NO. 121452

State of Illinois
SUPREME COURT

RICHARD LEE VAN DYKE d/b/a DICK VAN DYKE REGISTERED INVESTMENT ADVISOR,

Plaintiff-Appellee,

v.

JESSE WHITE, in his official capacity as Secretary of State of the State of Illinois, ILLINOIS DEPARTMENT OF SECURITIES, and TANYA SOLOV, in her official capacity as Director of the Illinois Department of Securities,

Defendants-Appellants

AMICUS CURIAE BRIEF OF THE PUBLIC INVESTORS ARBITRATION BAR ASSOCIATION

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STATEMENT OF THE IDENTITY OF THE AMICUS CURIAE, ITS INTEREST IN THE CASE, AND THE SOURCE OF ITS AUTHORITY TO FILE AN AMICUS BRIEF

Proposed Amicus Public Investors Arbitration Bar Association ("PIABA") is an international bar association comprised of attorneys who represent investors in securities cases, as well as state securities regulators and faculty at law schools who work on investor issues. Since its formation in 1990, PIABA has promoted the interests of public investors in all securities and commodities arbitration forums, while also advocating for public education regarding investment fraud and securities industry misconduct.

PIABA members regularly represent public investors in securities arbitration and litigation disputes against financial advisors, registered representatives, broker-dealers and registered investment advisors ("RIAs") registered by the Securities and Exchange Commission ("SEC") and the Financial Industry Regulatory Authority ("FINRA"). Our members and their clients have a strong interest in protecting public investors and customers of the securities industry from the misconduct of members of the securities industry, and in creating and maintaining a level playing field for public investors and customers of the securities industry in securities disputes with industry members.

PIABA monitors litigation and regulatory actions of concern to public investors and customers of brokers, broker-dealers and registered investment advisors, and identifies cases that have statewide or national significance. PIABA has identified this case as having such significance. To fulfill its role as a voice for

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public investors and customers of broker-dealers, PIABA frequently files *amicus* briefs in cases likely to impact the rights and protections afforded to public investors and customers of broker-dealers.

PIABA respectfully disagrees with the blanket holdings of the Illinois Court of Appeals, Fourth Judicial District that equity indexed annuities ("EIAs") are not securities, and that registered investment advisors do not owe fiduciary duties when recommending so-called "equity indexed annuities." It is common for financial advisors to hold both securities licenses and insurance licenses, and to incorporate hybrid products, like equity indexed annuities, fixed annuities, and variable annuities, in financial plans and recommendations for clients. They meet the classic test of what constitutes a security, as discussed *infra*. However, regardless of whether the Court classifies equity indexed annuities as securities or insurance products, it is an inescapable fact that they are almost always sold as investments, and most people who purchase them do so as investments. Holding financial advisors to the lower suitability standard prescribed by the Department of Insurance when the advisor holds himself out to the investor as a financial advisor will cause irreparable harm to investors, who are relying on that advisor to act in their best interest.

Moreover, PIABA is concerned that neither the district nor appellate court thoroughly analyzed whether the EIAs were investment contracts, and thus securities. Courts across the country, including the Supreme Court of the United States, have established factors used to determine whether an annuity is a security

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or insurance. This analysis must be performed using the information found in the EIA contracts, along with facts surrounding the recommendation of each EIA.

PIABA maintains that if the Appellate Court's holding is affirmed, it will provide legal precedent and authority for incorrect classification of these investment products, as well as for permitting fiduciaries such as broker-dealers and RIAs to provide investment advice that is not in the best interest of their clients, or otherwise violate statutes and rules designed for the protection of public investors and customers of broker-dealers. Moreover, a blanket holding that EIAs are not securities without further analysis will deprive investors of the protection of securities laws when the EIAs are in fact securities based on the factors long and well-established in cases like *Securities & Exchange Commission v. W.J. Howey Co.*, 328 U.S. 293 (1946) (*"Howey"*), *Otto v. Variable Annuity Life Ins. Co.,* 814 F.2d 1127, 1130 (7th Cir. 1986) *("Otto I")*, 814 F.2d 1127, 1142 (7th Cir. 1987) *("Otto II")* and *Holding v. Cook*, 521 F. Supp. 2d 832, 839 (C.D. Ill. 2007).

STATEMENT OF FACTS

Richard Lee Van Dyke, d/b/a Dick Van Dyke Registered Investment Advisor ("Van Dyke") was at all times a registered investment advisor who prepared financial plans, provided investment advice, and recommended investment and insurance products. Op., ¶¶ 5, 8. Included in his financial plans were recommendations that his clients purchase Equity Indexed Annuities. *Id.*, ¶ 6. Van Dyke sold 29 EIAs between December 2005 and December 2009. *Id.*, ¶¶ 6, 10. Then, between February 2009 and October 2010, Van Dyke advised his clients

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to liquidate these EIAs in order to purchase 33 new EIAs. *Id.*, ¶¶ 6, 10. He made these recommendations to elderly clients who, as a result, suffered losses in the form of surrender charges while Van Dyke earned a total of $360,579 in commissions. *Id.*, ¶¶ 6, 10, 11. Mr. Van Dyke's clients testified that they trusted and relied upon him, and uniformly followed his recommendations. Many of those clients had been customers of Van Dyke's for several years when he recommended the purchase and subsequent liquidation of the EIAs.

The Illinois Secretary of State and Illinois Securities Department (IDS) charged Van Dyke with fraudulent, deceptive, unethical or manipulative conduct in violation of Sections 12.A, F, G, I and J of the Illinois Securities Law. *Id.*, ¶ 7. After a six-day hearing, including expert testimony, the Secretary found that Van Dyke violated Section 12 of the Act because the EIAs were securities, he held himself out as a registered investment adviser, and he breached the fiduciary duties that he owed his clients as a registered investment adviser by recommending and misrepresenting the replacement EIAs. *Id*, ¶¶ 12, 13. In its order, the Secretary explained that the EIA transactions were unsuitable and not in the best interest of the clients based on their ages, the surrender charges, the undisclosed commissions and the loss of tax benefits. *Id.*, ¶ 14. The Secretary held that Van Dyke fraudulently misrepresented that the new EIAs were in the clients' best interests, and that the bonuses and interest outweighed the surrender charges, which was a violation of the Section 12.J of Act. *Id.*, ¶ 14. The Secretary also held that the EIAs were securities. *Id.*, ¶ 13. Van Dyke was sanctioned

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$330,000, was charged $23,500 for the State's investigation and expert fees, and was barred from selling securities in Illinois. *Id.*, ¶ 15.

Van Dyke filed for administrative review by the circuit court, which affirmed the Secretary's order and Van Dyke appealed. *Id.*, ¶ 16, 17. On appeal, the Appellate Court of Illinois, Fourth District, found that the EIAs sold by Van Dyke in this case "are not securities under the Illinois Securities Law of 1953 (Act) (815 ILCS 5/1 to 19 (West 2012))." Op., ¶ 25. The Appellate Court further held that the Secretary's finding that Van Dyke violated Section 12.J of the Act was against the manifest weight of the evidence, promulgating suitability factors that insurance agents must consider rather than the fiduciary standard applicable to investment advisers such as Van Dyke. *Id.* ¶ 37.

ARGUMENT

1. The Lower Courts Did Not Perform the Requisite Factual Analysis to Determine Whether the Equity Indexed Annuities were Securities or Non-Securities.

The Court concluded that the EIAs in issue were not securities despite its explicit recognition that "[i]n contrast to traditional fixed annuities, indexed annuities offer, in addition to a minimum annual return, a potential return on the account value that is tied through a formula to the performance of one or a combination of selected marked indexes…" *Id.* ¶ 9. Despite its own clear determination of this seminal fact, the Court then held that the Secretary's decision "failed to explain what an indexed annuity is, why indexed annuities fall within the definition of a security, or why it departed from the statutory language that

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annuities issued by insurance companies fall outside the definition of a security and are regulated instead as insurance companies." *Id.* ¶ 29.

The definition of a "security" under section 2.1 of the Illinois Securities Act lists at least twenty-six different kinds of contracts, transactions, or investments that are included as securities subject to the Act. Notably, the definition of "security" in the Illinois Securities Law and the Securities Act of 1933 are almost identical. *Sire Plan Portfolios v. Carpentier,* 8 Ill. App. 2d 354, 356 (1st Dist. 1956). It has long been established that whether a specific type of annuity contract constitutes a security or an insurance product is to be determined by federal law. 15 U.S.C. § 77b(a)(1); *SEC v. Variable Annuity Life Ins. Co. of Am. (VALIC)*, 359 U.S. 65, 67-68 (1959). The Securities Act of 1933 governs the offer or sale of any security through interstate commerce. *Id.* Both the Illinois Securities Law and Securities Act of 1933 define the term "security" as including any "investment contract." 815 ILCS 5/2.1; 15 U.S.C. § 77b(a)(1). Section 3(a)(8) of the Securities Act of 1933, however, provides an exemption under the Act for an "annuity contract" or "optional annuity contract" subject to state insurance laws. 15 U.S.C. § 77c(a)(8).

The federal securities laws require the courts to consider two competing policies in determining whether an annuity is a security or non-security. The first is set out by the broad statutory definition given to the term "security", which includes within its scope, among other instruments, "investment contract[s]." *See* § 2(1) of the 1933 Act, 15 U.S.C. § 77b(1); § 3(a)(10) of the 1934 Act, 15 U.S.C.

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§ 78c(a)(10). The competing policy is codified in § 3(a)(8) of the 1933 Act, which exempts from federal regulation "any insurance or endowment policy or annuity contract or optional annuity contract, issued by a corporation subject to [state regulation]." 15 U.S.C. § 77c(a)(8). The key determining factor is whether the purchaser bears the risk. Any instrument that qualifies as an insurance or annuity contract under § 3(a)(8) of the 1933 Act and *does not shift risk to the purchaser* is insulated from private actions brought under the 1934 Act. *Otto 1,* 814 F.2d at 1130 (holding that fixed annuity contract was entitled to section 3(a)(8) exemption)*; rev'd and remanded on reh'g Otto II,* 814 F.2d at 1130, 1142 (reversing prior ruling based on issuer's right to stop interest payments, which shifted risk to purchasers); *see also Assocs. in Adolescent Psychiatry v. Home Life Ins. Co. ("Adolescent Psychiatry")*, 729 F. Supp. 1162, 1169 (N.D. Ill. 1989) (evaluating fixed annuities under *Otto* and Rule 151, discussed immediately *infra*).

The critical issue as set out in *Otto* is how to determine what constitutes a "security", a term which under both the Illinois and Federal Securities Acts includes an "investment contract". 815 ILCS 5/2.1. 15 U.S.C. § 77b(a)(1); *SEC v. VALIC*, 359 U.S. at 67-68. Section 3(a)(8) of the Act also provides an exemption under the Act for an "annuity contract" or "optional annuity contract" subject to state insurance laws. 15 U.S.C. § 77c(a)(8); *Am. Equity Inv. Life Ins. Co. v. SEC*, 392 U.S. App. D.C. 1, 3, 613 F.3d 166, 168 (2010) (analysis of whether an annuity is either a security or an insurance product for purposes of section 3(a)(8) exemption involves, *inter alia*, a determination of whether, and to what extent,

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investment risk is borne by the purchaser or the seller). The test is complex and fact-specific and requires review of the nature and extent of contractual risk-shifting and guaranteed return on investment, as well as marketing efforts used in connection with the sale in question. *Adolescent Psychiatry, supra,* at 1173, ff.

The basic principles underlying the *Otto* test were set forth in a pair of Supreme Court decisions, see *VALIC,* 359 U.S. 65, and *SEC v. United Benefit Life Ins. Co*., 387 U.S. 202 (1967), holding that insurance products can be treated as securities if they place too much investment risk on policyholders. After its own extensive analysis of this question the SEC promulgated Rule 151, 17 C.F.R. § 230.151 ("Rule 151"), a safe-harbor provision that became effective on June 4, 1986.

The Seventh Circuit carefully analyzed Rule 151 and Supreme Court precedent in *Otto*. However, neither the IDS nor the courts below employed the *Otto* analysis or the test set forth in Rule 151, basing their decisions instead on a myopic application of Illinois statutory provisions. For this reason, PIABA suggests remand is required in order to make the determinations required under *Otto* and Rule 151. See also *Adolescent Psychiatry, supra,* at 1169-73 (remanding for further consideration due to lack of adequate attention to these issues).

The Secretary also failed to adequately support its own opinion under either *Otto* or Rule 151, relying heavily instead on Van Dyke's marketing approach and contract forfeiture provisions. Op. ¶ 10, 11. These facts are relevant to a degree, but they are not dispositive by themselves on issue of whether the EIAs in

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question are securities. Conversely, the Appellate Court looked solely to Illinois statutory authority, also failing to perform any analysis to determine whether the EIAs were securities. It focused its entire analysis on whether the EIAs met the definition of "face amount certificate," a type of contract listed in the Illinois Securities Act (815 ILCS 5/2.14); Op. ¶ 25. The Court did not make the necessary factual determination as to whether the seller or purchaser shouldered the market risks involved.

In the first place, the terminology used is not dispositive and often merely begs the question, as explained in *Integrated Research Servs. v. Ill. Secy. of State*, 328 Ill. App. 3d 67, 71-72 (Ill. App. Ct. 1st Dist. 2002):

> The statutory definition of "security" includes many types of transactions each separated by the disjunctive "or". The word "or" ordinarily is used in the disjunctive sense, meaning that the members of the sentence that it connects are to be taken separately. *In re C.N.,* 196 Ill. 2d 181, 752 N.E.2d 1030, 256 Ill. Dec. 788 (2001) (C.N.); *People v. Frieberg,* 147 Ill. 2d 326, 589 N.E.2d 508, 168 Ill. Dec. 108 (1992). Each phrase set off by the word "or: constitutes an independent basis for finding that a transaction is a security. See *C.N.,* 196 Ill. 2d at 210-11; *Schweig v. Schacht,* 276 Ill. App. 3d 311, 657 N.E.2d 1152, 212 Ill. Dec. 807 (1995). Thus an investment scheme involving cash foreign currency transactions is a security if it is an investment contract within the meaning of section 2.1, even though it is not a "put, call, straddle, option, or privilege entered into on a national securities exchange."

Secondly, as set forth in *Otto* and Rule 151, and as the District Court found in *Adolescent Psychiatry, supra*, the real issue is neither the name of the instrument or its categorization by state regulators, but rather, whether it fits the

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federal test of a security, which in turn involves an analysis of risk shifting, guaranteed returns, and related attributes:

> The next point that must be considered is how to tell a security from a non-security under the rule of *Otto*. The distinction appears to rest [here] on the frequency with which the insurer can alter the rate of excess interest on existing contributions under the contract [or engage in similar risk shifting, *i.e.*, transferring market-related or other risks to the purchaser]. It seems clear that an annuity contract which allows the insurer to alter the rate of excess interest on past contributions at any time will be deemed a security under *Otto*. On the other hand, a contract that allows the excess rate to be periodically readjusted for new contributions, but which guarantees that for the life of the contract each contribution will continue to receive the rate prevailing at the time it was made, will not be deemed a security. As will be seen below, Home Life's FA does not clearly fall into either category of instrument. But though *Otto* does not absolutely dictate this Court's conclusions one way or the other, the Court believes that the case, properly understood, supports the conclusion that the FA is not a security.

Adolescent Psychiatry, supra, 729 F. Supp., at 1173.

In short, mere facial denomination of an instrument as an "annuity" is irrelevant. The underlying contract may be a security or a non-security, based on its congruity with other types of products and transactions defined as a "security," the *Otto* test and Rule 151. Because the Appellate Court failed to properly analyze this central issue, the case should be reversed and remanded for this purpose.

2. Other Courts Have Concluded EIAs are Investment Contracts.

"Investment contracts" are routinely considered to be a type of security. The term "investment contract" should be broadly interpreted so as to "afford the investing public a full measure of protection". *Howey,* 328 U.S. 293 (1946); see also *Sire Plan Portfolios*, 8 Ill. App. 2d. at 356-357. Illinois has adopted the

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definition of "investment contract" from *Howey,* which is "a contract, transaction, or scheme whereby a person (1) invests money (2) in a common enterprise (3) with profits to come solely from the efforts of others." *Integrated Research Services,* 328 Ill. App. 3d at 72, citing *Howey* and *Ronnett v. American Breeding Herds, Inc.*, 124 Ill. App. 3d 842 (Ill. App. 1st Dist. 1984).

While the Illinois and Federal Securities Acts may exempt true "annuities" from treatment as securities under certain circumstances, "calling something an annuity does not necessarily make it one. Courts must look behind the 'label' to the substance of the agreement to determine whether a particular financial product is an 'annuity contract' exempt from the federal securities laws." *Holding v. Cook*, 521 F. Supp. 2d 832, 837 (C.D. Ill. 2007).

Classification of a particular type of annuity as a security or as insurance depends upon whether losses that may be incurred thereby are associated with the stock market, who bears the risk of loss, and related factors. *See, e.g., Otto I,* 814 F.2d at 1130, (holding that fixed annuity contract was entitled to section 3(a)(8) "annuity" exemption from securities laws)*; rev'd and remanded on reh'g, Otto II,* 814 F.2d at 1142 (7th Cir. 1987) (reversing prior dismissal, based on determination that issuer's retention of right to stop all excess interest payments passed the risk of nonpayment on to purchasers); *Malone v. Addison Ins. Marketing, Inc.*, 225 F.Supp. 743, 749 (W.D.Ky. 2002) (holding that variable annuities which did not guarantee minimum contract values or return of any specified portion of premium payments shifted those risks to the purchaser and were therefore securities);

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Luzerne County Ret. Bd. v. Makowski, 627 F.Supp.2d 506, 547, ff. (2007) (holding similarly that variable annuities that did not guarantee some fixed amount of benefit to the purchaser were securities).[1]

The marketing method used is also relevant to a security or non-security determination, to be considered along with other factors such as risk-shifting. In *Holding,* 521 F. Supp.2d at 836-838, plaintiffs asserted fraud and RICO claims based on purchases of annuity contracts which defendants contended were exempt from the federal securities laws. In reviewing the sufficiency of the evidence for summary judgment purposes, the Illinois District Court declined to base its decision solely on the underlying contracts, suggesting instead that further analysis was needed as to marketing:

> The Court does not believe it would be expedient to treat Fidelity's motion as one for summary judgment, because the contracts alone are not necessarily dispositive, even with a thorough briefing of their terms. Plaintiff correctly points out how Fidelity marketed the products is also a factor under Rule 151, which requires that the products **not be marketed primarily as investments**. The first *Otto* decision upon which Fidelity relies was based not only on the written contract terms, but also on how the product was marketed--"*primarily* on the basis of its stability and security." 814 F.2d at 1134 (emphasis in original); *see also* Christopher S. Petito, *Variable Annuities & Variable Life Insurance Regulation* (June 2006), Practicing Law Institute (Westlaw cite: "Variable Annuities & Variable Life Ins. Reg. s 2:2.3" at *2-35)("marketing may prove to be a critical element of section 3(a)(8) analysis"). The Court

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[1] As discussed *supra*, cases rely in turn on two Supreme Court cases, *VALIC*, 359 U.S. 65 (annuity which did not pay a specified and definite amount the annuitant held a security); and *United Benefit*, 387 U.S. 202 (although dollar amount of the fixed payments under a life annuity varied with its cash value, net premium guarantee ensured that a minimum annuity would be available at maturity; therefore it was an insurance contract, not a security). (*Id.* at 205-06.)

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> therefore believes that determining whether Plaintiff purchased "annuity contracts" within the meaning of §3(a)(8) is better left to a developed factual [**18] record after adequate time for discovery. *See, e.g., Assoc. In Adolescent Psychiatry*, 941 F.2d at 561 (decided on summary judgment); *Otto [I]*, 814 F.2d 1127 (decided on summary judgment).

Holding, 521 F. Supp. 2d at 839 (emphasis added); *see also*, *United States SEC v. Battoo*, 158 F. Supp. 3d 676, 690 (N.D. Ill. 2016) ("The relevant question with respect to variable annuities is whether they place the entire investment risk on the buyer or whether they provide some guarantee to the buyer.") (citing *Soranno v. New York Life Ins. Co.*, 1999 U.S. Dist. LEXIS 1963, 1999 WL 104403, at *9 (N.D. Ill. Feb. 24, 1999)).

The courts and agency below ignored these key components, declining to engage in the necessary analysis required by these and other cases. The resulting blanket statement that equity indexed annuities are not now and never can be securities is incorrect for this reason. Such a ruling would be harmful to investors and to the uniform regulation of annuities in the securities and insurance industries under both state and federal law if allowed to stand. Instead, this Court should rule that such a determination requires thorough case- and fact-specific analysis that depends upon the unique characteristics of the product being sold, and remand this case for such analysis.

As pointed out *supra*, at p. 9, neither the administrative agency nor the trial court even engaged in a detailed examination of the terms set out in the contracts,

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to say nothing of an *Otto* or Rule 151 analysis[2]. In its Petition for Leave to Appeal, the IDS alleges that Van Dyke sold these financial products "as investments with the potential to earn profits if the stock market rises," Pet., p. 3, thus noting the way they were marketed, and gave a detailed explanation of the commissions he earned and the forfeiture and recapture charges involved in the sales, *id.* pp. 4-6, but undertook no analysis of risk factors born by the customer or the seller. *Id.* Conversely, the Court of Appeals concluded that the agency had acted arbitrarily and capriciously by not doing any *statutory* analysis, thus ignoring *Otto*, Rule 151 and risk-shifting altogether.

3. Investment Advisors Owe a Fiduciary Duty to Their Customers Even when Recommending Insurance Products.

The Appellate Court concurred that Van Dyke acted as an investment adviser, yet failed to recognize that, as an investment adviser, Van Dyke was a fiduciary. A fiduciary duty requires an agent to treat its principal with the utmost candor, rectitude, care, loyalty, and good faith. *Ruderman v. Bank of Am.*, N.A., 2011 U.S. Dist. LEXIS 58785, (N.D. Ill. June 1, 2011) citing *Burdett v. Miller*, 957 F.2d 1375 (7th Cir. 1992). The Appellate Court ignored this obligation, applying the much weaker suitability standard based solely on its holding that the products at issue were not securities.

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[2] During the pendency of this litigation, Congress passed the Harkin Amendment to the Dodd-Frank Act, Pub. L. No. 111-203, Title 9, subtitle 1, § 989J (July 21, 2010). PIABA does not take a position on whether the Harkin Amendment is applicable, but it is another matter for the District Court to consider.

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It is beyond dispute that investment advisors such as Van Dyke owe a fiduciary duty to their clients. *SEC v. Capital Gains Research Bureau Inc.,* 84 S. Ct. 275, 282 – 283 (1963). Courts nationwide have consistently ruled that where, as here, such a fiduciary relationship exists, that fiduciary duty applies to all recommendations and advice provided by the investment adviser, including whether to buy or sell insurance products. For this reason, the Appellate Court erred in only requiring that Van Dyke make suitable recommendations, and instead should have evaluated whether churning annuities was in the elderly clients' best interests pursuant to the fiduciary duties Van Dyke owed to his clients.

In *Murphy v. Northwest Mutual Insurance Company*, 2005 US Dist. LEXIS 43627, 11 – 14 (W.D. Missouri 2005), the court held that allegations that the defendant held himself out as a retirement planner, provided advice to the plaintiff about retirement planning, and recommended a purported retirement plan that was funded by the purchase of cash value life insurance policies, were sufficient to show that the defendant owed a fiduciary duty to the plaintiff with respect to his insurance recommendations. The court explained that, although there is no fiduciary duty that generally exists between an insurer and an insured, nor any duty on the part of an insurance agent to advise customers as to their particular insurance needs, a fiduciary relationship does exist if the defendant holds himself out as an expert in securities and financial planning. *Id.* The court concluded that when an insurance agent acts as an investment adviser, the facts will support the

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imposition of a fiduciary duty upon the agent as to his insurance recommendations. *Id.*

Similarly, in *Estate of Migliaccio v. Midland Nat'l Life Ins. Co.* 436 F. Supp. 2d 1095, 1108 (C.D. Cal. 2006), the court held that the plaintiffs' allegations that the insurer's sales agents acted as their financial advisors, financial planners, and estate planning specialists were sufficient to establish a fiduciary duty with respect to the agents' recommendation of deferred annuities, even if such annuities were deemed to be insurance products rather than securities. The court explained that such a relationship is not merely that of an insurer – insured but rather showed a close and trusting relationship which justified imposing a fiduciary duty. *Id.*

Likewise, in *Gilmour v. Bohmueller* 2007 US Dist. LEXIS 64967, 87 – 88 (E.D. Penn. 2007), the court held that insurance agents who recommended that the plaintiffs use their assets to purchase equity indexed annuities were fiduciaries because they held themselves out as experts in estate planning and as certified senior advisors, and they purported to offer disinterested financial advice.

In *Kettle v. Leonard* 2012 US Dist. LEXIS 132205, 35 – 36 (E.D. North Carolina 2012), the court held that the defendant owed the plaintiffs a fiduciary duty with respect to his recommendation that they invest the bulk of their savings into equity indexed annuities because he held himself out to be a financial advisor, he invited plaintiffs to place their trust and confidence in him, he told plaintiffs that he had significant experience in the investment field, he developed a

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relationship with the plaintiffs that went beyond the annuity transactions that were the subject of the lawsuit, and he convinced the plaintiffs to make other investments in addition to the annuities.

The Northern District of Illinois similarly held that a plaintiff sufficiently alleged that a bank acted as a financial advisor and owed the plaintiff fiduciary duties because of the skills advertised by the bank and the trusting relationship between the plaintiff and the bank. *Ruderman,* 2011 U.S. Dist. LEXIS 58785 at 12. The defendant advised the plaintiff that her wealth was overly concentrated in her business, lacked liquidity and that she was at risk due to the volatility of commercial real estate. *Id.* at 3. She subsequently opened trust investment accounts managed by the defendant and also entered into loan agreements with the bank to provide capital to her business with the investment accounts as collateral. *Id.* at 3 - 4. Her business subsequently defaulted on the loans, resulting in the liquidation of the trust investment accounts, which were collateral for the loan. *Id.* at 7. The plaintiff filed a claim for breach of fiduciary duty for the losses she incurred due the loans and the misrepresentations and omissions made to her in the course of securing these loans. *Id.* at 4. The court found that the bank "held out its Wealth Management Group as having special skills, knowledge, and expertise in financial planning and investment management", the bankers communicated regularly with the plaintiff about her trust accounts, financial plans, and other financial matter, the defendant had superior expertise and skills, and the plaintiff "trusted and relied on the defendant for sound and independent advice on these

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matters." For these reasons, the court held that the plaintiff sufficiently stated a claim for breach of fiduciary duty for the misrepresentations made about loans. *Id.* at 12. Thus, even though the "products" at issue were bank loans with a bank, the court held that the facts alleged were enough to support that the bank owed the plaintiff fiduciary duties based on the relationship it developed with the plaintiff, its superior expertise, and the advice the bank provided to her. *Id.* at 18.

Citing *Burdett v. Miller*, the court in *Ruderman* explained that that "the common law imposes that duty when the disparity between the parties in knowledge or power relevant to the performance of an undertaking is so vast that it is a reasonable inference that had the parties in advance negotiated expressly over the issue they would have agreed that the agent owed the principal the high duty that we have described, because otherwise the principal would be placing himself at the agent's mercy." *Id.* at 15. Where the principal is not in a position to supervise or control the actions of the agent and entrusts the agent to take those actions on his behalf, "the fiduciary principle is designed to prevent that trust from being misplaced." *Id.*

Many other courts nationwide have similarly ruled that individuals who hold themselves out as financial advisors owe a fiduciary duty with respect to recommendations of insurance products and/or other products that are not securities. (See. e.g. *Prodigious Ventures Inc. v. YBE Hospitality Group LLC* 2017 US Dist. LEXIS 49130,*20 – 23 (E.D. North Carolina 2017) [holding that a financial advisor owed a fiduciary duty with respect to recommendations and

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advice concerning non-securities transactions because the plaintiffs had an ongoing relationship of trust and reliance with the advisor and the advisor had presented no evidence which indicated that he had repudiated his fiduciary duties or told his clients that he was not their fiduciary with respect to such recommendations]; *Abbit v. ING United States Annuity and Life Insurance Company*, 999 F. Supp. 2nd 1189, 1199 (S.D. Cal. 2014) [holding that allegations that the defendant had promised investors who purchased equity indexed annuities continued commitment, and thanked them for their ongoing trust and confidence in defendant as a preferred financial services provider, and that the plaintiffs trusted and relied upon the defendant, justified imposing a fiduciary duty with respect to the defendant's recommendations that the plaintiffs purchase equity indexed annuities]; *Fischer v. Aviva Life and Annuity Company*, 2010 US Dist. LEXIS 94537, 15 – 17 (E.D. Cal. 2010) [holding that allegations that the defendants who sold the plaintiff's equity indexed annuities were the plaintiffs' investment advisors, and that the plaintiffs trusted them were sufficient to support a claim for breach of fiduciary duty]; *Sanchez v. Aviva Life and Annuity Company* 2010 US Dist. LEXIS 64264, 15 – 17 (E.D. Cal. 2010) [holding that allegations that the defendants presented themselves as expert financial advisors who provided objective financial advice, and that the plaintiffs relied upon their expertise, were sufficient to show a fiduciary relationship with respect to the defendants' recommendation of equity indexed annuities]; *In Re National Western Life Insurance Deferred Annuities Litigation*, 467 F. Supp. 2nd 1071, 1087 (S.D.

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Cal. 2006) [holding that allegations that sales agents of equity indexed annuities held themselves out as objective financial planners who acted in the plaintiff's best interests were sufficient to show a fiduciary relationship]; *Negrete v. Fidelity and Guar. Life Ins. Co.*, 444 F. Supp. 2nd 998, 1003 – 1004 (C.D. Cal. 2006) [holding that allegations that the defendants who marketed and sold equity indexed annuities to the plaintiffs were the plaintiffs' financial advisors, estate planning specialists, and held themselves out as having superior knowledge were sufficient to show a fiduciary relationship]).

In short, as the authorities above hold, a financial advisor such as Van Dyke, who voluntarily induces his customers to trust and rely upon him for financial planning decisions and advice by holding himself out as a licensed investment advisor should not be permitted to escape or avoid his fiduciary obligations simply by recommending an insurance product. To hold otherwise would elevate form over substance and render the fiduciary relationship illusory, by placing greater importance on the specific financial product that was recommended rather than upon the nature of the relationship itself.

Here, it is indisputable that Van Dyke was in a continuous relationship of trust and reliance with his clients because he acted as their financial and investment advisor, he held himself out as having special expertise in the field of investments, he induced his clients to trust and rely upon him for financial advice, and he never repudiated that fiduciary relationship. Consequently, he should have been held to a fiduciary standard with respect to all of his recommendations,

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including his recommendation to purchase and/or liquidate the EIAs, regardless of whether the EIAs are deemed to be securitie s.

4. Securities Regulators Must Be Permitted to Protect Investors from EIA Sales Practice Abuses by Financial Advisors.

Regardless of whether the Court concludes the EIAs involved in this case are securities or insurance products, the complexity of EIAs as financial products, and the substantial potential for abuse in sales of EIAs, underscore the importance of continuing to allow regulation of sales of EIAs by the Illinois Securities Department. As it has been increasingly popular for financial advisors to recommend and similar agencies. Since it is true that complex hybrid products, like EIAs, are increasingly sold to investors, and particularly elderly investors, and concomitantly, that the state and industry self-regulatory organizations have issued numerous notices and regulations in order to protect investors, this appropriate regulatory oversight should be encouraged.

The Illinois Securities Department has investigated and sanctioned financial advisors for the sale of annuities several times over recent years. In a similar matter, *In Re Senior Financial Strategies Inc. d/b/a Pinnacle Investment Advisers, Thomas N. Cooper and Susan B. Cooper*, Case No. 0800064 (May 24, 2011), an investment adviser targeted senior investors, advertised that it was an investment advisor providing financial advice, and recommended to twelve elderly clients that they surrender existing annuities to purchase EIAs, resulting in surrender charges and penalties. The IDS held that the policies were investment contracts and that

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the financial advisor owed fiduciary duties and that the recommendations to surrender and purchase new annuities was a violation of their fiduciary duties because it was not in the best interest of the clients.

In August 2011, the Illinois Securities Department revoked the license of Steven Howard Delott after he was barred by the Financial Industry Regulatory Authority ("FINRA") for sales misconduct involving EIAs and life insurance. Like Van Dyke, Mr. Delott targeted senior investors and sold EIAs as investments. See *In Re Steven Howard Delott*, Case No. 0900272 (August 10, 2011).

FINRA is the securities industry self-regulatory organization that resulted from the merger of the National Association of Securities Dealers ("NASD") and the regulatory arm of the New York Stock Exchange.[3] The predecessor to FINRA was the NASD. Long ago, the federal government allowed securities broker-dealers to create self-regulatory organizations to oversee conduct in the securities industry. Maloney Act of 1938, Pub. L. No. 75719, 52 Stat. 1070 (1938) codified at 15 U.S.C. § 78o-3. Today, the government has delegated to NASD/FINRA much of the power to regulate the securities industry. *NASD v. SEC*, 431 F.3d 803, 804 (D.C. Cir. 2005) (NASD "serves as quasi-governmental agency, with express statutory authority to adjudicate actions" against stockbroker member firms who violate securities laws or regulations).

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[3] *See* News Release, FINRA, NASD and NYSE Member Regulation Combine to Form the Financial Industry Regulatory Authority (July 30, 2007), available at https://www.finra.org/newsroom/2007/nasd-and-nyse-member-regulation-combine-form-financial-industry-regulatory-authority.

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FINRA/NASD regulates the sales of EIAs by securities brokers and their registered representatives. That regulation applies to a representative of a securities broker-dealer firm selling an EIA regardless of whether the particular EIA the representative is selling is a product of an insurance company affiliated with a broker-dealer, or is the product an insurance company entirely unrelated to the securities industry. NASD Notice to Members 05-50, p. 6, n.2 (August 2005). Thus, FINRA/NASD regulates a broker selling an EIA regardless of whether the EIA is a security or insurance contract.

FINRA/NASD recognizes that there is not uniformity in the classification of EIAs as securities or insurance products. *Id.* at 1 & 5 ("[s]ome EIAs are not registered under the Securities Act of 1933 …" and "[d]ue to the uncertainty as to whether a particular EIA may be a security …"); *see also* North American Securities Administrators Association Informed Investor Alert, Annuities, p. 2 (November 3, 2010) ("some states consider them to be securities … and other states consider … to be insurance products …"), *available at* http://www.nasaa.org/2692/informed-investor-alert-annuities/. Regardless of classification, however, "EIAs are complex investments" subject to the potential for abusive sales practices. NASD NTM 05-50 at pp. 2 & 5; NASAA Investor Alert at p. 1 ("[a]nnuities are complex …").

When NASD appeared before the United States Senate Committee on Aging at its Hearing on Investment Fraud on the Elderly, NASD listed EIAs at the top of its list of financial products for which it had issued investor alerts warning

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"people about potential problem products or practices," and observed that EIA's are "often targeted for sales to seniors." Testimony on Elderly Investment Fraud; Elise B. Walter, NASD Executive Vice President, Regulatory Policy and Oversight; Before Senate Committee on Aging Hearing on Elderly Investment Fraud (March 29, 2006).

NASD told the Senate Committee that NASD was "particularly concerned" about the potential for abuse in the sale of EIA's. *Id.* at 4. One of the abusive practices FINRA/NASD focuses its enforcement resources on is sales in which the seller recommends the exchange of an existing annuity for an EIA (or the withdrawal of funds from an existing annuity product to purchase an EIA). *Id.*

With that complexity in EIAs as financial products, the potential for abuse in the sale of EIAs is present regardless of whether the person selling an EIA is licensed to sell securities, insurance products, or both securities and insurance products.

As demonstrated above, because Van Dyke was an investment advisor to his clients in the sales of EIAs, he was a fiduciary to them as a matter of law. Van Dyke's conduct, therefore, must be measured under a fiduciary standard of care—*i.e.*, the question must be whether Van Dyke acted in their best interests in recommending the annuity switch or exchange transactions to them.

In analyzing that question, the Court should be mindful of the substantial potential for abuse in the sale of a second (or subsequent) EIA to the same client. When a salesperson persuades a client to exchange an existing EIA for a new EIA,

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the only thing certain is that the salesperson and the insurance company he represents will earn a new set of fees and commission on the second sale. NASAA Informed Investor Alert at p. 2 ("[e]very time you move from one annuity to another, you are paying an additional cost …"). Beyond that certain cost, it's also likely the client will incur early surrender costs in giving up the first annuity if the exchange happens in the first five (sometimes longer) years after the purchase of the first annuity.

If the dollar benefits of the new annuity do not exceed the certain and likely costs of the switch, then purchasing the second annuity *cannot* be what is best for the client. That mathematical fact is true regardless of whether the Court sees EIAs as securities or insurance products. That's exactly why FINRA warns investors that "[g]enerally, the exchange or replacement of insurance or annuity contracts is not a good idea …." FINRA Investor Alert, Should You Exchange Your Variable Annuity? (March 2, 2006), *available at*, http://www.finra.org/investors/alerts/should-you-exchange-your-variable-annuity.

That FINRA Investor Alert obviously addresses variable annuities. But the Alert also addresses EIAs as well, explaining that EIAs "have characteristics of both fixed and variable annuities." *Id.*

The warning FINRA makes in the Alert about exchanging or replacing an insurance or annuity contract with another annuity applies with equal force to any annuity—indeed, it applies to the exchange or replacement of any financial asset

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with another very similar asset—regardless of whether the annuity is fixed, indexed, or variable. If an investor already has an existing asset in an asset class and the proposal is to exchange that asset for another functionally identical or very similar, when the quantifiable benefits of the proposed new asset do not clearly outweigh the costs of the exchange, the exchange cannot be what is best for the investor.

FINRA assures investors that the "best interests of the investor" standard protects them regardless of whether the person pitching an exchange to an investor is a "broker or insurance agent." *Id.* at 2 ("[y]our broker or insurance agent is permitted to recommend such an exchange to you ***only*** if it is your best interests …"; original emphasis). This Court should extend no less protection to investors in Illinois.

Given that investment advisors, like Van Dyke, owe their clients fiduciary duties, securities regulators, not insurance regulators, are in the best position to evaluate whether such duties were breached.

And with the certain and likely costs of the exchange of one EIA for another, the Court should conclude there is ample evidence in the record of this case that Van Dyke breached fiduciary duties to his clients unless Van Dyke points the Court to clear evidence that he identified the dollar costs and benefits of the switches for each of his clients and in each case the benefits exceeded the costs.

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CONCLUSION

The issue of whether an equity-indexed annuity is a security is one that depends on risk-shifting, marketing, and other complex factors that should be decided on well-established factors applied by courts across the country, including the Supreme Court of the United States. The blanket holding that EIAs are not securities is in direct conflict with these prior holdings, as well as the Illinois Securities Law and the Securities Act of 1933.

It is the responsibility of the Illinois Securities Department to protect customers from misconduct by broker-dealers, brokers and registered investment advisors. There is no dispute that Van Dyke was a registered investment advisor that owed fiduciary duties to his clients. Therefore, the Court of Appeals erred by applying the lower suitability standard in evaluating his conduct.

The holdings below could cause irreparable harm to investors in the future, particularly elderly investors who are often the target of complex products and incomprehensible sales tactics, such as annuity switching schemes. For the reasons stated above, PIABA respectfully requests that the Illinois Supreme Court reverse the holding of the Fourth District Court of Appeals and remand the issue to the Seventh Judicial Circuit for further evaluation of whether the EIAs at issue were securities. PIABA also respectfully requests that it reverse Appellate Court's holding and affirm the Circuit Court's holding that Van Dyke violated Section 12 of the Illinois Securities Act based on the fiduciary duties that he owed and

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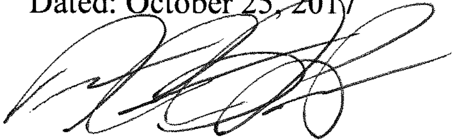
breached by recommending, misrepresenting, and switching the EIAs, regardless of whether the EIAs are considered "securities" under the Illinois Securities Law and Securities Act of 1933. PIABA respectfully requests that the Court affirm the district court's ruling.

Dated: October 25, 2017



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CERTIFICATE OF COMPLIANCE

I certify that this brief conforms to the requirements of Rules 341(a) and (b).

> The length of this brief, excluding the pages or words contained in the Rule 341(d) cover, the Rule 341(h)(1) statement of points and authorities, the Rule 341(c) certificate of compliance, the certificate of service, and those matters to be appended to the brief under Rule 342(a), is 28 pages containing 7,240 words.

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CERTIFICATE OF SERVICE

Under penalties as provided by law pursuant to Section 1-109 of the Code of Civil Procedure, the undersigned certifies that the statements set forth in the *Motion of Amicus Curiae Public Investors Arbitration Association For Leave to File Amicus Brief and Amicus Brief of the Public Investors Arbitration Association* are true and correct, except as to matters therein stated to be information and belief and as to such matters the undersigned certifies as aforesaid that he verily believes the same to be true.

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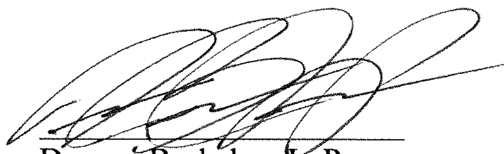

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