CERTIFIED FINANCIAL PLANNER BOARD OF STANDARDS, INC.

ANONYMOUS CASE HISTORIES
NUMBER 28739

This is a summary of a decision issued following the October 2015 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 and the Financial Planning Practice Standards 100-1 through 600-1.

I. Issues Presented

Whether a CFP® professional ("Respondent") violated CFP Board's *Standards of Professional Conduct* when he sold the client unsuitable variable annuities, recommended the client mortgage her home to invest the proceeds and sold the client a LTC insurance policy that did not meet her needs.

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

Client K's Initial Contact with GL

In 2002, 67-year old Client K met GL at an investment seminar. At the time, Client K was in the process of divorcing her husband of 45 years who had previously been responsible for all their finances. According to Respondent's testimony, Client K approached GL after the investment seminar to ask her to review a second-to-die insurance policy Client K maintained. GL "was not familiar with life insurance" so she asked Respondent to analyze the policy held by Client K. Respondent reviewed the policy and relayed his analysis to GL who then took it back to Client K. Respondent was not present at that meeting.

During the meeting to explain Respondent's analysis of Client K's insurance policy, GL had a conversation with Client K about long-term care. Respondent did not attend this meeting. GL used a marketing sample, a Transamerica Occidental Long Term Care insurance policy ("Transamerica LTC Policy") to discuss long-term care with Client K. The policy offered an unlimited benefit period and policy amount, provided for a daily benefit of $170 and a 5% benefit increase rider. The annual premium for the illustrated policy was $4,467.92. Respondent testified that Client K declined to purchase the long-term care policy because it was too expensive. GL then suggested that Client K meet with Respondent to discuss general financial planning. Client K scheduled a meeting in Respondent's office in October 2002.

October 2002 Meeting

In the meeting in October 2002, Respondent discussed with Client K how he did business and the scope of the planning process. According to Respondent, he did not recommend any products or discuss a home loan refinancing at this meeting. Respondent indicated that this was purely a fact-finding meeting. Respondent reviewed Client K's tax returns, mortgage statement, bank statements and brokerage statements. Respondent also had Client K complete a personal financial planning profile. In the profile, Client K indicated that she had an investment horizon of three to five years and that she was "primarily concerned with protecting the value" of her account and "preferred to minimize potential losses." Client K also informed Respondent that she was getting divorced from her husband, but that she would be able to keep her home, a quarter interest in an investment property owned by her husband, the insurance policy and he would pay for her healthcare. Client K also informed Respondent that she had inherited a brokerage account. Client K's ultimate goal was to earn enough income to maintain her lifestyle.

According to Respondent's testimony before the Commission, he communicated to Client K that he believed she would have insufficient assets to meet her income and liability obligations. Based on Respondent's preliminary analysis of Client K's portfolio, her monthly expenses were $4,500 and her monthly income was $3,450. As a result, Client K was incurring a shortfall of $1,000 per month and would exhaust her liquid assets in approximately eight years and be forced to sell her home to raise cash. Respondent also testified that he recommended that Client K sell her home while she was still married to her soon-to-be ex-husband to take advantage of the $500,000 capital gains exemption for married couples. Respondent testified that at this time, Client K stated that she did not want to sell her home. Respondent then proposed that Client K rent a room in her home or obtain employment to generate additional income. Respondent testified that Client K would not agree to rent a room in her house or obtain employment, which left Respondent with the need to put together a portfolio to generate income from her assets. Respondent also recommended that Client K reduce her expenses, which she could do if she contacted her mortgage broker to attempt to lower her interest rate.

GL offered the name of a mortgage broker she had previously worked with, MF. Respondent stated that he offered to provide Client K with the names of three mortgage brokers, but Client K decided to rely on GL's recommendation. Respondent stated that this was the extent of his involvement with Client K's refinancing. Sometime after this meeting, Client K indicated that she was leaning toward taking equity out of her house when she refinanced her home after speaking with MF.

November 2002 Financial Analysis

In November 2002, Respondent presented Client K with a Financial Analysis that contained a summary of her personal information and assumptions, a retirement planning analysis and an analysis of Client K's cash flow needs. According to the Financial Planning Profile of November 2002, Client K's assets were: 1) $27,828 in cash; 2) investments in stocks and bonds valued at $100,000; 3) a rental property valued at $187,600; and 4) her home valued at $1 million. According to Respondent, Client K had $1,443,855 in total assets and a $500,000 mortgage liability resulting in a $943,855 net worth. The mortgage had an annual interest rate of 5.75% and Client K was making monthly payments of $2,100, which resulted in the mortgage being a negative amortization mortgage.

With respect to Respondent's retirement planning and cash flow analysis, Respondent determined that Client K's goal was to obtain $54,000 per year in retirement income. Respondent projected that income would be funded with $5,400 in annual social security income and $18,000 rental income from her quarter interest in an investment property. Client K was also receiving $720 per month from her ex-husband for her health insurance. Thus, the remaining income would need to come from income generated from her investments.

Respondent's Recommendations

Respondent determined that Client K could not maintain the funds she received from the equity in her home in cash as she would be losing money due to the interest paid on the home equity. Client K could not hold the funds in bonds because the interest rate the bonds were paying at the time was at or below the interest rate of the mortgage and Client K would have had to hold the bonds to maturity to be guaranteed the exact amount of the investment. Respondent considered a third option, the Accumulator Plus Variable Annuity, which would have beneficial to Client K due to that fact that it could provide proper diversification and it had a guaranteed minimum income benefit rider. The annuity offered an income rider that would provide Client K with annual income based on the greater of the Roll-Up Benefit Base, which was the initial contribution guaranteed to grow at a 6% annually, or the Ratchet Benefit Base, which was the market value of the annuity account on the contract date.

Ultimately, Respondent presented three options to Client K:

1. Client K would liquidate her current her equity investments and invest approximately $160,000 in the annuity with a $6,400 bonus. Client K would be able to withdraw about 10,000 per year without reducing her guaranteed minimum income benefit base or incurring any surrender penalties. Respondent illustrated this annuity option in an illustration dated November 5, 2002.

2. Client K would liquidate all of her investments and invest approximately $270,000 in the VA with a $13,500 bonus. Mr. Kent would be able to withdraw approximately $17,000 per year without reducing her benefit base or incurring any surrender penalties. Respondent illustrated this annuity option in an illustration dated November 8, 2002.

3. Client K would liquidate all of her investments and combine the $200,000 in inequity she received from her home when she refinanced her mortgage to invest approximately $470,000 in the VA with a $23,500 bonus. Client K would be able to withdraw approximately $29,000 per year without reducing her benefit base or incurring any surrender penalties. Respondent illustrated this annuity option in an illustration dated November 8, 2002.

Client K's 2003 Variable Annuity

Client K chose the third option and purchased a variable annuity ("First Annuity"). On January 29, 2003, Client K made a $250,000 partial payment into the First Annuity by selling all of her investment portfolio. On March 10, 2003, Client K refinanced her home to help pay for First Annuity and transferred $242,000 into the First Annuity. As a result of the refinance, Client K's mortgage balance increased from $500,000 to $752,000. On March 14, 2003, Client K placed $242,000 from the equity Client K removed from her house in the First Annuity. Client K's total initial investment in the First Annuity was $492,000. Client K also received a $24,000 bonus amount.

On the application for the First Annuity, Client K indicated that her annual income was $30,000 and her estimated net worth was $1,000,000. Client K's assets consisted of $270,000 in cash, $500,000 in real estate. Client K listed her investment objective as "income and growth" with an investment time horizon of "7-9 years" and a "conservative/moderate" risk tolerance.

Respondent indicated that his plan for Client K was that she would not withdraw any money from the First Annuity in the first year and thereafter would withdraw no more than 6% annually from the First Annuity to supplement her income. This would have allowed the Guaranteed Minimum Income Benefit ("GMIB") for the First Annuity to be $56,284.53 beginning in year 10 and $87,683.16 beginning in year 15. Within 18 months, however, Client K deviated from Respondent's plan and withdrew $61,894.56. In the second year, Client K withdrew an additional $58,094.56 and by the third year, she had withdrawn a total of $141,199.11. As of February 2013, Client K had withdrawn a total of $555,835 from the First Annuity.

2003 Long-Term Care Policy

In September 2003, Respondent sold Client K a long-term care ("LTC") policy with a $3,000 annual premium, a four-year benefit period and $189,000 policy limit. Respondent testified that he conducted market research of the daily rate for long-term care in a semi-private room, which he asserted was $130. CFP Board provided no evidence to question the accuracy of Respondent's estimate. Respondent also estimated that the average stay in a nursing home was two and half years, plus some additional time in home care. CFP Board provided no evidence to question the accuracy of Respondent's estimate. Thus, Respondent determined that a four-year policy would be sufficient for Client K. Respondent also wanted to secure 5% compounding inflation protection, for which the LTC policy purchased by Client K provided.

Client K's 2006 Variable Annuity

In November 2005, Client K's ex-husband passed away. Around this same time, MF testified that Client K approached him to take additional equity out of the home. Client K refinanced her mortgage again taking equity out of the home by increasing her mortgage to $1,000,000. Client K received approximately $238,000 in cash from the refinance.

On March 21, 2006, Respondent arranged for the entire loan proceeds of $238,000 to be wired directly from escrow to his firm. Respondent and GL used the entire $238,000 to purchase a second variable annuity ("Second Annuity").

On the application for the Second Annuity, Client K indicated that her annual income was $60,000 and her estimated net worth was $1,915,000. Client K's assets consisted of $300,000 in cash, $615,000 in annuities, $1,000,000 in real estate. Client K listed her investment objective as "income and growth" with an investment time horizon of "greater than nine years" and a "moderate" risk tolerance.

Respondent indicated that he had the same plan for the Second Annuity as he had with the First Annuity. He anticipated that Client K would not need any income from the Second Annuity, but in the event she did need the income she would not take out more than 6% per year. This contributed to Respondent's indication that Client K had a time horizon greater than nine years. Client K did not take any withdrawals in the first year of the contract and thereafter did not exceed the 6% withdrawal from the Second Annuity.

Client K's 2007 Variable Annuity

In July 2006, Client K's daughter and the other shareholders in the investment property decided to sell the property. The property was sold for $1,100,000 with Client K receiving $262,000. Respondent testified that he discussed with Client K a 1031 exchange to another building and proposed that Client K place the proceeds in mutual funds if she did not want to do the 1031 exchange. Respondent ultimately recommended that Client K place half of the proceeds from the sale of the building into an annuity and the other half into an investment account. Respondent and GL sold Client K a "Third Annuity" with a $112,500 contribution and opened an "investment account" with the remaining $124,000 proceeds from the sale of Client K's rental property. Respondent and GL used this account to distribute money to Client K as her needs arose.

On the application for the Third Annuity, Client K indicated that her annual income was $60,000 and her estimated net worth was $1,915,000. Client K's assets consisted of $150,000 in cash, $850,000 in annuities, $1,000,000 in real estate. Client K listed her investment objective as "income and growth" with an investment time horizon of "greater than nine years" and a "moderate/aggressive" risk tolerance.

Respondent indicated that his plan for the proceeds of the sale of the investment property was that Client K would take the 6% withdrawals from the annuity and would deplete the principal and any interest earned on the investment account over the course of 10 years. Client K did not take any withdrawals in the first year of the contract and thereafter did not exceed the 6% withdrawal from the annuity.

Events Occurring After the Third Annuity

Respondent asserted that he warned Client K that she needed to control her excessive spending. Despite Respondent's and GL's warnings to the client that her expenses and spending habits were unsustainable and their efforts to stabilize her finances, she insisted upon remaining in a house she could not afford and refused to reduce her expenses.

2012 Client K FINRA Arbitration

In a statement of claim filed in December 2012, Client K, then 78 years old, alleged that Respondent, GL and Firm "lur[ed] her away from her previous financial advisor" and "induc[ed] her to liquidate and/or encumber her safe, diversified and profitable investments and assets in order to create capital to fund unsuitable investments." Client K stated that Respondent and GL misled her into purchasing unsuitable proprietary investments in order to generate commissions for themselves. Respondent and the other Respondents settled the arbitration filed by Client K for $300,000, with Respondent's errors and omission carrier contributing $120,000 to the settlement on his behalf.

III. Commission's Analysis and Conclusions Regarding Rule Violations

First, Second, Third, Fifth, Seventh, Eighth and Ninth Cause for Discipline

CFP Board's Complaint alleged that Respondent, a CFP Board designee, violated Rules 201, 202, 607 and 703 of the *Code of Ethics* and *Practice Standards* 300-1, 400-1 and 500-1 when he sold the client unsuitable variable annuities, recommended the client mortgage her home to invest the proceeds and sold the client a LTC insurance policy that did not meet her needs.

With respect to whether the variable annuities were suitable, the record reflects that Respondent's plan for how the variable annuities would meet Client K's goal of generating income to maintain her lifestyle and home was sound. Respondent provided a guarantee for the money Client K pulled out of the equity in her home and provided Client K with the ability to withdraw the amount she needed to meet her expenses. Respondent projected that Client K would need $54,000 in annual income to cover her expenses in 2002. This amount would rise with inflation and as Client K's expenses increased. With the $32,000 in income reported by Client K prior to purchasing the First Annuity coupled with the potential 6% withdrawal of $29,000 from the First Annuity, Respondent's plan appeared poised to provide Client K with sufficient income to meet her projected needs. Client K began deviating from this plan against Respondent's advice, however, having a negative impact on her investing outcome. Had Client K followed through with the plan to limit her withdrawals to 6%, she would have been able to annuitize the First Annuity in 10 years to generate a significant stream of income, while having sufficient liquidity through the 6% withdrawals to meet her income needs in the meantime. The basis for purchasing the Second Annuity and the Third Annuity were the same and were equally sound. Unlike the First Annuity, Client K largely followed the plan up until the time of the arbitration, only withdrawing the 6% amount and maintaining a solid benefit base for a potential annuitization. CFP Board Counsel focused on the fact that the annuities were illiquid and had a long time horizon. Under Respondent's plan, however, Client K would have had sufficient liquidity to meet her projected income needs with a small cushion through the 6% withdrawals. With respect to the time horizon, Client K's income needs were met for the period of the time horizon by her ability to make withdrawals from the annuity. By the time Client K would need additional income, she would be able to annuitize the annuities to generate the guaranteed stream of income. CFP Board Counsel also alleged that the allocations inside of the annuities were unsuitable. The Commission found, however, that the allocations within the annuities were diversified and matched Client K's stated risk tolerance and investment objective. Thus, the Commission determined that CFP Board did not meet its burden to demonstrate that the annuities were not suitable.

With respect to the allegation that Respondent recommended that Client K mortgage her home to invest the proceeds, the record was clear that Respondent did not take any part in Client K's mortgage transactions. MF testified that Respondent was not involved in the transaction and, other than the allegation in Client K's Statement of Claim, CFP Board did not offer any evidence to dispute MF's testimony on this issue. Thus, the Commission concluded that CFP Board did not meet its burden of proof on this issue.

Finally, with respect to the allegation that Respondent sold Client K a Long-Term Care insurance policy that did not meet her needs, the record did not contain any evidence that supported this allegation. The record did not contain any evidence to refute Respondent's projections regarding Client K's Long-Term Care needs. In addition, Respondent provided Client K with a policy that met her needs and was affordable for her based on her income. The policy originally presented to Client K by GL was not something Respondent had any responsibility for presenting or recommending. Further, the record indicated Client K could not afford the policy presented by GL. Thus, CFP Board did not meet its burden to provide that Respondent violated Rules 201, 202, 607 and 703 of the *Code of Ethics* and *Practice Standards* 300-1, 400-1 and 500-1.

Fourth Cause for Discipline

CFP Board's Complaint alleged that Respondent, a financial planning practitioner, violated Rule 701 of the *Code of Ethics* when he sold the client unsuitable variable annuities, recommended the client mortgage her home to invest the proceeds and sold the client a LTC insurance policy that did not meet her needs. As stated above, the Commission did not find that CFP Board proved the allegations in CFP Board's complaint. The Commission did find that Respondent failed to exercise appropriate diligence in his conduct with Client K when he: 1) failed to provide any cash reserve for Client K when purchasing the Second Annuity; and 2) provided inaccurate information regarding the value of the real estate and net worth of the client on the Second Annuity and Third Annuity applications by failing to appropriately account for the mortgages on Client K's home. Despite the fact that Respondent testified that GL completed the applications, Respondent was nonetheless responsible for their content because he made the recommendations and participated in the sale of the annuities as a financial planning practitioner. Thus, Respondent violated Rule 701 of the *Code of Ethics*.

Sixth Cause for Discipline

CFP Board's Complaint alleged that Respondent, a CFP Board designee and GL's supervisor, violated Rule 705 of the *Code of Ethics* when he sold the client unsuitable variable annuities, recommended the client mortgage her home to invest the proceeds and sold the client a LTC insurance policy that did not meet her needs. The record did not contain any evidence that would support a finding by the Commission that Respondent was GL's supervisor. Thus, CFP Board did not meet its burden to prove that Respondent violated Rule 705 of the *Code of Ethics*.

IV. Discipline Imposed

Article 3(a) of CFP Board's *Disciplinary Rules and Procedures* ("*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 Rule 701 of the *Code of Ethics.* Pursuant to Article 4.1 of the *Disciplinary Rules*, the Commission issued a Private Censure to Respondent.

The Commission considered in mitigation that Respondent had no prior disciplinary history with CFP Board and invested at least nine years in serving the client.

The Commission considered as an aggravating factor that Respondent did not maintain documentation of the different investment options he considered for the client.

In arriving at its decision, the Commission consulted Anonymous Case Histories 15250, 21409 and 24265. The Commission also consulted *Sanction Guideline* 11 (Diligence).