.investor.gov/senior-safe-act-fact-sheet>

and will encourage a more open dialogue. Another way to approach this is couching the conversation as one about planning for medical emergencies and not specifically about cognitive decline or financial exploitation, as some clients might take offense to the notion they could be taken advantage of.

Each investment adviser's policies and procedures will look slightly different depending on how the firm is structured, but a best practice approach starts with a Trusted or Emergency Contact Form. This form allows the investment adviser to alert a third party or family member if diminished capacity or financial exploitation is suspected. The investment adviser can then work with that contact to protect the client. For existing clients, a method for accomplishing this is incorporating the form into annual meetings after clients reach the age of 65. However, advisers know their clients best, and if appropriate, need not wait until age 65. For new clients, this can be incorporated in an investment adviser's onboarding procedure.

Additionally, it is recommended investment advisers revisit the designation every few years or as they feel appropriate to make sure the client and the designee are still on good terms.

External Reporting Obligations

Investment advisers and their employees also need to be aware of any reporting requirements. Some states have mandatory reporting laws specifically for broker dealers and investment advisers, while other states have laws that apply to the financial services industry as a whole. In fact, some states require all persons to report suspected elder abuse and/or financial exploitation. In contrast, other states may only have a voluntary reporting policy. Generally, the applicable state law is determined by the location of the client, not the investment adviser.

Recognizing the wide spectrum of reporting requirements, it is recommended firms be aware of the resources available regarding reporting laws to ensure disclosure is permitted, under what circumstances, and to whom disclosure should be made. For more information on this subject, the American Bar Association has compiled [Adult Protective Services Reporting Laws](#), which is a state-by-state list outlining who has to report, when to report, and how to report suspected elder abuse/financial exploitation. Additionally, investment advisers can visit [NASAA's website](#) to find information.

Internal Reporting Obligations

Regardless of other reporting obligations, all investment advisers should have policies and procedures in place that clearly spell out the steps an employee must take when they suspect a client may be vulnerable. Below is a list of action items or steps for investment advisers and their employees to follow:

1. As soon as practicable, report the suspicious activity or circumstances to the investment adviser's CCO.
2. Maintain a detailed record of the behavior in writing, including the specific client details, relevant dates, description of the events, outline of the steps taken to respond to the event, and any ancillary documentation that may be needed.
3. The CCO will determine if the situation requires escalation to the appropriate local or state agency.
4. The CCO will then determine if the behavior merits sharing with a previously authorized third-party or trusted

person for resolution.

5. The CCO is responsible for potentially declining a transaction on the suspicion of financial exploitation or diminished capacity, to the extent that the investment adviser has authority. Investment adviser's ability to delay or decline a transaction vary from state to state, and it is important to know what authority your firm has and what other reporting obligations are triggered by such action.

Conclusion

It's no secret the number of older investors is growing rapidly, and with that, investment advisers are seeing a commensurate rise in their client base of potential vulnerable investors. Because of this, it is more important than ever to make sure your firm is prepared. As we discussed in this article, investment advisers must make sure their employees are trained to know what vulnerable investors and financial exploitation are, how to spot the red flags, and what to do if they suspect a client might be suffering from diminished capacity or financial exploitation.

Questions? Contact the DCS Team

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