CERTIFIED FINANCIAL PLANNER BOARD OF STANDARDS, INC.

ANONYMOUS CASE HISTORIES
NUMBER 30033

This is a summary of a Settlement Agreement entered into at the June 2016 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 after January 1, 2009. 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) communicated, directly or indirectly, to clients or prospective clients misleading information directly or indirectly related to the certificant's professional qualifications or services when he misrepresented his compensation structure as "fee-only" despite receiving commissions; 2) failed to disclose to prospective clients or clients an accurate and understandable description of the compensation arrangements being offered; 3) failed to separately invoice clients each time he withdrew his fee from the client's account causing him to violate net-capital requirements; and 4) entered into, extended, or renewed investment advisory contracts which failed to disclose accurate advisory fees.

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

State 1 Law Violations and Failure to Report

In January 2012, Respondent founded Company, a registered investment adviser firm, where he was the sole owner and investment adviser representative. State 1 Office of Financial Regulation ("OFR") conducted an examination of Respondent and Company for the period of October 2013, through September 2014, and determined that Respondent and his firm had violated several securities rules and regulations.

In July 2015, Respondent and Company entered into a Consent Agreement wherein they accepted and consented, without admitting or denying, the following findings by OFR:

a) Respondent and Company violated State 1 law demonstrating unworthiness to transact the business of dealer, investment adviser or associated person, by violating State 1 Administrative Code, by taking action with clients' securities or funds, while having custody of clients' funds and failing to comply with State 1 Administrative Code.

b) Company violated State 1 law by failing to maintain a net capital of $25,000 for the 2013 fiscal year.

c) Company violated State 1 law by failing to give OFR telegraphic or facsimile notice within 24 hours that Company's net capital was less than required under State 1 Administrative Code, for which OFR immediately suspended Company's business operations for the 2013 fiscal year.

d) Company violated State 1 law by failing to submit audited financial statements to OFR for the 2013 fiscal year.

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e) Company violated State 1 law, by entering into, extending, or renewing investment advisory contracts which failed to include accurate advisory fees.

Respondent and Company agreed to cease and desist from violating State 1 Statutes, and OFR's rules promulgated thereunder. They also consented to pay, jointly and severally, an administrative fine of $7,500.

Respondent represents that he relied upon a compliance consultant who was unfamiliar with State 1's invoicing requirement, which requires state-registered advisers to send an invoice to the client each time a consulting fee is withdrawn from the client's custodian account if they wish to avoid additional net capital and custody requirements. Respondent contends that his former employer, a U.S. Securities and Exchange Commission-registered adviser, was only required to list the withdrawals on the client account statements issued by the custodian. According to Respondent, all of the fees that Company withdrew from client accounts were reflected on their account statements.

Respondent further represents that Comapny's net capital violation resulted from the failure to invoice clients prior to withdrawing fees from their accounts. According to Respondent, State 1 law deems an adviser that withdraws fees from a client's account without first sending an invoice to have taken custody of the client's funds. Therefore, that adviser becomes subject to a higher net capital requirement of $25,000. Respondent represents that he relied on the "errant advice" of his compliance consultant. According to Respondent, he believed that he only had a $2,500 net capital requirement because he was not advised that, by virtue of withdrawing fees from client accounts without sending an invoice, he was deemed to have taken custody of his clients' funds.

According to Respondent, OFR's finding that some of his client advisory contracts did not accurately reflect the advisory fees that were charged to clients was the result of his firm issuing revised contracts to some clients that reflected a higher fee rate than the previous version. Respondent claims that despite the higher rate reflected on the revised contracts, his firm continued to charge the lower rate quoted in the earlier contract and that no clients were overcharged.

Respondent did not submit a copy of the Consent Agreement to State 1's Department of Financial Services ("DFS") within 30 days after the final disposition of the action taken by OFR, as required by State 1 Statutes. Respondent blamed this failure on his lawyer. In addition, Respondent failed to update his contact information with DFS within 30 days, as required by State 1 Statutes. As a result of these violations, DFS issued a Letter of Guidance to Respondent in September 2015.

Misrepresentation of Compensation Method

In August 2013, CFP Board mailed to every CFP® professional a hard copy of the *Notice to CFP® Professionals: Importance of Accurate Compensation Disclosures* ("*Notice*"). In the *Notice*, CFP Board clearly explained that "a CFP® professional is required to disclose all compensation that may result from the provision of professional activities . . . [including], for example, first year commissions [and] renewal commissions in subsequent years." In September 2013, CFP Board emailed to Respondent its Notice to CFP® professionals ("Notice") regarding the definition of "fee-only."[1] Since 2008, CFP Board has defined the terms "Fee-Only" and "Compensation" as follows:

[1] The Notice, sent via email, stated that CFP Board had temporarily removed all "fee-only" data from the search tool. The Notice required CFP® professionals to review CFP Board's compensation disclosure rules and definitions and to update their search profiles with the description that accurately described their compensation.

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Fee-Only – A [CFP® professional] may describe his or her practice as "fee-only" if, and only if, all of the certificant's **compensation** from all of his or her client work comes exclusively from the clients in the form of fixed, flat, hourly, percentage or performance-based fees (emphasis added).

Compensation is any non-trivial economic benefit, whether monetary or non-monetary, that a [CFP® professional] or **related party receives or is entitled to receive** for providing professional activities (emphasis added).

According to CFP Board's records, Respondent entered "fee-only" as his compensation method on his "Find a CFP® Professional" search profile some time prior to September 2013. Later in September 2013, CFP Board removed "fee-only" from his search profile. In October 2013, Respondent re-entered "fee-only" as his compensation method. Respondent's search profile continued to indicate that his compensation method was "fee-only" as of November 2015.

Although Respondent has not been registered with a broker-dealer since 2011, he held active Variable Contracts, Life, and Accident and Health insurance producer licenses in State 2 until September 2015. Those licenses expired in October 2015.

Similarly, through Company, Respondent held an insurance agency license in State 1 as recently as November 2015. In late October 2015, however, he submitted a cancellation request to DFS to cancel the agency license, and sometime after November 2015, that license was cancelled.

Company's Form ADV Part 2B Brochure, dated August 2015, indicated the following under Item 4 – Other Business Activities:

"[Respondent] is a licensed independent insurance agent (Life and Health Licensed.) He is appointed to sell insurance with various insurance carriers and he may sell insurance products to clients for a commission. This causes a conflict of interest because he receives a commission from product sales as an independent insurance agent that is separate from the investment management fees outlined above…"

Contrary to the representation in the Form ADV Part 2B Brochure, Respondent stated that neither he nor Company was actively engaged in insurance sales. Respondent did, however, admit that in addition to fees for giving investment and financial planning advice, he received trail commissions from insurance products he had sold in the past.

According to Respondent, he sold two individual disability policies and three long-term care policies prior to 2011. The next year, in October 2012, at the request of a client in State 2, he sold a group disability policy to the client's company. That was the last insurance policy he sold. Nonetheless, he received commissions after that sale. In 2014, after being notified that he was still owed commissions for the sale of the disability policy, Respondent renewed his State 2 license and claimed over $1,300 in back commissions owed to him. He also received approximately $590 in trail commissions that year. In 2015, he received almost $400 in trail commissions. He has received approximately $65 in trail commissions so far this year, and expects the yearly total to be approximately $400. The total amount of commissions Respondent expected to receive from 2014-16 was $2,700.

Respondent received commissions while representing his compensation structure as "fee-only" on his "Find a CFP® Professional" search profile.

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III. Commission's Analysis and Conclusions Regarding Rule Violations

First Ground for Discipline

Pursuant to Article 3(a) of the *Disciplinary Rules and Procedures* ("*Disciplinary Rules*"), there are grounds to discipline Respondent for acts or omissions that violate Rule 2.1 of the *Rules of Conduct*, which provides that a certificant shall not communicate, directly or indirectly, to clients or prospective clients any false or misleading information directly or indirectly related to the certificant's professional qualifications or services.

Respondent communicated, directly or indirectly, to clients or prospective clients misleading information directly or indirectly related to the certificant's professional qualifications or services when he misrepresented his compensation structure as "fee-only" because he received and still receives trail commissions. Thus, Respondent violated Rule 2.1 of the *Rules of Conduct*.

Second Ground for Discipline

Pursuant to Article 3(a) of the *Disciplinary Rules*, there are grounds to discipline Respondent for acts or omissions that violate Rule 2.2(a)(1) of the *Rules of Conduct*, which provides that a certificant shall disclose to a prospective client or client an accurate and understandable description of the compensation arrangements being offered. This description must include information related to costs and compensation to the certificant and/or the certificant's employer.

Respondent, a certificant, failed to disclose to prospective clients or clients an accurate and understandable description of the compensation arrangements being offered when he, through Company, violated State 1 Administrative Code, by entering into, extending, or renewing investment advisory contracts that failed to disclose accurate advisory fees. Thus, Respondent violated Rule 2.2(a)(1) of the *Rules of Conduct*.

Third Ground for Discipline

Pursuant to Article 3(a) of the *Disciplinary Rules*, there are grounds to discipline Respondent for acts or omissions that violate Rule 4.3 of the *Rules of Conduct*, which provides that a certificant shall be in compliance with applicable regulatory requirements governing professional services provided to the client.

Respondent, a certificant, failed to be in compliance with applicable regulatory requirements governing professional services provided to the client when he, and/or Company: (a) violated State 1 Administrative Code by taking action with clients' securities or funds, while having custody of clients' funds and failing to comply with State 1 Administrative Code; (b) violated State 1 Administrative Code by failing to maintain a net capital of $25,000 for the 2013 fiscal year; (c) violated State 1 Administrative Code by failing to give OFR telegraphic or facsimile notice within 24 hours that Company's net capital was less than required under State 1 Administrative Code; (d) violated State 1 Administrative Code by failing to submit audited financial statements to OFR for the 2013 fiscal year; and (e) violated State 1 Administrative Code by entering into, extending, or renewing investment advisory contracts which failed to disclose accurate advisory fees. Thus, Respondent violated Rule 4.3 of the *Rules of Conduct*.

IV. Discipline Imposed

The Commission determined that Respondent's conduct violated Rules 2.1, 2.2(a) and 4.3 of the *Rules of Conduct,* providing grounds for discipline under Article 3(a) of the *Disciplinary Rules*.

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Pursuant to the terms of the Settlement Agreement, the Commission issued Respondent a private censure pursuant to Article 4.1 of the *Disciplinary Rules*.

The Commission cited in aggravation that:

1. Respondent canceled his insurance licenses, but still accepted the commissions that were held in reserve; and
2. Respondent had multiple previous client complaints that were dismissed or denied.

The Commission cited in mitigation that:

1. Respondent disclosed his conduct relating to the violation of State 1 laws to CFP Board;
2. Respondent had not previously been subject to discipline; and
3. Respondent cancelled his insurance licenses in State 1 and State 2.

The Commission consulted *Anonymous Case Histories* 28383, 29287, 29300 and 29234 and *Sanction Guidelines* 2 (Books and Records Violation), 20(c) (Misrepresentation to Non-Clients), 20(d) (Misrepresentation to Clients and Prospective Clients) and 30 (Securities Law Violation) in reaching its decision.

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