Financial Industry Regulatory Authority

2016 FINRA/SIFMA Senior Investor Protection Conference

Washington, DC | October 20-21, 2016

Regulatory and Legislative Update
Thursday, October 20
2:45 p.m. – 3:45 p.m.

Panelists explore the evolving regulatory structure surrounding senior investor protections and the challenges facing regulators and financial services professionals when developing an effective, efficient and integrated protection framework among state, federal and SRO regulators.

Moderator:

Andy Blocker
Executive Vice President, Public Policy & Advocacy
SIFMA

Panelists:

Kevin Goodman
Associate Director
U.S. Securities Exchange Commission (SEC)

Ann-Marie Mason
Vice President and Counsel
FINRA Litigation and Policy

Michael Rothman
President
North American Securities Administrators Association (NASAA)

Regulatory and Legislative Update Panelist Bios:

Moderator:

Ananias (Andy) Blocker is the Executive Vice President of Public Policy & Advocacy for SIFMA. In this capacity, Mr. Blocker leads a team who engage with lawmakers and regulators on international, federal and state issues impacting the financial services industry. Prior to joining SIFMA, Mr. Blocker was Managing Director, Federal Affairs Manager in the U.S. Office of Public Policy at UBS. Mr. Blocker represented UBS on a wide range of issues with a primary focus on banking, securities, and other financial services issues on Capitol Hill and in the Executive Branch. In particular, he was the lead lobbyist on financial services issues for UBS during both the legislative debate and the regulatory implementation of Dodd-Frank. In addition, he served as a trusted resource to inform both individual and institutional clients on political and policy actions in Washington and how they could impact their strategic investment decisions. Prior to his role at UBS, Mr. Blocker was Vice President of Government Relations at the New York Stock Exchange (now NYSE Euronext), where he was responsible for developing and coordinating lobbying strategy regarding market structure (including Reg NMS), corporate governance, international market collaboration, and tax issues. Prior to joining the Exchange, Mr. Blocker represented American Airlines in more than 20 international route negotiations between the U.S. and foreign governments, and worked to secure liability relief as part of the Air Transportation Safety and System Stabilization Act post September 11th. During his tenure in the public sector, he worked as Legislative Assistant to Congressman Martin Frost (D-TX), and Senior Budget Analyst for the Senate Budget Committee. He also worked for the Clinton White House, where as Special Assistant to the President for Legislative Affairs, he provided policy-making and strategic advice to the President, and contributed to the passage of the 1997 Bipartisan Balanced Budget Agreement. Mr. Blocker holds an undergraduate degree in Economics from Harvard University and an MBA from Georgetown University's McDonough School of Business.

Panelists:

Kevin W. Goodman leads the U.S. Securities and Exchange Commission's FINRA and Securities Industry Oversight group ("FSIO"), which is responsible for comprehensive oversight of FINRA, including conducting oversight examinations of broker-dealers to assess the quality of FINRA's examinations, as well as inspecting all areas of FINRA's operations. FSIO also oversees the MSRB. In addition, Mr. Goodman serves as a member of the Executive and Operating Committees for the SEC's National Examination Program. Prior to assuming his current role, Mr. Goodman led the SEC's National Broker-Dealer Examination Program for over three years. Mr. Goodman's SEC experience also includes having served for six years as Associate Regional Director of the SEC's Denver Regional Office, where he managed the examination program for the office. Mr. Goodman joined the SEC staff in Los Angeles in 1992 as an Attorney-Adviser, and later served as Branch Chief, Senior Special Counsel, and Assistant Director, all with the Investment Adviser/Investment Company Examination Program. Mr. Goodman graduated from Purdue University in 1982 with a degree in accounting and received his law degree from Indiana University in 1985. Prior to joining the SEC staff, Mr. Goodman practiced corporate and securities law in the private sector with an emphasis on mergers and acquisitions.

Ann-Marie Mason is Vice President and Counsel in the Litigation and Policy ("L&P") unit of the Regulatory Operations ("Reg Ops") Department at FINRA. As an attorney in Reg Ops, Ms. Mason manages a group of professionals who defends Reg Ops in non-disciplinary and appellate litigation matters and renders legal and interpretive advice to various constituents within and outside of FINRA. L&P also provides training to other FINRA employees who handle litigation matters. Prior to joining FINRA, Ms. Mason worked at Metropolitan Life Insurance Company ("MetLife") where she served as Senior Counsel in the Financial Services Unit. There, she worked on structured products, complex litigations, ERISA and employment law matters. Ms. Mason also served as the Intellectual Property Counsel for MetLife. Prior to MetLife, she worked as an Associate Attorney at Wade Clark Mulcahy in New York City, where she focused on multi-faceted civil litigation. Ms. Mason also worked as an Assistant District Attorney at the Kings County District Attorney's Office in Brooklyn, NY. While there, she rose to the ranks of Senior Trial Attorney having prosecuted various crimes, including homicides. Ms. Mason graduated magna cum laude from the University of Rochester, where she received her Bachelors of Arts. She received her Juris Doctorate from New York University School of Law.

Mike Rothman is the Commissioner of the Minnesota Department of Commerce (Department) and he currently serves as the president of the North American Securities Administrators Association (NASAA). Mr. Rothman was appointed by Governor Mark Dayton in January 2011. As Commissioner, Mr. Rothman oversees the Department's broad jurisdiction of more than 20 regulated industries. Mr. Rothman's top priorities include consumer protection, a clean energy future, and strong financial and energy sectors for Minnesota's economy. The Department regulates Minnesota's insurance industry, financial institutions, securities and real-estate sector. It also has a major role in overseeing the electric, natural gas and telephone sectors, energy conservation and efficiency, and administering low-income energy programs. Additionally, the Department regulates the accuracy of scales and pumps used for fuel and goods transactions in Minnesota's economy. He also is Chair of the Multi-Jurisdictional Committee, Vice Chair of the Cybersecurity Committee, and a member of both the Senior Issues/Diminished Capacity and Capital Formation Committees. He also is active in the National Association of Insurance Commissioners (NAIC), serving as Chair of the Senior Issues Task Force, Vice Chair of the Health Insurance and Managed Care (B) Committee, and member of various committees. He previously served on the NAIC Executive Committee (2014–2015) and chaired the Midwest Zone (2015). Mr. Rothman is a member of the Financial and Banking Information Infrastructure Committee (FBIIC), which is chartered under the President's Working Group on Financial Markets. This committee coordinates federal and state regulatory efforts to improve the reliability and security of the financial sector infrastructure. He also has been nominated by President Obama to serve on the Board of the newly-created National Association of Registered Agents and Brokers (NARAB), which will oversee a national licensing system for insurance agents and brokers. Mr. Rothman has been recognized for his focus on building financial capability in Minnesotans from kindergarten to retirement. He received the 2014 Desjardins Financial Education Award for State Government Policymakers from the Credit Union National Association (CUNA) and the 2014 Champions of Retirement Security Award from the Insured Retirement Institute (IRI). Commissioner Rothman graduated with honors from Carleton College and the University of Minnesota Law School, later teaching there as an adjunct professor. He began his career clerking for the Minnesota Court of Appeals, worked for the State Senate, and practiced law in Minnesota and California— most recently as a partner with Winthrop & Weinstine.

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Panelists

- **Moderator**
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Resources

NASAA Resources

- NASAA Guide to Practices and Procedures for Protecting Senior Investors and Vulnerable Adults from Financial Exploitation (September 2016)

  http://serveourseniors.org/wp-content/uploads/2016/09/NASAA-Guide-For-Developing-Practices-and-Procedures-For-Protecting-Senior-Investors-and-Vulnerable-Adults-From-Financial-Exploitation.pdf

- NASAA Members Adopt Model Act to Protect Seniors and Vulnerable Adults (February 2016)

  www.nasaa.org/38777/nasaa-members-adopt-model-act-to-protect-seniors-and-vulnerable-adults/

- 2016 NASAA Enforcement Report

  http://nasaa.cdn.s3.amazonaws.com/wp-content/uploads/2016/09/2016-Enforcement-Report-Based-on-2015-Data_online.pdf

- 2016 NASAA Broker-Dealer Coordinated Examinations: Summary of Preliminary Findings

  http://nasaa.cdn.s3.amazonaws.com/wp-content/uploads/2011/09/2016-BD-Coordinated-Exam-Preliminary-Findings.pdf

FINRA Resources

- FINRA *Regulatory Notice 15-37, Financial Exploitation of Seniors and Other Vulnerable Adults* (October 2015)

  www.finra.org/sites/default/files/notice_doc_file_ref/Regulatory-Notice-15-37.pdf

- FINRA Investor Alert: Plan for Transition: What You Should Know About the Transfer of Brokerage Account Assets on Death

  www.finra.org/investors/alerts/plan-transition-transfer-brokerage-account-assets-death

Joint Report Resources

- 2015 FINRA and SEC National Senior Investor Initiative Report

  www.sec.gov/ocie/reportspubs/sec-finra-national-senior-investor-initiative-report.pdf

- 2010 Addendum to SEC, NASAA and FINRA 2008 Report

  www.nasaa.org/wp-content/uploads/2010/08/SEC-NASAA_Senior_Report_0821210.pdf

- 2008 SEC, NASAA and FINRA Report on Practices Used by Financial Services Firms in Serving Senior Investors

  www.sec.gov/spotlight/seniors/seniorspracticesreport092208.pdf

- 2007 SEC, NASAA and FINRA Report on "Free Lunch" Sales Seminars

  www.finra.org/sites/default/files/Industry/p036814.pdf

Regulatory Notice 15-37

October 2015

Financial Exploitation of Seniors and Other Vulnerable Adults

FINRA Requests Comment on Rules Relating to Financial Exploitation of Seniors and Other Vulnerable Adults

Comment Period Expires: November 30, 2015

Executive Summary

FINRA seeks comment on proposed rules addressing the financial exploitation of seniors and other vulnerable adults. FINRA is proposing: (1) amendments to FINRA Rule 4512 (Customer Account Information) to require firms to make reasonable efforts to obtain the name of and contact information for a trusted contact person for a customer's account; and (2) the adoption of new FINRA Rule 2165 (Financial Exploitation of Specified Adults) to permit qualified persons of firms to place temporary holds on disbursements of funds or securities from the accounts of specified customers where there is a reasonable belief of financial exploitation of these customers.

The proposed rule text is available in Attachment A.

Questions regarding this *Notice* should be directed to:

- James S. Wrona, Vice President and Associate General Counsel, Office of General Counsel (OGC), at (202) 728-8270;
- Ann-Marie Mason, Director and Counsel, Shared Services, at (202) 728-8231; or
- Jeanette Wingler, Assistant General Counsel, OGC, at (202) 728-8013.

Notice Type

- Request for Comment

Suggested Routing

- Compliance
- Legal
- Operations
- Registered Representatives
- Senior Management

Key Topics

- Customer Accounts
- Financial Exploitation
- Senior and Vulnerable Adult Investors
- Temporary Holds on Disbursements
- Trusted Contact Persons

Referenced Rules

- FINRA Rule 4512
- Proposed FINRA Rule 2165
- SEA Rule 17a-3

Financial Industry Regulatory Authority

Action Requested

FINRA encourages all interested parties to comment on the proposal. Comments must be received by November 30, 2015.

Comments must be submitted through one of the following methods:

- Emailing comments to *pubcom@finra.org*; or
- Mailing comments in hard copy to:

  Marcia E. Asquith
  Office of the Corporate Secretary
  FINRA
  1735 K Street, NW
  Washington, DC 20006-1506

To help FINRA process comments more efficiently, persons should use only one method to comment on the proposal.

Important Notes: All comments received in response to this *Notice* will be made available to the public on the FINRA website. In general, FINRA will post comments as they are received.[1]

Before becoming effective, a proposed rule change must be authorized for filing with the Securities and Exchange Commission (SEC) by the FINRA Board of Governors, and then must be filed with the SEC pursuant to Section 19(b) of the Securities Exchange Act of 1934 (SEA).[2]

Background & Discussion

FINRA's experience with its Securities Helpline for Seniors™ has highlighted issues relating to financial exploitation of this group of investors.[3] Among these issues is a firm's ability to quickly and effectively address suspected financial exploitation of seniors and other vulnerable adults consistent with FINRA rules. Currently, FINRA rules do not explicitly permit firms to contact a non-account holder or to place a temporary hold on disbursements of funds or securities where there is a reasonable belief of financial exploitation of a senior or other vulnerable adult.

To address these issues, FINRA is proposing rules to provide firms with a way to respond to situations in which they have a reasonable basis to believe that financial exploitation of vulnerable adults has occurred, is occurring, has been attempted or will be attempted.[4] FINRA believes that a firm can better protect its customers from financial exploitation if the firm can: (1) place a temporary hold on a disbursement of funds or securities from a customer's account; and (2) notify a customer's trusted contact (or, if unavailable, immediate family member) of the firm's decision to place the temporary hold on a disbursement from the customer's account.

Proposed Rules

Trusted Contact Person—Proposed Amendments to Rule 4512

FINRA is proposing to amend Rule 4512 to require firms to make reasonable efforts to obtain the name of and contact information for a trusted contact person upon the opening of a non-institutional customer's account.[5] The proposal does not prohibit firms from opening and maintaining an account if a customer fails to identify a trusted contact as long as the firm made reasonable efforts to obtain it. FINRA believes that asking a customer to provide the name and contact information for a trusted contact person ordinarily would constitute reasonable efforts to obtain the information and would satisfy the proposed rule's requirements.

Consistent with the current requirements of Rule 4512, a firm would not need to attempt to obtain the name of and contact information for a trusted contact person for currently existing accounts until such time as the firm updates the information for the account either in the course of the firm's routine and customary business or as otherwise required by applicable laws or rules. With regard to updating the contact information once provided, FINRA believes that firms should consider asking the customer to review and update the name of and contact information for a trusted contact person periodically, such as when updating account information pursuant to SEA Rule 17a-3, or when there is a reason to believe that there has been a change in the customer's situation.[6]

FINRA intends the trusted contact person to be a resource for the firm in administering the customer's account and in responding to possible financial exploitation. The proposed rule would require that the trusted contact person be age 18 or older and not be authorized to transact business on behalf of the account. A firm may elect to notify an individual that he or she was named as a trusted contact person; however, the proposed rule would not require notification.

The proposed rule would also require that, at the time of account opening, a firm shall disclose in writing (which may be electronic) to the customer that the firm or an associated person is authorized to contact the trusted contact person and disclose information about the customer's account to confirm the specifics of the customer's current contact information, health status, and the identity of any legal guardian, executor, trustee or holder of a power of attorney, and as otherwise permitted by proposed Rule 2165. In addition, a firm would be required to provide this disclosure when it attempts to obtain the name of and contact information for a trusted contact person when updating information for currently existing accounts either in the course of the firm's routine and customary business or as otherwise required by applicable laws or rules. Firms would be required to provide this disclosure at account opening or when updating information for currently existing accounts, even if a customer fails to identify a trusted contact. As noted below, pursuant to proposed Rule 2165, when information about a trusted contact person is available, a firm must attempt to notify the trusted contact person that the firm has placed a temporary hold on a disbursement of funds or securities from a customer's account, unless the firm reasonably believes that the trusted contact person is engaged in the financial exploitation.[7]

Temporary Hold on Disbursement of Funds or Securities—Proposed New Rule 2165

FINRA is also proposing to permit "qualified persons" who reasonably believe that financial exploitation is occurring to place temporary holds on disbursements of funds or securities from the accounts of "specified adult" customers. Proposed Rule 2165 creates no obligation to withhold disbursement of funds or securities where financial exploitation may be occurring. Accordingly, Supplementary Material to proposed Rule 2165 would expressly state that the rule provides firms with a safe harbor when they exercise discretion in placing temporary holds on disbursements of funds or securities from the account of a specified adult under the circumstances denoted in the rule. It would further state that the rule does not require firms to place temporary holds on disbursements of funds or securities from the account of a specified adult.[8]

FINRA believes that "specified adults" may be particularly susceptible to financial exploitation.[9] Proposed Rule 2165 would define "specified adult" as: (A) a natural person age 65 and older;[10] or (B) a natural person age 18 and older who the firm reasonably believes has a mental or physical impairment that renders the individual unable to protect his or her own interests. Supplementary Material to proposed Rule 2165 would provide that a firm's reasonable belief that a natural person age 18 and older has a mental or physical impairment that renders the individual unable to protect his or her own interests may be based on the facts and circumstances observed in the firm's business relationship with the person.[11]

The proposed rule would denote the persons who can place a temporary hold on a disbursement as "qualified persons," which would mean associated persons of a firm who serve in supervisory, compliance or legal capacities that are reasonably related to the account of the specified adult. The proposed rule would define the term "account" to include any account of a firm for which a specified adult has the authority to transact business.

FINRA has proposed a broad definition of "financial exploitation." Specifically, financial exploitation would include: (A) the wrongful or unauthorized taking, withholding, appropriation, or use of a specified adult's funds or securities; or (B) any act or omission taken by a person, including through the use of a power of attorney, guardianship, or any other authority, regarding a specified adult, to: (i) obtain control, through deception, intimidation or undue influence, over the specified adult's money, assets or property; or (ii) convert the specified adult's money, assets or property.

Proposed Rule 2165 would permit a qualified person to place a temporary hold on a disbursement of funds or securities from the account of a specified adult if the qualified person reasonably believes that financial exploitation of the specified adult has occurred, is occurring, has been attempted or will be attempted.[12] If a firm places such a hold, the proposed rule would require the firm to immediately initiate an internal review of the facts and circumstances that caused the qualified person to reasonably believe that financial exploitation of the specified adult has occurred, is occurring, has been attempted or will be attempted. In addition, the proposed rule would require the firm to provide notification of the hold and the reason for the hold to all parties authorized to transact business on the account and, if available, the trusted contact person, no later than two business days after placing the hold. While oral or written (including electronic) notification would be permitted under the proposed rule, a firm would be required to retain records evidencing the notification.

If the trusted contact person is not available or the firm reasonably believes that the trusted contact person has engaged, is engaged or will engage in the financial exploitation of the specified adult, the proposal states that the firm shall attempt to contact an immediate family member,[13] unless the firm reasonably believes that the immediate family member has engaged, is engaged or will engage in the financial exploitation of the specified adult. For purposes of proposed Rule 2165, FINRA would consider the lack of an identified trusted contact person, the inability to contact the trusted contact person or a person's refusal to act as a trusted contact person to mean that the trusted contact person was not available. The same is true of an immediate family member. A firm may use the temporary-hold provision under proposed Rule 2165 when a trusted contact or an immediate family member is not available.

While the proposed rule does not require notifying the customer's registered representative of suspected financial exploitation, a customer's registered representative may be the first person to detect potential financial exploitation. If the detection occurs in another way, a firm may choose to notify and discuss the suspected financial exploitation with the customer's registered representative, unless the firm suspects that the registered representative is involved in the financial exploitation.

The temporary hold authorized by proposed Rule 2165 would expire not later than 15 business days after the date that the qualified person first placed the temporary hold on the disbursement of funds or securities, unless sooner terminated or extended by an order of a court of competent jurisdiction. In addition, provided that the firm's internal review of the facts and circumstances supports its reasonable belief that the financial exploitation of the specified adult has occurred, is occurring, has been attempted or will be attempted, the proposed rule permits the temporary hold to be extended by a qualified person for an additional 15 business days, unless sooner terminated by an order of a court of competent jurisdiction.

Proposed Rule 2165 would require firms to retain records related to compliance with the rule, which shall be readily available to FINRA, upon request. The retained records shall include records of: (1) requests for disbursement that may constitute financial exploitation of a specified adult and the resulting temporary hold; (2) the finding of a reasonable belief that financial exploitation has occurred, is occurring, has been attempted or will be attempted underlying the decision to place a temporary hold on a disbursement; (3) notification(s) to the relevant parties pursuant to the rule; and (4) the internal review of the facts and circumstances supporting the qualified person's reasonable belief that the financial exploitation of the specified adult has occurred, is occurring, has been attempted or will be attempted.

The proposed rule would require a firm that anticipates using a temporary hold in appropriate circumstances to establish and maintain specific written supervisory procedures reasonably designed to achieve compliance with the rule, including, but not limited to, procedures on the identification, escalation and reporting of matters related to financial exploitation of specified adults. The proposed rule would also require firms to develop and document specific training policies or programs reasonably designed to ensure that registered persons comply with the requirements of the rule.

Economic Impact Assessment

FINRA's experience with its Securities Helpline for Seniors has reaffirmed its understanding of the risks to customers of financial exploitation. The proposed rules are intended to further the protection of potentially at-risk customers by relieving firms from those FINRA rules that might otherwise discourage firms from exercising discretion to protect customers through placing a temporary hold on disbursements of funds or securities. Such a hold, combined with contact with a trusted person, also may permit these customers to stop unwanted disbursements and better protect themselves from financial exploitation.

The proposed rules not only better safeguard customers, to the extent that firms today do not provide protections for specified adults, but also better protect those firms that are already doing so.

The proposed amendments to Rule 4512 would require firms to attempt to collect information about a trusted person at the time of account opening or in the course of updating information for the account. Firms also would incur additional responsibilities to provide disclosure about the firm's right to share certain private information with the customer's trusted contact.

In addition, there may be significant impacts with respect to legal risks and attendant costs to firms that choose to rely on the proposed rule in placing temporary holds on disbursements; although the direction of the impact is ambiguous. The proposed rules may provide some legal protection to firms if they are sued for withholding disbursements where there is a reasonable belief of financial exploitation. At the same time, while proposed Rule 2165 creates no obligation to withhold disbursement where financial exploitation may be occurring or to refrain from opening or maintaining an account where no trusted contact is identified, this proposed rule might serve as a rationale for a private action against firms that do not withhold disbursements when there is a reasonable belief of financial exploitation. To reduce the latter risk, proposed Rule 2165 would explicitly state that it provides firms with a safe harbor when they exercise discretion in placing temporary holds on disbursements of funds or securities, but would not require firms to place such holds.

To the extent that firms today have reasons to suspect financial exploitation of their customers, they may make judgments with regard to making or withholding disbursements of funds or securities. As such, these firms may already face litigation risk with regard to their actions, whether or not they choose to disburse funds or securities.

Request for Comment

In addition to generally requesting comments, FINRA specifically requests comment on the following questions:

1. Should the scope of the proposed rules be expanded to encompass other requirements?
2. Are there approaches other than the proposed rulemaking that FINRA should consider?
3. Should Rule 4512 require customer consent to contact the trusted contact or is customer notice sufficient? Should the types of information that may be disclosed to the trusted contact under Rule 4512 be modified?
4. What are firms' current practices when they suspect financial exploitation has occurred, is occurring, has been attempted or will be attempted? Would the proposed rules change firms' current practices?
5. What are firms' views on any potential legal risks associated with placing or not placing temporary holds on disbursements of funds or securities at present and under the proposal?
6. Should the ages used in the definition of "specified adult" in proposed Rule 2165 be modified or eliminated?
7. Should the definition of "account" be expanded to include accounts for which a specified adult is a named beneficiary?
8. Should the scope of the persons included in the definition of "qualified person" in proposed Rule 2165 be modified?

9. Is the two business day period for notifying the appropriate parties under proposed Rule 2165 appropriate? If not, what circumstances may warrant a shorter or longer period?
10. Should the permissible time periods for placing and extending a temporary hold pursuant to proposed Rule 2165 be modified?
11. Should FINRA mandate specific procedures for escalating matters related to financial exploitation?

FINRA also specifically requests comments on the economic impact and expected beneficial results of the proposed rules.

12. What direct costs for the firm will result from the proposed rules?
13. What indirect costs will arise for the firm from the proposed rules?
14. Will the proposed rules impose different costs on firms of different sizes or with different business models?
15. What benefits will result for customers from the proposed rules? How extensive are these benefits?
16. What costs for customers will result from the proposed rules?
17. Are the costs imposed by the rules warranted by the potential benefit to customers arising from the proposed rules?
18. How will the proposed rules change business practices and competition among firms? Will these impacts differently affect small or specialized broker-dealers?
19. Are there other means or mechanisms to efficiently and effectively provide customers with suitable protections as contemplated by the SEA?

We request quantified comments where possible.

Endnotes

1. FINRA will not edit personal identifying information, such as names or email addresses, from submissions. Persons should submit only information that they wish to make publicly available. *See Notice to Members 03-73* (November 2003) (Online Availability of Comments) for more information.

2. *See* SEA Section 19 and rules thereunder. After a proposed rule change is filed with the SEC, the proposed rule change generally is published for public comment in the *Federal Register*. Certain limited types of proposed rule changes take effect upon filing with the SEC. *See* SEA Section 19(b)(3) and SEA Rule 19b-4.

3. *See* FINRA Launches Toll-Free FINRA Securities Helpline for Seniors (Apr. 20, 2015).

4. FINRA notes that Delaware, Missouri and Washington have enacted statutes that permit financial institutions, including broker-dealers, to place temporary holds on "disbursements" or "transactions" if financial exploitation of covered persons is suspected. *See* Del. Code Ann. tit. 31, § 3910 (2015); Mo. Rev. Stat. §§ 409.600-.630 (2015); and Wash. Rev. Code §§ 74.34.215, 220 (2015). Due to the small number of state statutes currently in effect and the lack of a uniform state or federal standard in this area, FINRA believes that the proposed rules would aid in the creation of a uniform national standard for the benefit of firms and their customers.

5. While the proposed amendments do not specify what contact information should be obtained, FINRA believes that a mailing address, phone number and email address for the trusted contact person may be the most useful to firms.

6. FINRA also notes that a customer's request to change his or her trusted contact person may be a possible red flag of financial exploitation (*e.g.*, a senior customer changing his trusted contact person from an immediate family member to a previously unknown third party).

7. With respect to disclosing information to the trusted contact person, FINRA notes that Regulation S-P excepts from the Regulation's notice and opt-out requirements disclosures made: (A) to comply with federal, state, or local laws, rules and other applicable legal requirements; or (B) made with client consent, provided such consent has not been revoked. *See* 17 C.F.R §§ 248.15(a)(1) and (a)(7)(i). FINRA believes that disclosures to a trusted contact person pursuant to proposed Rules 2165 or 4512 or with unrevoked customer consent would be consistent with Regulation S-P.

8. FINRA understands that some firms, pursuant to state law or their own policies, may already place temporary holds on disbursements from customers' accounts where financial exploitation is suspected.

9. *See* National Senior Investor Initiative: A Coordinated Series of Examinations, SEC's Office of Compliance Inspections and Examinations and FINRA (Apr. 15, 2015) (noting the increase in persons aged 65 and older living in the United States and the concentration of wealth in those persons during a time of downward yield pressure on conservative income-producing investments) (hereinafter Senior Investor Initiative). *See also* The MetLife Study of Elder Financial Abuse: Crimes of Occasion, Desperation, and Predation Against America's Elders (June 2011) (noting the many forms of

vulnerability that "make elders more susceptible to [financial]abuse," including, among others, poor physical or mental health, lack of mobility, and isolation); Protecting Elderly Investors from Financial Exploitation: Questions to Consider (Feb. 11, 2015) (noting that one of the greatest risk factors for diminished capacity is age).

10. *See, e.g.*, Aging Statistics, U.S. Department of Health and Human Services Administration on Aging (referring to the "older population" as persons "65 years or older"); Senior Investor Initiative (noting the examinations underlying the report "focused on investors aged 65 years old or older").

11. FINRA notes that a firm may not ignore contrary evidence in making a determination based on the facts and circumstances observed in the firm's business relationship with the natural person (*e.g.*, a court order finding a customer to be legally incompetent).

12. Proposed Rule 2165 would apply only to disbursements of funds or securities from the account of a specified adult and would not apply to transactions in securities.

13. For purposes of proposed Rule 2165, the term "immediate family member" shall include a spouse, child, grandchild, parent, brother or sister, mother-in-law or father-in-law, brother-in-law or sister-in-law, and son-in-law or daughter-in-law, each of whom must be age 18 or older.

ATTACHMENT A

Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

* * * * *

Text of Proposed Changes to FINRA Rule 4512

* * * * *

4000. FINANCIAL AND OPERATIONAL RULES

* * * * *

4500. BOOKS, RECORDS AND REPORTS

* * * * *

4512. Customer Account Information

(a) Each member shall maintain the following information:

(1) for each account:

(A) customer's name and residence;

(B) whether customer is of legal age;

(C) name(s) of the associated person(s), if any, responsible for the account, and if multiple individuals are assigned responsibility for the account, a record indicating the scope of their responsibilities with respect to the account, provided, however, that this requirement shall not apply to an institutional account;

(D) signature of the partner, officer or manager denoting that the account has been accepted in accordance with the member's policies and procedures for acceptance of accounts; [and]

(E) if the customer is a corporation, partnership or other legal entity, the names of any persons authorized to transact business on behalf of the entity; <u>and</u>

<u>(F) subject to Supplementary Material .06, name of and contact information for a trusted contact person who may be contacted about the customer's account, is age 18 or older and not authorized to transact business on behalf of the account; provided, however, that this requirement shall not apply to an institutional account.</u>

(2) through (3) No Change.

(b) A member need not meet the requirements of this Rule with respect to any account that was opened pursuant to a prior FINRA rule until such time as the member updates the information for the account either in the course of the member's routine and customary business or as otherwise required by applicable laws or rules.

(c) No Change.

• • • Supplementary Material: --------------

.01 through .05 No Change.

.06 Trusted Contact Person

(a) With respect to paragraph (a)(1)(F) of this Rule, at the time of account opening, a member shall disclose in writing, which may be electronic, to the customer that the member or an associated person of the member is authorized to contact the trusted contact person and disclose information about the customer's account to confirm the specifics of the customer's current contact information, health status, and the identity of any legal guardian, executor, trustee or holder of a power of attorney, and as otherwise permitted by Rule 2165.

(b) The absence of the name of or contact information for a trusted contact person shall not prevent a member from opening or maintaining an account for a customer, provided that the member makes reasonable efforts to obtain the name of and contact information for a trusted contact person.

Text of Proposed New FINRA Rule

* * * * *

2000. DUTIES AND CONFLICTS

* * * * *

2100. TRANSACTIONS WITH CUSTOMERS

* * * * *

2165. Financial Exploitation of Specified Adults

(a) Definitions

(1) For purposes of this Rule, the term "Specified Adult" shall mean: (A) a natural person age 65 and older; or (B) a natural person age 18 and older who the member reasonably believes has a mental or physical impairment that renders the individual unable to protect his or her own interests.

(2) For purposes of this Rule, the term "Account" shall include any account of a member for which a Specified Adult has the authority to transact business.

(3) For purposes of this Rule, the term "Qualified Person" shall mean an associated person of a member who serves in a supervisory, compliance or legal capacity that is reasonably related to the Account of the Specified Adult.

(4) For purposes of this Rule, the term "Trusted Contact Person" shall mean the person who may be contacted about the Specified Adult's Account in accordance with Rule 4512.

(5) For purposes of this Rule, the term "immediate family member" shall include a spouse, child, grandchild, parent, brother or sister, mother-in-law or father-in-law, brother-in-law or sister-in-law, and son-in-law or daughter-in-law, each of whom must be age 18 or older.

(6) For purposes of this Rule, the term "financial exploitation" shall include:

(A) the wrongful or unauthorized taking, withholding, appropriation, or use of a Specified Adult's funds or securities; or

(B) any act or omission taken by a person, including through the use of a power of attorney, guardianship, or any other authority regarding a Specified Adult, to:

(i) obtain control, through deception, intimidation or undue influence, over the Specified Adult's money, assets or property; or

(ii) convert the Specified Adult's money, assets or property.

(b) Temporary Hold on Disbursements

(1) A Qualified Person may place a temporary hold on a disbursement of funds or securities from the Account of a Specified Adult if:

(A) The Qualified Person reasonably believes that financial exploitation of the Specified Adult has occurred, is occurring, has been attempted, or will be attempted; and

(B) The member not later than two business days provides notification of the temporary hold and the reason for the temporary hold to:

(i) all parties authorized to transact business on the Account; and

(ii) the Trusted Contact Person, unless the Trusted Contact Person is unavailable or the member reasonably believes that the Trusted Contact Person has engaged, is engaged, or will engage in the financial exploitation of the Specified Adult, in which case the member shall attempt to contact an immediate family member of the Specified Adult, if available, unless the member reasonably believes that the immediate family member has engaged, is engaged, or will engage in the financial exploitation of the Specified Adult; and

(C) The member immediately initiates an internal review of the facts and circumstances that caused the Qualified Person to reasonably believe that the financial exploitation of the Specified Adult has occurred, is occurring, has been attempted, or will be attempted.

(2) The temporary hold authorized by this Rule will expire not later than 15 business days after the date that the Qualified Person first placed the temporary hold on the disbursement of funds or securities, unless sooner terminated by an order of a court of competent jurisdiction or extended either by an order of a court of competent jurisdiction or pursuant to paragraph (b)(3) of this Rule.

(3) Provided that the member's internal review of the facts and circumstances under paragraph (b)(1)(C) of this Rule supports the Qualified Person's reasonable belief that the financial exploitation of the Specified Adult has occurred, is occurring, has been attempted, or will be attempted, the temporary hold authorized by this Rule may be extended by a Qualified Person for no longer than 15 business days following the date authorized by paragraph (b)(2) of this Rule, unless sooner terminated by an order of a court of competent jurisdiction.

(c) Record Retention

Members shall retain records related to compliance with this Rule, which shall be readily available to FINRA, upon request. The retained records shall include, but shall not be limited to, records of: (1) request(s) for disbursement that may constitute financial exploitation of a Specified Adult and the resulting temporary hold; (2) the finding of a reasonable belief that financial exploitation has occurred, is occurring, has been attempted, or will be attempted underlying the decision to place a temporary hold on a disbursement; (3) notification(s) to the relevant parties pursuant to paragraph (b)(1)(B) of this Rule; and (4) the internal review of the facts and circumstances pursuant to paragraph (b)(1)(C) of this Rule.

• • • Supplementary Material: --------------

.01 Applicability of Rule. This Rule provides members with a safe harbor when they exercise discretion in placing temporary holds on disbursements of funds or securities from the Account of a Specified Adult under the specified circumstances denoted in the Rule. This Rule does not require members to place temporary holds on disbursements of funds or securities from the Account of a Specified Adult.

.02 Supervision. In addition to the general supervisory and recordkeeping requirements of Rules 3110, 3120, 3130, 3150, and Rule 4510 Series, a member relying on this Rule must establish and maintain specific written supervisory procedures reasonably designed to achieve compliance with this Rule, including, but not limited to, procedures related to the identification, escalation and reporting of matters related to financial exploitation of Specified Adults.

.03 Training. A member relying on this Rule must develop and document specific training policies or programs reasonably designed to ensure that registered persons comply with the requirements of this Rule.

.04 Reasonable Belief of Mental or Physical Impairment. A member's reasonable belief that a natural person age 18 and older has a mental or physical impairment that renders the individual unable to protect his or her own interests may be based on the facts and circumstances observed in the member's business relationship with the natural person.

NASAA

2016 NASAA
Broker-Dealer Coordinated Exam:
Summary of Preliminary Results

September 2016

Introduction

NASAA is the voice of state, provincial, and territorial securities administrators in the 50 states, the District of Columbia, Puerto Rico, the U.S. Virgin Islands, Canada, and Mexico. The role of NASAA members in securities regulation is crucial as they serve as the first line of defense for investors from every walk of life. As part of their role on the front lines of emerging issues in securities regulation, NASAA and its members consider protecting senior investors a core part of their mission. With 10,000 Americans projected to turn 65 every day between now and 2030,[1] and in excess of 77 percent of all financial assets in the United States concentrated in the hands of those individuals,[2] NASAA and its members believe that protecting senior investors is essential. Indeed, according to one study, seniors lose $2.9 billion to financial exploitation every year.[3] Furthermore, in an environment of low interest rates, yet increasingly lengthy retirements, senior investors are facing the challenge of searching for higher yielding investment products, which often come with increased risk.

In the last decade, NASAA and its members have developed a number of initiatives aimed at protecting senior investors, from policy matters, to advocacy, and even regulatory actions. Policy initiatives by NASAA and its members have included a 2008 joint report with the SEC and FINRA on issues related to senior investors;[4] the drafting of a model rule addressing so-called "senior designations" and a model act to address the financial exploitation of vulnerable adults; the development of the Senior$afe Training program for financial professionals as well as the Serve Our Seniors website; and strong support for the Senior$afe Act of 2016 in the United States Congress. These initiatives have been in addition to the day-to-day work of

[1] *See* "Baby Boomers Retire," Pew Research Center, available at http://www.pewresearch.org/daily-number/baby-boomers-retire/.

[2] Securities Industry and Financial Markets Association, Senior Investor Protection White Paper: SIFMA and The Industry's Efforts to Protect Senior Investors, Apr. 27, 2016, available at http://www.sifma.org/issues/item.aspx?id=8589960115.

[3] The MetLife Study of Elder Financial Abuse, June 2011, available at www.metlife.com/assets/cao/mmi/publications/studies/2011/mmi-elder-financial-abuse.pdf.

[4] Protecting Senior Investors: Compliance, Supervisory and Other Practices Used by Financial Services Firms in Serving Senior Investors (2008 Joint Report) (Sept. 22, 2008), available at https://www.sec.gov/spotlight/seniors/seniorspracticesreport092208.pdf.

NASAA members conducting examinations and initiating enforcement actions related to the exploitation of seniors and other vulnerable investors.

In 2016, NASAA members conducted a coordinated exam of broker-dealers ("Coordinated Exam") on issues related to senior investors. The Coordinated Exam sought information from the examined firms on policies, procedures, and training related to seniors and other potentially vulnerable customers. Twenty states sought information in several categories, including, among others:

- Proactive assessment efforts by the firms related to senior investors;
- Training provided by broker-dealers to employees regarding senior investors, the identification of elder abuse, and diminished capacity;
- Supervisory policies, procedures and other controls potentially relevant to senior investors; and
- Potential suitability concerns identified by member jurisdictions.

This report summarizes the preliminary findings as part of the ongoing dialogue between broker-dealers and NASAA members on the important issue of protecting senior investors.

COORDINATED EXAM HIGHLIGHTS:

- Approximately 20 percent of the exams involved a broker-dealer that has not established written supervisory procedures on **any** of the key senior issues focused on during the Coordinated Exam.
- The Coordinated Exam focused on three key senior investor related training topics. More than 62 percent of the exams related to a firm that offers training on **all** of these topics.
- There appears to be limited development of "trusted contact forms" at firms, and very limited use of the forms even after they are developed.
- Only 24 percent of the exams related to a brokerage that requires verification of senior clients' profile information more frequently than every 36 months.

- Potentially unsuitable recommendations to senior investors were identified in 10 percent of the exams.
- Firms permitting the use of "senior designations" may need to improve related controls and procedures.
- At most offices where *any* complaint had been filed in the 24-month period, the majority had been filed by senior clients.

Overview

The 2016 NASAA Coordinated Exam included 62 exams of broker-dealer offices during which the examination teams reviewed activity in senior client accounts. The Coordinated Exam primarily utilized a module designed for purposes of the Coordinated Exam. In addition to highlighting states' observations about broker-dealer practices, the Coordinated Exam was designed to identify possible relationships between supervision/training practices and sales related issues with senior clients. To that end, the exams collected information about each examined firm's policies and supervision practices along with transactional data.

The exams covered various broker-dealer models and office types. There were no mandates established with respect to the firms examined for the Coordinated Exam. Instead, each jurisdiction was encouraged to select the firms and offices examined in accordance with the jurisdiction's normal practices. This allowed for the jurisdictions to better account for qualitative and quantitative data and to maximize their ability to conduct relevant examinations.

The vast majority of the exams were conducted at branch or non-branch locations of broker-dealers while only a handful were identified as having been conducted at the firm's home office. Therefore, the data collected provides insight on the extent to which firms' policies and procedures related to senior investors have been implemented at remote locations.

At least 39 unique firms were examined during the Coordinated Exam. Some jurisdictions did not identify the name of the firm examined in accordance with jurisdictional requirements and practices. Consequently, these preliminary findings are being presented in terms of the number of exams conducted (i.e., X percent of the exams conducted indicated that the broker-dealer had a violation).

Committees or Personnel Dedicated to Senior Investor Issues

There are many complex and often sensitive issues that must be considered in order to better protect senior investors. Industry leaders have taken this charge very seriously, and many have created formal committees to develop useful practices and procedures. Some of the firms that have not created a senior investor-focused committee have at least designated one or more persons to address senior investor-related issues. Approximately 62 percent of the exams found that the broker-dealer had established a formal committee or designated at least one person to focus on senior investor issues.

Supervisory Procedures

Broker-dealers are required to establish and maintain supervisory systems and written procedures that are reasonably designed to ensure compliance with applicable securities laws.[5] Regulatory guidance has highlighted the importance of accounting for a firm's obligations to senior clients.[6] As a result, the Coordinated Exam assessed whether broker-dealers had developed written procedures specific to key concern areas and had incorporated enhanced controls into the firm's supervision of activity in senior client accounts.

The Coordinated Exam focused on whether the subject broker-dealer had implemented written procedures specific to four key issues:

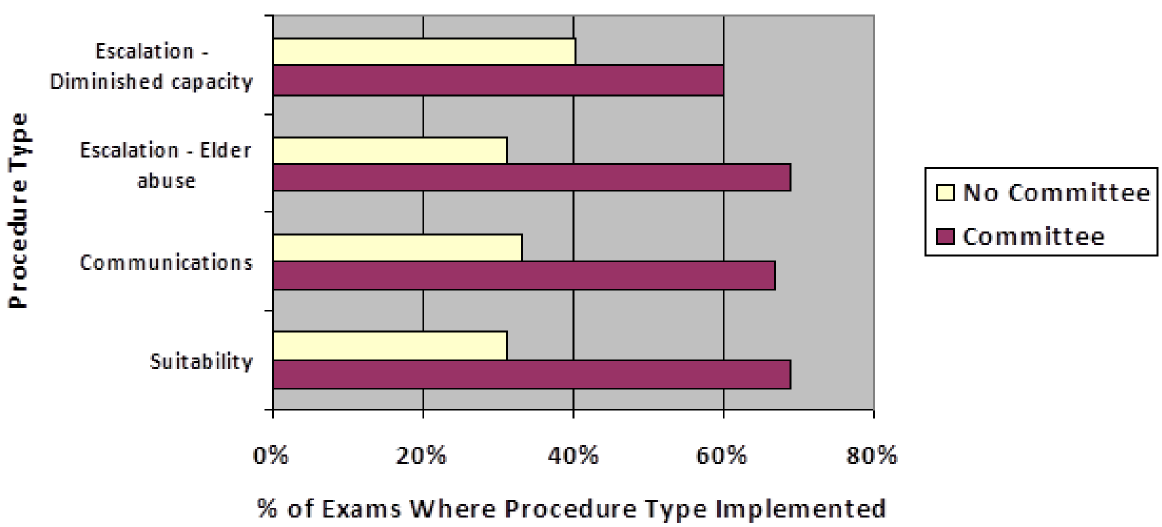
(1) The suitability of recommendations to senior investors;
(2) Communications with seniors;
(3) Escalation protocols in the case of suspected elder abuse; and
(4) Escalation practices in response to signs of diminished capacity.

[5] *See, e.g.* Uniform Securities Act § 204(a)(2)(J); *see also* FINRA Rule 3110.

[6] *See, e.g.* FINRA Regulatory Notice 07-43, September 2007, available at http://www.finra.org/sites/default/files/NoticeDocument/p036816.pdf.

About 39 percent of the exams resulted in findings that the brokerage had established written procedures addressing all four of these areas. On the other hand, 20 percent of the exams found that the brokerage had not established written procedures addressing *any* of the four areas.

As the chart below indicates, a firm with developed procedures on key areas related to senior investors is more likely to have designated a committee or personnel to focus on senior investors.



Training

There is some complexity and a great deal of sensitivity involved in identifying signs of elder abuse and diminished capacity. Similarly, the steps necessary to protect vulnerable seniors from various forms of intended and unintended harm can be equally complex. There are entire government agencies across the country dedicated solely to assisting senior citizens. Financial service professionals are not expected to be experts in this realm. However, they are well-positioned to serve as front-line defenders against the harm that elder abuse and diminished capacity may cause. Mandating participation in well-developed training will assist representatives and their firms in navigating those complexities and in protecting their senior clients.

The Coordinated Exam included an assessment as to whether examined firms currently provide training on communicating with seniors, escalating elder abuse and diminished capacity concerns, and suitability considerations for senior clients. Importantly, more than 62 percent of the exams found the firms offer training on all of these subjects. Moreover, virtually every firm that provides training on all three of the areas actually mandated that representatives take one or more of the trainings.

Communications with Senior Clients

Firms have recognized the need to take steps to improve their communications with senior clients. A 2008 report by NASAA, the SEC, and FINRA indicated that firms reported adopting practices such as increasing the frequency of contact with senior investors to stay on top of financial needs/life events and communicating in writing and documenting conversations with senior clients.[7] Such measures are essential to enhancing a firm's ability to prevent and mitigate the effects of elder abuse, but also toward recognizing signs of diminished capacity and supporting the recommendation of suitable investments by their representatives.

Trusted Contact Forms

One of the tools commonly discussed by financial service firms with respect to combatting the effects of elder abuse and diminished capacity is the "trusted contact form." Of course various names are used for this type of form, but the primary goal is the same. For purposes of the Coordinated Exam, a "trusted contact form" was defined as a form that captures the name and contact information of a trusted person that the firm may contact for purposes of administering

[7] 2008 Joint Report, *supra*, note 4 at 5.

the account or in the event of financial exploitation concerns.[8] Yet, only 39 percent of the exams indicated that the firm used some version of a trusted contact form.

To the extent this preliminary finding does not correspond with a broader impression of the use of trusted contact forms, this preliminary finding could indicate that awareness, and use, of trusted contact forms may be limited at certain branch locations.

In addition to asking if a firm has developed a form to collect trusted contact information, the Coordinated Exam also assessed how often the trusted contact information is actually collected. At firms where a trusted contact form was in use, less than 15 percent of all senior clients reviewed at those firms during the Coordinated Exam had a completed form.

There are various reasons why such information may not yet be on file. For example, a key factor could be whether or not the trusted contact form is only presented to a client at the time the account is opened or the client's profile is updated. The relatively recent implementation of trusted contact forms may also impact the current rate of use. More significant is the reality that many clients may hesitate to share such information, either out of concern about the privacy of the contact person or concern about allowing anyone else access to their own financial information. Financial service firms would be well advised to review their practices and communications related to trusted contact forms to maximize their ability to collect this information, especially from senior clients.

Frequency of Communications

There are many benefits to frequent communication with senior clients. In addition to serving client needs, frequent communications enhance the ability of representatives and brokerages to identify signs of diminished capacity or elder abuse. Moreover, frequent communications allow firms to update trusted contact information and key client profile information more

[8] Because such information may also be collected through other means, such as on new account opening forms, an affirmative response was required even is this type of information was collected on another form designed to collect additional information.

often. Some firms have long recognized the value of communicating more with senior clients.[9]

However, only 24 percent of the exams involved a firm that required verification of customer profiles of senior investors more often than the legal requirement of 36 months. Of course, it is possible that a firm verifies the profile information more often than every 36 months, but does not formally document more frequent verifications of senior clients' customer profile information. In any event, documentation of these verifications serves an important risk management purpose and may reflect the extent of a firm's investment in developing practices designed to protect its senior clients.

Other Communication Related Measures

The Coordinated Exam also sought to assess different ways that the brokerage industry has amended its communication methods with senior investors to account for common age-related changes in physical abilities, to identify/combat effects of elder abuse, and for general business risk management purposes. Firms examined during the Coordinated Exam have taken steps such as:

- Increasing the size of the font used in certain written communications;
- Documenting verbal communication more regularly; and
- Requiring meetings with senior clients to take place at the firm's office.

Suitability

An investor's age is obviously not the only factor to consider in a suitability analysis, but age can affect many of the other factors typically considered in a suitability analysis such as risk tolerance and investment objectives. Furthermore, senior investors who are retired face a greater challenge in overcoming the negative effects of an unsuitable recommendation that results in losses or a lack of sufficient liquidity.

[9] *See* 2008 Joint Report, *supra*, note 4 at 5-8.

Procedures and Controls

Broker-dealers are required to review trading activity in all client accounts. The Coordinated Exam sought insight into whether brokerages would take the position that they did not need to establish procedures *specific* to suitability for senior investors. That is, do firms feel there is no need for specific procedures because age and life circumstances should be considered in connection with securities recommendations to most, if not all, individual clients.

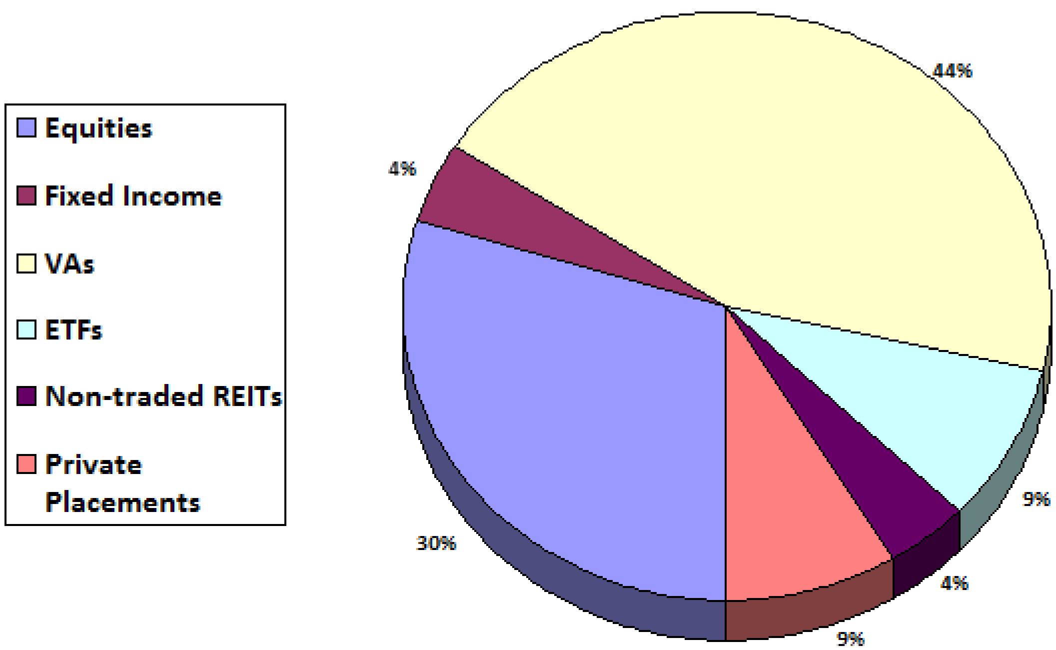
However, more than 72 percent of the exams found that firms had developed specific written procedures associated with suitability of recommendations to senior clients. Some firm responses suggested a view that suitability procedures specific to seniors were not necessary because of general suitability considerations. However, such a view appears to be in the minority.

Of the 45 exams where senior specific suitability procedures had been implemented, 21 involved a firm that mandated heightened reviews for the sale of certain investment products to seniors. Variable annuities and "alternative investments" were the primary product types for which firms mandated heightened reviews based on a specific age. Examples of alternative investments include, among others, investments in non-traded real estate investment trusts (REITs) and business development companies (BDCs). Examined firms utilize ages ranging from 55-80 as triggers for mandating heightened review before approving sales of selected products. One of the examined firms required heightened review before approving options activity for clients over the age of 70.

Broker-dealers are required to review trading activity in client accounts even in the absence of red flags. Interestingly, only 39 percent of all exams found that broker-dealers include clients' ages on the trade records used in connection with regular trade reviews. The inclusion of the age on trade review records could greatly improve a supervisor's ability to identify potentially unsuitable recommendations generally and specifically with respect to senior investors. Moreover, including the age on records reviewed by a supervisor would increase the number of firm personnel that might note suspect activity in an account that might indicate age-related diminished capacity or elder abuse.

Potentially Unsuitable Recommendations

Approximately 10 percent of the exams included in the Coordinated Exam identified potentially unsuitable recommendations to senior investors. The graph below is a breakdown of the frequency with which various products types were associated with the potentially unsuitable recommendations made to 41 senior clients included in the Coordinated Exam.



That variable annuities were the product most frequently associated with potentially unsuitable recommendations reinforces the importance placed on serving senior clients by state and federal securities regulators. In recent years, regulators have expressed concern about sales practices associated with variable annuities sales to senior investors.[10] In particular, there is a general concern with the sale of variable annuities to senior clients or those approaching retirement because of the penalty rates associated with early withdrawals.

Potential suitability issues were also identified with exchange-traded funds (ETFs) sold to seniors. The suitability concerns with ETFs primarily relate to non-traditional ETFs, such as leveraged and inverse ETFs. The "reset" periods associated with these products, which are often daily, can affect the suitability determination because the products are designed to achieve their objective within the reset period. Firms should closely monitor any sales of these products to senior investors given that these products are designed to be used as part of short-term trading strategies.

While traditional equities are not regularly discussed as priority concerns, regulators and the industry should note that 30 percent of suitability concerns identified during the Coordinated Exam involved equities. In fact, potential suitability issues related to equities far outweighed any identified concerns with other products that have received increased regulatory attention over the last few years such as non-traded REITs.

In the exams that evinced suitability concerns, there was no correlation with lack of training as the suitability concerns almost all occurred in exams of firms that actually *required* training on both senior investor suitability and communicating with seniors. Whether the potentially unsuitable recommendation was in fact unsuitable as well as whether the potentially unsuitable recommendations took place after the representatives participated in the mandatory training is beyond the scope of this report. Nonetheless, this finding should serve as a reminder to the industry that the mere existence of a training program, even a mandatory one, may not be enough if the training program is not adequately designed to effectively train representatives, if supervisors rely too heavily on the training, or if a firm ineffectively screens candidates at the hiring stage.

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[10] *See, e.g.* NASAA Informed Investor Alert: Annuities, available at http://www.nasaa.org/2692/informed-investor-alert-annuities/; *see also* FINRA Investor Alert: Variable Annuities Beyond the Hard Sell, available at https://www.finra.org/sites/default/files/InvestorDocument/p125846.pdf.

Marketing to Senior Investors

Through rulemaking and the issuance of industry-oriented guidance, financial service regulators have consistently stressed concern over potentially misleading marketing efforts related to senior investors.[11] Therefore, the Coordinated Exam reviewed common areas of concern to assess the prevalence of certain practices.

Seminars

Seminars targeting seniors, and especially "free lunch seminars," have been the subject of many investor alerts by state and federal regulators.[12] A report issued in 2007 by NASAA, the SEC, and FINRA concluded these seminars are designed to sell investments even though they are often touted as "educational;" attendees may not understand that the seminar is sponsored by a company tied to investments discussed at the seminar; and there were apparent weaknesses in firms' supervision of seminars.[13]

Thirteen of the offices examined had offered one or more investor-oriented seminars within the prior 12 months. Approximately 50 percent of these offices had offered seminars focused on senior investors or those approaching retirement. Importantly, these six exams resulted in no findings of concern by the examining jurisdiction. So, while concerns related to senior seminars still exist, the industry appears to have implemented improvements related to senior seminars.

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[11] *See, e.g.* NASAA Model Rule on the Use of Senior-Specific Certifications and Professional Designations, available at http://www.nasaa.org/wp-content/uploads/2011/07/3-Senior_Model_Rule_Adopted.pdf.

[12] *See, e.g.* NASAA Investor Alert: Free Meal Seminars, available at, http://www.nasaa.org/1950/senior-investor-alert-free-meal-seminars/; *see also* FINRA Investor Alert: "Free Lunch" Investment Seminars—Avoiding the Heartburn of a Hard Sell, available at http://www.finra.org/investors/alerts/free-lunch-investment-seminars.

[13] Protecting Senior Investors: Report of Examinations of Securities Firms Providing "Free Lunch" Sales Seminars, (Sept. 2007), available at https://www.sec.gov/spotlight/seniors/freelunchreport.pdf.

Senior Designations

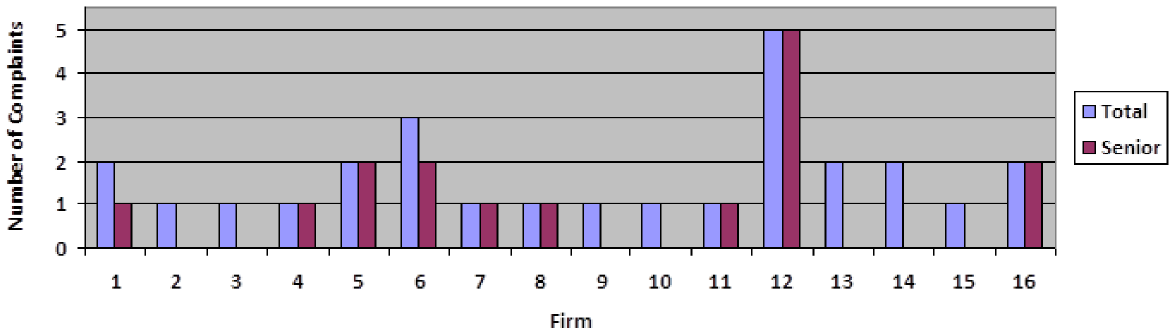
Approximately one-third of all exams involved a firm that permits representatives to use a "senior designation." For purposes of the Coordinated Exam, a senior designation was defined as any title or designation that conveys or suggests an expertise in senior investments or retirement planning. Of the firms that permit the use of senior designations, almost 48 percent of the exams were of firms that do not maintain a list of approved senior designations. Moreover, 25 percent of the exams where the broker-dealer allows the use of senior designations without a list of approved designations found that the firm did not even have procedures related to the approval of senior designations.

Thirty-two states have enacted rules designed to curb the use of designations that may mislead senior investors into believing that an individual has relevant expertise. These rules only permit the use of such designations when issued by a properly accredited entity to professionals who have completed an established training program and who are subject to reasonable monitoring and discipline for engaging in unethical conduct.

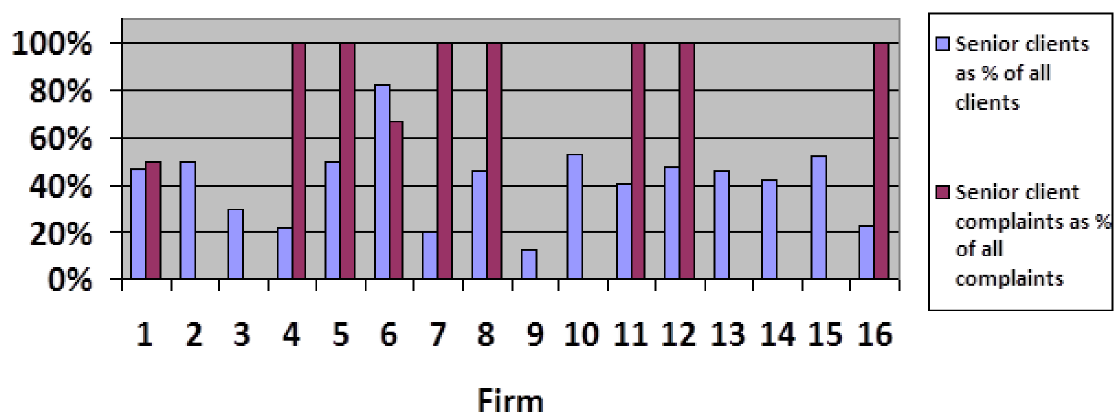
There are numerous designations used by financial service professionals that do not require sufficient, if any, demonstrated expertise or training on senior investor matters. Broker-dealers allowing the use of senior designations without appropriate controls and procedures are placing themselves and their senior clients at significant risk.

Complaints

While the focus of the Coordinated Exam was not enforcement-related, examiners observed an interesting trend in complaints that is worthy of mention. Examiners collected data on complaints related to the examined offices and filed within the prior 24 months. Overall, complaints filed by senior clients were found in approximately 15 percent of the offices examined.



More interesting is the fact that, over the relevant 24 month period at most offices where *any* complaint had been filed, the majority had been filed by senior clients.



Notably, in nearly 50 percent of offices with complaints, the relative frequency of senior client complaints was much higher than the percentage of the overall client base made up of senior clients. That is, the rate of complaints filed by senior clients is disproportionately high. Broker-dealers and regulators should continue their zealous efforts to effect change that will better educate financial service professionals and the investing public about suitability issues specific to senior investors.

Conclusion

NASAA and its members remain committed to advancing protections for senior investors. The Coordinated Exam is just one of the many efforts being undertaken currently by NASAA, the SEC, FINRA, and the industry. All of these efforts serve a shared objective—raising awareness of the issues affecting senior investors and fostering helpful changes in practices at firms and regulatory agencies.

The preliminary findings of the Coordinated Exam indicate that numerous broker-dealers are taking valuable steps such as designating personnel to focus on senior investor matters and developing procedures that are mindful of the common issues facing senior clients. Similarly, a majority of the exams involved a firm that has not only developed senior investor-specific training but has also mandated such training. It is also encouraging that examined broker-dealers are utilizing improved communication methods and are implementing age-related controls on certain investments.

However, these preliminary findings also identified areas where improvement appears needed. For example, it is concerning that 20 percent of the examinations involved firms that did not have written procedures on any of the areas previously highlighted by regulators. And while some firms are already using trusted contact forms, there is a need to enhance the methods and communications around collecting trusted contact information from senior clients to increase the rate at which such information is submitted. Senior investor complaints outpace the rate at which other clients filed complaints at the examined firms. In addition to the general relevance of this finding, it should serve to remind firms that improved communications with senior clients, and documentation of those communications, will not only serve these clients but will also serve an important risk-management purpose.

In sum, the preliminary findings from the Coordinated Exam indicate that past efforts to highlight senior investor matters have been successful at effecting change, but continued progress is necessary to best serve our aging population.

NASAA 2016
Enforcement Report

Based on 2015 Data

NASAA

Introduction

The North American Securities Administrators Association (NASAA) is an international association of all state, provincial and territorial securities regulators in the United States, Canada and Mexico. NASAA members have protected Main Street investors from fraud for more than 100 years.

Annually, NASAA conducts an enforcement survey of its U.S. members. It then analyzes the data and identifies trends. This year, 52 U.S. jurisdictions responded to the survey (Canadian NASAA members participate in a different enforcement survey; an overview is provided on page 6). The data, statistics and trends included in this report give a general overview of state enforcement efforts for the 2015 fiscal or calendar year.[1] Undoubtedly, however, this report undercounts many statistics since it does not include enforcement statistics from every jurisdiction on each survey question posed.

While securities markets are global, securities are sold locally by professionals who are licensed in every state where they conduct business. Our nation's unique complementary system of state, federal, and industry regulation helps to ensure fair markets for all investors. In enforcing our state securities laws, NASAA's U.S. members seek not only to sanction those who damage the integrity of our markets or cause harm to investors, but also to deter future financial misconduct. Credible deterrence involves several key elements: a strong legal framework with clear repercussions for misconduct; mechanisms and systems to detect and investigate misconduct; and decisive action and sanctions against those that violate the law.

Despite the hard work of NASAA's U.S. members and other regulators, securities fraud still poses a significant and real risk to investors. With interest rates expected to remain low – putting increased financial pressure on many Americans – the growing complexity of financial products and markets, and the increasing frequency of investment scams (many of which target our most vulnerable seniors), vigilance by regulators is essential. As this report demonstrates, NASAA members are well-prepared and equipped to meet this critical need and to aggressively protect the integrity of our markets and investors from fraud.

Sincerely,

Laura Posner
NASAA 2015-2016 Enforcement Section Chair
Chief, New Jersey Bureau of Securities
Office of the New Jersey Attorney General

2015-2016 NASAA Enforcement Section:
Joe Rotunda, Texas
Greg Strong, Delaware
Pat Ahern, Massachusetts
Jesse Devine, New York
Jason Roy, Manitoba

At a Glance:

- More than $530 million in monetary relief obtained for investors.
- More than 5,000 investigations conducted.
- More than 2,000 enforcement actions brought.
- More than 1,200 years of criminal relief obtained.
- More than 3,000 license sanctions.

[1] *The survey requests that each NASAA U.S. member provide statistics using that member's most recent full reporting year. Some members collect and report data on a calendar basis, while other members collect and report data on a fiscal year basis. For this report, 34 responding members reported statistics from the 2015 calendar year, and 18 members reported statistics from the 2014-2015 fiscal year.*

2015 Results

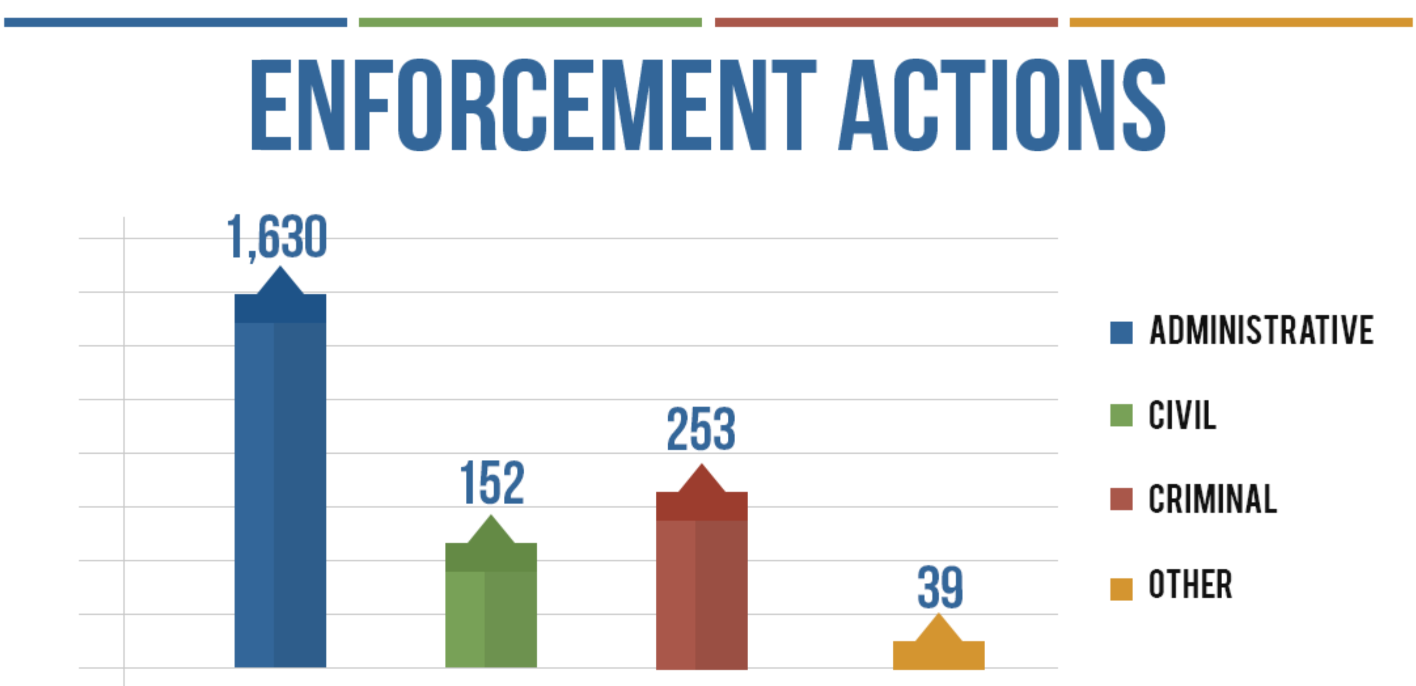
The vigorous, fair and effective enforcement of state securities laws through formal administrative, civil and criminal actions is a critical priority for NASAA members.

Investigations Conducted

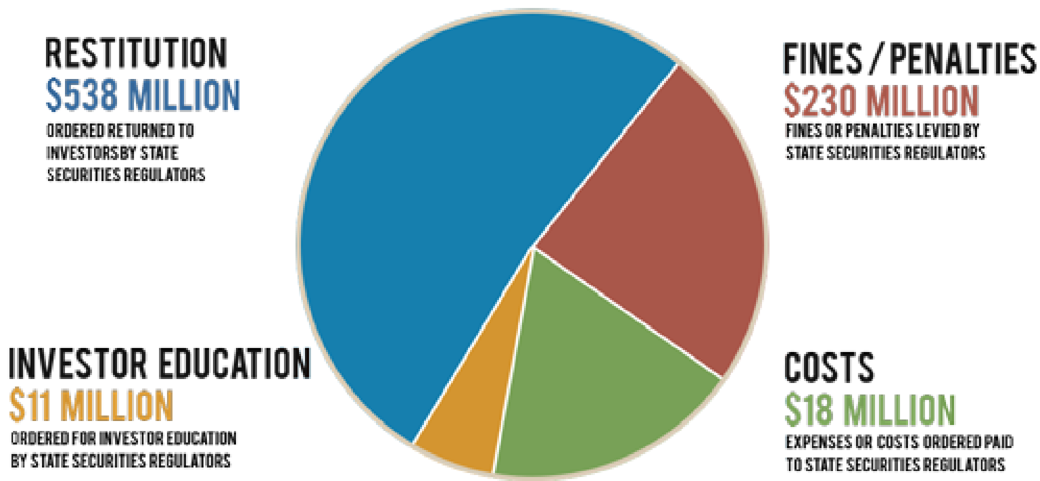
During 2015, state securities regulators conducted more than 5,000 investigations. These formal investigations are supplemented by extensive efforts to informally resolve complaints and referrals. Because investigations differ widely in their complexity and in the number of respondents and victims involved, the amount of time required to conduct an investigation can range from a few weeks to multiple years, with complex investigations often requiring a significant expenditure of both time and resources.

Enforcement Actions

Through NASAA's U.S. members' vigilance, in 2015, state securities regulators brought more than 2,000 enforcement actions against more than 2,700 respondents. As the charts that follow demonstrate, a single enforcement action often names several individuals and one or more companies as respondents. Large or complex cases can have numerous respondents.



MONETARY RELIEF OBTAINED

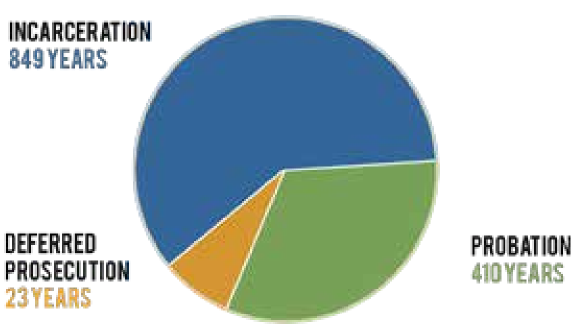


Relief Obtained

The sanctions imposed by NASAA's U.S. members for securities law violations range from bans on future activity or from trading in securities, to financial penalties and prison sentences. The sanctions imposed by state securities regulators can vary considerably from year-to-year, depending on the nature of the cases pursued.

As part of state securities regulators' continued focus on the investors in their jurisdictions, in 2015, NASAA's U.S. members ordered wrongdoers to return more than $530 million to aggrieved investors.[2] Additionally, NASAA's U.S. members levied fines or penalties of more than $230 million. In addition to restitution, disgorgement and fines or penalties, respondents also are often ordered by state securities regulators to pay part or all of the costs of the proceeding or for investor education initiatives. The states required that respondents pay almost $18 million in costs or expenses, and more than $11 million for investor education efforts in 2015.

CRIMINAL RELIEF OBTAINED



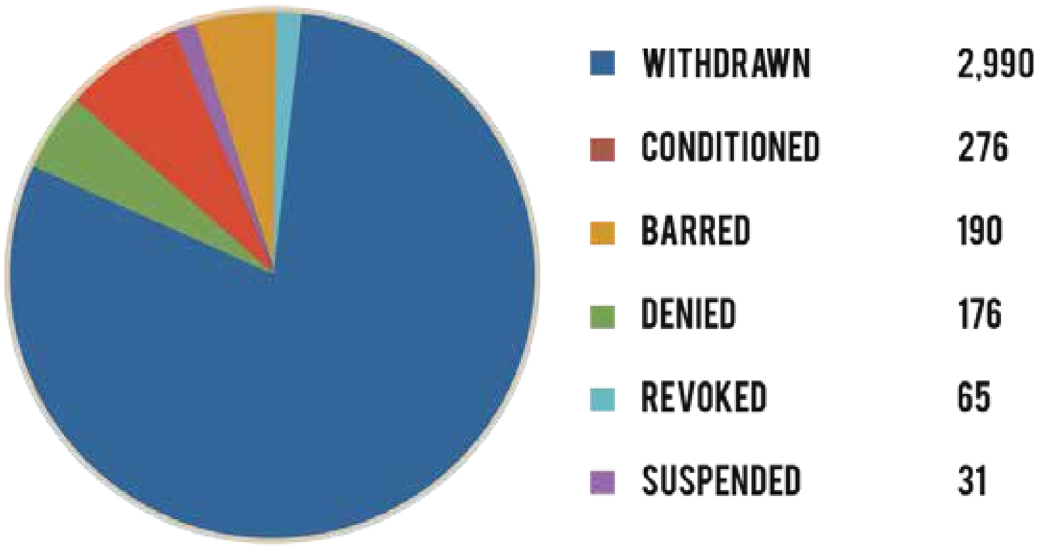
In addition to monetary sanctions, jurisdictions reported a continued high level of specific and general deterrence by imposing criminal sanctions. Collectively, in 2015, criminal defendants were sentenced to more than 1,200 years of incarceration, probation or deferred adjudication through the efforts of state securities regulators.

NASAA'S U.S. MEMBERS ORDERED WRONGDOERS TO RETURN MORE THAN $530 MILLION TO AGGRIEVED INVESTORS.

Importantly, state securities regulators also denied unscrupulous actors from operating in the securities industry and limited the activity of licensees/registrants. In 2015, more than 3,000 license/registration requests were withdrawn as a result of state action. While not all license/registration requests are withdrawn because a state regulator is about to take action to deny or limit the license/registration, many

[2] *This figure represents restitution reported by NASAA U.S. member jurisdictions. Not all jurisdictions provided a restitution amount. This figure does not account for unilateral and unreported returns to investors, or rescission offers by firms or investigative targets.*

LICENSE SANCTIONS



license/registration requests are withdrawn as a state is preparing to take action to deny, suspend, or revoke a license/registration.

In addition, more than 250 individuals had their licenses/registrations revoked or were barred from the industry, and more than 475 licenses/registrations were denied, suspended or conditioned as a result of state action.

Types of Products & Schemes

State securities regulators brought enforcement actions for a variety of different violations of state securities laws. While most state securities enforcement actions involve some sort of fraud, traditionally marked by material misrepresentations, false statements or a scheme designed to defraud or deceive investors, the form that fraud takes varies.

Most Reported Products & Schemes 2015

In order of frequency of investigations reported by states.

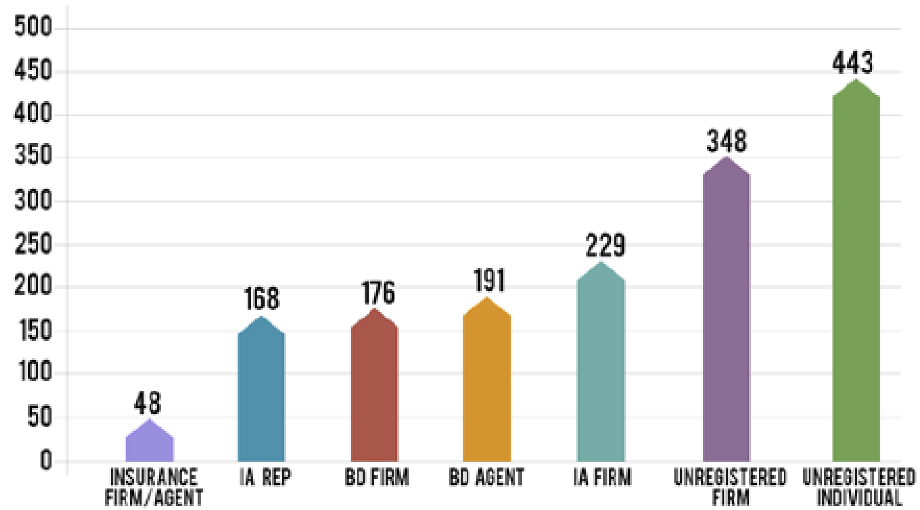
1. Ponzi Schemes
2. Real Estate Investment Program Fraud
3. Oil and Gas Investment Program Fraud
4. Internet Fraud
5. Affinity Fraud

In 2015, the most common fraudulent investment products involved real estate or oil and gas ventures. NASAA's U.S. members were particularly successful in bringing enforcement actions against violators selling these products in 2015. For example, Colorado secured an important District Court decision that makes clear that oil and gas interests are securities and subject to state securities laws.

In 2015, numerous state securities regulators settled enforcement actions brought against LPL Financial, LLC arising out of its sale of non-traded Real Estate Investment Trusts (REITs). The settlement required the firm to remediate losses for all non-traded REITs sold between January 1, 2008 and December 31, 2013 in violation of prospectus standards, state concentration limits, or the firm's own internal guidelines. LPL Financial, LLC, was also required to retain an independent third party to review and verify executed sales transactions during this period, which may include more than 2,000 sales, as well as to pay significant civil penalties to the states.

In addition to real estate and oil and gas investments, in 2015, state securities regulators continued to launch numerous investigations and enforcement actions involving variable and indexed annuities, hedge funds, life

TYPES OF RESPONDENTS



settlements/viaticals, and structured products, among others. Regardless of the product being sold or what the investment was in, the most common type of fraud cases remain Ponzi schemes.

VULNERABLE ADULTS, PRIMARILY SENIOR INVESTORS, WERE AGAIN TARGETED BY FRAUDSTERS DISPROPORTIONATLEY.

Reflecting a growing trend, in 2015, victims were often targeted through the internet, or as a result of being part of a specific race, religion, age bracket, profession, or other identifiable affinity group. Vulnerable adults, primarily senior investors, were again disproportionately targeted by fraudsters. In 2015, nearly one-third of all investigations conducted by states that reported senior specific information involved senior victims.

Looking forward, information reported by NASAA's U.S. members indicates that unscrupulous promoters may attempt to capitalize on strong real estate markets to continue to unlawfully sell promissory notes and other investments in real estate programs, as well as take advantage of fluctuations in the price of oil to continue to promote fraudulent investments in oil and gas drilling programs. In addition to these schemes and others reported in the top five, NASAA's U.S. members are warning the public against schemes involving private-placement transactions pursuant to Rule 506, where certain state securities laws are preempted by federal law.

Types of Respondents

A large percentage of the enforcement actions brought by NASAA's U.S. members in 2015 involved unregistered individuals and unregistered firms. However, for the first time since NASAA began conducting its annual enforcement survey, more registered individuals and firms were named as respondents than unregistered individuals and firms. In 2015, NASAA's U.S. members brought enforcement actions against 812 registered industry members, as compared with 791 unregistered individuals and firms.

The claims brought against registered members of the industry ran the gamut from fraud to books and records violations. Specifically, in 2015, there were 212 actions involving books and records violations; 70 actions involving suitability; 65 actions involving failure to supervise; and more than 200 actions involving other dishonest or unethical practices by registrants. Dozens of other actions involved unauthorized trading, churning, selling away and fraud.

MORE REGISTERED MEMBERS OF THE INDUSTRY WERE NAMED AS RESPONDENTS THAN UNREGISTERED MEMBERS FOR THE FIRST TIME SINCE NASAA BEGAN CONDUCTING ITS ENFORCEMENT SURVEY.

CANADIAN SECURITIES ADMINISTRATORS 2015 ENFORCEMENT REPORT SUMMARY

In early 2016, the Canadian Securities Administrators (CSA) released its 2015 Enforcement Report outlining how Canadian securities regulators actively are working to protect investors and the integrity of Canada's capital markets.

The CSA's 2015 Enforcement Report brings into focus the enforcement work done by CSA members against those who commit wrongdoing in Canada's capital markets. CSA members concluded cases against 350 individuals and companies.

The full report is on the CSA website (www.securities-administrators.ca) and on the websites of CSA members. The CSA, the council of securities regulators of Canada's provinces and territories, coordinates and harmonizes Canadian capital market regulation.

Highlights of the 2015 CSA Enforcement Report

Cases concluded against 184 respondents by contested hearings, 83 respondents by settlement agreement, and 83 respondents by court decision.

Concluded cased resulted in:

- Fines and administrative penalties of more than $138 million;
- Almost $112 million in restitution, compensation and disgorgement;
- Jail sentences totaling approximately 10 years handed down to 15 individuals;
- 108 cases commenced against a total of 165 individuals and 101 companies; and
- 35 freeze orders issued against a total of 84 individuals and companies, involving more than $13.5 million in assets in bank accounts.

2015 Case Highlights

NASAA's U.S. members conduct a wide range of investigations and enforcement actions, both individually and in cooperation with other NASAA members, and federal and international agencies. The enforcement matters discussed below – while only a small sample of NASAA's U.S. member efforts – highlight some persistent themes and significant areas of interest. These include classic Ponzi and pyramid schemes, frauds targeting seniors, and internet-related scams. In these cases, and through their ongoing enforcement work, NASAA's U.S. members protect investors, bring fraudsters to justice, and help obtain compensation for victim losses.

Ponzi Schemes

Ponzi schemes – fraudulent investment operations in which returns to early investors are paid out of funds from subsequent investors rather than legitimate profits – continue to be a common category of fraud. More than half of NASAA's U.S members reported Ponzi schemes as one of their top five types of securities fraud for the survey period.

> LIKE MANY INVESTMENT SCAMS, NELSON'S PROMISSORY NOTES ADVERTISED IMPROBABLY HIGH RATES OF RETURN, RANGING FROM 10-TO-21 PERCENT.

Ponzi schemes frequently involve fictitious or failing business operations, as exemplified by the case of Derek Nelson, whose real-estate investment fraud was investigated by the Texas State Securities Board. Nelson, through various business entities, sold investors approximately $37 million in promissory notes. He told investors he would use the proceeds to buy distressed properties and renovate them for rent or sale. Instead, Nelson used at least $20 million of investors' money to prop up a Ponzi scheme, paying investors their promised returns with money from other investors. Nelson also used $2.7 million of investor funds to pay for personal expenses and to contribute to his church. Like many investment scams, Nelson's promissory notes advertised improbably high rates of return, ranging from 10-to-21 percent. As a result of his fraud, Nelson was recently sentenced to 19 years in prison.

In addition to pursuing Ponzi scheme operators, NASAA's U.S. members focus on institutions that enable these Ponzi schemes through failures of supervision and oversight. For example, in 2015, the Virginia State Corporation Commission's Division of Securities and Retail Franchising investigated the failure of two companies, Wells Fargo Advisors, LLC and Fulcrum Securities, LLC, to properly supervise their employee Christopher Cunningham, who defrauded elderly clients in a $1.2 million Ponzi scheme. Working closley with the U.S. Secret Service, the Division of Securities found that Cunningham – who was subsequently permanently barred from the securities industry and sentenced to a 57-month federal prison term – solicited funds from investment clients based on false representations, including promises of guaranteed returns and statements that he was not being personally compensated in connection with the investments. In fact, Cunningham used investors' money to pay personal expenses and fund his unsuccessful private business venture, which purportedly designed and sold blast-proof materials to protect military troops. Virginia's parallel investigation of Wells Fargo Advisors and Fulcrum Securities concluded that both companies failed to supervise Cunningham, enforce their own policies and procedures, and properly review customer accounts. As a result of Virginia's investigation, investors will receive $470,000 in restitution.

WELLS FARGO ADVISORS AND FULCRUM SECURITIES FAILED TO SUPERVISE CUNNINGHAM, ENFORCE THEIR OWN POLICIES AND PROCEDURES, AND PROPERLY REVIEW CUSTOMER ACCOUNTS.

Internet Fraud

The Internet has allowed bad actors operating virtually anywhere and with only basic computer skills to enter the homes of many Americans and take advantage of vulnerable investors.

For example, after an extensive investigation by the Florida Office of Financial Regulation (OFR), in 2015, Scott Campbell was sentenced to 20 years of imprisonment and 10 years of probation for his role in defrauding dozens of investors in a long-running internet investment fraud scheme. For more than 10 years, Campbell operated a "sweetheart" investment scheme targeting single women with whom he had become acquainted via online dating services. Campbell enticed more than 30 victims into investing in his purported musical recording and talent search business with promises that each would receive two percent of his company's future profits. The OFR investigation revealed, however, that Campbell spent most of the $1 million in funds collected from investors on gambling and personal living expenses.

CAMPBELL OPERATED A "SWEETHEART" INVESTMENT SCHEME TARGETING SINGLE WOMEN WHITH WHOM HE HAD BECOME ACQUAINTED VIA ONLINE DATING SERVICES.

Internet bulletin boards are another common venue fraudsters use to prey on vulnerable investors. For example, in 2015, the Alabama Securities Commission (ASC) investigated a long-running international prime bank scheme where investors were solicited through Craigslist with the promise of exaggerated returns and/or non-recourse loans that required no repayment. Investors typically wired their funds to various companies owned and/or operated by the subjects or to attorney escrow accounts with the promise of large returns and/or access to large loans. The investors never received what was promised, and their funds were disbursed among the subjects for non-investment purposes. To date, there have been 18 separate convictions, as many as 10 individuals are awaiting trial or are fugitives from justice, and Italian authorities – with the assistance of the ASC – have identified and arrested six individuals in Italy who participated in these online schemes internationally.

Gatekeeper Frauds

Intermediaries, or "gatekeepers," are supposed to provide important services that benefit investors – for instance, accountants who provide independent assurance that a company's financial condition is portrayed accurately, or lawyers who ensure that company representations are accurate and truthful. Unfortunately, NASAA's U.S. members often must take enforcement action against gatekeepers who abuse their position of trust to carry out investment fraud.

For example, the Securities and Business Investments Division of the Connecticut Department of Banking filed two separate actions against James E. Neilsen, a Certified Public Accountant (CPA) and former registered broker-dealer agent, who took advantage of his unfettered access to his CPA clients' sensitive financial information and abused his position of trust to twice scam his CPA clients through fraudulent securities offerings. Specifically, Neilsen set up Ulysses Partners, LLC to solicit investments in hedge funds on a compensated basis, selling approximately $10 million of securities to investors, the majority of whom were his accounting clients. Neilsen represented that the investment would generate a high rate of return, but failed to provide key disclosures concerning the risks involved, how the offering proceeds would be used, or that the securities were not registered under state law. Following an administrative hearing, the Connecticut Banking Commissioner found that between 2005 and 2012, Ulysses Partners and Neilsen violated the Connecticut Uniform Securities Act by selling unregistered securities to 33 individuals who invested approximately $7.4 million in Ulysses Partners. The Commissioner also determined that Neilsen violated the antifraud provisions of the Act by misrepresenting the anticipated rate of return on the investments, guaranteeing principal, and omitting any type of written disclosure or discussion of risks. The Commissioner noted that the misrepresentations and omissions were made to investors who had trusted Neilsen for years as their personal and business accountant. The Commissioner ordered a permanent Cease and Desist, the defendants to make full restitution, and Ulysses Partners and Neilsen to pay a $25,000 fine.

> THE COMMISSIONER NOTED THAT THE MISREPRESENTATIONS AND OMISSIONS WERE MADE TO INVESTORS WHO HAD TRUSTED NEILSEN FOR YEARS AS THEIR PERSONAL AND BUSINESS ACCOUNTANT.

The Commissioner's order did not stop Neilsen, however. Just one year later, the Banking Commissioner again sanctioned Neilsen relating to a second fraudulent securities offering. In this matter, Neilsen entered into investment agreements with at least two individuals, one of whom was an accounting client, who invested at least $243,000 based on Neilson's representations that the investment would generate a 9 percent return with no risk of loss. Neilsen used investor monies to cover his personal expenses and failed to provide investors with written disclosures concerning investment risks and was again found to have violated the antifraud provisions of the Act. Neilsen also violated the Act by selling unregistered securities and by making a material misrepresentation to the agency in conjunction with its investigation. The Commissioner ordered a permanent Cease and Desist, the defendants to make full restitution, and Neilsen to pay a $300,000 fine. In addition, Neilsen was recently sentenced to eight years in prison by a federal Judge for the crimes he committed in connection with his fraudulent investment schemes.

The Washington State Department of Financial Institutions (DFI) also brought an action against a former accountant, Clarence Young, in 2015. In 1996, Young's accounting license was indefinitely suspended for, among other things, securities fraud, including the sale of unregistered securities, and failing to respond to a complaint by one of his clients. After his accounting license was suspended, however, Young continued to operate a tax consulting business. Young solicited his tax consulting business clients and others for investments in a feeder fund called Safeguard Capital, LLC. As detailed by the Washington Securities Administrator, "Young's investors were often his clients from his tax consulting business. The transactions he entered into with them were often based more on the trust clients had in Young than on substantive information about the investments." Young guaranteed investors a return of 18-to-24 percent on their investments, and represented that there was no risk. Young raised $2.2 million in investments for Safeguard. Rather than use the money as represented, Young used the majority of the money to fund his personal business and to make Ponzi scheme payments to other investors.

In January 2013, DFI entered charges against Young for securities fraud, sale of unregistered securities, acting as an unregistered salesperson, and acting as an unregistered investment advisor. In May 2013, the securities division entered into a consent order with Young. In 2015, Young pleaded guilty to 10 counts of securities fraud. The sentence imposed by the trial court, six months of work release followed by six months of home detention and payment of $1,264,802, was successfully appealed by the State based on the unjustifiable downward departure from the applicable sentencing guidelines. As a consequence, the appellate court has remanded the case to the trial court for resentencing within the standard range.

Michael Kwasnik, an estate planning attorney licensed in Pennsylvania and New Jersey, also used his position of trust as an attorney to gain the confidence of elderly victims and perpetrate an approximately $10 million fraudulent scheme. According to an action brought by the New Jersey Bureau of Securities, Kwasnik and his co-conspirators fraudulently offered and sold investments to 73 elderly victims that he falsely claimed were safe, secure, and guaranteed to earn a 12 percent annual return. Kwasnik told investors that investment funds would be used to purchase life insurance policies and beneficial interests in irrevocable life insurance trusts. Rather than investing the funds as promised,

> YOUNG'S INVESTORS WERE OFTEN HIS CLIENTS FROM HIS TAX CONSULTING BUSINESS. THE TRANSACTIONS HE ENTERED INTO WITH THEM WERE OFTEN BASED MORE ON THE TRUST CLIENTS HAD IN YOUNG THAN ON SUBSTANTIVE INFORMATION ABOUT THE INVESTMENTS.

Kwasnik used investment funds to pay existing investors and to transfer money to himself, his family members, his co-conspirators, and his law firm. A civil action brought by the New Jersey Bureau of Securities resulted in a judgment that ordered Kwasnik to pay $8.6 million in full restitution for the benefit of defrauded elderly investors and a $3.5 million penalty. The Court found that Kwasnik took advantage of his attorney-client relationships to sell the fraudulent investments, and abused his position as legal trustee to effect the transactions on behalf of his trust clients.

Earlier in 2015, Kwasnik pled guilty to criminal securities fraud in an action brought by the Delaware Investor Protection Unit for a similar scheme. There, Kwasnik falsely told Delaware investors that Capital Management of Delaware was in the business of buying and selling life settlements. Rather, the true business of Capital Management was to expand the fraudulent scheme that Kwasnik was operating in New Jersey and Pennsylvania

> THE COURT FOUND THAT KWASNIK TOOK ADVANTAGE OF HIS ATTORNEY-CLIENT RELATIONSHIPS TO SELL THE FRAUDULENT INVESTMENTS AND ABUSED HIS POSITION AS LEGAL TRUSTEE TO EFECT THE TRANSACTIONS ON BEHALF OF THIS TRUST CLIENTS.

commingled with that of Kwasnik's prior investors, misdirected into the client trust account of Kwasnik's law firm, and used to pay obligations owed to earlier investors and to satisfy preexisting debts of various Kwasnik-controlled entities. When Kwasnik's scheme collapsed, investors lost the entirety of their principal. In connection with his plea of guilty to securities fraud in Delaware, Kwasnik agreed to: pay more than $300,000 in restitution to three Delaware investors, affirmatively divulge his conviction to any future employer, investor, or business partner, and a 10-year bar from the securities industry.

Senior Fraud

Senior protection continues to be a primary focus of NASAA. In addition to passing the NASAA Model Act to Protect Vulnerable Adults from Financial Exploitation, a number of recent successful enforcement actions brought by NASAA U.S. members highlight state securities regulators' commitment to protecting senior investors. In addition to the Kwasnik matters in New Jersey and Delaware, highlighted above, the cases below from Minnesota and Missouri provide additional examples of the important work being done by state securities regulators to protect our seniors.

For example, Sean Meadows, a licensed insurance producer, and his financial planning and asset management firm, Meadows Financial Group LLC (MFG), operated a long-term Ponzi scheme in which Meadows stole more than $13 million from at least 100 individual victims – many of them seniors who lost their life savings. A joint investigation by the Minnesota Commerce Fraud Bureau and federal authorities resulted in Meadows being sentenced to 25 years in prison. Between 2007 and 2014, Meadows lured victims into removing funds from their retirement and other financial accounts by promising high rates of return in insurance and investment products when, in fact, he did not invest their funds. Instead, Meadows used money from new investors to make interest and/or principal repayments to existing investors. He also used the illicit proceeds of the Ponzi scheme to pay for personal expenses and bankroll his own extravagant lifestyle, including: making "salary" payments to himself; making payments to his spouse; paying expenses on personal investment properties; paying personal credit card bills; buying a car; traveling to Las Vegas; gambling at various casinos and online; and spending more than $135,000 at adult entertainment establishments.

AMONG THE VICTIMS DEFRAUDED BY MEADOWS WERE SENIOR CITIZENS, AND THE DISABLED, POOR OR TERMINALLY ILL. VICTIMS WERE LEFT IN FINANCIAL RUIN BECAUSE THEY LOST THEIR RETIREMENT FUNDS AND HOMES, THEIR ABILITY TO SUPPORT THEIR FAMILIES AND, IN ONE CASE, EVEN THE ABILITY TO PAY FOR CANCER TREATMENTS.

Among the victims defrauded by Meadows were senior citizens, and the disabled, poor or terminally ill. Victims were left in financial ruin because they lost their retirement funds and homes, their ability to support their families and, in one case, even the ability to pay for cancer treatments. Sadly, Meadows also had convinced many of the victims to pull money out of tax-deferred qualified accounts to "invest" with him, falsely assuring them that these would be tax-free rollovers when they were not. To cover up his scheme, he had also convinced his clients to have him prepare their income tax returns. He then filed fraudulent tax returns or, in some cases, did not file returns at all. As a result of Meadows's deceit, the victims not only lost their retirement savings; they also incurred significant tax liabilities.

The Securities Division of the Missouri Secretary of State's Office similarly shut down an investment scheme targeting senior investors run by Joanna L. Rich, an insurance agent associated with Financial Solutions Group, and FSG Fundraising, LLC (FSG). Rich collected in excess of $249,000 from at least seven investors – at least two elderly and one disabled – who were promised an unrealistically high 10 percent annual return and a 10 percent premium bonus. She told investors that the investment funds would be used for the startup costs of FSG and that the initial term would be three years to allow FSG to become profitable. Rich also provided some investors with false quarterly statements—on Financial Solutions Group letterhead—reflecting growth in the investors' funds. However, FSG was not actually making any profit to pay investors.

Rich and FSG did not use the investor funds for FSG purposes. Instead, Rich commingled investor funds with her personal funds and used them for personal expenditures, including payments to her son and the owner of Financial Solutions Group, cash withdrawals, and debit card purchases at businesses such as Ameristar Casino Resort and Spa, and for tickets to Chicago White Sox games. The Missouri Order requires Rich to pay restitution in the amount of $286,878 to the defrauded investors and to pay civil penalties in various amounts ranging from $1,000 to $25,000 for each violation of the Missouri Securities Act.

NASAA

Organized in 1919, the North American Securities Administrators Association (NASAA) is the oldest international organization devoted to investor protection. NASAA is a voluntary association whose membership consists of 67 state, provincial, and territorial securities administrators in the 50 states, the District of Columbia, Puerto Rico, the U.S. Virgin Islands, Canada, and Mexico.

In the United States, NASAA is the voice of state securities agencies responsible for efficient capital formation and grass-roots investor protection. Their fundamental mission is protecting investors who purchase securities or investment advice, and their jurisdiction extends to a wide variety of issuers and intermediaries who offer and sell securities to the public. NASAA members license firms and their agents, investigate violations of state and provincial law, file enforcement actions when appropriate, and educate the public about investment fraud. Through the association, NASAA members also participate in multi-state enforcement actions and information sharing.

For more information, vist: www.nasaa.org

NASAA

A GUIDE FOR DEVELOPING PRACTICES AND PROCEDURES FOR PROTECTING SENIOR INVESTORS AND VULNERABLE ADULTS FROM FINANCIAL EXPLOITATION

NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION

NASAA

Table of Contents

Quick Reference Guide

WHO

- Identify which persons are covered under state laws designed to fight financial exploitation. (pp. 6-7)
- Identify types of clients who might warrant additional safeguards from financial exploitation, such as those nearing age 65 or exhibiting signs of cognitive decline. (p. 7)

WHAT

- Train frontline personnel (call center staff, financial advisors, branch office staff) to recognize red flags for diminished capacity and financial exploitation. (pp. 9-10)
- Develop training and/or use existing training materials, including asking a state securities regulator to present the NASAA version of the Senior$afe program.
- Train frontline personnel how to communicate with persons experiencing reduced cognition. (pp. 7-8)
- Ask appropriate questions when there are red flags in a manner that always strives to maintain the client's dignity and independence.
- Train frontline personnel on the legal definitions of financial exploitation applicable in their state. (pp. 6-7)
- Develop an internal escalation and reporting protocol. (pp. 13-14)

HOW

REPORTING

- Know the reporting obligations for your jurisdiction (s). (pp. 12)
    - Some states make every "person" in that state a mandated reporter.
- Know whether it is the individual's obligation or the firm's obligation to report financial exploitation.
    - Even if not required to report, protect your client by reporting whenever there is a reasonable belief that a client has been or is being financially exploited or abused.
- Learn what required information is necessary for a report—who, what, when and where. (pp. 14)
    - Use NASAA's ServeOurSeniors.org website to get reporting information for Adult Protective Services.

- Develop clear, detailed internal procedures for reporting, including escalation protocols or incorporate such procedures into existing written supervisory procedures. (pp. 13-14)
    - Develop standard internal reporting forms for accurate and consistent reporting.
    - Consider establishing a specialized unit to monitor activity in accounts of vulnerable customers and clients.

THIRD-PARTY NOTIFICATION (pp. 16-18)

- Develop procedures to encourage clients to utilize customized advance directives, joint accounts, or designation of trusted contacts.
    - Design procedures to achieve compliance with federal and state privacy laws.
    - Make sure designations direct what information can be shared, what authority is conferred, and under what conditions.
    - Consider including the authority to provide notification of suspected cognitive decline.

DELAY IN DISBURSEMENTS (pp. 19-20)

- Develop procedures for internal review and decision making before, during, and after a delay of disbursement of customer funds from an account.
    - Include process for the conduct of any internal review related to disbursement delays.
    - Do not withhold funds longer than is permissible under applicable laws or is reasonably required by the situation in the absence of legal provisions.

ACCESS TO RECORDS (pp. 22)

- Develop strong working relationships with local Adult Protective Services agencies and encourage communications between APS and state securities regulators.
- Provide records requested by APS and law enforcement in a timely and complete manner.

Introduction

Demographers predict that in 16 years, the United States will be home to 72 million older persons, more than twice the number in 2000,[1] and it is estimated that 10,000 people reach the age of 65 every day.[2] Statistics show that baby boomers control more than $13 trillion in household investable assets[3] and as the population ages, the amount of wealth concentrated in the hands of older investors will increase. Unfortunately, for many people, aging is accompanied by diminished capabilities, including a diminished ability to assess and manage financial assets and resources, as well as a heightened susceptibility to financial exploitation.

Protecting older investors has been a long-standing priority for NASAA and its members, making senior investor protection, in light of the trend of diminishing capacity and senior financial exploitation, of keen importance.[4] As part of its ongoing effort to address the aging of America, NASAA formed the Senior Issues and Diminished Capacity Committee (Seniors Committee) in 2014 to undertake certain initiatives aimed at addressing these issues.

Consistent with the Seniors Committee's work to develop informational guides for the securities industry, NASAA has prepared this document to provide broker-dealers and investment advisers with useful information for detecting, reporting, and mitigating senior financial exploitation. Included are suggested practices firms may implement that are designed to detect and address instances of diminished capacity in senior and other clients. This Guide is designed to complement the recently adopted NASAA Model Legislation or Regulation to Protect Vulnerable Adults from Financial Exploitation (NASAA Model Act).

With the promulgation of the NASAA Model Act and its ongoing adoption as state law, coupled with clients' aging and diminished capacity, firms should review their policies and procedures applicable to the issues that may arise in dealing with the accounts of seniors.

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[1] *Dealing With Clients Facing Diminished Capacity: Financial Judgments Can Be the First To Go*, IA WATCH (March 17, 2014).

[2] *See* http://www.pewresearch.org/daily-number/baby-boomers-retire/.

[3] *Protecting Senior Investors: Compliance, Supervisory and Other Practices Used By Financial Services Firms in Serving Senior Investors*, SEC (Sept 22, 2008); *see also* Sue Asci, *Retirement of Boomers Will Create Market for Advisers*, INVESTMENTNEWS (Nov. 5, 2007), *available at* http://www.investmentnews.com/apps/pbcs.dll/article?AID=/20071105/FREE/711050311/-1/INIssueAlert.

[4] *See* NASAA Model Rule on the Use of Senior-Specific Certifications and Professional Designations, *available at* http://www.nasaa.org/wp-content/uploads/2011/07/3-Senior_Model_Rule_Adopted.pdf; *see also* Protecting Senior Investors: Compliance, Supervisory and Other Practices Used by Financial Services Firms in Serving Senior Investors, *available at* http://www.nasaa.org/wp-content/uploads/2010/08/SEC-NASAA_Senior_Report_092208.pdf.

Having up-to-date policies and practices in place that address potential cases of diminished capacity and financial exploitation will better equip financial services professionals to: 1) recognize diminished capacity and financial exploitation; 2) understand when and how to escalate reporting of such issues within a firm; and 3) direct reports to governmental agencies that can conduct additional investigations and provide needed services.

This Guide highlights certain requirements and options available under existing state laws, NASAA's Model Act, and voluntary practices, coupled with suggestions on how firms should develop policies and procedures to mitigate potential damage caused by senior exploitation and issues related to cognitive decline or diminished capacity. The Guide is structured around five key concepts: 1) identifying vulnerable individuals; 2) governmental reporting; 3) third-party reporting; 4) delaying disbursements from client accounts; and 5) continuing regulatory cooperation following reports or disbursement delays.

This Guide was compiled after substantial research, including interviews with securities industry associations representing broker-dealers and investment advisers, advocacy organizations for seniors, and other organizations representing agencies on the front lines of addressing senior financial exploitation and diminished capacity issues. NASAA also reviewed and analyzed existing reports and information on this important topic. Where appropriate, this Guide references NASAA Model Act provisions in an effort to assist in implementing its requirements or other similar state laws.

This Guide, however, does not create or modify existing regulatory obligations with respect to senior investors, and does not catalog the full range of compliance practices applicable to senior investors. Rather, this Guide focuses on steps that firms can take to identify and respond to issues that are common in working with senior investors and are likely to assist firms in utilizing the new statutory tools available to address issues related to senior financial exploitation and diminished capacity. We hope this Guide encourages financial services firms to continue to identify and implement additional practices that address the particular needs of senior investors.

Who is a "Senior" or "Vulnerable" Investor?

An initial step in determining how best to protect senior investors or vulnerable adults is identifying who is covered under applicable laws. Therefore, identifying which of a firm's clients may qualify for protection under statutes designed to combat financial exploitation or otherwise protect seniors is the likely starting place when developing policies, procedures, and practices meant to accomplish this goal. Existing laws and the NASAA Model Act often have explicit definitions of which individuals fall under the purview of these statutes. For example, the NASAA Model Act uses the term "eligible adult," and sets out a two-part definition that triggers the Model's other provisions, including reporting requirements. Firms also should consider how they will identify investors who may be targets of abuse, exploitation, or be more likely to suffer from some form of diminished capacity.

Guideline

ESTABLISH POLICIES THAT WILL ASSIST IN THE IDENTIFICATION OF PERSONS COVERED UNDER APPLICABLE STATE LAWS OR REGULATIONS DESIGNED TO FIGHT FINANCIAL EXPLOITATION.

Definitions for Seniors and Vulnerable Adults

Seven states, for instance, have adopted statutes or regulations that set forth a legal framework applicable to broker-dealers and/or investment advisers—or other financial institutions—that are designed to assist these entities in fighting the growing problem of financial exploitation of older adults. The number of state jurisdictions with statutes or regulations on point is increasing quickly. Vermont enacted a regulation that tracks the NASAA Model Act. Other states, including Alabama, Louisiana, and Indiana, have adopted laws with provisions that can be found in the NASAA model. Three states, Delaware, Washington, and Missouri, had laws in place before the approval by NASAA of its model act in January 2016.

As noted above, the NASAA Model Act is applicable to "eligible adults." This term is defined as any individual age 65 or older, and also includes any adult who would be subject to the adopting state's existing adult protective services laws. Although the NASAA Model Act and many other related state laws contain a triggering age, such laws may also apply to adults—regardless of age—exhibiting certain mental or physical disabilities. NASAA's Model Act expressly incorporates the adopting state's adult protective services' definitions.

Firms should develop training programs and procedures to better educate client-facing employees and their supervisors to recognize the signs and red flags that may indicate that a client or customer is in need of APS protections, whether financial or otherwise, or that raise concerns about diminished capacity. It is important to note, however, that certain provisions of state laws and the NASAA Model Act, such as delaying disbursements or notifying third parties, are only applicable if *financial* exploitation of an eligible adult is suspected. Other practices, such as obtaining trusted third-party contact information, may be used to provide similar protections when a client triggers concerns about diminished capacity. Equipping employees with the tools necessary to recognize red flags and other warning signs is critical to mitigating the damage so easily suffered in these situations.

Policies, Procedures, and Training to Recognize Potentially Vulnerable Investors

As noted above, firms should develop policies, procedures, and training programs to teach their employees how to recognize signs of diminished capacity, cognitive decline, financial impairment, or financial exploitation.

Financial professionals, particularly those with an ongoing relationship with the client, are in the unique position of being able to identify early signs of diminished capacity and red flags indicating financial exploitation. Financial professionals often notice, in their previously "sharp" clients, changes in comprehension or impairments to mathematical skills indicating diminished financial capacity that may, because of slow onset, be difficult for family members to recognize. Also, these professionals often can recognize changes in behavior or unusual financial activities that might indicate that the client is being exploited.

Guideline

DEVELOP AND REGULARLY REVIEW TRAINING PROGRAMS DESIGNED TO EDUCATE EMPLOYEES TO RECOGNIZE SIGNS OF DIMINISHED CAPACITY AND FINANCIAL EXPLOITATION.

Early identification of these issues may prevent a client or customer from becoming the victim of financial exploitation. Detecting and recognizing the signs of cognitive impairment or diminished capacity begin with developing strong relationships with the individual customer or client. As part of this relationship building, firms should increase the frequency and quality of communication with their clients, as many of the red flags signaling potential cognitive issues, such as memory lapses, disorganization, arithmetic mistakes, conceptual confusion, and

Guideline

DEVELOP SPECIAL TIPS AND STRATEGIES ON HOW TO COMMUNICATE WITH PERSONS EXPERIENCING DIMINISHED CAPACITY.

impaired judgment, can be detected in routine discussions with clients and customers. Firms should consider providing client-facing and other personnel, such as supervisors and compliance staff, an assessment tool for cognitive skills that can be incorporated into ongoing training on how to communicate with clients.

In discussions with stakeholders, several indicated that many people may be reluctant to talk about cognitive decline, but may be willing to discuss what to do with their finances in the event of a medical or other emergency. Discussions in this context provide an avenue to discuss powers of attorney and other advance directive options. Ideally, these types of discussions between a financial services professional and a client would take place upon account opening, at regular intervals thereafter, and as circumstances dictate. Ongoing communication with a client is critical both to establish a baseline from which to assess any behavioral changes or cognitive decline and to recognize when protective measures may become necessary.

Firms should develop policies and procedures to assist their employees in dealing with clients experiencing cognitive decline. Some examples may include policies and procedures:

- Enhancing supervisory oversight for an account where there is a suspicion that a client may be vulnerable.
- Documenting contact with seniors in case they have problems with lack of recall or need assistance with resolving any misunderstanding.
- Developing escalation procedures. Broker-dealer agents and investment adviser representatives should document suspected diminished capacity and escalate immediately. Policies should indicate to whom the matter should be escalated and when, though employees should be trained to do this early – at the first sign.

Guideline

PROVIDE TRAINING TO FRONTLINE EMPLOYEES ON HOW TO ASK APPROPRIATE QUESTIONS REGARDING POTENTIAL COGNITIVE DECLINE WHILE STILL MAINTAINING A CLIENT'S SENSE OF AUTONOMY AND DIGNITY.

Identifying Red Flags

Guideline
TRAINING PERSONNEL TO ASSIST WITH RECOGNIZING SIGNS OF COGNITIVE IMPAIRMENT DESPITE THE FACT THAT STANDARDS FOR QUALITATIVE ASSESSMENTS ARE UNCLEAR.

An integral component of a firm's policies and procedures should be training to spot the signs of cognitive decline or a reduced capacity to handle financial decisions. While there is no definitive list of the signs of diminished capacity or cognitive decline, in discussions with the various stakeholder groups and a review of prior reports on the subject, the following examples of "red flags" were cited.

- The investor appears unable to process simple concepts, such as:
    - a decline in the ability to do simple math problems;
    - difficulty in understanding important aspects of the account;
    - difficulty with checkbook management; and
    - confusion and loss of general knowledge regarding basic financial terms and concepts such as mortgages, wills, and annuities.
- The investor's behavior is erratic, including:
    - memory loss;
    - difficulty speaking or communicating;
    - inability to appreciate the consequences of decisions;
    - disorientation with surroundings or social settings; and
    - uncharacteristically unkempt appearance.
- The investor exhibits impaired judgment about investments or the use of money, including:
    - interest in get rich quick schemes;
    - extreme anxiety about the nature and extent of personal wealth;

- making decisions that are inconsistent with his or her current long-term goals or commitments; and
- failure to fulfill financial obligations such as paying bills, or paying the same bill multiple times.

Guideline

REVIEW AND CONSIDER ADAPTING EXISTING TRAINING MATERIALS FROM STATE APS AGENCIES AND OTHERS.

In developing policies and procedures and training programs, firms may want to review existing training materials developed by state agencies. These programs typically address the threshold issue of identification of impaired capacity and can be adapted to fit financial services models.[5] The materials also may provide an avenue to enhance relationships between the financial industry and local APS agencies—an important step in protecting the financial well-being of senior clients.

Guideline

TRAINING MATERIALS SHOULD INCLUDE INFORMATION ON RESOURCES FOR ADDRESSING FINANCIAL EXPLOITATION AND OTHER FORMS OF ELDER ABUSE.

Having strong, cooperative relationships among the financial industry, APS agencies, state regulators, and law enforcement is critical, as each group brings a unique perspective, skill set, and ability to act in order to protect seniors. When such cooperative relationships are in place, open communication is fostered between key stakeholders who can work together to protect our aging population.[6]

[5] NASAA has developed a training program entitled Senior$afe, designed for broker-dealers and investment advisers. For more information, please contact your state securities regulator.

[6] Information on how to contact the local APS agency or state securities regulator can be found at www.serveourseniors.org.

Detecting Senior Financial Exploitation

In addition to developing training programs and policies and procedures designed to identify senior and other vulnerable customers and clients, firms should also develop training programs, policies, and procedures designed to detect potential financial exploitation. Existing state law and the NASAA Model Act define financial exploitation and provide broker-dealers and investment advisers with certain obligations and tools that can be deployed to help prevent losses resulting from exploitation. It is important that firms are familiar with these definitions and that their employees are trained to identify the signs that indicate the possibility of financial exploitation. In discussions with securities industry stakeholders, elder advocates, and adult protectives service professionals, the signs and red flags that a senior customer or client could be the victim of financial exploitation include:

- Uncharacteristic and repeated cash withdrawals or wire transfers.
- Appearing with new and unknown associates, friends, or relatives.
- Uncharacteristic nervousness or anxiety when visiting the office or conducting. telephonic transactions.
- Lacking knowledge about his or her financial status.
- Having difficulty speaking directly with the client or customer without interference by others.
- Unexplained or unusual excitement about an unexplained or unusual windfall; reluctance to discuss details.
- Sudden changes to financial documents such as powers of attorney, account beneficiaries, wills, or trusts.
- Large, atypical withdrawals or closing of accounts without regard to penalties.

Guideline
PROVIDE EMPLOYEES WITH INFORMATIONAL MATERIALS DETAILING THE SIGNS OF DIMINISHED CAPACITY AND FINANCIAL EXPLOITATION.

Reporting Senior Financial Exploitation

Together with a program designed to assist firm employees to identify at-risk clients, firms also should clearly set forth the steps that must be taken in instances where financial exploitation of the client is suspected.

Mandatory vs. Voluntary Reporting

Nearly all states have existing state laws contain mandatory reporting requirements when there is a suspicion of elder abuse, whether physical, mental, or financial. Some of these laws specifically mandate reporting by broker-dealers and/or investment advisers.[7] Others, while not explicitly designed for broker-dealers or investment advisers, apply broadly to financial institutions, which may include broker-dealers and investment advisers.[8] Other state reporting laws could apply to broker dealers and/or investment advisers (or their employees) because the reporting requirement applies to all persons.[9] The NASAA Model Act contains a mandatory obligation to report potential financial exploitation when there is a reasonable belief that such exploitation may be occurring. Other states have adopted a voluntary reporting scheme under which broker-dealers and/or investment advisers may report their suspicions regarding the potential financial exploitation of their senior clients, but are not *required* to report.[10]

Broker-dealers and investment advisers, however, should adopt as a firm policy to report suspected financial exploitation *whether or not the firm has a legal obligation to report*. Reporting suspected financial exploitation to the appropriate law enforcement or regulatory or social services agency is a critical step necessary to protect vulnerable investors that firms should voluntarily take.

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[7] *See* Mississippi. MISS. CODE ANN. §43-47-7(1)(a).

[8] *See, e.g.*, Arkansas, ARK. CODE ANN. § 12-12-1708(a)(1); Colorado, COLO. REV. STAT. §18-6.5-108(1)(a)-(1)(b); District of Columbia, D.C. CODE § 7-1903(a)(1); Kansas, KAN. STAT. ANN. § 39-1402(a).

[9] *See, e.g.,* Oklahoma, OKLA. STAT. ANN. tit. 43A §10-104v1; Rhode Island, R.I. GEN. LAWS ANN. § 42-66-8; Florida, FLA. STAT. §415.1034(1)(a).

[10] *See, e.g.*, Missouri, MO. STAT. ANN. § 409.610; Iowa, IOWA CODE ANN. § 235B.3(4).

Reporting Mechanics

The landscape of reporting obligations varies not only as to the mandatory or voluntary nature of the reporting requirement, but also the scope of the permitted or required reporting by individuals or entities. Firms should remain particularly mindful that they, or their employees, may already be subject to certain reporting requirements.[11] It is important for the firm to understand its own, as well as its employees' reporting obligations, and to develop policies, procedures, and training programs accordingly.

Guideline

WHERE THERE IS A REASONABLE BELIEF (AFTER RESEARCHING AND INVESTIGATING A SITUATION) BY THE FIRM THAT A CLIENT HAS BEEN EXPLOITED FINANCIALLY, OR THAT EXPLOITATION IS IMMINENT, A FIRM SHOULD REPORT THE SITUATION TO THE APPROPRIATE STATE AGENCY OR AGENCIES, REGARDLESS OF WHETHER REPORTING IS MANDATED BY LAW.

Policies and procedures should include detailed criteria or red flags that would trigger broker-dealer or investment adviser reporting in compliance with a jurisdiction's reporting triggers and standards. For example, under the NASAA Model Act, a firm's reporting policies and procedures should outline the facts and circumstances that could result in the development of a reasonable belief that financial exploitation has occurred, is occurring, or may occur. The presence or observation of the red flags identified could form the basis for this belief, and might serve as a good starting point for such policies. Further, firms should develop clear, detailed escalation procedures, establishing direct lines of communication to ensure proper reporting. Training on these escalation procedures is critical to ensure that employees understand the steps necessary to report a potentially urgent situation involving a senior investor.

Guideline

UNDERSTAND REPORTING OBLIGATIONS AND TRIGGERS; WHETHER MANDATORY OR VOLUNTARY; AND TO WHOM THE OBLIGATION RUNS, THE FIRM OR THE INDIVIDUAL.

A firm's policies and procedures also should promote internal communication and coordination regarding the reporting of financial exploitation. This is especially important for larger, more complex firms in which one division may not be aware that suspicious activity

[11] NASAA recognizes that under some elder abuse reporting statutes, as under the NASAA Model Act, the duty or ability to report falls on the individual, while in others the duty or ability to report runs to the firm.

has been reported in a customer's account being managed in another division.[12] Such policies and procedures, of course, will depend on the size and nature of each individual broker-dealer or investment adviser and may include the creation of a specified office or division to monitor the activity in designated accounts.

Guideline

DEVELOP CLEAR, DETAILED ESCALATION PROCEDURES, ESTABLISHING DIRECT LINES OF COMMUNICATION TO ENSURE PROPER REPORTING.

Firms' policies and procedures also should mandate the use of specified internal reporting forms to ensure that each report contains pre-determined categories of information. Each firm should develop its own forms, both for internal information gathering and for external reporting, that contain critical information including:

- the name of the client;
- the relevant dates;
- a description of the events that led to the report;
- a description of the steps the firm has taken or expects to take in response to the event; and
- any relevant documentation related to the potential financial exploitation to ensure that the internal stakeholders and any outside agency receiving the report has all of the necessary information to evaluate the report.

These kinds of comprehensive reports will help alleviate inconsistent reporting, which, in the course of developing this Guide, was identified by APS agencies' as a major concern with financial firm reporting.

Guideline

MANDATE THE USE OF SPECIFIED INTERNAL REPORTING FORMS TO ENSURE ACCURATE AND CONSISTENT REPORTING.

Leveraging Existing Policies and Procedures

In developing these policies and procedures, broker-dealers and investment advisers should be able to draw from the policies and procedures already in place

[12] For example, the banking division may not be aware that the securities division is monitoring a particular customer's account.

related to monitoring their client's accounts. For example, firms should be able to leverage and modify their existing compliance framework for detection and prevention of excessive, unsuitable, or unusual trading, for monitoring client correspondence, or for other reporting obligations like Suspicious Activity Reports ("SARs"). Firms should also review other areas of their existing policies and procedures for opportunities to identify and detect areas that may be adapted and modified to facilitate the identification of diminished capacity and the reporting of financial exploitation.

Notifying Third Parties of Potential Issues

Notifying trusted third parties about diminished capacity concerns or unusual or potentially exploitative activity occurring in a senior investor's account can be an additional effective tool to assist in addressing harmful conduct. However, notifying third parties about the financial activity of a senior investor presents many challenges, requiring broker-dealers and investment advisers to implement clear policies to ensure that the concerns of both financial services providers and customers are addressed well in advance of the situation arising.

Privacy Concerns

Sharing financial and other potentially sensitive information with a third party is a delicate subject that raises significant privacy concerns. Before broker-dealers or investment advisers share information with third parties, including a client's family members, firms need to carefully consider potential ramifications of doing so. For example, federal privacy laws generally prohibit the sharing of financial information unless a client or customer has consented or another exception exists.[13] Further, sharing sensitive financial information with third parties, including family members, presents challenges as firms may not know all of the details of the relationship with the third party or family member or family members may be the suspected abusers. Firms, however, can overcome some of these challenges by implementing proactive disclosure and contractual advance directive measures early in the relationships with clients and updating them as appropriate.

Strategies for Effective Third-Party Notification

Developing strong relationships with investors is one of the most important weapons in detecting diminished capacity and in the fight against financial exploitation. Building strong client relationships and planning for more than the client's financial future in isolation before potential issues arise is critical, and particularly important as it relates to third-party notification and advance directives that memorialize a client's chosen course of conduct when faced later with

Guideline

FIRMS SHOULD BE AWARE OF THE PRIVACY CONCERNS AND IMPLICATIONS OF NOTIFYING THIRD PARTIES AS IT RELATES TO FINANCIAL EXPLOITATION AND DIMINISHED CAPACITY.

[13] Many of the federal privacy law concerns stem from provisions in Title V of the Gramm-Leach-Bliley Act, 15 U.S.C. 6801 et seq., and its implementing regulations such as the SEC's Regulation S-P, 17 C.F.R. § 248.1 et seq.

diminished capacity or financial exploitation. Firms should implement policies and procedures and related training programs that require disclosure, discussion and decisions regarding plans for potential future issues, and develop communication tools that emphasize the importance of future planning. These tools should facilitate discussions to guide the customer toward memorializing advance financial directives and a contingent power of attorney, or other appropriate devices. However, clients can be very resistant to these discussions and, consequently, reluctant to commit to such recommendations. The firm's communication strategies should address this likelihood by developing internal escalation procedures to help further educate customers and clients about the importance of such advanced planning.

Guideline

DEVELOP COMMUNICATION STRATEGIES TO ENGAGE CUSTOMERS AND CLIENTS ON ISSUES RELATED TO ADVANCED PLANNING, INCLUDING THE IMPLEMENTATION OF ADVANCE DIRECTIVES.

One potential strategy reported to be successful by financial professionals is to engage clients and customers on the topic of planning for medical emergencies generally in lieu of a specific discussion focused only on cognitive decline or financial exploitation. This approach could then grow into a discussion of other advance safeguards, with clients more willing to commit to the designation of their "financial agent" or "in case of" contact should the need arise in the future.

Firms should ensure that their employees are familiar with documents such as powers of attorney and advance financial directives, including the features and limitations of each. Policies and procedures should allow clients and customers to utilize customized advance directives or designate trusted contacts and direct what information can be shared and the conditions leading to the sharing. Because these measures are based on client consent, they can be tailored to fit the needs of specific clients and firms. Also, because clients consent to the sharing of such information under certain circumstances, firms that utilize advance directives or trusted contact procedures can minimize many of the privacy concerns discussed previously.

Guideline

DEVELOP POLICIES AND PROCEDURES THAT ALLOW CLIENTS AND CUSTOMERS TO UTILIZE CUSTOMIZED ADVANCE DIRECTIVES OR DESIGNATE TRUSTED CONTACTS AND DIRECT WHAT INFORMATION CAN BE SHARED AND THE CONDITIONS LEADING TO THE SHARING.

It is important, however, that advance directives or other forms of designation be affirmatively discussed and clearly designated, and not be buried in new account forms or privacy policy statements. To assuage concerns about validity, it is critical that customers and clients know why they are designating a contact and for what reason that individual may be contacted. Firms' policies and procedures should also provide clear guidance and processes for reviewing and updating third-party designations on a regular and as needed basis.

Third-Party Notification Under the NASAA Model Act and Other State Laws

The concept of designating trusted contacts is incorporated into the NASAA Model Act. Broker-dealers and investment advisers may only contact previously designated third parties about potential financial exploitation of an eligible adult. The NASAA Model Act's third-party disclosure provision requires the client or customer's consent, while some existing state laws allow for the notification of certain third parties without consent after a report has been made to the proper governmental agencies.[14] Firms should be sure their policies and procedures are designed to ensure compliance with the applicable state and federal law.

Guideline

ENSURE POLICIES AND PROCEDURES RELATED TO THIRD-PARTY NOTIFICATION ARE DESIGNED TO PROMOTE COMPLIANCE WITH FEDERAL AND STATE LAW.

[14] *See, e.g.,* MO. STAT. ANN. § 409.610.

Delaying Disbursements in Situations of Potential Financial Exploitation

Delaying or placing a temporary hold on a disbursement from a client or customer account in an effort to prevent losses from financial exploitation is an important and potentially very effective tool provided to firms in the NASAA Model Act and other existing state laws, and potentially under advance financial directives. Given the potential unintended disruptive consequences of delaying disbursements, however, firms should develop clear and robust policies and procedures designed to effectively utilize these delays and to ensure that such delays comply with the NASAA Model Act and other applicable law, including federal law, any advance directive contractual provisions, and are used only in appropriate circumstances.

Mechanics and Considerations when Delaying a Disbursement

Under the NASAA Model Act and existing state laws, generally, firms are required to complete or to continue a review or investigation after delaying a disbursement. Firms' policies and procedures should describe the procedure, processes, and content of their required internal review before, during, and following the delay of a disbursement. Firms also should develop robust training programs for their employees regarding these reviews and investigations. Such training is an important step in ensuring firms can successfully utilize disbursement delays when appropriate. Similar standards should be applied when the firm relies on a contractual advance directive that provides for a similar delay or hold.

Guideline

DEVELOP POLICIES AND PROCEDURES DESCRIBING THE PROCEDURE, PROCESSES, AND CONTENT OF INTERNAL REVIEWS BEFORE, DURING, AND FOLLOWING A DISBURSEMENT DELAY.

Firms should also have clear procedures and processes to facilitate the notifications required by the NASAA Model Act—notification to account holders and the relevant regulatory agencies—or by other applicable law or contractual advance directive. Because these notifications are often required in order to delay a disbursement, firms should pay particular attention to developing processes for ensuring notification occurs in a timely fashion. For example, firms should clearly designate who is responsible for the notification, whether it be the account's primary representative or someone from the firm's legal or compliance department. Firms also should maintain systems that facilitate the identification of those authorized to transact business on the account, as each of these people is also required to receive notification of a delayed disbursement under the NASAA Model Act. While no form of notification is specified in existing state laws or the NASAA Model Act, firms' policies and procedures should clearly define the form and contents of these notifications to ensure accurate and consistent notification. Firms also must ensure that such notifications are not sent to the suspected perpetrators of the financial exploitation. This is of particular importance for firms that may develop some type of automated notification system.

Guideline

DEVELOP CLEAR PROCEDURES AND PROCESSES TO FACILITATE THE NOTIFICATIONS REQUIRED WHEN A DISBURSEMENT DELAY IS UTILIZED.

Firms' notification procedures must also provide for clear guidance on which regulators to notify and the time frames for such notification. It is important to note that the state securities regulator and the local APS agency must be notified of a delayed disbursement under the NASAA Model Act, regardless of whether the agencies have already received notice of suspected financial exploitation. Further, the notification to the agencies should contain at least the same information as the notice to the account holders. Following a disbursement delay, firms should maintain open communication with state securities regulators and local APS agencies to report their internal findings, and they should fully cooperate with any concurrent agency investigation or action. This will ensure that the agencies have the information they need to act on any potential exploitation.

Communicating with Investors and Other Important Considerations when Delaying Disbursements

Firms also should develop communication tools to inform their customers and clients of the possibility of a delayed disbursement in situations of potential financial exploitation. As with third-party designations, the possibility of a delay in the disbursement of funds due to reasonably suspected fraud should be communicated clearly and conspicuously to customers and clients and not only appear in the fine print of a customer's account agreement or advisory contract.

Firms should carefully monitor the timing of delayed disbursements to ensure that funds are not withheld longer than is permissible. Firms should also closely monitor the timing of the delay as it relates to their internal investigation, as, under the NASAA Model Act, any delay beyond 15 business days must be authorized by the state securities regulator or APS agency, and the firm may need to seek court authorization if a delay longer than 25 business days is necessary.

Further, ensuring that a senior investor's funds are not unnecessarily delayed is critically important, as a delayed disbursement can have a significant impact on a senior investor. For example, if funds are delayed, senior investors could fall behind on paying their bills or checks they have written may bounce, which could result in additional fees. Firms should be mindful of these concerns when determining whether or not to delay disbursements and for how long. Firms' policies and procedures should be designed to minimize the time required to complete any required internal review or investigation and make the required notifications and reports. If these actions are completed in a timely manner and the proper authorities are involved, the consequences of a delay can be mitigated.

Guideline

CAREFULLY MONITOR THE TIMING OF DELAYED DISBURSEMENTS TO ENSURE THAT FUNDS ARE NOT WITHHELD LONGER THAN IS PERMISSIBLE.

Access to Records

Combatting financial exploitation involves cooperation among the private sector, regulatory agencies, APS, and law enforcement. With that in mind, and in an effort to strengthen relationships between the securities industry and state APS offices, this Guide contemplates, and NASAA's Model Act requires, that firms provide APS and law enforcement the relevant documents related to suspected financial exploitation. Regardless of whether mandated in state law, firms should develop strong working relationships with their local APS agencies and cooperate in APS investigations that may involve a firm's client or customer.

With the goal of fostering cooperation and better communication, a firm's policies and procedures should include specific guidelines and requirements regarding how to respond to inquiries from APS agencies, securities regulators or law enforcement whether the inquiry is instigated by the filing of a report of suspected financial exploitation or otherwise. Such cooperation will address a major concern raised by APS agencies regarding the reports of financial firms and the firms' the lack of engagement following an initial report: particularly, in the experience of some APS agencies, financial firms report, but fail to respond to follow-ups or requests for additional information in a timely fashion. Given the often urgent nature of financial exploitation, maintaining clear, open communication channels is critical, and firms should develop policies that promote this communication.

Guideline

FIRMS SHOULD DEVELOP STRONG WORKING RELATIONSHIPS WITH THEIR LOCAL APS AGENCIES AND STATE SECURITIES REGULATOR AND COOPERATE IN APS OR OTHER INVESTIGATIONS THAT MAY INVOLVE A FIRM'S CLIENT OR CUSTOMER.

Conclusion

While developing this Guide, NASAA has learned that many firms already have begun to implement successfully many of the suggestions in this Guide. While this is encouraging and formed the basis for many of the suggestions, NASAA hopes that more broker-dealers and investment advisers will think critically about protecting their senior clients from the adverse consequences of financial exploitation and diminished capacity. Implementing robust policies and procedures and training programs that encourage firms to address these issues holistically, and that foster strong relationships amongst industry, state securities regulators, local APS agencies, and law enforcement, will be a significant step toward addressing the serious issues facing seniors and other vulnerable investors.

NASAA MODEL LEGISLATION OR REGULATION TO PROTECT VULNERABLE ADULTS FROM FINANCIAL EXPLOITATION

Adopted January 22, 2016

Prefatory note:

Jurisdictions considering this model legislation or regulation, whether through legislative sessions or rulemaking, may need to consider certain small changes to terms, particularly with regard to certain designated terms. For example, this model refers to the "commissioner of securities" or "state securities commissioner" but in certain jurisdictions, that position may be held by a director of securities, or commissioner of banking and securities, or commissioner of corporations. Furthermore, this model refers to Adult Protective Services, but certain jurisdictions may require a more specific reference to the agency by exact name. Finally, with regard to Section 2 (Definitions), certain jurisdictions may use different defined terms (e.g. salesmen instead of broker-dealer agents); therefore, Section 2 may require certain slight changes to the definitions to align with existing securities statutes.

An Act to Protect Vulnerable Adults from Financial Exploitation.

Section 1. Short title. Sections___ to ___ may be cited as "An Act to Protect Vulnerable Adults from Financial Exploitation" and in this chapter as this act.

Section 2. Definitions. In this act, unless the context otherwise requires:

(1) **"Agent"** shall have the same meaning as in [insert state code section].

(2) **"Broker-dealer"** shall have the same meaning as in [insert state code section].

(3) **"Eligible adult"** means:

(a) a person sixty-five years of age or older; or
(b) a person subject to [insert state Adult Protective Services statute]

(4) **"Financial exploitation"** means:

(a) the wrongful or unauthorized taking, withholding, appropriation, or use of money, assets or property of an eligible adult; or

(b) any act or omission taken by a person, including through the use of a power of attorney, guardianship, or conservatorship of an eligible adult, to:

i. Obtain control, through deception, intimidation or undue influence, over the eligible adult's money, assets or property to deprive the eligible adult of the ownership, use, benefit or possession of his or her money, assets or property; or

ii. Convert money, assets or property of the eligible adult to deprive such eligible adult of the ownership, use, benefit or possession of his or her money, assets or property.

(5) “**Investment Adviser**” shall have the same meaning as in [insert state code section].

(6) “**Investment Adviser Representative**” shall have the same meaning as in [insert state code section].

(7) **“Qualified individual”** means any agent, investment adviser representative or person who serves in a supervisory, compliance, or legal capacity for a broker-dealer or investment adviser.

Section 3. Governmental Disclosures. If a qualified individual reasonably believes that financial exploitation of an eligible adult may have occurred, may have been attempted, or is being attempted, the qualified individual shall promptly notify Adult Protective Services and the commissioner of securities (collectively “the Agencies”).

Section 4. Immunity for Governmental Disclosures. A qualified individual that in good faith and exercising reasonable care makes a disclosure of information pursuant to section 3 shall be immune from administrative or civil liability that might otherwise arise from such disclosure or for any failure to notify the customer of the disclosure.

Section 5. Third-Party Disclosures. If a qualified individual reasonably believes that financial exploitation of an eligible adult may have occurred, may have been attempted, or is being attempted, a qualified individual may notify any third party previously designated by the eligible adult. Disclosure may not be made to any designated third party that is suspected of financial exploitation or other abuse of the eligible adult.

Section 6. Immunity for Third-Party Disclosures. A qualified individual that, in good faith and exercising reasonable care, complies with section 5 shall be immune from any administrative or civil liability that might otherwise arise from such disclosure.

Section 7. Delaying Disbursements. (1) A broker-dealer or investment adviser may delay a disbursement from an account of an eligible adult or an account on which an eligible adult is a beneficiary if:

(a) the broker-dealer, investment adviser, or qualified individual reasonably believes, after initiating an internal review of the requested disbursement and the suspected financial exploitation, that the requested disbursement may result in financial exploitation of an eligible adult; and

(b) the broker-dealer or investment adviser:

i. Immediately, but in no event more than two business days after the requested disbursement, provides written notification of the delay and the reason for the delay to all parties authorized to transact business on the account, unless any such party is reasonably believed to have engaged in suspected or attempted financial exploitation of the eligible adult;

ii. Immediately, but in no event more than two business days after the requested disbursement, notifies the Agencies; and

iii. Continues its internal review of the suspected or attempted financial exploitation of the eligible adult, as necessary, and reports the investigation's results to the Agencies within seven business days after the requested disbursement.

(2) Any delay of a disbursement as authorized by this section will expire upon the sooner of:

(a) a determination by the broker-dealer or investment adviser that the disbursement will not result in financial exploitation of the eligible adult; or

(b) fifteen business days after the date on which the broker-dealer or investment adviser first delayed disbursement of the funds, unless either of the Agencies requests that the broker-dealer or investment adviser extend the delay, in which case the delay shall expire no more than twenty-five business days after the date on which the broker-dealer or investment adviser first delayed disbursement of the funds unless sooner terminated by either of the agencies or an order of a court of competent jurisdiction.

(3) A court of competent jurisdiction may enter an order extending the delay of the disbursement of funds or may order other protective relief based on the petition of the commissioner of securities, Adult Protective Services, the broker-dealer or investment adviser that initiated the delay under this Section 7, or other interested party.

Section 8. Immunity for Delaying Disbursements. A broker-dealer or investment adviser that, in good faith and exercising reasonable care, complies with section 7 shall be immune from any administrative or civil liability that might otherwise arise from such delay in a disbursement in accordance with this section.

Section 9. Records. A broker-dealer or investment adviser shall provide access to or copies of records that are relevant to the suspected or attempted financial exploitation of an eligible adult to agencies charged with administering state adult protective services laws and to law enforcement, either as part of a referral to the agency or to law enforcement, or upon request of the agency or law enforcement pursuant to an investigation. The records may include historical records as well as records relating to the most recent transaction or transactions that may comprise financial exploitation of an eligible adult. All records made available to agencies under this section shall not be considered a public record as defined in [State public records law]. Nothing in this provision shall limit or otherwise impede the authority of the state securities commissioner to access or examine the books and records of broker-dealers and investment advisers as otherwise provided by law.

NATIONAL SENIOR INVESTOR INITIATIVE

A Coordinated Series of Examinations

The SEC's Office of Compliance Inspections and Examinations and FINRA

Table of Contents

Executive Summary

One of the primary missions of the Securities and Exchange Commission ("SEC") and the Financial Industry Regulatory Authority ("FINRA") is the protection of investors, of which senior investors are an important and growing subset. As part of a collaborative effort, staff of the SEC's Office of Compliance Inspections and Examinations ("OCIE")[1] and FINRA (collectively, the "staff") conducted 44 examinations of broker-dealers in 2013 that focused on how firms conduct business with senior investors as they prepare for and enter into retirement. These examinations focused on investors aged 65 years old or older; this report refers to these investors as "senior investors."

This report highlights recent industry trends that have impacted the investment landscape and prior regulatory initiatives that have concentrated on senior investors and industry practices related to senior investors. Additionally, the report discusses key observations and practices identified during the recent series of examinations. These examinations focused on a broad range of topics, including the types of securities being sold to senior investors, training of firm representatives with regard to senior specific issues and how firms address issues relating to aging (e.g., diminished capacity and elder financial abuse or exploitation), use of senior designations, firms' marketing and communications to senior investors, types of customer account information required to open accounts for senior investors, suitability of securities sold to senior investors, disclosures provided to senior investors, complaints filed by senior investors and the ways firms tracked those complaints, and supervision of registered representatives as they interact with senior investors. OCIE and FINRA staff are providing this information to broker-dealers to facilitate a thoughtful analysis with regard to their existing policies and procedures related to senior investors and senior-related topics and whether these policies and procedures need to be further developed or refined.

Questions concerning this report may be directed to:

- Kevin Goodman, National Associate Director, Office of Broker-Dealer Examinations, OCIE, SEC;
- Suzanne McGovern, Assistant Director, Office of Broker-Dealer Examinations, OCIE, SEC;
- John LaVoie, Supervisory Examiner, Office of Broker-Dealer Examinations, OCIE, SEC;
- Lisa Stepuszek, Director, Regulatory Programs, FINRA; and
- Leonard Derus, Associate Director, Regulatory Programs, FINRA.

Background on the Senior Investor Initiative

Introduction

The "Baby Boomers," those born between 1946 and 1964, began turning 65 in 2011. According to the most recent U.S. Census Bureau data, over 41 million people living in the United States, or more than 13% of the population, were 65 or older in 2011.[2] Moreover, the number of seniors living in the United States will increase dramatically in the future. For example, the number of people aged 65 or older is projected to be more than 79 million in 2040, which is over twice as many as in the year 2000.[3]

Over the past quarter century, this demographic has made dramatic economic gains. Housing has been a key driver of this wealth trend as well as strong market performance during that time period.[4] The Dow Jones Industrial Average increased from 2,031 points on May 31, 1988 to 16,717 points on May 30, 2014, a gain of nearly 723%.[5] As the Baby Boomers have begun to retire, they have started to draw from Social Security, savings, retirement accounts, and established home equity. Similar to previous generations, they typically purchase conservative income-producing investments as a source of reliable income streams during retirement.

From 2007 to 2010, however, the U.S. economy experienced its most substantial downturn since the Great Depression.[6] In response, the Federal Reserve Board took extraordinary steps to help stabilize the U.S. economy and financial system, which included reducing interest rate levels. One result of this economic downturn and the subsequent dramatic fall in interest rates was the significant corresponding decrease in the rate of return on liquid deposits (savings accounts), time deposits (certificates of deposit or "CDs"), and bonds (treasury and municipal). As a result, many senior investors have seen a significant reduction in the income streams on which they traditionally have depended during retirement.

The combination of high levels of wealth and downward yield pressure on conservative income-producing investments may create an environment conducive to the recommendation of more complex, and possibly unsuitable, securities to senior investors as a means of replacing that income stream. Staff is concerned that, after a lifetime of accumulated savings, senior investors may meet the financial and risk threshold requirements to invest in more complex financial securities and that broker-dealers may be recommending unsuitable transactions to these senior investors or may not be providing proper and understandable disclosures regarding the terms and related risks of those recommended securities, particularly non-traditional investments.

Prior Regulatory Initiatives

In September 2007, OCIE and the North American Securities Administrators Association ("NASAA") worked together with the National Association of Securities Dealers ("NASD") and the New York Stock Exchange Member Regulation Inc. (now combined as FINRA) on a collaborative initiative that included three components: active investor education and outreach to seniors and those nearing retirement age, targeted examinations to detect abusive sales tactics aimed at seniors, and aggressive enforcement of securities laws in cases of fraud against seniors.[7]

As a follow-up to the 2007 report, OCIE, FINRA, and NASAA collectively published a report in September of 2008[8] outlining practices that financial services firms can use to strengthen their policies and procedures for serving investors as they approach and enter retirement. The 2008 report describes new processes and procedures aimed at addressing common issues associated with interactions with senior investors that were implemented by some firms.

In August 2010, OCIE, FINRA, and NASAA published an addendum[9] to update the 2008 report on business practices regarding senior investors. The addendum includes feedback from firms that participated in the prior review and additional practices they may have implemented. The addendum focuses on specific, concrete steps that firms were taking or practices they had implemented since the prior review to identify and respond to issues that are common in working with senior investors. The addendum also includes other practices that staff identified in various industry publications. In addition, the addendum encourages financial services firms to strengthen their policies and procedures for serving senior investors as these investors approach and enter retirement.

Regulatory Guidance

In November 2011, FINRA issued Regulatory Notice 11-52,[10] which addresses the use of certifications and designations that imply expertise or specialty in advising senior investors ("senior designations"). Notice 11-52 outlines findings from a survey of firms that focused on the prevalence of senior designation usage, the extent to which particular senior designations were used or prohibited, and the supervisory systems in place regarding senior designations.

In September 2013, the SEC's Office of Investor Education and Advocacy and NASAA published an Investor Bulletin entitled "Making Sense of Financial Professional Titles."[11] The purpose was to help investors better understand the titles used by financial professionals, such as by noting that the requirements for obtaining and using certain titles vary widely. The Bulletin also warns investors against relying exclusively on a title in determining the expertise of any financial professional. It also encourages investors to evaluate the qualifications of a title held by a financial professional they are considering employing; provides a web-based resource for investors to research a financial professional's title; and stresses that neither the SEC nor state regulators grant, approve, or endorse any financial professional designations.

Also in 2013, eight government agencies issued joint guidance to financial institutions regarding reporting suspected financial exploitation of older adults.[12] This guidance discusses the obligations of firms relating to privacy protections for their investors and the variety of exceptions in cases of suspected financial abuse. In addition, the guidance enumerates possible signs of financial exploitation in older adults that might trigger the filing of a suspicious activity report ("SAR"). A SAR is a document that financial institutions must file with the Financial

Crimes Enforcement Network following, among other things, a suspected incident of money laundering or fraud.[13]

OCIE/FINRA National Senior Investor Initiative

Building on prior regulatory initiatives, OCIE's National Examination Program staff, in coordination with FINRA, initiated a series of 44 examinations of broker-dealers focused on the types of securities senior investors were purchasing and the methods firms were using when recommending securities. In an environment where traditional savings accounts and more conservative investments were earning historically low yields, OCIE and FINRA staff assessed whether broker-dealers were recommending riskier and possibly unsuitable securities to senior investors looking for higher returns or that such senior investors may be making financial decisions without fully appreciating the risks associated with those recommendations.

In connection with the examinations, staff met with representatives from the Consumer Financial Protection Bureau; the AARP Education and Outreach Group; and state regulators from Florida, Colorado, California, Texas, and North Carolina. The purpose of these discussions was to identify risks to senior investors that the industry groups and government agencies had observed, especially in geographic areas known to have large numbers of retirees. The majority of these groups expressed serious concerns about the unsuitable recommendation of high-risk securities, particularly the sale of complex investments, to senior investors.

This initiative was designed as a coordinated effort to protect senior investors, and staff worked collaboratively to ensure that the series of examinations conducted had common goals. Staff used a risk-based approach to identify examination candidates that conducted a retail business and that varied in business model and size. Some factors considered included the types of securities sold, the number of registered individuals, the number of associated independent contractors, and the number of branch offices. Staff also reviewed and considered other factors, such as previous sales practice and supervisory deficiencies, firm and registered individuals' disclosures, and customer complaints. Furthermore, staff received recommendations from SEC regional offices and FINRA district offices as these offices are familiar with the activities of the firms located in their geographic regions. In this initiative, staff reviewed how firms were marketing themselves to seniors; what information they were collecting from seniors relating to financial condition, risk tolerance, and investment objectives; what disclosures firms were providing to seniors; whether recommendations of securities were suitable for seniors; and how the firms were supervising their representatives when dealing with seniors. The examinations also reviewed how firms were training their representatives and supervisors on issues related to aging, such as diminished capacity and elder financial abuse.

In 2015, OCIE and FINRA examination staff will continue to review matters of importance to senior investors.[14]

Securities Purchased by Senior Investors

Examination Observations

The different types of securities being purchased by senior investors in the low interest rate environment present during the review period provide insight into how these investors are attempting to meet their financial goals and evolving needs. Staff asked firms to provide a list of the top revenue-generating securities purchased by their senior investors by dollar amount. The securities consisted of mutual funds, deferred variable annuities ("variable annuities"), equities, fixed income investments, and unit investment trusts ("UITs")/exchange-traded funds ("ETFs"). The examinations revealed that some senior investors purchased other securities such as non-traded real estate investment trusts ("REITs"), alternative investments, and structured products.

Staff observed that the following were among the top five revenue-generating securities at the examined firms based on sales to senior investors:

(1) Open-end mutual funds at 77% of the firms;

(2) Variable annuities at 68% of the firms;

(3) Equities at 66% of the firms;

(4) Fixed income investments at 25% of the firms;

(5) UITs and ETFs at 20% of the firms;

(6) Non-traded REITs at almost 20% of the firms;

(7) Alternative investments such as options, BDCs, and leveraged inverse ETFs at approximately 15% of the firms; and

(8) Structured products at 11% of the firms.

A description of the securities listed above, and potential benefits and risks related to these securities, is included in Appendix B.

Conclusion

Mutual funds, variable annuities, and equities were most often purchased by senior investors. More complex securities such as UITs, REITs, alternative investments, and structured products were also purchased by seniors, but such purchases were less frequent. Due to the wide-ranging nature of these investment products, it is critical that senior investors are fully informed of the features of any security they are purchasing, including the potential return and associated risks.

Training

Discussion of Relevant Rules

Training is an important tool for firms to help ensure that their representatives understand the needs of senior investors. FINRA Rule 1250(b) requires all broker-dealers to provide continuing education for their representatives, and their training plans must be appropriate for all business activities associated with the firm. This rule requires training programs, at a minimum, to cover the following with respect to their securities recommendations, services, and strategies: general investment features and associated risk factors, suitability and sales practice concerns, and applicable regulatory requirements. There is no requirement that a firm's training address issues specific to senior investors.

Examination Observations

More than 77% of the firms incorporated training specific to senior investors and senior issues in their training plans, typically on an annual basis, to educate employees on the needs of this unique investor group. The training addressed topics such as:

- Ensuring that clients, specifically seniors, were fully informed of the risks involved with each product. For example, one firm trained its representatives on its requirements to evaluate the client's understanding of the recommended product and to confirm completeness of all mandatory acknowledgment forms and disclosures.

- How investment needs change as investors age. For example, one firm's training emphasized that not all products were suitable for the same type of investors. Another firm instructed representatives that they must consider various factors when making recommendations to senior investors, such as current employment, primary expenses, sources of income, fixed or anticipated expenses, liquidity, and investment goals.

- Escalation steps in the event that a representative notices signs of diminished capacity or elder financial abuse. Approximately 13% of the firms specifically told their representatives to notify compliance or supervisory personnel if they suspected diminished capacity or elder financial abuse. For example, training material instructed representatives to contact compliance with a problematic or suspicious situation and to document meetings, conversations, or other exchanges with relatives and others about the situation if the representative had noticed signs of diminished capacity. One firm provided a training module focused on reporting suspected senior financial abuse. The module, among other things, encouraged the firm's representatives to ask questions, confirm who had authorization on the account, contact the at-risk senior (separately from the suspected abuser), and escalate the matter to the appropriate supervisor. Some tips or red flags which would trigger escalation included atypical or unexplained withdrawals, drastic shifts in investment style, and changes in beneficiaries listed in the IRA.

In addition, 64% of firms reported conducting general training classes and/or classes to educate firm representatives on sensitive matters relating to senior investors. For example, one firm provided a mandatory training class for all representatives focused on elder financial abuse and the exploitation of older adults as well as a new-hire training course on the recognition of senior financial abuse. This training described warning signs that may indicate possible elder financial abuse such as sudden changes in investment approach; changes in behavior of a senior client, which could stem from fear of a family member or guardian; problems reaching the senior in question; or a new family member or contact suddenly attempting to make transactions in the senior client's account without proper authorization. The training also detailed the representative's responsibilities related to those warning signs, in addition to reporting suspicious activity to management and attempting to converse with the elder investor outside the presence of the person influencing or acting on behalf of the elder investor.

Conclusion

FINRA Rule 1250(b) requires firms to have a training plan that is appropriate for all business activities. Senior investors represent a large percentage of the investing population, and training employees on sensitive senior matters is an important step in detecting elder financial abuse, detecting potential diminished capacity, and understanding the needs of senior investors. Staff found that most firms incorporate training specific to senior issues into their training plans.

Notable Practices: Training

- Requiring a series of mandatory continuing education training courses over a 12-month period. Some of the courses cover the stages of mental capacity (full or diminished) and solutions to handling an investor's potential diminished mental capacity (e.g., helping senior investors understand steps they will need to take to handle financial responsibilities, such as execution of a durable power of attorney; suggesting that a family member or third party attend meetings to protect the client's interests; escalating concerns with state agencies and regulators; and documenting all interactions).

- Training supervisory staff to assist personnel in handling an investor's potential diminished capacity and elder financial abuse concerns.

Use of Senior Designations

Discussion of Relevant Rules

Firms may allow their representatives to use senior-specific certifications and professional designations to imply expertise, certification, training, or specialty in advising senior investors.[15] The SEC and FINRA, consistent with other federal agencies, state securities regulators, and self-regulatory organizations ("SROs") do not grant, approve, or endorse any professional designation. FINRA's rule on supervision in effect at the time of the examinations (NASD Rule 3010)[16] required each firm to establish and maintain a system to supervise the activities of each registered person, including their use of designations. This rule was intended to safeguard against the use of designations by firm representatives to deceive investors or to act in an unscrupulous manner. FINRA Regulatory Notice 11-52 reminds firms of their supervisory responsibilities concerning the use of senior designations that suggest expertise, certification, training, or specialty in advising senior investors. Notice 11-52 also highlights sound practices while encouraging firms to bolster their own supervisory procedures.[17]

Examination Observations

State regulators, among others, have identified the use of senior designations in marketing and communications with the public as a possible risk to investors.[18] Firms and their representatives may use these designations to imply expertise or credentials that may be inaccurate or misleading. Some senior designations have requirements including training classes, testing requirements, continuing education, and recognition from an accredited institution. Other designations are less stringent, and some do not have any requirements. The meaning of what these designations entail or the experience they represent can be confusing to any investor who relies on financial professionals to assist them with their financial issues.

Almost 64% of the examined firms allowed their representatives to use senior designations in their sales efforts, and these firms collectively permitted the use of 25 different senior designations. The designations used entailed a wide range of qualifications, some of which included an approved curriculum, continuing education requirement, and recognition by an organization that is accredited by another institution. Some firms prohibited the use of senior designations that did not meet certain minimum curriculum and continuing education requirements. For example:

- 64% of the designations that firms allowed representatives to use required continuing education for the financial professional to maintain the title.

- 44% of the allowed designations were not recognized by any independent accrediting organization.

- Almost 30% of the firms prohibited titles or designations if the corresponding curriculum and continuing education requirement did not meet certain specified standards.

Of the 28 firms that allowed senior designations, 14% did not track which representatives had a senior designation, which may violate FINRA's rule on communications with the public (FINRA Rule 2210) and FINRA's rule on supervision in effect at the time of the examinations (NASD Rule 3010). As noted above, these rules require firms to know how their representatives hold themselves out to the public.

Conclusion

Senior designations have varying requirements, some more rigorous than others. For example, certain designations carry specific qualification requirements, while others have none. As a result, some of these designations may be misleading to the investing public. It is important that all investors not rely solely on a title to determine whether a financial professional has the appropriate expertise. In addition, the use of senior designations should be properly supervised. It may be prudent for firms that allow senior designations to adopt policies to safeguard against possible misuse of those senior designations.

Notable Practices: Senior Designations

- Requiring senior designations to have a verified curriculum, a continuing education element, and accreditation from a recognized independent institution.
- Requiring supervisory approval prior to the use of senior designations.
- Prohibiting the use of senior designations.

Marketing and Communications

Discussion of Relevant Rules

FINRA Rule 2210 includes requirements for a firm's communications with the public, including retail communications. Rule 2210(a)(5) defines retail communications to include any written (including electronic) communication that is distributed or made available to more than 25 retail investors within any 30 calendar-day period. Rule 2210(b)(1)(A) requires an appropriately registered principal to approve most retail communications before the earlier of its use or filing with FINRA's Advertising Regulation Department.[19] In addition, Rule 2210(c) requires broker-dealers to file certain retail communications with FINRA's Advertising Regulation Department. For example, with certain exceptions, broker-dealers must submit all retail communications concerning registered investment companies within ten business days of first use.

Rule 2210(d)(1) addresses the content standards of firms' communications with the public, which include the following:

- All member communications must be based on principles of fair dealing and good faith, must be fair and balanced, and must provide a sound basis for evaluating the facts in regard to any particular security or type of security, industry, or service. No member may omit any material fact or qualification if the omission, in light of the context of the material presented, would cause the communications to be misleading.

- No member may make any false, exaggerated, unwarranted, promissory, or misleading statement or claim in any communication. No member may publish, circulate, or distribute any communication that the member knows or has reason to know contains any untrue statement of a material fact or is otherwise false or misleading.

- Information may be placed in a legend or footnote only in the event that such placement would not inhibit an investor's understanding of the communication.

- Members must ensure that statements are clear and not misleading within the context in which they are made, and that they provide balanced treatment of risks and potential benefits. Communications must be consistent with the risks of fluctuating prices and the uncertainty of dividends, rates of return, and yield inherent to investments.

- Members must consider the nature of the audience to which the communication will be directed and must provide details and explanations appropriate to the audience.

- Communications may not predict or project performance, imply that past performance will recur or make any exaggerated or unwarranted claim, opinion, or forecast.

Rule 2210(f) includes requirements for public appearances. Rule 2210(f)(1) states that the content standards in Rule 2210(d)(1) also apply to public appearances by persons associated with broker-dealers. These public appearances include sponsoring or participating in a seminar, forum, radio, or television interview or otherwise engaging in public appearances or speaking activities that are unscripted and do not constitute retail communications, institutional communications, or correspondence. If an associated person recommends a security during a public appearance, Rule 2210(f)(2) requires the associated person to have a reasonable basis for the recommendation and to disclose certain conflicts of interest. In addition, Rule 2210(f)(3) requires firms to establish written policies and procedures that are appropriate to their business, size, structure, and customers to supervise their associated persons' public appearances. These procedures must provide for the education and training of associated persons who make public appearances as to the firm's procedures, documentation of such education and training, and surveillance and follow-up to ensure that such procedures are implemented and followed. Rule 2210(f)(4) clarifies that scripts, slides, handouts, or other written (including electronic) materials used in connection with public appearances are considered communications for the purposes of Rule 2210, and members must comply with all applicable provisions based on the communications' audience, content, and use (e.g., approval requirements for retail communications and content standards). Unscripted public appearances at a seminar are not subject to the principal pre-use approval requirements of Rule 2210(b)(1)(A).

Rule 17a-4(b)(4) under the Securities Exchange Act of 1934 ("Exchange Act") requires broker-dealers to preserve all of their communications with the public which are subject to FINRA rules. The records must be preserved for a period of not less than three years, the first two years in an easily accessible place.

Examination Observations

Staff reviewed marketing and advertising materials used by the examined firms and observed that the firms and their representatives used diverse approaches to promote services and securities to senior investors. A very small number of firms sent retail communications to senior investors specifically because of their age. Retirement planning was a dominant theme of retail communications focused on attracting senior investors. Other senior-related themes included long-term care insurance, wealth preservation, and wealth transfer. Firms promoted these themes through various channels such as brochures, print and electronic advertisement, newspaper columns, radio and television commercials, and seminars. Retirement seminars were a popular forum for soliciting potential investors, including senior investors.

With regard to radio, at least two firms permitted their representatives to host shows to broadly market the services they provide to investors, often discussing themes that may be appealing to senior investors such as retirement. Staff identified potential rule violations such as misleading advertisements and the failure to properly supervise the content of radio shows.

With regard to seminars, approximately half of the firms permitted representatives to host educational seminars covering a wide variety of investment topics, and at least five firms prohibited representatives from hosting seminars. Many seminars appeared designed to target senior investors, as well as middle-aged investors and investors approaching retirement. For example, some seminars focused on investors who were still working but were transitioning from the accumulation of wealth stage to retirement. Others were designed to discuss possible strategies regarding long-term retirement planning techniques that consider changes to income and when to start drawing from annuities, Social Security, pensions, and other defined benefit plan income.

Of the firms that permitted seminars and other forms of public appearances, staff observed that the firms generally had written supervisory procedures specifically covering this area. The specifics of written supervisory procedures differed among firms. For example:

- Some firms required a designated supervisor to review and pre-approve all materials related to the proposed seminar.

- Some firms stated that invitations to seminars could not imply that products would be sold during the seminar. Further, these firms required supervisors, or appropriate designees, to attend seminars periodically to ensure compliance with all regulatory and firm requirements.

- At least two firms established documentation standards for seminars. For example, some of the procedures required that representatives maintain documentation on the date(s) of the seminar, the title of the seminar, the seminar content, name(s) of firm representative hosting the seminar, the date the material for the seminar was submitted for approval, and the date the supervisor approved the seminar.

- Other firms required representatives to distribute evaluation forms to attendees to solicit feedback. Supervisors were then required to review these forms to help identify any issues of regulatory concern that may violate firm policies or the content requirements of FINRA Rule 2210.

Staff observed instances at two firms where the firm or its registered persons appeared to fail to comply with provisions that were set forth in the firm's written supervisory procedures. For example, deficiencies included the failure to obtain supervisory approval for materials used during seminars and, separately, the failure to maintain evidence of approval of seminar materials in contravention of firm written supervisory procedures that required such approval.

Conclusion

Retirement planning is often a dominant theme in retail communications that firms use to attract senior investors. Long-term care insurance, wealth preservation, and wealth transfer also are common senior investor-related themes. These communications take a variety of forms including brochures, print and electronic advertisement, newspaper columns, radio and television commercials, and seminars. Firms appeared to generally comply with content standards and rules requiring firms to have written policies and procedures, although staff noted a few instances of potentially misleading advertisements and the potential failure to properly supervise the content of radio shows as well as the potential failure to comply with a firm's written supervisory procedures for seminar materials.

Notable Practices: Marketing and Communications

- Having written supervisory procedures that require supervisory approval to participate in unscripted seminars and other forms of public appearances that are not subject to the principal pre-use approval requirements of FINRA Rule 2210(b)(1)(A).

- Distributing evaluation forms to seminar attendees to solicit feedback which are then reviewed by a supervisor to identify any issues of concern that may violate firm policies or the content requirements of FINRA Rule 2210(d)(1).

Account Documentation

Discussion of Relevant Rules

Both the SEC and FINRA have rules regarding the minimum information that firms must obtain and maintain for each customer account. Exchange Act Rule 17a-3(a)(17)(i)(A) requires broker-dealers to make and keep current a record for each customer account that includes the customer's name, tax identification number, address, telephone number, date of birth, employment status (including occupation and whether the customer is an associated person of a member, broker or dealer), annual income, net worth (excluding value of primary residence), and the account's investment objectives. In the case of a joint account, the account record must include personal information for each joint owner who is a natural person; however, financial information for the individual joint owners may be combined. The account record must indicate whether it has been signed by the associated person responsible for the account, if any, and approved or accepted by a principal of the member, broker or dealer. Rule 17a-3(a)(17)(i)(B) requires firms to furnish each customer with a copy of his or her account record within 30 days of opening the account and at least every 36 months thereafter. Furnishing account records is an important tool to help customers and firms promote the accuracy of investment profiles. This is of particular importance to senior investors due to changing liquidity needs and evolving objectives and risk tolerances, such as when investors move from accumulating assets to using assets to provide income during retirement.[20] Rule 17a-3(a)(17)(i)(B) also requires firms to notify customers of name or address changes of the customer or owner and to send updated customer account records reflecting changes in the account's investment objectives within 30 days.

FINRA Rule 4512(a)(1) requires, among other items, that a firm maintain the following information for each customer account: the customer's name and residence; whether the customer is of legal age; names of any associated persons responsible for the account, and if multiple individuals are assigned responsibility for the account, a record indicating the scope of their responsibilities with respect to the account; and signature of the partner, officer, or manager denoting that the account had been accepted in accordance with the member's policies and procedures.

Additionally, FINRA Rule 2090 requires firms to use reasonable diligence, in regard to the opening and maintenance of every account, to know and retain the essential facts concerning every customer and the authority of each person acting on behalf of such customer. FINRA has provided a "New Account Application Template" or voluntary model brokerage account form that firms may use as a resource when they design or update their new account forms.[21]

Examination Observations

Staff reviewed the types of information firms collected when opening accounts for senior investors to assess compliance with applicable rules. Approximately 98% of the firms collected the information for new customer account records required by the rules. At least 30% of the firms obtained more information than what is required, including detailed expense information (including short and medium-term expenses), retirement status, whether there was a durable power of attorney, mortgage-related information, insurance policy information, healthcare needs, sources of income (whether those sources are fixed or will be in the future), savings for retirement, and future prospects for employment. In addition, at least 23% of the firms adopted FINRA's New Account Application Template or a variation. The firms that did not use the template used customized, firm-specific new account forms or multiple documents to obtain the required customer information.

Staff also assessed firms' compliance with requirements for updating senior customer account information. Some firms used automated supervisory alerts to help ensure that updated customer investment profiles accurately reflected changes in customers' personal and financial circumstances. Aged account records were being relied on for recommendations at 32% of the firms; at those firms, some of the account information reviewed was more than 36 months old.

Conclusion

Almost all of the firms appear to be consistently meeting their obligations to collect the required customer account information for senior investors when opening new accounts, and in many cases, firms were obtaining more detailed information than is required by the applicable rules; however, some did not appear to be properly updating account information or appeared to be relying on account records aged more than 36 months. It is important for customer account information to be updated so that it properly reflects customer financial needs, investment objectives, and risk tolerance, among other things.

Notable Practices: Account Documentation

- Obtaining more detailed customer account information than what is required by the applicable rules. For example, firms obtained detailed expense information from customers and calculated both short and intermediate-term expenses, among others.

- Using automated supervisory alerts to help ensure that updated customer investment profiles accurately reflect changes in customers' personal and financial circumstances.

Suitability

Discussion of Relevant Rules

Broker-dealers generally have an obligation to recommend only those specific investments or overall investment strategies that are suitable for their customers. The concept of suitability appears in specific SRO rules and has been interpreted as an obligation under the antifraud provisions of the federal securities laws.[22] FINRA Rule 2111 requires firm representatives to have a reasonable basis to believe that a recommended transaction or investment strategy is suitable for the customer based on the information obtained through reasonable diligence to ascertain the customer's investment profile. A customer's investment profile includes, but is not limited to, the customer's age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance, and any other information the customer may disclose to the representative in connection with the recommendation.

FINRA Rule 2330 includes additional requirements for recommended purchases and exchanges of variable annuities. For example, Rule 2330(b)(1)(A) provides that for a recommended purchase of a variable annuity to be suitable in accordance with Rule 2111, firm representatives must have a reasonable basis to believe that the customers have been informed, in general terms, of the various features (both restrictive and beneficial) of variable annuities; the customers would benefit from certain features of variable; and the particular variable annuity as a whole, including any underlying sub-accounts, riders, and similar product enhancements, are suitable. Rule 2330(b)(1)(B) includes similar requirements for recommending the exchange of a variable annuity, requiring firm representatives to take into consideration factors such as whether customers would incur surrender charges, be subject to the commencement of a new surrender period, lose existing benefits, or be subject to increased fees or charges; whether customers would benefit from product enhancements and improvements; and whether customers have had another variable annuity exchange within the preceding 36 months. In addition, Rule 2330(b)(2) requires firm representatives to obtain, at a minimum, the following information before recommending the purchase or exchange of a variable annuity: customer age, annual income, financial situation and needs, investment experience, investment objectives, intended use of the variable annuity, investment time horizon, existing assets (including investment and life insurance holdings), liquidity needs, liquid net worth, risk tolerance, tax status, and any other information a reasonable person would need in making recommendations to customers.

Examination Observations

Staff analyzed the suitability of recommendations of variable annuities, alternative investments, mutual funds, structured products, REITs, equities, and municipal bonds to senior investors based on a variety of factors, including the appropriateness of exchanges, excessive fees, concentration of liquid net worth, short investment time horizon, and age.

Staff found evidence indicating that 34% of the firms made one or more potentially unsuitable recommendations of variable annuities. One of the most prevalent factors contributing to questions about these recommendations was the appropriateness of exchanges, especially in light of fees. For example, one firm representative displayed a consistent pattern of recommending that investors exchange variable annuity contracts purchased within the previous 36 months. In one of those cases, an investor funded the purchase of a new contract by selling a contract he had purchased less than three years earlier, incurring a surrender charge, a loss of death benefit, and an increase in fees. In this case, the cost and commissions charged with the new contract along with surrender charges, increased fees, and a new surrender schedule appeared to outweigh the benefits, given the investor's age.

Other factors that prompted staff's further review of recommendations of variable annuities included patterns of a large percentage of investors' liquid net worth being invested in variable annuities, investment time horizons and age not matching features of the product, firm representative not sufficiently collecting investment profile information, and investment objectives that appeared inconsistent with the terms of recommended variable annuities.

Approximately 14% of firms made potentially unsuitable recommendations to purchase alternative investments, which can be difficult to value, involve high purchase costs, have limited historical data, and often lack liquidity. For example, at one firm, representatives failed to consider the age (90) and low income of one investor, and the limited investment experience and "growth and income" investment objectives of another investor. These senior investors held the positions for less than ten days and experienced significant realized losses.

Less than 10% of firms made potentially unsuitable recommendations of other types of securities to senior investors. For example:

- 9% made potentially unsuitable recommendations of mutual funds. In one instance, staff believed that recommendations of C shares were potentially unsuitable because the customer's investment horizon was eleven years or more, the investment objective was income, and the purchase of Class A shares in the same fund would have qualified the customer for breakpoints.

- 7% made potentially unsuitable recommendations for sales of structured notes and market-linked CDs, which often lack liquidity, carry complex risks such as default risk, and are difficult to value. It appeared that firm representatives failed to consider investors' risk tolerances, investment concentrations, the illiquid nature of these securities, and investors' age and time horizon when assessing suitability. For example, representatives made multiple recommendations for market-linked CDs, which exceeded maximum firm thresholds of investable assets and product concentrations. One such recommendation was made to an 87 year-old investor with a moderate risk tolerance, an investment objective of growth, and investment experience that was limited to mutual funds. The product would not become liquid until the investor was 94 years old, and the investment tied up a significant percentage of the investor's assets.

- 7% of firms made potentially unsuitable recommendations for exchange-traded and non-traded REITs. For example, one firm employed a REIT Trading (switching) program that may have facilitated recommendations of REITS to senior investors. The program involved a recommendation to purchase a non-traded REIT followed by a recommendation to sell the REIT once it became publicly traded followed by a recommendation to buy a new-non traded REIT. In multiple cases, the firm representatives failed to combine orders to obtain volume discount benefits for their customers. In addition, staff cited several instances where firm representatives made the recommendations without adequate suitability information including investment objectives, risk tolerances, and investment experience.

Conclusion

In a low interest rate environment, firms may be recommending non-traditional investments to supplement the income streams of senior investors. Staff found that firms made more potentially unsuitable recommendations for non-traditional securities such as variable annuities, structured products, and REITs than for more traditional securities such as open-end mutual funds, equities, and fixed income investments. Firms must have a reasonable basis to believe that a recommended transaction or investment strategy is suitable for the investor based on the information obtained through reasonable diligence into an individual's investment profile.

Notable Practices: Suitability

- Adopting policies and procedures addressing suitability risks specific to senior investors.
- Requiring firm representatives to memorialize in firm computer systems conversations between the representatives and senior investors relating to the recommendations.
- Drafting product applications that require firm representatives to consider and document crucial investment profile information.
- Establishing strict firm product concentration guidelines for senior investors.

Disclosures

Discussion of Relevant Rules

Section 17(a)(2) of the Securities Act of 1933 ("Securities Act") makes it unlawful for any person in the offer or sale of securities, by the use of any means or instruments of transportation or communication in interstate commerce or by use of the mails, directly or indirectly to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading. In addition, Section 5 of the Securities Act requires that firms furnish a prospectus in connection with the offer or sale of mutual funds and variable annuities. Mutual fund and variable annuity prospectuses contain details on the product's objectives, investment strategies, risks, performance, distribution policy, fees and expenses, and fund management.

FINRA Rule 2010 requires members, in the conduct of their business, to observe high standards of commercial honor and just and equitable principles of trade. This rule speaks to the necessity of full disclosure in relation to material information without omissions regarding broker-dealer firms and their interactions with investors. In addition, other FINRA rules include additional disclosure requirements for special products, such as variable annuities. For example, FINRA Rule 2330(b)(1)(A)(i) requires firm representatives to describe to customers, in general terms, the various features of variable annuities prior to recommending their purchase or exchange. These features include potential surrender periods and surrender charges, tax penalties, mortality and expense fees, investment advisory fees, potential charges for and features of riders, the insurance and investment components, and market risk.

Examination Observations

Staff asked the examined firms to provide all of their disclosures to senior investors relating to the sale of investment products between January 2012 and October 2012. Staff believes that 89% of the firms provided senior investors with appropriate, detailed, and relevant disclosures concerning the recommended securities.

Staff noted that 68% of the firms had sold variable annuities, as one of the top five revenue-generating products, to their investors. In order to comply with the additional requirements in FINRA Rule 2330, many firms adopted a variable annuity disclosure form to evidence collection of the information required by the rule. This disclosure form described the features of the particular variable annuity such as mortality and expense fees, surrender fees and period, liquidity needs of the investor, all riders and account benefits from the variable annuity, and general information about the variable annuity. The majority of firms required their representatives to fill out and submit this form to supervisory officers prior to the variable annuity transaction.

In addition, firms often required customers to sign the disclosures provided to evidence receipt. These disclosures included the variable annuity application, acknowledgement of receipt of the prospectus, state forms when required,[23] a schedule stating commission percentage breakdown and average fund expense ratio breakdown, mortality and expense fees, surrender fees and years remaining if applicable, and average fund expense ratio. When the variable annuity investment was a significant concentration of the customer's assets, at least two firms required customers to sign a disclosure stating their awareness of the high concentration and their sufficiency of liquid assets to cover expenses. In cases where the investor was exchanging one variable annuity for another, almost 10% of firms provided disclosures that included a variable annuity transfer and exchange form, disclosure of surrender costs versus the benefits of the new products, a product comparison for the old and new products, and the total expenses of switch transactions.

Of the 11% of firms that appeared to fail to provide adequate disclosures to senior investors prior to a transaction, the majority (7%) did so in relation to variable annuity transactions. For example, the section of variable annuity forms or disclosure letters describing the comparative fees and benefits between the current and the proposed annuities was often incomplete. In addition, some firms provided what appeared to be inaccurate and misleading disclosures pertaining to variable annuities, such as by inaccurately disclosing the loss of a death benefit resulting from an exchange or by not clearly communicating, inaccurately describing, or failing to disclose surrender charges.

Staff also observed what appeared to be inaccurate, incomplete, or misleading disclosures in relation to affiliated private placements and REITs. For example, one firm made what appeared to be misrepresentations concerning premiums advanced, guaranteed interest payments, and return of principal, as well as omissions with regard to underpayment of insurance premiums, a 10% fee on amounts advanced, and an $11.7 million tax lien in private placement memorandums and market materials for affiliated private placements. Another firm provided what appeared to be misleading and inaccurate sales literature regarding REITs to customers prior to their solicited purchase and subsequent liquidations. This sales literature touted certain enhancements from the original offering such as lower fees, but the prospectuses revealed that fees for liquidation and operations actually increased.

Conclusion

In general, firms appeared to be providing appropriate disclosure to investors with regard to recommended securities. Staff observed what appeared to be inaccurate or incomplete disclosures primarily related to non-traditional securities such as variable annuities and REITs. Despite general compliance with disclosure requirements, it is important to note that it is unclear how well investors understand the disclosures they receive on recommended securities.

Notable Practices: Disclosures

- Requiring a customer signature on a disclosure form indicating that the customer received a prospectus when purchasing new open-end mutual funds.
- Requiring an explanation of the tax ramifications and alternative investment possibilities for all customers that purchase a variable annuity in an individual retirement account.
- Providing a detailed description of registered representative compensation (both direct and indirect) for each product sold on their website.
- Providing one comprehensive disclosure form that includes simple definitions for industry nomenclature and the schedule of fees and expenses related to specific securities.

Customer Complaints

Discussion of Relevant Rules

Investors dissatisfied with their accounts or the service provided by their registered representative or firm (among other reasons) may file a complaint with the firm, FINRA, the SEC, or other relevant regulatory agencies. Exchange Act Rule 17a-3(b)(18) requires firms to make a record of every written customer complaint (including electronic) received by the firm concerning its associated persons. The record must include the complainant's name, address, and account number; the date the complaint was received; the name of each associated person identified in the complaint; a description of the nature of the complaint; and the disposition of the complaint. The rule also requires firms to keep a record indicating that each of its customers has been provided with a notice containing the address and telephone number of the department of the member, broker or dealer to which any complaints as to accounts may be directed. These firms are required to preserve these records for a period of not less than three years, the first two years in an easily accessible place. Exchange Act Rule 17a-4(j) requires registered firms to promptly produce these records to representatives of the SEC upon request.

FINRA Rule 4513(a) requires firms to keep and preserve in each office of supervisory jurisdiction, either a separate file of all written customer complaints that relate to that office (including complaints that relate to activities supervised from that office) and action taken by the member, if any, or a separate record of such complaints and a clear reference to the files in that office containing the correspondence connected with such complaints. Rather than keep and preserve the customer complaint records required under this rule at the office of supervisory jurisdiction, the member may choose to make them promptly available at that office, upon request of FINRA. FINRA also requires firms to preserve customer complaint records for at least four years.

Rule 4513(b) clarifies that for purposes of this rule, "customer complaint" means any grievance by a customer or any person authorized to act on behalf of the customer involving the activities of the member or a person associated with the member in connection with the solicitation or execution of any transaction or the disposition of securities or funds of that customer.

FINRA Rule 4530(a)(1)(B) requires each member to report to FINRA promptly, but in any event not later than 30 calendar days, after the member knows or should have known of the existence of any written customer complaints involving allegations of theft or misappropriation of funds or securities or of forgery. In addition, Rule 4530(d) requires each member to report to FINRA statistical and summary information regarding written customer complaints in such detail as FINRA shall specify by the 15th day of the month following the calendar quarter in which customer complaints are received by the member. Supplementary Material .08 clarifies that a "customer" includes any person, other than a broker or dealer, with whom the member has engaged, or has sought to engage, in securities activities. It also clarifies that each member must report the following under Rule 4530(d): any written customer complaint reported under Rule 4530(a)(1)(B), any written grievances by customers with whom the member has engaged in securities activities that involves the member or a person associated with the member, and any securities-related written grievance by customers with whom the member has sought to engage in securities activities that involves the member or a person associated with the member.

Examination Observations

Staff reviewed a sample of complaints received by the firms examined to identify any patterns or trends, to detect potential deficiencies in the handling of senior investor accounts, and to detect issues related to firm activities.

While firms maintained records of investor complaints, at least two firms (5%) had difficulty aggregating the number of complaints received from senior investors because they did not track or code the complaints using the age of the customer. Conversely, at least one firm used an internal "senior-related" complaint code which allowed the firm to easily identify senior investor complaints. This use of a senior-related complaint code may help the firm identify issues and concerns specific to senior investors so that they can make necessary changes to:

- improve the effectiveness and the efficiency of their programs;
- identify approaches to manage the increasing challenges of cognitive decline;
- provide products or services that better meet the needs of the senior investors;
- identify and prioritize the underlying risks appropriate to a firm's business; and
- assess the integrity of firm controls to manage senior investor accounts.

Overall, customer complaints involved a wide range of securities and allegations of business conduct issues. The most common complaints among senior investors, with regard to business conduct issues, involved allegations of poor service or unreasonably high fees. Some of the other more common complaints involved allegations of misrepresentations, unsuitable investments, churning, unauthorized trading, and poor advice/recommendations. For example, one senior investor alleged that his account was churned and his registered representative engaged in unauthorized trading between 2007 and 2011. This firm terminated the registered representative after the representative acknowledged using discretion without obtaining prior written authorization. Another customer complaint alleged misrepresentation, unsuitable recommendations, and processing issues. Staff identified apparent deficiencies at the firm including failure to properly code customer complaints, failure to associate a registered representative to complaints, and failure to disclose complaints on the proper form (Form U4).

Conclusion

Staff observed that all of the firms examined were preserving and reporting customer complaints as required by the FINRA rules, but some had difficulty aggregating the number of senior complaints in their system. The most common complaint themes among senior investors were allegations of poor service and unreasonably high fees.

<u>Notable Practices: Customer Complaints</u>

- Coding complaints as "senior related" in internal systems to enhance a firm's ability to more appropriately respond to senior investors and analyze complaint data.

Supervision

Discussion of Relevant Rules

Section 15(b)(4)(E) of the Exchange Act authorizes the Commission to censure, place limitations on, suspend, or revoke the registration of any broker- dealer who has failed to reasonably supervise persons subject to its supervision with a view to preventing violations of the federal securities laws or rules.

Paragraph (a) of FINRA's rule on supervision in effect at the time of the examinations (NASD Rule 3010)[24] required each member to establish and maintain a system to supervise the activities of each registered representative, registered principal, and other associated person that was reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable NASD Rules. Rule 3010(a) also clarified that the final responsibility for proper supervision rested with the member. Rule 3010(b) required each member to establish, maintain, and enforce written procedures to supervise the types of business in which it engaged and to supervise the activities of registered representatives, registered principals, and other associated persons that were reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable Rules of NASD.

Under this rule, firms that relied on automated supervisory systems must, at a minimum, require a principal, or principals, of the firm to:

- approve the criteria used in the automated supervisory system;
- audit and update the automated supervisory system as necessary to ensure compliance with applicable FINRA and federal securities rules and regulations; and
- review exception reports produced by the automated supervisory system.

A principal using an automated supervisory system, aid, or tool for the discharge of supervisory duties remained responsible for compliance with this rule.

Many FINRA rules expand on the requirements in NASD Rule 3010 with regard to supervision of specific products and firm activities. For example, FINRA Rule 2330(d) includes additional supervisory and recordkeeping requirements for firms that sell variable annuities. The member also must establish and maintain specific written supervisory procedures reasonably designed to achieve compliance with the standards set forth in Rule 2330, implement surveillance procedures to determine if any of the member's associated persons are effecting inappropriate exchanges, and have policies and procedures reasonably designed to implement corrective measures to address inappropriate exchanges and the conduct of associated persons who engage in inappropriate exchanges. As another example, FINRA Rule 2360(b)(20)(A) requires each member that conducts public customer options business to ensure that its written supervisory system policies and procedures adequately address this options business.

Examination Observations

Staff's review of firm supervision of the business conducted with senior investors focused on firm supervisory processes, written supervisory procedures, exception reporting, internal controls, and compliance reviews. Staff observed that 77% of the firms maintained written supervisory procedures specific to supervision of firm representatives who deal with senior investors. At least 16% of firms used 70 years old as the age for implementing age-based policies and procedures, and at least 5% established age-based policies and procedures for investors as young as 60. Senior-related policies and procedures varied from firm to firm.

A majority of firms' procedures addressed general senior-related supervision, but 11% of firms specifically cited or included some of the themes from FINRA Regulatory Notice 07-43[25] in their written supervisory procedures. This Regulatory Notice addresses firm obligations relating to senior investors and highlights industry best practices, suitability concerns, communications with the public (including use of designations and seminars), and dealing with investors with diminished capacity and occurrences of suspected financial abuse. Topics from the Regulatory Notice addressed in the firms' procedures include the following:

- use of senior designations and credentials;
- approval channels for product recommendations;
- retail communications targeting senior investors;
- luncheon programs and seminars;
- heightened review of product suitability for seniors;
- heightened review of the use of margin accounts by seniors; and
- supervisory requirements to contact senior investors.

Multiple firms had written supervisory procedures that addressed suitability and know-your-customer requirements specifically for senior investors. For at least half of the firms, investor age played a critical role in establishing product suitability guidelines, assessing the suitability of transactions and accounts, and triggering exceptions or red flags. The procedures addressed the importance of obtaining investment profile information and a variety of senior-related topics including:

- dealing with investors who exhibit diminished capacity and other cognitive impairment;
- qualified plan rollovers;
- senior investors' appetite for increasing yield;
- current and future prospects for employment;
- sources of income and whether it is fixed or will be in the future;
- primary expenses including whether the customer still has a mortgage;
- income needed to meet fixed or anticipated expenses;
- savings for retirement and how they are invested;

- health care insurance and future needs to fund health care costs;
- rapid changes to financial profiles based on life events;
- third-party emergency contact information and permission to contact the third party in the event an issue requires clarification; and
- income and estate tax liabilities.

At least 30% of the firms had suitability guidelines for senior investors purchasing certain securities such as variable annuities, non-traded REITs, structured products, low-priced securities, high-yield funds, and other alternative products. At least 23% of the firms maintained such procedures for variable annuities and options. Generally speaking, the suitability product guidelines did not prohibit purchases of a particular product or security by senior investors. Rather, the written supervisory procedures typically included additional requirements or guidelines that firm representatives must follow when senior investors were purchasing certain securities. While these guidelines varied by firm and by customer age, they indicated that firms are paying increased attention to the accounts of senior investors. Examples of these product guidelines or requirements included:

- concentration guidelines for the sale of alternative products to investors who are 75 or older and red flags regarding the sale of variable annuities to senior investors;
- outreach requirements to ensure that investors understood the characteristics of the securities and risks associated with the transactions, such as requiring supervisors to call investors aged 70 or older who purchased variable annuities or requiring compliance departments to speak with customers aged 70 or older who purchased variable annuities and customers aged 75 or older who purchased market-linked CDs;
- heightened supervisory reviews of senior purchases of specific securities;
- pre-approval of purchases by customers aged 70 or older or prohibitions on sales of structured products to customers above a specific age unless the firm granted an exception; and
- exception reports that identified transactions in options securities by senior investors.

Some firms implemented procedures to review transactions by senior investors and/or senior investor accounts over a defined time period to determine whether transactions were suitable and to identify trends. For example, one firm required supervisors to review variable annuity purchases by investors aged 70 or older on a quarterly basis in order to identify potential patterns of inappropriate variable annuity exchanges.

At least three firms used centralized supervisory review groups at their main or regional offices for new accounts or transactions by senior investors. For example, one firm required a centralized supervisory review group to approve new brokerage accounts for investors aged 80 or older and to make initial determinations as to whether the securities to be purchased appeared to be suitable. Other firms required transactions to be routed to a review group based on the product type. One firm had a policy prohibiting investors aged 65 or older from purchasing variable annuities unless the firm representative documented additional written justifications for the purchases and the centralized review group approved the transaction based on its suitability.

Typically, firms' supervisory structures were supported with some degree of automation. Firms used a wide variety of exception, supervisory, and compliance reports that considered investor age and other factors in tandem, such as liquid net worth, account losses, market performance, or the cost of insurance riders. One firm had as many as 150 suitability, solicitation, and disclosure exception reports for opening and handling accounts for senior investors.

Exception reports typically focused on trends involving the number of senior accounts opened over a defined time period, red flags for individual accounts and transactions, investor losses exceeding $25,000 within a 12-month period, or red flags identifying purchases exceeding 25% of an investor's liquid net worth. Examples of exception reports include the following:

- purchases of $10,000 or more of equity securities by investors aged 65 or older;
- purchases of limited partnerships and unlisted REITs by investors aged 65 or older;
- firm representatives credited with 20 or more initial variable annuity purchases by senior investors during each quarter;
- withdrawals from accounts where a power of attorney has been executed; and
- electronic withdrawals from retirement accounts that may too quickly deplete the account balance when factoring in market performance, a customer's life expectancy, and the quantity of money in an investor's account.

At least seven firms had implemented comprehensive supervisory review systems and processes using automated systems and tools that were integrated with firms' branch supervision and compliance departments. These systems were often complex and contained sophisticated rules that factored in a number of variables that used rule and risk-based scenarios to score investor accounts and transactions. These systems flagged accounts or transactions based on investor characteristics such as age, investment objective, products purchased, and concentration. Generally, the analytic methodologies used in these systems were dynamic, allowing firms to customize the scoring thresholds specifically in senior accounts that would trigger elevated supervisory reviews. Once a transaction or account triggered an exception, firms typically had specific escalation processes for supervisory or compliance review. For example, depending on a firm's protocols, flagged transactions could be escalated to the next level of supervision or to the compliance department.

These systems were developed and supported either by third-party vendors or by the firms. Third-party systems contained exception reporting capabilities that allowed firms to customize exception reports and alerts based on firm criteria to identify questionable account activities. For example, one firm used an automated trade entry system that provided information in different formats for firm representatives and for supervisors or compliance personnel. The view for compliance personnel flagged transactions based on visual cues or risk scores. Color-coded flags based on various factors were used to identify inappropriate or abusive sales practice activity.

Customizing an automated supervisory system enabled firms to react to changing trends within the firm and industry by prioritizing their surveillance programs accordingly.

Conclusion

Most of the firms maintained written procedures related to supervision of firm representatives who deal with senior investors. Firms most frequently used the age of 70 when implementing age-based policies and procedures, but some firms established age-based policies and procedures for investors as young as 60. While general requirements, suitability requirements, product guidelines, and other supervisory procedures varied by firm and by customer age, they indicated that firms are paying increased attention to the accounts of senior investors. In addition, many firms are paying increased attention to transactions in non-traditional securities and have adopted specific supervisory procedures for investments such as variable annuities, non-traded REITs, structured products, and other alternative products. Finally, firm supervisory structures typically are supported by automated systems, which help firms identify and address issues related to senior investors.

Notable Practices: Supervision

- Establishing firm policies that address FINRA Regulatory Notice 07-43, which discusses enhanced suitability practices, communications, dealing with investors suffering from diminished capacity, and occurrences of suspected financial abuse.
- Maintaining product suitability guidelines for senior investors purchasing complex or alternative products such as variable annuities, equity-indexed annuities, REITs, and options.
- Using a centralized supervisory review group to approve transactions and new accounts.
- Using automated systems and tools that are integrated with firm's branch supervisory review system and compliance departments.

Conclusion

OCIE and FINRA staff regard compliance with laws, rules, and regulations applicable to dealings with senior investors to be a high regulatory priority, and the importance of this topic is likely to continue for both regulators and broker-dealers for many years.

The current environment, where traditional savings accounts and other conservative investments are earning historically low yields, may prompt firms to recommend and senior investors to purchase more non-traditional securities, such as variable annuities, non-traded REITs, structured products, and other alternative products. OCIE and FINRA staff are concerned that broker-dealers may be recommending unsuitable securities to senior investors or failing to adequately disclose the related risks. It is imperative that senior investors receive proper and understandable disclosures regarding the terms and risks related to securities recommended to them, particularly non-traditional investments.

This report highlights recent industry trends that have impacted the investment landscape and discusses the key observations and practices identified during the recent series of examinations with regard to securities sold to senior investors, training, use of senior designations, marketing and communications, account documentation, suitability, disclosures, customer complaints, and supervision. OCIE and FINRA staff are providing this information to broker-dealers to support their thoughtful analysis of their policies and procedures as they serve the needs of senior investors.

This Report is intended to highlight for firms risks and issues that staff of the SEC's Office of Compliance Inspections and Examinations and FINRA identified in the course of examinations of broker-dealers. In addition, this Report describes practices, issues, or factors that firms may consider to (i) assess their supervisory, compliance and/or other risk management systems related to risks and issues involving senior investors and (ii) make any changes, as may be appropriate, to address or strengthen such systems. These factors are not exhaustive, and they constitute neither a safe harbor nor "checklist." Other factors besides those described in this Report may be appropriate alternatives or supplements to consider, and some of the factors may not be applicable to a particular firm's business. They do not present any legal opinion or advice. Moreover, future changes in laws or regulations may supersede some of the factors or issues raised here. The adequacy of supervisory, compliance, and other risk management systems can be determined only with reference to the profile of each specific firm and other facts and circumstances.

Appendix A – Reference Material for Firms

Examination Priorities for 2015

- OCIE, SEC, Examination Priorities for 2015
  http://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2015.pdf
- FINRA, 2015 Regulatory and Examination Priorities Letter
  http://www.finra.org/web/groups/industry/@ip/@reg/@guide/documents/industry/p602239.pdf

Securities

- Office of Investor Education and Advocacy ("OIEA"), SEC, Mutual Funds: A Guide for Investors
  http://investor.gov/sites/default/files/mutual-funds.pdf
- OIEA, SEC Investor Bulletin: Variable Annuities – An Introduction (February 2014)
  http://www.sec.gov/investor/alerts/ib_var_annuities.pdf
- FINRA Investor Alert: Public Non-Traded REITS – Perform a Careful Review Before Investing
  http://www.finra.org/Investors/ProtectYourself/InvestorAlerts/REITS/P124232

Training

- FINRA Rule 1250: Continuing Education Requirements
  http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=10204

Senior Designations

- OIEA SEC-NASAA Investor Bulletin: Making Sense of Financial Professional Titles (September 2013)
  http://www.sec.gov/investor/alerts/ib_making_sense.pdf
- OIEA, SEC Investor Information, "Senior" Specialists and Advisors: What You Should Know About Professional Designations
  http://www.sec.gov/investor/pubs/senior-profdes.htm
- NASD Rule 3010: Supervision (superseded by FINRA Rules 3110 and 3170)
  http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=11763
- FINRA Rule 3110: Supervision (there are revisions that will be effective July 1, 2015)
  http://finra.complinet.com/en/display/display_main.html?rbid=2403&record_id=15446

- FINRA Regulatory Notice 11-52: Senior Designations (November 2011) *http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p125092.pdf*
- FINRA, Senior Designations *http://www.finra.org/industry/issues/seniors/p124734*
- CFPB, Senior Designations for Financial Advisers: Reducing Consumer Confusion and Risks (April 2013) *http://files.consumerfinance.gov/f/201304_CFPB_OlderAmericans_Report.pdf*
- North American Securities Administrators Association, Regulators Urge Investors to Carefully Check Credentials of 'Senior Specialists' (December 2005) *http://www.nasaa.org/7684/regulators-urge-investors-to-carefully-check-credentials-of-senior-specialists/*

Marketing and Communications

- FINRA Rule 2210: Communications with the Public *http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=10648*
- Exchange Act Rule 17a-4, Records to be preserved by certain exchange members, brokers and dealers *http://www.ecfr.gov/cgi-bin/text-idx?SID=8e0ed509ccc65e983f9eca72ceb26753&node=17:4.0.1.1.1&rgn=div5#se17.4.240_117a_64*

Account Documentation

- Exchange Act Rule 17a-3, Records to be made by certain exchange members, brokers and dealers *http://www.ecfr.gov/cgi-bin/text-idx?SID=1f5fa29b3dd8174ea183036757d3d99a&node=pt17.4.240&rgn=div5#se17.4.240_117a_63*
- FINRA Rule 2090: Know Your Customer *http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=9858*
- FINRA Rule 4512(a)(1): Customer Account Information *http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=9958*
- FINRA New Account Application Template *http://www.finra.org/Industry/Tools/P117268*

Suitability

- OIEA, SEC Investor Information, Suitability *http://www.sec.gov/answers/suitability.htm*

- OIEA, SEC Investor Information, SEC Center for Complaints and Enforcement Tips *http://www.sec.gov/complaint.shtml*
    - Tips, Complaints and Referrals Portal *https://denebleo.sec.gov/TCRExternal/disclaimer.xhtml*
- FINRA Rule 2111: Suitability *http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=9859*
- FINRA Rule 2330: Members' Responsibilities Regarding Deferred Variable Annuities *http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=8824*
- FINRA Regulatory Notice 13-31: Suitability (September 2013) *https://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p351220.pdf*

Disclosures

- Section 17(a)(2) of the Securities Act *http://www.sec.gov/about/laws/sa33.pdf*
- Section 5 of the Securities Act *http://www.sec.gov/about/laws/sa33.pdf*
- FINRA Rule 2010: Standards of Commercial Honor and Principles of Trade *http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=5504*
- FINRA Rule 2330: Members' Responsibilities Regarding Deferred Variable Annuities *http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=8824*

Customer Complaints

- Exchange Act Rule 17a-3, Records to be made by certain exchange members, brokers and dealers *http://www.ecfr.gov/cgi-bin/text-idx?SID=8e0ed509ccc65e983f9eca72ceb26753&node=17:4.0.1.1.1&rgn=div5#se17.4.240_117a_64*
- Exchange Act Rule 17a-4, Records to be preserved by certain exchange members, brokers and dealers *http://www.ecfr.gov/cgi-bin/text-idx?SID=8e0ed509ccc65e983f9eca72ceb26753&node=17:4.0.1.1.1&rgn=div5#se17.4.240_117a_64*
- FINRA Rule 4513: Records of Written Customer Complaints *http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=9959*
- FINRA Rule 4530: Reporting Requirements *http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=9819*

Supervision

- Section 15(b)(4)(E) of the Exchange Act
  http://www.sec.gov/about/laws/sea34.pdf
- FINRA Rule 2330(d): Members' Responsibilities Regarding Deferred Variable Annuities (Supervisory Procedures)
  http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=8824
- FINRA Rule 2360(b)(20)(A): Options (Duty to Supervise)
  http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=6306
- NASD Rule 3010: Supervision (superseded by FINRA Rules 3110 and 3170)
  http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=11763
- FINRA Rule 3110: Supervision (there are revisions that will be effective July 1, 2015)
  http://finra.complinet.com/en/display/display_main.html?rbid=2403&record_id=15446
- NASD Notice to Members 05-50: Member Responsibilities for Supervising Sales of Unregistered Equity-Indexed Annuities (August 2005)
  http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p014821.pdf

Additional Resources

- SEC Seniors Summit, in coordination with FINRA,NASAA and AARP (September 2007) *http://www.connectlive.com/events/secseniorssummit/*
- SEC-OCIE, NASAA, and FINRA, Protecting Senior Investors: Report of Examinations of Securities Firms Providing "Free Lunch" Sales Seminars (September 2007)
  http://www.sec.gov/spotlight/seniors/freelunchreport.pdf
- SEC-OCIE, NASAA, and FINRA, Protecting Senior Investors: Compliance, Supervisory and Other Practices Used by Financial Services Firms in Serving Senior Investors (September 2008)
  http://www.sec.gov/spotlight/seniors/seniorspracticesreport092208.pdf
- SEC-OCIE, NASAA, and FINRA, Protecting Senior Investors: Compliance, Supervisory and Other Practices Used by Financial Services Firms in Serving Senior Investors: 2010 Addendum (August 2010)
  http://www.sec.gov/spotlight/seniors/seniorspracticesreport081210.pdf
- SEC, Senior Investors *http://www.sec.gov/divisions/marketreg/seniorinvestors.htm*
- SEC Charges Operators of Boiler Room Scheme Targeting Seniors to Invest in Football-Related Scam
  http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370539842427
- FINRA Regulatory Notice 07-43: Senior Investors (September 2007)
  http://www.complinet.com/file_store/pdf/rulebooks/NASD07-43.pdf
- FINRA Regulatory Notice 08-27: Misleading Communications About Expertise (May 2008)

http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p038522.pdf

- NASD Notice to Members 04-89: NASD Alerts Members to Concerns When Recommending or Facilitating Investments of Liquefied Home Equity (December 2004) *http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p012714.pdf*
- FINRA Investor Alert: "Free Lunch" Investment Seminars – Avoiding the Heartburn of a Hard Sell *http://www.finra.org/investors/protectyourself/investoralerts/fraudsandscams/p036745*
- FINRA Investor Alert: Seniors Beware: What You Should Know About Life Settlements *http://www.finra.org/web/groups/investors/@inv/@protect/@ia/documents/investors/p125848.pdf*
- FINRA Investor Alert: Reverse Mortgages: Avoiding a Reversal of Fortune *http://www.finra.org/Investors/ProtectYourself/InvestorAlerts/RetirementAccounts/P038113*
- FINRA E-Learning Courses *http://www.finra.org/Industry/Education/OnlineLearning/E-learningCourses/index.htm*
    - Senior Investor Issues: Diminished Decisional Capacity
    - Senior Investor Suitability Considerations
    - Supervisory Considerations for Working with Seniors

Appendix B – Description of Securities

Below is a description of the top revenue-generating securities that the examined firms sold to senior investors and some of the potential benefits and risks related to these securities:

(1) Mutual funds pool investor money to purchase securities. Investors may purchase shares in the fund, from the fund itself, or through a broker for the fund. Open-end mutual funds are a type of investment company. They must register under the Investment Company Act of 1940 and issue securities under the Securities Act. Each mutual fund must deliver a prospectus to customers under Section 10(a) of the Securities Act. Risks related to mutual funds may include market risk and the risk derived from its underlying assets. Different types of mutual funds may also be subject to different types or levels of volatility, fees, and expenses.[26]

(2) Variable annuities are securities regulated by the SEC.[27] They are contracts between an investor and an insurance company under which the investor makes a lump sum payment or a series of payments in exchange for periodic payments by the insurer at some agreed upon future date.[28] Variable annuities offer certain potential advantages to investors. For example, they are a tax-deferred investment, offer a range of investment options, and often provide riders such as a guaranteed death benefit or other guarantees. On the other hand, variable annuities may have a surrender period that starts after the initial purchase and may last six to eight years or sometimes as long as ten years. If funds are withdrawn during the surrender period, the insurer will assess a surrender charge, typically a percentage of the amount withdrawn, which declines gradually over the period.

(3) Equities are a type of security that gives holders a share of ownership in a company.[29] Advantages to holding equities may include income from dividends, growth, and liquidity. Equities bear risk such as the potential realized or unrealized losses from market fluctuations.

(4) Fixed income investments include individual bonds and market-linked CDs. These investments may provide payments of a fixed amount on a fixed schedule to the owner for the duration of the investment. Although the consistency in the stream of income may be attractive, there are risks associated with each type of investment. Some risks may include market risk, credit risk, and default risk.[30]

(5) A UIT is a type of investment company that issues redeemable securities; makes a one-time public offering of a specific, fixed number of units; has a termination date that is established when it is created; does not actively trade its investment portfolio; and does not have a board of directors, corporate officers, or an investment adviser to render advice during the life of the trust. The amount of capital invested determines the proportionate share of principal and interest the investor receives from the trust. A UIT may buy back outstanding shares of the trust at the current net asset value, and shares may be redeemed at any time. UITs may carry risks such as illiquidity or inflation risk as well as risks derived from the underlying assets.[31]

(6) An ETF is an investment company that is traded like equity securities on an exchange. Although classified as an open-end company or UIT, it differs in many respects. For example, an ETF does not sell individual shares; investors usually purchase creation units with a basket of securities and subsequently sell those shares on the secondary market or sell creation units back to the ETF. An ETF holds assets such as equities, commodities, or bonds and trades close to its net asset value over the course of the trading day. Most ETFs track an index, a commodity, or a basket of assets such as an equity index or bond index. ETFs seek to achieve their stated objectives on a daily basis. Performance over longer periods of time may differ significantly from the index performance over those time periods. Some ETFs pursue active management strategies and publish their portfolio holdings on a daily basis. These products share many of the same risks as mutual funds.[32]

(7) REITs are corporations, trusts, or associations that own and usually operate income-producing real estate or real estate-related assets. REITs provide investors with a way to earn a share of income produced from commercial real estate without actually owning commercial real estate. Investors can purchase shares of REITs through a broker-dealer, and these shares typically offer high yields. Many REITs are registered with the SEC and are publicly traded on a stock exchange, offering investors a liquid investment in income producing real estate or real estate-related assets. There also are REITs that are registered with the SEC but are not publicly traded on an exchange. These non-traded REITs are generally illiquid investments with limited ability to redeem shares because there is no public market and potentially with high fees associated with their sale.[33]

(8) The definition of an alternative investment can vary, as they generally cannot be directly classified as traditional securities such as stocks or bonds. They can include exchange-traded notes, hedge funds, and private placements. Alternative investments can help investors diversify exposure away from mainstream markets (e.g., because of their low correlation coefficients with both equities and fixed income). Potential risks include difficulty in valuation, potentially high purchase costs and large initial investment, limited historical data, lack of liquidity, and complexity.[34]

(9) Structured securities products include structured notes and other market-linked securities, reverse convertible notes, principal-protected notes, and collateralized debt obligations. Structured products are not defined in the federal securities laws. They are sold in the retail market and usually consist of a traditional security combined with one or more other asset classes, typically a bond and an option component. As a result, structured products typically have some form of option or embedded financial derivative exposure. Structured products may offer investors varying levels of principal protection, high interest payments, leveraged exposure to the underlying asset class, and a fixed maturity date (in most cases), and they may seek to achieve a highly customized risk-return objective. Structured products, however, often carry complex risks, including default risk, lack of liquidity, lack of transparency, and valuation difficulty.[35]

Endnotes

[1] The views expressed herein are those of the staff of OCIE, in consultation with other staff of the Securities and Exchange Commission ("SEC" or "Commission") including the Division of Trading and Markets and in coordination with FINRA. The Commission has expressed no view on the contents of this report. This document was prepared by the SEC staff, in coordination with FINRA, and is not legal advice.

[2] Administration on Aging Administration for Community Living, U.S. Department of Health and Human Services, A Profile of Older Americans: 2012, page 1 (2012), available at http://www.aoa.gov/Aging_Statistics/Profile/2012/docs/2012profile.pdf.

[3] Id. at 3.

[4] Richard Fry, D'Vera Cohn, Gretchen Livingston, and Paul Taylor, The Rising Age Gap in Economic Well-being: The Old Prosper Relative to the Young, Pew Research Center, pages 1-2 (November 7, 2011), available at http://www.pewsocialtrends.org/files/2011/11/WealthReportFINAL.pdf.

[5] Dow Jones Industrial Average, available at http://finance.yahoo.com/echarts?s=%5EDJI.

[6] Changes in U.S. Family Finances from 2007 to 2010: Evidence from the Survey of Consumer Finances, Federal Reserve Bulletin, Vol. 98, No. 2 (June 2012), page 4, available at http://www.federalreserve.gov/pubs/bulletin/2012/pdf/scf12.pdf.

[7] Office of Compliance Inspections and Examinations Security and Exchange Commission, North American Securities Administrators Association, Financial Industry Regulatory Authority, Protecting Senior Investors: Report of Examinations of Securities Firms Providing "Free Lunch" Sales Seminars, page 2 (September 2007), available at http://www.sec.gov/spotlight/seniors/freelunchreport.pdf.

[8] Securities and Exchange Commission's Office of Compliance Inspections and Examinations, North American Securities Administrators Association, and Financial Industry Regulatory Authority, Protecting Senior Investors: Compliance, Supervisory and Other Practices Used by Financial Services Firms in Serving Senior Investors (September 22, 2008), available at http://www.sec.gov/spotlight/seniors/seniorspracticesreport092208.pdf.

[9] U.S. Securities and Exchange Commission's Office of Compliance and Inspections and Examinations, North American Securities Administrators Association, and Financial Industry Regulatory Authority, Protecting Senior Investors: Compliance, Supervisory and Other Practices Used by Financial Services Firms in Serving Senior Investors 2010 Addendum (August 12, 2010), available at http://www.sec.gov/spotlight/seniors/seniorspracticesreport081210.pdf.

[10] FINRA Regulatory Notice 11-52: FINRA Reminds Firms of Their Obligations Regarding the Supervision of Registered Persons Using Senior Designation (November 2011), available at http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p125092.pdf.

[11] SEC-NASAA Investor Bulletin: Making Sense of Financial Professional Titles (September 2013), available at http://www.sec.gov/investor/alerts/ib_making_sense.pdf.

[12] Board of Governors of the Federal Reserve System, Commodity Futures Trading Commission, Consumer Financial Protection Bureau, Federal Deposit Insurance Corporation, Federal Trade Commission, National Credit Union Administration, Office of the Comptroller of the Currency, and Securities and Exchange Commission, Interagency Guidance on Privacy Laws and Reporting Financial Abuse of Older Adults (2013), available at http://www.sec.gov/news/press/2013/elder-abuse-guidance.pdf.

[13] 12 CFR 208.62.

[14] The SEC's Examination Priorities for 2015 are available at http://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2015.pdf, and FINRA's 2015 Regulatory and Examination Priorities are available at http://www.finra.org/web/groups/industry/@ip/@reg/@guide/documents/industry/p602239.pdf.

[15] FINRA, Senior Designations, available at http://www.finra.org/industry/issues/seniors/p124734.

[16] NASD Rule 3010 (a, b, c, d, and g) has been superseded by FINRA Rules 3110 and 3170. Retired NASD Rule 3010 is available at http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=11763.

[17] See FINRA Regulatory Notice 11-52: FINRA Reminds Firms of Their Obligations Regarding the Supervision of Registered Persons Using Senior Designation (November 2011), available at http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p125092.pdf.

[18] North American Securities Administrators Association, Regulators Urge Investors to Carefully Check Credentials of 'Senior Specialists' (December 12, 2005), available at http://www.nasaa.org/7684/regulators-urge-investors-to-carefully-check-credentials-of-senior-specialists/.

[19] FINRA Rule 2210(b)(1)(C) and (b)(1)(D) provide certain exceptions from this requirement. For example, pursuant to FINRA Rule 2210(b)(1)(C), principal review is not required for communications which another broker-dealer filed with FINRA's Advertising Regulation Department and received a letter from the Department stating that the communication appears consistent with applicable standards. Also, FINRA Rule 2210(b)(1)(D) exempts from prior to use principal review any retail communication that is posted in an online interactive forum so long as the broker-dealer supervises the use of such communications in the same manner as required for supervising and reviewing correspondence pursuant to NASD Rule 3010(b).

[20] Using customer account records that are aged more than 36 months may increase the likelihood of unsuitable recommendations due to potential changes in customers' personal and financial circumstances.

[21] The voluntary template was created with input from industry professionals and other regulators to present investor with information in a clear, intuitive format. The template includes instructions and other information presented in plain English, highlights of key disclosures, and incorporation of related investor education information. For additional information, see http://www.finra.org/Industry/Tools/P117268.

[22] See Section 5(1)(2) of the Guide to Broker-Dealer Registration, Division of Trading and Markets, U.S. Securities and Exchange Commission (April 2008), available at http://www.sec.gov/divisions/marketreg/bdguide.htm.

[23] Numerous individual states prescribe specific form requirements for insurance sales. These form templates are developed and distributed by the states to the insurance carriers. The carriers then incorporate and provide the forms to the insurance agencies that offer the product.

[24] NASD Rule 3010 (a, b, c, d, and g) has been superseded by FINRA Rules 3110 and 3170. Retired NASD Rule 3010 is available at http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=11763.

[25] FINRA Regulatory Notice 07-43: FINRA Reminds Firms of Their Obligations Relating to Senior Investors and Highlights Industry Practices to Serve these Customers (September 2007), available at http://www.complinet.com/file_store/pdf/rulebooks/NASD07-43.pdf.

[26] For additional information, see "Mutual Funds," available at http://www.sec.gov/answers/mutfund.htm.

[27] Annuities, such as fixed annuities, are not securities and are thus not regulated by the SEC; they fall under the purview of state insurance regulators.

[28] For additional information, see "Variable Annuities," available at http://www.sec.gov/answers/varann.htm.

[29] For additional information, see "Stocks," available at http://investor.gov/investing-basics/investment-products/stocks#.VNN73zZOmUl.

[30] For additional information, see "Bonds," available at http://investor.gov/investing-basics/investment-products/bonds#.VL_yozZOnnt.

[31] For additional information, see "Unit Investment Trusts (UITs)," available at http://www.sec.gov/answers/uit.htm.

[32] For additional information, see "Exchange-Traded Funds," available at http://www.sec.gov/answers/etf.htm.

[33] For additional information, see "Real Estate Investment Trusts (REITs)," available at http://www.sec.gov/answers/reits.htm.

[34] For additional information, see "Investor Bulletin: Private Placements Under Regulation D," available at http://www.sec.gov/oiea/investor-alerts-bulletins/ib_privateplacements.html, and "Hedge Funds," available at http://www.sec.gov/answers/hedge.htm.

[35] For additional information, see "Investor Bulletin: Structured Notes," available at http://www.sec.gov/oiea/investor-alerts-bulletins/ib_structurednotes.html.

PROTECTING SENIOR INVESTORS:
COMPLIANCE, SUPERVISORY AND OTHER PRACTICES USED BY FINANCIAL SERVICES FIRMS IN SERVING SENIOR INVESTORS
2010 Addendum

U.S. Securities and Exchange Commission's
Office of Compliance Inspections and Examinations,*
North American Securities Administrators Association, and
Financial Industry Regulatory Authority
August 12, 2010

Today in the United States, nearly 40 million people are age 65 and older. This number is expected to more than double to 89 million by 2050.[1] In addition to these staggering numbers, many seniors find themselves with smaller nest eggs than they anticipated as a result of the economic downturn experienced over the past 18 months. Estimates show that total retirement assets decreased by $4.5 trillion, or 25%, from 2007 to the first quarter of 2009.[2]

In light of these demographics, Staff at the Securities and Exchange Commission ("SEC"), the Financial Industry Regulatory Authority ("FINRA") and the North American Securities Administrators Association ("NASAA") continues to view the protection of senior investors as a top priority. With this in mind, in March 2008, NASAA adopted the NASAA Model Rule on the use of Senior-Specific Certifications and Professional Designations in response to the possible risk to investors that a designation may be used to imply expertise or credentials, which may be inaccurate or misleading. As of February 2010, 19 states have adopted the NASAA Model and two states have adopted state specific rules prior to adoption of NASAA's Model.

As part of securities regulators' collaborative efforts to protect senior investors, we released a public report in September 2008 that summarizes practices used by financial services firms and securities professionals in serving senior investors. The report entitled "*Protecting Senior Investors: Compliance, Supervisory and Other Practices Used by*

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* This is a report of the Commission's Staff, FINRA and NASAA, and does not reflect the views of, or include findings or conclusions by, the Securities and Exchange Commission.

1 http://www.transgenerational.org/aging/demographics.htm#ixzz0bqbUpAAv.

2 At the end of 2007 U.S. retirement assets stood at $17.9 trillion. By the end of the first quarter of 2009 they were down to $13.4 trillion. See *The U.S. Retirement Market, 2008* at www.ici.org/pdf/fm-v18n5.pdf and *The U.S. Retirement Market, First Quarter 2009* at www.ici.org/pdf/09_q1_retmrkt_update.pdf.

Financial Services Firms in Serving Senior Investors"[3] ("2008 Report") was intended to assist industry firms in enhancing their compliance, supervisory and other practices.

To continue our efforts to protect senior investors, we asked some of the firms that participated in the original fact finding initiative to share with us any additional practices they may have implemented since the 2008 Report was published. In addition, Staff researched additional practices identified in various industry publications. This addendum to the September 2008 Report summarizes additional practices used by financial services firms and securities professionals in serving senior investors in the following areas:

- Communicating effectively with senior investors;
- Training and educating firm employees on senior-specific issues;
- Establishing an internal process for escalating issues and taking next steps;
- Obtaining information at account opening;
- Ensuring appropriateness of investments; and
- Conducting senior-focused supervision, surveillance and compliance reviews.

As stated in the 2008 Report, by sharing this information, we hope to provide practical examples to firms that are seeking to strengthen their infrastructure to assist them in working with senior investors in an ethical, respectful and informed manner. This 2010 Addendum does not create or modify existing regulatory obligations with respect to senior investors. It also does not catalog the full range of compliance practices applicable to senior investors. Rather, the 2010 Addendum focuses on specific, concrete steps that firms are taking to identify and respond to issues that are common in working with senior investors. By publishing this information, we also hope that financial services firms will identify and implement additional practices to help ensure that the financial services industry continues to be mindful of the particular needs of senior investors.

I. Practices Used by Financial Services Firms in Serving Seniors

During 2009, firms continued to implement new processes and procedures aimed at addressing common issues associated with their interactions with senior investors. Responding firms indicated they are enhancing procedures in the following areas:

A. <u>Communicating Effectively With Senior Investors</u>

Some firms indicated they are producing brochures and information aimed at educating senior investors on various topics. Examples include:

- A brochure outlining fraud awareness, advising clients to monitor their credit report for potential unauthorized activity, warning clients never to sign a blank or incomplete document or to give cash to a securities professional.
- A link on the firm's website to the following sites: SEC Investor Information for Seniors; FINRA Investor Alerts; and NASAA Senior Investor Resource Center.

3 *http://www.sec.gov/spotlight/seniors/seniorspracticesreport092208.pdf.*

- Recommendations to customers to maintain the following information in a safe and secure place to ensure that documents are easily accessible in case of an emergency, including:

    - An inventory of assets with account numbers, passwords and locations of safe-deposit boxes.
    - A list of debts and regular obligations, with a list of the institutions to which they are owed and account numbers.
    - A list of important contacts, such as doctors, lawyer, and securities professional.

B. Training Firm Employees on Senior-Specific Issues

Firms continue enhancing training for its securities professionals to focus on senior specific issues and to help securities professionals recognize potential financial abuse and signs of potential diminished capacity. These firms utilize a variety of training methods to help ensure the training is effective that include the following:

- Implementing a Firm Element continuing education course[4] providing guidance to help securities professionals identify special considerations they should be aware of when working with senior clients or clients approaching retirement.
- Reminding securities professionals what types of sales practices have been identified by regulators as posing potential risks when marketing to seniors.
- Providing real-life examples of SEC, FINRA and State actions taken with respect to senior financial abuse.
- Utilizing testing at the end of a training session to ensure learning.
- Providing enhanced training to supervisors regarding the review of a transaction based on specific factors or "red flags" the supervisor should consider in the review.
- Designating a particular individual/supervisor responsible for addressing questions regarding activities, practices and policies related to seniors.
- Providing a link on the internal website to outside resources that may be useful when selling securities to seniors such as: 1) SEC Investor Information for Seniors, 2) FINRA Investor Alerts, and 3) NASAA Senior Investor Resource Center.
- Providing a brochure or flyer for securities professionals to help them recognize issues that are unique to older clients: (i) best practices when working with seniors; (ii) information about identifying and recognizing diminished capacity and elder financial abuse; and (iii) the policies and procedures to be followed once diminished capacity or elder financial abuse is suspected. Examples of procedures include: asking clients to carefully read the materials discussed and, if desired, to take extra time to consult with a trusted family member or friend; avoiding use of financial jargon; familiarizing themselves with the resources in

[4] NASD Rule 1120.

the community for addressing the unique needs of older clients; and allowing extra time to meet so the client does not feel rushed.

- Providing a script to aid securities professionals in having difficult conversations with clients.

Firms told us they continue to include segments in their educational programs to help securities professionals identify signs or "red flags" that may indicate that an investor may have diminished capacity or a reduced ability to handle financial decisions. Firms indicated additional signs now included are:

- Recurring cognitive problems that become worse over time.
- Behavior that is out of character (e.g., the frugal client who becomes a spendthrift, the client who wants to upset a long-established investment strategy).
- Difficulty in understanding important aspects of the account.

C. Establishing an Internal Process for Escalating Issues and Taking Next Steps

Some firms told us they had created and adopted policies with respect to the next steps to take after an issue was identified and escalated. These policies include:

- Identifying a central point of contact within the Compliance Department to provide guidance on senior investor issues.
- Creating a mailbox for all senior investor related questions for follow-up.
- Escalating any suspected elder abuse to branch management and then to divisional counsel to determine whether the situation requires reporting to state authorities.
- Potentially declining a transaction or declining to open an account if there is suspicion of financial abuse or diminished capacity.

D. Obtaining Information at Account Opening

As discussed in the 2008 Report, pursuant to a variety of securities laws and rules, financial services firms are required to obtain sufficient information about an investor to ensure that recommendations are appropriate for the investor. The firms are also required to ensure that the investor's account is managed in a manner that is consistent with the investor's investment objectives. The information to be obtained includes the investors' age, financial and tax status, and investment objectives. We noted that some firms use the account opening process to obtain additional information about the client. For example, some firms are:

- Encouraging clients to identify a third party emergency contact. Allowing the firm to notify the identified individual if there is an issue or concern related to diminished mental capacity or financial abuse by a third party.
- Requiring that the employment status field on the new account form be filled out with one of the possible responses being "retired." This data helps the firm

identify clients who are in the “distribution” stage of life, as distinct from the “accumulation” stage.

E. Ensuring the Appropriateness of Investments

An investor’s age and life stage are important factors in assessing the appropriateness of recommendations for that investor. To address this issue, some firms are:

- Enhancing the firm’s new product committee process by analyzing and identifying potential risks to senior investors when creating new products and services.
- Conducting quality assurance calls to customers of a certain age or parameters as determined by the firm.
- Asking the following questions: How recently has the client profile information been updated? Have there been any significant changes with regard to the client’s employment status, marital status, physical condition or the needs of the client’s family or significant others? Has the client made the securities professional aware of recent changes or plans to change living arrangements that may have an impact on the client’s present or future financial needs? When a securities professional is advised or becomes aware that a client’s circumstances have changed the securities professional should obtain updated information and further consult with the client about whether the client’s investment objectives or needs have also changed.
- Reminding securities professionals that everyone goes through life stages and at each stage, the suitability or appropriateness of a product or service may shift. For example, clients in their late twenties might be getting married or starting a family.

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

Firms continue to utilize supervision and surveillance reports to attempt to capture transactions and practices that may impact seniors negatively. Some examples include:

- Using trending reports to identify patterns that may be indicative of potential abusive behavior by securities professionals.
- Analyzing the firm’s client base with respect to age demographics and using this information to help meet current and prospective customer needs.
- Creating policies that require a discussion during the annual branch audit with supervisors and sales professionals about sales to seniors.
- Maintaining trade blotters that can be filtered by “senior investor” status, as defined by the firm.
- Using the customer’s age as one factor in evaluating the appropriateness of an investment in light of risk tolerance.
- Conducting risk based statistical sampling based upon variables such as the customer’s age, product type, and whether a product replacement is involved.

- Requiring corrective action be taken when there is incomplete customer account documentation.
- Identifying securities professionals whose book of business includes a large percentage of sales to seniors where the subsequent activity associated with this business (such as cancellations or large outflows), could be an indicator of unsuitable sales practices.
- Reviewing the entire book of business and compliance records for those securities professionals whose book of business includes a large percentage of sales to seniors.

II. Conclusion

The protection of senior investors is a priority. The practices described in the 2010 Addendum and the 2008 Report should be particularly helpful to the financial services industry and securities professional that provide services to senior investors. As the number of senior investors increases each year and many senior's retirement assets decreased, it is important that firms remain mindful of the concerns in dealing with senior investors.

By sharing this information, the SEC, NASAA and FINRA Staff hope that financial services firms that are seeking to ensure that they serve senior investors in an ethical, respectful and informed manner will find useful suggestions. We also urge financial services firms to continue to develop practices that will help them to better serve senior investors.

PROTECTING SENIOR INVESTORS:
REPORT OF EXAMINATIONS OF SECURITIES FIRMS PROVIDING “FREE LUNCH” SALES SEMINARS

BY THE

OFFICE OF COMPLIANCE INSPECTIONS AND EXAMINATIONS
SECURITIES AND EXCHANGE COMMISSION

NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION

FINANCIAL INDUSTRY REGULATORY AUTHORITY

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I. INTRODUCTION AND SUMMARY

With the aging of the baby boom generation, a growing number of our nation's investors are at or near retirement age. Indeed, data presented at the first "*Seniors Summit*" held by the Securities and Exchange Commission (SEC) in July 2006 indicated that 75% of the nation's consumer financial assets, valued at $16 trillion, are held by households headed by someone who is 50 or older. Within the next 20 years, 75 million people will have celebrated their 60^{th} birthday. Because these "senior investors" are a growing segment of investors, financial services firms are increasingly focusing their marketing and sales of investment products towards the senior investor or those investors nearing retirement age. Within this broader context, securities regulators are concerned about the possibility of unscrupulous and abusive sales practices and investment frauds targeted towards senior investors. In fact, some data indicates that although individuals aged 60 or older make up 15% of the U.S. population, they account for 30% of fraud victims.[1]

In response to this concern, in May 2006, the SEC and the North American Securities Administrators Association (NASAA) announced a coordinated national initiative designed to protect seniors from investment fraud and sales of unsuitable securities.[2] Working together with the NASD and the NYSE Member Regulation Inc. (now consolidated as the Financial Industry Regulatory Authority, or FINRA), the SEC and NASAA initiative includes three components: active investor education and outreach to seniors and those nearing retirement age; targeted examinations to detect abusive sales tactics aimed at seniors; and aggressive enforcement of securities laws in cases of fraud against seniors. This joint and collaborative initiative by securities regulators is designed to build on the existing efforts that each regulator had underway, toward a shared mission to protect senior investors. This initiative is active and ongoing.

As part of this effort to protect senior investors, regulators initiated a series of coordinated on-site examinations of broker-dealers, investment advisers and other financial services firms that offer so-called "free lunch" sales seminars. These seminars are widely offered by financial services firms seeking to sell financial products, and they often include a free meal for attendees. Sales seminars are often advertised in local newspapers, through mass-mailed invitations, mass-email, and on websites. While specific data is not available regarding the actual number of sales seminars being conducted, regulators believe that the number of sales seminars has increased in recent years, as financial services firms are increasingly seeking to provide advice to seniors and those approaching retirement.

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1 "*NASAA Survey Shows Senior Investment Fraud Accounts for Nearly Half of all Complaints Received by State Securities Regulators,*" (July 17, 2006), available at http://www.nasaa.org/NASAA_Newsroom/Current_NASAA_Headlines/4998.cfm.

2 "*Securities and Exchange Commission and North American Securities Administrators Association Launch Program to Protect Senior Investors,"* (May 8, 2006), joint SEC and NASAA press release available at http://www.sec.gov/news/press/2006/2006-65.htm.

Examinations were targeted in areas of the country that have large populations of retirees. Examinations were conducted in Florida, California, Texas, Arizona, North Carolina, Alabama and South Carolina by state securities regulators in those states, NASD and the NYSE Member Regulation Inc. (now FINRA) and the SEC. This report summarizes the results of these examinations and was prepared by the SEC's Office of Compliance Inspections and Examinations, NASAA and FINRA (collectively, referred to in this Report as regulators or examiners).[3]

The purpose of the examinations was to review firms that offer sales seminars targeted to seniors and retirees for compliance with securities laws and rules (federal, state and self-regulatory organization (SRO) rules) designed to protect investors. Specifically, the examinations reviewed:

- Advertisements, seminar materials, and sales literature for any misrepresentations, exaggerations, or omissions of material information;

- Customer transactions engendered by these seminars to evaluate the suitability of investment recommendations that were made; and

- Supervisory systems, policies, and procedures used to detect and prevent violations of the securities laws for adequacy.

We conducted 110 examinations between April 2006 and June 2007. While each of our findings is described in greater detail in this report, in sum, we found that:

- **Sponsors of "free lunch" sales seminars offer attractive inducements to attend**. The seminars are commonly held at upscale hotels, restaurants, retirement communities and golf courses. In addition to providing a free meal, the firms and individuals that conduct these seminars often use other incentives (*e.g.*, door prizes, free books, and vacation deals) to encourage attendance.

- **Often, the target attendees are seniors**. Many of the "free lunch" sales seminars are designed to solicit seniors. They are advertised with names like "*Seniors Financial Survival Seminar*" or "*Senior Financial Safety Workshop,*" and offer "free" advice by "experts" on how to attain a secure retirement, or offer financial planning or inheritance advice. The advertisements used to solicit attendees often imply that there is an urgency to attend. For example, invitations include phrases such as "limited seating available" or "call ***now*** to reserve a seat." Some illustrative examples of advertisements used for sales seminars can be found in Appendix A to this report.

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[3] This report includes examination findings of the SEC's staff, FINRA's staff and the staff of the individual states regulatory authorities, which are not findings or conclusions of the Securities and Exchange Commission, FINRA or NASAA. This report includes findings from examinations conducted by NASD and NYSE Regulation Inc, now FINRA.

- **Seminars are designed to sell.** Many sales seminars were advertised as "educational," "workshops," and "nothing will be sold at this workshop," and many advertisements did not mention any investment products. Nonetheless, the seminars were intended to result in the attendees' opening new accounts with the sponsoring firm and, ultimately, in the sales of investment products, if not at the seminar itself, then in follow-up contacts with the attendees. To the extent that participants may attend a seminar in order to obtain educational insights and information, they should be aware that the primary goal of the sponsors of these "free lunch" seminars is to obtain new customers and sell investment products. Examiners found that the most commonly discussed products at the sales seminars were variable annuities, real estate investment trusts, equity indexed annuities, mutual funds, private placements of speculative securities (such as oil and gas interests) and reverse mortgages.

- **Some firms had particular compliance and supervisory controls that appeared to be effective. And, during a small number of the examinations (5 examination or 4% of those conducted), regulators found no problems or deficiencies.** During examinations, regulators identified specific compliance and supervisory practices that appeared to be effective in ensuring compliance with the securities laws and rules. For example, one broker-dealer required its employees to forward all materials to its home office for a supervisory and compliance review prior to using the materials at sales seminars. Another broker-dealer utilized checklists to aid supervisors with the approval process for seminars and seminar materials. More detailed examples of these practices are set forth in Appendix B to this report.

- **Half of the examinations found that firms used advertising and sales materials that may have been misleading or exaggerated or included seemingly unwarranted claims (in 63 of 110 examinations, or 57%). Many broker-dealer firms did not submit their sales material to NASD (now FINRA) for review, as required by NASD advertising rules.** The most common types of apparently misleading statements appeared on mailers and advertisements for the sales seminars, and involved statements about the safety, liquidity or anticipated rates of return. Statements included, for example: "Immediately add $100,000 to your net worth," "How to receive a 13.3% return," and "How $100K can pay 1 Million Dollars to Your Heirs." Additionally, some sales materials made comparisons between dissimilar investments or services, included representations about the expertise or credentials of the registered representative that may have been misleading or confusing, or involved testimonials that may have been misleading.

- **Individuals attending the sales seminars may not understand that the seminar is sponsored by an undisclosed company with a financial interest in product sales.** The mailers and advertisements for the sales seminars often focused on the individuals who would be conducting the seminar, and often included the name of the registered representative or investment adviser, a photograph and information about his/her background as an expert in providing investment advice, and his/her history in the local community. Individuals who attend the seminars or who are considering attending are not always provided with the name of the firm sponsoring the seminar, and may not be aware that product sponsors (*e.g.*, mutual fund companies and insurance companies) may provide funding for the seminars with the expectation that investment professionals will sell their products. In these situations, seminar attendees may not have known that the financial adviser speaking at the seminar was not unbiased in making product recommendations.

- **Many examinations found indications that firms had poorly supervised these sales seminars.** Examiners found indications of weak supervisory practices in 65 of the 110 examinations (or 59% of the examinations conducted). For example, a common finding was that firms had inadequate supervisory procedures or had not implemented their procedures with respect to sales seminars held by their employees.

- **Some examinations found indications that registered representatives or investment advisers holding the sales seminars had recommended investments that did not appear to be suitable for the individual customers.** In 25 of the 110 examinations (or 23% of examinations conducted), examiners found indications that unsuitable recommendations to purchase investments were made at the sales seminars, or following the seminar when an attendee opened an account. The investments appeared to be unsuitable in light of the customers' investment objectives or time horizon – *e.g.*, a risky investment was recommended to an investor with a "conservative" investment objective, or an illiquid investment was recommended to an investor with a short-term need for cash.

- **In some instances, the sales seminars may have involved fraud.** Examiners found indications of possible fraudulent practices in 14 examinations (or 13% of the examinations conducted), that involved potentially serious misrepresentations of risk and return, liquidation of accounts without the customer's knowledge or consent, and sales of fictitious investments.

As a result of the examinations, most firms have received deficiency letters or letters of caution that outlined apparent rule violations and deficiencies and requested that the firms examined take corrective actions (these letters were provided to 86 firms, or 78% of all examinations conducted). In addition, some examinations (25 of the 110, or 23%) are under review for possible further investigation or action by a state, FINRA or SEC.[4]

The results of these examinations lead regulators to conclude that financial services firms should take steps to supervise sales seminars more closely, and specifically take steps to

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4 Many examinations had multiple dispositions. For example, a deficiency letter may have been provided to the firm requesting corrective action, and findings from that exam may also have been referred for possible disciplinary or enforcement action.

review and approve all advertisements and sales materials for accuracy. In addition, firms should redouble efforts to ensure that the investment recommendations they make to seniors are suitable in light of the particular customer's investment objectives.

Regulators have compiled a list of supervisory practices that have been identified during examinations and that appeared to be effective, which is included in Appendix B of this report. This information may assist firms in considering their own supervisory practices with respect to sales seminars. Regulators further urge financial services firms to take steps to assure that supervisory procedures with respect to sales seminars are being implemented effectively. Regulators participating in these examinations will continue to focus examination, enforcement and regulatory efforts on the use of sales seminars targeted to seniors.

In addition, regulators conclude that, because seniors are targeted as attendees for sales seminars, ongoing investor education efforts for seniors should provide education with respect to "free lunch" sales seminars. Specifically, senior investors should understand that these are *sales* seminars -- that is, they are intended to result in the sales of financial products, and they may be sponsored by an undisclosed company with a financial interest in product sales. Investor education efforts should emphasize that, despite the claims of urgency that are sometimes made by sponsors of sales seminars, and in light of the possibility of misleading or exaggerated statements or claims about investment products or the expertise of the financial adviser, investors should take time to research the firm, the financial adviser as well as the product being offered before opening an account or making a purchase. Regulators make a variety of tools available to investors to assist them in understanding investment products and investigating a broker or other financial professional before investing, and many of these tools are listed in Appendix C to this report.

II. BACKGROUND: RISK ASSESSMENT AND SELECTION OF FIRMS FOR EXAMINATION

As a threshold matter, regulators focused on geographic areas with high populations of seniors. Thus, examinations were first initiated in Florida by the Florida Office of Financial Regulation, NASD and NYSE (now FINRA), and SEC staff. The examinations were then expanded to include other states in geographic areas that had large concentrations of senior citizens. Based on census data, some of the states with the highest senior populations were Florida, California and Texas, among others. In addition, census information reflected a high concentration of retirees in the states of Arizona, North Carolina, Alabama and South Carolina.[5] Regulators in each of these states and examiners from the NASD, the NYSE and the SEC commenced coordinated examinations during 2006 and 2007.

To identify firms for examination, regulators collected publicly available information including advertisements, invitations and websites that sought to target seniors for "free

5 U.S. Census Bureau, *Current Population Reports, 65+ in the United States* (Washington, D.C.: U.S. Government Printing Office, 2005), 23-209.

lunch" seminars. Examiners then developed a risk assessment model to identify the firms that appeared to present the highest risk of possible violations. Regulators considered the following factors in conducting this risk assessment:

- Whether the advertisements and/or sales literature appeared to target senior citizens;

- Whether the advertisements and/or sales literature appeared to have exaggerated, misleading and/or fraudulent representations, including testimonials;

- Whether the advertisements and/or sales literature discussed or referred to securities that appeared to be of high risk to the average senior citizen;

- Whether the entities/individuals identified in the advertisements and/or sales literature were appropriately registered to sell the securities discussed or referenced in the advertisements and/or sales literature;

- Whether the entities and/or individuals identified in the advertisements and/or sales literature had any prior disciplinary history and/or customer complaints within the last year;

- Whether the advertisements and/or sales literature, when used by a broker-dealer, were filed with and reviewed by NASD pursuant to NASD's advertising rules; and

- Whether the advertisements and/or sales literature offered any incentives to attend the seminars (*e.g*., prizes, trips, or books).

The regulators then evaluated the risk assessment data and selected firms for examination. Frequent communication among the regulators helped to ensure a consistent approach to examinations, and prevented any duplication in examinations.

The NASD's Department of Advertising Regulation was an integral part of the examination process. For broker-dealer firms, all advertisements and seminar sales literature were reviewed by NASD personnel to determine if the literature was in compliance with NASD's advertising rules. NASD's staff then provided each regulator conducting the examination with information about any areas of apparent non-compliance.

Each regulator conducted examinations. Some examinations were conducted jointly by state regulators and the NYSE or the SEC. Examinations included interviews with firm employees and reviews of records maintained by the firm. In their examination process, state regulators attended some sales seminars to ascertain what was being said during seminar presentations. Regulators followed their own protocols for examination process and disposition. Upon completion, some examination findings were referred to the most appropriate regulatory authority to handle the matter based on the types of potential violations identified.

Most of the firms examined were registered as broker-dealers, and many were also registered as investment advisers with a state or with the SEC. Some firms were registered as investment advisers, but not as broker-dealers. Employees of the firms examined were often licensed as registered representatives with NASD, and may also have been advisory representatives with the state, or advisers registered with the SEC. A small number of firms were not required to be registered under state or federal securities laws, and were examined by state regulators. The firms examined ranged in size and type -- from independent contractors at small firms to large firms with branch offices across the country -- although most were small local or regional firms. Many examinations were conducted at branch offices.

III. KEY SECURITIES LAWS AND REGULATIONS APPLICABLE TO SALES SEMINARS[6]

Registration: Sales seminars may be conducted by a registered representative, investment adviser or an unregistered person. Absent any exception or exemption, any firm that sells securities (as defined by the Securities Exchange Act of 1934, *e.g.*, stocks, bonds) must be registered as a broker-dealer. In addition, in order to discuss securities at a seminar sponsored by a broker-dealer, the presenter must be a licensed registered representative (under NASD Rule IM-1031 and NYSE Rule 345[7]). Investment advisers provide investment advice to purchase or sell securities for compensation and as part of a regular business. Investment advisers also sponsor sales seminars, and they may be required to be registered either with a state or with the SEC. Many sales seminars are designed to sell non-securities products (*e.g.,* insurance). Only firms selling or advising the purchase or sale of securities products are required to be registered.

Sales Literature: The materials used or distributed by broker-dealers at seminars are considered "sales literature" and are subject to the supervisory approval and record-keeping requirements under NASD and NYSE rules. In addition, these rules apply to any communications that are used to promote the seminars, such as advertisements in print, on the web or by radio or television broadcast.[8] Under these rules, sales literature must be approved by a registered principal prior to the seminar; the firm must maintain all sales literature in a separate file for three years; and the file must include the name of the registered principal that approved the seminar and the materials distributed at the seminar

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6 Individual states' securities laws also apply.

7 NASD and NYSE rules are separately cited in this report, as a common FINRA rulebook has not yet been developed.

8 Specifically, each advertisement, market letter, sales literature or other similar type of communication which is generally distributed or made available by a member firm to customers or to the public must be approved in advance by an allied member, supervisory analyst, or qualified person (under NYSE Rule 342(b)(1)).

(under NASD Rule 2210(b) and NYSE Rule 472(d)). The broker-dealer must also maintain information concerning the source of any illustrative data used in the seminar (under NASD Rule 2210(b)(2)(B)).

Seminars are public appearances, as are radio or television interviews or other speaking activities (under NASD Rule 2210 and NYSE Rule 472(1)). NASD and NYSE rules require that: "all member communications with the public shall be based on principles of fair dealing and good faith, must be fair and balanced, and must provide a sound basis for evaluating the facts in regard to any particular security or type of security, industry or service" (under NASD Rule 2210(d)(1)(A) and NYSE Rule 472(i)). These standards also apply to registered representatives' participation at seminars.

Anti-Fraud Rules: Federal and state securities laws and SRO rules prohibit making any untrue statement of a material fact, or omitting to state a material fact that is necessary to make the statements that are made not misleading (*e.g.,* under Section 17(a) of the Securities Act of 1934, Section 10(b) of the Exchange Act and Rule 10b-5, and Section 206 of the Investment Advisers Act of 1940).

Investment advisers (whether registered with the SEC or state or not) also have a fiduciary duty to provide full and fair disclosure of all material facts to their clients and their prospective clients. All advertising materials and other materials distributed at a seminar by an adviser are subject to these restrictions, including any representations about the adviser, its business and investment advice, such as performance data, investment strategies, education, background and experience (under Section 206 of the Advisers Act).

It is fraudulent for an SEC-registered adviser to distribute advertisements that contain or refer to testimonials or past specific recommendations that were profitable (under Rule 206(4)-1 under the Advisers Act). In addition, SEC-registered advisers cannot use advertisements that imply that a graph, chart, or formula will enable investors to make their own investment decisions without disclosing the limitations or difficulties of the approach (under Rule 206(4)-1 under the Advisers Act and various state securities statutes). Advisers may also not falsely promise to provide free services (Rule 206(4)-1 under the Advisers Act).

Broker-dealers may not make exaggerated or misleading endorsements of investments, and unwarranted predictions or projections of investment performance are also prohibited (under NASD Rules 2210(d)(1)(B), (d)(1)(d) and NYSE Rule 472(i)). In addition, broker-dealer testimonials must also include certain information: (1) the fact that the testimonial may not be representative of the experience of other customers; (2) the fact that the testimonial is not indicative of future performance or success; and (3) if more than a nominal sum is paid, the fact that it is a paid testimonial (under NASD Rule 2210(d)(2)(A) and NYSE Rule 472(j)(7)).

To prohibit potentially misleading advertisements and to ensure that communications are fair and balanced, NASD rules require that broker-dealers provide certain sales literature to its Department of Advertising Regulation for review. For example, advertisements and sales literature concerning mutual funds and variable annuities must be submitted to the FINRA for approval within 10 days of the time it is first used or published (under NASD Rule 2210(c)(2)(A)). Firms may also voluntarily submit other material for FINRA review and must pre-file other advertisements in some cases.

Duty to Recommend Securities that are Suitable: A broker-dealer may only recommend a security to a customer that it has determined is suitable for that customer in light of that customer's particular age, financial situation, risk tolerance, and investment objectives (*e.g.*, under NASD Rule 2310 and IM 2310-2 and NYSE Rule 405). Broker-dealers must obtain the customer's name, tax identification number, address, telephone number, date of birth, employment status, annual income, net worth, and investment objectives for each retail customer account (under Exchange Act Rule 17a-3(a)(17)(i)(A)). As a fiduciary, an adviser has an obligation to deal fairly with its clients and to act in their best interests (under Section 206 of the Advisers Act).

Supervisory Requirements: Broker-dealers must establish, maintain, and enforce written supervisory procedures to supervise the types of business in which they engage and to supervise the activities of registered representatives, registered principals, and other associated persons (under Section 15(b) of the Exchange Act and NASD Rule 3010(b) and NYSE Rule 342)). Similarly, investment advisers must adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act by the adviser or any of its supervised persons (Section 206 of the Investment Advisers Act and Rule 206(4)-7(a) thereunder).

IV. EXAMINATION FINDINGS

- **Sponsors of "free lunch" sales seminars often offer attractive inducements to attend**.

We found that sales seminars are commonly held at upscale hotels, restaurants, retirement homes, golf courses and other locations. A few were held at the offices of the firm sponsoring the seminar. Invitees were from the local community. Generally, the seminars were free. In some cases, in addition to providing a free meal, the firms and individuals that conducted these seminars used other incentives such as door prizes, free books ("A Free Tax Payer Awareness Guide"), free portfolio reviews and one even offered a $250 discount on a nursing home protection planning session. To further encourage attendance, some advertisements offered seminar attendees eligibility to win prizes such as tote bags, gift certificates or even a 3 night/4 day cruise for two.

- **Often, the target attendees are seniors**.

We found that many of the seminars were designed to appeal specifically to seniors. Some seminars also targeted religious affinities or associated groups such as the military. Many sales seminars were advertised in local newspapers or attendees were solicited to attend via mass invitations sent through the mail or via email. Many solicitations targeted seniors. Samples of advertisements can be found in Appendix A to this report.

The seminars had titles such as*: "Senior Financial Survival Seminar," "Senior Citizen Tax Specialist," "Senior Financial Safety Workshop,"* and *"Senior Citizen Retirement and Asset Protection Education Workshop."* Some communications explicitly stated that attendance was limited to those between, *e.g*., 60 and 85 years of age, or over 70 years of age. In the advertisements and/or invitations, the seminar sponsors often claim to offer advice on how to attain a secure retirement, financial planning, inheritance advice, and even "nursing home asset protection." Often, the ads and mailers featured photographs of happy and attractive seniors – perhaps to suggest that an attendee could achieve financial security or prosperity by attending the seminar.

Seminar sponsors appeared to target seniors, and to seek to limit attendance by the non-target attendees. Some ads and mailers were explicit in excluding attendance by advisers, attorneys, accountants, agents or brokers, or otherwise discouraged attendance by these professionals by charging them a costly attendance fee (as much as $1,000).

The ads and mailers often implied urgency, and that time was of the essence. They said things like: "Act Now!" "If you are over 60, you cannot afford to miss this seminar" "Seating is Limited!" "Reservations Required" "This is a time-sensitive offer!" "There is a financial storm brewing" "This is a *Must* Attend!" or "Startling presentation reveals costly mistakes that can ruin your finances."

Some ads and mailers used tactics to scare seniors into thinking that they might not be using the right investment professional, or to question their current investments. For example, they say, "If you're retired, YOU'RE A TARGET and you cannot afford to miss this workshop!" "How to Protect your Nest Egg from The Retirement *Vultures*," "Will you cause your family to split up and argue at your passing when your will or trust is read? Would you like to know how to prevent the possible breakup of your family?" and "Seniors, did you know that costly mistakes can tarnish your golden years?" These statements appear to be designed to scare vulnerable senior investors, and may help to open the door for seminar sponsors to sell unsuitable investments.

- **Seminars are designed to sell.**

While many sales seminars were advertised as "educational," "workshops," "educational dining seminar" and "nothing will be sold at this workshop," and many advertisements did not mention any investment products, all of the seminars were intended to result in product sales. They were intended ultimately to result in the attendees' opening new accounts with the sponsoring firm, and the sale of securities and other financial products. To the extent that participants may attend the seminar in order to obtain educational insights and information, they should be aware that the primary goal of the sponsors of the "free lunch" seminars is to obtain new customers and sell financial products.

Typically at a seminar, the seniors arrive at the restaurant or hotel and are shown to a private room, and to a seat. At the outset, they are usually given a questionnaire or contact card to fill out with their name, address, telephone number, and interests in particular investments or financial goals and are asked to return the card to the host. A slide show or power point presentation usually follows as drinks are served. Examiners found that the most commonly discussed products at the sales seminars were variable annuities, equity indexed annuities, real estate investment trusts, mutual funds, private placements and reverse mortgages. The food is usually not served until after the presentation is complete and the host has collected the contact information from the attendees. To ensure the attendees stay until the presentation is over, the door prizes are given last. The financial adviser speaking at the seminar also evaluates individual attendees' level of interest in opening an account and/or purchasing products.[9]

Following the seminar, seminar attendees can expect to receive additional solicitations from the firm to purchase investment products. Attendees are generally contacted by the financial adviser by telephone at least one or more times, using the contact information that the attendee provided at the seminar, and are solicited to schedule a further meeting with the financial professional and/or to open an account and purchase securities or other products. Typically, the attendee will also be added to the firm's mailing list of potential customers, and will receive additional sales materials in the mail following the sales seminar.

- **Some firms had particular compliance and supervisory controls that appeared to be effective. And, at a small number of firms (5 examinations, or 4% of the firms examined), regulators found no problems or deficiencies.**

Some examinations found that firms had specific compliance and supervisory practices that appeared to be effective in ensuring compliance with the securities laws and rules. These practices were in writing and were implemented. Particularly effective practices were those that facilitated a supervisor's advance review of the materials to be used in connection with sales seminars.

For example, one broker-dealer required its employees to forward all materials to its home office for a supervisory and compliance review prior to using them at sales seminars. Another broker-dealer utilized checklists to aid supervisors with the approval process for seminars and seminar materials. Another firm used what it called "mystery shoppers" (who were current firm employees) to attend seminars randomly to identify potential disclosure and compliance weaknesses and report back to their supervisor. These, and additional examples of effective compliance and supervisory practices found during examinations can be found in Appendix B to this report.

[9] At one firm, registered representatives kept a record of those who attended the seminars that included a notation of the attendees who made appointments to meet with the registered representatives after the seminar to discuss opening an account. The record also referred to those attendees who did not schedule a follow-up appointment and apparently only attended the seminar for the free lunch as "clowns."

- **Half of the examinations found that firms used advertising and sales materials that may have been misleading or exaggerated or included apparently unwarranted claims.**

The most common deficiency involved the use of potentially misleading advertising and sales literature in connection with the sales seminars. Examiners found deficiencies in 63 of the 110 examinations conducted (or 57% of the examinations conducted). Most frequently, these potentially misleading statements appeared in mailers and advertisements for the sales seminars, and involved statements about the safety, liquidity or anticipated returns of products. Additionally, some sales materials made comparisons between dissimilar investments or services, included representations about the expertise or credentials of the registered representative that appeared to be misleading or confusing, or involved testimonials that appeared to be misleading, or provided inaccurate or confusing information about the sponsoring firm.[10] Examples are described below.

⇒ *Claims about Safety, Liquidity or Returns*

Some seminar sponsors used what appeared to be misleading or exaggerated promises to lure attendees to sales seminars. For example, one advertisement for a sales seminar, called the "Senior Citizen's Retirement & Asset Protection Educational Seminar," stated, "Learn how you can earn 2-3 times more interest than what banks currently offer…*While keeping your money liquid!*" The following additional examples were found in various advertisements:

> "If you are between the ages of 65-85 join me for the most fascinating hour of your LIFE and I will show you how to immediately earn as much as $100,000, $200,000 or $300,000 . . . or more with the stroke of a pen," and "How to ***guarantee*** your IRA will <u>never</u> run out, regardless of market fluctuations."
>
> "Learn how to pass all of your assets on to your heirs while making sure the IRS gets only what you want them to have."
>
> "Immediately add $100,000 to your net worth"
>
> "You'll learn how to generate returns starting at 40% while your capital is held in an FDIC insured account."
>
> "How to receive a 13.3% return"

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[10] Specifically, in 41 of the 110 examinations (or 37%), firms may have made false, misleading, exaggerated or unwarranted statements or claims; and in 29 examinations (or 26%), the firm did not appear to provide a sound basis for evaluating the statements that were made. In addition, two firms appear to have made exaggerated or unwarranted claims, opinions, or forecasts related to the performance of securities, and an additional seven made comparisons in their advertisements and/or sales literature between investments or services, but did not disclose material differences between the investments or services.

"How $100K can pay 1 Million Dollars to Your Heirs"

"Get double digit growth potential with no risk of loss and no fees"

"Your deposit plus all gains are insured 100% without limit."

Advertisements like these seemed designed to attract attention by using exaggerated and potentially misleading claims. Examiners noted that seminar sponsors may be competing with each other for attendees, particularly in local areas with large populations of retirees, and may use hyperbolic and exaggerated ads in order to "stand out" from other seminar sponsors.

⇒ *Use of Testimonials*

Examiners found that some firms used testimonials from satisfied customers as part of their sales materials and presentations at sales seminars. Examiners observed that firms sometimes used testimonials by seniors who attested to the quality of service or the investments offered by the firm in their marketing efforts to other seniors as prospective customers.

As described above in this report, to protect investors from being misled by testimonials, broker-dealers must prominently disclose that the testimonial may not be representative of the experience of other customers, the testimonial may not be indicative of future performance or success, and if more than a nominal sum is paid, broker-dealers must disclose that it is a paid testimonial (under NASD Conduct Rule 2210(d)(2)(A) and NYSE Rule 472(i)(7)). Investment advisers registered with the SEC may not use testimonials at all (under Rule 206(4)-1 under the Advisers Act).

Examinations found that some firms did not fully comply with these requirements. For example, one broker-dealer firm employed an older gentleman on a part-time basis to help with public relations. He also held accounts with the firm. His job was to attend seminars, state that he was a current customer of the firm, and stand up and give unsolicited testimonials as to the quality of the firm and its investment management. He did not disclose that he was paid to provide the testimonial, that his experience may not be representative of other customers' experience, and is not indicative of future performance or success (as required under SRO rules).

The same firm invited its current customers to its sales seminars -- to receive a free meal -- and to provide impromptu testimonials to other attendees, *e.g.*: "I am happy with the account and the returns" and "It feels like being part of a family." These testimonials did not include disclosures that these customers' experience may not be representative of other customers' experience, and is not indicative of future performance or success (as required under SRO rules).

Other testimonials identified in the examinations included:

> "The [broker-dealer] puts client's best interest first."
>
> "You can trust [the broker-dealer]."
>
> "[I] like the approach to asset allocation which leads to broad diversification."

⇒ *Representations about the Expertise of the Financial Adviser*

Often, the advertising for sales seminars has a personal appeal and focuses on the individual person who is presenting the seminar. The advertisements frequently include a photograph of the seminar host and a description of that individual's background as an expert in providing financial advice, as well as highlighting his/her involvement in the local community. While examiners did not investigate the accuracy of all of the representations made about the background or expertise of the persons presenting the seminars, we found a few indications that information provided about the experience or the expertise of the presenter could be confusing or misleading to an attendee.

For example, two individuals distributed sales literature during a seminar that included a "team profile" of themselves as hosts of the seminar. The profile stated that one of the representatives used technical knowledge to develop an advanced mutual fund selection system combining various services and numerous data bases. Examination staff discovered that an off-the-shelf software program was used to identify potential mutual fund investments.

In other cases, individuals presenting seminars called themselves a "*Certified Senior Advisor,*" or "*Elder Care Asset Protection Specialist*" or "*Chartered Retirement Planning Counselor*" -- terms that suggest that the financial professional has some type of special credential or certification from a regulatory authority, when in fact there is no regulatory qualification or registration that recognizes such special expertise.[11] The use of these titles may be confusing or misleading to the public.

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[11] Regulators have warned that seniors may be confused by designations that imply some expertise in providing services to seniors. NASAA's Investor Alert is available at http://www.nasaa.org/NASAA_Newsroom/Current_NASAA_Headlines/4028.cfm. The SEC has provided information on professional designations, available at http://www.sec.gov/investor/pubs/senior-profdes.htm. Additionally, FINRA provides a list of professional designations and describes them for informational purposes only – without recommending or endorsing any designation. This information is available at http://apps.finra.org/DataDirectory/1/prodesignations.aspx.

- **Individuals attending the sales seminars may not understand that the seminar is sponsored by an undisclosed company with a financial interest in product sales.**

As described above, the mailers and advertisements for the sales seminars often focused on the individual person who conducted the seminar, and often included the name, photograph and background information of the individual registered representative or investment adviser that is scheduled to speak at the seminar. Members of the public who attended the seminars or considered attending were not always provided with the name of the firm that was sponsoring the seminar, and may not be aware that product sponsors (e.g., mutual fund companies and insurance companies) provide funding for these seminars.

Examiners found that advertising and sales material provided to prospective attendees at the seminars did not always disclose the name of the broker-dealer or the investment adviser firm that was sponsoring the seminar. In fact, in 12 of the 110 examinations (or 11% of the examinations conducted), firms used sales literature that provided the name of the individual who presented the seminar, but not the name of the firm where the individual worked.[12] In 7 of these instances, the registered representatives used alternative names to do business and used these names in their advertising or sales literature, but did not also reflect the name of the broker-dealer firm that they worked for and that was offering the products or services. Providing the name of the firm would allow a prospective attendee to better research the sponsoring firm in deciding whether to attend a sales seminar.

In addition, seminar attendees and those who considered attending likely did not know that some seminars were paid for (in part or in whole) by product sponsors. This information is not required to be disclosed in advertisements or mailers for sales seminars. Mutual fund firms and insurance companies often reimburse broker-dealers or investment advisers for expenses when they hold sales seminars to solicit investors to purchase the mutual funds or insurance products. In these examinations, examiners found that mutual funds, insurance companies and limited partnership sponsors frequently reimbursed broker-dealers or investment advisers for the costs of putting on the sales seminars (*e.g.,* rental of space, the food and beverages provided, publications, advertising expenses and other free items provided to attendees). Attendees likely did not know that the sponsors of the products discussed at the seminar had paid for the costs of the seminar. In these situations, seminar attendees may not have known that the financial adviser speaking at the seminar was not unbiased in making product recommendations.

12 Broker-dealers are required to reflect the name of the firm offering products and services in any advertisements or sales literature offering products or services. The name of the member must be prominently disclosed, and may also include a fictional name by which the member is commonly recognized or which is required by any state or jurisdiction (under NASD Conduct Rule 2210(d)(2)(c)(i) and (iii)).

While seminar attendees and those considering whether to attend likely were not aware that the seminar may have been paid for by a product sponsor, if a person attending a seminar purchases a security, they are required to receive relevant disclosure. Broker-dealers and investment advisers are required to disclose certain basic terms of the transaction to the customer or client, such as any payments they receive from third parties.[13] Most frequently, these disclosures are contained in the prospectus for the mutual fund or other product, or in the investment adviser's brochure (or in its Form ADV).[14]

Examinations found that, when customers purchased a security as a result of a seminar, firms provided disclosure that they received compensation from a product sponsor in the prospectus, in a statement of additional information, or in a separate disclosure form. However, in 8 examinations, the disclosure that firms provided in the prospectus stated that the firm *"may"* receive compensation from product sponsors based on assets under management, when, in fact the firm had actually received and was receiving such payments and reimbursements for seminar costs.

For example, examinations found that two broker-dealers had agreements with insurance companies under which the insurance companies paid the broker-dealers to sell their products (often called "revenue-sharing agreements"). With respect to one of these broker-dealers, most of its overall yearly sales were of the variable annuity products of a small number of insurance companies. It maintained compensation agreements with those insurance companies based on the sales that it made, and its customers' variable annuity assets that were held in their accounts with the broker-dealer for a certain length of time. The firm disclosed to investors that it "may" receive additional payments based on assets under management; however, it actually received over $1 million a year from these insurance companies, a significant amount of money for the firm based on its size.

Examinations also identified an instance of double-billing -- a registered representative obtained reimbursement for the same sales seminar expenses from multiple mutual funds. The registered representative had submitted the same restaurant bill to multiple mutual fund companies and received full payment from each of them.

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13 Broker-dealers must disclose the source and amount of any remuneration received or to be received from third parties in connection with a transaction under Rule 10b-10 under the Exchange Act. Advisers must make similar disclosures, generally under Section 206 of the Advisers Act, and in Form ADV Part II.

14 "[I]n the case of offerings registered under the Securities Act of 1933, the final prospectus delivered to the customer should generally set forth the information required by the proviso with respect to source and amount of remuneration. . . . In such situations the information specified in the proviso need not be separately set forth in the confirmation." Exchange Act Release No. 13508 (May 5, 1977) at n. 41.

- **Many broker-dealer firms did not submit sales materials to NASD for review as required.**

As described earlier in this report, to help ensure that communications by broker-dealers to the public are fair, balanced and not misleading, broker-dealers must provide certain sales material to NASD's Department of Advertising Regulation for review (now, this function is performed by FINRA's Department of Advertising Regulation). Advertisements and sales literature concerning mutual funds and variable annuities must be submitted for review within 10 business days of first use or publication (NASD Rule 2210(c)(2)(A)).

These examinations found that many firms did not submit materials to NASD as required. Specifically, NASD's Advertising Regulation Department reviewed all the advertisements and sales literature collected in these examinations that were used by NASD member firms or their associated persons. This review found that 31 broker-dealer firms had failed to submit their advertising and sales literature to NASD as required. If these materials had been submitted for review, it is likely that the firms would have been advised of potentially misleading or exaggerated statements or other concerns.

- **Many examinations found indications that firms had poorly supervised these sales seminars.**

One of the most frequent deficiencies cited during the examinations was inadequate supervision of employees who held sales seminars. Examiners found weak supervision during 65 of the 110 (or 59%) examinations conducted. In the other 45 examinations, firms appeared to have implemented adequate supervisory controls over sales seminars.

During the 65 examinations in which deficiencies were found, examiners identified 102 instances in which firms did not appear to have supervised their employees in a manner that was consistent with supervisory requirements under the securities laws and SRO rules. A frequently found problem was that firms had either not established supervisory procedures, or had established procedures but did not put systems in place to properly supervise their employees who held sales seminars consistent with those procedures (in 44 of the 110 examinations, or 40%).

Examinations found deficiencies in several areas. These included: (1) a lack of written policies and procedures to address compensation received by the firm or its employees from issuers for selling the issuers' products; (2) a lack of written policies and procedures relating to the sales literature used at sales seminars; (3) not reviewing or approving materials provided to potential investors at sales seminars; (4) not reviewing incoming and outgoing correspondence; and (5) not adequately supervising branch managers who themselves sold securities to customers, and held sales seminars. Some examples follow.

⇒ *Lack of Policies and Procedures with Respect to Sales Seminars*

Examinations revealed many instances in which firms did not have specific policies and procedures with respect to sales seminars and/or communications with the public. Some firms did not require that all materials used to advertise the sales seminars, or used at the sales seminars be reviewed and approved by a supervisor prior to use. While it is impossible to determine what the outcome would have been had these firms had supervisory procedures in place, because these firms lacked supervisory procedures, it appears they did not provide adequate supervision over sales seminars. This lack of supervision may have allowed potentially exaggerated claims and misrepresentations to be made (which are described elsewhere in this report), and to go undetected by the firm's supervisors.

For example, a firm did not have procedures to monitor effectively the activities of employees in its branch offices concerning their communications with the public. Although the firm's managers knew that employees were conducting seminars, the firm did not have procedures that required that supervisors receive and approve in advance all of the sales literature that its employees distributed to the public. Other examples follow:

- A branch office did not maintain documentation evidencing approval for its registered representatives to hold sales seminars, or approval of the materials used. Dozens of sales seminars were held.

- A branch manager who maintained his own customer accounts (*aka*, a "producing" branch manager) conducted and approved his own seminars, and did not obtain review or approval by his supervisor.

- A firm's advertisement touted a 38% rate of return without any risk. When examiners requested a copy of the firm's approval of the advertisement, it could not be provided, suggesting a lack of supervision.

In a number of instances, examiners found deficiencies relating to the supervisory review of correspondence.[15] For example, at one broker-dealer firm, examiners found that 2 letters from customers authorizing the transfer of securities and funds had been altered. Specifically, the account numbers had been changed without evidence of customer approval. This could have been indicative of a possible attempt at theft. A registered principal had reviewed the correspondence, but failed to do anything about the alteration or even request an explanation as to why it was altered.

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[15] In addition to the general requirement to establish, maintain, and enforce written supervisory procedures, broker-dealers must also establish procedures for the review and endorsement by a registered principal, of incoming and outgoing written and electronic correspondence of its registered representatives with the public (NASD Rule 3010(d)(1)). These procedures must be in writing and be designed to reasonably supervise each registered representative. Firms' processes must include methods of control over receipt and delivery of hard copy correspondence, communications received through facsimile transmissions and email (NYSE Rule 342.16 and 342.17 also address the review and approval of communications with the public).

⇒ *Problems with Supervision of Employees' "Outside Business Activities"*

At the outset of these examinations, regulators were concerned about the possibility that registered representatives or investment advisers may be holding sales seminars and selling products outside of their firms' supervisory controls. Thus, examiners paid particular attention to this issue.

To help ensure that broker-dealer firms can provide adequate supervision for the protection of investors, SRO rules address the business activities that can be performed by firm employees "outside" of their employment with a broker-dealer. These rules require that the employee provide notice to the firm, and the firm may also require approval of the employees' outside business activities (NASD Rule 3030 and NYSE Rule 346(b)).

Investment advisers registered with the SEC must implement policies and procedures reasonably designed to prevent violations of the Advisers Act by any of the adviser's supervised persons, including partners, officers, directors or employees of the investment adviser, or other person who provides investment advice on behalf of the investment adviser and is subject to the supervision and control of the investment adviser (under Rules 206(4)-7 and 202(a)(25) of the Advisers Act).

Most of the broker-dealer firms examined had procedures in place that addressed the outside business activities of employees. However, some firms had not actually implemented their own policies and procedures. For example, one firm required all of its registered representatives to complete a questionnaire on an annual basis disclosing their outside business activities. Its policies then required supervisory follow-up on certain outside business activities. In practice, however, the firm did not conduct any follow-up after its employees provided information about their outside activities.

Examinations also found a number of instances in which registered representatives and investment advisers hosted sales seminars and were ultimately selling investment products to the attendees of the seminars without their firms' knowledge of the seminars themselves. The registered representatives and investment advisers incorrectly considered these seminars to be "outside business activities," and thus outside the supervision and compliance controls of the firms. At one firm, for example, a registered representative, who was also a mortgage broker, hosted seminars on the subject of mortgages and then also sold securities products to the seminar attendees. These seminars were not supervised by his firm.

- **Some examinations found indications that registered representatives or investment advisers holding the sales seminars had recommended investments that did not appear to be suitable for the individual customers/clients.**

As described in this report, sales seminars are often used to attract new customers and clients. When opening a new account, customers complete a new account form with a broker-dealer, or sign an investment advisory contract with an investment adviser. As part of this process, a broker-dealer or investment advisory firm will obtain information about the customer/client and his/her investment objectives, risk tolerance, time horizon for investments, and overall investment needs. This information assists the firm in ensuring that the recommendations made are suitable for the particular customer or client in light of their age, income, net worth, investment experience and risk tolerance. The determination about whether a particular investment product is suitable is based on the particular investor and his or her individual investment objectives.

During each examination, examiners reviewed account documents and other information maintained by the firm about a sample of customers to evaluate whether the investments that were recommended to customers appeared to be suitable. Examiners' primary focus was on accounts that were opened by attendees at the seminars, though examiners also reviewed other accounts when appropriate.

In some examinations, examiners found indications that apparently unsuitable recommendations to purchase investments were made at the sales seminars, or following the seminars, when an attendee opened an account. Examiners had concerns about the suitability of products recommended in 25 of the 110 exams conducted, or in 23% of the examinations conducted.

Examiners noted concern that some firms may not be adequately considering the individual needs and circumstances of each customer when determining whether a product was suitable for that customer. For example, at one broker-dealer, examiners noted that the same investment objective was identified on almost every new account form in one branch. Despite differences in the customers' ages, net worth, income levels and investment experience, almost every new account form indicated that the customers had "growth" and "growth with income" as their investment objectives. Almost every customer was invested in the same annuity product, and in the same three sub-accounts. These investments suggest that all customers were treated the same way when the firm was recommending investments, instead of in accordance with their unique needs in light of the variances in their ages, net worth, incomes, and investment experiences. At another broker-dealer, examiners noted four senior investors whose stated incomes and net worth did not meet the requirements of the products they were sold.

Examiners also found situations in which specific products and types of accounts were recommended to individual seniors, which may have been unsuitable or inappropriate for these particular customers. We note that these products and accounts are suitable and appropriate for some investors, but are not suitable and appropriate for others in light of their investment objectives, the time horizon for investment, or the risk involved. Examples follow.

⇒ *Variable Annuities*

Variable annuities are generally considered long-term investment vehicles, and therefore, the investor's time horizon for holding the investment and the investor's liquidity needs are particularly relevant in determining whether it is a suitable investment. Also relevant is whether the investor already holds a variable annuity investment, and whether the various features and costs make the product suitable in light of the investors' existing holdings. In particular, firms are required to ensure that a new variable annuity is suitable when recommending that an existing variable product be "exchanged" for a new one. A replacement that doesn't improve the customer's existing position, and that is designed merely to generate new sales commissions, would be prohibited by NASD rules (Rule IM-2310.2).[16]

At one firm, a review of account records for a sample of customers who had purchased a variable annuity based on the firm's recommendations indicated that 66% of the customers had sold a variable annuity in order to purchase a new one, and that most of the customers had investment time horizons of 3-5 years or less (including some with horizons of 1-3 years). Because of the significant surrender fees that are charged to customers who sell their variable annuities within a certain time-frame (usually within seven years of purchase), these products did not appear to be suitable for these customers.

At another firm, a registered representative recommended that a customer invest approximately 80% of his stated net worth in variable annuities. To finance the purchase of these variable annuities, the registered representative recommended that the customer sell his existing investments that were providing greater diversification, liquidity and annual income to his portfolio. The customer's previous portfolio holdings also included a variable annuity with a death benefit valued at over $30,000, income-producing investments such as investment grade corporate bonds, preferred stock, and money market funds. Based on the customer's other diversified portfolio holdings, and the customer's investment objectives of growth and income, the recommendation to sell virtually all of the customer's assets and purchase a variable annuity appeared to be unsuitable.

⇒ *Real Estate Investment Trusts*

At one firm, examiners found that registered representatives recommended that customers with a conservative investment objective and risk tolerance invest in a real estate investment trust, which was an illiquid and speculative investment. The prospectus for the investment stated that "these investments entail a high degree of risk, are long term investments and are suitable if investors have no immediate need for liquidity or can bear the complete loss of the investment." Because of the lack of liquidity, high degree of risk and long term nature of the investment, these investments appeared to be unsuitable for customers with conservative investment objectives.

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16 "*NASD Regulation Reminds Members And Associated Persons That Sales of Variable Contracts Are Subject to NASD Suitability Requirements*" (Oct. 1989) NASD Notice to Members 96-86, available at:
http://www.finra.org/web/groups/rules_regs/documents/notice_to_members/p004697.pdf
FINRA has proposed a new rule that would create requirements for recommendations, review by a principal, and supervisory and training requirements tailored specifically to transactions in deferred variable annuities (proposed Rule 2821).

⇒ Low-rated Municipal Bonds

At one firm, a registered representative recommended that two senior investors with conservative investment objectives purchase non-rated and low-rated municipal bonds. One investor purchased multiple issues that subsequently went into default or that failed to pay interest. The non-rated municipal bonds represented approximately 80% of her stated liquid net worth. In another instance, a retired over 70 year old investor with a primary objective of income and a liquid net worth of between $25,000 and $49,999 had the majority of his liquid net worth invested in non-investment grade speculative bonds. These investments may not have been suitable for these customers.

⇒ Collateralized Mortgage Obligations

At one firm, several registered representatives had recommended that customers with conservative investment objectives purchase certain collateralized mortgage obligations (CMOs) with high degrees of risk (based on the particular tranches being sold). In some cases, the customer accounts used high percentages of margin to purchase the securities. In addition, these CMO positions were being actively traded in the customer accounts, generating significant commissions for the registered representatives involved. These transactions appeared to be unsuitable for the particular customers involved.

⇒ Fee-Based Accounts

Financial services firms offer different types of accounts to customers. In particular, in recent years, fee-based accounts have become a popular account choice, and have been offered by broker-dealers and investment advisers. In a fee-based account, a customer pays a fee based on the amount of assets in the account. In a commission-based account, a customer pays a commission charge on each transaction.[17]

Prior to opening a fee-based account for a customer, a broker-dealer must have reasonable grounds to believe that such an account is appropriate for that particular customer (under NASD NTM 03-68 and NYSE Rule 405A). In addition, broker-dealers must disclose all material components of the fee-based program to the customer, including the fee schedule, the services provided and the fact that the program may cost more than paying for the services separately (under NASD NTM 03-68). It may be inappropriate to place a customer in an account with a fee structure that reasonably can be expected to result in a greater cost than an alternative account offered by the firm (under NASD NTM 03-68, NYSE Rule 405A).

[17] In a recent decision, the Court of Appeals for the District of Columbia Circuit vacated Rule 202(a)(11)-1 under the Advisers Act, which provided, among other things, that fee-based brokerage accounts were not advisory accounts and were thus not subject to the Advisers Act. Financial Planning Ass'n v. SEC, 2007 U.S. App. LEXIS 7356, 482 F.3d 481 (D.C. Cir. 2007).

Examiners found indications that fee-based accounts may have been recommended to customers for whom they may not have been appropriate. At one firm, a registered representative recommended a fee-based account to a senior investor. The account charged a fee of 1.838% of assets under management. This customer's account had no transactions, and held three variable annuities, which had separate, total internal management costs of approximately 3% of the assets. The customer was being charged two levels of fees on the same assets, once by the insurance company for management fees and again by the broker-dealer for the account fee. This type of account may not have been appropriate for this particular customer, in light of her investment objectives and the portfolio holdings.

⇒ *Recommendations that Customers Use Equity from their Homes*

Regulators have urged caution about recommendations that investors, especially senior investors, obtain loans on their homes in order to finance the purchase of securities. By doing so, customers may suffer investment losses that could result in their inability to pay off the loans on their homes, and ultimately, risk the loss of their homes altogether.[18]

In one examination, an investment adviser had recommended that senior investors obtain mortgages or refinance their homes and liquidate their existing retirement accounts, in order to purchase equity-indexed universal life insurance (EIUL) policies. This investment strategy speculated that the rate of return earned on the EIUL policy would exceed the cost of the new mortgage on the client's home. Dozens of senior investors followed this advice and effectively mortgaged 100% of the value of their homes. This type of investment strategy may not have been suitable for individuals on a fixed income because if the market index failed to perform, the policy provided a low return, and the client remained responsible for the annual mortgage cost and insurance premiums associated with the EIUL policy. In addition, the adviser's seminar materials only provided a positive analysis of potential returns that could be earned by clients and did not appear to offer discussion of any risk factors in using this investment strategy. This may have been an unsuitable high-risk investment strategy for these clients.

- **In some instances, the sales seminars may have involved fraud.**

Examiners found indications of possible fraudulent practices in 14 examinations (or 13% of the examinations conducted). These involved potentially egregious misrepresentations of risk and return, liquidation of accounts without the customer's knowledge or consent, and sales of fictitious investment notes. Some instances of apparent fraud are described below. In total, 25 of the 110 examinations (or 23%) are under review for possible further investigation or action by a state, FINRA or SEC.[19]

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18 *See* NASD Investor Alert, *Betting the Ranch: Risking Your Home to Buy Securities* (March 15, 2004), available at http://www.finra.org/InvestorInformation/InvestorAlerts/MarginandBorrowing/BettingtheRanchRiskingYourHometoBuySecurities/P005961; NASD Notice to Members 04-89, *available at* http://www.finra.org/RulesRegulation/NoticestoMembers/2004NoticestoMembers/P012715.

19 Many examinations had multiple dispositions. For example, a deficiency letter may have been

It is important to note that the types of potentially fraudulent conduct identified in these examinations are not limited to sales seminars; rather, the types of potential frauds described below are similar to the types of fraud perpetuated against seniors and other types of investors through means other than sales seminars. Indeed, securities regulators have brought numerous enforcement actions involving these types of frauds.[20]

⇒ *Possible Misrepresentations about Risk and Expected Returns*

Several examinations uncovered instances where registered representatives or investment advisers may have overstated the potential benefits of a product or failed to disclose important risks for investors. In one instance, for example, the firm's seminar advertisement indicated that customers could earn up to a 38% rate of return without any risk, and incorrectly implied that fixed annuities were guaranteed by the government.

⇒ *Liquidating Accounts Without Investor Knowledge or Consent*

In another examination, examiners found that an investment adviser had liquidated clients' investments and used the proceeds to purchase potentially unsuitable investments apparently without the client's knowledge or consent. The investment adviser conducted seniors-only seminars at hotels, offering retirees free breakfast and financial advice. He used marketing materials that claimed to teach seniors how to eliminate taxes on IRA accounts, reduce or eliminate taxes on social security income, and increase yields on investments from 20% to 300%. After the seminars, the investment adviser scheduled one-on-one meetings with interested individuals on the pretext of preparing a financial plan for them. During these meetings, the investment adviser may have misled seniors into signing several blank authorization forms, claiming that he needed the forms to obtain additional financial information. Instead, the financial plans appear not to have

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provided to the firm requesting corrective action, and findings from that exam may also have been referred for possible disciplinary or enforcement action.

20 *See, e.g.,* SEC v. C. Wesley Rhodes, Jr., et al., SEC Lit. Rel. No. 20144 (June 5, 2007) (defendants allegedly defrauded seniors of $38 million by misrepresenting stock and bond purchases); SEC v. One Wall Street, Inc, et al, SEC Lit. Rel. No. 20123 (May 22, 2007) (defendants allegedly defrauded seniors of at least $1.6 million through false and misleading statements regarding investment risks); SEC v. Empire Development Group, et al., SEC Lit. Rel. No. 20122 (May 18, 2007) (defendants allegedly defrauded unsuspecting senior investors with limited means of nearly $2 million through the sale of unregistered securities in bogus real estate development companies); *Citigroup Global Markets to Pay Over $15 Million to Settle Charges Relating to Misleading Documents and Inadequate Disclosure in Retirement Seminars, Meetings for BellSouth Employees*, FINRA News Release (June 6, 2007), *available at* *http://www.finra.org/PressRoom/NewsReleases/2007NewsReleases/P019240*; *NASD Investor Alert Warns Workers About Early Retirement Investment Pitches*, FINRA News Release (Sept. 14, 2006), *available at* *http://www.finra.org/PressRoom/NewsReleases/2006NewsReleases/P017386*; *Kenneth Edward Stephens*, Decision 06-216, 2006 WL 3900166 (N.Y.S.E. Hearing Board December 13, 2006) (defendant allegedly defrauded seniors of over $1.3 million through unauthorized trading); *David A. Noyes & Co., Inc.*, Decision 05-98, 2005 WL 3439785 (N.Y.S.E. Hearing Panel November 9, 2005) (defendant allegedly made unsuitable sales of variable annuities to unsuspecting seniors resulting in a loss of approximately $375,000).

been created, and it appears that the investment adviser later completed the forms in order to liquidate the clients' existing portfolios and purchase equity-indexed annuities, without the knowledge, authorization, or consent of each of the clients.

⇒ *Possible Fraud in the Sale of Oil and Gas Partnerships*

At one firm, examiners discovered that the broker-dealer was involved in an apparent scheme that targeted elderly investors by selling unsuitable, unregistered oil and gas partnerships. The partnerships were sold through sales seminars. As part of this scheme, it appears that investors' funds may have been misappropriated. It also appears that the broker-dealer may have made misrepresentations regarding the risks involved with these partnerships, stating that they were safe investments that would generate an income of 10-12%, with minimal risk. It appears that approximately $10 million was raised from dozens of elderly retired investors. This registered representative may have made material misrepresentations and omissions to investors concerning the value, nature and/or disposition of their purported investments by reflecting the market value of these partnerships as the original principal invested. The market value was not ascertainable because a ready market did not exist for such securities.

⇒ *Sales of Fictitious "Notes"*

At another firm, examiners found indications that a registered representative, who conducted business out of a retirement community, may have sold a non-existent investment to a senior investor for approximately $10,000. The investor was told that her money would be loaned to real estate developers, when the money may have been used for personal expenses of the registered representative, mostly to repay trading losses he had incurred years prior, as well as interest on those losses.

V. CONCLUSION

The results of these examinations lead regulators to conclude that financial services firms should take steps to supervise sales seminars more closely, and specifically take steps to review and approve all advertisements and sales materials for accuracy and to ensure that they do not contain exaggerated or misleading claims. In addition, firms should redouble efforts to ensure that the investment recommendations they make to seniors are suitable in light of the particular customer's investment objectives. With the growing senior demographic, firms might consider specific training for their registered representatives and investment advisers regarding sales to senior investors.

Regulators have compiled a list of supervisory practices that have been identified during examinations and that appeared to be effective, which is included in Appendix B of this report. This information may assist firms in considering their own supervisory practices with respect to sales seminars. Regulators further urge financial services firms to take steps to assure that supervisory procedures with respect to sales seminars are being implemented effectively.

Regulators participating in these examinations will continue to focus examination, enforcement and regulatory efforts on the use of sales seminars targeted to seniors.

In addition, regulators conclude that, because seniors are targeted as attendees for sales seminars, ongoing investor education efforts for seniors should provide education with respect to "free lunch" sales seminars. Specifically, senior investors should understand that these are *sales* seminars -- that is, they are intended to result in the sales of financial products, and they may be sponsored by an undisclosed company with a financial interest in product sales. Investor education efforts should emphasize that, despite the claims of urgency that are sometimes made by sponsors of sales seminars, and in light of the possibility of misleading or exaggerated statements or claims about investment products or the expertise of the financial adviser, investors should take time to research the firm, the financial adviser as well as the product being offered before opening an account or making a purchase. Regulators make a variety of tools available to investors to assist them in understanding investment products and investigating a broker or other financial professional before investing, and many of these tools are listed in Appendix C to this report.

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APPENDIX A

SAMPLE ADVERTISEMENTS

This appendix contains a sample of advertisements (many of which appeared in local newspapers and mass-mailed invitations) soliciting attendance at sales seminars. They are included as illustrative examples of the types of advertisements commonly used. Including them in this report does not indicate that they contain either accurate or inaccurate statements. The names of the sponsors, addresses, telephone numbers and other identifying information have been redacted.

FREE FOOD.
FREE GOLF.
FREE DRINKS.

It doesn't get any better than this!

JOIN US FOR GOLF NIGHT
TUESDAY, MARCH 14, 2006

Enjoy a beautiful sunset!

Enjoy a complimentary gourmet dinner!

Enjoy an open bar!

And...

A special presentation on advanced estate and financial strategies for wealth retirees ages 70-85. This presentation is appropriate for those with a net worth of $3 million or more. It will be held at the finest penthouse office in all of South Florida —[redacted]

Attendees will receive...

- Priceless information
- An incredible dining experience
- A free sleeve of Titleist, Callaway or Nike golf balls
- A chance to win a free set of Callaway golf clubs

Presentation begins at 5pm...

- Followed by gourmet dinner
- An incredible sunset
- And free golf equipment

SEATING AVAILABLE TO FIRST 40 CALLERS. PLEASE RSVP 1-888[redacted]

The Experts in Retirement Income Planning

This appendix contains a sample of advertisements (many of which appeared in local newspapers and mass-mailed invitations) soliciting attendance at sales seminars. They are included as illustrative examples of the types of advertisements commonly used. Including them in this report does not indicate that they contain either accurate or inaccurate statements. The names of the sponsors, addresses, telephone numbers and other identifying information have been redacted.

How To Avoid the Costly Mistakes That Cause Retirees to Lose Their Financial Independence

8 Strategies to Protect Your Financial Security

We are conducting an informational workshop that covers many topics related to your retirement. NO, this is not another presentation by your local brokerage firm about investing. **There will be nothing sold at this workshop.** Our speaker will inform you about recent changes in Federal and State laws and show you how to avoid the biggest financial mistakes seniors make.

I would like to personally **invite you and up to three guests** to attend this workshop designed exclusively for seniors. As usual, when the government changes laws that apply to you, they do not personally notify you. You will learn about...

•**TAXES:**	Lower or eliminate taxes on Social Security, Interest Income, Capital Gains, and taxes upon death.
•**INCOME:**	Learn the techniques to increase your spendable income.
•**PROBATE:**	Become aware of critical facts regarding Trusts and Lawsuits.
•**TOD and POD:**	Learn how these can benefit seniors.
•**S-T-R-E-T-C-H IRAs:**	How to prevent your IRA from becoming an Internal Revenue Account upon death.
•**ANNUITIES:**	What are the Pros and Cons?
•**LOST MONEY IN THE MARKET?**	Learn what you can do about it!
•**NO LONG TERM CARE?**	Learn how you can protect your assets from a nursing home situation without expensive insurance!

Due to the popularity of this workshop, available seating is limited and reservations are required. Please respond immediately to guarantee a seat.

Monday **June 19, 2006** **11:00 am & 3:00 pm** **(meal following)**	***OR***	**Tuesday** **June 20, 2006** **11:00 am** **(meal following)**

LOCATION

[redacted]*Cafeteria*

[redacted]

Seating is limited. To make your reservations, call Toll Free 1-877-[redacted] (24 Hours)

PS: THE LAST WORKSHOP WAS FULL. IT COULD CHANGE YOUR LIFE!

(NOTE: LAWYERS, BROKERS, CPA'S OR ADVISORS MAY NOT ATTEND AS SPACE IS NEEDED FOR SENIORS.)

The presenter, speaker and sponsor of this information is a licensed, independent Insurance agent. The presenter, speaker and sponsor of this information (Invitation) as well as the information presented at the seminar is not related to, endorsed by, nor connected with and not approved by any Government Agency or organization. Although the seminar is providing information of value for consumers, the seminar is a solicitation for Insurance products such as Medicare supplements, Long Term Care Insurance, Life Insurance & Annuities. Some of the Insurance Companies that the licensed agent represents are [redacted]

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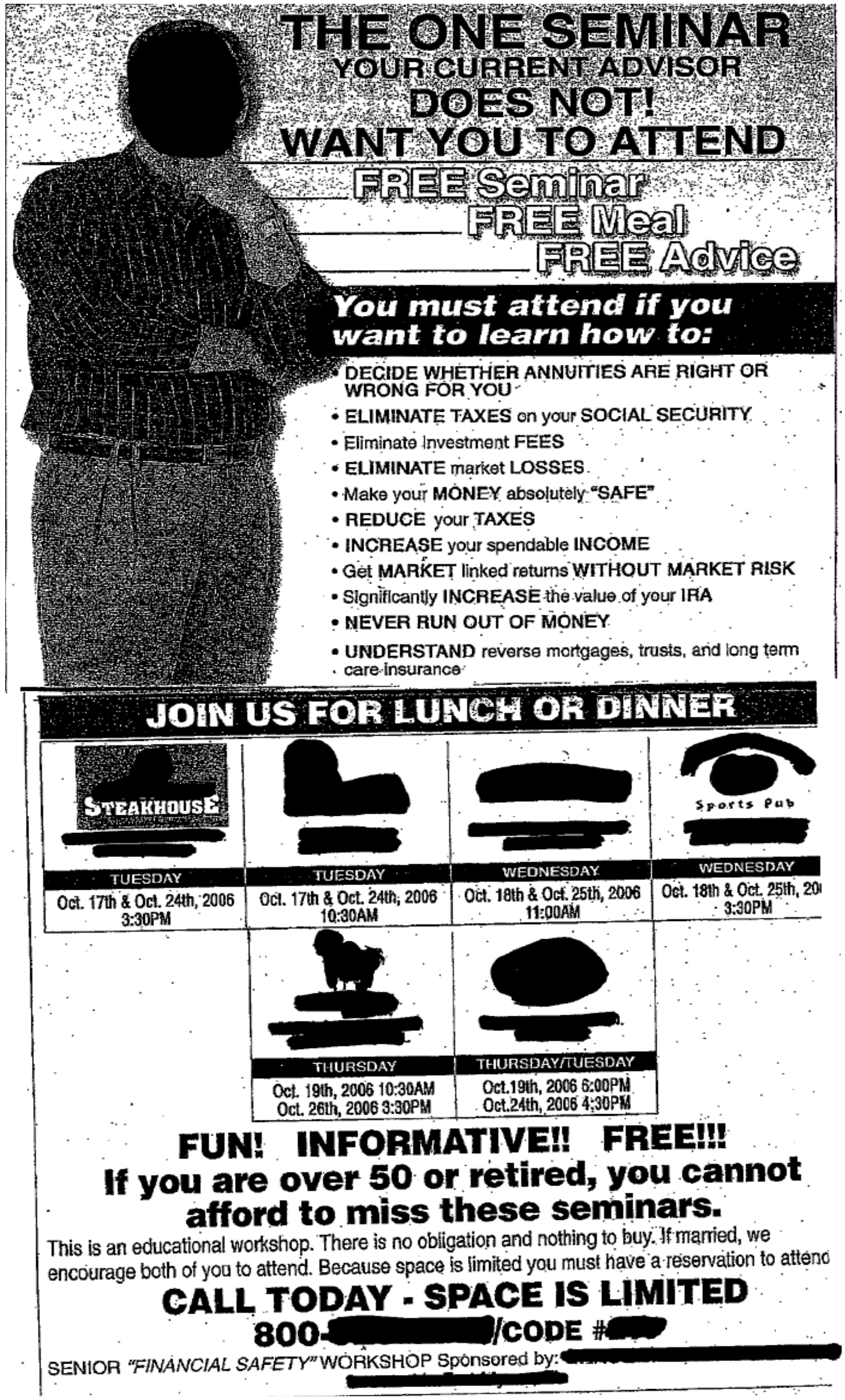

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FINALLY, A DIFFERENT SEMINAR!

If you own a mutual fund you must attend!

QUESTION? Is your mutual fund really performing as well as you think?

FACT: There are Mutual Funds that have an average annual return in excess of **12%*** for the past 70 years!

Learn how we:

- Select the most consistent performers
- Explore the most cost effective means of acquiring funds
- Choose the best money managers on Wall Street
- Use methods to minimize income tax consequences**

Come join our FREE Workshop with Lunch to follow

Wednesday, July 13	Thursday, July 14	Friday, July 15
11:00-12:30	11:00-12:30	11:00-12:30
[redacted]	[redacted]	[redacted]
Lunch to be served	*Lunch to be served*	*Lunch to be served*

Seating is limited.

Please call [redacted] or [redacted] at [redacted] for a reservation, 24 hours, 7 days a week

PLEASE BRING A COPY OF YOUR EXISTING MUTUAL FUND STATEMENTS FOR AN EYE OPENING ANALYSIS

[redacted]

Investment decisions by [redacted]. Inc. are made based on a client's specific investment objective, time horizon and risk tolerance. Information may not be [redacted] investors. Investments offered may involve risks, including [redacted] principal. Past performance does not guarantee future results. Consult your Registered Representative a[redacted] for more information. *Source from [redacted] the composite listings dated 07/31/2004 based on [redacted] nt [redacted] **We do not provide tax advice; refer to your accountant for professional tax guidance.

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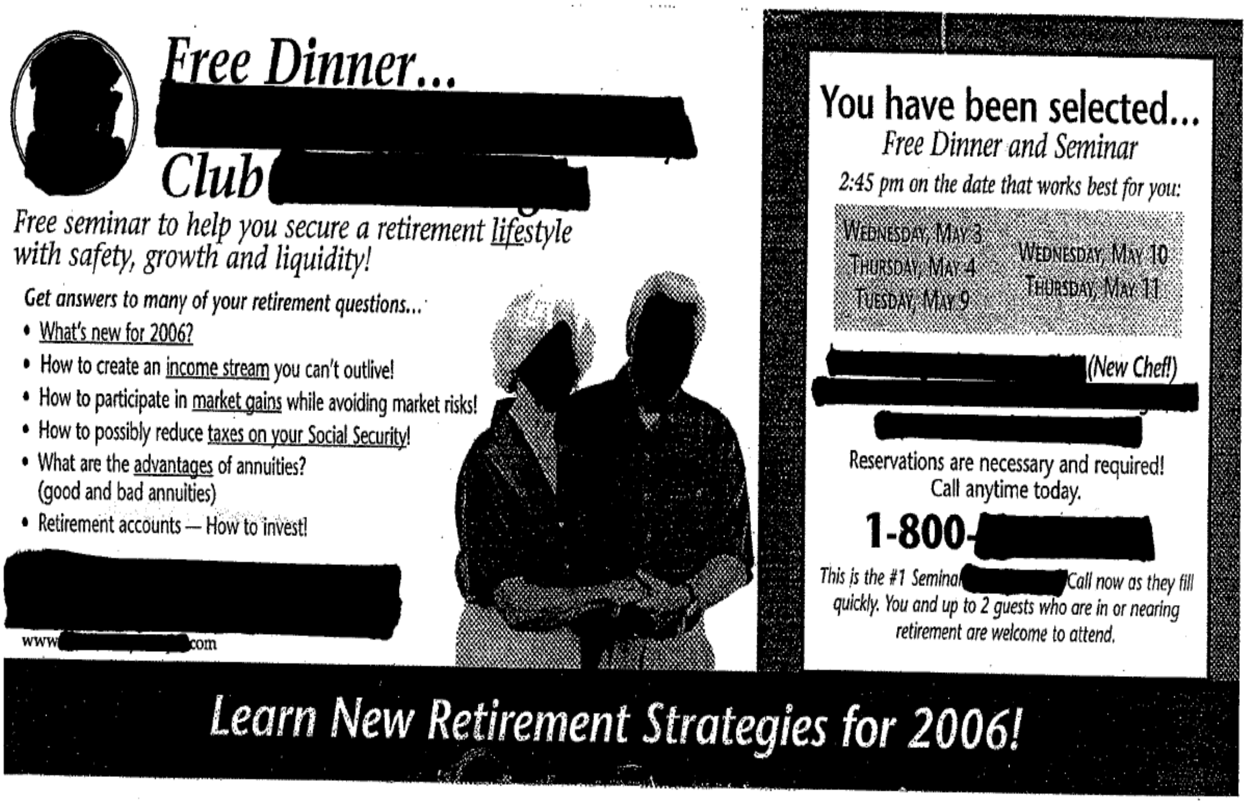

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Senior Financial Preservation Workshop

Are You Dissatisfied With Your Investment Performance?

If you are retired or nearing retirement, this is the one workshop you cannot afford to miss!

You and a guest are cordially invited to attend a
FREE SENIOR FINANCIAL PRESERVATION WORKSHOP.
Your lunch and program are
ABSOLUTELY FREE.
No products will be sold.

During the workshop we will discuss several areas that affect today's retirees.

Including:

- The most up to date Medicare information and recent changes
- Wills and Trusts
- Long-Term Care Insurance and is it right for you
- How to protect your assets from catastrophic illness and nursing home costs WITHOUT the high cost of long term care insurance
- How to earn Stock Market Linked Gains without Market Risk
- How to double, even triple your returns on what your CDs (certificates of deposit) are paying with no risk to your principal
- How to minimize taxes on your Social Security Income
- How to protect your assets from PROBATE
- How to increase your net worth
- Answers to YOUR most important retirement concerns

[redacted]
Monday, April 17th
Workshop begins at 11:00 a.m.
Lunch will be served immediately after the workshop.

[redacted]
Monday, April 17th
Workshop begins at 2:00 p.m.
Dinner will be served immediately after the workshop.

Brokers & Insurance Agents cost: $750.00

Seating is limited and reservations are required.
Call the 24-Hour seminar reservations hotline to make your reservation TODAY. Call NOW!!
TOLL FREE 1-800-[redacted] ext. 200

[redacted]

IF YOU ARE 50 OR OVER, DON'T MISS THIS FREE INFORMATION WORKSHOP!

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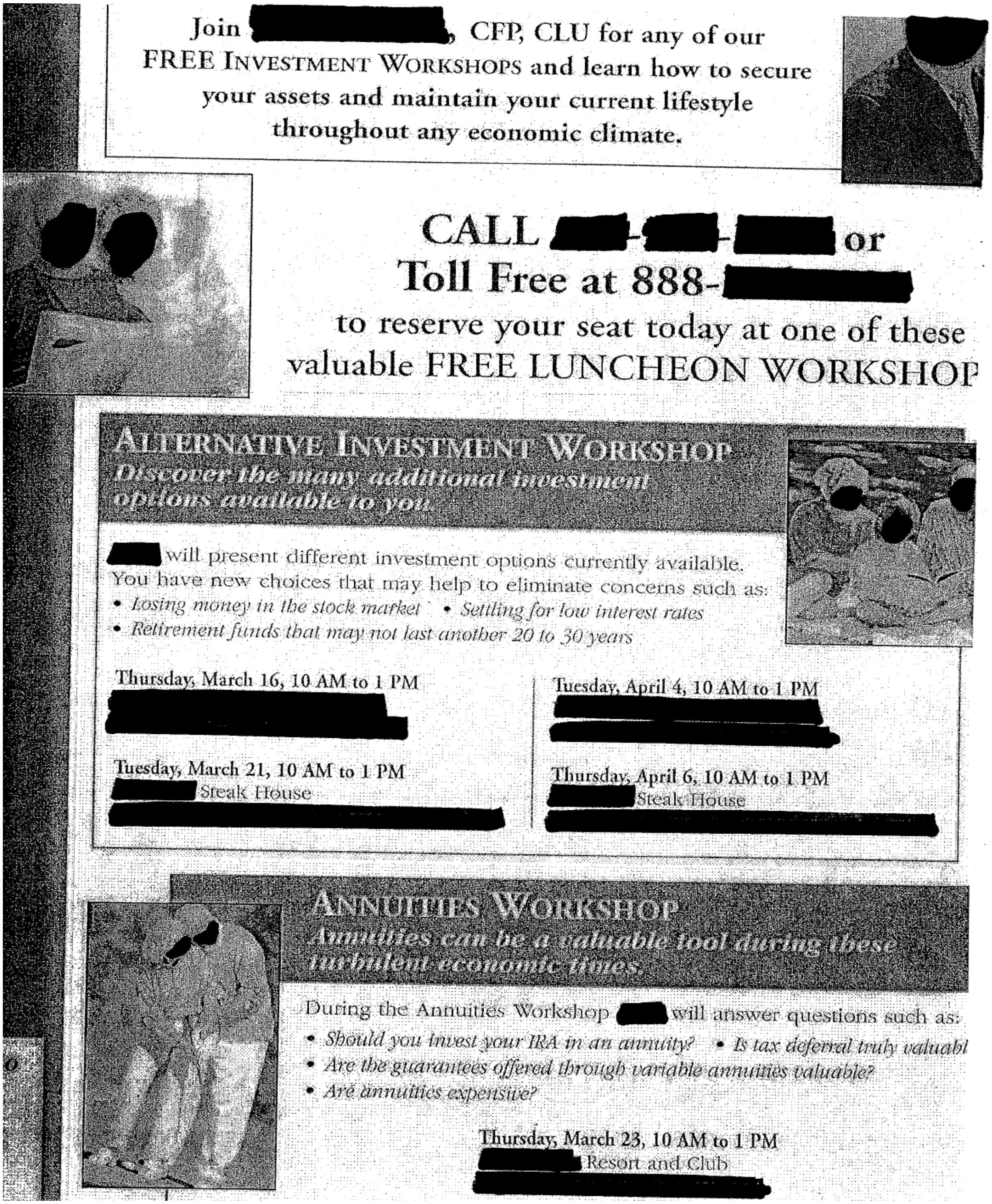

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[redacted] Cordially Invite You To Attend A Complimentary Dinner Workshop On:

FINANCIAL DEFENSE FOR SENIORS

If you're retired YOU'RE A TARGET and you cannot afford to miss this workshop!

This workshop is a broad collection of facts and circumstances intended to further educate you. Don't be fooled by workshops and seminars that focus on losing money to taxes and income increasing schemes. Often times, these seminars are geared toward funneling attendees into a single investment product that may be **very inappropriate.**

Call Today! As Seating Is Limited [redacted]

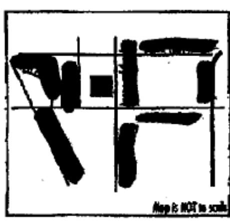
TOPICS TO BE DISCUSSED:

- What the true intentions of most seminar pitches really are.
- How financial "professionals" hide fees and commissions.
- What a real vs. a phony financial designation is.
- Why 99% of local seminars are attempting to sell Equity Indexed Annuities.
- The ANNUITY BONUS SCAM!
- Why so many "Financial Planners" call themselves President, CEO and/or Vice President of whatever company they represent.
- How many seminar presenters are just insurance agents masquerading as financial planners. The average person can study for 2 weeks and become an insurance agent.
- Why a revocable trust is not a "fix all."
- Why it takes more than one person to effectively manage your finances.
- Why REAL Financial Advisors have nothing to fear and why imitators are running for cover.

The Financial Defense For Seniors Workshop is Presented by [redacted] " Come hear facts, not smoke and mirrors - real life strategies on how to sift through the noise. This is an educational workshop with ABSOLUTELY no attempts to sell specific products. There is no cost or obligation to attend. We guarantee it will be time well spent.

Free Gourmet Meal immediately following the workshop!

DINNER	DINNER	DINNER
Tues., May 23, 2006	Wed., June 7, 2006	Wed., June 21, 2006
4:30 pm	4:30 pm	4:30 pm



Legal Counsel and Documents Prepared by:

[redacted]

LOCATION

[redacted] *Art Museum*

[redacted]

Spouses are urged to attend

No Brokers or Agents Admitted.

[redacted]

The Ethical Alternative

[redacted]

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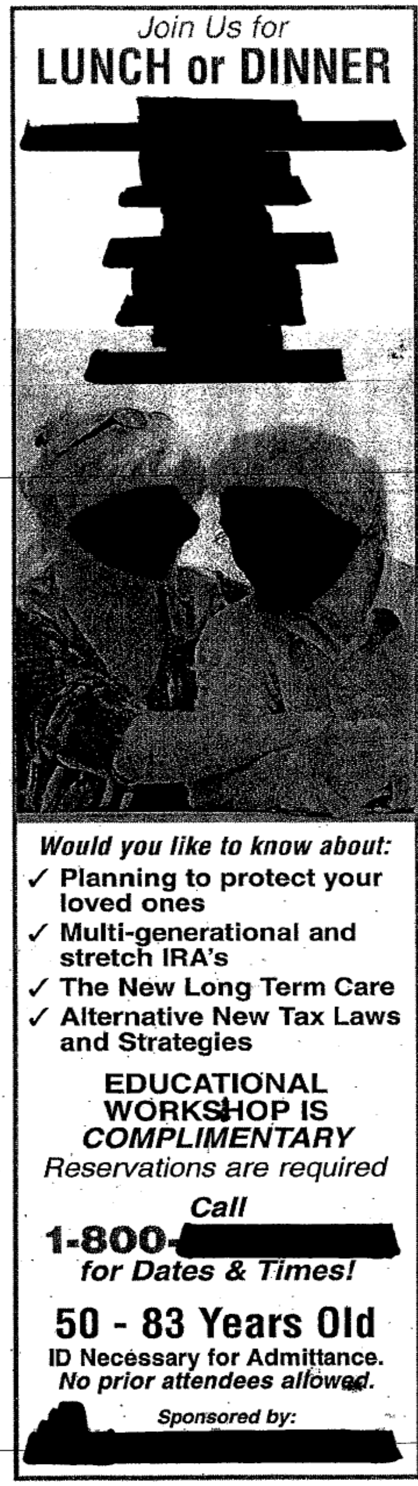

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[redacted]

Dinner Is On Us!

PRSRT STD
U.S. POSTAGE
PAID
[redacted]

Attn: Postmaster
Dated Material
[redacted]

[redacted]

Senior andVeterans Dinner 2006

Dinner Is On Us!

We would like to invite you to spend 60 minutes with The [redacted] **ADVISORY GROUP** as our guest for dinner. This dinner is by invitation only and is intended for persons age 60 and older that are interested in safely investing their retirment "nest egg".

LEARN THE FOLLOWING:

- ***Safety:*** *How to avoid losses on your investments, really!*
- ***Retired Veterans:*** *You may be eligible for $1,674 per month in unknown benefits!*
- ***CD Investors:*** *How to increase your CD interest rates!*
- ***Taxes:*** *How to reduce taxes on your social security, bank CD interest and others!*
- ***Fees:*** *How to eliminate the outrageous fees on your investments!*
- ***Creditors and Lawsuits:*** *How to protect your retirement "nest egg" with one simple beneficiary form!*
- ***Advanced Tax Planning:*** *$2 Million Estates and above - eliminate capital gain taxes!*
- ***Probate:*** *How to avoid probate expenses, time delays and lawyer fees at death!*
- ***IRA's and 401(k)'s:*** *Know your options!*

Your speaker will be [redacted]
"I enjoy helping retirees with financial decisions and protecting their retirement "nest egg". I would encourage you to attend and receive a valuable financial 2nd opinion."

As a **SPECIAL BONUS**, you will learn how you can earn a guaranteed 13.58% for the next 12 months.

Dinner Dates Available
Tuesday, April 18, 2006 - 3:00 p.m.
Wednesday, April 19, 2006 - 3:00 p.m.
Thursday, April 20, 2006 - 3:00 p.m.
(If married, both husband and wife should attend)
(Agents, Brokers, and Children Will Not Be Admitted)

[redacted]

Call
1-866-[redacted] (24 hrs)
Seating Is Limited And Fills Quickly
[redacted]

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[redacted]

DELIVERY CONFIRMATION NOTICE

Congratulations [redacted]

You are invited to join us for a <u>FREE LUNCH</u> *at* [redacted]
immediately following our "<u>SECURE RETIREMENT & ESTATE PLANNING SEMINAR.</u>"

[redacted]	OR	[redacted] COUNTRY CLUB [redacted]
Tuesday, April 18th at 10:45 AM		**Wednesday, April 19th at 10:00 AM**

<u>LEARN HOW TO</u>

* Reduce or Eliminate Social Security Taxes
* Participate in the Stock Market <u>without risk</u>
* Protect your assets
* Create income for life

DISCOVER THE FACTS AND STRATEGIES THAT WORK!

Presented by [redacted]

<u>Nothing</u> will be sold at this educational workshop.
There is <u>no cost or obligation</u>. <u>We guarantee it will be time well spent!</u>

Please RSVP to 1-800-[redacted]

All spouses are urged to attend. You may also invite a guest!

Call now, seating is limited! **Free Lunch!**

PLEASE RSVP

PRESORTED
FIRST CLASS
US POSTAGE
PAID
TAMPA, FL
PERMIT #78

FREE
Lunch at:

[redacted]

Tuesday, April 18th at 10:45am
or
[redacted]
COUNTRY CLUB
Wednesday, April 19th at 10:00am

COMPANY [redacted]
STREET ADDRESS [redacted]
CITY AND STATE [redacted] ZIP CODE [redacted]

[redacted]

N1766--00002789

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Is the Beneficiary of Your IRA the IRS?

Little Known Tax Laws Can Cost You Up to 71% Of Your IRA!

When Was The Last Time You Checked Your Beneficiary? Are You Sure You Have The Right One?

If You Are Retired Or About To Retire, Have Over $100,000 In IRAs, 401(K) and Other Retirement Accounts and Want To Help Protect Your "Nest Egg" From Being Taxed Up To 71%.

Learn Strategies that can potentially help YOU:

- Reduce your required minimum distribution and reduce your income taxes up to 42% or more!
- Create a family legacy using tax-deferred compounding through an Inherited IRA Trust, which can last for 60 or more years.
- Determine who should and should not be the beneficiary of your IRA.
- Find out why leaving your 401(K) at your company after you retire may be a huge mistake.
- Take money out of your IRA tax-free through little-known strategies.

(Based on applying the highest Federal Income and State Income Tax rates at death as well as the highest Federal Estate Tax rate and IRS publication 915 regarding the taxation of Social Security Benefits)
Please be sure to consult with a qualified tax advisor and an attorney.

ATTEND THIS FREE WORKSHOP!

Saturday, March 18, 2006
10:00 - 12:00 a.m.

Workshop to be held at:
[redacted]

[redacted]

Refreshments Served

[redacted]

Your Workshop Sponsor:
[redacted] Inc.-Registered Investment Advisor

Speaker: [redacted] CEO, CSA
has over 25 years of experience working with retiring employees of many local companies. He has been recognized as one of the nations "Top 1% of Financial Advisors" by [redacted]

Securities Offered Through
[redacted]
Member NASD/SIPC

Seating Is Limited, So Call (800) To Reserve Your Seat

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SENIOR FINANCIAL SURVIVAL SEMINAR

2006 Income Tax Update, Probate Questions Answered and Federal & State Guidelines to Help Protect Your Assets from Nursing Home Expense.

If you are age 55 or over, don't miss this FREE information seminar that could help protect your financial future.

CONTENTS OF THIS SEMINAR

- ❑ How to protect your assets for your loved ones from catastrophic illness and nursing homes without purchasing nursing home insurance.
- ❑ Learn what is exempt from Nursing Home attachment.
- ❑ How Investments (Annuities, Life Insurance, CDs, etc.) are affected by the "Spend Down Process".
- ❑ How to lower your income taxes.
- ❑ Reduce taxes on your Social Security benefits.
- ❑ Learn how a Revocable Living Trust may help you.
- ❑ How to increase your spendable income.
- ❑ How to avoid probate.

There are federal laws that will enable you to avoid paying thousands of dollars out of your pocket for taxes, probate and nursing home costs. The government will not notify you of your eligibility. You must educate yourself.
Come join us for this important information.

Seating is limited – there is no admission charge! No food – just the facts!

Nothing will be sold at this seminar! Please call to reserve your seat.

Call: 1-800-[redacted] Ext. 700

Time: 10:00 a.m.
When: Monday, April 3, 2006
Where: [redacted]

Sponsored by the [redacted] Call between 8:00 am and 8:00 pm.
Note: This seminar is free to the public. Insurance agents and financial advisors – $750 Admission Fee. We are members of the [redacted]

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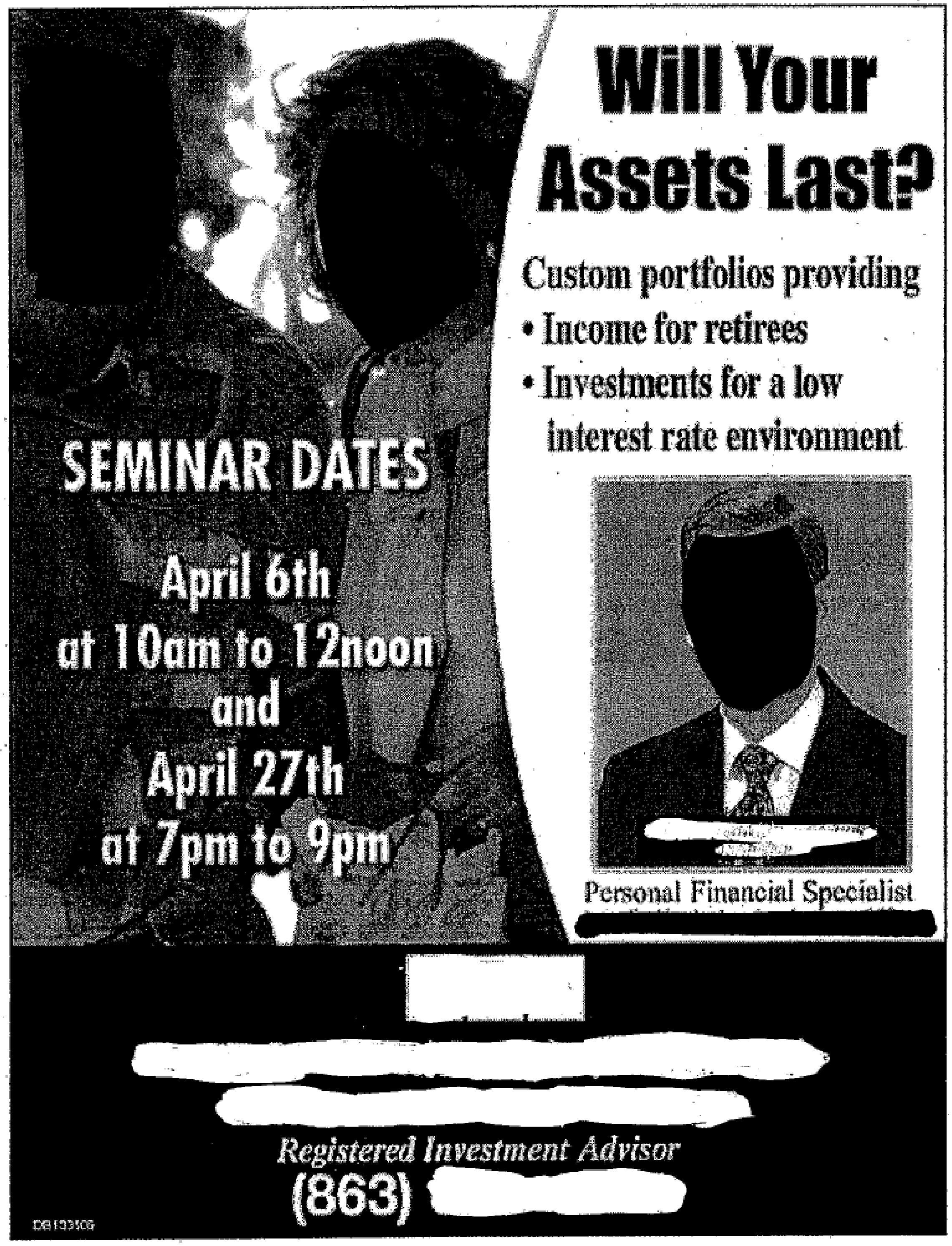

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APPENDIX B

EFFECTIVE COMPLIANCE and SUPERVISORY PRACTICES

During examinations of securities firms that provided "free lunch" sales seminars and in other examinations, examiners took note of several supervisory and compliance practices that appeared to be effective in ensuring adequate supervisory oversight and compliance with the securities laws with respect to sales seminars. These practices are described below. While these practices are not specifically mandated by the securities laws, individually or in combination they may be helpful to consider as securities firms are reviewing their supervisory and compliance practices in these areas.

Supervision of Seminars and Advertising

Regulators noted the following practices that were used in supervising individual registered representatives/investment advisers who held sales seminars and for reviewing and approving advertising materials for the seminars:

- The process for reviewing and approving proposed seminars and the advertising and other materials for the seminars was centralized, and included a dedicated compliance person with knowledge of the securities laws and rules with respect to advertising materials. The firm's policies and procedures clearly set forth the process for proposing seminars and advertising materials, and they were made known to all firm employees. Supervisory reviews of advertising and sales materials generally identified disclosure mistakes and potential problem areas that were corrected prior to the time the advertising materials were to be used.

- Policies and procedures for submitting proposals for sales seminars included specific timeframes for supervisory review and approval. For example, the approval and review process for seminar and advertising material required submissions of all materials three to four weeks prior to the seminar date. This allowed adequate time for supervisors to review and correct disclosure issues and any other issues identified prior to the seminar.

- All advertising material was forwarded to the home office for review and approval prior to use. This firm required information on seminar guest speakers to be forwarded and approved as well.

- One firm had two levels of supervisory approval for seminars and all sales materials and advertisements to be used at those seminars. The branch manager review was the first level of approval. The materials were then sent to the main office to be reviewed and approved by the compliance department.

- Written guidance was provided to all individuals who may be involved in sales seminars – the registered representatives who conduct sales seminars, the branch office manager and other supervisors who review and approve the seminars and sales materials as well as any compliance staff who may also review the sales seminars and materials prior to use. The guidance provided clear explanations of what was permissible and what was not permissible, both in terms of compliance with the securities laws, and compliance with the firm's own policies.

- ❖ Written checklists were used to aid firm employees in reviewing and approving sales seminar advertisements and sales literature to ensure that the materials used complied with regulatory requirements and the firm's policies.

- ❖ One firm's procedures required that supervisors or compliance staff make written edits to proposed sales seminar materials or advertising, and required that this marked-up draft be provided along with a final copy of the materials (showing that the changes had been made) to the reviewing official for the permanent file.

- ❖ Standardized, pre-approved materials and advertisements were used for sales seminars. The firm's procedures required that all marketing materials be created at a central level; individual registered representatives were not involved in creating their own seminar materials or advertisements. Registered representatives also used a standard outline for seminars.

- ❖ Materials for sales seminars were maintained in a centralized location. A complete package of seminar and advertising materials were filed and maintained in one place, including a copy of the request to host the seminar with indications of approval by the branch office manager and any other authorized approving official. The file included the title of the seminar, date, location, speaker, any guest speakers, the company they represent, the date the approval was given and the list of people who were invited to attend the seminar. The file also contained a list of attendees, whether they were a client or prospect, a photocopy of the actual seminar ad that ran in the newspaper, the approved marketing pieces that were distributed at the seminar, approved copies of the slide presentation and any other information given to attendees.

- ❖ Branch managers were expected to attend a percentage of the sales seminars presented by the sales people they supervised.

- ❖ "Mystery shoppers" (who were firm employees) were utilized on a random basis to attend sales seminars and to identify potential disclosure and compliance weaknesses, and report any issues back to the direct supervisors of the seminar hosts.

- ❖ All registered representatives were required to certify to their branch manager each month that they had provided all advertisements, sales literature, and correspondence items used during the month.

General Supervisory Practices

- Procedures explicitly addressed the review and monitoring of communications with clients and prospective clients. For example, monitoring systems were in place to effectively detect problematic communications by registered representatives in e-mail communications.

- The supervising principal actively reviewed correspondence, made frequent inquiries and provided feedback to the employed representative. This involvement appeared to enhance the firm's ability to identify and prevent any sales practice issues that may exist, and also provided supervised persons with individual training and guidance through active supervisory feedback on their communications.

- Annual training programs provided thorough and clear information about compliant and non-compliant practices. Training did not simply recite rule requirements, but included examples that were relevant to the nature of the work performed by the employees being trained.

APPENDIX C

RESOURCES FOR SENIORS

- The SEC provides important information for senior investors including explanations of different products, asset allocation and risk. You can also get information on affinity fraud, "senior specialists" and investment advisers and what to look for to identify and steer clear of potential frauds. http://www.sec.gov/investor/seniors.shtml

- FINRA also provides important information for senior investors. Its website has such items as *Broker Check* – that gives you the ability to look up the history of your investment professional to see if they have prior complaints or problems: http://www.finra.org/InvestorInformation/InvestorProtection/ChecktheBackgroundofYourInvestmentProfessional/index.htm

  FINRA's website also has tools and resources to protect senior investors and help them make informed investment decisions, including "Investor Alerts" that provide timely information on steering clear of investment scams and problems instead of just dealing with their aftermath. Subjects of recent alerts include "*Look Before You Leave: Don't Be Misled by Early Retirement Investment Pitches That Promise Too Much," Annuities and Senior Citizens: Senior Citizens should be Aware of Deceptive Sales Practices when Purchasing Annuities," and "Seniors Beware: What you should know About Life Settlements."* http://www.finra.org/InvestorInformation/InvestorAlerts/index.htm

- The North American Securities Administrators Association (NASAA) also has helpful information available for seniors on its website: http://www.nasaa.org/Investor_Education/Senior_Investor_Resource_Center/

  Resources include: a quick checklist of questions to ask before you invest, 10 tips to protect your nest egg and guidance on where to turn for help.

- Regulators have warned that seniors may be confused by designations that imply some expertise in helping seniors. Information regarding professional designations is available through NASAA's Investor Alert is at www.nasaa.org, the SEC's information on professional designations at http://www.sec.gov/investor/pubs/senior-profdes.htm and NASD's professional designation database found at http://apps.finra.org/DataDirectory/1/prodesignations.aspx.