CERTIFIED FINANCIAL PLANNER BOARD OF STANDARDS, INC.

ANONYMOUS CASE HISTORIES
NUMBER 28815

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 after January 1, 2009. Rules 1.1 through 6.5 of the *Rules of Conduct* were in effect.

I. Issues Presented

Whether a CFP® professional ("Respondent") violated CFP Board's *Standards of Professional Conduct* when she 1) recommended a client invest 75% of her IRA funds in a risky, illiquid alternative investment; 2) recommended and facilitated the sale of interests in six unregistered, real estate investment contracts to 55 of her clients; 3) facilitated the sale of investments without reasonable grounds to believe that the recommendation was suitable for her customers; and 4) failed to disclose a government investigation and a client-related civil suit on her 2011 Renewal Application.

II. Findings of Fact

On her October 2013 Renewal Application, Respondent disclosed her involvement in the following: 1) a 2009 State's Department of Commerce and Insurance, Securities Division Investigation ("State") and 2013 State Consent Order; and 2) a 2012 PS American Arbitration Association ("AAA") Arbitration. As a result of a routine background check, CFP Board discovered the following additional matter: a 2010 Civil Suit filed on January 6, 2010 by Respondent's client PD.

2009 STATE INVESTIGATION AND 2013 STATE CONSENT ORDER

In October 2009, the State issued an Order of Investigation ("Order") to Respondent. The Order notified Respondent that the State was commencing an investigation of Respondent to determine whether she violated any provisions of the State's Securities Act of 1980 ("Act"). The State's investigation concerned Respondent's recommendation and sale of certain fractional interests in deeds of trust. These products were represented by the product sponsor, DB, as non-securities and were therefore not registered as such.

In September 2010, the State served Respondent with a Subpoena Duces Tecum. The subpoena required Respondent to produce substantial documentation such as Respondent's sales and marketing materials, forms, lists of investors and communications all relating to DB. Respondent's former attorney responded to the State in September 2010, notifying the State that he would be representing Respondent during the State's investigation. In November 2010, Respondent's former attorney formally responded to the State's subpoena.

Consent Order

In March 2013, Respondent and her firm entered into a Consent Order with the State. The State determined that in 2007, Respondent placed four million dollars in client assets in transactions prohibited by the Act. Specifically, Respondent recommended and facilitated the sale of interests in six unregistered, unsuitable, and illiquid real estate investment contracts offered by DB to 55 of her clients. Respondent and her firm failed in their performance of the due diligence required of them as Investment Advisers to determine whether these investments were suitable for their clients' investment objectives, financial situation and needs, and did not discover that the DB offerings were not registered for sale in the State and were being sold to State investors unlawfully.

Conclusions of Law

In its Consent Order, the State cited the following conclusions of law:

1. State regulations state that it shall be deemed a 'dishonest or unethical business practice' by an investment adviser or investment adviser representative to place an order for the purchase or sale of a security pursuant to discretionary authority if the purchase or sale is in violation of the Act or any rule thereunder.

2. State regulations state that it shall be deemed a 'dishonest or unethical business practice' by an investment adviser or investment adviser representative under the Act if an investment adviser or investment adviser representative recommends:

> the purchase, sale or exchange of any security without reasonable grounds to believe that the recommendation is suitable for the customer on the basis of information furnished by the customer after reasonable inquiry concerning the customer's investment objectives, financial situation and needs, and any other information known by the broker-dealer[sic] (investment adviser or investment adviser representative)…

Respondent and her firm, for the purpose of settling the matter, admitted to the State's Findings of Fact and Conclusions of Law and agreed to the entry of the State's Order. The State ordered Respondent and her firm: 1) to comply with the provisions of the Act; and 2) to cease and desist from placing an order for the purchase or sale of a security pursuant to discretionary authority if the purchase or sale is in violation of the Act, or recommending the purchase, sale or exchange of any security without reasonable grounds to believe that the recommendation is suitable for the customer on the basis of information furnished by the customer after reasonable inquiry concerning the customer's investment objectives, financial situation and needs.

The State further ordered Respondent to: 1) pay civil penalties in the amount of $15,000.00; 2) amend her Form U4, disclosing the details of the Consent Order; 3) be subject to heightened disclosure requirements; and 4) amend her Form ADV, Parts 1 and 2, to disclose the Consent Order. The State also ordered that all persons in any way assisting, aiding, or helping Respondent or her firm in any of the aforementioned violations of the Act, shall cease and desist from all such activities in violation of the Act.

2010 PD CIVIL SUIT

In January 2010, KJ filed a Complaint against Respondent and her firm on behalf of his client, PD. The Complaint alleged that in 2007, PD retained Respondent as her investment advisor, transferring her investment funds, including an IRA, to Respondent to manage.

In January 2007, Respondent introduced PD to DB. The investment consisted of an interest in a $6.175 million first mortgage loan to DB, a limited liability company. Respondent recommended that PD invest her IRA funds in DB's mortgage loan. PD invested $50,000.00 of her IRA funds in that investment which amounted to 75% of her IRA.

After investing in the DB mortgage loan, and continuing through December 2009, PD's account statements reflected her DB mortgage loan investment as having a market value of, at least, $50,000.00. Respondent's compensation was calculated and paid based on that value.

In 2008, DB changed the nature of PD's investment in the DB mortgage loan from a pro-rata interest (i.e., one of numerous participating lenders) to a membership interest in a limited liability company known as DB SIP into which all of DB's mortgage loans were transferred and pooled, including the DB mortgage loan. PD's account statements continued to report the market value of her investment to be, at least, $50,000.00.

Some time prior to December 2009, DB defaulted on the $6.175 million mortgage loan in which PD had invested. DB SIP became the owner of the office building that secured the loan. PD never received any return on her investment, but was comforted by it retaining its $50,000.00 value as indicated in her periodic account statements. In December 2009, PD directed Respondent to liquidate the investment. At that time, Respondent notified PD that the DB investment could not be sold and, in fact, had no market value.

The Complaint alleged that the DB mortgage loan was a security as defined in the Act, and that this investment was not registered with the State. Therefore, Respondent unlawfully sold an unregistered security to PD and is liable to PD for relief, including the $50,000.00 that PD paid for the investment, as well as interest from the date of payment, less any income received.

The Complaint also alleged that the DB investment was unsuitable for PD. The funds invested in DB came from her IRA and should have been conservatively invested. The DB investment was not a conservative investment.

In addition, the Complaint alleged that Respondent misrepresented the DB investment to PD as a reliable, conservative, and successful issuer of commercial mortgage loan investments. Respondent did not disclose to PD that nearly all of the loans issued by DB were high-risk, subprime loans to borrowers who could not qualify for loans at market interest rates from banks or other institutional lenders. Respondent did not adequately disclose the material risks of the DB investment to PD, and failed to inform PD that there was no market for the re-sale of the investment, yet she continuously misrepresented the investment as having a market value of, at least, $50,000.00 on PD's account statements.

In September 2010, the matter settled with Respondent agreeing to purchase the DB SIP investment from PD for $45,000.00. PD had alleged damages of $75,000.00.

Respondent's attorney stated that Respondent did not receive any commissions for the DB SIP investment. As to why Respondent recommended that PD invest 75% of her IRA assets in the DB investment, Respondent's attorney noted that PD had significant holdings in her company-sponsored retirement plan and was looking to diversify her holdings in some "non-correlated alternative assets." Respondent's attorney stated that "based on her (PD's) substantial net worth [Respondent] reasonably believed that the DB SIP investment was suitable. The investment fit with her risk tolerance and was consistent with her investment objectives. [Respondent] explained the investment and how the product was structured in addition to providing the offering documents."

PD's November 2006 Risk Questionnaire indicated the following: 1) her annual income was $100,000.00; 2) her net worth exclusive of residence was over $2 million; 3) her risk tolerance was medium; 4) her investment experience was 11 or more years; and 4) the combination of her time horizon score and her risk aversion score placed her portfolio's asset allocation in the aggressive growth category. PD's September 2008 Risk Tolerance Portfolio Survey indicated that her investment objective was to generate high current income of 6% to 8% on her portfolio and the Survey placed her risk tolerance in the medium risk/growth category.

Respondent's attorney stated that Respondent had performed adequate due diligence on the DB investment prior to recommending it to PD. Respondent had discussions with RG who sat on the advisory panel of a corporation which served as the custodian for several of Respondent's firm's clients. Respondent also had discussions with JW, the CEO of DB. Respondent also: 1) reviewed the financial statement of the guarantor of the loan that was secured by the property; 2) reviewed an appraisal of the collateral; and 3) looked at the extensive history of past performance by the offeror. Respondent's attorney also noted that DB was represented by one of the most successful law firms in the country.

In its November 2013 Request for Information, CFP Board asked Respondent to explain the following: 1) when did Respondent learn that DB defaulted on the $6.175 million mortgage loan and when/if Respondent apprised PD of that fact; and 2) why did Respondent continue to value PD's DB investment at $50,000.00 and collect payment for investment advisory services based on that market value after DB's default.

In December 2013, Respondent's attorney responded. As to the first question regarding the default, Respondent's attorney stated:

> The business plan for the DB SIP provided that the obligation was 'rolled up' into the DB SIP which owned a pool of secured deeds that included the DB collateral. As a result, at the time of the default, this note and deed of trust was not partially owned by PD as it had been transferred to DB SIP in return for an interest in that entity.

As to the second question regarding the $50,000.00 valuation, Respondent's attorney stated:

> Respondent's firm based the valuation of DB SIP at the valuation that OLA reported. They did not try to value this interest as it would have been impossible to do so. The DB SIP unit value was first adjusted downward by OLA on May 2010 from 10.00/unit to 5.41/unit. Once it was adjusted by OLA, the basis for the fee was also adjusted.

In November 2014, CFP Board sent another Request for Additional Information to Respondent. CFP Board requested additional information on OLA, the valuation of the DB investment, PD's sources of liquidity, and what investment alternatives Respondent offered to PD in addition to the DB Investment.

In December 2014, Respondent responded to CFP Board's request. Respondent explained that OLA oversees the management of commercial real estate assets across the United States. They represent beneficiaries, trusts, and institutional and individual investors. OLA acquired DB, the prior manager of DB SIP. The role of OLA was to manage the liquidation of the assets held by DB SIP and other secured deeds and try to maximize the return on the investments to the clients holding DB SIP.

In her December 2014 response, Respondent provided documentation on the downward adjustment of DB SIP's value in PD's portfolio. PD's April 2010 Account Statement shows her DB SIP investment to be worth $10 per share for a total value of $54,000.00. One month later, PD's May 2010 Account Statement shows her DB SIP investment to be worth $5.41 per share for a total value of approximately $29,000.00.

Respondent stated that her firm adjusted PD's investment advisory services fee downward after the valuation of DB SIP was adjusted downward. Respondent provided CFP Board with a spreadsheet created to show the management fees charged to PD's IRA Account from January 2007 through March 2011, when PD closed her accounts. The spreadsheet shows management fees charged on PD's IRA through October 2009, then no fees charged from then on. Respondent stated that once DB SIP became a non-performing asset, she no longer charged a management fee.

Respondent stated that in addition to the $50,000.00 DB SIP investment, she managed $150,000.00 worth of other investments for PD, which included various mutual funds. Respondent provided portfolio value summaries for PD from 2008 and 2009 reflecting that Respondent managed a 529 Account for PD, and an individual account, in addition to the IRA that held the DB SIP investment.

Respondent explained that the DB SIP investment was to provide PD with monthly interest income. It provided diversification in addition to the securities she held both through Respondent's firm and through her company retirement plan with a housing authority. Respondent stated that she did not have any documentation from PD's company retirement plan. Respondent stated that in addition to recommending the DB SIP investment, she recommended other low volatility fixed income offerings. The interest rate on the secured loan was higher than the return from other fixed income offerings at that time. According to Respondent, at the time of her recommendation to PD, DB had never defaulted on any of their offerings.

Respondent stated that she learned of DB's default in April 2008, when she noticed the decrease in interest payments to clients holding the investment. Prior to this time, the interest paid to investors was 12.25% for 12-18 months. Beginning in April 2008, the interest rate dropped below the 12.25% annual rate. After July 2008, DB stopped making interest payments.

Respondent noted that she provided her clients with regular updates regarding DB SIP from JW in July-August 2008 regarding the status of the DB holding. She stated that she encouraged her clients to speak directly with JW regarding their concerns, and that she participated in conference calls with her clients and JW regarding the DB investment.

Respondent stated that after learning about DB in 2006 from RG, on March 23, 2007, she invested $50,000 of her SEP/IRA into a DB secured deed of trust. Her investment returned 12% annually, in monthly installments of $500, returning her principal investment of $50,000 on December 4, 2007. She stated that she received no payment, commission, or referral fee for recommending the DB Investments to her clients. Respondent's firm charges an asset-based management fee for managing assets and financial planning services.

2012 PS AAA ARBITRATION

In November 2012, attorney ML filed an Arbitration Amended Statement of Claim with AAA against Respondent and her firm on behalf on his client, PS. The Statement of Claim alleged that PS entered into an Investment Advisory Agreement with Respondent in September 2005, wherein Respondent would manage PS's entire life savings and investment income of $3.5 million. PS had no investment experience, required income from her investments as well as preservation of capital. Respondent allegedly pursued an overly aggressive trading strategy not in accordance with PS's objectives. For example, during an 11-month period, Respondent executed 100 purchases and 65 sales. Many mutual funds were sold within two to three months of purchase. The claim stated that PS was then audited by the IRS in 2009-2010.

Respondent's attorney filed an Answer on Respondent's behalf in December 2012. He stated that PS withdrew substantial sums of money to support her lifestyle, and that her investments were suitable. Respondent's attorney also stated that Respondent warned PS that she needed to cut her spending. From 2006 through 2012, Respondent managed PS's accounts and they performed well until the market downturn in 2008. PS incurred losses of approximately $240,000.00 or 6.5% of her invested principal. The losses were market losses. PS's accounts were invested in a diverse mix of products consistent with her investment objectives. A contributing factor to PS's losses was her excessive withdrawals. Moreover, PS did not follow Respondent's advice to: 1) sell her large house; 2) reduce expenses; and 3) get a part-time job.

In November 2013, Respondent agreed to settle her matter with PS by paying a settlement amount of $117,500.00. PS had alleged damages of $780,000.00.

PS's August 2006 Risk Questionnaire indicated the following: 1) her net worth exclusive of residence was $4 million; 2) her risk tolerance was very high; 3) her investment experience was 11 or more years; and 4) the combination of her time horizon score and her risk aversion score placed her portfolio's asset allocation in the aggressive growth category. PS's April 2009 Risk Questionnaire indicated her net worth exclusive of residence was $2,201,000.00, high risk tolerance and investment experience of 11 or more years.

In his December 2013 response to CFP Board, Respondent's attorney stated that PS had both an investment advisory and financial planning relationship with Respondent. Respondent's attorney provided CFP Board with copies of Investment Advisory Agreements dated September 2005, and February 2009. He also provided copies of Financial Goals Plans dated February 2009, August 2009, November 2009, March 2010 and July 2010.

Respondent's attorney explained that Respondent received no commissions for any of the investments she recommended to PS. He also stated that the only compensation Respondent received was the quarterly fee charged pursuant to the advisory agreement, which appeared to be 1.45% as per the February 2009 Investment Advisory Agreement.

Regarding the large number of purchases and sales, Respondent's attorney stated that PS's account was designed to be invested as an actively traded account. Respondent fully explained the strategy to PS and she understood and permitted Respondent to implement it.

Concerning PS's IRS Audit, Respondent's attorney noted that the audit had nothing to do with PS's investment accounts. She had started a business to produce plays. She incurred significant business losses during her start-up years and reported these losses on Schedule C of her 1040 Federal Income Tax Return. The IRS questioned these losses in its audit.

In November 2014, CFP Board sent another Request for Additional Information to Respondent. CFP Board requested additional information on PS's investment in DBI and how much of her losses were attributable to DB. In December 2014, Respondent responded to CFP Board's Request.

Respondent stated that PS invested $100,000.00 in DB SIP. She also invested in two other secured deeds: one for $100,000.00, and the other for $50,000.00. As of June 2008, PS had approximately $3,006,000.00 under Respondent's management.

As of December 2011, PS had losses of approximately $245,000.00. Of those losses, approximately $41,000.00 was attributable to the unit value of DB SIP. This amounted to 16.77% of her total portfolio losses. The other deeds of trust had not been appraised, nor liquidated at the time she transferred her assets from Respondent's firm.

FAILURE TO DISCLOSE

CFP Board requested an explanation for Respondent's failure to disclose the 2009 State Investigation on her November 2011 Renewal Application. Respondent's attorney stated that since Respondent had purchased PD's interest in DB SIP she and her attorney were under the impression that it was not a reportable or disclosable event.

III. Rule Violations

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

The Commission found that Respondent failed to exercise reasonable and prudent professional judgment in providing professional services when, in 2007, she recommended that PD invest 75% of her IRA funds in the DB Investment, a risky, illiquid alternative investment. Thus, Respondent violated *Code of Ethics* Rule 201.

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

The Commission found that Respondent failed to act in the interest of the client when, in 2007, she facilitated the sale of DB investments without reasonable grounds to believe that the recommendation was suitable for her customers, in violation of State Comprehensive Rules and Regulations. This violation was a finding of the State's Consent Order, to which Respondent admitted. PS, one of Respondent's financial planning clients, was an investor in DB. Thus, Respondent violated *Code of Ethics* Rule 202.

C. *Rule 606(a) – A CFP Board designee shall perform services in accordance with applicable laws, rules and regulations of governmental agencies and other applicable authorities.*

The Commission found that Respondent failed to perform services in accordance with applicable laws, rules and regulations of governmental agencies and other applicable authorities when, in 2007, she recommended and facilitated the sale of interests in six unregistered, real estate investment contracts offered by DB to 55 of her clients, in violation of State Comprehensive Rules and Regulations. In addition, in 2007, Respondent facilitated the sale of DB investments without reasonable grounds to believe that the recommendation was suitable for her customers, in violation of State rgulations. Thus, Respondent violated *Code of Ethics* Rule 606(a).

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

The Commission found that Respondent failed to perform services in accordance with applicable rules, regulations and other established policies of CFP Board when, in 2007, she recommended and facilitated the sale of interests in six unregistered, real estate investment contracts offered by DB to 55 of her clients, in violation of State regulations. In addition, in 2007, Respondent facilitated the sale of DB investments without reasonable grounds to believe that the recommendation was suitable for her customers, in violation of State regulations. This conduct also violated Rules 201, 202, 606(a), 607, 703 and 704. Thus, Respondent violated *Code of Ethics* Rule 606(b).

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.*

The Commission found that Respondent engaged in conduct that reflects adversely on her integrity and fitness as a CFP Board designee, upon the marks, and upon the profession when, in 2007, she: 1) recommended that PD invest 75% of her IRA funds in the DB Investment, a risky, illiquid alternative investment; and 2) in 2007, recommended and facilitated the sale of interests in six unregistered, real estate investment contracts offered by DB to 55 of her clients, in violation of State regulations. In addition, in 2007, Respondent facilitated the sale of DB investments without reasonable grounds to believe that the recommendation was suitable for her customers, in violation of State regulations. 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.*

Respondent failed to make and/or implement only recommendations that are suitable for the client when, in 2007, she facilitated the sale of DB investments without reasonable grounds to believe that the recommendation was suitable for her customers, in violation of State regulations. This violation was a finding of the State's Consent Order, to which Respondent admitted. (PS, one of Respondent's financial planning clients, was an investor in DB.) Thus, Respondent violated *Code of Ethics* Rule 703.

G. *Rule 704 – A CFP Board designee shall make a reasonable investigation regarding the financial products recommended to clients.*

Respondent failed to make a reasonable investigation regarding the financial products recommended to clients when, in 2007, she facilitated the sale of DB investments without reasonable grounds to believe that the recommendation was suitable for her customers, in violation of State regulations. This violation was a finding of the State's Consent Order, to which Respondent admitted. (PD, one of Respondent's investment advisory clients, was an investor in DB.) Thus, Respondent violated *Code of Ethics* Rule 704.

H. Rule 6.2 – A certificant shall meet all CFP Board requirements, including continuing education requirements, to retain the right to use the CFP® marks

Respondent failed to meet all CFP Board requirements, including continuing education requirements, to retain the right to use the CFP® marks when she failed to disclose the 2009 State Investigation and the 2010 PD Civil Suit on her 2011 Renewal Application. Thus, Respondent violated Rule 6.2 of the *Rules of Conduct*.

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

Respondent engaged in conduct that reflects adversely on her integrity and fitness as a certificant, upon the CFP® marks, and upon the profession when she failed to disclose the 2009 State Investigation and the 2010 PD Civil Suit on her 2011 Renewal Application. Thus, Respondent violated Rule 6.5 of the *Rules of Conduct*.

IV. Discipline Imposed

The Commission found grounds for discipline under Articles 3(a) and 3(g) of CFP Board's *Disciplinary Rules and Procedures* ("*Disciplinary Rules*"). Article 3(a) of CFP Board's *Disciplinary Rules* provides grounds for discipline for any act or omission that violates the *Code of Ethics* or *Rules of Conduct*. The Commission found grounds for discipline under Articles 3(a) because Respondent violated Rules 201, 202, 606(a), 606(b), 607, 703 and 704 of the *Code of Ethics* and Rules 6.2 and 6.5 of the *Rules of Conduct*. Article 3(g) provides grounds for discipline for any false or misleading statement made to CFP Board. The Commission found grounds for discipline under Article 3(g) because Respondent failed to disclose the 2009 State Investigation and the 2010 PD Civil Suit on her 2011 Renewal Application. 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 nine-month suspension, pursuant to Article 4.3 of the *Disciplinary Rules*.

In proposing this Counter Offer, the Commission considered in mitigation that:

1. Respondent demonstrated competency and follow up with client financial reports, risk tolerance questionnaires, clear intention to serve clients;
2. Emails to Respondent that the Commission reviewed from a client were very supportive and appreciative in nature;
3. Respondent's communication with the client demonstrated competency, integrity, professionalism and objectivity;
4. Respondent's clients' accounts performed well considering depressed market conditions at the time of the violations; and
5. The Respondent did not receive commissions on any purchases or sales of DB Investment.

The Commission considered in aggravation that Respondent did not immediately communicate to client the $50,000.00 loss in asset value when she became aware the interest payments were in default.

The Commission also reviewed *Anonymous Case History* 27321 and *Sanction Guidelines* 11 (Diligence), 30 (Securities Law Violation) and 31 (Suitability Violation).