CERTIFIED FINANCIAL PLANNER BOARD OF STANDARDS, INC.

ANONYMOUS CASE HISTORIES
NUMBER 31010

This is a summary of a Settlement Agreement entered into at the October 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. Issue Presented

Whether a CFP® professional ("Respondent") violated CFP Board's *Standards of Professional Conduct* by recommending that a client surrender of an annuity contract when Respondent did not properly estimate the cost basis of the annuity and incorrectly advised her client about the tax consequences of withdrawing funds from the annuity.

II. Findings of Fact

Respondent was certified as a CFP® professional on November 15, 1989. She has maintained her certification since that date. Respondent has passed five Financial Industry Regulatory Authority ("FINRA") examinations: (a) the Investment Company Products/Variable Contracts Representative Examination (Series 6), (b) the Uniform Securities Agent State Law Examination (Series 63), (c) the General Securities Representative Examination (Series 7), (d) the General Securities Principal Examination (Series 24), and (e) the Uniform Investment Adviser Law Examination (Series 65).

Respondent was associated with a FINRA member firm, XYZ Securities Company, from March 1986 through July 1990. Since March 1990, Respondent has been employed as an advisor with ABC. She also has been associated with QRS Financial Services, Inc. ("QRS"), a FINRA member firm, since August 1990. Respondent also has been licensed as an insurance salesperson with State since at least 1987.

2017 Customer Complaint

Claimants initially consulted with Respondent in 2006. Claimants subsequently worked with Respondent to establish a 529 college savings plan for their daughter, and Respondent also assisted Claimant Wife with an Investment Retirement Account ("IRA") rollover. Respondent affirms that she provided financial planning services to Claimants during some or all of the period 2006 through 2014.

Claimants allege that, in mid-2012, Respondent recommended that Claimant Husband surrender a BB annuity in order to "more aggressively fund" a variable life insurance policy on which Claimant Husband was the insured. At the time, the BB annuity was worth approximately $205,000. According to Respondent, the annuity had earned only approximately 1.37% over the previous 11.5 years and was outside of its surrender period.

Respondent informed Claimants that, given Claimant Husband's age (under 59), Respondent anticipated that Claimant Husband would be taxed approximately 30% on a gain of $35,000.00 ($10,500.00) and also would incur a tax penalty of approximately 10% on the gain ($3,500.00), for a total of approximately $14,000.00. According to Respondent, the "decision was not made lightly as [they] discussed [it] at least

3x (over a year period, maybe 2) before [they] did anything. [They] kept waiting for [Claimant Husband's] annuity to move…performance wise [sic]. It did nothing."

Respondent concedes that she calculated the projected tax penalty based on a BB account statement reflecting Claimant Wife's contributions to the annuity. In doing so, Respondent incorrectly assumed that the contributions to the BB annuity ($171,044.14) were equal to the cost basis of the annuity.

Respondent also concedes that she failed to ask Claimant Wife whether she had rolled over funds from a prior annuity into the BB annuity. Had she done so, Claimants would have advised her that Claimant Wife had rolled over funds that were originally invested with DD Life Insurance Company.

According to Claimants, rather than surrender the BB annuity, Claimant Wife elected to take a "more conservative" distribution of $110,000.00 in January 2013 and deposit some of the assets into the State Life Insurance Policy.

Claimants engaged a Certified Public Accountant ("CPA") to prepare their 2013 taxes. On October 1, 2014, the CPA informed Claimants that Respondent had miscalculated the cost basis of the annuity. The CPA determined that the $110,000.00 distribution would be taxed at a rate of 47.33%, including 25.57% for Federal taxes, 9.26% for California taxes and an early withdrawal penalty of 12.5% because of Claimant Wife's age. As a result, the CPA calculated that Claimants owed approximately $51,510.00 in additional taxes and penalties arising out of the $110,000.00 distribution.

On October 1, 2014, Claimant Wife contacted Respondent to inform her of the apparent miscalculation. They agreed to meet during the following week.

According to Claimants, Claimant Wife subsequently contacted BB to request additional information. An BB representative advised Claimant Wife that the cost basis of the annuity was $102,400.00 (the amount Claimant Wife originally invested with DD Life Insurance Company), not $171,044.00 (the amount of "contributions" identified on Claimant Wife's BB account statement).

The BB representative noted that Respondent could have requested a cost basis letter before recommending that the Claimant Wife surrender the annuity. Claimants subsequently obtained a cost basis letter confirming the BB representative's statement.

On October 8, 2014, Respondent met with Claimants to discuss relevant issues. During the meeting, Respondent admitted that she incorrectly assumed that the contribution amount reflected on the BB account statement was the cost basis of the annuity.

On September 29, 2017, Claimants sent a written complaint to ABC, indicating that they intended to file a claim with Respondent's (and QRS's) errors and omissions insurance carrier "for [Respondent's] negligence in advising [Claimants] to take a withdrawal" from Claimant Wife's BB annuity. Respondent contends that her office suggested that Claimants "put in a complaint about 3 years after [the] error . . . so that [they] would keep their client/firm relationship intact."

In the complaint, Claimants alleged that Respondent's miscalculation caused them to pay additional taxes to the IRS and State Franchise Board and to incur substantial penalties. Claimants stated that they had been forced to use their credit line to pay the unanticipated taxes and penalties, or risk liquidating non-liquid investments and suffering additional losses. Claimants further noted that, if they had been advised that the "tax liability of withdrawing $110,000 from the BB annuity was going to cost over $53,500 in

taxes and penalties, [they] never would have used the BB account for the source of additional funding for [Claimant Wife's] life insurance policy."

Respondent disclosed the complaint to CFP Board on January 22, 2018, in connection with her ethics declaration on her certification renewal. She affirmed that she has been or is currently "the subject of a written complaint that led to an investigation by an employer or other entity" and noted that she was "working on a complaint currently [but] had no arbitration or litigation."

Respondent provided additional detail regarding the complaint in her written response to CFP Board's Notice of Investigation, dated February 6, 2018. Respondent admitted that she had misinterpreted the account statement for the BB annuity and projected the tax gain incorrectly. Respondent described her mistake as an "honest error and accident," and confirmed that the "clients unfortunately had to pay tax on gains on a larger amount then [they] assumed. Therefore, generating a larger tax liability than anticipated."

On May 15, 2018, QRS and Claimants entered into a settlement for $93,759.34, consisting of (a) $62,818.76 in taxes, penalties and life insurance policy charges, (b) a "gross up" payment of $30,940.58 (assuming a combined federal and state tax rate of 33%) to account for the fact that the settlement payment would generate income for the 2018 tax year, and (c) $1,500.00 in attorney's fees.

Respondent's errors and omissions insurance carrier covered most of the claim. On July 11, 2018, the carrier notified Respondent that "all claims against [her had] been released or dropped."

Respondent's Form U4 was updated on May 31, 2018 to reflect the settled customer dispute. The relevant disclosure states "Client alleges [registered representative] provided inaccurate cost basis information related to a withdrawal from her annuity to invest in her life insurance policy in January 2013."

On July 11, 2018, in an e-mail communication with CFP Board Compliance Counsel, Respondent reaffirmed that the additional, unanticipated tax penalties and interest incurred by Claimants were "[her] fault, [because she] made an incorrect calculation of information that wasn't the Cost Basis."

III. Grounds for Discipline

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. When the certificant provides financial planning or material elements of financial planning, the certificant owes to the client the duty of care of a fiduciary as defined by CFP Board.

Respondent, a certificant, affirmed that she provided financial planning services to her client. Respondent failed to satisfy the fiduciary duty of care she owed to her client because she could not *reasonably* have believed it was in her client's best interest to, and a reasonable and prudent professional would not have: (a) assumed that the "contributions" reflected on an annuity account statement constituted the "cost basis" of the annuity; (b) failed to request information from her client or AXA that would have helped her to determine the correct cost basis of the annuity; and (c) recommended that her client surrender or cash out a portion of the annuity without verifying the cost basis, which caused her client to incur substantial tax penalties and interest.

Based on the allegations and conduct set forth herein, Respondent 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 4.5 of the *Rules of Conduct*, which provides that a certificant shall make and/or implement only recommendations that are suitable for the client.

Respondent, a certificant, failed to make and/or implement recommendations that were suitable for the client because she (a) assumed incorrectly that the "contributions" reflected on an annuity account statement constituted the "cost basis" of the annuity; (b) failed to request information from her client that would have helped her to calculate the correct cost basis of the annuity; and (c) recommended that her client surrender or cash out a portion of the annuity without verifying the cost basis, which caused her client to incur substantial tax penalties and interest.

Based on the allegations and conduct set forth herein, Respondent violated Rule 4.5 of the *Rules of Conduct*.

IV. Discipline Imposed

The Commission and Respondent entered into a Settlement Agreement in which Respondent consented to the Findings of Fact and Grounds for Discipline. Pursuant to the terms of the Settlement Agreement, the Commission issued to Respondent a Public Letter of Admonition as provided in Article 4 of the *Disciplinary Rules*.

The Commission found the following *Sanction Guideline* relevant to its decision: (1) a Suspension for at least one year and one day for Conduct 5 (Breach of Fiduciary Duty); (2) a Suspension for one year for Conduct 31 (Suitability Violation); and (3) a Private Censure for Conduct 11 (Diligence).

In coming to its decision to enter into the Settlement Agreement, the Commission considered the following aggravating factors: (1) Respondent's client suffered over $50,000 in harm; (2) the information regarding the Claimants' cost basis was available to Respondent had she called the annuity company with the Claimants on the phone; and (3) although Respondent admitted her mistake, the Commission did not believe that she accepted responsibility for the mistake.

In mitigation, the Commission identified that: (1) the Respondent had no prior disciplinary history with CFP Board; (2) the Respondent cooperated with CFP Board's investigation; and (3) this was an isolated incident, and not a pattern of misconduct.

Additionally, the Commission consulted *Anonymous Case History* ("ACH") 29051. In ACH 29051, a CFP® professional recommended that his client liquidate a variable annuity without (1) becoming the agent of record on the variable annuity; (2) handling the liquidation through his employer; (3) seeking approval from his employer for conducting outside business activities; and (4) knowing the cost basis of the variable annuity prior to making the recommendation. The transactions resulted in approximately $94,000 of taxable income and an approximate tax liability of $20,000. The client was required to take a loan against her home in order to pay her income taxes. The client filed a complaint against the CFP® professional with the State. The State subsequently issued an Administrative Complaint and Notice of Rights against the CFP® professional, finding that the CFP® professional's conduct violated State statutes

and the State administrative code by failing to observe high standards of commercial honor and just and equitable principles of trade required by National Association of Securities Dealers ("NASD") Rule 2110. After considering, in mitigation, that the CFP® professional had no prior disciplinary history and, in aggravation, that the CFP® professional's actions harmed the client, the Commission issued a public letter of admonition.