

NASD
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. EAF- 0400060001

RE: Hantz Financial Services, Inc., Respondent (CRD No. 46047)
John Hantz, Respondent (CRD No. 1462066)

Pursuant to Rule 9216 of NASD's Code of Procedure, Respondents Hantz Financial Services, Inc. ("HFS" or the "firm") and John Hantz ("Hantz") (collectively, "Respondents") submit this Letter of Acceptance, Waiver and Consent ("AWC") for the purpose of proposing a settlement of the alleged rule violations described in Part II below. This AWC is submitted on the condition that, if accepted, NASD will not bring any future actions against Respondents alleging violations based on the same factual findings.

Respondents understand that:

1. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by NASD's Department of Enforcement and National Adjudicatory Council ("NAC") Review Subcommittee or Office of Disciplinary Affairs ("ODA"), pursuant to NASD Rule 9216;
2. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against them; and
3. If accepted:
 - a. this AWC will become part of Respondents' permanent disciplinary records and may be considered in any future actions brought by NASD or any other regulator against them;
 - b. this AWC will be made available through NASD's public disclosure program in response to public inquiries about Respondents' disciplinary records;
 - c. NASD may make a public announcement concerning this agreement and the subject matter thereof in accordance with NASD Rule 8310 and IM-8310-2; and
 - d. Respondents may not take any action or make or permit to be made any public statement, including in regulatory filings or otherwise, denying, directly or indirectly, any allegation in this AWC or create the impression that the AWC is without factual basis. Nothing in this provision affects Respondents' testimonial obligations or right to take legal or factual positions in litigation or

other legal proceeding in which NASD is not a party.

Respondents also understand that their experience in the securities industry and disciplinary histories may be factors that will be considered in deciding whether to accept this AWC. This experience and history is as follows:

HFS has been an NASD member since 1999. Its principal offices are located in Southfield, Michigan. It has 16 branch offices in Michigan and Ohio, and approximately 270 registered representatives. HFS has no relevant formal disciplinary history.

John Hantz, age 43, has been registered as an associated person of an NASD member since 1986. He is currently registered as a General Securities Representative (Series 7) and a General Securities Principal (Series 24). John Hantz founded HFS in 1998, and currently serves as its President, CEO and Director. He owns 65% of HFS' parent company, the Hantz Group ("HG"). He has no relevant formal disciplinary history.

I.

WAIVER OF PROCEDURAL RIGHTS

Respondents specifically and voluntarily waive the following rights granted under NASD's Code of Procedure:

- A. To have a Formal Complaint issued specifying the allegations against them;
- B. To be notified of the Formal Complaint and have the opportunity to answer the allegations in writing;
- C. To defend against the allegations in a disciplinary hearing before a hearing panel, to have a written record of the hearing made, and to have a written decision issued; and
- D. To appeal any such decision to the NAC and then to the U.S. Securities and Exchange Commission ("SEC") and a U.S. Court of Appeals.

Further, Respondents specifically and voluntarily waive any right to claim bias or prejudgment of the General Counsel, the NAC, or any member of the NAC, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including acceptance or rejection of this AWC.

Respondents further specifically and voluntarily waive any right to claim that a person violated the ex parte prohibitions of Rule 9143 or the separation of functions

prohibitions of Rule 9144, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including its acceptance or rejection.

II.

ACCEPTANCE AND CONSENT

HFS and John Hantz hereby accept and consent, without admitting or denying the allegations or findings, and solely for the purposes of this proceeding and any other proceeding brought by or on behalf of NASD, or to which NASD is a party, prior to a hearing and without an adjudication of any issue of law or fact, to the entry of the following findings by NASD:

A. STATEMENT OF FACTS

1. Summary

From January 1, 2002 to June 30, 2004 (the "relevant period"), HFS engaged in certain fraudulent activities described below by misrepresenting or failing to disclose material conflicts of interest to customers, thereby violating NASD rules and Sections 17(a)(2) and (3) of the Securities Act of 1933.¹

HFS sold financial plans to its customers that recommended the customer purchase a variety of financial products, such as mutual funds, variable annuities and insurance products. As described below, the firm misrepresented to its clients that it and its employees were "independent" and "objective." HFS claimed that it offered its clients the opportunity to choose products from a number of different suppliers and stated it was not captive to one or a few product companies.

In fact, HFS had arrangements with a preferred supplier for each investment product and received substantial payments from each preferred supplier. It acknowledged to its preferred suppliers that it was not independent, it had a proprietary sales force, it could determine what its FAs sold, and it expected 90 percent of its sales of each investment product to be the preferred suppliers' products. In practice, HFS directed the

¹ Section 17(a)(2) of the Securities Act of 1933 (the "Securities Act") provides, in relevant part, that "It shall be unlawful for any person in the offer or sale of any security ... directly or indirectly to ... obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading." Section 17(a)(3) provides that it is unlawful to "engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser". The Supreme Court has held that establishing violations of Sections 17(a)(2) and 17(a)(3) does not require a showing of scienter. The Court found that the language of §17(a)(2) does not include a scienter requirement and the language of §17(a)(3) focuses on the effect of particular conduct on members of the investing public, rather than upon the culpability of the person responsible. *Aaron v. SEC*, 446 U.S. 680, 696-97 (1980).

vast majority of its sales of each product, up to 95%, to its preferred supplier in each product category.

HFS' revenue sharing arrangements differed from most other firms'. In some instances, the firm collected marketing fees from its preferred suppliers that were substantially higher than the fees received by most firms in the industry. HFS collected almost \$970,000 from the various preferred suppliers in 2002, almost \$1.5 million in 2003, and almost \$1.8 million in 2004. By the end of 2004, the revenue sharing payments gradually rose to account for 7% of HFS' total revenues, thereby becoming an increasingly important component of the firm's business.

The payments HFS received from its preferred suppliers were a substantial factor in the firm's decision to select, recommend and sell those suppliers' products. For example, in 2002, HFS learned that one mutual fund company, which had been its preferred supplier for several years, was no longer willing to pay it. HFS told the mutual fund supplier it would stop selling that supplier's mutual funds and would switch the firm's existing business to other mutual fund companies. HFS proceeded to negotiate a revenue sharing arrangement with a new preferred supplier. Sales of the old preferred supplier's product plummeted while the sales of the new supplier's funds soared. Moreover, HFS transferred more than \$20 million in assets from other mutual fund suppliers to the new preferred supplier at NAV. To provide an incentive for the HFS FAs to effect these switches, the new preferred supplier gave HFS and its FAs special cash compensation in the form of a payment of 50 basis points on each transfer. HFS customers were not told about this special cash payment.

During portions of the relevant period, as part of its overall financial planning process with its clients, HFS also recommended that thousands of its customers refinance their homes through Tranex Financial Services, Inc. ("Tranex"). Although the firm disclosed a general relationship with Tranex, HFS failed to adequately disclose that HFS' parent company owned and controlled Tranex, thereby making Tranex an affiliate of HFS. Furthermore, HFS paid a fee that amounted to 25% of the net yield spread that Tranex earned on the loan to FAs who recommended the mortgage refinance loans and referred mortgage customers to Tranex. HFS did not disclose the fact or amount of this compensation to customers.

In addition, HFS sold limited partnership products to customers who did not meet the minimum suitability requirements on net worth or income established by the issuer, the State of Michigan, or HFS. HFS also distributed a sales brochure without obtaining the required review from NASD's Advertising Regulation Department. Finally, HFS and John Hantz failed to adequately supervise and the firm failed to maintain adequate supervisory systems to ensure compliance with the federal securities laws and NASD rules.

2. Background

HFS is dually registered as a broker dealer and an investment advisor. Its 270 registered personnel work in sixteen branches in Michigan and three in Ohio. John Hantz, its President, CEO, and principal owner, had been a top producer and Midwest Regional Manager with a large, national, financial-planning firm before he founded HFS in 1998.

HFS charges its clients \$300 to \$2,500 to prepare a detailed financial plan. Based upon the interviews with and information provided by the clients, HFS FA's recommend that customers purchase various securities products (mutual funds, variable annuities, real estate direct participation programs/limited partnerships, and variable universal life) and other financial products (including mortgage loans, fixed annuities, life insurance, disability insurance and long term care insurance). HFS sells both its plans and its financial products through registered representatives, known internally as Financial Advisors ("FAs"). The FAs, who are employees of the firm, generally are hired with little or no industry experience and learn to do business according to the Hantz model.

3. HFS Made Misrepresentations about its "Independence"

In speaking with potential customers, HFS' FAs generally portrayed themselves as "independent" financial consultants. HFS' FAs generally began their initial client interviews with potential clients by closely following a detailed script in HFS' First Year Training Manual:

I would like to give you a little background on myself. First of all, as I may or may not have mentioned to you I am an *independent* financial consultant. Do you know what that means? To be an independent financial consultant means *a lot more freedom and flexibility to offer a number of different products and services without being captive to one or a few product companies*. It allows me to better service my clients to help them reach their financial goals because there is more objectivity.
[Emphasis added].

In its primary sales brochure entitled "More Choices – More Results", which it typically provided to customers, HFS stressed its ability to offer "choices from a multitude of services and products." In an advertisement published in Fall 2000, HFS claimed to sell "the most comprehensive array of products available in the market today," and in a February 2003 advertisement, it claimed to offer "individually designed financial plans and a wide range of investment products."

The firm's assertions in its sales brochure, these advertisements, and the FAs' claims to customers, were misleading because HFS' product offerings were in essence limited to the preferred suppliers' products for each type of investment.

In confidential presentations sent to firms HFS was considering as potential preferred partners, HFS conceded that it was not independent and that it did not behave like ordinary "independent broker/dealer firms." It wrote:

"The [Hantz Group] Business Model is unique in the financial planning industry. In many respects, it is almost the complete opposite of the traditional Independent Broker/Dealer business model."

In several presentations to preferred suppliers, HFS boasted: "Because it knows its role as a product distributor, HG is the best firm in the nation at selling proprietary product." Elsewhere, it described its goal of being the "best controlled distribution company in the world at selling their partners products". HFS said that product manufacturers could utilize HFS' brokers as their own "proprietary sales force" and expect those brokers to sell the "proprietary" products 90% of the time.

In fact, HFS selected one "Preferred Supplier" in each product category and then delivered almost all of its sales to that supplier:

<u>Product Category</u>	<u>Preferred Supplier</u>	<u>% of Sales</u>
Mutual Funds	Mutual Fund Company X	84.54 % ²
Variable Annuities	VA Company A	96.45 %
Fixed Annuities	Fixed Annuity Company J	92.83 %
VUL Insurance	Insurance Company N	99.45 %
Term Life Insurance	Insurance Company N	81.97 %
Disability Insurance	Insurance Company M	80.71 %
REITs	Limited Partner Company C	94.95 %
Long-Term Care Insur.	Insurance Company C	84.63 %

While claiming to be independent, objective, and freely able to offer the products of a number of different suppliers, HFS was effectively acting as the proprietary sales arm for specific product manufacturers. HFS did not disclose to its customers that it was, in essence, recommending the products of only one preferred supplier in each product category, although the average investor would have considered that information to be material.

4. HFS' Revenue Sharing Arrangements Presented Undisclosed Conflicts of Interest

a. HFS Negotiated Extraordinary Revenue Sharing Arrangements

With several of its preferred suppliers, HFS did not simply accept the marketing fees that were being offered by those companies. It negotiated persistently with them to

² The sales figures for Mutual Fund Company X cover the period July 1, 2003 (the quarter when Mutual Fund Company X first became the mutual fund preferred supplier) to September 30, 2004. Later, approximately 95 percent of HFS' fund sales were of Company X's fund.

maximize the amount of marketing fees in return for the agreement to maximize sales of those suppliers' products. As HFS directed increasing volumes of business to its preferred suppliers, it sometimes re-opened negotiations and sought even higher levels of marketing fees. Eventually, HFS secured several revenue sharing arrangements that were significantly higher, for several important product categories, than the fees normally paid in the industry, especially when compared to fees paid to firms of HFS' size and asset base:

Product Category	Preferred Supplier	Recent Revenue Sharing Payments
Mutual Funds	Mutual Fund Company X	45 bps on new sales 5 bps on aged assets
Variable Annuities	VA Company S	25-35 bps on new sales (depending on the product)
Fixed Annuities	Fixed Annuity Company J	45 bps on new sales
Limited Partnerships	Limited Partner Company C	50 bps on new sales
Variable Universal Life	Insurance Company N	9 % of target premiums
Disability Insurance	Insurance Company M	60 % of first year premiums
Long Term Care Insurance	Insurance Company C	Varying scale based on client age

These agreements allowed HFS to collect a steadily increasing amount of money from marketing fees:

- 2002 - \$ 968,772
- 2003 - \$ 1,487,772
- 2004 - \$ 1,838,691
- Total - \$ 4,295,235

HFS' marketing fees accounted for a significant percentage of its overall revenues – 5% in 2002, 6% in 2003, and 7% in 2004. The revenues were also important to the firm's profitability. For example, without its marketing fees, HFS' net profits in 2002 would have fallen from \$1,026,374 to only \$57,602. Because of the magnitude of these fees, revenue sharing arrangements became an increasingly critical component of the firm's business concept.

b. HFS' Business Structure Maximized Its Revenue Sharing Opportunities

HFS designed its structure and procedures to allow it to focus its sales effort on the products of its preferred suppliers. In a confidential marketing presentation it made to its preferred suppliers, HFS asserted:

Since HG's entire sales force are employees, not independent contractors, HG can dictate how they do business. ... Unlike independent broker/dealer firms, almost all of HG's new hires come

from outside the industry, so HG can train them to do business its way.

An official who worked for a preferred supplier sent an internal e-mail describing HFS' system as follows: "Hantz has strong control over the reps which can be manipulated based upon the best deal and the best timing that can be derived."

On the rare occasions when HFS hired an experienced person, it required the new FA to undergo a "detox" program to re-educate the FA on how to do business according to the Hantz business model. HFS brought in representatives from the preferred suppliers to train its FAs on all the positive features of that supplier's products. The FAs received little or no training regarding the products of non-preferred suppliers, and were discouraged from speaking with the wholesalers who could have offered them educational information about alternative products.

HFS subjected its new FAs to very close supervision, especially during their first year of employment. Managers routinely tested the FAs on how well they had memorized their sales scripts. The supervisors trained them on which products to recommend to their customers, and helped them to become comfortable with the preferred suppliers' products, but only those products. HFS' supervisors and employees also discouraged new FAs from recommending the products of non-preferred suppliers during weekly "case study" peer review meetings.

Many of HFS' 270 FAs conducted little or no due diligence to determine which financial products were most appropriate to recommend to their clients. Instead, they relied almost entirely on two top managers who analyzed the many product choices and selected what was deemed to be the best supplier in each product category. The FAs then recommended the chosen products, based almost entirely upon the selections made by a small group of management personnel. The FAs and customers were encouraged to focus on general concepts of financial planning and long term goals. They were not encouraged to focus on other factors, such as the specific costs or features of a given product, or the performance of that product in comparison to the products offered by other product suppliers. Hantz Group's confidential Business Plan stated:

Product performance is de-emphasized. ... Goal Orientation -- Identifies long-term goals and de-emphasizes need for 'best investment product.' [The HFS business model] appeals to consultants who believe that specific product choices are less important than the planning process.

Elsewhere in its confidential Business Plan, HG described that its goal was to develop "Increased Share of Wallet -- Increased wallet-share initially and over time. More accounts per client. Larger account size." Once HFS developed a client, it aggressively sought new opportunities to earn income by offering a widening spectrum of financial products -- car insurance, home insurance, life insurance, mortgage refinancing, tax planning, estate planning, and other financial products.

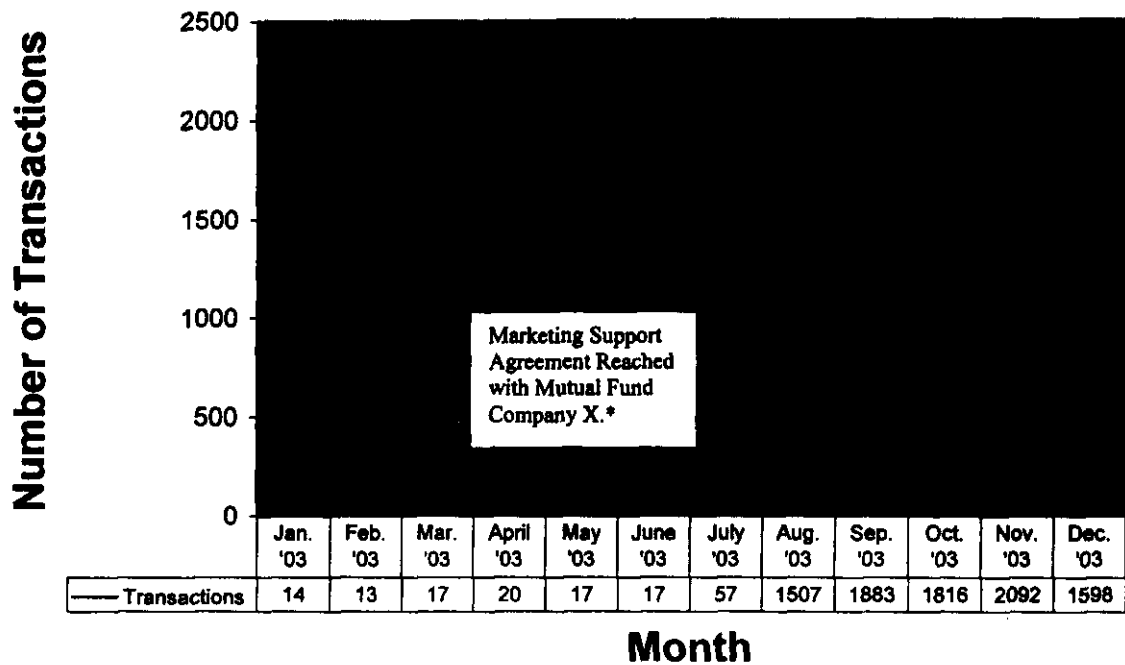
c. HFS Selected its Preferred Suppliers Based in Substantial Part Upon the Suppliers' Willingness to Pay Marketing Fees, Presenting an Undisclosed Conflict of Interest

During the relevant period, HFS switched from one preferred supplier to another in only the mutual fund area. A substantial factor in HFS's decision to pick its new preferred suppliers was the suppliers' willingness to pay marketing fees. When HFS dropped that preferred supplier, sales of that supplier's products plummeted. When HFS selected the new preferred supplier and that firm began paying marketing fees, sales of that supplier's products soared.

HFS sold the mutual funds of Mutual Fund Company O ("Company O") from 1998 to 2002, when HFS discovered that that preferred supplier had stopped paying marketing fees. HFS told Company O that unless it paid HFS the marketing fees supposedly owed, HFS would stop sending Company O new business and move current assets out of Company O's funds.

When Company O did not resume marketing fee payments, HFS stopped recommending the sale of Company O's funds to new customers and sales of Company O's funds decreased substantially. Later, after HFS had negotiated a new revenue sharing agreement with Mutual Fund Company X ("Company X"), HFS named Company X as its new preferred supplier. Once that new agreement was signed, sales of Company X's funds skyrocketed, while sales of the old preferred supplier's funds fell, until over 90 percent of HFS' mutual fund sales were of Company X's funds. HFS also recommended that more than 2000 of its existing mutual fund customers transfer their existing mutual fund holdings to Company X.

HFS 2003 Sales of Products of Mutual Fund Company X



* Marketing support agreement between HFS and Mutual Fund Company X became effective July 21, 2003. There were 12 transactions before July 21 and 45 transactions on or after July 21.

By November 2003, based on HFS' impressive volume of sales, Company X granted HFS an improved revenue sharing arrangement that allowed HFS to collect 45 basis points on sales and 5 basis points on assets (instead of the 27 basis points that had previously been paid by Company X). The terms of this deal were among the most generous found anywhere in the industry.

5. **HFS' FAs Received Compensation For Directing Business to an Affiliated Mortgage Company, Creating a Conflict of Interest**

Hantz Group, HFS' parent company, acquired Tranex in approximately 1999. Tranex is a licensed Michigan mortgage broker that originates residential loans for its customers. HG replaced most of the Tranex loan officers who had previously originated its mortgage loans and began using the HFS FAs as Tranex's exclusive sales arm. After receiving extensive training, the HFS FAs began handling many of the various duties of the former loan officers, such as educating the homeowners about mortgage product options, taking mortgage applications, disseminating the various mandatory HUD

disclosure forms, and collecting the necessary documentation required at loan closings. Tranex employees subsequently handled the underwriting, credit analysis, and loan decision, and attended the actual closing.

In return for recommending a mortgage loan to their clients, and then handling many of the various mortgage-related tasks, HFS paid the FAs referral fees that equaled 25% of the net yield spread that Tranex earned for originating and closing the mortgage loans. In some instances this compensation accounted for as much as a quarter of the FAs' annual income. These fees gave the FAs incentive to recommend mortgage refinancing to their clients. It also provided them with a financial incentive to recommend a mortgage loan from Tranex, instead of from competing mortgage brokers or lenders. This financial incentive presented HFS and its FAs with a conflict of interest.

6. HFS Misrepresented or Failed to Adequately Disclose Material Facts About its Relationship with Its Preferred Suppliers and With Tranex

a. HFS Did Not Disclose to Its FAs or Its Clients Its Exclusive Relationships With Its Preferred Suppliers or the Marketing Fee Arrangements

Despite the actual conflicts of interest described above, HFS did not disclose: a) that it had selected preferred suppliers; b) that it was directing substantially all of its business to those suppliers; or c) that those preferred suppliers were paying significant marketing fees to HFS with the understanding that HFS would direct most of its business to them. HFS' actions gave rise to a conflict of interest, but the firm did not provide its clients with disclosure that would enable the clients to make sufficiently educated decisions about how to handle the conflict.

HFS' clients could not learn from the FAs that HFS was collecting marketing fees because the firm's management did not tell the FAs that the firm was receiving the fees. HFS management opted not to inform the FAs about the revenue sharing arrangements, because management did not believe the information was relevant or necessary for FA's. Only a handful of HFS' top managers knew anything about the revenue sharing program.

HFS also failed to mention any specific information about the marketing fee arrangements in the written disclosure documents it routinely provided to its clients. The firm presented each of its clients with a Financial Planning Agreement and a Form ADV-Part II.³ Although these documents contained numerous disclosures relating to compensation, they notably failed to include specifics about the revenue sharing arrangements. HFS did not disclose to its clients that it had preferred suppliers, or specify the terms and/or amounts of compensation the firm was collecting.

³ Form ADV is the "Uniform Application for Investment Advisor Registration" that investment advisory firms file with the SEC and/or state securities regulators to disclose details about their business operations. HFS distributed Part II of this form to its clients at the time they first entered into a planning agreement, and made it available at other times as well.

b. Neither HFS Nor its FAs Adequately Disclosed to Clients or Regulators that the FAs Were Working for a Closely Affiliated Company and Receiving Fees For Recommending and Referring Clients to Tranex

HFS either misrepresented or did not adequately disclose to customers its FAs' relationship with Tranex. In written disclosures to clients from 2002 to 2004, HFS stated that "no referral fees of any kind were being paid by either" Tranex or HFS to the HFS FAs. Beginning in April 2004, HFS stated: "No referral fees of any kind will be paid by either Tranex or the Hantz Group for said referrals." This failed to disclose the fees paid to the HFS FAs in connection with the Tranex mortgage referrals.

The 2004 disclosure document also mischaracterized the role that the HFS FAs played in the mortgage loan process: "Once an introduction [of the customer to Tranex] is made, Tranex representatives then handle the application, mortgage approval and closing process." In fact, the FAs remained a main point of contact with the customers from loan application through loan closing, and played a critical role throughout the process.

When Tranex sold mortgages to customers who were recommended by an affiliated business, federal law required that the mortgage customers receive a written document (an Affiliated Business Arrangement Disclosure Statement) disclosing the affiliation between Tranex and the company providing the mortgage referral. The Affiliated Business Arrangement Disclosure Statement was specifically designed to disclose the nature of the relationship between the affiliates and to reveal the amount or percentage of the referral fee that was being paid. Neither HFS nor Tranex provided this required disclosure to customers until September 2003.

Michigan's mortgage regulators sent a letter to Tranex in October 2002 asking whether HFS officials were conducting mortgage business. Tranex's reply letter stated that the HFS employees were not engaged in mortgage brokerage activity. The letter also suggested that Tranex's customers were receiving the Affiliated Business Arrangement Disclosure Statement at a time when they were not. Finally, Tranex did not disclose to Michigan mortgage regulators that HFS FAs were receiving compensation from HFS for mortgage referrals.

Moreover, even though the HFS FAs were conducting the face-to-face interviews and taking the mortgage applications, they avoided signing as the "interviewer" and left the signature line blank pursuant to a firm policy:

ONLY TRANEX EMPLOYEES may sign a mortgage application as interviewer. This means that if you are an advisor of HFS, you are not to sign a mortgage application. It must be signed by [a Tranex employee]. ... THIS IS A SERIOUS COMPLIANCE ISSUE. [Emphasis in original].

Clients were not provided with sufficient disclosures to alert them about the close affiliation between HFS and Tranex and the resulting conflicts of interest. If HFS' clients had fully understood the financial incentives the FAs were receiving for recommending a Tranex mortgage, they would have considered the FAs' recommendations more cautiously.

7. HFS and John Hantz Failed to Establish and Follow an Adequate Supervisory System to Monitor the Revenue Sharing Arrangements and the Related Disclosures

HFS failed to adequately supervise its FAs who had a) suggested to investors that they and their firm were "independent"; b) failed to disclose that HFS was selling almost exclusively the products of its preferred suppliers; and c) failed to disclose that the preferred suppliers were paying significant marketing fees to HFS that created a financial incentive to promote the products of its preferred suppliers. HFS also failed to establish, maintain and enforce supervisory systems and procedures reasonably designed to prevent the FAs and the firm from engaging in the activities discussed above.

As examples, HFS' procedures contained no provisions requiring officials to monitor what the firm and its FAs told customers about revenue sharing arrangements, HFS' "independence", or HFS' freedom to offer products from a wide range of product suppliers. Finally, the firm failed to establish adequate procedures designed to determine whether the product companies had made appropriate disclosures in their product prospectuses and statements of additional information about the revenue sharing arrangements that had been reached with HFS.

Because John Hantz owned more than 65% of HFS' parent company, Hantz Group, he received the majority of the financial benefits that were generated by HFS' undisclosed revenue sharing arrangements. Furthermore, as HFS' President, CEO, and Director, John Hantz directly supervised the firm's revenue sharing program. He failed to adequately monitor the firm's revenue sharing activities or its disclosures regarding the conflicts of interest described herein. John Hantz did not adequately ensure that HFS maintained and enforced the supervisory procedures and systems described herein. As a result, John Hantz failed to adequately supervise HFS' activities with respect to its revenue sharing program.

8. HFS Received and Did Not Ensure Adequate Disclosure of Special Cash Compensation

In approximately July 2003, HFS entered into an agreement with Mutual Fund Company X that allowed HFS to transfer its clients from the funds of other mutual fund families into Company X mutual funds at net asset value ("NAV"). Since there would be no sales commissions paid to the HFS FAs for moving clients to Company X mutual funds at NAV, HFS and Company X entered into an agreement that allowed the FAs to receive 50 bps on gross sales for all money transferred into Company X mutual funds at

NAV. The special deal lasted from July 21, 2003 to January 21, 2004. Company X did not grant this same deal to other broker-dealers who sold its mutual funds.

Company X's payment to HFS and its FAs constituted "special cash compensation" under NASD Rule 2830(l). Company X's prospectuses and statements of additional information ("SAIs") did not adequately disclose the special cash compensation paid to HFS in three respects: they never mentioned HFS by name; they did not indicate that Company X was paying special cash compensation to the HFS FAs for their NAV transfers, but not to other firms; and they did not disclose the "details" of the special cash compensation arrangements, such as the specific basis points or dollar amounts that were being paid to the HFS FAs.

HFS' Written Supervisory Procedures Manual ("the WSP Manual") stated that HFS would not enter into special cash compensation arrangements unless such arrangements were adequately disclosed in the fund's prospectuses and SAIs. Moreover, the WSPs required HFS to ensure such disclosure was made before HFS would accept special cash compensation.

HFS failed to follow the provisions of its WSPs and failed to comply with NASD Conduct Rule 2830(l). Accordingly, HFS' clients who received recommendations to transfer assets from their existing mutual funds to the funds of Company X were not alerted to a potentially significant conflict of interest. The clients had no way of knowing that the FAs who recommended the NAV transfers had received special cash compensation that amounted to an economic incentive to recommend the transfer.

9. HFS Sold Limited Partnerships to Customers Who Did Not Meet Certain Minimum Suitability Requirements

During the relevant period, when HFS recommended limited partnerships to its clients, it overwhelmingly recommended and sold a product offered by one preferred supplier, Limited Partner Supplier C ("LP Supplier C"). These products could only be sold to investors who satisfied the minimum suitability requirements in: a) LP Supplier C's own prospectus; b) the State of Michigan's guidelines for limited partnerships; and c) HFS' Registered Rep Manual dated April 18, 2003 ("the RR Manual"). Because it failed to follow these guidelines, however, HFS sold limited partnerships to customers who did not have sufficient assets or income to meet these minimum suitability thresholds.

While HFS made 808 total sales of these limited partnership products, at least 19 (2.4%) of those sales were made to clients who failed to meet LP Supplier C's minimum suitability requirements that they have either a) a minimum annual income of \$45,000 and a minimum net worth of \$45,000 (excluding home, furnishings and personal automobiles); or b) a minimum net worth of \$150,000 (excluding home, furnishings and personal automobiles).

At least 51 of HFS' 808 clients (6.3%) who purchased LP Supplier C limited partnerships failed to meet Michigan's suitability requirements that they have a) an annual

gross income of at least \$60,000 and a net worth (not including home, furnishings and personal automobiles) of at least \$60,000; or b) a net worth (not including home, furnishings and personal automobiles) of at least \$225,000.

At least 537 of HFS' 808 clients (66.5%) who purchased LP Supplier C limited partnerships failed to comply with the requirement in the HFS procedures that they have at a minimum \$1,000,000 net worth.

HFS calculated the net worth of its clients by including the value of a client's home, furnishings and automobiles. Michigan and LP Supplier C calculated their minimum net worth thresholds by excluding the value of these three items. Therefore, HFS was unable to provide its supervisors with a means of properly determining whether its FAs were recommending the sale of limited partnerships to customers for whom they were not suitable. HFS' failure to adopt and implement appropriate procedures for uniformly calculating net worth therefore led to the recommendations that did not meet the various suitability requirements, and management's inability to prevent the violations.

10. HFS Failed to Obtain NASD's Review of Its Discovery Interview Brochure

HFS routinely distributed a tri-fold Discovery Interview Brochure to all its clients and potential clients from 1998 through 2004. This brochure suggested that HFS offered "More Choices" and a "full range of financial services and products." It also suggested that HFS offered "choices from a multitude of services and products to meet every investment need." Prior to November 2004, the firm failed to file this brochure with the NASD Advertising Regulation Department. As a result, HFS never obtained the review required under NASD Conduct Rule 2210(c)(2)(A).

B. VIOLATIONS

1. HFS Made Claims of "Independence": Violations of Sections 17(a)(2) and 17(a)(3)⁴ of the Securities Act of 1933 and NASD Conduct Rule 2110⁵

⁴ Section 17(a)(2) of the Securities Act of 1933 (the "Securities Act") provides, in relevant part, that "It shall be unlawful for any person in the offer or sale of any security ... directly or indirectly to ... obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading." Section 17(a)(3) provides that it is unlawful to "engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser". The Supreme Court has held that establishing violations of Sections 17(a)(2) and 17(a)(3) does not require a showing of scienter. The Court found that the language of §17(a)(2) does not include a scienter requirement and the language of §17(a)(3) focuses on the effect of particular conduct on members of the investing public, rather than upon the culpability of the person responsible. *Aaron v. SEC*, 446 U.S. 680, 696-97 (1980).

⁵ NASD Conduct Rule 2110 provides: "A member, in the conduct of his business, shall observe high standards of commercial honor and just and equitable principles of trade."

As described above, HFS engaged in fraudulent activity when it encouraged its FAs to suggest to clients that both they and the firm were "independent", "not captive to one or a few product companies", and free to offer a number of different products. These statements were misleading, and in violation of Sections 17(a)(2) and 17(a)(3) of the Securities Act and NASD Conduct Rule 2110.

2. HFS Entered into Revenue Sharing Arrangements that Created Conflicts of Interest, Without Disclosing the Arrangements to Its Clients: Violations of Sections 17(a)(2) and 17(a)(3)⁶ of the Securities Act and NASD Conduct Rule 2110

As described above, HFS engaged in fraudulent activity when it failed to inform its clients that it sold almost exclusively the products of certain preferred suppliers and that HFS selected those suppliers based in substantial part upon those firms' willingness to pay significant marketing fees. HFS' clients were not informed that HFS had a financial incentive to promote the products of its preferred suppliers or that HFS was taking its own financial interest into account when deciding which products to recommend to its customers. These omissions of material facts constituted a violation of Sections 17(a)(2) and 17(a)(3) of the Securities Act and NASD Conduct Rule 2110.

3. HFS and John Hantz Failed to Establish and Follow an Adequate Supervisory System to Monitor its Revenue Sharing Arrangements and Related Disclosures: Violations of NASD Conduct Rule 3010⁷ and 2110

As described above, HFS and John Hantz did not adequately supervise the firm's employees with respect to HFS' revenue sharing activities. They also failed to adopt, follow or enforce a supervisory system that adequately covered these activities. No system was in place to prevent the firm and its FAs from a) suggesting to investors that they and their firm were "independent"; b) failing to disclose that HFS sold almost exclusively the products of its preferred suppliers; and c) failing to disclose that the preferred suppliers were paying significant marketing fees to HFS that created a financial incentive to promote the products of preferred suppliers.

⁶ Section 17(a)(2) of the Securities Act of 1933 (the "Securities Act") provides, in relevant part, that "It shall be unlawful for any person in the offer or sale of any security ... directly or indirectly to ... obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading." Section 17(a)(3) provides that it is unlawful to "engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser". The Supreme Court has held that establishing violations of Sections 17(a)(2) and 17(a)(3) does not require a showing of scienter. The Court found that the language of §17(a)(2) does not include a scienter requirement and the language of §17(a)(3) focuses on the effect of particular conduct on members of the investing public, rather than upon the culpability of the person responsible. *Aaron v. SEC*, 446 U.S. 680, 696-97 (1980).

⁷ NASD Conduct Rule 3010 required members to assign responsibility for each aspect of its business to an appropriately registered principal. Assigned supervisors are required to reasonably supervise activities under their purview. Rule 3010 also requires each member to establish both supervisory systems and written supervisory procedures specifically tailored to the member's business that address the activities of its registered and associate persons.

John Hantz, by serving as HFS' President, CEO, Director, and primary owner, had ultimate responsibility for the firm's supervisory failures. As a result, HFS and John Hantz violated NASD Conduct Rules 3010 and 2110.

4. HFS Received Undisclosed Special Cash Compensation for NAV Transfers of Mutual Funds -- Violations of NASD Conduct Rules 2830(I), 3010 and 2110

As described above, HFS arranged for Mutual Fund Company X to pay special cash compensation to the FAs for NAV transfers. These payments were not disclosed in Company X's prospectuses or related documents, as required by NASD Conduct Rule 2830(I).⁸ HFS did not have supervisory procedures to confirm that the required prospectus reviews were conducted, as required by NASD Conduct Rule 2830(I). As a result, HFS violated NASD Conduct Rules 2830(I), 3010 and 2110.

5. HFS' Business Practices in the Mortgage Area Generated Undisclosed Conflicts of Interest -- Violations of NASD Conduct Rule 2110

HFS failed to adequately disclose the fact that the FAs received referral fees as compensation for recommending their clients to the affiliated mortgage subsidiary. As a result, HFS violated NASD Conduct Rule 2110.

6. HFS Sold Limited Partnerships to Clients Who Did Not Meet the Suitability Requirements -- Violations of NASD Conduct Rules 2310,⁹ 3010 and 2110

As described above, HFS sold limited partnerships to customers who did not meet the minimum suitability requirements (in terms of assets and/or income) as laid out in the product supplier's prospectus, the State of Michigan regulations, and HFS' Registered Representative Manual. As a result, HFS violated NASD Conduct Rules 2310 and 2110. Furthermore, HFS did not have adequate procedures in place to allow supervisory personnel to know whether a client had sufficient net worth to purchase the limited partnership product. As a result, HFS violated NASD Conduct Rule 3010.

⁸ NASD Conduct Rule 2830(I) provides: "No member shall accept any cash compensation from an offeror unless such compensation is described in the current prospectus of the investment company. When special cash compensation arrangements are made available by an offeror to a member, which arrangements are not made available on the same terms to all members who distribute the investment company securities of the offeror, a member shall not enter into such arrangements unless the name of the member and the details of the arrangements are disclosed in the prospectus."

⁹ NASD Conduct Rule 2310 -- Recommendations to Customers (Suitability) : (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 ... his financial situation and needs. (b) Prior to the execution of a transaction recommended ..., a member shall make reasonable efforts to obtain information concerning ... (1) the customer's financial status ... and (4) such other information used or considered to be reasonable by such member or registered representative in making recommendations to the customer.

7. HFS Failed to Obtain the Necessary Review of an Advertisement -- Violations of NASD Conduct Rules 2210¹⁰ and 2110

HFS distributed its Discovery Interview Brochure for almost six years without submitting it to the NASD Advertising Regulation Department for its review and comment. As a result, HFS violated Conduct Rules 2210 and 2110.

C. SANCTIONS

Respondent **John Hantz** consents to the imposition, at a maximum, of the following sanctions:

1. A censure;
2. A fine in the amount of \$25,000; and
3. A suspension from acting in a supervisory capacity with any NASD member for a period of thirty (30) days.

Respondent **Hantz Financial Services, Inc.** also consents to the imposition, at a maximum, of the following sanctions:

1. a censure;
2. a fine in the amount of \$675,000.

Respondent **Hantz Financial Services Inc.** further consents to undertake the following:

- a. HFS shall place and maintain on its public website within 15 days of the date of Notice of Acceptance of this AWC disclosures regarding
 - (i) its preferred supplier relationships, including:
 - (a) the existence of the preferred suppliers;
 - (b) the names of the preferred supplier firms and the products for whom they serve as the preferred supplier;
 - (c) the amount of revenue sharing payments that HFS receives from each of the preferred suppliers based on a reasonable estimate from historical experience, expressed in basis points or dollars;
 - (d) the total amount of revenue sharing payments (expressed in dollars) that HFS receives annually, starting with the amount received in 2005 as of the date of Notice of Acceptance of this AWC and updated each year thereafter;
 - (e) that the equity owners of the Firm may benefit financially from the revenue sharing payments HFS receives; and
 - (f) that HFS does not generally receive revenue sharing payments from non-preferred suppliers; and

¹⁰ NASD Conduct Rule 2210(c)(2)(A) provides that advertising and sales literature concerning registered investment companies (including mutual funds) must be filed with NASD's advertising department within 10 days of the date of first use.

- (ii) the details of the relationship between HFS and Tranex Financial Services, Inc., including
 - (a) the common ownership and control;
 - (b) the specific tasks conducted by the HFS FAs in the mortgage loan process;
 - (c) the fact that the FAs receive 25% of the net yield spread that Tranex earns on the mortgage loans referred by the FAs.
- b. HFS shall send the information contained in paragraph a above:
 - (i) to its current customers within 90 days from the date of Notice of Acceptance of this AWC; and
 - (ii) to new customers upon the opening of an account.
- c. HFS shall devise and implement within 90 days of the date of Notice of Acceptance of this AWC a policy and set of procedures to ensure that HFS is complying with its obligations under this AWC, the federal securities laws, and NASD rules.
- d. HFS shall devise and implement within 90 days of Notice of Acceptance of this AWC a policy and set of procedures for training its FAs regarding
 - (i) disclosures of the financial incentives that
 - (a) HFS receives from its preferred suppliers; and
 - (b) the FAs receive for mortgage referrals to Tranex; and
 - (ii) disclosures to customers regarding the "independence" of HFS and/or its FAs.
- e. HFS shall retain, within 60 days of the date of Notice of Acceptance of this AWC, the services of an Independent Consultant not unacceptable to NASD Staff. The Independent Consultant ("IC") shall, at HFS' expense, review and make recommendations concerning the adequacy of HFS' policies, procedures and disclosures as they relate to the matters described in this AWC.
- f. Within 120 days of the Notice of Acceptance of this AWC, The IC shall prepare a written report and present it to HFS and NASD staff. The report shall outline the steps already taken by HFS to address the issues discussed in the AWC. If necessary, the report should recommend further steps that need to be taken, including any recommendations regarding changes that may be necessary to HFS' supervisory and compliance procedures and systems or recommendations for the adoption of revised disclosures relating to the matters discussed in this AWC.
- g. Within 30 days after delivery of the IC's report, HFS shall either adopt all recommendations made by the IC or, if it determines that a recommendation is unduly burdensome or impractical, propose an alternative procedure designed to achieve the same objective. HFS shall submit such proposed alternatives in

writing to the IC and the NASD staff. Within thirty days of receipt of any proposed alternate procedure, the IC shall: (i) reasonably evaluate the alternative procedure and determine whether it will achieve the same objective as the IC's original recommendation; and (ii) provide HFS with a written decision reflecting his or her determination. HFS will implement the IC's ultimate determination with respect to any proposed alternative procedure and must adopt all recommendations deemed necessary and appropriate by the IC.

- h. Within 45 days of receiving the IC's report or the IC's written decision reflecting his or her determination as to proposed alternative procedures, HFS shall adopt and implement all recommendations made by the IC. HFS shall also send a written letter to NASD staff confirming the steps it has taken to (i) address the various concerns described in this AWC; and (ii) fully implement the IC's recommendations.
- i. HFS shall cooperate fully with the IC and shall provide him or her with access to HFS' files, books, and records, as reasonably requested by the IC. HFS will also provide the IC with access to the employees, contractors and affiliates of HFS and its affiliated companies.
- j. To ensure the independence of the IC, HFS:
 - (i) shall not have the authority to terminate the IC, without the prior written approval of NASD Staff;
 - (ii) shall compensate the IC, and persons engaged to assist the IC, for services rendered pursuant to this AWC at their reasonable and customary rates;
 - (iii) shall not be in and shall not have an attorney-client relationship with the IC and shall not seek to invoke the attorney-client privilege or any other doctrine or privilege to prevent the IC from transmitting any information, reports, or documents to NASD staff.
- k. To further ensure the independence of the IC, HFS shall require the IC to enter into an agreement that provides that, for the period of the engagement and for a period of two years from completion of the engagement, the IC shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with HFS, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity. Any firm with which the IC is affiliated in performance of his or her duties under this AWC shall not, without prior written consent of NASD Staff, enter into any employment, consultant, attorney-client, auditing or other professional relationship with HFS, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement.
- l. For good cause shown, and upon receipt of a timely application from the IC or HFS, NASD staff may extend any of the procedural dates set forth above.

III.

OTHER MATTERS

- A. HFS and John Hantz understand that they may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. Respondents understand that they may not deny the charges or make any statement that is inconsistent with the AWC in this Statement. This Statement does not constitute factual or legal findings by NASD, nor does it reflect the views of NASD or its staff.
- B. John Hantz agrees to pay the monetary sanctions imposed on him within ten days of the notice of acceptance of this AWC.
- C. HFS agrees to pay the monetary sanctions imposed on it within the timeframes outlined in the installment payment plan approved by NASD staff and the National Adjudicatory Council.
- D. HFS and John Hantz specifically and voluntarily waive any right to claim that they are unable to pay, now or at any time hereafter, any monetary sanction imposed in this matter.

The undersigned certify on behalf of HFS and John Hantz that they have read and understand all of the provisions of this AWC and have been given a full opportunity to ask questions about it, and that no offer, threat, inducement, or promise of any kind, other than the terms set forth herein, has been made to induce them to submit it.

Hantz Financial Services, Inc.

6/29/05
Date

By: [Signature]

Name: John Hantz

Title: CEO

4/29/05
Date

[Signature]
John Hantz

Reviewed by:



Bradley J. Schram, Esq.

Hertz, Schram & Saretsky, P.C.

1760 South Telegraph Road - Suite 300

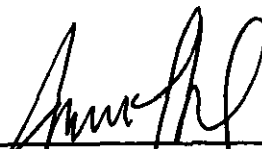
Bloomfield Hills, MI 48302-0183

Counsel for Respondents Hantz Financial Services, Inc. and John Hantz

Accepted by NASD:

8/11/05

Date



James E. Day, Chief Counsel
Department of Enforcement
Signed on behalf of the Director of ODA,
by delegated authority

ATTACHMENT

CORRECTIVE ACTION STATEMENT

Hantz Financial Services, Inc. ("HFS") is in the process of drafting a brochure for review by NASD's Advertising Regulation Department. The purpose of this brochure is to inform our clients of some of the critical disclosure issues that financial services firms face today and the potential conflicts of interest issues that may arise from certain relationships between HFS and its product providers. It is our desire for these issues and relationships to be adequately disclosed and transparent to our clients. This brochure will detail the types of relationships that the Hantz Group, Inc. ("HG") and HFS have with various product providers. It will fully disclose that HFS receives compensation, in differing forms and amounts, based upon various arrangements with each product supplier (including preferred product suppliers). These disclosures will supplement the agreed upon requirements contained in the AWC at pages 18 and 19 (Section C(a)(i) and (ii)).

HFS has accepted, waived and consented in the AWC at page 18 (Section B7) to a finding that it failed to obtain the necessary review of an advertisement in violation of Conduct Rules 2210 and 2110. On June 20, 2005, HFS received notice from NASD's Advertising Regulation Department that the tri-fold brochure that was the subject of the violation was reviewed by the NASD with the following comment: "the material submitted appears to be consistent with applicable standards."

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