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October 8, 2019

via email to pubcom@finra.org
Jennifer Piorko Mitchell
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

RE: Regulatory Notice 19-27 -- Retrospective Rule Review on Issues Relating to Senior Investors

Dear Ms. Mitchell:

The University of Pittsburgh Securities Arbitration Clinic (the "Clinic") appreciates the opportunity to comment on the Financial Industry Regulatory Authority's ("FINRA") retrospective rule review on issues relating to senior investors. The Clinic, a University of Pittsburgh curricular offering, provides legal representation to investors who have limited resources, often advocating for people whose claims represent much of their life savings. The Clinic provides the following commentary on Rules 2165 and 3240, the current reporting requirements, the 2018 Sanction Guidelines, and the overall effectiveness of the current regime to address FINRA's concerns about the financial exploitation of senior investors.

General Effectiveness, Challenges, and Economic Impact

It is evident that the above Rules were created because FINRA recognizes that senior investors are at greater risk than other investors of financial exploitation.

Rule 2165 and Rule 4512 appear to be an attempt to protect senior investors from themselves and third-parties. By "themselves" we mean senior investors whose mental decline or diminished capacity causes them to make irrational financial decisions. By "third-parties" we mean strangers, family members, and caregivers who attempt to take advantage of senior investors' diminished capacity.

But where are the protections for senior investors from their own broker-dealer, or member firms?

Senior investors maybe susceptible to those who appear to be helping them, but in fact have other motives. Because of their "advisor" relationship, brokers have the opportunity to take advantage of their senior investors just as much as third-parties. Unfortunately, brokers are in a stronger position to take advantage of their senior investors.

For example, it may be obvious that abuse is occurring when a senior investor begins to withdraw the majority of funds from his/her account and a family member or caretaker conjunctively starts receiving unreasonably large checks. Yet, when brokers take advantage of the dependent nature of their senior client and choose to make unsuitable investments for their own financial gain, it is not easily recognizable to outsiders. In addition, while we often think of the financial exploitation of senior investors as an *intentional* act, we must not forget the numerous and unfortunate scenarios that arise from the negligence of brokers to adequately inform senior clients of the nature and consequences of their investment decisions.

At the Clinic, our clientele consists largely of senior investors who have suffered just this type of negligence as a result of their broker's action. Many clients claim that they were informed by their broker that they were in a low risk investment and cannot begin to understand how they suddenly lost their retirement. Upon review, it usually turns out that the type of product that the client believes he/she was invested in was not at all what his/her broker had invested their funds.

One should also consider that the current rules, specifically Rule 2165, not only fail to protect senior investors from corrupt brokers, but may help facilitate a broker's scandalous activity. For example, Rule 2165 *permits* a member firm to place a temporary hold on the disbursement of funds if they believe financial exploitation of the investor has occurred or will occur. The word "permit" makes this Rule optional rather than obligatory. Obviously, a corrupt broker is not going to place a hold on his/her client's account if he/she is conducting the financial exploitation. Because of this permissive rather than mandatory structure, unscrupulous brokers will be able to continue their financial exploitation.

FINRA must implement policies that focus specifically on the unique challenges of senior investors and how broker's are regulated as they relate to senior investors. Many senior investors may struggle to understand the investment and the necessary paperwork, making them dependent upon third-parties or their brokers to thoroughly explain and make appropriate investment decisions. In order to protect senior investors from financial exploitation from their brokers, we recommend that brokers take certain "extra" steps before investing senior client's capital. For example; certain "extra steps" could include creating easy to read and understandable guidelines for investments, or explaining exactly what and how the broker should be telling senior investors about the investment.

Rule 2165

In response to the question posted about Rule 2165's safe harbor application to transactions in securities, it is our opinion that this extension of the rule could be in the best interest of senior investors if applied correctly. While the current state of securities trading requires investors to

strategically buy and sell securities in nanoseconds[1], we realize that practically, senior investors do not generally have similar trading strategies. Senior investment strategies are less likely to revolve specifically around the timing of these transactions, and more likely to revolve around a less risky, but high probability of return strategy such as with bond. Therefore, the proposal to extend Rule 2165's safe harbor requirement to cover transactions could be helpful if the threshold for stopping these transactions is recognizing a large deviation in the investors strategy. Take for example a senior investor who for the past decade has dealt with transactions in bonds for 90% of his/her investment portfolio suddenly dumping a large percent of his/her account into high volatility stocks. This should flag a firm that fraudulent investing is occurring and a stoppage on an account should take place until the firm can verify the senior investor is purposefully making this trade. It must be a large threshold however, because as mentioned earlier many investors do rely heavily on the timing of their trades, and therefore a firm who accidentally stops a trade on the basis of a "hunch" could have a significant impact for an investor relying on the timing of the investment. Additionally, if fraudulent exploitation of a senior investor's securities account occurs, Rule 10b-5 is in place to protect them.[2] However, it should be recognized that the practicality of using 10b-5 is costly and difficult to prove. Therefore senior investors would probably use this route to recover damages as a last resort, and firms should use this extension of Rule 2165 to prevent the need for such litigation.

However, Rule 2165's safe harbor extension should not apply in situations where there is a reasonable belief a customer has an impairment 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. There is no standard for determining whether a customer has a valid impairment and this would allow a firm too much subjective control over a customer's account. Additionally, it would be easy for a broker to abuse this standard and simply put a stoppage to a senior's account without needing to prove if he/she had reasonable cause. Expanding the safe harbor would only afford member firms more control and power over senior investors, who are already susceptible to abuse by brokers as well as third parties

Reporting Requirements

FINRA should develop a Rule 2165-related problem code for use in meeting reporting requirements pursuant to FINRA Rule 4530. Rule 2165 plays a vital role in situations where financial exploitation might have occurred. Recording this event and reporting it to FINRA allows for several benefits both to the customer, the member firm, and FINRA itself. A Rule 2165-related problem code could benefit customers because there would be more documentation explaining a hold of their account. Whether a hold is wrongful or correct, the documentation of the hold would allow for greater clarity from the customer perspective. In the case that the hold was made wrongfully or there are complications regarding the hold, the reporting requirement will allow for easier access to justice because the discovery process surrounding specific dates and times that the hold was made would be easier to attain. In addition, as contemplated below, FINRA could use

[1] *See generally* John Markoff, *Time Split to the Nanosecond Is Precisely What Wall Street Wants*, NY Times (June 29, 2018), https://www.nytimes.com/2018/06/29/technology/computer-networks-speed-nasdaq.html.

[2] Kurt M. Swenson, *Remedies for Private Parties Under Rule 10b-5*, 10 B.C.L. Rev. 337 (1969), http://lawdigitalcommons.bc.edu/bclr/ vol10/iss2/7.

this data to find trends in when a hold is made and why in order to track warning signs of exploitation.

There are also a number of benefits for member firms. Recording the hold with FINRA may take time but it will ensure that the member firm has recorded their action in the event that they are charged with a wrongful hold. If the member firm can show that, at the time in question, they had reasonable belief in the possibility of exploitation, than they will be more protected in any future action. Similar to the benefits to the customers, discovery in any future action will be eased by the existence of a report showing the time, date, and reason for the decision. Finally, as discussed below, FINRA may be able to use the data to give member firms better tools to use for future situations of possible exploitation. Reporting events described in Rule 2165 to FINRA will also improve the tools that FINRA has to work with. By seeing when and why a Rule 2165 hold takes place, FINRA can use this data to improve its ability to protect customers and member firms. FINRA will be able to develop better metrics to determine if exploitation is actually happening, warning signs that indicate that a hold should be placed, and systemic issues in customer exploitation.

The risks involved in placing reporting requirements on this rule are that member firms would be less likely to place a hold and that it will increase broker fees. The first risk is that member firms may take placing a hold on a customer account "more seriously" if they need to report the hold to FINRA, this may disincentivize placing the hold in the first place, which may lead to more, not less exploitation. This is certainly a risk of adding a reporting requirement, however, in regards to the member firms, the reporting requirement would allow greater ability to show their reasonable belief in issuing the hold and therefore actually lessen the legal risk they are subjècted to. The other risk is that the reporting requirements will raise fees on customers. This is likely to be minimal if it occurs at all and will be outweighed by the benefits of the requirement. Both of these risks are concerns but are outweighed by the benefits of (1) safety, (2) security, and (3) new tools to combat exploitation.

Guidance is needed when complaints related to placing a temporary hold pursuant to Rule 2165 should be placed on Forms U4 and U5. These forms are used by member firms to report activity of associated persons. These forms are also used for disclosing customer complaints, and due to the possibility that these reports could negatively affect the broker, more guidance is needed.

Rule 3240

Based upon the reading of Rule 3240, the rule is effective in addressing potential misconduct in lending arrangements between registered persons and their senior customers. Each investor-lending relationship seems to be covered through the five scenarios listed in the Rule. By having the written procedure requirement, we can be certain that immediate family members or others are not taking advantage of senior investors. The Rule encompasses many of the most common lending scenarios, but could be broader to ensure total protection for their senior investor.

Many times, however, some sort of relationship already exists between a registered person and a senior customer, prior to entering into a broker-customer relationship. As such, it is imperative to look into the loans and agreements, which may have been made prior to the broker-customer relationship, because a broker may take advantage of a senior customer. Brokers are

more likely to form broker-dealer relationships with customers because of the amount of money involved in the transactions. Brokers could easily enter into deals that would be favorable to the broker and not the customer because of the broker-customer relationship and, therefore, lending that occurs during the "cooling-off" period, when a senior customer is changing brokers, should be monitored.

Sanction Guidelines

In order to better ensure the protection of senior investors, the Sanction Guidelines should be amended to include "specified adult," including those 65 or older or anyone 18 or older who a member reasonably believes has a mental or physical impairment that renders the individual unable to protect his or her own interests. The current Sanction Guidelines aim to protect investors and strengthen market integrity through self-regulation. With the other FINRA rules developed to protect specifically senior investors, it only makes sense to include protections in the sanctions FINRA imposes on member firms for violating such rules. The arbitration process is designed to lower the need for full litigation in many cases, and as such should reflect the common law as much as possible to afford individuals and member firms the most judicious outcome. Moreover, senior customers, who are the individuals most likely to be exploited in the investment environment, should be as protected as possible during the adjudication process.

Common law is host to many protections for those who are at higher risk for deception, fraud, and the like. Contract law, for instance, provides the "undue influence" defense for persons with weaknesses which makes them likely to be overly affected by persuasion.[3] The Sanction Guidelines currently list, "whether the respondent exercised undue influence over the customer" as one of the principal considerations. It is an unfortunate reality in our society that seniors are likely the victim of undue influence, whether in estates, contracts, trusts, securities transactions, or otherwise.[4]

Additionally, there are focus groups in many jurisdictions that are attempting to better define and refine elements of elder law to prevent financial elder abuse in all aspects of a senior's life. The The Borchard Foundation Center on Law and Aging, in their most recent report, states "[t]he need for a clear definition of undue influence has emerged as California probate courts and probate courts across the country increasingly must deal with conservatorship petitions alleging that undue influence is imminent, is actively taking place, or took place within the prior few months and is in danger of occurring again."[5] With the growing concern in many jurisdictions of conservatorships leading to elder abuse, FINRA would be ameliorating some of the pressure of senior investors and their family members by including "specified adults" in the principal considerations of the Sanction Guidelines. The key to protection of senior investors is prevention of any incident that could affect their investments. By including this category of at-risk customers, it would help to deter abuse and also encourage members to properly monitor the accounts and investments of such customers.

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[3] Restatement (Second) of Contracts § 177.

[4] Birkel, Julia L., Byrne, John M., Bernatz, Dr. Susan I., *Litigating Financial Elder Abuse Claims*, Los Angeles Lawyer, October 2007.

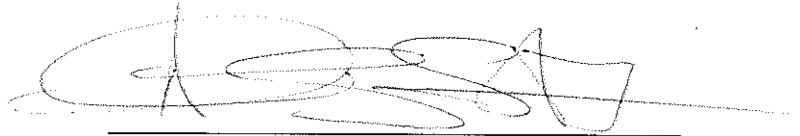
[5] Undue Influence: Definitions and Applications (A Project Supported by The Borchard Foundation Center on Law and Aging), *California Administrative Office of the Courts* (March 2010).

If the Sanction Guidelines included specified adults in the principal considerations, members would be more likely to monitor their senior investors' portfolios and ensure greater protection of those "specified adults" which FINRA is aiming to protect.

Conclusion

The Clinic agrees with FINRA that senior investors are at a greater risk of financial exploitation than other investors. In order to strengthen the financial security of senior investors, we recommend the above adaptations and additions to the current Rules.

Respectfully Submitted,



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