CERTIFIED FINANCIAL PLANNER BOARD OF STANDARDS, INC.

ANONYMOUS CASE HISTORIES
NUMBER 23352

This is a summary of a decision issued following the July 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* ("*Standards*") when he failed to: 1) perform an investigation and analysis into the insurance needs of his clients prior to recommending that they purchase insurance policies; 2) perform a cash flow analysis regarding his client's ability to pay the premiums for the insurance policies recommended by Respondent; and 3) present his insurance recommendations and ensure that the recommendations met his client's expectations with respect to their ability to "premium offset" in five years.

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

Client A Grievance

In 2000, Client A and her husband began working with Respondent. According to the Client A Grievance, Respondent acted as Client A and her husband's financial advisor. After reviewing the Client A's finances, Respondent determined that Client A's husband was the sole source of income for the Client A household. Respondent determined that Client A's husband had only $500,000 of life insurance and minimal group life insurance. Based on this information, Respondent recommended that Client A purchase a $1,500,000 life insurance policy with Client A's husband as the insured. The policy was issued in November 2000 and required the Client A to pay annual premiums of $55,000.

Less than a year after purchasing the life insurance policy from Respondent, Client A's husband passed away. Respondent assisted Client A with obtaining the insurance proceeds, rolling over her 401k into a survivor's IRA, investing the insurance proceeds, and managing approximately $4,000,000 of Client A's assets. According to the Client A Grievance, Respondent indicated that he would invest Client A's assets more conservatively because Client A's sole source of income was gone.

Respondent also discussed the idea of purchasing a life insurance policy for which Client A would be the insured. According to the Client A Grievance, Respondent stated that the life insurance policy would reduce estate taxes, provide a guaranteed rate of return and allow Client

A to draw on the cash value of the life insurance policy. Client A stated that her main financial goal was to ensure that she had enough money to care for herself without the assistance of her children. According to the Client A Grievance, Respondent stated that Client A was in a financial position to purchase the life insurance policy to minimize her estate tax liability while ensuring that she had enough money to care for herself. In October 2003, Client A purchased a $1,500,000 whole-life insurance policy from Life Insurance Company ("Company").[1] The annual premium for the policy was $38,906. Respondent did not present any insurance policies from other insurance companies prior to Client A's purchase.

In November 2003, Respondent recommended that Client A purchase life insurance policies for her two daughters and her son-in-law. According to the Client A Grievance, Respondent represented that the policies would be a good investment to replace the bond component of her portfolio, and Client A would be able to draw on the cash value of the policy if she needed cash. In Respondent's April 2010 statement to CFP Board, Respondent indicated that Client A purchased the policies solely so to ensure her daughters would have adequate life insurance. Further, Respondent asserted that Client A had sufficient assets to cover the costs of the premiums and could access the cash value of the policies should she have an immediate need for cash. In December 2003, Client A purchased three policies in total, each with annual premiums of $10,001.[2] Respondent did not present any insurance policies from other insurance companies prior to Client A's purchase.

In May 2005, Respondent proposed that Client A purchase an additional life insurance policy for which she was the insured. According to the Client A Grievance, Respondent represented that the insurance policy would be a good investment to replace the bond component of her portfolio, and Client A would be able to draw on the cash value of the policy if she needed cash. In July 2005, Client A purchased an $850,000 20 payment life insurance policy from Company.[3] The policy was designed to have significant Paid Up Additions ("PUA"). The annual premium, including the PUAs, was $64,627.40. According to the Client A Grievance, Respondent represented to Client A that with the PUAs, the policy would "premium offset" in approximately five years. Respondent stated that he illustrated a six-year "premium offset" using the 2005 dividend scale. In total, Client A's annual premium obligation was $133,537. Respondent did not present any insurance policies from other insurance companies prior to Client A's purchase.

Soon after purchasing the life insurance policies, Client A began to experience cash flow shortages. According to Respondent, Client A purchased a new home and completely remodeled the home, spending in excess of $2,000,000 on the project. Client A also withdrew funds from her investment accounts to enable Client A to own the home without any debt. Client A used $700,000 of her investment assets to assist her daughter with purchasing a new home. The sale of securities for the purchase of two homes caused Client A to incur significant capital gains

[1] CFP Board requested in its February 2011 request, but did not receive, an explanation of how Respondent determined the amount of insurance that was appropriate for Client A.
[2] CFP Board requested in its February 2011 request, but did not receive, an explanation of how Respondent determined the amount of insurance that was appropriate for Client A.
[3] CFP Board requested in its February 2011 request, but did not receive, an explanation of how Respondent determined the amount of insurance that was appropriate for Client A.

taxes. Finally, Respondent asserted that Client A's monthly budget of $12,000 far exceeded the $8,000 monthly budget Respondent and Client A had previously agreed to. Respondent did not provide copies of any cash flow he may have prepared for Client A.

Client A filed complaints with the State Department of Insurance ("Department") and Company. In her complaints, Client A asserted that Respondent did not determine whether she had sufficient cash flow to maintain the insurance policies he had recommended to her. The Department and Company denied Client A's complaint.

Client B and C Grievance

In September 2004, Respondent entered into a Financial Planning Agreement ("FP Agreement") with Clients B and C. In the FP Agreement, Respondent agreed to develop a written financial plan containing an asset analysis, cash flow review, tax planning and an overall review of Clients B and C's financial situation, including the anticipated purchase of a vacation home. The FP Agreement provided for a $5,000 fee.[4]

Over the next several months, Respondent met with Clients B and C's accountant and their portfolio managers. According to an undated statement from Respondent, he provided the following services to Clients B and C:

1. Respondent advised Clients B and C's advisors to sell securities to realize capital gains to offset the Clients B and C's significant tax loss carry-forwards;
2. The portfolio managers advised Clients B and C's that they should not finance the purchase of their vacation home with a mortgage. Respondent proved that financing the home with mortgage was to Clients B and C's financial benefit;
3. Respondent analyzed Clients B and C's cash flow and determined that they had sufficient assets to maintain their current lifestyle; and
4. Respondent reviewed Clients B and C's auto insurance, homeowners insurance, liability umbrella, health insurance, social security, and wills and trusts.

In 2005, Respondent advised Client B to apply as the insured for a $3,000,000 whole life insurance policy with Company.[5] The policy included three riders: 1) an enhanced accelerated benefit rider; 2) a secondary insured purchase option rider ("Purchase Rider"), which would allow Client C to purchase up to $5,000,000 of insurance at Client B's death; and 3) a PUA rider. Including the cost of the Purchase Rider and the PUA, the total annual premium for Client B's policy was $200,000. According to the Client B and C Grievance, Respondent represented to Clients B and C that they would have to pay premiums for five years, at which time the dividends would allow them to offset any future premiums. In Respondent's statement, he asserts that Clients B and C signed an illustration indicating that the "premium offset" strategy would require them to pay premiums on the policy for 10 years. The premium offset planning

[4] In February 2011, CFP Board requested a copy of the financial plan Respondent prepared for the Clients B and C. Respondent stated that he did not prepare a financial plan.
[5] CFP Board requested in its February 2011 request, but did not receive, an explanation of how Respondent determined the amount of insurance that was appropriate for the Clients B and C.

concept was done using the 2005 dividend scale. Respondent did not present any insurance policies from other insurance companies prior to the Client B's purchase.

In April 2008, Respondent recommended that Client C purchase a $4,000,000 20 payment life insurance policy from Company. The policy contained a PUA rider and an enhanced accelerated benefit rider. Including the cost of the PUA, the total annual premium for Client C's policy was $239,934. According to the Client B and C Grievance, Respondent represented that Client C would have to make annual premium payments of $130,000 for five years. Respondent did not present any insurance policies from other insurance companies prior to the Client C's purchase.

Clients B and C did not realize they were required to make $439,934 in total annual premium payments until they requested the illustrations in February 2009. In Respondent's statement, he asserts that Clients B and C were concerned about making premium payments for several years. Respondent illustrated that Clients B and C would only have to make premium payments for five years using a "premium offset" strategy. The premium offset planning concept was done using the 2008 dividend scale.

In 2008, Client B contacted Respondent and requested an in-force illustration for his policy. Respondent provided Client B with an illustration indicating that he would continue paying premiums until the 10th year of the policy. Respondent also provided Client B with two additional illustrations. The first illustration demonstrated that using a "natural offset," Client B could pay premiums for six years, rather than 10 years. The second illustration demonstrated that if Client B paid an additional $45,165 with his fifth-year premium, he would not be required to make further premium payments.

In the Client B and C Grievance, Clients B and C alleged that Respondent: 1) failed to present them with any insurance alternatives from insurance companies other than Company; 2) misrepresented the number of years Clients B and C would have to make premium payments on their policies; and 3) advised Clients B and C to purchase insurance with required annual premiums obligations that damaged Clients B and C's ability to meet their financial planning objectives.

Client D and E Grievance

In March 2008, Respondent entered into a Financial Consulting Agreement with Clients D and E in which Respondent agreed to analyze Clients D and E's financial situation, including, but not limited to, estate planning, retirement planning, college funding, business succession, insurance analysis, insurance needs analysis, cash management and budget management. The Financial Consulting Agreement provided for a $3,500 fee that was subsequently waived when Clients D and E transferred their accounts to Respondent's control.

Clients D and E transferred four accounts to Respondent's control: 1) The Client D and E Living Trust; 2) Client D's Simplified Employee Pension Individual Retirement Account ("SEP-IRA"); 3) Client D's Individual Retirement Account ("IRA"); and 4) Client E's IRA. In April 2008, Clients D and E completed Investor Profile Questionnaires ("Profiles") for each account they transferred to Respondent's control. In the Profiles, Clients D and E indicated that they had a moderate risk tolerance, an investment horizon of five to 10 years and sought conservative growth and to accumulate assets for retirement. Based on these responses, Respondent recommended that Clients D and E place a significant portion of their portfolio into fixed income investments. As Client D moved towards retirement, the percentage of fixed income assets in the portfolio would increase. Respondent recommended a laddered bond portfolio of relatively short term bonds to enable Clients D and E to earn higher returns than long term bonds were offering at the time.

Respondent also advised Clients D and E regarding life insurance. Respondent asserts that Clients D and E sought insurance for income replacement, cash accumulation and the ability to use the death benefit as a "'safety net' for asset annuitization in retirement." Clients D and E previously met with Insurance Company and discussed purchasing a $2,000,000 life insurance policy with annual premiums of $83,000. Clients D and E expressed to Respondent that they were uncomfortable with the Insurance Company policy because it took 13 years for the cash value of the policy to equal the amount of the premiums Clients D and E would have paid into the policy. Respondent provided Clients D and E with multiple illustrations using the PUA to decrease the number of years before the cash value of the policy would equal or exceed the premiums Clients D and E paid into the policy.

In May 2008, Clients D and E purchased two whole life insurance policies from Company. Client D's policy provided $1,879,260 in benefits and contained a PUA and an enhanced accelerated benefits rider.[6] The annual premium, including the cost of the PUA, was $83,000. Client E's policy provided $1,887,464 in benefits and contained a PUA and an enhanced accelerated benefits rider.[7] The annual premium, including the cost of the PUA, was $37,999.99. According to Respondent, some of the proceeds from Clients D and E's laddered bond portfolio would be used to pay insurance premiums. According to Clients D and E, the premiums were supposed to be paid entirely from the proceeds of bond sales and that their cash accounts were not to be used for the annual premium payments. Despite these instructions, in May 2008, Respondent withdrew $120,999.99 from Clients D and E's cash account. After Clients D and E complained, Respondent replaced the cash in the account. Finally, Clients D and E asserted that Respondent indicated that they would only pay premiums on the policies for five years, at which point the premiums would offset. After receiving the illustrations, Clients D and E realized that they were required to pay the premiums for the life of each policy.

Clients D and E filed complaints against Respondent with Company, the Department and the Financial Industry Regulatory Authority, Inc. ("FINRA") alleging that Respondent breached his fiduciary duty when he: 1) improperly used cash from their accounts to pay the initial premium for their life insurance policies; 2) misrepresented that they would only have to pay premiums for five years; and 3) failed to create a cash flow analysis to ensure that they could afford the cost of the premiums. Respondent responded to the complaint by stating that: 1) the only way Clients D

[6] CFP Board requested in its February 2011 request, but did not receive, an explanation of how Respondent determined the amount of insurance that was appropriate for Client D.
[7] CFP Board requested in its February 2011 request, but did not receive, an explanation of how Respondent determined the amount of insurance that was appropriate for Client E.

and E could pay the initial premium was to use cash from their account; 2) he illustrated the five-year "premium offset" for Clients D and E, but they chose not to implement it because they were unsatisfied with the death benefit and premium costs; and 3) he performed a cash flow analysis that analyzed Clients D and E's ability to pay the premiums depending on whether Client D was employed. Guardian and the Department denied Clients D and C's claims. The FINRA inquiry had not been formally closed at the time of the hearing.

III. Commission's Analysis and Conclusions Regarding Rule Violations

A. Rule 201 violation - 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 perform adequate investigation and analysis into the insurance needs of Clients A, B, C, D and E prior to recommending that they purchase insurance policies; and 2) failed to perform adequate cash flow analysis regarding Clients A, B, C, D and E's ability to pay the premiums for the insurance policies recommended by Respondent. The Commission noted that Client A was not a sophisticated investor and held Respondent in a position of trust and confidence. Moreover, Respondent should have documented his advice to Client A regarding her purchase of a home and her cash flow planning. The Commission also noted that Respondent should have provided a written cash flow for Clients B, C, D and E based on the written agreements Respondent signed with Clients B, C, D and E. Finally, the Commission noted that due to the complexity of the riders and options purchased on the policies Respondent sold, he failed to ensure that Clients A, B, C, D and E understood the policies and the impact the planned premiums would have on their cash flow. Thus, Respondent violated Rule 201 of the *Code of Ethics*.

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

Respondent entered into a financial planning engagement with the Clients B, C, D and E. Both engagements were memorialized by a written contract detailing Respondent's responsibility to review, among other things, the clients' asset allocation, estate planning, retirement planning, college funding, business succession, insurance analysis, insurance needs analysis, cash management and budget management. The Commission determined that Respondent failed to act in the interests of Clients B and C when he failed to perform adequate investigation and analysis into the insurance needs of Clients B and C prior to recommending that they purchase insurance policies. The Commission also determined that Respondent failed to act in the interests of Clients D and E when he: 1) failed to perform adequate investigation and analysis into the insurance needs of Clients D and E prior to recommending that they purchase insurance policies; and 2) failed to perform adequate cash flow analysis regarding the Clients D and E's ability to pay the premiums for the insurance policies recommended by Respondent. Respondent claimed that he was not in a financial planning engagement with Clients D and E. The Commission determined, however, that given the existence of a Financial Consulting Agreement signed by Clients D and E and Respondent and the evidence in the record indicating that

Respondent thought the fee had been collected by his partner, Respondent entered into a financial planning engagement with Clients D and E. Thus, Respondent violated Rule 202 of the *Code of Ethics*.

C. *Rule 606(b) violation – In all professional activities, a CFP Board designee shall perform services in accordance with the 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 perform adequate investigation and analysis into the insurance needs of Clients A, B, C, D, and E prior to recommending that they purchase insurance policies; 2) failed to perform adequate cash flow analysis regarding Clients A, B, C, D, and E's ability to pay the premiums for the insurance policies recommended by Respondent; 3) violated Rules 201, 202, 607 and 703 of the *Code of Ethics*; and 4) violated *Practice Standards* 300-1 and 400-3. Thus, Respondent violated Rule 606(b) of the *Code of Ethics*.

D. *Rule 607 violation – 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 perform adequate investigation and analysis into the insurance needs of Clients A, B, C, D, and E prior to recommending that they purchase insurance policies; and 2) failed to perform adequate cash flow analysis regarding Clients A, B, C, D, and E's ability to pay the premiums for the insurance policies recommended by Respondent. Thus, Respondent violated Rule 607 of the *Code of Ethics*.

E. *Rule 703 violation – 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 B, C, D, and E. Both engagements were memorialized by a written contract detailing Respondent's responsibility to review, among other things, the clients' asset allocation, estate planning, retirement planning, college funding, business succession, insurance analysis, insurance needs analysis, cash management and budget management. The Commission determined that Respondent failed to make and implement only recommendations which were suitable for Clients B, C, D, and E when he recommended that Clients B, C, D, and E purchase several life insurance policies without: 1) performing adequate investigation and analysis into the insurance needs of Clients B, C, D, and E prior to recommending that they purchase insurance policies; and 2) performing adequate cash flow analysis regarding Clients B, C, D, and E's ability to pay the premiums for the insurance policies recommended by Respondent. Thus, Respondent violated Rule 703 of the *Code of Ethics*.

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

Prior to delivering investment recommendations, Respondent was required to assess Clients A, B, C, D, and E's financial situation to determine the likelihood of reaching their objectives by continuing the present course of action. The Commission noted that Clients A, B, C, D, and E believed that they had entered into a financial planning engagement with Respondent by virtue of the agreements he signed and the services Respondent held himself out as providing. Prior to recommending the purchase of insurance policies, Respondent failed to perform: 1) adequate investigation and analysis into the insurance needs of Clients, B, C, D and E; and 2) adequate cash flow analysis regarding Clients B, C, D and E's ability to pay the premiums for the insurance policies recommended by Respondent. With respect to Client A, Respondent held himself out as a financial planner based on the services he provided to her with respect to her budget, purchase of insurance and her purchase of a home. The Commission determined that Respondent failed to generate the detailed cash flow analysis that was necessary to recommend insurance policies with aggregate annual premiums of $133,000 when Client A had no source of income other than her investments. Respondent violated *Practice Standard* 300-1.

G. Practice Standard 400-3 violation – Presenting the financial planning recommendations.

Respondent was required to present his financial planning recommendations and to make a reasonable effort to assist Clients A, B, C, D, and E in understanding their current financial situation, Respondent's recommendations, and the ability of Respondent's recommendations to meet the clients' goals, needs and priorities. The Commission determined that Respondent failed to appropriately present his financial planning recommendations because he: 1) failed to provide a written plan to Clients B and C pursuant to the terms of the FP Agreement; and 2) failed to properly present his insurance recommendations and ensure that the recommendations met Clients A, B, C, D, and E's expectations with respect to their ability to "premium offset" in five years. The Commission noted that Respondent should have met with his clients at the time each policy was issued to review the policies with the clients. As Respondent was in a financial planning relationship with all three clients, he should have documented the clients' understanding in a more thorough manner other than having the clients sign illustrations. Thus, Respondent violated *Practice Standards* 400-3.

IV. <u>Discipline Imposed</u>

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 201, 202, 606(b), 607 and 703 of the *Code of Ethics.* The Commission found grounds for discipline under Article 3(b) because Respondent violated *Practice Standards* 300-1 and 400-3.

Pursuant to Article 4.3 of the *Disciplinary Rules*, the Commission issued a three-year suspension.

The Commission considered the following mitigating factors:

1. Respondent maintained a clean disciplinary record for 30 years;
2. Respondent provided illustrations to Clients A, B, C, D and E; and
3. Client A's spending contributed to her cash flow shortfall.

The Commission considered the following aggravating factors:

1. Respondent made several statements during the hearing that were inconsistent with statements in the written record;
2. Respondent held himself out as a financial planner to Clients A, B, C, D and E but did not provide financial planning services to Clients A, B, C, D and E;
3. Respondent failed to provide CFP Board with his Form ADV Part II, as requested; and
4. Respondent fails to understand that he is unable to "switch hats" between being an insurance salesman and a financial planner.

V. Appeals Committee Decision

Respondent appealed the Commission's decision. The Appeals Committee affirmed the Commission's factual findings and discipline.