What's So Special About Seniors Anyway?

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Many in our industry may ask, "Is the "senior investor issue" anything more than a suitability issue?"[1] Although senior investor issues are primarily suitability issues, there is much more to consider if firms want to properly service their senior clientele. In this article, we discuss the relationship between firms and senior investors, we examine some firm best practices that have been cited with approval by regulators, and we forecast what will likely become "standard practices" when dealing with senior investors.

Overview

When we speak of senior investors, we define the group to include those at or near retirement, ***with assets that are or may be irreplaceable.*** To date there is only guidance on how to handle this demographic group. FINRA Notice to Members 07-43 ("NTM 07-43") was the first useful industry guidance to members searching for ways to construct a supervisory framework for sales to seniors. In NTM 07-43, there was no mandate to act, just a "reminder" to members that "age and life stage can be important factors," in determining the appropriateness of investments and that "firms should make sure that the procedures they have in place take these considerations into account where appropriate." [2] NTM 07-43 primarily focused on suitability and communications issues. FINRA suggested that a suitability assessment should include information on the customer's liquidity needs, expenses, sources of income, retirement savings and healthcare insurance.

FINRA also provided specific suggestions for firms by recommending the appointment of a senior designee (much like a firm's AML designee). Further, subject to privacy constraints, regulators encouraged the implementation of programs to involve seniors' families in investment decisions and the use of special training for staff to better understand and meet the needs of older investors.

A few months after NTM 07-43, the National Society of Compliance Professionals ("NSCP") released a white paper entitled "When the Baby Boom Era Becomes the Retirement Explosion". Therein, industry experts expanded upon the best practices proposed by NTM

07-43 and identified additional areas where firms could protect an aging client base. Specifically, NSCP discussed including the client's accountant or attorney in the decision making process, dissemination of customized documents for senior clients with an easy-to-read format, including an enlarged typeface, and consideration of a policy mandating client contact at the commencement of the customer relationship.

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What Firms Have Done to Address the Issues

As the crescendo built with numerous enforcement actions, warnings about "Free Lunch Seminars" and "Senior Specific Designations, the SEC, along with NASAA and FINRA**,** released a joint report at the Third Annual Senior Summit detailing results of an industry-wide poll on current activities participating firms had adopted to protect senior investors.[3] The report (available online at www.sec.gov) broadly speaking, indicated that firms have implemented, some if not all of the following processes:

1. Special Policies and Procedures

An undisclosed number of firms had established age-based restrictions on certain products or product features. Further, firms had reviewed or were in the process of reviewing and curtailing the use of proposed senior designations. Finally, firm(s) had developed firm-wide escalation procedures for suspected victimization of senior investors.

2. Communications with Seniors

The Joint Report indicated that there appeared to be a commitment to increased frequency of contact with senior investors. Conversations were documented in writing to assist in the event of a memory lapse or to help resolve any misunderstanding. Additionally, documentation could or would be sent to clients to confirm and reiterate what was discussed.

3. Training Firm Employees On Senior-Specific Issues

Various training programs were discussed and the use of hypothetical situations to illustrate the potential issues that securities professionals may encounter was suggested as was the creation of web-based modules focused on the following categories: diminished capacity, suitability, communicating with senior investors, advertising, the use of professional designations, and elder financial abuse. Finally, discussion was had relating to the collaboration of firms with gerontologists and other aging experts to help securities professionals understand and meet the needs of senior investors.

4. Training on How to Identify Declining Capacity

Additionally, the report discussed the prospect of providing agents with training on how to identify when clients appear to have declining capacity. For example, would an agent be aware that a client is suffering from declining capacity when the investor appears unable to process simple concepts, has memory loss, difficulty speaking or communicating or appears unable to appreciate the consequences of decisions? Additionally, having an escalation procedure when declining capacity is identified was also highlighted.

5. Conducting Senior-Focused Supervision, Surveillance and Compliance Reviews

Finally, firm(s) discussed restricting high-risk trading for investors over a certain age unless pre-approved, using exception reports to isolate activities and accounts for additional review, e.g., a commission-to-asset ratio above a certain percentage over a preceding period, trading losses above a certain level.

What Might be Coming in the Future?

Given the expanded approach to suitability, the first challenge for firms in dealing with seniors (as well as other investors) is to determine whether and to what extent to incorporate "life stage" considerations into interactions with customers and account documentation. For example, should the account opening documents be changed? Should professionals be required to gather information concerning clients' expenses? Is additional guidance on suitability needed? These are just some of the questions that firms should be asking themselves when assessing the adequacy of their suitability determinations and processes for bringing new clients to the firm.

In addition to this, on October 21 2008, FINRA released a "New Account Application Template," proposing that firms gather information such as annual expenses and special expenses. Traditionally, this information has not been collected and used in the context of a retail brokerage account application to assess the suitability of a product, suggesting that regulators have taken a more holistic approach to suitability that is closely tied into the "life stage" concept introduced by FINRA 07-43 and akin to those responsibilities of a fiduciary.

It is likely that FINRA will implement a very broad based rule requiring firms to have adequate policies and procedures to protect their senior investors. At that time it is likely that state regulators will have paved the way with additional requirements. Given the education provided to both firms and investors by regulators and the egregiousness of the cases publicized by regulatory enforcement agencies, our belief is that most firms will already have implemented the following procedures:

Client Education

Firms will provide clients with educational materials on topics that are important to senior investors such as fraud prevention, identity theft, retirement issues and useful public resources. This information may be provided in brochures, statement stuffers or posted on your firm's website.

Employee Education

Firms will provide specific training on issues as part of an on-going compliance program. Key topics of interest are suitability, fraud awareness, elder abuse, use and misuse of powers of attorney, diminished capacity, seminars and sales material and the proper use of professional designations.

Supervision

Firms' supervisory and surveillance resources will be used to pinpoint transactions, products, and activities that pose a greater degree of potential risk to senior investors (e.g., complex products, IRAs rolled over from qualified retirement plans, retirement seminars, concentrated positions, third-party discretionary accounts, insurance and annuity transactions, and products that don't make economic sense for a senior investor). Systems and reviews will be calibrated so that age is a component in generating exceptions or alerts. The firm's supervision and compliance modules will be the focus of regulatory review in the future.

Conclusion

Firms will continue to devote more resources to the senior investor because they should. The economics of the issue warrant it: there is more money in the senior client base than in any other. Adoption of best practices is a start, but, as with any other policy, it is the implementation and documentation of implementation that will keep firms out of harms way. In coming articles, we will examine the new regulatory initiatives as they happen and review enforcement cases to pull from them the lessons to be learned.

ENDNOTES

1 The views expressed in this article are those of the authors and not necessarily of their firms or the clients whom they represent.

2 The term "'life stage' refers to the key milestones in an investor's life, such as marriage, buying a home, saving for childrens' college education, preparing for retirement and retirement". (September 22, 2008 FINRA/NASAA/SEC Joint Report, p. 3).

3 *Protecting Senior Investors: Report of Examinations of Securities Firms Providing "Free Lunch" Sales Seminars* (SEC/NASAA/FINRA Sept. 2007); *Protecting Senior Investors: Compliance, Supervisory and Other Practices Used by Financial Services Firms in Serving Senior Investors* (FINRA/NASAA/SEC Sept. 2008).