

Small Firms Forum

New York Marriott Marquis
April 11, 2007



Advising Senior Investors: Challenges and Opportunities



Panelists:

Dominick F. Evangelista

Partner, Securities Law

Bressler, Amery & Ross, P.C.

Kenneth A. Kamen

President

Mercadien Securities LLC

Miriam Lefkowitz

General Counsel/Director of Compliance

J.B. Hanauer & Co.

What is a Senior?

- ◆ Under state elder abuse statutes, most states consider individuals age 60 and older to be “elderly” or “seniors”
- ◆ For Annuity purchases, “senior consumers” are considered to be over 65. (National Association of Insurance Commissioners (NAIC) Life Insurance and Annuities Committee)
- ◆ 27 states have adopted NAIC’s suitability regulations, or similar ones, to protect consumers.
- ◆ An industry trade association suggested raising the age of a “senior” be 75; one regulator proposed that the age be lowered to 55.

Sources:

NAIC 2006 Suitability in Annuity Transactions Model Regulations

NAIC News Release March 6, 2006 on expansion of 2003 Senior Protection in Annuity Transactions Model Regulations

Current Landscape

- ◆ Individuals aged 60 and over make up 15 percent of the U.S. population.
- ◆ 75% of the nation's consumer financial assets are in households headed by someone 50 years or older.
- ◆ 29 percent of the nation's net worth is held by people 65 years of age and older; by 2040, the group will hold 42 percent of it.

What Opportunities Do Seniors Present?

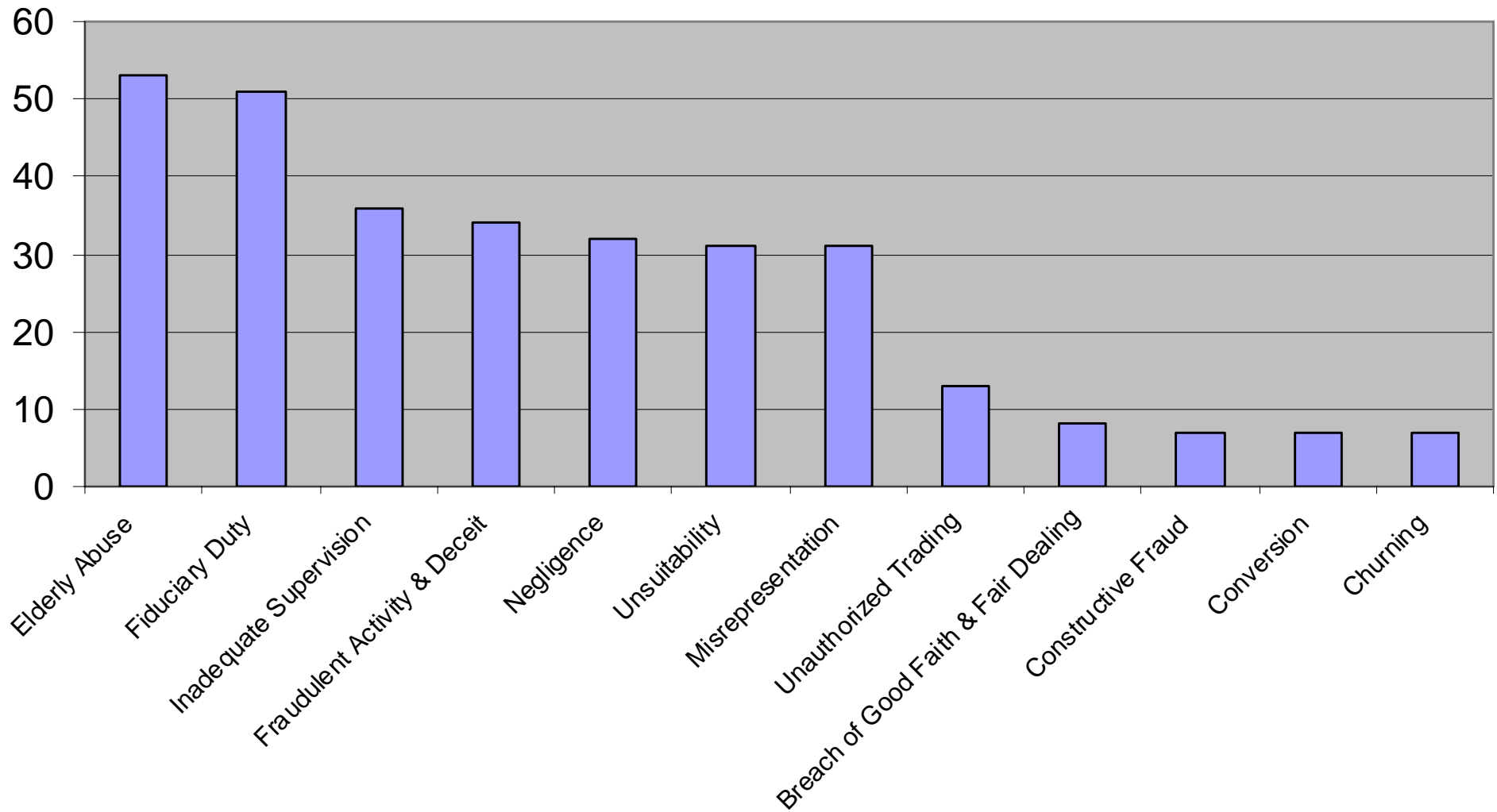
- ◆ Working Baby Boomers Moving Toward Retirement
 - ▶ Accumulate Wealth v. Wealth Depletion
- ◆ Understand and recognize Senior Issues and Needs
- ◆ Partnering With Other Professionals
- ◆ Recruiting Brokers/Advisors With The Proper Skill Set

Opportunity and Risk: Two Sides of the Same Coin

- ◆ Trust/trustee issues
- ◆ Children managing parents' money or unhappy with management of money
- ◆ Children of first marriage vs. second spouse
- ◆ Parents investing (or not) for the next generation; growth v. income and safety of principal
- ◆ Retired businessman with too large an appetite for risk
- ◆ Highly appreciated and therefore concentrated positions
- ◆ Depletion of capital/spending issues
- ◆ “Optics” of the senior claimant, handling older folks in a hearing
- ◆ Tax basis issues – stepped up v. capital gain taxes
- ◆ De Facto Fiduciary Duties
 - ▶ Fact sensitive determination

Most Frequent Senior Allegations

Summary of 53 cases involving seniors with awards over \$50K



Allegations

Opportunity Ahead: Proceed with Caution

- ◆ Elder Abuse Statutes
- ◆ Financial Exploitation
- ◆ Reporting Statutes
- ◆ Heightened Scrutiny of Products and Sales Efforts
 - ▶ Variable Annuities
 - ▶ Deferred Variable Annuities
 - ▶ Equity Indexed Annuities
 - ▶ Margin Borrowing
 - ▶ Over Concentration
 - ▶ Mental Capacity
 - ▶ “Free Lunch” Seminars
 - ▶ FA Titles/Senior Designations
 - ▶ Unrealistic Promises about Future Growth/Return/Risk

Advising Senior Investors: Challenges and Opportunities



Panelists:

Dominick F. Evangelista

Partner, Securities Law

Bressler, Amery & Ross, P.C.

Kenneth A. Kamen

President

Mercadien Securities LLC

Miriam Lefkowitz

General Counsel/Director of Compliance

J.B. Hanauer & Co.

Elder Abuse Statutes

- ◆ A recent NASAA survey measuring senior investment fraud indicates
- ◆ that 45 percent of investor complaints come from seniors and one
- ◆ third of state enforcement actions involve senior fraud. There is no
- ◆ federal statute dealing directly with financial abuse of the elderly.
- ◆ More than half of the states in the U.S., as well as the Virgin Islands and Guam, have statutes that prohibit “exploitation” of the elderly.
- ◆ For example, under a Florida statute, "exploitation" occurs when a person who:
 - 1) stands in a position of trust and confidence with a vulnerable adult and knowingly, by deception or intimidation, obtains or uses or endeavors to obtain for use, a vulnerable adult's funds, assets, or property with the intent to temporarily or permanently deprive a vulnerable adult of the use, benefit, or possession of the funds, assets, or property for the benefit of someone other than the vulnerable adult; or
 - 2) knows or should know that the vulnerable adult lacks the capacity to consent, and obtains or uses, or endeavors to obtain or use, the vulnerable adult's funds, assets, or property with the intent to temporarily or permanently deprive a vulnerable adult of the use, benefit, or possession of the funds, assets, or property for the benefit of someone other than the vulnerable adult.

Financial Exploitation or Abuse

- ◆ Washington State's statute forbids "exploitation" of a frail elder, and defines exploitation as "the illegal or improper use of a frail elder or vulnerable adult or that person's income or resources, including trust funds, for another person's profit or advantage."
- ◆ California also defines "financial abuse" as when a person or entity does any of the following: 1) takes, secretes, appropriates, or retains real or personal property of an elder or dependent adult to a wrongful use or with intent to defraud, or both; or 2) assists in taking, secreting, appropriating, or retaining real or personal property of an elder or dependent adult to a wrongful use or with intent to defraud, or both.

Reporting Statutes

- ◆ Forty-two states have enacted statutes calling for certain individuals to report elderly abuse.
- ◆ Some make reporting mandatory for police officers, social workers, etc. and permissive for other groups, including, for example, employees of financial institutions and attorneys.
- ◆ Other states make reporting mandatory for everyone.

Example of Reporting Requirement

- ◆ In Florida, financial institutions must develop compliance programs so that their officers, trustees, and employees know when they should make a report.
- ◆ Failure to report, or preventing another from doing so, is a second degree misdemeanor punishable by up to 60 days of imprisonment.
- ◆ Florida does not, however, provide civil penalties or allow a cause of action against those who merely fail to report an incident.

Heightened Scrutiny of Products and Sales Efforts



Potential Problematic Products/Trading Strategies

- ◆ Variable Annuities
 - ▶ Sample Procedures and Firm Compliance Worksheets
- ◆ Use of Margin Borrowing
- ◆ Concentration in Equities
- ◆ High Commission/Volume Trading
- ◆ High Risk Investments
- ◆ Illiquid Investments

Variable Annuities

Variable annuities sales to seniors have the attention of regulators

- ◆ High commissions
- ◆ Deferred sales charges Exposure to market risk
- ◆ “Switch” transactions - selling one product to buy another
- ◆ Give equity exposure and guaranteed income for life
- ◆ Variable death benefit

Variable Annuities: Understanding the Product

- ◆ Adequately screen new sales agents or train agents about the details of the product
- ◆ Brokers must explain the material aspects of the product to the customers
- ◆ Proactive measures include: web based training program for brokers; monitor point of sale policy regarding point of sale disclosures; monitor post-sale activity; and formation of an “Oversight and Compliance Committee” to monitor implementation of these policies.

Deferred Variable Annuities

- ◆ Age is a factor to consider when recommending deferred variable annuity policies due to long maturity
- ◆ Assess client's income needs and fully disclose surrender charges for early withdrawals

Equity Indexed Annuities

- ◆ Many of the contracts are difficult for the average person to readily understand how index credits are calculated
- ◆ Some contracts fail to fully explain that the policy may have 0% interest in a given year
- ◆ Surrender charges in effect for 10-15 years and the maturity date of the annuity is beyond the actuarial life expectancy of the annuitant.

Margin Borrowing

- ◆ Margin transaction may not be suitable for an elderly investor, but a distinction may be made for non-purpose lending
- ◆ Use of margin in an elderly client's account may lead to liability
- ◆ The Equal Credit Opportunity Act (“ECOA”) prohibits a creditor from using age as a “negative” factor when determining “creditworthiness.”
- ◆ The firm must ensure that an elderly client's investment objectives are honored while using margin, but the firm cannot refuse to offer margin, or force a client to close off a margin position, based solely on age.
- ◆ Determination should be made on a client-by-client basis

Over Concentration in Equities

- ◆ Focus on asset allocation and diversification
- ◆ Variances with “accepted” asset allocation models could lead to liability
- ◆ The appropriateness of allocation in light of, among other factors, the client’s age.
- ◆ The contention is that once a client reaches a certain age, large equity concentration is unsuitable and that FAs have a duty to monitor and “rebalance” the customer’s account as the client ages.

Duty to Ascertain Mental Capacity?

- ◆ A stockbroker's obligation to a client does not include the duty to ascertain the client's mental competence.

“Free Lunch” Seminars

- ◆ Caution should be used when sponsoring a free luncheon and investment presentation for the residents of a senior community.

FA Titles/Designations

- ◆ NASAA has urged seniors to carefully check the credentials of any individual who holds himself out as a “senior specialist,” noting that individuals use these designations to create a false sense of comfort among seniors.
- ◆ NASAA warns against individuals holding nothing more than a designation as a senior specialist, who are not licensed, and who imply they have more expertise in structuring the investments of seniors.
- ◆ State regulators are particularly concerned with claims received which indicate that a “senior specialist” has asserted that they can structure investments to reduce taxes, minimize risks, and avoid probate laws.

Unrealistic Promises about Future Growth/Return/Risk

- ◆ Representations to Seniors that investments were “practically risk free” should be avoided
- ◆ Telling investors that an investment “as safe as can be” and that they “would not lose their money” are highly suspect
- ◆ Promoting proprietary investments to the exclusion of similar non-proprietary investments raises concerns

Advising Senior Investors: Challenges and Opportunities



Panelists:

Dominick F. Evangelista

Partner, Securities Law

Bressler, Amery & Ross, P.C.

Kenneth A. Kamen

President

Mercadien Securities LLC

Miriam Lefkowitz

General Counsel/Director of Compliance

J.B. Hanauer & Co.