CERTIFIED FINANCIAL PLANNER BOARD OF STANDARDS, INC.

ANONYMOUS CASE HISTORIES
NUMBER 30850

This is a summary of a decision issued following the June 2018 hearings of the Disciplinary and Ethics Commission ("Commission") of Certified Financial Planner Board of Standards, Inc. ("CFP Board"). The conduct at issue in this case occurred after January 1, 2009. The Rules in effect at that time under the *Rules of Conduct* were Rules 1.1 through 6.5.

I. Issues Presented

Whether a CFP® professional ("Respondent") violated CFP Board's *Standards of Professional Conduct* when he (1) made an unsuitable investment recommendation to a client; (2) misrepresented the values of annuities being recommended to that client; (3) placed his interest above his client's interest by making an unsuitable recommendation that resulted in more than $25,000 in commission fees for the Respondent; and (4) failed to report a subsequent suspension by the Financial Industry Regulatory Authority ("FINRA") to CFP Board within 30 days.

II. Findings of Fact

Respondent first became associated with a FINRA-registered broker-dealer in 1993 and has passed the Series 6, 7, 24, 63, and 65 FINRA examinations. He was registered with ABC from 2009 until 2015, at which time the firm was acquired by DEF. Respondent remained registered with DEF until April 2017 when, as noted on the Form U5 filed by the firm, he was terminated for his "[l]ack of confidence after settlement of customer complaint[s] and nondisclosure of outside business activity."

2017 FINRA AWC

In June 2017, Respondent executed a FINRA Letter of Acceptance Waiver and Consent ("AWC"), finding that, in September 2014, Respondent recommended several annuity transactions to one of his clients without reasonable basis, violating FINRA Rules 2111, 2330, and 2010. The AWC also found that the Respondent engaged in an outside business activity with the same client without providing prior written notice to the firm in violation of FINRA Rules 3270 and 2010.

With respect to the unsuitable recommendations, the FINRA AWC found that Respondent recommended several unsuitable transactions to a client, including: (a) the exchange of an existing variable annuity for a new one; (b) the sale of an existing variable annuity to purchase two fixed equity-indexed annuities;[1] and (c) the liquidation of three additional variable annuities and the transfer of the proceeds to ABC. The AWC stated that the client's existing variable annuities all provided for guaranteed minimum income available upon annuitization equal to three times the premiums paid, and that the client, age 59, was primarily interested in increased income for retirement. The AWC found that (a) the new variable annuity and the two fixed equity-indexed annuities did not offer the same income growth potential as the client's existing variable annuities; (b) the liquidation of the three remaining variable annuities did not provide any guaranteed income; (c) in the event that the client chose not to annuitize, the existing products offered higher death benefits than the new products; and (d) by exchanging an existing variable annuity for a new variable annuity,

[1] The suitability charge in the FINRA AWC did not apply to the purchases of the fixed equity-indexed annuities but did relate to the sale of the variable annuity.

Respondent exposed the client to the risk of incurring surrender charges with a new seven-year surrender period. The AWC found that Respondent's commissions on the sale of the annuities was $25,460.

The AWC found that, as a result of these unsuitable recommendations, Respondent violated FINRA Rules 2111 and 2330, which require registered representatives to have a reasonable basis to believe that a recommended variable annuity transaction is suitable in light of the customer's age, financial situation and needs, risk tolerance, and investment objective, as well as Rule 2010, which requires registered representatives to observe high standards of commercial honor and just and equitable principles of trade.

With respect to the outside business activity, the AWC found that, in September 2014, the Respondent charged the same client $2,500 for consulting services that he provided in connection with the construction of a modular office building for her medical practice. The AWC found that Respondent engaged in this outside business activity without providing prior written notice to his firm or obtaining permission from the firm to engage in the activity, and, as a result, Respondent violated FINRA Rule 3270, which prohibits business activities outside the scope of the relationship between the registered representative and his firm, unless he or she has provided prior written notice to the firm, and Rule 2010.

In the AWC, Respondent consented to the following: (a) a four-month suspension; (b) a $10,000 fine; and (c) the disgorgement of commissions received ($25,460 plus interest).

Article 13.1 of the *Disciplinary Rules* provides that a letter or other writing from a governmental or industry self-regulatory authority to the effect that a Respondent has been the subject of an order of professional discipline by such authority shall conclusively establish the existence of such professional discipline for purposes of disciplinary proceedings and shall be conclusive proof of the basis for such discipline by the Respondent. As defined in Article 13.4 of the *Disciplinary Rules*, professional discipline "shall include the suspension, bar or revocation as a disciplinary measure by any governmental agency, industry self-regulatory organization or professional association."

2012 FINRA Arbitration

In 2012, married clients of Respondent filed a FINRA arbitration against him, alleging that, in 2007, while Respondent was employed with GHI, he recommended that they invest the majority of their retirement assets in speculative stocks, mutual funds, and non- traded real estate investment trusts ("REITs"), despite the clients' low risk tolerance. The clients alleged unsuitability, misrepresentation and breach of fiduciary duty against Respondent. The parties settled the matter on April 2014 for $25,000.

Respondent stated that his former firm, GHI, provided him with legal representation with respect to this claim and that GHI paid the claimant $25,000 for its "nuisance" value. Respondent's Central Registration Depository ("CRD") report reflects three other customer complaints, all of which appear to emanate from the client who filed this arbitration claim.

2015 FINRA Arbitration

In November 2015, the client whose transactions were the subject of Respondent's 2017 FINRA AWC filed a FINRA arbitration claim against him alleging that Respondent sold her unsuitable variable annuities and equity indexed annuities, causing alleged losses of approximately $1,575,843.60 in guaranteed income. In January 2017, the parties settled the matter for $480,000.

Respondent and the client met at Respondent's church in August 2013 shortly after the client moved to State A. The client's disclosure documents stated that the client, who was in her late 50s at the time, was a medical doctor with annual income of between $200,000 and $499,000 and liquid net worth of more than $2.5 million. Among her investments were five variable annuities collectively valued at over $3 million. According to Respondent, the client sought both guaranteed lifetime income and the ability to pass along money to her children upon her death.

In September 2014, the client transferred her assets to Respondent at ABC. The client's existing variable annuities had a guaranteed minimum income benefit rider that would guarantee minimum income but only if she elected to annuitize her investment.[2] Respondent stated that the client told him that she did not want to annuitize the investment because she wanted it to be part of her children's inheritance and the annuity's death benefit would be lost upon annuitization. Respondent also stated that he believed the annual fee for the existing variable annuities of 3.95% was high. Respondent stated that, for these reasons, he recommended that the client surrender the annuities and replace approximately half of them with (1) a new variable annuity with a lifetime withdrawal feature that would not require annuitization and a lower expense ratio than the existing annuities, and (2) two fixed annuities with guaranteed withdrawal amounts for life and lower expense ratios. The balance of the client's money from the surrender of the original variable annuities would be invested in a brokerage account. Respondent said that the client approved of the transactions. The client's signature and/or initials appear on the various annuity application and analysis forms detailing information with respect to the transactions. Respondent's commission on the sale of the annuities was $25,460.

On the client's Annuity Analysis Form, which the client initialed and signed, Respondent represented that the client's current annuities would only grow by seven percent compound interest for two years before maturity. However, according to the client in her statement of claim, her existing annuities were actually set to grow in value by seven percent compound interest for eight more years. Respondent admitted in his Answer that he incorrectly represented the growth benefit for the existing annuities, stating that he received incorrect information from an annuity wholesaler. As stated on the Annuity Analysis Form, the annuities recommended by the Respondent would grow for ten years at only a six percent simple interest. Further, although the Annuity Analysis Form states that the client would lose a death benefit by replacing the existing variable annuities and that the loss was not a concern to Respondent because she has substantial assets, the client contended that the Respondent never discussed this point with her. Additionally, Respondent stated that, because the client was so focused on her desire not to annuitize, he did not perform a comparison of the client's potential monthly income should she annuitize the existing variable annuities with potential monthly income that she would receive under the replacement/new investments.

In her statement of claim, the client contended that the liquidation of the remaining variable annuity accounts and the transfer of the proceeds to a brokerage account was not in her best interest because she did not need immediate income while still working, but rather desired guaranteed future income for retirement. Respondent stated that the liquidation of the variable annuities and transfer of the funds to a brokerage account ensured that the client's variable annuity to investable asset ratio was in line with industry best practices.

Failure to Disclose FINRA Suspension to CFP Board

Article 13.2 of the *Disciplinary Rules* requires CFP® professionals to disclose professional discipline, including suspensions, to CFP Board within 30 days of notification of the discipline. Respondent admitted in his Answer that he did not make the required disclosure, citing his "clinical depression" that resulted from his termination and his settlement with FINRA.

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[2] At the hearing, Respondent confirmed that the client was not required to annuitize to use the annuity; annuitization was only required if she opted to use the rider.

III. <u>Grounds for Discipline</u>

First Ground for Discipline

Pursuant to Article 3(A) of the *Disciplinary Rules*, there are grounds to discipline Respondent for acts or omissions that violate Rule 1.4 of the *Rules of Conduct*, which provides that a certificant shall at all times place the interest of the client ahead of his or her own.

CFP Board's Complaint alleged that Respondent, a certificant, failed to place his client's interests ahead of his own when he recommended that she sell all five of her existing variable annuities to purchase new annuities and open a brokerage account, which was unsuitable and did not provide the same benefits as her existing annuities. The FINRA AWC is conclusive proof that Respondent's recommendations to replace or sell the client's existing variable annuities were unsuitable because the new investments did not provide the same income growth potential, did not provide guaranteed income, provided lower death benefits without annuitization, and exposed the client to the risk of surrender charges with a new surrender period on the new variable annuity. The AWC is also conclusive proof that Respondent received substantial commissions in connection with the unsuitable transactions. For these reasons, Respondent placed his interests ahead of the client's in violation of Rule 1.4.

Separate from the FINRA AWC proof, the Commission also determined that Respondent's recommendations to sell or replace the variable annuities and purchase new annuities and open a brokerage account with cash were unsuitable, and caused losses of guaranteed income for the client while generating substantial commissions for Respondent. Specifically, the Commission viewed the information that the Respondent received regarding the client's investment objectives for the annuity transactions as conflicting. Respondent stated that the client was not concerned with losing the death benefit in her existing variable annuities because her children are adults; however, she also said that she did not want to annuitize her existing variable annuities in order to benefit from the guaranteed minimum income benefit because she wanted her children to inherit her assets. Despite this conflict and the fact that annuitization would only be required if she chose to utilize the guaranteed minimum income benefit rider, Respondent still recommended that the client sell or replace the existing annuities and lose the annuities' death benefit, which the Commission believed was unsuitable. In addition, Respondent admitted that he never performed an income analysis for the client prior to the sale and replacement of the variable annuities. For these reasons, Respondent placed his interests ahead of the client's and violated Rule 1.4 of the *Rules of Conduct*.

Second Ground for Discipline

Pursuant to Article 3(A) of the *Disciplinary Rules*, there are grounds to discipline Respondent for acts or omissions that violate Rule 2.1 of the *Rules of Conduct*, which provides that a certificant shall not communicate, directly or indirectly, to clients or prospective clients any false or misleading information directly or indirectly related to the certificant's professional qualifications or services. A certificant shall not mislead any parties about the potential benefits of the certificant's service. A certificant shall not fail to disclose or otherwise omit facts where that disclosure is necessary to avoid misleading clients.

Respondent, a certificant, misrepresented the differences between the client's existing variable annuities and the new annuities he recommended, and failed to disclose material information in connection with those recommendations. As Respondent admitted in his Answer, he provided incorrect information to the client with respect to the income growth potential of the client's existing annuities, misrepresenting the differences between the existing and recommended products. Thus, Respondent violated Rule 2.1 of the *Rules of Conduct*.

Third Ground for Discipline

Pursuant to Article 3(A) of the *Disciplinary Rules*, there are grounds to discipline Respondent for acts or omissions that violate Rule 4.3 of the *Rules of Conduct*, which provides that a certificant shall comply with applicable regulatory requirements governing professional services provided to the client.

Respondent is a certificant. The FINRA AWC is conclusive proof that Respondent failed to comply with FINRA Rules 2111, 2330, 3270, and 2010, which are regulatory requirements governing professional services provided to the client. Respondent also admitted this ground for discipline in his Answer. Thus, Respondent violated Rule 4.3 of the *Rules of Conduct*.

Fourth Ground for Discipline

Pursuant to Article 3(A) of the *Disciplinary Rules*, there are grounds to discipline Respondent for acts or omissions that violate Rule 4.4 of the *Rules of Conduct*, which provides that a certificant shall exercise reasonable and prudent professional judgment in providing professional services to clients.

Respondent, a certificant, failed to exercise reasonable and prudent professional judgment in providing professional services to clients when he: (a) recommended unsuitable transactions to his client without having a reasonable basis for believing that the transactions were suitable for the client, in violation of FINRA Rules 2111, 2330 and 2010; and (b) engaged in outside business activities without providing prior written notice to, or obtaining the approval of, his firm, in violation of FINRA Rules 3270 and 2010. The FINRA AWC is conclusive proof of these facts. Thus, Respondent violated Rule 4.4 of the *Rules of Conduct*.

Fifth Ground for Discipline

Pursuant to Article 3(A) of the *Disciplinary Rules*, there are grounds to discipline Respondent for acts or omissions that violate Rule 4.5 of the *Rules of Conduct*, which provides that, in addition to the requirements of Rule 1.4, a certificant shall make and/or implement only recommendations that are suitable for the client.

Respondent, a certificant, failed to make and/or implement only recommendations that were suitable for his client when he recommended that the client sell her existing annuities to purchase new annuities which were unsuitable and which did not provide the same benefits as the existing annuities. FINRA's AWC is conclusive proof of these facts. Thus, Respondent violated Rule 4.5 of the *Rules of Conduct*.

Sixth Ground for Discipline

Pursuant to Article 3(D) of the *Disciplinary Rules*, there are grounds to discipline Respondent for acts that are the proper basis for professional discipline. The acts set forth in FINRA's AWC are the proper basis for professional discipline, and Respondent's FINRA suspension constitutes professional discipline. Therefore, the AWC is conclusive proof that there are grounds to discipline Respondent for acts that are a proper basis for professional discipline. Respondent admitted this ground for discipline in his Answer.

Seventh Ground for Discipline

Pursuant to Article 3(E) of the *Disciplinary Rules*, there are grounds to discipline Respondent for an act or omission that violates these Disciplinary Rules or an order of discipline. Under Article 13.2 of the Disciplinary Rules, every

CFP® professional who receives a suspension of a professional license must notify CFP Board within 30 calendar days after receiving notification of the suspension. On June 6, 2017, FINRA notified Respondent of the following sanction: a four-month suspension from association in any capacity with any FINRA member firm. As Respondent admitted in his Answer, he failed to report this suspension of a professional license to CFP Board within the required 30 calendar days. Therefore, Respondent's omission violates Article 13.2.

IV. Discipline Imposed

The Commission found that Respondent's conduct violated Rules 1.4, 2.1, 4.3, 4.4, 4.5 of the *Rules of Conduct*, providing grounds for discipline under Articles 3(a), 3(d), and 3(e) of the *Disciplinary Rules*.

After careful consideration of the evidence in Respondent's matter, the Commission determined to issue Respondent a suspension for one year and one day pursuant to Article 4.3 of the *Disciplinary Rules*. The suspension is effective from October 2018 until October 2019 if Respondent does not appeal this order.

In arriving at its decision, the Commission determined that the applicable Sanction Guidelines recommended:

1. Conduct 14: Failure to Disclose to CFP Board (Private Censure).
2. Conduct 30: Securities Law Violation (Public Letter of Admonition).
3. Conduct 31: Suitability Violation (Suspension for One Year).
4. Conduct 34: Professional Discipline as defined in Article 13.6 involving a Suspension for more than Three Months (Suspension for at Least One Year and One Day).

The Commission then consulted *Anonymous Case Histories ("ACHs")* to determine if any *ACHs* contained precedent that warranted a deviation from the Sanction Guidelines. The Commission focused on *ACH* 27713, in which the Commission found that a CFP® professional violated Rule 201 of the *Code of Ethics* and Rules 1.4, 4.5, and 6.5 of the *Rules of Conduct* when he recommended and sold clients alternative investments that resulted in an unsuitable concentration of the clients' assets in alternative investments, and recommended and sold clients alternative investments that were unsuitable due to the clients' ages, risk tolerances, and investment objectives. In that case, the Commission issued a one-year suspension to the CFP® professional. The Commission also consulted *ACH* 22986 and *ACH* 15094, which resulted in four-year and five-year suspensions, respectively, determining those matters to involve more egregious conduct than that of Respondent.

The Commission considered whether there were any material aggravating and mitigating factors, and, if so, what weight those factors may have on the sanction. The Commission did not consider any mitigating factors. However, in aggravation, the Commission considered that:

1. Respondent did not disclose his FINRA suspension to CFP Board;
2. The client was harmed or potentially harmed with respect to the loss of her death benefit and potential guaranteed minimum income benefit from the replacement/sale of the existing variable annuities;
3. Respondent had three other customer complaints;
4. Respondent's unsuitable recommendations were surprising given his long career and extensive experience; and
5. Respondent's lack of remorse for his conduct in his written submissions or during his testimony.

Based on all of these factors, the Commission determined that it was appropriate to issue a suspension of a year and one day.