CERTIFIED FINANCIAL PLANNER BOARD OF STANDARDS, INC.

ANONYMOUS CASE HISTORIES
NUMBER 28508

This is a summary of a decision issued following the February 2014 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 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) recommended the Biotech Company stock to Client without giving the client the prospectuses or PPMs for the penny stock investments: 2) sold the Biotech Company stock to Client without the knowledge or approval of Firm; 3) discouraged the Clients from selling the penny stocks, while he sold his own Biotech Company shares; 4) recommended to Client the loan to Biotech Company, a company in which he had a personal stake, without disclosing the inherent conflict of interest; and 5) personally reimbursed Client $30,000 as compensation for a loan recommendation he made to Client.

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

2013 Client Arbitration

The Clients alleged in the SOC that Respondent: 1) failed to execute a July 16, 2008 order to sell everything in their accounts, valued at $4,044,243.87, resulting in a $895,057.90 loss; 2) failed to disclose mutual fund breakpoints and inform the Clients that by aggregating their purchases in A shares, they would have achieved lower costs; 3) engaged in a private securities transaction and penny stock fraud when he failed to disclose the full extent of his secret ownership interest and involvement in a biotechnology company ("Biotech Company"); 4) engaged in settling away when he paid Clients $30,000 to settle a complaint regarding one of the penny stock companies that had defaulted on a loan recommended to Client by Respondent; 5) made unsuitable recommendations regarding investments and over-concentrated their accounts in equities in 2008 and 2009, resulting in a loss of approximately $1,400,000; and 6) engaged in fraud and misrepresentation to keep from executing the sell order at meetings held in September 2008, November 2008 and April 2009.

The Clients claimed that they gave Respondent's colleague the sell order in July 2008, and she acknowledged the instruction in a subsequent meeting when she stated that it was a good call to sell back in July. At the same meeting, Respondent stated that he did not know why everything wasn't sold and did not deny that the sell order had been given to Respondent's colleague. The Clients stated that although the accounts were not discretionary, Respondent and his colleague treated them as if they were discretionary. The sell order was not executed by Respondent and his firm until May 2009 when the Clients' attorney sent a complaint letter to firm's compliance department. After the sale, the balance in the account was approximately $3,100,000 with a resulting $895,000 loss.

According to the Clients, Respondent had been cheating them for years by using an allocation of mutual fund A, B and C shares along with Unit Investment Trusts ("UITs") and Exchange Traded Funds ("ETFs") in order to deny the Clients the advantage of break points on substantial mutual fund positions. Instead of aggregating the Clients' holdings in one, two or three large fund families to achieve zero commission breakpoint, Respondent and his colleague bought into 16 large fund families, composed principally of C shares.

The Clients also alleged that Respondent sold them 650,000 shares of Biotech Company penny stocks, valued at $149,500, without disclosing Respondent's ownership interest and involvement in Biotech Company, and without giving the Clients the prospectuses or private placement memoranda ("PPMs") for the penny stock investments. The stock has since become worthless. The Clients stated that Respondent encouraged them to hold the penny stocks that were bought through him at other firms, or in certificate-form outside of Firm, in order to conceal the nature and extent of his illegal activities. In so doing, Respondent engaged in outside business activities and private securities transactions without the knowledge or approval of his firm, in violation of the firm's policy and FINRA rules. Additionally, Respondent discouraged the Clients and others from selling the penny stocks in order to artificially inflate the value, while he sold his shares.

In response to CFP Board's August 2013 RFAI regarding Respondent's failure to disclose his ownership interest in Biotech Company when he recommended the stock to Client, and the resulting conflict of interest issue, Respondent's attorney stated:

> "Respondent did not have a secret ownership interest in Biotech Company, and he was not an employee of Biotech Company. He recalls that, at some point, he had purchased Biotech Company shares in the open market and held these shares between 1997 and 1999. He did not discourage Client, or any customer, from selling their Biotech Company shares."

Additionally, Respondent stated that he referred Client and his brother to Biotech Company and vouched for both Biotech Company and its founder. Client and his brother purchased the Biotech Company stock, but the purchase did not occur at Firm. According to Respondent's attorney, Respondent was not involved in the transaction; he simply made an unpaid referral to Client and his brother.

In 2001, Client complained to Respondent about a loan he made to one of Respondent's penny stock companies that was in default. Respondent personally reimbursed Client $30,000 and asked him to forget about it. According to the Clients, this was not the first settlement Respondent had entered into without Firm's approval, and in violation of Firm's written supervisory procedures and FINRA rules. These undisclosed settlements were an attempt to avoid regulatory scrutiny regarding the underlying complaints.

The Clients also alleged that in several meetings with Respondent and his colleague prior to July 2008, Client informed them that he was planning to retire and wished to purchase a building for his practice, and that he would continue to hold said building as landlord after selling his practice. Instead, Respondent and his colleague invested the Clients in technology, precious metals, commodities, and over-concentrated their portfolio in equities, foreign securities and emerging markets. In December 2007, the Clients' portfolio was valued at over $4,500,000 and had fallen to approximately $4,000,000 in July 2008 when the Clients met with Respondent. The Clients expressed concern and informed Respondent and his colleague that they wanted the portfolio liquidated as soon as possible, in order to purchase the above-mentioned building.

The Clients alleged that Respondent and his colleague made the following misrepresentations, among others, to keep from executing the sell order: 1) the values on the account statements were not a true reflection of their worth, and the bonds were actually worth more: 2) the precious metal funds were actually gold and not stocks, although they were obviously stock mutual funds; 3) zero risk has a different meaning today than it did back in July 2008; 4) an insured municipal bond has zero risk; and 5) Respondent and his colleague misunderstood the sell order and thought the Clients meant them to sell only the individual equities, not including equity mutual funds which represented the bulk of the account. The Clients claimed a total of $1,500,000 in damages.

Respondent stated that the Clients' claim was baseless and that Client's wife should be removed as a party since she had no standing to sue given that she was not a joint account holder on any of her husband's accounts. Client's wife did have a small account at Firm, but that account was not a subject of the Clients' SOC. Respondent stated that the Clients sought to blame Firm and the individual brokers for losses they suffered as a result of the 2008-2009 market collapse. In 1995, Client opened several brokerage accounts with Firm: 1) an individual Account; 2) an IRA Account; and 3) a Money Purchase Pension Plan Account ("MPPP Account"). Client was a highly successful plastic surgeon and single at the time, and his goal was to construct an investment portfolio for long-term growth with moderate risk. Client stated that he had considerable investment experience and accounts at other brokerage firms.

Respondent did not recall the details of the recommendations he made to Client as he ceased being Client's broker and financial advisor in late 1999 or early 2000. Thereafter, Respondent's colleague became the Clients' advisor. Respondent's attorney stated that Respondent was merely the owner of the Firm, which employed Respondent's colleague. The Clients' alleged that Respondent was present at several client meetings between Respondent's colleague and the Clients. Respondent's attorney provided copies of the following account-related documents: 1) a 1995 financial plan Respondent prepared for Client: 2) two 1995 balance sheets; 3) a 2008 new account form; and 4) 1998 and 2000 option agreements.

In June and July 1995, Client transferred securities valued at: 1) $450,000 into his Money Purchase Pension Plan Account ("MPPP Account"); 2) $14,000 into his IRA Account; and 3) $175,000, including penny stock, into his Individual Account. Respondent was Client's broker and financial advisor of record at that time. As referenced above, Respondent ceased acting as Client's broker and financial advisor in late 1999 or early 2000 and Respondent's colleague became Client's financial advisor.

A balance sheet from August 1995 shows the total asset value of the investments Client transferred to Respondent was approximately $645,000, representing 2.23% in liquid assets, 82.48% in fixed assets, 13.40% in equities and 1.89% in International. After Respondent's repositioning, the assets represented 1.68% in liquid assets, 48.67% in fixed income, 43.26% in equities and 6.38% in International.

When Client transferred the above-mentioned assets into the MPPP Account in 1995, he and Respondent discussed several potential asset allocations and investment options. Subsequently, they agreed on a recommended group of diversified mutual funds in compliance with Client's investment objectives. Over the next four years, Respondent would meet Client regularly to review the account and recommend re-allocations that Respondent believed would benefit Client. In 1995 and 1996, Client made a few unsolicited purchases in low priced securities in his Individual and IRA Accounts and was largely inactive for the next several years as he was busy with his multi-million dollar account at a securities firm. ("Securities Firm"). At Securities Firm, Client utilized over $1,250,000 in margin to purchase $4,990,000 in individual equity securities. These equity positions were mostly tech stocks and penny stocks, including: 30,000 shares of Advance Systems International, 50,000 shares of a website, 100,000 shares of a gem company and 640,000 shares of Biotech Company. According to Respondent, Biotech Company is the penny stock company that the Clients claim was purchased at Brokerage. Biotech Company was actually purchased outside of Brokerage.

By April 1999, Client's MPPP Account had substantially appreciated in value and he subsequently opened a Defined Benefits Plan Account ("DBP Account") at Brokerage, initially funded with approximately $57,000. In March 2000, Client transferred his Securities Firm assets, comprised of equities valued at $5,740,000 and a $1,257,000 margin debt to his Brokerage Individual Account. The majority of the transferred Securities Firm assets were in tech stocks or penny stocks. Over the next three years, Client engaged in unsolicited transactions in this account, including the purchase and sale of covered call options. By February 2003, the net equity of the Securities Firm securities had declined in value to less than $20,000 in his Individual Account. From 2000 to 2003, the investments in the MPPP and DBP accounts remained the same, and with the exception of minor changes agreed upon with Client, the investments were mostly a mix of income or growth based mutual funds and UITs.

From 2004 to 2008, Respondent's colleague met with Client several times a year to review his accounts and discuss asset allocation. No action was taken without Client's instructions. In December 2004, Client deposited

$982,000 into his Individual Account to invest in the markets. Respondent's colleague recommended a diversified mix of growth or income based mutual funds and UITs based on Client's past experience at Securities Firm. Respondent's colleague also recommended dollar cost averaging based on the market's volatility. Client received all applicable breakpoints. Client desired a similar investment approach for his DBP Account and Respondent's colleague followed Client's instructions.

According to Respondent, on July 16, 2008, the Clients met with Respondent's colleague and Respondent to discuss his accounts. Because of the market decline, Client's wife urged Client to sell his securities because she felt the stock market was too unstable. However, Client did not agree and did not instruct the respondents to liquidate his accounts. Client's wife was not authorized to direct transactions in Client's account. During the July 16, 2008 meeting, Client discussed his interest in purchasing a building for his medical practice. Client asked if the securities in his Individual Account could be readily liquidated if he needed funds to purchase the property. Respondent's colleague informed him that the securities were liquid and could be promptly sold when needed. Client did not instruct Respondent's colleague to liquidate or sell. Client did not complain about a failure to follow instructions and liquidate. Instead, in September 2008, Client transferred $80,000 from his Individual Account to his DBP Account and deposited an additional $50,000 into his DBP Account to purchase additional securities he discussed with Respondent's colleague.

In April 2009, Clients met with Respondent and Respondent's colleague. The Dow Jones Industrial Average ("DJIA") had dropped below 7,000 and Clients insisted that the market was crashing and that they should liquidate their account. However, Client did not instruct the Respondent and his colleague to liquidate. Clients informed Respondent's colleague that she wanted to file a complaint based on the respondents' failure to liquidate in July 2008. Client did not instruct the respondents to liquidate until May 2009. Respondent and his colleague did not recommend any speculative or penny stocks to Client, and they are not liable for Clients' losses because the investments were suitable for his financial circumstances, experience and investment needs.

III. <u>Commission's Analysis and Conclusions Regarding Rule Violations</u>

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

CFP Board's Complaint alleged that Respondent failed to exercise reasonable and prudent professional judgment in providing professional services when he: 1) sold the Biotech Company stock to Client as an outside business activity and private securities transaction; and 2) settled away from Firm by personally reimbursing Client $30,000 as compensation for a loan recommendation he made to Client in 2001 without the knowledge or approval of his firm, in violation of the firm's policy and FINRA rules.

The Commission determined that while Respondent's decision to "off-handedly" endorse Biotech Company led to a series of actions on the part of Client to initiate and further his involvement with Biotech Company, the Commission did find that Respondent "sold" Biotech Company stock to Client as an outside business activity or private securities transaction. The Commission determined that Respondent failed to act in a reasonable and prudent manner when he personally reimbursed Client for the losses he incurred on the loan. Thus, Respondent violated *Code of Ethics* Rule 201.

B. *Rule 202 – A financial planning practitioner shall act in the interest of the client.*

CFP Board's Complaint alleged that Respondent failed to act in the interest of the client when he: 1) recommended the Biotech Company stock to Client without giving the client the prospectuses or PPMs for the penny stock investments: 2) sold the Biotech Company stock to Client as an outside business activity and private securities transaction without the knowledge or approval of Firm, in violation of Firm's policy and

FINRA rules; 3) discouraged the Clients from selling the penny stocks, while he sold his own Biotech Company shares; and 4) recommended that Client issue a loan to Biotech Company, resulting in a loss to the client.

The Commission found that the record did not support CFP Board's allegation that Respondent recommended, or provided any undeniable affirmation of, Biotech Company stock to Client. The record also did not support CFP Board's allegation that Client had purchased Biotech Company from Respondent, or Firm. In fact, documentation from the transfer of securities from Securities Firm to Firm shows that Client owned the stock before transferring the securities to Brokerage. The record also demonstrated that Client had engaged in penny stock purchases prior to his moving his account to Firm. Finally, the record was devoid of any evidence linking Respondent to the loan that was made between Client and Biotech Company. Thus, Respondent did not violate *Code of Ethics* Rule 202.

C. *Rule 401(a) – In rendering professional services, a CFP Board designee shall disclose to the client material information relevant to the professional relationship, including, conflict(s) of interest, the CFP Board designee's business affiliation, address, telephone number, credentials, qualifications, licenses, compensation structure and any agency relationships, and the scope of the CFP Board designee's authority in that capacity.*

CFP Board's Complaint alleged that Respondent failed to disclose to the client material information relevant to the professional relationship when he recommended the Biotech Company stock to Client without giving the client the prospectuses or PPMs for the penny stock investments.

The Commission found that the record was devoid of any evidence indicating that Respondent failed to disclose material information about Biotech Company in connection with a recommendation to purchase the stock. Further, while Respondent's decision to "off-handedly" endorse Biotech Company led to a series of actions on the part of Client to initiate and further his involvement with Biotech Company, the Commission did find that Respondent "sold" or recommended Biotech Company stock to Client, in a manner in which he would have been required to furnish such information. Thus, Respondent did not violate *Code of Ethics* Rule 401(a).

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

CFP Board's Complaint alleged that Respondent failed to advise his employer of outside affiliations which may reasonably compromise his services when he: 1) sold the Biotech Company stock to Client as an outside business activity and private securities transaction; and 2) settled away from Firm by personally reimbursing Client $30,000 as compensation for a loan recommendation he made to Client in 2001 without the knowledge or approval of Firm, in violation of Firm's policy and FINRA rules.

The Commission determined that while Respondent's decision to "off-handedly" endorse Biotech Company led to a series of actions on the part of Client to initiate and further his involvement with Biotech Company, the Commission did not find that Respondent "sold" Biotech Company stock to Client as an outside business activity or private securities transaction. The Commission did find that Respondent's failure to notify Firm of a settlement such as the private business activity transaction with Client reasonably compromised his duty of loyalty to his employer. While the explanation of this activity by Respondent was to avoid potential liability and settle all issues between Client and Respondent or Firm, the action did nothing but cast Firm in an unappealing light as to the depth of Respondent's involvement. Thus, Respondent violated *Code of Ethics* Rule 407(a).

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

CFP Board's Complaint alleged that Respondent engaged in conduct that reflects adversely on his integrity and fitness as a CFP Board designee, on the CFP® marks and on the profession when he: 1) recommended the Biotech Company stock to Client without giving the client the prospectuses or PPMs for the penny stock investments: 2) sold the Biotech Company stock to Client as an outside business activity and private securities transaction without the knowledge or approval of Firm, in violation of Firm's policy and FINRA rules; 3) discouraged the Clients from selling the penny stocks, while he sold his own Biotech Company shares; 4) recommended to Client the loan to Biotech Company, a company in which he had a personal stake, without disclosing the inherent conflict of interest, resulting in a loss to the client; and 5) settled away from Firm by personally reimbursing Client $30,000 as compensation for a loan recommendation he made to Client in 2001 without the knowledge or approval of Firm, in violation of Firm's policy and FINRA rules.

By Respondent's decision to "off-handedly" endorse Biotech Company set the tone for all other findings in this case. Respondent's actions, however insignificant at the time, led to an unflattering settlement with FINRA. Respondent's small misstep blossomed into events that have created an unfortunate outcome for Respondent. Despite this, the Commission did not find evidence of items 1, 2, 3, or 4 as alleged by CFP Board in its Complaint. The Commission determined that Respondent's actions did not rise to a recommendation to purchase the stock that would have required him to make disclosures. Respondent readily admits he made a settlement payment to Client. While the explanation of this activity by Respondent was to avoid potential liability and settle all issues between Client and Respondent or Firm, the action did nothing but cast Firm in an unappealing light as to the depth of Respondent's involvement. Thus, Respondent violated *Code of Ethics* Rule 607.

F. *Rule 703 – A financial planning practitioner shall make and/or implement only recommendations which are suitable for the client.*

CFP Board's Complaint alleged that Respondent failed to make and/or implement only recommendations which are suitable for the client when he: 1) recommended the Biotech Company stock to Client without giving the client the prospectuses or PPMs for the penny stock investments: 2) discouraged the Clients from selling the penny stocks, while he sold his own Biotech Company shares; and 3) recommended to Client the loan to Biotech Company, a company in which he had a personal stake, without disclosing the inherent conflict of interest, resulting in a loss to the client.

The Commission found no evidence in the record to indicate that in the period of time assessed in this matter that Respondent's recommendations to the Client's were unsuitable. Thus, Respondent did not violate *Code of Ethics* Rule 703.

G. *Rule 705 – A CFP Board designee shall properly supervise subordinates with regard to their delivery of financial planning services and shall not accept or condone conduct in violation of the Code of Ethics.*

CFP Board's Complaint alleged that Respondent failed to properly supervise a subordinate with regard to her delivery of financial planning services when he failed to ensure that Respondent's colleague followed Client's instruction to sell all the investments in his account. The Commission determined that there was no evidence to suggest that Respondent failed to supervise Respondent's colleague based upon the materials provided in this hearing. Thus, Respondent did not violate *Code of Ethics* Rule 705.

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, 407(a) and 607 of the *Code of Ethics.* Pursuant to Article 4.1 of the *Disciplinary Rules*, the Commission issued the Respondent a Private Censure.

The Commission considered no mitigating or aggravating factors.

In arriving at its decision, the Commission consulted *Sanction Guidelines* 11 (Diligence), 14(a) (Failure to Disclose to CFP Board) and 20 (Fraud, Misrepresentation or Deceit). The Commission also consulted *Anonymous Case Histories* 19875 and 15982.