BEFORE THE
DEPARTMENT OF CORPORATIONS
STATE OF CALIFORNIA

In the Matter of the Desist and Refrain Order Against:	)	
	)	File No. 38300
	)	OAH No. L2004080137
RONALD EDWARD REISWIG, JANET SUE REISWIG, FEP, INC., FIDELITY INSURED DEPOSITS, INC., RICK ANDREW LEON, PAUL GREWAL, and DONALD ANTHONY FRACCHIA,	)	
Respondents.	)	

DECISION

The attached Proposed Decision of the Administrative Law Judge of the Office of Administrative Hearings, dated October 5, 2004, is hereby adopted by the Commissioner of Corporations as his Decision in the above-entitled matter with the following technical and minor changes pursuant to Government Code Section 11517(c)(2)(C).

(1) The name "Svendsen" is substituted for "Svenson" as follows:

(a) In the third sentence of paragraph number 25 of the Factual Findings, on page 10 of the Proposed Decision;
(b) In the first sentence of paragraph number 26 of the Factual Findings, on page 10 of the Proposed Decision;
(c) In the first sentence of paragraph number 27 of the Factual Findings, on page 10 of the Proposed Decision;
(d) In the fourth sentence of paragraph number 27 of the Factual Findings, on page 10 of the Proposed Decision;
(e) In the fifth sentence of paragraph number 27 of the Factual Findings, on page 10 of the Proposed Decision;
(f) In the first sentence of paragraph number 28 of the Factual Findings, on page 11 of the Proposed Decision; and,
(g) In the second sentence of paragraph number 28 of the Factual Findings, on page 11 of the Proposed Decision.

(2) The number "1,314" is substituted for the number "1,296" in the first sentence of paragraph number 46 of the Factual Findings, on page 14 of the Proposed Decision.

This Decision shall become effective on NOV 0 3 2004.

IT IS SO ORDERED NOV 0 3 2004.

WILLIAM P. WOOD
California Corporations Commissioner

BEFORE THE
DEPARTMENT OF CORPORATIONS
STATE OF CALIFORNIA

In the Matter of the Desist and Refrain Order Against: RONALD EDWARD REISWIG, JANET SUE REISWIG, FEP INC., FIDELITY INSURED DEPOSITS, INC., RICK ANDREW LEON, PAUL GREWAL, and DONALD ANTHONY FRACCHIA, Respondents.	File No. 38300 OAH No. L2004080137

PROPOSED DECISION

On August 18, 19, 20 and 23, 2004, Administrative Law Judge Timothy S. Thomas, Office of Administrative Hearings, heard this matter in Los Angeles, California.

Karen L. Patterson, Senior Corporations Counsel, represented complainant, the Commissioner of the Department of Corporations (hereinafter the Commissioner).

John Baker, Attorney at Law, represented all named respondents except Paul Grewal, who did not request a hearing, or appear.

The parties requested that final arguments be presented by written brief, according to a stipulated schedule. Respondents' closing brief was received on August 30, 2004, and marked as Exhibit 45. Complainant's closing brief was received on August 31, 2004, and marked as Exhibit 46.[1] Complainant's reply brief was received on September 7, 2004, and marked as Exhibit 47. Respondents' reply brief was received on September 7, 2004, and marked as Exhibit 48. The parties' opening hearing briefs were marked as Exhibits 49 (respondents) and 6 (complainant).

The matter was deemed submitted on September 7, 2004.

[1] Complainant's Closing Brief attaches four exhibits that are evidentiary in nature. The exhibits are not received into evidence, nor considered in reaching this decision.

The Admissibility of Exhibit 44

Complainant offered Exhibit 44, a partial transcript of proceedings before the Office of Administrative Hearings on July 17, 2003. Respondents objected to pages 180 to 191 of the document as irrelevant, and the objection was taken under submission. The pages at issue reflect the testimony at a prior hearing of a witness named Sullivan. Upon review and further consideration of the matter, the objection is sustained, and pages 180 to 191 are stricken from the record.

FACTUAL FINDINGS

The FID/FEP Business Model

1. In the opinion of the Commissioner, respondents are engaged in the offer and sale of a security that is subject to qualification by the Commissioner without having sought or obtained the qualification authorizing them to so act. The Commissioner issued an order, pursuant to Corporations Code section 25532, on July 20, 2004, directing respondents to desist and refrain from effecting any transaction in, or inducing or attempting to induce the purchase or sale of, any security in this state, unless and until qualification has been made. All respondents except Grewal requested a hearing in a timely fashion, and this hearing commenced within 15 days after the requests for a hearing were filed.[2]

2. Respondent Ronald Edward Reiswig (hereinafter R. Reiswig), who is licensed by the Department of Insurance as a Life Agent, is the owner and CEO of respondent FEP, Inc. (FEP). The company was incorporated on August 25, 1997, and is licensed by the Department of Insurance, doing business as Family Estate Insurance Services out of offices in Laguna Hills. FEP's only business is the sale of annuities, and its only income derives from commissions earned from the sale of annuities.

3. Respondent Janet Sue Reiswig (hereinafter J. Reiswig) is also licensed by the Department of Insurance as a Life Agent. She is the owner and president of Fidelity Insured Deposits, Inc. (FID), and is married to R. Reiswig. FID, which was incorporated on August 29, 2000, is described by J. Reiswig as a "marketing company," is not licensed by the Department of Insurance or any other regulatory body, and exists for the sole purpose of generating business for FEP.[3] The business plan that accomplishes that purpose involves the advertising by FID of high yields on certificates of deposit (CD) in newspapers throughout the state, and currently in Arizona and Nevada as well. J. Reiswig conducts daily internet research of the rates of return for federally-insured CDs offered around the country, and places ads in approximately 20 newspapers that offer a rate of return substantially higher than any rate offered by institutions that are insured by the Federal Deposit Insurance

[2] A prior Desist and Refrain Order was issued in September of 2002. The matter was dismissed in July 2003 for failure to bring the matter to a hearing within 15 days of the request for a hearing pursuant to Corporations Code section 25532, subdivision (d).

[3] J. Reiswig testified that FID is now also in the business of marketing office space, equipment and furnishings, but that as of July 2003 FID had no source of income or funds other than what it received from FEP.

Corporation (FDIC). In most cases, the rate advertised by FID is roughly twice what can be acquired from any source offering FDIC protection. FID is not, itself, a federally insured institution. J. Reiswig chooses a rate to advertise that in her judgment is most likely to attract depositors and cause them to call her sales agents.

4. The advertisements placed by J. Reiswig contain telephone numbers for salespeople located within or near the geographic area served by the particular newspaper. FID has 11 offices in California, as well as offices in Arizona and Nevada, and each office is staffed by a salesperson who is employed by both FID and FEP. Customers responding to an advertisement are required to make a personal appointment with the salesperson in order to acquire the advertised CD. During the appointment, the salesperson's paramount goal is to sell the customer an annuity. Any FID customer who insists upon buying a CD, as advertised, is referred by the FID salesperson to an institution he or she finds on a list of institutions provided the salesperson daily by J. Reiswig that offers the highest rates for an FDIC-insured CD. The customer makes application to that institution directly, sometimes with the help of the FID salesperson, who calculates the difference between the return offered by the FDIC-insured CD that is purchased from the other institution, and the rate offered by FID in its advertisement. FID pays that difference in the form of a "bonus" check issued by FID. This payment is made by FID within seven days after the customer returns proof to FID that he or she actually acquired the CD. The funds for the bonus on each and every CD obtained in this manner come from FEP. Thus, at all times relevant to this matter, FID had no income, only expenses for advertising and staffing incurred to support the annuity sales operations of FEP.

5. An advertisement that appeared in The San Francisco Chronicle on August 9, 2004, is typical of all advertisements relevant to this matter. In prominent, bold type the reader is told of the availability of an "FDIC CD" at 5.50%, offered by "Fidelity Insured Deposits," named in somewhat smaller type. In much smaller type adjacent to the promise of a 5.50% yield is an asterisk, and the words, "12 Mo Yield." Telephone numbers for four area offices are shown, below which is the following language in what may be best described as "fine print":

> *Bonus Reflected. (FED REG DD) FDIC 230 TRUTH IN SAVINGS ACT: Early withdrawal penalties apply; Bank fees may reduce earnings. CD Annual Percentage Yield + FID Inception Bonus = Yield; Limited to 1 Per Family, Limit/Minimum $5,000. Not offer to sell securities. Issuing Institution Member FDIC, not FID. CD Insured By FDIC to $100,000. Accurate as of: 07.26.2004

6. FID and its salespeople fully expect that their customers will be enticed into their offices by the advertisements of CD rates much higher than available elsewhere. In fact, each CD actually sold pursuant to the advertising strategy represents a loss to FID and FEP. Respondents fully expect a great percentage of callers will be elderly people who are traditionally attracted to safe, federally-insured investments. FID is not affiliated with FDIC in any way, and the "bonus" paid by FID as part of the sale of a CD is not insured by FDIC.

7. At any given time in the last two years, from 10 to 13 salespeople worked for FID/FEP in the various branch offices. Most of them are paid 40% of the commissions earned by FEP on the sale of annuities, and none of them is paid anything for the sale of a CD. FEP offers annuities from three insurance companies: National Western Life Insurance Company (National Western), Business Men's Assurance Company of America (BMA), and American Investors Life. FEP's commissions from National Western have historically been between 10% and 13% of the principal amount of the annuity, but are currently 6.75% and 9.75% on the products known as Confidence Flex 85 and Confidence Flex 45, respectively, which remain among the highest commissions paid by insurance companies in the industry.

8. In the six months between February 1, 2004, and August 6, 2004, FEP sold $35,906,000 worth of annuities. These sales were the result of 16,130 telephonic responses to the newspaper advertisements. The sales force made 2,905 appointments for people who called the various offices, arranged for the sale of 542 CDs and completed the sale of 952 annuities during that time. J. Reiswig estimated that FID spends $100,000 per month advertising a product that loses money each time it is sold. R. Reiswig estimated that FEP funds bonuses paid by FID at the rate of $20,000 per month.

9. The general sales presentations do not vary significantly among the salespeople, nor do they vary from customer to customer. At the appointment arranged by the salesperson contacted by telephone, customers are told that the advertised CD offer is limited to a deposit of $5,000 for one year.[4] Thus, solely by way of example, if FID promised a yield of 5.5% and identified a one-year CD through a bank in Boston that paid a rate of 3%, FID would pay the customer, by check, $125, and the customer would deposit $5,000 with the Boston bank and earn the remainder of the promised return.[5] But if the customer has more than $5,000 to invest, which is usually the case, the salesperson will ask if the customer is interested in realizing even greater rates of return on his or her money. Frequently, the answer to that question is "yes." The salesperson then launches into a rehearsed comparison of the CD investment vehicle to an annuity, usually either the Flex 45 or Flex 85. The salesperson takes a piece of scratch paper and bisects the page with a vertical line, outlining the terms of the CD transaction on the left side, and the terms of the annuity transaction on the right side. The annuity option, in the case of the Flex 85 product, for example, stresses that National Western will pay an 8% bonus immediately upon purchase of the annuity, plus the prevailing interest rate in the first year of the annuity (which is 3% in all transactions involved in this matter). The annuitant may therefore expect an 11% return in the first year after purchase of the annuity. The presentation also stresses flexibility, in that at the election of the annuitant, additional deposits may be made in the first five years of the annuity, and each such annual deposit will be rewarded with a bonus equal to 5% of the additional deposit.[6] (Thus, the product is called "Flex 85.") The salesperson assumes a certain level of investment for

[4] The CD advertised may be purchased only in the amount of $5,000, which is the meaning intended by the ad's language, "Limit/Minimum $5,000."

[5] At 3%, the customer would earn $150 in one year on his or her $5,000 investment. FID's "bonus" of $125, added to the $150 from the bank, would give the customer a return of $275, or 5.50%.

[6] And the salesperson also earns a commission on each additional deposit that is made during the first five years after the annuity is sold.

illustrative purposes, and demonstrates how the annuity will yield significantly more income over time than a CD will yield. The difference in the yield of the two investments becomes more dramatic the greater the amount of the investment contemplated, because the customer may realize the FID-supplemented rate of return on the CD for only the first $5,000 of the money the customer is willing to deposit. The notes that reflect the presentations made to the customers involved in this matter do not, however, make clear that the Flex 45 and Flex 85 deposits cannot be withdrawn after the first year, or after five years, without penalty. Although one settlement option, which may be elected after five years, permits the penalty-free withdrawal of the annuity value over another five years, or 10 years total, most options contemplate surrender charges for 15 years.

10. The presentations by FID/FEP salespeople include providing their customers with brochures, or photocopies of brochures. One of the brochures is an FID publication that touts the company as, "Striving to offer our clients the highest FDIC insured CDs available!" The brochure also states, "Disclaimer: Fidelity Insured Deposits is not acting as a bank, nor is acting as employee of any bank. Fidelity Insured Deposit's only purpose is to provide fully insured investments with the highest rate of returns for its customers. All Certificates of Deposit purchased by the client are done on a direct Bank to client basis." Under "Frequently Asked Questions," FID represents that "[O]ur Certificates of Deposit are always insured. The FDIC insures 100% of your deposits up to $100,000." No mention of annuities or other insurance-related products are mentioned anywhere in the brochure.

11. A second brochure, or photocopy thereof, is given to customers who express interest in the higher yields promised with the annuity products. The Confidence Flex 85 brochure, produced by National Western, sells Flex 85 as "an excellent financial accumulation and distribution program." The handout describes the 8% "premium bonus," and the subsequent 5% bonuses, plus the current interest rate, which is guaranteed not to fall below 3%. Further description of the annuity emphasizes the tax-deferred nature of the investment, indicating that taxes are not imposed until the money is withdrawn. "You can select the time of funds withdrawal and when you are taxed. More importantly perhaps, you can select an income settlement option and spread the taxes payable over a number of years." Two additional clauses in the brochure discuss the matter of withdrawal and penalties for early withdrawal:

> CHOOSE PENALTY-FREE WITHDRAWALS OR INTEREST INCOME
> After the first policy anniversary, you may withdraw annually up to 10% of the Accumulation Account, without early withdrawal penalty. In the alternative, you can receive your interest income monthly, giving you the flexibility to meet unexpected financial needs. We treat any penalty-free withdrawals you take within the prior 12-months from the date of a request for full withdrawal of Cash Value as having been made in anticipation of the full withdrawal of Cash Value. Therefore, a full withdrawal charge is made on that amount at the time of the full withdrawal of Cash Value.

ELECT AN INCOME SETTLEMENT OPTION
An income settlement option may be elected by the owner at any time after the 5th Certificate Year. A great variety of income settlement options are available to you. The income settlement option allows you to spread the deferred income taxes over a number of years; thus, possibly reducing those same income taxes.

Except as conveyed by the language quoted above, the brochure does not specifically inform the reader that a deposit in the form of a Flex 85 annuity will tie up the annuitant's deposit for 10 years, or 15 years, or any other period of time, or that earlier withdrawals will result in substantial penalties.

12. Following the decision to purchase an annuity, the FID customer, who has unknowingly become a customer of FEP, signs and receives copies of a number of additional documents. One of the documents is an "Information and Disclosure" brochure, which when signed by the annuity applicant is intended to provide proof that the salesperson reviewed the brochure's information with the customer. The document is also signed by the salesperson, who acknowledges that he or she has reviewed the disclosure and information with the applicant. The Information and Disclosure brochure for the Flex 85 contains the following relevant language:

8% FIRST YEAR PREMIUM BONUS
Each premium paid into the CONFIDENCE FLEX 85 during the first certificate year will be increased by 8% before interest is credited.

5% PREMIUM BONUS YEARS 2 THROUGH 5
Each premium paid during certificate years 2 through 5 will be increased by 5% before interest is credited.

INTEREST RATE
Premiums and Premium Bonuses in the CONFIDENCE FLEX 85 earn the current base interest rate of _____%.[7] Renewal rates are subject to change but are guaranteed to never be less than 3%.

SETTLEMENT OPTIONS AT ANNUITY DATE
A Settlement Option may be elected by the owner anytime after the 5th certificate year. Settlement Options include:
1. Income for life
2. Life Income with a Guaranteed Period
3. Life Income with Installment Refund
4. Survivorship Annuity
5. Monthly Income for Fixed Period not less than 5 years
6. Annual Income for fixed Period not less than 5 years

[7] In each instance relevant to this matter, the salesperson inserted the figure "3" in this space.

7. Proceeds Held at Interest Only for a Period not less than 5 years

The FID/FEP salespeople who testified in this matter confirmed that the settlement options offered by the Flex policies mean that in no circumstances can an individual retrieve his or her money any sooner than 10 years after the funds are committed. That is, no settlement option may be selected sooner than following the fifth year, and no option permits total, penalty-free withdrawal in less than five years thereafter.

13 When applicable, the customer signs a Notice to California Residents Age 65 or Older, which reads:

> Please be advised that the sale or liquidation of any stock, bond, IRA, certificate of deposit, mutual fund, annuity, or other asset to fund the purchase of an annuity or life insurance policy may have tax consequences, early withdrawal penalties, or other costs or penalties.
>
> You may wish to consult an independent legal or financial advisor before selling or liquidating any assets prior to the purchase of any life or annuity products.
>
> I have received a copy of this disclosure and I understand its contents.

14. The customer must sign an Application for Annuity that is filled out by the salesperson. The document, which is sent to the insurance company that underwrites the annuity, includes the customer's name and address, the identity of the beneficiary, the type of plan purchased, and the amount to be deposited. The Application for Annuity is forwarded by the salesperson to the insurance company along with the customer's check for the full amount of the investment. Once the application is approved, the insurance company sends the annuity policy to FEP, and the salesperson calls the customer to request that he or she come into the FEP office to receive the policy. The customer is asked to sign an Annuity Policy/Certificate Delivery Receipt, acknowledging receipt of the policy. Typically, the customer takes the policy home and files it away.

15. The policy is a multiple page document typical of insurance policies generally. One version of the National Western policy includes a "General Information" page that describes the basic terms of the annuity. Among those terms is a "Maturity Date." Unless the annuitant specifies a different date in the application, the maturity date defaults to the annuitant's 99th birthday. The date may be changed after issuance of the policy, but may not be changed to a date earlier than the "fifth certificate anniversary." Other copies of the policy refer to an "Annuity Date," defined as the date the insurance company begins monthly income payments. The National Western policy also includes a Right to Cancel clause, which provides that the annuitant must return the certificate to the company within 20 days after the customer receives it if he or she desires to cancel the policy.

The National Western policy, under "Annuity Benefits," describes in more detail the settlement options found in the brochure described in Finding 12. Section 3.3 of the policy informs the reader that the annuitant may withdraw funds at any time, subject to a withdrawal charge found in a chart elsewhere in the policy. The withdrawal charge is 25% in the first six years of the annuity with respect to the amounts deposited in the first year, and 10% in the first six years with respect to the amounts deposited thereafter. Section 3.4, however, describes a "Penalty-Free Withdrawal Option," whereby one may withdraw up to 10% of the account per year after the first year, and section 3.5 provides that one may withdraw interest earnings annually without penalty after the first year.

The Brodsky Transaction

16. Zelda Brodsky is an 81-year-old resident of Encino. Her husband is 77. Mrs. Brodsky responded to an FID advertisement in the LA Times that promised a "very attractive" (Brodsky's description) rate of return on a CD. She made an appointment and, along with her husband, met with FID/FEP salesperson Amber Gomez in her Woodland Hills office for over an hour. Mrs. Brodsky testified that Gomez was "very persuasive," but never mentioned the word "annuity," nor did they discuss any product other than a CD. Mrs. Brodsky also testified that she did not know what an annuity was. The Brodskys told Gomez they wished to deposit $12,000 in a CD for one year, and understood that they could not "touch" the money during that time. On a second visit with Gomez on October 22, 2003, a check for $12,000 was made out to National Western. The Brodskys both signed an Application for Annuity, evidencing a purchase of the Flex 45 annuity, as well as the disclosure acknowledgment form. Mrs. Brodsky testified that neither she nor her husband read the documents they were asked to sign. It appears from their file that the Brodskys cashed out another annuity to secure the funds necessary to purchase the Flex 45.[8]

17. Mrs. Brodsky testified that she and her husband later received a "briefcase full of documents" from National Western, but did not form an understanding of what they meant for several months. Eventually, Mrs. Brodsky formed the impression that whatever they had purchased required them to wait 15 years before they could access their money. She called Gomez, who told Mrs. Brodsky not to worry because "people live longer these days." She called National Western and was told that she was given exactly what she had bargained for. Knowing they would be penalized 25%, or $3,000, the Brodskys cancelled the policy anyway. Mrs. Brodsky called a columnist at the Los Angeles Times and asked for his assistance. As a result of the call, Steve Lopez of the Times wrote an article that appeared in the newspaper on July 30, 2004, entitled, "A New Low Hit in Hustling the Elderly." The Brodskys received reimbursement of their entire investment, including the $3,000 penalty, from National Western the day prior to Mrs. Brodsky's testimony in this matter.

[8] This fact can be argued two ways. First, it tends to contradict Mrs. Brodsky's testimony that she had never heard of an annuity. On the other hand, it begs the question, why would the Brodskys transfer their funds from one annuity to another, and tends to support Mrs. Brodsky's testimony that they desired only to move into a CD.

18. Amber Gomez, who is no longer employed by FID, testified that it was her standard practice to review the newspaper advertisement with the customer, both on the telephone and in the first office meeting. It was also her practice to ask the customer how long it would be before he or she needed the money the customer was contemplating investing. If the answer to the question indicated no short-term need, then Gomez would introduce the idea of a tax-deferred, insured annuity, and demonstrate its benefits on a piece of paper. Gomez sold only the National Western Flex 45 and Flex 85 products. Before she left the company, between February and June, 2004, Gomez fielded 1,845 calls in response to FID advertisements, made 410 appointments, sold 12 CDs and 85 annuities in the principal amount of $2,745,000.

19. Gomez testified that she recalls the Brodsky office appointments. Her notes indicate a discussion took place concerning the Flex 45 annuity, and that the discussion covered the 4% bonus and 3% interest rate for a return of 7%.[9] Gomez demonstrated that her customers' $12,000 payment would grow to $12,854.40 after one year. The notes further reflect an explanation of a 5% bonus, plus a 3% rate of return, in years two through five of the annuity that would apply to additional contributions made in those years. Other notes tend to support Gomez' testimony that she covered the settlement options that applied to the annuity, including the option to take 10% of the account value, or interest income each year after the first year. It also appears that Gomez discussed income options after five years, for an additional five years, ten years, or for life.

The Woods Transaction

20. Douglas Dale Woods, an El Segundo resident who is not of retirement age, responded to an FID advertisement in his newspaper in March or April, 2004, that promised a 5% yield on a "12 Mo. FDIC INSURED CD or IRA ROLLOVER." He made an appointment and met for over an hour with respondent Rick Leon at the Los Angeles office of FID/FEP. Woods was interested in the advertised rates on a CD for himself and for his mother as well. Woods was aware from reading the ad that he could not receive the advertised rate of return on any amount greater than $5,000, and was therefore receptive to the ad's representation of "Other higher rates available," and Leon's suggestion of greater returns on two products offered by Western National, the Confidence Flex 45 and Confidence Flex 85 plans.

21. Woods indicated to Leon that he had $20,000 to invest, and a discussion ensued about whether it should be distributed $5,000 into a CD at 5%, and $15,000 into a CD at the lower rate then available, or whether the Confidence Flex plans were preferable. Leon verbally compared the advantages of the Flex 45 and Flex 85 annuities to the CD. He also made notes for Woods by way of illustration. Although Mr. Woods has a degree in accounting, he found the explanation of an annuity "confusing," and did not understand that

[9] The notes, found on the back of page 1 of Exhibit 27, actually indicate a return of 7.12%, which reflected the Annual Percentage Yield (APY). For simplicity's sake, the Factual Findings throughout this Decision reflect straight-line interest rate returns.

the product was actually a 15-year annuity. No where in Leon's notes is a 15-year time period reflected.

22. Woods returned home and through an internet search concerning the Flex 85 product, found a Forbes magazine article warning of unscrupulous sales practices. He did not purchase an annuity from Leon.

23. Leon, a Life Agent licensed by the Department of Insurance, testified that he spent a great deal of time with Woods and fully explained the annuity products. He recalled that Woods declined to buy an annuity because he did not want to commit his funds for "five to ten years."

24. Between February and August, 2004, Leon sold $3.8 million in annuities for FEP. During that time, he received 2,412 telephone calls responding to FID advertisements, made 391 appointments, sold 32 CDs and 97 annuities.

The Joe Transaction

25. A resident of the Palos Verdes area, Wilbur A. Joe, an older gentleman, saw an FID ad in the Los Angeles Times in July 2004, which offered a CD at an interest rate of 7.5%. He called FID and was told that the ad was a misprint, that the actual rate being offered was 5.5%, with a $5,000 limit. Joe and his wife kept an appointment at the Long Beach office on July 12, 2004, where they met with salesman Soren Svenson for one and one-half hours. Joe inquired about the CD, and was immediately told about the Flex 85 annuity that could accommodate amounts greater than $5,000. Joe testified that he was informed that the product paid an 8% bonus, plus 3.5% for five years. He testified that he was told that he could get all of his money out of the annuity in five years without penalty.

26. Joe and Svenson signed the Information and Disclosure document and consummated a transaction for a $25,000 annuity. Joe did not appreciate the penalty associated with taking his money out of the annuity until after he received his policy and read an article in the Los Angeles Times about the FID annuity practices. Joe has written a letter to National Western in an attempt to cancel the policy.

27. Svenson testified that he reviewed the LA Times advertisement with Joe on the telephone, and again when they met in Long Beach. He claims that he typically explains to callers that FID is not a bank, but discusses the CD option first. He then proceeds to explain the advantages of the Flex 85 product, and admitted that he does so without first determining whether that is an appropriate investment for the particular client who is before him. Svenson's presentation is generally as described in Findings 9 through 12. Svenson testified that he thought Joe was happy with his policy until the LA Times article appeared on July 30, 2004. He cannot explain why Joe may have thought he could get all of his money back in five years.

28. In the six months between February and August, 2004, Svenson sold over six million dollars in annuities for FEP, the highest of any FEP salesperson for that period. Svenson fielded 1,296 calls, made 312 appointments, sold 58 CDs and 146 annuity policies.

The Autenreith Transaction

29. In March of 2004, Otto Autenreith, a 76-year-old resident of Culver City, responded to a newspaper advertisement that offered an attractive rate on his "favorite investment vehicle." Autenreith met with Rick Leon in the West Los Angeles office of FID on two occasions for a total of approximately two hours. The initial discussion moved rather quickly from the CD offer, to "something else." The customer testified that he made clear to Leon that he was only interested in a one year CD, and that he "didn't pay attention to the other stuff." He does not think that the salesman used the word "annuity," stating that he would have "walked out" had he heard the word. Nevertheless, Autenreith invested in two National Western Confidence Flex 85 products, one for $30,000, and a second in the amount of $21,044.[10] On the $30,000 check made out to National Western and handed to Leon, Autenreith wrote "1 yr. CD" in the memo space at the check's lower left portion.[11] He did not read the brochures or the various documents that Leon had him sign, calling his actions "the most stupid thing I ever did in my life."

30. It was not until after Autenreith saw the LA Times article of July 30, 2004, he testified, that he realized for the very first time that he had not actually acquired CDs, but annuities.

31. Rick Leon confirmed that he gave Autenreith all the usual brochures, plus a list of top-ranked insurance companies (according to Ward's 50 Benchmark Group), as well as Standard & Poor's rating for National Western and certain material touting the safety and yield advantages of fixed annuities. He testified, "Otto is a reader," and recalled that he did take the time to look at what he signed.

The Calabrese Transaction

32. In February 2004, 80-year-old Michael M. Calabrese, of Anaheim, saw a newspaper advertisement for a 4.40% interest rate on a CD deposit. This version of the FID ad stated, in fine print, "Min. limit $10,000," which Mr. Calabrese interpreted to mean that $10,000 was the minimum deposit he could make. He and his wife met with FID salesman Charles Lyster in Orange and made arrangements to obtain a CD through Pacific Mercantile Bank. He received his bonus check of $167 from FID through the mail.

33. In July of 2004, Calabrese saw another FID advertisement offering a CD at 6.26%, called Lyster, and made an appointment for him and his wife to see the salesman. This time the Calabreses were willing to invest their life savings of $97,000 in a CD due to

[10] The second annuity transaction represented an IRA rollover.
[11] The second check was annotated, "IRA – rollover."

the very attractive rate of interest. Lyster told Calabrese that this new offer was limited to a payment of $5,000, and the customers started to leave the office. According to Calabrese, Lyster then offered to sell him an "FDIC insured" annuity underwritten by BMA that would yield 5%. A product description given to the couple described a "Value Master" annuity that was to pay them 5% for the first year, and a minimum of 3% annually thereafter. The description indicated that "free" withdrawals could be made of interest only, or 10% of the accumulated value annually. Otherwise, the document indicates that annuitization options are "Available after first 24 months, withdrawal charges do not apply if a payment option of at least 6 years certain or income for life is selected." Withdrawals not consistent with the annuitization options (that are not spelled out in the summary document) were subject to substantial, but serially decreasing, "surrender charges" for 10 years.

34. On July 30, 2004, the Calabreses obtained a cashier's check in the amount of $96,852.13 from their bank, and on August 3 invested the entire amount in the BMA Value Master annuity product. Mr. Calabrese wrote a separate check, payable to BMA, for $147.87, bringing the total investment to $97,000. Despite his earlier testimony that Lyster had broached the subject of an annuity, Mr. Calabrese testified that he thought he was merely "adding onto" his earlier CD deposit. Corroborative of this testimony is the smaller check, on which Mr. Calabrese wrote, "Add on to CD Deposit." The customer also testified that Lyster told him and his wife that they could withdraw their money after two years.

35. Lyster testified that he explained the difference between an annuity and a CD to the Calabreses, and asked if they needed their money back in one year. They replied that they did not. Lyster denied telling the couple that they could get their money back in two years.

36. Almost immediately after concluding the transaction with FEP, Mr. Calabrese read the LA Times article and demanded his money back by letter of August 9, 2004. He is awaiting a reply from BMA.

The Haage Transaction

37. Robert M. Haage is an 80-year-old resident of Montclair, California. On April 5, 2004, Haage saw an advertisement in his newspaper, the Inland Valley Daily Bulletin, for a CD yielding 4.5%. Within days he saw another advertisement by FID for a CD at 5.00%. Simultaneously, Haage logged onto the FID website and found an offer of a CD at 5.5%.

38. On April 14, 2004, Haage and his wife met with respondent Donald Fracchia at the Riverside office of FID. Haage testified that the couple asked for a $10,000 CD at 5%, but that Fracchia "talked all around the subject." Haage said he was "appalled" at the salesman's ability to "dissimulate." Nevertheless, Haage accepted the proffered FID and Value Master brochures, and wrote a check in the amount of $10,000, payable to BMA, at the time of their first meeting. He claimed he thought he was getting a CD. When he got home and read the BMA brochure, Haage claims he realized for the first time that the BMA product was a 12-year annuity. Haage sent a letter to Fracchia by facsimile on April 15,

2004, citing the lack of reference in the materials he took home with him to a two-year CD that he was interested in acquiring. When Haage did not receive a same-day reply, he stopped payment on his check. On April 16, 2004, Haage wrote to R. Reiswig and asked for a return of the check. On April 19, 2004, J. Reiswig wrote to BMA, asking the insurer to cancel the application for annuity and to return the Haage check to Mrs. Haage. Instead, BMA sent its own refund check on May 5, 2004. Because Haage had, in the meantime, stopped payment on the check, Haage returned the BMA check to the company after BMA also returned the customer's original check.

39. Fracchia confirmed that Haage first asked for a $10,000 CD, but that he explained the advertisement contemplated a limit of $5,000 on that product. Haage seemed upset, but inquired, "What else do you have?" Fracchia testified that it is his practice to introduce the subject of an annuity with a customer who has more than $5,000 to invest, and if the customer will not need the principal returned in the short term. According to the salesman, he gave Haage the FID and BMA brochures and attempted to go over them with the customer.

40. Fracchia testified that Haage was rude to the FID receptionist, was late for his appointment,[12] and was generally condescending toward the salesman. According to Fracchia, whenever he offered to explain the BMA annuity product, Haage reminded Fracchia that he, Haage, was a founder of a credit union and better able to understand the finer points of finance than was Fracchia.

41. For reasons that are not clear from the evidence, Fracchia had never before, or since the Haage transaction, sold the BMA Value Master annuity to anyone. Fracchia agreed that with this product, the annuitant would have to wait a minimum of eight years to recover his or her principal without penalty.

42. Fracchia, who was relatively new to FID and the annuity business at the time of the Haage transaction, received 227 calls in response to newspaper advertisements between February and August, 2004. He made 72 appointments, sold 22 CDs and 85 annuities with a face value of $3,000,000 during that time.

The Brokaw Transaction

43. Sylvia Brokaw is a 71-year-old resident of Newport Beach. In late February 2004, she responded to an advertisement in the LA Times that offered a CD yielding 5.0%[13] by making an appointment to see Mark Sostak at the Laguna Hills office of FID. During the one and one-half to two hour meeting, also attended by her husband Charles Brokaw, Mrs.

[12] Haage claimed that Fracchia had failed to appear for their first appointment, that he, Haage, had to pay for parking that he felt should have been validated, and that the second appointment ran afoul of his alternate parking arrangements. Fracchia testified that Haage did not have an appointment the first time he came into the office, and that he offered to interrupt the second meeting to allow the customer to move his car.

[13] Ms. Brokaw's transaction file (Exhibit 32) also includes an ad from the morning of the day of her testimony at this hearing, in which FID offered a "FDIC CD" yielding 5.50%.

Brokaw told Sostak that they had $5,000 to invest. According to Brokaw, Sostak told her that he had "something better" than a CD for her, and that if she signed up that day she would qualify for a bonus with a National Western product. Brokaw testified that the salesman said she would get another bonus after five years. On the application for the annuity purchased by the Brokaws, Sostak wrote, under "Special Requests," the words, "Set Maturity for 2009." Brokaw felt she "could live with" a five-year time frame. The customer was aware the National Western product was not a CD, but could not recall whether the word "annuity" was used by Sostak. Brokaw did recall that she was promised a $1,400 bonus if she invested her entire available funds of $35,000, which she and her husband agreed to do. Brokaw testified that Sostak covered the advantages of the CD and National Western product very quickly, and that she really only understood "the bottom line."

44. Following her investment with FID, Brokaw had a meeting on April 27, 2004, with her regular financial advisor. She showed her advisor the National Western paperwork, and it was brought to her attention that the investment was actually a Flex 45, 15-year annuity. Brokaw testified that she called FID several times, without response. By letter of June 3, 2004, National Western declined to cancel the policy. Brokaw's husband wrote National Western again on August 3, 2004, enclosing a copy of the Steve Lopez article from the LA Times. No additional response from the insurer or FID has been received.

45. Mark Sostak testified that it is his practice to discuss the purchase of an annuity if the client indicates a willingness to consider a "longer term." He said that he sells the National Union Confidence Flex products 99% of the time, and describes the annuity as "an incredible investment" in his discussions with clients. Sostak testified that he recalls that the Brokaws told him they would not need all of their money in one year, and were interested in a greater return. He testified that he carefully explained the characteristics of the Flex 45 as they went over the product brochure together, including the options available after five years. Sostak testified that he felt the Brokaws understood what they were getting.

46. Sostak fielded 1,296 calls in response to advertisements between February and August, 2004, made 239 appointments, and arranged for the sale of 41 CDs. He brokered 50 annuity contracts during that time with a face value of $1,872,000.

The Gallagher Transaction

47. Charlene Gallagher, a 69-year-old resident of North Hollywood, met with Amber Gomez in Woodland Hills for 45 minutes after seeing an advertisement for a 4.5% yield on a CD sometime in 2003. She did not think the ad mentioned a term limit on the investment. Gallagher told Gomez that she wished to place $30,000 into a CD at 4.5%, but was told that the Flex 45 plan was a better way to invest because the interest rate could increase. Gallagher testified that she did not appreciate that the plan was not a form of CD, although Gomez did tell her that while insured, the product was not insured by the FDIC. According to Gallagher, the word "annuity" was not used. After hearing the description of the Flex 45, Gallagher was under the impression that she could receive a return of her entire principal in five years, without penalty.

48. At a second meeting in June 2003, Gallagher wrote a check for $30,000. She claimed to be "shocked" when she received her annuity contract, and called Gomez, who told her that she could not take her money out in five years without penalty. Gallagher thought she was "stuck." She also understood Gomez to say that she had to contribute additional monies to cover insurance on the transaction, and paid $50 to National Western in March 2004 and again in April 2004. Gallagher was confused about this requirement despite the fact that Gomez had highlighted language on a National Western document that states, "Additional deposits *may* be added to your Tax-Deferred Annuity during the first policy year." (Emphasis added.) Meanwhile, in February 2004, Gallagher deposited $5,000 with Gomez and FID for a CD in response to another ad she saw in the LA Times, after she declined Gomez' suggestion that the money be put into the Flex 45 plan. Gallagher received a $120 bonus paid by FID on the CD.

49. Amber Gomez testified that she recalls that Gallagher initially wanted to invest $10,000, but finally sold her a $30,000 Flex 45 annuity. She testified that she fully explained the terms and options with the plan, and gave the customer a sheet to keep track of additional deposits to be made in the first year, which Gomez encouraged because she earned a commission on each one. Gomez denied telling Gallagher that additional payments were required to pay for insurance on the transaction.

The Tanori Transaction

50. Antonio A. Tanori is a 79-year-old resident of West Covina, who responded to an advertisement in the LA Times that offered a CD at 5.0%. Tanori wished to purchase a CD with the $14,000 available to him, and had no understanding that there was a monetary limit on the CD offering. On January 8, 2004, Tanori met with Mark Sostak in the Glendale office of FID for about one hour. According to Tanori, after inquiring about the CD, Sostak touted a "better deal" in the form of an annuity, which Tanori understood he could liquidate in five years. Tanori wrote two checks totaling $14,000, and noted on the application for the Flex 45 annuity that the "maturity date" was to be 2009. Tanori admitted during his testimony that he did not carefully read the policy after receiving it, and said he did not appreciate that he had purchased an annuity that would not permit penalty-free access to all of his funds for at least 10 years until after he read the LA Times exposé by Steve Lopez.

51. Tanori acknowledged having received the standard brochures and literature regarding the Flex 45 annuity, but stated it was "hardly discussed," and admitted he did not read the materials. He also acknowledged signing all the standard documentation. Tanori said he is "fairly competent" to handle his own affairs, but admitted to confusion regarding the annuity purchase. Tanori received the annuity contract, which reflected an "annuity date" of January 12, 2025, which would fall in the annuitant's 100th year.

52. Sostak testified that he asked Tanori, "as a courtesy to him," if he would be interested in earning more interest if he had no immediate need for the funds, and proceeded

to explain the Flex 45 plan. His notes from the meeting with his client confirm that he compared the CD at 5% to the Flex 45 annuity, demonstrating that Tanori would realize a $560 bonus immediately, plus $436 additional interest in the first year at 3%. The notes also reflect a discussion that after the first year, Tanori could begin withdrawals of 10% of the annuity value, or monthly interest payments. Sostak admitted, however, that he did not, during his face-to-face presentation, provide the customer with the information regarding the number of years that the money must be committed, and that his notes of the Tanori presentation likewise do not reflect a minimum 10-year commitment. Sostak explained that this information is in the policy itself, which is, of course, not available to the consumer until after the decision is made and the check written.

53. Sostak testified that he wrote the phrase "Set Mat Date 2009" on Tanori's National Western annuity application as a reminder to him (Sostak) to discuss the client's annuity options after five years. Sostak testified that he liked to schedule meetings with his customers in order to conduct annual "financial checkups," as his customers' "depository consultant." Neither Sostak nor respondents offered any evidence of Sostak's qualifications to act as a financial advisor other than as a salesman of annuities.

The Ebbert Transaction

54. Dorese Ebbert, 51 years of age, is a resident of Venice, California. She called Rick Leon of the West Los Angeles office of FID in response to an LA Times advertisement for a CD at 5.25%. The two met for two and one-half hours at the time of their first meeting, when Ebbert indicated she and her husband had $50,000 to invest. Leon explained that she would be limited to $5,000 in the CD at the rate quoted, but said he had a "five-year insurance annuity" that was a better product in any event. Ebbert wrote a check for $50,000 toward a Flex 85 policy, but told Leon she wanted to talk it over with her husband. After doing so, Ebbert returned two days later and met with Leon a second time, on April 13, 2004, having decided to limit their commitment to $20,000, with which she purchased a Flex 85 annuity. Meanwhile, the Ebberts had seen another ad for a CD by FID, and desired to also deposit $3,500 in such an account. Instead, at a third meeting, Leon sold Ebbert a second annuity underwritten by National Western (plan name, "Liberty Champion"), that created a Roth IRA for Ebbert, who testified that she did not know what that description on the application really meant.

55. The Ebberts read the LA Times article by Steve Lopez, and rescinded their deals with National Western. They received reimbursement of their principal deposits on August 16, 2004.

56. Leon recalled that Ebbert said she and her husband had more than $100,000 to invest, and that he sold her on a Flex 85. After filling out the paperwork, Ebbert expressed reservations that the money ($50,000) would be tied up too long, and the deal was cancelled. Soon thereafter, Ebbert deposited $20,000 into an annuity, and another $3,500 in an IRA rollover transaction.

The Rodrigues Transaction

57. Minnie Rodriguez, an 80-year-old resident of Winnetka, California, responded to an FID advertisement in the LA Times in February 2004 that offered an FDIC-insured CD at 5.50% interest. She met with Amber Gomez in Woodland Hills for 45 minutes on February 19, 2004, and was told that the CD offer was limited to a $5,000 deposit. Gomez said, however, that she had a five-year annuity product that paid a bonus, a higher rate of return, and was simply "better." Rodrigues testified that she said she was interested in investing $30,000 for five years, and did execute an application for a Confidence Flex 85 annuity in that amount.[14] At a second meeting, Rodrigues was asked to sign a document that showed an "annuity date" of 2024, and she refused to sign.[15] When Gomez convinced her that the date could be changed to 2009, Rodrigues agreed, and on March 16, 2004, the client executed a change to reflect a "maturity date" of 2009. Rodrigues testified that she believed this change would enable her to liquidate the policy, without penalty, in five years.

58. When the policy was delivered to Rodrigues, she interpreted what she read as a 15-year annuity, and called Gomez, who was by then no longer employed with FID. She also called National Western, who denied her any relief.

59. Gomez does not recall the meetings with Rodrigues, but assumes she made the same presentation to her that she made to all callers. She testified that she would not have sold the Flex 85 if the product was not suitable for the particular customer.

The Downey Transaction

60. Cheryl Downey (hereinafter C. Downey), who lives in Santa Monica, responded to an FID advertisement in the LA Times, on behalf of her 84-year-old mother, Ruth Downey (R. Downey), who lives in Minnesota. The elder Downey had complained about the low interest rates generally available, and her daughter noted that the offered rate was twice what she had seen elsewhere. C. Downey made an appointment and attended a meeting with Rick Leon on February 18, 2004, accompanied by her mother, who was visiting at the time.

61. According to the testimony of C. Downey, when she inquired about the advertised CD, Leon said he had an annuity that paid 11% interest in the first year, and 8% per year thereafter. According to her mother,[16] Leon said that FID had "a special annuity offer going on." C. Downey testified that she told Leon her mother needed to maintain her money in a short-term investment, and that he replied that the annuity was a five-year product. R. Downey also recalls, and her contemporaneous, handwritten notes corroborate, that Leon said the annuity was a five year product that would mature in February 2009, after which

[14] Rodrigues testified that Gomez tried to talk her into investing $45,000, and the agent's notes confirm that that amount was discussed.

[15] It is assumed that the document placed before Ms. Rodrigues at the second meeting was the policy delivery receipt.

[16] Mrs. Ruth Downey testified by way of declaration. (See Exhibit 10.)

time she could "do whatever I want at maturity." He touted the Flex 85 as offered by an A-rated insurance company. Leon provided the standard brochures and other materials to the clients, which C. Downey "scanned." Both women decided to invest with FID. R. Downey put $10,000 into a CD and another $10,000 into a Flex 85 annuity, and her daughter deposited $5,000 into a CD. Both received their bonus checks for the CD deposits from FID. R. Downey also testified that Leon offered the free assistance of an FID/FEP attorney to help her with financial planning in general.

62. R. Downey returned to Minnesota, and her National Western policy was mailed to her there. After reading the LA Times article by Steve Lopez, C. Downey called her mother and asked her to refer to the policy terms, whereupon the women formed the impression that she had in fact purchased a 15-year annuity. C. Downey described her mother's reaction as, "terrified." C. Downey called Leon, who advised his customer to "sit tight," as R. Downey could withdraw 20% of the principal after five years. C. Downey told Leon that that was unacceptable given her mother's age, and demanded a refund, and that FID pay any penalty that would result. Leon asked for two weeks to work on the problem, a time period that had not yet elapsed as of the time of the hearing.

63. Leon testified that R. Downey was "pretty sharp" for her age, and had told him that she worked for an insurance company for many years.[17] According to the salesman, R. Downey was not concerned about the length of the annuity contract because the money was for her daughter.

The Abata Transaction

64. William Abata, an 86-year-old resident of La Habra, testified in this matter by speakerphone. Sometime in mid-2003, Abata read an advertisement in the Orange County Register, and met with Charles Lyster in the City of Orange office of FID for 30 minutes. Abata testified, "we started out talking about a CD, and ended up talking about a five-year annuity." He testified that he specifically asked if he and his wife could get their money out of the annuity in five years, and that Lyster answered, "yes." At a second visit with Lyster on July 3, 2003, accompanied by his wife, Abata purchased a Flex 45 plan for $70,000. The policy named his wife, who is 30 years his junior, as annuitant. Abata testified that it was not until he read the LA Times article by Mr. Lopez on July 30, 2004, that he understood he could not access his funds in five years. He asked National Western for relief, which resulted only in a change of the policy maturity date from July 11, 2046, to July 11, 2008.

65. Lyster testified that Abata assured him an annuity was appropriate because it was for his younger wife, and denied telling the customer that he could get all of his money out of the deal in five years. The transaction documents support Lyster's testimony that Abata signed all of the standard paperwork associated with an annuity purchase.

[17] While Leon seemed to rely on the elder Downey's experience, it is not known in what capacity she actually worked in the industry, or whether Leon had that information at the time of the transaction.

The Coulson Transaction

66. Robert Coulson, an 81-year-old resident of Fountain Valley, responded to an advertisement he saw in the LA Times regarding a CD with a 5.0% interest rate in May of 2004 by calling Charles Lyster in the Orange office of FID. The two individuals met at the FID office for two or two and one-half hours on May 24, 2004. Coulson, who had $40,000 to invest, testified that Lyster told him that Indy Mac Bank of Pasadena limited its CDs to $5,000, which the witness found unusual. Coulson testified that he told Lyster he wanted his money tied up for no longer than two years, and purchased a one-year CD for $5,000. Lyster recommended the remaining $35,000 be placed in a BMA product. Coulson said that he did not understand the terms the salesman was using, that the annuity transaction was simply "over my head," but admitted that he did not tell Lyster of his confusion. At a second meeting on May 26, 2004, Coulson signed the paperwork necessary to acquire a $35,000 BMA Value Master annuity. Later, Coulson's daughter reviewed the policy and told him he did not purchase a two-year CD as he thought he had. Coulson wrote a letter to Lyster on June 10, 2004, requesting a refund, stating, "After reviewing the terms, I have come to the conclusion that this is not at all what we had discussed. I was under the impression I was purchasing a two year CD that paid the interest earned after the two year maturity. I have no use for a ten year annuity that involves a 9% cash surrender value after the initial two years." On or about June 21, 2004, Coulson received his refund from BMA. Coulson also closed his $5,000 CD account, and paid a small penalty for doing so.

67. Lyster testified that Coulson indicated in their first meeting that he wanted a high yield on a safe investment, but gave no indication it had to be a CD, and could not remember him saying he did not want anything that tied up his money more than two years. Lyster felt that his customer understood the sales presentation. After selling a CD and annuity, Coulson told him that his daughter had reviewed the paperwork and did not believe the annuity was appropriate for her father. Lyster agreed to facilitate a refund from BMA.

Credibility Findings

68. The Administrative Law Judge found all of the clients of FID/FEP who testified to be credible.[18] While there may be a tendency on the part of some to blame the respondents and other salespersons for their own lack of understanding or negligence, there is no other evidence or appearance of bias. Their stories were remarkably similar, but there is no indication of collaboration. Each testified pursuant to subpoena, and each testified without obvious rancor or the appearance of ill-will that was in any way disproportionate to the indignities they felt that they had experienced.

69. The salespersons were generally polished, intelligent and prepared. As they had all rehearsed and performed the annuity sales presentations hundreds of times, it is not surprising that their recall of the sales scenarios was excellent. But even in hearing, the sales

[18] And while respondents question the accuracy of their testimonies, and their memories, they agree that the customers who testified were credible. (See Respondents' Reply Brief, Exhibit 48, page 6.)

re-creations were sometimes difficult to follow, and complicated. There is little doubt that most of the information claimed to have been communicated to the complaining witnesses was, in fact, given to them in one form or another. The paper trail is quite good. But it is also clear that the information communicated that distinguished annuities from a CD emphasized the positive aspects of the annuity: the much higher interest rates associated with the Flex 85 product, for example, in the first year yielded an 11% return. Graphically presented in the "T" graph form common to all of the salespersons, the yield undoubtedly jumped off the page at the customers during meetings, just as the large font shouting "5.50% CD" grabbed their attention while reading the newspaper in the first instance. But the fact that most affects the credibility of the salespersons is the core concept that drives the business of FEP: the salesperson makes not one dime on the sale of the product being advertised. Thus, the claim by virtually all of the sales witnesses that they would only mention the annuity product if assured that the customer did not need use of the money in the short term is suspect. In fact, none of the sales witnesses was convincing that the true timeframe contemplated by the annuity products was satisfactorily explained to the customer, and none of the notes that were the focus of the presentation contained adequate proof of a claim to the contrary. Claims by, for example, Mr. Leon that he saw himself as a financial advisor to his customers are met with considerable skepticism in light of the lack of evidence of any training in the field, and the exceedingly narrow options available to service a diverse set of client portfolios. In fact, most members of the sales force limited their sales exclusively to the National Western Confidence Flex annuity products. Others, including Gomez and Lyster, testified that they would never intentionally place a client in an "unsuitable" financial product, but the record lacks any evidence of the experience or training needed to make such a determination. Likewise, Sostak's testimony that he brought up an annuity to client Tanori merely "as a courtesy to him," is not believable.

70. Respondent R. Reiswig was of no assistance as a witness. He claimed to have suffered severe health problems in the recent past, and has little or no memory for details. J. Reiswig, on the other hand, was instrumental in creating an impression of FID and FEP as veritable "cash cows" masquerading as sources of financial advice and offerors of exceedingly favorable CD rates of return. She was often evasive in her answers. For example, when asked to confirm that her company, FID, had no income of its own, she attempted on several occasions to say that FID was in the business of "marketing space, equipment and furnishings," as well as advertising CDs. But eventually, the witness conceded that FID has no source of income other than FEP, which finances the CD bonus money paid to customers by FID. J. Reiswig also testified that the rate of complaints by customers of FID is one-half of one percent, a very specific and impressive figure. On further questioning, she revealed that the company has no system for logging complaints, no records, and the testimony about complaint history was, essentially, made up. When asked how she might explain the consistent nature of the complaints heard in this hearing from more than a dozen customers, J. Reiswig accused counsel for complainant of "coaching" them, without having a shred of evidence to support the claim.

LEGAL CONCLUSIONS

Is the CD, Coupled with a Bonus, a Security?

1. The Corporate Securities Law of 1968 (Corp. Code, § 25000, et seq.) regulates the advertising, offer and sale of securities in the State of California. Persons who engage in the regulated activities must obtain a certificate from the Corporations Commissioner as a broker-dealer, unless exempted. (Corp. Code, §§ 25210, subd. (a), 25200 et seq.) Before a broker-dealer may advertise and sell a security in this state, the terms of the transaction must be qualified in advance by the Commissioner, unless exempted (Corp. Code, §§ 25110, 25100 et seq.), and any advertisement must be submitted to the Commissioner for prior approval. (Corp. Code, § 25300, subd. (a).) Advertisements will not be approved for publication if, in the opinion of the Commissioner, they are misleading. (Corp. Code § 25302, subd. (a).) Any untrue or misleading statement of a material fact, or the omission of a material fact that makes the statements made misleading in the sale of a security is unlawful. (Corp. Code, § 25401.) Broker-dealers who fail to comply with an order of the Commissioner may have their certificates revoked by the Commissioner. (Corp. Code, § 25212.1.)

2. Pursuant to Corporations Code section 25532, subdivision (a), the Commissioner, complainant herein, may order respondents to desist and refrain from the offer or sale of a security if the offer or sale is subject to qualification under the Corporate Securities Law of 1968, and has not been so qualified. As against respondents R. Reiswig, J. Reiswig and FID, complainant issued such an order in September 2002, and against all current respondents on July 20, 2004. Respondents' sales practices have not changed in any significant way since the 2002 order was issued, although the parties agree that respondents are not certificated as broker-dealers, and have not sought qualification by the Commissioner of the CDs advertised by FID. There is no evidence that the respondent salespeople are exempt from certification under Corporations Code section 25200 et seq., or that the CD, packaged with a bonus, is exempt from qualification under Corporations Code section 25100 et seq. Rather, respondents assert that a CD, even when packaged with a bonus payment, is not a "security" within the meaning of the securities law.

3. Corporations Code section 25019 lists numerous financial instruments and transaction types within its definition of "security," but is obviously not inclusive of all inventions of man's genius for finding new ways to profit from the assets of others. Seeking to provide more definition, a line of cases in California utilized the "risk of capital" test, reasoning that the act's "objective is to afford those who risk capital at least a fair chance of realizing their objectives in legitimate ventures whether or not they expect a return on their capital in one form or another." (*Silver Hills Country Club v. Sobieski* (1961) 55 Cal.2d 811, 815.) More recently, however, California appellate courts have adopted the federal courts' test of whether a device constitutes a security, because the California Corporate Securities Law was modeled after the Securities Act of 1933. (*Leyva v. Superior Court* (1985) 164 Cal.App.3d 462.)

The parties agree that if the CD, coupled with a bonus payment, is a security, then it would be as an "investment contract." "An investment contract ... means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party." (*Securities & Exchange Commission v. W.J. Howey Co.,* et al. (1946) 328 U.S. 293, 298-299.) The *Howey* court concluded that the above definition,

> permits the fulfillment of the statutory purpose of compelling full and fair disclosure relative to the issuance of 'the many types of instruments that in our commercial world fall within the ordinary concept of a security.' It embodies a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits. (*Id.* at p. 299. Citation omitted.)

4. A CD, standing alone, is not an investment contract, as it offers sufficient safeguards to the investor by virtue of FDIC insurance protection. (*Weaver v. Marine Bank* (1982) 455 U.S. 551.) The question remains, however, whether the CD offered by respondents, coupled as it is with the payment of a bonus by FID, is an investment contract.

Complainant cites *Safeway Portland Employees' Federal Credit Union v. C.H. Wagner & Co.* (9th Cir. 1974) 501 F.2d 1120, in urging an affirmative answer to the question of whether respondents' marketing scheme amounts to the sale of a security. In that matter, a broker-dealer had marketed unregistered securities that consisted of CDs coupled with a bonus payable at the time of the maturity of the CD. As in this matter, by means of the bonus, the broker-dealer was able to offer interest rates on the CD in excess of what the insured market was offering at the time. In finding the packaged product to be a security in the form of an investment contract, the court reasoned that the promised return on the customer's investment depended, at least in part, on the success of the broker-dealer's efforts in obtaining the CD and in paying the bonus, and the payment of the bonus was dependent on the continued success and solvency of the broker-dealer.

In an attempt to distinguish *Safeway*, respondents point out that, unlike C.H. Wagner, FID receives no commission on the sale of CDs. (In *Safeway*, the broker-dealer sold the interest-rate enhanced CDs to "investors." The sources of payment of the bonuses were borrowers willing to pay a premium to obtain loans from the banks issuing the CDs.) But this distinction is without a difference. That C.H. Wagner's motivation was to generate a commission on the brokering of CDs does not differ conceptually from respondents' motives in ultimately realizing commissions on annuities. Next, respondents point out that there is no post-transaction, entrepreneurial activity in their brokering of the CDs, only the ministerial act of writing a check. But there is no distinction at all between that fact and the facts of *Safeway* except in the timing of the so-called ministerial act: in the latter case, the interest rate bonus was paid at the time of maturity of the CD, while in the present matter the bonus is paid within one week after the customer independently purchases the CD and returns to FID with proof thereof. Lastly, respondents boldly state, "there is no risk of insolvency and

the CD buyer is virtually assured of being paid."[19] The solvency of FID, which has no income whatsoever to support its operations, would seem to be in doubt at all times, and its customers are left to rely upon the solvency and good will of FEP, a company they are unaware exists when acquiring a CD from FID.

Changing their tone from bold to blithe, respondents assert that the amount of the bonuses in the marketing program they employ is too small to require regulation.[20] In light of the testimony of R. Reiswig to the effect that FEP finances bonuses to the tune of $20,000 per month, it cannot be successfully argued that, in the aggregate at least, the potential for losses to consumers is insubstantial.

5. One of respondents' arguments, however, requires further analysis. Citing *SEC v. Life Partners, Inc.* (D.C. Cir. 1996) 102 F.3d 587, they assert that the lack of entrepreneurial efforts in determining the success or failure of the enterprise prevents us from labeling the CD package a security. Rather, the argument proceeds, payment of the bonus to the customer is a mere ministerial act. *Life Partners* holds that pre-purchase acts of marketing the transaction are to be given less importance than post-purchase activities, and where the post-purchase "activities" are limited to the ministerial functions of the payment of life insurance proceeds upon the death of the original policy holder, an event not within the control of the promoter, the device is not a security. But *Life Partners* has not been followed in other federal courts. (See, e.g., *SEC v. Tyler* (N.D. Texas 2002) 2002 US Dist. LEXIS 2952, a case involving viatical settlements found to satisfy the *Howey* test.) State courts in Arizona (*Siporin v. Carrington* (2001) 200 Ariz. 97), Colorado (*Joseph v. Viatica Management* (2002) 55 P.3d 264), Indiana (*Poyser v. Flora* (2003) 780 N.E.2d 1191) and Michigan (*Michelson v. Voison* (2003) 658 N.W.2d 188) have all recently criticized or distinguished *Life Partners* and taken more broad views of the purposes of securities regulations and the economic realities of the particular situations.

The holding in *Life Partners* was directly criticized in *Wuliger v. Christie* (ND Ohio 2004) 310 F.Supp.2d 897, wherein the court found a viatical investment program similar to the one in *Life Partners* to have met the requirement in *Howey* that there be sufficient post-purchase entrepreneurial activities by the promoter. Judge Katz concluded:

> [E]conomic realities dictate against a narrow approach since there will always be opportunistic entrepreneurs who attempt to evade liability on those distinctions. In the end the investments offered by Alpha and peddled by its agents were an opportunity to 'contribute or invest' money into a common enterprise and share profits derived, with the critical aspects of a successful investment riding on the 'expertise' of Alpha. Keeping in mind the expansive approach employed in a securities analysis, the Court finds the viatical investments in this case constitute securities under the federal securities act.

---

[19] See Respondents' Trial Brief, Exhibit 49, page 6.
[20] See Respondents' Closing Brief, Exhibit 45, page 4.

6. In our matter we focus, of course, not on the annuities sold by FEP, as those instruments are regulated by the Department of Insurance, but on the CDs coupled with the bonuses paid by FEP. The customers of FID rely upon its agents to identify the appropriate bank or institution as a source of the CD, and more importantly, rely completely upon the two respondent entities as the source of funds that constitute the critical aspect of the program: the bonus. While the acts associated with these services may seem ministerial, the Administrative Law Judge is persuaded that the authorities require a liberal interpretation of the securities law that promotes its purpose, which is "to protect the public against the imposition of unsubstantial, unlawful and fraudulent stock and investment schemes and the securities based thereon." (*People v. Syde* (1951) 37 Cal.2d 765, 768.) Furthermore, the case that most closely mirrors the business model under scrutiny here is *Safeway Portland Employees' Federal Credit Union v. C.H. Wagner, supra,* 501 F.2d 1120, which found the existence of an investment contract, and hence, a security, on very similar facts.

> Even if it were assumed that the CDs are not securities or that they are exempt securities ... and that [the promoter's] indebtedness to [the client] is a security, it does not follow that only the latter violated the Act. The combination of the two created an integrated investment package which must be viewed in its entirety in determining whether it is within or without the Act. This package differs fundamentally from the CDs issued by Bank in that there is a greater rate of return to [the client]. [Respondent's] own ability to pay [the client], an investment risk foreign to that associated with the CDs, is also an inherent part of the package.
>
> The nature of the economic inducement is of great significance. [The client] made one payment for the package, and, more importantly, there is no doubt but that the inducement for the purchase was the total combined rate of interest to be realized.

(*Safeway Portland Employees' Federal Credit Union v. C.H. Wagner, supra,* 501 F.2d 1120, at p. 1123.)

Moreover, it has been held, "The touchstone [of a security] is the presence of an investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial *or managerial* efforts of others." (*People v. Smith* (1989) 215 Cal.App.3d 230, 237, quoting *United Housing Foundation, Inc. v. Forman* (1975) 421 U.S. 837, 852. Emphasis added.) The FID and FEP clients are completely dependent upon both the entrepreneurial and managerial efforts of respondents in order to realize the advertised returns on their investments. The fact that most of the entrepreneurial efforts of respondents occurred pre-purchase does not render them irrelevant, nor minimize either the managerial efforts nor the risk of FEP's solvency taken, if unknowingly, by the investors.

The Commissioner's determination that the CDs packaged with FEP-funded bonuses, as promoted by respondents, are securities within the meaning of the Corporate Securities Law of 1968, is sustained. The evidence established that respondents engaged in the offer and sale of a security within the State of California. The Commissioner's determinations that

the securities have not been qualified by the Commissioner, and that respondents Leon, Grewal and Fracchia have effected and are effecting transactions in securities as broker-dealers without having first applied for and secured from the Commissioner certificates authorizing them to so act, are also sustained.

Did Respondents Make Untrue Statements, or Were the Securities Offered or Sold in a Misleading Fashion?

7. "It is unlawful for any person to offer or sell a security in this state or buy or offer to buy a security in this state by means of any written or oral communication which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading." (Corp. Code, § 25401.)

8. The advertisements for CDs at artificially-inflated interest rates are inherently misleading, and the inability to appreciate from a reading of the advertisement, 1) that the CD offer is limited to an investment of $5,000, and 2) that the entire $5,000 CD is not FDIC insured, is not restricted to the elderly victim. The ads' fine print is not sufficient to alert the average reader to the true facts as reflected in Findings 2 through 6, and no amount of explanation that may be imparted once the customer is sitting across from the salesperson vitiates the violation that occurred under section 25401 as soon as the advertisement appeared in the newspaper.

9. Respondents are unapologetic of their actions in luring unsuspecting customers into their branch offices for the express purpose of converting their interest in a CD to interest in an annuity. Reasonable minds cannot differ, and respondents do not really dispute, that the advertisements are intended to "grab" the attention of investors, particularly elderly investors who seek the safest investments, while the authors of the ads have every incentive to not sell the advertised product, and have every incentive to sell FIP's only product, an annuity. The testimony from the salespeople who claim to be financial advisors, who offer annuity as a service to their clients, who claim to desire only what is appropriate for them, is discounted entirely. Only one incentive is at work here, and it is not to assist these mostly elderly witnesses to pass their golden years in financial security.

10. The evidence is also overwhelming that nearly all of the 15 complaining witnesses purchased annuities reasonably thinking either that they purchased a CD, as advertised, or an annuity that would permit them to withdraw their funds, without penalty, in one, two or five years. Equity and the spirit of the securities law of this state will not permit respondents to successfully rely on insurance policy language provided after the fact, or ambiguous brochure language, or verbal sales pitches that highlighted the rate of return and did not make clear the time period to which the funds were being committed.

11. The Commissioner's determination that respondents are offering and selling securities by means of written and oral communications including untrue statements of

material fact, and omission of material facts necessary to make the statements not misleading, is sustained.

ORDER

1. Respondents are ordered to desist and refrain from the further offer or sale in the State of California of the securities described herein unless and until qualification of the securities has been made pursuant to the Corporate Securities Law of 1968.

2. Respondents Leon, Grewal and Fracchia are further ordered to desist and refrain from the further offer or sale in the State of California of the securities described herein unless and until they have applied for and secured certificates authorizing them to act as broker-dealers.

DATED: October 5, 2004

TIMOTHY S. THOMAS
Administrative Law Judge
Office of Administrative Hearings