

NASD OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT,	:	
	:	
Complainant,	:	Disciplinary Proceeding
	:	No. C10030087
v.	:	
	:	Hearing Officer - AWH
	:	
GILBERT ALAN CARDILLO	:	Hearing Panel Decision
(CRD #1110960)	:	
450 Riverside Drive	:	
Riverhead, New York 11901	:	
	:	September 22, 2004
Respondent.	:	

Registered principal found liable for making an unsuitable recommendation to a customer, in violation of NASD Conduct Rules 2310 and 2110. Respondent (1) fined \$6,600, (2) suspended in all capacities for 10 business days, (3) ordered to offer to pay customer for any loss upon surrender of the variable annuity certificate, and (4) ordered to pay costs.

Appearances:

Philip A. Rothman, Esq. and Jennifer A. Greca, Esq., for the Department of Enforcement

Ghillaine A. Reid, Esq. and Noel Christopher Bonilla II, Esq., for Gilbert Alan Cardillo

DECISION

Introduction

On October 17, 2003, the Department of Enforcement (“Enforcement”) issued a Complaint in this matter against Gilbert Alan Cardillo (“Respondent” or “Cardillo”), alleging that he made an unsuitable recommendation to his customer, in violation of NASD Conduct Rules 2310 and 2110.

Cardillo filed an Answer to the Complaint, denying the alleged violation, and he requested a hearing. A hearing on the allegations against Cardillo was held in New York, New

York on June 10, 2004, before a hearing panel composed of the Hearing Officer and two current members of the District 10 Committee. Both parties filed post-hearing briefs.

Findings of Fact¹

The Respondent

Cardillo first became registered with NASD as a General Securities Representative (“GSR”) in 1983 and, as a General Securities Principal (“GSP”) in 1985, through his association with former NASD member firms. Stip. 1-2. From July 6, 1993, to March 25, 2002, Cardillo was registered with NASD as a GSR and GSP through his association with FIS Securities, Inc., which later became Quick & Reilly, Inc. (“Quick & Reilly”). Stip. 3. Currently, he is registered with NASD as a GSR and GSP through another member firm. Stip. 6. He has no disciplinary history.

The Customer

In February 2001, AP was a sixty-four-year-old retiree who had not worked since 1978, due to a back injury. Stip. 11; Tr. 15-16. He and his wife had an annual income of approximately \$17,000, which consisted of his Social Security benefits, and his wife’s part-time income of approximately \$400 per month. Tr. 18, 22-23, 31, 164. He was not required to pay income tax on his income. Tr. 178. AP had two years of formal education in Italy before immigrating to the United States in 1954. Tr. 15-17. He cannot read or write English. Tr. 15-16, 116-17, 129, 160.²

¹ References to Enforcement’s exhibits are designated as CX_; Respondent’s exhibits, as RX_; Stipulations, as Stip. _; and the transcript of the hearing, as Tr. _.

² The Hearing Panel credits the testimony of AP, his wife, and his accountant that he cannot read or write English. His inability to do so is not contradicted, as Cardillo would have it, merely by his ability to read and write numbers and his signature, or by his possession of a driver’s license. While he may be able to recognize and understand some written words in English, the Hearing Panel believes his corroborated testimony that he is unable to read the financial documents at issue in this case.

In 2000, because they were no longer able to afford living in New York, AP and his wife sold their primary residence in Patchogue. They moved in with his stepdaughter who also lived in Patchogue, until they could buy a house near his son in North Carolina. Tr. 19. In February 2001, AP's net worth consisted of approximately \$148,000 in proceeds from the sale of his home, which he deposited into his Fleet Bank checking account, and three fixed annuities, which were valued at between \$80,000 and \$90,000. Tr. 17-18. AP also had a \$5,000 life insurance policy. Tr. 23. AP used approximately half of the proceeds from the sale of the house to purchase a house in North Carolina, leaving him with \$80,000 available for savings or investment. Tr. 23. He has never owned any real estate other than his own home. Tr. 33.

In early February 2001, shortly after purchasing the house in North Carolina, AP went to Fleet Bank's Patchogue branch to get advice on investing his remaining \$80,000. Tr. 23. AP spoke with an employee of Fleet Bank, initially expressing a desire to purchase a CD. The employee encouraged him to meet with Cardillo, mentioning that the interest rates on CDs were low at that time. Tr. 25. Another bank employee then scheduled an appointment for AP to meet Cardillo approximately a week later. Tr. 25-26.

On February 12, 2001, AP and his wife met with Cardillo to discuss AP's investment options with regard to the \$80,000 that remained from the sales proceeds of his home. AP explained that he was retired, had recently sold his home, and was interested in investing the \$80,000 in such a way that would give him monthly income. Tr. 29, 273, 287, 291, 340-41. From his conversation with AP, Cardillo learned that AP collected Social Security and had fixed annuities previously purchased from another firm, but from which he did not draw an income. Tr. 31, 277, 290, 299, 322. Cardillo estimated AP's net worth at between \$100,000 and \$500,000, but he did not inquire into the source of AP's income, the extent of his assets, or his

plans for the future. Tr. 346, 351, 369. Cardillo did not determine that AP and his wife were living with a relative to save expenses, or that they planned to move to North Carolina. He erroneously believed that the house AP sold was not his primary residence.³ Tr. 341.

Recommendation of a Variable Annuity

During the meeting on February 12, 2001, Cardillo recommended that AP purchase a Fidelity Advisor Generations variable annuity (“Fidelity Annuity”) in the amount of \$80,000. The Fidelity Annuity is a variable annuity with a seven-year declining contingent deferred sales charge, ranging from seven percent the first year to two percent the seventh year. Tr. 226; CX-9, p. 122. As a variable annuity, it allows an investor’s funds to grow tax-deferred until the funds are withdrawn. Gains that are withdrawn are taxed as ordinary income. The purchaser may withdraw yearly up to ten percent of the amount invested without penalty. *Id.*

The Fidelity Annuity’s annual mortality and expense (“M&E”) charges are 0.95 percent. CX-8, p. 42. Cardillo recommended that AP purchase an enhanced death benefit at an additional cost of 0.05 percent per year, which brought AP’s total M&E charges to 1.00 percent per year. Tr. 226-27, 306, 309; CX-8, p. 75, CX-9, p. 106. Cardillo received approximately \$1,600 in commissions from AP’s investment in the Fidelity Annuity. Tr. 315.

Cardillo recommended that AP invest in five separate sub-accounts, each of which included equity securities, and three of which exclusively contained equities. Tr. 324, 352-53; CX-5, p. 30, CX-8, p. 89-91. Each sub-account also charged internal management fees, which amounted to 0.948 percent per year. Tr. 232; CX-8, p. 45. As a result, the total cost to AP for the Fidelity Annuity was 1.948 percent per year. Tr. 232.

³ He testified: “I believed I asked him about the house. To the best of my recollection, this was not his primary residence.” Tr. 341. The Hearing Panel does not credit this testimony. If he had believed the house was not AP’s primary residence, he would have, or should have, inquired about the value of his primary residence or his present living arrangements.

When he recommended the Fidelity Annuity, Cardillo assumed that, in addition to his Social Security income, AP was earning money “off-the-books,” and that the Fidelity Annuity was suitable for AP because it offered him tax deferred growth. Tr. 304-05, 345. Cardillo did not ask for documents or inquire further about AP’s source of income in order to support his assumption of additional income. Tr. 304, 345-46. When asked why he thought the variable annuity’s tax-deferred benefit made it a suitable investment for AP, Cardillo stated:

[I]t was my impression that he was earning money that was like many tradesmen, I got the impression he was doing side jobs. I can’t tell you why I got the impression . . . But he apparently has a history of putting money in tax-deferred investments.

Tr. 304-05.

Cardillo also assumed that AP’s investment horizon was six to ten years, and conceded that the Fidelity Annuity would not be a suitable investment for a person with a shorter investment horizon. Tr. 299, 348-49, 373-74. However, he did not inquire into AP’s future plans for possible use of the \$80,000 that remained from his sale proceeds. AP had planned to move to North Carolina and help his son establish a pizzeria business there. Tr. 61. Moreover, once AP and his wife moved to North Carolina from his step-daughter’s house in Patchogue, their expenses and need for additional income was uncertain. AP’s wife had been working part-time as a hairdresser in New York, earning about \$400 per month; she intended not to work in North Carolina because of back injuries. Tr. 84, 112, 143.

There is conflict in the evidence concerning the type of investment AP thought he was purchasing. AP testified that he told Cardillo he wanted monthly income, and he did not want to invest in any stocks because he could not read and follow the stock market. Tr. 23, 26, 28-29, 30, 114, 118. He also testified that he told Cardillo he wanted a CD, and did not care that interest rates were low. Tr. 29, 73. However, the testimony of both AP and his wife indicates

that Cardillo explained to them that the investment was likely to fluctuate in value. Both recalled Cardillo using a pie analogy to indicate that values could go up or down. Tr. 103-04, 127-28.

Cardillo testified that AP said that he wanted a rate of return that was higher than what he would receive on a CD or from a fixed annuity. Tr. 274. Accordingly, AP must have had the impression that, although the value would go up or down, the overall rate of return would exceed interest rates on CDs or fixed annuities. However, he told Cardillo that he did not want to take any risk and that he could not afford to lose any money. Tr. 30. The Hearing Panel finds particularly credible the testimony of AP's wife, who was candid and forthright in her testimony.

She summed up the meeting with Cardillo as follows:

My husband doesn't know too much about this stuff, and he was trying to explain to Mr. Cardillo something like he wanted to invest money into something where he get – to get like a check like once a month. That is what he wanted without losing any money. He kept telling Mr. Cardillo that he didn't want to lose money at his age, and Mr. Cardillo explained to him – advised him about an investment, he wouldn't really be losing money, it would be better than a CD.

Tr. 114-15.

AP received his first quarterly statement in the mail for the Fidelity Annuity in April 2001. CX-16. The statement indicated that the value of the annuity had dropped by \$6,500. Tr. 45, 132; CX-16. After a number of unsuccessful attempts to contact Cardillo, AP and his wife finally met with Cardillo, who told AP, for the first time, that he could not withdraw his money from the Fidelity Annuity for seven years without paying a penalty fee. Tr. 45, 49, 138, 178-80.

Shortly thereafter, AP met with his sister's insurance agent and accountant, Leonard Turano. Tr. 50, 158-59. Turano also held a securities license. Tr. 157. Speaking mainly in Italian because he found AP's English limited, Turano explained the investment that AP had

purchased and the account documents that he had signed. Tr. 163-70. Turano concluded that AP could not read the annuity contract, would be incapable of monitoring the sub-accounts, and, because of the source and small amount of his income, would not derive any tax benefit from the investment. Tr. 176-78. Turano then prepared a letter to Quick & Reilly for AP's signature. The letter requested the return of AP's investment. CX-17. Quick & Reilly declined to refund AP's money, finding nothing wrong with the sale of the Fidelity Annuity.

Discussion

NASD Conduct Rule 2310(a) provides that, in recommending a purchase of a security to a customer, a broker "shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and financial situation and needs." Moreover, a representative must "make reasonable efforts to obtain information concerning: (1) the customer's financial status; (2) the customer's tax status; (3) the customer's investment objectives; and (4) such other information used or considered to be reasonable by such . . . registered representative in making recommendations to the customer." NASD Conduct Rule 2310(b).

Additionally, NASD Notice to Members 96-86⁴ provides various factors to consider in conducting a suitability analysis when recommending variable annuities. Among others, the specific factors applicable to the facts of the instant case are (1) the customer's need for liquidity; (2) the customer's immediate need for retirement income; and (3) the customer's investment sophistication and whether he or she is able to monitor the investment experience of the separate account. Notice to Members 96-86, at *5.

⁴ 1996 NASD LEXIS 108 (Dec. 1996).

A broker violates Rule 2310 if there is a showing that he lacked reasonable grounds for believing that his recommendation of a particular security was suitable for a customer or he failed to obtain information concerning the suitability of his recommendation before executing the transaction.⁵ Furthermore, the Rule provides “that a representative may make only such recommendations as would be consistent with a customer’s financial situation and needs.”⁶

Cardillo testified that the Fidelity Annuity was suitable for AP because: “it gave him what he wanted. He already had a couple of different fixed annuities. It was suitable because it offered him tax deferred growth.” Tr. 304. However, the Panel finds that AP did not want to risk principal, and did not want to invest in any stocks. In describing the sub-accounts, Cardillo testified that 20 percent of the investment was put into an “equity income portfolio,” 20 percent, into a “balanced portfolio,” 20 percent, into an “asset allocation portfolio,” 20 percent into a “mid-cap portfolio,” and 20 percent, into a “growth portfolio.” AP did not understand the word “portfolio,” and obviously did not equate “stocks” with any description of the sub-accounts as containing “equities” or “mid-caps.” Cardillo testified that AP “was interested in earning more money, he was interested in earning something.” Tr. 273. That is true. AP wanted to “earn” a higher interest rate on his money, but that does not translate, as Cardillo would have it, to an interest in “growth” equities. Moreover, it is clear that tax deferred growth is not an objective of, or benefit to, someone like AP who pays no income tax. In short, AP’s financial profile and needs were not suitable for a variable annuity.

⁵ See *District Bus. Conduct Comm. v. Moore*, No. C01970001, 1999 NASD Discip. LEXIS 27, at **12-13 (NAC Aug. 9, 1999) (finding respondent liable for failing to consider customers’ overall financial situation, level of investment experience, sophistication, or financial needs).

⁶ *District Bus. Conduct Comm. v. Kunz*, No. C3A960029, 1999 NASD Discip. LEXIS 20, at *62 (NAC July 7, 1999).

Cardillo failed to make reasonable inquiries into AP's financial status, tax status, investment objectives, or need for a monthly income. He failed to consider AP's lack of investment sophistication. AP's Social Security income in 2000 was less than \$14,000. Tr. 22; CX-12. According to AP's 2001 federal tax return, he and his wife had a total adjusted gross income of \$12,556. CX-13, p. 147. Cardillo made an unwarranted assumption that AP was earning money on-the-side, and he failed to determine that the proceeds from the sale of AP's house that were not being invested were intended to buy another house, and, therefore, could not be considered to be liquid. He did not know that AP and his wife were not living in their own home, and was unaware of AP's plans to move to North Carolina or how that move would affect his need for monthly income.

Without an accurate assessment of AP's total assets, income, expenses, and plans for the future, Cardillo came to the conclusion that AP's investment horizon was six to ten years, and that AP did not need access to the money for the foreseeable future. His conclusions did not have a reasonable basis. He had no reason to believe that (1) AP's income was any greater than what he was told, (2) his expenses would remain constant after moving out of his step-daughter's house, (3) his wife would continue to work after they moved to North Carolina, or (4) he planned to back his son's business venture in North Carolina. Without that knowledge, he could not reasonably conclude that an investment with risk of loss of principal would be suitable for AP. Even if a customer seeks to engage in a highly speculative or an otherwise aggressive investment, a broker is under a duty to refrain from making recommendations that are incompatible with the customer's financial profile.⁷

⁷ *DOE v. Jack H. Stein*, No. C07000003 2001 NASD Discip. LEXIS 38, at *10 (NAC Dec. 3, 2001), *aff'd*, 2003 SEC LEXIS 338 (Feb. 10, 2003).

The variable annuity did not provide the income or liquidity that AP required. While it is true that AP could have drawn ten percent of his investment each year without penalty, AP was under the impression that he could not do so for a year. He did not know how to draw that income down, and, as a consequence, to supplement their income, his wife has continued to work despite her back condition. Moreover, to the extent that he might have made such withdrawals, he would have had a smaller amount of principal working for him. After purchasing the annuity AP learned that there was a penalty for cashing in his investment before the expiration of seven years, and, consequently, he has not done so.

AP had limited education, limited English literacy, and limited investment experience. Cardillo had no reason to believe that AP could monitor the investments in the sub-accounts or reallocate them among other investment options that were available to him.

Because Cardillo (1) lacked reasonable grounds for believing that his recommendation of a variable annuity was suitable for AP; and (2) failed to obtain relevant information concerning the suitability of his recommendation before executing the transaction, particularly concerning AP's need for liquidity and retirement income, and his lack of investment sophistication and inability to monitor the sub-accounts, he violated Conduct Rules 2310 and 2110⁸ when he recommended that AP purchase the Fidelity Annuity.

Sanctions

The NASD Sanction Guideline for unsuitable recommendations calls for a fine of \$2,500 to \$75,000 and a suspension for a period of 10 business days to one year. It also notes that the fine amount should be increased by the amount of a respondent's financial benefit, or the respondent should be required to offer rescission to the injured customer. In egregious cases, the

⁸ A violation of another NASD rule or regulation constitutes a violation of Conduct Rule 2110. *See Steven J. Gluckman*, Exchange Act Release No. 41,628, 1999 SEC LEXIS 1395, at *22 (July 20, 1999) (citations omitted).

Guideline urges consideration of a suspension of up to two years or a bar. NASD SANCTION GUIDELINES, 97 (2004 ed.). Enforcement believes, and the Hearing Panel agrees, that Cardillo's misconduct is serious and negligent, but not egregious. The misconduct involved a single customer and a single transaction; there are no aggravating circumstances. Accordingly, Enforcement seeks a suspension in all capacities for 30 days, a fine of \$5,000, and an order that Cardillo offer to rescind the Fidelity Annuity and pay AP for any losses suffered, as well as interest on the \$80,000 he invested in the variable annuity from February 15, 2001 to the present.

The Hearing Panel finds the following Principal Considerations in the Introductory Section of the Guidelines applicable to Cardillo's misconduct: Cardillo did not accept responsibility for or acknowledge his misconduct; prior to intervention, he did not voluntarily and reasonably attempt to pay restitution or otherwise remedy the misconduct; his misconduct caused direct injury to AP in that he was not able to draw the monthly income he sought from the investment, or additional amounts to provide financial assistance to his son; his misconduct resulted in a monetary gain of \$1600 in commissions; and AP was not a sophisticated investor who could understand, monitor, or control in any way his investment.

Accordingly, to remediate his misconduct, the Hearing Panel will fine Cardillo \$6,600 (\$5,000 plus the \$1600 commission), suspend him in all capacities for 10 business days, order him to offer to pay AP, upon AP's surrender of the Fidelity Annuity Certificate, the difference, if any, between (1) the amount AP receives upon surrender of the Certificate, and (2) \$80,000 (the original amount invested) plus interest, calculated pursuant to 26 U.S.C. §6621 (a)(2),⁹ from

⁹ The interest rate is used by the Internal Revenue Service to determine interest due on underpaid taxes. This rate, which is adjusted each quarter, reflects market conditions, and thus approximates the time value of money for each quarter in which the customer lost use of his funds.

February 15, 2001, to the date this Decision becomes final;¹⁰ and order him to pay costs in the total amount of \$3,503.53, consisting of a \$750 administrative fee and a \$2,753.53 transcript fee.

Conclusion

For making an unsuitable recommendation to a customer, in violation of NASD Conduct Rules 2310 and 2110, Gilbert Alan Cardillo is (1) fined \$6,600, (2) suspended in all capacities for 10 business days, (3) ordered to offer to pay customer AP, upon AP's surrender of his Fidelity Annuity Certificate, the difference, if any, between (a) the amount AP receives upon surrender of the Certificate, and (b) \$80,000 plus interest, calculated pursuant to 26 U.S.C. §6621 (a)(2), from February 15, 2001, to the date this Decision becomes final; and (4) ordered to pay costs in the total amount of \$3,503.53, consisting of a \$750 administrative fee and a \$2,753.53 transcript fee.

These sanctions shall become effective on a date set by NASD, but not sooner than 30 days from the date this Decision becomes the final disciplinary action of NASD, except that if this Decision becomes the final disciplinary action of NASD, the suspension shall become effective with the opening of business on Monday, November 15, 2004, and end at the close of business on Monday, November 29, 2004.

SO ORDERED.

Alan W. Heifetz
Hearing Officer
For the Hearing Panel

¹⁰ Because Cardillo cannot force rescission by the underwriter of the Fidelity Annuity, the Hearing Panel believes that the remedy ordered is the closest to rescission it could order, without harm to the customer.

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