CERTIFIED FINANCIAL PLANNER BOARD OF STANDARDS, INC.

ANONYMOUS CASE HISTORIES
NUMBER 22866

This is a summary of a decision issued following the June 2011 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) failed to disclose in the financial planning agreement that his employer had a material conflict of interest because it maintained "preferred supplier" relationships in which it received financial bonuses for selling the "preferred suppliers'" products that were in excess of the financial compensation it received for selling other products; 2) failed to provide the client with sufficient alternatives to his investment recommendations; 3) implemented his investment recommendations prior to presenting the client with the initial financial plan; and 4) placed a majority of the client's assets in deferred annuities, which did not provide a regular income stream to meet the client's projected expenses and did not meet their goal of minimizing estate taxes.

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

In June 1999, Clients won $4,000,000 in a State Lottery. At the time, Client #1 was a 70-year old retiree and Client #2 was 69 years old. Clients immediately placed their winnings into the following three accounts: 1) $400,000 in four Certificates of Deposit ("CDs"); 2) $200,000 in a credit union account; and 3) $2,500,000 in a Money Market Fund.

Initial Meeting

In July 1999, Clients met with Respondent seeking advice on how to invest their lottery winnings. Respondent recommended that Clients have Respondent prepare a financial plan to analyze their financial position, needs and goals. As part of the financial planning process, Clients completed an Investor Questionnaire ("Questionnaire"). Clients indicated on the Questionnaire that they had $3,000,000 in liquid assets, a moderate risk tolerance, an intermediate investment horizon, no investment experience and sought income as their investment objective. Clients also signed a Financial Planning Agreement with Respondent in which Clients agreed to pay $2,000 for the highest level of financial planning detail offered by Respondent's Financial Advisory Firm ("Firm"). Respondent did not disclose in the Financial Planning Agreement that Firm maintained "preferred supplier" relationships in which Firm received financial bonuses for selling "preferred supplier" products. The financial bonuses were in excess of the financial compensation Firm received for selling other products.

After Clients completed the Questionnaire, Respondent and another financial planner completed a memorandum summarizing Clients' investable assets in July 1999 ("Memorandum"). The Memorandum indicated that Clients continued to maintain $3,000,000 exactly as it had been initially invested immediately after Clients won the lottery. The Memorandum also recommended that Clients divide their investable assets into the following low and high liquidity investments:

1. Low liquidity investments:
    a. $430,000 in a Fixed Annuity: Respondent recommended this investment for Clients because they sought to place a portion of their winnings in a conservative position that allowed for tax-advantaged growth;
    b. $400,000 in a Annuity (Annuity A): Respondent recommended this investment for Clients because they sought a conservative way to participate in the stock market while achieving tax-advantaged growth;
    c. $650,000 in another Annuity ("Annuity B"): Respondent recommended this investment because Clients sought a tax-advantaged vehicle, a wide variety of investment options and diversification;
    d. $650,000 in a third Annuity ("Annuity C"): Respondent recommended this investment because Clients sought a tax-advantaged vehicle, a wide variety of investment options and diversification; and
    e. $70,000 in a Variable Universal Life Insurance policy ("VUL"): Respondent recommended this investment because the clients sought to avoid an estimated estate tax of $2,000,000.

2. High liquidity investments:
    a. $200,000 in a Bond Fund;
    b. $400,000 in Bank CDs;
    c. $200,000 in a Credit Union Money Market Fund; and
    d. $1,000 in a Bank Money Market Fund.

After receiving the recommendation from Respondent, Clients completed another Investment Questionnaire ("July Questionnaire"). In the July Questionnaire, Clients indicated that they had liquid assets of $3,000.000, a moderate risk tolerance, a long-term investment horizon, in excess of 30 years of investment experience and sought capital appreciation as their investment objective.

Based on the recommendations and the July Questionnaire, Respondent prepared a Summary containing a proposed retirement scenario. In the proposed scenario, Respondent indicated that Clients' expenses were $28,000 per year, plus the additional $70,000 per year to fund the VUL policy. Respondent indicated that Clients would receive $34,000 in income to cover estimated annual expenses of $98,000. Respondent also recommended that Clients purchase long-term care policies. Finally, Respondent indicated that Clients had adequate cash to purchase a new home and to finance several hunting trips they expressed interest in taking.

In July 1999, Respondent placed $196,000 in a Bond Fund. In July 1999, Respondent placed $430,000 in the Fixed Annuity, $400,000 in Annuity A, $650,000 in Annuity B and $650,000 in Annuity C. In July 1999, Respondent purchased the VUL policy with a $2,000,000 death benefit. These purchases were made in accordance with the Summary.

1999 Financial Plan ("1999 Plan")

In July 1999, Respondent presented the 1999 Plan to Clients. In the Suggested Cash Flow Management section of the 1999 Plan, Respondent's suggested cash flow indicated that Clients would receive a total income of $60,000 and incur expenses of $92,000 in 1999, resulting in a negative cash flow of $32,000. The 1999 Plan does not indicate whether the expenses include the $70,000 VUL premiums required to maintain the VUL. In his December 2010 response to CFP Board, Respondent stated that Clients were able to fund the VUL based on the current cash flow projections that were developed in the 1999 Plan, which identified the significant dividend income Clients were receiving from the Bank Money Market Fund. Respondent did not address whether the 1999 Plan accounted for the VUL premium under the asset allocation Respondent had implemented six days prior to the 1999 Plan. Finally, the 1999 Plan did not contain a summary of the investment recommendations or any alternatives Respondent may have presented to Clients.

After implementing the 1999 Plan, Clients made the following withdrawals to pay for federal and state taxes they incurred as a result of their lottery winnings:

1. $100,000 from a Bond Fund in November 1999;
2. $85,000 from a Bond Fund in December 1999; and
3. $300,000 from Annuity B in March 2000.

From July 2000 through November 2001, Clients withdrew approximately $280,000 from the annuities they purchased in July 1999 for gifting purposes, income needs and to finance renovations on their home. The 1999 Plan did not account for any of Clients' gifting, income or home improvement needs.

In January 2000, Clients obtained a $240,000 construction loan at a rate of 8% interest. Under the terms of the construction loan, Clients were required to repay the principal, plus interest, in October 2000. In December 2000, Clients refinanced the construction loan ("2000 Mortgage"). The 2000 Mortgage had a principal amount of $248,000, a fixed interest rate of 4.95%, and a 30-year term. A mortgage broker affiliate of Firm ("Mortgage Broker"), acted as the mortgage broker for the 2000 Mortgage. In 2003, Clients refinanced their mortgage through Mortgage Broker ("2003 Mortgage"). The 2003 Mortgage had a principal amount of $240,000, an adjustable interest of 4.45%, and a 30-year term. The 1999 Plan addressed the anticipated costs of the 2000 Mortgage. In his testimony during the hearing, Respondent indicated that he received a referral fee for referring Clients to Mortgage Broker.

In May 2002, Clients completed an updated Investment Questionnaire ("2002 Questionnaire") in which they indicated that they had $3,000,000 in liquid assets, a moderate risk tolerance, a 10-year investment horizon, 32 years of investment experience, and sought capital appreciation as their investment objective. That same day, Respondent recommended that Clients withdraw $360,000 from Annuity C and place it into a new annuity ("Annuity D"). Clients incurred a $16,000 surrender charge from Annuity C and received a $25,000 bonus payment from Annuity D. Respondent also recommended that Clients withdraw $410,000 from Annuity A and place the funds into a new annuity ("Annuity E"). Clients incurred a $31,000 surrender charge from Annuity A and received a $29,000 bonus payment from Annuity E.

2002 Financial Plan ("2002 Plan")

In June 2002, Respondent presented the 2002 Plan to Clients. The 2002 Plan indicated that Clients' net worth was $1,600,000 with liquid assets of $3,800 and $1,500,000 in annuities. The 2002 Plan did not contain any investment recommendations or a suggested asset allocation. After Respondent presented the 2002 Plan to Clients, the following transactions occurred in Clients' accounts:

1. In December 2002, Clients withdrew $51,000 from the VUL, incurring a loss of $52,000;
2. From June 2002 through January 22004, Clients withdrew approximately $214,000 for gifting, income and vacation needs;
3. In March 2004, Clients withdrew $425,000 from the Fixed Annuity and placed $320,000 into another account; and
4. In April 2004, Clients used the remaining proceeds from their March 2004 withdrawal from the Fixed Annuity and placed $100,000 into Securities.

2004 Financial Plan ("2004 Plan")

In November 2004, Respondent presented the 2004 Plan to Clients. The 2004 Plan indicated that Clients had a net worth of $1,800,000. The 2004 Plan projected that Clients' income would range from $84,000 to $85,000 for 2004 through 2007. The 2004 Plan projected that Clients' expenses would range from $40,000 to $43,000 for 2004 through 2007. The 2004 Plan did not indicate whether the expense projections accounted for the $480,000 in withdrawals Clients had taken since 2000 to provide for gifting and income needs. Respondent included an Asset Allocation Analysis and a Tax and Financial Planning Implementation memorandum with the 2004 Plan.

After Respondent presented the 2004 Plan to Clients, the following transactions occurred in Clients' accounts:

1. From November 2004 through September 2005, Clients withdrew approximately $150,000 for gifting and income needs; and
2. On April 2005, Clients withdrew $100,000 in Securities and placed the funds in a different new annuity ("Annuity F").

Clients' Arbitration

In 2007, after Clients decided to transfer their accounts to another broker, Clients filed for arbitration against Respondent and Firm. In the Arbitration Statement of Claim, Clients alleged that: 1) Firm was negligent and breached its fiduciary duty in handling Clients' account because Firm only recommended investments from its "preferred suppliers" that provided Firm with special compensation for selling the "preferred suppliers'" products, as evidenced in National Association of Securities Dealers ("NASD") Letter of Acceptance, Waiver and Consent ("AWC"); 2) Firm churned Clients' investments by recommending that they exchange annuities, causing Clients to incur early surrender penalties; 3) Respondent's recommendation of the VUL policy was inappropriate because Clients were unable to afford the cost of the annual premiums; and 4) Firm recommended that Clients obtain a mortgage on their home solely to generate fees for Mortgage Broker.

III. Commission's Analysis and Conclusions Regarding Rule Violations

A. *Rule 102 – In the course of professional services, a CFP Board designee shall not engage in conduct involving dishonesty, fraud, deceit or misrepresentation, or knowingly make a false or misleading statement to a 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 misrepresentation and made a false or misleading statement to Clients when he: 1) failed to disclose in the Financial Planning Agreement that Firm had a material conflict of interest because it maintained "preferred supplier" relationships in which Firm received financial bonuses for selling the "preferred suppliers'" products that were in excess of the financial compensation Firm received for selling other products; and 2) inaccurately conveyed to Clients through his Form ADV that he did not receive referral fees from Mortgage Broker. The Commission noted that Respondent's explanation that the "preferred supplier" relationships were described in product prospectuses was not credible because issuers do not create separate prospectuses for each individual firm distributing its products and Respondent did not provide a prospectus to support his claim. In addition, the Commission noted that Respondent admitted in his testimony that he received referral fees from Mortgage Broker. 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: 1) failed to disclose in the Financial Planning Agreement that Firm had a material conflict of interest because it maintained "preferred supplier" relationships in which Firm received financial bonuses for selling the "preferred suppliers'" products that were in excess of the financial compensation Firm received for selling other products; 2) failed to provide Clients with any sufficient alternatives to his investment recommendations; 3) implemented his investment recommendations prior to presenting Clients with the 1999 Plan; and 4) inaccurately conveyed to Clients through his Form ADV that he did not receive referral fees from Mortgage Broker. The Commission noted that Respondent's explanation that the "preferred supplier" relationships were described in product prospectuses was not credible because issuers do not create separate prospectuses for each individual firm distributing its products and Respondent did not provide a prospectus to support his claim. In addition, the Commission noted that Respondent admitted in his testimony that he received referral fees from Mortgage Broker. Thus, Respondent violated Rule 201 of the *Code of Ethics*.

C. Rule 202 –A financial planning practitioner shall act in the interest of the client.

Respondent entered into a financial planning engagement with Clients, pursuant to which he prepared three financial plans. The Commission determined that Respondent failed to act in the interests of Clients when he: 1) failed to disclose in the Financial Planning Agreement that Firm had a material conflict of interest because it maintained "preferred supplier" relationships in which Firm received financial bonuses for selling the "preferred suppliers'" products that were in excess of the financial compensation Firm received for selling other products; 2) failed to provide Clients with any sufficient alternatives to his investment recommendations; 3) implemented his investment recommendations prior to presenting Clients with the 1999 Plan; and 4) inaccurately conveyed to Clients through his Form ADV that he did not receive referral fees from Mortgage Broker. The Commission noted that Respondent's explanation that the "preferred supplier" relationships were described in product prospectuses was not credible because issuers do not create separate prospectuses for each individual firm distributing its products and Respondent did not provide a prospectus to support his claim. In addition, the Commission noted that Respondent admitted in his testimony that he received referral fees from Mortgage Broker. Thus, Respondent violated Rule 202 of the *Code of Ethics*.

D. Rule 606(b) – In all professional activities 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 the applicable rules, regulations and other established policies of CFP Board when he: 1) failed to disclose in the Financial Planning Agreement that Firm had a material conflict of interest because it maintained "preferred supplier" relationships in which Firm received financial bonuses for selling the "preferred suppliers'" products that were in excess of the financial compensation Firm received for selling other products; 2) failed to provide Clients with any sufficient alternatives to his investment recommendations; 3) implemented his investment recommendations prior to presenting Clients with the 1999 Plan; 4) inaccurately conveyed to Clients through his Form ADV that he did not receive referral fees from Mortgage Broker; 5) violated Rules 102, 201, 202, 607, 701 and 703 of the *Code of Ethics*; and 6) violated *Practice Standards* 100-1, 200-1, 300-1, 400-1 and 400-2. The Commission noted that Respondent's explanation that the "preferred supplier" relationships were described in product prospectuses was not credible because issuers do not create separate prospectuses for each individual firm distributing its products and Respondent did not provide a prospectus to support his claim. In addition, the Commission noted that Respondent admitted in his testimony that he received referral fees from Mortgage Broker. Thus, Respondent violated Rule 606(b) of the *Code of Ethics*.

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) failed to disclose in the Financial Planning Agreement that Firm had a material conflict of interest because it maintained "preferred supplier" relationships in which Firm received financial bonuses for selling the "preferred suppliers'" products that were in excess of the financial compensation Firm received for selling other products; 2) failed to provide Clients with any sufficient alternatives to his investment recommendations; 3) implemented his investment recommendations prior to presenting Clients with the 1999 Plan; and 4) inaccurately conveyed to Clients through his Form ADV that he did not receive referral fees from Mortgage Broker. The Commission noted that Respondent's explanation that the "preferred supplier" relationships were described in product prospectuses was not credible because issuers do not create separate prospectuses for each individual firm distributing its products and Respondent did not provide a prospectus to support his claim. In addition, the Commission noted that Respondent admitted in his testimony that he received referral fees from Mortgage Broker. Thus, Respondent violated Rule 607 of the *Code of Ethics*.

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

The Commission determined that Respondent failed to provide services diligently when he: 1) failed to disclose in the Financial Planning Agreement that Firm had a material conflict of interest because it maintained "preferred supplier" relationships in which Firm received financial bonuses for selling the "preferred suppliers'" products that were in excess of the financial compensation Firm received for selling other products; 2) failed to provide Clients with any sufficient alternatives to his investment recommendations; 3) implemented his investment recommendations prior to presenting Clients with the 1999 Plan; and 4) inaccurately conveyed to Clients through Respondent's Form ADV that he did not receive referral fees from Mortgage Broker. Thus, Respondent violated Rule 701 of the *Code of Ethics*.

G. Rule 703 – A financial planning practitioner shall make and/or implement only recommendations which are suitable for the client.

Respondent entered into a financial planning engagement with Clients, pursuant to which he prepared three financial plans. The Commission determined that Respondent failed to make and implement only recommendations which were suitable for Clients when he recommended that Clients continue to place a majority of their assets into deferred and fixed annuities despite ample evidence of Clients' significant withdrawal activity. The Commission specifically noted that the 10% withdrawal options featured by some of the annuities were insufficient to meet Clients' liquidity needs and Respondent failed to take into account the income tax implications of withdrawals from annuities. Thus, Respondent violated Rule 703 of the *Code of Ethics*.

H. Practice Standard 100-1 - Defining the scope of engagement.

Prior to providing any financial planning service, Respondent was required to mutually define the scope of the engagement with Clients. As part of this obligation, Respondent was required to disclose any material conflicts of interest. The Commission determined that Respondent did not disclose to Clients that: 1) Firm maintained "preferred supplier" relationships in which Firm received financial bonuses for selling the "preferred suppliers'" products that were in excess of the financial compensation Firm received for selling other products; and 2) he did not receive referral fees from Mortgage Broker. The Commission noted that Respondent's explanation that the "preferred supplier" relationships were described in product prospectuses was not credible because issuers do not create separate prospectuses for each individual firm distributing its products and Respondent did not provide a prospectus to support his claim. In addition, the Commission noted that Respondent admitted in his testimony that he received referral fees from Mortgage Broker. Thus, Respondent violated *Practice Standards* 100-1.

I. Practice Standards 200-1 - Failing to determine a client's personal and financial goals, needs and priorities.

Prior to making recommendations to Clients, Respondent was required to mutually define the client's personal and financial goals, needs and priorities. In the Financial Planning Agreement, Respondent represented that he would provide cash flow planning and income tax planning. The Commission determined that the 2002 Plan and the 2004 Plan failed to address Clients' income needs, as evidenced Clients' withdrawal of approximately $280,000 since the implementation of the 1999 Plan. Thus, Respondent violated *Practice Standard* 200-1.

J. Practice Standard 300-1 - Analyzing and evaluating the client's information.

Prior to delivering his investment recommendations to Clients, Respondent was required to assess Clients' financial situation and determine the likelihood of Clients reaching their objectives by continuing their present course of action. Prior to Respondent developing the 2002 Plan, Clients withdrew approximately $280,000 from their low-liquidity investments to provide for their necessary cash flow. Prior to Respondent developing the 2004 Plan, Clients withdrew approximately $214,000 from their low-liquidity investments to provide for their necessary cash flow and income. The Commission determined that Respondent failed to identify that Clients' withdrawals indicated that they needed increased cash flow to meet their objectives and to reevaluate his recommendation of allocating Clients' investment assets in low-liquidity investments in the 2002 Plan and 2004 Plan. The Commission noted that the 10% withdrawal options featured by some of the annuities were insufficient to meet Clients' liquidity needs and Respondent failed to take into account the income tax implications of withdrawals from annuities. Thus, Respondent violated *Practice Standard* 300-1.

K. Practice Standard 400-1 - Failing to identify and evaluate financial planning alternatives.

After analyzing Clients' current situation and prior to developing and presenting his recommendations, Respondent was required to identify and evaluate financial planning alternatives. The Commission determined that Respondent analyzed Clients' situation after winning the lottery and only presented one investment alternative that involved Clients investing a significant portion of their investable assets in low-liquidity annuities. Further, the Commission determined that by evaluating and presenting only one alternative, Respondent failed to provide Clients with a financial planning alternative that allowed for more liquidity to meet Clients' cash flow needs. Prior to Respondent developing the 2002 Plan, Clients withdrew approximately $280,000 from their low-liquidity investments to provide for their necessary cash flow. Prior to Respondent developing the 2004 Plan, Clients withdrew approximately $214,000 from their low-liquidity investments to provide for their necessary cash flow and income. The Commission determined that with respect to the 2002 Plan and the 2004 Plan, Respondent failed to present and develop any financial planning alternatives that addressed Clients' obvious cash flow needs. The Commission noted that the 10% withdrawal options featured by some of the annuities were insufficient to meet Clients' liquidity needs and Respondent failed to take into account the income tax implications of withdrawals from annuities. Thus, Respondent violated *Practice Standard* 400-1.

L. Practice Standard 400-2 violation - failing to develop the financial planning recommendations.

After identifying the appropriate investment alternatives and Clients' current course of action, Respondent was required to present recommendations reasonably designed to meet Clients' goals, needs and priorities. Prior to Respondent developing the 2002 Plan, Clients withdrew approximately $280,000 from their low liquidity investment to provide for their necessary cash flow. Prior to developing the 2004 Plan, Clients withdrew approximately $214,000 from their low liquidity investment to provide for their necessary cash flow and income. The Commission determined that with respect to the 2002 Plan and the 2004 Plan, Respondent failed to present and develop any financial planning alternative that addressed Clients' obvious cash flow needs. The Commission noted that the 10% withdrawal options featured by some of the annuities were insufficient to meet Clients' liquidity needs and Respondent failed to take into account the income tax implications of withdrawals from annuities. Thus, Respondent violated *Practice Standard* 400-2.

IV. Discipline Imposed

The Commission found grounds for discipline pursuant to 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 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 *Practice Standards*. The Commission found grounds for discipline under Article 3(b) because Respondent violated *Practice Standards* 100-1, 200-1, 300-1, 400-1 and 400-2. The Commission issued Respondent a suspension for three months, pursuant to Article 4.3 of the *Disciplinary Rules*.

While considering the degree of sanction to impose, the Commission identified the following mitigating factors:

1. Respondent did not have prior disciplinary history;
2. At the time the conduct occurred, Respondent was new to the industry and relied upon his firm for advanced planning support; and
3. The conduct at issue occurred seven to 12 years prior to the hearing.

The Commission identified as an aggravating factor that Respondent failed to change his strategy in the 2002 Plan and the 2004 Plan despite ample evidence that the initial investment strategy was not effective.

V. Appeals Committee Decision

Respondent appealed the Commission's decision. The Appeals Committee affirmed the Commission's findings of fact and rule violations but modified the discipline imposed. The Appeals Committee determined that the Commission's consideration as a mitigating factor that Respondent was new to the industry and relied upon his firm for advanced planning support was clearly erroneous. The Appeals Committee was alarmed at Respondent's assertion that he should not be held responsible for planning strategies and business practices that are inherently damaging to clients and are inconsistent with the goals and operating practices of CFP® professionals simply because he was a new CFP® professional. The Appeals Committee determined that all CFP® professionals should be held to the same standard. Therefore, the Appeals Committee modified the sanction imposed by the Commission from a three-month suspension to a suspension for one year and one day.