CERTIFIED FINANCIAL PLANNER BOARD OF STANDARDS, INC.

ANONYMOUS CASE HISTORIES
NUMBER 28835

This is a summary of an order issued following the June 2015 hearings of the Disciplinary and Ethics Commission ("the Commission") 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 failed to exercise reasonable and prudent judgment when he: 1) through his alter ego, his company, borrowed money from multiple clients, including a financial planning client; and 2) personally borrowed money from a client.

II. Findings of Fact

On November 4, 2013, CFP Board received an anonymous grievance filed against Respondent. The grievant attached two promissory notes entered into by Respondent's Registered Investment Advisor, JCI. The grievant alleged that each note reflected a loan agreement through which Respondent borrowed $100,000 from clients of JCI. CFP Board Counsel determined that the grievance provided information indicating a potential violation of CFP Board's *Standards of Professional Conduct* and commenced an investigation.

On November 19, 2013, CFP Board mailed a Notice of Investigation ("NOI") to Respondent requesting information and documentation regarding the grievance. On April 14, 2015, CFP Board issued a Second Amended Complaint to Respondent. On May 4, 2015, Respondent filed an answer to the Second Amended Complaint. In his answer, Respondent requested that the Commission review his matter based solely on the written record submitted by the parties.

On June 18, 2015, a Hearing Panel of the Commission met to review Respondent's matter based on the written record. On June 22, 2015, the Hearing Panel requested that the parties brief the following issues:

- Whether CFP Board had jurisdiction over the conduct alleged in the Second Amended Complaint based on Respondent's assertion that JCI, and not Respondent, engaged in the conduct at issue.

- Whether CFP Board, if it imposed discipline against Respondent, would violate the legal principles of interference with contractual relations and restraint of trade.

The Hearing Panel also requested that Respondent provide an explanation of his role in soliciting, structuring developing and/or finalizing all of the loan transactions, a description of the corporate structure of JCI and a description of the role any of the owners, directors or officers played in soliciting, structuring, developing and/or finalizing the loan transactions. The Hearing Panel also notified the parties that it was holding the hearing open until such time as the Hearing Panel determined that the record in Respondent's matter was complete.

The Commission carefully considered the written record in this matter and found as follows:

JCI's Corporate Structure

In May 2008, Respondent held a 90% ownership interest in JCI and LK and CK each held 5%. While the exact date of this transaction is not clear from the record, sometime in 2013, SM purchased half of Respondent's interest in JCI (45%) and joined the firm as Vice President. Thus, by June 2013 Respondent held a 45% ownership interest in JCI, with SM holding the other 45% of his previous 90%. LK and CK still each held 5%.

JCI's Directors are Respondent, LK, CK and SM, who replaced DJ in 2014. The Officers of JCI are Respondent (President) and SM (Secretary), who replaced DJ in 2014. JCI's Employees are Respondent and SB, an employee since 2012. DJ was an employee until 2014.

WJD/MS Promissory Notes

On May 12, 2008, JCI entered into a promissory note with WJD in the amount of $100,000. The note provided for monthly installment payments of $583.33 beginning on June 15, 2008 and continuing until the principal balance of the note and any accrued interest was paid in full. The promissory note was a five-year callable note issued by JCI at 7% annual interest.

Respondent indicated that WJD had a net worth in excess of $2.5 million and had been seeking an appropriate, fixed income investment for her portfolio. Respondent indicated that WJD was "aware" of the risks involved with the promissory notes and of the conflict of interest Respondent had due to his status as her financial advisor. Respondent acknowledged that he did not have WJD acknowledge the conflict of interest in writing.

Respondent further indicated that WJD was a close, personal friend of Respondent. WJD viewed the promissory note as an investment that allowed her to earn a better rate than she was able to find in other investments given the current market rates. Respondent stated that WJD was happy with the terms of the promissory note and expressed an interest in renewing the note due to its interest rate and consistency of payments.

JCI accommodated her request on June 15, 2013, by executing another promissory note between WJD and JCI in the amount of $100,000. The note provided for monthly installment payments of $583.33 beginning on June 15, 2013 and continuing until the principal balance of the note and any accrued interest was paid in full. The promissory note was a five-year callable note issued by JCI at 7% annual interest. JCI paid the balance of the WJD loan on January 20, 2014 using the proceeds of a loan received from a family member.

In a letter dated February 25, 2014, WJD confirmed her support of Respondent and her satisfaction with the promissory note. She also stated that Respondent explained the need for the loan and discussed the conflicts of interest with her. WJD stated that the proceeds for the loan were drawn from excess cash she had in the bank that was earning very little interest.

Respondent stated that the reason for the promissory note was in response to the significant downturn of the markets during 2008 and 2009, and the tightened lending practices of banks for commercial operating loans. Respondent stated that he explored financing through commercial sources at the time but did not make any formal applications to secure alternative financing. The rationale for determining the amounts borrowed were partially based on the projected increased cash flow needs of JCI due to the market downturn, and the need to establish a new office to expand business. Respondent determined the interest rate after researching prevailing market rates and having discussions with the lenders as to what rate would be the most beneficial to the lenders and within the means of the borrower.

RSH Promissory Notes

On May 12, 2008, JCI entered into a promissory note with RSH in the amount of $50,000. The note provided for monthly installment payments of $291.67 beginning on June 15, 2008 and continuing until the principal balance of the note and any accrued interest was paid in full. The promissory note was a five-year callable note issued by JCI at 7% annual interest. JCI borrowed money from RSH because the firm needed capital for the operating expenses of JCI.

On June 30, 2009, Respondent personally entered into a promissory note with RSH in the amount of $50,000. The note provided for monthly installment payments of $291.67 beginning on August 15, 2009 and continuing until the principal balance of the note and any accrued interest was paid in full. The promissory note was a five-year callable note issued by Respondent at 7% annual interest.

JCI fully repaid both promissory notes on January 6, 2011.

AGC Promissory Notes

JCI also entered into a promissory note with AGC on December 28, 2010, in the amount of $100,000. The note provided for monthly installment payments of $583.33 beginning on January 15, 2011 and continuing until the principal balance of the note and any accrued interest was paid in full. The promissory note was a five-year callable note issued by JCI at 7% annual interest. JCI paid the AGC promissory note in full on December 16, 2012 using the proceeds of the SM stock purchase.

BS, LLC entered into a loan with AGC on March 15, 2011, in the amount of $50,000. The note provided for monthly payments in the amount of interest due beginning on April 1, 2011 and continuing until the principal balance of the note and any accrued interest was paid in full. The promissory note was a five-year callable note issued by BS, LLC at 7% annual interest. JCI paid the BS, LLC loan off using the proceeds of the SM Stock Purchase and took the loan as a receivable from BS, LLC to JCI. JCI wrote off the receivable in 2013 and Respondent claimed the income and paid the resulting taxes.

The record contained a copy of a document prepared by Respondent prepared for AGC and titled "A Financial Profile" AGC's "Financial Profile" dated January 30, 2010. This profile included the following: 1) a retirement objective timeline; 2) a retirement income sources timeline; 3) a retirement analysis results timeline; 4) a retirement balances and distribution timeline; 5) education goals for AGC's children; 6) a long-term care needs analysis timeline; and 7) estate planning information.

Respondent indicated that AGC has a net worth in excess of $2.5 million and had been seeking an appropriate, fixed income investment for her portfolio. Respondent indicated that AGC was "aware" of the risks involved with the promissory notes and of the conflict of interest Respondent had due to his status as her financial advisor. Respondent admitted that he did not have AGC acknowledge the conflict of interest in writing. Respondent provided the same rationale for the need for the AGC promissory note as he had for the two WJD promissory notes.

In a letter dated February 25, 2014, AGC confirmed her support of Respondent and her satisfaction with the promissory note. She confirmed that Respondent explained the existing conflict of interest to her, and she chose to proceed with the loan. AGC also confirmed that her note was earning 7% annually and was made with funds she had invested in a money market account that was previously earning a low rate of return.

2010 State Consent Order

Respondent acknowledged that ES entered into a consent order with the State, but alleged that he was not sanctioned personally. Respondent did not deny that on August 31, 2010, State issued a Notice of Hearing ("Notice") to ES. Respondent also did not deny that in its Notice, State alleged that Respondent was employed by ES to offer and sell securities to the general public. Respondent did not deny in his answer that he became registered in State on September 15, 2009. On October 2, 2008, Respondent offered and sold $50,000 of MPFC VI Class B Notes to WJD, a State resident, which Respondent did not deny in his answer. In addition, on October 3, 2008, Respondent offered and sold $150,000 of MPFC VI Class B Notes to MW, a State resident, which Respondent did not deny in his answer.

Respondent also did not deny that on November 9, 2010, ES entered into a Consent Order with State. Respondent did not deny that ES acknowledged, without admitting or denying, the truth of the allegations contained in the Notice. Respondent did not deny that ES acknowledged a violation of the Act. Respondent also did not deny that State censured ES and fined ES $5,360 and assessed ES the costs of the investigation - $500.

III. Rule Violations

First Cause for Discipline

CFP Board's Complaint alleged that pursuant to Article 3(a) of the *Disciplinary Rules and Procedures* ("*Disciplinary Rules*"), there were grounds to discipline Respondent for acts or omissions that violate the *Code of Ethics* and the *Rules of Conduct*. Respondent asserted in response to these allegations that he "engaged in these transactions in his capacity as an agent of [JCI]" and that any "violations found by CFP Board as a result of the activities of JCI [we]re beyond the scope of CFP Board's jurisdiction, [we]re overreaching and would constitute violations of the legal principles of interference with contractual relations and restraint of trade." Among other arguments made in support of his assertion, Respondent noted the numerous references in CFP Board's *Standards of Professional Conduct* to individuals and certificants, not companies or entities such as JCI. Respondent also stated that it was "well-settled law" that a corporation and its shareholders are deemed separate entities and that he undertook the loans on behalf of JCI and not by himself personally. Thus, Respondent argued that CFP Board does not have jurisdiction over the loans to the clients at issue in this matter.

CFP Board Counsel responded to this argument by stating the Commission should find that JCI was the alter-ego of Respondent and that he could not do through JCI what he could not do on his own. CFP Board Counsel also addressed Respondent's argument that violations found by the Commission would interfere with Respondent's contractual relations and would constitute a restraint of trade by stating that Respondent entered into a contract with CFP Board in which he agreed that he would abide by CFP Board's *Standards of Professional Conduct*, and that CFP Board enforcing those rules against Respondent would amount to holding Respondent responsible for his obligations under his contract with CFP Board.

After considering the arguments of Respondent and CFP Board Counsel, the Commission determined that JCI and BS, LLC were the alter ego of Respondent and that Respondent could not do through an entity or other individual what he could not do personally given his obligations as a CFP® professional. Thus, Respondent's actions in securing loans from his clients to JCI and BS, LLC were a violation of CFP Board's *Standards of Professional Conduct*. The record established that Respondent was the president and founder of JCI, and at the time he secured loans from WJD and RSH he was the 90% owner of JCI. Respondent was the only individual involved with soliciting, structuring, developing and/or finalizing the loan transactions and none of the other owners, directors or officers took part in soliciting, structuring, developing or finalizing the loan transactions. Funds from JCI were used to repay a loan made by AGC to BS, LLC, a restaurant venture that appears to be wholly unrelated to the business of JCI save for its connection to Respondent. Funds from JCI were used to repay a personal loan

Respondent received from RSH in 2009. With respect to BS, LLC, the record indicated that BS, LLC was a pass-through entity of Respondent. Respondent also took the BS, LLC loan as personal income after BS, LLC was unable to repay the loan on its own. Respondent used these corporations as a vehicle through which he borrowed money. These facts collectively, along with additional facts in the record, indicate that JCI and BS, LLC were the alter egos of Respondent with respect to the loan transactions at issue.

Further, the application of CFP Board's *Standards of Professional Conduct* urged by Respondent frustrates an essential purpose of the contract Respondent entered into with CFP Board. Under Respondent's proposed application, a CFP® professional could form an LLC and, acting as an agent of the LLC, make misrepresentations to clients, place his or her interest ahead of the clients with impunity, and violate any one of the other rules in the *Standards of Professional Conduct*. An essential purpose of the agreement with CFP Board is that the CFP® professional agrees to abide by CFP Board's *Standards of Professional Conduct*. To allow Respondent to avoid this requirement under his proposed interpretation of the *Standards of Professional Conduct* would frustrate an essential purpose of the agreement entered into between CFP Board the CFP® professional. Therefore, the Commission cannot accept Respondent's proposed application of the *Standards of Professional Conduct* and the Commission finds grounds for discipline based on the following violations:

The Commission determined that Respondent violated Rule 201 of the *Code of Ethics* when he: 1) through his alter ego, JCI, borrowed money from two clients, WJD, by executing a $100,000 promissory note on May 12, 2008, and RSH by executing a $50,000 promissory note on the same day, May 12, 2008; and 2) engaged in investment advisory business in State in October 2008 without proper registration causing his broker-dealer, ES, to be in violation of State Law. In support of its finding that Respondent failed to exercise reasonable and prudent judgment in borrowing money from two clients, the Commission determined that Respondent borrowed money from clients at an interest rate that was not reflective of the risk the clients were taking given the financial state of JCI, including the negative cash flow JCI generated in the years during which JCI borrowed the funds.

The Commission also determined that Respondent violated Rule 607 of the *Code of Ethics* when he: 1) through his alter ego, JCI, borrowed money from two clients, WJD, by executing a $100,000 promissory note on May 12, 2008, and RSH by executing a $50,000 promissory note on the same day, May 12, 2008; and 2) engaged in investment advisory business in State in October 2008 without proper registration causing his broker-dealer, ES, to be in violation of State Law. In support of its finding that Respondent engaged in conduct that reflects adversely on his integrity and fitness as a certificant, upon the CFP® marks, and upon the profession in borrowing money from two clients through JCI, the Commission determined that Respondent borrowed money from clients at an interest rate that was not reflective of the risk the clients were taking given the financial state of JCI, including the negative cash flow JCI generated in the years during which JCI borrowed the funds.

The Commission also determined that Respondent violated Rule 606(b) of the *Code of Ethics* when he: 1) through his alter ego, JCI, borrowed money from two clients, WJD, by executing a $100,000 promissory note on May 12, 2008, and RSH by executing a $50,000 promissory note on the same day, May 12, 2008; and 2) engaged in investment advisory business in State in October 2008 without proper registration causing his broker-dealer, Evolve, to be in violation of State Law. The Commission found above that Respondent's action violated Rules 201 and 607, thereby violating Rule 606(b).

The Commission also determined that Respondent violated Rule 1.4 of the *Rules of Conduct* when he: 1) through his alter ego, JCI, borrowed money from a financial planning client, AGC, by executing a promissory note for $100,000 on December 28, 2010; 2) through his alter ego, BS, LLC, entered into a loan with AGC on March 15, 2011, in the amount of $50,000; 3) through his alter ego, JCI, borrowed money from his client, WJD, by executing a renewal of a $100,000 promissory note on June 15, 2013; and 4) personally executing a $50,000 promissory note with RSH on June 30, 2009. In support of its finding that Respondent failed to place the interests of his client ahead of his own, and in the case of AGC violated his fiduciary duty, the Commission determined that Respondent borrowed money from clients at an interest rate that was not reflective of the risk the clients were taking given the financial state of JCI, including the negative cash flow JCI generated in the years during which JCI borrowed the funds.

The Commission determined that Respondent violated Rule 2.2(e) of the *Rules of Conduct*, when he, through his alter ego, JCI, borrowed money from a financial planning client, AGC, by executing a $100,000 with AGC on December 28, 2010 but did not provide a conflict of interest disclosure in writing with the client. The record contained a copy of a document prepared by Respondent prepared for AGC and titled "A Financial Profile" AGC's "Financial Profile" dated January 30, 2010. This profile included the following: 1) a retirement objective timeline; 2) a retirement income sources timeline; 3) a retirement analysis results timeline; 4) a retirement balances and distribution timeline; 5) education goals for AGC's children; 6) a long-term care needs analysis timeline; and 7) estate planning information. This document demonstrates that Respondent was in a financial planning relationship with AGC. The record further indicated that AGC was "aware" of the risks involved with the promissory notes and of the conflict of interest Respondent had due to his status as her financial advisor. Respondent acknowledged, however, that he did not have AGC acknowledge the conflict of interest in writing. The record does not contain any evidence that Respondent made a written disclosure regarding his conflict of interest with respect to the loans to AGC.

The Commission also determined that Respondent violated Rule 3.6 of the *Rules of Conduct* when he: 1) through his alter ego, JCI, borrowed money from a financial planning client, AGC, by executing a promissory note for $100,000 on December 28, 2010; 2) through his alter ego, BS, LLC, entered into a loan with AGC on March 15, 2011, in the amount of $50,000; 3) through his alter ego, JCI, borrowed money from his client, WJD, by executing a renewal of a $100,000 promissory note on June 15, 2013; and 4) personally executing a $50,000 promissory note with RSH on June 30, 2009.

The Commission also determined that Respondent violated Rule 4.4 of the *Rules of Conduct* when he: 1) through his alter ego, JCI, borrowed money from a financial planning client, AGC, by executing a promissory note for $100,000 on December 28, 2010; 2) through his alter ego, BS, LLC, entered into a loan with AGC on March 15, 2011, in the amount of $50,000; 3) through his alter ego, JCI, borrowed money from his client, WJD, by executing a renewal of a $100,000 promissory note on June 15, 2013; and 4) personally executing a $50,000 promissory note with RSH on June 30, 2009. In support of its finding that Respondent failed to exercise reasonable and prudent professional judgment in providing professional services to his clients, Commission determined that Respondent borrowed money from clients at an interest rate that was not reflective of the risk the clients were taking given the financial state of JCI, including the negative cash flow JCI generated in the years during which JCI borrowed the funds.

The Commission also determined that Respondent violated Rule 6.5 of the *Rules of Conduct* when he: 1) through his alter ego, JCI, borrowed money from a financial planning client, AGC, by executing a promissory note for $100,000 on December 28, 2010; 2) through alter ego, BS, LLC, entered into a loan with AGC on March 15, 2011, in the amount of $50,000; 3) through his alter ego, JCI, borrowed money from his client, WJD, by executing a renewal of a $100,000 promissory note on June 15, 2013; and 4) personally executing a $50,000 promissory note with RSH on June 30, 2009. In support of its finding that Respondent failed to engaged in conduct that reflects adversely on his integrity and fitness as a certificant, upon the CFP® marks, and upon the profession, the Commission determined that Respondent borrowed money from clients at an interest rate that was not reflective of the risk the clients were taking given the financial state of JCI, including the negative cash flow JCI generated in the years during which JCI borrowed the funds. The Commission did not find sufficient evidence to indicate that Respondent borrowed funds from one client in order to pay off the loans of another clients.

Second Ground for Discipline

The Commission did not found grounds for discipline under Article 3(b). CFP Board alleged that Respondent violated *Financial Planning Practice Standard* 100-1 when he did not make a conflict of interest disclosure in writing to AGC. While Rule 2.2(e) of the *Rules of Conduct* requires a conflict of interest disclosure to be in writing, as discussed above, the Commission found no express requirement under *Practice Standard* 100-1 that a disclosure be in writing.

IV. Discipline Imposed

The Commission found that Respondent violated Rules 201, 606(b) and 607 of the *Code of Ethics,* Rules 1.4, 2.2(e), 3.6, 4.4 and 6.5 of the *Rules of Conduct*, providing grounds for discipline under Article 3(a) of the *Disciplinary Rules*. After careful consideration of the evidence in Respondent's matter, the Commission has decided to issue the following discipline under Article 4.3:

Suspension for one year and one day

Notwithstanding the Commission's finding that JCI and BS, LLC were Respondent's alter ego, the Commission determined that there were grounds for discipline under this matter that did not rely on its finding of an alter ego. This includes, but is not limited to, Respondent's personal loan from RSH, which was a violation of Rules 1.4, 3.6, 4.4 and 6.5 of the *Rules of Conduct*. The Commission determined that even if the record did not contain sufficient evidence to make the finding that JCI and BS were the alter egos of Respondent, the rule violations and corresponding grounds for discipline in this matter that did not depend on the alter ego finding were sufficient to warrant the discipline imposed by the Commission.

The Commission considered in mitigation that Respondent had no prior disciplinary history with CFP Board.

In aggravation, the Commission considered that Respondent received multiple loans from clients and placed clients in high-risk loans.

In arriving at this decision, the Commission consulted *Sanction Guidelines* 3 (Borrowing from a Client), 5 (Breach of Fiduciary Duty) and 14 (Failure to Disclose in Writing, Discuss, or Disclose Required Information to Client). The Commission did not consider any *Anonymous Case Histories*.