Regulatory Notice 22-05

Senior Investors

FINRA Adopts Amendments to FINRA Rule 2165

Effective Date: March 17, 2022

Summary

FINRA has adopted amendments to Rule 2165 (Financial Exploitation of Specified Adults) to permit member firms to: (1) place a hold on a securities transaction (in addition to the already-permitted hold on a disbursement of funds or securities) where there is a reasonable belief of financial exploitation; and (2) extend a temporary hold on a disbursement or transaction for an additional 30 business days, beyond the current maximum of 25 business days (for a total of 55 business days), if the member firm has reported the matter to a state regulator or agency, or a court of competent jurisdiction. The amendments to Rule 2165 become effective March 17, 2022.

The 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; or
- Jeanette Wingler, Associate General Counsel, OGC, at (202) 728-8013.

Background and Discussion

Rule 2165

Rule 2165 is the first uniform national standard for placing temporary holds to address suspected financial exploitation.[1] Rule 2165 permits a member firm to place a temporary hold on a disbursement of funds or securities from the account of a "specified adult"[2] customer when the firm reasonably believes that financial exploitation of that adult has occurred, is occurring, has been attempted or will be attempted. The amendments to Rule 2165 permit member firms to place temporary holds on securities transactions as well.[3]

Rule 2165 provides member firms and their associated persons with a safe harbor from FINRA Rules 2010 (Standards of Commercial Honor and Principles of Trade), 2150 (Improper Use of Customers' Securities or Funds; Prohibition Against Guarantees and Sharing in Accounts)

February 15, 2022

Notice Type
- Approval

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

Key Topics
- Customer Accounts
- Financial Exploitation
- Senior Investors
- Temporary Holds

Referenced Rules & Notices
- FINRA Rule 2010
- FINRA Rule 2150
- FINRA Rule 2165
- FINRA Rule 11870
- Regulatory Notice 20-34

and 11870 (Customer Account Transfer Contracts) when member firms exercise discretion in placing temporary holds consistent with the requirements of Rule 2165. FINRA encourages member firms to take advantage of the Rule 2165 safe harbor where there is a reasonable belief of customer financial exploitation.

Since Rule 2165 became effective in 2018, temporary holds have provided member firms a way to quickly respond to suspicions of financial exploitation before potentially ruinous losses occur for the customer. FINRA's report for the five-year anniversary of the FINRA Securities Helpline for Seniors® highlights several matters that illustrate the positive impact of placing temporary holds on disbursements to address financial exploitation.[4] For example, the matters include temporary holds placed by member firms to prevent senior investors from losing:

- $200,000 (representing approximately two-thirds of the investor's account) related to a Central Intelligence Agency lawsuit scam;
- $10,000 in a lottery scam;
- $60,000 in a romance scam; and
- $50,000 to financial exploitation by a brother-in-law.

Rule Safeguards

Rule 2165 also includes important safeguards that apply equally to holds on disbursements and transactions that are designed to ensure that there is not a misapplication of the rule, including the requirements that:

- a member firm must have a reasonable belief that financial exploitation of a specified adult has occurred, is occurring, has been attempted, or will be attempted;
- a member firm provide notification of the hold and the reason for the hold to all parties authorized to transact business on the account (including the customer) and the customer's trusted contact person no later than two business days after the date that the member firm first placed the hold;[5]
- a member firm that places a hold pursuant to the rule immediately initiate an internal review of the facts and circumstances that caused the member to reasonably believe that the financial exploitation of the specified adult has occurred, is occurring, has been attempted, or will be attempted;[6]
- in addition to the general supervisory and recordkeeping requirements of FINRA rules, a member firm relying on Rule 2165 establish and maintain written supervisory procedures reasonably designed to achieve compliance with the specific requirements of the rule, including, but not limited to, procedures related to the identification, escalation and reporting of matters related to the financial exploitation of specified adults;[7]

- any request for a hold be escalated to a supervisor, compliance department or legal department rather than allowing an associated person handling an account to independently place a hold;[8]
- a member firm relying on the rule develop and document training policies or programs reasonably designed to ensure that associated persons comply with the requirements of the rule;[9] and
- a member firm relying on the rule retain records related to compliance with the rule, which shall be readily available to FINRA, upon request.[10]

Retrospective Review

In August 2019, FINRA launched a retrospective review to assess the effectiveness and efficiency of its rules and administrative processes that help protect senior investors from financial exploitation. The review indicated that FINRA's steps to protect seniors have provided helpful and effective tools in the fight against financial exploitation, but it also suggested some additional tools, guidance and rule changes. In October 2020, FINRA published *Regulatory Notice 20-34*: (1) summarizing the retrospective rule review process, including the predominant themes that emerged from retrospective review comment feedback; (2) seeking comment on proposed amendments to Rule 2165 to further address suspected financial exploitation of senior investors and other specified adults; and (3) providing guidance to aid member firms and senior investors and other specified adults.

Amendments to Rule 2165

Transactions in Securities

While placing a hold pursuant to Rule 2165 stops funds or securities from leaving a customer's account, prior to the amendments, the rule did not apply to transactions in securities.[11] Commenters to *Regulatory Notice 20-34* supported extending Rule 2165 to permit a member firm to place a temporary hold on a transaction in securities when the firm has a reasonable belief that the customer is being financially exploited. Even if a temporary hold is placed on a disbursement out of the customer's account, these commenters noted that executing a related transaction may result in significant financial consequences for the customer (*e.g.,* adverse tax consequences, surrender charges, the inability to regain access to a sold investment that has been closed to new investors or trading by a perpetrator in inappropriate high risk or illiquid securities).

While some state laws permit placing holds on transactions,[12] FINRA amended Rule 2165 to create the first uniform national standard for placing holds on securities transactions related to suspected financial exploitation. Under the safe harbor approach, a member firm is permitted, but not required, to place a temporary hold on a transaction when there is a reasonable belief that the customer is being financially exploited.[13]

Hold Period

FINRA recognizes that placing or extending a temporary hold is a serious step for a member and the affected customer. Prior to the amendments, Rule 2165 allowed a member firm to place a temporary hold on a specified adult customer's account for up to 25 business days if the criteria in the rule are satisfied. More specifically, the temporary hold authorized by Rule 2165 would expire not later than 15 business days after the date that the member first placed the temporary hold, unless otherwise terminated or extended by a state regulator or agency or a court of competent jurisdiction (state authority).[14] In addition, provided that the member 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 rule permits the member to extend the temporary hold for an additional 10 business days, unless otherwise terminated or extended by a state authority.[15]

Commenters to *Regulatory Notice 20-34* generally indicated that the period originally provided in Rule 2165 may not be sufficient when a matter is under consideration by a state authority. These commenters supported extending the current 25-business day hold period to provide member firms with a longer period to resolve matters.[16] The costs of financial exploitation can be devastating to customers, particularly older customers who rely on their savings and investments to pay their living expenses and who may not have the ability to offset a significant loss over time. Furthermore, the rule's safeguards are designed to ensure that there is not a misapplication of the rule.

To provide member firms with additional time to resolve matters and for state authorities to conduct thorough investigations, FINRA amended Rule 2165 to permit extending a temporary hold on a disbursement of funds or securities or a transaction in securities for an additional 30 business days if the member firm has reported the matter to a state authority.[17] As a result, member firms would be able to maintain a disbursement or transaction hold up to a maximum of 55 business days where the rule's criteria are satisfied (including the external reporting to a state authority), unless otherwise terminated or extended by a state authority.

In addition, Rule 2165(d) requires members to retain records related to compliance with the rule, which shall be readily available to FINRA, upon request. To evidence compliance with Rule 2165 in placing or extending a temporary hold, a member firm is required to retain records of the reason and support for any extension of a temporary hold, including information regarding any communications with or by a state authority.[18]

Endnotes

1. *See* Securities Exchange Act Release No. 79964 (Feb. 3, 2017), 82 FR 10059 (Feb. 9, 2017) (Notice of Filing of Partial Amendment No. 1 and Order Granting Accelerated Approval of File No. SR-FINRA-2016-039).
2. The definition of "specified adult" in Rule 2165 covers those investors who are particularly susceptible to financial exploitation. A "specified adult" is (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. *See* Rule 2165(a)(1). Supplementary Material .03 to Rule 2165 provides that a member 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 member firm's business relationship with the person.
3. *See* Securities Exchange Act Release No. 94061 (Jan. 25, 2022), 87 FR 4974 (Jan. 31, 2022) (Notice of Order Approving a Proposed Rule Change to Amend Rule 2165 (Financial Exploitation of Specified Adults)).
4. *See* Protecting Senior Investors 2015–2020: An Update on the FINRA Securities Helpline for Seniors, Other FINRA Initiatives and Member Firm Practices (Apr. 2020) (Senior Helpline Anniversary Report).
5. *See* Rule 2165(b)(1)(B). A trusted contact does not have authority to transact business in an account by virtue of being designated as a trusted contact. For a discussion of the role of a trusted contact, *see, e.g.,* Establishing a Trusted Contact.
6. *See* Rule 2165(b)(1)(C).
7. *See* Rule 2165(c)(1).
8. *See* Rule 2165(c)(2).
9. *See* Supplementary Material .02 to Rule 2165.
10. *See* Rule 2165(d).
11. For example, prior to the amendments, Rule 2165 did not apply to a customer's order to sell his shares of a stock. However, if a customer requested that the proceeds of a sale of shares of a stock be disbursed out of his account at the member firm, then the rule could apply to the disbursement of the proceeds where the customer is a "specified adult" and there is reasonable belief of financial exploitation.
12. Currently 22 states (with over half of the U.S. population) have enacted laws permitting investment advisers and broker-dealers to place temporary holds on disbursements and transactions. As of February 2022, the following states permit holds on disbursement and transactions: Arkansas, Arizona, California, Florida, Hawaii, Iowa, Kentucky, Minnesota, Mississippi, Missouri, Nebraska, New Jersey, New Mexico, North Dakota, Ohio, Oklahoma, South Carolina, Texas, Utah, Virginia, Washington and West Virginia.
13. Regarding whether the best execution obligation applies to a member firm's decision to place a temporary hold on a securities transaction where there is a reasonable belief of customer financial exploitation, "[b]roker-dealers are reminded that nothing under the federal securities laws or FINRA rules obligates them to accept an order where they believe that the associated compliance or legal risks are unacceptable." *See* SEC Staff Bulletin: Risks Associated with Omnibus Accounts Transacting in Low-Priced Securities (Nov. 12, 2020).

14. *See* Rule 2165(b)(2). Rule 2165 allows a member firm to extend a temporary hold upon a state authority's request to do so. The state authority would not have to issue a formal order. However, the member firm would need to maintain a record of the state authority's request.

15. *See* Rule 2165(b)(3).

16. For example, according to a comment letter submitted by National Adult Protective Services Association (NAPSA), representing adult protective services programs that play a critical role in investigating suspicions of financial exploitation, the average duration of an investigation for matters reported to the federal National Adult Maltreatment Reporting System is 52.6 days.

17. The 30-business day hold period in Rule 2165(b)(4) is in addition to the 15-business day hold in Rule 2165(b)(2) and the 10-business day hold in Rule 2165(b)(3). Rule 2165 permits maintaining a hold or extending the hold only if the member firm's internal review of the facts and circumstances supports the firm's reasonable belief that financial exploitation of the specified adult has occurred, is occurring, has been attempted, or will be attempted.

18. *See* Rule 2165(d)(6).