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Via email to pubcom@finra.org

Jennifer Piorko Mitchell
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

RE: Proposed Amendments to FINRA Rule 2165 and Retrospective Rule Review Report

Dear Ms. Mitchell:

The University of Pittsburgh Securities Arbitration Clinic (the "Clinic") once again appreciates the opportunity to comment on the Financial Industry Regulatory Authority's ("FINRA") retrospective rule review on issues relating to senior investors. The Clinic, a University of Pittsburgh curricular offering, provides legal representation to investors who have limited resources, often advocating for clients whose claims represent much of their life savings. The Clinic provides the following commentary on the proposed amendments to Rule 2165, specifically the increased holding extension period and the inclusion of transactions in securities.

In a comment letter dated October 8, 2019 regarding FINRA's request for retrospective review on Rule 2165, the Clinic expressed concern about protections for senior and vulnerable investors from their own broker-dealer or member firms. In the comment letter, the Clinic highlighted significant issues regarding the subjective control a firm has when determining whether a customer has a valid impairment, and the increase in potential abuse by brokers towards senior investors. For similar reasons and for further reasons established in this comment letter, the Clinic opposes extending Rule 2165 to transactions in securities for customers with the aforementioned impairments. Similarly, the Clinic also opposes the proposed increase in the safe harbor period. While we acknowledge that an adequate period for review of the facts and circumstances must be allowed, the increase to fifty-five (55) business days is excessive.

Opposition to the Assessment Phase Survey

In order to assess the effectiveness of a particular rule, FINRA will often seek commentary on their notices, obtain input from advisory committees, as well as distribute anonymous surveys to member firms. The purpose of these anonymous surveys is to validate the feedback FINRA has already received, as well as to create an opportunity for member firms to provide their views. During the first quarter of 2020, FINRA developed and circulated an anonymous survey to its member firms to receive input on the effectiveness of Rule 2165. In total, two hundred thirty-eight (238) firms responded out of the three thousand five-hundred and sixteen (3,516) firms that fall under FINRA.

The Clinic has a number of issues with relying on the responses to this survey to rule on the effectiveness of Rule 2165 and whether or not the proposed amendments should be implemented. First, the population pool of the survey is biased. The respondents to the survey are all member firms that stand to benefit from an increase to the extension of the holding period of a customer's account as well as the rule's safe harbor provisions. Second, the questions are highly conclusory—member firms provided responses to the questions asked without being required to provide any information to support their claims. Third, the survey was provided to 3,516 member firms, of which only 238 member firms responded—only 6.769% of all member firms. This is an inadequate and unrepresentative sample size of member firms to evaluate industry standards and gauge the impact of Rule 2165. There has been no attempt to investigate the economic harms caused by holds on disbursements or transactions to clients, the ratio of legitimate to illegitimate holds, average length of time to resolve a hold, or the overall amount in dispute. Without such data, and with such a small and biased sample size of member firm survey respondents, this survey should not be relied upon to draw any legitimate conclusions about the effectiveness of Rule 2165 and its proposed amendments.

Safe Harbor Provision & Potential Harms by Member Firms

Rule 2165 provides member firms with a safe harbor from FINRA Rules 2010, 2150, and 11870 when member firms exercise discretion in placing temporary holds on disbursements of funds or securities from the accounts of specified adults consistent with the requirements of Rule 2165. Under Rule 2165's safe harbor approach, a firm would be permitted, but not required, to place a temporary hold on a client's account when there is a reasonable belief that the customer is being financially exploited. Neither the current Rule 2165—nor the proposed amendments to the rule—provides a safeguard that would prohibit member firms from taking advantage of a client by placing a hold on an account to financially benefit themselves.

First, there is no built-in mechanism to enable clients a means for recovery if a hold is placed on their account and they suffer harm as a result of this hold. Customers may incur costs from the extended delay, the value of their account could decrease over time, and they would lose access to their freedom of financial disposition by not being able to withdraw the balance of their account when they so desire. There are also a number of situations where a customer's account could be placed on a hold due to a member firm misidentifying financial exploitation, negligence on the behalf of a member firm, or there could be an unreasonable extension of the hold due to substandard internal compliance procedures.

Additionally, elderly Americans face an almost equal amount of risk of being financially exploited by strangers—such as member firms—than as by their friends or family.[1] Member firms are in a unique position to perpetrate financial exploitation of elderly and vulnerable individuals. There is the potential for an illegitimate hold to be placed on an elderly or vulnerable customer's account in order for the member firm to financially benefit themselves. A member firm could place a hold in order to report higher quarterly earnings, to prevent a vulnerable or elderly customer from leaving their firm and taking their money elsewhere, or to simply continue to earn maintenance fees when a customer is considering leaving. This is a non-exhaustive list of possibilities. There are many other unfortunate reasons why a member firm could potentially undertake such illegitimate holds in order to financially benefit themselves.

In Rule 2165's current form, in order for a member firm to place a temporary hold on an elderly or vulnerable customer's account there must be an internal review mechanism in place. The member firm placing the hold on the account is required to conduct an internal review of the facts and circumstances that led to the hold being placed on the account in the first place. There is no external reporting requirement, such as to an outside state agency or a court of competency, for either the initial holding period or for an extension of this holding period. The proposed amendments to Rule 2165 contemplate the addition of another potential thirty (30) day holding period. This would add a requirement for a member firm to notify an outside state agency or a court of competency of their hold on the customer's account, but at this point up to twenty-five (25) business days could have passed with no external reporting requirement. This is an incredibly

[1] MetLife, The MetLife Study of Elder Financial Abuse 3, 7 (2011) ("Cases involving strangers as the perpetrators comprised 51% of the articles.").

long period of time, and one in which financial exploitation of the vulnerable customer by the member firm could have already taken place. It is also in contrast to parallel state regulations that have been passed to prevent the financial exploitation of these vulnerable individuals. The majority of these state regulations require member firms to report a hold—and their internal review of the facts and circumstances leading to it—to an outside state regulatory agency or a court of competency prior to receiving any extension of this initial holding period.[2] The proposed amendments to Rule 2165 far exceed any current state regulation that has been enacted, and they do nothing to further protect vulnerable and elderly investors from financial exploitation by member firms.

Without an external reporting requirement until twenty-five (25) business days have already passed, there is no failsafe if an illegitimate hold is placed on an account by a member firm. This means that if an elderly or vulnerable customer is being financially exploited by a member firm, it would be the member firm itself that would be responsible for reviewing the facts and circumstances of the financial exploitation—this is an incredibly problematic standard that does not account for such exploitation of customers by member firms themselves. Even if a hold is legitimate and there are facts and circumstances that support this hold, there is still no outside organization that is being notified of this process and which can monitor the speed, thoroughness, and overall effectiveness of the review process.

Increased Holding Extension Period

FINRA Rule 2165(b) currently allows a member to place a temporary hold on the disbursement of funds and securities from the account of a specified adult if certain conditions are

[2] *See generally* states that have enacted such protections, a list of which is available at https://www.nasaa.org/industry-resources/senior-issues/model-act-to-protect-vulnerable-adults-from-financial-exploitation/.

met. First, the member firm must reasonably believe that financial exploitation has occurred, is occurring, has been attempted, or will be attempted. Secondly, they must inform all parties authorized to transact on the account/the trusted contact person within two (2) business days. Finally, they must initiate an internal review of the facts and circumstances leading to the hold on the disbursement of funds and securities. This initial holding period may last for up to fifteen (15) business days so that the member may conduct the internal review of the facts and circumstances that led them to believe financial exploitation of the individual was taking place. Unlike many of the similar protective statutes enacted by state legislatures, this initial hold does not need to be confirmed by an outside organization or reported to an outside agency.[3]

This rule also allows the initial holding period of fifteen (15) business days to be extended for ten (10) additional business days for further internal review—with no outside approval necessary—if the member firm determines that their belief is reasonably supported. This is a very low bar for a member to meet, especially due to the fact that this review of the facts and circumstances is conducted internally within the member firm rather than by an outside regulatory agency or watchdog organization. This proposed amendment to Rule 2165, in addition to the proposed changes outlined elsewhere in this Comment, purports to increase the extension on the holding period even further. The proposed changes would maintain the initial ten (10) business day extension, but it would also allow another thirty (30) business day extension under the newly proposed Rule 2165(b)(4). This change is unwarranted, excessive, and could lead to financial harm for vulnerable investors who may be financially taken advantage of or exploited by members.

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[3] *See generally* states that have enacted such protections, a list of which is available at https://www.nasaa.org/industry-resources/senior-issues/model-act-to-protect-vulnerable-adults-from-financial-exploitation/.

The proposed addition to Rule 2165(b) would allow members to have up to fifty-five (55) business days to hold the disbursement of funds and securities from the account of a specified adult if they have a reasonable belief that financial exploitation has occurred and they report it to a state agency or a court of competency. Fifty-five (55) business days is at least eleven (11) weeks that a member could hold the disbursement of funds for these individuals. This means that for up to eleven (11) weeks, a member would be unable to access the money that is rightfully theirs, and upon which they may depend. Many senior and vulnerable investors place their money into relatively safe and stable investments because they rely upon the consistent and steady disbursement of funds. However, in addition to using these disbursements for daily living costs, many of these vulnerable individuals count on the ability to have a sum of money that they are able to withdraw and have disbursed to them in the case of an emergency, unexpected health scares, or unanticipated and large costs. For many individuals, not having the ability to access these funds being held for them by a member for up to eleven (11) weeks could have a potentially life-changing negative impact.

Pursuant to FINRA Rule 2090 members have a duty to know—and retain—the essential facts about every one of their clients so that they can effectively service the customer's account. Members should have a general awareness about what is occurring in their customers' lives, as well as how their customers normally behave, what their risk tolerance is, whether they would be at risk for unexpected medical/other expenses, etc. If they are following the mandates of Rule 2090 to know their customers, members should not need fifty-five (55) business days to determine whether or not there is financial exploitation taking place. If financial exploitation of these customers—who are traditionally at higher risk of such exploitation—is taking place, a member should be able to identify it, and take steps to prevent or rectify it much sooner than fifty-five (55) business days. Additionally, elderly Americans in particular face an almost equal amount of risk of being financially exploited by strangers—such as stock brokers, dealers, or investment advisors—than as by their friends/family.[4] Thus, by allowing members to have up to fifty-five (55) business days to conduct this internal review—which does not have an outside reporting requirement or oversight by an agency—if financial exploitation is being done by the member it will be even harder to detect or prevent.

Finally, this proposed amendment to Rule 2165 is far in excess of any state statutes that have been enacted to protect vulnerable adults from financial exploitation. We conducted a survey of 28 states where the legislatures have promulgated such protections, based largely on the North American Securities Administrators Association (NASAA)'s Model Act.[5] When the average total holding period of the disbursement of funds was taken, including the original hold and any potential extension, it came out to 24.82 business days. Currently, Rule 2165 allows for a potential total of twenty-five (25) business days with the original hold and the extension. This proposed change would more than double the current FINRA-allowed hold on disbursement of funds or securities, and it would also more than double the average total holding period of all states that have statutorily enacted such financial exploitation protections. While we acknowledge that an adequate period for review of the facts and circumstances must be allowed, fifty-five (55) business days is simply excessive and increases the chances that a vulnerable individual could be financially exploited by a member.

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[4] MetLife, The MetLife Study of Elder Financial Abuse 3, 7 (2011) ("Cases involving strangers as the perpetrators comprised 51% of the articles.").

[5] NASAA, *NASAA Model Legislation or Regulation to Protect Vulnerable Adults from Financial Exploitation* (2016). *See generally* states that have enacted such protections, a list of which is available at https://www.nasaa.org/industry-resources/senior-issues/model-act-to-protect-vulnerable-adults-from-financial-exploitation/.

Transactions in Securities

The proposed amendments to Rule 2165 permit a member firm to place a temporary hold on a transaction in securities when the firm has a reasonable belief that a client is being financially exploited. The expansion of Rule 2165 drastically increases the control a member firm can exercise over a client's account, with relatively little oversight. As previously noted, the reasonable belief standard for implementing a hold is a very low bar for a member to meet, especially because this review of the facts and circumstances is conducted internally within the member firm rather than by an outside regulatory agency or watchdog organization.

Next, the proposed changes allow a cumulative amount of fifty-five (55) business days to hold the client's transactions. This is an excessive amount of time to resolve the issue. As previously noted, the average length of holds for states that adopted the NASAA Model Act was 24.82 business days.[6] Furthermore, most states required an outside court or agency to initiate the extension. While the proposed changes to FINRA Rule 2165 would allow the thirty (30) day extension "if the member firm had reported the matter to a state agency or a court of competent jurisdiction," this is still a major deviation from states' requirements of agency or court involvement before extending the hold past the initial fifteen (15) business days.

FINRA Rule 2090 provides that members have a duty to know—and retain—the essential facts about every one of their clients so that they can effectively service the customer's account. If members are adhering to Rule 2090's mandates, then twenty-five (25) business days is enough to determine on the facts whether financial exploitation is taking place. Markets can be extremely volatile—a client may suffer severe impact to their account(s) during the eleven (11) week hold. This severe impact on the value of an account could be completely unanticipated, such as what

[6] *Id.*

happened to the financial market when the Covid-19 pandemic first struck the world and the market drastically changed. In such a situation, if a hold were placed on an account—whether legitimate or not—a customer would suffer severe financial loss if they were unable to withdraw their funds immediately or a hold was placed on any transactions.

While the member firms and associated persons are provided safe harbor for the hold, the client would be left without recourse for any losses. If a hold was placed on a lucrative transaction, the window of time to "buy low" will have already passed. Ultimately, the rule provides too much deference to members without adequate protections to clients and erodes the client's freedom of financial disposition.

Finally, the proposed rule amendments fail to provide any real protections to elderly and vulnerable investors. The safe harbor approach does not require members to place a hold on an account, nor does it have any meaningful reporting requirements. The client is left with neither true protection from exploitation nor recourse for losses suffered. As previously noted, the majority of states mandate reporting to an outside state regulatory agency or a court of competency prior to an extension being granted on the hold of a customer's account. In addition, only sixteen (16) states permit member firms to place temporary holds on transactions in securities. The proposed amendments to Rule 2165 go far beyond what any state has currently enacted. These proposed amendments displace the risk onto the customer while the member firm retains no risk; rather, the member firms should be required to report legitimate instances of financial exploitation within the initial holding period or be held accountable for failure to know the client. By placing the responsibility onto the firm, it would incentivize more timely compliance and remove the risk of economic harm from the client. Because of these reasons, Rule 2165 should not be amended to include transactions.

Conclusion

The Clinic opposes the proposed amendments to Rule 2165. The goal of FINRA in creating the amendments was to combat the serious problems of financial exploitation of seniors and other vulnerable adults. The Clinic shares such concerns. However, a longer holding period provides too much discretion to member firms who are motivated by pecuniary gain and does not provide any greater protections to—or a cause of action for—investors whose funds are held in error. For similar reasons as the above, Rule 2165 should not be extended to encompass transactions in securities due to the potential negative economic impact it could have on vulnerable investors.

Respectfully Submitted,

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