CERTIFIED FINANCIAL PLANNER BOARD OF STANDARDS, INC.

ANONYMOUS CASE HISTORIES
NUMBER 25698

This is a summary of a Settlement Agreement entered into at the June 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. Issues Presented

Whether a CFP® professional ("Respondent") violated CFP Board's *Standards of Professional Conduct* when he: 1) described three private placement funds to a client as being safe and secure when they were actually highly speculative, nonpublic investments; 2) recommended and implemented a life insurance exchange for a client that resulted in more expense and less benefit for the client and a large commission for Respondent; 3) recommended and implemented an annuity exchange for a client that created a surrender penalty of approximately $21,000 for the client and a large commission for Respondent; 4) recommended three private placements to a client in which Respondent was personally invested; 5) accepted an interest-free loan from a client without executing a promissory note; and 6) forwarded a client's contact information to the representatives of three private placements without the client's consent.

II. Findings of Fact

2010 Grievant Civil Suit

In July 2010, Grievant filed a Complaint against Respondent and several other individuals and entities (collectively "Defendants"). In October 2010, the Defendants filed a Motion to Compel Arbitration. The matter was compelled to Arbitration on or about March 2011.

2011 Grievant FINRA Arbitration

In March 2011, Grievant filed a Statement of Claim against Respondent and several other individuals and entities (collectively "Arbitration Respondents"). The Statement of Claim alleges several causes of action against the Arbitration Respondents including: 1) lack of suitability; 2) churning; and 3) self-dealing. Damages alleged were $6,870,000. The specific allegations made against Respondent are discussed in detail, below.

According to the Statement of Claim, Grievant was a 90-year-old businessman, an unsophisticated investor who had accumulated his wealth through the tile flooring industry, starting his company in 1948 and operating it until the time he sold it in 1991. In 1991, his total net assets were $8,579,902. In 1995, Grievant turned his assets over to the Arbitration Respondents, including Respondent, a long-time friend, to manage. Grievant alleges that as a result of Arbitration Respondents' wrongful decision to substitute their objectives for his, his assets had dwindled to $3,607,000 by 2008.

The Arbitration Respondents filed their Statement of Answer on May 31, 2011. They asserted a general denial as to all Grievant's causes of action. They also contended the following:

1) From 1995 through 2008, Grievant required $400,000 per year for disposable income, totaling $5.2 million for the period;
2) Between 1997 and 2005, Grievant withdrew an additional $1,431,754.66 from his Revocable Trust for personal needs and/or investments outside involvement by the Arbitration Respondents';
3) Grievant characterized himself as a sophisticated investor with many years of experience in stocks and bonds;
4) The only significant loss Grievant incurred in his portfolio occurred in 2008, during one of the worst bear markets;
5) Grievant often made independent investment decisions which did not involve any of the Arbitration Respondents; and
6) Grievant's legal, tax and financial advisor reviewed, approved and consulted on most, if not all, of the investment decisions involving his estate.

On or about November 2, 2012, the Arbitration settled for $100,000. Respondent personally contributed the entire amount to the settlement. Respondent could not provide a copy of the settlement agreement as it was confidential among all the parties.

Allegations against Respondent

Life Insurance Exchange

According to the Statement of Claim, Respondent convinced Grievant to terminate his two existing life insurance policies with Insurance Company 1 and Insurance Company 2, which were issued prior to 1994 ("Old Policies"). These policies had a total payout on death of approximately $2 million. In 1994 and 1996, Respondent replaced these policies with two new insurance policies with Insurance Company 3, which required higher annual payments, and had a total death payout of approximately $1.75 million. The Statement of Claim alleged that the new policies were more expensive with less benefit, and the only reason for Respondent to exchange the policies was to generate commissions for himself.

Respondent stated that Grievant went to Respondent, expressing his displeasure with the life insurance policies recommended by a previous advisor. Grievant wanted more stable policies with guaranteed payouts, as well as guaranteed premium amounts. When Respondent reviewed the policies, he determined that both policies were underfunded and would collapse. It became clear that Grievant would, at some point, be required to invest significant funds in both policies based on their underperformance. As a result, Respondent recommended that Grievant purchase the two Insurance Company 3 whole life insurance policies.

Respondent was not able to provide copies of either the Old Policies as they were issued prior to 1994. Respondent was also unable to provide any details on the original policies, such as premium amounts, cash value or face amount.

Respondent provided copies of the two new Insurance Company 3 Policies. The first policy was issued on with a face amount of $750,000, quarterly premium of $22,000 and cash value of $932,000. The second policy was issued with a face amount of $1 million, quarterly premium of $42,000 and cash value of $459,000. Respondent stated that these replacement policies were somewhat more expensive, but were more stable and provided guaranteed payouts and guaranteed premium amounts.

Respondent did not explain why Grievant wanted guaranteed payouts and guaranteed premium amounts. Respondent received a commission of $85,000 for the life insurance policy exchange. Respondent disclosed to Grievant that he would receive a commission for the exchange.

Annuity Exchange

According to the Statement of Claim, in 2005, Respondent exchanged Grievant's Old Variable Annuity for two New Annuities, creating a surrender penalty of $21,000. At least one of these new annuities was only a five-year annuity, requiring Grievant to repurchase another annuity in five years, entitling Respondent to another commission and requiring Grievant to commit new principal. The Statement of Claim alleged that these actions constituted churning.

Respondent stated that Grievant came to him and required an immediate withdrawal, explaining that he needed cash. Respondent allegedly did not recommend the annuity exchange until Grievant explained his immediate need for additional income and cash. Grievant was adamant about needing an additional $400,000 per year and wanted Respondent to provide a solution for his needs. Respondent had numerous meetings with Grievant and recalled specifically disclosing the annuity surrender fee to Grievant. Grievant was allegedly not concerned with the surrender fee and wanted to proceed with the exchange.

In 2005, the Old Variable Annuity was surrendered in full because a partial surrender was not permitted and the funds were then placed into two separate New Annuities: 1) Flexible Premium Deferred Annuity – Equity Indexed Policy with a deposit of $226,000; and 2) Single Premium Immediate Annuity Policy with a deposit of $738,000. This policy was a five-year annuity.

Respondent explained the rationale for the annuity exchange. He stated that the New Annuities had guaranteed payout rates. Grievant wanted as many guarantees as possible with respect to the amounts he would receive from his annuities. Since the funds were going to be annuitized, and because of Grievant's expressed desires for guaranteed payments, the Old Variable Annuity was less attractive given his needs and desires because its performance was tied to the stock market. Since the Old Variable Annuity lacked the guarantees Grievant wanted, the New Annuities provided a better option for him.

Respondent received a commission of $17,000 on the annuity exchange. As to Grievant's sudden need for income of $400,000 per year, Respondent did not offer a definitive explanation. Respondent stated that Grievant never explained why he had this immediate need for income, and that Respondent did not believe it was his business to make such an inquiry about his client's needs. Respondent added that during Arbitration, it was discovered that Grievant was heavily involved in numerous additional outside investments.

Respondent was not able to provide CFP Board with a copy of the Old Variable Annuity Policy. However, he did provide CFP Board with copies of the New Annuities Applications and Policies.

Private Placements

According to the Statement of Claim, Respondent advised Grievant to place 43% of his total assets into several highly speculative, nonpublic companies which were unsuitable for Grievant, given his age, income, net worth and investment objectives. Respondent allegedly misrepresented these investments to Grievant as being safe and secure, when Respondent knew, or should have known of the investments' riskiness. Grievant's Account Application for his Charitable Trust showed his risk tolerance to be moderate. His Brokerage Account Application indicated Grievant's risk tolerance to be conservative.

The speculative investments included ST, a firm providing software and data integration solutions which was a high-risk venture that never produced any meaningful income. Respondent allegedly convinced Grievant to invest approximately $1,330,000 into ST. Two similar investments were PB, a firm offering wireless technology advertising and CL, a provider of software that streamlined dispatching and towing operations. CL was in bankruptcy in 2011 and PB was no longer in business. Grievant lost $605,000 in PB and CL.

Respondent allegedly advised Grievant to borrow money to invest in these companies ($450,000) and to sign loan guarantees ($270,000) on behalf of ST. This advice was inappropriate as Respondent owned large stakes in each of these companies.

Respondent's Answer to the Statement of Claim asserted that Grievant independently made the investments in ST, PB and CL. Respondent allegedly did not recommend that Grievant invest in any of these three companies. Rather, Respondent gave the representatives from these three companies the names of accredited investors, including Grievant's, whom he thought might be interested in these start-up ventures. Once Respondent passed these names along, he allegedly had no involvement whatsoever in analyzing, suggesting or encouraging Grievant to make an investment, or in conducting any due diligence into these companies.

According to Respondent's Answer, Grievant unilaterally decided to invest in ST with an initial investment of $150,000 in 2003, then increased his investment to a total amount of $1,000,000 in 2006. Grievant invested $250,000 in PB in 2006 and $100,000 in CL in 2006, as well. Respondent alleged that ST was actually a thriving company and Grievant's $1,000,000 investment was currently worth approximately $1,390,000. Respondent's Answer did not specifically address the allegations that Respondent recommended that Grievant borrow money to invest in these companies, or the allegations that Respondent advised Grievant to sign loan guarantees on behalf of ST.

Respondent did not receive any commissions for Grievant's investments in ST, PB or CL. Respondent was an investor/shareholder in each of the three companies and allegedly disclosed his involvement to Grievant.

CFP Board requested copies of all subscription agreements and private placement memorandums for all three private placements. Respondent responded with numerous documents, stating that he had forwarded "all of the Subscription Agreements the parties could locate." He did not provide copies of any private placement memorandums.

Personal Loans

According to the Statement of Claim, Respondent took advantage of the long-term friendship he had with Grievant by obtaining personal, interest-free loans for himself. As Grievant's investment advisor, Respondent had a duty to act in the interest of the client, and to not engage in self-dealing. Under no circumstances was it in Grievant's best interest to give interest-free loans to Respondent.

Respondent's Answer to the Statement of Claim did not address the allegations concerning the personal loans. Respondent accepted two personal loans from Grievant in the amount of $50,000 each. The first loan was made in September 2005 and Respondent repaid that loan in June 2006. The second loan was made in September 2006, and was repaid in October 2006. Respondent did not execute promissory notes to memorialize these loans.

Respondent and Grievant were close friends and would often speak with one another about their own individual investments. At the time Grievant made these loans to Respondent, CL was seeking additional capital investment and Respondent did not have the liquidity to make another capital contribution into CL. Respondent had a discussion with Grievant about this situation and Grievant allegedly insisted that Respondent take a $100,000 loan from him. Respondent did not pay any interest on either loan.

Scope of Engagement

Grievant approached Respondent in 1994 when he was dissatisfied with the insurance product his previous financial advisor sold to him. It was in 1994, and afterwards in 1996, that Respondent sold the two insurance policies to Grievant. Later, Respondent assisted Grievant in obtaining guaranteed income through the recommendation of laddered annuities. Respondent also assisted Grievant in preparing a Charitable Remainder Trust. Respondent did not provide Grievant with a financial plan. He also stated that there were no engagement documents between Respondent and Grievant, only account opening documents pertaining to the insurance policies and annuities. Respondent never performed a total net worth analysis on Grievant. Respondent asserted that Grievant never shared the extent of his outside investments with Respondent, and it was not until the Arbitration that the extent of Grievant's outside investments was discovered.

III. <u>Rule Violations</u>

A. *Rule 102 Violation – In the course of professional activities, 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.*

Respondent engaged in conduct involving misrepresentation when he described three private placement funds to a client as being safe and secure when they were actually highly speculative, nonpublic investments. Thus, Respondent violated Rule 102.

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

Respondent failed to exercise reasonable and prudent professional judgment in providing professional services when he: 1) described three private placement funds to a client as being safe and secure when they were actually highly speculative, nonpublic investments; 2) recommended and implemented a life insurance exchange for a client that was inappropriate because it resulted in more expense and less benefit for the client, but a large commission for Respondent; 3) recommended and implemented an annuity exchange for a client that was inappropriate because it created a surrender penalty of $21,000 for the client and a large commission for Respondent; 4) recommended three private placements to a client in which Respondent was personally invested; and 5) accepted an interest-free loan from a client without executing a promissory note and on terms that were unfair and unreasonable to the client. Thus, Respondent violated Rule 201.

C. *Rule 409 Violation – If a CFP Board designee enters into a personal business transaction with a client, separate from regular professional services provided to that client, the transaction shall be on terms which are fair and reasonable to the client.*

Respondent failed to enter into a personal business transaction with a client on terms which were fair and reasonable to the client when he accepted an interest-free loan from a client and without executing a promissory note. Thus, Respondent violated Rule 409.

D. *Rule 501 Violation – A CFP Board designee shall not reveal, or use for his or her own benefit, without the client's consent, any personally identifiable information relating to the client relationship or the affairs of the client.*

Respondent revealed, and used for his own benefit, without the client's consent, personally identifiable information relating to the client relationship or the affairs of the client when he forwarded a client's contact information to the representatives of three private placements without the client's consent. Respondent personally invested in these private placements. Thus, Respondent violated Rule 501.

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

Respondent failed to perform services in accordance with applicable rules, regulations and other established policies of CFP Board when he: 1) described three private placement funds to a client as being safe and secure when they were actually highly speculative, nonpublic investments; 2) recommended and implemented a life insurance exchange for a client that was inappropriate because it resulted in more expense and less benefit for the client, but a large commission for Respondent; 3) recommended and implemented an annuity exchange for a client that was inappropriate because it created a surrender penalty of $21,000 for the client and a large commission for Respondent; 4) recommended three private placements to a client in which Respondent was personally invested; 5) accepted an interest-free loan from a client without executing a promissory note and on terms that were unfair and unreasonable to the client; and 6) forwarded a client's contact information to the representatives of three private placements without the client's consent. Respondent personally invested in these private placements, violating Rules 102, 201, 409, 501, 607 and 704. Thus, Respondent also violated Rule 606(b).

F. *Rule 607 Violation – A CFP board designee shall not engage in any conduct which reflects adversely on his or her integrity or fitness as a CFP Board designee, upon the marks, or upon the profession.*

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) described three private placement funds to a client as being safe and secure when they were actually highly speculative, nonpublic investments; 2) recommended and implemented a life insurance exchange for a client that was inappropriate because it resulted in more expense and less benefit for the client, but a large commission for Respondent; 3) recommended and implemented an annuity exchange for a client that was inappropriate because it created a surrender penalty of $21,000 for the client and a large commission for Respondent; 4) recommended three private placements to a client in which Respondent was personally invested; 5) accepted an interest-free loan from a client without executing a promissory note and on terms that were unfair and unreasonable to the client; and 6) forwarded a client's contact information to the representatives of three private placements without the client's consent. Respondent personally invested in these private placements. Thus, Respondent violated Rule 607.

G. *Rule 704 Violation – A CFP Board designee shall make a reasonable investigation regarding the financial products recommended to clients.*

Respondent failed to make a reasonable investigation regarding the financial products recommended to clients when he: 1) recommended and implemented a life insurance exchange for a client that was inappropriate because it resulted in more expense and less benefit for the client, but a large commission for Respondent; and 2) recommended and implemented an annuity exchange for a client that was inappropriate because it created a surrender penalty of $21,000 for the client and a large commission for Respondent. Thus, Respondent violated Rule 704.

H. Discipline Imposed

Article 3(a) of CFP Board's *Disciplinary Rules and Procedures* 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, 409, 501, 606(b), 607 and 704 of the *Code of Ethics.* The Commission and Respondent entered into a Settlement Agreement in which Respondent consented to the Findings of Fact and Rule Violations. Based on the terms of the Settlement Agreement, the Commission issued to Respondent an eight-month Suspension of Respondent's right to use the CFP® marks, pursuant to Article 4.3 of the *Disciplinary Rules*.

The Commission considered the following mitigating factors:

1. The personal loans occurred with only one client with whom Respondent had a long-term relationship;
2. The only harm to the client was the lack of any interest payments and Respondent repaid the client in full less than nine months from the first loan and one month from the second loan;
3. The annuity exchanges took place in 2005 after numerous meetings with the client and the client's attorney. The attorney, who was also the client's attorney-in-fact under the client's durable power of attorney, was involved in the planning of these transactions along with many others. The attorney received copies of all pertinent information and approved the transactions;
4. The life insurance exchanges took place in the mid-1990's and the client did not complain until 2010. The record reflected that there was a reasonable explanation for the exchanges, which was to lock in client's premium payments and death benefits.
5. The Financial Industry Regulatory Authority, Inc. arbitration was settled for essentially nuisance value.

The Commission did not consider any aggravating factors.

In reaching its decision, the Commission consulted Anonymous Case Histories 15935 and 25362 and *Sanction Guidelines* 3 (Borrowing from Client), 7 (Conflict of Interest), 13 (Failure to Act in Client's Interest Outside the Financial Planning Relationship) and 31 (Suitability Violation).