CERTIFIED FINANCIAL PLANNER BOARD OF STANDARDS, INC.

ANONYMOUS CASE HISTORIES
NUMBER 20996

This is a summary of a decision issued following the March 2012 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 prior to January 1, 2009. The Rules in effect at that time under the *Code of Ethics and Professional Responsibility* ("*Code of Ethics*") were Rules 101 through 705.

I. Issues Presented

Whether a CFP® professional ("Respondent") violated CFP Board's *Standards of Professional Conduct* when he: 1) represented that an annuity maximization concept was appropriate and reasonably designed to meet Client's needs and goals; 2) failed to disclose to Client that he received a commission due to his sale of a universal life insurance policy to her; 3) misrepresented Client's assets in order to obtain the universal life insurance policy; 4) recommending a transaction that was inappropriate for Client but allowed Respondent to gain financially; 5) failed to disclose the tax consequences of the sale of mutual funds; 6) failed to fully investigate Client's heir's tax liability by considering the state and federal inheritance tax exemptions and the cost basis of each individual annuity; and 7) failed to appropriately determine Client's cash flow needs in relation to her potential long-term care needs.

II. Findings of Fact Relevant to the Commission's Decision

In his April 2008 statement, Respondent indicated that he began working with Client while working at Firm. After their first review, Respondent learned that Client held a total of nine annuities that she had held for approximately 15 to 20 years. Client had not used the principal or the interest from any of the annuities.

In a review in late 2003, Respondent alleges that Client was concerned about passing assets to her daughter given that most of the gains were tax-deferred. To address this concern, Respondent and a wholesaler presented the Annuity Maximization Concept in which Client would annuitize her current annuities and use the income stream to fund a universal life insurance policy. In preparation for the presentation, Respondent reviewed two years of Client's tax returns, her annuity statements, her mutual fund accounts, her current expenses and her current income stream. After his review, Respondent prepared a balance sheet indicating that Client had a net worth of approximately $600,000, approximately $500,000 of which was invested in nine annuities. Additionally, Respondent determined that Client had an annual income of $27,000, which was sufficient to cover her current expenses. Respondent also estimated that after annuitizing her annuities, Client would have an additional $15,000 in income per year. Finally, Respondent estimated that Client's assets would enable her to cover long term care for three years at $72,000 annually.

Respondent prepared several Annuity Maximization concepts demonstrating how Client would benefit from annuitizing her annuities and using the proceeds to purchase a universal life insurance policy. In these concepts, Respondent assumed that Client's annuities were worth approximately $480,000 with a tax cost-basis of approximately $300,000 and a 4% growth rate for five years. After 10 years, Respondent assumed the value of the annuities would be $580,000. At an Income in Respect of a Decedent ("IRD") tax rate of 36%, Client's daughter would incur $98,000 in taxes upon inheritance. According to Respondent's concept, Client's daughter's final inheritance if Client kept the annuities would be $480,000.

Respondent represented that Client could avoid these consequences if she annuitized her annuities and obtained a total annual income stream of $80,000, with $28,000 taxed at a rate of 28%. Using the remaining stream of income, Respondent anticipated that Client would purchase a $600,000 universal life insurance policy with annual premiums of $65,000. The proceeds of the policy would then pass tax free to Client's daughter as beneficiary of the policy. Respondent asserted that this would result in a $120,000 gain for Client's daughter. After the transaction, Respondent represented Client would have approximately $120,000 in liquid assets to meet unforeseen needs such as nursing home care.

In October 2003, Client completed an application for a universal life insurance policy Company A. According to Respondent's testimony during his deposition in October 2007, Company A declined Client's application. In February 2004, Client completed an application for a $700,000 a Company B universal life insurance policy. In February 2004, Company B stated that Client's financial information did not justify a $700,000 policy. Further, Company B stated that in order to justify a $700,000 policy, additional financial information would be necessary. In March 2004, the wholesaler provided additional financial information to justify a $700,000 policy. The wholesaler provided a balance sheet for Client that indicated she had a net worth of $770,000. The increase in net worth was due to the addition of $20,000 in vehicles, $50,000 in jewelry, and $100,000 in personal property.[1] In addition to an increase in net worth, the balance sheet indicated that Client had an annual income of $37,000. When asked at his deposition where the wholesaler received the new financial information he provided to Company B, he stated that Respondent sits with the client and obtains the financial information Company B provides to the carrier. In Respondent's deposition, he did not recall providing the wholesaler with the new financial information.

In March 2004, Respondent had Client and her daughter sign a statement in which they acknowledged that they understood the Annuity Maximization Concept, that Client would be annuitizing her annuities, and that Client would be liquidating her mutual funds to pay the first premium for the universal life insurance policy. In April 2004, Respondent liquidated $65,000 worth of her mutual funds to fund the first premium for the life insurance. Respondent did not discuss the tax consequences of liquidating mutual funds with Client. In May 2004, based on the new financial information provided, Company B issued a universal life insurance policy with a

[1] In a declaration filed by Client's granddaughter, she stated that the new financial information submitted by the wholesaler was false.

face value of $610,000. Respondent received a commission of approximately $10,000. Respondent did not disclose to Client that he received a commission on the sale of the life insurance product.

In August 2006, Client's attorney sent a letter to Respondent stating that the annuity maximization transaction was a "financial disaster" and "threaten[ed] to impoverish Client for the rest of her life." After a meeting between Client's attorney, Client, her granddaughter and her granddaughter's husband, Respondent and other Firm representatives, Firm proposed that the face value and the annual premiums of the universal life insurance policy be reduced to $300,000 and $33,000, respectively.

In February 2007, Client filed a civil suit against Respondent alleging elder abuse, conspiracy to commit elder abuse, fraud on an elder, conspiracy to defraud an elder, breach of fiduciary duty, conspiracy to breach fiduciary duty, constructive fraud on an elder, conspiracy to commit constructive fraud on an elder, conversion and accounting. Per the Complaint, Client alleged that Respondent misrepresented to her that the Annuity Maximization transaction described above was appropriate, necessary and desirable for Client because it enabled her to avoid adverse tax consequences and to preserve the liquidity of her assets for future needs. Client alleged that as a result of these misrepresentations, she suffered a loss of income, funds set aside for personal care and maintenance, and assets essential to her health and welfare. Client requested compensatory and punitive damages and attorney's fees.

In April 2007, Respondent generally denied the allegations raised in Client's Complaint. On January 23, 2008, Respondent settled with Client for $625,000. Respondent did not personally contribute to the settlement.

III. Commission's Analysis and Conclusions Regarding Rule Violations

A. *Rule 102 – In the course of professional activities, a CFP Board designee shall not engage in conduct involving dishonesty, fraud, deceit or misrepresentation, or knowingly making a false or misleading statement to the client, employer, employee, professional colleague, governmental or other regulatory body or official, or any other person or entity*

The Commission determined that Respondent engaged in conduct involving dishonesty, deceit and misrepresentation, and knowingly made a false or misleading statement to the client when he: 1) misrepresented that the Annuity Maximization Concept was appropriate and reasonably designed to meet Client's needs and goals; 2) failed to disclose to Client that he received a commission due to his sale of a universal life insurance policy to her; 3) failed to disclose the tax consequences of the sale of mutual funds; and 4) misrepresented Client's assets in order to obtain the universal life insurance policy. Thus, Respondent violated *Code of Ethics* Rule 102.

B. *Rule 201 – A CFP Board designee shall exercise reasonable and prudent professional judgment in providing professional services*

The Commission determined that Respondent failed to exercise reasonable and prudent professional judgment in providing professional services when he failed to undertake an objective analysis of the annuity maximization strategy, which would have limited the use of the annuity maximization strategy to those annuities with a low cost basis. Respondent left Client with approximately $120,000 of assets to meet unforeseen needs such as nursing home care. The Commission determined that Respondent's estimates regarding the cost of care appear to be low for the area in which Client lived and Respondent unreasonably relied on Client's assertion that she would not need care because her daughter would provide it. Respondent also failed to disclose the tax consequences of the sale of mutual funds. Thus, Respondent violated *Code of Ethics* Rule 201.

C. *Rule 202 – A CFP Board designee shall act in the interest of the client*

The Commission determined that Respondent engaged in comprehensive data gathering when he reviewed Client's tax returns, expenses, income and investment portfolio to provide her with advice regarding estate planning and income tax planning. Based on his comprehensive review of Client's finances, the Commission determined that Respondent made recommendations that significantly altered Client's financial portfolio. The Commission also determined that the Respondent stood to gain from these transactions due to the large annual premiums Client would be paying. Finally, the Commission also determined that Respondent failed to act in the best interests of Client when he advised her to pursue a strategy that left her with insufficient liquid assets to meet possible long-term care needs and that provided questionable tax relief to Client. Thus, Respondent violated *Code of Ethics* Rule 202.

D. *Rule 606(b) – A CFP Board designee shall perform services in accordance with applicable rules, regulations and other established policies of CFP Board*

The Commission determined that Respondent failed to perform services in accordance with applicable rules, regulations and other established policies of CFP Board in violation of *Code of Ethics* Rules 102, 201, 202, 607, 701, 702 and 703 when he: 1) misrepresented that the Annuity Maximization Concept was appropriate and reasonably designed to meet Client's needs and goals; 2) failed to disclose to Client that he received a commission due to his sale of a universal life insurance policy to her; 3) misrepresented Client's assets in order to obtain the universal life insurance policy; 4) placed his interests ahead of Client's by recommending a transaction that was inappropriate for Client but allowed Respondent to gain financially; 5) failed to disclose the tax consequences of the sale of mutual funds; 6) failed to fully investigate Client's heir's tax liability by considering the state and federal inheritance tax exemptions and the cost basis of each individual annuity; and 7) failed to appropriately determine Client's cash flow needs in relation to her potential long-term care needs. Thus, Respondent violated *Code of Ethics* Rule 606(b).

E. Rule 607 – A CFP Board designee shall not engage in conduct which reflects adversely on integrity or fitness as a CFP Board designee, upon the marks, or upon the profession

The Commission determined that Respondent engaged in conduct that reflects adversely on his integrity and fitness as a CFP Board designee, upon the marks, and upon the profession when he: 1) misrepresented that the Annuity Maximization Concept was appropriate and reasonably designed to meet Client's needs and goals; 2) failed to disclose to Client that he received a commission due to his sale of a universal life insurance policy to her; 3) misrepresented Client's assets in order to obtain the universal life insurance policy; 4) placed his interest ahead of Client's by recommending a transaction that was inappropriate for Client but allowed Respondent to gain financially; 5) failed to disclose the tax consequences of the sale of mutual funds; 6) failed to fully investigate Client's heir's tax liability by considering the state and federal inheritance tax exemptions and the cost basis of each individual annuity; and 7) failed to appropriately determine Client's cash flow needs in relation to her potential long-term care needs. Thus, Respondent violated *Code of Ethics* Rule 607.

F. Rule 701 – A CFP Board designee shall provide services diligently

The Commission determined that Respondent failed to provide services diligently when he failed to: 1) fully investigate Client's heir's tax liability by considering the state and federal inheritance tax exemptions and the cost basis of each individual annuity; 2) disclose the tax consequences of the sale of mutual funds; 3) appropriately determine Client's cash flow needs in relation to her potential long-term care needs; and 4) ensure that accurate information was provided to Company B's underwriting department. Thus, Respondent violated *Code of Ethics* Rule 701.

G. Rule 702(b) – A CFP Board designee shall not enter into an engagement without securing sufficient information to satisfy the CFP designee that the CFP Board designee has the ability to either provide requisite competent services or to involve other professionals who can provide such services

The Commission determined that Respondent engaged in comprehensive data gathering when he reviewed Client's tax returns, expenses, income and investment portfolio to provide her with advice regarding estate planning and income tax planning. Based on his comprehensive review of Client's finances, the Commission determined that Respondent made recommendations that significantly altered Client's financial portfolio. Finally, the Commission determined that Respondent entered into an engagement without securing sufficient information to determine whether he had the ability to provide requisite competent services or to involve other professional who can provide such services when he exclusively relied on the wholesaler to locate an insurer willing to underwrite the universal life insurance policy necessary to execute the Annuity Maximization strategy. Thus, Respondent violated *Code of Ethics* Rule 702(b).

H. *Rule 703 – A CFP Board designee shall make and/or implement only recommendations which are suitable for the client*

The Commission determined that Respondent failed to make and implement only recommendations that were suitable for Client when recommending the unsuitable Annuity Maximization strategy for Client without: 1) fully investigating Client's heir's tax liability by considering the state and federal inheritance tax exemptions and the cost basis of each individual annuity; 2) disclosing the tax consequences of the sale of mutual funds; 3) appropriately determining Client's cash flow needs in relation to her potential long- term care needs; and 4) ensuring that accurate information was provided to Company B's underwriting department. Thus, Respondent violated *Code of Ethics* Rule 703.

I. *Practice Standard 400-2 – The financial planning practitioner shall develop the recommendation(s) based on the selected alternative(s) and the current course of action in an effort to reasonably meet the client's goals, needs and priorities*

After identifying the appropriate investment alternatives and Client's current course of action, Respondent was required to present recommendations reasonably designed to meet Client's goals, needs and priorities. The Commission determined that Respondent engaged in comprehensive data gathering when he reviewed Client's tax returns, expenses, income and investment portfolio to provide her with advice regarding estate planning and income tax planning. Based on his comprehensive review of Client's finances, the Commission determined that Respondent made recommendations that significantly altered Client's financial portfolio. Finally, the Commission determined that Respondent failed to present and develop any financial planning alternative that met Client's needs and goals because he failed to: 1) fully investigate Client's heir's tax liability by considering the state and federal inheritance tax exemptions and the cost basis of each individual annuity; 2) appropriately determine Client's cash flow needs in relation to her potential long-term care needs; and 3) ensure that accurate information was provided to Company B's underwriting department. Thus, Respondent violated *Practice Standard 400-2.*

J. *Practice Standard 500-2 – The financial planning practitioner shall select appropriate products and services that are consistent with the client's goals, needs and priorities*

Respondent was required to investigate products or services that reasonably addressed Client's needs. The Commission determined that Respondent engaged in comprehensive data gathering when he reviewed Client's tax returns, expenses, income and investment portfolio to provide her with advice regarding estate planning and income tax planning. Based on his comprehensive review of Client's finances, the Commission determined that Respondent made recommendations that significantly altered Client's financial portfolio. Finally, the Commission determined that the products and services Respondent selected were not suitable for Client because he failed to: 1) fully investigate Client's heir's tax liability by considering the state and federal inheritance tax exemptions and the cost basis of each individual annuity; 2) appropriately determine Client's cash flow needs in relation to her potential long-term care needs; and 3) ensure that accurate information was provided to Company B's underwriting department. Thus, Respondent violated *Practice Standards 500-2.*

A. Discipline Imposed

The Commission found grounds for discipline under Articles 3(a) and 3(b) of CFP Board's *Disciplinary Rules and Procedures* ("*Disciplinary Rules*"). Article 3(a) of CFP Board's *Disciplinary Rules* provides grounds for discipline for any act or omission that violates the *Code of Ethics*. The Commission found grounds for discipline under Article 3(a) because Respondent violated Rules 102, 201, 202, 606(b), 607, 701, 702(b) and 703 of the *Code of Ethics.* Article 3(b) of CFP Board's *Disciplinary Rules* provides grounds for discipline for any act or omission that violates the *Financial Planning Practice Standards.* The Commission found grounds for discipline under Article 3(b) because Respondent violated *Practice Standards* 400-2 and 500-2. Pursuant to Article 4.3 of the *Disciplinary Rules*, the Commission issued a two-year suspension. In addition to the suspension, the Commission required Respondent to complete nine hours of continuing education, six of which had to focus on universal life or variable annuities and three focusing on financial planning.

The Commission cited as a mitigating factor that Respondent was cooperative.

The Commission cited as aggravating factors that Respondent did not show any remorse for his actions and did not understand the universal life insurance policy or the risks associated with the policy.