

Considerations for Recognizing and Addressing Participants with Diminished Capacity

Testimony of Naomi Karp before the
ERISA Advisory Council
September 17, 2020

As an attorney who has worked for over 35 years at the intersection of law, aging, and policy, I'm grateful for the opportunity to share insights into how various industries, professionals and service providers identify and address challenges posed by diminished capacity. In particular, I aim to help employers, plan sponsors, and plan service providers, as well as the agencies that serve them, protect plan participants from costly financial mistakes, fraud and financial abuse.

My experience and expertise prepare me well for this task.

- As a *legal services attorney* representing low-income and older clients, I directed a program serving individual age 60+ with the greatest economic and social need. My cases included thorny issues such as whether a frail older man retained the cognitive capacity to execute a power of attorney, protecting the rights of a double amputee who wished to keep his home but had voluntarily consented to a guardianship, and providing civil remedies to an older immigrant whose family had defrauded her.
- During my 17 years at the *American Bar Association's Commission on Law and Aging*, I conducted research, wrote reports and policy briefs, and advocated on such aging issues as guardianship and other surrogate decision-making, planning for incapacity, health care decision-making, elder abuse, mediation, bioethics and public benefits.
- As a senior policy advisor at *AARP's Public Policy Institute*, I co-authored two reports on monitoring court-appointed guardians as well as studies on power of attorney abuse and the impact of diminished capacity on older investors.

- From 2011 – 2019, I served as a senior policy analyst at the federal *Consumer Financial Protection Bureau’s Office for Older Americans (CFPB)*. My many projects and publications included the *Managing Someone Else’s Money* guides, an advisory published jointly with the SEC on *Planning for Diminished Capacity and Illness*, two sets of recommendations for banks and credit unions on preventing and responding to elder financial exploitation, and a study of Suspicious Activity Reports filed by financial institutions with the federal government to flag suspected elder financial exploitation. My colleague, Lisa Schifferle, currently works at the CFPB’s Office for Older Americans and will describe for you some of those initiatives.

Since last October, I have been a Consulting Research Scholar at the Stanford Center on Longevity and have my own consulting practice. Current projects include work on state legislative issues involving elder financial exploitation for AARP, development of content for the Department of Justice’s Elder Justice Initiative, and collaborating with Dr. Marti DeLiema and Steve Vernon on a project that you will hear more about from them on a panel tomorrow.

On top of my professional experience, I have my recent lived experience. I am the primary caregiver for my 95-year-old mother with dementia. With help from my husband, I make her personal and financial decisions, including the management of her defined benefit and defined contribution accounts. Caregiving has been especially challenging and painful during the pandemic, when I could not see my mother for three months, but she is fortunate to have 24-hour care, and loving and highly educated family members. Others are not so lucky, so we must take extra pains to help them.

Today I’ll provide some background on diminished financial capacity, and some basics on elder financial exploitation and its connection to diminished capacity. I’ll articulate some specific recommendations for employers, plan sponsors, service providers, and other key

players with the goal of enhancing the later life economic security of participants. I will cite specific findings from my work that underpin these recommendations.

Capacity generally, and financial capacity

Capacity is not an all-or-nothing concept – it is specific to the task at hand. In everyday legal practice, the definition of “diminished capacity” depends largely on the type of decision or transaction involved. Similarly, clinicians such as physicians or mental health professionals look at a “domain-specific” model of capacity. A domain is a cohesive area of cognitive or functional behavior. Financial capacity is one such domain model. Others include “consent capacity” for medical decision-making and “independent living capacity.”

Research over the past 15 years or so helps define financial capacity, which is the type of capacity most relevant to the issues you’re addressing today. Financial capacity is “the capacity to manage money and financial assets in ways that meet a person’s needs and which are consistent with his/her values and self-interest.” Financial capacity comprises a range of knowledge, performance and judgment skills, including basic monetary abilities such as identifying and counting money, understanding debt and loans, conducting cash transactions, paying bills, and maintaining judgment to act prudently and avoid financial exploitation.

Financial capacity is one of the first abilities to decline as cognitive impairment encroaches, yet individuals and their families often are unaware of the deficits. Declining financial skills can be detected in people with mild cognitive impairment, before the onset of Alzheimer’s disease or another dementia. Once a person is diagnosed with Alzheimer’s, financial capacity declines rapidly. Diminished financial capacity also may be associated with other diagnoses.

Research demonstrates that financial abilities decline even without mild cognitive impairment. Perhaps you are familiar with the study that shows that the ability to make effective financial decisions peaks at middle age, with the mean age at which financial mistakes are minimized being 53.3 years. Of course, this can't be generalized to everyone, and many older people retain their financial acuity into advanced age.

Because we can't anticipate whether our financial capacity will decline over time—or even suddenly, such as with a severe stroke—planning ahead for possible incapacity is critical. Designating someone with legal authority to manage our money if we no longer can is key—whether it be through a power of attorney, a trust, or a combination of mechanisms. It's in our best interests to choose someone ourselves, someone we know and trust, rather than having a court or a federal agency choose for us, as in guardianship. Our chosen fiduciaries—who we might also call financial caregivers or financial advocates—can manage the whole range of financial tasks that we can't perform, and should do so in accordance with our communicated needs and preferences. They can help protect us from making mistakes, and from fraud and financial exploitation. But we also need to remember to maximize independence, autonomy and agency as long as possible, and to involve older adults in decision-making to the extent possible even after they develop some level of cognitive impairment.

Elder financial exploitation

Preventing financial exploitation is vital for those with diminished financial capacity, due to their vulnerability to fraud and abuse. The judgment to detect a fraud or scam is diminished. Elder financial exploitation is widespread and under-reported, and the incidence and prevalence studies we do have are likely to underestimate the extent of this mistreatment among older adults with diminished capacity. Surveys tend to only include cognitively intact

subjects and only community-dwelling participants. More than 50% of residents of nursing homes and assisted living have some form of dementia. And yet they can still be victims of financial exploitation, despite living in those settings.

At CFPB, I co-led the first-ever public analysis of Suspicious Activity Reports (SARs) filed with the Treasury's Financial Crimes Enforcement Network (FinCEN) by financial institutions such as banks, brokers and money services businesses regarding elder financial exploitation. We found:

- Elder financial exploitation SAR filings quadrupled from 2013 to 2017
- The average amount lost by an older adult was \$34,200
- One third of the individuals who lost money were ages 80 and older
- Losses were much greater when the older adult knew the suspect, and 25% of suspects were family members, especially adult children
- The length of time the suspicious activity lasted was considerably higher than average when the targeted person had diminished capacity
- Fewer than one-third of these SARs indicated that the financial institution reported the suspicious activity to a local, state or federal authority.

Recommendations for employers, plan sponsors, plan service providers, the Department of Labor, and other key stakeholders

Based on the totality of my experience and the current environment, I suggest the following actions to enhance protections for plan participants and to help their caregivers and others protect them:

- ⇒ **Provide mandatory training for staff of employers, plan sponsors and service providers on diminished capacity and financial exploitation.** In 2011, AARP surveyed financial advisors and compliance officers at securities firms, banks,

investment adviser firms and life insurance companies regarding diminished capacity. We found that a significant majority of financial services professionals recognized that diminished capacity is a problem they confront in conducting business.

While most firms offered some resources on diminished capacity to their professionals, only a small minority required such training. Their advisors and compliance officers thought it should be required. While this survey is several years old, none of my experience during the interim has suggested that mandatory training on diminished capacity has become more prevalent.

This training could encompass recognizing red flags for impaired financial decision-making ability, understanding the risks for the client and the firm, and procedures and protocols for action and escalation.

⇒ **Educate plan participants on the risks posed by diminished capacity and ways to plan in advance to protect against those risks.** Employers and plans should offer programs and resources on several aspects of this issue: financial exploitation and scams, and how to avoid them; risks posed by unanticipated health problems; the benefits of advance planning for future money management; and tools and resources for advance planning. Many resources exist to educate people on financial exploitation and scams, including the CFPB's Money Smart for Older Adults, the Federal Trade Commission's Pass it on! materials, AARP fraud watch resources and others. There are also lots of resources and tools on planning for incapacity with regard to health care decision-making, but much less on financial decision-making. The project underway that is a collaboration between the University of Minnesota and the Stanford Center on Longevity (with funding from the Society of Actuaries and AARP) will fill a huge gap in that regard, and employers, plans and servicers should plan to use the tools.

One challenge that arises when designing training and resources about diminished capacity and financial decision-making is the need to make the case that multi-faceted planning is essential without scaring people or confronting them too brutally with the realities of cognitive impairment and dementia. Research suggests that scare tactics and negative messaging don't work well. As you'll learn from Dr. DeLiema, in our study we tested more positive messages and ways to characterize the unfortunate events that could happen in the future, and we believe we have identified ways to address those challenges. Employers, plans and servicers should walk that fine line when providing resources to those who can benefit from them.

- ⇒ **Institute a panoply of practices, policies and resources to prevent and respond to elder financial exploitation.** In 2016, CFPB issued a broad set of recommendations for banks and credit unions on preventing and responding to financial exploitation. Assuming that these practices are permitted under ERISA (about which I am not an expert), most of these recommendations could apply to plan sponsors and service providers, and many could apply to employers as well. The recommendations were developed based on extensive expert interviews with financial institutions, law enforcement, social services, technology experts and academics. Key recommendations include:
- *Developing and implementing internal protocols*
 - *Training management and staff on financial exploitation, including clear definitions, red flags for exploitation and action steps to prevent and respond to suspicious events*
 - *Detecting financial exploitation by harnessing technology* that is particularly tailored to risks faced by older participants. Technological approaches are especially urgent in the COVID era when there are few opportunities for face-to-face interaction that could signal financial exploitation or diminished capacity.

- *Reporting all cases of suspected exploitation to relevant federal, state and local authorities.* Personnel need to be aware of state reporting mandates, the fact that federal privacy laws are not a barrier to reporting, and the need to expedite document requests when authorities are investigating reports.
- *Offering participants the opportunity to consent in advance to disclosure of account information to trusted third parties when the plan provider or servicer suspects diminished capacity or financial exploitation.* FINRA Rule 4512 requires broker/dealers to give clients the opportunity to provide the name of a trusted contact. This is a good practice for a broad spectrum of providers—it ensures that the firm knows who to contact when the older person is at risk, and removes privacy concerns because the person has consented.
- *Offering protective opt-in account features* such as the ability to set alerts for specified account activity, and providing read-only account access for authorized third parties so that a designated family member or friend can monitor an account for irregularities without having access to funds or transactions.

⇒ **Develop protocols on holding transactions, in accordance with applicable laws.**

FINRA Rule 2165 allows broker/dealers to place a temporary hold on a disbursement of funds or securities from the account of a specified adult if the FINRA member reasonably believes that financial exploitation of the specified adult has occurred, is occurring, has been attempted or will be attempted. A substantial number of states have similar provisions about transaction holds permitted if the financial institution suspects financial exploitation and takes certain other steps. Once a vulnerable adult's money or assets have been transferred, they can be incredibly difficult to recover, often with dire consequences to the individual, so it's critical to keep the money from going out the door while we investigate.

- ⇒ **Honor powers of attorney and other fiduciary arrangements, but monitor accounts for abuse.** A financial services provider’s refusal to honor a valid power of attorney can create hardships for individuals who need designated surrogates to act on their behalf. Concerns about whether a document meets state law requirements and whether a document is forged are legitimate, as are well-founded concerns that powers of attorney can be “licenses to steal.” Yet many financial services providers insist that individuals execute powers of attorney on their forms. This is not only inconvenient in most cases, but also often impossible when the older adult has already lost capacity and therefore can no longer execute such a document. Providers and servicers should have procedures to ensure that decisions on whether to accept a power of attorney are made promptly and are only based on appropriate legal considerations. Frontline staff should recognize red flags for power of attorney abuse.

- ⇒ **Provide resources and referrals to low-cost legal services providers, daily money managers, and other key services** to help older adults plan for incapacity and obtain help with managing finances.

- ⇒ **Build on lessons learned during the COVID era.** During the pandemic, new paradigms are developing to provide services, training and communication in a socially distant, virtual world. Apply these lessons to staff training, provision of online resources and efforts to stay connected to participants and their caregivers. Older adults may feel a heightened awareness of the need to “get their affairs in order.” Take advantage of this moment to engage them on issues of advance planning for incapacity and financial caregiving. Make online and mobile platforms more accessible. Be aware that business and advance planning transactions requiring notarization can now be conducted remotely in almost all states, based on state emergency orders and new legislation. Be on the lookout for COVID-related scams and exploitation by family members living with the older adult.

⇒ **Support research and evaluation** of interventions introduced to minimize the financial impact of diminished capacity. In my experience, there are often a plethora of ideas for addressing a problem. Some are brought to fruition, and few are evaluated for their efficacy. Let's use our resources to identify the ones that really work

This is an important topic, and not an easy one. I frequently struggle in my role as a caregiver and a fiduciary for my mother—and I am an expert in the field. But when it's your personal life and your family, expertise only goes so far. Let's always remember that this is about real people and situations that are messy and imperfect, and approach it with sensitivity and flexibility.

Thank you very much for the opportunity to testify today.