

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2014039418401**

**TO: Department of Enforcement
Financial Industry Regulatory Authority ("FINRA")**

**RE: Kestra Investment Services, LLC (f/k/a NFP Advisor Services, LLC
and NFP Securities, Inc.), Respondent
Member Firm
CRD No. 42046**

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, Respondent Kestra Investment Services, LLC ("Kestra," the "Firm" or "Respondent") submits this Letter of Acceptance, Waiver and Consent ("AWC") for the purpose of proposing a settlement of the alleged rule violations described below. This AWC is submitted on the condition that, if accepted, FINRA will not bring any future actions against Respondent alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

- A. Respondent hereby accepts and consents, without admitting or denying the findings, and solely for the purposes of this proceeding and any other proceeding brought by or on behalf of FINRA, or to which FINRA is a party, prior to a hearing and without an adjudication of any issue of law or fact, to the entry of the following findings by FINRA:

BACKGROUND

Kestra has been a FINRA member firm since 1997. Kestra conducts a general securities business and is headquartered in Austin, Texas. Kestra currently has approximately 1,845 registered representatives and 639 branch offices.

RELEVANT DISCIPLINARY HISTORY

Kestra has no relevant prior disciplinary history.

OVERVIEW

Between October 1, 2013 and June 30, 2014 (the "Relevant Time Period"), Kestra failed to reasonably supervise its registered representatives' recommendation of multi-share class variable annuities ("VAs") to its customers. Kestra also failed to provide training to its registered representatives and principals on the sale and supervision of multi-share class VAs. By engaging in this conduct, Kestra

violated NASD Rule 3010(a) and (b), and FINRA Rules 2010 and 2330(d) and (e).

Moreover, Kestra also failed to establish, maintain, and enforce an adequate supervisory system, including written supervisory procedures, that was reasonably designed to review and monitor consolidated reports sent to customers by registered representatives. By engaging in this conduct, Kestra violated NASD Rule 3010(a) and (b), and FINRA Rule 2010.

FACTS AND VIOLATIVE CONDUCT

Failure to Supervise VA Share Class Recommendations

Kestra failed to reasonably supervise its registered representatives' recommendation of multi-share class variable annuities ("VAs") to its customers. During the Relevant Time Period, Kestra sold 1,873 individual VA contracts of \$25,000 or greater, totaling over \$280 million in principal investments. Of those VA sales, approximately 19%, totaling \$52 million in investments, were L-share contracts. Despite the significant role that VA sales played in Kestra's overall business, the Firm failed to implement a supervisory system and procedures designed to reasonably ensure suitability in its multi-share class VA sales, including L-share contracts.

Kestra sold VA contracts with the option of various different share classes. The B-share contract is the most common share class sold in the industry and typically has a seven-year surrender period. L-share contracts typically provide a shorter surrender period, of three to four years, than B-share contracts, which typically have a surrender period of 7 years. Insurance companies design L-share contracts so that customers pay a higher fee for the benefit of a shorter surrender period. The L-share contract provides the flexibility of a shorter surrender period and the fees associated with L-share contracts, which are assessed as long as the contract is held, are typically between 35 and 50 basis points higher annually than most B-share contracts. L-share contracts are designed for investors with short-term time horizons or who want the optionality of being able to surrender the L-share contract sooner than a B-share contract. Pursuant to the terms established by the insurance company manufacturers, if a purchaser chooses not to surrender an L-share contract during the surrender period, the purchaser continues to pay a higher annual fee for the life of the contract, unless the contract provides for a "persistence credit."¹

Despite the fact that 19% of the VAs sold at Kestra during the Relevant Time Period were L-share contracts, the Firm failed to establish, maintain, and

¹ Some L-Share contracts have a specific provision, commonly called a "persistence credit," which reduces the annual fees so it is comparable to a B-share contract after the product is held for a period of time, generally seven to ten years.

enforce a reasonable supervisory system and written supervisory procedures (“WSPs”) related to the sale of multi-share class VAs. Kestra also failed to provide training to their registered representatives and principals on the sale and supervision of multi-share class VAs. Kestra’s WSPs and training materials failed to provide registered representatives and principals guidance or suitability considerations for sales of different VA share classes. More specifically, the Firm did not provide training or guidance to their registered representatives on the features of various available share classes, the associated fees and surrender charges, and did not provide them with adequate information to compare share classes to make suitability determinations.

Because of the lack of training and guidance, registered representatives did not have the tools to present potential purchasers with a side-by-side comparison of the fees and surrender charges or other information detailing the potential impact of the increased fee if the L-share contract was held by the customer for a long term.

In addition, Kestra failed to establish, maintain, and enforce WSPs or provide sufficient guidance or training to their registered representatives and their principals on the sale of long term income riders with multi-share class VAs, particularly the combination of L-share contracts with long-term income riders.

Based on the foregoing, Kestra violated NASD Rule 3010(a) and (b) and FINRA Rules 2330(d) and (e), and FINRA Rule 2010.

Failure to Supervise Consolidated Reports

A consolidated report is a single document that combines information regarding most or all of a customer’s financial holdings, regardless of where those assets are held. Consolidated reports supplement, but do not replace, customer account statements required pursuant to NASD Rule 2340.

FINRA Regulatory Notice 10-19 reminded member firms that consolidated reports are communications with the public by the firm and must be clear, accurate, and not misleading. Under the Notice, firms that allow individual representatives to deliver consolidated reports to customers were reminded to supervise the activity. For instance, where the consolidated reports reflect assets held away from the firm, the firm was reminded to ensure that registered representatives were taking reasonable steps to accurately reflect information regarding outside accounts and assets. The notice detailed the risks associated with poor safeguards, including use of account information for fraudulent activity, inaccurate reporting causing customers to be misled or confused, reliance by customers on the valuations in dealings with third parties, and misuse of the information by firm personnel.

During the Relevant Time Period, more than 400 of Kestra's representatives utilized consolidated reports, both for their own use and to help their clients have a comprehensive picture of their assets. Although most of these representatives used a vendor such as Aldridge or Black Diamond to generate the consolidated reports, at least 31 generated such reports manually.

Kestra supervised the generation and dissemination of consolidated reports in the same manner that it supervised correspondence generally. If a consolidated report was sent to a client via mail or personal delivery, then the representative was required to submit the report for review through the Advertising Compliance Review ("ACR") system, which requires that sales supervisors review and approve outgoing correspondence. The Firm's review of consolidated reports submitted to this system was generally limited to determining whether such reports were consistent with the pre-approved template, and did not include an independent verification of whether asset values provided on the reports were accurate.

Consolidated reports that were disseminated to customers via email were not required to be submitted through the ACR system. Instead, such reports were reviewed only as part of the firm's email review process. As a result, an emailed consolidated report would be reviewed only if it was selected for a "spot check" or was flagged because it utilized one of the firm's selected lexicon of potentially problematic words.

During the Relevant Time Period, Kestra's WSPs regarding consolidated reports did not require the independent verification of asset values that were provided on the reports. Instead, they required approval only of the templates that were to be utilized for the consolidated reports. They did not specifically require the review of consolidated reports prior to their dissemination to the customers – in fact, they provide no detail about how consolidated reports are monitored or who at the firm is responsible for monitoring them. Moreover, the WSPs did not require the sending of back-up data to allow for verification of the substantive accuracy of the data.

As a result, although a retrospective review of a sample of the consolidated reports did not reveal any instances that were inaccurate or misleading, during the Relevant Time Period Kestra did not have an adequate supervisory system, or WSPs, to reasonably ensure that consolidated reports were individually reviewed and that their reporting of assets was accurate. Kestra's failure to properly supervise the consolidated reports being sent by registered representatives violated NASD Rule 3010(a) and (b) and FINRA Rule 2010.

B. Respondent also consents to the imposition of the following sanctions:

Censure and a \$475,000 fine.

Respondent agrees to pay the monetary sanction upon notice that this AWC has been accepted and that such payment is due and payable. Respondent has submitted an Election of Payment form showing the method by which it proposes to pay the fine imposed.

Respondent specifically and voluntarily waives any right to claim that it is unable to pay, now or at any time hereafter, the monetary sanction imposed in this matter.

The sanctions imposed herein shall be effective on a date set by FINRA staff.

II.

WAIVER OF PROCEDURAL RIGHTS

Respondent specifically and voluntarily waives the following rights granted under FINRA's Code of Procedure:

- A. To have a Complaint issued specifying the allegations against it;
- B. To be notified of the Complaint and have the opportunity to answer the allegations in writing;
- C. To defend against the allegations in a disciplinary hearing before a hearing panel, to have a written record of the hearing made and to have a written decision issued; and
- D. To appeal any such decision to the National Adjudicatory Council ("NAC") and then to the U.S. Securities and Exchange Commission and a U.S. Court of Appeals.

Further, Respondent specifically and voluntarily waives any right to claim bias or prejudgment of the Chief Legal Officer, the NAC, or any member of the NAC, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including acceptance or rejection of this AWC.

Respondent further specifically and voluntarily waives any right to claim that a person violated the ex parte prohibitions of FINRA Rule 9143 or the separation of functions prohibitions of FINRA Rule 9144, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including its acceptance or rejection.

III.

OTHER MATTERS

Respondent understands that:

- A. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by the NAC, a Review Subcommittee of the NAC, or the Office of Disciplinary Affairs ("ODA"), pursuant to FINRA Rule 9216;**
- B. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against me; and**
- C. If accepted:**
 - 1. this AWC will become part of my permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against me;**
 - 2. this AWC will be made available through FINRA's public disclosure program in accordance with FINRA Rule 8313;**
 - 3. FINRA may make a public announcement concerning this agreement and the subject matter thereof in accordance with FINRA Rule 8313; and**
 - 4. Respondent may not take any action or make or permit to be made any public statement, including in regulatory filings or otherwise, denying, directly or indirectly, any finding in this AWC or create the impression that the AWC is without factual basis. Respondent may not take any position in any proceeding brought by or on behalf of FINRA, or to which FINRA is a party, that is inconsistent with any part of this AWC. Nothing in this provision affects Respondent's: (i) testimonial obligations; or (ii) right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.**
- D. Respondent may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. Respondent understands that it may not deny the charges or make any statement that is inconsistent with the AWC in this Statement. This Statement does not constitute factual or legal findings by FINRA, nor does it reflect the views of FINRA or its staff.**

The undersigned, on behalf of the Firm, certifies that a person duly authorized to act on its behalf has read and understands all of the provisions of this AWC and has been given a full opportunity to ask questions about it; that Respondent has agreed to its provisions voluntarily; and that no

offer, threat, inducement, or promise of any kind, other than the terms set forth herein and the prospect of avoiding the issuance of a Complaint, has been made to induce the Firm to submit it.

10/25/2016
Date (mm/dd/yyyy)

Respondent Kestra Investment Services, LLC

By: 

Name: MIKE PEDRON

Title: SVP, CCO

Reviewed by:



Jon Eisenberg
Counsel for Respondent
K&L Gates LLP
1601 K Street, N.W.
Washington, D.C. 20006
Phone: (202) 778-9348
Email: Jon.Eisenberg@klgates.com

Accepted by FINRA:

11/2/2016
Date

Signed on behalf of the
Director of ODA, by delegated authority



Michael P. Manly
Senior Regional Counsel
FINRA Department of Enforcement
12801 North Central Expy., Ste. 1050
Dallas, Texas 75248
Phone: (972) 716-7692
Email: Michael.Manly@FINRA.org