

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER, AND CONSENT
NO. 2018059035703**

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

RE: O.N. Equity Sales Company, Inc. (Respondent)
Member Firm
CRD No. 2936

Pursuant to FINRA Rule 9216, Respondent O.N. Equity Sales Company, Inc. 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 in this AWC.

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

The O.N. Equity Sales Company, Inc. (“ONESCO”), is a broker-dealer that offers various investment products, including deferred variable annuities, to the public through its 760 registered representatives in 334 branch offices. The firm is headquartered in Cincinnati, Ohio, and has been a member of FINRA (and formerly NASD) since December 1968. Respondent does not have any relevant disciplinary history.

OVERVIEW

From March 2014 through September 2017, ONESCO failed to establish and maintain a supervisory system, and failed to establish, maintain, and enforce written supervisory procedures, that were reasonably designed to supervise the sale of variable annuities. As a result, the firm failed to detect that its representative (Representative A) recommended an unsuitable investment strategy involving the liquidation of retirement funds to purchase variable annuities followed by the short-term withdrawal of funds from those annuities to purchase whole life insurance policies.¹

¹ Representative A entered into a separate Acceptance, Waiver, and Consent agreement with FINRA for, among other things, recommending an unsuitable investment strategy involving variable annuities, in violation of FINRA Rules 2111 and 2330. *See* AWC No. 2018059035701 (November 2020).

Based on the foregoing, ONESCO violated NASD Rule 3010 (for conduct before December 1, 2014), FINRA Rule 3110 (for conduct on or after December 1, 2014), FINRA Rule 2330, and FINRA Rule 2010.

FACTS AND VIOLATIVE CONDUCT

This matter originated from customer complaints to FINRA and ONESCO regarding Representative A, a former ONESCO registered representative.

Firms must supervise the suitability of securities recommendations, including the purchase and liquidation of variable annuities.

Variable annuities are complex investments that are commonly marketed and sold to retirees or individuals saving for retirement. Due in part to the complexity of these products, FINRA issued Rule 2330 to require that firms provide more comprehensive and targeted protection to investors who purchase or exchange variable annuities.

Among other things, FINRA Rule 2330 requires that (1) a registered principal review each variable annuity transaction and approve such transaction only if the principal has determined that there is a reasonable basis to believe that the transaction would be suitable; and (2) firms establish and maintain specific written supervisory procedures reasonably designed to achieve compliance with the standards set forth in Rule 2330.

In addition, FINRA Rule 3110 and its predecessor, NASD Rule 3010,² require FINRA members to establish and maintain supervisory systems, and to establish, maintain, and enforce written procedures, to supervise the activities of its associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules, including FINRA Rule 2330 and FINRA Rule 2111, which requires members to have a reasonable basis to believe a recommended transaction or investment strategy is suitable for the customer. Rule 3110 requires that, where there are red flags of possible misconduct, the firm investigate the red flags and act upon the results of the investigation.

FINRA Rule 2010 requires FINRA members, in the conduct of their business, to observe high standards of commercial honor and just and equitable principles of trade.

Representative A's Unsuitable Investment Strategy

Between March 2014 and September 2017, Representative A recommended an unsuitable investment strategy to ONESCO customers. Representative A was one of the top producers at the firm, and in 2016 was recognized as the firm's highest producer for variable annuities. While associated with ONESCO, Representative A recommended an unsuitable investment strategy to 76 customers involving variable annuities and whole life insurance policies that he characterized as "building your own bank" or "infinite banking." Representative A's strategy was predicated on persuading customers to

² FINRA Rule 3110 superseded NASD Rule 3010 on December 1, 2014.

liquidate their retirement accounts, which typically held a portfolio of mutual funds, to use the proceeds of that liquidation to purchase variable annuities, and then to liquidate the variable annuities in order to build cash value in whole life insurance policies. Notwithstanding their varying employment, income, and family situations, Representative A typically recommended that his customers purchase the same variable annuities with the same income riders and similar asset allocations. These recommendations were inconsistent with the customers' investment profiles, including their time horizon, liquidity needs and risk tolerance. Representative A's recommended investment strategy generally involved three steps.

First, Representative A recommended that his customers liquidate their retirement savings, which they often held in qualified, tax-deferred accounts such as 401(k)s or IRAs. As a result, these customers lost benefits associated with their 401(k)s, including services such as access to investment advice, telephone help lines, educational materials, and workshops. Assets held in 401(k) plans are typically protected from creditors and legal judgments, and certain 401(k) plans may allow for penalty free withdrawals.

Next, Representative A recommended that customers purchase a variable annuity with funds liquidated from their retirement plans. Representative A generally recommended that his customers purchase an X, or bonus, share class variable annuity. These products, which add a cash bonus to the contract, typically have the longest surrender periods of any variable annuities offered in the marketplace and charge higher mortality and expense fees than other share classes. Early withdrawals decrease the amount of the bonus awarded under the contract. Representative A also recommended customers invest in a guaranteed minimum withdrawal benefit rider, which allows lifetime withdrawals of a specified percentage once the customer reaches a specified age. Both the X-share and the withdrawal rider increased the customers' fees for purchasing the variable annuity, and thus were uniquely unsuited for customers who intended to make short-term withdrawals from the variable annuity.

Finally, Representative A recommended that his customers take early withdrawals, causing them to lose benefits associated with the variable annuity and incur surrender charges. Representative A's recommendations that customers make withdrawals from their variable annuities generally fell into two categories: (1) large one-time withdrawals to pay premiums on whole life insurance policies, from which customers could loan themselves money; and (2) large one-time withdrawals to pay various expenses, such as the purchase of a home or the settlement of a divorce.

Variable annuities typically assess surrender charges for customers taking early withdrawals beyond a specified percentage of the annuity's account value. As part of Representative A's investment strategy, the 76 customers who purchased variable annuities and took short-term withdrawals incurred \$371,395 in surrender charges. ONESCO was paid \$732,634 in gross commissions for the sale of these annuities.

ONESCO failed to reasonably supervise Representative A's recommendations.

Representative A's variable annuity sales were submitted to a team of principals for suitability review. As noted above, Representative A recommended a series of transactions to his customers, involving the liquidation of retirement savings, the purchase of variable annuities, and the partial liquidation of those annuities. ONESCO's reviewing principals were aware that Representative A was recommending variable annuities, but they were not made aware of the other components of Representative A's recommended strategy. In fact, no one at the firm conducted a suitability analysis of Representative A's recommended investment strategy as a whole.

ONESCO's written procedures required that principals perform a suitability review for all variable annuity transactions. These procedures specifically advised that variable annuities "often contain surrender penalties and are generally not appropriate for customers with a short-term investment horizon." The policies also identified various "special circumstances" that the principals should consider when reviewing a transaction, including whether (1) the customer was under the age of 59 ½; (2) the representative recommended the purchase of a bonus share class annuity; (3) the source of funds for the purchase was a qualified retirement plan; (4) the customer could incur surrender charges; or (5) a high concentration of the customer's net worth was being invested in the variable annuity.

The firm did not provide any guidance to reviewing principals about what they should do if one or more of these factors was present, and it did not have any monitoring system to review for trends or patterns suggesting that representatives were disproportionately recommending transactions involving one or more of these special circumstances. As a result, reviewing principals failed to detect or take action when Representative A's recommended variable annuity sales met several of these special circumstances or revealed other red flags of possible unsuitability.

Moreover, Representative A routinely recommended his customers take withdrawals from their variable annuities shortly after they were purchased, causing them to incur significant surrender charges, tax penalties, and additional charges. Representative A did not advise ONESCO that he was routinely recommending early withdrawals from variable annuities, nor did ONESCO independently detect he was doing so. As a result, ONESCO failed to supervise these recommendations.

As a result of its failure to have reasonable supervisory systems and procedures, ONESCO approved all of Representative A's recommended variable annuity transactions, including unsuitable recommendations to 76 customers.

ONESCO failed to reasonably investigate and act upon red flags.

ONESCO's procedures recognized that the short-term surrender of a variable annuity is a red flag. On three occasions, variable annuity issuers contacted ONESCO or its parent company, and raised concerns about the surrender charges being incurred by

Representative A's customers. ONESCO failed to conduct a reasonable investigation in response to these inquiries:

- In September 2015, an issuer requested that ONESCO explain why Representative A's customers were taking early withdrawals from their variable annuities and incurring surrender charges. In response, ONESCO accepted Representative A's explanation for the withdrawals, notwithstanding that many of those explanations were inaccurate, without verifying these explanations or reviewing the suitability of Representative A's "building your own bank" strategy. This issuer requested a second explanation for unusual withdrawals and surrender charges in February 2017. Again, the firm requested an explanation from Representative A, but took no additional supervisory steps and did not contact a single customer.
- In June 2016, a second issuer asked ONESCO's parent company about an unusual amount of withdrawals from the variable annuities of Representative A's customers. Although this inquiry was forwarded to ONESCO, the firm did not investigate these withdrawals and surrender charges, or request an explanation from Representative A. In April 2017, this issuer terminated Representative A as an agent authorized to sell or service its products, including variable annuities. ONESCO did not investigate the circumstances leading to this termination.

These inquiries identified specific customers who had incurred surrender charges within weeks, sometimes days, of purchasing their variable annuity. The June 2016 inquiry also identified withdrawals from variable annuities that were being sent to ONESCO's parent company for payment on insurance premiums. Notwithstanding this information, the firm failed to investigate these customers' early withdrawals. The firm's inaction allowed Representative A's unsuitable recommendations to continue and additional customers to be harmed.

As a result of the foregoing, ONESCO violated NASD Rule 3010, and FINRA Rules 2330, 3110, and 2010.

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

- a censure;
- a fine of \$275,000; and
- restitution to the customers listed on Attachment A in the total amount of \$1,001,141.86, which includes interest as further described below.

Respondent agrees to pay the monetary sanctions 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 an inability to pay, now or at any time after the execution of this AWC, the monetary sanctions imposed in this matter.

Restitution is ordered to be paid to the customers listed on Attachment A to this AWC in the total amount of \$1,001,141.86, which includes interest at the rate set forth in Section 6621(a)(2) of the Internal Revenue Code, 26 U.S.C. § 6621(a)(2), from the customer's surrender charge date through February 1, 2021.

A registered principal on behalf of Respondent shall submit satisfactory proof of payment of restitution and prejudgment interest (separately specifying the date and amount of each paid to each customer listed on Attachment A) or of reasonable and documented efforts undertaken to effect restitution. Such proof shall be submitted by email to EnforcementNotice@FINRA.org from a work-related account of the registered principal of Respondent. The email must identify Respondent and the case number and include a copy of the check, money order, or other method of payment. This proof shall be provided by email to EnforcementNotice@FINRA.org no later than 120 days after the date of the notice of acceptance of the AWC.

If for any reason Respondent cannot locate any customer identified in Attachment A after reasonable and documented efforts within 120 days after the date of the notice of acceptance of the AWC, or such additional period agreed to by FINRA in writing, Respondent shall forward any undistributed restitution and interest to the appropriate escheat, unclaimed property, or abandoned property fund for the state in which the customer is last known to have resided. Respondent shall provide satisfactory proof of such action to FINRA in the manner described above, within 14 calendar days of forwarding the undistributed restitution and interest to the appropriate state authority.

The imposition of a restitution order or any other monetary sanction in this AWC, and the timing of such ordered payments, does not preclude customers from pursuing their own actions to obtain restitution or other remedies.

Restitution payments to customers shall be preceded or accompanied by a letter, not unacceptable to FINRA, describing the reason for the payment and the fact that the payment is being made pursuant to a settlement with FINRA and as a term of this AWC.

The sanctions imposed in this AWC shall be effective on a date set by FINRA.

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 its acceptance or rejection.

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 Respondent; and
- C. If accepted:
 - 1. this AWC will become part of Respondent's permanent disciplinary record and may be considered in any future action brought by FINRA or any other regulator against Respondent;
 - 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 its subject matter 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 testimonial obligations or 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.

The undersigned, on behalf of Respondent, certifies that a person duly authorized to act on Respondent's 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 the AWC's provisions voluntarily; and that no offer, threat, inducement, or promise of any kind, other than the terms set forth in this AWC and the prospect of avoiding the issuance of a complaint, has been made to induce Respondent to submit this AWC.

April 9, 2021

Date

Andrew VanHoy

O.N. Equity Sales Company, Inc.
Respondent

Print Name: Andrew VanHoy

Title: CCO

Reviewed by:



Marion Little
Counsel for Respondent
Zeiger, Tigges & Little, LLP
41 S. High Street
3500 Huntington Center
Columbus, OH 43215

Accepted by FINRA:

April 30, 2021

Date

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



Kathryn S. Gostinger
Senior Counsel
FINRA
Department of Enforcement
55 W. Monroe St., Suite 2700
Chicago, IL 60603

ATTACHMENT A
AWC No. 2018059035703

<u>CUSTOMER INITIALS</u>	<u>TOTAL RESTITUTION</u>
MA	\$9,000
LB	\$3,556.04
RB	\$3,951.15
PB	\$9,035.53
DB	\$53,899.29
MB	\$16,725.72
GC	\$11,021.55
RC1	\$21,845.91
RC2	\$6,792.41
SC	\$17,136.52
AC	\$9,771.67
JC	\$5,346.30
TD	\$5,372.05
AD	\$6,389.37
DD	\$114,692.48
MCE	\$4,048.76
MF	\$18,430.34
PF	\$7,080.12
NF	\$29,947.38
GF	\$6,414.76
BF	\$3,891.40
MF	\$2,599.89
FG	\$10,849.82
GG	\$5,657.44
KG	\$1,903.99
KG2	\$3,006.53
KG3	\$15,888.75
SH	\$23,520.77
JH	\$5,322.35
MHF	\$10,447.56
MH	\$1,225.19
DJ	\$13,376.12
JK	\$1,582.31
LL	\$31,385.66
TM	\$4,559.05
WM	\$25,437.37

ATTACHMENT A
AWC No. 2018059035703

KM	\$87,977.85
AM	\$6,689.73
MM	\$2,092.12
BCM	\$16,858.10
EM	\$2,876.07
WM	\$2,506.79
JN	\$36,500.42
TO	\$17,576.49
GP	\$11,142.58
AR	\$29,964.43
MR	\$3,024.32
RR	\$4,100.13
RS	\$24,664.12
SS	\$11,431.57
SS2	\$22,622.00
JS	\$7,894.48
RS	\$12,654.42
AS	\$1,267.73
MS	\$20,998.31
MS2	\$2,933.01
MT	\$1,650.41
TT	\$53,104.19
RT	\$2,605.03
DT	\$3,692.40
RV	\$8,416.59
MV	\$18,043.98
BW	\$13,633.53
JW	\$6,815.83
WW	\$14,908.56
MW	\$11,688.57
JW	\$15,696.55
TOTAL	\$1,001,141.86

STATEMENT OF CORRECTIVE ACTION
SUBMITTED BY O.N. EQUITY SALES COMPANY, IN CONNECTION WITH THE
LETTER OF ACCEPTANCE, WAIVER AND CONSENT, FINRA MATTER NO.
2018059035703

This Corrective Action Statement is submitted by the Respondent. It does not constitute factual or legal findings by FINRA, nor does it reflect the views of FINRA or its staff.

Upon discovering a representative had recommended distributions from variable annuities for purposes of funding a life insurance policy as part of an investment strategy, ONESCO issued an educational and training alert to all sales representatives and adopted additional reports for monitoring and assessing the suitability of such trading activity. Such measures included:

- ONESCO issued Alert 2018-3 on August 14, 2018 identifying the conditions that must be met in order to recommend a distribution from a variable annuity with the intent of funding a life insurance policy. The Alert also (a) introduced a new form that offered additional disclosures to customers who wished to utilize assets from a variable annuity to fund a life insurance policy; and (b) required the submission of the Best Interest Documentation Form (ONESCO-3) with any recommendation to liquidate a variable annuity in order to purchase or fund a life insurance policy.
- Amended the Firm's written supervisory procedures/compliance and operations manual related to both sell recommendations and liquidations of annuity assets to fund life insurance.
- Amended the Firm's variable annuity disclosure form to specifically require the client to disclose its intent to use any distributions or proceeds from the variable annuity to fund the purchase of a life insurance policy. The Firm instructed suitability review principals not to approve a proposed transaction if the customer fails to answer this question, and to conduct a further review where the customer answers the question affirmatively.
- Instructed suitability review principals to escalate for further review any submission that appears it may involve the use of a securities product to fund life insurance or any instance where there is an indication that a customer may initiate a 72(t) program.
- In August 2018, the Firm created several forms of additional exception reports, including an Insurance Review Report.

Based upon the data collected and reviewed since August, 2018, the Firm has determined that the systematic liquidation of variable annuities to fund life insurance was isolated to a single representative and is not wide-spread throughout the Firm.