

AARP Public Policy Institute



Protecting Older Investors: The Challenge of Diminished Capacity

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Research Report

AARP[®]

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AARP's Public Policy Institute informs and stimulates public debate on the issues we face as we age. Through research, analysis and dialogue with the nation's leading experts, PPI promotes development of sound, creative policies to address our common need for economic security, health care, and quality of life.

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EXECUTIVE SUMMARY

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. 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 urgent need to equip business, government, and the aging network with appropriate interventions.

Diminished Financial Capacity and Implications for the Financial Services Industry

Financial capacity is “the capacity to manage money and financial assets in ways that meet a person’s needs and which are consistent with his/her values and self-interest.”¹ It encompasses such core skills as identifying and counting money, understanding debt and loans, conducting cash transactions, paying bills, and maintaining judgment to act prudently and avoid financial exploitation. Financial capacity is one of the first abilities to decline as cognitive impairment encroaches, yet older people, their families, and others are frequently unaware that these deficits are developing. Declining skills are detectable before cognitive impairments progress to a diagnosis of Alzheimer’s disease. Once an individual has mild Alzheimer’s, skills such as understanding investment options and determining returns decline rapidly.

Because these impairments can appear subtle but progress quickly, planning ahead for possible incapacity—such as setting up powers of attorney, joint accounts, and trusts—is critical. Preventing financial exploitation is vital for those with diminished capacity because they are vulnerable to fraud and abuse. Studies show that the prevalence of financial exploitation is high; a 2011 study estimated that older victims lose \$2.9 billion annually.

With the shift toward defined contribution retirement plans and the growing complexity of the financial services industry, good financial advice has become critically important to investors approaching or in retirement. Older investors are served by individuals with a variety of licenses and registrations who recommend or sell a complex array of investment products.

Financial professionals, like investors, face new challenges as their clients age. The issues they face include—

- the appropriateness of investment products,
- effective communication with older clients who may have physical or sensory challenges,
- diminished capacity to make decisions and execute transactions, and
- the potential for fraud and abuse by trusted family members, friends, or strangers.

¹ D. C. Marson, K. Hebert, and A. Solomon, “Assessing Civil Competencies in Older Adults with Dementia: Consent Capacity, Financial Capacity, and Testamentary Capacity,” in *Forensic Neuropsychology: A Scientific Approach*, 2nd ed., ed. G. J. Larrabee (New York, NY: Oxford University Press, forthcoming), 401–437.

Regulators, self-regulatory organizations, trade groups, and individual financial services companies have begun to grapple with senior investor issues and the challenges of diminished capacity specifically. The extent to which the industry is prepared for the age boom is unknown. AARP's Public Policy Institute undertook this study to assess financial services professionals' awareness of diminished financial capacity and current industry practices and protocols for serving cognitively impaired clients. This report, which is based on a literature review, a survey of frontline financial advisors and compliance officers, and dialogue at a multidisciplinary roundtable, provides a snapshot of the current state of practice and proposes avenues for developing policy and practice solutions to protect vulnerable investors.

Key Findings

A survey of 360 financial advisors and 166 compliance officers from various types of firms, along with an expert roundtable, revealed the following:

The Problem

Most financial professionals report that diminished capacity is a problem for them or for their firms.

- Advisors recognize signs of diminished capacity exhibited by their clients, although the extent of their baseline knowledge of signs of diminished capacity is unclear.

Industry Protocols and Practices

Most firms have protocols for action when an advisor suspects diminished capacity.

- The most frequently cited protocols and practices offered by firms were ascertaining whether a client has a power of attorney, and including a power of attorney in a client's file and keeping it up-to-date. At least two-thirds of respondents also made a practice of discussing powers of attorney with clients and asking clients to bring a trusted person once the advisor notes signs of diminished capacity.
- Most advisors would contact their supervisor or compliance department when deciding how to proceed.
- Protocols require advisors to escalate the case—reach out to their supervisor or compliance department—when clients lack an emergency contact, agent under power of attorney, or other fiduciary.
- Most advisors say protocols require them to stop making sales recommendations when they suspect diminished capacity.
- The majority of advisors hold all transactions while awaiting direction from firm experts, although about a third hold only transactions detrimental to the client. Compliance officers disagree—only about a third of compliance officers said that advisors should hold all transactions.
- About half of advisors say that they themselves are authorized to decide whether to contact a third party about a client with suspected diminished capacity—but most compliance officers say the advisor is not the primary decision-maker about contacting third parties.

- When advisors escalate the case to the compliance department, almost all compliance officers would contact the agent under power of attorney, emergency contact, or other fiduciary while continuing to discuss or monitor the account with the advisor. Over half would stop making sales recommendations until the concern about capacity is resolved.

Training and Resources

Although an overwhelming majority of advisors and compliance officers said companies should require training on diminished capacity, only a third of advisors (and a quarter of compliance officers) said their companies require such training.

- Advisors say most firms offer them resources for dealing with clients who may have diminished capacity. The resources most frequently available include access to a legal expert; articles, brochures, or other written materials; and Web-based training (although compliance officers report access to Web-based training in far lower numbers).
- The most heavily used resources focus on financial exploitation and liability concerns, and users identified these as the “most useful” resources.

Privacy and Liability Issues

Firms have privacy, legal, and liability concerns regarding clients with diminished capacity.

- Firms find privacy rules a challenge when dealing with diminished capacity, although most compliance officers responding to the survey did not hear concerns about privacy from advisors very often.
- Compliance officers have major concerns about legal and liability issues, including (1) determining whether the client has capacity to authorize transactions; (2) carrying out requested transactions that are potentially detrimental to the client; (3) heirs bringing lawsuits for transactions carried out when the client lacks capacity; (4) determining whether a fiduciary (e.g., agent under power of attorney) has authority to act on a client’s behalf; and (5) financial abuse by family, friends, fiduciaries, and others.

Protecting Against Financial Exploitation

Advisors monitor accounts to protect clients after fiduciaries take over the decision making.

- Eighty-six percent of advisors would monitor account activities to detect possible abuse by an agent under power of attorney.
- Three-quarters would require confirmations and account statements be sent to the client as well as the agent.
- Half would use signature-checking procedures.

Practice and Policy Solutions

Individual firms, industry groups, regulators, administrative agencies, and others should consider taking the following steps to better serve vulnerable investors whose ability to transact business is impaired.

Individual firms:

- Require training on an array of diminished capacity issues.
- Establish firm protocols if none exist, including procedures for “worst case scenarios.”
- Develop or modify firm privacy policies to maximize client privacy while exercising damage control.
- Monitor accounts after a fiduciary takes over.
- Engage in dialogue and collaboration with state agencies and regulators.

Industry associations:

- Develop, refine, and publicize “best practices.”
- Develop ethical standards for when advisors can take “protective action.”
- Create interdisciplinary and public/private collaboratives to address key issues.
- Develop and disseminate industry-specific training modules on diminished capacity.
- Collaborate on producing handbooks on diminished capacity for financial professionals.

Legislators and regulators:

- Require continuing education on diminished capacity for a broad spectrum of financial professionals.
- Clarify federal privacy regulations.
- Develop model regulations on compliance with state privacy laws.
- Enact or strengthen legislation to promote acceptance of powers of attorney while preventing, detecting, and redressing power of attorney abuse.

Federal and state administrative agencies:

- Reach out to financial community.
- Study additional issues and convene groups. (The Securities and Exchange Commission and the Consumer Financial Protection Bureau can play this role.)

Consumer and professional groups:

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

INTRODUCTION

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 advisors, 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. The potential for financial exploitation of cognitively impaired investors underscores the urgent need to equip business, government, and the aging network with appropriate interventions. Financial services professionals—and industry regulators—struggle to define their roles in dealing with individuals with diminished capacity. They need to increase their knowledge base as well as their policy and practice solutions.

AARP’s Public Policy Institute undertook this study to assess financial services professionals’ awareness of diminished financial capacity, and current industry practices and protocols for serving clients who may lack the ability to make financial decisions. This report, which is based on a literature review, a survey of frontline financial advisors and compliance officers, and dialogue at a multidisciplinary roundtable, provides a snapshot of the current state of practice. It proposes avenues for developing policy and practice solutions to protect vulnerable investors.

Working with Mrs. Maple

Mrs. Maple is a 75-year-old widow who has been doing business with Mr. Green at Willow Securities for 15 years. Mrs. Maple has always had a pattern of conservative investment and uses the monthly investment income to supplement her Social Security check. She enjoys face-to-face meetings with Mr. Green every couple of months.

Last week Mrs. Maple called Mr. Green, sounding very agitated, to complain that she only received \$1,000 in her monthly check from Willow. She angrily stated that someone must be stealing her money because she should be getting \$2,500. She fretted that she wouldn’t be able to pay her bills. Mr. Green calmly reminded her that she has been receiving \$1,000 per month over the past year and a half.

The next day Mrs. Maple called again to complain that Mr. Green hadn’t shown up at the diner for their coffee date. Mr. Green reminded her that they’d met the previous week. Mrs. Maple sheepishly said “Oh, I keep forgetting things lately.” She also mentioned that a new friend who is helping her out told her about a great new social media company—she couldn’t remember the name—and that she wanted to buy a thousand shares to get in on the action and make lots of money. Mr. Green said he didn’t think that kind of investment fit in with her investment goals. Mrs. Maple said “I’m coming in tomorrow so we can take care of this”—and then she didn’t show up. But a few days later she came into the office, looking disheveled, and seemed to be happy with her current portfolio of investments.

Mrs. Maple has no children. Willow Securities is unaware of any power of attorney she may have created, nor is there an emergency contact listed on the account.

Mr. Green faces a number of questions and challenges in providing services to Mrs. Maple and handling her account. Is her ability to manage her finances impaired? If so, is the impairment due to ongoing cognitive decline or a temporary condition that may be

corrected by medication or other treatment? Can Mr. Green contact a third party, such as a relative or a state agency, to report his concerns? If Mrs. Maple can no longer handle her investment decisions, does she have a legally authorized agent or surrogate to take over the account? Who can Mr. Green approach for help within his company, and what is the company protocol? How should he handle transactions while he is sorting out these issues? Is Mrs. Maple vulnerable to financial exploitation, and can Mr. Green do anything to protect her assets? How can Mr. Green and his colleagues prepare themselves for the next Mrs. Maple?

BACKGROUND

Demographics and Disability

Ongoing demographic trends will sharply boost the number of people with cognitive impairments in the coming years. The older population (65+) numbered 39.6 million in 2009. As the boomers come of age, the older population will spiral, reaching 55 million by 2020. Within the older population, the number of “old old” (age 85+) is growing especially rapidly—and is expected to reach 6.6 million by 2020.²

At the same time, Alzheimer’s disease and related dementias are becoming more prevalent. In 2011, an estimated 5.4 million people in the United States have Alzheimer’s disease. One out of eight people age 65+ has Alzheimer’s and nearly half of Americans over age 85 suffers from it.³ By 2050, the number of Americans 65 and older with Alzheimer’s will likely hit 13.5 million. In addition, 20 to 40 percent of dementia cases are caused by medical conditions besides Alzheimer’s disease, such as vascular dementia and Parkinson’s disease.⁴

Even among those without dementia, mild cognitive impairment affects about 22 percent of those aged 71 and older—approximately 5.4 million Americans.⁵ Cognitive impairment contributes to decreased quality of life, increased neuropsychiatric symptoms, and increased disability.

Older Investors and the New Retirement Paradigm

Individual investors have become more responsible for their own retirement security with the shift from employer-sponsored defined-benefit plans to defined-contribution retirement plans. This shift, which began around 1980, coincided with the development of a more complex financial services industry. Individuals approaching and in retirement bear not only the risk of loss but also the responsibility for choosing investments. In this environment, good financial advice and the ability to comprehend it become even more important.

Like other investors, older investors buy an array of financial products and are served by individuals with a variety of licenses and registrations. The financial services industry could more accurately be described as several distinct industries that compete to serve the investing public. The banking, securities, and insurance industries all offer products to help people invest for retirement. The industries are generally regulated based on the products and services they offer. The financial services industry could be more accurately described as several separate and distinct industries—the securities industry, which includes brokers and investment advisers; the insurance industry, which includes the life insurance industry; and the banking industry. The Gramm-Leach-

² U.S. Administration on Aging, *A Profile of Older Americans: 2010*, http://www.aoa.gov/AoARoot/Aging_Statistics/Profile/index.aspx, retrieved April 19, 2011.

³ Alzheimer’s Association, *2011 Alzheimer’s Disease Facts and Figures*, http://www.alz.org/downloads/Facts_Figures_2011.pdf, retrieved April 19, 2011.

⁴ Ibid.

⁵ B. L. Plassman et al., “Prevalence of Cognitive Impairment without Dementia in the United States,” *Archives of Internal Medicine* 148, no. 6: 427–34.

Bliley Act of 1999 broke down barriers between banks and other financial services firms and allowed banks to offer securities and insurance products in their branches. Bank employees who sell securities or insurance products must have the appropriate securities or insurance license.

The individuals who work as advisors are usually identified by one of the professional titles listed in the box below, although they may have more than one title. For example, a person may be both a registered representative of a brokerage and a life insurance agent.

Advisors Have Different Regulators, Offer Different Products, and Work in Different Organizations

Professional Titles	Regulator	Products/ Services Offered	Where They Work
Securities Brokerage Firm Representatives	SEC, FINRA, State Securities Regulators	Securities products, including stocks, bonds, investment companies (e.g., mutual funds), and variable contracts (e.g., variable annuities)	Large, national brokers (sometimes called wire houses), regional brokers, smaller offices as representatives of large or regional brokerages, or even banks (working as broker representatives)
Investment Advisor Firm Representatives	SEC, State Securities Regulators	Primarily provide investment advice; may make investments on their clients' behalf, including securities and insurance products	Large firms, including large securities firms Smaller firms with only a few employees or even as proprietors of their own firms
Life Insurance Agents/Producers	State Insurance Regulators	Sell life insurance products, including fixed and indexed annuities	Captive agents – working for and selling products of only one firm Independent agents – authorized to sell products from more than one life insurance company Employees or agents of an independent marketing organization – may have a contract to sell the insurance products of one or more insurance companies

Note: SEC = Securities and Exchange Commission; FINRA = Financial Industry Regulatory Authority.

Large firms, especially those in the securities industry with its heavy reliance on prescribed rules of conduct, are more likely to have dedicated compliance departments, staffed with professionals who help ensure their firms' compliance with applicable laws and regulations. Investment adviser firms registered with the U.S. Securities and Exchange Commission (SEC) are also required to have a chief compliance officer.

The SEC is the primary regulator of the securities industry. Federal securities law requires brokers and their representatives to register with a self-regulatory organization

(SRO). The primary SRO for the securities industry is the Financial Industry Regulatory Authority (FINRA). Securities include stocks, bonds, mutual funds (which may include a combination of stocks, bonds, and other investments), and even variable annuities (which share some features with mutual funds, but have different tax treatment, withdrawal penalties, fees, risks, and expenses, and may often include guarantees and other insurance features).⁶ Investment advisers, who give financial advice and may manage the investments of others, are regulated either by the SEC or the states, depending on the amount of assets they manage. In addition, representatives of broker-dealers and investment advisers must register with or be licensed by state securities regulators; registrants and licensees are subject to examination to ensure compliance with state securities laws.

The life insurance industry is regulated by the states. It offers annuities, which have features that act like an investment as well as features that act like insurance. The states exclusively regulate fixed annuities and indexed annuities (whose returns are indexed to something like the S&P 500). The states also share responsibility for regulating variable annuities with the SEC, with the states regulating the life insurance company's activities and, in some states, the activities of variable annuity sellers. The life insurance industry also offers various life insurance products with savings and investment components.

Privacy obligations of financial services firms and their representatives come into the spotlight when cognitive impairments threaten the ability of older investors to handle their investments. All financial professionals are required to protect the privacy of their clients. Industry privacy regulations can even prohibit revealing that an individual *is* a client. For example, many states prohibit revealing that an individual has purchased life insurance. Revealing that an individual is a client can also violate Regulation S-P, the main source of federal privacy regulation for broker-dealers and federally registered investment advisers.

The Model Regulation on Privacy of Consumer Financial and Health Information adopted by the National Association of Insurance Commissioners (NAIC), on which many state privacy regulations are based, is similar to Regulation S-P. The NAIC Model Regulation governs the actions of insurers, their agents, and other entities licensed under a state's insurance laws.

Under Regulation S-P and the NAIC Model Regulation, broker-dealers, registered investment advisers (RIAs), insurers, and insurance agents may not disclose nonpublic personal information about a consumer to a nonaffiliated third party unless they meet the following conditions:

1. Have a privacy policy and provide the consumer with a notice about the privacy policy;
2. Have provided the consumer a required opt-out notice;

⁶ Even though variable annuities are offered by life insurance companies, they must be sold through brokers and their representatives registered by the SEC and FINRA.

3. Have given the consumer a reasonable opportunity to opt out of any disclosures to nonaffiliated third parties before the disclosure; and
4. The consumer does not opt out.⁷

There are exceptions to these rules, including the exception to Regulation S-P to prevent actual or potential fraud, unauthorized transactions, claims, or other liability.⁸ There are also exceptions for disclosures to people who hold a legal or beneficial interest relating to the consumer and to people acting as a fiduciary or representative capacity on the consumer's behalf.⁹ The NAIC Model Regulation has exceptions and limitations that are analogous to Regulation S-P exemptions.

Regulation S-P and the NAIC Model Regulation were adopted to comply with the Gramm-Leach-Bliley Act's provisions governing the sharing of personal information with nonaffiliated third parties as the Act broke down barriers between the banking, insurance, and securities industries. Neither Regulation S-P nor the NAIC Model Regulation was intended to deal with contacting a family member or social services agency when a customer has shown signs of diminished capacity; therefore, neither has an express exception governing a client's suspected diminished capacity. However, firms may be able to mitigate any potential application of these regulations by asking for an emergency contact and incorporating within their privacy policies a notice that the firm will contact that person in the event of emergency.¹⁰

Financial Capacity

Capacity is not an all-or-nothing concept—it is specific to the task at hand. Capacity also fluctuates over time—mental abilities vary in the course of a day depending on stressors and energy level, and fluctuations occur even in adults diagnosed with dementia. In everyday legal practice, the definition of “diminished capacity” depends largely on the type of decision or transaction under consideration.¹¹ Thus, in the financial services context, the legal determination would focus on the capacity to transact certain business, such as understanding personal financial needs and goals, understanding investment and product choices, contracting for the purchase of a particular product, or giving a particular professional the discretion to manage an account. Similarly, a clinician, such as a physician or mental health professional, looks at a “domain”-specific model of capacity. Domain refers to a cohesive area of cognitive or functional behavior. Financial capacity is one such domain model, and a clinical assessment examines the functional abilities important for handling financial transactions. Other examples of domains include “consent capacity” (functional abilities needed for medical decision making) and “independent living capacity” (skills that enable the individual to live independently and be safe).¹²

⁷ See Regulation S-P, §§ 248.4, 248.10.

⁸ Regulation S-P, § 248.15 (a)(2)(ii).

⁹ Regulation S-P, § 248.15(a)(2)(iv) and (v).

¹⁰ The firm would then be complying with its privacy policy, which is incorporated within the rule.

¹¹ American Bar Association Commission on Law and Aging and American Psychological Association, *Assessment of Older Adults with Diminished Capacity: A Handbook for Lawyers* (2005).

¹² *Ibid.*, 11–12.

Recent research helps define financial capacity. It is “the capacity to manage money and financial assets in ways that meet a person’s needs and which are consistent with his/her values and self-interest.”¹³ Financial capacity comprises a range of knowledge, performance, and judgment skills acquired over a lifetime. These core skills include basic monetary abilities such as identifying and counting money, understanding debt and loans, conducting cash transactions, paying bills, and maintaining judgment to act prudently and avoid financial exploitation.¹⁴

Financial capacity is one of the first abilities to decline as cognitive impairment encroaches, yet patients and their families often are unaware that these deficits are developing. Declining financial skills can be detected in people with mild cognitive impairment in the year before they have progressed to a diagnosis of Alzheimer’s disease.¹⁵ Once the diagnosis progresses to Alzheimer’s, financial capacity declines rapidly. For example, one study showed that 48 percent of subjects with mild Alzheimer’s could understand investment options and determine returns, but one year later just 26 percent were fully capable of doing so. Tests of financial judgment, indicating vulnerability to financial scams and other types of exploitation, also show marked and rapid decline among people with mild Alzheimer’s disease.¹⁶

While this report focuses on people with diagnosable cognitive impairments that result in impaired financial decision making, financial abilities decline even before mild cognitive impairment. With age, adults experience substantial diminution in cognitive function that affects financial decision making. Evidence indicates that, after peaking in middle age, the ability to make effective financial decisions declines. A study of life-cycle patterns in financial mistakes based on 10 types of credit transactions concluded that the mean age at which financial mistakes are minimized is 53.3 years, after which performance goes steadily downhill.¹⁷ (Of course, these generalized findings about advances and declines in financial decision making cannot be applied to each individual—many older people retain their financial acuity into advanced age, and the interplay of different types of financial acumen is complex.)

Implications for Older People and Their Families

Because impairments to financial capacity can appear subtle but can then progress rapidly, planning ahead for possible incapacity is critical. Elder law attorneys and estate planners are key players in providing guidance about advance planning for financial decision making, but primary care clinicians and others can also play an important role

¹³ Marson et al. (forthcoming).

¹⁴ E. Widera, V. Steenpass, D. Marson, and R. Sudore, “Finances in the Older Patient with Cognitive Impairment: ‘He Didn’t Want Me to Take Over,’” *Journal of the American Medical Association* 305, no. 7: 698–706.

¹⁵ K. L. Triebel et al., “Declining Financial Capacity in Mild Cognitive Impairment,” *Neurology* 73 (2009).

¹⁶ R. Martin et al. “Declining Financial Capacity in Patients with Mild Alzheimer Disease: A One-Year Longitudinal Study” *American Journal of Geriatric Psychiatry* 16, no. 3 (2008).

¹⁷ S. Agarwal, J. C. Gibson, X. Gabaix, and D. Laibson, *What Is the Age of Reason?* (Chestnut Hill, MA: Center for Retirement Research at Boston College, 2010).

in detecting impaired financial capacity and referring people to appropriate services.¹⁸ Advance planning tools include joint bank accounts and durable powers of attorney, both of which are relatively simple and allow individuals to choose people to help manage their finances privately, without court involvement. People with mild cognitive impairment or even mild Alzheimer's disease may retain the capacity to designate a trusted person as their financial agent even if they can no longer handle some of their own business transactions.

Advance planning tools such as powers of attorney, joint accounts, and trusts are often referred to as alternatives to guardianship. Guardianship is a relationship created by state law in which a court gives one person or entity (the guardian) the duty and power to make personal and/or property decisions for another (the incapacitated person or ward). A judge appoints a guardian upon finding that an adult lacks capacity to make decisions for him or herself. Guardianship is seen as a last resort, since it takes away basic rights, is time-consuming and expensive, and may put a decision maker in place who has no previous relationship with the incapacitated person. Powers of attorney promote autonomy, although they involve some risk to the person creating the arrangement because they transfer substantial authority to the agent with no court or other oversight. Because of this risk, they are sometimes called “licenses to steal.”¹⁹

Preventing financial exploitation is vital for those with diminished capacity due to their vulnerability to fraud and abuse. Elder mistreatment incidence and prevalence data are scarce, but recent studies show that abuse is widespread and under-reported. A recent national study indicates that one in ten older adults is a victim of mistreatment, with 5.2 percent experiencing financial mistreatment by a family member—and the survey respondents were all cognitively intact.²⁰

On a statewide level, an extensive New York State study of people age 60 and over found that the one-year incidence of any form of abuse was 76 per 1,000. The highest rate of mistreatment was major financial exploitation, with a rate of 41 per 1,000 surveyed. Respondents reported theft of money or property, items being used without permission, impersonation to get access, and forcing or misleading to get items such as money, bank cards, accounts, and power of attorney. Reported cases were the “tip of the iceberg;” the New York survey's documented elder abuse incidence rate was nearly 24 times greater than the number of cases referred to social service, law enforcement, or legal authorities.²¹ Both of these studies excluded or under-included older people with

¹⁸ C. P. Sabatino, “Damage Prevention and Control for Financial Incapacity,” *Journal of the American Medical Association* 305, no. 7: 707–8.

¹⁹ For additional information on powers of attorney and how they can be abused, see L. A. Stiegel, and E. V. Klem, *Power of Attorney Abuse: What States Can Do About It* (Washington, DC: AARP Public Policy Institute, 2008).

²⁰ R. Acierno, M. A. Hernandez, A. B. Amstadter, H. S. Resnick, K. Steve, W. Muzzy, and D. G. Kilpatrick, “Prevalence and Correlates of Emotional, Physical, Sexual and Financial Abuse and Potential Neglect in the United States: The National Elder Mistreatment Study,” *American Journal of Public Health* 100 no. 2: 292–7.

²¹ Lifespan of Greater Rochester, Inc., et al., *Under the Radar: New York State Elder Abuse Prevalence Study* (Rochester, NY: Lifespan of Greater Rochester, Inc., May 2011).

cognitive impairments, and it is quite likely that rates of financial exploitation are higher for this population.

The Investor Protection Trust surveyed older people and children of seniors about financial exploitation in 2010. They found that 20 percent of Americans aged 65 or older—more than 7.3 million senior citizens—already have “been taken advantage of financially in terms of an inappropriate investment, unreasonably high fees for financial services, or outright fraud.” About 15 percent of children of people 65 and older think their parents have been financially abused, and 40 percent worried that they “have already become or will become less able to handle their personal finances over time.”²²

Finally, a 2011 study estimated the annual financial loss by victims of elder financial abuse in 2010 at \$2.9 billion.²³ This represents a 12 percent increase over the estimate for 2008.

Implications for the Industry

With the aging of the population, an increasing number of investors will need advice and guidance from financial services firms. As of 2010, baby boomers owned more than \$15 trillion of financial assets²⁴ and held 60 percent of mutual fund assets in the United States.²⁵ Thus, older clients will make up a significant and increasing proportion of the market for a diverse set of financial products. With that client base, firms need to deal with a range of issues affecting senior investors, including the following:

- the appropriateness of products,
- effective communication with older clients who may have physical or sensory challenges,
- diminished capacity to make decisions and execute transactions, and
- the potential for fraud and abuse by trusted family members, friends, or strangers.

Regulators, self-regulatory organizations, trade groups, and individual financial services companies have begun to grapple with senior investor issues—and the challenges of diminished capacity specifically. Recognizing the growing importance of the topic, Fidelity Investments commissioned a survey of financial advisors and trust officers in 2009 on advisors’ experience with Alzheimer’s disease. Harris Interactive fielded this online survey of 369 advisors from April 14-22, 2009. Key findings include the following:

- The great majority of advisors have been exposed to Alzheimer’s disease through their client base (including the clients themselves and the clients’ parents, in-laws, and spouses). Only 16 percent of advisors surveyed had not had any exposure to Alzheimer’s through their client base.

²² Infogroup/ORC. *Elder Investment Fraud and Financial Exploitation: A Survey Conducted for Investor Protection Trust* (Washington, DC: Infogroup/ORC, June 15, 2010), http://www.investorprotection.org/downloads/pdf/learn/research/EIFFE_Survey_Report.pdf.

²³ *The MetLife Study of Elder Financial Abuse: Crimes of Occasion, Desperation, and Predation against America’s Elders* (New York, NY: MetLife, June 2011).

²⁴ AARP Public Policy Institute estimate based on data obtained from the Survey of Consumer Finances 2007.

²⁵ D. Sabelhaus, M. Bogdan, and D. Schrass, “Characteristics of Mutual Fund Investors 2010,” *Investment Company Institute Research Fundamentals* 19, no. 7: 10, <http://www.ici.org/pdf/fm-v19n7.pdf>.

- While a majority of advisors do plan in advance, four out of ten deal with the issue only when the need arises. Fifty nine percent said “we plan in advance with all clients to be prepared in case this happens, and 41 percent said “we set up the appropriate mechanisms as the need arises.”
- The top three ways that advisors said they would change the way they manage the relationship if they suspect the client suffers from Alzheimer’s are have spouse/family participate in decision-making (87 percent); have activities/decisions confirmed/well documented (81 percent); and execute a power of attorney (34 percent).
- Financial advisors are looking for a broad range of resources to help them feel more prepared, with “best practice guidelines, recommendations, and research” leading the list.²⁶

The SEC, FINRA, and the North American Securities Administrators Association (NASAA) collaborated on a report on protecting senior investors, issued in September 2008.²⁷ The report summarizes practices voluntarily shared by securities professionals, financial services firms, and industry groups. Key practices relevant to diminished capacity fell into seven categories.

1. Supervisory and compliance structure (e.g., developing escalation procedures and internal processes that permit financial professionals to obtain advice from others within the firm on next steps; consolidating relevant information into one website).
2. Communication with investors (e.g., educating investors about the benefits of advance planning; documenting conversations with investors).
3. Training on how to identify diminished capacity (including identification of “red flags”).
4. Internal process for escalating issues and taking next steps.
5. Obtaining information at account opening (i.e., identifying third-party emergency contact)
6. Practices to address risks of power of attorney abuse.
7. Senior-focused supervision, surveillance, and compliance reviews.

FINRA has developed a training module to educate registered representatives on ways of identifying, working with, and responding to senior investors with potential diminished—or diminishing—decisional capacity. The training module, titled “Senior Investor Issues: Diminished Decisional Capacity,” is available on FINRA’s website as an E-Learning course.²⁸ Available to member and nonmember firms for a fee, the course provides detailed information on what diminished capacity is, how a financial services

²⁶ Fidelity Investments, *Financial Advisor Alzheimer’s Study: Selected Findings for AARP Roundtable – November 16, 2010* (Unpublished PowerPoint presentation).

²⁷ FINRA, SEC, and NASAA, *Protecting Senior Investors: Compliance, Supervisory and Other Practices Used by Financial Services Firms in Serving Senior* (September 22, 2008). An addendum was issued on August 12, 2010.

²⁸ www.finra.org; <http://www.sec.gov/divisions/marketreg/seniorinvestors.htm>.

professional can recognize it, and how to proceed when the issue arises. Detailed case scenarios bring the issue to life, and quizzes reinforce the messages.

State securities regulators are working with medical professionals to improve identification of diminished financial capacity and vulnerability to financial exploitation. Through the Elder Investment Fraud and Financial Exploitation prevention program, 24 securities regulators will train thousands of medical professionals about how to spot older Americans who may be particularly vulnerable to investment fraud and abuse.²⁹ Through collaboration with adult protective services agencies, health-related organizations, and financial professional groups, the program aims to increase recognition of diminished capacity and referrals for intervention.

²⁹ *Tackling Investment Swindles of Seniors as a Medical Problem: 24 Securities Regulators Across U.S. to Train Doctors to Spot & Report Elderly Financial Victimization*; http://www.investorprotection.org/downloads/pdf/learn/press/EIFFE-PP_Press_Release_11-17-10.pdf; P. Span, "When Dementia Drains the Pocketbook," *New York Times*, The New Old Age blog (February 28, 2011), <http://newoldage.blogs.nytimes.com/2011/02/28/when-dementia-drains-the-pocketbook/>.

METHODOLOGY

In order to better understand financial services professionals' awareness of diminished financial capacity and current practices, AARP commissioned a survey of 166 compliance officers and 360 advisors.³⁰ Advisors included life insurance agents, representatives of brokers, and representatives of investment advisers. Advisors who responded worked at investment adviser firms, large national broker-dealers, regional broker-dealers, life insurance companies, and banks (all referred to in this report as "advisors"). Some of the types of advisors in the sample may not have stand-alone compliance departments in their organizations, especially if the organizations are small. Compliance officers surveyed were drawn from a list supplied by FINRA.³¹ The survey was conducted by telephone and online between August 19 and October 4, 2010. The margin of error for advisors was +/-5.2%. For compliance officers, the margin of error was +/-7.6%.

The questions posed to advisors and compliance officers addressed the same topics, with slight variations due to the distinct roles of the two sets of respondents. The topics included the following:

- degree of challenge posed to individual practice by diminished capacity,
- recognition of "red flags" for diminished capacity,
- firm's protocols for responding to diminished capacity,
- access to and use of resources and training,
- practices in specific circumstances involving diminished capacity of client,
- for compliance officers, development of firm's protocols and actions pursuant to protocols, and
- for compliance officers, legal concerns raised by specific situations involving diminished capacity.

In this report, when comparing responses of advisors and compliance officers, all differences are significant unless otherwise noted. The same is true when comparing responses of types of advisors.

After completion of the survey, content analysis, and initial findings, the Public Policy Institute convened a multidisciplinary, one-day roundtable of experts to review the survey results and to exchange information about financial services firms' protocols, liability concerns, and financial exploitation. Participants discussed potential policy and legal remedies, and education for the industry, consumers, and family members. Roundtable participants included counsel and compliance officers from advisor firms, elder law experts, state and federal regulators, representatives of self-regulatory organizations and industry associations, gerontologists, consumer organization staff, a neuropsychologist, and a representative of the organization of state adult protective services agencies.

This report includes the survey findings as well as key discussion points and recommendations from the roundtable.

³⁰ In this report, we use the generic term "advisor" (with an "o") to refer to financial sales professionals regardless of the type of license they or their organization holds. The term "investment adviser" (with an "e") refers to a person, including a firm, registered either with the SEC or a state under the Investment Advisers Act.

³¹ Companies report a list of key officers, including compliance officers, to FINRA.

FINDINGS

At most financial services firms, front-line salespeople—referred to here as advisors—are the first to notice that a client may be showing signs of diminished decision-making capacity. These individuals often have regular contact with the client. They are most likely to notice that a client is demonstrating early warning signs of diminished capacity, such as giving confusing or conflicting instructions regarding a transaction, frequently repeating orders or questions, or seeming to have trouble understanding financial terms or concepts. Compliance officers have an important role to play as well. AARP's survey of these two sets of financial professionals and the discussion at AARP's interdisciplinary roundtable yielded key findings on the current landscape.

The survey findings show differences between the compliance professionals and advisors, but they also showed differences between advisors in different settings. For purposes of analysis, the advisors have been combined within four categories, based on the type of firm where they work:

- large securities firms and banks,
- small to mid-sized securities firms,
- investment adviser firms, and
- life insurance firms.

Where differences are included between types of advisors, sample sizes are small. For that reason, although differences are significant, they cannot be generalized to the larger advisor population.

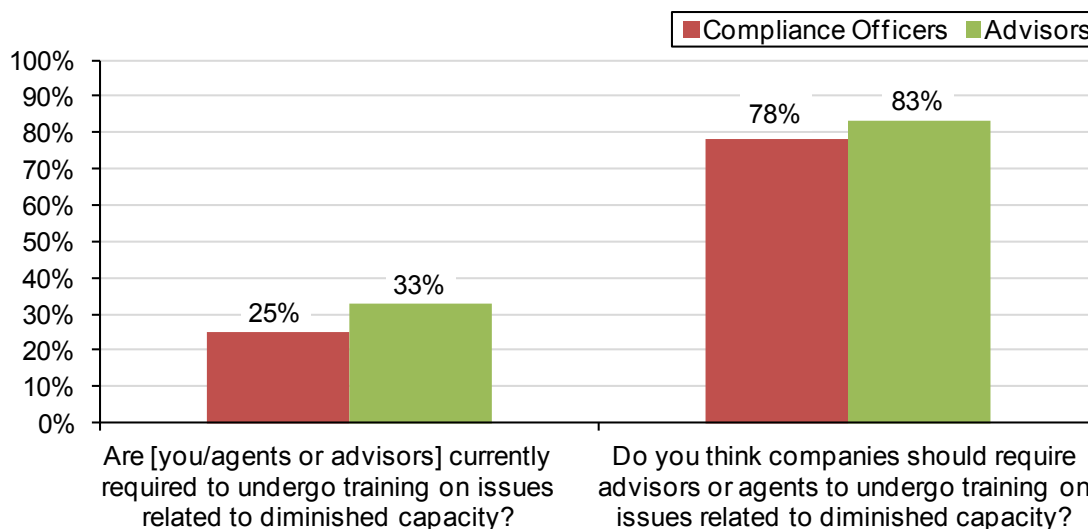
Recognition That Diminished Capacity Poses Challenges

A significant majority of financial services professionals recognize that diminished decision-making capacity is a problem they confront in conducting business. In AARP's survey, 61 percent of advisors reported that diminished capacity is a problem for them, and 74 percent of compliance officers perceived it to be a problem for advisors in their firms. Notably, 10 percent of compliance officers and 4 percent of advisors surveyed said it was a major problem for them.

Advisors observe signs of diminished capacity exhibited by their clients. Respondents were given a list of behaviors or events that could signal that a client has diminished capacity and reported on the frequency with which they occur. Most commonly, advisors say that clients with suspected diminished capacity frequently repeat orders or questions (63 percent often or sometimes) and have trouble understanding basic financial terms and math concepts that they were previously able to grasp (61 percent often or sometimes). They also exhibited other warning signs for diminished capacity, such as memory loss, inability to process information, or erratic behavior (61 percent).

One limitation of AARP's survey is that it did not measure advisors' and compliance officers' baseline knowledge of signs of diminished capacity. Since these signs could also be caused by other conditions (e.g., temporary effects of medications, stress from traumatic life events) and the topic is complex, it is difficult to accurately assess this knowledge via a relatively short survey.

Figure 1
Advisors and Compliance Officers View Diminished Capacity as a Problem in Their Practices



* Totals may not add up 100% due to rounding.

Source: AARP Diminished Capacity Questionnaire

Prepared by AARP Public Policy Institute.

Firm Protocols and Responses to Diminished Capacity

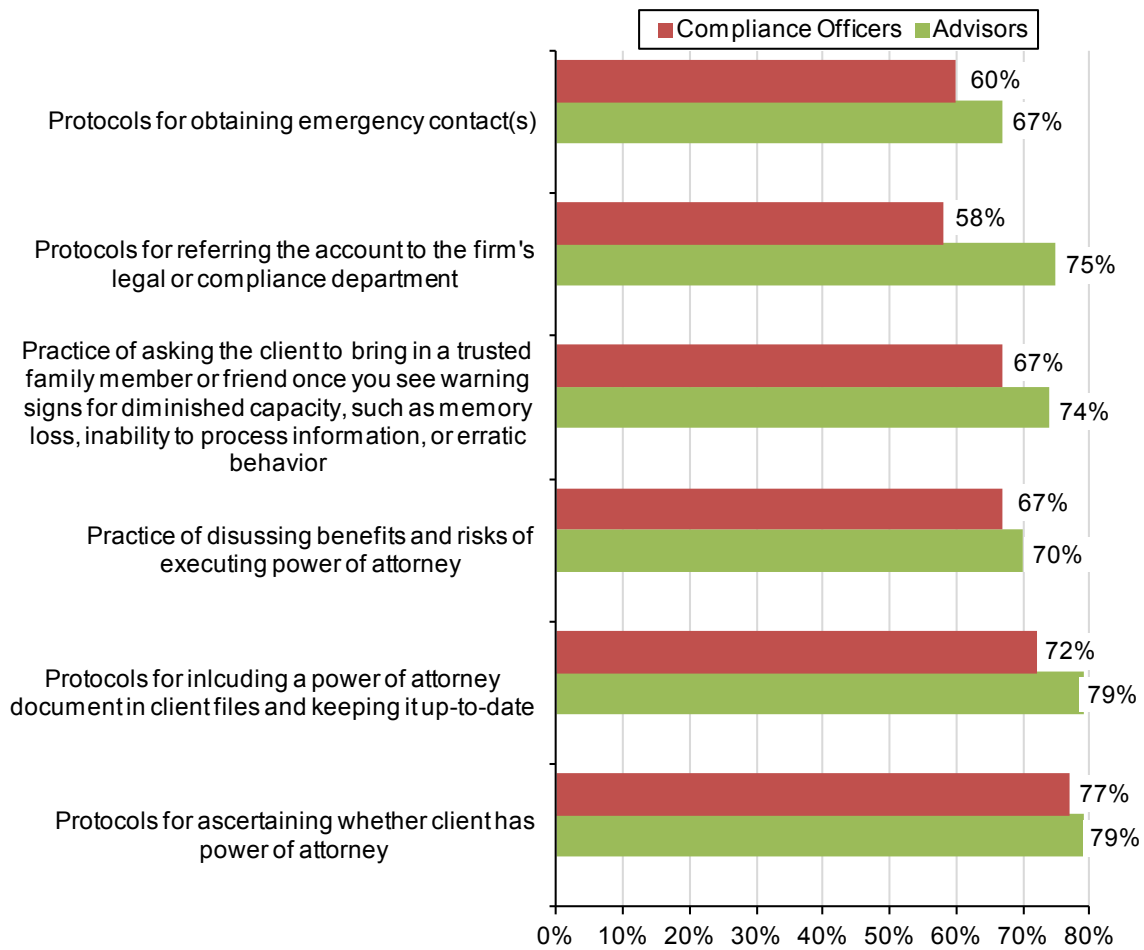
While advisors and compliances officers have identified clients’ diminished capacity as a problem, there are differences in how firms and individuals within them have responded. In the AARP survey, an overwhelming majority of advisors and compliance officers said their firms have protocols to address specific needs when an advisor suspects a client has diminished capacity, including determining whether a client has a power of attorney or including one in the client’s file. Most advisors and compliance officers found their firms’ protocols and resources useful, but they also believed much more needs to be done.

The most frequently cited processes were protocols to (1) ascertain whether a client has a power of attorney, and (2) include a power of attorney in a client’s files and keep it up to date. At least two-thirds of both advisors and compliance officers said their firms have some sort of practice of discussing a power of attorney with clients and a practice of asking clients to bring a trusted family member or friend when signs of diminished capacity are noted. Advisors were far more likely than compliance officers—75 percent to 58 percent—to say their firm had protocols for referring the account to the firm’s legal or compliance department. This finding may stem from the fact that the compliance officer sample was drawn from the FINRA database and probably did not include compliance officers for RIAs or insurance companies. Those entities are likely to have different decision and supervision paths.

Required Consultation/Escalation

Most advisors and compliance officers say advisors should contact their supervisors or compliance officer when they suspect diminished capacity. AARP asked whom advisors would—or should—contact when deciding how to proceed if they suspect a client has diminished capacity. Most advisors would likely consult either their supervisor

Figure 2
Firms Offer Advisors Various Practices and Protocols Regarding Clients Who Exhibit Diminished Capacity



Source: AARP Diminished Capacity Questionnaire
 Prepared by AARP Public Policy Institute.

(43 percent) or their firm’s compliance department (37 percent) when they suspect a client is showing signs of diminished decision-making capacity. Compliance officers identified either the supervisor (39 percent)³² or the compliance department (49 percent) as the person the advisor should contact. Only 8 percent of advisors and 7 percent of compliance officers identified the firm’s legal department as the appropriate contact. Interestingly, 13 percent of advisors stated they would be unlikely to consult with any of the individuals identified in the survey (supervisor, compliance division, legal division, or corporate security division), whereas only 2 percent of compliance officers provided that answer.

Some types of advisors are unlikely to escalate cases to supervisors or contact compliance officers. This may reflect organizational structures in their firms—some may

³² The difference between the advisor response regarding contacting the supervisor and the compliance officer response is not significant.

not even have supervisors or compliance departments.³³ Among advisors, those at large securities firms (60 percent combined) were more likely to say they would contact a supervisor than life insurance agents (41 percent) or investment adviser representatives (27 percent). Small to mid-sized securities firm representatives (51 percent) were more likely than investment adviser representatives (27 percent) to say they would contact their firm's compliance officer. Investment adviser representatives were more likely (34 percent) than advisors from either large securities firms (2 percent) or small to mid-sized securities firms (6 percent) to say they would not consult any of the individuals identified in the survey. These findings suggest that more independent advisors and those at smaller firms, such as investment adviser representatives and insurance agents, may be hungry for information, guidance, and support when clients show signs of diminished capacity.

Most firm protocols require escalation. A strong majority of both advisors and compliance officers said their firm's protocols included some sort of escalation when the advisor suspects diminished capacity and the client lacks an emergency contact, agent under power of attorney, or other fiduciary. When asked what their firm's protocols direct, 85 percent of advisors and 87 percent of compliance officers³⁴ said the advisor should reach out to his/her supervisor. Eighty percent of advisors and 89 percent of compliance officers said their firm's protocols require advisors to contact the firm's compliance department.

Investment adviser representatives differed in their answers from other advisors. Large securities firm representatives (95 percent), small to mid-sized securities firm representatives (90 percent), and life insurance agents (86 percent) were much more likely than investment adviser representatives (69 percent) to say that consulting a supervisor was a step in their company's protocols.

Actions Taken When Diminished Capacity Is Evident

Most advisors say protocols require them to stop making sales recommendations when they suspect diminished capacity. Compliance officers and advisors differed in their perception of company protocol requirements as to whether advisors should stop sales recommendations when they suspect a client's decision-making capacity has diminished. While 83 percent of advisors said their firm's protocols required them to stop making sales recommendations until the situation is resolved, only 71 percent of compliance officers answered affirmatively to the same question. The percentages were reversed when respondents were asked whether the firm's protocols required the advisor to communicate with the client about the steps taken: 90 percent of compliance officers said their firm's protocols required advisors to communicate with clients about the steps they took, but only 77 percent of advisors answered yes to this question.

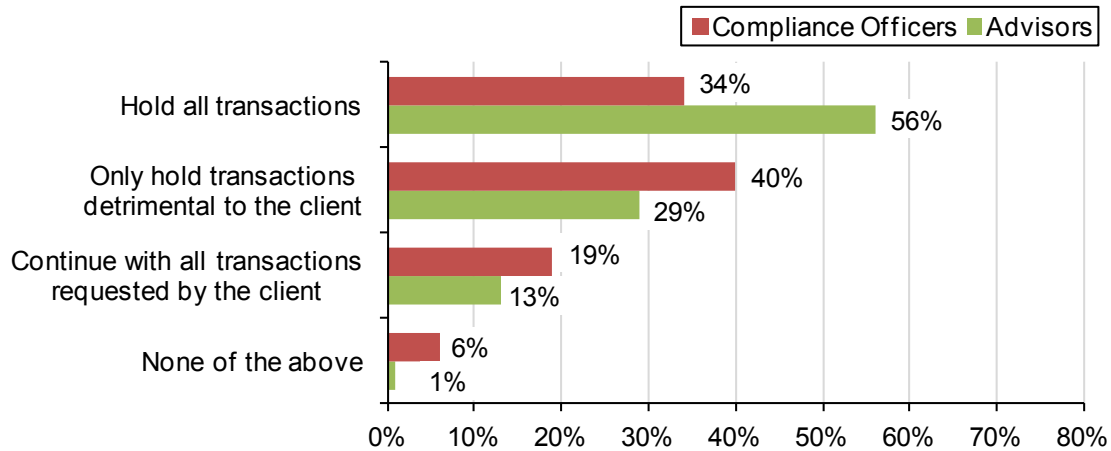
The majority of advisors hold all transactions while awaiting direction from firm experts, but compliance officers disagree with this approach. Compliance officers and

³³ Securities, investment adviser, and life insurance firms are all required by their regulators to supervise their sales forces, but securities firms tend to have more structured compliance procedures to comply with FINRA rules. Life insurance agents and investment adviser representatives may have less structured compliance procedures. Independent life insurance agents, for example, may not have protocols for communications with the life insurance company's compliance officials.

³⁴ Not a significant difference between advisor and compliance officer respondents.

Figure 3

The Majority of Advisors Hold All Transactions while Awaiting Direction on How to Proceed



*Totals may not add up to 100% due to rounding.

Source: AARP Diminished Capacity Questionnaire

Prepared by AARP Public Policy Institute.

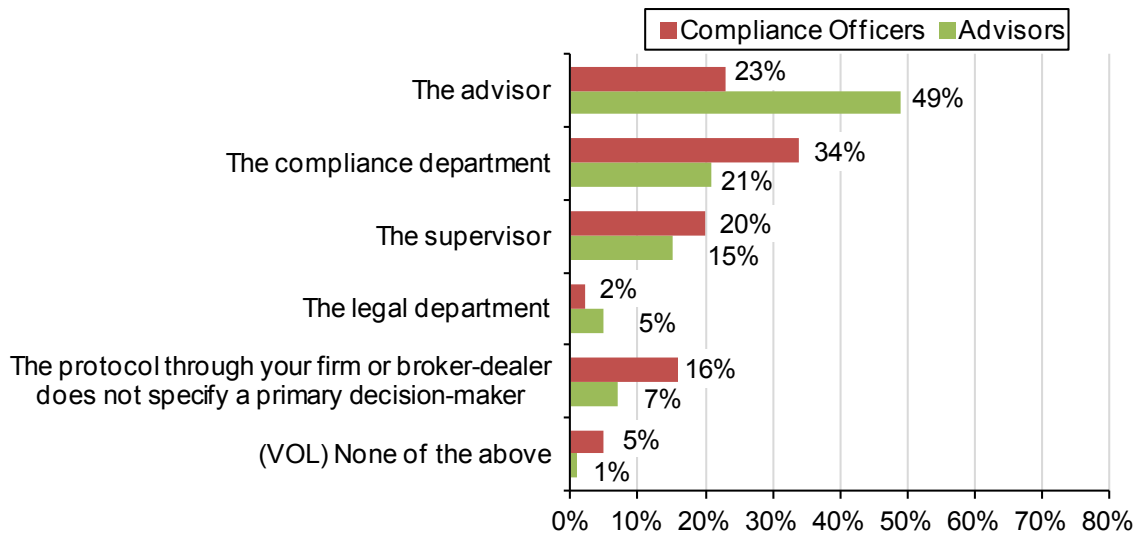
advisors differed on which—if any—transactions to hold while they await direction from a supervisor, other firm personnel, or someone legally authorized to act on a client’s behalf. Over half of advisors (56 percent) said they hold all transactions, while only 34 percent of compliance officers said that advisors should do so. Less than a third of advisors (29 percent) said they hold only transactions detrimental to the client, but 40 percent of compliance officers said that advisors should hold only detrimental transactions. Interestingly, 13 percent of advisors said they continue with *all* transactions requested by the client while awaiting direction, and 19 percent of compliance officers said advisors should do so.³⁵

Industries differed as to which transactions to hold when the advisor suspects diminished capacity and is waiting for further direction. Large securities firm representatives (60 percent) and life insurance agents (64 percent) were more likely than investment adviser representatives (40 percent) to say they would hold all transactions. While 45 percent of investment adviser representatives said they would hold only transactions detrimental to the client, only 24 percent of small to mid-sized firm representatives and 21 percent of life insurance agents said they would hold only detrimental transactions.

Advisors and compliance officers differed as to who decides whether to contact a third party. Respondents differed considerably when asked about their firm’s protocols on who decides whether to contact a third party about a client who may have diminished capacity. Almost half of the advisors (49 percent) said the advisor is the person within the firm who decides whether to contact the agent under a power of attorney, the emergency contact, or other fiduciary. Only a fifth of the advisors (21 percent) said the compliance department was their firm’s primary decision maker about whether to make such a contact. In contrast, only 23 percent of compliance officers said the advisor was the primary decision maker as to whether such a contact should be made, and 34 percent said the compliance

³⁵ Not a significant difference between advisor and compliance officer respondents.

Figure 4
Responses Varied Widely on Who Decides whether to Contact a Third Party when an Advisor Suspects Diminished Capacity



*Totals may not add up to 100% due to rounding.

Source: AARP Diminished Capacity Questionnaire

Prepared by AARP Public Policy Institute.

division should make the decision. About 15 percent of advisors and 20 percent of compliance officers said the advisor’s supervisor was the appropriate person to decide.³⁶

Only 2 percent of compliance officers and 5 percent of advisors said their firm’s legal department was the appropriate department to make such a decision.³⁷ Moreover, 16 percent of compliance officers and 7 percent of advisors said the protocols of their firm or broker-dealer failed to specify who should decide whether to contact a fiduciary or emergency contact.

Among advisors, investment adviser representatives (66 percent) were more likely than large securities firm advisors (40 percent) and life insurance agents (45 percent) to say they (the advisor) are the primary decision maker under their firm’s protocols. Small to mid-sized firm advisors (27 percent) were more likely than investment adviser representatives (11 percent) to say the compliance department is the primary decision maker.

These divergences in the answers may be caused in part by firms having different protocols. There is no explicit regulatory guidance regarding what firms must do when there is a concern about diminished capacity, and firms are free to come up with solutions that fit their business models. It is also unknown whether this divergence reflects the size of different firms or merely the fact that firms developed their solutions separately. The differences among the advisors in different industries are undoubtedly due in part to different regulatory systems in the securities, investment advice, and insurance industries. Larger firms are more likely to have formalized legal and compliance departments and systems, as are firms regulated by FINRA, which includes most securities firms.

³⁶ Not a significant difference between advisor and compliance officer respondents.

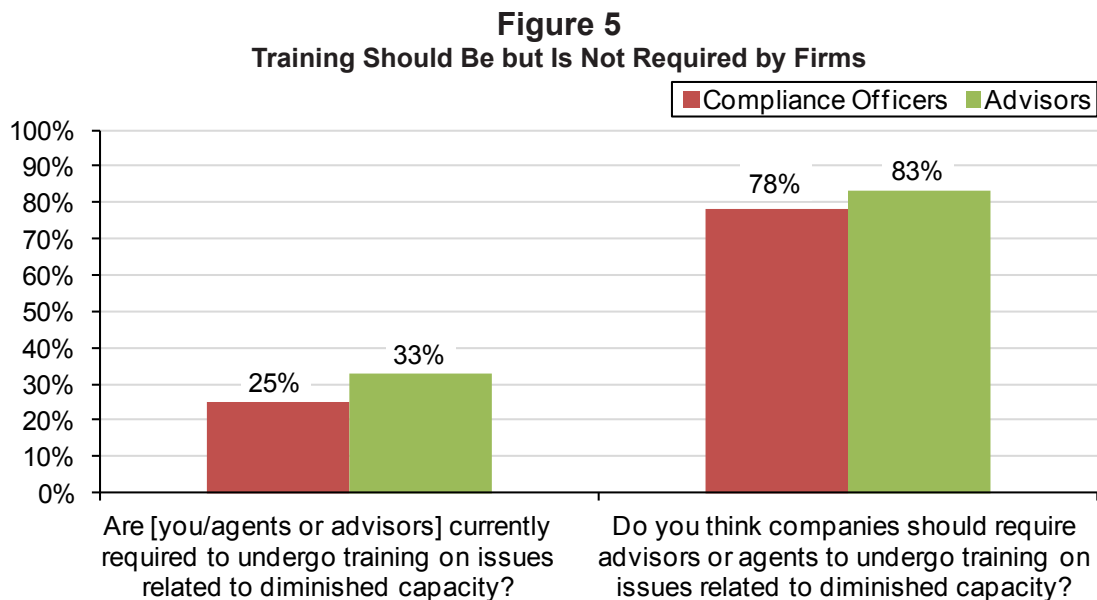
³⁷ Not a significant difference between advisor and compliance officer respondents.

Smaller firms, including many that employ life insurance agents and representatives of investment advisers, are less likely to have formal compliance departments. Finally, advisers and compliance officers in larger firms may be competing for control over these determinations.

Upon escalation, compliance officers contact an agent, emergency contact, or other fiduciary. When compliance officers were asked about their course of action when an advisor follows company protocol and escalates the case to the compliance or legal department, 92 percent said they would contact the agent under a power of attorney, emergency contact, or other fiduciary. Ninety-two percent also said they would continue to discuss or monitor the account with the advisor. Eighty-two percent said they would communicate with the client about the steps taken. Other actions were not taken as frequently. Sixty-two percent said they would stop making sales recommendations until the concern is resolved. Only 27 percent said they would stop transactions involving only certain products. During the roundtable, some firm compliance personnel volunteered that they might report a case of suspected diminished capacity to a social services agency, regardless of privacy regulations.

Information, Resources, and Training Offered to Advisors

Respondents say training should be required by firms but isn't. An overwhelming majority of both advisors (83 percent) and compliance officers (78 percent)³⁸ said companies should require advisors to undergo training on issues related to diminished capacity. However, only 33 percent of advisors and 25 percent of compliance officers said their companies currently require such training. Among investment adviser representatives, only 15 percent said they are currently required to take training on issues



Source: AARP Diminished Capacity Questionnaire
Prepared by AARP Public Policy Institute.

³⁸ Not a significant difference between advisor and compliance officer respondents.

related to diminished capacity. Again, this may reflect the absence of an institutional structure with comprehensive mandates.

Firms offer advisors resources to deal with clients who exhibit diminished capacity. Survey respondents reported that their firms offered resources, practices, and procedures to address their needs when working with clients with suspected diminished capacity. Most advisors (59 percent) said that their firms offered communications tips and strategies on how to interact with clients who may have diminished capacity, although fewer compliance officers (43 percent) said their firms offered such tips and strategies. More than half of advisors (56 percent) also said their firms made recommendations about specific financial products and tools that provide added safeguards for older clients. While few said advisors were required to undergo training, more than half of advisors said their firm offered training in the following areas:

- The FINRA training module on diminished capacity (62 percent);
- How to identify and report suspected elder financial abuse of clients by third parties (57 percent);
- How to identify warning signs for diminished capacity (54 percent); and
- Specifically addressing diminished capacity issues (51 percent).

Compliance officers answered affirmatively less frequently than the advisors. Only 27 percent said their firms offered the FINRA module, and only 35 percent said their firms offered training on how to identify warning signs of diminished capacity.

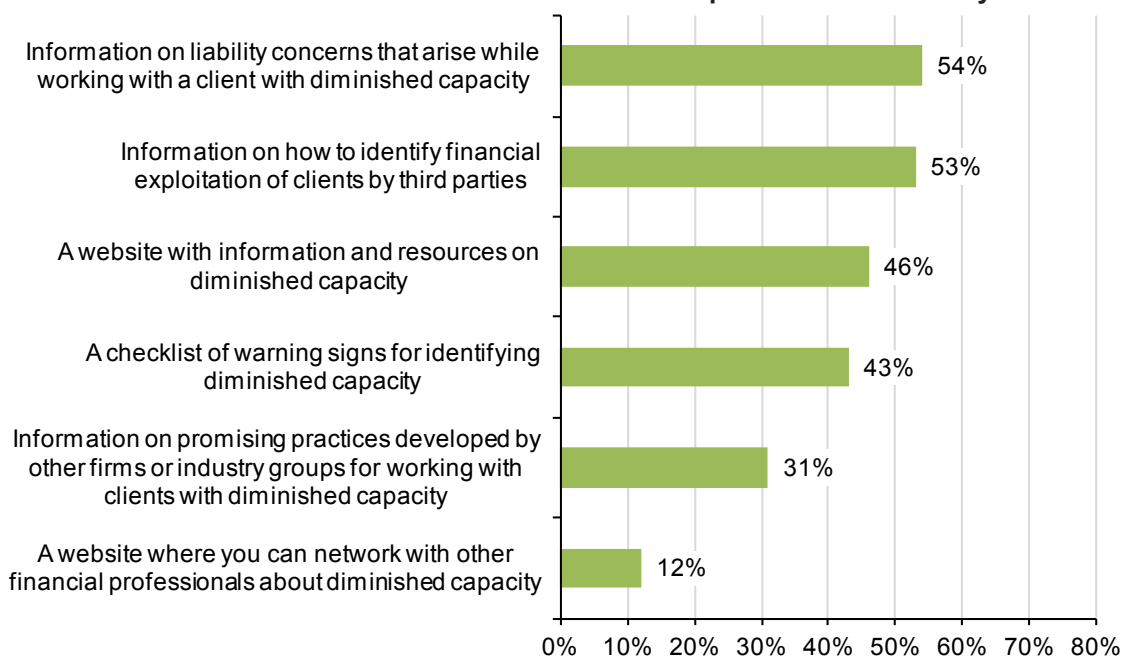
When asked what resources and information on diminished capacity firms make available to advisors, more than half of the advisors (58 percent) and compliance officers (51 percent)³⁹ said they had access to a legal expert. About two-thirds of advisors (66 percent) and 61 percent of compliance officers⁴⁰ said advisors had access to articles, brochures, or other written materials. Advisors and compliance officers differed in their perception of whether web-based training and webinars were available to advisors. Fewer than half of compliance officers reported that advisors have in-house access to web-based training (40 percent) or webinars (37 percent). In contrast, more than half of advisors said their organizations offered web-based training (64 percent) and webinars (51 percent). Among advisors, those from large (69 percent) and small to mid-sized (75 percent) securities firms were more likely than those from investment advisers (48 percent) to say they had web based training. Advisors from securities firms were also more likely to have used the tools and resources suggested in the survey.

The most heavily used resources focus on financial exploitation and liability concerns. When asked what resources they had actually used, more than half of the advisors responding to the survey said they used information on how to identify financial exploitation of clients by third parties (53 percent) and information on liability concerns that may arise when working with clients who have diminished capacity (54 percent). Fewer said they used information on promising practices developed by other firms or industry groups for working with these clients (31 percent) or a website where they could network with other professionals about diminished capacity (12 percent).

³⁹ Not a significant difference between advisor and compliance officer respondents.

⁴⁰ Not a significant difference between advisor and compliance officer respondents.

Figure 6
Advisors Most Often Use Resources about Financial Exploitation and Liability Concerns



Source: AARP Diminished Capacity Questionnaire
 Prepared by AARP Public Policy Institute.

Advisors who use resources and tools find them useful. Of those who had used tools and resources to help them in their interactions with clients with diminished capacity, 89 percent or more found the resources very or somewhat useful. The most frequently accessed resources—those focusing on financial exploitation and liability concerns—were also rated the most useful. The least frequently used resource by advisors—“a website where you can network with other financial professionals about diminished capacity”—received a 93 percent positive rating by those who had used it.⁴¹

While information on promising practices developed by other firms or industry groups was cited as the least useful source of information, more than 90 percent of those who did use it thought it was useful. Only 36 percent of respondents found this source very useful, and another 10 percent identified it as “not too useful.”

Compliance officers rated the list of tools and resources very highly in terms of their potential usefulness to advisors. More than 90 percent of compliance officers viewed most tools favorably, with the exception of “train the trainer resources on diminished capacity,” which got a 72 percent approval rating.

Privacy, Legal, and Liability Issues

Firms find privacy rules a challenge when dealing with diminished capacity; compliance officers hear some concerns about client privacy from advisors. Privacy issues are a concern for the financial services industry when dealing with clients who show signs of diminished capacity, although the level of concern varies. In the discussion

⁴¹ This small subsample (n = 42) makes generalizability a problem.

at the AARP Roundtable, the tension between requirements to protect client privacy and the desire to reach out to someone to protect a client who may show signs of diminished capacity are more of a concern when a firm does not have emergency contact information. For instance, Roundtable participants believed that a firm could subject itself to legal liability if it contacted the wrong son or daughter—the son or daughter who would exploit a vulnerable parent. Similarly, they expressed concern that a firm could subject itself to legal action by the client if it acts on—and reports—its suspicion of diminished capacity that is later found to be unfounded (although this would not be true under state adult protective services laws). Several company compliance personnel expressed concern that a firm could violate privacy regulations by contacting a family member or even a local adult protective services agency. As one participant expressed it, firms “can choose the lawsuit they want to defend.”

In the survey, about 31 percent of compliance officers said that advisors told them privacy was an issue when dealing with a client who shows signs of diminished capacity very often or somewhat often. Many compliance officers (42 percent) said advisors were not concerned about privacy issues too often, and another 25 percent said it was not at all a concern.

Compliance officers have major concerns about legal and liability issues stemming from conducting transactions for those who may have diminished capacity. More than half of compliance officers said determining whether clients have capacity to authorize financial transactions (51 percent) and carrying out requested potentially detrimental transactions (54 percent) are major concerns for them. Many of these respondents also said they had major concerns about the following:

- heirs bringing lawsuits for carrying out damaging transactions requested by someone who has diminished capacity (45 percent);
- determining when a fiduciary has the legal authority to act on a client’s behalf (45 percent); and
- financial abuse by family or friends (42 percent), legally-authorized fiduciary (33 percent) and the firm’s own financial advisor (31 percent).

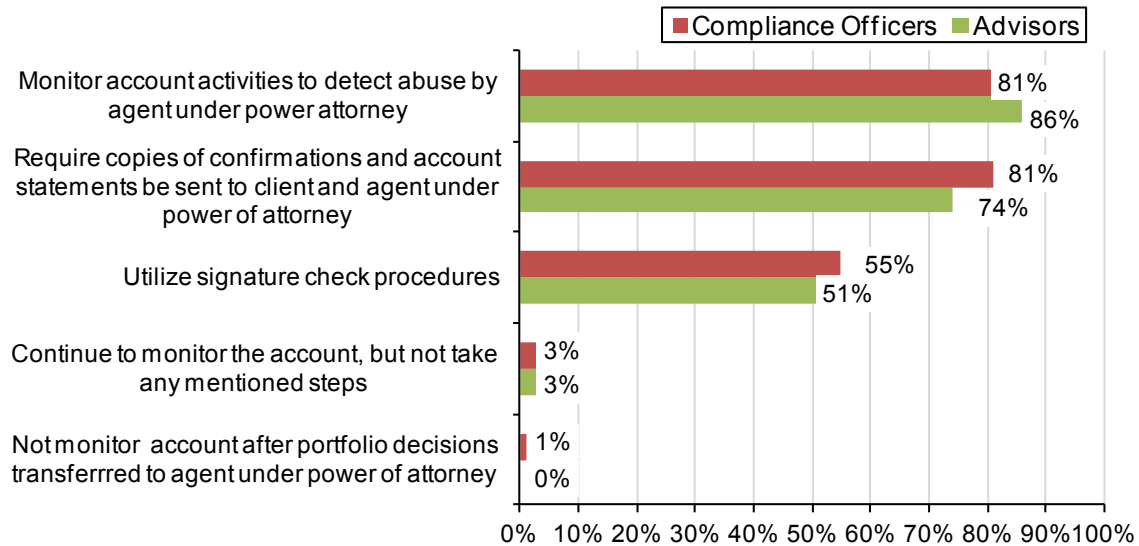
Most compliance officers were concerned about these legal threats—the issues were rated “not a concern” by less than 20 percent of compliance officers. However, 48 percent reported that they were not concerned about financial abuse by the financial advisor.

Monitoring the Account after Agent under Power of Attorney Takes over Decisions

Advisors take steps to monitor account activity after decision-making authority is transferred to an agent under a power of attorney.⁴² Most advisors (86 percent) stated they would monitor the account activities to detect possible abuse by an agent under a power of attorney after the agent takes over account decision making. Similarly, 76 percent of agents said they would require copies of confirmations and account statements be sent to the client as well as the agent under the power of attorney. Over half (51 percent) of

⁴² The AARP survey referred to powers of attorney and did not explicitly refer to inter-vivos trusts. Some investors have these trusts for which they are trustee until they lose capacity, when a successor trustee takes over. Trusts raise similar issues to those raised by powers of attorney, for example, determining the onset of diminished capacity and preventing financial exploitation by the fiduciary.

Figure 7
Advisors Take Steps to Protect the Client after an Agent under Power of Attorney Takes over Account Decisions



Source: AARP Diminished Capacity Questionnaire
Prepared by AARP Public Policy Institute.

advisors said they would use signature-checking procedures. Only 1 percent said they would not monitor the account. Compliance officers reported similar percentages for what the advisors in their firm would do in this situation. These responses suggest that firms are aware that abuse by fiduciaries is a real threat and that monitoring and other oversight steps are important.

NEXT STEPS: PRACTICE AND POLICY SOLUTIONS

With the aging boom and greater understanding of diminished financial capacity, industry groups, consumer organizations, regulators, and other stakeholders seek practice and policy tools for serving older and vulnerable investors whose ability to transact business is impaired. The AARP survey, roundtable discussion, and literature review provide fertile ground for developing next steps to promote investor protection while recognizing marketplace realities. This section lays out a menu of potential options for individual firms, industry groups, regulators, and others. Stakeholders have begun implementing some of these, while others remain conceptual and require further development and evaluation.

Individual Firm

Financial services firms can strengthen their ability to serve clients with diminished capacity and support their employees in the following ways.

- **Require training on diminished capacity.** As the AARP survey showed, almost all advisors and compliance officers think that financial organizations should require training on diminished capacity, but few firms require it now. This training could encompass recognizing red flags for impaired financial decision-making ability, understanding the risks for the client and the firm, and procedures and protocols for action and escalation. The AARP survey showed that training on firm protocols also is critical, because advisors and compliance officers appear to differ on what protocols require and this finding may reflect confusion among employees.
- **Establish firm protocols if none exist.** The AARP survey clearly shows that diminished capacity is a problem for most financial advisors. Demographics will heighten the problem. Firm protocols can provide overall guidance and give frontline employees somewhere to turn. Protocols can also help advisors take proactive steps for new clients. These include prompts for establishing emergency contacts and discussing the importance of designating a legally authorized surrogate (such as an agent under power of attorney), as well as providing basic information about creating powers of attorney.
- **Develop a cadre of experts within the firm.** Specialization may ensure a higher level of expertise and be cost-effective. After identification of red flags, experts can advise front-line personnel as well as assist in managing a challenging case. Employees must know who the experts are and how to contact them. Firms should ensure that their experts receive training on all issues that arise in connection with diminished capacity. For example, training should cover the risks and benefits of powers of attorney and trusts, and how to build safeguards against fiduciary abuse into the documents.
- **Develop or modify firm privacy policies.** Discussion at AARP's Roundtable flagged the extent to which financial services professionals are concerned about privacy issues and need guidance. A firm's privacy policy can, by its terms, give notice that it will reach out to third parties if the firm suspects diminished capacity. Firms may be able to revise their written policies that allow them to maintain client privacy while providing the flexibility to reach out to a third party under limited and specific circumstances. Such approaches may avoid violations of SEC Regulation S-P and similar regulations on the state and federal levels.

- **Monitor accounts after a fiduciary takes over.** The great majority of advisor and compliance officer respondents to AARP’s survey stated that they take actions to protect the investor with diminished capacity even after account decisions are transferred to an agent under power of attorney. Some 86 percent of advisors monitor account activities to detect possible abuse by the agent and 76 percent require that copies of confirmations and account statements be sent to the client as well as the agent. These are good practices for maintaining vigilance against financial exploitation, and they could also apply when the client has a living trust and a trustee takes over account transactions. About half of respondents also utilize signature check procedures—checking the signature of the investor against other signed documents received in order to determine authenticity. These procedures may be cumbersome, but they could be effective in flagging improper transactions.⁴³
- **Develop relationships with state agencies and regulators to promote dialogue on serving investors with diminished capacity.** Industry representatives at the AARP Roundtable expressed confusion and frustration arising from situations in which they reached out to a state APS agency, a disabilities office, a state unit on aging, or other government entity and received inadequate help to deal with a client. Meetings or other communication between firms (or industry groups) and state agencies may lay the groundwork for more productive interaction when a problem arises. For example, APS personnel could explain their jurisdiction, define what constitutes self-neglect and financial exploitation, and give other procedural and substantive guidance.
- **Focus on a particular client demographic for surveillance.** The 2008 SEC/FINRA/NASAA report listed “senior-focused supervision, surveillance and compliance reviews” as one of seven key areas of practice for serving senior investors. Roundtable participants highlighted this practice as well. By selecting cases for review based on the age of clients, combined with other risk factors for diminished financial capacity, firms could identify overall trends in the way advisors handle accounts as well as flag risks to particular investors. The information garnered in senior-focused surveillance could improve firm protocols, identify advisors deviating from protocols, and act to protect particular clients.
- **Develop procedures for “worst case scenarios” as part of firm protocols.** Some chains of events confronting financial services firms seem to defy clear solutions. For example: the client shows obvious signs of diminished capacity; the client has provided no emergency contact and has no power of attorney; or the client asks the advisor to proceed with transactions that are risky, inappropriate, or deviate from prior investment patterns. Firms should have clear, if flexible, protocols for such cases. The firm protocol could look something like this: escalate to firm specialists in diminished capacity or other designated individual or department; document thoroughly; seek outside agency help if appropriate (e.g., state APS); after all diligent efforts to minimize risks to client, halt all activity on account (if you haven’t already).

⁴³ FINRA, NASAA, and SEC, *Protecting Senior Investors*, p. 11. In the power of attorney situation, these could be used to determine the authenticity of the power of attorney document, since forged powers of attorney constitute one type of power of attorney abuse. Stiegel and Klem, *Power of Attorney Abuse*, p. 5. Signature checks can also be used to guard against financial exploitation more broadly, as they can flag unauthorized orders when the investor’s signature is forged.

Industry Associations or Groups

Industry associations or networks can play a leading role in helping firms serve clients with diminished capacity by the following.

- **Continue to develop, refine, and publicize “best practices.”** The 2008 SEC/FINRA/NASAA joint report and the 2010 supplement shined a light on practices developed by companies leading the charge in this arena. Industry and self-regulatory groups have held panel discussions at national meetings. But these and other industry groups can do more to focus specifically on older investors with diminished capacity. For example, at the AARP Roundtable an insurance company executive suggested that an industry standard of requiring a “secondary addressee” when policies are sold would provide a needed contact when diminished capacity interferes with the ability to transact business. Industry associations could publicize this concept and foster discussion at NAIC meetings and other forums.
- **Develop ethical standards for when advisors can take “protective action.”** For attorneys, the American Bar Association Model Rules of Professional Conduct 1.14(b)⁴⁴ states, “When the lawyer reasonably believes that the client has diminished capacity, is at risk of substantial physical, financial or other harm unless action is taken and cannot adequately act in the client’s own interest, the lawyer may take reasonably necessary protective action, including consulting with individuals or entities that have the ability to take action to protect the client and, in appropriate cases, seeking the appointment of a guardian *ad litem*, conservator or guardian.” The bar developed this rule bearing in mind the seriousness of the attorney-client privilege. Industry groups and regulators could examine whether a similar standard would be appropriate within the context of firms’ privacy obligations—and consider the best vehicle for imposing such a standard.⁴⁵
- **Develop and strengthen relationships with adult protective services agencies and national organizations focusing on financial exploitation.** Only half of respondents in the AARP advisor survey said that they have used a resource with information on how to identify financial exploitation of clients. The financial services industry needs to know more about financial abuse of older people, the jurisdiction and resources of APS, how to refer cases, and relevant state laws on adult mistreatment. APS needs to learn more about the industry’s experiences with vulnerable clients, industry protocols, and how the industry and APS can become effective partners. These partnerships can be developed on the state level and nationally. There is precedent for collaboration, for example the Elder Investment Fraud and Financial Exploitation prevention program.⁴⁶
- **Create interdisciplinary task forces to address the intersection of financial services and diminished capacity.** To truly advance the field will require collaboration between

⁴⁴ American Bar Association Model Rules of Professional Conduct, Rule 1.14, Client with Diminished Capacity, http://www.americanbar.org/groups/professional_responsibility/publications/model_rules_of_professional_conduct/rule_1_14_client_with_diminished_capacity.html, accessed July 7, 2011.

⁴⁵ Financial professionals have no overarching code of professional conduct similar to those that lawyers must follow, although certain organizations such as the Certified Financial Planner Board of Standards, Inc. do have codes of ethics and/or rules of conduct. See, e.g., <http://www.cfp.net/Learn/Ethics.asp>.

⁴⁶ See page 15.

industry, APS, regulators, law enforcement, mental health and medical professionals, and social service providers. Industry leaders can spearhead the development of teams to address key issues in a sustained manner.

- **Develop and disseminate industry-specific training modules on diminished capacity.** FINRA’s excellent web-based training is a great tool for broker-dealers and their registered representatives. Financial services professionals need more awareness about this resource: only 21 percent of respondents to the advisor survey noted that they would go “outside of my company, such as FINRA or other training,” when looking for resources on diminished capacity. Perhaps this resource could be made available to non-FINRA members through arrangements with other industry groups or SROs. Similar training geared to specific industries, for example, insurance, could enhance the reach of training and could ensure that issues specific to particular financial professionals are addressed. Finally, industry groups could create materials and reach out to sole proprietors and very small firms with no infrastructure to develop their own materials and training.
- **Fund and collaborate to create handbooks on diminished capacity for financial professionals.** The American Bar Association and the American Psychological Association have worked with professional groups to produce high-quality, authoritative, and profession-specific handbooks on diminished capacity. These include handbooks for attorneys, judges, and psychologists.⁴⁷ Each handbook describes key concepts of and diagnostic tools for diminished capacity, in the context of the specific professional setting. A capacity handbook for the financial services industry globally—or for specific subgroups of professionals—would be an important desktop resource to advance understanding and serve as a go-to source on a daily basis. Participants at the AARP Roundtable expressed interest in using such a handbook.

Legislators and Regulators

Legislators and regulators play an indispensable role in ensuring that financial firms and the professionals who work for them are prepared to serve their clients who experience diminished capacity. They set the rules of the road within which firms act. An efficient means of addressing the dearth of education is through regulation or legislation, where legislative action is required. Regulatory educational requirements would also better ensure consistency among educational offerings. As identified below, regulators and legislators should consider taking the following actions:

- **Require continuing education on diminished capacity for securities broker representatives.** FINRA requires representatives associated with a securities firm to complete a continuing education curriculum, which includes both a regulatory element and a firm element.⁴⁸ The firm element includes product- and client-specific educational materials. FINRA should include, as an element of its firm element continuing education elements, a requirement that representatives associated with a firm take training on protecting older investors with diminishing capacity.

⁴⁷ *Assessment of Older Adults with Diminished Capacity: A Handbook for Lawyers; Assessment of Older Adults with Diminished Capacity: A Handbook for Psychologists; Judicial Determination of Capacity of Older Adults in Guardianship Proceedings*, <http://apps.americanbar.org/aging/publications/publicationslistorder.shtml#capacity>.

⁴⁸ See NASD Rule 1120.

- **Develop consistent model rules on continuing education.** The North American Securities Administrators Association (NASAA) and the National Association of Insurance Commissioners (NAIC) should develop model rules for continuing education requirements covering sales to seniors and diminished capacity. The models should be consistent with each other and usable both in states that must adopt by statute and in states that may adopt them by regulation. States should adopt laws or rules consistent with NASAA and NAIC models.
- **Require investment adviser representatives to obtain continuing education.** The SEC does not have a continuing education requirement for representatives of investment advisers registered with the commission. The SEC should establish one, including a requirement covering sales to seniors and diminished capacity.⁴⁹
- **Clarify federal privacy regulations.** The SEC should consider issuing guidance on Regulation S-P to clarify what firms can disclose and to whom when a client exhibits signs of diminished capacity. Some firms have stated that they find themselves caught between privacy concerns (and regulatory obligations) and the need to take action to protect the client and his/her investments. These firms express the need for a “good faith safe harbor” for disclosures to relatives or other third parties.
- **Develop model regulations on compliance with state privacy laws.** NASAA and the NAIC should develop model rules, and—in the case of the NAIC—bulletins, that clarify what information may be revealed to whom by insurance companies and agents, as well as state-registered investment advisers without violating state-level privacy requirements. States should adopt these models.
- **Enact or strengthen legislation to promote acceptance of powers of attorney and prevent, detect, and redress power of attorney abuse.** When an investor loses capacity to make financial decisions, the best remedy for all concerned is for a trusted individual to step into the shoes of the incapacitated person and handle the account in accordance with the principal’s preferences and interests. States should ensure that their power of attorney laws enhance autonomy by facilitating appointment of an agent and the acceptance of POA documents by third parties such as financial services firms. At the same time, these laws should safeguard the principal against power of attorney abuse. The 2006 Uniform Power of Attorney Act (UPOAA) includes provisions to meet both of these goals.⁵⁰ Ten states and the U.S. Virgin Islands had enacted the UPOAA by mid-2011, but most other state laws fall short at least in part. Cognitively impaired investors will be better served if states strengthen provisions for acceptance of POAs and to address POA abuse, either by adopting the UPOAA or drafting their own measures that are at least as protective.
- **Study default surrogate or other decision-making options.** Most states have default surrogacy laws for health care decision making when a patient’s capacity is diminished. These laws generally provide a hierarchy of family members and sometimes close friends who become authorized by operation of law to make certain

⁴⁹ SEC Staff Report, *Study on Investment Advisers and Broker-Dealers: As Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act* (Washington, DC: Securities and Exchange Commission, January 2011), pp. 138–9 (SEC Staff recommendation that SEC could consider requiring that investment adviser representatives be subject to federal continuing education and licensing requirements).

⁵⁰ Stiegel and Klem, *Power of Attorney Abuse*, p. 19.

decisions if the incapacitated person has not appointed a health care proxy. There is no analog for financial decision making, yet financial decisions can be as life-changing and urgent as health care decisions. This option is controversial and the health care model may be ill-advised for financial decision making, but it may be worth examining. State legislative study committees, professional organizations, academics, and policy researchers could research the concept of providing a legally authorized surrogate who could handle transactions, at least under limited circumstances, when investments or assets are in jeopardy and there is no power of attorney, guardianship, or conservatorship.

Federal and State Administrative Agencies

Federal and state agencies can improve service to and protections for investors with diminished capacity by building bridges with the private sector and with other agencies, as well as by conducting key research to develop new policies and practices. These activities should include the following:

- **Reach out to the financial community.** Just as industry associations can strengthen their relationships with adult protective services agencies and national organizations addressing financial exploitations, state adult protective services agencies and state units on aging can take proactive steps to collaborate with the financial services community. Through this outreach, state agencies can educate financial services groups and firms about their services, protocols, and basic facts about aging and cognitive impairments—and the groups can develop strategies for future efforts.
- **Conduct further research and convening of stakeholders.** The SEC Office of Investor Education and Advocacy should conduct further research to serve investors with diminished capacity. Based on its research, the office could:
 - write a white paper on additional legislative and regulatory options;
 - serve as a convener for stakeholders, including state and federal agencies (such as the Office of Financial Protection for Older Americans in the CFPB) and industry, on serving clients with diminished capacity and its nexus with financial exploitation;
 - help educate the investing public about diminished capacity; and
 - perform additional research on the issue.

In addition, the CFPB's Office of Financial Protection for Older Americans could research and explore policy options regarding diminished capacity. While the CFPB's jurisdiction doesn't extend to regulating investments, the conundrums that arise when an older person's financial capacity is impaired go beyond the investment world to banking, lending, and a broad array of other financial transactions. With its office devoted to older Americans, the CFPB is a natural home for further research in this arena.

Consumer and Professional Groups

Consumer groups representing older people and people with cognitive disabilities are key stakeholders that can play a role in advancing the field. Professional groups representing lawyers, mental health professionals, health care professionals, and

fiduciaries, among others, can play a constructive role in protecting investors with diminished capacity. These groups could —

- **Provide public education for older investors, family members, and caregivers.** Topics of particular importance for consumer education include the following:
 - the nature of and risks stemming from diminished financial capacity,
 - the importance of being proactive through advance planning for financial decision-making (e.g., powers of attorney, trusts, joint accounts),
 - potential consequences of failure to plan (e.g., guardianship, financial exploitation) and
 - red flags for diminished capacity and financial exploitation.
- **Educate fiduciaries on how to serve.** Handling another person’s finances is not an easy task, nor is it obvious how to meet fiduciary standards. Producing a guide for lay fiduciaries such as agents under powers of attorney and court-appointed guardians is one approach to giving fiduciaries, especially family members, tools for managing investments for another person. The American Bar Association Commission on Law and Aging developed a similar guide to serving as a health care proxy.⁵¹ The ABA’s model guide has been adapted with state-specific information in at least five states, and several more are undertaking this effort, illustrating the perceived utility of this approach to assisting family members and others in serving as surrogates.⁵²
- **Serve on interdisciplinary working groups to develop additional policy and practice solutions.** Like industry groups, consumer groups and a spectrum of professional organizations can be key players in task forces to advance the field. The AARP Roundtable made headway by bringing together an interdisciplinary group of stakeholders. A more sustained effort can dig deeper and flesh out ideas fully.

⁵¹ American Bar Association Commission on Law and Aging, *Making Medical Decisions for Someone Else: A How-To Guide*. (Chicago, IL: American Bar Association, 2009).

⁵² See, e.g., the New Hampshire handbook, <http://www.courts.state.nh.us/probate/handbook.pdf>; the Vermont version, http://www.vtethicsnetwork.org/forms/making_medical_decisions.pdf; and the Florida handbook, http://med.fsu.edu/userFiles/file/KappFloridaDraft_revisedFEB2011.pdf.