CERTIFIED FINANCIAL PLANNER BOARD OF STANDARDS, INC.

ANONYMOUS CASE HISTORIES
NUMBER 28738

This is a summary of a Settlement Agreement entered into at the February 2015 hearings of the Disciplinary and Ethics Commission ("DEC") of Certified Financial Planner Board of Standards, Inc. ("CFP Board"). The conduct at issue in this case occurred both prior to and after January 1, 2009. The rules in effect for conduct occurring prior to January 1, 2009 were Rules 101 through 706 of CFP Board's *Code of Ethics*. The Rules in effect for conduct occurring after January 1, 2009 were Rules 1.1 through 6.5 of CFP Board's *Rules of Conduct*.

I. Issues Presented

Whether a CFP® professional ("Respondent") violated CFP Board's *Standards of Professional Conduct* when he 1) failed to inform his clients of the taxes, penalties and interest associated with a Net Unrealized Appreciation ("NUA") strategy; 2) failed to diligently follow up with the clients regarding the NUA strategy; 3) offered the Clients free advisory services, a refund of advisory/financial planning fees already paid and compensation for the early withdrawal penalty; and 4) did not provide documents requested by CFP Board.

II. Findings of Fact

In August 2013, CFP Board discovered Respondent's involvement in a 2011 Financial Industry Regulatory Authority, Inc. ("FINRA") Arbitration filed by Mr. and Mrs. Client ("2011 Client FINRA Arbitration"). Respondent did not disclose the arbitration on his August 2013 Renewal Application. During the course of its investigation, CFP Board sent several written requests to Respondent seeking documentation related to the 2011 Client FINRA Arbitration. Respondent repeatedly refused to provide documents requested by CFP Board during the investigation.

March 2009 Complaint Letter to Firm

In March 2009, the Clients filed a complaint with Firm against Respondent. The Clients stated that they first met with Respondent and his associate JL in March 2008, based on a recommendation from Mrs. Client's boss and colleagues. At that time, the Clients had retirement accounts totaling approximately $300,000 with RW, JC, MA and PX. Mr. Client had recently become unemployed and JC was one of his former employers.

According to the Clients, during a meeting on March 21, 2008 with Respondent and JL, they informed Respondent and JL that they were satisfied with the performance of their JC account and wished to leave the assets in their current location. However, Respondent persuaded Mr. Client to transfer the JC account because he informed them that he had a special way of dealing with JC common stock that would permit the Clients to withdraw from the account without penalty. Respondent stated that this would make $80,000 available to the Clients, but would result in a $30,000 increase in the Clients' income for 2008 and they would have to pay the resulting taxes. However, Respondent informed the Clients that they could pay the taxes on the "back end." The Clients stated that Respondent did not inform the clients that these taxes would be at a 25% tax rate and that there would also be a 10% withdrawal penalty, and Respondent did not advise them to consult a tax professional. The Clients also stated that they trusted Respondent to act in their best interest because he had been so highly recommended by Mrs. Client's colleagues.

Based on Respondent's recommendation, the Clients transferred all their retirement assets to Firm, with the exception of Mrs. Client's 401(k) account with PX where she was still employed.

According to the Clients, they met with Respondent in February 2009 to review their portfolio and Respondent informed them that he would not be charging them any fees for the year because of the severe decline in the stock market. Respondent informed the Clients that most of their losses came from the JC stock, which was valued at $12 per share when the meeting was held. The Clients stated that Respondent's mention of the JC stock surprised and confused them because they assumed that the stock had been sold for cash as part of their account transfer. The Clients also stated that the monthly statements Respondent provided to them made no mention of JC stock.

The Clients stated that after doing some research, they learned that the cash they believed to be available to them per Respondent's monthly statements was actually JC stock. Mr. Client became concerned that if the stock's value continued to plummet, they would be unable to meet their tax obligations. Respondent advised that the clients have their tax returns completed after which they would revisit the issue. After the Clients met with Respondent in February 2009, he sent a follow-up letter to the Clients regarding their tax estimate. Respondent informed the Clients that they would need approximately $11,000 to pay for the 2008 distribution.

In February 2009, the Clients met with HB representative GR to have their tax returns prepared. GR informed the Clients that they owed in excess of $12,000 in federal taxes, including a $3,346 penalty to the IRS, but this figure did not include the amount owed for state taxes. If the state taxes were included, the Clients would owe a total of $14,900. After their meeting with GR, Ms. Client called Respondent and left a voicemail message for a return call and also emailed him because the Clients were alarmed about the amount of taxes they owed.

In March 2009, JL called Mr. Client and stated that the penalty amount quoted by GR was an error and assured him that JL would resolve it. In March 2009, the Clients had a teleconference with JL who again reassured them that there would not be any penalties. Mr. Client again expressed his concerns regarding their ability to meet their tax obligations and asked JL about Respondent's recommendation regarding options trading, but JL informed them that this was probably not feasible due to the rapid decline in the JC stock's value. JL also informed them that they could put in a stop loss order for the stock if its value went down to $10 per share to ensure that the Clients would have sufficient funds to cover taxes and penalties. In March 2009, the JC stock price dropped to $10 per share and the Clients' JC shares were sold pursuant to the stop loss order.

According to the Clients, up until this time, Respondent had not contacted them since their February 2009 meeting with GR after which they left him the voicemail and email messages. Mr. Client did manage to reach Respondent by telephone on one occasion, but Respondent immediately informed him that he would return his call later. However, instead of calling Mr. Client back, Respondent had JL return the call. By March 2009, Mr. Client confirmed with GR and GR's Firm representative, AR, that the $12,000 tax indebtedness was accurate. GR suggested that they call FV, the administrators of the JC 401(k) plan, regarding the possibility of a reversal of the original transfer, but FV informed them that the transfer could not be reversed.

According to the Clients, Respondent eventually called Mr. Client in March 2009 and informed him that JL would pay the $3,346 tax penalty on their behalf. Mr. Client informed Respondent that he would discuss the matter with his wife and get back to Respondent regarding his offer. After consulting with another investment advisor, the Clients decided to complain directly to Firm.

The Clients alleged that Respondent misled them and failed to thoroughly explain what he was going to do with their JC stock and also failed to explain the consequences of the transfer. The Clients also stated that Respondent's actions caused them to incur the following taxes: 1) $3,346 in IRS penalties; 2) $7,436 in federal taxes; 3) $1,455 in state taxes; and 4) $448 in penalties and interest to the state. As a result of Respondent's actions, the Clients owed a total of $12,685 in taxes, penalties and interest. The Clients stated that it did not make sense to pay $12,685 in taxes for a distribution that they did not need or request.

October 2009 Firm Letter of Reprimand

After Firm received the Client's complaint letter in March 2009, it conducted a thorough review of the Clients' relationship history with Respondent and Respondent's disciplinary history with Firm. JR, Registered Principal, reviewed the complaint and spoke with the Clients and Respondent. In a letter to Firm's compliance department, JR concluded that Respondent's recommendation was not suitable based on the clients' age and that Respondent failed to follow up on the strategy with the Clients.

In January 2009, Firm's Compliance Manager sent an email to the CCO regarding Respondent's heightened supervision. The Compliance Manager noted that Respondent had already received six caution letters from Firm from January 2003 to February 2005.

In a Field Governance Board Approval Form Report ("Field Governance Report") the Firm found: 1) that Respondent failed to properly inform the clients that the rollover transaction to a non-qualified account would entail early withdrawal penalties; 2) a discrepancy between the Clients' statement that Respondent offered them free advisory services, a refund of advisory fees already paid, and compensation for the early withdrawal penalty and Respondent's statement that the offer to refund planning fees was because the clients were unhappy with the plan and that the offer to pay the withdrawal penalty was through Respondent's Errors and Omissions ("E & O") policy and, therefore, not a direct client settlement. The review found potential violations regarding Firm's compliance manual.

In October 2009, Firm concluded its investigation of Respondent's conduct as it related to the Clients. Firm determined that Respondent failed to follow its policies. Specifically, Firm found that Respondent did not adequately inform a client about fees and tax consequences relating to the use of a Net Unrealized Appreciation ("NUA") strategy. Firm stated that Respondent's failure resulted in the firm offering the clients a $12,800 settlement. Respondent was subsequently placed on heightened supervision for continued brokerage related concerns. Firm issued Respondent the Letter of Reprimand and $2,500 fine because of his failure to follow its policies.

Firm informed Respondent that his February 2009 heightened supervision plan would remain in effect until February 2010 and that failure to comply with the terms of the heightened supervision plan and/or any future violations of company policy would be considered grounds for termination. Respondent signed the Letter of Reprimand in October 2009.

2011 Client Statement of Claim

In their August 2011 Statement of Claim, the Clients alleged that after their previous investment advisor died, they met Respondent in May 2008 to discuss transferring their investment assets to Respondent and Firm. During the first meeting, the Clients informed Respondent that Mr. Client held two retirement accounts: an IRA account with Baird and a Savings and Investment Plan account at JC. The Clients stated that they preferred to leave the Savings and Investment Plan account at JC and only wished to rollover Mr. Client's RW IRA account, valued at approximately $200,000, to Respondent for management. The Clients stated that the Savings and Investment Plan account, valued at approximately $81,000, was invested 70% in JC stock and had performed well for them over the years.

In June 2008, the Clients transferred both retirement accounts to Respondent at Firm. In 2009, the Clients met with their tax advisor at HB to prepare their 2008 tax returns and were informed that they had incurred federal and state tax penalties associated with the July 18, 2008 transfer of Mr. Client's IRA account at Firm to the Clients' joint account, also at Firm. When the Clients confronted Respondent about the unexpected tax consequences, Respondent initially insisted that the tax advisor had erred, but after confirmation from HB, Respondent stopped communicating with the Clients. The Clients stated that they were forced to place a stop loss order on the JC stock to ensure that they would have enough money to pay their tax obligation.

The stop loss order was executed at the market low and the Clients suffered an approximate $85,000 loss on the JC stock as a result of Respondent's recommendation and were forced to pay approximately $12,000 in taxes and penalties. The Clients sought $98,000 in damages plus interest and costs.

Respondent's Answer to the Statement of Claim

In October 2011, Respondent filed his Answer to the Client Statement of Claim. In Respondent's Answer, he stated that the tax implications of the stock distribution were disclosed and any alleged losses were the result of the Client's own actions. Mr. Client's investment objective was "appreciation with acceptance of risk" and his risk tolerance was aggressive, which is appropriate for an investor who seeks maximum return in speculative and growth investments.

Respondent stated that he first met with the Clients on May 21, 2008, when they informed him that were interested in rolling over Mr. Client's RW IRA in order to consolidate their retirement account "under one roof." In May 2008, Respondent met with Mr. Client to discuss the relative benefits of rolling over his JC 401(k) plan to Firm. The account was invested in mutual funds valued at $38,000 and JC stock valued at $85,000. According to Respondent, Mr. Client was unemployed and sought ways to augment their cash reserves and fund a business.

According to Respondent, he, JL and the Clients jointly called FV regarding the rollover of the mutual funds and the FV representative informed them that the cost basis of the JC stock was approximately $33,000. Respondent and the Clients discussed taking advantage of a NUA strategy, by taking a lump sum distribution from the JC 401(k) and moving it to a non-qualified account. Respondent stated that the FV representative advised Mr. Client to consult a tax professional and review FV's online publication regarding NUA and its applicable tax implications.

In June 2008, the Clients decided to move the JC stock and met with Respondent and JL to review the financial plan, and discuss the possibility of moving the money to a non-qualified account. According to Respondent, he and JL informed the Clients that the transaction had tax implications. In June 2008, the Clients met with Respondent and JL to review the final financial plan. Respondent, JL and the Clients discussed the JC rollover and the tax implications, specifically the 10% tax penalty associated with the early withdrawal and transfer to a non-qualified plan.[1]

According to Respondent, at a meeting in July 2008, he suggested that the Clients sell the JC stock or sell enough to cover their anticipated tax bill, but they refused. Respondent also suggested that the Clients sell covered call options in anticipation of the stock's continued decline in value, but they refused because they were concerned about the stock being called, as well as the trading costs. Respondent and JL informed the Clients that if they moved the stock into a non-qualified account, Firm would cover the transaction costs. Although the Clients agreed to move the stock into anon-qualified account, they still refused to sell.

In July 2008, JL held a telephone review of the account with Mr. Client regarding the volatility in the market and recommended that the Clients sell the JC stock which was trading at $30 per share, but Mr. Client refused. By October 2008, the market suffered a nearly 40% decline and the JC stock was trading at $16 per share, but Mr. Client still refused to sell. In February 2009, the stock was trading at $12 per share and Mr. Client wanted to sell his stock and move to all cash, but Respondent recommended that he only sell enough to pay the taxes and let the

[1] The statement conflicts with Respondent's statement that the only tax issue not directly addressed with the Clients was the 10% tax penalty. Respondent and JL later acknowledge an error regarding the application of the 10% tax penalty.

rest of the stock recover. At a meeting in March 2009, Respondent continued to advise Mr. Client to hold on to the stock, but Mr. Client directed JL to place a stop loss order on the stock with a $10 guarantee.

According to Respondent, in March 2009, Mr. Client complained to Firm and pursuant to firm policy, Respondent was prohibited from direct contact with the Clients.[2] Respondent denies telling the Clients that they could withdraw the JC stock from the 401(k) without the normal taxation. Instead, Respondent informed the Clients that the rollover would have tax implications and that they needed to consult with a tax professional.

Respondent and JL stated that the only tax issue they did not discuss with the Clients was the 10% tax penalty for distributions before age 55 and admit an error with regard to the application of the 10% tax penalty. Respondent and JL stated that when they called FV to inquire about any applicable tax penalties, they were mistakenly informed that no penalties would apply.

According to Respondent, had the Clients implemented any of the three strategies that Respondent and JL recommended at the time the recommendations were made, including immediate liquidation upon distribution, sale of covered call options or holding the JC stock and filing for an extension and payment plan for their taxes, they would be in a much better financial position today. The Clients' losses in connection with the JC stock are the result of the Clients' refusal to follow Respondent's recommendations.

2012 FINRA Award

In November 2012, the FINRA arbitrators issued an award in the Clients' favor. After considering the pleadings, testimony and evidence, the arbitrators determined that Respondent and Firm are jointly and severally liable to the Clients for:

1. $70,154 in compensatory damages;
2. interest on the $70,154 compensatory damage amount at a rate of 6% per annum from June 2008 through December 2012;
3. $2,000 in costs;
4. $225 as reimbursement for the non-refundable portion of the FINRA filing fee; and
5. $35,000 in attorneys' fees.

According to the FINRA Award, the causes of action related to the Clients' allegations that Respondent and JL advised them that they would be able to transfer their JC stock without the normal taxation associated with an early IRA withdrawal. The Clients asserted that they incurred taxes and withdrawal penalties that caused them to sell their JC stock at or near the market low in order to satisfy the tax consequences.

III. Rule Violations

A. *Rule 102 – In the course of professional activities, a CFP Board designee shall not engage in conduct involving dishonesty, fraud, deceit or misrepresentation, or knowingly make a false or misleading statement to a client, employer, employee, professional colleague, governmental or other regulatory body or official, or any other person or entity.*

Respondent engaged in conduct involving dishonesty, fraud, deceit or misrepresentation, or knowingly made a false or misleading statement to his clients when he: 1) informed the Clients that they would be able to transfer their JC stock without the normal taxation associated with an early IRA withdrawal by using the NUA strategy;

[2] Note that this does not address the Clients claim in their March 2009 letter that Respondent failed to respond to their calls and email from February 2009 until March 2009.

and 2) failed to properly disclose the fees and tax consequences of the NUA strategy to the Clients. Thus, Respondent violated *Code of Ethics* Rule 102.

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

Respondent failed to exercise reasonable and prudent professional judgment in providing professional services when he: 1) recommended an unsuitable NUA strategy given the Clients' circumstances; 2) failed to properly disclose the fees and tax consequences of the NUA strategy to the Client; 3) failed to diligently follow up with the Clients regarding the NUA strategy; and 4) offered the Clients free advisory services, a refund of advisory/financial planning fees already paid and compensation for the early withdrawal penalty, without the knowledge of Firm's Compliance Department, in violation of Firm's policy. Thus, Respondent violated *Code of Ethics* Rule 201.

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

Respondent failed to act in the interest of the client when he: 1) recommended an unsuitable NUA strategy given the Clients' circumstances; 2) failed to properly disclose the fees and tax consequences of the NUA strategy to the Client; and 3) failed to diligently follow up with the Clients regarding the NUA strategy. Thus, Respondent violated *Code of Ethics* Rule 202.

D. Rule 401(b) – In rendering professional services, a CFP Board designee shall disclose to the client the information required by all laws applicable to the relationship in a manner complying with such laws.

Respondent failed to disclose to the clients the information required by all laws applicable to the relationship in a manner complying with such laws when he: 1) failed to properly inform the Clients that the rollover transaction to a non-qualified account would entail early withdrawal penalties; and 2) attempted to settle with the Clients without the knowledge of the Firm Compliance Department, in violation of Firm's policy. Thus, Respondent violated *Code of Ethics* Rule 401(b).

E. Rule 406 – A CFP Board designee shall perform professional services with dedication to the lawful objectives of the employer and/or in accordance with the Code of Ethics.

Respondent failed to perform professional services with dedication to the lawful objectives of the employer and in accordance with the *Code of Ethics* when he: 1) recommended an unsuitable NUA strategy given the Clients' circumstances; 2) failed to properly disclose the fees and tax consequences of the NUA strategy to the Client; 3) failed to diligently follow up with the Clients regarding the NUA strategy; and 4) attempted to settle with the Clients by offering the Clients free advisory services, a refund of advisory/financial planning fees already paid and compensation for the early withdrawal penalty, without the knowledge of Firm's Compliance Department, in violation of Firm's policy. As a result of this conduct, Respondent was issued a Letter of Reprimand by Firm, fined $2,500, and placed on continued Heightened Supervision. Thus, Respondent violated *Code of Ethics* Rule 406.

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

Respondent failed to perform services in accordance with applicable rules, regulations and other established policies of CFP Board when he: 1) failed to properly inform the Clients that the rollover transaction to a non-qualified account would entail early withdrawal penalties; and 2) attempted to settle with the Clients by offering the Clients free advisory services, a refund of advisory/financial planning fees already paid and compensation for the early withdrawal penalty, without the knowledge of Firm's Compliance Department, in violation of Firm's policy, thereby violating Rules 102, 201, 202, 401(b), 406, 607, 701, 702(a) and 703 of the *Code of Ethics*. As a result of this conduct, Respondent was issued a Letter of Reprimand by Firm, fined $2,500, and placed on continued Heightened Supervision. Thus, Respondent violated *Code of Ethics* Rule 606(b).

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

Respondent engaged in conduct that reflects adversely on his integrity and fitness as a CFP Board designee, upon the CFP® marks and upon the profession when he: 1) failed to properly inform the Clients that the rollover transaction to a non-qualified account would entail early withdrawal penalties; and 2) attempted to settle with the clients by offering the Clients free advisory services, a refund of advisory/financial planning fees already paid and compensation for the early withdrawal penalty, without the knowledge of Firm's Compliance Department, in violation of Firm's policy. As a result of this conduct, Respondent was issued a Letter of Reprimand by Firm, fined $2,500, and placed on continued Heightened Supervision. Thus, Respondent violated *Code of Ethics* Rule 607.

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

Respondent failed to provide services diligently when he failed to: 1) adequately inform the Clients about fees and tax consequences relating to the use of a NUA strategy; and 2) failed to properly inform the Clients that the rollover transaction to a non-qualified account would entail early withdrawal penalties. Thus, Respondent violated *Code of Ethics* Rule 701.

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

Respondent failed to make and implement only recommendations that are suitable for the Clients when he recommended an unsuitable NUA strategy given the Clients' circumstances. Thus, Respondent violated *Code of Ethics* Rule 703.

J. *Rule 6.1 – A certificant shall abide by the terms of all agreements with CFP Board, including, but not limited to, using the CFP® marks properly and cooperating fully with CFP Board's trademark and professional review operations and requirements.*

Respondent failed to abide by the terms of all agreements with CFP Board and failed to cooperate fully with CFP Board's Professional Standards Department's investigation by repeatedly failing to provide requested information and documentation to CFP Board. Thus, Respondent violated *Rules of Conduct* Rule 6.1.

K. *Rule 6.5 – A certificant shall not engage in conduct which reflects adversely on his or her integrity or fitness as a certificant, upon the CFP® marks, or upon the profession.*

Respondent engaged in conduct that reflects adversely on his integrity and fitness as a CFP® professional, upon the CFP® marks and upon the profession when his Firm issued him a Letter of Reprimand by Firm, fined him $2,500, and placed him on continued heightened supervision. Thus, Respondent violated *Rules of Conduct* Rule 6.5.

L. Practice Standard 400-2 – The financial planning practitioner shall develop the recommendation(s) based on the selected alternative(s) and the current course of action in an effort to reasonably meet the client's goals, needs and priorities.

Respondent failed to develop recommendations expected to reasonably meet the clients' goals, needs and priorities when he: 1) recommended an unsuitable NUA strategy given the Clients' circumstances; 2) failed to properly disclose the fees and tax consequences of the NUA strategy to the Client; and 3) failed to diligently follow up with the Clients regarding the NUA strategy. Thus, Respondent violated *Practice Standard* 400-2.

M. Practice Standard 500-2 – The financial planning practitioner shall select appropriate products and services that are consistent with the client's goals, needs and priorities.

Respondent failed to properly the investigate product or services that reasonably addressed the clients' needs and that were suitable for the clients when he: 1) recommended an unsuitable NUA strategy given the Clients' circumstances; 2) failed to properly disclose the fees and tax consequences of the NUA strategy to the Client; and 3) failed to diligently follow up with the Clients regarding the NUA strategy. Thus, Respondent violated *Practice Standard* 500-2.

IV. <u>Discipline Imposed</u>

The Commission found grounds for discipline under Articles 3(a) and 3(b) of CFP Board's *Disciplinary Rules and Procedures* ("*Disciplinary Rules*"). Article 3(a) of the *Disciplinary Rules* provides grounds for discipline for any act or omission that violates the *Rules of Conduct*. The Commission found grounds for discipline under Article 3(a) because it found that Respondent violated Rules 102, 201, 202, 401(b), 406, 607, 701, 702(a) and 703 of the *Code of Ethics* and Rule 6.5 of the *Rules of Conduct*. Article 3(b) of CFP Board's *Disciplinary Rules* provides grounds for discipline for any act or omission that fails to comply with the *Practice Standards*. The Commission found grounds for discipline under Article 3(b) because Respondent violated *Practice Standards* 400-2 and 500-2. 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 to Respondent a one-year suspension, pursuant to Article 4.3 of the *Disciplinary Rules*. The Commission also ordered Respondent to complete 10 hours of remedial education in the areas of retirement planning and income tax planning prior to the end of his suspension.

In reaching its decision, the Commission considered in aggravation that:

1. Respondent was placed on heightened supervision by his employer at time of the investment transaction as result of being cautioned six times by his employer;
2. Respondent was not experienced in the NUA investment transaction he attempted for the clients; and
3. Respondent attempted to settle with clients in violation of firm policies.

In mitigation, the Commission cited that Respondent did not attempt to personally benefit from the investment transaction.

In arriving at its decision, the Commission consulted Anonymous Case Histories 26476, 27406, 15904 and 25999. All of these cases involved unsuitable investments and resulted in a sanction of a one year and one day suspension. The Commission also consulted *Sanction Guidelines* 11 (Diligence), 12 (Employer Policies Violation), 14(b) (Failure to Disclose), 17 (Failure to Respond to CFP Board Request), 20(d) (Misrepresentation to Clients and Prospective Clients), and 31 (Suitability).