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AUG 22 2014
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UNITED STATES OF AMERICA
BEFORE THE SECURITIES AND EXCHANGE COMMISSION

IN THE MATTER OF:

MICHAEL A. HOROWITZ and
MOSHE MARC COHEN

RESPONDENTS.

ADMINISTRATIVE PROCEEDING
FILE NO: 3-15790

MOSHE MARC COHEN'S

PREHEARING BRIEF

INTRODUCTION

Respondent Moshe Marc Cohen ("Cohen or "Respondent) through his Pro Se Defense will demonstrate to the Court his innocence on all counts and how the Division unjustifiably succeeded in harassing Respondent through their 6.5 year investigation of Cohen in order to attempt to force him to admit to charges he did not violate. Why it has taken Mr. Haggerty and his crew close to seven years to investigate and conclude that an alleged "misrepresentation" has occurred makes this case even more suspect to making this personal. Cohen will show that through the Division's carefully structured and manipulating tactics and choice of words, they have concocted to banter up arguments and responses that hold no air. What should have taken just 1 day to allege by the Division, turned out to be a nearly a decade of wild and corrupt arguments by the Division in order to justify their case against Cohen. Cohen has always maintained his innocence and contrary to the Division's' well known slippery "catch my theory of the day". Cohen has stayed consistent with his story and position and thus adamant about following through within this administrative procedure in order to prove his innocence. This case all boils down to one check box on a form that was well intended and justified by the Respondent but the Division has created an alleged scheme which this is certainly not.

They Division seeks to wrongly charge Respondent with 10b-5 charges together with 17(a) as well as Rule 17a-3(a(6). Cohen seeks a fair trial in an unconstitutional setting, and as such respectfully requests of the Hearing Judge to allow Cohen a fair trial.

Overview of Annuity Strategy[1]

During the period of January and February of 2008, Moshe Marc Cohen a registered representative of Woodbury Financial Services Inc. (a then subsidiary of the Hartford Life Insurance Company and now a subsidiary of AIG) sold Variable Annuity contracts to Institutional clients on a non-recommended basis. Although these annuity contracts were typical variable annuity contracts offered by most Insurance & Annuity companies, these annuities differed as to the way the purchasers structured the ownership and annuitants within the contract. The intention of the purchasers were to use these variable annuities as a strategy to invest within these contracts with the possibility of short-term gains with little risk at the demise of the annuitant.

Respondent Cohen learned about this annuity strategy from Michael Horowitz, a Successful Morgan Stanley Broker from Los Angeles, CA who was using the strategy himself. The institutional investors that placed the annuity orders through Cohen, were already familiar and purchased annuities in such manner from other Brokers before Cohen was even aware that such strategy existed.

In order to give a better understanding to how these annuities were utilized, an understanding of the history of Annuities would be helpful.

Traditional fixed annuities pay a fixed amount of income, often for life to their owners. For example, if a 65-year-old investor purchases a $1 million annuity and designates himself as the

[1] The Overview of the Annuity Strategy is based on the joint Wells Submission of the Platinum and Centurion Family of Funds together with the BDL Group, Howard Feder, and the Nominees. Centurion, Platinum and BDL Group LLC are those that are referred to as the Institutional Investors and Hedge Fund within the OIP.

"annuitant," or the measuring life, the insurance company will agree to pay him, say, $50,000 a year for life. Usually the transaction is irrevocable; if the investor/annuitant lives a long life, say into his nineties, then he will end up better off for making the investment, but if he dies sooner, say, at age 70, then the insurance company comes out ahead because it keeps most of the $1 million.

Insurance companies found annuities to be so profitable that they sought to convince investors to purchase them well before the investor needed the annual income from the annuity. The vehicle for that inducement is the variable annuity. There, the investor hands over the $1 million years in advance of the date on which the money would convert into an annuity (*i.e.*, years before the investment would "annuitize"). The investor then chooses a mutual fund type of fund (called Separate Accounts[2]) from a menu of options that vary based on the issuing company; the money grows in the account on a tax deferred basis until the investor needs the income stream; and then — on the agreed date— the money in the variable annuity annuitizes and payouts begin. Because no one knows in advance what the precise sum will be on the date when the contract annuitizes, and therefore what the yearly income stream will be, it is called a "variable" annuity.

Because investors would be reluctant to turn over their money irrevocably many years before the "investment" annuitizes, insurance companies modified variable annuities to provide the investors with various inducements:

Death Benefit

If a person designated by the owner or (investor) as the "annuitant" dies before annuitization, then all the money in the investor's account would be returned to the investor

[2] The funds within a variable annuity are generally referred to as subaccounts or separate accounts.

without penalty as a "Death Benefit."[3] Thus, whereas the death of an annuitant *after* annuitization simply terminates the income stream, the death of an annuitant *before* annuitization results in a return of all the initial invested money— and possibly more, if the investor's account increased in value as a **"Death Benefit"**[4] as described in many of the Variable Annuity Brochures.

Principal Guarrantees

The annuity contracts are designed with a floor. For example, if an investor invests $1 million to be annuitized on some future date, the insurance company guarantees that even if the separate account the investor has selected decreased in value substantially, the investor would still have a minimum of $1 million to annuitize on the designated annuitization date.

Over the years Insurance Companies enhanced these guarantees to include various lifetime and death benefit guarantees in order to keep up with the ever-evolving guarantees offered by their insurance competitors. It was this competitiveness between the various carriers that created the opportunities to invest in strategies that allowed an investor to be as aggressive as they desired with the insurance sponsored "parachute of guarantees".

Immediate Sign on Bonus

In many cases, the insurance companies recorded an immediate sign-on bonus — generally

[3] See Page 3, 45-49 of Metlife's Brochure in Exhibit 480 of Division which was submitted as Respondent Exhibit 480 in order to make the consistency of the exhibits easier to follow. Metlife Brochure clearly defines the differences between the Investment and the Death benefits of an Annuity.

[4] See Respondent Exhibit 947 Page 8 of the Genworth Brochure that clearly describes the methods of withdrawals of one's "investments" but purposely leaves out "Death Benefits" as a withdrawal method as Death Benefits are described in detail on pages 22 of the Genworth Brochure. It is clear that a payout through an Annuity's Death Benefit feature is not considered to be a withdrawal or "access of the investment". Since an annuity's Death Benefit payout is not considered to be a withdrawal of the "investment", insurance companies waive any surrender charges upon Death of the Annuitant.

around 5-6% of the initial premium payments — that were added immediately to the values of the contract. Their competitiveness once again caused many companies to outdo the other in their bonus rates offered as well as the loosening of restrictions of when these bonuses vest within the contract. This sign-on bonus was amongst other benefits offered that was the appealing feature to the Investors related to this proceeding.

No Underwriting

The companies issuing variable annuities have also decided that they would require no underwriting.[5] This is in contrast to their life insurance products, where the companies issue the life insurance policies only after a rigorous comprehensive inquiry into the health and anticipated longevity of the insured. Annuity companies have taken the position that the more questions asked by annuity applications the more people will be deterred from applying to their company's annuity contracts. So they have taken the position that they would generally just ask for a name, address, date of birth and social security number for both the owners and the annuitants. They ask no questions about health and in many cases no financial information. They conduct no physical exam. "The insurance companies thus made a calculated business decision to take the healthy with the sick, *i.e.*, the losers with the winners, in an effort to capture as much of this lucrative business as possible."[6] Insurance Companies have always marketed annuities as an alternative to life insurance for those that are uninsurable.

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[5] As long as the Initial premium was under each company's self-determined limit no financial or health questions were asked.

[6] Goldsholle Decl. ¶¶ 8-9; Hager Decl. ¶¶ 9-10. Respondent Exhibit

Waiver of Surrender Charges at Death, Confinement to Nursing Home or Terminal Illness

Insurance companies generally have restrictions of their contracts as to when an investor could withdraw upon their contracts in the first 7-9 years. These are called Surrender Period or "Surrender Charges". Depending on the company, they generally range from 7-9 years with a decreasing schedule each year until the percentage reaches zero. These surrender charges were designed as a deterrent to investors in withdrawing their funds early, while keeping these contracts as long as possible on the insurance company's books in order to create a longer revenue stream for their sponsors. Surrender charges were also designed to recover some of the marketing costs incurred through their design and sale. Insurance Companies have also relied on the fact that a percentage of purchasers would have life changing needs that perhaps would cause them to cash out early allowing the carriers to book those charges when incurred as revenue.

Aware of the fact that these surrender charges stymied the sales of Annuities, in order to gain an advantage on their competition, annuity companies started marketing the waiving of their surrender charges as a way to induce investors to choose their companies. For instance, most of the contracts related to this proceeding offered a built-in rider that waived the surrender charges if a purchaser had to be confined to a nursing-home or was diagnosed with a terminal illness. Most annuity contracts also allow a purchaser the right to withdraw up to 10% per annum of their account value without incurring a surrender charge.

All of the Annuity contracts related to this proceeding also waived the surrender charges by the Death of the Annuitant or Owner during the surrender charge period.[7] **This waiving of the**

[7] The determination of whether the Death Benefit was triggered by the Owner or Annuitant, is whether the contracts were Annuitant-Driven or Owner-Driven. In all cases where Trusts were designated as Owners- the contracts would automatically be designated as Annuitant-Driven and would pay at the demise of the Annuitant.

surrender charge by the Annuity companies when a Death Benefit is paid on the death of an annuitant, was the determining factor that the investors chose to invest in these annuity contracts.

Clawback on the Bonuses

Many Insurance Companies even went as far as immediately vesting the Bonuses on their products in order to appeal to more purchasers or advisors who typically vet out the various companies in their client's best interest. Almost all of the contracts related to this proceeding offered an immediate vesting of the bonus at death.

Enhanced Death Benefit Riders

Insurance Companies, as another creative way to maintain their edge on the competition, frequently added more bells and whistles to the Death Benefit within their contracts. Some companies would offer a highest anniversary watermark Death Benefit of the values within the contract, others would grow the Death Benefit at a guaranteed rate of return, while others would even add between a 25% to 75%[8] bonus to any gains within the contract as a Death Benefit Payout. Some companies in order to outduel their competitors, even offered a mix, or an all of the above Death Benefit option.

This meant if $1 million dollars was invested in an account that grew to say $1.2 million dollars when the Owner or Annuitant died – under the 75% bonus in earnings death benefit rider; an additional $150,000 would be added to the Death Benefit thus paying out a Total Death Benefit

[8] See Sunlife Enhanced Benefit Brochure in Division and Respondent Exhibit 507.

of $1,350,000 to its owner. This would be the case regardless of when or how the owner or annuitant dies. These benefits were heavily marketed in order to favor one company over another. These death benefits in essence offered a guarantee on not only the principal invested but in some cases a guarantee of a return regardless of when the annuitant died.

There is a clear pattern of the annuity industry's intent, of having clients focus more and more on the Death Benefit features of the annuity, to seemingly justify the high costs of owning a Variable Annuity by the public.

No Insurable Interest Requirement

Annuities had no insurable interest requirements at the time, which means that an investor can buy an annuity on the life of anyone they choose without the need to have any relationship or financial interest. This was true for all the companies that were utilized by Respondent in this proceeding. Most states specifically exclude Annuities from the laws of life insurance. The NJ Department of Insurance, the jurisdiction that the annuity contracts sold fall under, specifically stated that "no need for a relationship between the Annuitants, Owners, and Beneficiaries must exist".

New Jersey's lack of annuity insurable interest laws, together with the Death Benefit Riders available to contracts sold within the State of NJ, was the reason the fund and owner's chose to use their NJ addresses to purchase the annuities related to this proceeding.

No Annuitant Signatures on Application

Many Annuity companies do not even require an Annuitant's signature on the application as they have no contractual rights to the contracts and are merely used as a life measuring tool to the variable annuity contract with no access to funds or decision making rights to the contracts themselves.

Note that this is contrast to Life insurance where insurability is needed so that insured's signatures must always be procured.

Parties to an Annuity Contract

The first page of an annuity application typically asks for the identity of three parties:

1. **The Annuitant** - The annuitant is the individual designated to serve as the measuring life for the contract
2. **The Purchaser (Owner)** –The Owner could be anyone- even a complete stranger to the annuitant.
3. **The Beneficiary-** The beneficiary is the person or entity that would collect the Death Benefit upon the demise of the Annuitant and could be anyone including a complete stranger to the Annuitant.

Non-Related Party Investor Opportunity

With no questions regarding the health of the annuitant and the absence of any insurable interest requirement, the application forms for the variable annuities asked for very little information. Thus, an investor can buy a variable annuity, choose a complete stranger as the annuitant, regardless of their health or even with a short-life expectancy; and expect that the beneficiary collect on the proceeds of the "Death Benefit" which not only guaranteed their premiums but perhaps even a nice return no matter how long the annuitant lived.

This insurance company created opportunity, was the motive for the institutional investors known as Centurion and Platinum (managed and/or owned by Murray Huberfield, Mark Nordlicht, Brian Jedwab, Ari Glass, Gilad Kalter and others) through their subsidiary called BDL Group LLC (managed by Howard Feder) to place their orders through Respondent Cohen for the purchase of variable annuity contracts in 2008. In Sum, with no recommendation or solicitation of Cohen to the investors, the Institutional Investors expected to get their money back – with the bonus and any appreciation – within a short-period of time as a Death Benefit payout contractually obligated to, by the various insurance Companies involved.

FACTUAL CHRONOLOGY[9]

Michael Horowitz ("Horowitz") was introduced to the concept of Variable Annuities with third-party short-lived annuitants by an insurance company sponsored seminar[10] given by their wholesalers in mid- 2007 attended by many of his colleagues and the compliance personnel of Morgan Stanley. Mr. Horowitz was also provided a WSJ article titled **"Investing with a Safety Net: How to exploit your Annuities"**[11] (April 18, 2007) by Lincoln Personnel. This widely available WSJ article was circulated by various financial and insurance companies through an email and other means of communication. In Lincoln's own words this article was described in email sent from Lincoln as follows: "Please find a fairly positive article on Variable annuities". The article talks about using annuities with Short-lived Annuitants as well as stating that "if you plan to keep it [any variable annuities in general] for more than

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[9] As reported in the Wells Submission of the Centurion, Platinum, and BDL Group of funds and amended to reflect Respondents Cohen's Role. Cohen had no knowledge of the chronology of anything that occurred between Horowitz and the fund as well as the specific chronology of the fund and related parties to the fund outside of what is described in Cohen's role later in this brief. This chronology is factual and was gathered from the 85,000+ documents and close to approximately 1 million pages provided through the discovery process by the Division. **The purpose of recreating the timeline is important to Cohen's Defense and to show that the solicitation of the funds occurred prior to Cohen ever knowing that such Annuities even existed.**

[10] OIP paragraph 11; M Horowitz Tr. 14:22-24:11.

[11] Division Ex 192 & Respondent Ex.1149

5 years, it isn't worth paying the cost". Intriguing that they promote such an article but now try to "Spin" the issue realizing its impact on their profitability.[12]

In mid-October 2007, the Morgan Stanley representative Michael Horowitz presented Centurion with the annuity strategy.[13] On or about October 22, 2007, Brian Jedwab, a portfolio manager at Centurion, had a phone call with Horowitz to discuss the strategy.[14] The Funds' outside counsel, Robert Bourguignon of Troutman Sanders LLP, and Greg Yaris, Horowitz's attorney, also participated.[15] Horowitz explained that he had legal access to individuals who had short life expectancies and outlined the strategy.[16] He stated that he had successfully used this strategy with individual clients before and that he wanted to implement it on a larger scale with an institutional investor.[17]

As detailed in Centurions Wells Submission, a few days later, Horowitz came to Centurion's office for a meeting that included the Funds' managers, Murray Huberfeld (Centurion's founder and Chairman) and Mark Nordlicht (Platinum's founder and Chief Investment Officer), as well as Harvey Werblowsky (the Funds'General Counsel).[18] Horowitz again described the strategy. He stated that he got the idea for the strategy from a representative of an insurance company at an insurance conference.[19] He explained that the insurance companies' applications did not ask any questions about the health of the annuitants, so the strategy could be carried out while answering every question on the applications truthfully. He also stated that several insurance companies had

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[12] Cohen does recall reading the article when circulated by the WSJ but didn't take notice of its true meaning till after his conversations with Horowitz. Respondent Exhibit 1149
[13] Nordlicht Tr. 45:6-46:24.
[14] B. Jedwab Tr. 67:10-68:6
[15] Id.; Bourguignon Tr. 33:20-23
[16] B. Jedwab tr. 68:24-69:24.
[17] Id. At 72:16-73:8.
[18] Huberfeld Tr. 48:14-25; Nordlicht Tr. 48:1-25; 50:15-19.

[19] Nordlicht Tr. 50:24-51:14; Werblowsky Tr. 26:5-15.

answered questions indicating that the strategy was permissible.[20] Horowitz explained that he had a legitimate relationship with hospices, which enabled him to identify people who would be willing to serve as annuitants.[21] He assured everyone that the annuitants would be recruited legally and that the annuitants would be paid.[22]

Another aspect of the strategy was to purchase the annuities using nominees, rather than directly by the Funds.[23] The Funds' managers flagged this issue for legal review.[24] They asked Bourguignon to draft a memorandum analyzing whether the prospectus issued by Lincoln prohibited the use of nominee owners.[25] They also asked Bourguignon to assist in setting up a structure to implement the strategy, by drafting nominee agreements as well as formation documents for a separate entity, BDL, to execute the transactions.[26] Setting up distinct entities to handle specific investments was a standard practice for Centurion.[27] The Funds' managers hired Howard Feder, an experienced trader and Nordlicht's former colleague, to manage the strategy.[28] On November 21, 2007, Bourguignon sent Feder a draft legal memorandum concluding that the Lincoln prospectus did not prohibit the use of nominee owners.[29]

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[20] Werblowsky Tr. 23:23-24:9; 26:5-15.

[21] Nordlicht Tr. 66:23-67:10; Werblowsky Tr. 27:16-28:3.

[22] *See* Nordlicht Tr. 57:1-58:10
[23] Nordlicht Tr. 58:11-63:3.
[24] *Id.* at 61:21-62:6.
[25] Bourguignon Tr. 58:23-59:12.
[26] *Id.* at 29:1-17; B. Jedwab Tr. 85:17-86:8, 100:24-101:8
[27] B. Jedwab Tr. 91:23-92:16.
[28] Nordlicht Tr. 84:8-85:16, 97:13-98:21
[29] Staff Investigative Ex. 561 and Respondent Exhibit 561.

During the same period, the Funds' managers also sought out legal advice on the full scope of the strategy. They asked Werblowsky to assess its legality.[30] Werblowsky, an attorney with extensive experience in health care law,[31] concluded that because the insurance companies chose not to inquire into the annuitants' health — *i.e.*, because they chose to forego underwriting — there was no obligation to volunteer any affirmative disclosure.[32] Werblowsky's primary concern was with the annuitants themselves. He confirmed with Horowitz and Yaris, Horowitz's attorney, that: (1) health information would be used in compliance with HIPAA regulations; (2) annuitants would provide knowing consent; and (3) annuitants would be compensated.[33] Werblowsky then told Huberfeld that as long as there was consent and the annuitants were paid[34], as he understood was the case from Horowitz, BDL could proceed with the transaction.[35] Additionally, Feder asked his father, Saul Feder, a partner at the law firm of Regosin Edwards Stone & Feder, for legal advice. Because Saul Feder believed that the annuity strategy was legal, he advised his son that he could move forward.[36]

After Centurion and Platinum's Managers and Howard Feder received legal opinions from Werblowsky, Bourguignon and Saul Feder they set up the structure to conduct the strategy and decided to purchase eight annuities from Lincoln as an initial investment. They recruited trusted individuals to serve (for a fee) as nominees in purchasing the annuities and executed the nominee agreements that Bourguignon had drafted.

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[30] Werblowsky Tr. 33:7-33:12
[31] *Id.* at 8:22-10:23
[32] *Id.* at 77:13-78:25
[33] *Id.* at 35:5-35:15, 39:2-42:12.
[34] Note that the Division doesn't dispute that these 3 requirements of Werblowsky were fulfilled with the Chicago Annuitants related to this proceeding.
[35] *Id.* at 45:17-46:7.
[36] S. Feder Tr. 99:3-99:18, 126:14-20.

After the initial annuity purchases, and at the suggestion of his father, Feder made efforts to formally memorialize Troutman's approval of the use of nominees.[37] Thus, in late November 2007, Feder asked Bourguignon to convert the Troutman memorandum into a more formal legal opinion. Because Troutman had a potential conflict continuing to represent BDL,[38] Werblowsky put Feder in touch with Barry Weissman, an experienced insurance law partner at Sonnenschein Nath & Rosenthal LLP (now Dentons).[39] After explaining the strategy to Weissman[40], Feder asked Weissman for a written legal opinion on whether the insurance laws of certain relevant states prohibited the undisclosed use of nominees in purchasing variable annuities.[41]

Cohen's Role

On or around December of 2007, David Zakheim an insurance salesman Cohen worked together with, introduced Respondent Cohen to Mr. Horowitz. Mr. Horowitz, an employee of Morgan Stanley told Cohen that he knew of a Hedge Fund that was interested and ready to purchase a substantial amount of variable annuities for the family members and partners of the Fund. Horowitz stated that since Morgan Stanley no longer allowed the procurement of their sale, while the various insurance companies were still interested in the business, Horowitz asked Cohen if he would be interested in placing the Orders on behalf of the funds. Mr. Horowitz also stated that since the annuitants were already procured for the annuities the investors wanted to purchase, Cohen just needed to gather, organize, complete the annuity applications with the information provided by Feder & Gottesman, and then submit the business to his Broker Dealer and various carriers for issue. Mr. Horowitz stated that No

[37] *See* S. Feder Tr. 99:3-99:18.
[38] Bourguignon Tr. 71:2-74:9
[39] Werblowsky Tr. 63:19-66:2.
[40] *See* Weissman Tr. 24:4-18, 26:12-21
[41] *See id.* at 46:18-47:24

solicitation or recommendations would be needed by Cohen as the Hedge Funds [42]were ready to purchase and were savvy with an extensive background in Insurance and Variable Annuities.

Concerned over the Suitability requirements of such annuity sales, Cohen used his background and knowledge of being a Securities Principal and downloaded the relevant suitability memos from FINRA – NASD's website. After an in depth review and comparing the various Finra Guidance Memos (NTM's) that related to Variable Annuities and suitability requirements[43], Cohen sent an email on December 26th, 2007 to Mr. Horowitz that included the FINRA Memo 2821 as an attachment that was scheduled to go into effect on May 8th, 2008. This memo clearly stated the suitability requirements for variable annuity sales at that time as well as the future changes of suitability in regards to recommended vs. order-taking sales that would go into effect after May 2008.[44] This email and Finra memo was sent over to Horowitz in advance of their discussion to discuss the fact that Cohen's in depth research concluded that the sales would be exempt from the heightened suitability requirement as well as exempt from many of the new information gathering requirements (which include "Liquidity Needs" which was the equivalent to the "Investment Access Information" that Woodbury had on their Annuity Point of Sale document) under the suitability rules then in effect.

As the OIP in paragraph 91 states "Horowitz began pitching his [alleged] scheme to "institutional investors"" and is followed up by paragraph 92 that "on or about October 25th, 2007, Horowitz met 2 principals of two affiliated hedge funds in New York City. As a result of the meeting, the principals decided to establish an affiliated entity, Institutional Investor 1 to facilitate the funds joint

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[42] The OIP claims that the two affiliated Hedge Funds opened up an entity called BDL Group and referred to in the OIP as Institutional Investor 1. Mr. Cohen was unaware at the time that the funds opened a new entity called BDL Group and was also unaware of the fact that nominees were being used. His understanding was that the fund was investing on behalf of the family members of the Fund Managers. He was also made aware by Horowitz that the fund had in excess of $100 million dollars in assets.

[43] Finra NASD NTM 01-23 together with other NTM's were also reviewed by Cohen but not sent to Horowitz.

[44] Note that Finra Rule 2821's initial scheduled date was May, 8, 2008. It was postponed to 2010. While parts of 2821 were amended and became law in 2010, other parts were left intact and retroactively became law on May 8, 2008. Note the Annuities in question are pre-2821 which had a much smaller need for information gathering which **DID NOT "INCLUDE THE INVESTMENT ACCESS"** question as part of the suitability review requirement in recommended variable annuity sales.

investment.......". Paragraph 95 of the OIP then continues and states that "Horowitz told Cohen that Horowitz or his associates would supply Cohen with the Customers and the hospice patient annuitants while Cohen would serve as the registered representative............" We clearly see from these 3 OIP paragraphs that Cohen neither Solicited nor made any recommendations to the Owners or Nominees of the fund for the variable annuity contracts that relate to this proceedings. As there was no solicitation by Cohen, no suitability requirement of the sales by Cohen or his Broker Dealer were necessary. Any optional completion of the data gathering did not alter the fact that these were non-solicited orders and sales to institutional type of investors.

Horowitz also told Cohen that since he was no longer writing any variable annuity business, he provided his best friend Asher Gottesman of AM Consulting Group the Variable Annuity Concept. Asher, together with his brother Abe, managed AM Consulting Group and were now seeking to market and license the Annuity Concept to other advisors. After a brief conference call, Abe Gottesman, Horowitz, Respondent Cohen and Zakheim, agreed to meet in person in Las Vegas, NV on January 4, 2014.

After meeting in Vegas, the parties agreed to allow Respondent Cohen the use of the variable annuity concept in order to be used by the hedge funds previously referred to by Michael Horowitz.

Gottesman and Cohen agreed to put together a formal agreement between them, but due to not agreeing to the terms as well as the concern that that the agreement might be in violation of security commission sharing agreements- the parties could not agree and thus never executed any agreement between themselves. No direct or indirect monies or funds were ever exchanged between Respondent Cohen and Horowitz or the Gottesmans.

Considering that the hedge fund was highly sophisticated; already familiar and comfortable with the use of Variable Annuities utilizing short-lived Annuitants; including the present ownership of such annuities in their portfolio holdings; no recommendation or solicitation was needed by Respondent

Cohen with any of the Annuities that were sold in these proceedings. His role merely consisted of placing the orders of the annuities for the Hedge Funds and facilitating their issuance.

In order to assure himself that this strategy really existed, Cohen reviewed each of the Insurance Company's prospectuses, brochures and marketing material in order to better understand all the features and benefits to each company's variable annuity. What he discovered was that some companies were Annuitant-driven while others were Owner-driven. This was disturbing to Cohen, as it meant that the contracts that were designed as Owner-driven would not payout a Death benefit at the death of the annuitant; rather it would pay out at the death of the Owner. In essence, what the fund thought they were buying was not the case. As disturbing as this news was, the solution was spelled out right within the prospectuses as well. Each of the Company's prospectuses stated that where a non-natural owner was designated as an owner of the annuity, the contract would either stay or become an Annuitant-driven contract. This meant that all the companies that the fund was planning on purchasing, would now pay the Death Benefits upon the Death of the Annuitants and not the Owners.

Cohen called Horowitz and Gottesman with the owner-driven problem and solution to convey his recommendation for the use of trusts. Gottesman, then set up a conference call with Howard Feder on January 12, 2008 (to the best of Cohen's knowledge, that was the first communication between Cohen and Feder) of which he described his findings of the problem together with the solution of using Trusts as the direct owner of the annuities. Cohen reviewed the list of carriers and explained the difference between the owner-driven vs annuitant driven issues but made no recommendations or suggestions to specific companies. He also was not given Feder's direct contact nor the name of the Fund or of BDL at this call. Although Cohen cannot recall the name, Cohen was aware that there was another fund manager on the call. Cohen also remembers David Zakheim being on this call. Feder was relieved to learn that Cohen's due diligence averted a future problem potentially caused by the improper titling of the annuities that the fund was planning on purchasing. Note, that at this point Cohen was unsure who the specific owners were going to be, nor how the fund planned on owning the annuities they were planning to purchase. All Cohen knew, was that the fund partners and family members of the fund were ready to purchase annuities and were waiting for some legal opinions to be completed. Feder, at that point said that he would have his attorney review Cohen's findings and more than likely have him create trusts to own these annuities. At that point, the conversation ended and the call was completed.

This is what Cohen testified to in his interviews when he testified to the SEC that he recommended the use of trusts[45]. A few days letter Cohen was told that the Fund did their legal review and decided that trusts would be used in order to avoid the issue that Cohen discovered.

On January 13, 2008 Howy Feder sent an email[46] to Gottesman stating that he needed the Broker Dealer's forms immediately in order to move forward. That prompted a conversation between Gottesman and Cohen, making him aware that Feder and the Fund needed to also review the Broker Dealer forms like they were doing with the life insurance applications. Aware of the pending legal reviews by the fund of both the applications and structure in its entirety, this did not surprise Cohen at the least; and even assured him further that all was in good order. Cohen's own review of both the Woodbury Account Form as well as the Woodbury Annuity Point of Sale form, did not seem to conflict or raise any concerns as to the way the Fund intended to use the variable annuities they planned on purchasing.

On January 13, 2008 Cohen received an email summarizing the list of annuities that Feder and the Fund needed applications for. They needed the proper forms in order to place their orders through Cohen once their legal opinions came in with the following companies.

[45] Cohen Tr. 66:24-67:11 and 86:20-89:3

[46] Respondent Ex. 1143A this exhibit also discusses the fact that Cohen was going to review if New England, Security benefit and Allstate offered an Annuity-Driven contract or at least the option to use a trust in order to turn the contracts into an annuitant-driven contract.

- GE (Genworth)
- Sunlife,
- ING,
- Metlife,
- AIG,
- Hartford Directors
- Hartford Leaders

Gottesman's email also stated that they are waiting to hear back from the fund on New England, Security Benefit and Allstate and that Mike will be talking to "them [fund] in order to get them to accept more companies" besides these additional 3 companies. This email is inconclusive whether the Mike referred to in the email was Mike Wolf (Horowitz's Attorney) who previously spoke to the fund with Horowitz and is referenced to in this email or Mike Horowitz. Regardless of which Mike this email refers to, it is evident from this email that Respondent at no point in time solicited or made any recommendations to Feder, BDL, Nominees, Owners or the funds to purchase any variable annuities. **The only recommendations made by Cohen in this entire annuity strategy was to utilize Trusts in order to avoid the problem of who's death the annuity Death benefit would be tied to.**

While Respondent was doing his own due diligence review on the various companies and the use of variable annuities with unrelated parties and short-lived annuitants, Cohen was aware that the fund had previously received a positive legal opinion letter from their legal advisors but was awaiting the final legal opinion from a top law firm in regards to the strategy in order to continue their procurement of additional variable annuities.

On January 15th, 2008 Respondent was given the go ahead by both Gottesman and Mike[47] as the fund's legal opinion came back and the fund was now prepared to move forward in their purchase of additional variable annuities. Barry Weissman issued a formal written opinion concluding that an applicant had no such disclosure obligation.[48] Although Cohen was not aware of the specifics of the legal opinion given by the fund nor the name of the attorney involved, he was assured by the email that Horowitz received dated January 15, 2008 which is the same date that Weisman issued his formal written opinion that an application had no such disclosure obligations and that the funds' final review to move forward was an indication that all was within the spirit of the law.

Respondent Cohen was relieved to see that his own due diligence not only conferred to the analysis of a reputable hedge fund and a very successful Morgan Stanley Broker; but also to multiple legal opinions from the top law firms all endorsing the use of such variable annuities. Respondent Cohen greatly relied upon the endorsement of the Fund's top lawyers and would not have moved forward if not for their endorsement at the time.

On the same date of January 15, 2008, Howard Feder sent a series of emails to Gottesman of which Gottesman cut and pasted the messages into new emails to Cohen[49] that stated that the

[47] Division Ex 404 as well as Resp. Ex 404. Email from Feder to Horowitz stating opinion letter came in on 1-15-08.
[48] Staff Investigative Ex. 585 and Respondent Ex. 585 (Mem. Ex. B).

[49] Gottesman insisted on not sharing Feder's contact info while the licensing agreement details were ironed out. This factor wasn't a big concern to Cohen as he was aware that Feder was leaving on a family trip to Israel for 10 days and thus available via email only, while Cohen was busy celebrating the Birth of a son on January 17, 2008 and preparing for the Bris ceremony (circumcision) 8 days later. Since Cohen and Gottesman never agreed to the

applications were completed or attempted to be completed but that Feder was leaving tomorrow to Israel and did his best in the completion of the applications.

Cohen was always under the impression that he would be getting completed applications from the Fund and this was also confirmed by an email Gottesman sent to Cohen on January 15, 2008 in Exhibit 1143C at 11:03AM PT (2:03PM Eastern Standard time). It stated "I haven't received anything from you today. Howie is leaving tomorrow [to Israel] and needs to be able to fill out the paperwork before he leaves." [50]

Gottesman than got an email from Feder at 10:23PM PT on January 15, 2008 (1:23AM NY time) that stated the following *"Where am I fedexing the documents I have to? Just a warning that there will be paperwork for you guys to fill out. I did the best I could getting signatures. All information that hasn't been filled out I will send to you and you guys will have to fill it in. Sorry about this but I did the best I could on my end."* [51]*(Respondent Exhibit 1143D).*

On or around January 16, 2008 Feder sent the first set of applications to Gottesman (in Los Angeles) by Fed Ex and asks Gottesman in a January 17th email if he received the Fedex.

Gottesman responds that "I received 4 signature pages for each trust for each of the seven products. I am going to work in completing and getting it over to the BD [Marc] so they receive it on Monday. Once they review the complete package we'll see if we need anything else"

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terms of the licensing agreement nor effectuated its execution, Gottesman finally shared Feder's direct contact info on February 1, 2008.See Respondent Exhibit 1147B.

[50] Respondent Exhibit 1143C.

[51] Respondent Exhibit 1143D (ABG 008770)

Feder then responds on the same date" I know I left a lot for you to do but I didn't have a lot of time to complete it (sorry). Time is important so I appreciate the speed. Please keep me updated and if there are any questions either call me or email me.

Fast forward to January 21st 2008, Gottesman emails Feder that says "They [Cohen and staff] are completing the paperwork. In order to expedite the process I sent complete applications with all the associated documents and Marc and his team will be completing them and getting back to me with any questions.[52]

When Respondent Cohen, received the applications, lots of information was missing and he immediately called Gottesman in order to complete the missing information correctly and submit the orders to the Broker Dealer and various carriers.

Although this was only 4 days after the birth of Cohen's son and a very hectic time in his life, Cohen made every effort to assure that all was done correctly and that the annuity applications as well as the Broker Dealer forms were answered correctly to the best of his knowledge.

SUITABILITY

Although Cohen was fully aware that the heightened suitability requirements were not needed due to the fact that these orders were unsolicited by Cohen and considered to be orders as the OIP confirms, Cohen chose to answer the Suitability forms with the information he got from Gottesman and Horowitz as to the 'Investment Access" question correctly. Although Cohen had no duty to be concerned as to the funds awareness to the Surrender charges or to the "access of investment" within the Annuity, he conferred with both Gottesman and Horowitz that the funds

[52] Respondent Exhibit 1147B

were fully aware of the Surrender charges that would apply upon cancellation of the contracts within the surrender period.[53]

Cohen's interpretation of question 4 of the Broker Dealer's Annuity Point of Sale forms was that it was not referring to "Time Horizon", rather it was a question as to when the investor "anticipates to begin to access this "investment"". It clearly meant what it says.

"Suitability" in its entirety is designed to protect the Investor, It needs to be looked at from the perspective of the investor and not the "Broker Dealer" or Insurance Companies Perspective or benefit. This is where the Division's claim fails. They are attempting to redefine who "Suitability" is for and have schemed their arguments in the OIP in a way that is not only illogical but laughable.

Question 4 Investment Access of Woodbury Financial Services form is as follows:

"I anticipate that I will begin to access this investment:"

A--- Never

B—0--5 years

C--- 6 – 10 years

D--- 11—15 years

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[53] Finra (NASD) Online Suitability NTM 01-23 states in Endnote 7 "A member or associated person who simply effects a trade initiated by a customer without a related "recommendation" from the member or associated person is not required to perform a suitability analysis, although members may elect to determine whether a security is suitable under such circumstances for their own business reasons. See In re Thomas E. Warren, III, 51 S.E.C. 1015, 1019 n.19, 1994 SEC LEXIS 508, *11 n.19 (1994). The end of the End Note 7 continues ("[T]he NASD and other suitability rules have long applied only to 'recommended' transaction."); Clarification of NTM 96-60, 1997 NASD LEXIS 20 (FYI, Mar 1997) (stating that a member's suitability obligation under Rule 2310 applies only to securities that have been recommended by the member). **Similarly, the Suitability rule does not apply where a member merely gathers information on a particular customer, but does not make any "recommendations." This is true even if the information is the type generally gathered to satisfy a suitability obligation.**

E --- 15+ years

F-- after 59.5

Although not required to be completed, Respondent Cohen correctly chose 11-15 years to this question**. His reasoning at the time, was that this question clearly referred to the "Investment" in the Annuity and not the "Death Benefit" to the annuity.**

Cohen's Reasoning for choosing 11-15 years was as follows: although he was comfortable that the Fund was well aware of the surrender period which ranged from 7-9 years in the annuities purchased by the Fund, the Fund never expected the "need" to withdraw any investments at all, as their testimony clearly stated that their expectations were to collect the "Death Benefits" within a short period of time. This question in essence became obsolete or at best a "Never" as the correct answer which was even longer than what was chosen in the "Investment Access Question".

So Cohen was left weighing whether the "Never" or the "11-15 years" would be the more conservative response to this question. In a case where "Suitability" was required, Cohen felt that the "Never" response was less conservative of an answer vs the answered "11-15 years". His reasoning was that in case an annuitant did not die as expected by the Fund, the 11-15 years was the best answer that clearly wouldn't overlap to the 9 years surrender period of some of the annuities sold. Cohen basically pegged the answer to the surrender period of 6-9 years within the annuities sold and felt that since some of the contracts had 9 year surrender periods choosing the answer that starts with 6 years would perhaps cause liability. Through the above analysis, the best answer was chosen of "11-15 years".

Note that even under the wrong premise that Suitability was needed in the variable sales related to this proceedings, the question clearly **related to the "Investment" and not the "Death**

Benefit" thus making the "11-15 years" answer the most suitable answer based on the same analysis.

As described earlier in the description of annuities, the annuity value is called "Investment" only during the lifetime of the annuitant; while that same value converts or transforms to a "Payout" or "Death Benefit" at the death of the annuitant. Anything contrary to this view would make every Annuity company's brochures false advertisement and deceiving.

Review of the Investigative Testimony's of Feder together with many of the other witnesses questioned by the SEC, clearly show how the Division's knowledge to such distinction existed. The Division intentionally designed their questions in a dubious and deceiving way in order to induce the response of a "short-term intent" to the "Death Benefits"; but seemingly caused the witnesses to imply that such intent was for the "Investment" itself. As Cohen will display during the hearing, that through this unethical display of trickery by the Division, in order to entrap the witnesses' response even went unnoticed by the witnesses' experienced counsel.

Further supporting Cohen's distinction between a "Death Benefit" and an "Investment" are at least 3 court rulings which Cohen will provide during the hearing confirming that a clear distinction between a "Death Benefit" and "Investment" exist.

Knowing that the fund managed a large pool of variable annuities already on their books while also carrying a substantial amount of life insurance policies within their portfolio, Cohen felt that the due diligence he took for his "own records and knowledge" of assuring that the Fund and their managers understood the surrender charges within the annuity products was sufficient.

<u>WOODBURY FINANCIAL SERVICES</u>

Considering the fact that Woodbury knowingly and maliciously lied and misled not just the other insurance companies involved, but Federal, State and other organizations like Finra and others, in order to destroy Cohen's ability to sell insurance and financial products in the future; Respondent Cohen did not feel they deserved much mention in this brief.

Mentioning of just a few bewildering lies, facts and allegations made by Woodbury is still warranted in order to demonstrate that this was not about "Cohen's alleged Suitability violations", rather this was a calculated attack on Cohen by Woodbury with the assistance of Cohen's former partners, Michael Frieda and Fredda Elzweig; in order destroy his ability to ever compete against his former partners and former Broker Dealer – "Woodbury".

Aware that Cohen was unhappy with both Woodbury and his former partners, through the use of an illegal computer tapping software on Cohen's laptop and Desktop by his former partners, they were made aware that Cohen was not only in the consideration stages of leaving both, but was in the final stages of switching his registration to World Equity Group Inc. a Broker Dealer, as well as the negotiations of new office space weeks before any variable annuity contracts were written. There was clear motive then and there is clear motive now – by both Woodbury and Cohen's former partners in destroying his credibility within the securities and insurance industries.

Here are just some of the "best seller lies and statements" made by Woodbury to others that were unfounded and outright lies.

- Cohen was not only member of the Kahana Chai organization but its treasurer in 1991 which is a U.S. and OFAC banned terrorist organization – impressive feat at the young age of 15.
- Cohen's then attorney Alexander Novak was indicted in the 1st World Trade Center bombing and cut a deal as an informant to stay out of prison. – intriguing once again since Mr. Novak was not a Muslim extremist but rather an Orthodox Jew from Long Island.
- That Cohen hired a "Goon" to break into the car of the Illinois Veteran's Hospital Medical Director's car to steal a trove of annuitants' info.
- That Cohen, BDL, Platinum, Centurion, Huberfield, Nordlicht, and others were money laundering through the purchase of these annuities in order to fund terrorist activities.
- That Cohen only attempted to resign but did not actually resign in order to state that he did not cooperate with their investigation after he resigned and falsely stated that Woodbury Terminated him for cause.

Just to make certain that the record is clear, none of the above false statements are true and once a liar always a liar.

THE ANNUITANTS

There were a total of 5 Chicago based annuitants used in the annuity contracts purchased by the Funds through Cohen as a registered representative of Woodbury. Each of the Annuitants received compensation for their consensual use of their lives in the annuities sold. They, or their designees signed authorizations allowing such use, verified by 2 separate attorneys that met with each of annuitants or their designees to assure that the annuitants or their designees had knowledge of, received compensation and consented to be used as annuitants in the variable annuities sold by Cohen.

Cohen had no involvement whatsoever in the procurement of any of the Chicago annuitants that agreed to be used as annuitants in any of the variable annuity he sold. He was under the impression that the investors had a connection together with Horowitz to a stream of annuitants that were eager to allow the use of their lives as the measuring life in these annuities. When Horowitz described the concept to Cohen, one of the first questions Cohen asked was "do you have them sign a consent and a Hippa form?" in order to be assured that these people consented. Horowitz responded that not only did they have a signed Hippa and consent form, but it also addressed the compensation the annuitants or their families received.

Later on, Cohen requested from Gottesman that if he chose to move forward in the order- taking processing of these annuities on behalf of the fund or their family members, he and any of his related parties or companies be added to the Hippa form's used by

Horowitz in order to be in compliance of any Hippa rules, should they apply. He also wanted to protect himself in case any heirs, insurance companies or related parties ever claimed that the annuitants were unaware that they were being used as annuitants in the contracts purchased by the investors.

Only years later, through the information provided by the SEC, did Cohen learn of who the parties were that procured the consent of either the annuitants and/or their designees together with more details about each of the annuitants used by the owners in the purchase of the annuities in this proceeding.

Note that the impression created by the Division that the annuitants related to Cohen's proceedings were victims of an alleged scheme, is an outright lie by the Division. Each of the 5 Chicago based annuitants related to the annuities sold by Cohen, either consented or had their designees consent to being used as annuitants. They voluntarily, willfully and gladly signed the Hippas and consent forms together with any annuity carrier forms needed in return for compensation that was in the thousands of dollars. Regardless of their sad hardships, the annuitants were better off financially in exchange for their no-risk, little hassle consent of being used as annuitants in these annuities.

The Division has knowingly deceived the public in creating the false image of the pitiful abuse of these annuitants, in order to capture the attention of both their superiors and the commission to justify these proceedings.

The Division's touting of the abuse of the annuitants, originated from the Respondent's former Broker Dealer -- Woodbury Financial Services Inc. ("Woodbury")[54] of whom Respondent has a pending arbitration against.

Because Woodbury was owned and managed by the Hartford Life Insurance Co. in 2008, they chose to discredit Cohen and destroy his career by alleging knowingly false information to FINRA through his U5, the SEC, the FBI, IRS and literally dozens of insurance companies claiming the following:

"that the annuitants were unaware of being used- (Since proven false),

that the signatures of the annuitants were forged (Since proven false),

that insurable interest laws were broken (Since proven false)

that there was identity theft of the annuitants (since proven false)."

In order to discredit these knowingly false allegations made by Woodbury, Respondent Cohen, through his attorney- Alex Novak of Novak, Juhase and Stern LLP summoned another attorney Kim Juhase to Chicago to investigate and interview each of the annuitants in order to make sure that the annuitants previously consented to be used as annuitants for the annuities purchased in January and February of 2008 through Cohen. This took place in March of 2008 and Mr. Juhase's findings were evident that the Woodbury's claim were not only false, but that all of the annuitants previous consent. Being that Cohen was unaware to the details of how to locate these annuitants, Mr. Juhase coordinated with Horowitz and Feder to travel and meet each annuitant used by Cohen.

~~[54] Owned by the Hartford in 2008, and now owned by AIG.~~

Juhase's findings of all in good order in relation to the annuitants, was also confirmed by a second attorney hired by Feder and the fund called Elchonon Firestone Esq.

THE CONTRACTS

In sum, a total of 28 annuities were sold by Cohen during this period. Every Annuity application was reviewed 4-5 times to assure that every detail was completed correctly before being sent to the Broker Dealer and various carriers.

The Annuity contracts that were used had no restrictions in the use of nominees; no requirements for insurable interest; no restrictions as to the use of trusts in the ownership of such funds; no financial; no health questions; and no restrictions in using the variable annuity strategy that used by the investors.

Every annuity application completed by Cohen utilizing the information provided by Feder and or the Gottesmans; had accurate information as to the owners and annuitants with the exception of one annuitant [55] that apparently provided his wrong identifying and social security information to the annuity finder. This was discovered after Feder and the Fund submitted a Death Claim that was refused by an insurance company based on the inconsistencies of the identifying information between what was completed on the Death claim vs what the Death certificate stated.

[55] Jimmy Mayo who had 2 identities of which he and a friend routinely played impersonated each other unbeknownst to any of the parties involved in this proceedings. This led to an insurance company to deny a claim and the Fund and Trust successfully sued the State of Illinois and Funeral home to correct the information in order to collect on the Annuity Death Benefit.

On February 28, 2008, AIG SunAmerica sent letters to the nominees stating that it was terminating their annuity contracts.[56] Nordlicht initially told Feder to "fight to keep [the] policies in place,"[57] and Feder responded that he would be "shocked" if the contracts were not reinstated.[58] However, on March 23, 2008 a month after Cohen resigned from Woodbury and while Cohen was in process of registering with his new broker dealer, Feder emailed Nordlicht stating, "We are on hold for now, everyone wants to reevalaute [sic] the entire process a to z to make sure everything is being done properly, even though I think that's being done anyway."[59] Two days later, Nordlicht told Feder to "hold off on the new accounts for now."[60]

Despite becoming aware of the annuity strategy in late 2007 and early 2008,[61] most of the insurance companies paid out death benefits rather than seeking to rescind. Of the eight insurance companies involved, five paid death benefits, while three rescinded the contracts and returned monies to the owners of the policies. None of the insurance companies has sued any of the investors, or more importantly to this proceeding Cohen.

Woodbury, through their documented lies attempted to force most of the annuity companies to cancel (or "bust the trades" as threatened by Smallidge) their contracts sold by Cohen.

Evidence through the Hearing will show, that Woodbury demanded such cancellations or recession by AIG but then refused to accept the monies back from AIG. AIG complied and cancelled the contracts and through letters written to the Trusts and their attorneys admit that they were

[56] E.g. Division and Respondent Ex. 343.
[57] Division and Respondent Ex 442
[58] *Id*

[59] FND0123767
[60] Division and Respondent Ex. 130.
[61] See, e.g., Staff Ex 344 (AIG letter stating in was informed of strategy by Woodbury on February 19, 2008).

forced by Woodbury to cancel the annuity contracts even though it clearly violated their own contractually obligated non-cancelable and incontestability clauses within their contracts. This bullying of Woodbury upon AIG was clearly against all insurance and security regulations then in effect. Ironic that Woodbury forced others to cancel the contracts, while they themselves made no such demand of the contracts written by the Hartford Life Insurance Company nor demanded that any Hartford Policies be busted or cancelled.[62]

Tim Stone, a compliance officer of Woodbury in 2008, who the Division has identified as their key witness against Cohen was the chosen person in charge in destroying Cohen's credibility and career within the Industry. Many instances of Stone trying to use his law enforcement background, together with his newly acquired law degree as the means to create and destroy Cohen, the Investors, as well as the contracts purchased by the investors will be submitted during the hearing. One such example which exemplify such illegal posturing and demands made by Stone, was his demand of Security Benefit Life, a company that Cohen wrote 2 variable annuities with, to illegally cancel and rescind the contracts written by them. Concerned over what Stone demanded of them, they demanded a letter of indemnification from Woodbury. The the record will show – Woodbury refused to provide any such letter. This was not an isolated case, but rather a pattern of Stone's newly acquired power to justify his crucifixion of Cohen.

[62] Note that Woodbury Regionals, Directors and IMO's received additional bonuses and compensation based on the amount of Hartford Life (Woodbury's parent company) products they sold.

ARGUMENTS

The Staff through their ambiguous issuance of the OIP against Horowitz and Cohen and through their related press releases in regards to both Horowitz and Cohen suggesting that the annuity strategy constituted a fraud under Rule 10b-5, and 17(a) amongst other violations; against the insurance companies, against the investors, against the individual annuitants, and against the Broker Dealers – is outright wrong.

Although Cohen's OIP seems to begin by section titled "Cohen's Role" in Paragraph 90, it really only begins at paragraph's 94 to 101 of the OIP.

Cohen's Role in the OIP

90. By early Fall 2007, Horowitz had sold over $20 million of the stranger-owned variable annuities to individual investors but desired to pump greater capital into the scheme. Searching for a large source of financing, Horowitz began pitching his scheme to institutional investors.

Cohen, at the time did not have any information about this paragraph, nor feels it needs to be addressed. As such, if it does entail any such information related to Cohen, he denies any knowledge or anything involved in this paragraph.

91. On or about October 25, 2007, Horowitz met with the principals of two affiliated hedge funds in New York City. As a result of the meeting, the principals decided to establish an affiliated entity, Institutional Investor 1, to facilitate the funds' joint investment in Horowitz's annuity scheme.

Cohen, at the time did not have any information about this paragraph, nor feels it needs to be addressed. As such, if it does entail any such information related to Cohen, he denies any knowledge or anything involved in this paragraph.

92. In December 2007, a certain variable annuity issuer terminated Horowitz's and the Signing Rep's appointments to sell its variable annuity products after determining that Horowitz and the Signing Rep had been selling stranger-owned annuities. Another variable annuity issuer subsequently terminated Horowitz's appointment to sell its annuities as well.

Cohen, at the time did not have any information about this paragraph, nor feels it needs to be addressed. As such, if it does entail any such information related to Cohen, he denies any knowledge or anything involved in this paragraph.

93. Unable to sell annuities through Broker-Dealer 1 or through the Signing Rep, Horowitz sought out a new broker through whom he could perpetuate his scheme.

Cohen, at the time did not have any information about this paragraph, nor feels it needs to be addressed. As such, if it does entail any such information related to Cohen, he denies any knowledge or anything involved in this paragraph.

94. In December 2007, Horowitz met with Cohen in Las Vegas and described his stranger-owned annuities investment strategy to him. At the time, Cohen was a registered representative with Broker-Dealer 3.

Cohen, does not deny the fact that he met Mr. Horowitz briefly together with David Zakheim and Abe Gottesman in Las Vegas. In case there are any allegations in this paragraph, they are denied.

95. Horowitz told Cohen that he had a "hedge fund" client, who wanted to invest in stranger-owned variable annuities on a short-term basis. Horowitz told Cohen that Horowitz or his associates would supply Cohen with the customers and the hospice patient annuitants, while Cohen would serve as the registered representative on the additional tranche of stranger-owned variable annuities sales. In exchange, Cohen would pay Horowitz's associates a "consulting fee." Cohen agreed to the arrangement.

Cohen adds to the first sentence of this paragraph ".....through the use of their Death Benefits on behalf of the funds family members" is what Horowitz told Cohen.

Cohen agrees to the second sentence of paragraph 95 but adds "that these customers were ready to purchase annuities without any solicitation or recommendations made by Cohen."

Cohen strongly denies the last sentence in paragraph 95 and did not agree to the arrangement.

96. Between January and February 2008, Cohen, while an associated person of Broker-Dealer 3, sold at least 28 deferred variable annuities contracts to nominees of Institutional Investor 1, utilizing the deferred variable annuity products of at least 7 different insurance companies. Collectively, these nominees purchased approximately $40 million in variable annuities.

Cohen does not deny or argue this paragraph and will be argued during the hearing.

97. In each of the annuities he sold, Cohen designated a hospice or nursing home patient as the contract annuitant, utilizing patient ID and Health Data supplied to Cohen by Horowitz's associates (who, in turn, had received the data from Annuitant Finders 2 and 3). Accordingly, Cohen knew that the annuities were being purchased with the intention of using them as vehicles for short-term investment.

Cohen had no clue at the time, of any information of their status or where they came from outside of having an understanding that their life expectancies were short and that they were from the Chicago area. The word "designated" is an untrue statement as Cohen had no role in matching or designating any annuitants to any specific owner or trust. An association to Horowitz's associate – is an untrue statement as well. Cohen had no knowledge or reason to believe that Horowitz and the Gottesmans were associates and remembers to the contrary that Horowitz said that he gave the strategy over to Gottesman his best friend.

At the time Cohen did not even know that annuitant Finder 2 and 3 existed. Cohen denies the last sentence of paragraph 97.

> **98. As was the case at Broker-Dealers 1 and 2, variable annuities sales at Broker-Dealer 3 were subject to principal review to ensure that the proposed sale was suitable and that the investment was being used for its intended purpose. With respect to each annuity contract that he sold, Cohen was required to complete a "variable annuity point of sale" form. Among other information, Cohen was required to state when his customers intended to begin accessing their annuity investment, and whether they intended to do so during the surrender charge period.**

Cohen never had knowledge as to the process of principal review in order ensure that the proposed sale was suitable and that the investment was being used for its intended purpose within Broker Dealer 1 and 2.

Broker Dealer's 3 (Woodbury) Principal review was only necessary for recommended and/or solicited sales and not necessary for order-taker sales with no solicitation or recommendations made by Respondent. "Intended use" was not a necessary element of suitability or as a Broker Dealer's requirement at the time of these sales.

Barring any institutional investor sales requirements or restrictions of Woodbury at the time, no suitability requirements were needed; since these investors had over $100 million dollars in assets as the hearing will show together with the fact that no solicitation by Cohen took place outside of placing the orders on their behalf.

As such, there were no Federal, State, SEC, FINRA or even Woodbury rules that required the completion of a suitability review for these sales. Any voluntary information completed within the "variable annuity point of sale" forms were completed for informational gathering purposes only and not as part of a suitability requirement of any Federal or Broker Dealer rules. Any information relied upon by any parties to these completed forms, would thus be immaterial even if a duty to disclose existed which they obviously don't in regards to the sponsors and broker dealer.

The last sentence of paragraph 98 in the OIP, makes the wrong assumption that Cohen was required to state when his customers intended to begin accessing their annuity investment, and whether they intended to do so during the surrender charge period. As these were unsolicited orders and as well as institutional orders no such requirement was necessary. These variable annuity orders had a double exemption to the suitability requirements normally placed upon any other recommended sales.

Also note that the last sentence within paragraph 98 is misleading as these two statements are either one and the same or at the least the last statement is not something that was asked upon on the broker dealer form.

Even under the flawed arguments that suitability requirements were a necessary element to these sales, the section titled "Suitability" would justify the correct response of "11-15 years" that Respondent chose.

> **99. As part of the principal review, Broker-Dealer 3 principals scrutinized the investment access information that Cohen provided on behalf of his customers to ensure that that each customer would not need access to their investment during the surrender charge period in the annuity being purchased. Each of the variable annuity products that Cohen sold had a surrender charge period of at least 7 years.**

Either Woodbury was under no obligations to scrutinize the "investment access" question due to the non-solicitation or institutional aspect of the trades or as footnote 53 of this brief quoting FINRA NTM 01-23 says the following. **"Similarly, the Suitability rule does not apply where a member merely gathers information on a particular customer, but does not make any "recommendations." This is true even if the information is the type generally gathered to satisfy a suitability obligation."** Its information would become immaterial and thus not actionable by the Division in a misrepresentation or scheme case.

Even under the flawed arguments that suitability requirements were a necessary element to these sales, the section titled "Suitability" would justify the correct response of "11-15 years" that Respondent chose.

The following statement in the OIP is out right wrong and does not apply:

"principal scrutinized the investment access information that Cohen provided on behalf of his customers to ensure that that each customer would not need access to their investment during the surrender charge period in the annuity being purchased".

Feder testified to the following:

Q: Did you have any discussions with Michael Horowitz about the importance of a customer's response to questions concerning the length of time they intended to hold the annuities?

A: No

Q: Did you have discussions with Michael Horowitz about surrender charges that were written into the annuities contracts?

A: Surrender charge of what?

Q: Surrender charges that would be incurred if the contract had to be surrendered before a certain period of time?

A: I might have had a conversation with him, but it wasn't of importance to me, because we weren't planning on surrendering any of the contracts.

(5/11/11 Feder Investigative Tr. Ex 639, at 238:7-25.

Feder clearly shows the intent of purchasing these annuities were for the "Death Benefit" provisions and not the "investments" within the contracts. He clearly stated and implied such by

his response of "but it wasn't important to me, because we weren't planning on surrendering any of the contracts".

This alone should make the SEC's Division of Enforcement department (led by Mr. Lee Buck, Peter Haggerty and others) suspect, as they failed to provide this information under the Brady Provisions of the law.

> **100. Knowing that Broker-Dealer 3 would not approve his variable annuity sales if he provided truthful investment access information for his customers, Cohen providedfalse information regarding how soon the customers intended to access the investment (i.e.,not before "11 to 15 years") on each of the 28 Broker-Dealer 3 "Annuity-Point of Sale"forms that he completed.**

Either Woodbury was under no obligations to scrutinize the "investment access" question due to the non-solicitation or institutional aspect of the trades or as footnote 53 of this brief quoting FINRA NTM 01-23 says the following. "**Similarly, the Suitability rule does not apply where a member merely gathers information on a particular customer, but does not make any "recommendations." This is true even if the information is the type generally gathered to satisfy a suitability obligation."** Its information would become immaterial and thus not actionable by the Division in a misrepresentation or scheme case.

Even under the flawed arguments that suitability requirements were a necessary element to these sales, the section titled "Suitability" would justify the correct response of "11-15 years" that Respondent chose.

The following statement in the OIP is out right wrong and does not apply:

"principal scrutinized the investment access information that Cohen provided on behalf of his customers to ensure that that each customer would not need access to their investment during the surrender charge period in the annuity being purchased".

Feder testified to the following:

Q: Did you have any discussions with Michael Horowitz about the importance of a customer's response to questions concerning the length of time they intended to hold the annuities?

A: No

Q: Did you have discussions with Michael Horowitz about surrender charges that were written into the annuities contracts?

A: Surrender charge of what?

Q: Surrender charges that would be incurred if the contract had to be surrendered before a certain period of time?

A: I might have had a conversation with him, but it wasn't of importance to me, because we weren't planning on surrendering any of the contracts.

(5/11/11 Feder Investigative Tr. Ex 639, at 238:7-25.

Feder clearly shows the intent of purchasing these annuities were for the "Death Benefit" provisions and not the "investments" within the contracts. He clearly stated and implied such by

his response of "but it wasn't important to me, because we weren't planning on surrendering any of the contracts".

This alone should make the SEC's Division of Enforcement department (led by Mr. Lee Buck, Peter Haggerty and others) suspect, as they failed to provide this information under the Brady Provisions of the law.

As demonstrated earlier, the SEC clearly is aware that the "investment access" question was answered truthfully but chooses to warp the question's true meaning in order to justify their case against Respondent.

> **101. By providing false investment access information for the nominees of Institutional Investor 1, and by failing to disclose that they intended to access their annuities well within the surrender charge period, Cohen was able to fraudulently obtain principal approval of his stranger-owned annuities sales. As a result of Cohen's fraudulent acts and practices, the insurance companies whose variable annuities Cohen sold unwittingly issued stranger-owned variable annuities to Cohen's customers, and paid out substantial upfront sales commissions to Cohen**

As Feder clearly stated above, there were no intentions by the nominees or the funds to "access their [investments within their] annuities" within the surrender period as their intentions and hopes were to collect on the Death Benefits and Death Benefits only; and not through the surrender of the cash values or "Investments" within the annuities.

The flawed arguments of the Division that Q. 4 of "Investment Access" Annuity form incorporates the both withdrawals and Death Benefit too; and thus needing the expectation of the Death Benefit payout within its response - is insulting to all insurance agents or advisors intelligence worldwide. What authority does the Division have in changing a simple question's meaning in order to better fit in to their scheme of creating an alleged scheme to charge a respondent whenever they choose? Last I checked we were in the USA and not USSA (intended to sound like USSR).

Any ambiguity within a question, should not be used as the source to a Division's enforcement case in order to allow their harassment of a Respondent over a 7 year period to an alleged scheme that did not exist.

Paragraph 101 of Cohen's OIP then tries to tie that "as a result of Cohen's fraudulent acts and practices, the insurance companies whose various annuities Cohen sold unwittingly issued stranger-owned variable annuities to Cohen's customers." caused the insurance company to be the "losing party" (a required element of fraud) as well the misimpression than insurance companies reliance to the "Investment access question" (another required element of fraud) cannot be true and fails as a matter of law.

The attempt of the Division to create an inference between the Broker Dealer form and the insurance companies in order to claim that they were the "losing party" as a necessary element of fraud as chapter 101 of the OIP alleges is barred by case law thus creating no victims and no party that could rely upon any of the Suitability questions asked by the broker dealer.

This alone should be grounds for dismissal. When there is no true reliance nor any "loss party" when an allegation of fraud is made, the fraud charges must be dropped.

Once again the attempt of the Division to consider the broker dealer form as a part of the life insurance company application would fail as a matter of law. Since Insurance companies can require applicants to provide any information material to a risk. "Information not asked for is presumably deemed immaterial" *Stipcich v. Metropolitan Life Ins. Co.,* 277 U.S. 311,316 (1928) As the Supreme Court of Appeals of Virginia observed in affirming a verdict for an insurance applicant who did not disclose his wife's cancer:

> *had [the insurance company] considered the health of the insured was material to the risk assumed, under the type of policy...issued, it could have required evidence of insurability, or a medical examination of the person to be insured, or a written application setting forth the physical condition of such person, or, at the least, it could have made an oral inquiry as to such fact.*

Greensboro Nat. Life ins. Co. vs Southside Bank, 142 S.E.2d 551,555 (Va. 1965).

We clearly see that Insurance Companies cannot claim that a duty to disclose exists when they themselves fail to ask the question on their application. No obligation of a duty to Disclose would apply to Respondent Cohen as well, since his relationship with all of the Insurance Companies related to this proceedings were that of a "broker" and not of an "agent", thus exempting his duty to disclose to any of the companies at hand.

His only duty to disclose was to the "Owners" of the contracts which are challenged or questioned in this proceedings.

The position of the Division that insurance companies are better off with an outside broker dealer form than they are with their own applications is preposterous making and cannot be true.

The Division's statement in paragraph 101 that the insurance companies relied upon the alleged "misstatement" of Cohen and paid out substantial upfront sales commission to Cohen is void as to a matter of law. This alone should be grounds of dismissal.

Insurance companies can't be better off with the Broker Dealer forms which are not part of their applications then they are with their own applications since it's a well-established law "that if an insurance company does not ask the question, there is no duty to provide that information.

The insurance companies Cohen used to place the orders of nominees, made a calculated business decision not to request any information concerning the annuitants' health or life expectancies, or concerning the beneficial ownership of the contracts. If they wanted such additional information, they should have asked. Cohen had no duty to volunteer information that was unsolicited. One of the insurance companies required a certification that the listed owner was the beneficial owner, and consequently Cohen did not sell that companies product (Nationwide Financial), nor did Feder or the fund purchase any annuity contracts from Nationwide Financial.

To establish primary liability under Section 10(b) and Rule 10b-5, the Commission would have to prove a material misrepresentation (which there wasn't), a material omission if there was a duty to speak (which there wasn't), or the use of a fraudulent device(which as the motion pending in the court shows that an alleged misrepresentation and alleged scheme are not the same and there is no scheme in the allegations against Cohen) . Each theory requires scienter, which is critically absent here.

Insurance Companies.

Although, the Division has affirmatively stated that this case is not about insurance fraud in their "Reply to the opposition of the Motion to Quash" Respondent will clearly address these issues in order to eliminate the potential "scienter" that the Division might claim to present their case. The Staff has previously suggested several theories under which it believes defrauded the insurance companies --through the use of short-lived annuitants, nominees, forms signed in blank,[45] non-New York addresses, and signatures outside of New York. There are fundamental flaws with each of these fraud theories that have already failed.

Contracts with insurance companies must be "strictly construed" against the insurer. The reason for this well-established rule is that insurance contracts are drafted by insurance companies, which control the contracts' language. It is up to the insurance company to ask the questions that it wants answered. If an insurance company chooses not to ask a question, an applicant or broker may reasonably conclude that the company does not want that information. This negates any inference of scienter based on a failure to volunteer information.

As for the use of **short-lived annuitants**, there was no duty to volunteer information about the annuitants' health, and a duty to disclose voluntarily can arise only where disclosure is necessary to make prior statements not misleading or where there is an affirmative duty to disclose (as in the fiduciary context). Neither circumstance is present here.

Moreover, **there was no fraud in the use of nominees or in the use of non-New York addresses and signing forms out of state**. Nominees are routinely and legally used in a variety of contexts, and courts have held that listing a nominee as an owner or beneficiary on an insurance application is not a misrepresentation. The use of non-New York addresses likewise was not fraudulent: The record shows that: (1) the insurance companies did not require an applicant to use only one, principal residential address on applications; and (2) when asked, insurance companies expressly authorized the use of addresses other than a primary residence. Thus, Cohen lawfully submitted application materials that truthfully listed an address outside of New York where the they could receive their mail..

Nor did the use of nominees violate any prohibitions on corporate beneficial ownership. No such prohibition was imposed on any of the application forms sold by Cohen.

If the Division attempts to claim otherwise through a reliance on a tax provision in a single insurance company's prospectus concerning tax consequences for certain corporate owners they must be shut down as it does not support a finding of even an implicit misrepresentation about the Clients' ownership interest, much less a material one.

Scheme Liability

Cohen's "activities' as the Division like to refer too, did not constitute a fraudulent "scheme." An actionable "scheme" here would require affirmative, deceptive conduct that *creates* a material misimpression in the minds of the insurance companies. There is no such deceptive conduct here. Moreover, case law bars the Staff's apparent effort to rely on non-actionable omissions and misrepresentations in support of a "scheme" theory of liability.

Annuitants. The Staff's insinuations that suggest that Cohen defrauded some or all of the annuitants is similarly misplaced. Cohen had no contact with the annuitants and no involvement in the process by which they were recruited to participate in the strategy. Cohen also had no reason to doubt Horowitz, a Morgan Stanley broker, who told him that the annuitants were willing participants and would be fairly compensated for their risk-free consent to serve as annuitants.

Moreover, Cohen understood that even when the contracts lost money within the annuity, the annuitants bore no risk in the transactions and were well compensated with signed authorizations consenting to their use as annuitants to the annuities sold.

In sum, the Cohen had no knowledge of any misconduct in regards to these annuities and acted in good faith through a reasonable reliance on Horowitz, his lawyer, the fund, the funds lawyers and also his own due diligence that in no way seemed to restrict the use of annuities and annuitants within the insurance companies and broker dealer.at any time.

Cohen did not defraud any of the insurance companies, any of the annuitants, any of the Owners (which would include the nominees, Trusts, Trustees and Funds) or even his broker dealer. To the contrary, Cohen made no misrepresentations in either the Broker Dealer forms; the insurance company forms, to the Owners, and or annuitants or to any other parties involved while he acted in good faith. Respectfully, Cohen asks that these allegations and

charges be dismissed.

I. COHEN ACTED IN GOOD FAITH

Under any 10b-5 theory of liability, the Division has the burden of establishing scienter, *i.e.*, the "intent to deceive, manipulate, or defraud."[63]

For allegations of primary liability, the Staff must prove "at the least, . . . an extreme departure from the standards of ordinary care . . . to the extent that the danger was either known to the defendant or so obvious that the defendant must have been aware of it."[64] In other words, recklessness, as long as it is extreme recklessness, suffices for primary liability.

A defendant's scienter for either primary liability must extend not only to specific facts, but also to the circumstances that make statements or omissions fraudulent.[65] Thus, scienter cannot be inferred from a failure to disclose if the duty to disclose is "not so clear,"[66] or if "the materiality of the [information] is highly debatable."[67]

"cannot be inferred from a failure to disclose if the duty to disclose is "not so clear,"

Based on the above, Cohen's duty to disclose was either non-existent or at best "not so clear" as Cohen's argument of being exempt of suitability rules and thereby exempt from a duty

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[63] ECA, Local 134 IBEW Joint Pension Trust *ECA, Local 134 IBEW Joint Pension Trust v. JP Morgan Chase Co.*, 553 F.3d 187, 198 (2d Cir. 2009) ("*ECA*"); *SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1467 (2d Cir. 1996).

[64] *ECA*, 553 F.3d at 198 (internal quotation marks omitted).

[65] *See, e.g., Kalnit v. Eichler*, 264 F.3d 131, 143-44 (2d Cir. 2001) (holding awareness of undisclosed facts but not of duty to disclose insufficient to establish scienter); *Hirsch v. du Pont*, 553 F.2d 750, 759 (2d Cir. 1977) (stating "knowledge of the *fraud*, and not merely the undisclosed material facts, is indispensable" to aiding and abetting claim) (emphasis added).

[66] *Kalnit*, 264 F.3d at 143-44

[67] *Kalnit v. Eichler*, 99 F. Supp. 2d 327, 343 n.15 (S.D.N.Y. 2000); *see also In re GeoPharma, Inc. Sec. Litig.*, 411 F. Supp. 2d 434, 446 (S.D.N.Y. 2006); *L.L. Capital Partners v. Rockefeller Center Properties, Inc.*, 921 F. Supp. 1174, 1183 (S.D.N.Y. 1996).

to speak must be considered due to the fact that these annuity sales were unsolicited or institutional sales or even exempt based on both thus exempting these sales from any suitability requirements. This suitability exemption would eliminate the duty to speak and would defeat any scienter claims made by the Division.

"the materiality of the [information] is highly debatable".

Based on the above, Cohen's scienter cannot be inferred as the materiality of the information is highly debatable.

The intent of the "investment access" question is pretty clear that it does not address the "Death Benefit" but rather addresses the "Investments" within the annuity. This would eliminate any misrepresentation claims of the Division.

Even according to the Division's illogical stance that it might refer to both, it would at least be considered to be "Highly Debatable" thus scienter could not be inferred.

Cohen will show that the materiality of the "investment access" question during the time period of January –February of 2008,(when these annuities were sold), should not be debatable and would rather consider the "investment access" question "immaterial" thus making the Division's entire case of an alleged "straightforward misrepresentation" against him crumble.

Legal Reliance

Reliance on the advice of counsel is "evidence of good faith" and is a "relevant consideration" in determining whether the requisite scienter exists[68]. Depending on the

[68] *Howard v. SEC*, 376 F.3d 1136, 1147 (D.C. Cir. 2004); *see also, e.g., In re Digi Int'l Inc., Sec. Litig.*, 14 F. App'x 714, 717 (8th Cir. 2001); *SEC v. Steadman*, 967 F.2d 636, 642 (D.C. Cir.

circumstances of a particular case, reliance on legal advice can negate the requisite scienter for fraud in at least two ways. First, a defendant may assert a full-fledged advice of counsel defense, which requires a defendant to "show that he [(1)] made complete disclosure to counsel, [(2)] sought advice as to the legality of his conduct, [(3)] received advice that his conduct was legal, and [(4)] relied on that advice in good faith."[69]

Alternatively, a defendant may present a general good faith defense based on evidence of attorney advice[70] and may do so even if all of the elements of a full-fledged advice of counsel defense are not satisfied.[71] In *Howard*, for example, the D.C. Circuit vacated an SEC order and remanded the case for reconsideration, despite the SEC's undisputed claim that the defendant could not satisfy the elements of a full-fledged advice of counsel defense.[72] The court held that the defendant still could not be found to have acted with scienter in light of the "powerful evidence" of his good faith, including the fact that outside counsel oversaw the closing and drafted the relevant documents for the transactions, as well as that a colleague had informed the defendant that outside counsel approved the transactions.[73]

Cohen reasonably believed that he did not owe a duty to disclose information not specifically asked of him, that they did not withhold material information, and that — to the extent

1992); *In re Reserve Fund Sec. & Derivative Litig.*, 732 F. Supp. 2d 310, 321 n.8 (S.D.N.Y. 2010).

[69] *Markowski v. SEC*, 34 F.3d 99, 105 (2d Cir. 1994). If these elements are satisfied, a specific jury instruction on the advice of counsel defense is warranted. *See, e.g., United States v.*

Walters, 913 F.2d 388, 392 (7th Cir. 1990).

[70] *E.g., Howard*, 376 F.3d at 1147 ("[R]eliance on the advice of counsel need not be a formal defense; it is simply evidence of good faith, a relevant consideration in evaluating a defendant's scienter.") (citing *Bisno v. United States*, 299 F.2d 711, 719 (9th Cir. 1961)); *United States v. Okun*, No. 3:08-CR-132, 2009 WL 414009, at *6 (E.D. Va. Feb. 18, 2009).

[71] *See SEC v. Snyder*, 292 F. App'x 391, 406 (5th Cir. 2008) (holding that when relying on the advice of an attorney "[t]he defendant does not have the burden of proving any 'elements' of the defense before the jury can weigh the defendant's theory").

[72] 376 F.3d at 1147.
[73] *Id.* at 1148

questions were answered by Cohen — the questions were answered accurately. These beliefs were correct as a matter of law, as multiple lawyers concluded on behalf of the funds and Horowitz and of which relied upon at the time of starting the annuity sales. At a minimum, the Cohen's understanding was not an extremely reckless position given that the Division's apparent position is at best highly debatable.

In addition, Cohen relied upon a number of factors before and during the time that he was involved in placing the orders of the fund and/or nominees in the use of this annuity strategy that negate any inference of scienter, including:

- Cohen was aware of the Discussions that Horowitz, Feder, and the funds had in regrads to the annuity strategy with multiple attorneys, both in-house and outside counsel of the Hedge Fund, all of whom were informed of the use of short-lived annuitants and nominees, and none of whom found the strategy to be unlawful.

- Relying on the reputation of Horowitz, a Morgan Stanley broker whom Cohen was aware worked with his own attorney who reviewed and designed the Hippas used in the transaction. He also reviewed all aspects of th transaction and was familiar with the strategy in its entirety. Cohen also relied on the fact that Horowitz made that the idea for the strategy had first come from an insurance company representative and had been successfully executed before.

- Reviewing of all of the annuity applications, correspondence and prospectuses of each of the contratcts sold, all of which indicated that the insurance companies had made a business decision not to pursue information regarding the health of the annuitants or the use of nominees or even the fact that upon the death of a short-lived annuitant the Death Benefits would pay.

If needed, Respondent could detail the evidentiary factors demonstrating good faith.

II. THERE WAS NO FRAUD AGAINST THE INSURANCE COMPANIES

Although the Division in their Opposition to Cohen's Opposition to Quash the Division's Counsel affirmatively stated that "this case is not about Insurance Fraud", Respondent wants to make certain factors clear.

A. Annuity Contracts Are Construed Against Insurance Companies

It is a well-established legal principle that any ambiguity in an insurance company's documentation must be construed against the insurance company. As the Second Circuit has explained, "[b]ecause insurance contracts are inevitably drafted by insurance companies, New York law construes insurance contracts in favor of the insured and resolves all ambiguities against the insurer."[74] In this regard, "questions on insurance applications must be strictly construed against the insurance company when it seeks to avoid liability by citing the answers thereto as misrepresentations."[75] Accordingly, a misrepresentation can exist only when the questions are "so plain and intelligible that any applicant can readily comprehend them."[76]

B. There Was No Fraud in the Use of Short-Lived Annuitants

The Division at one point in their investigation expressed the view that the failure to volunteer unsolicited health information about the annuitants constitutes a fraud on the insurance companies. Under this theory, even though there was no affirmative misrepresentation, and even though the annuity application forms asked no health questions, the Staff alleges there was a fraud by omission in the failure to volunteer that the annuitants

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[74] *Vella v. Equitable Life Assurance Soc'y of U.S.*, 887 F.2d 388, 391 (2d Cir. 1989); *see also Home Ins. Co. of Ill. (N.H.) v. Spectrum Info. Techs., Inc.*, 930 F. Supp. 825, 837 (E.D.N.Y. 1996) ("Ambiguity must be construed in favor of the insured because of the drafters' control over the provision's language[.]").

[75] *Bifulco v. Great N. Ins. Co.*, No. 99-CV-0119E(M), 2001 WL 877335, at *3 (W.D.N.Y. July 3,2001).

[76] *Dineen v. Gen. Accident Ins. Co. of Philadelphia*, 110 N.Y.S. 344, 346 (N.Y. App. Div. 1908); *see also Home Ins. Co. of Ill.*, 930 F. Supp. at 837 (collecting support for this proposition); *Nadel v. Manhattan Life Ins. Co.*, 621 N.Y.S.2d 180, 182 (N.Y. App. Div. 1995) ("In evaluating whether answers to questions on insurance applications are misstatements, the questions posed must be so plain and intelligible that any applicant can readily comprehend them and any ambiguity will be construed in favor of the insured . . . .").

were short lived. This theory, however, finds no support in the law.

As demonstrated below, in the federal securities context there is clear precedent for the proposition that an applicant, when presented with a form, cannot be charged with fraud in failing to volunteer answers to questions above and beyond those asked in the form. In the state insurance context, the law is even clearer: non-disclosure of health information, including information regarding terminal illnesses, which an insurance company could have requested but did not request, is not fraudulent. State courts have reached this conclusion for two reasons:

(1) applicants have no duty to affirmatively disclose health information to insurance companies when the companies have chosen not to request it; and

(2) even if applicants somehow have a duty to disclose, insurance companies that do not ask health questions are estopped from claiming that the unsolicited health information is material.

(This should preclude the Division from claiming that there was a reliance by the insurance to unwittingly issue these annuity contracts and there for pay substantial commissions)- with no reliance and no loss the Fraud theories of the Division must be discarded.

1. Cohen Had No Duty To Volunteer Unrequested Health Information Regarding Short-Lived Annuitants

Rule 10b-5 provides that "[i]t shall be unlawful for any person . . . to omit to state a material fact necessary in order to make the statements made . . . not misleading." But "an omission is actionable under the securities laws only when the [buyer] is subject to a duty to disclose the omitted fact[]"; absent the existence of such a duty, the failure of a buyer to disclose any fact, even a material fact, is simply not actionable.[77] There was no duty to disclose in this case.

The simplest circumstance in which a duty to disclose arises is when a party is subject to an "independent statutory or regulatory disclosure obligation," such as an SEC rule governing required disclosure on a securities filing.[78] But here, there clearly is no statute or regulation requiring applicants or brokers to volunteer unsolicited health information on annuity applications.

The final possible source for finding an obligation to voluntarily disclose is when "disclosure is necessary to make prior statements not misleading."[79] But here disclosure was not necessary to correct a prior statement because Cohen never made any statements to the insurance companies that related to the health of the annuitants. The only statements made by Cohen to the insurance companies prior to purchasing the annuities were on the application forms. The forms contained no health-related questions. The only questions on these forms that related in any way to the annuitants' physical state were those asking for the annuitants' ages and genders. That information was provided. Similarly, the broker dealer forms contained no questions related to the annuitants' physical state.

A federal claim of securities fraud against an applicant cannot be predicated on the applicant's failure to answer questions that are not asked on the application form. The answers on the form cannot, as a matter of law, constitute an initial disclosure that triggers some sort of

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[77] *Vacold LLC v. Cerami*, 545 F.3d 114, 121 (2d Cir. 2008) (quoting *In re Time Warner Inc. Sec. Litig.*, 9 F.3d 259, 267 (2d Cir. 1993)) (first alteration in original); *see also San Leandro Emergency Med. Grp. Profit Sharing Plan v. Philip Morris Cos.*, 75 F.3d 801, 810 (2d Cir. 1996) (affirming dismissal of Rule 10b-5 claim against company for non-disclosure of marketing plans because it had no duty to disclose, "[e]ven . . . assum[ing] . . . that the . . . marketing plans constituted material information").

[78] *Dodona I, LLC v. Goldman, Sachs & Co.*, 847 F. Supp. 2d 624, 646 (S.D.N.Y. 2012); *In re Bank of Am. Corp. Sec., Derivative, & Emp. Ret. Income Sec. Act (ERISA) Litig.*, 757 F. Supp. 2d 260, 315-16 (S.D.N.Y. 2010) (finding defendant had disclosure obligation under SEC rules of Form 8-K, which require disclosure of "material definitive agreement[s] not made in the ordinary course of business").

[79] *E.g., In re Time Warner Inc. Sec. Litig.*, 9 F.3d 259, 268 (2d Cir. 1993).

an obligation to answer other questions which the form could have, but did not, ask. In *In re Morgan Stanley Information Fund Securities Litigation*,[80] which involved allegations of fraudulent omissions under Sections 11, 12, and 15 of the Securities Act, the plaintiffs alleged that the defendants should have volunteered information beyond that sought on the registration form. The Second Circuit rejected that claim, holding that, because the defendants had accurately provided all of the information required to be disclosed under SEC Form N-1A for registering their management investment companies, the defendants were under no duty to volunteer any additional information.[81] Relying on precedent interpreting omissions under various securities laws including Section 10(b), the court specifically "decline[d] to hold that defendants' disclosure of the information called for by [the] Form . . . gave rise to a duty to make disclosures about 'related subjects' not called for by the Form."[82] Similarly here, the limited questions posed on the annuity applications about the annuitants' physical state were answered completely and no additional information was volunteered. Cohen was under no duty to disclose information about the annuitants' health, even if that were somehow considered a "related subject []."[83]

It is clear then, that the federal securities laws create no obligation to volunteer unsolicited health information or information on the application that would include the time a purchaser chooses to hold the annuity whether by Death Benefit or by the Investment itself..

The case law is even clearer under the relevant state insurance laws. It is well-~~established that "[a]n applicant~~ for insurance is under no duty to volunteer information where no

[80] 592 F.3d 347 (2d Cir. 2010).

[81] *See id.* at 365-66

[82] *Id.* at 366.

[83] *Id.; see also, e.g., In re Bank of Am. Corp. Sec., Derivative, & Emp. Ret. Income Sec. Act (ERISA) Litig.*, No. 09 MD 2058, 2012 WL 1353523, at *7 (S.D.N.Y. Apr. 12, 2012) ("[T]heComplaint's omission theory does not identify with particularity any statements that were rendered misleading by the omission . . . . Absent such a link to misleading statements, the Complaint does not plausibly allege an actionable omission.").

question plainly and directly requires it to be furnished."[84] Following this principle, insurance law cases consistently reject the suggestion that an insurance applicant has a duty to voluntarily disclose a terminal illness, or other health information, which an insurance company could have requested but did not.[85] Rather, "[i]f [an insurer] wishe[s] to make a duty to disclose knowledge of terminal illnesses a condition of the policy, it should . . . include[] such a provision in the policy."[86]

If an insurance Company can't make a claim against an insured or a broker for not voluntarily disclosing the knowledge of a terminal illness- How could the Division try and create a new reliance on behalf of the insurance company and claim that they are the losers caused by the Broker Dealers form? The Division's claim of a reliance by the insurance companies and a loss caused by unwittingly issuing annuity contracts and thereby paying commissions is not only illogical but close to a mockery of one's intelligence.

2. *Because the Insurance Companies Decided To Forego Asking for Health Information, the Division Cannot Now Claim That Information Was Material*

To be actionable under the securities laws, an omitted fact must be "material."[87] The

[84] *Vella*, 887 F.2d at 393 (applying New York law).

[85] *See, e.g., Block v. Voyager Life Ins. Co.*, 303 S.E.2d 742, 744-45 (Ga. 1983) (insured applicant for credit life insurance had no duty to disclose his terminal cancer because "no health questions were ever asked of" him and "the policy . . . had no disqualification or exclusion for pre-existing health problems"); *Mulvihill v. Am. Annuity Life Ins. Co.*, 328 N.W.2d 402, 402-03 (Mich. App. 1982) (applicant for credit life insurance had no duty to disclose insured's terminal cancer because "[t]he insurance company did not request the information, and plaintiff did not have the duty to volunteer it"); *Uslife Credit Life Ins. Co. v. McAfee*, 630 P.2d 450, 453-55 (Wash. App.1981) (applicant for credit life insurance had no duty to disclose insured's terminal cancer "absent a request for health information or a statement of good health by an insurer"); *Southard v. Occidental Life Ins. Co. of Cal.*, 142 N.W.2d 844, 847-48 (Wis. 1966) (insured applicant for group-life insurance had no duty to disclose quadriplegia because application only asked whether he had a "serious illness").

[86] *Mulvihill*, 328 N.W.2d at 403.

[87] *Basic Inc. v. Levinson*, 485 U.S. 224, 231, 238 (1988).

obligation to disclose and the materiality of the information are two distinct elements of a securities law violation.[88] The Staff Division has asserted that unsolicited health information was material to the insurance companies, based upon insurance companies' internal policies, or testimony from their representatives, **indicating that they would not have knowingly issued annuities to purchasers who were using short-lived annuitants.** The Staff argues that insurance companies have reasons for not wanting to issue such policies, including that: (1) the annuities are designed to be long-term products providing retirement incomes (which is why they have large surrender fees in early years and tax penalties for early withdrawals); (2) the insurance companies incur up-front costs in issuing annuities that they cannot recoup with short-lived annuitants; (3) the use of short-lived annuitants materially alters the risk of the annuities in a way not accounted for in the insurance companies' fees; and (4) annuities issued to short-lived annuitants could harm other purchasers by forcing insurance companies to raise fees on all annuities, or otherwise change their management approach.

The critical flaw in the Staff's materiality theory is that the insurance companies made a business decision not to publicize any internal policies pertaining to the annuitants' life expectancies and not to ask any questions aimed at ascertaining the health or anticipated longevity of the annuitants. The insurance companies — and consequently the Staff — are estopped from claiming that the involvement of short-lived annuitants was material.

If the insurance companies felt that using short-lived annuitants was material, or that fact that the investors might want to take withdrawals out early was "material", they should have asked it on the applications itself to assureit would become "material" Relying on the Broker Dealer's suitability form which is designed exclusively to protect the interests

[88] *See Levine v. NL Indus., Inc.*, 926 F.2d 199, 202 (2d Cir. 1991) ("[W]e do not examine whether [defendant] had a duty to disclose, because we conclude that [the] allegations did not satisfy the requirement of materiality.").

<u>of the investor would not create the "investment access" question into a "material" factor on behalf of the annuity companies.</u>

<u>This should cause the Division's arguments to fail once again.</u>

a. The Insurance Companies Made a Business Decision To Forgo Asking for Health Information

Nothing prevents insurance companies from posing health-related questions on annuity applications or other forms. Indeed, insurance companies regularly ask extensive health-related questions before issuing products.[89] As just one example, a life insurance application available online for MetLife, one of the insurance companies involved in this case, contains two pages of questions exclusively devoted to the applicant's health and the health of the applicant's family members.[90] In addition, with respect to certain products, insurance companies require medical examinations.

In the context of annuities, the insurance companies understood fully that they should ask these sorts of questions if they wanted to weed out short-lived annuitants. In an April 2007 Wall Street Journal Article, "How to Exploit Your Annuities," the author commented on the fact that variable annuities are best-suited for people in poor health:

> [I]f you're in poor health or you're a retiree looking for income, here's an intriguing alternative: Buy variable annuities with part of your nest egg — and then wring maximum advantage out of the guarantees. . . . [S]uppose your health is deteriorating and your thoughts are turning to your heirs. Mr. Daughtrey recently had one such client. He arranged for the client to buy five separate variable annuities, investing $100,000 in each. . . . Sound risky? It wasn't. The client's heirs profited handsomely from those funds that took off. What if a fund flopped? The heirs instead pocketed the annuity's guaranteed minimum death benefit. "It allows you to take more risk than you usually would," Mr. Daughtrey says. "*It's one of the*

[89] Hager Decl. ¶ 10.

[90] *See* MetLife Life Insurance Application and Forms Package for Use in New York, *available at* http://www.accessbrkg.com/CompanyForms/MetLife/MetLife_Application_2008.pdf.

few opportunities to take advantage of an insurance company."[91]

Despite being aware that their variable annuity products are most attractive to individuals in poor health and with short life expectancies, and despite being in the business of eliciting health information when they want it, the insurance companies in this case did not ask for any health information on the relevant annuity applications or related forms. Any internal insurance company policies against issuing annuities to short-lived annuitants were never disclosed to the applicant pool and are therefore irrelevant. The only public statements the Staff has identified, contained in background sections of certain prospectuses, do not suggest a policy forbidding the use of short-lived annuitants; **they merely explain, in non-mandatory language, the general design of the product as a guide to the potential purchaser.[92] A statement to the effect that an investment is intended for one investment goal does not mean that an investor is forbidden from investing with a different investment goal in mind.**

When asked, the insurance companies readily confirmed that they had made the deliberate decision not to ask for health information on annuity applications. For example, in email correspondence between Horowitz and a Lincoln representative, the Lincoln representative explained that the company did not engage in "underwriting," *i.e.*, had not asked for health information, for these annuity products, but rather "aggregat[ed] the risk [associated with a given

[91] Division and Respondent Ex. 570 (emphasis added). This article was sent to Saul Feder by Horowitz on November 1, 2007. Saul Feder then forwarded the article to Feder.

[92] *See, e.g.*, FND02922 (Lincoln Prospectus stating that the "contract is designed . . . to provide retirement income . . . ."); FND0107021 (MetLife Prospectus stating that the "contract is intended for retirement savings or other long-term investment purposes."). *See generally* Securities and Exchange Commission, Form N-1A, at 7, *available at* http://www.sec.gov/about/ forms/formn-1a.pdf ("The purpose of the prospectus is to provide essential information about the Fund in a way that will help investors to make informed decisions about whether to purchase the Fund's shares described in the prospectus."). The Division will attempt in their arguments to provide many brochures that say an annuity is a long term vehicle. **But no where does that statement convey a restriction that it must only be used for a long term basis -rather its intent is more of a guide to the public.**

policy holder] with all the other policies holders."[93] Other insurance companies similarly stated in writing that they did not engage in underwriting for these annuity products.[94]

In sum, the insurance companies made a conscious business decision not to ask for health information or any information relating to the annuitants, or the amount that the owners or nominees were planning on holding the annuities.[95]

The Division in its attempt to claim that the carriers' reliance in our case is different, have attempted to create no laws and ignore those on the books. Although these proceedings have their own rule books for procedures, evidence, hearsay and etc,-- Nothing gives them the right to redefine the law in order for them to justify their case. We ask of the Court to rein in the Division and compel them to stick to the law of the US Constitution and not allow them to redefine or create the law through their own set of cliff notes.

In sum, insurance companies have made a conscious decision not to ask for certain information whether it is for the health of annuitants or even the amount of time one chooses to keep their annuities in force. **As demonstrated below, that decision should precludes them and especially the Division from maintaining a materiality claim.**

[93] BDL01110

[94] *See* FND0107341 (AIG); BDL01117 (Nationwide). These emails were forwarded from Horowitz to Feder.

[95] Goldsholle Decl. ¶¶ 8-9; Hager Decl. ¶¶ 9-10. Notably, the National Association of Insurance Commissioners ("NAIC") — the body with extensive expertise in this area — held a hearing in May 2010 on the issue of stranger-originated annuity transactions. In 2011, it approved a model bulletin for state commissioners to issue regarding these transactions. *See* Jeff Jeffrey, NAIC OKs Model on Stranger-Originated Annuity Transactions, InsuranceNewsNet.com, available at http://insurancenewsnet.com/article.aspx?id=254402&type=lifehealth#.UazjFdKyBlo. This bulletin states that in order to avoid these transactions insurance companies should take various steps, including "[r]evisit[ing] annuity application processes to ensure that specific questions are posed with regard to the relationship between the annuitant and contract owner, and the manner in which the contract is being funded." NAIC, Stranger-Originated Annuity Transactions, NAIC Sample Bulletin, available at http://www.naic.org/documents/legal_bulletin_111018_stoa.pdf.
The NAIC — consisting of the nation's experts in regulating the insurance industry — thus recognized that it was a failure of the insurance companies to ask the necessary questions on their applications that facilitated these transactions, and their proposed remedy is that the insurance companies simply *ask more questions.*

b. The Decision To Forgo Asking for Information Estops a Materiality Claim

The U.S. Supreme Court has held that, since insurance companies can require applicants to provide any information material to a risk, "information not asked for is presumably deemed immaterial."[96] As the Supreme Court of Appeals of Virginia observed in affirming a verdict for an insurance applicant who did not voluntarily disclose the insured's cancer:

> Had [the insurance company] considered the health of the insured was material to the risk assumed . . . it could have required evidence of insurability, or a medical examination of the person to be insured, or a written application setting forth the physical condition of such person, or, at the least, it could have made an oral inquiry as to such fact.[97]

In other words, when an insurance company declines to ask for information, the company is estopped from later claiming that the information was material.

Indeed, if the company did not ask for the information or otherwise notify the applicant of its importance, that applicant was "*entitled to suppose that [the insurance company] considered [the fact] to be irrelevant* to assessing the risk in issuing the policy."[98]

Here, the insurance companies chose not to ask for information that they commonly ask for in other contexts. The Staff's contrary suggestion that this information was material to the companies thus fails as a matter of law. The insurance companies' decision not to ask bars any claim that the information was material.[99]

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[96] *Stipcich v. Metropolitan Life Ins. Co.*, 277 U.S. 311, 316 (1928); *see also Vella*, 887 F.2d at 393.

[97] *Greensboro Nat. Life Ins. Co. v. Southside Bank*, 142 S.E.2d 551, 555 (Va. 1965).

[98] *Vella*, 887 F.2d at 389, 393 (emphasis added).

[99] By contrast, without any citation to the U.S. Supreme Court's language in *Stipcich*, the district court in Rhode Island in *Western Reserve I* stated that the use of short-lived annuitants

There Was No Fraud in the Use of Nominees

The Division in the past has taken the position that the use of nominees was fraudulent under the theory that it was both a material omission and a material misrepresentation to list nominees as the owners and beneficiaries of the variable annuity contracts when the true owners, the Division contends, were the Funds.

The Division further claimed in the past that the use of nominees was not only fraudulent in and of itself, it also enabled the Clients to circumvent: (1) contribution limits purportedly imposed by the insurance companies that, if exceeded, would have triggered additional inquiries; (2) geographic limitations on product features that were not available in New York, where BDL and the Funds were based, but that were available in states outside of New York, where the nominees had addresses; and (3) a purported prohibition by one insurance company against corporate beneficial ownership of variable annuities.

There was no fraud in the use of nominees or Trust Accounts. This is not a case where the insurance companies included in their application forms an express prohibition against beneficial ownership. These were sophisticated insurance companies who chose not to include such prohibitions on their application forms or to ask for beneficial ownership

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without disclosure to the insurer "*could* be found material by a jury." 15 F. Supp. 2d at 283 (emphasis added). That holding is flatly inconsistent with the Supreme Court's pronouncement that "information not asked for is presumably deemed immaterial." *Stipcich*, 277 U.S. at 316.

But even assuming that the *Western Reserve I* opinion regarding materiality is correct as a matter of law, it is not applicable here. In this case, because the insurance companies were on notice of the potential relevance of health information but chose not to ask, and then affirmatively confirmed that they were not seeking this information through underwriting, both the insurance companies and the SEC are estopped in our case from claiming materiality.

information. Under those circumstances, there is no affirmative duty to volunteer information to them; because of their sophistication, the insurance companies must ask their questions clearly, and any ambiguities must be resolved against them.[100] When the insurance companies do not prohibit or ask about nominees, the use of nominees in dealing with insurance companies is simply not fraudulent, even if, by doing so, the applicants are able to circumvent a limitation — or even a law — that the insurance companies seek to enforce.

1. Using Undisclosed Nominees in the Insurance Context, Even To Circumvent Requirements, Is Not Fraudulent

Using nominees to purchase products from insurance companies is not fraudulent, even when used to circumvent an insurance company's limitation. In *Kramer v. Lockwood Pension Services, Inc.*,[101] Judge Batts rejected the argument that using a nominee as part of a structured transaction seeking to avoid the application of the insurable interest requirement amounted to fraud-by-circumvention.[102]

Kramer involved stranger-originated life insurance transactions. Outside investors wanted to take out life insurance policies on Kramer's life, even though they did not have the insurable interest explicitly required by New York state law. To circumvent the absence of an insurable interest, the outside investors used Kramer and his children as nominees, so that the insurance companies would think that Kramer and his children (who obviously had an insurable interest) were the real investors[103]. After Kramer died, the insurance company refused to pay any death benefits, and asserted fraud claims against Kramer's estate and the investors, claiming they

[100] *See supra* § V.A
[101] 653 F. Supp. 2d 354 (S.D.N.Y. 2009).
[102]
[103] *Kramer*, 653 F. Supp. 2d at 364-67

had no insurable interest and had used Kramer and his children as a front to "circumvent[] New York's insurable interest rule."[104]

Judge Batts granted the motion to dismiss the insurance company's claims, noting that the company had failed to identify any misrepresentation or omission. The decision first sets forth the insurance company's theory that the use of nominees was fraudulent:

> The closest [the insurance company] comes to pleading fraud at any point in their counterclaims is their allegation that ". . . Mr. Kramer, Lockwood and the Trustee implicitly represented that (a) the Kramer August Trust would be the true owner and beneficiary of the requested Phoenix Policies (i.e. not just a strawman) and (b) the Kramer August Trust and its intended beneficiary had an insurable interest in Mr. Kramer's life.[105]

Judge Batts then concluded that this theory lacks merit:

> These "implicit" representations are just that, implicit, and do not appear on the face of the application for life insurance. *Kramer never represented, nor omitted to disclose who the eventual beneficiary of his insurance trust would be, as that question was never asked of him. . . . If Phoenix needed to know the beneficiaries of the Arthur Kramer Insurance Trust prior to determining whether to issue the policy it could have asked for that documentation or conducted an investigation. They cannot now claim that failure to disclose the identity of the beneficiaries of the Trust is fraud.*[106]

Judge Batts thus held that under New York state law it is neither an affirmative misrepresentation nor a misleading omission to list only a nominee as the "owner" or "beneficiary" on an application for a life insurance policy even if the nominee has assigned its beneficial interests to a third party stranger, and even if the nominee is being used to circumvent a statutory insurable interest requirement.

[104] *Id.* at 369.
[105] *Id.* at 379.
[106] *Id.* (emphasis added).

In a case decided shortly after *Kramer*, Judge Scheindlin considered a similar life insurance arrangement, and reached a different conclusion. Articulating the same position articulated by the Division in our case, Judge Scheindlin held that an applicant who purchased a life insurance policy through a strawman or nominee to circumvent the insurable interest requirement could be found to have engaged in fraud under New York law.[107]

The New York Court of Appeals subsequently vindicated Judge Batts and rejected Judge Scheindlin's conclusion. On appeal from *Kramer*, the Second Circuit certified to the New York Court of Appeals the following question: "Does New York Insurance Law . . . prohibit an insured from procuring a policy on his own life and immediately transferring the policy to a person without an insurable interest in the insured's life, if the insured did not ever intend to provide insurance protection for a person with an insurable interest in the insured's life?"[108] New York's highest court held that New York law permits an insured immediately to assign the proceeds of a life insurance policy to a stranger, even without an insurable interest.[109] By structuring a transaction in which the beneficiary immediately assigns his or her interest in a life insurance policy to a third party stranger, the beneficiary is acting as a nominee with the purpose of circumventing the insurable interest requirement. The fact that the Court of Appeals permitted this practice is a rejection of the Staff's view that the use of nominees to circumvent the insurable interest requirement constitutes fraud.

This case law makes clear that the undisclosed use of a nominee to *Kramer v. Phoenix* purchase an insurance product is not fraudulent, even if the nominee is used to avoid a requirement mandated by statute. And if using nominees does not amount to fraud in the life insurance context, it should certainly not be fraudulent in the variable annuity context.

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[107] *Penn. Mutual Life Ins. Co. v. Wolk*, 739 F. Supp. 2d 387, 389-91, 394-5 (S.D.N.Y. 2010).
[108] *Kramer v. Phoenix Life Ins. Co*, 15 N.Y.3d 539, 545 (N.Y. 2010).
[109] *Id.* at 551.

In contrast to the insurable interest requirement in *Kramer*, the limits in this case are not statutory requirements. They are at best language in the prospectuses that in our view is binding on no one. If there was no fraud in *Kramer* in circumventing the statutory insurable interest requirement, then there is no fraud in circumventing language in a prospectus.

D. <u>The Staff Cannot Establish a Fraudulent "Scheme" Under Subsection (a) and (c) of Rule 10b-5</u>

The Division has indicated that, even in the absence of a misrepresentation or omission actionable under subsection (b) of Rule 10b-5, the program as a whole constituted a fraudulent "scheme" that could be established under subsections (a) and (c).[110] The Staff has articulated the position that scheme liability under subsections (a) and (c) would not require proof that the statements amounted to misrepresentations or proof that any omissions were tied to any duty to disclose.

Such an attempt to contort what is fundamentally a case involving statements and omissions into a scheme liability theory would be unfruitful. Any effort by the Staff to rely on omissions or statements, then "back door" them into the scheme subsections in order to avoid requirements inherent in subsection (b), is barred by the case law. Misrepresentation and omission cases must be brought under that provision. Only in cases where the alleged fraud was perpetrated through conduct rather than statements or omissions could the Staff invoke subsections (a) or (c). Because this case is a statements or omissions case, it must be brought under subsection (b), and the Staff cannot circumvent its burden of proving that the statements

[110] Subsection (b) of the rule, the subsection most generally relied on, makes it unlawful for any person to "make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made . . . not misleading." 17 C.F.R. § 240.10b-5(b). Subsections (a) and (c) of Rule 10b-5 make it "unlawful for any person, directly or indirectly . . .
(a) [t]o employ any device, scheme, or artifice to defraud, [or] . . . (c) [t]o engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security." 17 C.F.R. § 240.10b-5(a), (c). Subsection (c) uses the phrase "course of business" rather than scheme, but we still refer to both
(a) and (c) as the scheme subsections.

amount to misrepresentations, or that the omissions are tied to a duty to disclose.

Furthermore, to the limited extent that the Staff's allegations go beyond statements and omissions and rely also on conduct, and the conduct component is then used as a vehicle to invoke the scheme subsections for everything, including the statements and omissions, the result would still be the same. The Staff will still have to demonstrate that the statements were false, and if it relies on omissions, it must prove there was a duty to disclose.

Finally, insofar as the Staff relies on conduct, it must show that the conduct was the equivalent of a misrepresentation, in that the defendant affirmatively gave the victim a false impression. Courts have universally rejected scheme liability in cases where the defendant did not *create* the misimpression through its conduct, but rather only did not *correct* a mistaken *assumption* in the mind of the counterparty or in the marketplace.

1. *The SEC Must Bring Misrepresentation or Omission Cases Under Subsection (b) and Cannot Backdoor Such Cases Through Subsections (a) and (c)*

Courts have repeatedly held that "where the primary purpose and effect of a purported scheme is to make a public misrepresentation or omission," subsection (b) is the exclusive source of primary liability under the securities laws.[132] In fact, "courts have routinely rejected the SEC's attempt to bypass the elements necessary to impose 'misstatement' liability under subsection (b) by labeling the alleged misconduct a 'scheme' rather than a 'misstatement.'"[133] Allegations of scheme liability cannot be used as a "back door into liability for those who help others make a false statement or omission in violation of subsection (b) of Rule 10b-5."[134]

[132] *SEC v. Kelly*, 817 F. Supp. 2d 340, 343 (S.D.N.Y. 2011) (citing, *inter alia*, *Janus Capital Grp. v. First Derivative Traders*, 131 S. Ct. 2296 (2011) (holding that only the "maker" of the statement could be liable under Rule 10b-5(b))); *accord SEC v. KPMG*, 412 F. Supp. 2d 349 (S.D.N.Y. 2006).

[133] *Kelly*, 817 F. Supp. 2d at 343 (collecting cases).

[134] *In re Parmalat Sec. Litig.*, 376 F. Supp. 2d 472, 503 (S.D.N.Y. 2005).

Where, as here, the SEC alleges a misrepresentation *and* a scheme, courts reject the scheme claims when the "conduct" is essentially a reiteration of the misrepresentation.[135]

Because the SEC's allegations of "scheme" liability here — the use of short-lived annuitants and the use of nominees — are the same as the facts that allegedly should have been volunteered to the insurance companies, Cohen cannot be liable under subsections (a) or (c). The "scheme" claims are merely a "reiteration" of the misstatement and omission claims,[136] and therefore all the burdens that the Staff seeks to avoid — the burden of proving that the statements amounted to misrepresentations, and the burden of proving that the omissions were tied to a duty to disclose — remain squarely on the Staff.

2. *A Violation of Any Subsection of Rule 10b-5, Including the Scheme Subsections, Requires Proof of "Deceptive" Conduct*

Even if the Staff could avoid bringing this case under subsection (b) covering statements and omissions, and instead found a way to bring this case under (a) and (c) covering schemes, it would still not avoid the burdens they seek to avoid. That is because it would bear the very same burdens even if it could bring this as a scheme case.

All three subsections are promulgated pursuant to the same statutory section. Section 10(b) of the Exchange Act — from which all three subsections of Rule 10b-5 derive their authority — states that "[i]t shall be unlawful for any person . . . [t]o use or employ . . . any . . . *deceptive* device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors." (emphasis added). Pursuant to the authority granted in the statute, the SEC

[135] *See, e.g., SEC v. Lucent Technologies,* 610 F. Supp. 2d 342, 361 (D.N.J. 2009) ("The alleged 'deception in this case arose from the failure to disclose the real terms of the deal,' which is 'nothing more than a reiteration of the misrepresentations and omissions that underlie plaintiffs [sic] disclosure claim.'").

[136] *See id.*

promulgated Rule 10b-5. "Rule 10b-5 encompasses only conduct already prohibited by § 10(b)."[137] Thus, all three prongs of Rule 10b-5, even (a) and (c), must satisfy the statutory "deceptive" requirement.[138]

3. *Statements Are Not "Deceptive" Under Section 10(b) Unless They Amount to Misrepresentations, and Omissions Are Not "Deceptive" Unless They Involve a Breach of Duty*

In *SEC v. Dorozhko*,[139] the Second Circuit addressed the question of what the statutory term "deceptive" in Section 10(b) of the Exchange Act means as applied to omissions and misrepresentations. Of course, any interpretation of the word "deceptive" as used in the statute would apply to all three subdivisions — including the scheme provisions — of the Rule 10b-5, promulgated pursuant to that statute.

The Court of Appeals determined that for a statement to be deceptive, it must amount to a misrepresentation; for an omission to be deceptive, it must involve a breach of duty.[140] In so doing, it relied on the presence of the word "deceptive" in Section 10(b). Because the Court of Appeals' conclusion rested on the *statute's* use of the term "deceptive," its determination necessarily applies to all sections of the Rule that were promulgated pursuant to that statutory provision. Any action under the Rule, no matter which subsection, must therefore prove that the statements amounted to misrepresentations and the omissions were tied to a duty to disclose.

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[137] Stoneridge Inv. Partners, LLC *v. Scientific-Atlanta*, 552 U.S. 148, 157 (2008).

[138] *See United States v. Finnerty*, 533 F.3d 143, 148 (2d Cir. 2008); *SEC v. Alternative Green Techs., Inc.*, No. 11 Civ. 9056 (SAS), 2012 WL 4763094, at *5 (S.D.N.Y. Sept. 24, 2012) (holding that conduct must be "inherently deceptive when performed") (internal quotation marks omitted); *SEC v. Simpson Capital Mgmt.*, 586 F. Supp. 2d 196, 201 (S.D.N.Y. 2008) (stating that a claim under subsections (a) or (c) must include an allegation that the defendant "committed a . . . deceptive act").

[139] 574 F.3d 42 (2d Cir. 2009).

[140] *Id.* at 50. In making the latter determination, the court adopted the position urged upon it by the SEC: "silence is fraudulent only if there is a duty to disclose." *Id.*

1. Conduct Is Not "Deceptive" Unless the Defendant Creates a Misimpression in the Mind of the Alleged Victim

In this case, the Staff has asserted that it might rely not only on omissions and misrepresentations, but also on conduct on the part of the Cohen. The Staff gave as an example the conduct in determining how much money would be allocated to which insurance company so as to stay below any of the insurance companies' underwriting triggers. However, as demonstrated below, for conduct to be "deceptive" under any of the subsections of Rule 10b-5, it must amount to the equivalent of an affirmative misrepresentation, and it must be a misrepresentation created by the defendant. If the alleged victim enters the marketplace with its own mistaken assumptions — as the insurance companies did here — scheme liability cannot be established on the basis that the non-fiduciary defendant has failed to correct those assumptions. This is true even where the defendant has deliberately exploited the mistaken assumption, has breached accepted rules of conduct, and has taken steps to avoid detection.

In *U.S. v. Finnerty*,[141] the Second Circuit held that Finnerty did not convey "an impression that was misleading, whether or not it could have a bearing on a victim's investment decision in connection with a security."[142] Even though some customers "may have expected that Finnerty would not engage in [interpositioning,] . . . *unless their understanding was based on a statement or conduct by Finnerty*, he did not commit a primary violation of § 10(b)."[143]

Like the investors in *Finnerty*, who mistakenly *assumed* compliance with a NYSE rule that prohibited interpositioning, the insurance companies here at most may have incorrectly *assumed* that the applicants were not acting as nominees for anyone, were paying the premiums

[141] 533 F.3d 143 (2d Cir. 2008).
[142] *Id.* at 149.

[143] *Id.* at 150 (emphasis added).

with their own assets, and that the annuitants were free of serious medical conditions. The Clients did not voluntarily correct those assumptions (which were unknown to them), but the Clients had no duty to do so. Therefore, their conduct does not amount to fraud under subsections (a) or (c).

Similarly, in *SEC v. Pentagon Capital Management*,[144] Judge Sweet found that the defendant hedge fund managers had engaged in multiple practices to avoid detection by the mutual fund police, including breaking up their investments into small tranches "with the intention of not drawing too much attention to the size of the overall purchase" and "to avoid detection."[145] The court held that the "evidence established that Defendants acted with the intent to deceive any fund that might have rejected their market timed trades into accepting those trades by 'staying below the radar.'"[146]

Notwithstanding these findings, the court rejected the SEC's assertion that the defendants' conduct amounted to a "scheme" in violation of Rule 10b-5. Judge Sweet recognized that the defendants did not affirmatively *create* any misimpression in the minds of the funds that were allegedly victimized.[147] Rather, the mutual funds (like the insurance companies

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[144] 844 F. Supp. 2d 377 (S.D.N.Y. 2012).

[145] *Id.* at 393, 414.

[146] *Id.* at 414.

[147] In another market timing case, the court granted summary judgment in part in favor of the

SEC, but only after finding that the "SEC has demonstrated that [the defendant] made misrepresentations to the various mutual funds," and, in addition, that the defendants engaged in schemes to evade clear prohibitions on market timing that mutual funds sought to enforce. *SEC v. Ehrenkrantz King Nussbaum, Inc.*, No. 05 CV 4643 (DRH) (GRB), 2012 WL 893917, at *11-12 (E.D.N.Y. Mar. 15, 2012). Here, however, there were no misrepresentations, and no explicit prohibition or enforcement effort by the insurance companies.

in our case) entered the marketplace with their own mistaken *assumption* that no applicant would seek lawfully to exploit the loopholes in the investment structure that they designed.[148]

In sum, the Staff cannot avoid the requirement that it prove that any allegedly fraudulent statements amounted to misrepresentations, and that any allegedly fraudulent omissions amounted to a breach of a duty to disclose.

RULE 2310 Rule in effect during the time period in question

- Specifically excludes non-recommended Sales
- Specifically excludes institutional Sales
- Does not include "Liquidity Needs" or "Investment Access" review.
- If no suitability needed then regardless of gathered information answers stay immaterial.

Rule 2821 Was not in effect prior to May 8th, 2008.

- Required "Suitability review by Principal of variable annuities regardless of whether recommended or not" eventually rescinded in 2010.
- Requires the "Liquidity Needs" or "investment Access" suitability review thus being material.

- No scheme or misrepresentation involved

- No violation of 17(a)(1) or (2) if no violation of

- Prima Facie Elements for Rule 10B-5 CAUSE OF ACTION

Conclusion

As such, Respondent Cohen respectfully requests that the Division's case against him be dropped as he will attempt to show that the Division's case is baseless and that it lacks substance to in order to prove his innocence in this matter.

Respectfully Submitted August 20, 2014.

By: Moshe Marc Cohen – Pro-Se

INFORMATIONAL

Online Suitability

Suitability Rule And Online Communications

SUGGESTED ROUTING

The Suggested Routing function is meant to aid the reader of this document. Each NASD member firm should consider the appropriate distribution in the context of its own organizational structure.

- Senior Management
- Legal & Compliance
- Executive Representative

KEY TOPICS

- Suitability
- Online Communications

Executive Summary

In light of the dramatic increase in the use of the Internet for communication between broker/dealers and their customers, NASD Regulation, Inc. (NASD Regulation) is issuing a Policy Statement to provide members[1] with guidance concerning their obligations under the National Association of Securities Dealers, Inc. (NASD®) general suitability rule, Rule 2310,[2] in this electronic environment.[3] NASD Regulation filed this Policy Statement on March 19, 2001, with the Securities and Exchange Commission (SEC). Pursuant to Section 19(b)(3)(A) of the Securities Exchange Act of 1934 and SEC Rule 19b-4(f)(1), the Policy Statement became immediately effective upon filing.

The Policy Statement briefly discusses some of the issues created by the intersection of online activity and the suitability rule. The Policy Statement then provides examples of electronic communications that NASD Regulation considers to be either within or outside the definition of "recommendation" for purposes of the suitability rule.[4] In addition, the Policy Statement sets forth guidelines to assist members in evaluating whether a particular communication could be viewed as a "recommendation," thereby triggering application of the suitability rule.[5]

NASD Regulation emphasizes, however, that this current Policy Statement does not (1) alter member obligations under the suitability rule or (2) establish a "bright line" test for determining whether a communication does or does not constitute a "recommendation" for purposes of the suitability rule. No single factor discussed below, standing alone, necessarily dictates the outcome of the analysis.

NASD Regulation recognizes that brokerage firms are using technology to offer many new beneficial services to customers, and it supports the continued development and use of technology to enhance investor education and access to information. These technological advances may have regulatory implications in the context of rules other than the suitability rule, and, therefore, we expect to issue future statements or guidance on the subject of online activities in the securities industry. NASD Regulation is aware, however, that technology is developing rapidly, and we want to avoid impeding the growth of new technological services for investors.

Questions/Further Information

Questions or comments concerning the information contained in this Policy Statement may be directed to either Nancy C. Libin, Assistant General Counsel, Office of General Counsel, NASD Regulation, Inc., at (202) 728-8835 or *nancy.libin@nasd.com,* or James S. Wrona, Assistant General Counsel, Office of General Counsel, NASD Regulation, Inc., at (202) 728-8270 or *jim.wrona@nasd.com.*

NASD Regulation Policy Statement Regarding Application Of The NASD Suitability Rule To Online Communications

Background

Technological developments in recent years have profoundly affected the securities industry.[6] One of the most dramatic changes is the way in which brokerage firms use the Internet to communicate with their customers. In addition to more traditional channels of communication such as the telephone and postal mail, broker/dealers and customers now transmit information to each other through broker/dealers' Web Sites, e-mail, Web phones, personal digital assistants, and hand-held pagers. Broker/dealers also use the Internet to provide lower-cost, unbundled services to customers. Among other things, broker/dealers have used the Internet to provide investors with new tools to obtain access to important analytical information, conduct their own research, and place their own orders. Technological advancements have provided many benefits to investors and the brokerage industry. These technological innovations, however, also have presented new regulatory challenges, including those arising from the application of the suitability rule to online activities.

The NASD's suitability rule states that in recommending to a customer the purchase, sale, or exchange of any security, a member shall have reasonable grounds for believing that the recommendation is suitable for such customer. As the rule states, a member's suitability obligation applies to securities that the member "recommends" to a customer.[7] The NASD's suitability rule generally has been violated when a broker/dealer "recommends" a security to a customer that might be suitable for some investors, but is unsuitable for that particular customer.

Applicability Of The Suitability Rule To Electronic Communications

There has been much debate recently about the application of the suitability rule to online activities.[8] Two major questions have arisen: first, whether the current suitability rule should even apply to online activities, and second, if so, what types of online communications constitute "recommendations" for purposes of the rule.

In answer to the first question, NASD Regulation believes that the suitability rule applies to all "recommendations" made by members to customers—including those made via electronic means—to purchase, sell, or exchange a security. Electronic communications from broker/dealers to their customers clearly can constitute "recommendations." The suitability rule, therefore, remains fully applicable to online activities in those cases where the member "recommends" securities to its customers.

With regard to the second question, NASD Regulation does not seek to identify in this Policy Statement all of the types of electronic communications that may constitute "recommendations." As NASD Regulation has often emphasized, "[w]hether a particular transaction is in fact recommended depends on an analysis of all the relevant facts and circumstances."[9] That is, the test for determining whether any communication (electronic or traditional) constitutes a "recommendation" remains a "facts and circumstances" inquiry to be conducted on a case-by-case basis.

NASD Regulation also recognizes that many forms of electronic communications defy easy characterization. Nevertheless, we offer as guidance the following general principles for member firms to use in determining whether a particular communication could be deemed a "recommendation." As illustrated by the examples provided below, the "facts and circumstances" determination of whether a communication is a "recommendation" requires an analysis of the content, context, and presentation of the particular communication or set of communications. The determination of whether a "recommendation" has been made, moreover, is an objective rather than a subjective inquiry. An important factor in this regard is whether—given its content, context, and manner of presentation—a particular communication from a broker/dealer to a customer reasonably would be viewed as a "call to action," or suggestion that the customer engage in a securities transaction. Members should bear in mind that an analysis of the content, context, and manner of presentation of a communication requires examination of the underlying substantive information transmitted to the customer and consideration of any other facts and circumstances, such as any accompanying explanatory message from the broker/dealer.[10] Another principle that members should keep in mind is that, in general, the more individually tailored the communication to a specific customer or a targeted group of customers about a security or group of securities, the greater likelihood that the communication may be viewed as a "recommendation."[11]

Scope Of The Term "Recommendation": Examples

In order to provide guidance to members, NASD Regulation offers some examples of electronic communications that could be viewed as within or outside the definition of "recommendation." These examples are intended to show the application of the above-mentioned general principles.

In addition to when a member acts merely as an order-taker regarding a particular transaction,[12] NASD Regulation generally would view the following activities and communications as falling outside the definition of "recommendation":

- A member creates a Web Site that is available to customers or groups of customers. The Web Site has research pages or "electronic libraries" that contain research reports (which may include buy/sell recommendations from the author of the report), news, quotes, and charts that customers can obtain or request.
- A member has a search engine on its Web Site that enables customers to sort through the data available about the performance of a broad range of stocks and mutual funds, company fundamentals, and industry sectors. The data is not limited, for instance, to, and does not favor, securities in which the member makes a market or has made a "buy" recommendation. Customers use and direct this tool on their own. Search results from this tool may rank securities using any criteria selected by the customer, and may display current news, quotes, and links to related sites.[13]
- A member provides research tools on its Web Site that allow customers to screen through a wide universe of securities (*e.g.*, all exchange-listed and Nasdaq securities) or an externally recognized group of securities (*e.g.*, certain indexes) and to request lists of securities that meet broad, objective criteria (*e.g.*, all companies in a certain sector with 25 percent annual earnings growth). The member does not impose limits on the manner in which the research tool searches through a wide universe of securities, nor does it control the generation of the list in order to favor certain securities. For instance, the member does not limit the universe of securities to those in which it makes a market or for which it has made a "buy" recommendation. Similarly, the algorithms for these tools are not programmed to produce lists of securities based on subjective factors that the member has created or developed, nor do the algorithms, for example, produce lists that favor those securities in which the member makes a market or for which the member has made a "buy" recommendation.
- A member allows customers to subscribe to e-mails or other electronic communications that alert customers to news affecting the securities in the customer's portfolio or on the customer's "watch list." Such news might include price changes, notice of pre-scheduled events (such as an imminent bond maturation), or generalized information. The customer selects the scope of the information that the firm will send to him or her.

NASD Regulation generally would view the following communications as falling within the definition of "recommendation":

- A member sends a customer-specific electronic communication (*e.g.*, an e-mail or pop-up screen) to a targeted customer or targeted group of customers encouraging the particular customer(s) to purchase a security.[14]
- A member sends its customers an e-mail stating that customers should be invested in stocks from a particular sector (such as technology) and urges customers to purchase one or more stocks from a list with "buy" recommendations.
- A member provides a portfolio analysis tool that allows a customer to indicate an investment goal and input personalized information such as age, financial condition, and risk tolerance. The member in this instance then sends (or displays to) the customer a list of specific securities the customer could buy or sell to meet the investment goal the customer has indicated.[15]
- A member uses data-mining technology (the electronic collection of information on Web Site users) to analyze a customer's financial or online activity—whether or not known by the customer—and then, based on those observations, sends (or "pushes") specific investment suggestions that the customer purchase or sell a security.

Members should keep in mind that these examples are meant only to provide guidance and are not an exhaustive list of communications that NASD Regulation does or does not consider to be "recommendations." As stated earlier, many other types of electronic communications are not easily characterized. In addition, changes to the factual predicates upon which these examples are based (or the existence of additional factors) could alter the determination of whether similar communications may or may not be viewed as "recommendations." Members, therefore, should analyze all relevant facts and circumstances, bearing in mind the general principles noted earlier and discussed below, to determine whether a communication is a "recommendation," and they should take the necessary steps to fulfill their suitability obligations. Furthermore, these examples are based on technological services that are currently used in the marketplace. They are not intended to direct or limit the future development of delivery methods or products and services provided online.

Guidelines For Evaluating Suitability Obligations

NASD Regulation believes that members should consider, at a minimum, the following guidelines when evaluating their suitability obligations. None of these guidelines is determinative. Each is but one factor to be considered in evaluating all of the facts and circumstances surrounding the communication.

- A member cannot avoid or discharge its suitability obligation through a disclaimer where the particular communication reasonably would be viewed as a "recommendation" given its content, context, and presentation.[16] NASD Regulation, however, encourages members to include on their Web Sites (and in other means of communication with their customers) clear explanations of the use and limitations of tools offered on those sites.

- Members should analyze any communication about a security that reasonably could be viewed as a "call to action" and that they direct, or appear to direct, to a particular individual or targeted group of individuals—as opposed to statements that are generally made available to all customers or the public at large—to determine whether a "recommendation" is being made.[17]

- Members should scrutinize any communication to a customer that suggests the purchase, sale, or exchange of a security—as opposed to simply providing objective data about a security—to determine whether a "recommendation" is being made.[18]

- A member's transmission of unrequested information will not necessarily constitute a "recommendation." However, when a member decides to send a particular customer unrequested information about a security that is not of a generalized or administrative nature (*e.g.*, notification of a stock split or a dividend), the member should carefully review the circumstances under which the information is being provided, the manner in which the information is delivered to the customer, the content of the communication, and the original source of the information. The member should perform this review regardless of whether the decision to send the information is made by a representative employed by the member or by a computer software program used by the member.

- Members should be aware that the degree to which the communication reasonably would influence an investor to trade a particular security or group of securities—either through the context or manner of presentation or the language used in the communication—may be considered in determining whether a "recommendation" is being made to the customer.

NASD Regulation emphasizes that the factors listed above are guidelines that may assist members in complying with the suitability rule. Again, the presence or absence of any of these factors does not by itself control whether a "recommendation" has been made or whether the member has complied with the suitability rule. Such determinations can be made only on a case-by-case basis taking into account all of the relevant facts and circumstances.

Conclusion

The foregoing discussion highlights some suggested guidelines to assist in determining when electronic communications constitute "recommendations," thereby triggering application of the NASD's suitability rule. NASD Regulation acknowledges the numerous benefits that are enjoyed by members and their customers as a result of the Internet and online brokerage services. NASD Regulation emphasizes that it neither takes a position on nor seeks to influence any firm's or customer's choice of a particular business model in this electronic environment. At the same time, however, NASD Regulation urges members both to consider all compliance implications when implementing new services and to remember that customers' best interests must continue to be of paramount importance in any setting, traditional or online.

As new technologies and/or services evolve, NASD Regulation will continue to provide statements or guidance regarding the application of the suitability rule and other rules.[19] To date, NASD Regulation has worked to resolve various suitability-related issues with federal and state regulators, NASD Regulation's e-Brokerage Committee, the NASD's Legal Advisory Board and Small Firm Advisory Board, NASD Regulation's Standing and District Committees, and the NASD membership. This open dialogue has been beneficial, and NASD Regulation will continue to work with regulators, members of the industry and the public on these and other important issues that arise in the online brokerage environment.

Endnotes

1 For purposes of this Policy Statement, the terms "member" and "broker/dealer" include both firms and their associated persons.

2 NASD Rule 2310 provides in pertinent part:

(a) In recommending to a customer the purchase, sale or exchange of any security, a member 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 as to his financial situation and needs.

(b) Prior to the execution of a transaction recommended to a non-institutional customer,...a member shall 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 member...in making recommendations to the customer.

NASD Rule 2310 applies to equity and certain debt securities, but not to municipal securities. Municipal securities are covered by Municipal Securities Rulemaking Board (MSRB) Rule G-19 ("Suitability of Recommendations and Transactions; Discretionary Accounts").

3 Although the focus of this Policy Statement is on the application of the suitability rule to electronic communications, much of the discussion is also relevant to more traditional communications, such as discussions made in-person, over the telephone, or through postal mail.

4 This Policy Statement focuses on "customer-specific" suitability under NASD Conduct Rule 2310. The word "recommendation" appears in quotation marks whenever it is discussed in the context of a customer-specific suitability obligation. A broker/dealer must also have a reasonable basis "to believe that the recommendation could be suitable for at least *some* customers." *In re F.J. Kaufman and Company of Virginia,* 50 S.E.C. 164, 168, 1989 SEC LEXIS 2376, *10 (1989) (emphasis in original). This is called "reasonable basis" suitability, and it "relates only to the particular recommendation, rather than to any particular customer." *Id. See also In re Charles E. Marland & Co., Inc.,* 45 S.E.C. 632, 636, 1974 SEC LEXIS 2458, *10 (1974) (recommending mutual fund switching creates rebuttable presumption of unsuitability); *In re Thomas Arthur Stewart,* 20 S.E.C. 196, 207, 1945 SEC LEXIS 318, *25 (1945) ("[T]he lack of reasonable grounds for recommending [switching shares of mutual funds]" was the basis for finding broker had violated NASD's suitability rule based on a "reasonable basis" theory.).

Although not directly addressed in this Policy Statement, in certain instances, a suitability violation also can be based on an inappropriate frequency of trades, often referred to as excessive trading or churning. *See* IM-2310-2, Fair Dealing With Customers ("Some practices that have resulted in disciplinary action and that clearly violate this responsibility for fair dealing are.... [e]xcessive activity in a customer's account."). A broker/dealer could violate the suitability rule, for example, where it recommended to a customer an excessive (and, based on the customer's financial situation and needs, an inappropriate) number of securities transactions and the customer routinely followed the broker/dealer's recommendations. *See, e.g., In re Harry Gliksman,* Exchange Act Rel. No. 42255, at 4, 1999 SEC LEXIS 2685, at *6 (Dec. 20, 1999) ("Under [Rule 2310], recommendations may be unsuitable if the trading is excessive based on the customer's objectives and financial situation."); *In re Rafael Pinchas,* Exchange Act Rel. No. 41816, at 11-12, 1999 SEC LEXIS 1754, at *22 (Sept. 1, 1999) ("[E]xcessive trading, by itself, can violate NASD suitability standards by representing an unsuitable frequency of trading").

5 While other NASD rules may cover circumstances where members are making recommendations (*see, e.g.,* Rule 2210, "Communications with the Public"), this Policy Statement is limited to a discussion of the suitability rule.

6 *See* SEC Guidance on the Use of Electronic Media ("Use of Electronic Media"), Release Nos. 34-7856, 34-42728, IC-24426, 65 Fed. Reg. 25843, 25843, 2000 SEC LEXIS 847, at *4 (Apr. 28, 2000) ("By facilitating rapid and widespread information dissemination, the Internet has had a significant impact on capital-raising techniques and, more broadly, on the structure of the securities industry.").

7 A member or associated person who simply effects a trade initiated by a customer without a related "recommendation" from the member or associated person is not required to perform a suitability analysis, although members may elect to determine whether a security is suitable under such circumstances for their own business reasons. *See In re Thomas E. Warren, III,* 51 S.E.C. 1015, 1019 n.19, 1994 SEC LEXIS 508, *11 n.19 (1994) ("We do not believe the suitability claims brought against the Applicant are supported by the record. There is no evidence that Warren recommended the transactions that were effected in these accounts."), *aff'd,* 69 F.3d 549 (10th Cir. 1995) (table format); SEC Announcement of Final Rule on Sales Practice Requirements for Certain Low-Priced Securities, Release No. 34-27160, 54 Fed. Reg. 35468, 1989 SEC LEXIS 1603, at *52 (Aug. 22, 1989) ("[T]he NASD and other suitability rules have long applied only to 'recommended' transactions."); Clarification of Notice to Members ("NtM") 96-60, 1997 NASD LEXIS 20 (FYI, Mar. 1997) (stating that a member's suitability obligation under Rule 2310 applies only to securities that have been recommended by the member). Similarly, the suitability rule does not apply where a member merely gathers information on a particular customer, but does not make any "recommendations." This is true even if the information is the type of information generally gathered to satisfy a suitability obligation.

Members should nonetheless remember that, under NASD Rule 2110, they are required to comply with know-your-customer obligations. Pursuant to these obligations, members must make reasonable efforts to obtain certain basic financial information from customers so that members can protect themselves and the integrity of the securities markets from customers who do not have the financial means to pay for transactions. *See* NtM 96-32, 1996 NASD LEXIS 51 (May 1996) (reminding members of their know-your-customer obligations), *supplemented and clarified on different grounds by* NtM 96-60 (Sept. 1996); see also NtM 99-11, 1999 NASD LEXIS 77 (Feb. 1999) ("While [this Notice] does not address firms' suitability obligations in connection with recommended transactions or their know-your-customer obligations, firms are reminded that the existence of these obligations does not depend upon whether a trade is executed on-line or otherwise."); NtM 98-66, 1998 NASD LEXIS 81 (Aug. 1998) (noting that members should provide a description of "any internal system protocols designed to fulfill a member's 'know your customer' obligations"). Unlike the suitability rule, the NASD's know-your-customer requirements apply to members regardless of whether they have made a "recommendation."

8 *See generally* SEC Commissioner Laura Unger, *Online Brokerage: Keeping Apace of Cyberspace* (Nov. 1999) ("Unger Report") (discussing various views espoused by online brokerage firms, regulators and academics on the topic of online suitability). The Unger Report can be accessed through the SEC Web Site at *www.sec.gov/news/spstindx.htm* (last modified on May 4, 2000). *See also Developments in the Law—The Law of Cyberspace, 112 Harv. L. Rev. 1574,* 1582-83 (1999) (The article highlights the broader debate by academics and judges over whether "to apply conventional models of regulation to the Internet.").

9 Clarification of NtM 96-60, 1997 NASD LEXIS 20 (FYI, Mar. 1997).

10 For example, if a broker/dealer transmitted a research report to a customer at the customer's request, that communication may not be subject to the suitability rule; whereas, if the same broker/ dealer transmitted the very same research report with an accompanying message, either oral or written, that the customer should act on the report, the suitability analysis would be different.

11 *See* Online Brokerage Services and the Suitability Rule, NASD Regulatory & Compliance Alert, at 20 (Summer 2000) (noting that the more individualized and particular the communication about a security, the closer the communication is to being viewed as a "recommendation"). The *Regulatory & Compliance Alert* article is also available at *www.nasdr.com/rca_summer00.htm. See also* Thomas L. Taylor III & Alan S. Petlak, Q&A Online: Chat, Research, Compliance Reporter, July 31, 2000, at 11 (stating that a factor to consider when determining whether a communication is a "recommendation" is the degree to which it is individualized and specific).

12 *See supra* note 7 and accompanying text.

13 Note, however, that hyperlinks conceivably could create suitability obligations, depending, for example, on the information provided to and from the hyperlinked site, the extent to which a member endorses the content of the hyperlinked site, the nature of the firm's relationship to the hyperlinked site, and other attendant facts and circumstances. It should also be noted that NASD Regulation has previously issued guidance regarding the responsibility of members for the content of hyperlinked sites. *See* Letter from Thomas Selman, Vice President, NASD Regulation, Disclosure and Investor Protection to Craig Tyle, General Counsel, Investment Company Institute, Nov. 11, 1997. This letter can be accessed through NASD Regulation's Web Site at *www.nasdr.com /2910/2210_01.htm. See also* Use of Electronic Media, *supra* note 6, at 65 Fed. Reg. at 25848-25849, *32-49 (discussing responsibility for hyperlinked information). In addition, NASD Regulation has provided guidance to firms regarding the use of "chat rooms" and "bulletin boards." *See* NtM 96-50, 1996 NASD LEXIS 60 (July 1996).

14 Note that there are instances where sending a customer an electronic communication that highlights a particular security (or securities) will not be viewed as a "recommendation." For instance, while each case requires an analysis of the particular facts and circumstances, a member generally would not be viewed as making a "recommendation" when, pursuant to a customer's request, it sends the customer (1) electronic "alerts" (such as account activity alerts, market alerts, or price, volume, and earnings alerts) or (2) research announcements (*e.g.*, a firm's "stock of the week") that are not tailored to the individual customer, as long as neither—given their content, context, and manner of presentation—would lead a customer reasonably to believe that the firm is suggesting that the customer take action in response to the communication.

15 Note, however, that a portfolio analysis tool that merely generates a suggested mix of general classes of financial assets (*e.g.*, 60 percent equities, 20 percent bonds, and 20 percent cash equivalents), without an accompanying list of securities that the customer could purchase to achieve that allocation, would not trigger a suitability obligation. On the other hand, a series of actions which may not constitute "recommendations" when considered individually, may amount to a "recommendation" when considered in the aggregate. For example, a portfolio allocator's suggestion that a customer could alter his or her current mix of investments followed by provision of a list of securities that could be purchased or sold to accomplish the alteration could be a "recommendation." Again, however, the determination of whether a portfolio analysis tool's communication constitutes a "recommendation" will depend on the content, context, and presentation of the communication or series of communications.

16 Although, as noted previously, a broker/dealer cannot disclaim away its suitability obligation, informing customers that generalized information provided is not based on the customer's particular financial situation or needs may help clarify that the information provided is not meant to be a

"recommendation" to the customer. Whether the communication is in fact a "recommendation" would still depend on the content, context, and presentation of the communication. Accordingly, a member that sends a customer or group of customers information about a security might include a statement that the member is not providing the information based on the customers' particular financial situations or needs. Members may properly disclose to customers that the opinions or recommendations expressed in research do not take into account individual investors' circumstances and are not intended to represent "recommendations" by the member of particular stocks to particular customers.

Members, however, should refer to previous guidelines issued by the SEC and NASD that may be relevant to these and/or related topics. For instance, the SEC has issued guidelines regarding whether and under what circumstances third-party information is attributable to an issuer, and the SEC noted that the guidance also may be relevant regarding the responsibilities of broker/dealers. Use of Electronic Media, *supra* note 6, at 65 Fed. Reg. at 25848-25849, *32-49 (discussing entanglement and adoption theories). *See also supra* note 13 and discussion therein.

17 We note that there are circumstances where the act of sending a communication to a specific group of customers will not necessarily implicate the suitability rule. For instance, a broker/dealer's business decision to provide only certain types of investment information (*e.g.*, research reports) to a category of "premium" customers would not, without more, trigger application of the suitability rule. Conversely, members may incur suitability obligations when they send a communication to a large group of customers urging those customers to invest in a security.

18 As with the other general guidelines discussed in this Policy Statement, the presence of this factor alone does not automatically mean that a "recommendation" has been made. For example, where a customer affirmatively requests to be alerted (by e-mail or pop-up screen) when a security reaches a specific price-point, when a company issues an earnings release, or when an analyst changes his or her recommendation of a particular security, the broker/dealer's decision to send the customer the requested information, without more, would not necessarily trigger a suitability obligation.

19 In this regard, NASD Regulation is considering further discussion of the application of the suitability rule to electronic communications involving initial public offerings in future guidance.

In the Matter of Certain Variable Annuities (HO-10840)

DECLARATION OF GERRY H. GOLDSHOLLE

[DOCUMENT 8 OF 9]

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June 7, 2013

DECLARATION OF GERRY H. GOLDSHOLLE

Pursuant to 28 U.S.C. § 1746, I declare under penalty of perjury that the following is true and correct:

1. I am retained by Curtis, Mallet-Prevost, Colt & Mosle LLP, counsel to the Clients[1] as an expert in the design, marketing and sale of insurance products, including variable annuities.

2. I am a graduate of Columbia Law School. After completing my military service, I began my career as a trial attorney with the Securities and Exchange Commission, where I headed the special enforcement and surveillance unit in the SEC's New York Regional Office (1965-1967). After several years as an associate at the law firms Kronish, Lieb, Shainswit, Weiner & Hellman (now, "Cooley LLP") and Gates & Laber, I joined the Law Department of Metropolitan Life Insurance Company ("MetLife") in 1971 and held a series of positions of increasing responsibility including Assistant General Counsel (1975-1979); Vice-President for Long Range Strategic Planning and Corporate Planning and Development (1979-1983); Vice-President for Investment and Fiduciary Services (1983-1987); and Vice-President in charge of Brokerage Operations, President and CEO of MetLife Marketing Corporation, and Chief Brokerage Executive (1988-1991). At the time I elected early retirement from MetLife in 1991, the unit I headed was producing approximately 15% of MetLife's total new individual life and annuity premiums.

3. After retiring at age 51 from MetLife, I formed a financial services consultancy (initially named, "Advice & Counsel International Inc.") that worked with banks, insurance

[1] "Clients" refers to the following entities and individuals: Platinum Management (NY) LLC and Platinum Credit Management LP (f/k/a Centurion Credit Management LP) (collectively, "the Funds"); BDL Group LLC ("BDL"); Murray Huberfeld; Mark Nordlicht; Brian Jedwab; Howard Feder; Richard Jedwab; Marilyn Jedwab; Bina Levy; Daniel Zeidman; Esther Zeidman; and Judah Perlstein.

companies, brokerage firms and industrial companies in matters involving the design, distribution and structuring of a variety of insurance products, including variable annuities. Now known as Advice Company, my firm now primarily operates one of the leading consumer-focused legal and insurance related websites, FreeAdvice.com, as well as several other sites.

4. I have served as an expert in insurance and securities related litigation matters for counsel to various insurance companies, insurance brokers and insurance agents and for several government agencies, including the United States Department of Justice and the Securities and Exchange Commission. Several of my expert assignments, including the matter I was engaged in by the SEC, involved Stranger-Owned Life Insurance and Viatical and Life Settlements. I also am a founding member of the law firm, Advocate Law Group P.C.

5. For approximately 20 years, I have been serving on the State Bar of California's Group Insurance Programs Committee. I have served as Chair of its Life Insurance Subcommittee for most of the past 20 years and chaired the full Committee for two terms. I formerly served as a member of, and as the Chair of the Administrative Law Committee of the New York City Bar Association. I also served for many years as a member of the Federal Regulation of Securities Committee of the American Bar Association's Business Law Section, and chaired its subcommittee on "going private." In addition, I served as a member, Vice-Chair and Chair of the Insurance Committee of the American Bar Association's Administrative Law and Regulatory Practice Section, and on the Council of that section.

6. I understand that in 2007, the Funds formed BDL to execute a program in which third-party nominees (trusts and individuals), using money provided by the Funds/BDL, purchased variable annuity contracts from various insurance companies. I have been advised that the annuitants for these contracts were diagnosed as terminally ill, and that the nominees

were contractually obligated to turn the annuity proceeds over to BDL upon receipt. I understand that the insurance companies were not told that the owners of the contracts were nominees for Platinum or BDL, and that the insurance companies were not told that the annuitants were terminally ill. I understand that each of the variable annuity contracts issued contained provisions that involved life contingencies – a promise by the life insurer to pay a death benefit equal to the initial amount paid to purchase the annuity – regardless of the value of the assets in the separate accounts underlying the annuity – to the owner of the annuity upon the death of the annuitant.

7. I have reviewed the 36 applications submitted on behalf of the nominees for the Funds to 8 different insurance companies. In none of these applications did the insurance company ask any questions about the health of the annuitant. In none of these applications did the insurance company ask any questions as to whether the owner of the annuity would be using his, her or its own funds to make the purchase, or if there was any plan or understanding with any third party with regard to transferring any incidents of ownership of the annuity, or if the owner was in any way working with or on behalf of an undisclosed investor.

8. I know from my 20-plus years of experience in the insurance business, both at MetLife and as a consultant, that when life insurance companies design products containing life contingencies they make a series of explicit decisions in terms of both the product features being offered, the applications being used, and the underwriting criteria they will apply prior to issuing the products, largely to eliminate the inherent risk of "adverse selection." The decisions the life insurance companies make generally represent a compromise between the various arms of the insurer. The units of the life insurer responsible for financial results and compliance – t

– want to carefully evaluate the features, risks and benefits of the insurer's products and apply strict controls on issue and underwriting of the products to increase the likelihood that the products will ultimately be profitable for the insurer. However, the sales arm of the life insurer is rewarded on the volume of new business it produces, not the profitability of that business. The sales arm generally seeks to maximize sales by making the products as attractive and as remunerative as possible to the producers in its distribution channels and making the sales and issue process as easy and fast as possible for the producers so that the producers will choose the insurer's products rather than products of another insurer. Ultimate profitability of the products is among the very least of the sales arm's concerns. The producer's objective is reasonably simple – absent any express preference from the customer as to which company's product the customer wants – the producer wants the application and issue process to be as easy and effortless as possible and to maximize its commission. The easier it is for the applicant and producer to complete the application and associated documents, the fewer and less intrusive the questions the life insurer asks, the less stringent the underwriting criteria that the life insurer applies, and the faster the life insurer will issue the product and pay the producer its commission, the more likely it is the producer will recommend a particular company's products.

9. Life insurers know that the more questions they ask, the more intrusive the questions they ask, and the more underwriting scrutiny they give applications, the fewer applications will be submitted, and the fewer annuities will be sold. Here the insurers that designed these applications made a conscious decision to exclude any questions regarding the health of the annuitant both in the applications the applicants were required to fill out or to seek any such information from the producers or applicants or annuitants apart from the application. Not asking questions about the health of the annuitant was an informed and calculated business

decision by the insurance companies. The insurance companies were aware that if they did not ask about the health of the annuitant, the applicant would be under no obligation to provide that health information to them. The insurance companies likewise know that if they do not ask about the health of the annuitant, they are likely to experience adverse selection, and issue some annuities on the lives of terminally ill persons. The insurers know that in such a case, because of the high front-end commissions they pay the producers, and the life contingency guarantees they built into the variable annuity, any annuities they issue to such an annuitant will likely cause a loss to the company. Not asking these questions almost certainly was an informed and calculated business decision by the insurance companies, and if not, it was reckless, particularly with large individual variable annuities.

10. I also observed that the applications from these insurers did not ask if the "owner" of the policy (the nominee in this case) was standing in for an undisclosed third-party, or was using the money of an undisclosed third party to purchase the policy. That too was an informed and calculated business decision by the insurers. With other insurance products marketed by some of these very same insurers (e.g., high value life insurance), the insurers ask in their applications: (i) whether the applicant intends to sell or transfer the policy, (ii) whether any third party is financing the premiums; and (iii) the purposes of procuring the product. The insurance companies ask these questions because if they are answered truthfully, the information provided might cause the underwriting department to refuse to issue the product. They also know that if the questions are not answered truthfully, the insurance company has a right to rescind the product. By choosing not to ask the questions, the life insurer has made the calculated decision to accept the risk that some annuities are being purchased by investors who are using these products as a speculative investment. With the variable annuities at issue here, the insurers knew

that if they asked whether the owner was standing in for an undisclosed third party, or was using funding provided by a third party, fewer applications would be submitted. Not asking these questions almost certainly was an informed and calculated business decision by the insurance companies, and if not, it was reckless, particularly with large individual variable annuities.

11. I understand that the SEC Staff takes the view that where the application asks for the name of an "owner" and "beneficiary," the insurer is asking for the "real" or "beneficial" owner, and the "ultimate" beneficiary (i.e., the undisclosed third party). That is *not* what the life insurer is asking, and if the insurer wanted to ask that question, it certainly knew how to do so. The life insurer was simply asking for a name of a person that is buying the annuity and the name of the person to whom it should pay the money when the annuity matures either because of the death of the annuitant or the owner's decision to begin taking a stream of annuity income. As noted in the paragraph above, if these insurers really wanted to know whether an investor was working behind the scenes, they knew exactly how to ask for that information. They would have asked, as they do in their applications for high value life insurance, whether the applicant intends to sell or transfer the annuity and whether a third party was financing the annuity consideration. They did not ask those questions here and would not expect any applicant to volunteer that information.

12. I understand that the SEC Staff contends that the broker/dealer's "point of sale" forms were relied upon by the insurance companies to screen out investors like BDL through suitability questions. I reviewed the brokerage forms in connection with the annuities purchased by BDL. The purposes of the suitability questions in the producer's point of sale forms appears to have been to protect the broker from potential claims by the customer that the product was unsuitable, or that the broker made inappropriate recommendations, failed to make appropriate

disclosures and/or was overreaching. It is also well known in the insurance industry that suitability questions are often filled out by the broker, not the applicant, and that the applicant might never see the completed form.

Dated: June 7, 2013
Sausalito, CA

Gerry H. Goldsholle

15085061

In the Matter of Certain Variable Annuities (HO-10840)

DECLARATION OF WILLIAM HAGER

[DOCUMENT 9 OF 9]

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June 7, 2013

Respondent
Exhibit
exhibitindexes.com #478
1132

CONFIDENTIAL TREATMENT REQUESTED

DECLARATION OF WILLIAM HAGER

Pursuant to 28 U.S.C. § 1746, I declare under penalty of perjury that the following is true and correct:

Qualifications

1. I am retained by Arnold & Porter LLP, counsel to the Clients,[1] as an expert in the regulation, design, marketing and sale of insurance products, including variable annuities.

2. I am a graduate of the University of Northern Iowa and received a law degree from the University of Illinois in 1974. Shortly after law school, I worked for three years (1975-1978) in the Iowa Department of Insurance, first as the Department's General Counsel and then as the Chief Deputy of the Department. In the latter position, my responsibilities included supervising the review of all life and health policy forms, including for annuities, submitted by insurers for approval by the State. After leaving government, I served for three years as general counsel and director of government relations to the American Academy of Actuaries, a professional association whose 17,000 members provide actuarial services in such areas as annuities and life and health insurance.

3. In 1986, I returned to the Iowa Department of Insurance to serve as the Insurance Commissioner for four years. As Commissioner, I was responsible for the regulatory oversight of all insurance companies, agents and brokers authorized to conduct business in Iowa. I also oversaw state regulation of the securities industry, with Iowa's Supervisor of Securities reporting directly to me. While Commissioner, I was a member of the National Association of Insurance Commissioners, which is an organization of the insurance commissioners of all 50 states that

[1] "Clients" refers to the following entities and individuals: Platinum Management (NY) LLC and Platinum Credit Management LP (f/k/a Centurion Credit Management LP) (collectively, "the Funds"); BDL Group LLC ("BDL); Murray Huberfeld; Mark Nordlicht; Brian Jedwab; Howard Feder; Richard Jedwab; Marilyn Jedwab; Bina Levy; Daniel Zeidman; Esther Zeidman; and Judah Perlstein.

meets regularly to consider and evaluate national insurance issues and to formulate responsive model insurance laws and regulations. My roles within this association included: Member of the Executive Committee, Chair of the Life Insurance Committee, and Chair of the Financial Services and Insurance Regulation Task Force.

4. Following my tenure as Commissioner of Insurance (1986-1990), I was appointed CEO of the National Council on Compensation , Inc. ("NCCI"). NCCI is an insurance rating and data collection bureau, owned by its member insurers, specializing in workers' compensation. It provides rate making services, database products, software, publications and consultation services to regulatory authorities, legislatures, and more than 700 insurance companies. I remained at NCCI for eight years.

5. Since 2000, I have been the President of Insurance Metrics Corporation, through which I provide reinsurance arbitration, insurance consulting, and expert insurance witness services. Since 2010, I have also been an elected member of the Florida House of Representatives. In that capacity, I am Vice Chair of the Insurance and Banking Subcommittee.

6. As an expert witness, approximately half of my work is for insurance companies and the other half is for policyholders.

<u>Background</u>

7. I understand that in 2007 the Funds, through the subsidiary BDL, executed a program in which third-party nominees (trusts and individuals), using money provided by BDL, purchased variable annuity contracts from various insurance companies. I have been advised that the annuitants for these contracts were diagnosed as terminally ill and that the nominees were contractually obligated to turn the annuity proceeds over to BDL upon receipt. I understand that the insurance companies were not told that the owners of the contracts were

nominees for the Funds or BDL or that the annuitants were terminally ill. I understand that each of the variable annuity contracts issued contained provisions that involved life contingencies—a promise by the life insurer to pay a death benefit equal to the initial amount paid to purchase the annuity regardless of the value of the assets in the separate accounts underlying the annuity—to the owner of the annuity upon the death of the annuitant, if the annuitant dies before the contract annuitizes.

8. I have reviewed the 36 applications submitted on behalf of the nominees for the Funds to eight different insurance companies. In none of these applications did the insurance company ask: any questions about the health of the annuitant; whether the owner of the annuity would be using his, her, or its own funds to make the purchase; if there was any plan or understanding with any third party about the ownership of the annuity; or if the owner was in any way working with or on behalf of an investor.

<u>Opinion</u>

9. Based on my more than 20 years of experience regulating and working in the insurance industry, I know that life insurance companies are extremely deliberate in drafting the questions posed on applications for insurance and annuities. The insurance companies understand that if they choose not to ask for information then the applicant will be under no obligation to disclose that information. However, the insurance companies also understand that if they ask more questions fewer people will be willing to purchase the product. Typically, an insurance company's application questions are decided upon through a committee composed of attorneys, actuaries, and sales representatives. There is always a tension between the attorneys and actuaries—who want to ask more questions in order to better assess the risk—and the sales representatives—who want to ask fewer questions in order to improve sales. The questions

posed on an application reflect a conscious compromise between the interest in being informed about the risk and the interest in increasing sales. Even after the initial application form is settled upon, the insurance company will continue to monitor the market, as well as developments in the law, and will change questions if they deem it appropriate.

10. Here, the insurance companies whose applications I have reviewed decided not to ask any questions regarding the health of the annuitant on the applications for their variable annuity products. Insurance companies have extensive experience drafting health-related questions when they wish to do so, such as in health and life insurance applications. These variable annuity applications, like all insurance company forms, would only have been implemented after internal approval by attorneys, actuaries, and sales representatives, as well as review by each state in which they would be used. In my opinion, not asking about the health of the annuitants on these variable annuity applications was an informed and calculated business decision by the insurance companies. Specifically, the insurance companies were aware that not asking for this information would permit people to purchase annuities for annuitants with short life expectancies and not disclose that fact, but the insurance companies decided this cost was outweighed by the benefit of increasing sales of their products.

11. The insurance companies whose applications I have reviewed also decided not to ask what I would refer to as "nominee questions" -- *e.g.*, whether the owner of the policy was standing in for an undisclosed third party or whether the owner was using the money of an undisclosed third party to purchase the policy. Again, insurance companies have experience drafting and including nominee questions on applications when they wish to do so. I believe that not asking nominee questions was another informed and calculated business decision by the insurance companies. Specifically, the insurance companies were aware that not asking for this

information would permit people to purchase annuities as nominees standing in for third parties and not disclose that fact, but the insurance companies decided this cost was outweighed by the benefit of increasing sales of their products.

12. I understand that the SEC Staff takes the view that where an application asks for the name of an "owner" and "beneficiary," the insurer is asking for the "real" or "beneficial" owner and the "ultimate" beneficiary (*i.e.*, the undisclosed third party). In my opinion, the SEC Staff's view is incorrect. Having evaluated insurance application questions as a regulator for many years, I do not understand the terms "owner" and "beneficiary" to refer to beneficial owners and ultimate beneficiaries. Moreover, insurance companies are aware that ambiguity in their questions will be construed against them. They were fully capable of asking unambiguous questions seeking information about beneficial owners and ultimate beneficiaries. They chose not to ask those questions here.

13. I understand that the SEC Staff contends that the insurance companies used suitability questions on brokerage account forms as a substitute for asking questions of applicants. I disagree with this contention. It is well known in the insurance industry that brokerage account forms are intended to document brokers' compliance with their obligations to offer products to customers with a suitable profile.[2] Brokerage account forms are not intended to be used by insurance companies to bind applicants. It is also well known in the insurance industry that suitability questions are often filled out by the broker, not the applicant, and that the applicant might never see the completed form. Any errors on the brokerage account forms are the responsibility of the broker and/or the insurance company working with that broker. In my

[2] *See, e.g.*, 17 CFR § 240.17a-3 ("The Commission has required that broker-dealers create and maintain certain records so that, among other things, the Commission, self-regulatory organizations ("SROs"), and State Securities Regulators . . . may conduct effective examinations of broker-dealers. . . . The primary purpose of Rule 17a-3(a)(17) is to provide regulators, particularly State Securities Regulators, with access to books and records which enable them to review for compliance with suitability rules.").

opinion, it is not plausible that the insurance companies used suitability questions on brokerage account forms as a substitute for asking questions of applicants.

14. I understand that the SEC Staff also contends that the insurance companies used disclosures in their prospectuses as a substitute for asking questions of applicants. For example, the SEC Staff contends that the prospectuses imposed contribution thresholds, as well as in one case a prohibition against corporate beneficial ownership, that the Clients purportedly circumvented or violated. Even assuming the Staff's interpretation of the prospectus terms is correct, I disagree with the Staff's premise that a prospectus can be used to expand the scope of an applicant's representations to an insurance company. It is well known in the insurance industry that prospectuses, like brokerage account forms, are intended to protect applicants, not to be used against them by insurance companies.[3] In my opinion, it is not plausible that the insurance companies used disclosures in their prospectuses as a substitute for asking questions of applicants.

Dated: June 7, 2013
Boca Raton, FL

William Hager

[3] [3] *See* Securities and Exchange Commission, Form N-1A 7, available at http://www.sec.gov/about/forms/formn-1a.pdf ("The purpose of the prospectus is to provide essential information about the Fund in a way that will help investors to make informed decisions about whether to purchase the Fund's shares described in the prospectus").