FINANCIAL PROFESSIONALS WITH DIMINISHED CAPACITY

NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION

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NASAA

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Introduction

The North America Securities Administrators Association (NASAA) established a working group within the Senior Issues/Diminished Capacity Committee to research the issues of diminished capacity and cognitive impairment that affect financial professionals. The goals of the working group were to understand the scope of the concerns presented by financial professionals with diminished capacity, understand impediments to addressing the challenges of financial professionals with diminished capacity, and to provide guidance and identify possible tools and resources to the industry. To this end, the working group initiated dialogues with broker-dealers, investment advisers, and compliance consultants of various sizes. The working group was interested in learning how the industry copes with all forms of diminished capacity and how cognitive impairment impacts financial professionals.

Industry members identified several types of cognitive impairment, including accidents and traumatic injury; side effects and reactions to medications; a medical diagnosis unrelated to dementia; drug and alcohol addiction; as well as the many types of dementia. Industry members reported that diminished capacity may be temporary or a long-term condition and could occur at all ages.

The methods and resources used to address situations where financial professionals exhibited signs of cognitive impairment varied by firm size and structure. In consideration of these conversations, the working group is publishing this paper summarizing how the firms are managing these sensitive situations by addressing this issue through communication, education, and succession planning.

QUESTIONS PRESENTED

The working group was interesting in understanding:

- How firms identify representatives with a suspected cognitive impairment;

- Challenges firms experience that prevent firms from addressing employees exhibiting symptoms of cognitive impairment or diminished capacity;

- Practices or tools the firms use to address financial professionals with cognitive impairment or diminished capacity; and

- What role, if any, securities regulators may have in assisting firms with addressing financial professionals with cognitive impairment or diminished capacity.

Compliance Issues

The ability to make financially sound decisions is one of the first abilities to decline with cognitive impairment.[1] This is especially concerning when the person who is experiencing the cognitive decline is entrusted to provide financial services and advice to others.

Financial professionals experiencing diminished capacity raises complex issues regarding providing effective service to the client and compliance with their duties under the securities laws.

Some of the issues are:

- **Standards of Conduct.** How are financial professionals taking the necessary steps to comply with the applicable standard of care governing the client relationship? Are financial professionals conducting due diligence before making recommendations? Are financial professionals able to discern potential conflicts of interest? How are these conflicts resolved?
- **Continuing education and training.** Are financial professionals able to satisfactorily complete continuing education requirements and training?
- **Client data, books, and records.** Are financial professionals able to keep client information physically secure? Are they more susceptible to cybersecurity threats? Are they accurately maintaining required records?
- **Fraud.** Are financial professionals more likely to be victims of fraudulent schemes, which may then be sold to clients?
- **Supervision.** How are they supervised differently in light of potential diminished capacity? If they are responsible for supervision, how are they able to effectively supervise others?
- **Trades and service to clients.** Are trades being effected accurately and timely? Are trades being properly discussed with clients?

[1] https://pubmed.ncbi.nlm.nih.gov/19770468/ (showing that declining financial skills are detectable in the year before a person's mild cognitive impairment converts to Alzheimer's). See also https://www.aarp.org/content/dam/aarp/research/public_policy_institute/cons_prot/2011/rr2011-04.pdf (according to AARP's survey results, most financial professionals reported that diminished capacity in their clients is a problem for them or their firms).

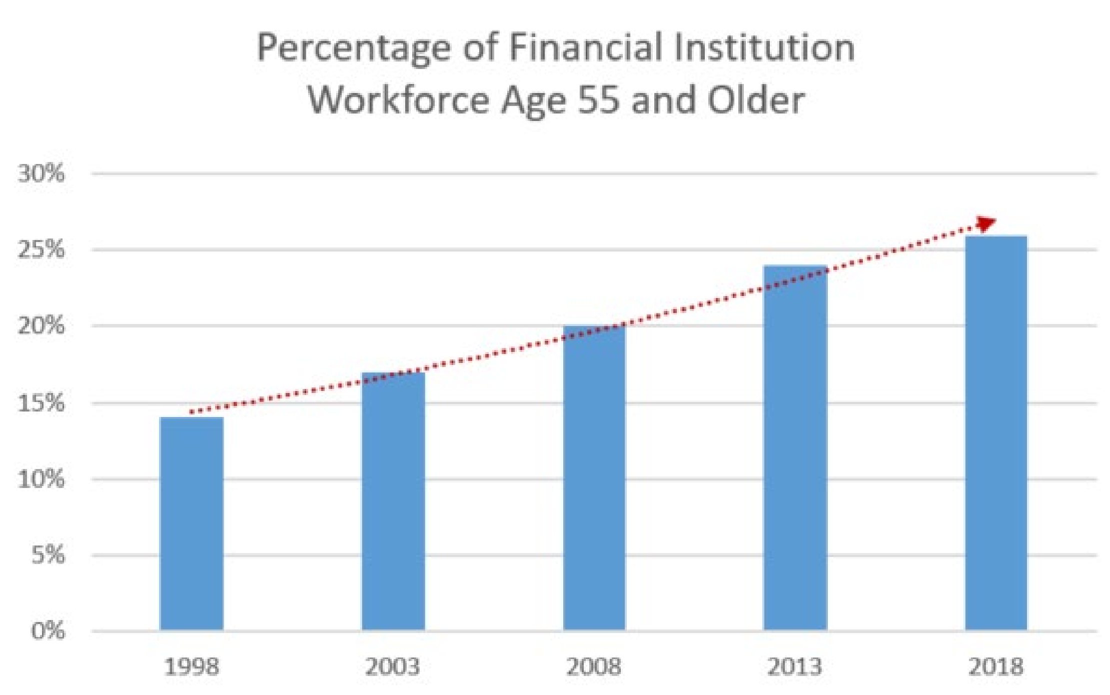
- **Disclosures.** Are clients receiving accurate and sufficient disclosures about products? Are financial professionals able to adequately describe the benefits and risks of products to clients?
- **Client harm.** Are clients experiencing financial losses due to the diminished capacity or cognitive impairment?

While discussions with industry members frequently identified employment law and discrimination concerns, several firms did not view the issue in terms of compliance with securities laws.

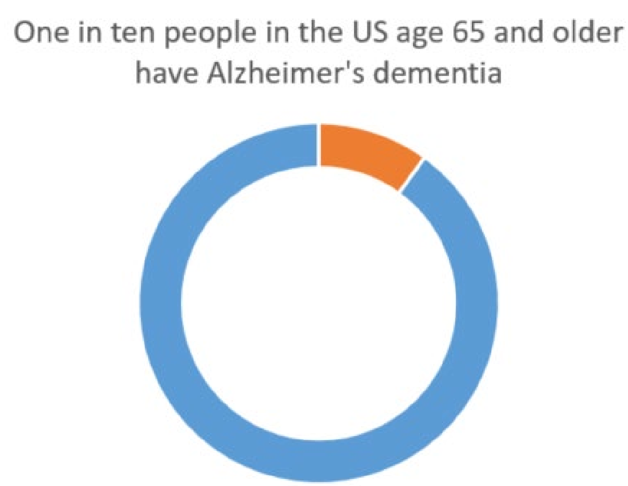
SCOPE OF THE PROBLEM

At this time, the working group is unable to determine how many financial professionals are currently operating with some level of diminished capacity or cognitive impairment. The financial industry is an aging industry. Approximately 26% of the securities, commodities, and financial services sales agents are age 55 and older.[2] Recent studies show that an estimated 5.8 million Americans are living with Alzheimer's, 11.6 million have mild cognitive impairment, and 38.4 million have elevated levels of beta-amyloid, a protein fragment associated with Alzheimer's.[3] These numbers are expected to rise, and by no means are financial professionals immune.

[2] https://www2.deloitte.com/insights/us/en/industry/financial-services/aging-workforces-baby-boomers-financial-services.html
[3] https://www.alz.org/alzheimers-dementia/facts-figures (pages 17-18)

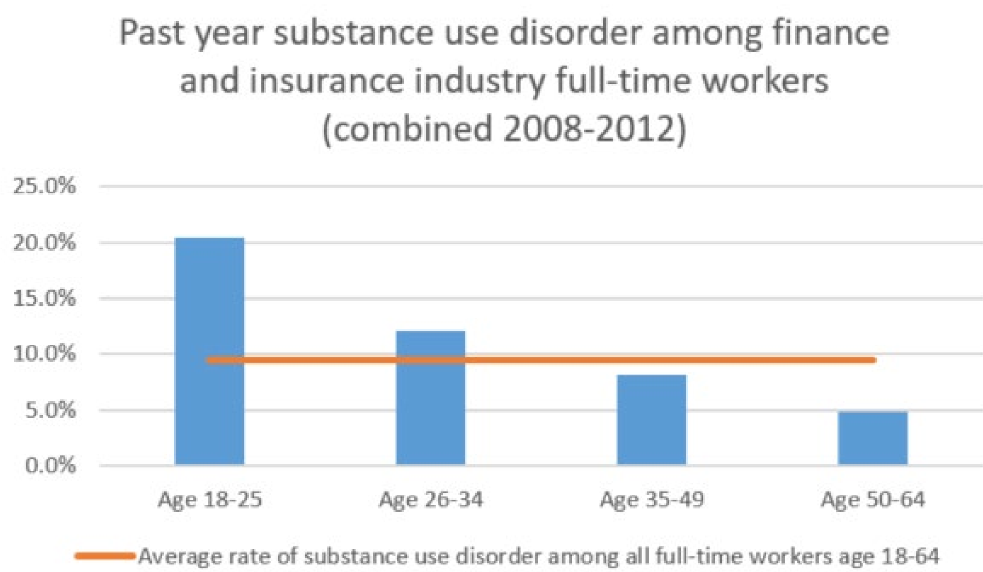


Source: Deloitte Insights, Tapping into the aging workforce in financial institutions

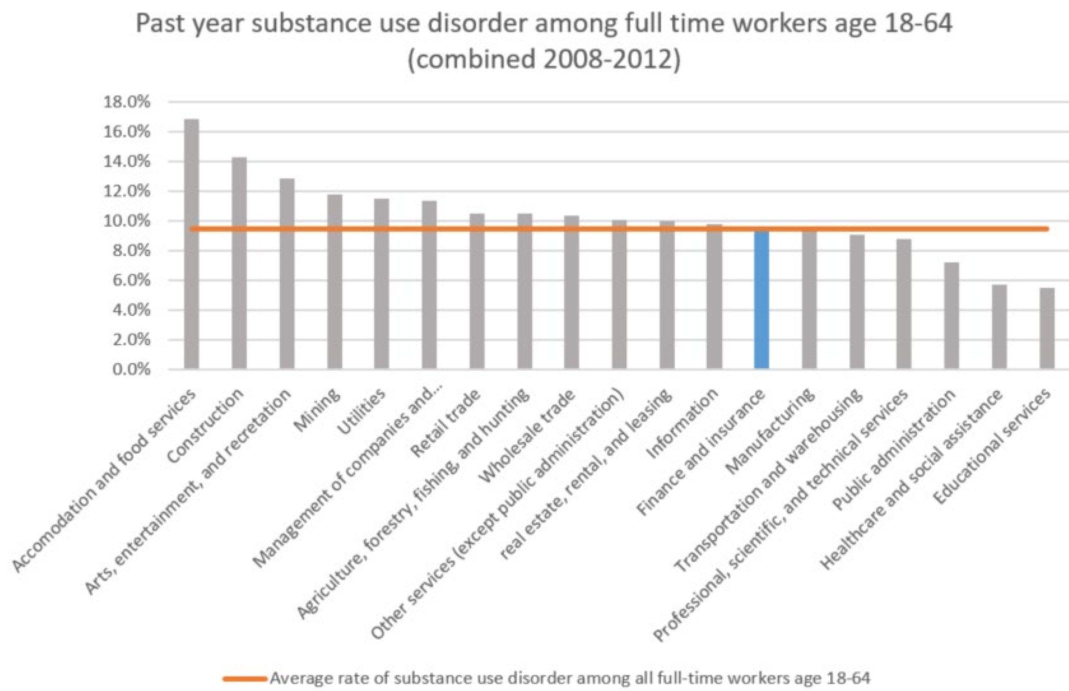


Source: Alzheimer's Association, 2019 Alzheimer's Disease Facts and Figures, https://www.alz.org/media/documents/alzheimers-facts-and-figures-2019-r.pdf

Industry members stressed that diminished capacity and cognitive impairment could be caused by a variety of factors other than age. In particular, industry members cited alcohol and drug abuse as a cause of cognitive impairment. It is unclear how many financial professionals may be operating with some other form of cognitive impairment. Although workers in the finance and insurance industry had slightly lower than average substance abuse issues compared to all workers (9.4% for finance and industry compared to 9.5% for all full time workers), younger workers in the finance and insurance industry had a higher than average rate of substance abuse.



Source: Substance Abuse and Mental Health Services Administration, Substance Use and Substance Use Disorder by Industry (https://www.samhsa.gov/data/report/substance-use-and-substance-use-disorder-industry)



Source: Substance Abuse and Mental Health Services Administration, Substance Use and Substance Use Disorder by Industry (https://www.samhsa.gov/data/report/substance-use-and-substance-use-disorder-industry)

The working group believes that financial professionals would experience similar levels of diminished capacity or cognitive impairment as the general population. Discussions with industry and NASAA members clearly indicated that firms and regulators are currently seeing financial professionals with diminished capacity.

CHALLENGES FOR FIRMS

Firms identified many challenges to addressing representatives with cognitive impairment, which included legal issues, human resource issues, and U5 disclosure issues.

The legal issues include discrimination, medical privacy issues, and unlawful termination lawsuits, which can place the firms, as well as individual managers, at risk of civil actions due to resistance from the representative in question. Industry members frequently stated concerns about potential litigation and compliance with anti-discrimination laws, including the Age Discrimination Act of 1967, the Americans with Disabilities Act of 1990, and other employment laws. Some firms raised concerns about whether they would be required to provide accommodations to persons with age-based cognitive decline. Due to these concerns, firms were reluctant to establish policies based on age. Firms stressed that decisions to terminate a financial professional were necessarily based on the ability of the person to perform the duties of employment or contract. Cognitive impairment by definition implies that the person is not capable of understanding or realizing that their mental capacity is declining. Observations made by those working alongside the person are valuable; however a true diagnosis can only be determined by medical and neuro-psychologist professionals.

Firms were unclear on their obligations to maintain the privacy of medical information disclosed to them. Although firms as employers are not subject to the same privacy requirements as medical providers,[4] firms were concerned about what could be disclosed to third parties, such as family members, clients, and co-workers.

Firms expressed concern over disclosures to put on a representative's Form U5 when terminating due to the exhibition of symptoms of cognitive impairment and diminished capacity particularly where the firm does not have confirmation of a medical diagnosis or a finding of incapacity. Firms balance investor protection, duty of candor, and concerns over inviting a slander suit.

In regard to the human resource issues, firms indicated that they must carefully balance being respectful to representatives and investor protection. Firms also stated that frequently the representative may be in denial that there is an issue or may realize there is an issue but be unwilling to acknowledge it. There were many reasons given for a representative who may be in denial. The representative may be afraid of stigma should they admit an issue. The representative may be the primary income earner of the family and not in a position to lose his/her income. Some industry members identified that a person experiencing cognitive issues may have good days and bad days, which may make it difficult to identify and address concerns. Additionally, while firms recognized the potential for client harm, they want to be respectful of representatives and the business built throughout their career.

Firms also indicated that it may be difficult to identify a capacity issue due to persons surrounding the financial professional. Persons within the office or a family member may try to hide or otherwise cover for problematic behavior. This may be due to a desire to maintain income for an office or family, denial, or a desire to maintain the reputation of the financial professional.

Discussions with industry members highlighted challenges particular to firms with smaller or more remote offices. Firms often learn of concerns due to reports from coworkers that had day-to-day interactions with the financial professional, who were able to notice red flags of a cognitive impairment and make a report to supervisors. Persons in smaller or

[4] See 45 C.F.R. §§ 160.103 and 164.512(b)(1)(v). See also https://www.hhs.gov/hipaa/for-individuals/employers-health-information-workplace/index.html

more remote offices were less likely to have similar day-to-day contact to be able to identify concerning behavior or to make such reports to supervisors for additional action. Solo practitioners appeared to be at the greatest risk, where their most frequent compliance contact would come from a state or federal regulatory agency.

HOW FIRMS LEARNED OF PROBLEMS, SPECIAL TOOLS USED, RED FLAGS

There were three major ways firms identified that representatives were experiencing diminished capacity: electronic surveillance, client complaints, and observation by firm staff. Firms were able to detect issues with diminished capacity by electronic monitoring and error reports. Firms electronically monitored representatives by monitoring call logs and trade corrections in comparison to a peer group. Firms also used internal data analysis to identify trends of the financial professional and compare his/her behavior with those in their peer group.

In some instances, firms were made aware of representatives with diminished capacity through communications with clients. Client complaints were sometimes a source, but not often cited. In particular, long-term clients notified firms of concerning changes in their representative's behavior. Many firms reported that clients were not a reliable source possibly due to clients not wanting to upset long-term relationships with representatives. In several cases, firms stated that clients were just as likely to change representatives without notifying the firm of concerns as they were to notify the firm of potential issues. In those cases, it was usually after a financial loss to the client that the firm was notified.

Several firms stated that its own compliance staff, assistants, and other employees have identified circumstances in which representatives were experiencing diminished capacity. Issues were identified during compliance examinations, and by co-workers such as branch managers, supervisors, and support and administrative staff. Firms may also be alerted by family members of the financial professional. Firms often indicated that staff were able to observe changes in behavior due to frequent, day-to-day contact with the financial professional.

Firms felt that much of the training on elder financial abuse of clients, especially portions of the training relating to the identification of red flags of diminished capacity and financial abuse, were equally relevant to identifying financial professionals with diminished capacity. For example, a typical red flag for diminished capacity is forgetfulness and confusion. This may manifest itself as forgetting regularly scheduled meetings, frequent requests to reset passwords, and frequent transaction errors. Another sign was an inability to assemble necessary documents for an in-house audit. Other red flags included reports from a supervisor or coworker who noticed concerning behavior or other firm staff who noted that the representative was unusually aggressive or showed up to work disheveled.

Firms indicated that continuing education was a tool to identify possible capacity issues. Persons with diminished capacity or cognitive impairment may be unable to complete required continuing education, which may become grounds for termination. Firms also noted that prior to the implementation of online continuing education, the inability of a person to complete continuing education within the required time period would provide an additional indication of diminished capacity or cognitive impairment. It was noted during discussions with industry members that this tool would not be available to investment adviser representatives as they do not have a continuing education requirement.

TOOLS AND PRACTICES FIRMS USE TO ADDRESS SITUATIONS WHERE FINANICAL PROFESSIONALS SHOW SIGNS OF COGNITIVE IMPAIRMENT

Each firm approached issues related to diminished capacity differently. Firm size, structure, and resources played a role in how firms addressed the issue. Some firms approached the issue through its human resources department while other firms had a holistic team response. However, firms of various sizes and business models repeatedly identified three common tools used to address situations where a representative was exhibiting signs of cognitive impairment or diminished capacity: communication, education and training, and succession planning. Firms reported that best outcomes occurred when firms had a formal plan to address such a situation.

The first step most firms took was to communicate with the representative about what had been observed and provide the representative an opportunity to respond. The communications focused on the behavior without labeling it. Only in some cases did the representative disclose that there was a known issue. In the reported cases, the firm encouraged the representative to either temporarily or permanently transition clients to other representatives. The firms relayed stories of supporting the representative by honoring the representative's desire when they wanted to maintain privacy throughout the transition. In instances where the cognitive impairment was due to illness or medications, some firms provided accommodations to address the impairment.

The firms also discussed more difficult situations where the representative denied there was any issue. In some situations the representative was supported by an assistant or family member who covered for the representative. In these cases, the firm responses varied greatly. Some firms assigned a compliance staff to be present at the branch at all times. In one situation, the firm identified cognitive issues due to depression through electronic surveillance and call logs. When the representative denied there was a potential for client harm, the firm suspended the representative from the firm for six months.

Firms identified the senior investor financial exploitation training provided to its compliance and supervisory staff as being helpful to identify and resolve situations where a representative is exhibiting signs of diminished capacity or cognitive impairment. Some of the third-party resources identified by firms include those published by the individual states, NASAA[5], SIFMA[6], and Financial Services Institute (FSI)[7]. The working group noted that the websites of these organizations contain information on protecting seniors from financial exploitation, but do not expressly address cognitive impairment or diminished capacity of financial professionals.

Firms used succession planning to address situations. Several firms stated that they emphasize succession planning for all representatives, no matter the age or life stage as cognitive impairment or diminished capacity can occur at any age; however, none of the firms reported that succession planning was required for all financial professionals. It may be a result of an accident, medication, life changes or health conditions. Two benefits of succession planning are (1) providing representatives, even those just starting out in the industry with peace of mind for later years; and (2) providing representatives with the ability and comfort of choosing who will take over and care for their clients should an issue arise.

CONCLUSION

Addressing financial professionals with cognitive impairment or diminished capacity requires sensitivity and respectfulness. Each situation will present differently and firms will have varying resources to address these concerns. However, through communication, succession planning, and education and training firms can support representatives to transition out of the business while protecting investors.

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[5] Senior$afe™ was created in Maine for use by banks and credit unions in order to increase identification and reporting of suspected cases of elder financial exploitation. NASAA has collaborated with the Maine Council for Elder Abuse Prevention to retool Senior$afe so that it is available not only for banks and credit unions but also for broker-dealers and investment advisers. See: https://www.nasaa.org/industry-resources/senior-issues/seniorafe-training/.

[6] The SIFMA Senior Investor Protection Resource Center: https://www.sifma.org/explore-issues/senior-investors/. Last viewed 12/26/19.

[7] The FSI Elder Abuse webpage: https://financialservices.org/elderabuse/. Last viewed 12/26/19.

Discussions with industry members and other regulators clearly indicates that firms are encountering financial professionals with diminished capacity or cognitive issues. Those contacted throughout the industry believe there are roles for regulators to play in identifying the problem and setting guidelines and goals on how to address it. A major part of the solution to this growing issue is to raise awareness with firms about resources that are available, encouraging firms to implement succession plans and offer retirement tools that can be used throughout a representative's career so there will not be the need for uncomfortable confrontations.

The working group has identified the following items for firms to consider:

- **Risk assessment.** Consider whether there are factors particular to the firm's business structure and size that may make identifying diminished capacity or cognitive issues more difficult. Smaller offices or remote branches may have additional challenges identifying diminished capacity and cognitive issues.
- **Supervision.** Consider whether staff know how and to whom they should report concerns of suspected diminished capacity. Consider developing policies to follow up on red flags. Consider the use of error reports and other electronic surveillance to detect red flags. Consider whether additional supervision or heightened supervision is appropriate.
- **Training.** Consider whether appropriate staff are trained to recognize the red flags of diminished capacity and cognitive impairment, including supervisors, management, and support staff.
- **Succession planning.** Consider encouraging, or even requiring, all financial professionals to establish a succession plan regardless of age.

The working group recommends further study to determine if other considerations or actions would be appropriate.