

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934  
Release No. 75837 / September 3, 2015

INVESTMENT ADVISERS ACT OF 1940  
Release No. 4190 / September 3, 2015

INVESTMENT COMPANY ACT OF 1940  
Release No. 31806 / September 3, 2015

Admin. Proc. File No. 3-15006

In the Matter of  
  
RAYMOND J. LUCIA COMPANIES, INC.  
and  
RAYMOND J. LUCIA, SR.

OPINION OF THE COMMISSION

CEASE-AND-DESIST PROCEEDING

INVESTMENT ADVISER PROCEEDING

INVESTMENT COMPANY PROCEEDING

*Grounds for Remedial Action*

Antifraud Violations

Former registered investment adviser and its owner committed securities fraud by making material misrepresentations to prospective clients about their retirement wealth management strategy. *Held*, it is in the public interest to bar the owner from associating with an investment adviser, broker, or dealer; revoke respondents' investment adviser registrations; order respondents to cease and desist from further violations of the provisions violated; and order civil penalties of \$250,000 against the investment adviser and \$50,000 against the owner.

APPEARANCES

*Marc J. Fagel, Jonathan C. Dickey, and Mark J. Schonfeld* of Gibson, Dunn & Crutcher LLP, for Respondents.

*John B. Bulgozdy, David J. Van Havermaat, and Peter Del Greco*, for the Division of Enforcement.

Appeal filed: December 27, 2013  
 Last brief received: July 13, 2015  
 Oral Argument: July 31, 2015

## I. Introduction

Respondents have appealed, and the Division of Enforcement has cross-appealed, an initial decision finding that Raymond J. Lucia Companies, Inc. (“RJLC”), violated Sections 206(1), 206(2), and 206(4) of the Investment Advisers Act of 1940 by misleading prospective clients about its Buckets of Money (“BOM”) retirement wealth management strategy, and that Raymond J. Lucia, Sr. (“Lucia” and, with RJLC, “Respondents”), aided and abetted and caused RJLC’s violations.<sup>1</sup> In particular, the Administrative Law Judge (“ALJ”) found that, at seminars Respondents conducted to pitch their BOM strategy to prospective clients, Respondents misrepresented that they had performed two backtests (one from 1966 to 2003 and another from 1973 to 1994) proving that a model portfolio following the BOM strategy during difficult historical market periods would substantially increase in value while also providing annual retirement income. Respondents’ statements about the backtests were misleading, the ALJ found, because Respondents did not inform prospective clients that the backtests (i) used assumed inflation and Real Estate Investment Trust (“REIT”) rates that did not reflect historical rates, (ii) did not deduct advisory fees, and (iii) did not actually follow the BOM strategy by “rebucketizing” (*i.e.*, reallocating assets between “buckets” of portfolio assets). The ALJ found that Respondents did not inform prospective clients that actual backtests would have shown their model portfolio exhausting its assets before the end of the backtest periods rather than substantially increasing in value.

For these violations, the ALJ barred Lucia from associating with an investment adviser, broker, or dealer; revoked RJLC’s and Lucia’s investment adviser registrations; ordered RJLC and Lucia to cease and desist from further violations of the Advisers Act; and imposed civil penalties of \$250,000 on RJLC and \$50,000 on Lucia.

The ALJ also found that RJLC did not violate, and Lucia did not aid and abet and cause a violation of, Advisers Act Rule 206(4)-1(a)(5) concerning fraudulent advertisements by investment advisers because he found that Respondents’ live slideshow presentation did not qualify as an “advertisement” under that rule. The ALJ further found that RJLC did not violate

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<sup>1</sup> *Raymond J. Lucia Cos., Inc.*, Initial Decision Release No. 540, 2013 WL 6384274 (Dec. 6, 2013). Lucia owned RJLC, which was registered with the Commission as an investment adviser from September 2002 through December 2011. Lucia, who was also a registered investment adviser, sold RJLC’s assets in 2010 to his son, Raymond J. Lucia, Jr. RJLC is now defunct.

Advisers Act Section 204 concerning the maintenance of records by investment advisers.<sup>2</sup> The Division cross-appealed only the Rule 206(4)-1(a)(5) findings.

We find that RJLC violated, and Lucia aided and abetted and caused RJLC's violations of, Advisers Act Sections 206(1), 206(2), and 206(4), and Rule 206(4)-1(a)(5). For these violations, we impose the same sanctions as the ALJ imposed. We base our findings on an independent review of the record, except with respect to those findings not challenged on appeal.

Finally, we reject Respondents' contention that the administrative hearing was an unconstitutional procedure because the Commission ALJ who presided over this matter was not appointed in accordance with the Appointments Clause of the U.S. Constitution.<sup>3</sup> As we explain below, a Commission ALJ is a "mere employee"—not an "officer"—and thus the appointment of a Commission ALJ is not covered by the Clause.

## II. Facts

At the center of this proceeding is a slideshow presentation<sup>4</sup> that Respondents projected onto a screen at seminars to pitch their BOM strategy to prospective clients; in particular, the proceeding focuses on the slideshow's discussion of two "backtests" to prove the efficacy of Respondents' BOM strategy during difficult historical market periods. At issue is, (i) whether Respondents led prospective clients to believe that they had performed backtests, as the Division claims, or hypothetical illustrations, as Respondents claim; (ii) if the former, whether Respondents had actually performed backtests; and (iii) if Respondents had not actually performed backtests but nevertheless led prospective clients to believe that they had done so, whether there is a difference between Respondents' purported backtest results and the results that actual backtests would have shown.

We begin by summarizing the undisputed facts surrounding the slideshow presentation and Respondents' calculations in support thereof. We then present the conflicting evidence regarding Respondents' assertions during that presentation, including the meaning of the term "backtest" and the parties' expert evidence on the effect that using historical inflation and REIT rates, including advisory fees, and rebucketizing would have had on Respondents' "backtest" calculations.

### A. The BOM seminar presentation

The BOM strategy, which Lucia developed, generally advocates using safe portfolio assets for retirement income before depleting riskier assets, thereby giving riskier assets time to

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<sup>2</sup> The ALJ found that Section 204 did not apply to Respondents' backtests because they did not concern the performance of specific managed accounts or specific securities recommendations.

<sup>3</sup> See U.S. Const. art. II, § 2, cl. 2.

<sup>4</sup> Lucia has been presenting a variation of the slideshow since around 2000. Lucia used the version of the slideshow discussed herein from around 2009 to 2010.

grow.<sup>5</sup> From approximately 2000 through 2011, Lucia pitched the BOM strategy to prospective RJLC clients at seminars across the United States.<sup>6</sup> As noted, Lucia used a slideshow that he projected onto a screen during his seminar presentations.<sup>7</sup> The slideshow consisted of four parts:<sup>8</sup> (i) a general discussion of investment risks and strategies; (ii) a description of various hypothetical couples following strategies purportedly inferior to BOM; (iii) a description of the BOM strategy and how it would work for a hypothetical couple dubbed the “Bold Bucketeers”; and (iv) the 1966 and 1973 backtests at issue in this proceeding.<sup>9</sup>

## 1. The three hypothetical couples

After beginning the presentation with a lengthy discussion of various investment risks and strategies, Lucia described three hypothetical couples to illustrate problems caused by following strategies purportedly inferior to BOM. For the illustrations, each couple was assumed to have a \$1 million nest egg to invest with the goals of leaving \$1 million to their children and producing \$60,000 in annual retirement income.<sup>10</sup>

### a. Conservative Campbells

The slideshow stated that one couple, dubbed the “Conservative Campbells,” invested their \$1 million nest egg in conservative investments such as CDs, bond funds, and individual

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<sup>5</sup> The Division has not argued that the BOM strategy itself violates the securities laws.

<sup>6</sup> Lucia estimates that he presented the BOM strategy at about forty seminars per year, and to over 50,000 total seminar attendees, the purpose of which was to generate leads for RJLC. To that end, Respondents gave prospective clients response cards to complete at the seminars to indicate their interest in a complimentary financial planning consultation with an RJLC advisor. Lucia also promoted the BOM strategy on his nationally syndicated radio show, *The Ray Lucia Show*, and in three books on investing for retirement that he authored: *Buckets of Money: How to Retire in Comfort and Safety* (2004); *Ready . . . Set . . . Retire!* (2007); and *The Buckets of Money Retirement Solution: The Ultimate Guide to Income for Life* (2010).

<sup>7</sup> Lucia also used a similar version of the slideshow in pitching the BOM strategy in a video posted on RJLC’s website on February 16, 2009 (the “Webinar”). The OIP does not mention the Webinar, but Respondents introduced it as evidence of what Lucia told prospective clients at the seminars.

<sup>8</sup> It is undisputed that Lucia was responsible for, and approved the content of, the slideshow.

<sup>9</sup> As noted, Respondents contend that they did not lead prospective clients to believe that they had performed backtests. But because Respondents used the word “backtest” in their seminars to describe their analysis of how the BOM strategy would have fared for a model portfolio from 1966 to 2003 and 1973 to 1994, we also use that word to describe their analysis. That word is also appropriate because, as discussed below, we find that Respondents led prospective clients to believe that they had performed backtests.

<sup>10</sup> Most slides for this portion of the presentation included disclaimers that “[t]his is a hypothetical illustration and is not representative of an actual investment.”

bonds. Their portfolio produced a hypothetical 6% annual return but the Campbells also withdrew \$60,000 per year for income (*i.e.*, 6% of the portfolio). The slideshow stated that the problem with this strategy is that, assuming 3% annual inflation, the purchasing power of the Campbells' \$60,000 annual income would diminish to \$44,644 in ten years, \$33,221 in twenty years, and \$24,719 in thirty years. As a result, if the Campbells died after thirty years, their children would inherit \$1 million but with the equivalent purchasing power of \$411,987 from the initial retirement date. And if the Campbells indexed their \$60,000 annual income to 3% assumed inflation every six years, they would run through their nest egg within twenty-seven years.<sup>11</sup>

#### **b. High Rolling Hendersons**

The slideshow stated that a second couple, dubbed the “High Rolling Hendersons,” invested their \$1 million nest egg in stocks because they believed that, since stocks average 10% in annual return, in thirty years their portfolio would be worth \$4,203,320 after withdrawing \$60,000 for annual inflation indexed income. But the Hendersons would have problems if they retired at the beginning of a big bear market. For example, the slideshow stated that if the Hendersons had retired on January 1, 1973, the beginning of a two-year period when the market declined by 41.13%, they would have exhausted their portfolio in seventeen years based on the performance of the S&P 500 for that period assuming that they had withdrawn \$60,000 in annual income indexed by 3% annual inflation.<sup>12</sup>

#### **c. Balanced Buttafuccos**

The slideshow stated that a third couple, dubbed the “Balanced Buttafuccos,” invested their \$1 million nest egg 40% in bonds and 60% in stocks. The slides stated that the Buttafuccos have a “better more ‘balanced’ approach” than the Campbells and Hendersons. But when their strategy is “backtested” with a retirement date starting on January 1, 1973, the Buttafuccos are shown to have exhausted their retirement portfolio in twenty-one years. The slides stated that the “backtest” was based on the performance of the S&P 500, an assumed 6% constant bond return, and the Buttafuccos having withdrawn \$60,000 annual income for the first six years, \$71,500 annual income for the next six years, and \$85,500 annual income for another six years.<sup>13</sup>

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<sup>11</sup> For indexing, the slideshow clarified that the couple would increase the amount they withdrew for annual income every six years assuming 3% inflation for each of the six years. Thus, the Conservative Campbells would withdraw \$60,000 each year for six years, and then \$71,500 each year for another six years, and so on.

<sup>12</sup> Like the Campbells, the Hendersons were assumed to have increased the amount they withdrew for income every six years assuming 3% inflation for each of the six years.

<sup>13</sup> Although not stated explicitly in the Buttafucco slides, the annual income for each six year period in Respondents' “backtest” increased assuming 3% inflation for each of the six years (*i.e.*, \$60,000 with 3% annual inflation after six years equals about \$71,500).

## 2. Description of the BOM strategy

The slideshow then described how the BOM strategy would work for a fourth hypothetical couple, dubbed the “Bold Bucketees,” who also had a \$1 million nest egg.<sup>14</sup> In following the BOM strategy, the Bold Bucketees divided their portfolio into three “buckets” of assets: Bucket #1 held “[s]afe money in a self-depleting bucket aimed at providing income to live on for” six years (*e.g.*, CDs, T-bills, bonds); Bucket #2 held “[s]afe, or moderately safe, money aimed at replacing Bucket #1 with inflation indexed income for the next period (6 years)” (*e.g.*, bonds, fixed annuities); and Bucket #3 held “[h]igher risk money invested for long term growth potential” (*e.g.*, stocks and REITs).<sup>15</sup>

In illustrating the BOM strategy, the slideshow stated that Bucket #1 was assumed to have a 4% return, Bucket #2 a 5.5% return, and Bucket #3 a 10% stock return and 7.75% REIT dividend return, and that \$60,000 income was indexed by an “[a]ssumed 3% inflation” every six years.<sup>16</sup> At the end of the initial six year period, Bucket #1 had been fully depleted for income, at which point the assets from Bucket #2 were used for income for the next six years. After twelve years, Bucket #2 had also been fully depleted for income. But the long term assets in Bucket #3 had grown to a value of \$1.4 million which, the slideshow stated, was then “[r]e-[b]ucketize[d] for another 12 years.”<sup>17</sup>

## 3. Backtest slides

Finally, Lucia discussed the backtests at issue here, beginning with the backtest from 1973 to 1994, and concluding with the backtest from 1966 to 2003.

### a. 1973 backtest slides

The slideshow introduced the 1973 backtest by asking, “But Can Buckets Stand Up To The Test Of The ‘73/’74 Grizzly Bear?” The next slide, titled “Back Tested Buckets,” set forth the assumptions for the backtest, including that (i) the Bold Bucketees invested their \$1 million portfolio beginning on January 1, 1973; (ii) the portfolio was 20% invested in REITs; (iii) “actual treasury rates of return” were used “to calculate fixed income/bond returns”; (iv) “actual S&P 500 returns” were used “to calculate growth returns”; and (v) the Bold Bucketees withdrew annual income of \$60,000 from 1973 to 1978, \$71,500 from 1979 to 1984,

<sup>14</sup> Most slides for this portion of the slideshow included disclaimers that “[r]ates of return are hypothetical in nature and are for illustrative purposes only.”

<sup>15</sup> REITs issue equity and/or debt securities to raise capital to purchase and manage income-producing real estate, such as apartment complexes, shopping centers, and office buildings.

<sup>16</sup> The slideshow disclaimed, *inter alia*, that “[i]nvesting in real estate and [REITs] involve special risk, such as: limited liquidity and demand for real property . . . .”

<sup>17</sup> “Rebucketization” meant that portions of the assets in Bucket #3 would be reallocated to Buckets #1 and #2 after their assets had been fully depleted for income.

\$85,500 from 1985 to 1990, and \$96,000 from 1991 to 1994.<sup>18</sup> The slideshow concluded that the Bold Bucketeers' portfolio would have been worth \$1,544,789 by 1994, the same point in time when the Balanced Buttafuccos' portfolio would have been worth \$0.<sup>19</sup>

#### **b. 1966 backtest slides**

The slideshow introduced the 1966 backtest by asking, "What would have happened if you retired in 1966?"<sup>20</sup> The slideshow then compared 1966 backtests that Respondents calculated for three different portfolios: (i) a version of the Balanced Buttafuccos' portfolio;<sup>21</sup> (ii) a version of the Bold Bucketeers' portfolio without REITs; and (iii) a version of the Bold Bucketeers' portfolio with REITs. The slideshow stated that, for the 1966 backtests: (i) the "examples are based on actual market returns for the period(s) listed"; (ii) "[b]ond returns are based on US Treasury returns"; (iii) "[s]tock returns are based on S&P 500 returns"; (iv) "REIT returns are based on a 7% annual return"; and (v) "[i]nflation is based at 3% annual."<sup>22</sup>

For the version of the Balanced Buttafuccos' portfolio, the slideshow stated that the \$1 million beginning balance was invested 60% in stocks and 40% in bonds, from which \$50,000 annual income was withdrawn on a pro rata basis. The slides concluded that, by 2003, the portfolio would have been worth \$30,000 with \$0 remaining for annual income.

The slideshow then stated that when the BOM strategy was applied to the same \$1 million portfolio invested 60% in stocks and 40% in bonds (*i.e.*, Bold Bucketeers without REITs), the \$50,000 annual income was withdrawn from bonds first rather than pro rata. As a

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<sup>18</sup> The slides did not state the inflation or REIT rates used in the 1973 backtest or whether advisory fees, such as those charged by RJLC, were factored into the 1973 backtest. Lucia testified that annual income was indexed by 3% inflation every six years for the period of 1973 to 1990, but that Respondents made an error in calculating 3% inflation indexed income for the final period of 1991 to 1994. Respondents' expert, John Hekman, calculated that 3% inflation indexed income for that period would have been \$102,092, not \$96,000.

<sup>19</sup> The slides for the 1973 backtest included a disclaimer that "[r]ates of return are hypothetical in nature and are for illustrative purposes only."

<sup>20</sup> In the Webinar, Lucia introduced the slides by stating that he "did a backtest" for his "friend," Ben Stein, who had asked him this question concerning how the BOM strategy would have fared during the market stagnation of 1966 to 1982, a period when the Dow Jones Industrial Average began and ended at around 1,000 points. Stein is an actor, writer, and economic commentator, who spoke at some of Respondents' seminars.

<sup>21</sup> The slides for the 1966 backtests did not mention the Balanced Buttafuccos, but the first portfolio backtested used the same balanced portfolio approach (60% stocks, 40% bonds).

<sup>22</sup> The slides did not state whether advisory fees were factored into the backtests. Also, unlike earlier slides, the 1966 backtest slides did not include disclaimers. But in the Webinar, Lucia stated: "[L]et's pretend that from that point forward [*i.e.*, 1966], inflation was three percent. We know it was more. But we wouldn't have known that at the time." Lucia testified that he presented the backtest assumptions the same way in the seminars and Webinar.

result, by 2003, the portfolio would have been worth \$1.2 million with \$150,000 for annual income.

Finally, the slideshow stated that when REITs were added, the \$1 million portfolio following the BOM strategy became split 40% in stocks, 40% in bonds, and 20% in REITs (*i.e.*, Bold Bucketees with REITs), and the \$50,000 annual income was withdrawn from bonds and REITs first.<sup>23</sup> The slideshow concluded that, by 2003, the portfolio would have been worth \$4.7 million with \$150,000 for annual income.

## **B. Respondents' actual backtest calculations**

### **1. 1973 backtest calculations**

Before the hearing, Respondents produced two spreadsheets that they claimed to have used in calculating the 1966 and 1973 backtests. But during the hearing, Respondents admitted that they did not actually use the spreadsheet they produced for the 1973 backtest to perform that backtest and that the spreadsheet included some assumptions that differed from their backtest. Respondents also admitted that they have no other documentary support for the 1973 backtest.

During the hearing, Lucia also asserted that the slideshow misstated the assumptions used for the 1973 backtest.<sup>24</sup> Lucia testified that rather than using actual S&P 500 returns and treasury returns for the entire twenty-one year period of the 1973 backtest (as presented in the slideshow), Respondents used those returns for only the first two years and then used a flat 10% stock return and 6% bond return for the remaining years. Lucia testified that he neglected to correct the error during his seminar presentations.<sup>25</sup>

But using assumptions similar to those that Lucia testified Respondents actually used in performing the 1973 backtest, Respondents' expert, John Hekman, was unable to replicate the 1973 backtest result presented in the slideshow.<sup>26</sup> Hekman calculated that, by 1994, the Bold

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<sup>23</sup> Lucia clarified in the Webinar that income is initially drained from the REIT "dividend yield" and bonds, and that the REIT itself is liquidated at a later point for income. Lucia referred in the Webinar to the REIT investment for the 1966 backtest as "direct ownership in real estate."

<sup>24</sup> Lucia testified that he personally "did some of the work early on" for the 1973 backtest but that it was completed by an RJLC employee.

<sup>25</sup> Respondents also concede that the 1973 backtest did not include advisory fees or rebucketize the stock investments after bonds and REITs were drained for income. As noted above, this information was not included in the slides for the 1973 backtest.

<sup>26</sup> Hekman, who holds a Ph.D. in economics, is a managing director at FTI Consulting, a firm that provides consulting and expert testimony regarding financial matters. Hekman assumed a 6% bond rate, actual S&P 500 returns for the first two years, 10% stock returns for the remaining years, a 5% annual increase in REIT principal, and a REIT dividend rate ranging between approximately 6.6% and 7.76% per year. Hekman also adjusted the Bold Bucketees' initial \$60,000 annual income by 3% annual inflation every six years (*e.g.*, \$60,000 for the first



Bucketeeers' portfolio would have been worth \$507,194, an amount substantially lower than the \$1,544,789 claimed in the slideshow. Respondents offered no evidence related to this discrepancy or otherwise explained it. It is therefore unclear how Respondents arrived at \$1,544,789.

## **2. 1966 backtest calculations**

As noted, Respondents also produced a spreadsheet that they claimed to have used in calculating the 1966 backtest. Respondents specifically used that spreadsheet in calculating the 1966 backtest of the version of the Bold Bucketeeers' portfolio with REITs.<sup>27</sup> Respondents did not produce any documentary support for the other two 1966 backtests.<sup>28</sup>

The spreadsheet shows that the backtest to which it was applicable used the following factors: (i) a \$1 million investment beginning on January 1, 1966, split 40% in stocks, 40% in bonds, and 20% in REITs; (ii) \$50,000 income withdrawn in 1966, adjusted each subsequent year by 3% inflation; (iii) actual annual S&P 500 returns as a proxy for stock returns; (iv) actual annual treasury returns as a proxy for bond returns; (v) a flat REIT principal of \$200,000; and (vi) a flat 7% REIT dividend yield. During the first eleven years of the backtest, income was withdrawn from the \$14,000 annual REIT dividend yield (7% on \$200,000) with the remaining amount withdrawn from T-bills. At the end of the eleventh year, the \$200,000 REIT principal was liquidated and reinvested in T-bills, and then from years twelve through fifteen the remainder of the T-bill investment was drained for income. Thereafter, from 1981 through 2003, the entire Bold Bucketeeers' portfolio remained in stocks rather than being rebucketized. No advisory fees were factored into the backtest.<sup>29</sup>

### **C. The parties' experts agree that Respondents did not perform actual backtests.**

Respondents' expert, Hekman, and the Division's expert, Steven Grenadier,<sup>30</sup> agreed that a backtest uses data from a specific historical period to evaluate how an investment strategy

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six years, \$71,500 for the next six years, etc.), and did not deduct advisory fees or rebucketize the portfolio.

<sup>27</sup> RJLC's Director of Financial Planning, Richard Plum, testified that he performed the 1966 backtest calculations in 2004 at Lucia's request. Lucia testified that he designed the 1966 backtest.

<sup>28</sup> Plum testified that he created spreadsheets for the 1966 backtests of the Balanced Buttafuccos' portfolio and the Bold Bucketeeers' portfolio without REITs, but Respondents did not produce these spreadsheets to the Division.

<sup>29</sup> The spreadsheet Respondents produced as empirical evidence of the 1973 backtest used the same assumptions as the 1966 backtest spreadsheet, except that it began on January 1, 1973, rather than January 1, 1966, and assumed that an initial \$60,000 rather than \$50,000 was needed for annual income, with that amount adjusted each subsequent year by 3% inflation.

<sup>30</sup> Grenadier is a Professor of financial economics at Stanford University.

would have actually performed during that period.<sup>31</sup> Both experts also agreed that, based on their understanding of the term, the slideshow did not present the results of actual backtests.<sup>32</sup> Grenadier opined that Respondents did not conduct backtests because they used assumed rather than historical inflation and REIT rates, and did not include transaction costs for implementing the BOM strategy.<sup>33</sup> Grenadier also concluded that, by not rebucketizing, Respondents' backtest spreadsheets "concentrate[d] assets in a manner inconsistent with the [BOM] portfolio allocation strategy as outlined in the presentation."

Nonetheless, Respondents disputed that there is an established definition of "backtest" and introduced evidence that, they claimed, showed that it is standard in the financial planning industry to use assumed rates in backtests. Lucia testified that, in the financial planning industry, backtests routinely use "not only averages, for example, inflation, but also . . . hypothetical other investment returns . . ."<sup>34</sup> As an example, Respondents introduced a brochure issued by American Funds (a large mutual fund house), which used a 4% assumed inflation rate for a backtest from 1961 to 2010. Lucia testified that in addition to American Funds, "there are dozens of variable annuity companies and software companies that do the same thing."

But other than the American Funds' brochure and Lucia's testimony, Respondents did not introduce any evidence of companies using assumed rather than historical data in backtests. To the contrary, Respondents introduced into evidence brochures from Fidelity Investments and Financial Engines Income+ reporting the results of backtests that appear to have used historical stock, bond, and inflation rates.

Respondents also claimed that the American Funds brochure was an example of an industry practice not to include fees in backtests. But it is unclear from the brochure if the two backtests discussed therein included fees. The brochure does not mention fees for the first backtest but it implies that the second backtest included fees by stating that the results "are at net asset value."<sup>35</sup> Also, although not mentioned by Respondents as an example of industry practice concerning fees, the backtest in the Financial Engines Income+ brochure discussed above

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<sup>31</sup> Respondents' chief compliance officer, Theresa Ochs, also testified that a backtest needs to use accurate historical data to provide an accurate indication of how a strategy may have performed in the past.

<sup>32</sup> Hekman also testified that he understood from reviewing the slideshow that it did not purport to present the results of actual backtests.

<sup>33</sup> Respondents' other expert, Kevin T. Gannon, also testified that he would not "use a hypothetical rate of return in a backtest" because he would use actual data in a backtest. Gannon, a Certified Public Accountant, is a managing director and president of Stanger & Co., a real estate investment banking firm.

<sup>34</sup> Plum similarly testified that the financial planning industry has always used a mixture of "historical return rates" and "hypothetical assumed annual inflation rate[s]" in backtests.

<sup>35</sup> "Net asset value" is "[t]he market value of a share in a mutual fund, computed by deducting any liabilities of the fund from its total assets and dividing the difference by the number of outstanding fund shares." Black's Law Dictionary 1061 (7th ed. 1999).

included fees, and the Fidelity brochure discussed above disclosed that fees were not included in its backtest.

#### **D. The difference between Respondents' purported backtest results and what actual backtests would have shown**

The Division's expert, Grenadier, analyzed the two spreadsheets Respondents produced as empirical evidence of the 1966 and 1973 backtests.<sup>36</sup> He concluded that the spreadsheets "use[d] important and inaccurate assumptions about inflation, investment returns and liquidity, and implementation costs that significantly affect the results and produce misleading information." Grenadier reran the calculations in the spreadsheets "[s]ubstituting actual, historical data," and produced the results discussed below showing "relatively lower ending portfolio balances than what is reflected in the presentation and spreadsheets, or portfolios that are entirely depleted resulting in substantial unmet income needs." Respondents introduced evidence, including testimony from their expert witnesses, challenging some but not all of Grenadier's findings.<sup>37</sup>

##### **1. The effect from using historical inflation rates**

Grenadier found that the backtest spreadsheets were significantly impacted by using a fixed and assumed 3% inflation rate rather than historical inflation for each of the years considered because many high inflation years occurred early in the backtest periods. Grenadier found that relatively higher inflation as measured by the Consumer Price Index ("CPI"),<sup>38</sup> such as the double-digit inflation of the late 1970s to early 1980s, would have caused the Bold Bucketeers' portfolios to deplete their assets faster in the early years "to have withdrawals that ke[pt] up with inflation," and as a result they would have had "less portfolio later to accumulate returns to consume on."<sup>39</sup>

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<sup>36</sup> While, as noted above, Respondents admitted that they mistakenly produced the 1973 backtest spreadsheet, Grenadier's analysis of it is still relevant because it contains assumptions similar to those Respondents claimed to have used in the 1973 backtest. It differs only in that it used actual S&P 500 returns and treasury returns for the length of the backtest rather than 10% stock and 6% bond returns after the first two years, and that it adjusted the amount withdrawn for income by 3% inflation each year rather than by six year increments (*i.e.*, \$60,000 for the first six years, \$71,500 for the next six years, etc.).

<sup>37</sup> Respondents also introduced evidence to show that their assumed 3% inflation and 7% REIT dividend rates were reasonable to use in hypothetical illustrations. But this evidence is irrelevant because, as we find below, Respondents led prospective clients to believe that they performed backtests and not hypothetical illustrations, and backtests use historical and not assumed data.

<sup>38</sup> CPI measures inflation and is maintained by the Bureau of Labor Statistics. Grenadier specifically used CPI-U, which is a category of CPI measuring inflation for urban consumers.

<sup>39</sup> CPI-U was 11.3% in 1979, 13.5% in 1980, and 10.3% in 1981. Lucia agreed that investors would have experienced double digit inflation during this period.

Grenadier found that by substituting annual historical inflation rates as measured by CPI-U for Respondents' fixed 3% rate, the revised 1966 backtest spreadsheet shows the BOM portfolio being "fully depleted by 1986" and the revised 1973 backtest spreadsheet shows the BOM portfolio being "fully depleted by 1989."<sup>40</sup>

Respondents' expert, Hekman, countered that CPI-U overstated inflation for two reasons. First, Hekman stated that a 1996 report issued by a commission appointed by the Senate Finance Committee (the "Boskin Commission"), and a subsequent paper issued ten years later by a former commission member (Robert Gordon), found that CPI-U had been overstating increases in the annual cost of living. Hekman stated that, based on those findings, CPI-U is "too high by an average of 1.2% per year through 1996 and 1.0% thereafter." Second, Hekman stated that "the most realistic inflation rate for retirees is one that accounts for [their] declining pattern of spending," and concluded that an additional 2% should be deducted from annual CPI-U on top of the corrections suggested by the Boskin Commission and Gordon.

Based on those downward adjustments to CPI-U, Hekman ran two recalculations of the 1966 backtest spreadsheet. In the first, Hekman found that by substituting annual CPI-U adjusted by the Boskin Commission corrections (*i.e.*, annual CPI-U minus 1.2% through 1996 and 1.0% thereafter) for Respondents' fixed 3% rate, the 1966 backtest spreadsheet shows the BOM portfolio running out of money in 1994. In the second, Hekman found that by reducing annual CPI-U by an additional 2% on top of the Boskin Commission corrections to account for reduced retiree spending and substituting that data for Respondents' 3% rate, the 1966 backtest spreadsheet shows the BOM portfolio increasing to a value of over \$6.6 million by 2003.

While Grenadier agreed that retirees over sixty-five tend to spend less money than non-retirees, he testified that "has nothing whatsoever to do with inflation." Grenadier testified that to account for any decrease in spending in the 1966 backtest spreadsheet, the assumed \$50,000 per year income—and not inflation—should be decreased.

## **2. The effect from using historical REIT rates of return**

Respondents acknowledge that, from 1966 to 1971, REITs were not readily available to investors. For this reason, Grenadier was unable to factor historical REIT returns into the 1966 backtest spreadsheet for that period. For the period after 1971, Grenadier also found it significant in analyzing both the 1966 and 1973 backtest spreadsheets, that Respondents' slideshow did not make clear whether Respondents were using assumed returns from publicly traded REITs, public non-traded REITs, or private REITs.<sup>41</sup>

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<sup>40</sup> Lucia testified that he does not dispute that, if historical inflation as measured by CPI-U had been used in the 1966 or 1973 backtest spreadsheets, it would have resulted in the model BOM portfolios being fully depleted before the end of the backtest periods.

<sup>41</sup> Publicly traded REITs file with the Commission and have their shares traded on an exchange, public non-traded REITs file with the Commission but do not trade their shares on an exchange, and private REITs neither file with the Commission nor trade their shares on an exchange.

For the first category, Grenadier found that substituting annual historical returns for publicly traded REITs as measured by the National Association of Real Estate Investment Trusts (“NAREIT”) All REIT Index<sup>42</sup> back through 1972 into the 1966 backtest spreadsheet (leaving all other data unchanged) resulted “in a total investment in REITs of only \$85,646 at the time the REIT investment [was] liquidated, as compared to \$200,000 in the original spreadsheet, and total assets of only \$1.3 million at the end of 2003, as compared to \$4.7 million in the original spreadsheet.”<sup>43</sup> Grenadier also found that substituting such data into the 1973 backtest spreadsheet (leaving all other data unchanged) resulted “in a total investment in REITs of only \$134,031 at the time the REIT investment [was] liquidated, as compared to \$200,000 in the original spreadsheet, and total assets of only \$2.8 million at the end of 2003, as compared to \$4.1 million in the original spreadsheet.”<sup>44</sup>

For the last two categories, Grenadier found that, to the extent Respondents were using public non-traded or private REITs, the backtest spreadsheets should have considered “the ability and potential cost to liquidate the REIT investment.”<sup>45</sup> As noted, Respondents’ 1966 backtest spreadsheet liquidated the \$200,000 REIT principal at the end of the eleventh year after T-bills had been drained down to a level at which they could no longer cover income.<sup>46</sup> In doing so, Grenadier found that the spreadsheets “ignore that redemption of private and/or public non-traded REITs may be difficult and costly.”

Gannon did not offer expert testimony concerning the effect on the backtests from using annual historical REIT returns.<sup>47</sup>

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<sup>42</sup> NAREIT began maintaining indices of annual returns for publicly traded REITs in 1972.

<sup>43</sup> Gannon testified that a more reasonable index to use for historical publicly traded REIT returns is the NAREIT Equity REIT Trust Index (“NAREIT Equity Index”), which includes REITs invested only in real estate equity, because equity REITs were the subject of Respondents’ backtests. Grenadier testified that he used the NAREIT All REIT Index because it was unclear whether the REIT investment in the backtests was limited to only equity or mortgage REITs. In any event, Gannon did not analyze, and it is unclear from the record, what effect substituting data from the NAREIT Equity Index into the spreadsheets would have had on the spreadsheet results.

<sup>44</sup> The 1973 backtest in the slideshow ended in 1994, but the 1973 backtest spreadsheet was calculated through 2003.

<sup>45</sup> While publicly traded REITs are highly liquid, non-traded REITs are substantially less liquid because they generally have a minimum required holding period after which redemption characteristics vary by REIT. Some non-traded REITs may allow investors to redeem shares once a quarter, subject to certain requirements; others link redemption to a required liquidity event after a fixed amount of time.

<sup>46</sup> The 1973 backtest spreadsheet liquidated the \$200,000 REIT principal at the end of the ninth year.

<sup>47</sup> Respondents retained Gannon to opine on the use of a hypothetical 7% REIT rate of return in hypothetical illustrations.

### 3. The effect from deducting advisory fees

Grenadier found that if a strategy has implementation costs, like BOM, it is important when backtesting the strategy to include such costs because they “may reduce, and at times eliminate, the benefits of [the] strategy.” Grenadier found that, by assuming zero implementation costs, Respondents’ backtest spreadsheets overstated “the ending portfolio balances.” In particular, Grenadier found that the backtest spreadsheets should have included “cost[s] associated with an investment in the S&P 500 Index,” T-bills, and REITs. By incorporating representative mutual fund fees on the stock portfolio into the spreadsheets (leaving all other data unchanged), Grenadier found that the value of the model portfolio dropped in the (i) 1966 backtest spreadsheet to \$2.5 million from \$4.7 million by 2003; and (ii) 1973 backtest spreadsheet to \$3.1 million from \$4.1 million by 2003.<sup>48</sup>

Respondents offered no expert testimony on the issue of costs. And Lucia testified that he knew fees can significantly reduce a portfolio’s returns over time.

### 4. The effect from rebucketizing

Grenadier concluded that the 1966 and 1973 backtest spreadsheets were inconsistent with the BOM strategy presented in the seminars because they did not rebucketize after T-bills and REITs had been exhausted for income and instead left all assets in stocks. Grenadier noted that for both spreadsheets, “the average S&P 500 return over the time period in which the portfolios [were] entirely invested in stocks [was] higher than the average for the time period in which the portfolios [were] also invested in other assets besides stocks.” In addition, although not directly addressed by Grenadier, from the record evidence it appears that, for the period in the 1966 backtest spreadsheet that the model portfolio was entirely invested in stocks (1981 to 2003), the average S&P 500 return was substantially higher than T-bill returns and about equivalent to publicly traded REIT returns as measured by the NAREIT Equity Index. And from 1986 to 2003, when the BOM portfolio in the 1973 backtest spreadsheet was entirely invested in stocks, the average S&P 500 return was substantially higher than T-bill returns and slightly higher than publicly traded REIT returns as measured by the NAREIT Equity Index.

Respondents conceded that they did not rebucketize the 1966 or 1973 backtests and offered no expert testimony to support their approach. Lucia also admitted at the hearing that the BOM strategy does not advocate that investors leave their assets in stocks after draining other assets for income,<sup>49</sup> and stated in the Webinar that investors (i) should not “put a hundred percent of [their] money into the stock market” and (ii) should “never drain that stock portfolio for

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<sup>48</sup> Grenadier used the average equity mutual fund fee of 0.8% for 1966 to 1970 and 1% for 1971 to 1977. Thereafter he used 0.05% to match the fee charged by the least expensive mutual fund (Vanguard 500 Fund) for that period.

<sup>49</sup> Plum similarly testified that “[p]utting a hundred percent into stocks” is “not a Buckets of Money strategy,” and that RJLC did not believe investors “should be a hundred percent in stock.”

income.”<sup>50</sup> Lucia also testified that he was aware that if the 1966 backtest spreadsheet had been rebucketized, the model portfolio would have ended up with significantly less money.

Lucia testified, however, that seminar attendees would have known that the backtests were not rebucketized. While Lucia acknowledged that the slideshow made no explicit disclosure that the backtests did not rebucketize, he testified that seminar attendees would nonetheless have known that the backtests were not rebucketized because he explained to them that rebalancing is not always necessary. Lucia testified that, during the seminars, he drew out a bucket strategy by hand to show that the stock bucket does not have to be rebalanced and mentioned an academic article by Sandeep Singh, Ph.D., CFA, and John Spitzer, Ph.D., finding that retirees “could live off of the dividends and the income stream from the equity portfolio and an annuity contract” without rebalancing.

No evidence corroborates Lucia’s testimony on this point. To the contrary, the Webinar shows that Lucia diagramed the bucket strategy and mentioned the Singh/Spitzer article to criticize the “rebalancing method,” which involves withdrawing income from a retirement portfolio on a pro rata basis and rebalancing the entire portfolio annually. Lucia stated in the Webinar that the Singh/Spitzer article found that the “rebalancing method” is inferior to the BOM strategy. Lucia did not state in the Webinar that rebalancing was unnecessary in following the BOM strategy after Buckets #1 and #2 had been depleted.

#### **E. Investor testimony**

Two RJLC clients who had attended Respondents’ seminars, Richard R. DeSipio and Dennis Wayne Chisholm, testified at the hearing.<sup>51</sup> DeSipio testified that, for the period of market stagnation starting in 1966, he understood that the BOM strategy was “backtested or checked out and that it held up relatively well compared to the other three investment programs,” and that the 1966 backtest used “actual performance data” and “average inflation” that accurately reflected inflation during that historical era. DeSipio testified that he thought the 1966 backtest showed “that over a longer projected period of time, certainly for ‘66 going forward, that [the BOM strategy] held up under the various market conditions that occurred over the years.”

DeSipio testified that if he knew the inflation rate used in the 1966 backtest was not the historical rate he would have “come to question” the backtest’s results, and that it would have been an important factor for him to know that the model BOM portfolio would have been reduced to \$0 in twenty years if Respondents had used historical inflation rates and deducted advisory fees in the backtest. DeSipio also testified that he does not recall Lucia disclosing that the 1966 backtest did not rebucketize the model BOM portfolio. DeSipio testified that he would not want his entire retirement portfolio to be invested in stocks, as was done here in backtesting the BOM strategy without rebucketizing.

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<sup>50</sup> Lucia also wrote in a letter to RJLC clients dated October 9, 2008, that he “would never – NEVER – advocate being 100% invested in stocks.”

<sup>51</sup> DeSipio attended a seminar in Philadelphia, Pennsylvania in 2007, and Chisholm attended a seminar in Portland, Oregon in 2007.

Chisholm testified that he understood from the seminar that a bear market “would not be an issue” for the model BOM portfolio “because [the strategy] was a proven method of investing, that it had been backtested,” and “would do well over good times as well as bad times.” Chisholm testified that in deciding whether to become an RJLC client, it would have been important to him to know that the model BOM portfolio would have been exhausted in sixteen years if the 1973 backtest had used historical inflation. Chisholm testified that “it would have lessened his confidence in” the backtests if he had known that 3% inflation was not the historical rate.

Chisholm testified that Lucia did not say anything at the seminar about the availability of REITs in 1966 and that he would have wanted to know if REITs were not readily available in evaluating the value of the 1966 backtest. Chisholm testified that Lucia emphasized during the seminar that portfolio assets be rebucketized but did not disclose that the 1966 and 1973 backtests did not rebucketize. Chisholm testified that he assumed that the backtests rebucketized and that he would have liked to have known that they did not rebucketize. Like DeSipio, Chisholm testified that he would not want his entire retirement portfolio invested in stocks.

### III. Discussion

#### A. RJLC willfully violated Advisers Act Sections 206(1), (2), and (4).

##### 1. Legal Standard

Advisers Act Sections 206(1), (2), and (4) make it unlawful for an investment adviser, by jurisdictional means,<sup>52</sup> “directly or indirectly: (1) to employ any device, scheme, or artifice to defraud any client or prospective client; (2) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client; . . . or (4) to engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative.”<sup>53</sup> There is significant overlap among Sections 206(1), (2), and (4),<sup>54</sup> the

<sup>52</sup> Respondents do not dispute that RJLC was an investment adviser or that the Commission has jurisdiction by virtue of their actions in interstate commerce. Respondents also do not dispute that they acted willfully, which is shown where a person intends to commit an act that constitutes a violation; it does not require that the actor “also be aware that he is violating one of the Rules or Acts.” *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (internal quotation marks and citation omitted).

<sup>53</sup> 15 U.S.C. § 80b-6(1), (2), & (4). Section 206(4) further provides that “[t]he Commission shall, for the purposes of this paragraph (4) by rules and regulations define . . . such acts, practices, and courses of business as are fraudulent, deceptive, or manipulative.” *Id.* § 80b-6(4). But to violate Section 206(4), there is no precondition that one of its underlying rules, such as Rule 206(4)-1, have been violated. *See Warwick Capital Mgmt., Inc.*, Advisers Act Release No. 2694, 2008 WL 149127, at \*8-9 (Jan. 16, 2008) (finding a violation of Section 206(4) without an associated rule violation).

<sup>54</sup> *Cf. John P. Flannery*, Advisers Act Release No. 3981, 2014 WL 7145625, at \*14 (Dec. 15, 2014) (finding the subsections of Exchange Act Rule 10b-5 “to overlap,” with each



boundaries of which do not need to be delineated here. For purposes of this proceeding, it is sufficient to note that all three sections encompass the making of fraudulent misstatements of material fact and omissions of material fact necessary to make statements made not misleading.<sup>55</sup>

Scienter, which can be established through recklessness, is necessary to violate Section 206(1).<sup>56</sup> Negligence is sufficient to violate Sections 206(2) and (4).<sup>57</sup> Lucia's conduct and his scienter or negligence are imputed to RJLC.<sup>58</sup>

## **2. Respondents made fraudulent statements and omissions in the backtest slides.**

Respondents' backtest slides were misleading because: (1) they falsely stated that Respondents had backtested a model BOM portfolio; (2) they stated that backtesting proved that such a portfolio would have withstood two difficult historical market periods when actual backtesting would have shown the opposite; and (3) even using Respondents' flawed assumptions, they overstated the 1973 backtest result by over \$1 million.

First, Respondents conveyed to prospective clients that they had performed actual backtests of a model portfolio following the BOM strategy. In addition to using the word "backtest" to describe their analysis, Respondents' slideshow introduced the 1966 backtest by asking, "What would have happened if you retired in 1966[?]," and introduced the 1973 backtest by asking, "Can Buckets Stand Up To The Test Of The '73/'74 Grizzly Bear?" Because of such statements, the two seminar attendees who testified at the hearing, DeSipio and Chisholm, justifiably believed that Respondents had performed backtests.

But Respondents had not actually performed backtests. The parties' experts agreed that backtests use historical data. And instead of using historical data, Respondents' backtests used

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encompassing, among other things, making fraudulent misstatements of material fact), *appeal docketed*, No. 15-1080 (1st Cir. Jan. 16, 2015); *see also SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963) ("Congress intended the Investment Advisers Act of 1940 to be construed like other securities legislation enacted for the purpose of avoiding frauds, not technically and restrictively, but flexibly to effectuate its remedial purposes." (internal quotation omitted)).

<sup>55</sup> *Warwick Capital Mgmt.*, 2008 WL 149127, at \*8-9 (finding that an investment adviser violated Sections 206(1), (2), and (4) by making false and misleading statements about its assets and performance).

<sup>56</sup> *Vernazza v. SEC*, 327 F.3d 851, 860 (9th Cir. 2003); *SEC v. Steadman*, 967 F.2d 636, 641 (D.C. Cir. 1992).

<sup>57</sup> *Steadman*, 967 F.2d at 643 n.5, 647.

<sup>58</sup> *A.J. White & Co. v. SEC*, 556 F.2d 619, 624 (1st Cir. 1977) (holding that a firm "can act only through its agents, and is accountable for the actions of its responsible officers"); *Warwick Capital Mgmt.*, 2008 WL 149127, at \*9 n.33 ("A company's scienter is imputed from that of the individuals controlling it.").

assumed inflation and REIT rates. Also, it was blatantly untrue for Respondents to claim that their backtests followed the BOM strategy when they did not rebucketize the model portfolio and instead left all of its assets in stocks after safer assets had been drained for income. The BOM strategy included rebucketization and forbade investing all portfolio assets in stocks.<sup>59</sup>

Second, the purported results of Respondents' backtests were misleading. Had Respondents performed actual backtests beginning in 1966 and 1973 by using historical inflation and REIT rates and rebucketizing, their model portfolio would have been shown to have exhausted its assets rather than having grown in value to \$4.7 million and \$1,544,789, respectively, by the end of the backtest periods.

In particular, Respondents' use of a flat 3% inflation rate made the backtest results misleading because historical inflation as measured by CPI-U was substantially higher during the backtest periods. Because annual CPI-U reached double digits in the late 1970s and early 1980s, inflation adjusted annual income would have substantially increased early in the backtest periods, thereby substantially decreasing principal and ultimately causing the model portfolio to be exhausted before the backtests ended. As discussed above, this result would not change for the 1966 backtest even using Hekman's downward adjustment to CPI-U based on the Boskin Commission corrections.<sup>60</sup>

In addition, Respondents' use of a flat 7% REIT dividend rate on a constant \$200,000 REIT principal made the backtest results misleading because it was higher than historical REIT rates of return. As Grenadier demonstrated without contradiction, substituting data from the NAREIT All REIT Index back through 1972 resulted in REIT principal dropping to \$85,646 in Respondents' 1966 backtest spreadsheet and \$134,031 in Respondents' 1973 backtest spreadsheet, and lower valued portfolios as a consequence.<sup>61</sup> The 1966 backtest was further inflated by Respondents' use of entirely fictitious REIT rates for 1966 to 1971, a period when REITs were generally unavailable to investors.

Also, Respondents' failure to rebucketize the backtests inflated their results because, during the period when the model BOM portfolio was fully invested in stocks, S&P 500 returns were substantially higher than T-bill returns and about equivalent to publicly traded REIT

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<sup>59</sup> As noted above, the ALJ also found that Respondents' statements about the backtests were misleading because Respondents did not inform prospective clients that the backtests did not deduct advisory fees. Given our other findings, which amply support liability and the sanctions imposed, we have determined not to reach this additional basis for liability.

<sup>60</sup> Hekman recalculated only the 1966 backtest using the Boskin Commission corrections; he did not also recalculate the 1973 backtest. In addition, Respondents' contention, supported by Hekman's conclusion, that CPI-U should be further reduced to account for reduced retiree spending is not persuasive because, as Grenadier observed, it unjustifiably conflates spending levels with inflation.

<sup>61</sup> Respondents did not demonstrate that Grenadier's calculations would be materially different using the NAREIT Equity Index instead of the NAREIT All REIT Index.

returns. A rebucketized model BOM portfolio would have been invested in all three assets, not just stocks.<sup>62</sup>

Third, Respondents overstated the 1973 backtest result by over \$1 million even using their assumptions. Respondents concede that they have no documentary support for the \$1,544,789 result they presented to seminar attendees, and their expert, using assumptions similar to those Respondents claim to have used, concluded that the model BOM portfolio would have been worth only \$507,194 at the end of the 1973 backtest. Thus, Respondents either fabricated the 1973 backtest result or presented it to seminar attendees without ensuring its accuracy.

### **3. Respondents' fraudulent statements and omissions were material.**

For a misleading statement to be material, “there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the ‘total mix’ of information made available.”<sup>63</sup> It would have been significant to a reasonable investor in considering whether to become an RJLC client or implement the BOM strategy to know that: (i) Respondents’ purported backtests did not use historical inflation or REIT rates or even follow the BOM strategy by rebucketizing; (ii) actual backtests beginning in 1966 and 1973 would have shown the model portfolio to have been exhausted by the 1980s rather than providing decades of payouts with an increase in residual principal; and (iii) Respondents presented a result for the 1973 backtest that was over \$1 million higher than even their flawed assumptions would have shown.

Our conclusion is supported by testimony from prospective clients who attended Respondents’ seminars. DeSipio and Chisholm testified that they would have found it important to know that Respondents’ backtests did not use historical inflation and that actual backtests using historical data would have shown the model portfolio to have exhausted its assets. Chisholm also testified that he would have wanted to know that the backtests did not rebucketize and that REITs were not readily available in 1966. And DeSipio testified that that he would not want his entire portfolio to be invested in stocks, as was done here by not rebucketizing the backtests.

### **4. Respondents made the fraudulent misstatements and omissions with scienter.**

Respondents acted at least recklessly.<sup>64</sup> Lucia designed the backtests and was responsible for the backtest slides. In approving and using the backtest slides, it was Lucia’s decision to tell

<sup>62</sup> Lucia also admitted in testimony that not rebucketizing caused the backtests to show higher portfolio returns.

<sup>63</sup> *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988).

<sup>64</sup> The recklessness required to violate Section 206(1) “is not merely a heightened form of ordinary negligence; it is an ‘extreme departure from the standards of ordinary care, . . . which presents a danger of misleading buyers or sellers that is either known to the [respondent] or is so obvious that the actor must have been aware of it.’” *Steadman*, 967 F.2d at 641-2 (quoting *Sundstrand Corp. v. Sun Chem. Corp.*, 553 F.2d 1033, 1045 (7th Cir. 1977)).

seminar attendees that he had backtested the BOM strategy to show how a portfolio implementing it in the past would have performed over historical time periods with specific negative market performance. But Lucia knew that the backtests were not based on historical data and did not rebucketize, and therefore knew or must have known of the risk of misleading prospective clients to believe that Respondents had performed actual backtests of a model BOM portfolio. Indeed, because Lucia admitted that the BOM strategy does not advocate keeping all portfolio assets in stocks, he knew or must have known that it was untrue to claim that the backtests followed the BOM strategy.

Also, Lucia knew or must have known that the backtest results he presented were misleading. Lucia knew that: (i) actual inflation was higher than 3% early in the backtests and fluctuated annually; (ii) REITs did not produce flat 7% dividend rates on flat principal; and (iii) not rebucketizing caused the backtests to show higher portfolio returns.

Finally, Lucia acted recklessly, at the very least, in presenting the 1973 backtest results without ensuring their accuracy. As discussed above, Respondents provided no support for their 1973 backtest and Hekman was unable to replicate its results. Lucia also admitted in testimony that the 1973 backtest slides misstated the methodology Respondents purportedly used for the backtest.

**B. Lucia willfully aided and abetted and caused RJLC’s violations of Advisers Act Sections 206(1), 206(2), and 206(4).**

To establish aiding and abetting liability, the Commission must find: (i) a primary violation of the securities laws by RJLC; (ii) that Lucia substantially assisted RJLC’s primary violation; and (iii) that Lucia provided such assistance with the requisite scienter.<sup>65</sup> The scienter requirement may be satisfied by evidence that Lucia knew of or recklessly disregarded the wrongdoing and his role in furthering it.<sup>66</sup>

Because the primary violations of Advisers Act Sections 206(1), 206(2), and 206(4) are premised on the imputation of Lucia’s conduct and scienter to RJLC for the reasons discussed above, we find that Lucia satisfies the elements for aiding and abetting liability. Lucia substantially assisted RJLC’s primary violations because he designed the backtests, was responsible for the backtest slides, and made the material misstatements about the backtests to seminar attendees. Lucia provided such assistance with scienter because he knew or must have known that the statements he made about the backtests to seminar attendees were misleading. Because we find that Lucia aided and abetted RJLC’s primary violations, “he necessarily was a cause of the violations.”<sup>67</sup>

<sup>65</sup> *Howard v. SEC*, 376 F.3d 1136, 1143 (D.C. Cir. 2004); *Eric J. Brown*, Advisers Act Release No. 3376, 2012 WL 625874, at \*11 (Feb. 27, 2012).

<sup>66</sup> *Brown*, 2012 WL 625874, at \*11.

<sup>67</sup> *Zion Capital Mgmt. LLC*, Advisers Act Release No. 2200, 2003 WL 22926822, at \*7 (Dec. 11, 2003).

**C. RJLC willfully violated, and Lucia willfully aided and abetted and caused RJLC's violation of, Advisers Act Section 206(4) and Rule 206(4)-1(a)(5) thereunder.**

Advisers Act Rule 206(4)-1(a)(5) provides that it constitutes a fraudulent act, practice, or course of business within the meaning of Section 206(4) for an investment adviser “directly or indirectly, to publish, circulate, or distribute any advertisement . . . which contains any untrue statement of a material fact, or which is otherwise false or misleading.”<sup>68</sup> The Rule defines “advertisement” to include “any notice, circular, letter *or other written communication* addressed to more than one person . . . which offers . . . investment advisory service[s] with regard to securities.”<sup>69</sup> As the Ninth Circuit found, “[t]he term ‘advertisement’ is broadly defined in Rule 206(4)-1(b)” and includes “[i]nvestment advisory material which promotes advisory services for the purpose of inducing potential clients to subscribe to those services.”<sup>70</sup>

Respondents urge us to apply the same reading of Rule 206(4)-1 as did the ALJ, who found that their slideshow presentation was not an “advertisement” because it did not qualify as a “written communication” under Rule 206(4)-1(b).<sup>71</sup> The ALJ based his finding on precedent that he understood to hold that a “written communication” includes “only traditional media, including books, newsletters, and newspaper and magazine advertisements.”<sup>72</sup> And because “[t]here is no evidence that slideshow printouts or synopses thereof were handed out to seminar participants or otherwise published in printed or handwritten form at the seminars,” the ALJ found that the slideshow presentation was not a “‘written communication’ as that term has been interpreted.”<sup>73</sup>

But none of the cases cited by the ALJ, nor any other case, has held that only traditional media qualifies as a “written communication” under Rule 206(4)-1(b). To the contrary, the cases cited by the ALJ merely found that a “written communication” *includes* newsletters, newspaper advertisements, and books.<sup>74</sup> They did not exclusively define those words.

The plain language of Rule 206(4)-1(b) also does not limit a “written communication” to traditional media or require that a “written communication” be in hard-copy rather than

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<sup>68</sup> 17 C.F.R. § 275.206(4)-1(a)(5).

<sup>69</sup> 17 C.F.R. § 275.206(4)-1(b) (emphasis added).

<sup>70</sup> *C.R. Richmond & Co.*, 565 F.2d at 1104.

<sup>71</sup> *Raymond J. Lucia Cos.*, 2013 WL 6384274, at \*50-51.

<sup>72</sup> *Id.* at \*51. The ALJ cited the following cases as precedent: *SEC v. Suter*, No. 81-3865, 1983 WL 1287, at \*11-12 (N.D. Ill. Feb. 11, 1983), *aff'd*, 732 F.2d 1294 (7th Cir. 1984); *SEC v. Lindsey-Holman Co.*, No. 78-54-MAC, 1978 WL 1129, at \*2-3 (M.D. Ga. Aug. 6, 1978); *C.R. Richmond & Co.*, 565 F.2d at 1104.

<sup>73</sup> *Raymond J. Lucia Cos.*, 2013 WL 6384274, at \*51.

<sup>74</sup> *Suter*, 1983 WL 1287, at \*11-12; *Lindsey-Holman Co.*, 1978 WL 1129, at \*2-3; *C.R. Richmond & Co.*, 565 F.2d at 1104.

electronic or projected form.<sup>75</sup> The Rule’s only limitations on what qualifies as a “written communication” are that it be “written”<sup>76</sup> and a “communication.”<sup>77</sup> Both of those limitations are met here. There is no question that the slideshow was written. And its projection onto a screen along with Lucia’s presentation of its contents was a communication to seminar attendees. Thus, the slideshow was a “written communication” within the meaning of Rule 206(4)-1(b).

The slideshow also meets the two additional requirements of the Rule’s broad definition of “advertisement.” First, the slideshow was addressed to more than one person—typically to an audience of one hundred to five hundred people. Second, the slideshow offered RJLC’s investment advisory services with regard to securities. Indeed, Respondents used the slideshow presentation to generate leads for RJLC. To that end, Respondents handed out response cards for seminar attendees to complete if they wanted to meet with an RJLC advisor. Lucia also repeatedly offered RJLC’s services throughout the Webinar presentation of the slideshow. And Respondents treated the slideshow as marketing and advertising material requiring review by RJLC’s broker-dealers.

The remaining elements of Rule 206(4)-1 have also been satisfied. By projecting the slideshow onto a screen and presenting its contents during the seminars, Lucia published, circulated, and distributed it.<sup>78</sup> And as set forth above, the slideshow contained untrue statements of material fact and was misleading.

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<sup>75</sup> Although not specifically interpreting the phrase, “written communication,” we have previously advised that, under Rule 206(4)-1, “electronically disseminated advertisements are subject to the same prohibitions against misleading disclosure as advertisements in paper.” *Use of Electronic Media by Broker-Dealers, Transfer Agents, and Investment Advisers*, Advisers Act Release No. 1562, 1996 WL 242059, at \*6 (May 9, 1996); *see also id.* at \*2 n.4 (“[T]he antifraud provisions of . . . section 206 of the Advisers Act and the rules thereunder, apply to information delivered and communications transmitted electronically, to the same extent as they apply to information delivered in paper form.”).

<sup>76</sup> At the time we adopted Rule 206(4)-1 in 1961, Webster’s Third New International Dictionary defined “written” as the past participle of “write,” which it in turn defined as, *inter alia*, (i) “to set forth in written language . . . reveal, describe, treat of, or depict by means of words”; and (ii) “to form or produce letters, words, or sentences with a pen, pencil, or machine.” Webster’s Third New Int’l Dictionary 2640-41 (1961).

<sup>77</sup> Webster’s Third New International Dictionary defined “communication” as, *inter alia*, (i) “the act or action of imparting or transmitting”; (ii) “facts or information communicated”; and (iii) “interchange of thoughts or opinions.” *Id.* at 460.

<sup>78</sup> Webster’s Third New International Dictionary defined “publish” as, *inter alia*: (i) “to declare publicly”; (ii) “to impart or acknowledge to one or more persons”; and (iii) “to place before the public (as through a mass medium).” Webster’s at 1837. It defined “circulate” as, *inter alia*, (i) “to spread widely”; and (ii) “to cause to pass from person to person and [usually] to become widely known.” *Id.* at 409. And it defined “distribute” as, *inter alia*, “to give out or deliver esp. to the members of a group.” *Id.* at 660.

Accordingly, we find that RJLC willfully violated Section 206(4) on the additional ground that its conduct constitutes a fraudulent act, practice, or course of business as defined in Rule 206(4)-1(a)(5). And because that primary violation is premised on the imputation of Lucia's conduct and scienter to RJLC as discussed above, we find that Lucia willfully aided and abetted and caused RJLC's violation of Section 206(4) and Rule 206(4)-1(a)(5).

**D. Respondents' arguments against liability lack merit.**

**1. Respondents contend that they did not mislead prospective clients.**

Respondents claim that they explicitly told seminar attendees, through both the slides and the actual words spoken by Lucia, that they were presenting hypothetical illustrations using hypothetical assumptions. Respondents claim that the slides themselves "specifically and repeatedly explained that '[r]ates of return are hypothetical in nature and are for illustrative purposes only'" and that "[t]his is a hypothetical illustration and is not representative of an actual investment." And Respondents claim that Lucia, in presenting the slides, "expressly informed seminar attendees that he was using *hypothetical, pretend, assumed* rates of return."<sup>79</sup>

We find that such statements did not change the overall impression that Respondents had performed backtests showing how the BOM strategy would have performed during the two historical periods.<sup>80</sup> In addition to using the word "backtest," Respondents' slideshow introduced the 1966 backtest by asking, "What would have happened if you retired in 1966[?]," and introduced the 1973 backtest by asking, "Can Buckets Stand Up To The Test Of The '73/'74 Grizzly Bear?" And the two seminar attendees who testified understood from Lucia's

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<sup>79</sup> Respondents also contend that seminar attendees would have understood that the inflation and REIT rates used were hypothetical because: (i) the attendees were "comprised primarily of retirees and near-retirees who had lived through periods of high inflation, [and no reasonable attendee] would have understood the 3% annual inflation rate . . . to be based on actual historical inflation"; and (ii) "a reasonable investor understands that in reality return rates fluctuate, and respondents' illustrations, rather than being based on real-life data, incorporated an assumed constant rate of return." But DeSipio and Chisholm did not make such assumptions. To the contrary, they justifiably understood from Respondents' presentation that Respondents had used historical rates in their backtests.

<sup>80</sup> Cf. *C.R. Richmond & Co.*, 565 F.2d at 1106-07 (finding that advertisements were "deceptive and misleading in their overall effect," in violation of Advisers Act Section 206(4) and Rule 206(4)-1, "even though [it might be argued that] when narrowly and literally read, no single statement of a material fact was false" (quoting *Spear & Staff, Inc.*, Advisers Act Release No. 188, 1965 WL 88746, at \*3 (1965))); see also *id.* at 1105 ("[C]onduct with respect to [Rule 206(4)-1] is to be measured from the viewpoint of a person unskilled and unsophisticated in investment matters, . . . and the terms 'fraud' and 'deceit' are used in a flexible and non-technical sense to effectuate the [Advisers] Act's remedial purposes.").

presentation that Respondents had performed backtests showing that the BOM strategy could increase a portfolio's value during the two historical periods.<sup>81</sup>

Moreover, regardless of Respondents' disclaimers about hypothetical rates, Respondents misled seminar attendees by not rebucketizing the 1966 and 1973 backtests. In other words, it would have been just as misleading for Respondents not to rebucketize if they had in fact stated that they were presenting a hypothetical illustration that purportedly followed the BOM strategy as it was for them not to rebucketize what was described as a backtest. Rebucketizing was a key aspect of the BOM strategy, and keeping all assets in stocks—the result of not rebucketizing—contravened the strategy (and substantially inflated the resulting returns). Thus, not rebucketizing made it untrue for Respondents to claim that their model portfolio, whether presented as a “hypothetical illustration” or a backtest, followed the BOM strategy.

Respondents' 1973 backtest results were also false regardless of disclaimers about hypothetical rates. As noted, Respondents' expert did not come within \$1 million of the 1973 backtest results using Respondents' own hypothetical inflation rate and other assumptions similar to those that Respondents claim to have used. Consequently, even if Respondents were presenting hypothetical illustrations and not backtests, it was misleading for them to present such grossly inaccurate results.

Respondents contend that the only purpose of the seminar presentation was to compare BOM to three other strategies, and that the Division failed to show that, had Respondents “used historical data rather than hypothetical assumptions . . . [the BOM] strategy would have failed to outperform the other investment strategies illustrated.”<sup>82</sup> For example, Respondents assert that they used the same 3% inflation rate for each of the strategies illustrated and there was no showing that, “under a higher inflation rate, Lucia's strategy would not have nonetheless outperformed the alternatives he illustrated.”

We reject this argument because the purpose of the backtest slides was not only to compare strategies but also to show the efficacy of the BOM strategy during difficult historical market periods. Respondents misled seminar attendees to believe that, as Chisholm testified, BOM “was a proven method of investing, that it had been backtested,” and “would do well over good times as well as bad times.” But actual backtests would have shown that the BOM strategy would not have done well over the two historical “bad times” chosen. And again, regardless of

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<sup>81</sup> Respondents also contend that Lucia referenced “direct ownership in real estate” when discussing the period from 1966 to 1971 in the backtest. But the 1966 backtest slides specifically stated that “REIT returns are based on a 7% annual return,” and the 1966 backtest spreadsheet referred only to REITs. And Respondents did not clarify during the seminars that REITs were generally unavailable from 1966 to 1971 and that they actually meant “direct ownership in real estate” when discussing that period.

<sup>82</sup> Respondents similarly argue that there can be no finding of materiality here because the Division has made no “allegation (much less an evidentiary showing) . . . that, had Mr. Lucia used actual rates of return . . . and ‘rebucketized,’ his recommended strategy would not have outperformed the alternative approaches illustrated in the seminar.”



this contention, not rebucketizing the backtests and presenting grossly inaccurate 1973 backtest results made Respondents' representations false and misleading.

Respondents also assert four reasons why their assumptions were reasonable and not used to mislead seminar attendees. First, Respondents contend that they submitted "expert testimony supporting the reasonableness of the assumed inflation rates and REIT return rates used in the illustrations." For example, Hekman "testified that the use of a 3% inflation rate for hypothetical retirement planning calculations is universally recognized," and Gannon "testified that a 7% REIT return rate for 1966-2003 . . . was reasonable and supported by available indices." We reject this argument because Hekman and Gannon made clear that their opinions about the reasonableness of Respondents' inflation and REIT rates did not apply to backtests but rather to hypothetical illustrations, and Respondents led seminar attendees to believe that they had performed backtests.

Second, Respondents contend that it was reasonable not to rebucketize the backtests because to do so "would have been highly speculative" and potentially led to accusations of manipulating rebalancing dates because the "strategy illustrated . . . did not represent an actual portfolio with specific investments, but rather a general approach to diversification," and "[d]eciding when and how to shift asset classes would turn entirely on a client's individualized holdings and the market conditions at the time." We reject this contention because, even if Respondents genuinely held these concerns, it was misleading for them not to disclose to seminar attendees that the backtest results were inflated because they did not rebucketize. Respondents' contention also seems insincere considering that Respondents had no apparent difficulty or reservation in shifting asset classes in the backtest spreadsheets from REITs to T-bills.

Third, Respondents contend that their assumptions were reasonable because there is no established definition of "backtest" precluding the use of assumed rates. Respondents contend that to base liability here on "a firm definition not found in the securities laws," would violate due process by denying Respondents "fair notice of what conduct is required or proscribed," and be an abuse of discretion by imposing "regulatory changes through litigation" rather than rulemaking. Respondents also contend that "[e]ven if one were to posit that Mr. Lucia misused the term 'backtest,' it cannot be denied that he informed visitors of his seminars exactly how he was using it."

We reject these arguments. In finding liability, we need not define "backtest" in all contexts, we just need to assess its use by Respondents here. That use was in conjunction with other statements that misled seminar attendees to believe that Respondents had analyzed how a model portfolio would have performed had it implemented the BOM strategy in the past. Respondents never informed attendees that their assumptions would not actually show, as they claimed, whether the model BOM portfolio could "stand up to" the market challenges starting in 1966 or 1973.<sup>83</sup>

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<sup>83</sup> Respondents similarly contend that we would violate due process if we interpreted "written communication" in Rule 206(4)-1 to include their live slideshow presentation, and that

Fourth, Respondents contend that their assumptions were reasonable because it was industry practice to use assumed rates in backtests. As an example of that practice, Respondents point to the American Funds brochure “that included multiple illustrations of ‘back-testing withdrawal rates,’ all using hypothetical (rather than actual) inflation rates over an historical period.” But Respondents introduced no expert testimony to establish industry practice, and their own inflation and REIT experts agreed that backtests use historical rates. And while the backtests in the American Funds brochure used an assumed 4% inflation rate, two other brochures in the record, from Fidelity and Financial Engines Income+, reported the results of backtests that appear to have used historical stock, bond, and inflation rates.

## **2. Respondents contend that their statements about the 1966 and 1973 backtests were not material.**

Respondents make various other arguments that do not concern the validity of the backtests, but focus more on materiality. Respondents assert that their presentation cannot have been material because they did not recommend or sell securities at the seminars, and it is undisputed that their disclosures to attendees who eventually became Firm clients were “100% complete and accurate.” But liability under Section 206 does not require that the fraudulent conduct be in connection with the offer or sale of securities.<sup>84</sup> To the contrary, Section 206 includes within its scope misrepresentations that are not specific to a client investment decision.<sup>85</sup>

Respondents also contend that they “submitted un rebutted evidence at the hearing showing that after [they] ceased using the illustrations in question once concerns were raised by the SEC examination staff [in 2010], the response rate of seminar attendees who filled out contact cards requesting to meet with an RJLC adviser did not decline.” We find that the

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“the appropriate way to bring [the rule] up to date is through rulemaking.” We also reject this argument because, as discussed above, Rule 206(4)-1 has discernible parameters that gave Respondents fair notice that their conduct fell within its scope. And even if we were applying a new interpretation of the rule, “[i]t is well settled that an agency ‘is not precluded from announcing new principles in an adjudicative proceeding. . . .’” *Cassell v. FCC*, 154 F.3d 478, 486 (D.C. Cir. 1998) (quoting *NLRB v. Bell Aerospace Co.*, 416 U.S. 267, 294 (1974)).

<sup>84</sup> *SEC v. Lauer*, No. 03-80612-CIV, 2008 WL 4372896, at \*24 (S.D. Fla. Sept. 24, 2008), *aff’d*, 478 F. App’x 550 (11th Cir. 2012); *see also Applicability of the Investment Advisers Act*, Advisers Act Release No. 1092, 1987 WL 112702, at \*9 (Oct. 8, 1987) (staff interpretive release stating that the Section 206 provisions “do not refer to dealings in securities but are stated in terms of the effect or potential effect of prohibited conduct on the client”).

<sup>85</sup> *See, e.g., SEC v. C.R. Richmond & Co.*, 565 F.2d 1101, 1106 (9th Cir. 1977) (investment adviser violated Section 206 by making misrepresentations in a book and newsletter concerning its investment strategy and the results of a model portfolio); *see also Applicability of the Investment Advisers Act*, 1987 WL 112702, at \*9 (staff interpretive release stating that “the Commission has applied Sections 206(1) and (2) in circumstances in which the fraudulent conduct arose out of the investment advisory relationship between an investment adviser and its clients, even though the conduct does not involve a securities transaction”).

response cards are not determinative of materiality because they do not show whether attendees would have expressed interest in the Firm if they had been told that backtests showed the model BOM portfolio exhausting its assets during the two historical periods. This is because Respondents never told the truth about the backtests; they simply stopped using the backtest slides. And even if the response cards were relevant to materiality, Respondents introduced insufficient evidence to establish what the cards showed. Respondents' contention is based solely on vague testimony from Lucia's son that during the periods before and after Respondents stopped using the backtest slides, "basically the same" percentage of seminar attendees who filled out response cards checked a box to meet with a financial advisor.<sup>86</sup>

### 3. Respondents contend that they cannot have acted with scienter.

Respondents make various arguments that Lucia cannot have acted with scienter, and that he was, at worst, negligent in that his "hypothetical illustrations . . . were inartfully prepared." Respondents contend that Lucia "testified that he subjectively believed his use of the term 'backtest' encompassed the utilization of hypothetical information." We reject this self-serving contention because it is contradicted by Lucia's representations to seminar attendees that the backtest slides showed how a portfolio implementing the BOM strategy in 1966 or 1973 would have performed. In other words, our finding of liability does not hinge on Lucia's use of the word "backtest." Lucia made numerous other statements suggesting that the slides reflected historical results, and he knew or must have known that using hypothetical data in the backtests would not reflect historical results.

Respondents also deny any scienter by pointing to "third party review [of the backtest slides] by both the registered broker-dealers who had supervisory oversight" of the Firm,<sup>87</sup> as well as Commission staff in a 2003 examination of the Firm,<sup>88</sup> who never told Respondents "that the slides were in any way misleading." Respondents contend that they therefore were "not aware of red flags suggesting that the slides were misleading." We reject these arguments. First, Respondents were well aware of the facts that rendered the backtest slides misleading for the reasons discussed above, and thus any reliance they placed on third party review would not have been reasonable.<sup>89</sup> Second, there is no evidence that: (i) Respondents brought the backtests to

<sup>86</sup> Lucia's son testified that based on response card data, from January to June 2010, a period when the slides were used, about 50% of seminar attendees wanted to meet with a financial advisor, and from January to June 2011, when the slides were no longer used, about 47% of seminar attendees wanted to meet with a financial advisor.

<sup>87</sup> Respondents' registered broker-dealers, Securities America (from 2002 to 2007) and First Allied (from 2007 to 2011), reviewed RJLC's marketing and advertising material, including the slideshow, before it was distributed publicly.

<sup>88</sup> The examination was conducted by the Division of Investment Management's compliance office, a precursor office to the Commission's Office of Compliance Inspections and Examinations ("OCIE").

<sup>89</sup> *Cf. Flannery*, 2014 WL 7145625, at \*33 (rejecting reliance-on-counsel defense, in part, because respondent "was well aware of the facts that rendered the statements at issue misleading").

the attention of the Commission staff or broker-dealers; (ii) Respondents provided any support for the backtest slides that would have permitted a meaningful review of their content; or (iii) the Commission staff or broker-dealers addressed the backtests with Respondents. Thus, we are not presented with a situation where a third party told Respondents that the backtest slides were not misleading and Respondents relied on that advice. To the contrary, the Commission staff told Respondents in a deficiency letter dated December 12, 2003, that RJLC “should not assume that [its] activities not discussed in this letter are in full compliance with the federal securities laws.”

As support for this last contention, Respondents point to *SEC v. Slocum, Gordon, & Co.*, in which the court concluded that the defendant investment adviser could not be found to have intentionally omitted material facts about its account structure (which created a potential conflict of interest by commingling firm and client funds) from its Form ADV in violation of Advisers Act Section 207 and Rule 204-1(c).<sup>90</sup> The court found that it was reasonable for the defendant to believe that its account structure complied with the securities laws because two Commission examinations and annual independent auditor examinations failed to identify issues with it.<sup>91</sup> But *Slocum* is inapposite because the defendant relied on the advice of counsel in structuring its accounts and subsequently brought its account structure to the Commission’s attention.<sup>92</sup> Here, there is no evidence that Respondents relied on counsel or brought the backtest slides to the Commission’s attention.

#### **E. Respondents’ Appointments Clause argument lacks merit.**

Respondents argue that the ALJ who presided over this matter and issued the initial decision, ALJ Cameron Elliot, was not appointed in a manner consistent with the Appointments Clause of the Constitution.<sup>93</sup> Respondents further claim that, in light of this purported constitutional violation, the proceedings “are themselves invalid and any resulting orders should be vacated.” We find that the appointment of Commission ALJs is not subject to the requirements of the Appointments Clause.<sup>94</sup>

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<sup>90</sup> 334 F. Supp. 2d 144 (D.R.I. 2004).

<sup>91</sup> *Id.* at 180-82.

<sup>92</sup> *Id.* at 160-61.

<sup>93</sup> Congress has empowered “[e]ach agency [to] appoint as many administrative law judges as are necessary,” and it has established a comprehensive scheme to govern the details of ALJs’ employment in the civil service. 5 U.S.C. §§ 3105, 1101 *et seq.*; *see also* 15 U.S.C. § 78d-1(a) (authorizing the Commission to delegate functions to “an administrative law judge”); Exchange Act Section 4(b), 48 Stat. 885 (original Exchange Act provision authorizing the Commission to appoint “examiners”). The Commission has for many decades relied upon ALJs to prepare initial decisions in its administrative proceedings.

<sup>94</sup> The constitutional claims raised here implicate many “threshold questions” regarding the Commission’s rules and practices. *Elgin v. Dep’t of Treasury*, 132 S. Ct. 2126, 2140 (2012); *see also Thunder Basin Coal Co. v. Reich*, 510 U.S. 200, 214-15 (1994). In the course of considering the constitutional claims, we address those questions and legal principles. It is important that the Commission have an opportunity to address constitutional issues in the first

Under the Appointments Clause, certain high-level government officials must be appointed in particular ways: “Principal officers” must be appointed by the President (and confirmed by the Senate), while “inferior officers” must be appointed either by the President, the heads of departments, or the courts of law.<sup>95</sup> The great majority of government personnel are neither principal nor inferior officers, but rather “mere employees” whose appointments are not restricted by the Appointments Clause.<sup>96</sup> It is undisputed that ALJ Elliot was not appointed by the President, the head of a department, or a court of law.<sup>97</sup> Respondents therefore contend that his appointment violates the Appointments Clause because, in their view, he should be deemed an inferior officer. The Division counters that he is an employee and thus there was no violation of the Appointments Clause.

Our consideration of this question is guided by the D.C. Circuit’s decision in *Landry v. FDIC*, which addressed whether ALJs should be deemed inferior officers or employees.<sup>98</sup> *Landry* held that, for purposes of the Appointments Clause, ALJs at the Federal Deposit Insurance Corporation (“FDIC”) who oversee administrative proceedings to remove bank executives are employees rather than inferior officers. *Landry* explained that the touchstone for determining whether adjudicators are inferior officers is the extent to which they have the power to issue “final decisions.”<sup>99</sup> Although ALJs at the FDIC take testimony, conduct trial-like hearings, rule on the admissibility of evidence, have the power to enforce compliance with discovery orders, and issue subpoenas, they “can never render the decision of the FDIC.”<sup>100</sup> Instead, they issue only “recommended decisions” which the FDIC Board of Directors reviews *de novo*, and “[f]inal decisions are issued only by the FDIC Board.”<sup>101</sup> The ALJs thus function as aides who assist the Board in its duties, not officers who exercise significant authority

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instance, as it has in the past. *See, e.g., Gary M. Kornman*, Exchange Act Release No. 59403, 2009 WL 367635, at \*12 (Feb. 13, 2009) (Double Jeopardy claim); *Vladen Vindman*, Securities Act Release No. 8670, 2006 WL 985308, at \*11 & n.60 (Apr. 14, 2006) (Seventh Amendment claim).

<sup>95</sup> The Clause provides that the President “by and with the advice and consent of the Senate, shall appoint . . . officers of the United States . . . but the Congress may by law vest the appointment of such inferior officers, as they think proper, in the President alone, in the courts of law, or in the heads of departments.” U.S. Const. art. II, §2, cl. 2.

<sup>96</sup> *Landry v. FDIC*, 204 F.3d 1125, 1134 (D.C. Cir. 2000) (quoting *Freytag v. Commissioner*, 501 U.S. 868, 882 (1991)); *Buckley v. Valeo*, 424 U.S. 1, 126 (1976).

<sup>97</sup> The Commission constitutes the “head of a department” for purposes of the Appointments Clause when its commissioners act collectively. *See Free Enter. Fund v. Public Co. Accounting Oversight Bd.*, 561 U.S. 477, 512-13 (2010).

<sup>98</sup> *Landry*, 204 F.3d at 1130-34.

<sup>99</sup> *Id.* at 1133-34.

<sup>100</sup> *Id.* at 1133.

<sup>101</sup> *Id.*

independent of the Board’s supervision. Because ALJs at the FDIC “have no such powers” of “final decision,” the D.C. Circuit “conclude[d] that they are not inferior officers.”<sup>102</sup>

The mix of duties and powers of the Commission’s ALJs are very similar to those of the ALJs at the FDIC. Like the FDIC’s ALJs, the Commission’s ALJs conduct hearings, take testimony, rule on admissibility of evidence, and issue subpoenas. And like the FDIC’s ALJs, the Commission’s ALJs do not issue the final decisions that result from such proceedings. Just as the FDIC’s ALJs issue only “recommended decisions” that are not final, the Commission’s ALJs issue “initial decisions” that are likewise not final.<sup>103</sup> Respondents may petition us for review of an ALJ’s initial decision,<sup>104</sup> and it is our “longstanding practice [to] grant[] virtually all petitions for review.”<sup>105</sup> Indeed, we are unaware of any cases which the Commission has not granted a timely petition for review. Absent a petition, we may also choose to review a decision on our own initiative,<sup>106</sup> a course we have followed on a number of occasions.<sup>107</sup> In either case, our rules expressly provide that “the initial decision [of an ALJ] shall not become final.”<sup>108</sup> Even where an aggrieved person fails to file a timely petition for review of an initial decision and we do not order review on our own initiative, our rules provide that “*the Commission* will issue an

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<sup>102</sup> *Id.* at 1134.

<sup>103</sup> *See* 17 C.F.R. § 201.360(a)(1) & (d). We note that the FDIC Board has discretion to “limit the issues to be reviewed to those findings and conclusions to which opposing arguments or exceptions have been filed by the parties.” 12 C.F.R. § 308.40(c)(1).

<sup>104</sup> 17 C.F.R. § 201.411(b).

<sup>105</sup> Rules of Practice, Exchange Act Release No. 35833, 1995 WL 368865, at \*80-81 (June 9, 1995); *see also* Rules of Practice, Exchange Act Release No. 33163, 1993 WL 468594, at \*59 (Nov. 5, 1993) (explaining that we are “unaware of any case in which the Commission has declined to grant a petition for review”). We reiterated this policy in the context of amendments to our Rules of Practice in 2004 that eliminated the filing of oppositions to petitions for review. We deemed such oppositions pointless, “given that the Commission has long had a policy of granting petitions for review, believing that there is a benefit to Commission review when a party takes exception to a decision.” Proposed Amendments to the Rules of Practice and Related Provisions, Exchange Act Release No. 48832, 2003 WL 22827684, at \*13 (Nov. 23, 2003).

<sup>106</sup> 17 C.F.R. § 201.411(c); *see also* 15 U.S.C. § 78d-1(b) (providing that “the Commission shall retain a discretionary right to review the action of any . . . administrative law judge . . . upon its own initiative or upon petition”).

<sup>107</sup> *See, e.g., Dian Min Ma*, Exchange Act Release No. 74887, 2015 WL 2088438, at \*1 (May 6, 2015) (“determin[ing] to review the [ALJ’s] decision on [our] own initiative,” setting aside the initial decision in part, and providing that “as modified,” the initial decision “has become the final decision of the Commission”); *Michael Lee Mendenhall*, Exchange Act Release No. 74532, 2015 WL 1247374, at \*1 (Mar. 19, 2015) (“determin[ing] *sua sponte* to vacate the [ALJ’s] initial decision”); *George C. Kern, Jr.*, Exchange Act Release No. 29356, 1991 WL 284804, at \*1 (June 21, 1991) (“On its own initiative, the Commission ordered review of the [ALJ’s] initial decision . . .”).

<sup>108</sup> 17 C.F.R. § 201.360(d)(1).

order that the decision has become final,” and it “becomes final” only “upon issuance of the order” by the Commission.<sup>109</sup> Under our rules, no initial decision becomes final simply “on the lapse of time” by operation of law; instead, it is “the Commission's issuance of a finality order” that makes any such decision effective and final.<sup>110</sup> Moreover, as does the FDIC, the Commission reviews its ALJs’ decisions *de novo*. Upon review, we “may affirm, reverse, modify, set aside or remand for further proceedings, in whole or in part,” any initial decision.<sup>111</sup> And “any procedural errors” made by an ALJ in conducting the hearing “are cured” by our “thorough, *de novo* review of the record.”<sup>112</sup> We may also “hear additional evidence” ourselves, and may “make any findings or conclusions that in [our] judgment are proper and on the basis of the record.”<sup>113</sup> For this reason, although ALJs may play a significant role in helping to shape the administrative record initially, it is the Commission that ultimately controls the record for review and decides what is in the record. As we have explained before, we have “plenary authority over the course of [our] administrative proceedings and the rulings of [our] law judges—before and after the issuance of the initial decision and irrespective of whether any party has sought relief.”<sup>114</sup>

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<sup>109</sup> 17 C.F.R. § 201.360(d)(2) (emphasis added). The effect of this rule, which was enacted pursuant to our general rulemaking authority under the securities laws, is that our ALJs’ initial decisions (like the FDIC’s ALJs’ recommended decisions) do not become the final and effective decision of the agency without affirmative action on our part—specifically, our issuance of a finality order. *See, e.g., Goolu, Inc.*, Exchange Act Release No. 71788, 2014 WL 1213742 (Mar. 25, 2014); *L. Rex Andersen, CPA*, Exchange Act Release No. 63209, 2010 WL 4256161 (Oct. 28, 2010); *David A. Zwick*, Exchange Act Release No. 56826, 2007 WL 4145827 (Nov. 20, 2007). It is not until the issuance of such an order that the Commission’s “right to exercise such review [*i.e.*, review of an initial decision on our own initiative] is declined.” *See* 15 U.S.C. § 78d-1(c). In short, under our rules, an ALJ’s initial decision does not “become[] the decision of the agency without further proceedings,” and any theoretical distinction between the potential legal effect of an initial decision as opposed to a recommended decision is immaterial. *Cf.* 5 U.S.C. § 557(b).

<sup>110</sup> Exchange Act Release No. 49412, 2004 WL 503739, \*12 (Mar. 12, 2004); *see also* 17 CFR § 201.360(d)(2) (providing that the Commission’s “order of finality shall state the date on which sanctions . . . take effect”).

<sup>111</sup> 17 C.F.R. § 201.411(a); *see also* 5 U.S.C. § 557(b) (“On appeal from or review of the initial decision, the agency has all the powers which it would have in making the initial decision . . .”).

<sup>112</sup> *Heath v. SEC*, 586 F.3d 122, 142 (2d Cir. 2009); *see also, e.g., In the Matter of Anthony Fields*, Exchange Act Release No. 74344, 2015 WL 728005, \*20 (Feb. 20, 2015) (“[O]ur *de novo* review cures any evidentiary error that the law judge may have made.”).

<sup>113</sup> 17 C.F.R. §§ 201.411(a), 201.452.

<sup>114</sup> *Michael Lee Mendenhall*, 2015 WL 1247374, at \*1. This includes authority over all evidentiary and discovery-related rulings. And the fact that our ALJs may rule on evidentiary matters and discovery issues (subject to our *de novo* review) does not distinguish them from the

Notwithstanding the direct relevance of *Landry*, Respondents claim that the decision should not control here because, in their view, it “was wrongly decided.” They claim that *Landry* “is inconsistent with” *Freytag v. Commissioner*, in which the Supreme Court deemed a Tax Court “special trial judge” to be an inferior officer.<sup>115</sup> But, as *Landry* recognized, ALJs are different from those special trial judges.<sup>116</sup> The far greater role and powers of the special trial judges relative to Commission ALJs, in our view, makes *Freytag* inapposite here.

*First*, unlike the ALJs whose decisions are reviewed *de novo*, the special trial judges made factual findings to which the Tax Court was required to defer, unless clearly erroneous.<sup>117</sup> *Second*, the special trial judges were authorized by statute to “render the [final] decisions of the

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FDIC’s ALJs in *Landry*. See 204 F.3d at 1134 (observing that the FDIC’s ALJs make rulings on the “admissibility of evidence” and “discovery order[s]”).

<sup>115</sup> *Freytag*, 501 U.S. at 880-82. Respondents insist that Judge Randolph’s concurring opinion in *Landry* had the better reading of *Freytag*. For the reasons given in text, we reject this argument. And in any event, Respondents would not be entitled to relief even under the reasoning of the *Landry* concurrence. Our review of ALJ’s decisions—like that performed by the FDIC—is *de novo*; thus, given our “*de novo* review” and our “thorough rejection of [Respondents’] various claims of error” on the merits, Respondents “suffered no prejudice” from the manner of appointment of our ALJs. *Landry*, 204 F.3d at 1144 (Randolph, J., concurring).

<sup>116</sup> *Landry*, 204 F.3d at 1133 (explaining that the special trial judges at issue in *Freytag* exercised “authority . . . not matched by the ALJs. . .”).

<sup>117</sup> See *Landry*, 204 F.3d at 1133. Respondents argue that Commission ALJs exercise significant authority because the Commission accords “considerable weight” to those ALJ credibility findings that are based on witness demeanor. *Kenneth R. Ward*, Exchange Act Release No. 47535, 2003 WL 1447865, at \*10 (Mar. 19, 2003), *aff’d*, 75 F. App’x 320 (5th Cir. 2003). We do not view the fact that we accord Commission ALJs deference in the context of demeanor-based credibility determinations to afford our ALJs with the type of authority that would qualify them as inferior officers. *First*, as we have repeatedly made clear, we do not accept such findings “blindly,” and we will “disregard explicit determinations of credibility” when our *de novo* review of the record as a whole convinces us that a witness’s testimony is credible (or not) or that the weight of the evidence warrants a different finding as to the ultimate facts at issue. *Ward*, 2003 WL 1447865, at \*10; *accord Francis V. Lorenzo*, Exchange Act Release No. 74836, 2015 WL 1927763, at \*10 n.32 (Apr. 29, 2015); *Ofirfan Mohammed Amanat*, Exchange Act Release No. 54708, 2006 WL 3199181, at \*8 n.46 (Nov. 3, 2006); see also *Kay v. FCC*, 396 F.3d 1184, 1189 (D.C. Cir. 2005) (“The law is settled that an agency is not required to adopt the credibility determinations of an administrative law judge.”). *Second*, our practice in this regard is no different from the FDIC’s and so does not warrant a departure from *Landry*. Compare *[Redacted] Insured State Nonmember Bank*, FDIC-82-73a, 1984 WL 273918, at \*5 (June 18, 1984) (stating, “as a general rule,” that “the assessment of the credibility of witnesses” by the ALJ is given “deference” by the FDIC) with *Ramon M. Candelaria*, FDIC-95-62e, 1997 WL 211341, at \*3-4 (Mar. 11, 1997) (noting that the FDIC’s ALJ found respondent to be “entirely credible” but the Board rejected respondent’s testimony “in light of the entire record”).



Tax Court” in significant, fully-litigated proceedings involving declaratory judgments and amounts in controversy below \$10,000.<sup>118</sup> As discussed above, our ALJs issue initial decisions that are not final unless the Commission takes some further action. *Third*, the Tax Court (and by extension the court’s special tax judges) exercised “a portion of the judicial power of the United States,” including the “authority to punish contempts by fine or imprisonment.”<sup>119</sup> Commission ALJs, by contrast, do not possess such authority.<sup>120</sup>

Based on the foregoing, we conclude that the mix of duties and powers of our ALJs is similar in all material respects to the duties and role of the FDIC’s ALJs in *Landry*.<sup>121</sup> Accordingly, we follow *Landry*, and we conclude that our ALJs are not “inferior officers” under the Appointments Clause.<sup>122</sup>

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<sup>118</sup> *Freytag*, 501 U.S. at 882.

<sup>119</sup> *Id.* at 891.

<sup>120</sup> *See* 17 C.F.R. § 201.180. The Commission’s rules provide ALJs with authority to punish contemptuous conduct only in the following ways. If a person engages in contemptuous conduct before the ALJ during any proceeding, the ALJ may “exclude that person from such hearing or conference, or any portion thereof,” or “summarily suspend that person from representing others in the proceeding in which such conduct occurred for the duration, or any portion of the proceeding.” *Id.* 201.180(a). Finally, if a party fails to make a required filing or to cure a deficiency with a filing, then a Commission ALJ may enter a default, dismiss the case, decide the particular matter at issue against the person, or prohibit the introduction of evidence or exclude testimony concerning that matter.” *Id.* 201.180(c). Any such decision would, of course, be subject to *de novo* Commission review. And while Commission ALJs may issue subpoenas to compel noncompliance, they are powerless to enforce their subpoenas. The Commission itself would need to seek an order from a federal district court to compel compliance. *See* 15 U.S.C. § 78u(c). In this respect, too, our ALJs are akin to the FDIC’s ALJs that *Landry* found to be mere employees. *See* 12 C.F.R. §§ 308.25(h), 308.26(c), 308.34(c) (providing that an aggrieved party must apply to a federal district court for enforcement of a subpoena issued by a FDIC ALJ).

<sup>121</sup> Beyond *Landry*, we believe that our ALJs are properly deemed employees (rather than inferior officers) because this is how Congress has chosen to classify them, and that decision is entitled to considerable deference. *See Burnap v. United States*, 252 U.S. 512, 516 (1920). For example, Congress created and placed ALJ positions within the competitive service system, just like most other federal employees. *See infra* footnote 93. Like most other employees, an ALJ who believes that his employing agency has engaged in a prohibited personnel practice can seek redress either through the Office of Special Counsel or the Merit Systems Protection Board. *See* 5 U.S.C. §§ 1204, 1212, 1214, 1215, 1221. And ALJs—like other employees—are subject to reductions-in-force. *See id.* § 7521(b).

<sup>122</sup> We do not find any relevance in the fact that the federal securities laws and our regulations at times refer to ALJs as “officers” or “hearing officers.” There is no indication that Congress intended “officers” or “hearing officers” to be synonymous with “Officers of the United States,” U.S. Const. art. II, § 2, cl. 2, and the word “officer” in our regulations has no such meaning. We also note in this regard that the Administrative Procedure Act “consistently

#### IV. Sanctions

The Division requests that we affirm the sanctions imposed below, including that (i) Lucia be barred from associating with an investment adviser, broker, or dealer; (ii) Respondents' investment adviser registrations be revoked; (iii) Respondents be ordered to cease and desist from further violations of the Advisers Act; and (iv) RJLC pay civil penalties of \$250,000 and Lucia pay civil penalties of \$50,000. We do so for the following reasons.

##### A. Bar from associating with an investment adviser, broker, or dealer

We may suspend or bar Lucia from associating with an investment adviser, broker, or dealer under Advisers Act Section 203(f) if we find that (i) he was associated with an investment adviser during the relevant period, (ii) he willfully violated, or willfully aided and abetted the violation of, the Advisers Act or its rules, and (iii) the sanction is in the public interest.<sup>123</sup> In addition, if we find that the latter two elements have been established, we may also suspend or bar Lucia from associating with a broker or dealer under Section 15(b)(6) of the Securities Exchange Act of 1934.<sup>124</sup>

There is no question that Lucia was associated with an investment adviser, and, as discussed above, we find that he willfully aided and abetted and caused RJLC's violations of Advisers Act Sections 206(1), (2), and (4) and Rule 206(4)-1(a)(5). Thus, we must determine whether a bar is in the public interest.

In assessing whether an associational bar would be in the public interest, we consider: the egregiousness of the respondent's actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the respondent's recognition of the wrongful nature of his or her conduct, the sincerity of the respondent's assurances against future violations, and the likelihood that the respondent's occupation will present opportunities for future violations.<sup>125</sup> The remedy is intended to "protect[] the trading public from further harm," not to punish the respondent.<sup>126</sup> Our inquiry is flexible, and no one factor is dispositive.<sup>127</sup>

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uses the term 'officer' or the term 'officer, employee, or agent'" to "refer to [agency] staff members." Kenneth Culp Davis, *Separation of Functions in Administrative Agencies*, 61 HARV. L. REV. 612, 615 & n.11 (1948); *see also* 1 U.S.C. § 1 ("'officer' includes any person authorized by law to perform the duties of the office"). *Cf.* 5 U.S.C. §§ 556, 557 (referring to official who presides over evidentiary hearing as the "presiding employee").

<sup>123</sup> 15 U.S.C. § 80b-3(f).

<sup>124</sup> 15 U.S.C. § 78o(b)(6)(A)(i).

<sup>125</sup> *See Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981).

<sup>126</sup> *McCarthy v. SEC*, 406 F.3d 179, 188 (2d Cir. 2005).

<sup>127</sup> *Kornman*, 2009 WL 367635, at \*11.

Lucia's misconduct was egregious. As an investment adviser, Lucia owed fiduciary duties to his prospective clients.<sup>128</sup> Lucia violated those duties, and betrayed the trust and confidence of his prospective clients, by making the material misrepresentations and omissions discussed above. We have repeatedly stated that "conduct that violates the antifraud provisions of the securities laws is especially serious and subject to the severest of sanctions under the securities laws."<sup>129</sup>

Lucia's misconduct was recurrent: he made the material misrepresentations and omissions in the slideshow at dozens of seminars every year during the relevant period. Lucia also acted with a high degree of scienter as he knowingly or recklessly misled prospective clients for the purpose of increasing RJLC's client base and the fees generated therefrom. Thus, Lucia repeatedly and intentionally placed his and RJLC's own interests over those of his prospective clients.

Lucia has not recognized the wrongful nature of his misconduct, and his failure to do so casts doubt on his assurances against future violations. In addition, because Lucia disregarded his fiduciary duties in the past in the manner shown here there is reason to believe that he will disregard them in the future.

Lucia's various arguments do not undermine the need for a bar or argue for a lesser remedy. Lucia contends that the credibility of his assurances and his recognition of wrongdoing are demonstrated by his decision to immediately stop using the backtest slides and withdraw his books from circulation after receiving the deficiency letter from OCIE on December 17, 2010, that outlined the deficiencies forming the basis of this proceeding.<sup>130</sup> These actions do weigh in Lucia's favor but they do not outweigh the concerns raised by his intentional and recurrent fraud.<sup>131</sup>

Lucia asserts that his occupation will not present opportunities for future violations because he has left the securities industry.<sup>132</sup> Lucia states that he wound down RJLC's

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<sup>128</sup> *Capital Gains*, 375 U.S. at 194.

<sup>129</sup> *Marshall E. Melton*, Advisers Act Release No. 2151, 2003 WL 21729839, at \*9 (July 25, 2003); *Justin F. Ficken*, Advisers Act Release No. 2803, 2008 WL 4610345, at \*3 (Oct. 17, 2008).

<sup>130</sup> Lucia argues that his actions are comparable to those at issue in *Steadman*, in which the court vacated an injunction against an investment adviser in part because the alleged violations "were corrected immediately after the SEC notified the appellants that charges were pending." 967 F.2d at 648. But unlike our findings here, the *Steadman* court found that the defendants did not act with scienter and therefore did not violate federal securities antifraud provisions.

<sup>131</sup> *Cf. Kornman*, 2009 WL 367635, at \*11 (stating that assurances against future misconduct "are not an absolute guarantee against misconduct in the future"; the Commission weighs them against the other *Steadman* factors in assessing the public interest.).

<sup>132</sup> Lucia claims that he "simply desires to continue serving as an in-demand public speaker, consultant, and media personality on retirement planning and other topics," and invites us to make clear that, if we impose a bar, such activity would not violate the bar. Lucia contends that

operations, sold its assets, and withdrew its investment adviser registration. Lucia also states that he is no longer associated with an investment adviser or broker-dealer, no longer holds a license as a registered representative, withdrew his own personal investment adviser registration, and has no intention of ever again being an investment adviser or registered representative of a broker-dealer. He also does not challenge the permanent revocation of his and RJLC's investment adviser registrations. Lucia contends that he has therefore demonstrated that his assurances against future violations are credible and that his occupation will not present opportunities for future violations.

But taking these steps does not ensure that Lucia will not seek to become associated again with an investment adviser, broker, or dealer. And like Lucia's decision to stop using the backtest slides, these steps do not make his assurances sufficient considering that he intentionally and repeatedly misled prospective clients to whom he owed fiduciary duties.<sup>133</sup> Thus, there is a reasonable likelihood that, without a bar, Lucia will again threaten the public interest by reassociating with an investment adviser, broker, or dealer.

Lucia asserts that several mitigating factors justify a lesser remedy. He contends that a bar would deter businesses from working with him in his career as a public media personality and therefore "propel[] him towards personal bankruptcy." But "[f]inancial loss to a wrongdoer as a result of his wrongdoing does not mitigate the gravity of his conduct."<sup>134</sup>

Lucia contends that he is a "40-year industry veteran with no disciplinary record." But his lack of previous securities law violations does not outweigh the concern that, for the reasons discussed above, Lucia will pose a continuing danger to investors if a bar is not imposed. Lucia's repeated misconduct for a prolonged period demonstrates that he has a propensity for conduct that would subject the investing public to future harm.

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such work is protected by the publisher exclusion to the definition of "investment adviser" in Advisers Act Section 202(a)(11), 15 U.S.C. § 80b-2(a)(11)(D), and is thus outside the scope of an associational bar. But because of "the inherent difficulty of enumerating every position that [Lucia] could take that would be prohibited by, or consistent with," a bar order, granting Lucia's request would undermine the remedial purpose of imposing a bar. *See James M. Schneider, CPA*, Exchange Act Release No. 69922, 2013 WL 3327751, at \*5-6 (July 2, 2013) (order denying request that the Commission clarify that its Rule 102(e) suspension order did not preclude movant from accepting non-accounting positions). In any event, we note that the publisher exclusion concerns only who is considered an investment adviser, and not whether a person is *associated with* an investment adviser. The definition for "person associated with an investment adviser" is set forth in Adviser Act Section 202(a)(17), 15 U.S.C. § 80b-2(a)(17).

<sup>133</sup> Also, according to FINRA's BrokerCheck, Lucia did not end his association with investment adviser RJL Wealth Management, LLC, the successor firm to RJLC, until the initial decision was first issued in July 2013, thus casting further doubt on his intention to not reenter the industry. We may take official notice of this information on BrokerCheck, available at [www.finra.org/Investors/ToolsCalculators/BrokerCheck](http://www.finra.org/Investors/ToolsCalculators/BrokerCheck). *See* 17 C.F.R. § 201.323 (rule of practice relating to official notice).

<sup>134</sup> *Kornman*, 2009 WL 367635, at \*9 (internal quotation and citation omitted).

Lucia contends that there are no allegations of misappropriation, investor losses, or complaints by any seminar attendees about the presentation. But the absence of injury to RJLC's clients or prospective clients is not mitigating because our public interest analysis "focus[es] . . . on the welfare of investors generally and the threat one poses to investors and the markets in the future."<sup>135</sup>

Lucia argues that the initial decisions in *Corbin Jones*<sup>136</sup> and *Joseph C. Lavin*<sup>137</sup> demonstrate that investor losses are an important consideration. But these cases are inapposite because they involved findings that the respondents' violations were egregious, in part, because they caused investor losses.<sup>138</sup> While the absence of investor injury is not mitigating, its existence may be considered in determining the egregiousness of the respondent's actions.<sup>139</sup> Here, even without investor injury as an aggravating factor, Lucia's misconduct was egregious and a bar is in the public interest.

As an alternative to a bar, Lucia contends that it would be more appropriate to impose a censure and require undertakings such as "retain[ing] a monitor to ensure that any public presentations he makes do not utilize 'backtests' or hypothetical illustrations of relative strategy performance." Lucia contends that such remedies would be more in line with the lesser remedies imposed in seven settled Commission proceedings.<sup>140</sup> But we have repeatedly found that the remedies imposed in settled actions are inappropriate comparisons because pragmatic

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<sup>135</sup> *Kornman*, 2009 WL 367635, at \*9; *vFinance Invs., Inc.*, Exchange Act Release No. 62448, 2010 WL 2674858, at \*17 (July 2, 2010); see also *Christopher A. Lowry*, Advisers Act Release No. 2052, 2002 WL 1997959, at \*5 n.21 (Aug. 30, 2002) (finding that respondent's repayment to clients of funds he diverted from them did not "excuse[] his initial misrepresentations"), *aff'd*, 340 F.3d 501 (8th Cir. 2003); *James C. Dawson*, Advisers Act Release No. 3057, 2010 WL 2886183, at \*3 (July 23, 2010) (barring respondent in part because his "dishonesty in defrauding his clients breached the trust that is the underpinning of the fiduciary relationship, regardless of whether there was any net loss of money to his clients").

<sup>136</sup> Initial Decision Release No. 568, 2014 WL 668853 (Feb. 21, 2014).

<sup>137</sup> Initial Decision Release No. 373, 2009 WL 613543 (March 10, 2009).

<sup>138</sup> *Jones*, 2014 WL 668853, at \*4; *Lavin*, 2009 WL 613543, at \*5.

<sup>139</sup> See, e.g., *Dawson*, 2010 WL 2886183, at \*3 ("[O]ur finding that Dawson's conduct was egregious is based on the nature of the violation itself, not solely on any calculation of financial harm to his clients.").

<sup>140</sup> Lucia cites *New England Inv. and Retirement Group, Inc.*, Advisers Act Release No. 3516, 2012 WL 6591597 (Dec. 18, 2012); *Modern Portfolio Mgmt., Inc.*, Advisers Act Release No. 3702, 2013 WL 5740461 (Oct. 23, 2013); *Equitas Capital Advisors, LLC*, Advisers Act Release No. 3704, 2013 WL 5740460 (Oct. 23, 2013); *Independent Fin. Group*, Advisers Act Release No. 1891, 2000 WL 1121531 (Aug. 8, 2000); *William J. Ferry*, Advisers Act Release No. 1747, 1998 WL 487681 (Aug. 19, 1998); *Meridian Inv. Mgmt. Corp.*, Advisers Act Release No. 1779, 1998 WL 898489 (Dec. 28, 1998); *LBS Capital Mgmt., Inc.*, Advisers Act Release No. 1644, 1997 WL 401055 (July 18, 1997).

considerations “such as the avoidance of time-and-manpower-consuming adversary proceedings,” justify accepting lesser remedies in settlement.<sup>141</sup> In addition, the appropriate remedy depends on the facts and circumstances presented and cannot be determined precisely by comparison with actions taken in other cases.<sup>142</sup> Here, the alternative remedy that Lucia proposes do not provide sufficient protection for investors given the nature of his misconduct and the opportunity that continued association with an investment adviser, broker, or dealer would present for future violations.

Accordingly, we find that it is in the public interest to bar Lucia from associating with any investment adviser, broker, or dealer. A bar will prevent Lucia from putting investors at further risk and serve as a deterrent to others from engaging in similar misconduct.

## **B. Revocation of Respondents’ investment adviser registrations**

Under Advisers Act Section 203(e), we may suspend or revoke an investment adviser’s registration if we find that (i) the investment adviser, or any person associated with it, willfully violated, or willfully aided and abetted the violation of, any provision of the Advisers Act and (ii) the sanction is in the public interest.<sup>143</sup> We consider the same public interest factors discussed above for determining whether to revoke an investment adviser’s registration.<sup>144</sup>

Lucia states in his brief that “he makes no challenge to . . . ordering the registrations of [Respondents] as investment advisers permanently revoked.” The evidence amply supports such revocation, for the reasons discussed above, as being necessary to protect the public interest.<sup>145</sup>

## **C. Cease-and-desist orders**

Advisers Act Section 203(k) authorizes us to issue cease-and-desist orders for violations of the Advisers Act.<sup>146</sup> Such orders must be in the public interest, which we determine by

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<sup>141</sup> *Michael C. Pattison, CPA*, Exchange Act Release No. 67900, 2012 WL 4320146, at \*11-12 (Sept. 20, 2012) (quoting *Nassar and Co., Inc.*, 47 SEC 20, 26 & n.37 (1978)); *Ficken*, 2008 WL 4610345, at \*4. We also note that settlements are not precedent. *Citizens Capital Corp.*, Exchange Act Release No. 67313, 2012 WL 2499350, at \*5 n.27 (June 29, 2012). The remedies imposed on Respondents are amply justified by our findings of violations, as discussed.

<sup>142</sup> *Ficken*, 2008 WL 4610345, at \*4; *see also Butz v. Glover Livestock Comm’n Co., Inc.*, 411 U.S. 182, 187 (1973) (holding that a sanction imposed within the authority of an administrative agency is “not rendered invalid in a particular case because it is more severe than sanctions imposed in other cases”); *Geiger v. SEC*, 363 F.3d 481, 488 (D.C. Cir. 2004) (holding that, because the “Commission is not obligated to make its sanctions uniform,” the court would not compare the sanctions imposed in the case to those imposed in previous cases).

<sup>143</sup> 15 U.S.C. § 80b-3(e).

<sup>144</sup> *See Sherwin Brown*, Advisers Act Release No. 3217, 2011 WL 2433279, at \*6 (June 17, 2011).

<sup>145</sup> Again, Lucia’s conduct and level of intent are imputed to RJLC.

looking to whether there is some risk of future violation.<sup>147</sup> The risk “need not be very great” and is ordinarily established by a single past violation absent evidence to the contrary.<sup>148</sup> We also consider whether other factors demonstrate a risk of future violations, including the factors discussed above concerning Lucia’s bar as well as whether the violation is recent, the degree of harm to investors or the marketplace resulting from the violation, and the remedial function to be served by the cease-and-desist order in the context of any other sanctions being sought.<sup>149</sup> This inquiry is flexible, and no single factor is dispositive.<sup>150</sup>

Here, Respondents’ violations, the egregiousness of their misconduct, and the other public interest factors discussed above establish a risk of future violations. Accordingly, we find that it is in the public interest to order Respondents to cease and desist from committing or causing any violations or future violations of Advisers Act Sections 206(1), 206(2), and 206(4) and Rule 206(4)-1.

#### D. Civil penalties

We may impose civil penalties under Advisers Act Section 203(i) if we find that Respondents willfully violated the Advisers Act and such penalties are in the public interest.<sup>151</sup> Both factors are satisfied here. Respondents repeatedly made fraudulent misstatements and omissions in willful violation of the Advisers Act and their fiduciary duties. Their conduct was egregious and thus warrants the imposition of penalties as a deterrent to Respondents and others against committing similar violations. Such considerations are not outweighed by Respondents’ clean disciplinary history or the lack of evidence concerning investor loss or unjust enrichment.

Also, because Respondents’ violations involved fraud and were in reckless disregard of a regulatory requirement, we find that second-tier penalties are warranted.<sup>152</sup> Therefore, because

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<sup>146</sup> 15 U.S.C. § 80b-3(k).

<sup>147</sup> *Robert L. Burns*, Advisers Act Release No. 3260, 2011 WL 3407859, at \*8 n.34 (Aug. 5, 2011).

<sup>148</sup> *KPMG Peat Marwick LLP*, Exchange Act Release No. 43862, 2001 WL 47245, at \*24 (Jan. 19, 2001), *pet. denied*, 289 F.3d 109 (D.C. Cir. 2002).

<sup>149</sup> *Id.* at \*26.

<sup>150</sup> *Id.*

<sup>151</sup> 15 U.S.C. § 80b-3(i). In determining whether penalties are in the public interest, we consider: (i) whether the act or omission involved fraud; (ii) whether the act or omission resulted in harm to others; (iii) the extent to which any person was unjustly enriched; (iv) whether the individual has committed previous violations; (v) the need to deter such person and others from committing violations; and (vi) such other matters as justice may require. *Id.*

<sup>152</sup> Section 203(i) establishes a three-tier system for calculating penalties: (i) first-tier penalties are permissible for securities law violations; (ii) second-tier penalties are permissible for securities law violations involving “fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement”; and (iii) third-tier penalties are permissible for violations that satisfy the second-tier penalty requirements and “directly or indirectly resulted in substantial

the amounts imposed by the ALJ (\$250,000 upon RJLC and \$50,000 upon Lucia) are within the permissible second-tier range,<sup>153</sup> and are in the public interest, we grant the Division's request and impose those same amounts upon Respondents.<sup>154</sup>

Respondents contend that penalties are unwarranted against RJLC because it has no assets or operations, is no longer registered as an investment adviser, and is a dormant corporate shell. Respondents also contend that imposing an uncollectable penalty against RJLC will prejudice Lucia without any benefit to the public interest. These contentions are meritless. If RJLC lacked the ability to pay penalties, it was required under Commission Rule 630(a) to present evidence thereof.<sup>155</sup> It has failed to do so.<sup>156</sup> Respondents also have not explained how Lucia would be prejudiced if we order RJLC to pay penalties.

Accordingly, we find that it is in the public interest to impose second-tier penalties of \$250,000 upon RJLC and \$50,000 upon Lucia.

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losses or created significant risk of substantial losses to other persons or resulted in substantial pecuniary gain to the person who committed the act or omission.” *Id.*; 17 C.F.R. § 201.1004.

<sup>153</sup> The maximum second-tier penalty the Commission could impose for a single act of misconduct is \$375,000 for RJLC and \$75,000 for Lucia. 17 C.F.R. § 201.1004 & Pt. 201, Subpt. E, Tbl. IV.

<sup>154</sup> Although the amounts imposed by the ALJ are within the second-tier range, he categorized them as third-tier penalties. We find that this categorization was unwarranted because the Division did not establish: (i) that Respondents' clients or prospective clients suffered any losses or were at significant risk of suffering substantial losses or (ii) whether Respondents' gain from the fraud was substantial. For the latter consideration, while the Division introduced evidence showing that Respondents' business was profitable, it did not demonstrate the extent to which Respondents' misconduct was responsible for that profit. In any event, we find that the amounts imposed are warranted as second-tier penalties for the reasons discussed above.

<sup>155</sup> 17 C.F.R. § 201.630(a).

<sup>156</sup> Respondents also have waived their right to assert the defense of inability to pay because they did not raise the issue before the ALJ. *David Henry Disraeli*, Advisers Act Release No. 2686, 2007 WL 4481515, at \*19 (Dec. 21, 2007), *aff'd*, 334 F. App'x 334 (D.C. Cir. 2009).



An appropriate order will issue.<sup>157</sup>

By the Commission (Chair WHITE and Commissioners AGUILAR and STEIN);  
Commissioners GALLAGHER and PIWOWAR, dissenting. A dissenting opinion will issue  
separately.

Brent J. Fields  
Secretary

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<sup>157</sup> We have considered all of the parties' contentions. We have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed in this opinion.

UNITED STATES OF AMERICA  
before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 75837 / September 3, 2015

INVESTMENT ADVISERS ACT OF 1940  
Release No. 4190 / September 3, 2015

INVESTMENT COMPANY ACT OF 1940  
Release No. 31806 / September 3, 2015

Admin. Proc. File No. 3-15006

In the Matter of  
RAYMOND J. LUCIA COMPANIES, INC.  
and  
RAYMOND J. LUCIA, SR.

ORDER IMPOSING REMEDIAL SANCTIONS

On the basis of the Commission's opinion issued this day, it is

ORDERED that Raymond J. Lucia, Sr. be barred from association with any investment adviser, broker, or dealer; and it is further

ORDERED that the investment adviser registrations of Raymond J. Lucia Companies, Inc. and Raymond J. Lucia, Sr. are revoked; and it is further

ORDERED that Raymond J. Lucia Companies, Inc. and Raymond J. Lucia, Sr. cease and desist from committing or causing any violations or future violations of Sections 206(1), 206(2), and 206(4) of the Investment Advisers Act of 1940 and Rule 206(4)-1; and it is further

ORDERED that Raymond J. Lucia Companies, Inc. pay a civil money penalty of \$250,000; and it is further

ORDERED that Raymond J. Lucia, Sr. pay a civil money penalty of \$50,000.

Payment of the civil money penalty shall be (i) made by United States postal money order, certified check, bank cashier's check, or bank money order; (ii) made payable to the Securities and Exchange Commission; (iii) mailed to Enterprises Services Center, Accounts Receivable Branch, HQ Bldg., Room 181, 6500 South MacArthur Blvd., Oklahoma City, OK

73169; and (iv) submitted under cover letter that identifies the respondent and the file number of this proceeding.

By the Commission.

Brent J. Fields  
Secretary