

CERTIFIED FINANCIAL PLANNER BOARD OF STANDARDS, INC.

ANONYMOUS CASE HISTORIES
NUMBER 26425

This is a summary of a decision issued following the November 2011 hearings of the Disciplinary and Ethics Commission (“Commission”) of Certified Financial Planner Board of Standards, Inc. (“CFP Board”). The conduct at issue in this case occurred prior January 1, 2009. The Rules in effect at that time under the *Code of Ethics and Professional Responsibility* (“Code of Ethics”) were Rules 101 through 705.

I. Issues Presented

Whether a CFP[®] professional (“Respondent”) violated CFP Board’s *Standards of Professional Conduct* when he: 1) issued two promissory notes to a client in connection with a real estate-related outside business activity without prior approval from his firm; and 2) was terminated by his firm for issuing the promissory notes.

II. Findings of Fact Relevant to the Commission’s Decision

In 2002, Respondent entered into a financial planning relationship with a client and prepared a financial plan for the client and his wife. In 2004, Respondent notified his firm that Respondent and his wife would be engaging in real estate-related outside business activity and his firm approved this limited outside business activity. In 2005, Respondent reviewed the 2002 financial plan for the client in light of the client’s divorce. The client maintained two open brokerage accounts at Respondent’s firm with Respondent as the representative of record on the accounts.

In 2007, Respondent and the client entered into a real estate investment together. Respondent recognized a possible conflict of interest and consulted with his business attorney. Based on the attorney’s advice, Respondent borrowed money from the client money to invest in the real estate venture instead of the allowing the client to act as a limited partner in the venture. Respondent did not consult his firm’s compliance department regarding this transaction with the client.

In March 2008, Respondent signed a promissory note in which he agreed to pay his client the greater of: 1) 15% of the net profit realized by Respondent on the sale of a house; or 2) the initial borrowed sum of \$25,000.00 plus accrued interest at the rate of 7% per annum. The promissory note stated that the entire payment shall be paid within 10 days of the closing of the property. Respondent subsequently sold the house at a loss and was unable to pay the client the amount agreed at the date specified in the promissory note.

In November 2010, Respondent and the client entered into a modification and renewal of the promissory note. The modified promissory note allowed Respondent to pay the client the remaining sum of approximately \$25,700 in successive monthly installments of \$1,000.00 with the first payment commencing on November 15, 2010 and continuing until all principal and

interest was paid. Respondent did not send the client any payments on November 15, 2010 or December 15, 2010.

In December 2010, the client sent Respondent a letter demanding full repayment of the loan in the amount of approximately \$25,700 by February 2011. In January 2011, the client sent a letter to Respondent's broker-dealer stating that his promissory note arrangement with Respondent did not involve any financial investments and no monies were withdrawn from his brokerage account. In January 2011, the business conduct committee of Respondent's firm met to discuss Respondent's issuance of two promissory notes in connection with real-estate related outside business activity and terminated Respondent's registration with the firm. During the disciplinary hearing before the Commission, Respondent's attorney acknowledged that Respondent violated National Association of Securities Dealers ("NASD") Rule 2370 by not properly disclosing the transaction to his firm.

III. Commission's Analysis and Conclusions Regarding Rule Violations

A. *Rule 201 – A CFP Board designee shall exercise reasonable and prudent professional judgment in providing professional services.*

The Commission determined that Respondent failed to exercise reasonable and prudent professional judgment in providing professional services when he issued two promissory notes to a client in connection with real estate-related outside business activity and did not notify his firm of this transaction. Thus, Respondent violated *Code of Ethics* Rule 201.

B. *Rule 406 – A CFP Board designee who is an employee shall perform professional services with dedication to the lawful objectives of the employer and in accordance with this Code of Ethics.*

The Commission determined that Respondent did not perform professional services with dedication to the lawful objectives of his employer and in accordance with CFP Board's *Code of Ethics* when he issued two promissory notes to a client in connection with real estate-related outside business activity without prior approval for the promissory notes and was terminated by his broker-dealer. Thus, Respondent violated *Code of Ethics* Rule 406.

C. *Rule 407(a) – A CFP Board designee shall advise his employer of outside affiliations which reasonably may compromise service to an employer.*

The Commission determined that Respondent failed to advise his employer of outside affiliations that reasonably may have compromised his service to his employer when he issued two promissory notes to a client in connection with real estate-related outside business activity without receiving prior approval from his employer. Thus, Respondent violated *Code of Ethics* Rule 407(a).

D. Rule 409 – If a CFP Board designee enters into a personal business transaction with a client, separate from regular professional services provided to that client, the transaction shall be on terms which are fair and reasonable to the client and the CFP Board designee shall disclose, in writing, the risks of the transaction, conflict(s) of interest of the CFP Board designee, and other relevant information, if any, necessary to make the transaction fair to the client.

Respondent issued two promissory notes to a client in connection with a real estate-related outside business activity and failed to fulfill his obligations described in the promissory notes. In addition, Respondent recognized a potential conflict of interest and consulted with his attorney instead of clarifying and obviating the risks with his compliance department. As a result of this conduct, the Commission determined that Respondent entered into a personal business transaction with a client on terms that were not fair and reasonable to the client and Respondent failed to disclose, in writing, the risks of the transaction, conflict(s) of interest of Respondent, and other relevant information necessary to make the transaction fair to the client. Thus, Respondent violated *Code of Ethics* Rule 409.

E. Rule 606(a) – In all professional activities a CFP Board designee shall perform services in accordance with applicable laws, rules and regulations of governmental agencies and other applicable authorities.

The Commission determined that Respondent failed to perform professional services in accordance with the applicable laws, rules and regulations of governmental agencies and other applicable authorities when he issued two promissory notes to a client in connection with a real estate-related outside business activity without seeking prior approval from his firm in violation of NASD Rule 2370. Thus, Respondent violated *Code of Ethics* Rule 606(a).

F. Rule 606(b) – In all professional activities a CFP Board designee shall perform services in accordance with applicable rules, regulations and other established policies of CFP Board.

The Commission determined that Respondent failed to perform professional services in accordance with applicable rules, regulations and other established policies of CFP Board when he violated *Code of Ethics* Rules 201, 406, 407(a), 409, 606(a) and 607. Thus, Respondent violated *Code of Ethics* Rule 606(b).

G. Rule 607 – A CFP Board designee shall not engage in conduct which reflects adversely on his integrity or fitness as a CFP Board designee, upon the marks, or upon the profession.

The Commission determined that Respondent engaged in conduct that reflects adversely on his integrity and fitness as a CFP Board designee, upon the marks, and upon the profession when he:
1) issued two promissory notes to a client in connection with a real estate-related outside

business activity without prior approval from his firm; 2) was terminated by his firm; and 3) violated NASD Rule 2370. Thus, Respondent violated *Code of Ethics* Rule 607.

IV. Discipline Imposed

Article 3(a) of CFP Board's *Disciplinary Rules and Procedures* ("*Disciplinary Rules*") provides grounds for discipline for any act or omission that violates the *Code of Ethics*. The Commission found grounds for discipline under Article 3(a) because Respondent violated Rules 201, 406, 407(a), 409, 606(a), 606(b) and 607 of the *Code of Ethics*. Pursuant to Article 4.2 of the *Disciplinary Rules*, the Commission issued the Respondent a Public Letter of Admonition.

The Commission did not consider any mitigating factors.

The Commission considered the following aggravating factors:

1. Respondent stated multiple times that he did not consider the client who signed the promissory note to be a client despite Respondent managing the client's assets.
2. Respondent's attorney acknowledged that Respondent violated the spirit of NASD Rule 2370.
3. Respondent acknowledged the possible impropriety of his conduct by consulting with his lawyer but did not consult with his firm's compliance department.