CERTIFIED FINANCIAL PLANNER BOARD OF STANDARDS, INC.

ANONYMOUS CASE HISTORIES
NUMBER 25389

This is a summary of a decision issued following the March 2013 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. Issue Presented

Whether a CFP® professional ("Respondent") violated CFP Board's *Standards of Professional Conduct* when he recommended and sold a 73-year-old client two variable annuities and a variable universal life insurance policy.

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

Background

Respondent met Client 1 and Client 2 in 1995 and prepared wills, trusts, and powers of attorney. Respondent or Respondent's firm prepared Income Tax and Estate Tax Returns for the Clients. After Client 1 died in November 1999, Client 2, aged 73, sought Respondent's financial advice for investment and retirement planning.

Upon her husband's death, Client 2 inherited stocks and bonds in the Client 1 Revocable Trust worth $300,000, $10,000 from a jointly-held checking account, and three Individual Retirement Accounts ("IRAs") worth $300,000 (Investment Fund: $51,000; Annuity 1: $105,000; Annuity 2: $171,468). The total estate listed on the U.S. Estate Tax Return was $663,000. Client 2 also owned a condominium assessed at $100,000. Using these figures, Respondent approximated Client 2's net worth at $800,000. Respondent was in charge of managing all or most of Client 2's assets.

In December 1999, Client 2 completed a New Account Form. She selected every investment objective except speculation and listed her investment experience as moderate. She listed her annual income as $30,000 and net worth as $500,000.

Company 1 Variable Annuity

In January 2000, Respondent's assistant submitted a Company 1 variable annuity application on behalf of Client 2. The Company 1 variable annuity was issued in January 2000. It was funded by 1035 exchanges from the annuities that Client 2 inherited from her late husband. Respondent said the Company 1 variable annuity was also funded with an IRA account Client 2 inherited and with $61,000 from an IRA account Client 2 already owned. The total amount of the Company 1 variable annuity was $382,000.

Client 2 did not pay any surrender charges, fees or taxes on her 1035 exchanges. The Company 1 variable annuity had surrender charges for nine years. Client 2 added an Enhanced Death Benefit rider that expired after the annuity date in 2011 and cost 0.25% per year deducted on a monthly basis. Respondent invested the variable subaccount in a mix of growth and income accounts.

Company 2 Variable Annuity

In January 2000, Client 2 completed a Client Data Sheet for the Client 2 Revocable Trust representing that she had an annual income of $75,000 and a net worth of $700,000. Client 2 selected every investment objective and listed her investment experience as limited.

In January 2000, Client 2 completed a Company 2 variable annuity application. Company 2 issued the deferred variable annuity to Client 2 in February 2000 for an initial premium of $300,000 with the Client 2 Revocable Trust as the owner. The Company 2 variable annuity had surrender charges for eight years. Respondent allocated 100% of the investments in growth equities.

Company 3 Variable Universal Life Insurance

In January 2000, Client 2 completed a life insurance application to purchase a $300,000 flexible premium Company 3 variable universal life insurance policy in the Client 1 Revocable Trust from the stocks and bonds in the trust. The insurance policy provided a $600,000 death benefit. Under Question 12: Representative's Certification, Respondent listed Client 2's annual income as $100,000 and net worth at $1,000,000. According to the application, Respondent selected a 100% growth asset allocation for the investment portion of the policy.

In February 2000, Company 3 rejected Client 2's application because she acknowledged having been treated or diagnosed with cancer, heart disease or stroke within the past 10 years. In February 2000, Client 2 was given a medical exam to qualify for Company 3 life insurance and was approved. In March 2000, Company 3 issued a policy that contained contingent deferred sales charges for 10 years and yearly mortality and expense, administrative, and sales fees.

After several years, the variable universal life policy was running low on funding and in danger of lapsing. In June 2009, Client 2 surrendered the policy and received $50,152.68 of her original $300,000. Client 2 spent $250,000 for nine years of insurance that, if she had died during that period, would only have paid out $600,000.

Financial Planning

Respondent's professional relationship with Client 2 encompassed multiple financial planning subject areas including: insurance planning, investment planning, income tax planning, retirement planning, and estate planning. Due to the duration and breadth of the relationship, Client 2 reasonably understood that Respondent was providing comprehensive financial planning services. Respondent also recommended and sold three products to Client 2 that totaled $982,000, encompassing all of her net worth. When taken together, these factors prove the existence of a financial planning relationship between Respondent and Client 2.

2010 Client FINRA Arbitration

In May 2010, Client 2 filed a Statement of Claim in FINRA arbitration against Respondent and Kovack Securities, Inc. Client 2 claimed that Respondent recommended and sold her products that over concentrated her assets in insurance product and equities. In August 2010, Respondent filed an Answer to the Statement of Claim. Respondent stated that the two variable annuities and variable universal life policy were suitable to Client 2's needs and objectives. In November 2011, the parties entered into a settlement agreement wherein Respondent and Kovack Securities, Inc. agreed to pay Client 2 $65,000.

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 while the client reasonably believed that she was in a financial planning relationship, Respondent was not required to provide a written plan. Thus, Respondent did not violate *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 recommended and sold Client 2 two variable annuities and a variable universal life insurance policy, which resulted in the concentration of Client 2's assets in illiquid and unsuitable products. The Commission determined that Respondent's recommendations were made shortly after Client 2's husband had passed and were equity based. In addition, the variable universal life policy had high costs due to Client 2's age and rating. Given that Client 2 was 73-years old at the time of the recommendations, had limited financial experience, and had just had her husband pass, these recommendations were not suitable. Thus, Respondent violated *Code of Ethics* Rule 201.

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

The Commission determined that Respondent failed to act in the interest of Client 2 when he recommended and sold her two variable annuities and a variable universal life insurance policy, which resulted in the concentration of Client 2's assets in illiquid and unsuitable products. The Commission determined that Client 2 had a reasonable belief that Respondent was providing her with financial planning services due to Respondent's work on estate, investment and insurance planning, and Respondent or his firm's income and estate tax services. Respondent's recommendations were unsuitable due to the fact that Client 2 was of an advanced age, had limited experience with investments and virtually all of her assets were placed in equity-based instruments. Finally, the Commission noted that the Company 1 annuity's 5% guarantee was effectively limited due to its placement in an IRA, which required the client to take required minimum distributions. 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 when he recommended and sold Client 2 two variable annuities and a variable universal life insurance policy, which resulted in the concentration of her assets in illiquid and unsuitable products. The Commission determined that Client 2 had a reasonable belief that Respondent was providing her with financial planning services due to Respondent's work on estate, investment and insurance planning, and Respondent or his firm's income and estate tax services. Respondent's recommendations were unsuitable due to the fact that Client 2 was of an advanced age, had limited experience with investments and virtually all of her assets were placed in equity-based instruments. Finally, the Commission noted that the Company 1 annuity's 5% guarantee was effectively limited due to its placement in an IRA, which required the client to take required minimum distributions. 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 his or her 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 recommended and sold Client 2 two variable annuities and a variable universal life insurance policy, which resulted in the concentration of her assets in illiquid and unsuitable products. The Commission determined that Client 2 had a reasonable belief that Respondent was providing her with financial planning services due to Respondent's work on estate, investment and insurance planning, and Respondent or his firm's income and estate tax services. Respondent's recommendations were unsuitable due to the fact that Client 2 was of an advanced age, had limited experience with investments and virtually all of her assets were placed in equity-based instruments. Finally, the Commission noted that the Company 1 annuity's 5% guarantee was effectively limited due to its placement in an IRA, which required the client to take required minimum distributions. 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 held himself out as a financial planner and engaged in a financial planning relationship but did not diligently perform the financial planning process. The Commission determined that Client 2 had a reasonable belief that Respondent was providing her with financial planning services due to Respondent's work on estate, investment and insurance planning, and Respondent or his firm's income and estate tax services. Respondent's recommendations were unsuitable due to the fact that Client 2 was of an advanced age, had limited experience with investments and virtually all of her assets were placed in equity-based instruments. Finally, the Commission noted that the Company 1annuity's 5% guarantee was effectively limited due to its placement in an IRA, which required the client to take required minimum distributions. Thus, Respondent violated *Code of Ethics* Rule 701.

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

The Commission determined that Respondent failed to make and/or implement only recommendations that were suitable for Client 2 when he recommended and sold her two variable annuities and a variable universal life insurance policy, which resulted in the concentration of her assets in illiquid and unsuitable products. The Commission noted that the variable universal life insurance policy had high costs and was not in Client 2's best interests. Further, illustrating the performance of the policy with a 12% return was imprudent and misleading. Finally, the Commission determined that given the complexity of the products, Client 2's age and education and Respondent's position of trust and confidence, simply having Client 2 sign disclosure forms and utilize the free look period was not sufficient to ensure this recommendation was suitable. Thus, Respondent violated *Code of Ethics* Rule 703.

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

The Complaint alleged that Respondent failed to mutually define the scope of engagement before providing financial planning services when he recommended and sold Client 2 two variable annuities and a variable universal life insurance policy without completing a scope of engagement or financial planning agreement. The Commission determined that at the beginning of the engagement, the scope of the engagement was not required to be in writing. Thus, Respondent did not violate *Practice Standard 100-1*.

I. Practice Standard 200-1 – Determining a client's personal and financial goals, needs and priorities

The Commission determined that Respondent failed to mutually define Client 2's personal and financial goals, needs and priorities before making recommendations because he recommended and sold her two variable annuities and a variable universal life insurance policy using only the limited information from the Client Data Sheets. The information collected on the Client Data Sheets was insufficient as Client 2 selected every investment objective on the Client Data Sheets and Respondent did not seek to clarify Client 2's objectives. Further, the Commission noted that Respondent did not perform a cash flow analysis. Thus, the Commission determined that Respondent violated *Practice Standard 200-1*.

J. Practice Standard 200-2 – Obtaining quantitative information and documents

The Commission determined that Respondent failed to obtain sufficient quantitative information and documents prior to making a recommendation when he recommended and sold Client 2 two variable annuities and a variable universal life insurance policy without completing a cash flow analysis to determine if the products would leave her with sufficient liquid assets to cover expenses. Thus, Respondent violated *Practice Standard 200-2*.

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

The Commission determined that Respondent failed to analyze Client 2's information to gain an understanding of her financial situation when he recommended and sold her two variable annuities and a variable universal life insurance policy without understanding her objectives or obtaining enough information in order to analyze her situation. Thus, Respondent violated *Practice Standard 300-1*.

L. Practice Standard 400-2 – Developing the financial planning recommendations

The Complaint alleged that Respondent failed to develop recommendations in an effort to reasonably meet Client 2's goals, needs and priorities when he recommended and sold her two variable annuities and a variable universal life insurance policy that concentrated her assets in illiquid and unsuitable products. The Commission determined, however, that *Practice Standard* 400-2 was not in effect at the time of Respondent's conduct. Thus, Respondent did not violate *Practice Standard 400-2*.

M. Practice Standard 500-2 – Selecting products and services for implementation

The Complaint alleged that Respondent failed to select appropriate products and services that were consistent Client 2's goals, needs and priorities when he recommended and sold her two variable annuities and a variable universal life insurance policy that concentrated her assets in illiquid and unsuitable products. The Commission determined, however, that *Practice Standard* 500-2 was not in effect at the time of Respondent's conduct. Thus, Respondent did not violate *Practice Standard 500-2*.

IV. 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 the *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*. Article 3(b) of the 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 CFP and *Practice Standards* 100-1, 200-1, 200-2 and 300-1. Pursuant to Article 4.3 of the *Disciplinary Rules,* the Commission issued a four-year suspension.

While considering the degree of sanction to impose, the Commission considered in mitigation that at the time of the hearing, it had been 12 years since the conduct at issue had occurred.

The Commission considered the following aggravating factors:

1. Respondent had past disciplinary history relating to suitability of life insurance and annuities; and
2. Client 2's age, education and investment experience contributed to the creation of a relationship of trust and confidence with Respondent. Further, Respondent and/or his firm provided estate planning, tax, investment and retirement advice to Client 2. These factors contributed to Client 2's reasonable belief that a financial planning relationship existed.

The Commission consulted Anonymous Case Histories 23352 and 15094. The Commission also consulted *Sanction Guidelines* 5 (Breach of Fiduciary Duty), 11 (Diligence), 13 (Failure to Act in a Client's Best Interests), 20(b) ("Holding Out" as a Financial Planner to a Client, Then Not Providing Financial Planning Services to that Client), 20(d) (Misrepresentation to Clients and Prospective Clients) and 31 (Suitability). While the categories of Respondent's conduct when considered in isolation typically result in lesser sanctions, the three prior letters of caution, Respondent's pattern of conduct related to suitability, the client's age and the multiple customer complaints, as documented in BrokerCheck, warranted a four-year suspension.