

FINANCIAL EXPLOITATION: SCHULTZ COLLINS, INC. & RISK CONTROL

This essay provides a brief description of fraud and exploitation risks that investors are more and more likely to encounter. It concludes by outlining a coordinated effort, encompassing several new programs, which Schultz Collins, Inc. [SCI] has begun to implement. **Our goal is to keep your money safe.**

The essay is, in some ways, a supplement to *“What Investors and Trustees Should Know about Investment Advice”* (April, 2019) which can be accessed on our [website](#). That article detailed a pervasive and systematic risk to investor wealth from firms operating in the financial products and services industry. This risk can become acute when investment firms employ an agency standard of practice, rather than a fiduciary standard of practice.¹

By contrast, this essay focuses on the risk of exploitation by individuals either within the industry (e.g., financial fraud by a rogue broker or investment advisor), or outside the industry (e.g., financial theft by a friend, relative, caregiver, or ‘scammer’). To make the analysis manageable, we limit the discussion to retired investors.

Although retired investors are particularly vulnerable to the sorts of risk we discuss below, all investors should be aware of them.

Retired Investors, Cognitive Decline, Scams & Fraud

An obvious point of vulnerability for many older investors is a decline in cognitive ability so severe as to impair the ability to make good decisions. One estimate is that half of all people over 80 residing in the U.S. suffer from cognitive decline ranging from mild impairment to full-blown dementia.² But, given the increasingly complex landscape of financial topics (health care decisions, spending needs, spending wants (leisure), portfolio strategies, estate-planning / end-of-life care, etc.), even mild impairments can potentially derail prudent decision making.

Furthermore, as soon as the subject of cognitive decline is consciously considered, the stress meter may redline – for the investor, the immediate family, and (not least) the investment advisor. A thicket of new

¹ Even firms asserting that they follow a fiduciary standard of practice may draft Investment Advisory Agreements designed to excuse them by contract from important fiduciary duties. See, for example, the analysis of Steve Fast (a partner of the Day Pitney law firm), et al.: “Latent Liability: The Investment Management Agreement Lurking in the File,” [Representing Estate and Trust Beneficiaries and Fiduciaries](#), 2017. Mr. Fast cautions estate and trust attorneys to review client Investment Advisory Agreements lest they contain provisions that permit brokers or investment advisors to engage in opportunistic behaviors.

² T.S. Bernard, “As Cognition Slips, Financial Skills Are Often the first to Go,” [New York Times](#) (April 24, 2015). According to the Center for Retirement Research at Boston College, there are two main ‘research’ tests to assess financial capacity: (1) performance based assessments – e.g., can the subject successfully pay a bill; and (2) clinical assessments – e.g., interviews and cognitive tests [“Cognitive aging and the capacity to manage money,” Anek Belbase and Geoffrey T. Sanzenbacher (January, 2017)].

topics, new complications, new agendas, new tasks, and new regulations suddenly and urgently present themselves. The investor steps into a landscape populated by regulators seeking to mitigate the risk of elder abuse, neurologists seeking to understand aspects of brain development, psychologists seeking to provide counsel to individuals and families confronting the specter of dysfunction, gerontologists seeking to understand the process and problems of aging, estate planners offering legal documents that may significantly reshape previous financial planning, and a host of other potential new players. The landscape is both strange and disconcerting; negotiating that landscape can be expensive and time consuming; exploring issues may create (or, uncover) uncomfortable family dynamics.

A comprehensive discussion of all these issues is well beyond our aim in this essay. Rather, we wish to make several observations which may be relevant to many investors. Some of the observations stem from a collection of research essays compiled and published by Oxford University Press.³ We direct readers interested in further details to that excellent compendium.

Psychologists identify two types of cognitive functioning:

1. Fluid Intelligence: how fast and accurately we process information; and,
2. Crystallized intelligence: knowledge obtained by education and experience.

Fluid intelligence appears to peak in the 20's; crystallized intelligence often remains relatively stable over time.

Problems in managing money are one of the first areas of cognition to be impaired with age. Tell-tale signs include repeated phone calls to the advisor regarding the same subject matter; inability to recall signing paperwork; forgetting prior conversations; manifesting atypical interest in risky investments; and difficulty understanding basic financial concepts.

Some tell-tale signs of fraud victimization include sudden changes in beneficiaries, increases in debt, inability of advisors and staff to recognize handwriting on documents authorizing transactions, unusually large withdrawals from bank accounts or investment portfolios (especially when coupled with an inability to articulate the purpose for the withdrawal), and introducing a 'new best friend' to financial discussions.

General Observations

The following is a list of facts and academic opinions culled primarily from the Oxford University compendium.

Older investors confront challenges and issues unique to their population segment. These include:

- Spending ("Decumulation") issues such as the role of Social Security income, health care /

³ Financial Decision Making and Retirement Security in an Aging World, eds. Olivia S. Mitchell, P. Brett Hammond and Stephen P. Utkus (Oxford University Press), 2017: "The goal of this volume is to review emerging research on the changing capacity of aging households to manage their own finances, to assess the implications for financial decision making and behavior later in life, and to draw out options for addressing key concerns."

insurance spending, selling the home or tapping home equity, and provisions for old age transition to assisted living.

- Enhanced value for leisure must be weighed against possible decreases in mobility, hearing, and sight; changes of behavior as a result of prescription drugs; and, in some cases, depression.
- Anxiety concerning the preservation and sustainability of a nest egg, coupled with possible social isolation, may increase willingness to accept “advice” or “assistance” from individuals looking to implement scams, frauds, and thefts.

Fraud directed at older Americans is estimated to amount to \$50 billion per year, not counting ancillary costs such as legal expenses. A 2014 study estimated the prevalence of elder financial fraud to be approximately 14% for those above age 60 in Florida and Arizona.⁴ Fifty-six percent of financial planners report that an older client was a victim of financial exploitation, with an average loss of approximately \$50,000. Once victimized, older investors manifest a statistically significant propensity to subsequent acceptance of risky undertakings. This makes such victims susceptible to repeated exploitation – serial scamming.

Although cognitive impairment is a risk factor for financial exploitation, it is by no means the only one. A factor of “overconfidence” makes older, affluent, college-educated males particularly likely to fall victim to fraud.⁵

Surveys find family members are reluctant to discuss financial events that can harm future financial well-being. The most common catalyst for promoting such discussion was the illness or death of a family member or friend. The most common impediments to discussion were fear of family conflict and discomfort with the subject matter.

Some New Regulations

Effective February 5, 2018, the Securities and Exchange Commission adopted two new rules:⁶

- Rule 2165: Financial Exploitation of Specified Adults. The rule permits financial firms, under

⁴ The 2010 Investor Protection Trust Elder Fraud Survey reported that one out of every five adults over the age of 65 has been victimized by a financial fraud. North American Securities Administrators Association Model Legislation to Protect Vulnerable Adults from Financial Exploitation: Legislative Test & Updated Commentary for 2018 Legislative Session. The National Adult Protective Services Association reports (as of April 2019) that one in 20 older adults have experienced some form of financial exploitation in the recent 12 months. Family members are the abusers 90% of the time.

⁵ The 2017 study from the Center for Retirement Research Study cited earlier finds that people are usually unaware that they are slipping into a state of cognitive impairment. Even those diagnosed with dementia may continue to feel confident about their ability to handle financial affairs. That makes this population group particularly susceptible to fraud.

⁶ This discussion is based, in part, on (1) the 2018 research paper “Elder Law Issues and Recent Developments” by Elizabeth R. Carter, Professor of Law at Louisiana State University; (2) “The North American Securities Administrators Association Model Legislation to Protect Vulnerable Adults from Financial Exploitation: Legislative Text and Updated Commentary for 2018 Legislative Session;” and, (3) “The Legal, Ethical, and Practical Considerations Involving the Exploitation of Seniors,” by Stuart C. Bear and Francis J. Rondoni presented to the 2017 Elder Law Institute.

certain conditions, to place a temporary hold on a disbursement of funds or securities from the Specified Adult's account(s). A 'specified adult' is a person age 65 or older, or a person over age 18 with a significant impairment that renders the person unable to protect his or her own interests. 'Financial Exploitation' means (a) the wrongful or unauthorized taking, withholding, appropriation, or use of a Specified Adult's funds or securities; (b) any act or omission by a person, including through the use of a power of attorney, guardianship, or any other authority regarding a Specified Adult, to obtain control, through deception, intimidation or undue influence, over the Specified Adult's money, assets or property.

- Rule 4512: Amendments to Customer Account Information to Include "Trusted Contact." Essentially, this is the name and contact information for a trusted contact person age 18 or older, who may be contacted about the customer's account.

The new legal and regulatory environment poses challenges to investment advisors. Advisors may face legal liability if they fail to exercise care when dealing with clients exhibiting diminished capacity for prudent decision making. Should an advisor continue to follow client instructions when such actions may violate the advisor's fiduciary duties? Under what circumstances should the advisor ignore the confidentiality provisions of the Advisory Agreement – not to mention state privacy laws – by contacting non-authorized individuals who are not party to the engagement?⁷

Some consultants recommended that investment advisors revise their agreements to allow them to immediately terminate the engagement if they feel that the client is asking them to implement instructions that would violate a fiduciary duty. Fortunately, the Trusted Contact rule provides an alternative remedy for concerned advisors. The North American Securities Administrators Association has crafted model legislation making it mandatory for brokers and advisors to report financial exploitation, to delay disbursement of funds from a client's account, and to obtain "advance consent" from investors for advisor notification to regulatory agencies of suspected financial exploitation – i.e., sharing of records with law enforcement and state adult protective service agencies. The model legislation provides immunity for advisors from civil and administrative liability for such reporting, disbursement delay, and regulatory notifications.

Schultz Collins: Positive Assistance & Risk Mitigation Procedures

Team Approach

As you are undoubtedly aware, SCI has recently invited several highly qualified individuals to join our firm. Our new associates are among the most highly educated and qualified practitioners in the investment advisory profession.

With their arrival comes additional firm capacity and leverage. SCI is moving towards a more team-oriented approach to the supervision of client portfolios. Over time, we anticipate that our new

⁷ In certain situations, state law may require the advisor to alert government protective services. The problem is that, in general, a person isn't deemed incapacitated until a doctor declares that he is. This may create an untenable situation for the advisor.

associates will rapidly become involved in important aspects of all our client engagements. This mitigates the possibility of unintended and undetected mistakes; but, of equal importance, having more than one set of eyes on client financial affairs provides a second opinion regarding the integrity of a client's decision process.

The Trusted Contact Project

SCI is implementing a 'Trusted Contact' program. The Trusted Contact Rule directs brokerage firms to obtain the name and contact information for a "trusted contact" for all accounts that are newly opened or updated. The Rule, as espoused by FINRA, enables a firm to contact the designated person whenever there are concerns about the client's financial management decisions. Such contact will not violate investor privacy or account confidentiality restrictions. Under current standards, the contact person does not have any management authority over client assets.

Experts disagree about the events that should trigger a 'financial capability' assessment, and about who should conduct it. Some attorneys caution that advisors should not unintentionally cross into areas that are beyond the bounds of their profession – i.e., should avoid the unauthorized practice of law or psychology. Where does an advisor's duty or capacity to contact a family member or friend under the 'Trusted Contact' program stray into providing legal advice when the trusted contact asks the inevitable question: what do you recommend that I do? The advisor is authorized to share information regarding the advisor's concerns; it does not allow an advisor to assume the role of an attorney or psychologist.

While registered investment advisory firms are not yet required to collect information on trusted contacts, Schultz Collins is moving to implement a Trusted Contact program across its client base. Initial priority will be given to new accounts, upgraded accounts, and accounts owned by older investors. Additionally, SCI will ask for permission to reach out to any individual named as a trusted contact in order to facilitate future communications and to clarify to them that SCI is not a substitute for an attorney or a law enforcement agency. A trusted contact who wishes to take any action regarding account management will need authorizing documents such as a Power of Attorney [POA], signed by the client(s). This observation leads to the next section: the Everplans Project.

The Everplans Project

Everplans is an online platform designed to help people facilitate – and coordinate – contingency planning in the event of difficult circumstances like the onset of physical disabilities, cognitive impairments, or, ultimately, end-of-life issues. Schultz Collins is offering the use of this platform to our clients – and to those whom our clients invite to use it – on a complimentary basis.

To limit opportunities for fraud, theft, and financial abuse, experts recommend proactive estate planning among clients and professional advisors. Estate and trust attorneys encourage clients to consider whom they would appoint as their authorized representative in case they were unable to make independent financial decisions. Proactive estate planning often encompasses a myriad of 'authorizing' or 'directing' documents such as Wills and Living Trusts, Health Care Directives, and Powers of Attorney.

It is a good standard of practice for investment advisors to determine and document the identities of

those granted the power to act on behalf of the client.

However, even when clear directives and authorizations exist, the implementation of a plan can easily bog down, for a number of reasons, such as: important log in credentials remain unknown; out-of-state custodians refuse to recognize a power of attorney drafted in the state of investor domicile; asset titling is not synchronized with plans for the disposition of wealth; important health history is not available on a timely basis; names and addresses of financial vendors are unknown; insurance policy information is not readily available; beneficiary designations conflict or are out of date; and a plethora of other 'easily overlooked minor details.'⁸

It is easy to feel overwhelmed by the mammoth project of compiling the necessarily comprehensive information that can be provided in a clear and organized manner to family members, trusted friends, or caretakers so as to enable them to step in, if the situation demands it, and run things smoothly.

Everplans is designed to make the process of capturing and sharing the relevant data as easy as possible, while overlooking nothing that might matter. We think it is valuable for a number of reasons:

1. Because the information on the platform can be entered bit by bit, you don't have to do everything at one fell, immense and daunting swoop. An otherwise intimidating task can be undertaken one item at a time. This increases the likelihood that each bit of relevant and important information will eventually find its way into the system!
2. Even though you work at inputting information piecemeal, your efforts remain coordinated. You can decide to whom you will give rights to view certain sorts of information – family members, trusted contact, executor, attorney, successor trustee, and so forth. The information in the database is easy to update as things change.
3. Most importantly: as investment advisors, we have all too much experience helping with the project of compiling all the relevant information after the fact. We are urged to recommend Everplans by our exasperating and sorrowful experience with the post mortem affairs of both clients and members of our own families. With even our most competent and organized clients it can be a crushing task for us, and far more so for their families, fiduciaries, and other advisors.

Using Everplans, you can securely store information in the cloud about wills, accounts, insurance policies, log in credentials, real estate, advisors, funeral wishes, trust and investment accounts, and so forth – even information about pets. The platform allows you to share certain sorts of information with trusted family members and advisors, while keeping other sorts private. You may determine which sorts of information you would like to share with which important people. You can control when they gain access to your information. You can invite as many or as few people as you want to participate. If

⁸ A great source of potential confusion and potential economic disaster stems from a lack of coordination among professional advisors. Almost every CPA encounters clients who initiated bizarre tax strategies; almost every estate and trust attorney encounters clients who unwittingly changed asset titling (or, titled newly-acquired assets inappropriately) in such a way as to frustrate their expressed intentions; almost every financial advisor encounters clients who undertake surprising and ill-considered investment changes, given their expressed objectives and predilections for risk.

anything happens to you, their access to the system will enable your trusted friends, family and advisors to find the important information they'll need, when they need it.

To the extent that there is a record of your present intentions, strategies, and implemented tactics, and to the extent that the data you record in it are shared with professional advisors and family members, it can be a bulwark against future depredations aimed at you, and at all that you have worked so hard to establish for yourself, and for your heirs.

As a bonus, Everplans can be a great way to get organized and stay that way, by maintaining the data in the system as things change in the real world.

Survey of Financial Circumstances & Preferences Project

Regulators and custodians have always required that SCI document compliance with investment suitability standards.⁹ Since our founding in 1995, we have met this requirement by collecting information from clients about their circumstances, objectives, and preferences using our Client Confidential Questionnaire. A completed Questionnaire indicated that we knew our clients well enough to be confident that our recommendations were suitable for them, and in their best interest. The Questionnaire was of course never intended to replace our interviews with clients, which go far deeper into the topics that the Questionnaire can by nature cover only superficially.

In view of the topics addressed above, we have added new material to the Questionnaire that asks clients to consider and sketch out, more broadly, their investment objectives, preferences, perceived obstacles, and other items. That information could prove critically important, not just because it would inform our investment recommendations, but to prevent fraud. For example, if you had used the Questionnaire to document that one of your investment objectives was to gift funds to a church, a school, or a charity, we would be likely to look askance at your sudden request a few years later to transfer \$25,000 per month to your at-home care assistant's checking account.

For existing clients, completing the enhanced Questionnaire will be voluntary. We recognize that such forms are a bother. Nevertheless, we urge you to complete it: an ounce of prevention ...

We would be happy to send you the enhanced Questionnaire, on request; otherwise, we can leave further details until a face-to-face client meeting.

The Secret Word Security Enhancement

SCI has begun asking each of our clients to provide us a 'Secret Word' that we can use to confirm their identity. While not yet a widespread practice throughout the financial industry, the Secret Word will probably become the norm within a few years. The Secret Word comes in handy when someone calls an advisor representing that he is a client, but no one present in the office is familiar with the client's voice. If the caller can provide the Secret Word, even a new SCI employee who has never met him can feel confident that the caller is indeed the client.

⁹ SCI has always acknowledged that it acts as a fiduciary within the scope of the client engagement. This standard is more favorable to investors than the more commonly used 'suitability' standard.

Care should be taken not to use a Secret Word for identification elsewhere (e.g., as a password for a web site, a pin number, etc.); nor should it be an easily ascertainable word or phrase (e.g., mother's maiden name). Additionally, the Secret Word should be shared only with advisor(s) and Trusted Contacts as described above.

Finally, of course, not only should the Secret Word be hard to guess, and hard to forget, it should be hard to get. The Secret Word should be stored securely (i.e., not on a post it note attached to a computer monitor!). The Everplans platform would be a good place to store it.

It is important in this connection to note that, while SCI will have stored client Secret Words in our database, we cannot be relied upon as a way for clients to gain access to them, for the simple reason that for us to divulge a Secret Word to anyone – even the client who had given it to us in the first place – would be to defeat the whole point of it.

Conclusion

A growing number of bad actors are bent on transferring investors' money into their own pockets. New scams and schemes arise constantly; and, unfortunately, abusive and greedy "friends" and "caretakers" are all too common. The complexity of financial decisions – especially when transactions can occur at lightning speed over the internet – can create a confusing and disorienting environment for any investor. When cognitive impairment, overconfidence, and elder abuse find their way into this mix, bad things can happen. Consumer protection organizations, law enforcement agencies, asset custodians, and financial advisors strive not only to alert investors to these dangers; but to provide barriers against fraud and exploitation.

We at SCI stand ready to do what we can to protect our clients from such risks, and invite you to take part in the initiatives we have undertaken to do so.