Protecting Older Investors: The Challenge of Diminished Capacity

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As the Baby Boom Generation enters retirement, the incidence of Alzheimer's disease and other dementias will grow. Individuals in this generation and beyond will be largely responsible for their own retirement security—yet their ability to manage investments may decline due to diminished financial capacity. This report shares original research findings about financial services industry practices and protocols to address diminished capacity and makes recommendations for stakeholders and policy makers.

Diminished Capacity and the New Retirement Paradigm

As the population ages and the incidence of Alzheimer's disease and other dementias grows, an increasing number of older investors are at risk of having diminished capacity to transact business. Financial capacity is one of the first abilities to decline as cognitive impairment encroaches, yet older people, their families, and others are frequently unaware of these developing deficits.

With the shift from defined benefit to defined contribution plans and other forms of do-it-yourself retirement, good financial advice is critically important.

Investment advisers, brokers, insurance agents, and others selling an array of financial products must be equipped to respond appropriately when a client or potential client signals that he or she may lack the capacity to make financial decisions. Cognitively impaired investors are at risk for financial exploitation, and this threat underscores the need to equip business, government, and others with appropriate tools.

Key Findings

A survey of advisors and compliance officers from the securities, investment advice, and life insurance industries, as well as an expert roundtable, revealed the following:

- Most respondents find that diminished capacity is a problem for financial professionals and their firms.
- Most firms have protocols to address diminished capacity. The most frequently cited were ascertaining whether a client has a power of attorney and keeping it up-to-date.
- Frontline advisors and compliance officers do not agree on which transactions to hold while resolving concerns about diminished capacity. Most advisors said they hold all transactions, while only a third of compliance officers agreed. Another third of advisors said they hold only transactions detrimental to the client.
- Financial professionals think that training on diminished capacity should be required by firms, but it is not.

Advisors say most firms offer them resources for dealing with clients who may have diminished capacity, including access to experts, written materials, and Web-based training. Heavily used resources for financial advisors focus on financial exploitation and liability.

Compliance officers are concerned about privacy, legal issues, and liability, including determining whether the client has capacity to authorize transactions, determining whether a fiduciary has authority to act on a client's behalf, and preventing financial abuse of the client.

Advisor practices reflect concerns about financial exploitation of their clients. These practices include monitoring account activities to detect possible abuse by agents under power of attorney, and requiring that clients continue to receive documentation of transactions even when an agent has taken over the account.

Key Practice and Policy Solutions

The report's recommendations fall broadly into five categories, depending on which stakeholder should consider the recommendation.

Firms should:

- require training;
- establish protocols, including procedures for worst case scenarios;
- develop privacy policies that balance client privacy with the need to protect clients' interests; and
- monitor accounts to guard against fiduciary abuse.

Industry associations should:

- develop ethical standards for when advisors can take "protective action";
- develop and disseminate industry-specific training modules; and
- work in public/private collaboratives (including state and federal administrative agencies).

Legislators and regulators should:

- require continuing education for a spectrum of financial professionals;
- clarify privacy regulations; and
- strengthen power of attorney laws to promote acceptance while guarding against abuse.

Consumer and professional groups should:

- provide public education for older investors, family members and caregivers on the importance of advance planning, red flags for diminished capacity and financial exploitation; and
- educate fiduciaries (such as agents under a power of attorney) on how to handle the finances of the person who has appointed them.

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