CERTIFIED FINANCIAL PLANNER BOARD OF STANDARDS, INC.

ANONYMOUS CASE HISTORIES
NUMBER 27841

This is a summary of a Settlement Agreement entered into at the October 2013 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 to January 1, 2009. The Rules in effect at that time under the *Code of Ethics* were Rules 101 through 705.

I. Issue Presented

Whether a CFP® professional ("Respondent") violated CFP Board's *Standards of Professional Conduct* when he sold clients a tenant in common ("TIC") interest that concentrated the clients' total net worth and investable assets into a single property without performing a cash flow analysis to determine if the clients would have sufficient income and liquid assets to cover their living expenses.

II. Findings of Fact

Clients met Respondent in 2003 shortly after they sold a piece of real estate. The Clients owed capital gains tax on the proceeds they received from selling the property. Respondent sold the Clients a TIC interest in order to take advantage of Internal Revenue Code Section 1031 to defer the Clients' capital gains tax.

In December 2003, Mr. Client completed a New Account Form for a joint account with Mrs. Client and indicated a net worth of approximately $1,100,000 excluding their $300,000 home. Mr. Client indicated that his risk tolerance was moderate and time horizon was intermediate (3-10 years). In December 2003, the Clients signed 1031 TIC Acknowledgements. In December 2003, the Clients also signed a TIC Purchaser Questionnaire and indicated a purchase payment of approximately $500,000. The TIC was sold in 2007 and the Clients once again had proceeds subject to capital gains tax.

The Clients returned to Respondent for assistance. In December 2007, the Clients completed a New Account Form and indicated a net worth of approximately $892,000 excluding their $550,000 home. They indicated that their risk tolerance was moderate and time horizon was long term (10+ years). The Clients indicated that their investment objective was growth and income. Both Mr. and Mrs. Client were 60 years old. Respondent recommended that the Clients invest in a TIC.

In December 2007, the Clients completed a Direct Placement Participation Programs Disclosure Form and indicated a net worth of approximately $792,000 exclusive of their $550,000 home. The Clients indicated that they were investing approximately $656,000 in the TIC. The Clients' investment of approximately $656,000 represented 49% of their total net worth including primary residence and 83% of their investable assets. Respondent received a $39,000 commission for selling the TIC to the Clients.

In March 2012, the Clients filed a Statement of Claim in Financial Industry Regulatory Authority, Inc. ("FINRA") Arbitration against Respondent. The Clients alleged that Respondent misrepresented the benefits of the TIC and that the TIC was unsuitable for them. In May 2012, Respondent filed his Amended Answer to the Statement of Claim. Respondent claimed that the investment was suitable and the Clients were informed of the risks. In January 2013, the parties settled the arbitration for approximately $250,000. According to the Settlement Agreement, Respondent paid $150,000 of the settlement and Respondent's former broker-dealer paid $100,000.

According to the December 2007 Direct Placement Participation Programs Disclosure Form, the approximately $656,000 investment in TIC represented 49% of the Clients' entire net worth. The approximately $656,000 investment also represented 83% of the Clients' investable assets. Respondent's recommendation of the TIC concentrated 83% of the Clients' retirement assets in real estate. Moreover, Respondent's recommendation unsuitably concentrated the Clients into a single piece of real estate.

Respondent stated that he relied on the Clients' representations that they did not need the money they invested in the TIC for their income needs. The Clients stated that they had government pensions that would provide retirement income. Respondent also stated that he did not complete a cash flow analysis. Respondent acted unreasonably when he concentrated 83% of the Clients' retirement assets in an illiquid product without conducting a cash flow analysis to determine if the clients' income needs could be met by other means.

Respondent also contended in his Amended Answer to the Statement of Claim that the Clients were experienced in TIC and real estate investments and were fully informed of the risks associated with the TIC. However, the Clients' acknowledgment of investment risks and past TIC experience did not absolve Respondent of his duty to follow FINRA's rules and CFP Board's *Standards*.

III. Rule Violations

A. Rule 701 – A CFP Board designee shall provide services diligently.

Respondent sold the Clients a TIC interest that unsuitably concentrated the Clients' total net worth and investable assets into an illiquid investment without performing a cash flow analysis to determine if the Clients would have sufficient income and liquid assets to cover their living expenses. By selling the Clients an unsuitable TIC interest without performing a cash flow analysis, Respondent failed to provide services diligently. Thus, Respondent violated *Code of Ethics* Rule 701.

IV. Discipline Imposed

Article 3(a) of CFP Board's *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 Rule 701 of the *Code of Ethics.* The Commission and Respondent entered into a Settlement Agreement in which Respondent consented to the Findings of Fact and Rule Violations. Based on the terms of the Settlement Agreement, the Commission issued a Public Letter of Admonition to Respondent, pursuant to Article 4.2 of the *Disciplinary Rules*.

The Commission considered the following mitigating factors:
1. The 1031 exchange Respondent performed was of a prior speculative real estate investment;
2. The record did not contain any evidence that Respondent influenced the Clients' decision to purchase the TIC, as the Clients were seeking the benefits of a 1031 deferral for a prior speculative real estate investment;
3. The Clients stated no need for income or cash flows;
4. The Clients were experienced in real estate investment;
5. The Clients did not realize an actual loss; and
6. Respondent had been licensed since 1992 with no prior complaints.

The Commission considered the following aggravating factors:
1. The Client's past success with speculative real estate investments did not absolve Respondent of the responsibility to thoroughly analyze his recommendation of the TIC;
2. The lack of diversification and imprudence of the investment strategy should have been clear; and

3. Despite the fact that the Clients expressed a desire for the TIC investment, Respondent still had an obligation to ensure that the investment was suitable for the Clients.

The Commission did not consult any Anonymous Case Histories but considered *Sanction Guidelines* 11 (Diligence) and 13 (Acting in the best interest of a client outside of a planning engagement) in arriving at its decision. The Commission noted that the FINRA arbitration settlement was equal to 17% of the amount sought by the aggrieved parties.