BEFORE THE NATIONAL BUSINESS CONDUCT COMMITTEE
NASD REGULATION, INC.

In the Matter of District Business Conduct Committee For District No. 8 (CHI) Complainant, vs. Miguel Angel Cruz Shelby Township, MI, Respondent.	DECISION Complaint No. C8A930048 District No. 8 Dated: October 31, 1997

I. Introduction

This matter was appealed by Miguel Angel Cruz ("Cruz") pursuant to NASD Procedural Rule 9310. After a review of the record, we find that Cruz made unsuitable recommendations and misrepresentations of material facts in connection with sales of variable life insurance policies, and circulated radio advertisements that were misleading and did not comport with the NASD's advertising rule. We also find that Cruz engaged in outside business activities without providing prompt written notice to his firm. Accordingly, we impose on Cruz a censure, $30,000 fine, and $8,206.75 in DBCC hearing costs. We also suspend Cruz from using sales literature and advertisements for one year, and thereafter require him for a period of one year to file, and to obtain from the NASD Advertising Department staff a "no objection" letter concerning, all of his advertisements and sales literature prior to use. We require Cruz to provide to NASD staff proof of $6,544.12 restitution to three customers within 90 days of this decision, and we require Cruz to requalify as an investment company and variable contracts representative within 90 days of this decision.

Background. During all times relevant to the complaint, Cruz was associated with the Equitable Life Assurance Society of the United States ("Equitable" or "the Firm"). Cruz first became employed by Equitable in June 1982, and first registered with Equitable as an investment company products and variable contracts representative in 1984. Cruz was terminated from Equitable in or about January 1994, and he currently is not associated with an NASD member.

II. Proceedings Below

Complaint. The complaint was in five causes. The first and second causes alleged respectively that, in selling the Equitable Incentive Life Insurance policy ("the Incentive") to public customers, Cruz: made certain misrepresentations about the product and himself, in violation of Article III, Sections 1 ("Section 1") and 18 ("Section 18") of the Rules of Fair Practice (now Conduct Rules 2110 and 2120); and made unsuitable sales, in violation of Section 1 and Article III, Section 2 of the Rules of Fair Practice (now Conduct Rule 2310). The third cause alleged that Cruz failed to file timely with the NASD an amended Form U-4 Uniform Application for Securities Industry Registration or Transfer ("Form U-4") to reflect that Equitable had received 50 customer complaints, in contravention of Article IV, Section 2(c) of the NASD's By-Laws and Section 1. The fourth cause alleged that Cruz circulated certain deficient radio advertisements, failed to submit these advertisements to the NASD and the Firm for approval, and engaged in other misconduct that violated Section 1 and Article III, Section 35 ("Section 35") of the Rules of Fair Practice (now Conduct Rule 2210). The fifth cause alleged that Cruz accepted compensation for acting as a distributor for NuSkin International ("NuSkin") without giving Equitable prompt written notice of these activities, in violation of Section 1 and Article III, Section 43 ("Section 43") of the Rules of Fair Practice (now Conduct Rule 3030).

DBCC Action. The DBCC made findings consistent with the first (misrepresentations),[1] second (suitability), and fifth causes (outside business activity) of complaint. The DBCC dismissed the third cause (failure to update Form U-4) as unsupported by the record.[2] Under the fourth cause, the DBCC found that Cruz violated Section 35 by circulating radio advertisements that contained incomplete, exaggerated, unwarranted, and/or misleading statements and which failed to include Equitable's name. The DBCC dismissed the allegation that Cruz failed to submit advertisements to Equitable or the NASD's Advertising Department, and the DBCC made no findings as to the allegation that the advertisements omitted language relating to delivery and review of the prospectus. Based on the foregoing, the DBCC: barred Cruz; required him to disgorge $1,600 in commissions and pay $10,909 in restitution to the customers at issue; fined him $415,000; and assessed $8,206.75 in costs. This appeal followed.

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[1] As to the first cause, the DBCC reviewed each customer's testimony and found that Cruz made some, but not all, of the misrepresentations alleged in the complaint.

[2] The DBCC dismissed Cruz' alleged failure to update timely his Form U-4 because the evidence showed that: Equitable did not inform Cruz that it had received some of the customer complaints at issue; Equitable instructed Cruz not to report customer complaints of which Cruz was made aware; and Equitable prohibited registered representatives from completing and filing updated Forms U-4 without the firm's explicit direction to do so. Based on our review of the record, we affirm the DBCC's dismissal of the third cause.

III. Discussion

On May 6, 1997, a hearing was held before a subcommittee of the National Business Conduct Committee ("NBCC"). The respondent, who was represented by counsel, attended the hearing, as did the regional attorney who presented this matter to the DBCC. After a careful review of the entire record, including the parties' arguments and briefs on appeal, we modify the DBCC's findings and sanctions as set forth below.[3]

A. Summary of the Product

The Incentive is a flexible premium variable life insurance product that permitted the policyholder to vary the amount and frequency of premiums and the size of the face amount. Equitable calculated a "target premium" (based on age, sex, and face amount of insurance), which generally was the amount of annual premium necessary to maintain a whole life policy in the same face amount. The policyholder was required to pay an initial premium, and would designate a "planned premium"; the policyholder was not "required," however, to pay the planned premium or any other premium besides the initial premium. Although no additional premiums were "required," the policyholder would have to pay additional premiums to keep the policy from lapsing if the cash surrender value of the policy -- the value of the funds in the policy account ("Policy Account"), less a deferred contingent sales load (described below) and any policy loans -- was insufficient to cover the cost of insurance and other fees. Thus, the policyholder would not have to pay additional premiums unless the net value of the policy was insufficient to cover insurance costs and policy fees. In fact, certain charts and illustrations included in the prospectus for this product led customers to believe that the performance of the funds in the Policy Account would cover the cost of the policy.

The policyholder could increase or decrease the policy face amount (to a minimum of $50,000) after purchasing the policy. Equitable charged a fee (which was a prorated "surrender charge") if the face amount were decreased during the first 10 policy years. Equitable also charged a fee for increases in the size of the face amount. Policyholders could elect one of two death benefits: Option A, which paid a fixed benefit equal to the policy's face amount; or Option B, which paid a variable benefit equal to the policy's face amount plus the value of the Policy Account.[4] Under both options, the beneficiary received, at a minimum, the face amount of the policy.

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[3] Cruz attached to an April 8, 1997, continuance request excerpts from a transcript of testimony given to the NASD by Ron Doane ("Doane"), who was the chief compliance officer of Equitable during the relevant period. On April 28, 1997, the regional attorney submitted a transcript of the entire investigatory testimony of Doane, along with the related exhibits. By letter dated May 1, 1997, the NBCC Subcommittee informed the parties that pursuant to NASD Procedural Rule 9312 it had -- on its own motion -- determined to admit Doane's investigatory testimony along with the related exhibits. We ratify the NBCC Subcommittee's decision in this regard.

[4] Option A generally had a lower cost of insurance than Option B.

Equitable deducted two fees directly from the initial premium: a state premium tax (which ranged from one percent to four percent); and a one-time charge (which ranged from $250 to $348) to cover processing fees, medical exams, and other administrative fees. After these deductions were made, the balance of the premium -- the "net premium"-- was placed into the Policy Account. The policyholder had the choice of allocating the net premium to the Guaranteed Interest Division ("GID") (which paid a guaranteed interest rate) and/or to one or more of the investment divisions of the separate account ("Separate Account"). The Separate Account consisted of a number of investment divisions (generally, mutual funds), which were subject to market risk and fluctuation. Thus, the performance of the investment in the Policy Account would affect the cash surrender value of the account, which in turn would affect the amount of funds needed to maintain the policy.[5] Equitable deducted from the Policy Account the remaining fees and expenses, which included: a monthly administrative charge (which varied from $4 to $8); the cost of insurance (which varied based on age, sex, health, risk class, and amount of insurance); transaction charges for changes in the face amount and withdrawals; an annual mortality and expense risk charge (.6 percent or less); and an investment management fee (which ranged from .4 percent to .5 percent of assets under management). The following chart, which is simplified and contains some assumptions, is provided to illustrate the basic features of the product.

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	Policy Year 1	**Policy Year 2**
1) Initial Premium	$6,560.00	
Planned Annual Premium		$4,000.00
2) Deductions from Premium		
i) State Premium Tax (2% to 4%)	$ 131.20	$ 80.00
ii) First Year Administrative Fee	$ 250.00	N/A
3) Net Premium	**$6,178.80**	**$3,820.00**

4) Allocation of Net Premium in the Policy Account: The Net Premium ($6,178.80 for year one and $3,820 for year two) is then placed in the Policy Account, and is allocated based on the designation on the policy application. That is, on the policy application, the customer: 1) designates how the funds will be allocated among the investment divisions of the Separate Account and the GID; and 2) designates from which division of the Policy Account remaining expenses will be paid. The customer made the allocations on the policy application as follows:

Illustration of Allocations of Net Premium

[5] That is, an increase in the investment in the Policy Account would increase the cash surrender value of the account, and would decrease the amount the policyholder had to pay to cover costs and fees and keep the policy in effect. The converse was true for a decrease in the investment. Thus, the policyholder would not be required to make additional premium payments if the amount of premiums paid, plus the investment performance, were greater than the annual costs and fees (including the surrender charge).

Initial Allocation to Investment Option	Year 1 For Premium (%/$ Amount)	For Deduction (%/$ Amount)	For Premium (%/$ Amount)	Year 2 For Deduction (%/$ Amount)
GID	--		--	
Common Stock Fund	15% ($926.82)		15% ($573)	
Money Market Account	35% ($2,162.58)	100% ($2,162.58)	35% ($1,337)	100% ($1,337)
Balanced Fund	10% ($617.88)		10% ($382)	
Aggressive Fund	5% ($308.94)		5% ($191)	
High Yield Fund	--		--	
Global Fund	5% ($308.94)		5% ($191)	
Conservative Investors	25% ($1,544.70)		25% ($955)	
Growth Investors	5% ($308.94)		5% ($191)	
Total	100% ($6,178.80)	100% ($2,162.58)	100% ($3,820)	100% ($1,337)

This illustration shows that for year one: 1) 65 percent of the net premium ($4,016.22) was invested in various mutual funds in the Separate Account; 2) 35 percent of the net premium ($2,162.58) was invested in the money market account of the Separate Account; and 3) the customer determined that 100 percent of the remaining fees and costs (which are outlined below) would be paid by the funds in the money market account. Thus, 35 percent of the net premium paid for 100 percent of the following remaining fees:[6]

	Policy Year 1	Policy Year 2
5) Remaining Deductions		
i) Monthly Administrative Charge (fee varied from $4 to $8 per/month and did not apply in policy year)	N/A	$ 48.00
ii) Cost of Insurance	$921.36	$921.36 *(estimate)*
iii) a mortality and expense risk charge	$ 4.48	$ 4.48
Total	$925.48	$969.36 *(estimate)*

Note that, in year one, after the "Remaining Deductions" of $925.48 were subtracted from the $2,162.58 in the money market account, there was $1,207.52 in the money market account. That surplus could be used to fund the policy in future years.

6) Cash Surrender Value: The cash surrender value of the account was calculated by subtracting the surrender charge and loans from the value of the amount in the Policy Account (i.e., net premium), which would vary depending on market fluctuation. If this amount was enough to cover the costs and fees of the policy, then the policy would remain in force and the customer would not have to pay additional premiums.[7]

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6 Note that if the funds in the money market account did not cover the remaining costs and fees, Equitable would take a pro rata share of the money in the investment funds to cover the excess costs.

7 The "net cash surrender value" was calculated by subtracting cost of insurance and administrative fees from the cash surrender value; if the net cash surrender value was a positive amount, the policy would stay in force, but if the net cash surrender value was a negative amount, the policy would lapse. The customer could borrow against the cash surrender value of the account or withdraw up to the net cash surrender value of the policy.

For example, the value of the account on the opening date of the account in year one (this assumes there has been no change in the value of funds in the Policy Account due to market fluctuations) was: $6,178.80 (net premium) - $925.48 (costs and fees) = $5,253.32. Equitable then deducted a surrender charge of $1,340, to yield a cash surrender value of $3,913.32.[8]10 years, this charge was considered in calculating the value of the account because it would become a real expense to the account if the account were surrendered. As noted in the illustrations above, the cost of insurance and fees in year two was approximately $969.36. Also note that the "planned premium" was a proposed premium amount, which the customer was not required to pay; rather the customer only had to pay a premium if the cash surrender value of the account was not sufficient to cover costs. Thus, because the cash surrender value of the account was $3,913.32 and the costs and fees were $969.36, the policy had a positive net cash surrender value in year two and the customer did not have to make an additional premium payment in year two to keep the policy from lapsing (assuming the value of the funds in the Separate Account did not significantly decrease).[9]

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B. Misrepresentations and Unsuitable Recommendations

1. Facts

Equitable's Sales Practices. Equitable provided its sales force with sales materials that promoted the Incentive as an investment program similar to a mutual fund with the added benefit of insurance and which focused on "investment concepts" such as diversification and risk. In addition, the prospectus prominently highlighted the investment features of the product, and provided projections of the size of the death benefits based on the performance of the various investment divisions/mutual funds in the separate account (assuming rates of return at 4 percent, 8 percent, and 12 percent). The prospectus gave the overall impression that the product was self-funding, and that customers might not have to make future premium payments. Moreover, it was permissible under Equitable's guidelines to sell policies where the premium equaled as much as 20% of the customer's gross income and the face amount was as much as 10 times the customer's income.

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[8] Note that although the surrender charge was only imposed if the account lapsed within

[9] To keep the policy from lapsing, at the very minimum the customer had to keep on deposit funds sufficient to cover the cost of insurance and fees plus the surrender charge.

Equitable's Compliance Practices. First, the record is devoid of evidence showing that Equitable applied suitability standards to the entire product. Equitable used only an underwriting standard to determine if the Incentive was a suitable product for its customers. Second, the record establishes that during the relevant period, Equitable's compliance department had a policy of not filing radio advertisements with the NASD as long as they met Equitable's "three-part rule." Under the "three-part rule," Cruz and his agency manager, John Krahnert ("Krahnert") were advised that the radio advertisements would be acceptable for compliance purposes provided the advertisements were: (1) general in nature; (2) not product specific; and (3) did not mention Equitable's name. Third, the record demonstrates that Cruz' sales materials were continuously approved by Equitable's compliance department. Fourth, it is undisputed that Equitable deliberately refused to allow the filing of amended Forms U-4, which had the effect of shielding from NASD inquiry customer complaints regarding Equitable's variable life insurance policies.

Cruz' Sales Presentations. At the DBCC hearing and on appeal to us, Cruz denied all of the allegations of misrepresentations and unsuitability. Cruz described his investment philosophy and sales presentation and practices (which he claimed varied little) as follows.

Cruz asserted that he primarily sold the Incentive because it was a high-quality product that offered multiple benefits (life insurance and investment) and uses (retirement, education, estate planning, and mortgage protection). Cruz described his customers as "mid-scale," and he claimed that they had the sophistication to understand the features of the Incentive. Cruz encouraged his customers, many of whom were not affluent, to use the Incentive for budgeting and savings purposes, and as a means of providing a better financial future for their children. Cruz asserted that he was deeply religious, and marketed his services through church groups and through WMUZ, a Christian radio station in the Detroit, Michigan area. Cruz testified that he called himself a financial "steward," as that term had biblical connotations, and that he often began his first meeting with a customer with a prayer.

Cruz explained that he held two sales meetings with each customer, during which he gave a detailed presentation of the features of the Incentive. Cruz also stated that he gathered information about the customer's finances, insurance needs, and investment objectives, to ensure that all sales were suitable. At the first meeting, Cruz reviewed the customer's pay stubs and tax information, and gathered information about the customer using his Financial Fact Finding worksheet. Cruz then reviewed his "What You Should Know About Mac Cruz" sales piece, and emphasized the sections that discussed his background, affiliation with Equitable, compensation structure, and the fact that he most often recommended the Incentive. Cruz claimed that he clearly disclosed that he was selling variable life insurance and that he was a registered representative of Equitable, not a financial planner, so that the customer was clear on the product and services he was offering. Cruz then made a second appointment with the customer.

Between the first and second meeting, Cruz consulted an Equitable publication entitled "Financial Needs Analysis" ("FNA") to determine the "suitable" amount of premium and face amount in light of the customer's cash needs.[1] Once he determined the appropriate premium level under the FNA, Cruz established an estimated "target premium," or amount of money the customer was willing to commit to put into the policy each year. Cruz considered this amount to be "forced savings." According to Cruz, Equitable encouraged agents to use "target premiums" because it was "middle of the road," neither "insurance rich" nor "investment rich."[2] Cruz then calculated the amount of insurance (i.e., face amount) the proposed premium would purchase. Cruz consulted a second Equitable publication entitled "Agent's Guide to Financial Underwriting" ("Agent's Guide") to determine if the proposed face amount of insurance was "suitable."

At the second meeting, Cruz recommended that the customer purchase the Incentive. Cruz gave the customer the prospectus and the "Disclosure Statement" document, which he used to lead the customer through the prospectus point-by-point and which the customer signed. Using this document, Cruz highlighted a number of points in the prospectus, including: cost of insurance; fees and expenses; surrender charges; and the free-look/cancellation period. Cruz explained that the face amount could be changed, and discussed the flexible nature of the premium, but warned that the policy would lapse if the customer did not pay the first-year premium and 70 percent of the second-year premium. After reviewing this information, Cruz left the room and let the customer decide whether he or she wished to purchase the product.

If the customer wished to proceed, Cruz then established the initial and annual premium by discussing with the customer how much he or she felt comfortable investing each year. Cruz then gave the customer an estimate of the amount of insurance the target premium would purchase.[3] Cruz encouraged each customer to review the policy brief and annual statement, which Equitable later mailed to the customer and which set out the exact face amount and cost of insurance. Cruz completed the policy application, on which the customer designated a planned premium, beneficiary, and the allocation of funds in the Policy Account, and on which the customer acknowledged he or she was purchasing insurance. Cruz also completed the Large Amount Supplement ("LAS"), on which he would indicate the customer's income, net worth, and investment objectives. The customer also completed an HIV disclosure form and an avocation questionnaire (if necessary), and received from Cruz the names of doctors from whom the

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[1] Cruz claimed that Equitable also used the "20 percent Rule," under which the premium of a variable life insurance policy could be as much as 20 percent of the gross annual income of the customer.

[2] According to Cruz, there were three approaches: 1) "investment rich," under which the policyholder placed a majority of the money into the separate account and took out $50,000 in insurance, the minimum amount; 2) "insurance rich," under which most of the premiums were used for insurance (large face amount) and a small portion was placed in a separate account; and 3) target premiums.

[3] Cruz asserted that he could not determine the actual face amount at the point of sale, and that only the underwriting department could ascertain the exact figure once it reviewed the application. The actual face amount of the policy was filled in once it was approved by the underwriting department.

customer could obtain a physical exam and tests. Cruz then asked the customer for a check, on which the customer would note that it was for "flexible premium variable life insurance premium." Lastly, Cruz gave the customer a temporary insurance agreement for coverage until the policy was approved.

Cruz argued that all of the policies at issue fell within the amounts suggested by the FNA and the Agent's Guide, and that at the time he made the sales at issue, it was Equitable and industry practice to use the target premium approach and these two underwriting guides as a basis for determining suitability. Cruz further claimed that there were no other suitability guidelines for the policy face amounts and premiums, although he understood that the NASD suitability concept generally applied to the sales at issue. Cruz further claimed that all of the policies were approved by Equitable's underwriting department, and that Carolann Mathews in Equitable's compliance department contacted each of the complaining customers to verify information about the customers' finances and objectives.

In 1982, Cruz began working at the Equitable's Krahnert Agency, in Edison, New Jersey. For approximately two years, Cruz successfully sold whole life and term life insurance products. Krahnert was responsible for training and supervising Cruz. Additionally, Albert Dawson ("Dawson") was the Northeast regional compliance officer responsible for the Krahnert Agency and Cruz. In April, 1984, at the urging of Joel Albert ("Albert") -- a district manager at Equitable -- Cruz registered with Equitable to sell variable life insurance products.

Equitable/Cruz Association. In 1985, Cruz moved his office to the Millar Agency in Troy, Michigan, and began working with Anthony Amaradio ("Amaradio"), Equitable's top producer at the time. Although he was located in Michigan, Cruz was supervised from New Jersey by Krahnert, who was not registered as a principal. Upon arriving at the Millar Agency, Cruz accompanied Amaradio on a few variable life insurance sales calls. Cruz immediately became concerned about Amaradio's sales presentations, and contacted Dawson to discuss the appropriate manner in which to market and sell the Incentive. In June 1985, Cruz went to New York to meet with Dawson and a number of other individuals in Equitable's compliance department. During the meeting, compliance staff reviewed Cruz' sales materials and sales presentation to ensure that they complied with applicable rules. At the conclusion of the meeting, Cruz obtained Dawson's agreement to have an Equitable compliance team travel to Michigan to review all of the sales materials and operational procedures. Cruz repeatedly called Dawson to arrange for a firm date for the compliance team's meeting in Michigan, which was finally scheduled for July 22-23, 1985.

During the July 1985 meeting, all of the sales materials used by Cruz during his sales presentation were reviewed and evaluated by Equitable's compliance staff. The July 1985 compliance meeting, in part, dealt with Amaradio's radio spots. Dawson did not mention to Cruz during the meeting any requirement that those advertisements had to be approved and filed with the NASD. Cruz asked what he was required to tell customers about the services he provided. Dawson instructed Cruz to describe the product in "generic terms," such as "Tax Planning," "Financial Assets, Retirement Planning, Will and Trust, Investment Company variable contract; budget analysis, and financial plan[ning]." Dawson assured Cruz that he would "[g]et a product person to come out and rewrite the sales/marketing literature." Dawson advised Cruz to continue using his existing sales literature until revised sales materials were prepared by Equitable's compliance department, discussed with his agency manager, and then filed by Equitable's compliance department with the NASD. Pursuant to Dawson's directions, on October 11, 1985, Cruz submitted copies of his revised sales literature and materials for approval and filing by Dawson, at Equitable's compliance office, with copies to Krahnert.[4] The record demonstrates that Equitable led Cruz to believe that Equitable would clear and file all such materials. The record further demonstrates that Cruz continuously submitted to Dawson his sales literature, which Dawson approved but never filed with the NASD.

In 1987 and 1988, Cruz requested meetings with Equitable's compliance staff (including Equitable's chief compliance officer) to address customer complaints that had been filed with Equitable and to refine his presentation. During these meetings, compliance staff reviewed, critiqued, and revised Cruz' sales materials and presentation. Cruz incorporated these changes and submitted his sales literature for Equitable's final approval. After these compliance meetings, Equitable's compliance department approved for Cruz' use the following sales literature: "What You Should Know About Mac Cruz," which described Cruz' education, background, registration with Equitable, compensation structure, and the product; "Summarizing the Economy," which outlined trends in the economy and the stock market as they related to the Separate Account; "Financial Fact Finding," a worksheet Cruz used to gather information about a customer's finances, insurance needs, and investment objectives; and "Disclosure Statement," which highlighted numerous features of the Incentive. The evidence shows that Cruz used all of these materials in the sales at issue in this matter.

In October 1990, Tom Wiltrakis ("Wiltrakis"), who had served as Equitable's Midwest compliance officer, assumed Dawson's position, in part because the Firm wanted someone with substantial securities industry experience in that office. Wiltrakis conducted an examination of the Krahnert Agency and determined that Dawson had improperly approved Cruz' sales materials, failed to file his sales literature with the NASD, and misinformed Cruz as to whether certain radio advertisements had to be approved and filed with the NASD. Cruz cooperated with Wiltrakis' efforts to rectify the sales literature and other deficiencies. Additionally, in 1991, Cruz met with compliance staff to establish new parameters (by way of face amount and premium) for selling the Incentive.

During his tenure, Cruz sold 3,000 insurance policies, 2,000 of which were variable life insurance products, and was one of the Firm’s top two producers. Between 1985 and 1991, Cruz' annual first-year commissions ranged from $100,000 to $500,000, from which Krahnert received a 12 percent override.

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[4] These materials included, but were not limited to, Cruz' business card, biographical description, summary sales piece describing features of the variable insurance product, referral sheet, and financial fact-finding form.

Fees, Deductions, and the Policy Account. Equitable deducted directly from the initial premium a state premium tax (which ranged from one percent to four percent) and a one-time administrative charge (which ranged from $250 to $348). The balance of the premium was then placed into the Policy Account. The following remaining fees and expenses were deducted from the Policy Account: a monthly administrative charge, which ranged from $4 to $8; the cost of insurance, which varied based on age, sex, health, risk class, and amount of insurance; transaction charges for changes in the face amount and withdrawals; an annual mortality and expense risk charge (.6 percent or less); and an investment management fee, which ranged from .4 percent to .5 percent of assets under management.

Sales Loads and Commissions. The Incentive did not have a front-end sales load, but Equitable levied a surrender charge (i.e., a contingent deferred sales load) on policies that lapsed or were surrendered during the first 10 policy years. The surrender charge was calculated as a percentage of the target premium and premiums paid during the first ten policy years, but did not exceed 50 percent of one target premium. After six policy years, the surrender charge decreased by 20 percent per year, and after year 10, no surrender charge was imposed.[1] Policyholders had a free-look period, during which they could examine and cancel the policy for a full refund without incurring a surrender charge. Agents were paid a commission of 40 percent to 50 percent of the first year premium, and 4 percent of premiums paid during policy years two through 10. Commissions were not deducted from premiums, but were paid directly to the agent by Equitable Variable Life Insurance Company, a subsidiary of Equitable that owned the product.

Loans, Withdrawals, and Tax Benefits. The Incentive policyholder could either borrow against the cash value of the policy or withdraw funds from the policy. The policyholder could borrow up to 90 percent of the policy's net cash surrender value, and be charged net interest of 1 percent. Loans reduced the insurance benefit by the amount borrowed, and reduced the amount in the Policy Account because policy funds (equal to the amount of the loan) were placed in the GID to secure the loan.[2] Policyholders could withdraw from the Policy Account a minimum of $500 and as much as the net cash surrender value of the account, for which Equitable would charge a transaction fee (the lesser of $25 or 2 percent of the amount withdrawn). Withdrawals also reduced the death benefit, cash surrender value, and value of the Policy Account by the amount withdrawn, plus the transaction fee. Unless a policy was deemed a "modified endowment,"[3] accumulated values in the Policy Account, loans, and withdrawals generally did

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1 Thus, the maximum charges were: 50 percent for years one through six; 40 percent for year seven; 30 percent for year eight; 20 percent for year nine; and 10 percent for year 10.

2 The amount that secured the loan remained in the Policy Account, but was placed in the GID where it earned interest; if the GID did not contain sufficient funds to secure the loan, Equitable would withdraw funds from the Separate Account. The amount borrowed accrued interest, generally at a rate of 1 percent greater than the interest paid on the amount in the GID, for a net interest loan rate of 1 percent.

3 A modified endowment is a life insurance policy that after July 21, 1988, failed to meet the "seven-pay" test. The seven pay test stated that if the premiums in the policy at any time during the first seven years of the policy exceeded a certain amount, which was equivalent

not accrue taxes.[4] Thus, policyholders could use the amount in the investment account to pay for future expenses -- such as college tuition or retirement benefits -- without incurring tax liability at that time. The policy also could be used for estate planning purposes. Death benefits passed income-tax-free to the beneficiary upon the death of the policyholder; if the policyholder lived to the age of 95, the policy matured and Equitable paid the policyholder the amount in the Policy Account, which could be subject to federal taxation.[5]

2. NBCC Findings for Misrepresentations and Unsuitable Recommendations

a. Misrepresentations. The first cause alleged that Cruz made certain specific misrepresentations in violation of Sections 1 and 18. Upon a careful review of the record, we affirm the findings of violations of Section 1, but dismiss the allegations of violations of Section 18 because the record does not support a finding that Cruz acted with scienter.[6]

As noted, the evidence shows that Cruz continuously consulted with Equitable's legal and compliance staff to ensure that his sales literature and presentations complied with the securities laws. The evidence also shows that Equitable's compliance staff approved his sales material. In addition, sales literature that the Firm provided to its sales force promoted the Incentive as an investment program similar to a mutual fund with the benefit of insurance. Moreover, Equitable's sales literature focused on "investment concepts" such as diversification and risk, and included lengthy discussion of the investment divisions of the Separate Account (e.g., aggressive stock, balanced, high yield, money market), the various types of investment objectives customers should consider, and how investment objectives related to the choice of funds (e.g., that a customer willing to tolerate risk for greater gain should invest in the Aggressive Stock Division). The prospectus also prominently highlighted the investment features of the product, and provided projections of the size of the death benefits based on the performance of the various investment divisions, assuming rates of return of 4 percent, 8 percent, and 12 percent.

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to the amount that would pay for a hypothetical policy on the insured after seven years, the policy no longer qualified for tax-deferred status.

4 Partial withdrawals generally were not taxable if the amount withdrawn did not exceed the basis of the policy (the amount of premiums paid less any amount recovered through a tax-free policy distribution).

5 During the life of the policy, interest and earnings would be taxed if the policy were surrendered and the cash surrender value exceeded the premiums paid.

6 Scienter is a mental state embracing an intent to deceive, manipulate, or defraud. Ernst & Ernst v. Hochfelder, 425 U.S.185, 193-94 (1976). Scienter has been defined as not merely knowing a falsity but rather having an intent to defraud. A person acts with scienter if he knowingly, intentionally, or recklessly omits or misrepresents a material fact. Recklessness has been defined as "highly unreasonable misrepresentation, not merely simple or even excusable negligence, but an extreme departure from ordinary care and which presents a danger of misleading buyers, that is either known or so obvious that the actor must have been aware of it." Sanders v. Nuveen & Co., 554 F.2d 790, 793 (7th Cir. 1977).

In addition, the complaint alleged that Cruz misrepresented that the policy was self-funding and did not require future payments and misrepresented that the costs and fees were minimal. We note that the prospectus implied that customers would not have to make future premium payments, in that it stated: "Premiums may be invested whenever and in whatever amount determined by the policyholder. . . . .Other than the initial premium there are no scheduled or required premium payments (however, under certain conditions, additional premiums may be needed to keep the policy in effect)." Furthermore, Albert and Krahnert each testified that Equitable promoted the concept of "vanishing premiums" or self-funding (i.e., that the investment returns would pay entirely the cost of insurance and fees), although they believed that Cruz did not represent the product in this way.

We find that the evidence does not show that Cruz intentionally or recklessly misrepresented the product to his customers. While we find that in specific instances -- as noted below -- Cruz failed to describe the product accurately, we also find that in making these misrepresentations Cruz did not act with scienter. Accordingly, we dismiss the Section 18 allegations. We limit our findings of misrepresentations to violations of Section 1, and note that Section 1 does not require a showing of scienter. See In re Larry Ira Klein, Exchange Act Release No. 37835 (October 17, 1996). We note that the DBCC did not address the evidence and respondent's arguments regarding scienter.

In reaching our findings, we were constrained by the following facts: 1) the complaint was drafted narrowly, in that it alleged that Cruz made very specific misrepresentations; 2) the customers' testimony often did not address whether Cruz made the specific misrepresentations; and 3) the customers' testimony was often vague due to the passage of time (five to seven years) between the alleged misconduct and the DBCC hearing. Additionally, we find insufficient support in the record for some of the DBCC's misrepresentation findings. For example, the DBCC concluded that Cruz misrepresented the product on the sole basis that he described the product as an "investment with an insurance wrap." We note that this expression is widely used to describe variable life insurance, and we find that simply describing the product as such is not a misrepresentation. Rather, we have made findings of a misrepresentation where the evidence shows that Cruz went beyond merely describing the product as an "insurance wrap," and instead represented that the product was an investment with an incidental, or no, insurance component, that the product was self-funding, or that most of the premium would be invested in the Investment Account component of the product. Additionally, we have dismissed findings where the evidence did not support the allegations in the complaint, such as the allegation that Cruz represented himself as "an independent financial consultant who recommended products."

b. Unsuitable Recommendations. Cruz argued that the suitability rule applied only to the securities portion of the product. We disagree.

The NASD's suitability rule applies and, at the time of these transactions, applied to variable life insurance products. Variable life products are registered with the Securities and Exchange Commission ("SEC") as securities.[7] Therefore, the NASD's suitability rule applied

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[7] It has been established for nearly 40 years that variable life insurance products are securities subject to the requirements of the Securities Act of 1933 and the Exchange Act of

and applies to the entire product, not just to the Investment Account. In our view, it would be an unworkable interpretation of the suitability rule to say, both legally and practically, that one portion of a recommended securities product was subject to the NASD's jurisdiction and its suitability rule, but that another portion was somehow exempt from the NASD's jurisdiction. Such an interpretation would ignore the fact that the entire product is a security.

It is well-established that the suitability rule requires an associated person to make an independent determination whether an investment is suitable for a particular customer, taking into account the customer's investment objectives and financial needs. Regardless of the Firm's course of conduct, and Cruz' efforts to obtain guidance and to question conduct he viewed as inappropriate, Cruz should be held accountable for assuring that he did not recommend and sell a product to a customer that the person did not want. It would be unsuitable, under any standard, to recommend and sell a product to a customer when the product was inconsistent with the customer's investment objectives and financial needs.[8]

Nonetheless, given all the facts and circumstances of this case, we do not believe that Cruz should be held accountable for the full range of suitability issues raised by the sales of the Incentive.[9] As discussed above,[10] Equitable's selling program for the Incentive was characterized

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1934. See SEC v. Variable Life Insurance Company, 359 U.S. 65 (1959); See also SEC v. United Benefit Life Insurance Co., 387 U.S. 202 (1967); Exemptions of Certain Life Insurance Contracts and Their Issuers from Federal Securities Laws, Investment Company Act Release No. 7644 (Jan. 31, 1973). Additionally, the Incentive prospectus noted that the product was a security and was subject to various federal securities laws and regulations.

8 We note that it is acceptable, and indeed is desirable, for a salesperson to try to demonstrate that a customer should adopt objectives different from that which the customer originally expresses if the salesperson reasonably believes that the original objective is less suitable and so long as the different objective is appropriate for the customer. For example, even when a customer originally indicates she does not want insurance, it would be appropriate for a salesperson to try to demonstrate to the customer that she needs insurance, or variable life insurance, if that product is appropriate for the customer. Where a customer initially has indicated she does not have a particular objective, however (by indicating for example that she does not want insurance), it is incumbent upon the salesperson to ensure that the customer has expressly determined to change her objective in the manner recommended by the salesperson. The mere fact that a customer buys a product consistent with the objective recommended by the salesperson is not, by itself, an indication that the customer has expressly determined to adopt the new objective contrary to the customer's original expressed preference. Indeed, the resulting purchase of such a product might be equally consistent with a conclusion that the salesperson failed to adequately explain the product to the customer. Proof of a customer's express decision to change a clearly-expressed objective will vary from case to case, and is lacking in this case.

9 See DBCC No. 10 v. William Joseph Lucadamo, Complaint No. 10930053 (NBCC May 20, 1997) (Lucadamo conducted a reasonable investigation of the products at issue and had an adequate and reasonable basis for relying on the information provided by the firm).

10 See discussion above on pages 6-7 and 9-10.

by an effort to sell this particular product to a wide spectrum of customers. Cruz repeatedly raised questions about the propriety of the sales materials and the sales presentations being made. Taken as a whole, the record reflects a concerted effort by Cruz to ascertain the proper way to proceed and to conduct himself accordingly. Under these circumstances, we find it inappropriate to sanction Cruz for any suitability violations that rest on the issue of whether the product, and particularly the premium size, was incompatible with customers' particular financial profile. Rather, we have restricted our suitability analysis to the question of whether recommendations and sales of the Incentive were inconsistent with the particular customers' objectives.[11]

While we are not making specific findings as to the suitability of the size of premium as to this case, for the reasons discussed above, we think it would be helpful to adopt more specific guidelines with respect to size of premium and other aspects of this product that raise potential suitability issues. While we are developing such guidelines, we remind the industry that even in the absence of specific guidelines, it is the obligation of member firms to develop procedures to assure that a sale of its products is suitable. Moreover, a member firm's registered representatives are under an obligation to ensure that each policy is suitable for a specific customer. Thus, merely relying on underwriting guidelines does not fulfill these obligations.[12]

Equitable's compliance manuals warned that variable life products were securities and that the sales must be suitable in light of a customer's investment objectives, financial needs, and situation. Thus, Cruz was aware that Equitable required him to recommend and sell products that were consistent with each customer's financial objectives and needs. At the time that Cruz made these sales, established case law made clear that as an associated person he had a duty to recommend and sell products that were consistent with the customer's specific investment

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[11] In making this conclusion, we are not passing judgment on the product or the suitability of the size of premium. Indeed, we would reiterate what we said in the NASD's Notice to Member 96-86 ("NTM 96-86") in December 1996, that a member and its associated persons must have reasonable grounds for believing that a variable insurance product recommended to a customer is suitable for that customer on the basis of the facts disclosed by the customer regarding his or her other securities holdings and financial situation and needs.

[12] We reject Cruz' argument that no violation of Section 2 is established because the sales met Equitable's underwriting guidelines. Merely determining that a customer meets a firm's internal suitability guidelines does not fulfill the associated person's obligation to make an independent determination that an investment is suitable for a particular customer. See Nazmi C. Hassanieh, Exchange Act Rel. No. 35029 (Nov. 30, 1994); In re Patrick G. Keel, 51 S.E.C. 282 (1993). Moreover, the FNA and Agents Guide are underwriting guidelines that the Firm used to evaluate risk to the Firm and affordability of the policy (among other things). These guidelines did not address customer-specific suitability issues, such as whether the customer wanted insurance. Regardless of a customer's acquiescence in a particular investment strategy, it is the associated person's duty to make recommendations consistent with the customer's objectives and needs. In re Paul F. Wickstat, 50 S.E.C. 785 (1991).

objectives and needs. In re F.J. Kaufman & Co., 50 S.E.C. 272 (1989).[13] On this basis, we reject Cruz' notice argument.

c. Customer-Specific Findings. Our specific findings are set out below and are based on our review of the record, which includes the testimony of the following nine customers, which the DBCC found credible and which it credited over Cruz' assertions.[14]

John and Patricia Hartshorn. On September 26, 1988, John and Patricia Hartshorn ("Hartshorn") each purchased an Incentive policy from Cruz. Patricia's policy had a face amount of $183,131, and an initial and planned annual premium of $1,000. John's policy had a face amount of $393,069, and an initial and planned annual premium of $3,000. John and Patricia Hartshorn were both teachers, aged 30 and 27, respectively. The couple's total income was $42,000, for 1988 and $51,000 for 1989. Patricia testified that the couple's net worth at that time was $42,000, and that they had low living expenses and virtually no debt. Prior to purchasing the policies from Cruz, neither had investment experience or experience purchasing insurance. Patricia had $1,000 in a retirement plan through her employer and John had approximately $1,800 in a tax-sheltered annuity through the public school system. Additionally, John had $40,000 in life insurance ($30,000 in term life and $10,000 in whole life) and Patricia had $30,000 in term insurance, which she would lose if she stopped working. Although the couple did not own a home, they intended to purchase one in the near future and were going to use a $26,000 gift for a down payment on a house.

The Hartshorns learned of Cruz in 1988 through radio advertisements on WMUZ. The couple contacted Cruz because they were considering starting a family and wanted some financial advice on how to invest their extra money. Patricia testified that while the couple did not have the specific intention of purchasing insurance, when they met with Cruz they informed him that they wanted insurance. Cruz described the Incentive as life insurance "wrapped around" an investment and stated that the insurance would shield the amount in the Separate Account from taxes. Patricia testified that she understood that a portion of the expenses would be paid from the profits earned by the investments; Patricia was unclear, however, as to whether Cruz or a friend of her father-in-law represented this to her.[15] She also understood that a portion

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[13] As we stated supra in note 21, this is not to say that an associated person cannot attempt to demonstrate that a customer should consider an insurance product when the customer initially expresses an interest in some other product if the associated person has a reasonable basis for believing that the other product is less suitable than the recommended product and that the recommendation is suitable based on the customer's objectives and needs.

[14] We observe that the DBCC heard the witnesses' testimony and was in a position to observe their demeanor. See In re Charles E. French, Exchange Act Rel. No. 37409 (July 8, 1996). Additionally, based upon our independent review, we find that the record does not contain substantial evidence which would warrant setting aside the DBCC's credibility determinations. In re Joseph H. O'Brien, II, 51 S.E.C. 1112 (1994). As noted below, however, there are certain instances in which we have set aside findings because a customer's testimony did not support the allegations in the complaint.

[15] She further acknowledged that she knew she was purchasing an insurance policy.

of her premiums paid for the cost of insurance, and that the greater the return on the investment in the Separate Account, the less she had to pay for the policy. Cruz also told the Hartshorns that the premium was flexible, that they were not required to pay $4,000 every year, and that they could opt to pay their premiums every other year if they wished.

Patricia acknowledged receiving "What You Should Know About Mac Cruz" and the "Disclosure Statement" entitled "Read The Prospectus." Although Patricia initially testified that she could not recall receiving the prospectus, she later testified that she remembered receiving a prospectus on the same day that she received the Disclosure Statement. Patricia also acknowledged receiving a policy brief, which described the various fees, surrender charge, and the cost of insurance for the policy. The Hartshorns surrendered their policies in August 1991 and received from Equitable $1,432.92 -- the cash surrender value of their policies.[16]

Contrary to the DBCC, we find no misrepresentation and suitability violations. Although Cruz described the product as insurance wrapped around an investment and an "insurance wrap," merely describing the product in this way, without more, cannot form the basis for a finding of a misrepresentation. Additionally, the evidence does not show that Cruz misrepresented the product as primarily an investment or mutual fund. Patricia admitted that she knew she was buying insurance and an investment. Furthermore, we find that the evidence does not show that Cruz represented that the policy would be "self-funding." Patricia understood that the greater the return on investment, the less she might have to pay to keep the policy in force. Although Cruz might have told the customers that they could pay every other year (which may or may not have been true depending on the investment performance and the amount of premiums paid), the evidence does not support the allegation that Cruz told the customers that the policy would pay for itself. We also dismiss as unsupported by the record the DBCC's finding that Cruz represented himself as a financial planner and that he told customers that his education gave him experience in financial services.

Based on the record before us, we are unable to conclude that the policies were unsuitable for these customers. We note that the customers instructed Cruz that they wanted an investment and insurance, which is what Cruz sold them. Moreover, Patricia testified that the couple was interested in the tax-deferred features of the policy.[17] We further find that the product was otherwise consistent with the customers' investment objectives and financial situation and needs.

<u>William DeMaire.</u> On May 28, 1990, William DeMaire ("DeMaire") signed an application for an Incentive policy, which had a face amount of $432,900, an initial premium of $2,000, and a planned annual premium of $3,000. At the time, DeMaire was a letter carrier for

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[16] Thus, the Hartshorns did not recoup $2,567.08 of their initial $4,000 in premiums.

[17] Cruz argued before us that the portion of the complaint regarding the Hartshorns is time- barred because the complaint was filed more than five years after Cruz sold the policy. Cruz' argument is moot in light of our dismissal of this portion of the compliant. In any event, Cruz' argument is meritless, as the Commission consistently has held that NASD disciplinary proceedings are not subject to a statute of limitations. <u>In re Larry Ira Klein</u>, Exchange Act Rel. No. 37835 (Oct. 17, 1996).

the U.S. Postal Service and also worked part-time in the reserves as a military police officer. DeMaire earned approximately $29,000 per year, was 28 years old, was married, and had one child. He did not own a home and had no immediate plans to buy one. DeMaire had completed two years of college and had no prior investment experience. DeMaire had $4,000 in a government savings plan, $2,800 in an IRA, and $1,400 in government bonds. DeMaire estimated that his net worth was $39,900. DeMaire had approximately $500,000 in term life insurance through his employers.

DeMaire met Cruz in 1990 after listening to his radio program on WMUZ. DeMaire's investment objective was to save money and to plan for retirement, and, in particular, to save the $250 check he received each month from his military service. During their meeting, DeMaire and Cruz discussed these investment objectives. Cruz then recommended the Incentive, which Cruz described as insurance that wrapped around an investment to protect it from taxes. DeMaire explained to Cruz that he already had approximately $500,000 in insurance coverage and that he was not interested in another insurance policy. Cruz acknowledged that he had ample insurance, but stated that for Cruz' proposal to work, the investment would have to be wrapped with an insurance policy "so we could get from point A to point B without being taxed on it or taxed later on it." It was DeMaire's understanding that the insurance component was necessary to protect his money in the investment portion of the policy, which Cruz claimed would be "working" for him. Cruz led DeMaire to believe that the insurance portion of the policy would be minimal.

Although he acknowledged receiving the annual report and prospectus, DeMaire stated he had no experience reading these documents, and further claimed that he purchased the policy because he trusted Cruz based on their common Christian faith. The policy lapsed in 1991. After complaining to the Equitable, DeMaire received a full refund on the policy.

We modify the DBCC's finding that Cruz misrepresented the product as an investment program similar to a mutual fund and find that Cruz misrepresented the product to DeMaire by leading him to believe that the insurance component of the product was incidental, in violation of Section 1. Based on Cruz' presentation, the customer believed that almost all of his money would be placed in the investment funds of the Separate Account.[18] Furthermore, DeMaire only

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[18] We reject Cruz' argument that there was no misrepresentation because he supplied the prospectus to the customers. In support of his argument, Cruz relies on a number of cases in which the federal courts have dismissed civil actions brought by private parties against brokers for alleged oral misrepresentations. These cases focus on whether the customer justifiably relied on the oral misstatements when the customer also received a prospectus that contradicted the oral misrepresentations. We find that these case are inapposite because reliance is not an element in actions brought by a self-regulatory organization or the SEC. SEC v. Rana Research Inc., 8 F.3d 1358, 1363-64 (9th Cir. 1993); In re Robert A. Foster, 51 S.E.C. 1211 (1994). Additionally, the fact that an unsophisticated customer receives a prospectus disclosing the nature of the product is no defense to allegations of misrepresentation or unsuitability. In re Larry Ira Klein, Exchange Act Rel. No. 37835 (Oct. 17, 1996); Robert A. Foster, supra at 1213; In re Underhill Securities Corp., 42 S.E.C. 689, 694 n.8 (1965); accord, In re Billings Associates, 43 S.E.C 641, 646 n.10 (1967); Hanley v. SEC, 415 F.2d 589, 597 (2d Cir. 1969).

purchased the product because he believed that the insurance was minimal and necessary to protect the investment from taxes.

We find that the policy was unsuitable because it was inconsistent with the customer's investment objectives and goals. The evidence shows that Cruz sold the customer $432,000 in life insurance even though DeMaire clearly told him that he did not want or need additional insurance. The record shows that the customer wanted an investment vehicle in which he could save money for retirement. Moreover, DeMaire testified that he ultimately was not interested in any tax benefit that might accrue from placing his investments in the Incentive since the premiums would be taken out of his paychecks on a pre-tax basis. Thus, we find that it was inconsistent with the customer's clearly stated investment objectives for Cruz to sell DeMaire the Incentive, and we conclude that Cruz thereby violated Sections 1 and 2.

Lenore Bindek. On December 21, 1988, Lenore Bindek ("Bindek") signed an application to purchase an Incentive policy which had a face amount of $196,078 and an initial premium and planned semi-annual premium of $2,000. In 1988, Bindek was a 57-year-old secretary who had completed two years of college and who planned to retire in 1992. Bindek earned approximately $20,000 a year, and her husband earned $75,000 a year. The couple had no dependent children, owned a home (which had no mortgage) and other properties, and had $475,000 in total assets. Prior to purchasing the policy, Bindek had owned stock jointly with her husband, but had never managed any investments; rather, her husband handled all investment decisions. Bindek owned a certificate of deposit and a 401(k) account (which in 1995 was valued at $30,000), but she had no other investment experience. Bindek's husband, who was a funeral director, had $100,000 in a profit-sharing plan, which would be used for retirement. Bindek also owned $5,000 in term life insurance through her employer.

Bindek learned of Cruz through a friend and former co-worker, who worked for Cruz during this time. Bindek's friend told her that Cruz could obtain an investment return far in excess of the 5 percent her bank was offering. Bindek made an appointment to see Cruz based on her friend's representations. Bindek's objective in meeting with Cruz was to invest $2,000 -- which she termed her "mad money" -- each year for five years until she retired. Bindek hoped to accrue a "nest egg" that she could spend at will during her retirement. According to Bindek, she explained to Cruz her objective of accruing a "nest egg" for retirement and her desire to invest in stock or mutual funds. She told Cruz many times that she wanted to invest on a short-term basis and obtain a better return on her money than the banks were paying. Bindek further stated that she did not want or need life insurance.[19]

Bindek admitted that she purchased the product based on her friend's representations and urging, not Cruz'. Bindek testified that she did not pay much attention to Cruz' presentation or how he was to invest the money, and that she consulted her friend with questions about the

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[19] Although Equitable originally declined her policy (for health reasons) and required her to submit to a second blood test, Bindek stated that she did not understand she was purchasing insurance.

product.[20] Bindek also admitted she had received a lot of correspondence and information from Equitable (including the annual report, prospectus, and Disclosure Statement), but she explained that she quickly glanced at it and then hid it from her husband to avoid potential embarrassment. Bindek's policy lapsed in September 1989, was reinstated in November 1989 with a second $2,000 premium payment, and lapsed again in October 1990. Although Bindek complained to Equitable that she could not afford to lose the $4,000 in premiums, the Firm refused to refund her money.[21]

We dismiss the DBCC's findings that Cruz misrepresented that the policy was an investment and self-funding. Bindek testified that she did not pay attention to Cruz' presentation, consulted her friend about the product after, as well as before, Cruz' presentation, and decided to invest with Cruz based on her friend's urging. Thus, it is unclear from the record whether Cruz, or Bindek's friend, misrepresented the product to her, or exactly what Cruz told her.

We affirm the finding that the Incentive was unsuitable for Bindek and we find that Cruz violated Sections 1 and 2. Bindek clearly told Cruz that: 1) she generally wanted to invest in stock or mutual funds; 2) she did not want insurance; and 3) she wanted to invest her money for five years, at which time she would retire and would need to collect the funds. The Incentive was inconsistent with those investment objectives, especially given the fact that the policy imposed a substantial surrender charge in the first 10 policy years and did not provide the liquidity Bindek was seeking. Specifically, Bindek would have incurred a substantial surrender charge (up to 50 percent of the target premium) if she had sought withdrawal of the funds from the account at the five-year point.[22] Additionally, even though Bindek had access to her investment through a policy loan or a withdrawal, during the first 10 policy years she only had access to the net cash surrender value -- not the full value -- of the account because of the contingent deferred sales load (i.e., the surrender charges reduced the amount she could withdraw or borrow.) The policy also imposed administrative fees and costs for insurance, which she did not want and which further eroded her investment.

Thomas Tengler. On June 13, 1990, Thomas Tengler ("Tengler") signed an application for an Incentive policy which had a $366,299 face amount, $500 initial premium, and $500 planned quarterly premium. In 1990, Tengler was 22 years old, married, and worked as a cost estimator. Tengler earned $21,000 a year, and his wife earned approximately $13,000. The couple did not own a home or have children. Tengler stated that his liabilities totaled $6,000, which included his wife's student loans, credit card bills, and a car loan. Tengler had completed high school and three months of trade school, and his wife held a bachelor's degree in photography; neither had investment experience and neither had previously consulted with a

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20 Bindek testified that if Cruz discussed insurance she did not hear it because she wanted an investment.

21 It appears from the evidence that Bindek lost all of the $4,000 in premiums which she paid.

22 Bindek would have had to wait 10 years to have access to the full amount of funds in the account and not incur a surrender charge.

financial services professional. Tengler owned $30,000 in group life insurance through his employer at the time he purchased the Incentive.

In 1990, Tengler and his wife attended a benefit for a local youth ministry, during which Cruz spoke about finances and the need to develop a financial plan and budgeting strategies. Cruz' office later contacted Tengler to make an appointment to meet with Cruz, which the couple agreed to do. During their meeting, Tengler explained that the couple's objectives were to eliminate some debt, begin a savings program, enroll in college, invest $5,000, and save money to purchase a home.[23] Tengler further explained that he "was going to need to start school soon and . . . . needed to generate something to help with school costs." At the time he met with Cruz, Tengler and his wife had considered purchasing life insurance, but decided it was not a priority because they did not have a house or children.

During their meeting, Cruz assured Tengler that he would formulate a plan to meet his goals. Cruz discussed the "variable life plan" and told the customer that it offered solid performance and was the best option for the customer's future needs. Cruz then presented Tengler with the prospectus, which Cruz reviewed and highlighted.[24] Tengler understood from Cruz that he was purchasing $366,299 in life insurance, which Cruz claimed he and his family would "need" as his family grew. Tengler agreed to purchase the product because he trusted Cruz. Tengler later claimed that Cruz falsely told him that "almost all" of the $2,000 in initial premiums would be placed in the investment account. Equitable canceled Tengler’s policy and returned his premiums after receiving a customer complaint letter.

We dismiss the DBCC's findings that Cruz misrepresented the product as an investment, but we affirm the finding that Cruz misrepresented that a significant portion of the premium would be invested in the Separate Account, in violation of Section 1. First, while Cruz represented that the product offered solid performance, the evidence does not show that Cruz represented the product as strictly an investment. Tengler testified that Cruz did not promise a specific rate of return on the account. Additionally, Tengler knew that he was purchasing insurance and an investment. Furthermore, Tengler did not testify that Cruz characterized the product as a mutual fund or other type of investment. The evidence does show, however, that Cruz represented that virtually all of his initial premium would be placed in the investment portion of the policy. We find that Cruz' statement led the customer to believe that "almost all" of his premium would be invested in the various investment divisions net of fees.[25]

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[23] The LAS listed the customer's objectives as family income, education fund, and mortgage protection.

[24] Tengler testified that he had never seen or reviewed a prospectus, that Cruz told him that it was "difficult even for experts to understand," and that he (Tengler) did not later review the prospectus.

[25] While it is true that only a $348 fee and annual premium tax was deducted from the initial premium, the cost of insurance later was deducted from the amount that was placed into the Policy Account. Thus, nearly 40 percent of Tengler’s initial premiums paid for fees and the cost of insurance.

Next, we find that the recommendation of the product was unsuitable in light of the customer's investment objectives and that Cruz violated Sections 1 and 2. The evidence shows that the customer did not want additional insurance, and thus we find that it was unsuitable for Cruz to sell the customer a product he did not want. Additionally, the Incentive was inconsistent with the customer's goals. The customer wished to save money and receive a return on his investment so that in the near term he could pay for his education, eliminate debt, and buy a home. As noted with Bindek, the Incentive was not fully liquid until policy year 10 and required a long-term commitment because of the contingent deferred sales load. Tengler desired a liquid investment, not an illiquid investment with an insurance component.

Paul Quinn. On June 20, 1990, Paul Quinn ("Quinn") purchased an Incentive policy with a $484,261 face amount, and a $3,000 initial and annual premium. Quinn was an unmarried 25-year-old high school graduate, living with his parents. He was self-employed as a bread distributor with an annual income of $32,000 a year. Quinn's assets included: a cottage (which he sold in 1995 for $22,000); $3,000 in stock; business equipment and his business, which he valued at $30,000 and which was encumbered by $15,000 in outstanding debt; two mutual funds, valued at $2,000; and $4,000 in land. Quinn estimated that his liabilities were $40,000 and his net worth was $85,000. Quinn had a discount brokerage account, in addition to the aforementioned stocks and mutual funds, and also had a $14,000 whole life insurance policy.

Quinn learned of Cruz through a radio advertisement on WMUZ. During a meeting, Quinn explained to Cruz that his goal was expanding his business, to which Cruz responded that Quinn needed to gain a solid financial footing before he could help him with the business. Quinn further stated that he "strictly wanted a [sic] investment that would grow rapidly and have a good rate of return" and was not interested in purchasing life insurance.[26] Cruz recommended an "investment program," which Quinn understood to include investments and life insurance. (Cruz told Quinn that he might need life insurance when he got married.) Quinn believed that the Incentive was "an investment program with the added benefit of a high amount of life insurance." Cruz stated that the investment program would allow him to generate tax-free income and to diversify his investment between mutual funds, individual stocks, and a money market account. Cruz further characterized the product as a good shelter against "shifting economies" in that when "one market is down, another market is not," thereby creating diversification. Finally, Cruz represented that Quinn was required to pay premiums for the first three years, that the premiums would decline in the first three policy years ($3,000 for the first year, $1,800 for the second year, and $800 for the third year), and that thereafter the investment would pay for itself.

Quinn admitted that he reviewed the Disclosure Statement and prospectus with Cruz and that he received a copy of the policy, but he asserted that he reviewed these documents quickly. Quinn testified that he purchased the policy because the combination of investment options intrigued him and because he trusted Cruz based on their common Christian values. Following a letter of complaint to the Equitable, the Firm canceled Quinn's policy and refunded his premium.

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[26] The LAS listed Quinn's objectives as family income, education funds, mortgage protection, and retirement.

We reverse the DBCC's finding that Cruz characterized the policy as an investment. We affirm the finding that Cruz misrepresented the product by leading Quinn to believe that the policy was self-funding, in violation of Section 1. As noted above, the record clearly indicates that Cruz represented that after three years of premium payments, the policy would become self-funding. Although Cruz emphasized the investment features and investment divisions, Quinn stated that Cruz did mention that the policy contained a high amount of insurance. Thus, we cannot find that Cruz represented the product as having an incidental insurance feature.

We find that the policy was unsuitable for Quinn in light of his investment objectives. Quinn's goal in meeting with Cruz was to obtain advice and assistance with his bread business. Quinn was interested only in making an investment that would generate a good rate of return. As Quinn noted, he had no children, spouse, or home, and had no interest in buying life insurance or devoting a portion of his funds to insurance. Although he knew he was purchasing a program that included insurance, he did so because Cruz led him to believe that the insurance was a side benefit and that his money primarily would be invested in mutual funds and equities. Thus, we find that the recommendation of the Incentive was inconsistent with Quinn's investment objectives, and that it was therefore an unsuitable recommendation in violation of Sections 1 and 2.

Gordon and Anne Sheill. On December 7, 1989, Gordon Sheill ("Sheill") signed an application to purchase an Incentive policy, which had a face amount of $161,290, an initial premium of $1,750, and a planned semi-annual premium of $1,750. Anne Sheill, Gordon’s wife, signed an application on the same date for a policy with a face amount of $113,636, and an initial and a planned semi-annual premium of $750. At the time of purchase, Gordon was 53 and Anne was 48. Gordon held a master's degree in education and was a social studies and science teacher, while Anne was a special education teacher. Gordon's income was approximately $40,000, and Anne's $37,000. The couple previously had invested in mutual funds. Gordon had approximately $85,000 in a 403(b) annuity and Anne had $10,000 in a similar account. The Sheills owned their home, which was valued at $90,000 and had no mortgage, and had few liabilities. Gordon had approximately $80,000 in whole life insurance and $205,000 in term life insurance, while Anne had $10,000 in whole life and $45,000 in term life.

Gordon learned of Cruz through advertisements on WMUZ and through a presentation on investment issues that Cruz gave at a men's church group. Gordon subsequently made an appointment with Cruz because he was not "knowledgeable" about investments and wanted some investment advice. At their first meeting, Gordon explained that the couple's objective was to address their income needs at retirement and to plan against the threat of inflation on their income. Gordon explained that although it was not the couple's intention to purchase additional insurance, they were not opposed to doing so because they soon would be losing their term life insurance, which totaled $250,000. Cruz then recommended the Incentive, which he explained was an investment program wrapped around an insurance policy. Cruz explained that the product was one of the best of the programs he had researched and that the return on the investment portion of the product would more than cover the cost of insurance. Gordon understood, however, that he would be required to make annual premium payments, at least until retirement.

Subsequent to their purchase, Gordon submitted to the Equitable two letters in which he complained that the disclosure in the prospectus of the cost of insurance and fees was inadequate. After reviewing the annual report and determining that half of his premium went into the separate account, Gordon decided that the cost of the policy was excessive for the insurance. The couple ultimately surrendered the policies and received $1,304.78.[27]

We dismiss the DBCC's finding that Cruz characterized the policies as primarily an investment similar to a mutual fund. We reverse the DBCC's finding that Cruz represented the product as self-funding. The evidence shows that Cruz described the program as an investment with an insurance wrap, but does not show that Cruz represented that the customers were purchasing solely an investment or mutual fund. Rather, the customers knew they were purchasing both an insurance and an investment vehicle and wanted both insurance and an investment. Although Gordon testified that Cruz represented that the investment would pay for the cost of insurance, he also admitted that he knew he had to pay the premium until retirement. As we stated above,[28] we find a misrepresentation violation where Cruz made representations that led the customers to believe that the product was an investment with an incidental, or no, insurance component, that the product was self-funding, or that most of the premium would be invested in the Investment Account component of the product. Since Gordon knew that he would be required to make payments until retirement, we cannot conclude that Cruz represented that the product would be self-funding.

We are unable to conclude on the basis of the evidence before us that the policies were unsuitable. Although the customers did not describe their investment objectives very clearly in the record, it appears to us that the customers wanted insurance and an investment vehicle for retirement, which the Incentive provided. The customer's testimony was not that Cruz sold the couple a product that they did not want, but was that the quality of the disclosure in the prospectus was poor. Furthermore, we find that the product was consistent with the customers' investment objectives and financial situation and needs. Accordingly, we dismiss the allegation of unsuitability.

Lois LeVasseur. On August 1, 1990, Lois LeVasseur ("LeVasseur") signed an application for an Incentive policy with a face amount of $246,305, an initial premium of $6,560, and a planned annual premium of $4,000. LeVasseur was 50 and a licenced practicing nurse. At the time she purchased her policy, LeVasseur had recently divorced her husband[29] and did not have a retirement plan or IRA. Her income was between $22,000 and $25,000 per year, and she

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[27] Thus, the customers failed to recoup $3,695.22 of the $5,000 in premiums they had paid.

[28] See discussion above at page 13.

[29] At the hearing, LeVasseur stated that she had changed her name to "Isola" because of a recent divorce. For purposes of this decision, we will refer to her as "LeVasseur."

had one son living with her whom she supported. LeVasseur owned a home, which was valued at $84,000 and had a $55,000 mortgage, and also owned property worth $20,000. In addition, LeVasseur had received $20,000 in a recent divorce settlement. LeVasseur had approximately $3,000 in life insurance through her employer. Other than purchasing Chrysler stock through an employee investment plan, LeVasseur had no investment experience and had never met anyone in the financial services industry.

LeVasseur learned of Cruz through his advertisements on WMUZ. LeVasseur made an appointment to see Cruz because she needed assistance in planning for her retirement. During their meeting -- which LeVasseur's 20-year-old son attended -- she informed Cruz that she had not anticipated her recent divorce, had no retirement savings or pension plan, and needed Cruz' advice on how to invest her $20,000 divorce settlement for retirement. LeVasseur claimed that she was interested in investing in an annuity and had no interest in purchasing life insurance.[30] Cruz told her that he would take care of her needs and that he understood her fears. Cruz asked LeVasseur how much money she was willing to invest each year, to which she responded that she could invest $6,500 initially and thereafter $1,000 each year -- the approximate amount of her yearly income tax refund. LeVasseur testified that she anticipated investing more money in successive years. Cruz assured LeVasseur that he would put her into a "good plan," which he described as a life insurance policy with a savings or investment plan. On August 5, 1991, LeVasseur wrote a complaint letter to the Equitable in which she requested that the Firm cancel her policy because she could not afford the premiums. In September 1991, LeVasseur surrendered her policy and received $4,939.39 -- the net cash surrender value of her policy.[31]

We dismiss as unsupported by the record the DBCC's finding that Cruz represented the Incentive as an investment similar to a mutual fund. LeVasseur testified that she understood that the Incentive was an insurance policy with a savings account. She did not testify that Cruz represented the product as a mutual fund or that he otherwise led her to believe that the Incentive was an investment with little or no insurance component.

We find that the policy was unsuitable for LeVasseur in light of her investment objectives and that Cruz violated Sections 1 and 2. LeVasseur wanted to plan for her retirement by investing her divorce settlement in an annuity or retirement account. Although the Incentive may be used for retirement planning, LeVasseur had no interest in buying life insurance or devoting a portion of her funds to purchase insurance. LeVasseur wanted a product which satisfied her retirement needs, not an insurance product that also imposed fees (thereby eroding her investment). Cruz should have recommended an investment vehicle in which the customer could have invested her funds without subjecting such funds to sizeable fees and costs imposed by the Incentive and which was strictly for investment purposes (not insurance). Thus, we find that the Incentive was inconsistent with LeVasseur's investment objectives and that Cruz' recommendation therefore was unsuitable.

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[30] LeVasseur's LAS indicated that in addition to retirement, her objectives were family income and mortgage protection.

[31] Thus, LeVasseur failed to recoup $1,620.61 of the $6,560 in premiums she paid.

Rene Holt. On September 1, 1990, Renee Holt ("Holt") completed an application to purchase an Incentive policy which had a $294,810 face amount, a $1,000 initial premium, and a $1,000 semi-annual premium. At that time, Holt was 32, was unmarried, had no dependents, and lived with her parents in their home. She worked as an office manager for an orthodontist and earned $23,000 per year. Holt had a 401(k) plan through her previous employer and a $50,000 variable life insurance policy through Prudential, but she had no other investment experience.

As a result of a referral from customer LeVasseur, Cruz called Holt to make an appointment to see him.[32] Holt, along with her parents, met with Cruz and informed him that she had money in a 401(k) which she needed to roll over into another account. Holt told Cruz that she wanted to invest for her retirement and wanted an investment vehicle into which she could place extra money to earn interest or a return. She did not want an investment that would require her to make annual payments or deposits because she could not afford to make such payments on an annual basis. Holt informed Cruz that she had a variable life policy and that she did not want or need additional insurance. During the meeting, Cruz discussed the Incentive and explained that the product allowed the customer to diversify between conservative or risky investment funds; Holt claimed that Cruz did not inform her that the product involved insurance. Holt testified that she understood that her Prudential variable life policy combined life insurance and an investment, and that it could be used for retirement. She also claimed that Cruz' presentation led her to believe that she was purchasing a retirement vehicle, which was "totally an investment, no insurance."[33] Furthermore, Holt claimed that she believed that the face amount on her policy represented "the total investment. . . . [at] retirement. If I put so much money in, it could grow to be that [face] amount." Finally, Holt admitted that she received and reviewed the prospectus and the "Disclosure Statement" with Cruz, but she claimed that he told her not to worry because it was difficult to read.

Holt received a premium notice in March 1991, at which time she realized for the first time that she had purchased life insurance. Holt made a second $1,000 premium payment to keep her policy from lapsing. Holt later canceled the policy on the basis that she did not need $300,000 in additional insurance because she had no dependants and was single. According to the record, Holt paid $2,000 in premiums and received $1,076.10 for the surrendered policy.

We modify the DBCC's findings that Cruz misrepresented the product as an investment and find that Cruz misrepresented the product as an investment with no insurance component, in violation of Section 1. Holt understood from Cruz' presentation that she was purchasing an investment vehicle, which was comprised of stocks and mutual funds and which had no insurance component. She had previous experience with a variable life insurance product and understood that, unlike her other policy, the Incentive was strictly an investment, without an insurance component. According to Holt's testimony (which the DBCC found to be credible), Holt did not suspect the Incentive was an insurance policy when she was asked to name

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[32] The evidence showed that Cruz asked each customer for a list of 15 referrals that he used to solicit clients. LeVasseur listed Holt on her referral list.

[33] Holt acknowledged taking a medical exam and designating beneficiaries on her policy applications, which she thought was routine and not unusual.

beneficiaries because she believed that she had to do so in case she died before becoming eligible to collect. Holt also acknowledged taking a medical exam but thought it was necessary because of her age (albeit she was 32 years old when she purchased the policy).

Next, we find that the product was unsuitable because it was inconsistent with the customer's stated investment objectives and that Cruz violated Sections 1 and 2. Holt wanted an investment with which she could save for retirement and expressly did not want additional life insurance. Holt noted that she already had a variable life insurance policy, was not married, and had no children, and therefore had no need (in her opinion) for more insurance. Holt also wanted an investment vehicle that did not require her to make scheduled payments, but rather allowed her to deposit funds at her discretion; the Incentive did not meet these investment objectives. While it is clear that the premiums were flexible, unlike an IRA, money market account, and other retirement savings vehicle, the Incentive would have required Holt to make payments in the future to keep the policy from lapsing because the cost of insurance and other fees eventually would have absorbed her initial premium. Accordingly, we conclude that the policy was inconsistent with Holt's investment objectives.

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Aside from the specific findings of misrepresentations set out above, we dismiss as unsupported by the record the remaining allegations of misrepresentations for the aforementioned customers. Furthermore, we find that under the particular circumstances of this case, it is unfair to affirm the findings of unsuitability and misrepresentations as to six non-testifying customers, as to whom the DBCC made findings based on these customers' hearsay statements.[34] Accordingly, we dismiss the allegations regarding those customers.

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[34] While in other cases we have affirmed findings based solely on hearsay, we note that the testimony of the customers who appeared before the DBCC was particularly helpful in clarifying ambiguities in the record; we did not, however, have the aid of DBCC hearing testimony to clarify facts as they related to the non-testifying customers. In re Gary L. Greenberg, 50 S.E.C. 242 (1990) (holding that before Commission will rely on hearsay it will determine the evidence's probative value by examining whether: the declarant is biased; the statement is contradicted by direct evidence; the statement is sworn or made under oath, and the level of detail in the statement; the declarant was able to testify at hearing; and the hearsay is corroborated by independent evidence.) We note that on cross-examination Cruz elicited from some of the customers testimony that undercut the allegations of misrepresentation and unsuitability. Additionally, we note that: 1) the non-testifying customers did not submit sworn or notarized affidavits; 2) Cruz in his testimony and submissions contradicted the non-testifying customers' statements as to unsuitability and the misrepresentations; and 3) the evidence indicated that these customers were willing to testify at the DBCC hearing. In fact, the DBCC hearing was held in Detroit, close to where most of the customers lived, and the customers indicated to the NASD that they would be willing to testify. Gary L. Greenberg, supra (dismissing suitability violation where customer did not testify because only evidence as to customer's financial status and investment objectives was hearsay evidence, which respondent contradicted).

3. NBCC Sanction for Misrepresentations and Unsuitable Recommendations

In fashioning the sanctions for the misrepresentations, we have considered the relevant Sanction Guideline[35] and that: 1) there was no prior or similar misconduct; 2) Cruz conducted a reasonable investigation into the manner in which he could market the product;[36] 3) Cruz made a number of misrepresentations about the Incentive; 4) we have made findings of misrepresentations as to four customers; 5) the misrepresentations are attributable to Cruz' negligence; 6) Equitable approved of Cruz' presentations and sales literature that formed the basis for many of the misrepresentations; and (7) Cruz' misrepresentations caused the customers to misunderstand the fundamental nature and features of the product in which they were investing. Based on the foregoing, we impose on Cruz a $10,000 fine, which is on the low end of the fine range suggested under the Guideline. This amount is appropriately remedial given the facts and circumstances of this case. We also require Cruz to requalify as an investment company and variable contracts representative within 90 days from the date of this decision, or thereafter to be suspended until he requalifies in such capacity.

In fashioning the sanction for the unsuitability findings, we have considered the relevant Sanction Guideline[37] and that: 1) there was no prior misconduct; 2) Cruz made unsuitable recommendations to six customers; 3) there was no misunderstanding of the customers' financial resources; 4) the customers were relatively unsophisticated and the product was difficult to understand; and 5) the disclosure in the prospectus was difficult to comprehend. We have also considered that Cruz sold the product consistent with the directives and training he received at Equitable (i.e., he used target premiums and sold policies that fell within underwriting guidelines) and that he diligently consulted with Equitable's legal and compliance staff in an effort to ensure that his sales literature and presentations complied with the securities laws. While we recognize that a registered person has certain duties in sales to customers that cannot be avoided by reliance on information provided by an employer, SEC v. Hasho, 784 F. Supp. 1059 (S.D.N.Y. 1992) (a registered person cannot avoid his duty to investigate by blindly relying on an employer's brochure), the record demonstrates that Cruz conducted a reasonable investigation into the manner in which he could market the product. See Lucadamo, supra. Furthermore, unlike the respondent in Hasho and similar cases in which the SEC has rejected as a defense reliance on a firm’s compliance advice, Cruz had no reason to question the accuracy of the materials or advice Equitable provided. We also note that this case is very different from Hasho because Cruz extensively documented his compliance efforts. Based on the foregoing, we impose on Cruz a $10,000 fine, which is on the low end of the fine range suggested under the Guideline. This amount is appropriately remedial in light of the facts and circumstances of this case. We also find that the requirement that Cruz requalify as an investment company and variable contracts representative -- which we imposed as part of the sanctions for the misrepresentations -- also is appropriate for the unsuitability recommendations in light of Cruz' lack of appreciation of, or at least his lack of understanding of, NASD suitability requirements.

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35 See NASD Sanction Guidelines (1993 ed.) ("Guidelines") at 29 (Misrepresentations and Material Omissions of Fact).

36 See discussion above at pages 9 - 10.

37 See Guidelines at 34 (Suitability).

Finally, based on our finding that Cruz misrepresented the product and/or made unsuitable recommendations, we require Cruz to provide proof of restitution in the amount of the premiums each customer lost, as follows: $4,000 to Bindek; $1,620.61 to LeVasseur; and $923.90 to Holt, for a total of $6,544.12.[38] Cruz is ordered to provide to staff of NASD Regulation District No. 8, within 90 days of this decision, proof of restitution in these amounts, or thereafter to be suspended in all capacities until he provides such proof. We set aside the requirement that Cruz disgorge his commissions because the record contained conflicting evidence as to how Cruz' commissions were calculated.

C. Advertising Violations

Cause four alleged that Cruz violated Section 35 by causing to be circulated radio advertisements that contained incomplete, exaggerated, unwarranted, and/or misleading statements about: Cruz' background, training, and experience; the securities products available from Cruz; and the expected investment performance of variable life insurance products. The complaint further alleged that Cruz violated Section 35 because he caused to be circulated radio advertisements that were not submitted to or approved by Equitable or the NASD's Advertising Department prior to use, and that failed to include Equitable's name and required language relating to delivery and review of the prospectus. As set forth below, we affirm the DBCC's findings that the advertisements at issue omitted material facts and were misleading, and we affirm the DBCC's dismissal of the allegation that Cruz failed to file the advertisements with the Firm and the NASD.

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[38] These figures represent the difference between premiums paid and the surrender value of the policy Equitable paid to the customers. We do not require restitution to the remaining customers as to whom we have made findings because Equitable refunded the full premiums to them.

1. Facts The undisputed evidence shows that in 1987, Cruz approached Dawson (to whom he had been referred by Krahnert)[1] about using radio advertisements to solicit new business and customers.[2] During a meeting on the matter, Dawson instructed Cruz that he could place radio advertisements without Equitable's approval and without filing with the NASD if the advertisements met three requirements; that is, the advertisements: 1) could not mention Equitable by name; 2) could not mention a product by name; and 3) had to be "generic." Cruz discussed Dawson's instructions with Krahnert, who told Cruz he had received the same advice from Dawson. Cruz then placed a number of radio advertisements with WMUZ. On occasion, Cruz asked Dawson for guidance in wording the advertisements, and was instructed that he could use terms such as "life insurance" and "investment sensitive growth." Cruz admitted that he did not show the radio scripts to his managers at Equitable, but he claimed that they knew that he was using the advertisements and the general content of the advertisements, yet never asked to review them. The evidence corroborated Cruz' statements in this regard. In 1990, when Wiltrakis assumed Dawson's position as the Northeast regional compliance officer, he discovered that Cruz was using the scripts. Eventually, Wiltrakis instructed Cruz to submit them for approval by the NASD.

The undisputed evidence shows that from February 1989 through July 1991, Cruz caused to be aired advertisements, which he either drafted or had staff at WMUZ draft for his review and approval. Cruz did not dispute that he caused the advertisements to air on WMUZ, that he used the advertisements to solicit public customers to purchase the Incentive, and that the advertisements induced customers to invest with Cruz. It is also clear that the advertisements were required, but failed, to meet the provisions of Section 35 governing public communications and advertisements.[3] After a careful review of the record, which included the testimony of Jane Flood ("Flood") -- an investigator with the NASD's Advertising Department -- we make the following findings.

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[1] During the relevant period, Equitable's compliance procedures required associated persons to submit advertisements to the agency manager (here, Krahnert), who then forwarded them to the regional compliance officer (here, Dawson). The regional compliance officer then determined whether the Firm needed to file the advertisements with the NASD. Thus, Dawson was responsible for: 1) determining whether the Firm had to file the advertisements with the NASD; and 2) filing the advertisements with the NASD. As noted below, Dawson's policy was that none of the advertisements at issue required NASD filing or Firm approval.

[2] Cruz told Dawson that he would devote 70 percent of the advertisements to "business," and the remaining 30 percent to matters relating to stewardship and the Christian community. These latter advertisements are not at issue in this matter.

[3] Section 35 establishes general standards for communications with the public, and additional specific requirements for advertisements (i.e., material published or designed for use in newspapers, periodicals, and radio) and sales literature (i.e., a written communication distributed to the public, which does not meet the definition of "advertisement"). The materials at issue in this matter constitute advertisements. Contrary to suggestions by Cruz, advertisements that do not mention a specific product are subject to the requirements of Section 35. See In re Sheen Financial Resources, et al., Exchange Act Rel. No. 35477 (Mar. 13, 1995).

2. NBCC Findings for Advertising Violations

Product, Broker/Dealer, and Registered Representative Disclosure. The evidence shows that the advertisements failed to disclose the selling broker/dealer's name (i.e., Equitable), the type of product being offered (i.e., flexible variable life insurance), and the name of the product (i.e., the Incentive). The advertisements mentioned Cruz by name and contained his phone number at Equitable, but did not state that Cruz was registered with a broker/dealer (in general) or with Equitable. Furthermore, many of the advertisements described Cruz as a "financial steward," which gave the listener no clear indication of how Cruz was registered or, in the context of some advertisements, gave the impression that he was a financial planner.[4] We agree with the DBCC and Flood that the failure to include product and broker/dealer identification in the advertisements at issue constituted an omission of a material fact, in violation of Section 35(d)(1)(A).[5] We note that the listener could not determine from the radio advertisements what product Cruz was offering or through which broker/dealer he was offering it, and thus we find that the advertisements failed to provide a sound basis about the services and security being offered. We also find that Cruz' failure to disclose that he was a registered representative of Equitable was an omission of a material fact that caused the advertisements to be incomplete and misleading, in violation of Section 35(d)(1)(A).[6] We further find that the failure to include Equitable's name in the advertisements violated 35(d)(2)(A),[7] which requires that advertisements contain the name of the member disseminating such advertisements.

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[4] For example, Cruz stated:

From the very first meeting with Dr. Cruz, you go over budgeting . . . debt reduction . . . investment options . . . retirement planning . . . educational planning . . . your financial portfolio. You have direct access [sic] to one of the world's top producers in the financial services industry -- that man is Dr. Mac Cruz, your personal financial steward. Exhibit 29, page 15.
See also Exhibit 29, pages 3, 9, 15,31, 36, 37; Exhibit 30, pages 11, 14, 21, 27; and Exhibit 31, pages 22 and 26.

[5] Section 35(d)(1)(A) provides that all communications with the public must provide a sound basis for evaluating the facts about any particular security or type of security, industry discussed, or services offered, and prohibits omissions of material facts or qualifications if the omission would cause the communication to be misleading.

[6] Although Flood testified that only some of the advertisements should have disclosed Cruz' registered representative status, for the reasons set forth above, we find that the following advertisements should have contained such disclosure: Exhibit 29, pages 3, 9, 15, 28, 29, 30, 31, 32, 33, 34, 36, and 37; Exhibit 30, pages 3, 11, 14, 21, 27; and Exhibit 31, page 22 and 26.

[7] We find that the advertisements contained in the following exhibits violated Sections 35(d)(1)(A) and 35(d)(2)(A): Exhibit 29, pages 3, 9, 15, 30, 31,32, 33, 34, 36, and 37; Exhibit 30, pages 3, 11, 14, and 21; and Exhibit 31, pages 22 and 26. Although Flood did not specifically so testify, we also find that the Exhibit 29, pages 23, 28, and 29, and Exhibit 31, page 27 failed to include broker/dealer and product disclosure, in violation of Sections 35(d)(1)(A) and 35(d)(2)(A).

<u>Omissions Regarding Cruz' Rankings and Reputation.</u> In a number of advertisements, Cruz asserted that he was an expert in financial services and that he was ranked as one of the world's top producers, but did not provide any specific supporting data or information about these statements. For example, one advertisement stated, "You have direct access to one of the world's top producers in the financial services industry -- that man is Dr. Mac Cruz," while another explained that Cruz was "rated in the top one percent worldwide [sic] in the financial services industry." None of these advertisements included the name or type of ranking and the criteria for the ranking, or information about the individuals against whom Cruz was ranked or to which industry the ranking applied. Other advertisements instructed customers to invest with Cruz because he could provide them with "expert" advice. These advertisements failed to provide listeners with relevant information or a sufficient basis for evaluating Cruz' claimed expertise. Accordingly, we find that the aforementioned advertisements violated Section 35 (d)(1)(A) because they omitted supporting data and failed to provide a basis for evaluating Cruz' statements about his rankings, reputation, and expertise, which prospective customers would deem material in selecting a financial services professional.[8]

<u>Promissory and Exaggerated Statements and Omission of Risk Disclosure.</u> A number of advertisements contained promissory or exaggerated statements about the investment performance and results customers could expect, and failed to disclose that inherent in investing was the risk of fluctuating prices. For example, Cruz claimed that if customers invested with him, they could expect to: "Get a hold of . . . finances and enjoy financial security"; plan a "debt-free" vacation; and purchase furniture and boats. Cruz represented that he could show customers how to double their income in one year, and how to invest $2,000 a year and "make it grow substantially." Cruz also claimed that life insurance was a short-term to medium-term investment that "multiplies your money substantially," and that he could advise customers on how to make their investments and savings "grow" and "multiply" while minimizing bills and expenses. We find, consistent with the views of Flood and the DBCC, that the advertisements at issue violated Sections 35(d)(1)(A) and 35(d)(1)(B)[9] because they impermissibly promised wealth and financial security, contained exaggerated and unwarranted claims about expected investment performance, and failed to warn customers of the risk of fluctuating prices.[10]

[8] In addition to the previously mentioned statement, we find that the statements contained in Exhibit 29, pages 15, 28, 29, 32, 34 and 37 violated Section 35(d)(1)(A). Additionally, even though Flood did not so specifically testify, we find that Cruz' promises to provide "expert" guidance and advice in investing, which are contained in Exhibit 30, pages 3, 11, and 14, also violated Section 35(d)(1)(A).

[9] Section 35(d)(1)(B) prohibits the use of exaggerated, unwarranted, or misleading statements or claims in public communications.

[10] We find that the following exhibits contained similar promissory statements and omissions of material fact: Exhibit 29, pages 9, 23, 28, 29, 30, 32, and 33; and Exhibit 30, pages 3, 11, and 14.

Other Omissions, Misrepresentations, and Violations. The evidence shows that Cruz employed inappropriate sales techniques in soliciting sales of the Incentive. In two advertisements, Cruz instructed listeners that Congress was considering changes to the federal tax laws "that will take away tax advantages on investments." These advertisements then urged customers to invest with Cruz before the end of the year so that customers would be "grandfathered" and not be affected by these changes. See Exhibit 29, pages 36 & 37. We find that these advertisements failed fully to describe the scope of the proposed legislation (e.g. , to what types of investments the changes applied and how the proposed legislation would change the then-current tax laws), were misleading, and utilized inappropriate sales techniques (i.e., "scare tactics"). Thus, we find that these advertisements failed to comply with principles of fair dealing and failed to give the customers a basis on which to evaluate Cruz' statement, in violation of Section 35(d)(1)(A).[11]

Cruz also omitted or misrepresented material facts about features of the product he was offering. Specifically, in two advertisements, Cruz represented that customers could invest in "life insurance" and "have access to your money to use for" education, vacations, major purchases, or retirement. These advertisements, however, failed to disclose that Cruz was describing variable life insurance (as opposed to whole or term life insurance) and that access to the money was through a policy loan or withdrawal, for which the customer would be charged interest or a fee. In another advertisement, Cruz implied that because he was compensated through commissions and other service fees, the out-of-pocket expense for purchasing the Incentive was minimal. While it is true that Cruz was paid a commission, the advertisement does not disclose that customers were required to pay initially some fees and the cost of insurance or that customers could incur substantial surrender charges. Accordingly, we find that these statements violated Section 35(d)(1)(A).[12]

Lastly, Cruz made exaggerated claims and omitted and misstated material information about his credentials and experience. In one advertisement, Cruz stated that "corporations are spending thousands of dollars for Dr. Cruz to teach their management teams" certain budgeting and management skills. Cruz admitted at the DBCC hearing that while in the past he may have provided these services, he was not providing such services to corporations at the time the advertisement was broadcast. We find that this advertisement, as worded, misled listeners to believe that Cruz currently was providing such services. In another advertisement, Cruz claimed to have had seven years of experience with the Bell System when in fact, he worked for New Jersey Bell for three years.[13] Lastly, Cruz implied in another advertisement that his doctorate in organizational planning (which was a doctorate in education) enhanced his abilities to make investment recommendations, which is an exaggerated claim because his degree was not related to financial services or business. Based on the foregoing and consistent with Flood's testimony, we find that these statements violated Sections 35(d)(1)(A) and 35(d)(1)(B).[14]

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11 We find that Exhibit 29, pages 36 and 37, violated Section 35(d)(1)(A).

12 We find that Exhibit 29, pages 30, and 31, and Exhibit 31, page 26, violated Section 35(d)(1)(A).

13 Cruz argues that the findings regarding his experience at Bell Labs should be dismissed because management at WMUZ drafted the advertisement based on sales literature

Finally, we note that the complaint alleged that the advertisements failed to include language relating to the delivery and review of the prospectus, and that the DBCC made no finding as to this allegation. No one -- including Flood, the regional attorney, and the respondent -- addressed this issue or explained the basis for the allegation before either us or the DBCC. Accordingly, we dismiss this allegation as unsupported by the record.

3. NBCC Sanction for Advertising Violations

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that Equitable had approved and that contained a typographical error. Cruz admitted that he approved all advertisements prior to their being aired, and therefore we find that he is responsible for the error and misstatement.

[14] We find that Exhibit 30, pages 21 and 27, and Exhibit 31, page 22, violated Sections 35(d)(1)(A) and 35(d)(1)(B).

Furthermore, we affirm the DBCC's dismissal of the allegation that Cruz failed to file the advertisements with Equitable and the NASD, in violation of Section 35(c)(1). The evidence shows that: Dawson advised Cruz that he could use radio advertisements to solicit business without NASD filing if the advertisement met the three-part requirement described above; and it was the Dawson's and the Firm's policy that the advertisements at issue were not required to be filed with the NASD. Additionally, Krahnert, Albert, and Dawson knew that Cruz was using radio advertisements to solicit business, and knew the contents of the advertisements at issue, but did not see that the advertisements were filed because it was not the Firm's policy to do so. Additionally, it was Dawson's obligation (not Cruz') under the Firm's procedure to ensure that the advertisements were filed on behalf of Equitable. Even when instructed by the NASD in 1990 to file the advertisements, Equitable's compliance staff maintained that the advertisements at issue did not have to be filed. Based on these unique facts, we agree with the DBCC that it would not be equitable to hold Cruz responsible for the failure to file.

To be clear, however, the Firm's knowledge of the scripts does not excuse the finding that Cruz circulated misleading or otherwise deficient advertisements because Cruz was responsible for drafting and approving the content of all advertisements. Additionally, Cruz cannot shift the regulatory responsibility to his managers or the Firm for assuring that the contents of the advertisements conformed with Section 35. In re Charles E. Kautz, Exchange Act Rel. No. 37072 (Apr. 5, 1996). As noted infra, we also reject respondent's advice of counsel defense.

In assessing sanctions, we have considered the Guideline for misleading advertisements[15] and the following factors: there was no prior misconduct; there was no failure to cease using advertisements after being advised by the NASD to do so; there were approximately 20 advertisements that we found to be violative; and Cruz cooperated with the NASD and promptly corrected the advertisements. We also have considered that Cruz implied to customers that they could attain financial security and wealth by investing with him, and also made outrageous promises that customers could double their money. Some of Cruz' advertisements also gave the erroneous impression that he was a financial planner, when he really was an insurance agent. Moreover, we note that the advertisements prompted customers to invest with Cruz. We also note that Cruz admittedly drafted advertisements that mentioned certain types of investment vehicles, and thus went beyond Dawson's guidelines. Notwithstanding the false and misleading nature of Cruz' advertisements, we have considered Equitable's advice to Cruz, and Cruz' reasonable reliance thereon, that he did not have to submit the advertisements to Equitable for approval or file them with the NASD, provided they met certain requirements. Accordingly, we impose a $5,000 fine, which is below the minimum suggested in the Guideline for intentionally or recklessly misleading advertisements. We also suspend Cruz from using sales literature and advertisements for one year, and thereafter require him for a period of one year to file all advertisements and sales literature with the NASD prior to use and receive from the NASD Advertising Department staff a "no objection" letter prior to use.

D. Failure to Disclose Outside Business Activity

Cause five alleged that from September 1990 through July 1991, Cruz was employed by and/or accepted compensation from NuSkin and failed to give prompt written notice of such activities, in violation of Section 43. For the reasons set out below, we affirm the DBCC's finding of a violation of Section 43.

1. Facts

In the Fall of 1990, Cruz and his wife, Jean Cruz, became involved with NuSkin -- a cosmetic and skin care company -- because the couple had determined that Jean needed her own personal project.[16] In late September of 1990, Cruz submitted to NuSkin an application to become a distributor. According to Cruz, in late October 1990, NuSkin approved of the application, which was in Cruz' name only (not his and his wife's name). On October 1, 1990, however, Cruz submitted to Equitable an "Annual Compliance Notification Form" ("Notification Form"), on which Cruz indicated that he had not engaged in any outside business activities.

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15 See Guidelines at 5 (Advertisements and Sales Literature -- Misleading or Failure to Comply with Specific Standards).

16 NuSkin sold skin care products, hair care products, and nutritional supplements on a wholesale basis to "distributors," who were independent contractors; distributors then sold NuSkin products on a retail basis. Distributors were paid commissions or "bonuses" for the sale of Nu Skin products and for sponsoring other distributors who in turn sold NuSkin products.

Cruz claimed that he immediately informed Albert of his involvement with NuSkin, who in turn informed Krahnert, and that both approved of his activity.[17] Krahnert and Albert denied receiving oral notification of Cruz' activities. Rather, Krahnert and Albert maintained that they first learned of Cruz' outside business activities in late April or early May 1991 when an employee at the Krahnert Agency (Cruz's sister-in-law) informed them both that Cruz and his wife were involved with NuSkin. Upon learning of Cruz' activities, Krahnert requested that Cruz disclose to Equitable his business activities with NuSkin.[18] On May 2, 1991, Cruz submitted a Notification Form, on which he explained that: he was an "independent distributor" for NuSkin; he devoted three hours per week to NuSkin; he primarily gave motivational speeches to prospective NuSkin clients; he did "very limited . . . personal retailing"; and his wife did most of the selling of the product.[19]

In July 1991, after learning that the State of Michigan was investigating NuSkin, Krahnert claimed that he renewed his inquiry with Cruz about NuSkin and learned the full extent of Cruz' involvement with the company (i.e., that Cruz had signed a distributor's agreement). At the same time, Krahnert also learned from a customer complaint letter that Cruz had offered a customer "an opportunity to invest in NuSkin." Accordingly, Krahnert directed Cruz to terminate his and his wife's relationship with NuSkin. Cruz first requested that Equitable permit Jean to be a distributor for NuSkin, but later agreed that both he and Jean would sever all business dealings with that company.

Finally, Cruz admitted that prior to filing the May 2, 1991, Notification Form with Equitable, he received approximately $2,000 in commissions from NuSkin. Cruz' 1990 federal income tax return shows that he received $2,556 in sales from NuSkin. Cruz also admitted that he and Jean used his offices at Equitable to hold NuSkin sales presentations and meetings.

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17 Cruz asserted that he did not disclose his involvement with NuSkin on the October 1, 1990, Notification Form because his application had not been approved at the time.

18 Krahnert testified that in April or May 1991, Cruz told Krahnert that NuSkin was Jean's business, that Jean was involved with selling NuSkin, and that he only provided training and motivational talks as a way to support his wife in her new business venture. Krahnert claimed that Cruz did not specifically disclose that he had signed the distributor agreement with NuSkin and that he understood that Cruz was not promoting or selling the product.

19 The evidence shows, however, that two of Cruz' customers (one of whom was William DeMaire) filed customer complaints with Equitable regarding the sale of the Incentive, in which the customers also referred to Cruz' efforts to sell NuSkin.

2. NBCC Findings for Outside Business Activity

The issue before us is whether Cruz provided prompt written notice of his outside business activity to Equitable, as required by Section 43. The evidence shows that Cruz became a distributor in or about October 1990 for NuSkin, that he did not provide written notification to Equitable until May 2, 1991, and that he admittedly received $2,000 from NuSkin prior to providing written notice to the Firm. Additionally, on October 1, 1990, Cruz filed a Notification Form in which he affirmatively represented he was not involved in any outside business, even though he had just submitted an application to become a NuSkin distributor and knew that he could soon be engaged in an outside business.

Although Cruz claims that he gave oral notice of the outside activities, both Krahnert and Albert deny receiving such notice. Furthermore, the rule requires prompt written, not oral, notification. Cruz claimed that he reported the activity in May 1991 because that is when he was scheduled to file the Notification Form with Equitable. Section 43 and Equitable's compliance procedures require, however, that an associated person make prompt disclosure of the business activity.[20] Additionally, the relevant Equitable compliance guide reminded associated persons that they had a continuing obligation to provide Equitable with notice of any new business activities. Waiting approximately eight months to disclose the activity did not constitute "prompt" disclosure. Finally, we reject Cruz' argument that there is no violation because Cruz' activity did not involve a security. Section 43 requires disclosure of all business activity, not just those that are securities-related.[21] Accordingly, we find that between September 1990 and May 1991, Cruz failed to give prompt written notice of his outside activities, in violation of Sections 1 and 43.[22]

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[20] Equitable's 1990 and 1991 compliance guides stated that an associated person was required to complete a "Registered Representative Outside Business Activity Form" when employment or compensation from any business activity occurred outside the relationship with Equitable. (As an aside, we note that Cruz completed the Notification Form, not the Registered Representative Outside Business Activity Form). The 1990 and 1991 compliance guides further stated that the associated person had to give prompt written notice and that Section 43 imposes a continuing obligation to provide notice to an agent's manager of any new business activities.

[21] Additionally, Section 43 exempts from the rule's disclosure requirements activity subject to Article III, Section 40 of the Rules of Fair Practice (now Conduct Rule 3040), which specifically requires the reporting and approval of private securities transactions. Thus, Section 43 specifically requires disclosure of all business activities, whereas Section 40 requires disclosure and approval of private securities transactions.

[22] Although the complaint alleged that respondent failed to disclose the outside business activity from September 1990 to July 1991, we limit our finding to September 1990 to May 1991.

3. NBCC Sanction for Outside Business Activity

In assessing sanctions, we have considered the Guideline for outside business activity,[23] and that there was no prior similar misconduct and there was no similarity between Equitable's business and NuSkin's business. We have also considered that Cruz failed to report the activity for eight months, that he only reported the activity after being confronted by Albert and Krahnert, that he admittedly used his office at Equitable for NuSkin activities without the Firm's permission, and that he referred at least two of his Equitable customers to his wife to buy NuSkin products. We observe that the relevant Guideline recommends a fine of $2,500 to $50,000 and no suspension or bar in a typical case. Based on the aforementioned considerations, we assess a fine of $5,000, of which $2,000 represents the approximate amount of compensation Cruz admitted he received prior to disclosing such activity.

IV. Procedural Issues

Respondent argued that the misrepresentations, suitability, and advertising violations should be dismissed because he relied on Equitable's attorney's advice in preparing his sales materials, sales presentations, and radio advertisements. The defense of advice of counsel is available only when scienter or intent is an element of the violation, and even then it is not a complete defense, but only one factor to be considered. Markowski v. SEC, 34 F.3d 99, 104-05 (2d Cir 1994) (citing SEC v. Savoy Industries, 665 F.2d 1310 (D.C. Cir. 1991). We dismiss Cruz' argument because his alleged reliance on advice of counsel is not a defense to any of the violations we have found, as none of the violations require a showing of scienter or intent.[24]

We deny Cruz' motion (which he made before the DBCC) to compel the production of a number of specified and unspecified documents, including: an Equitable document relating to the firm's internal policies and procedures and the firm's internal communications about Cruz and his sale's practices; all "exculpatory" information and NASD staff reports and documents that were created in the investigation or were used in the DBCC's deliberative process; and case law or other documents supporting the allegations in the complaint of suitability and misrepresentations. The Commission has made clear that NASD's Code of Procedure does not grant, and cannot be read to grant, respondents the right to wholesale discovery of NASD files. In re Michael Alan Leeds, 51 S.E.C. 500, 507 (1993).[25] Thus, a respondent is not entitled to general pre-trial discovery, nor is a

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[23] See Guidelines at 31 (Outside Business Activities).

[24] To prove this defense, the respondent must show that he: 1) made complete disclosure to counsel; 2) sought counsel's advice as to the legality of his conduct; 3) received the advice that the conduct was legal; and 4) relied in good faith on the advice. Id. at 1314 n.28. Cruz has not shown that he meets each element of the defense. For example, Cruz has not shown that for the advertising violation he disclosed fully the contents of the advertisements and was instructed by counsel that the radio advertisements comported fully with NASD rules.

[25] NASD Procedural Rule 9224(a) (formerly Article II, Section 7(a) of the Rules of Fair Practice) governs evidence in DBCC proceedings and requires that staff "shall make available to

respondent entitled to NASD investigatory reports or internal staff memoranda. See id; see also In re Steven B. Theys, 51 S.E.C. 473, 480-81 (1993).[26] Finally, we find that respondent has not shown how he was prejudiced by the failure to receive the documents. See Steven B. Theys, supra at 481. To the contrary, we note that Cruz submitted as his own exhibits a number of exhibits he had sought from staff that he apparently later obtained from Equitable or other sources.[27] We further find that Cruz failed to show that the documents he sought to compel were material.[28]

We also deny respondent's request for a motion to strike customer questionnaires, 50 customer complaint letters, and the radio scripts. Contrary to respondent's assertion, we find that the questionnaires were not drafted with a bias against Cruz. Rather, the questionnaires were sent to complaining customers, and were drafted to elicit further information about respondent's sales practices. We find that all of the customer complaints were admitted properly because they related to the failure to update the Form U-4 alleged in cause three and were not prejudicial. Additionally, we have limited our findings of a violation of Section 35 to only those radio scripts

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respondents and their counsel any documentary evidence and the names of any witnesses the staff intends to present at the hearing no later than five (5) business days prior to the hearing."

[26] We also reject respondent's assertion that he was prejudiced because the NASD failed to obtain and produce to him all exculpatory evidence. We find that there was no evidence in the record that the staff possessed or suppressed exculpatory evidence.

[27] For example, Cruz requested documents showing that the firm prohibited him from contacting regulatory authorities, approved of his sales literature, and employed "clever" marketing tactics, all of which were introduced by Cruz or staff at the DBCC hearing. Cruz included in his exhibits evidence addressing these issues.

[28] Cruz sought production of documents showing that: Equitable's compliance procedures and supervision were lax. We find that this evidence is not material because Equitable's supervision and compliance failures do not excuse Cruz' violations of NASD rules. In re Michael Brian Kormos, Exchange Act. Rel. No. 35823 (June 8, 1995); In re Charles E. Kautz, Exchange Act Rel. No. 37072 (Apr. 5, 1996). Additionally, Cruz requested that the DBCC use its authority under Procedural Rule 8210 to obtain reports from Equitable's customer complaint committee showing that Equitable never determined that Cruz had violated Equitable's rules. We find that these reports are not relevant to whether Cruz violated NASD rules and thus are not material. See In re Timoleon Nicholaou, 51 S.E.C. 34 (1994) at n. 8 (stating that the NYSE did not have to prove a violation of a Merrill Lynch rule in order to find that Nicholaou violated Exchange rules). Cruz also has not met the standard for requiring the DBCC to invoke its authority under Procedural Rule 8210 because these reports are not material and Cruz admitted at the NBCC hearing that he never asked Equitable for these reports. See In re David Arm, 50 S.E.C. 338 (1990) (requiring respondent to show that the evidence he sought was relevant and material; that he had made a timely and good faith effort to obtain the evidence from the firm; and that the evidence was available from an individual or entity that was subject to the NASD's jurisdiction).

that Cruz used to sell the Incentive, and we have made no findings as to scripts that were unrelated to the sale of a security, or to use Cruz' terms, were purely "devotional."

We reject respondent's claim that the DBCC and NBCC prejudged this matter because these committees approved an offer of settlement for Equitable, which involved allegations of a failure to supervise Cruz to prevent the misconduct at issue in this proceeding. Procedural Rule 9226 specifically provides that if there is more than one respondent in a disciplinary proceeding, each respondent may submit an offer of settlement and the DBCC and NBCC may accept or reject any one or all of the respondents' offers. Additionally, the Commission has held that a hearing panel is not disqualified because the hearing panel previously considered and rejected a respondent's offer of settlement in which the respondent consented to the findings of violations that were at issue in the later hearing. In re Keith L. De Santo, Exchange Act Rel. No. 358690 (June 19, 1995), aff'd 1996 WL 128256 (2d Cir. 1996). Furthermore, the SEC and the Second Circuit have rejected the argument that the Commission, in accepting from one respondent an offer of settlement in which facts and findings are stipulated, became biased toward or prejudged a non-settling co-respondent. In re C. James Padget, et al., Exchange Act Rel. No. 38423 (Mar. 29, 1997) (citing Sinclair v. SEC, 444 F.2d 399, 401-2 (2d Cir. 1971); In re Stuart-James, et al, 50 S.E.C. 468, 470-72 (1991) (same).

V. Inability to Pay

Finally, Cruz asserted he was unable to pay the fine, restitution, and the disgorgement ordered by the DBCC. In light of Cruz' claim of an inability to pay, prior to the NBCC hearing we requested that Cruz complete a form entitled "Disclosure of Assets and Financial Information" ("Disclosure Form")[29] to evaluate his claim. See In re Michael H. Novick, Exchange Act Rel. No. 37503 (July 31, 1996) (requiring the NASD to consider proof of inability to pay disciplinary fine). See also In re Tony Reed, Exchange Act Rel. No. 37572 (Aug. 14, 1996) (Remand Order) (requiring NASD to consider respondent's claim of inability to pay in assessing order of restitution). The NBCC Subcommittee reviewed the Disclosure Form with Cruz during the NBCC hearing and requested that he submit another form because it was unable to formulate an accurate picture of Cruz' finances based on his first submission.

After a thorough review of the Cruz submissions, we find that Cruz has not proven a bona fide inability to pay the order of restitution and the $30,000 fine that we have imposed. Cruz' Disclosure Form shows that he has assets of $1,033,709, liabilities of $1,564,417, and a net worth of ($530,708). We do not find that this is an accurate portrayal of his financial status, nor do we find that this substantiates his claim of inability to pay. We note that $414,000 of his liabilities consist of the fine that the DBCC imposed in this matter. We further note that Cruz co-owns with business partners 29 rental properties, and that he lists as a liability on his Disclosure Form $190,560 in mortgage down payments which the business partners apparently fronted and loaned to Cruz. Cruz has not provided us with any evidence of this indebtedness. Furthermore, the Disclosure Form indicates that this liability will only come due upon the sale of

[29] The Commission utilizes the Disclosure Form in determining a respondent's inability to pay disgorgement, interest, or penalties assessed in connection with SEC enforcement actions. See SEC Practice Rule 630, 17 C.F.R. § 201.630.

the rental properties, which is not impending. We note that if we deduct the DBCC's fine and the amount owed for down payments, Cruz' liabilities are $988,857 (including the $30,000 fine we have imposed) and $958,857 (excluding our fine), which would yield a net worth of $44,852 and $74,852, respectively.[30]

While it is clear that Cruz' income has decreased significantly since leaving the securities industry, the evidence does not show that he is, as he claims, on the verge of bankruptcy. Rather, the evidence shows that there are steps he can take and resources that he can tap to pay the fine. For example, we note that Cruz can afford to make approximately $7,202 in charitable contributions each year and that he spends $14,330 per year on his car leases. We find that the fine and the restitution that we have imposed are as important as these expenses, and that funds can be diverted from these sources to pay the NASD and the customers. Furthermore, we note that Cruz has recently refinanced his home (for which there currently is no equity against which he can borrow) and extinguished approximately $55,000 in credit card debt. Thus, it appears that Cruz has a line of credit through his credit cards that he may use to pay our $30,000 fine and restitution order. Cruz has the option of liquidating some of his assets, such as some of the real estate he owns, and may utilize the NASD's installment plan to pay the fine. Furthermore, we note that although Cruz is currently unemployed, we have eliminated the bar from employment in the securities industry. While we concede that it may take some restructuring of Cruz's finances for him to pay the fine and restitution, we find that he has not proven a bona fide inability to pay.

VI. Conclusion

In summary, we affirm the DBCC's findings that Cruz made unsuitable recommendations to DeMaire, Bindek, Tengler, Quinn, LeVasseur, and Holt, and reverse the DBCC's findings that Cruz made unsuitable recommendations to the Hartshorns and Sheills. We reverse and dismiss the DBCC's Section 1 misrepresentation findings as to the Hartshorns and Sheills, and one of the Section 1 misrepresentation findings as to Quinn (where the DBCC found that Cruz misrepresented the product as an investment). We modify the DBCC's misrepresentation finding as to DeMaire and find that Cruz misrepresented the product by leading the customer to believe that the insurance component was incidental. We modify the DBCC's finding as to Holt and find that Cruz misrepresented the product as an investment with no insurance component. We affirm the Section 1 misrepresentation findings of violation as to customers Tengler, Quinn (where the DBCC found that Cruz misrepresented to Quinn that the product was self-funding), and Holt. With respect to the Section 18 misrepresentation allegation, we reverse and dismiss the finding that Cruz had violated Section 18. We affirm the dismissal of the failure to file an updated Form U-4 and affirm the outside business activity violation. As to the advertising violations, we affirm the dismissal of the failure to file the advertisements, dismiss the allegation (as to which the DBCC did not make findings) that the advertisements failed to include certain prospectus delivery language, and affirm the remaining allegations of misleading and deficient advertisements.

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[30] Cruz' assets appear understated. We note that Cruz' Disclosure Form lists expenses for improvements and repairs on the rental properties. We further note that the appraised value of such properties (which was used to calculate his assets) was determined prior to the improvements, and thus is probably higher than what is reflected on the Disclosure Form.

As to the sanctions, we affirm the censure and $8,206.75 in DBCC hearing costs. We eliminate the bar and the requirement that Cruz disgorge to customers his commissions, and reduce the fine to $30,000 ($10,000 for the misrepresentation violations, $10,000 for the unsuitable recommendations, $5,000 for the advertising violations, and $5,000 for the outside business activity violation). We clarify that Cruz is required to provide proof of restitution to three customers within 90 days of this decision,[31] or be suspended in all capacities until he provides such proof. We also require Cruz to requalify as an investment company and variable contracts representative within 90 days of this decision, or be suspended in all capacities until he requalifies. Finally, we suspend Cruz from using sales literature and advertisements for one year, and thereafter require him for a period of one year to file all advertisements and sales literature prior to use and to obtain from the NASD Advertising Department staff a "no objection" letter.[32]

On Behalf of the National Business Conduct Committee,

Joan C. Conley, Corporate Secretary

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[31] As part of the sanctions for the misrepresentation and suitability violations, Cruz is ordered to provide proof of restitution in the amount of the premiums each customer lost: Bindek ($4,000); Le/Vasseur ($1,620.22); and Holt ($923.90), for a total of $6,544.12.

[32] Pursuant to NASD Procedural Rule 8320, any member who fails promptly to pay any fine, other monetary sanction, or costs imposed in this decision, after seven days' notice in writing, may summarily be suspended or expelled from membership for non-payment. Similarly, the registration of any person associated with a member who fails promptly to pay any fine, other monetary sanction, or costs imposed in this decision, after seven days' notice in writing, may summarily be revoked for non-payment.

Finally, we have considered all of the arguments of the parties. They are rejected or sustained to the extent that they are inconsistent or in accord with the views expressed herein.