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Attorney for Securities and Insurance Departments

BEFORE THE STATE AUDITOR
AND COMMISSIONER OF SECURITIES
HELENA, MONTANA

IN THE MATTER OF:) CASE NO. 03-31-05-142 I
)
WADDELL & REED, INC.,) NOTICE OF PROPOSED AGENCY
6300 LAMAR AVENUE) DISCIPLINARY ACTION
OVERLAND PARK, KS, 66202,) AND OPPORTUNITY FOR HEARING
A Broker-Dealer firm registered in)
Montana and a federally covered Investment)
Advisor firm notice filed in Montana;)
ROBERT HECHLER, Individually and in his)
capacity as President, CEO and CFO for)
WADDELL & REED; ROBERT WILLIAMS,)
individually and in his capacity as)
Executive Vice President and National Sales)
Director for WADDELL & REED; and)
)
WILLIAM JELINEK, individually and in his)
capacity as a financial advisor, MICHAEL)
COSTLE, individually and in his capacity as a)
financial advisor, CHARLES GRIFFITH,)
individually and in his capacity as a financial)
advisor, MICHAEL ERICKSON, individually and)
in his capacity as a financial advisor, PATRICIA)
MATTHEW, individually and in her capacity as a)
financial advisor, KEVIN FREDENBERG,)
individually and in his capacity as a financial)
advisor, BRYAN THIES, individually and in his)
capacity as a financial advisor, WILLIAM)

SOLOMON, individually and in his capacity as a)
 financial advisor. KRISTINE VOORHEES,)
 individually and in her capacity as a financial)
 advisor. JUDY RIESENBERG, individually and)
 in her capacity as a financial advisor.)
 CHRISTOPHER FABER, individually and in his)
 capacity as a financial advisor, WILLARD)
 FLADAGER, individually and in his capacity as a)
 financial advisor, THOMAS TILLEMAN,)
 individually and in his capacity as a financial)
 advisor, GREGORY SCHMAUTZ, individually)
 and in his capacity as a financial advisor. VANCE)
 BENNETT, individually and in his capacity as a)
 financial advisor, ROBERT A. SMITH,)
 individually and in his capacity as a financial)
 advisor, THOMAS ADOLPH, individually and in)
 his capacity as a financial advisor, BRIAN)
 LETHERT, individually and in his capacity as a)
 financial advisor, ALBERT MARTINEZ,)
 individually and in his capacity as a financial)
 advisor, DANNY BERG, individually and in his)
 capacity as a financial advisor, EILEEN)
 ASHWAL, individually and in her capacity as a)
 financial advisor, JASON RENSKERS,)
 individually and in his capacity as a financial)
 advisor, MICHAEL BENTZ, individually and in)
 his capacity as a financial advisor, THOMAS)
 AGNEW, individually and in his capacity as a)
 financial advisor, JAYLA FROST, individually)
 and in her capacity as a financial advisor, GUS)
 SHARP, individually and in his capacity as a)
 financial advisor. JUDITH SEAMAN, individually)
 and in her capacity as a financial advisor, and)
 R. RAMONA SMITH, individually and in her)
 capacity as a financial advisor,)
)
 Respondents.)

Staff of the Securities and Insurance Departments (Departments) of the office of the State Auditor as Commissioner of Securities and Insurance of the state of Montana (Commissioner), pursuant to the authority of the Securities Act of Montana, Section 30-10-101, et seq., Montana Code Annotated (2003) (MCA), and the Insurance Code of Montana, Section 33-1-101, et seq., Montana Code Annotated (2003) (MCA), is proposing to the Commissioner that he take specific action against Waddell & Reed, Inc. (Waddell), with a principle place of business located at

6300 Lamar Avenue, Overland Park, Kansas. 66202, Robert Hechler (Hechler), Robert Williams (Williams) and William Jelinek (Jelinek), Michael Costle (Costle), Charles Griffith (Griffith), Michael Erickson (Erickson), Patricia Matthew (Matthew), Kevin Fredenberg (Frendenberg), Bryan Thies (Thies), William Solomon (Solomon), Kristine Voorhees (Voorhees), Judy Riesenber (Riesenber), Christopher Faber (Faber), Willard Fladager (Fladager), Thomas Tilleman (Tilleman), Gregory Schmautz (Schmautz), Vance Bennett (Bennett), Robert A. Smith (Robert Smith), Thomas Adolph (Adolph), Brian Lethert (Lethert), Albert Martinez (Martinez), Danny Berg (Berg), Eileen Ashwal (Ashwal), Jason Renskers (Renskers), Michael Bentz (Bentz), Thomas Agnew (Agnew), Jayla Frost (Frost), Gus Sharp (Sharp), Judith Seaman (Seaman), R. Ramona Smith (Ramona Smith), as identified above for violations of the Montana Securities Act and the Montana Insurance Code. The Commissioner has authority to take such action under the provisions of Sections 30-10-102, 30-10-107, 30-10-201, 30-10-301, 30-10-304, 30-10-305, 30-10-309, 30-10-321, 33-1-102, 33-1-301, 33-1-311, 33-1-317, 33-1-1302, 33-17-201, 33-17-231, 33-17-1001, 33-17-1101, 33-18-202, and 33-18-204, MCA.

In particular, the Departments' staff recommend specific action against Waddell and the individuals named as Respondents, including imposition of appropriate fines, appropriate restitution with interest and revocation or suspension of Respondents' registrations pursuant to the provisions of the Montana Securities Act, as well as imposition of fines, appropriate restitution with interest and revocation or suspension of Respondents' insurance producer's licenses pursuant to the provisions of the Montana Insurance Code.

Service of process is pursuant to § 30-10-107 (8), MCA and § 33-1-601-616, MCA.

REASONS FOR ACTION

There is probable cause to believe that the following facts, if true, justify and support such specific action.

ALLEGATIONS SPECIFIC TO SECURITIES LICENSING

1. Waddell & Reed, Inc. (Waddell) is a broker-dealer firm registered with Montana, and a federally covered investment advisor firm notice filed with Montana, and having a principle place of business at 6300 Lamar Avenue, Overland Park, Kansas, 66202.
2. Waddell referred to their retail sales personnel as "advisors". The Department refers to each of Waddell's retail sales personnel who conducted business in Montana as "Montana advisors" for purposes of this pleading.
3. The time period relevant to this action began in April 2000 and continued through August 2002.
4. Robert Hechler (Hechler) was the President, CEO and CFO for Waddell during the relevant time period. Hechler was not registered in Montana to sell either securities or insurance during the relevant time period.
5. Robert Williams (Williams) was the Executive Vice President and National Sales Director for Waddell during the relevant time period. Williams was not registered in Montana to sell either securities or insurance during the relevant time period.
6. During the relevant time period Waddell employed the following Respondents as Montana advisors: Jelinek, Costle, Griffith, Erickson, Matthew, Fredenberg, Thies, Solomon, Voorhees, Riesenber, Faber, Fladager, Tilleman, Schmautz, Bennett, Robert Smith, Adolph, Lethert, Martinez, Berg, Ashwal, Renskers, Bentz, Agnew, Frost, Sharp, Seaman, and Ramona Smith.

7. During the relevant time period Respondents Jelinek, Costle, Griffith, Enckson, Matthew, Fredenberg, Thies, Solomon, Voorhees, Riesenber, Faber, Fladager, Tilleman, Schmutz, Bennett, Robert Smith, Adolph, Lethert, Berg, Ashwal, Renskers, Bentz, Agnew, Frost, Sharp, Seaman, and Ramona Smith were registered in Montana as securities salespersons pursuant to § 30-10-201, MCA.

8. During the relevant time period Respondents Jelinek, Costle, Griffith, Enckson, Matthew, Fredenberg, Thies, Solomon, Voorhees, Riesenber, Faber, Fladager, Tilleman, Schmutz, Bennett, Robert Smith, Adolph, Lethert, Berg, Ashwal, Renskers, Bentz, Agnew, Sharp, Seaman, and Ramona Smith were registered in Montana as investment advisor representatives pursuant to § 30-10-201, MCA.

9. During the relevant time period Respondent Martinez was not registered in Montana as a securities salesperson. During the relevant time period neither Martinez nor Frost were registered in Montana as an investment advisor representative.

10. During the relevant time period Waddell and Respondents Jelinek, Costle, Griffith, Enckson, Matthew, Fredenberg, Thies, Solomon, Voorhees, Riesenber, Faber, Fladager, Tilleman, Schmutz, Bennett, Robert Smith, Adolph, Lethert, Martinez, Berg, Ashwal, Renskers, Bentz, Agnew, Frost, Sharp, Seaman, and Ramona Smith effected 155 exchanges of a variable annuity product from United Investors Life Insurance Company for a Nationwide Life Insurance Company variable annuity product.

11. During the relevant time period the mean age of Waddell's customers who were affected by the 155 exchanges was 55 years, 11 months; the mode age was 54 and the median age was 56 years. The average value of the annuities exchanged for Montana customers during this period was \$88,153.92; the average surrender penalty was \$1,502.81; the average

commission was \$5,262.32. There were 45 exchanges where the policies were valued over \$100,000 and 19 exchanges where the policies were valued over \$200,000.

12. An extreme example of the Respondents' behavior involves Waddell's customer identified as F.F. who was 63 years of age at the time Waddell exchanged his ULLIC variable annuity for a Nationwide variable annuity. The variable annuity policy was valued at \$347,816.47 at the time of the exchange (May 9, 2001), causing a surrender penalty of \$14,030.00 to be charged against the account and commissions of \$20,427.73 to be paid on the account.

13. During the relevant time period Waddell failed to reasonably supervise its Montana advisors by failing to provide appropriate criteria for conducting suitability analyses on each of the 155 exchanges of variable annuities for Montana customers in violation of Montana law as alleged in this Notice.

14. During the relevant time period Waddell engaged in dishonest and unethical practices in the securities business by urging and effecting the 155 exchanges of variable annuities for Montana customers without any appropriate suitability analysis.

15. During the relevant time period Waddell engaged in dishonest and unethical practices in the securities business by urging and effecting the 155 exchanges of variable annuities for Montana customers and charging the customers unreasonable fees for those exchanges.

16. During the relevant time period Respondents Jelinek, Costle, Griffith, Erickson, Matthew, Fredenberg, Thies, Solomon, Voorhees, Riesenber, Faber, Fladager, Tilleman, Schmautz, Bennett, Robert Smith, Adolph, Lethert, Martinez, Berg, Ashwal, Renskers, Bentz, Agnew, Frost, Sharp, Seaman, and Ramona Smith engaged in dishonest and unethical practices

in the securities business by urging and effecting the 155 exchanges of variable annuities for Montana customers without any appropriate suitability analyses.

17. During the relevant time period Respondents Jelinek, Costle, Griffith, Erickson, Matthew, Fredenberg, Thies, Solomon, Voorhees, Riesenber, Faber, Fladager, Tilleman, Schmautz, Bennett, Robert Smith, Adolph, Lethert, Martinez, Berg, Ashwal, Renskers, Bentz, Agnew, Frost, Sharp, Seaman, and Ramona Smith engaged in dishonest and unethical practices in the securities business by urging and effecting the 155 exchanges of variable annuities for Montana customers and charging unreasonable fees for those exchanges.

18. During the relevant time period Respondent Jelinek engaged in dishonest and unethical practices in the securities business by effecting an exchange of a variable annuity for a different variable annuity without authorization from his customer.

ALLEGATIONS SPECIFIC TO SECURITIES and INSURANCE FRAUD VIOLATIONS

19. The Department realleges by incorporation each of the above paragraphs from 1-18.

20. Waddell founded United Investors Life Insurance Company (UILIC) in 1961. UILIC sold a variable annuity product through Waddell. A variable annuity product has both securities and insurance features. The money customers use to purchase the product is invested in a family or families of mutual funds, less the various fees, charges and commissions associated with the annuity product. In this case, Waddell had proprietary interest in the mutual funds where UILIC customer's funds were invested. The insurance part of the product is a guarantee of income for the life of the customer, or for a specified period.¹

¹ While the basic purpose of life insurance is to provide an income for a beneficiary at the death of the insured, the annuity is intended to provide an income for the life of the annuitant. Barron's Dictionary of Insurance Terms, Fourth Edition, p. 30 (2000).

21. In the mid 1980's, Torchmark, Inc. (Torchmark) purchased both Waddell and ULLIC. The two companies remained wholly owned subsidiaries of Torchmark until November 1998, when Waddell was spun-off into a separate, publicly traded company. Waddell continued to primarily offer its customers ULLIC's variable annuity products after Waddell was spun-off.

22. ULLIC was wholly owned by Torchmark during the relevant time period and continues to be so owned at the present time. Torchmark is a publicly traded holding company with sufficient reserves to meet Montana's statutory requirements for insurers. Torchmark maintained those statutory reserves during the relevant time period and continues to do so at the present time.

23. In or about 1999, Waddell sought to have ULLIC share a portion of the annual mortality and expense ("M&E") charges ULLIC collected from variable annuity policyholders who had purchased through Waddell. Waddell sought 25 basis points² on both existing assets under management as well as new sales of ULLIC products. Initially the two parties reached a sharing agreement that gave Waddell 25 basis points on existing assets under management and 20 basis points on new assets. The parties later disputed the terms of the agreement with ULLIC refusing to pay the 20 basis points, alleging that Waddell agreed to promise not to exchange the ULLIC product sales for a product with a different company

24. As a result of the dispute, in early 2000 Waddell began to search for a variable annuity provider to replace ULLIC. During April of 2000 Hechler created a spreadsheet analyzing the potential profitability of switching the firm's ULLIC variable annuity business to

² Waddell sought asset-based commissions from ULLIC for selling and servicing ULLIC's variable annuity policies. Asset-based commissions are calculated on an annual percentage of the assets resulting from investment of the annual premiums. Charges and fees on variable annuity policies are referred to as "basis points." One basis point equals 1/100 of 1% of the asset value; 100 basis points equals 1% of the asset value.

another provider, based on M&E fees. His spreadsheet assumed that there would be exchanges by 90% of customers who held annuities with no remaining surrender charge, and exchanges by 20 – 65% of customers who had held variable annuities for five to eight years and thus would need to pay surrender charges to make an exchange.

25. In May of 2000, UILIC filed a lawsuit against Waddell in Alabama district court seeking repayment of funds taken directly out of the W&R Target Funds, Inc. (Target) mutual funds account. Target is Waddell's proprietary mutual fund company that supplies the mutual fund investments for both the UILIC and Nationwide variable annuities. The case filed by UILIC eventually went to the Alabama Supreme Court where certain facts were affirmed by the Court, including the following

- a) That UILIC paid a commission to Waddell for the sale of each variable annuity policy;
- b) That Waddell was actively seeking to exchange the UILIC products in the existing book of business for a variable annuity product from a company other than UILIC;
- c) That UILIC agreed to pay Waddell 20 basis points as commission on new sales and 25 basis points on the existing book of business;
- d) That Waddell owned and managed the mutual fund company into which the UILIC variable annuities were invested.

26. In August 2000, Waddell reached an agreement with Nationwide and by December 2000, began offering Nationwide's products to Waddell customers, primarily the Select and Select Plus variable annuity. Nationwide's variable annuity relies on the very same Target mutual funds as UILIC's products that were sold by Waddell.

27. The Nationwide variable annuity products offered a number of insurance features not available in ULLIC's primary variable annuity product. Nationwide's insurance features were offered either as optional riders for an annual fee measured as a percent of the value of the account each year or as part of the product itself. Nationwide's annuities are more costly to the customers over time. Additionally, the Nationwide Select Plus variable annuity is the only product which offers a so-called "bonus" feature: a "3% bonus", at cost of 45 basis points per year for 7 years. In order to break even on the "bonus" feature, the annuity would have to reach a rate of return of at least 7.75%.

28. During the relevant time period, Waddell engaged in an aggressive national effort to exchange the variable annuity investments of its customers from ULLIC to the substantially similar variable annuities provided by Nationwide.

29. As a result of this aggressive effort, Waddell's advisors recommended, and Waddell exchanged, more than 6,700 variable annuities nationally from ULLIC to Nationwide. This national book of business that was exchanged was worth approximately \$616 million. Those exchanges generated more than \$37 million in commissions to Waddell, and cost its customers approximately \$9.8 million in surrender charges, nationally.

30. During the relevant time period, Waddell exchanged 155 ULLIC variable annuities for Nationwide annuities in Montana. These exchanges affected at least 145 Montana customers, costing them at least \$235,935.42 in surrender charges.

31. In response to the Departments' investigation, numerous Waddell customers indicated that their Montana advisor told them that the Nationwide products would provide cost saving to the customer, a better return and represented a "better product" than the ULLIC variable

annuity. Furthermore, these customers indicated they felt they had “no choice” in the decision and that there would be no monetary impact to them.

32. The underlying investment portfolios of the Nationwide products (Select and Select Plus) were almost identical to those in the ULLIC products (Advantage II and Advantage Gold) offered through Waddell, and were proprietary to Waddell. However, Nationwide’s annuities are more costly to the customers over time, but provided a higher income to Waddell.

33. The exchanges of variable annuities by Waddell customers were costly to customers in several ways, including the following:

- a) Customers who switched before the end of their contingent deferred sales charge (CDSC)³ period paid surrender charges.
- b) All customers who switched incurred a new CDSC on their new product and could not sell the new product during the CDSC period without paying the new surrender charge.
- c) Customers who switched into the Nationwide variable annuities paid higher ongoing M&E fees than they had been charged with the ULLIC products.

34. Waddell made money in several different ways by recommending to its customers to switch from ULLIC to Nationwide variable annuities, including the following:

- a) The firm and the advisors made a commission on each exchange.
- b) Waddell also received a 25 basis point fee from the M&E fee paid by its customers for the Nationwide annuities.

³ This period is commonly referred to as a “hold” period. It is a specific period of time during which a customer is charged a fee for early withdrawal of money from the investment product. If the customer holds on to the investment product for the complete time period specified by not withdrawing any money from the product, they pay no fee. Thus these sales charges are deferred and contingent upon the customer keeping their money invested in the product for the “hold” period.

- c) Waddell eliminated the risk of decreasing the assets under Waddell's management, which could have occurred if UILIC replaced or supplemented the Waddell mutual funds with funds offered by other companies, or utilized a different group of advisors to sell their product.

35. In response to the Departments' investigation, Waddell's customer and Montana residents, R.K. and P.K. indicated they "have had to use money from [their] annuities to pay [their] rising heating bills, property taxes, and insurance. [They] live from one social security check to the next." This couple indicated "[They] are considering taking a reverse mortgage on [their] home to make ends meet." This couple exchanged their UILIC product for the Nationwide product with only one year left on their hold period, only to begin a new hold period with a new CDSC and higher M&E fees.

36. During the relevant time period, Hechler issued a series of memoranda to the advisors, including Montana advisors, repeatedly encouraging them to replace existing UILIC variable annuities with Nationwide variable annuities, including the following:

- a) **January 31, 2001** - in a memorandum on this date, Hechler stated that UILIC's issuance of subpoenas [part of the lawsuit previously discussed] "suggests that UILIC is no longer interested in a constructive relationship with Waddell & Reed, whereby you and your clients can receive the competitive products and services to which you and they are entitled." The memorandum stated Hechler's confidence in the firm's compliance procedures and encouraged switches "whenever appropriate and suitable."
- b) **February 9, 2001** - Hechler sent a memorandum on this date to the sales force stating that he wanted "to stress, again, that you should continue to use

Nationwide products wherever appropriate. . . . This is especially important since ULLIC no longer appears to value a constructive, mutually supportive relationship with Waddell & Reed ”

- c) **February 15, 2001** - Hechler sent another memorandum on this date reassuring the sales force of his confidence in the firm's compliance procedures. He also reiterated that the field should be undeterred in using Nationwide products for clients where appropriate and suitable.
- d) **March 6, 2001** - Hechler sent a memorandum on this date and a "Question and Answer" attachment to the sales force advising them that ULLIC was terminating the Principal Underwriting Agreement under which Waddell was selling ULLIC's products effective April 30, 2001, and encouraging advisors to exchange ULLIC variable annuities for Nationwide variable annuities.
- e) Hechler's **March 6, 2001** memorandum stated that "one might question [ULLIC's] incentive for seeking to provide us a high level of service"; questioned whether " ULLIC's variable and other business will receive meaningful attention or resources going forward"; and stated "once ULLIC has terminated the Principal Underwriting Agreement, it has the right to reassign variable annuity policies to non-Waddell & Reed representatives and to make [other] mutual funds...available to clients. It is reasonable to expect these actions by ULLIC, one outcome of which would be to cut off the flow of policy information to Waddell & Reed advisors. It therefore is very important that, in the time between now and April 30, you be especially proactive with your clients and take necessary steps to protect your relationships with them. To support that effort, divisions soon will

receive a list of UILIC policies sold and serviced by advisors within that division. We urge you to utilize this information as appropriate in securing your client relationships.”

- f) Hechler’s **March 6, 2001** memorandum claimed that UILIC could replace Waddell’s underlying mutual funds with other mutual funds, in which case the advisors’ trailing commissions would cease.
- g) Hechler’s **March 6, 2001** memorandum also suggested that UILIC would assign an unaffiliated advisor to the WADDELL clients, which “has an enormous potential to confuse our clients and set up a competition for their policy between the existing Waddell & Reed advisor and the newly named representative.” In addition, an attachment stated “there can be no assurance that UILIC will endeavor to continue to provide account information to our advisors, perhaps leaving them cut off from information regarding their clients’ accounts.”
- h) **March 21, 2001**, a week after receiving a letter from UILIC, Hechler sent an e-mail to Waddell’s Chief Marketing Officer with “some notes and ideas that might be used in communications with the sales force that could be used by Advisors as they work with their clients.” Some of these “ideas” were that UILIC’s financial condition could deteriorate to the point that it would no longer be viable as a separate company, and that UILIC’s employees could be demoralized to the extent that turnover would be high, which in turn could have a detrimental effect on the level and quality of policyholder service. Hechler also noted in his e-mail that, since UILIC’s original purpose was to provide insurance products for Waddell & Reed’s mutual fund shareholders, clients could be told, “with the

recent action of terminating its arrangement with Waddell & Reed, its primary distributor, it may be a good time to review your insurance needs to determine if more attractive alternatives are available.”

37. During the relevant time period, Williams also issued memoranda to the sales force encouraging them to replace existing ULLIC variable annuities with Nationwide variable annuities, including the following:

- a) **April 6, 2001** - Williams and Waddell’s Chief Marketing Officer sent a memo to all division managers that included a list of all ULLIC policies for each advisor in the district, an approved letter for clients, and a Q&A sheet. The letter told customers that the policies might be reassigned but that the lawsuit with ULLIC did not affect their ULLIC policies. It also stated that clients, in deciding whether to switch, could make the determination based on whether the benefits of the new policy, retention of service and desire to keep the advisor outweighed the costs of an exchange. The Q&A sheet gave no guidance to assist an advisor in determining the suitability of an exchange. It did, however, list the client’s desire to remain with the Waddell advisor, and concerns about whether ULLIC would service the policy properly in the future, as factors which could be taken into account in deciding whether to recommend an exchange.
- b) Williams’ **April 6, 2001** Q&A also contained statements casting doubt on whether ULLIC would live up to its commitment of continued service, and raised the possibility that ULLIC would close or fail as a result of severing ties to Waddell.

38. In response to the Departments' investigation and following these numerous memoranda, customers indicate Waddell's Montana advisors sent letters to these customers indicating "[r]ecently, to our surprise, United Investors Life informed us of its decision to end this long-standing relationship with Waddell & Reed." See attached **Exhibit A**. Additionally, in response to the Departments' investigation, Montana customers indicated, among other things that "Waddell & Reed were not getting along with United Investors." and "Waddell & Reed was not working with United Investors Life."

39. Following the numerous memoranda, the number of exchanges from ULLIC variable annuities to Nationwide variable annuities began to increase dramatically. Between March 1, 2001 and the end of June 2001, Waddell engaged in over 2500 exchanges from ULLIC to Nationwide variable annuities, involving assets of approximately \$269 million, surrender charges of \$4.7 million, and commissions of \$16.1 million nationally. During the month of March 2001, the number of exchanges from ULLIC policies to Nationwide policies jumped 540% over the previous month from 27 to 145 nationally. In April, the number of exchanges jumped another 490% over March's total from 145 to 711, and ranged from 451 to 819 per month nationally for the following six months.

40. As mentioned above, the number of exchanges from ULLIC to Nationwide variable annuities by Waddell's Montana advisors effected during the relevant period was 155. During the relevant period, these Montana exchanges involved assets of approximately \$13,663,857.83, surrender charges of \$232,935.42, and commissions of \$815,659.52.

41. During April 2001 there were 6 exchanges from ULLIC policies to Nationwide policies among Montana customers and in May 2001, 28 exchanges occurred. Thus, an increase

of 466% exchanges occurred in Montana from April to May. In June, there were another 30 exchanges, for an increase of 500% over April's total

42. In response to the Departments' investigation, at least one Montana customer indicated the Waddell advisor made the exchange without first informing the customer, that the customer was informed after the exchange was made.

43. In a letter dated March 14, 2001, as the switching activity was beginning to occur, the president of ULLIC assured Hechler that ULLIC would continue to provide compensation to Waddell advisors and would continue to provide service to both Waddell policyholders and advisors. Despite learning this information and knowing its importance to the advisors, and despite having repeatedly made statements questioning whether this would occur, neither Hechler nor anyone else at Waddell relayed this information to Waddell's advisors until on or about May 8, 2001.

44. On or about May 1, 2001, Waddell entered into a Limited Selling Agreement with SAL Financial Services, which in turn had an agreement with ULLIC. The Limited Selling Agreement obligating Waddell advisors to continuing servicing all remaining ULLIC policies and allowing the advisors to receive information about those. Again, despite the importance of this information to the advisors, particularly in light of statements Hechler and others repeatedly made questioning whether it would occur, Waddell's advisors were not notified of this agreement until June 12, 2001.

ALLEGATIONS RELEVANT TO INSURANCE LICENSING VIOLATIONS

45. The Department realleges by incorporation each of the above paragraphs from 1-44.

46. Waddell operated an insurance agency in various Montana locations but was licensed to operate as an insurance agency in only one of those locations during the relevant time period. Specifically, during the relevant time period the Great Falls branch office was also licensed as "W&R Insurance Agency of Montana, Inc." This insurance agency was appointed with ULLIC from March of 1986 through October of 2002. This insurance agency was also appointed with Nationwide beginning in August of 2000 and continuing to the present.

47. During the relevant time period each of the Respondents identified as Montana advisors were licensed as insurance producers in Montana, with the exception of Martinez and Ashwal. Martinez and Ashwal were not licensed as insurance producers or in any other capacity pursuant to Montana's Insurance Code.

48. During the relevant time period Waddell's Montana advisors who were not affiliated with the Waddell insurance agency were required to have an appointment on their individual producers license with both ULLIC and Nationwide in order to exchange the variable annuity products of these companies. The following Montana advisors were affiliated with Waddell's Great Falls agency: Agnew, Bennett, Costle, Erickson, Fladager, Fredenberg, Griffith, Jelinek, Lethert, Matthew, Riesenber, Schmautz, Sharp, Ramona Smith, Robert Smith, Thies, Tilleman, and Voorhees.

49. During the relevant time period the following individual insurance producers did not work in the Waddell insurance agency office, despite being listed as an affiliate for that office: Agnew, Bennett, Costle, Erickson, Fladager, Fredenberg, Jelinek, Lethert, Matthew, Schmautz, and Sharp.

50. During the relevant time period the following Montana advisors did not have the proper appointment with Nationwide: Agnew, Ashwal, Erickson, Fladager, Jelinek, Lethert, Martinez, Matthew, Renskers, Seaman, Schmautz, Solomon, and Tilleman.

51. During the relevant period the following Montana advisors did not have the proper appointment with ULLIC: Ashwal, Martinez and Renskers.

CONCLUSIONS OF LAW SPECIFIC TO SECURITIES ACT VIOLATIONS

1. The Montana State Auditor is the Securities Commissioner. Section 2-15-1901, MCA.
2. The Securities Commissioner has jurisdiction over this matter pursuant to §§ 30-10-107, 30-10-201, 30-10-301, 30-10-304, 30-10-305, 30-10-309, and 30-10-321, MCA.
3. The Securities Act shall be construed to protect investors and for the protection of the public, pursuant to § 30-10-102, MCA.
4. Waddell is registered as a broker-dealer pursuant to §§ 30-10-103 (1), and 30-10-201, MCA.
5. Waddell is a federal covered investment adviser notice filed in Montana pursuant to §§ 30-10-103 (8) and 30-10-201, MCA.
6. Respondents Jelinek, Costle, Griffith, Erickson, Matthew, Fredenberg, Thies, Solomon, Voorhees, Riesenber, Faber, Fladager, Tilleman, Schmautz, Bennett, Robert Smith, Adolph, Lethert, Berg, Ashwal, Renskers, Bentz, Agnew, Frost, Sharp, Seaman, and Ramona Smith were registered securities salespersons pursuant to §§ 30-10-103 (20), 30-10-201, MCA, and conducted investment advisory business pursuant to those registrations during the relevant time period.

7. Respondents Jelinek, Costle, Griffith, Erickson, Matthew, Fredenberg, Thies, Solomon, Voorhees, Riesenber, Faber, Fladager, Tilleman, Schmutz, Bennett, Robert Smith, Adolph, Lethert, Berg, Ashwal, Renskers, Bentz, Agnew, Sharp, Seaman, and Ramona Smith are registered investment advisor representatives pursuant to §§ 30-10-103 (12), 30-10-201, MCA, and conducted securities business pursuant to those registrations during the relevant time period.
8. All other Respondents are subject to regulation because they or their company conducts securities business within the state of Montana or they committed acts in violation of Montana law.
9. Variable annuities are defined as securities pursuant to § 30-10-103 (22), MCA.
10. Respondents other than Hechler and Williams either engaged in the business of effecting securities transactions or sold, offered to sell, or offered to buy a security for value in Montana pursuant to §§ 30-10-103 (1), (15) and (20), MCA, when they exchanged the ULLIC variable annuities for a Nationwide variable annuity.
11. Respondents violated § 30-10-301 (1) (b), MCA, by omitting material statements necessary to make their sales pitch to the customers with regard to exchanging ULLIC annuities for Nationwide annuities not misleading.
12. Respondents violated § 30-10-301 (1) (c), MCA, by engaging in an act, practice and course of business that acted as a fraud upon the customers when they exchanged the ULLIC annuities for the Nationwide annuities knowing there is no material difference between these products, and charging full retail commissions for the exchanges.
13. Respondents Waddell, Hechler and Williams knowingly provided substantial support through memoranda and other management materials and tools utilized to assist

Jelinek, Costle, Griffith, Erickson, Matthew, Fredenberg, Thies, Solomon, Voorhees, Riesenbergr, Faber, Fladager, Tilleman, Schmautz, Bennett, Robert Smith, Adolph, Lethert, Martinez, Berg, Ashwal, Renskers, Bentz, Agnew, Frost, Sharp, Seaman, and Ramona Smith when the advisors committed fraudulent practices by omitting material facts in statements to their customers during the relevant time period, making each Respondent jointly and severally liable for their contribution to the damages and penalties pursuant to §§ 30-10-102, 30-10-107, 30-10-301 (1) (b) and 30-10-321, MCA.

14. Respondents Waddell, Hechler and Williams knowingly provided substantial support through memoranda and other management materials and tools utilized to assist Jelinek, Costle, Griffith, Erickson, Matthew, Fredenberg, Thies, Solomon, Voorhees, Riesenbergr, Faber, Fladager, Tilleman, Schmautz, Bennett, Robert Smith, Adolph, Lethert, Martinez, Berg, Ashwal, Renskers, Bentz, Agnew, Frost, Sharp, Seaman, and Ramona Smith when they committed fraudulent practices by engaging in deceitful acts, practices or courses of business during the relevant time period, making each Respondent jointly and severally liable for their contribution to the damages and penalties pursuant to §§ 30-10-102, 30-10-107, 30-10-301 (1) (c) and 30-10-321, MCA.
15. Waddell engaged in dishonest and unethical practices in the securities business when they urged and effected the 155 exchanges of variable annuities for Montana customers without appropriate suitability analyses, in violation of § 30-10-201 (13) (g), MCA, and ARM §§ 6.10.126 (1) (c), and 6.10.127 (1) (a).

16. Waddell engaged in dishonest and unethical practices in the securities business when they urged and effected the 155 exchanges of variable annuities for Montana customers and charged unreasonable fees for those exchanges, in violation of § 30-10-201 (13) (g), and ARM §§ 6.10.126 (1) (k), and 6.10.127 (1) (h) and (j).
17. Respondents Jelinek, Costle, Griffith, Erickson, Matthew, Fredenberg, Thies, Solomon, Voorhees, Riesenber, Faber, Fladager, Tilleman, Schmutz, Bennett, Robert Smith, Adolph, Lethert, Berg, Ashwal, Renskers, Bentz, Agnew, Frost, Sharp, Seaman, and Ramona Smith engaged in dishonest and unethical practices in the securities business when they urged and effected the 155 exchanges of variable annuities for Montana customers without appropriate suitability analyses, in violation of § 30-10-201 (13) (g), MCA, and ARM § 6.10.126 (2) (f).
18. Respondents Jelinek, Costle, Griffith, Erickson, Matthew, Fredenberg, Thies, Solomon, Voorhees, Riesenber, Faber, Fladager, Tilleman, Schmutz, Bennett, Robert Smith, Adolph, Lethert, Berg, Ashwal, Renskers, Bentz, Agnew, Frost, Sharp, Seaman, and Ramona Smith engaged in dishonest and unethical practices in the securities business when they urged and effected the 155 exchanges of variable annuities for Montana customers and charged unreasonable fees for those exchanges, in violation of § 30-10-201 (13) (g), and ARM § 6.10.126 (2) (f).
19. Respondent Jelinek engaged in dishonest and unethical practices in the securities business when he effected an exchange of a variable annuity in a customer's account without authorization, in violation of § 30-10-201 (13) (g), and ARM § 6.10.126 (2) (f).

CONCLUSIONS OF LAW SPECIFIC TO INSURANCE CODE VIOLATIONS

20. The Montana State Auditor is also the Insurance Commissioner. Section 2-15-1903, MCA.
21. The administration of the Insurance Code of Montana, § 33-1-101 et seq., MCA, is under the supervision and control of the Insurance Commissioner, pursuant to § 33-1-301, MCA.
22. The Insurance Code of Montana shall be administered to protect the interests of insurance consumers, pursuant to § 33-1-311, MCA.
23. Respondent Waddell was licensed as an insurance agency pursuant to § 33-17-201, MCA, and had proper appointments with ULLIC and Nationwide pursuant to § 33-17-231, MCA.
24. Respondents Jelinek, Costle, Griffith, Erickson, Matthew, Fredenberg, Thies, Solomon, Voorhees, Riesenberg, Faber, Fladager, Tilleman, Schmautz, Bennett, Robert Smith, Adolph, Lethert, Berg, Renskers, Bentz, Agnew, Frost, Sharp, Seaman, and Ramona Smith were licensed insurance producers pursuant to § 33-17-201, MCA.
25. Respondents Riesenberg, Ramona Smith, Robert Smith, Solomon, Thies, and Voorhees were appointed to sell ULLIC's and Nationwide's annuity products pursuant to §§ 33-17-201 and 231, MCA, because they were named affiliates of Waddell's Great Falls insurance agency and they worked at the Waddell agency.
26. Respondents Waddell, Jelinek, Costle, Griffith, Erickson, Matthew, Fredenberg, Thies, Solomon, Voorhees, Riesenberg, Faber, Fladager, Tilleman, Schmautz, Bennett, Robert Smith, Adolph, Lethert, Martinez, Berg, Ashwal, Renskers, Bentz,

Agnew, Frost, Sharp, Seaman, and Ramona Smith committed insurance fraud pursuant to § 33-1-1302, MCA, when in the course of offering the Nationwide annuity to their customers who owned ULLIC annuities they made misrepresentations regarding the products with reckless indifference as to whether the representations were true, for the purpose of having the customers rely on the misrepresentations to the customers detriment.

27. All Respondents violated § 33-18-204, MCA, by making written and oral misrepresentations and incomplete comparisons regarding the ULLIC annuity and the Nationwide annuities for the purpose of inducing customers to exchange their ULLIC annuities for a Nationwide annuity product.
28. Respondents Waddell, Hechler and Williams violated § 33-18-202 (4), MCA, by making misleading representations regarding ULLIC's financial condition and its legal reserve system.
29. Respondents Martinez and Ashwal were not licensed as insurance producers in Montana in violation of § 33-17-201, MCA.
30. Respondents Agnew, Bennett, Costle, Erickson, Fladager, Fredenberg, Jelinek, Lethert, Matthew, Schmutz, and Sharp violated § 33-17-1101, MCA, because they did not transact the business of insurance in Waddell's Great Falls insurance agency despite being identified as affiliates to the agency license.
31. Respondents Agnew, Ashwal, Erickson, Fladager, Jelinek, Lethert, Martinez, Matthew, Renskers, Seaman, Schmutz, Solomon, and Tilleman violated § 33-17-231, MCA, by failing to have the proper appointment with Nationwide prior to selling the Nationwide variable annuity.

32. Respondents Ashwal, Martinez, and Renskers violated § 33-17-231, MCA, by failing to have the proper appointment with ULLIC prior to selling the ULLIC variable annuity.
33. Respondents Jelinek, Costle, Griffith, Erickson, Matthew, Fredenberg, Thies, Solomon, Voorhees, Riesenberg, Faber, Fladager, Tilleman, Schmautz, Bennett, Robert Smith, Adolph, Lethert, Berg, Renskers, Bentz, Agnew, Frost, Sharp, Seaman, and Ramona Smith violated § 33-17-1001 (1) (c), MCA, by failing to comply with the requirements of §§ 33-1-1302, 33-18-204, MCA.
34. Respondent Jelinek, Costle, Griffith, Erickson, Matthew, Fredenberg, Thies, Solomon, Voorhees, Riesenberg, Faber, Fladager, Tilleman, Schmautz, Bennett, Robert Smith, Adolph, Lethert, Berg, Renskers, Bentz, Agnew, Frost, Sharp, Seaman, and Ramona Smith violated § 33-17-1001 (1) (f), MCA, when, in the conduct of their affairs under their insurance producer's licenses, they used fraudulent, coercive or dishonest practices.
35. Respondents Jelinek, Costle, Griffith, Erickson, Matthew, Fredenberg, Thies, Solomon, Voorhees, Riesenberg, Faber, Fladager, Tilleman, Schmautz, Bennett, Robert Smith, Adolph, Lethert, Berg, Renskers, Bentz, Agnew, Frost, Sharp, Seaman, and Ramona Smith violated § 33-17-1001 (1) (g), MCA, by misrepresenting the terms of the Nationwide and/or ULLIC annuities.

RELIEF SOUGHT

1. Each Respondent be held jointly and severally liable for the following:
 - a. Fines not to exceed \$5,000 per person for each identifiable violation of § 30-10-301 (1) (b), MCA, pursuant to § 30-10-305 (3), MCA;

- b. Fines not to exceed \$5,000 per person for each identifiable violation of § 30-10-301 (1) (c), MCA, pursuant to § 30-10-305 (3), MCA;
 - c. Restitution equal to the commissions paid by each of the 155 identified victims. equal to the loss they have experienced as a result of the Respondents' conduct. plus 10% annual interest on the restitution from the date of each violation. pursuant to § 30-10-309 (1), MCA;
 - d. Reasonable attorneys fees and costs associated with bringing the administrative action, pursuant to § 30-10-309 (1), MCA;
 - e. Reimbursement for the costs of the investigation performed by the Department, pursuant to § 30-10-210.
2. Respondent Waddell:
- a. Fined not to exceed \$5,000 for each identifiable violation of § 30-10-201 (13) (g), MCA and ARM §§ 6.10.126 (1) (c) and 6.10.127 (1) (a), pursuant to § 30-10-305 (3), MCA.
 - b. Fines not to exceed \$5,000 for each identifiable violation of § 30-10-201 (13) (g), MCA. and ARM §§ 6.10.126 (1) (k) and 6.10.127 (1) (h) and (j), pursuant to § 30-10-305 (3), MCA;
 - c. Fines not to exceed \$5,000 for each identifiable violation of § 30-10-201 (13) (k), MCA, pursuant to § 30-10-305 (3), MCA;
3. Respondents Jelinek, Costle, Griffith, Erickson, Matthew, Fredenberg, Thies, Solomon, Voorhees, Riesenber, Faber, Fladager, Tilleman, Schmautz, Bennett, Robert Smith, Adolph, Lethert, Berg, Ashwal, Renskers, Bentz, Agnew, Frost, Sharp, Seaman, and Ramona Smith fines not to exceed \$5,000 per person for each

identifiable violation of § 30-10-201 (13) (g), MCA, and ARM § 6.10.126 (2) (f), pursuant to § 30-10-305 (3), MCA:

4. Respondents Hechler and Williams fined not to exceed \$5,000 each for each identifiable violation of §§ 30-10-301 (1) (b), and 30-10-301 (1) (c), MCA, where they knowingly provided substantial assistance to the other Respondents pursuant to §§ 30-10-305 and 321, MCA.
5. Respondents Hechler and Williams pay the following amounts for their actions where they knowingly provided substantial assistance to the other Respondents pursuant to § 30-10-321, MCA:
 - a. Restitution equal to the commissions paid by each of the 155 identified victims, equal to the loss they have experienced as a result of the Respondents' conduct, plus 10% annual interest on the restitution from the date of each violation, pursuant to § 30-10-309 (1), MCA;
 - b. Reasonable attorneys fees and costs associated with bringing the administrative action, pursuant to § 30-10-309 (1), MCA.
6. Waddell, Jelinek, Costle, Griffith, Erickson, Matthew, Fredenberg, Thies, Solomon, Voorhees, Riesenber, Faber, Fladager, Tilleman, Schmautz, Bennett, Robert Smith, Adolph, Lethert, Martinez, Berg, Ashwal, Renskers, Bentz, Agnew, Frost, Sharp, Seaman, and Ramona Smith fined not to exceed \$5,000 per person for each act of fraud in violation of §33-1-1302, MCA, pursuant to § 33-1-317, MCA.
7. Respondents Waddell, Hechler and Williams fined not to exceed \$5,000 per person for violating § 33-18-202 (4), MCA, pursuant to § 33-1-317, MCA.

8. All Respondents fined not to exceed \$5,000 per person for violating § 33-18-204, MCA, pursuant to § 33-1-317, MCA.
9. Respondents Ashwal and Martinez fined not to exceed \$5,000 per person for violating § 33-17-201, MCA, pursuant to § 33-1-317, MCA.
10. Respondents Jelinek, Costle, Griffith, Erickson, Matthew, Fredenberg, Thies, Solomon, Voorhees, Riesenber, Faber, Fladager, Tilleman, Schmautz, Bennett, Robert Smith, Adolph, Lethert, Berg, Renskers, Bentz, Agnew, Frost, Sharp, Seaman, and Ramona Smith fined not to exceed \$5,000 per person for each violation of § 33-17-1001, MCA, pursuant to § 33-1-317, MCA.
11. Respondents Agnew, Bennett, Costle, Erickson, Fladager, Fredenberg, Jelinek, Lethert, Matthew, Schmautz, and Sharp fined not to exceed \$5,000 per person for violating § 33-17-1101, MCA, pursuant to § 33-1-317, MCA.
12. Respondents Agnew, Ashwal, Erickson, Fladager, Jelinek, Lethert, Martinez, Matthew, Renskers, Seaman, Schmautz, Solomon, and Tilleman fined not to exceed \$5,000 per person for violating § 33-17-231, MCA, pursuant to § 33-1-317, MCA.
13. Any other such relief allowed by law or required by justice.

STATEMENT OF RIGHTS

You are entitled to a hearing to respond to this notice, present evidence and arguments on all issues involved in this case. You have a right to be represented by an attorney at any and all stages of this proceeding. You may demand a formal hearing before a hearing examiner appointed by the Commissioner pursuant to the Montana Administrative Procedure Act, sections

2-4-601, MCA. and following, including Section 2-4-631, MCA. If you demand a hearing, you will be given notice of the time, place and the nature of the hearing.

If you want to contest the proposed action under the jurisdiction of the Commissioner, you must advise the Commissioner within fifteen (15) days of the date you receive this notice. You must advise the Commissioner of your intent to contest the proposed action by writing to Roberta Cross Guns, Special Assistant Attorney General, State Auditor's Office, 840 Helena Avenue, Helena, Montana 59601. Your letter must clearly indicate whether you demand a hearing, or whether you waive formal proceedings and, if so, what informal proceedings you prefer for disposition of this case. Pursuant to Section 2-4-603(2), MCA, you may not request to proceed informally if the action could result in suspension, revocation or any other adverse action against a professional license. Should you request a hearing on the matters raised in this Notice, a hearing must be held within 45 days of the request, unless postponed by mutual consent of the parties, pursuant to § 33-1-701 (2), MCA.

Should you request a hearing, you have the right to be accompanied, represented, and advised by counsel. If the counsel you choose has not been admitted to practice law in the state of Montana, he or she must comply with the requirements of Application of American Smelting and Refining Co., (1973), 164 Mont. 139, 520 P.2d 103.

CONTACT WITH SECURITIES COMMISSIONER'S OFFICE

If you have questions or wish to discuss this matter, please contact Roberta Cross Guns, legal counsel for the State Auditor, at 840 Helena Avenue, Helena, MT, 59601, (406)-444-2040 or, within Montana, (800)-332-6148. If an attorney represents you, please make any contacts with this office through your attorney.

POSSIBILITY OF DEFAULT

Failure to give notice or to advise of your demand for a hearing or informal procedure within fifteen (15) days, will result in the entry of a default order imposing the disciplinary sanctions against you and your license, without further notice to you, pursuant to 6.2.101, Administrative Rules of Montana and the Attorney General's Model Rule 10. 1.3.214.

DATED this 27th day of April 2005.

JOHN MORRISON
State Auditor and ex-officio
Commissioner of Securities and Insurance

By: *Roberta Cross Guns*
Roberta Cross Guns
Special Assistant Attorney General