

FINRA's expansion of safeguards to prevent the financial exploitation of specified adults in Rule 2165

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FINRA has continued its efforts to expand protections for "specified adults" by amending its Rule 2165.¹ Prior to the amendments, FINRA Rule 2165 allowed FINRA member firms to place temporary holds on disbursements of funds and securities in situations involving the financial exploitation of those individuals.

Rule 2165 encourages, but does not require, member firms to place a temporary hold on the account of a "specified adult" customer if the firm reasonably believes that "financial exploitation" has occurred.

With the amendments (which went effective on March 17, 2022), FINRA has indicated that it has created the first uniform national standard for placing temporary holds on securities transactions in the accounts of these customers in such situations, while also increasing the permitted duration of temporary holds on transactions and disbursements, as discussed more fully below.

Notably, while Rule 2165 does not impose a requirement to place temporary holds in financial exploitation scenarios, it does provide member firms and their associated persons with a safe harbor from certain FINRA rules if such holds are placed in accordance with Rule 2165.

Rule 2165

In 2017, FINRA implemented Rule 2165 to help member firms respond to and combat the "serious and growing problem" of the financial exploitation of specified adult customers.² Rule 2165 encourages, but does not require, member firms to place a temporary hold on the account of a "specified adult" customer if the firm reasonably believes that "financial exploitation" has occurred, is occurring, has been attempted or will be attempted.

FINRA Rule 2165(a)(1) defines a "specified adult" as: (1) a natural person age 65 and older; or (2) a natural person age 18 and older who the member reasonably believes, based on the facts and

circumstances observed in the member's business relationship with the person, has a mental or physical impairment that renders the individual unable to protect his or her own interests.

A "reasonable belief that a natural person age 18 or 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 natural person."

Notably, contrary evidence of the person's inability to protect their interests in making such a determination (for example, as covered in a court order) may not be ignored as part of this assessment.³

FINRA Rule 2165(a)(4) defines "Financial exploitation" to mean: (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.

A member firm may place temporary holds if the following safeguard requirements of Rule 2165 are met:

Reasonable Belief of Financial Exploitation. 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.

Notification. No later than two business days after the temporary hold is placed, the member firm notifies the customer's trusted contact and all parties authorized to transact business on the account, including the customer, of that hold.⁴

If the firm reasonably believes that the trusted contact person or party authorized to transact business on the account is unavailable or is (or will be) engaged in the financial exploitation, the firm need not provide notification of the temporary hold to that party.⁵

FINRA notes, however, that if the firm's investigation indicates that the authorized party or trusted contact is not engaged in financial exploitation, the firm should provide the notification to those parties.⁶

A “trusted contact” is a person aged 18 or over that the customer has authorized as required under FINRA Rule 4512 for the firm to contact in limited circumstances, such as when the firm has a concern about activity in the customer’s account but cannot reach the customer.

Importantly, a trusted contact does not have authority to act on the customer’s behalf, execute transactions, or engage in activity in a customer’s account.⁷ The trusted contact “is intended to be a resource for the member in administering the customer’s account, protecting assets, and responding to possible financial exploitation.”⁸

FINRA has previously noted that it encourages firms to attempt to resolve a matter with a customer before placing a temporary hold, unless there is a reasonable belief that doing so would cause further harm to the Specified Adult. FINRA has also noted that if a temporary hold is not placed, the rule does not require notifying the trusted contact person.

FINRA further indicates that a member firm can terminate a temporary hold after communicating with either the customer or their trusted contact.

According to FINRA, member firms thus far have successfully invoked Rule 2165 to prevent financial losses ranging from \$10,000 to \$200,000.

According to FINRA, a customer’s objection to a temporary hold learned during such an exchange may be used in determining whether such a hold should be placed or lifted and that while “not dispositive, [member firms] should weigh a customer’s or trusted contact person’s objection against other information in determining whether a hold should be placed or lifted.”⁹

Furthermore, FINRA has stated that “[w]hile the 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 member may choose to notify and discuss the suspected financial exploitation with the customer’s registered representative, unless the member suspects that the registered representative is involved in the financial exploitation.”¹⁰

Internal review. On placing the temporary hold, the member firm must immediately conduct an internal review of the facts and circumstances that caused the member firm to have a reasonable belief of financial exploitation.

Written procedures. In order to rely on Rule 2165, a member firm must establish and maintain written supervisory procedures reasonably designed to achieve compliance with the rule. These

procedures must include, but not be limited to, the identification, escalation and reporting of matters related to the exploitation of Specified Adults.

In addition, the procedures must identify the title of each person authorized to place, terminate, or extend a temporary hold. Importantly, per those procedures, the person placing the temporary hold must be an associated person of the member firm who serves in a supervisory, compliance or legal capacity, and not the associated person handling an account.¹¹

Training. A member firm should develop and document training policies or programs reasonably designed to ensure that its associated persons comply with Rule 2165.

Record retention. A member firm must retain records related to compliance with Rule 2165 that must be readily available for FINRA to review upon request.

The required records must include the following:

- (1) requests for the disbursements or transactions 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 the temporary hold;
- (3) the name and title of the associated person that authorized the temporary hold;
- (4) notification(s) of the temporary hold to the relevant parties pursuant to the rule;
- (5) the internal review of the facts and circumstances supporting the member’s reasonable belief that the financial exploitation of the Specified Adult has occurred, is occurring, has been attempted or will be attempted; and
- (6) the reason and support for the extension of any temporary hold including communications with a state regulator, agency or court of competent jurisdiction.¹²

New amendments to FINRA Rule 2165

With the advent of Regulatory Notice 22-05, FINRA broadened the scope of Rule 2165 in two important ways. First, FINRA expanded the type of temporary hold that can be applied to accounts under the Rule. Second, FINRA increased the duration of the temporary hold under Rule 2165.

1. FINRA extends Rule 2165 to securities transactions.

Originally, Rule 2165 only allowed member firms to place a temporary hold on the disbursement of funds or securities if the rule’s requirements were met. With the prior version of the rule, a firm could not prevent a customer’s order to sell his or her shares of a stock, but the firm could block the disbursement of the proceeds of the stock sale if the conditions of Rule 2165 were satisfied.¹³

FINRA has now amended Rule 2165 to allow member firms to also place temporary holds on securities transactions where the rule’s requirements are satisfied.¹⁴ As amended, a member firm can now

block both the securities transaction itself and the disbursement of the proceeds from the transaction.

Regulatory Notice 22-05 notes that this expansion of the rule seeks to protect Specified Adults against the significant financial consequences of executing a securities transaction, including surrender charges, adverse tax consequences, or the inability to regain access to an investment.¹⁵

FINRA noted that, at the time Regulatory Notice 22-05 was issued, 22 states already permitted investment advisers and broker-dealers to temporarily hold securities transactions, but that this amendment made Rule 2165 the first uniform national standard in this space.¹⁶

2. FINRA extends the duration of the temporary holds under Rule 2165.

Rule 2165 previously allowed member firms to place temporary holds on a specified adult customer's account for no more than 25 business days (an automatic 15 business days and an additional 10 business days) if the requirements of Rule 2165 were satisfied, while allowing for hold terminations or extensions by a state regulator or agency or a court of competent jurisdiction.¹⁷

Per Regulatory Notice 22-05, FINRA amended Rule 2165 to permit a stay for an additional 30 business days, for a total of 55 business days, if in addition to satisfying Rule 2165's criteria, the member firm also reports the matter to a "state authority."¹⁸ The Notice indicates that this amendment was made in response to concerns that the original 25-day period was insufficient time for a state authority to consider the matter.¹⁹

Indeed, FINRA received data that the average length of an investigation into matters reported to the federal National Adult Maltreatment Reporting System is 52.6 days.²⁰ FINRA previously conducted a survey in which approximately 53 percent of respondents said that a member firm had been unable to resolve the matter within the 25-business day period originally provided under the Rule.²¹

According to FINRA, member firms thus far have successfully invoked Rule 2165 to prevent financial losses ranging from \$10,000 to \$200,000.²²

The safe harbor

FINRA has noted that member firms and their associated persons who comply with Rule 2165 are protected 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) and 11870 (Customer Account Transfer Contracts) when member firms exercise discretion in placing temporary holds consistent with the requirements of Rule 2165."²³

However, FINRA has warned that it will pursue disciplinary action where a firm uses Rule 2165 for "inappropriate purposes," such as withholding disbursements simply to prevent a customer from transferring assets to another firm.²⁴

Moreover, a firm "may not avail itself of the Rule 2165 safe harbor if it blocks transactions or disbursements where there is not a reasonable belief of financial exploitation regarding such transactions or disbursements."²⁵

Conclusion

The amendments to Rule 2165 strengthen the tools member firms have to prevent the financial exploitation of their specified adult customers, while providing a safe harbor from certain FINRA rules. For more information on these amendments, firms can review the specifics of Regulatory Notice 22-05.²⁶

Notes

¹ See Regulatory Notice 22-05 (Feb. 15, 2022), <https://bit.ly/3Q0vtzg>.

² Regulatory Notice 17-11 at 1. FINRA cites various studies concluding that adults age 65 and older are more likely to be victims of financial exploitation (<https://bit.ly/3KveHqA>). *Id.* at 6 n.2.

³ See Rule 2165(b)(1)(A) (<https://bit.ly/3AZtPcU>), Supplementary Material .03 to Rule 2165 (<https://bit.ly/3AZtPcU>), and Regulatory Notice 17-11 at 7 n.14 (<https://bit.ly/3KveHqA>).

⁴ See Rule 2165(b)(1)(B)(i)-(ii), <https://bit.ly/3AZtPcU>.

⁵ *Id.*

⁶ See *Frequently Asked Questions Regarding FINRA Rules Relating to Financial Exploitation of Senior Investors* (FAQ), Q.2.1, available at <https://bit.ly/3WJzlxD>.

⁷ See FINRA, *Establishing a Trusted Contact*, available at <https://bit.ly/3QVq25P>. The trusted contact requirement is not applicable to institutional accounts. See FINRA Rule 4512(a)(1)(F) and (c), <https://bit.ly/3PWITed>.

⁸ See FAQ 4.1, <https://bit.ly/3WJzlxD>, (containing further information about temporary holds and the role of trusted contacts).

⁹ See Regulatory Notice 17-11 at 4, <https://bit.ly/3KveHqA>.

¹⁰ *Id.* at 5.

¹¹ FINRA has stated that "Where a questionable transaction or disbursement involves less than all assets in an account, a member should not place a blanket hold on the entire account. Each transaction or disbursement should be analyzed separately. In addition, where a transaction or disbursement at issue involves all of the assets of the account (e.g., an ACATS transfer request), the member must permit transactions or disbursements from the account where there is not a reasonable belief of financial exploitation regarding such disbursements (e.g., regular bill payments)." See FAQ 1.2, <https://bit.ly/3WJzlxD>.

¹² See Regulatory Notice 17-11 at 4-5, <https://bit.ly/3KveHqA>; Regulatory Notice 22-05 at 2-3, <https://bit.ly/3KypeSb>.

¹³ Regulatory Notice 17-11 at 4, <https://bit.ly/3KveHqA>.

¹⁴ Regulatory Notice 22-05 at 3, <https://bit.ly/3KypeSb>.

¹⁵ *Id.*

¹⁶ *Id.* These 22 states include: 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. *Id.* at 5 n.12.

¹⁷ *Id.* at 4.

¹⁸ *Id.* at 4. In response to a question as to whether a member firm may extend a temporary hold beyond the period indicated in Rule 2165 per the request of a state authority based on the state's need for additional time to investigate the matter, FINRA has answered that Rule 2165 "allows a member to extend a temporary hold upon a state agency's request to do so. The state agency would not have to issue a formal order. In addition, Rule 2165 does not require a member to report a state agency's request to FINRA. However, the member would need to maintain a record of the state agency's request." See FAQ 3.2, <https://bit.ly/3WJzlxD>.

¹⁹ Regulatory Notice 22-05 at 4, <https://bit.ly/3KypeSb>.

²⁰ *Id.* at 6 n.16.

²¹ Regulatory Notice 20-34 at 8, <https://bit.ly/3Q1SIJb>.

²² Regulatory Notice 22-05 at 2, <https://bit.ly/3KypeSb>.

²³ *Id.* at 1-2. FINRA also reminds member firms that, with respect to the best execution obligation, “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.” *Id.* at 5 n.13 (quoting SEC Staff Bulletin: Risks Associated

with Omnibus Accounts Transacting in Low-Priced Securities (Nov. 12, 2020)). FINRA has previously noted that it has not included the requirement to report customer complaints as part of the safe harbor. See Regulatory Notice 20-34 at 13, <https://bit.ly/3Q1SIJb>.

²⁴ Regulatory Notice 20-34 at 4, <https://bit.ly/3Q1SIJb>.

²⁵ FAQ 1.2, <https://bit.ly/3wjzlxD>.

²⁶ <https://bit.ly/3KypeSb>

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