RECEIVED
09 OCT 27 AM 11:27
ARKANSAS SECURITIES DEPT.

BEFORE THE ARKANSAS SECURITIES COMMISSIONER
CASE NO. S-08-043
ORDER NO. S-08-043-09-FO01

In the Matter of:

Timothy Alonza Lilly,
David Larry Puckett,
Joe A. Richards, and
First Fidelity Financial Group
of Maumelle, LLC **Respondents**

ORDER

On May 22, 2008, the Staff of the Arkansas Securities Department ("Staff") filed its Request for Cease and Desist Order in this matter. I entered a Cease and Desist Order on May 23, 2008 ("Cease and Desist Order"). In accordance with Arkansas Code Annotated § 23-42-209(a)(2), Respondents filed a request on June 19, 2008, seeking a hearing on the Cease and Desist Order, but requesting that the hearing be postponed pending negotiations with the Staff.

On August 8, 2008, and upon the request of the parties, I entered a Scheduling Order and Submission of Case on Briefs with the intention that this matter would be decided upon the submitted briefs. The parties complied with the briefing schedule set forth in the Scheduling Order and Submission of Case on Briefs. However, the submissions did not include stipulated facts necessary to support findings of fact as required under the Arkansas Administrative Procedures Act, Arkansas Code Annotated §§ 25-15-201 through 219. See Ark. Code Ann. § 25-15-210(b)(2) (2002) ("A final decision shall include findings of fact and conclusions of law, separately stated."); Ark. Code Ann. § 25-15-208(a)(6) (2002) ("Findings of fact shall be based exclusively on the evidence and on matters officially noticed.").

A hearing on this matter was held on June 17, 2009. Testimony was received from three witnesses and eight exhibits were accepted into evidence. Additionally, the parties filed a Stipulation of Facts with four exhibits on July 17, 2009.

This Order affirms the Cease and Desist Order with respect to Respondents Timothy Alonza Lilly, David Larry Puckett, and First Fidelity Financial Group of Maumelle, LLC. This Order vacates the Cease and Desist Order with respect to Joe A. Richards. Accordingly, references to "Respondents" throughout this Order references only Respondents Timothy Alonza Lilly, David Larry Puckett, and First Fidelity Financial Group of Maumelle, LLC.

FINDINGS OF FACT

The following findings of fact are based upon the testimony and exhibits introduced and received at the hearing on this matter, as well as the Stipulation of Facts with accompanying exhibits.

1. First Fidelity Financial Group of Maumelle, LLC ("First Fidelity"), is an Arkansas limited liability company owned and formed by Mr. Lilly on March 17, 2008. Its address is 650 Edgewood Drive, Suite 100, Maumelle, Arkansas 72113. First Fidelity describes itself as a financial services firm, but it is not registered with the Arkansas Securities Department ("Department") as a broker-dealer, investment adviser, or in any other capacity pursuant to the Arkansas Securities Act ("Act").

2. Timothy Alonza Lilly is a licensed insurance agent and a resident of Maumelle, Arkansas. Although Mr. Lilly had passed his Series 65 test, which would have allowed him to work as a registered investment adviser or representative of an investment adviser pursuant to the Act, he is not registered with the Department as an investment adviser or as a representative of

an investment adviser. Mr. Lilly owns Covenant Senior Advisors, an insurance agency, which shares office space with First Fidelity.

3. David Larry Puckett is a licensed insurance agent and a resident of Maumelle, Arkansas. He worked for and with Mr. Lilly at First Fidelity. He is not registered with the Department in any capacity pursuant to the Act. Mr. Puckett was paid a salary by First Fidelity to sell certificates of deposit ("CDs") as part of a marketing program known as "Safe Money University."

4. Joe A. Richards is a licensed insurance agent and a resident of Greenbrier, Arkansas. He worked for and with Mr. Lilly at First Fidelity. He is not registered with the Department in any capacity pursuant to the Act.

5. In early April 2008, Mr. Lilly, Mr. Puckett, and Mr. Richards attended a training session for a marketing program called "Safe Money University" held at the Irwin Agency in Hot Springs, Arkansas. "Safe Money University" is part of a marketing program sponsored by First Fidelity Financial Group, LLC, of Florida ("First Fidelity Florida"), Assurance Financial Resource Group, LLC, and Safe Money University, LLC. The instructor at the training session was Brian Keller with First Fidelity Florida. Mr. Keller is also the author of the training manual that was distributed at the training session.

6. "Safe Money University" is a marketing program used by insurance agencies to increase sales of insurance products to senior citizens. To obtain new customers, "Safe Money University" emphasizes the offer and sale of FDIC-insured bank CDs packaged with promotional incentives resulting in annual percentage yields higher than those offered by the issuing banks. The promotional incentive is the insurance agency's addition of funds to the purchase money contributed by a customer to purchase a CD from an FDIC-insured bank. By adding this

promotional incentive to the customer's purchase money, an entity utilizing the "Safe Money University" program advertised the availability of FDIC-insured CDs with annual yields above the yields actually offered by the issuing banks.

7. Materials provided as part of the "Safe Money University" training included sample advertisements and advertising instructions, explanations of the "gratuitous recommendations" of CDs, telephone answering scripts, caller inquiry sheets, answers to frequently asked questions, initial meeting questionnaires, suitability questionnaires, a retail presentation, and instructions on working with senior citizen clients. Respondents used these materials, including the sample advertising, in advertising the FDIC-insured bank CDs packaged with the promotional incentives.

8. First Fidelity told its customers that the CD sales program was an advertising and marketing program geared to obtain customers for other services and products. These other services and products presumably were insurance products offered by Covenant Senior Advisors, as First Fidelity has no insurance or securities license and has no business other than the sale of the CDs at issue.

9. Respondents informed customers that First Fidelity tried to find the best possible annual percentage yields on CDs for its customers. Most CDs sold to First Fidelity customers were issued by Discover Bank. The remainder of the CDs sold to First Fidelity customers were issued by IndyMac Federal Bank, FSB, which offered better yields at the time of purchase. Respondents found IndyMac Federal Bank, FSB through the recommendation of Chris Corjay with the Irwin Agency.

10. Respondents told customers that First Fidelity was a "full service financial services company." At times, Respondents performed a sort of suitability analysis prior to selling

a CD packaged with the promotional incentive. Respondents performed a "needs analysis" on each person that bought a CD through First Fidelity. First Fidelity would only add the promotional incentive to the CD if the needs analysis was completed, the customer had at least $50,000 in assets, and the customer had been offered other products or scheduled a second appointment. Customers were also required to sign a form indicating that they had been offered a fixed annuity with a stated rate and term and declined to purchase such annuity. Some customers completed a "confidential client estate planning and long term care analysis" that sought information regarding levels of life insurance, annuities, retirement accounts, checking accounts, savings accounts, brokerage accounts, securities accounts, and income sources. According to Mr. Puckett, Respondents would not sell a CD packaged with the promotional incentive if the investment would have been unsuitable for the particular customer.

11. Originally, the CDs packaged with promotional incentives advertised by Respondents had a term of 90 days. When customers expressed very little interest in these CDs, Respondents contacted Mr. Keller of First Fidelity Florida and Mr. Corjay with the Irwin Agency. Mr. Keller and Mr. Corjay advised Respondents to offer a 12-month CD and increase the advertised percentage yield. Respondents followed the advice of Mr. Keller and Mr. Corjay, but had difficulty calculating the amount of money First Fidelity needed to contribute in order to reach the advertised percentage yield. Accordingly, the promotional incentive added by Respondents was not always accurate. At times, Respondents added more money than was necessary to reach the advertised annual percentage yield. In some cases Respondents did not add sufficient funds to reach the annual percentage yield.

12. On May 14, 2008, First Fidelity advertised in the *Arkansas Democrat Gazette* an FDIC-insured CD with a 4.75% annual yield. In order to achieve the advertised yield, First

Fidelity had to add a promotional incentive to the purchase money contributed by a purchasing customer. Respondents told customers that Respondents would add the money necessary so that customers would receive the advertised annual percentage yield. When these additional amounts were in fact added, the funds came from Covenant Senior Advisors.

13. Respondents gave customers wanting to purchase an advertised CD a document entitled "Certificate of Deposit Bonus Disclosure" ("Disclosure Form"). One such Disclosure Form executed on May 8, 2008, reflected that the CD being sold was issued by a bank paying an "Annual Percentage Yield of 3.51%." The Disclosure Form provided that although the purchaser was writing a check for $30,000, his "FDIC insured Certificate of Deposit account will be opened for $30,118.75." With the addition of $118.75 by Respondents, the purchaser would realize a 4.75% annual percentage yield on his $30,000 investment.

14. From April 10, 2008, until May 20, 2008, Respondents sold FDIC-insured bank CDs packaged with promised promotional incentives to at least twenty-one customers using two banks, Discover Bank and IndyMac Federal Bank, FSB. The majority of these CDs were sold by Mr. Puckett on behalf of First Fidelity. In each case, First Fidelity was required to add additional funds to the customer's purchase money in order for the customer to receive the advertised annual percentage yield.

15. On May 20, 2008, Department examiners served a subpoena upon Respondents at the office of First Fidelity. This subpoena required Respondents to make available all records pertaining to the advertisement appearing on May 14, 2008, regarding an FDIC-insured certificate of deposit providing 4.75% annual yield. Department examiners discovered that in certain instances First Fidelity had failed to make the payments necessary to reach the promised annual percentage yield. Ten customer files reflected insufficient payments of funds necessary

to reach a 4.75% annual yield on CDs issued by Discover Bank. Four customer files reflected sufficient or more than sufficient payments of funds necessary to reach the 4.75% annual yield on CDs issued by Discover Bank. Two customer files reflected insufficient payments of funds necessary to reach a 4.75% annual yield on CDs issued by IndyMac Federal Bank, FSB, and five customer files reflected sufficient or more than sufficient payments of funds necessary to reach the 4.75% annual yield on CDs issued by IndyMac Federal Bank, FSB. In addition, the examiners discovered that First Fidelity had paid the additional interest directly to one investor and cancelled the purchase CDs by two investors.

16. None of the purchasers of the CDs, nor any other person, has filed a complaint with the Department regarding the advertisement or sale of the CDs by Respondents.

17. These enhanced CDs delivering 4.75% annual yields are not registered with the Department, and no proof of exemption appears in the records of the Department.

CONCLUSIONS OF LAW

18. The Act was promulgated to protect investors and utilizes a broad and flexible definition of security to determine which transactions fall under the Act's jurisdiction. Carder v. Burrow, 327 Ark. 545, 549 (1997). Whether Respondents' offers and sales of CDs packaged with promotional incentives were securities transactions under the Act depends not upon labels or titles, but upon consideration of all relevant facts. See Grand Prairie Sav. and Loan Ass'n, Stuttgart v. Worthen Bank and Trust Co., 298 Ark. 542, 545 (1989) (quoting Schultz v. Rector-Phillips-Morse, Inc., 261 Ark 769, 777 (1977)). Accordingly, in determining whether the offers and sales of CDs packaged with promotional incentives constituted securities transactions, the hearing officer must consider not just the CDs that customers purchased and received, but the promotional incentives and all other relevant aspects of the transactions. See, e.g., Safeway

Portland Employees' Fed. Credit Union v. C.H. Wagner & Co., Inc., 501 F.2d 1120, 1123 (9th Cir. 1974) (holding that the combination of a certificate of deposit with a bonus "created an integrated investment package which must be viewed in its entirety" in determining whether it was covered by the securities laws).

19. The Act's definition of security includes any note or evidence of indebtedness. Ark. Code Ann. § 23-42-102(15)(A)(i), (vi) (2000 & Supp. 2009). This definition should be given its ordinary meaning unless the context otherwise requires. Grand Prairie Sav. and Loan Ass'n, Stuttgart, 298 Ark. at 545-546; see also Marine Bank v. Weaver, 455 U.S. 551, 556 (1982). A CD is a specialized type of promissory note. It is a security in the form of a note or evidence of indebtedness unless the context otherwise requires. See Securities and Exchange Comm'n v. Randy, 38 F. Supp.2d 657, 666 (N.D. Ill. 1999).

20. Certificates of deposit issued by FDIC-insured banks normally are not considered securities due to the context in which the CDs are typically sold. This context is the existence of the substantial body of banking regulation applicable to a typical commercial transaction between the purchaser of a CD and the issuing FDIC-insured bank. Banking regulations provide ample protection to the typical purchaser of an FDIC-insured bank CD. In Marine Bank, the U.S. Supreme Court held a CD issued by an FDIC-insured bank was not a security due to the comprehensive laws and regulations which govern the banking industry and protect the consumer.

> The definition of "security" . . . provides that an instrument which seems to fall within the broad sweep of the [Securities Exchange Act of 1934] is not to be considered a security if the context otherwise requires. It is unnecessary to subject issuers of bank certificates of deposit to liability under the antifraud provisions of the federal securities laws since the holders of bank certificates of deposit are abundantly protected under the federal banking laws.

Marine Bank, 455 U.S. at 558-59.

21. However, the Marine Bank Court and courts in subsequent decisions have recognized that this does not mean all CDs are not securities. "It does not follow that a certificate of deposit or business agreement between transacting parties invariably falls outside of the definition of a 'security' as defined by the federal statutes. Each transaction must be analyzed and evaluated on the basis of the content of the instruments in question, the purposes to be served, and the factual setting as a whole." Marine Bank, 455 U.S. at 560 n.11; see also Olson v. E.F. Hutton & Co., Inc., 957 F.2d 622, 628 (8th Cir. 1992) (citations omitted) ("In determining whether Marine Bank removes a given investment from the protection of the securities laws, courts have focused on whether existing regulations guarantee a return of the investment. Where such guarantees exist, the securities laws provide no added protection. However, when the investment is not guaranteed, Marine Bank does not bar application of the securities laws to what would otherwise qualify as a security.")

22. If the Respondents' customers are adequately protected by banking regulations throughout the purchase transaction then the CDs packaged with promotional incentives may not be treated as securities in the form of notes or evidences of indebtedness. See Randy, 38 F.Supp.2d at 666. In other words, adequate investor protections must exist outside of the Act. See, e.g., Wolf v. Banco Nacional de Mexico, S.A., 739 F.2d 1458, 1461 (9th Cir. 1984), cert. denied, 469 U.S. 1108 (1985) (holding that certificates issued by a foreign bank were not securities because Mexico's banking regulations provided protections equivalent to U.S. federal banking regulations); Olsen, 957 F.2d at 628-29 (holding that when a broker engages in churning, CDs should be treated as securities because the federal banking laws do not protect against investors losses).

23. The context surrounding the transactions at issue dictates that the Act's definition of security in the form of notes or evidences of indebtedness should receive its normal application. Banking regulations did not govern the Respondents' various representations and actions and offered investors no protection in the event Respondents failed to follow through on their promises. Respondents represented to customers that they had determined which FDIC-insured banks were offering the highest annual yield on CDs. Respondents used the yield actually offered by the issuing bank to determine a separate advertised annual percentage yield obtainable only through Respondents. Respondents advertised in a newspaper of general circulation the availability of the CDs with a yield that was available not through the issuing bank, but only through Respondents. Respondents performed analyses to determine whether or not the customer should actually purchase a CD. Once a customer elected to purchase a CD, Respondents attempted to calculate the amount of promotional incentive First Fidelity (through Covenant Senior Advisors) would need to add in order for the customer to receive the annual percentage yield promised by Respondents. Respondents would then collect payment from the customer and submit all necessary information and payment to the issuing bank. At some point, Respondents were to send the issuing bank the necessary payment for the promotional incentive. All the customer had to do was complete necessary paperwork and submit payment for the CD to the Respondents. The customers could not receive the annual percentage yield promised by Respondents without the direct participation and control of the transaction by Respondents. Banking regulations offered no protection to the customers when they relied on the representations and actions of Respondents to obtain an FDIC-insured CD with a certain annual percentage yield. Accordingly, the context of the transactions at issue demands that the definitions contained in the Act be given their normal applications. The CDs packaged with

promotional incentives offered and sold by the Respondents are notes or evidences of indebtedness defined as securities in Arkansas Code Annotated § 23-42-102(15)(A)(i) and (vi).

24. The Arkansas Supreme Court has held that the context of an isolated commercial transaction between professional bankers is not intended to be covered by the Arkansas Securities Act. See Grand Prairie Sav. and Loan Ass'n, Stuttgart, 298 Ark. at 546 (holding that the Arkansas Securities Act did not apply to transactions between "banks and bankers"). However, the transactions at issue are not the type of isolated commercial transactions which the Arkansas Supreme Court has held are not covered by the Act. The transactions at issue were not ordinary commercial transactions between an FDIC-insured bank and its customers. These transactions involved ordinary customers who were relying solely upon the efforts of Respondents, as described above, to obtain an annual percentage yield that was promised by Respondents, not the issuing bank.

25. The CDs packaged with promotional incentives offered and sold by Respondents are also investment contracts under the Act's definition of a security. See Ark. Code Ann. § 23-42-102(15)(A)(xi). A security in the form of an investment contract exists when a transaction is an investment in the risk capital of a venture with an expectation of benefits but with a lack of control on the part of the investor. See Smith v. State, 266 Ark. 861, 865 (Ark. App. 1979); Carder, 327 Ark. at 549; see also Securities and Exchange Comm'n v. W.J. Howey Co., 328 U.S. 293, 298-99 (1946) ("[A]n investment contract . . . means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party . . . ."); Grand Prairie Sav. and Loan Ass'n, Stuttgart, 298 Ark. at 545 (noting that the test used in Smith is substantially the same as the Howey test used in the federal courts).

26. The various customers invested money in a venture with Respondents expecting to receive an annual percentage yield above that otherwise available on FDIC-insured bank CDs. The customers had no direct control over the investment. Also, the customers contributed toward the risk capital of the venture. The money invested by the customers was always subject to the risk that Respondents would not fulfill their promises and the customers would not receive the annual percentage yield advertised by Respondents. Assuming Respondents submitted a customer's payment and necessary paperwork, but failed to add the promotional incentive, a customer likely would still receive an FDIC-insured CD with the annual percentage yield offered by the issuing bank. However, this does not change the nature of the investment; it is still a security in the form of an investment contract. As the U.S. Supreme Court stated in Howey:

> We reject the suggestion . . . that an investment contract is necessarily missing where the enterprise is not speculative or promotional in character and where the tangible interest which is sold has intrinsic value independent of the success of the enterprise as a whole. The test is whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others. If that test be satisfied, it is immaterial whether the enterprise is speculative or non-speculative or whether there is a sale of property with or without intrinsic value.

W.J. Howey Co., 328 U.S. at 301.

27. In Grand Prairie Sav. and Loan Ass'n, 298 Ark. at 545, the Arkansas Supreme Court noted that the Arkansas test for a security is substantially the same test as set forth in Howey used in the federal courts. But in Schultz, the Arkansas Supreme Court had rejected an express adoption of the Howey test in favor of a more flexible case by case analysis, holding:

> We agree with the general approach taken by the Minnesota Supreme Court that the definition of a security within the meaning of the Arkansas Securities Act should not be given so narrow a construction [as set forth in Howey], and that it is better to determine in each instance from a review of all the facts, whether an investment scheme or plan constitutes an investment contract . . . within the scope of the statute.

Schultz, 261 Ark. at 781. The CDs packaged with promotional incentives offered and sold by Respondents are investment contracts under the risk capital test set forth in Smith and the Howey test utilized by the federal courts. Further, the CDs packaged with promotional incentives offered and sold by Respondents are investment contracts under an analysis of all relevant factors as set forth in Schultz and Grand Prairie.

28. The transactions through which Respondents broadly advertised, offered and sold investments in the form of FDIC-insured bank CDs packaged with promotional incentives were neither normal commercial transactions between an FDIC-insured bank and its customers, nor were they transactions in which the customers were fully protected by banking regulations. Considering all the relevant facts, the instruments were packaged, advertised, marketed, and sold as the type of investments that the Act is intended to govern. The Respondents' actions in offering and selling FDIC-insured bank CDs packaged with promotional incentives constituted a transaction in securities as defined in Arkansas Code Annotated § 23-42-102(15)(A)(i), (vi), and (xi).

29. It is unlawful for any person to offer or sell any security unless it is registered, exempt, or a covered security. Ark. Code Ann. § 23-42-501 (2000). Respondents violated Arkansas Code Annotated § 23-42-501 when they offered and sold FDIC-insured bank CDs packaged with promotional incentives that were not registered, exempt, or covered securities.

30. In accordance with Arkansas Code Annotated § 23-42-209(a)(2)(C), the Cease and Desist Order should be affirmed as to Respondents Timothy Alonza Lilly, David Larry Puckett, and First Fidelity Financial Group of Maumelle, LLC. As to Respondent Joe A. Richards, the evidence offered by the Staff regarding Mr. Richard's participation in the securities transactions is insufficient to support an affirmation of the Cease and Desist Order.

ORDER

As to Timothy Alonza Lilly, David Larry Puckett, and First Fidelity Financial Group of Maumelle, LLC, the Cease and Desist Order entered on May 23, 2008, is AFFIRMED.

As to Joe A. Richards, the Cease and Desist Order entered on May 23, 2008, is VACATED.

A. Heath Abshure
Arkansas Securities Commissioner
October 27, 2009