

SECURITIES LAW SERIES

Elder Abuse in the Securities Industry

FINRA INVESTIGATIONS
4
VOLUME

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ELDER ABUSE IN THE SECURITIES INDUSTRY

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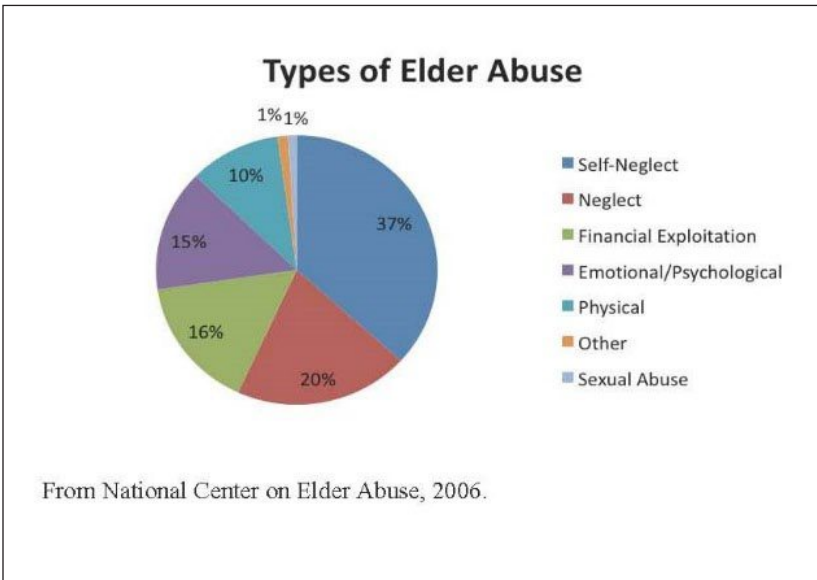
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DISCLAIMER

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Introduction

Based on research conducted by the National Center on Elder Abuse in 2006, 16% of elder abuse was caused by financial exploitation, which ranked third followed right after self-neglect and neglect by others. This percentage had increased from 12.3% since 2001; however, elder abuse is vastly under reported. According to one study, only 1 in 44 cases of financial abuse is ever reported. In many cases, cognitive impairment and the need for help with activities of daily living make elderly victims particularly vulnerable to financial abuse.



With baby boomers turning into senior citizens, financial exploitation of seniors has become an increasingly serious issue for securities industry regulators.

No financial product is per se unsuitable for senior investors; however, a senior's investment time span and other factors may impact whether certain products or strategies are suitable. In March 2017,

the SEC approved the adoption of new FINRA Rule 2165 (Financial Exploitation of Specified Adults) to permit members to place temporary holds on disbursements of funds or securities from the accounts of specified customers where there is a reasonable belief of financial exploitation of these customers. The SEC also approved amendments to FINRA Rule 4512 (Customer Account Information) to require members to make reasonable efforts to obtain contact information of a trusted person for a customer's account. Both rules are effective February 5, 2018. The definition of "Specified Adult" in Rule 2165 covers those investors who are particularly susceptible to financial exploitation. They can be summarized into the following categories:

- A natural person age 65 and older.
- 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.

The rule has a broad definition of "**financial exploitation**", which includes:

- The wrongful or unauthorized taking, withholding, appropriation, or use of a Specified Adult's funds or securities; or
- Any act or omission taken by a person, including through the use of a power of attorney, guardianship, or any other authority, regarding a Specified Adult to (i) obtain control, through deception, intimidation or undue influence, over the Specified Adult's money, assets or property; or (ii) convert the Specified Adult's money, assets or property.

Understanding FINRA Rules 2165 & 4512 in Protecting Senior Investors

The changes approved by the SEC involved two key steps to protect investors:

1. Firms will be required to make reasonable efforts to obtain the name and contact information for a trusted contact person for a customer's account.
2. Firms will be permitted to place a temporary hold on a disbursement of funds or securities when there is reasonable belief of financial exploitation.

New FINRA Rule 2165 – Temporary Hold on Disbursement of Funds or Securities

This rule permits firms who reasonably believe that financial exploitation has occurred, is occurring, has been attempted or will be attempted, to place a temporary hold on the disbursement of funds or securities from the account of a Specified Adult customer. However, this rule does not *require* members of FINRA to place temporary holds on disbursements of funds or securities from the account of a Specified Adult. It is up to the members' judgment to determine if a temporary hold is reasonably necessary.

- **FINRA Rule 2165 only applies to disbursements not securities transactions.** It is important to note that Rule 2165 does not apply to securities transactions. For example, if a Specified Adult places an order to sell securities, the member must execute that order even if the member firm suspects financial exploitation. Rule 2165 only applies when the Specified Adult

instructs the member to disperse the proceeds of the stock sale that Rule 2165 applies.

- **Attempt to resolve.** Unless a member reasonably believes that doing so would cause further harm to a Specified Adult, FINRA encourages the member firm to attempt to resolve a matter with a customer before placing a temporary hold.
- **Procedures after temporary hold.** Immediately after a temporary hold under Rule 2165 is put in place, the member firm is required to take the following steps:
 1. Initiate an internal review of the facts and circumstances that caused the member to reasonably believe that financial exploitation of the Specified Adult has occurred, is occurring, has been attempted or will be attempted.
 2. Within two business days after the date that the member first placed the hold on account, notify all parties authorized to transact business on the account and the **Trusted Contact Person** (see page 3) of the existence of the hold and the reason for the hold. A member is not required to notify anyone that is unavailable or who the member reasonably believes is a person or party that has engaged, is engaged, or will engage in the financial exploitation of the Specified Adult.
- **Termination of temporary hold.** Rule 2165 does not preclude a member from terminating a temporary hold after communicating with either the customer or trusted contact person. A customer's objection to a temporary hold or information obtained during an exchange with the customer or trusted contact person may be used in determining whether a hold should be lifted.
- **Expiration and extension of hold if necessary.** The tempo-

rary hold authorized by Rule 2165 expires not later than 15 business days after the initial hold is put in place. Unless otherwise terminated or extended by an order of a state regulatory or agency or court of competent jurisdiction. If the initial internal review warrants it, the Rule also permits an extension of 10 business days unless otherwise terminated or extended by the above-mentioned authorities.

- **Required records to be retained.** The required records to be retained by Rule 2165 include the following:
 - Request for disbursement that may constitute financial exploitation of a Specified Adult and the resulting temporary hold;
 - 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;
 - The name and title of the associated person that authorized the temporary hold on a disbursement;
 - Notifications to the relevant parties pursuant to the rule;
 - The internal review of the facts and circumstance supporting the member's reasonable belief that the financial exploitation of the Specified Adult has occurred, is occurring, has been attempted or will be attempted.

- **Supervision.** Rule 2165 requires members to establish and maintain written supervisory procedures reasonably designed to achieve compliance with the rule. This includes, but is not limited to, procedures related to the identification, escalation and reporting of matters related to the financial exploitation of Specified Adults. Member firms must identify each person author to place, terminate or extend a temporary hold on

behalf of the member.

- **Blanket hold is not permitted.** When a questionable disbursement involves less than all assets in an account, a member may not place a blanket hold on the entire account. Each disbursement must be analyzed separately.

Amended FINRA Rule 4512 – Trusted Contact Person

A 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](#). However, the amended rule 4512 does not prohibit members from opening or maintaining an account if a customer fails to identify a Trusted Contact Person as long as the member makes reasonable efforts to obtain the information.

- **A member may use its discretion in relying on any information provided by the Trusted Contact Person.** The rule does not require a member to notify the Trusted Contact Person that they have been designated as such by the customer. .
- **Members and customers can benefit from the Trusted Contact Person in various ways:**
 - To update customers' contact information or health status if members fail to reach the customers after multiple attempts;
 - To express concerns about possible Alzheimer's, dementia or other forms of diminished capacity;

- To address possible financial exploitation before placing temporary hold on a disbursement;
 - To use the Trusted Contact Person as a source of information after a temporary hold has been put in place (assuming the member does not reasonably believe that the Trusted Contact Person is engaged in the financial exploitation).
- **Red flag.** Members should note that a customer’s request to change his or her Trusted Contact Person might be a possible sign of financial exploitation.

How to Handle Existing Financial Exploitation of Senior Investors

Both FINRA rules 2165 and 4512 focus on the prevention of financial exploitations of senior investors. This section focuses on how the senior investors and their designated representatives should handle the situation if financial exploitation has already occurred.

There is no Federal statutory private cause of action for financial abuse or exploitation of an elderly person. This means that private parties cannot bring lawsuits based on any particular United States statute designed to protect the elderly. The **Elder Justice Act** signed into law by President Obama in March 2010 as a part of the **Patient Protection and Affordable Care Act** is the first federal elder abuse prevention law although it is not specifically targeting financial exploitation. The Elder Justice Act provides federal resources to “prevent, detect, treat, understand, intervene in and, where appropriate, prosecute elder abuse, neglect and exploitation.” Pursuant to **31 U.S.C. §5318(g) (3) Reporting of Suspicious Transactions**, any financial institution or associated person that makes a disclosure regarding a

possible violation of law or regulation, will not be liable to any person under any law or regulation of the United States, for such disclosure or for any failure to notify the person involved in the transaction or any other person of such disclosure. This federal statute protects firms and individuals reporting potential financial abuse or exploitation of elderly persons from running afoul of the federal **Right to Financial Privacy Act of 1978**.

Federal administrative agencies have been struggling to balance financial exploitation of senior investors between treating them as private “family matters” and “crimes”. Nevertheless, financial exploitation of the elderly has become a growing epidemic that costs seniors an estimated \$2.9 billion annually.

At the State level, all 50 states have some sort of legislation requiring Adult Protective Services (APS). APS is the last resort in protecting seriously impaired adults, including seniors, who have no family or friends to protect them. In some states, the APS statute also provides a private cause of action for financial exploitation of senior investors. In other states, the APS statute can nevertheless serve as guidance for firms as to the types of activities that constitute elder abuse or exploitation. 33 states, the District of Columbia and Puerto Rico addressed financial exploitation of the elderly and vulnerable adults in the **2016 legislative session**.

Below are some highlights of legislative initiatives in various states regarding added protections for seniors investors. Any further questions related to Financial Exploitation of Senior investors should be directed to **Robert Herskovits, Esq. at robert@herskovitslaw.com or via telephone at 212-897-5410.**

State	Statute	Descriptions
Colorado	H.B. 1018 & S.B. 109	Expanded its mandatory reporting law to include adults with intellectual or development disabilities and clarified that financial institutions must report if a person directly observes abuse or exploitation.
Connecticut	S.B. 896 & S.B. 1005	Gave abused, neglected, exploited, or abandoned elderly people a civil cause of action and required certain financial agents to receive training on elderly fraud, exploitation and financial abuse
Georgia	H.B. 72	Included abuse, neglect and exploitation of disabled adults and elder persons as a racketeering activity.
Illinois	H.B. 1156, 1201, 1588, 3529, 3752, & 4109	Changed the civil liability provision of financial exploitation of an elderly or disabled person.
Maine	L.D. 1272 & 1348	Included financial exploitation in the definition of abuse.
New Jersey	A.B. 736, 738, 2461, 3948 & S.B. 205, 925, 203, 2762, 3182	Increased penalties for identify theft when victim is a senior citizen or veteran. Created new offense of theft by financial exploitation of a vulnerable person and the elderly.

New York	A.B. 83, 2176, 2325, 2481, 3305, 3743, 4467, 5336, 5969, 6555 6665, 7612 & S.B. 852, 262, 1417, 639, 148, 239, 530, 2289	Enacted the Elderly Abuse Protective Act relating to elderly abuse protective services. Included the financial exploitation of the elderly or disabled within the definition of the crime of larceny. Authorized banks to refuse payment of moneys when there is reason to believe that a vulnerable adult is being financially exploited.
North Carolina	H.B. 397 & S.B. 653	Clarified that upon conviction for exploitation of an elderly or disabled adult, any seized assets shall be used to satisfy the defendant's restitution obligation ordered by the court.

ABOUT THE AUTHOR

Since he began practicing law in 1996, Robert Herskovits has represented securities industry participants in a variety of litigation, arbitration and enforcement actions, first as associate general counsel to an NYSE broker-dealer firm, and later as an attorney and partner at various law firms.

Rob is a certified arbitrator for FINRA, AAA, and the NFA, and has participated in an estimated 200 arbitration proceedings before FINRA.

At the end of 2011, Robert formed Herskovits PLLC to provide legal representation to broker-dealers, investment advisors, securities industry professionals, and investors in securities litigation, securities arbitration and securities industry regulatory defense for matters appearing before FINRA and other self-regulatory bodies, as well as before the SEC, state securities authorities, and state and federal courts. In addition to dealing with regulatory matters, Robert provides representation in employment, contract, and general commercial litigation for these same financial services clients.

The impetus for founding his own firm was Robert's recognition that securities and financial services industry clients were not always being well-served by some of the larger law firms, particularly with regard to billing inefficiencies. He recognized that, sometimes, their large size and broad practice structure actually hindered them from constructing the hands-on, personal relationships necessary to truly understand their client's priorities and goals in representative matters.

He formed Herskovits PLLC to fill a void in the marketplace by offering clients involved in the securities profession experienced legal services while still recognizing and appreciating the budgetary limitations imposed on these businesses by a weak economy and a

constrained market.

Robert's insight is to provide a broad range of business-related services in a small-firm atmosphere, so that his clients do not have to deal with multiple firms or, alternatively, work with multiple attorneys at a single large firm who are unfamiliar with the particular concerns that securities industry participants face. Herskovits PLLC knows its clients, understands its clients' business, and provides its clients with offer cost-effective representation.

Robert is dedicated to providing legal expertise and advocacy that will empower his securities and financial services clients to operate their businesses and pursue their professions with as little disruption and cost as possible when faced with problems, whether they are customer or employee disputes, enforcement actions, or regulatory investigations.

Prior to forming Herskovits PLLC, Robert was a partner with Gusrae Kaplan Nusbaum PLLC, for more than five years.

Robert is the Co-Chair of the Committee for Securities and Exchanges of the New York County Lawyers' Association, and is admitted to practice in the States of New York and Mississippi and before various federal courts throughout the country, including the U.S. Supreme Court.