Vulnerability and Financial Advice:

A Broader Look at the Factors That May Increase the Risk of Client Vulnerability

Contents

This paper is for educational purposes and is intended to promote further awareness and discussion of client vulnerability. This paper does not interpret or replace any existing regulatory requirements or create any new regulatory requirements. In particular, this paper does not interpret the proposed *Amendments to National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations and changes to Enhance Protection of Older and Vulnerable Clients.*

Introduction

One of the MFDA's key regulatory priorities is the protection of seniors and vulnerable clients. Over the last several years, the MFDA has implemented several policy, education and regulatory initiatives to meet this objective. These have included i) participating in policy development with the Canadian Securities Administrators on the use of a Trusted Contact Person and Temporary Holds to protect vulnerable clients; ii) organizing educational events providing guidance on protecting and servicing senior clients and iii) implementing a risk-based focus in both Compliance and Enforcement activities on seniors and other vulnerable clients.

Older clients and clients with limited financial resources can be more likely to display characteristics of vulnerability than other clients. As noted in the 2020 MFDA Client Research Report, 22% of MFDA Member clients were 65 years of age or older. Further, 18% of clients 65 years of age or older had less than $100,000 in financial wealth[1]. However, age and limited savings are certainly not the only factors that increase the risk of vulnerability. Accordingly, we are issuing this discussion paper to encourage consideration of the various factors that may increase the risk of client vulnerability and share certain best practices and practical actions to help meet the needs of vulnerable clients.

Who are Vulnerable Clients?

The definition of vulnerable clients used by most regulators is similar and typically refers to clients whose personal circumstances make them more susceptible to harm or financial losses. On March 5, 2020 the Canadian Securities Administrators published proposed amendments to National Instrument 31-103 dealing with the use of Trusted Contact Persons and Temporary Holds that includes a definition of a vulnerable client as a client "who may have an illness, impairment, disability or aging process limitation that places the client at risk of financial exploitation."[2]

The Financial Conduct Authority in their 2021 guidance for firms on the fair treatment of vulnerable customers, explained that the definition they use for vulnerable customers is intentionally broad and stated that: "A vulnerable customer is someone who, due to their personal circumstances, is especially susceptible to harm, particularly when a firm is not acting with appropriate levels of care."[3]

Both the CSA proposed amendments to National Instrument 31-103 and the guidance to firms from the Financial Conduct Authority propose different definitions of vulnerable client. The CSA definition, which is more narrow, was drafted to reflect the particular scope and purpose of the CSA regulatory

[1] MFDA, 'Client Research Report 2020'
[2] Canadian Securities Administrators, March 5, 2021 'Proposed Amendments to National Instrument 31-103'
[3] Financial Conduct Authority, 2021, 'Guidance for firms on the fair treatment of vulnerable customers"

initiative. This MFDA discussion paper takes a much broader look at the concept of vulnerability and, while this will no doubt be beneficial to Members in informing their interactions with clients, the broader commentary should in no way be construed to interpret any existing or proposed regulatory requirements, particularly *Amendments to National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations and changes to Enhance Protection of Older and Vulnerable Clients*.

As discussed further below, when looking at vulnerable clients broadly these clients may not only be at risk of further harm but may also have different needs than other clients. We recognize that clients may not want the label "vulnerable" applied to them and therefore while we use this term in this paper, we suggest that Members do not use it in their interactions with clients.

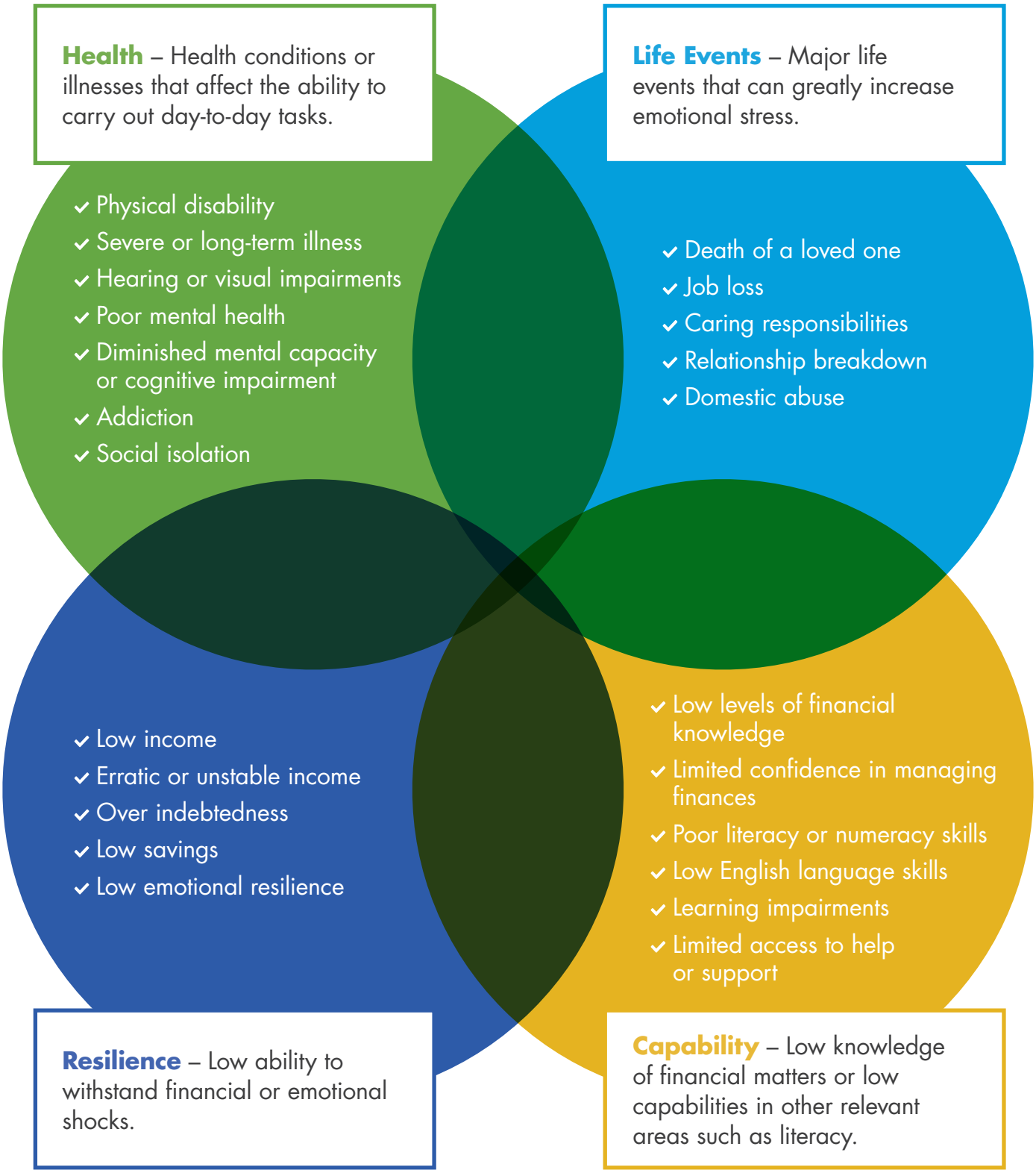
While vulnerability can be permanent, in many cases it is transient because client circumstances constantly change. This can cause clients who were not previously vulnerable to become vulnerable during that stage of their life. For example, a client who loses their spouse may become vulnerable at that stage of their life. While a client who was previously unemployed may now have sufficient income to cover their expenses and therefore may no longer be vulnerable due to a positive change in their circumstances.

Why is it Important to Identify and Understand the Needs of Vulnerable Clients?

It is important to identify vulnerable clients not only because these clients may be more susceptible to harm, but also because they may have additional or different needs than other clients. For example, some vulnerable clients may find certain forms of communication challenging or stressful. If Members are not able to adequately identify vulnerable clients and understand their potential needs, it can result in gaps in communication, inadequate customer service, unsuitable advice, and poor outcomes for clients which can lead to client complaints.

What are the Factors that Increase the Risk of Vulnerability?

There are some groups of clients who are more likely to display characteristics of vulnerability than others, such as seniors, new immigrants and the unemployed. However, rather than simply looking at demographic groups, a broader look at the factors or drivers that increase the risk of vulnerability may provide a better understanding of vulnerability and the different needs of these investors. These include:



These characteristics of vulnerability are complex and overlapping. For example, a major life event such as a relationship breakdown or bereavement may lead to further vulnerability such as poor mental health or low financial resilience. All clients are at some risk of becoming vulnerable and they may become more or less vulnerable throughout the course of their lives. A heightened period of vulnerability can be short (for example, a hospital stay) or long term (for example, an extended period of unemployment).

Members should also understand how vulnerability can be perpetuated or exacerbated by the actions, or inaction of the Member. For example, unsuitable investment advice can lead to greater stress and anxiety or lead the client to take actions that may cause further harm. e.g. selling investments at inopportune times, borrowing money, including from credit cards or high interest loans to meet a cash flow shortfall.

The Impact of Vulnerability

Members should recognize the impact of vulnerability on clients. Vulnerable clients may be more likely to fall into debt, take unnecessary investment risks or fall victim to financial fraud. Each of these consequences can in turn further worsen a client's mental health and financial and emotional resilience.

In looking particularly at financial fraud, researchers have found older age and decreased level of cognitive function, decreased psychological well-being and lower literacy to be important markers of increased susceptibility to financial fraud.[4] Research conducted by the British Columbia Securities Commission found those who had difficulty "making ends meet each month" and those who were worried about running out of money in retirement to be more susceptible to investment fraud.[5]

It is also important to recognize that the COVID-19 pandemic has significantly increased social isolation which can be a cause of vulnerability and a significant factor contributing to the risk of financial exploitation and investment fraud.The North American Securities Administrators, FINRA and the SEC issued an advisory to raise awareness of this risk, noting that research has found that people are more likely to be victimized if they are isolated and do not have anyone to discuss an investment proposal with.[6]

Vulnerable clients may be significantly less able to represent their own interests. They may also be more prone to certain behavioural biases that negatively affect decision making. For example, vulnerable clients may be more likely to suffer from behavioural patterns such as "scarcity mindset" which can reduce mental bandwidth and lead clients to focus on certain factors at the expense of others.[7] This may mean that these clients, especially those who may not be financially resilient,

[4] For example see James, Boyle and Bennet (2014). 'Correlates of Susceptibility to Scams in Older Adults Without Dementia'. Journal of Elder Abuse and Neglect. and Gamble, Boyle, Yu and Bennet (2014) 'The Causes and Consequences of Financial Fraud Among Older Americans'. Boston College Center for Retirement

[5] See British Columbia Securities Commission, 2012 'National Investment Fraud Vulnerability Report'

[6] See NASAA, FINRA and SEC, 2021, 'Social Isolation and the Risk of Investment Fraud'

[7] See Mullainathan & Shafir, 2013 'Scarcity: Why having too little means so much'

are more likely to make mistakes in their financial decisions. Vulnerable clients may have reduced ability to analyze short-term and long-term considerations and may fall prey to the promise of an immediate reward. They may fail to detect the longer-range adverse consequences of their actions.[8]

Vulnerable clients may not be able to understand the information they are sent or may struggle to communicate their needs. For example, sight and hearing impairments can make certain channels of communication impossible to use and make alternative communication formats essential.

Some of the additional consequences of vulnerability that have been highlighted in research include:

- Increasing pre-occupation limiting ability to manage and think clearly;
- Decreased processing ability due to competing pressures;
- Forgetfulness;
- Difficulty keeping facts straight;
- Failure to fulfill financial obligations such as paying bills;
- Lack of perspective, especially when experiencing something for the first time, not fully understanding the implications, unable to make comparisons, or see the "big picture";
- Changing behaviours, thinking and attitudes including attitudes toward taking risks. People may become more careless or reckless and interested in get rich quick schemes.

[8] See Denburg, 2015 'The Neurology of Financial Decision Making'

Meeting the Needs of Vulnerable Clients

Although vulnerable clients are at greater risk of harm, that does not mean that they will suffer harm, particularly if Members act with appropriate levels of care. Some of the actions Members can take include:

- ✔ Ensure staff have the appropriate training to recognize vulnerability including potential red flags or warning signs and to respond appropriately to meet the needs of vulnerable clients;
- ✔ Support vulnerable clients to articulate their needs and describe what support would help them. Start with open-ended questions and listen carefully to answers;
- ✔ Ensure all communications and information about products and services are presented in ways that are understandable and that important terms and concepts are explained clearly. This includes providing simple and clear explanations of fees and embedded or other compensation in a transparent manner. Use simple language and avoid the use of jargon;
- ✔ When using written communication, use large type where possible to make documents easier to read. Use images or pictographs where appropriate to help convey information;
- ✔ When dealing with clients who may have difficulty hearing, speak slowly, enunciate and reduce background noise as much as possible;
- ✔ Offer multiple channels of communication so clients have a choice in the way they communicate with the Member. Where possible, avoid inflexibility such as automated customer service helplines with no clear exits which can be difficult for people with complex needs to use;
- ✔ Provide clients with adequate time to understand information and make decisions;
- ✔ Document conversations with vulnerable clients and provide them with written summaries and instructions for any further actions or follow-up;
- ✔ Establish more frequent contact with vulnerable clients to address questions or concerns and monitor changes in their circumstances;
- ✔ When approving investment products for sale, consider the potential impact on vulnerable clients. Could features of an investment product exploit vulnerable clients?
- ✔ When building digital solutions, look for opportunities to proactively offer help. For example, some digital solutions have the functionality to pick up on hesitation or "hover time" and automatically generate chats or provide simple definitions when a reader hovers over a word or phrase;
- ✔ Consider the needs of vulnerable clients when designing the complaints process and be mindful of any difficulties that the complaint handling procedures may pose for vulnerable clients. These clients may be particularly susceptible to abandoning a justified complaint as a result of a prolonged and unduly complex process.[9] Apply the communication tips described above to help clients to communicate their concerns comfortably and consider encouraging vulnerable clients to include a trusted family member or friend in the discussion.

[9] Canadian Securities Administrators, 2019, "Suggested Practices for Engaging with Older or Vulnerable Clients"

Additional Resources

The information provided in this paper is in part a summary of some of the concepts discussed in guidance issued in 2021 by the U.K Financial Conduct Authority entitled "Guidance for firms on the fair treatment of vulnerable customers." Members interested in further information and practical guidance on dealing with vulnerable customers may also wish to review the full FCA guidance.

In addition, CSA Staff Notice 31-354, "Suggested Practices for Engaging with Older or Vulnerable Clients" includes, among other things, lists of red flags that may be helpful warning signs of vulnerability or diminished capacity.

Lastly, MFDA Bulletin #0797-P, "Seniors and Vulnerable Clients" discusses practices to protect vulnerable clients.

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