

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

---

In the Matter of :  
: INITIAL DECISION  
RAYMOND J. LUCIA COMPANIES, :  
: July 8, 2013  
INC. and RAYMOND J. LUCIA, SR. :  
:

---

APPEARANCES: John Bulgozdy, David Van Havermaat, and Peter Del Greco, Esqs.,  
representing the Division of Enforcement, Securities and Exchange  
Commission

Michael Perlis, Wrenn Chais, and Christopher Lee, Esqs., representing  
Respondents Raymond J. Lucia, Sr. and Raymond J. Lucia Companies,  
Inc.

BEFORE: Cameron Elliot, Administrative Law Judge

## SUMMARY

This Initial Decision finds that Respondent Raymond J. Lucia Companies, Inc. (RJLC), violated Sections 206(1), 206(2), and 206(4) of the Investment Advisers Act of 1940 (Advisers Act) by misrepresenting the validity of purported backtesting in seminars for prospective investors, and that Respondent Raymond J. Lucia, Sr. (Lucia) aided and abetted RJLC's violations of Sections 206(1), 206(2), and 206(4) of the Advisers Act, and bars Lucia from associating with an investment adviser, broker, or dealer, revokes Lucia's and RJLC's investment adviser registrations, imposes a civil penalty of \$50,000 on Lucia and \$250,000 on RJLC, and orders Lucia and RJLC to cease and desist from further violations of the Advisers Act.

## I. INTRODUCTION

### A. Procedural Background

The Securities and Exchange Commission (Commission) issued its Order Instituting Cease-and-Desist Proceedings (OIP) on September 5, 2012, pursuant to Section 15(b) of the

Securities Exchange Act of 1934 (Exchange Act), Sections 203(e), 203(f), and 203(k) of the Advisers Act, and Section 9(b) of the Investment Company Act of 1940 (Investment Company Act). Lucia and RJLC filed their Answers on September 19, 2012.<sup>1</sup>

The parties filed their prehearing briefs by November 5, 2012. A hearing was held on November 8-9, 13-14, 19-21, 2012, and December 17-18, 2012, at the Commission's headquarters in Washington, DC. The admitted exhibits are listed in the Record Index issued by the Secretary of the Commission on April 19, 2013.<sup>2</sup> The Division of Enforcement (Division) and Lucia thereafter filed post-hearing briefs and post-hearing reply briefs.<sup>3</sup>

## **B. Summary of Allegations**

The instant proceeding concerns alleged misrepresentations of backtested returns of fictional investment portfolios using Lucia and RJLC's proprietary Buckets of Money® (BOM) strategy, and their misleading application of (i) historical inflation rates, (ii) investment adviser fee impact, (iii) returns on Real Estate Investment Trust (REIT) securities, and (iv) reallocation of assets in fictional backtested portfolios utilizing the BOM strategy in slideshow presentations offered by Lucia and books authored by Lucia, a registered investment adviser, and RJLC, a previously registered investment adviser, located in San Diego, California. OIP, p. 2. The OIP alleges that RJLC violated Sections 206(1), 206(2), and 206(4) of the Advisers Act and Rule 206(4)-1(a)(5) thereunder; Lucia aided and abetted and caused RJLC's violations of Sections 206(1), 206(2), and 206(4) and Rule 206(4)-1(a)(5) thereunder by knowingly or recklessly misrepresenting the accuracy of the backtested investment portfolios to prospective investment clients; and RJLC violated Section 204 of the Advisers Act and Rule 204-2(a)(16) thereunder by failing to maintain proper books and records. OIP, pp. 9-10.

---

<sup>1</sup> Lucia and RJLC filed separate Answers, but they are substantively identical. Lucia and RJLC presented a unified defense and, where appropriate, are referred to collectively as Respondents.

<sup>2</sup> On April 12, 2013, counsel for Respondents offered a Submission of Recent Decision (Submission) in support of its notion of the "realities and inherent difficulties in ascertaining the value of REIT shares." The Submission also offered an excerpt of the 2014 Budget of the Federal Government to support their arguments regarding inflation rates. I will admit the decision and excerpt as part of the official record. I found little of value in the decision, particularly in comparison with the testimony of the various experts, and the Budget excerpt is irrelevant because I do not reach the question of misrepresentation of inflation rates.

<sup>3</sup> Citations to the transcript of the hearing are noted as "Tr. \_\_\_\_". Citations to Lucia's Answer are noted as "Lucia Answer \_\_\_\_," and to RJLC's Answer as "RJLC Answer \_\_\_\_." Citations to exhibits offered by the Division and Respondents are noted as "Div. Ex. \_\_\_\_" and "Resp. Ex. \_\_\_\_", respectively. The Division's and Respondents' post-hearing briefs are noted as "Div. Br. \_\_\_\_" and "Resp. Br. \_\_\_\_", respectively. The Division's and Respondents' post-hearing reply briefs are noted as "Div. Reply \_\_\_\_" and "Resp. Reply \_\_\_\_," respectively. The Division's and Respondents' pre-hearing briefs are noted as "Div. Pr. H Br. \_\_\_\_" and "Resp. Pr. H Br. \_\_\_\_", respectively.

Lucia and RJLC deny most of the key allegations. Lucia Answer, pp. 3-7; RJLC Answer, pp. 3-7. Lucia and RJLC deny that the BOM slideshow presentations were misleading and deny that their backtests were misleading due to their use of a 3% inflation rate, their failure to consider investment adviser fees, their use of assumed REIT rates, and their failure to reallocate assets after a certain period. Lucia Answer, pp. 3-7; RJLC Answer, pp. 3-7.

## II. FINDINGS OF FACT

The findings and conclusions herein are based on the entire record. I applied preponderance of the evidence as the standard of proof. See Steadman v. SEC, 450 U.S. 91, 102 (1981). I have considered and rejected all arguments, proposed findings, and conclusions that are inconsistent with this Initial Decision.

Out of the four misrepresentations that the OIP alleges violate the Advisers Act, I find the presentation's use and depiction of "backtests" with REITs, by itself, misleading. Also, the sanction imposed would not change even if were to find merit to the remaining allegations. I therefore do not make any findings as to the other three alleged misrepresentations.

### A. Background

#### 1. Lucia

Lucia, at the time of the OIP, was a 61-year old registered investment adviser and the sole owner of RJLC. Lucia Answer, pp. 1-2.<sup>4</sup> Lucia began his financial management career in 1974 as an insurance agent with Penn Mutual Insurance Company, which he left in 1991. Tr. 1031. Afterward, Lucia was self-employed for a few months before joining John Hancock as a general agent. Tr. 1033-34. Lucia left John Hancock in 1995 and joined Acacia Life Insurance Company. Tr. 1034. In 1996, Lucia registered with the Commission as an investment adviser, associated with RJLC, which registered as an investment adviser in 2002. RJLC Answer, p. 1; Div. Ex. 2, p. 5; Tr. 1035.

Lucia has hosted the *Ray Lucia Show* on the radio since 1990, and the show became nationally syndicated in 2000. Tr. 1025-26. In 2010, the BIZ Network began televising the *Ray Lucia Show*. Tr. 1025-26. Lucia has authored three books promoting the BOM strategy—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). Lucia also used two websites, [www.rjlwm.com](http://www.rjlwm.com) and [www.raylucia.com](http://www.raylucia.com), for marketing and posted some of his seminars on the latter. Tr. 624; Lucia Answer, p. 2.

---

<sup>4</sup> Lucia attended Palomar Junior College for a year and a half, beginning in 1967, Western Illinois University between 1968 and 1969, San Diego State between 1969 and 1970, and received a bachelor's degree from United States International University in 1971. Tr. 1030. Lucia received his Series 7 license in 1983, Series 24 license in 1997, a Certified Financial Planner designation in 1988, and a Series 63 license in 2002. Tr. 1032-35.

Until June 2010, Lucia was the sole owner of RJLC. Lucia Answer, pp. 1-2. Lucia was also sole owner of a network of financial companies associated with RJLC. *Id.*, p. 1-2; Tr. 516. In addition to being sole owner of RJLC, Lucia owned Lucia Financial, LLC (Lucia Financial), a registered broker-dealer for RJLC; RJC Enterprises, Inc., Lucia's media company; and partially owned LLK Insurance Services, LLC. Tr. 73, 516; Div. Ex. 2, p. 4. Lucia collected income from RJLC through Ray Sr. Sole Proprietor. Tr. 517.

## 2. RJLC

Lucia founded RJLC in 1994, and between 2006 and 2010, RJLC operated under the fictitious business name RJC Wealth Management. RJLC Answer, p. 1; Tr. 1026-27; Div. Ex. 2, p. 4, n.4. Between 2002 and 2011, RJLC was a registered investment adviser. Lucia Answer, p. 1; RJLC Answer, p. 1. RJLC had an investment committee, which performed diligence on proposed products and approved products that RJLC-affiliated advisors could sell.<sup>5</sup> Tr. 1301, 1569-70. Lucia and his son, Ray Lucia, Jr. (Lucia, Jr.) were members of the investment committee. Tr. 1076-77, 1301. Lucia, Jr. now operates RJC Wealth Management, LLC (RJCWM), a registered investment adviser and partial successor to RJLC. Tr. 1233-34; Lucia Answer, p. 1.

Between 2002 and 2007, RJLC had a network agreement with Securities America. Tr. 474, 1475, 1601. Lucia and Securities America jointly owned an investment adviser, RJC Financial Network, which operated as a joint business development effort to handle leads generated from Lucia's slideshow presentations. Tr. 446-47. Investment advisers for the joint venture, including Lucia, were registered representatives of both RJLC and Securities America. Tr. 475-76. Fees generated through the investment advisers were split between RJLC and Securities America, depending upon the source of the lead. Tr. 502. Lucia generated most, if not all, of the leads. Tr. 1075. Securities America reviewed marketing and advertising generated by Lucia and RJLC before public distribution, including radio and television spots and the slideshow presentations given by Lucia. Tr. 564-65, 683, 694; Resp. Ex. 20.

In 2007, RJLC and Securities America ended their network agreement. Tr. 474. Although there were apparently multiple reasons for the split between the companies, one such reason was an unfavorable audit of RJLC by Securities America in summer 2007. Tr. 454-60. At least one of the subjects of the audit was the BOM strategy; Theresa Ochs (Ochs), Securities America's relationship manager with RJLC, provided marketing materials to the auditors, including a booklet on the "bucket strategy," and answered auditors' questions about marketing materials. Tr. 456, 457:5, 458. In particular, Securities America had previously asked RJLC for the basis of its claimed REIT returns. Tr. 566. Ultimately, the chief compliance officer of Securities America told Ochs, who later became RJLC's chief compliance officer, that he would

---

<sup>5</sup> RJLC as an investment adviser did not directly sell securities. The securities were sold through the broker-dealer arm of RJLC's affiliated broker-dealers, Securities America, Inc. (Securities America), and later, First Allied Securities, Inc. (First Allied). Tr. 476, 502. The advisors would make the recommendations, and then execute the sales through the affiliate broker, with whom the registered representatives had independent contractor agreements. Tr. 476, 502.

“make it very difficult” for Lucia to stay associated with Securities America. Tr. 460-61, 467-68. Following its split from Securities America, in 2007, RJLC entered into a similar networking agreement with First Allied, which lasted until 2011. Tr. 1475. Like Securities America, First Allied reviewed advertisements, including television and radio spots, and marketing materials, including the slideshow presentation at issue, from a compliance perspective. Tr. 527-30; Div. Exs. 24-49; Resp. Exs. 25-29.

### 3. RJLC’s Business Model

The Lucia family of companies has been very successful: it employed about eight people in 2000, and grew to employ 100 at the time of the hearing, with gross revenue of close to \$20 million. Tr. 1220, 1347, 1693. In 2010, RJLWM employed forty-three investment adviser representatives and operated thirteen offices nationwide. Div. Ex. 2, p. 4. During the period between January 1, 2009, and January 31, 2010, RJLC and Lucia Financial generated a combined gross income of \$14.1 million, of which RJLC registered representatives (including Lucia and Lucia, Jr.) generated advisory fees of approximately \$1.7 million. Div. Ex. 4, p. 8; Tr. 1660. RJLC earned most of its investment adviser revenue by collecting fees for assets under management, but this constituted a paltry fraction of revenues in comparison with the commissions generated through sales of securities through affiliated brokers. Tr. 492, 1656; Div. Ex. 2, p. 7.<sup>6</sup> As of early 2010, RJLC had approximately 4,700 active accounts and \$300 million in assets under management. Div. Ex. 2, p. 6; Tr. 491-92.

Sales of securities through RJLC’s affiliated brokers were RJLC’s main income generator. Between January 1, 2009, and January 31, 2010, RJLC collected \$12.4 million in gross commissions from sales of securities through First Allied, \$8.7 million of which was paid to Lucia as commissions on the sale of non-traded REITs – undoubtedly the biggest seller for RJLC during that period. Div. Ex. 2, p. 7; Div. Ex. 4, p. 8; Tr. 104, 1349. RJLC invested more than \$143 million in non-traded REITs for its clients during the same period. Div. Ex. 4, p. 8; Tr. 506. Of the \$12.4 million in gross commissions from sales of securities, RJLC paid \$2.7 million, or approximately 22%, to its registered representatives.<sup>7</sup> Div. Ex. 4, p. 8.

Lucia and Lucia, Jr. unconvincingly tried to downplay the importance of REITs to their bottom lines. Lucia reasoned that REITs generate a one-time fee, unlike other products, which continue to generate fees over time. Tr. 1348. Because Lucia was paid from his sole proprietorship, rather than from any one of his family of companies, Lucia paid much of the overhead of those companies, including salary, marketing, travel, and general office expenses. Tr. 1349, 1352, 1657. That is, Lucia’s \$8.7 million in gross commissions was not his actual take-home pay, and there have been years when his tax returns have shown a loss of close to \$1 million. Tr. 1347, 1349. Lucia, Jr. emphasized that the revenues reported in the examination

---

<sup>6</sup> It also earned revenue for hourly charges, fixed-fee consulting arrangements, and management fees for wrap programs it co-sponsored. Tr. 492-3, 517.

<sup>7</sup> RJLC used to pay its advisors based upon a percentage of sales commissions and fees, but in 2011, it moved to an all-salary employment model. Tr. 502, 1076-77, 1569. The reason for this change is not entirely clear, but it is also not material to the outcome of this proceeding.

reports (Div. Exs. 2 and 4) were merely gross revenues, and did not account for expenses. Tr. 1661-62. He also testified that in 2011, which was a “transition year” in which revenues were down to about \$16 million, the Lucia family of companies lost \$2 million. Tr. 1693-94.

Although I have no reason to doubt that Respondents have had good years and bad years, the Lucia family of companies are, overall, highly profitable, and Respondents have done very well for themselves, in part through their seminars. According to Lucia, Jr., August 2012 was a “record month,” with \$1.6 million in gross revenues. Tr. 1655. In 2011, the family of companies, despite the reported loss of \$2 million, was still successful enough that Lucia, Jr. paid himself a \$325,000 salary and took ownership withdrawals of “a couple hundred thousand” more, for a total of “about half a million dollars.” Tr. 1694, 1701. Lucia, too, continues to collect a \$300,000 salary from RJLWM in addition to fees for leads and a markup on advertisement sales on his show, \$1.8 million of which came from RJLWM. Tr. 1025, 1697-99. Lucia admitted that there have been years when he has made \$1 million. Tr. 1347.

More importantly, REITs generated “a high percentage of the revenue” for Respondents. Tr. 1347-48. Even assuming REITs generated the smallest profit margin of all the products sold, REITs were the clear moneymaker for RJLC (and RJLWM). According to Lucia, Jr., expenses in 2010 were “seven to eight million dollars a year plus rep comp and bonuses.” Tr. 1661. As noted, representative compensation and bonuses were \$2.7 million for January 2009 through January 2010. Div. Ex. 4, p. 8. Thus, total expenses for 2010 were at most approximately \$10.7 million, compared to \$12.4 million in gross commissions alone, leaving Lucia and RJLC with a substantial profit. Indeed, about 70% of gross commissions (\$8.7 million) came from sales of non-traded REITs, which are by themselves adequate to cover all overhead except compensation for registered representatives. Overall, therefore, non-traded REITs have been very important, even crucial, to Respondents’ profitability, and Respondents possess and have possessed an overwhelming incentive to sell as many of them as possible.

#### 4. Lucia Financial

Lucia Financial was a registered broker-dealer, wholly owned by Lucia. Tr. 73, 469. Lucia Financial acted as a “limited use” broker-dealer for RJLC, maintaining no client accounts. Tr. 471-72. Lucia Financial’s sole purpose was to collect revenue from marketing reimbursements and marketing revenues paid to Lucia and RJLC. Tr. 472-74. Issuers of non-traded REITs paid marketing reimbursements to Lucia for hosting seminars on those products. Tr. 474. Marketing revenues were a portion of distribution fees earned through sales of non-traded REITs by advisors registered with First Allied (and previously Securities America) and RJLC. Tr. 474. Between January 1, 2009, and January 1, 2010, Lucia Financial collected \$1,140,151 in marketing reimbursements and marketing revenue, 96% of which came from just four REIT issuers. Div. Exs. 4, p.5, 52.

#### 5. Sale of RJLC and Lucia Financial

Citing his interest in devoting more time to his media career, in April 2010, Lucia sold RJLC’s client accounts, as well as Lucia Financial’s brokerage business to his son, Lucia, Jr. Tr. 507-10, 1027. Following the sale, and beginning in June 2010, Lucia, Jr. wholly owned the

registered investment adviser RJLWM, with the client accounts purchased from RJLC. Tr. 587, 1027. Additionally, Lucia, Jr. created Lucia Securities, LLC (Lucia Securities) to take over the brokerage business from Lucia Financial and act as broker-dealer to RJLWM. Tr. 469, 587-89. Lucia maintains active involvement with RJLWM, including his investment adviser registration. Tr. 1024.

## **B. Buckets of Money**

Lucia developed the BOM strategy in the mid-1990s, trademarking the term in 2000. Tr. 1037, 1046. After years of difficulty protecting the BOM trademark, in 2011 Lucia rebranded the strategy The Bucket Strategy<sup>®</sup>. Tr. 1047.

In its simplest terms, the BOM strategy advocates spending income and principal from safe assets prior to depleting riskier assets in a portfolio, giving the riskier assets sufficient time to grow, and lengthening the lifespan of investors' nest eggs.<sup>8</sup> Tr. 75, 800, 1055; Div. Ex. 1, p. 179.<sup>9</sup> Lucia based the strategy, in part, on information he learned after reading a 1998 article by John Bowen, Jr. in the journal Financial Planning, which advocated the idea of withdrawing income from less volatile assets before withdrawing from assets that are more volatile. Tr. 1037, 1044-45.

Lucia presented BOM as a retirement strategy, touting its ability to ensure long-term, inflation-adjusted income.<sup>10</sup> Tr. 1055, 1073. A common marketing phrase used by Lucia was "aim to retire in comfort and safety." Tr. 347, 1082. Lucia offered, and RJLC advisors provided, free BOM plans for prospective investors, and the plans could include investment assets already held, proposed investments, or a combination of both. Tr. 729-30, 1068.

---

<sup>8</sup> The parties dispute the precise nature of the BOM strategy. The Division asserts that it "involves allocating a client's assets among three 'buckets,'" that is, it is an asset allocation strategy. Div. Br., p. 6. Respondents assert that it is a "retirement asset withdrawal strategy," and is neither a "model portfolio" nor an asset allocation strategy. Resp. Br., p. 30; Resp. Reply, p. 2. It is not necessary to resolve this issue, because the outcome would be the same however the BOM strategy is characterized. Accordingly, I assume without deciding that Respondents' characterization is the correct one.

<sup>9</sup> Div. Ex. 1, which is the same as Resp. Ex. 3, was produced by Respondents during a 2010 examination by the Commission's Office of Compliance Inspections and Examinations (OCIE). Tr. 68, 86. It is a version of the slideshow Lucia used during his seminars no earlier than March 1, 2009, and was apparently the most recent version of the slideshow provided during the 2010 examination of Respondents. Tr. 86, 582. Because Div. Ex. 1 is not paginated, the cited page numbers are the last three numbers of one of the Bates numbers on the exhibit, SEC-LA3937-00XYZ, thus: "Div. Ex. 1, p. XYZ." For ease of reference, I cite only to the Division's exhibit. By contrast, Div. Ex. 21 is the version of the slideshow used during the 2003 Commission examination, discussed infra. Tr. 1484.

<sup>10</sup> Lucia and Richard Plum (Plum), an employee of RJLC who assisted in creating the backtests, testified that the strategy could be tailored to investors at any life stage. Tr. 908, 1056-57. However, retirees and near-retirees were the target audience. Tr. 1060.

A typical “bucket” strategy consists of three buckets of assets, though it could involve more if necessary. Tr. 75, 610-15. The first bucket holds low-risk, liquid assets, such as certificates of deposit, structured notes, treasury notes, investment contracts, or other cash-equivalent investments. Tr. 727-28. Lucia encourages spending bucket one assets and the income generated from them before assets in either the second or the third bucket are used. Tr. 610-15. Second and third buckets contained progressively riskier assets; typically bonds and structured notes in the second, and stocks and REITs in the third. Tr. 728-29. RJLC did not typically manage first or second bucket assets. Tr. 727-28. RJLC managed at least a portion of third-bucket category assets for a majority of its customers. Tr. 729.

Lucia introduced BOM in his slideshow presentations, in his books, and on his website as a “time-tested” strategy based upon “empirical evidence” and “science, not art.” Div. Exs. 10, 16; Tr. 624-25, 1050, 1111. Lucia also frequently referred to it as a “backtested” strategy. Div. Ex. 1, pp. 437, 467; Div. Ex. 50, p. 22; Div. Ex. 66, p. 47.

### **C. The BOM Seminars**

The BOM seminars are the nucleus of Lucia’s business. Lucia marketed his BOM strategy through free slideshow presentation seminars to prospective investors in cities across the country. Tr. 629-30, 1071; Div. Ex. 18. Lucia travelled to multiple cities every year, giving approximately forty BOM seminar presentations per year. Div. Ex. 18; Tr. 1070. Between March and May 2009, for example, Lucia listed on his website fifteen planned seminars throughout the country. Div. Ex. 27. The venues varied, but each typically held a few hundred people. Tr. 1061. Lucia estimates that he has given his BOM slideshow presentation to 50,000 people. Tr. 1061. The presentation included a series of PowerPoint slides, mainly introduced by Lucia, followed by, or preceded by, audience questions. Tr. 1066. Associates of Lucia, including Plum, would often attend the seminars and help field questions from audience members. Tr. 734, 736.

The purpose of these slideshows was to generate leads for RJLC, and now for RJLWM. Tr. 526, 1075. At the end of every presentation, Lucia handed out contact cards, which attendees filled out and returned to Lucia and his associates. Tr. 279, 378, 436. RJLC’s investment advisers followed up on those leads, offering a free BOM consultation. Tr. 1068, 1559. RJLC only made money if the seminar attendees met with an RJLC investment adviser, received the free BOM consultation, and then either purchased investment products through RJLC or opted to have an RJLC advisor manage a portion of the investor’s portfolio. Tr. 1067-68.

### **D. The BOM Slideshow**

At the heart of this proceeding is Lucia’s BOM slideshow presentation that Lucia gave at his BOM seminars. Lucia has been giving a variation of the slideshow presentation since around 2000. Tr. 672. Lucia has amended the slides over time, but the principles and the progression of the message have remained the same. Tr. 834-36; see also Div. Ex. 1 (2009 version of the slideshow); cf. Div. Ex. 21 (2003 version of the slideshow). Of the 126 slides in the slideshow, the first fifteen slides are focused upon investment concerns and goals; and another thirty-nine of the show focus upon Lucia’s confrontation of conventional investment wisdom and strategies.



Div. Ex. 1. Lucia then progresses through a series of fictional investor portfolios to validate his strategy. Div. Ex. 1. After the fictional investors, Lucia introduces the BOM strategy and his backtests, twenty-seven and eighteen slides, respectively. Div. Ex. 1. Lucia is responsible for, and approves the content of, the slideshow. Tr. 572, 834, 1066-67.

### 1. The Fictional Investors

Suitably named fictional investors each start with \$1 million in retirement savings, require \$60,000 a year in inflation-indexed income, and aspire to bequeath \$1 million to their children. Div. Ex. 1, p. 420. The first three fictional investors, comprising twenty-one slides, are subjected to what Lucia asserts are the pitfalls of conventional investment strategies.

#### a. The “Conservative Campbells”

The risk averse Conservative Campbells invest only in low-risk instruments, including certificates of deposit, individual bonds, and Ginny Maes (securities issued by the National Government Mortgage Association). *Id.*, p. 421. The Campbells’ investments are considered “safe & guaranteed.” *Id.* The Campbells’ income withdrawals are not indexed for inflation, so even though they are able to withdraw \$60,000 a year, over the course of decades, their purchasing power diminishes. *Id.*, p. 422. Assuming the Campbells passed away after thirty years, their \$1 million principal investments will still be worth \$1 million, but assuming inflation, that, too, sees its purchasing power diminish by more than half. *Id.*, p. 423.

#### b. The “High Rolling Hendersons”

The risk tolerant High Rolling Hendersons invest 100% of their retirement savings in the stock market. *Id.*, p. 427. If the Hendersons enjoyed a flat 10% return from the stock market every year for thirty years, their portfolio would be worth \$4,203,320 in thirty years. *Id.*, p. 427. That total allows for an inflation-indexed withdrawal of \$60,000 a year. *Id.*, 427. Lucia criticizes such a strategy, however, because, as the slideshow presents, if the Hendersons had retired in 1973, right before the nadir of that period’s “Grizzly Bear Market” lows, they would have gone bankrupt within seventeen years. *Id.*, p. 432.

#### c. The “Balanced Buttafuccos”

The Balanced Buttafuccos, who invested in a balanced portfolio of 40% bonds and 60% stock, are also subjected to a retirement date of January 1, 1973, leading into the Grizzly Bear Market. *Id.*, p. 435. They enjoy income for only twenty-one years, until completely depleting their portfolio. *Id.*, p. 436. The Buttafuccos’ 60/40 stock and bond mix is what Lucia uses as a proxy for the industry standard balanced portfolio he frequently denigrates. *Id.*, p. 437; Tr. 1272. The slideshow suggests that the Buttafuccos are the main comparator to Lucia’s “bucketized” investors. Div. Ex. 1, p. 437. The Buttafuccos’ results were described as “backtested.” *Id.*, p. 437.

#### d. The “Bold Bucketeers”

As a contrast to the three previous fictional investors, the slideshow next introduces the Bold Bucketeers, the first investors in the slideshow to structure a portfolio around BOM principles, and also the first fictional investors to invest in REITs. Id., pp. 439, 449. Having the same initial resources and goals as the three previous investors, the Bucketeers employ a three-bucket strategy, with the addition of REITs. Id., p. 465. The portfolio contains 40% stocks, 20% REITs, and 40% bonds—referred to in testimony as a “40-20-40” strategy. Id., p. 465; Tr. 780, 806-07. \$200,000 is invested in REITs, which produce an assumed dividend rate of 7.75% per year, and a stock portfolio that grows at an assumed 10% rate. Div. Ex. 1, p. 465. The REIT and stock market investments grow uninterrupted during a twelve-year period, ultimately leaving \$1.4 million. Id., p. 465.

#### 2. The Backtest Slides

##### a. The ’73 Backtest

The slideshow reintroduces the ’73 Grizzly Bear Market following the three fictional investors and the Bucketeers. Id., p. 466. The following slide, titled “Back Tested Buckets,” provides that the Bold Bucketeers’ portfolio, with the same 40-20-40 investment assumptions, would be worth \$1,544,789, twenty-one years after retiring on January 1, 1973 (’73 Backtest). Id., p. 467. The slide notes that the twenty-one year period compares to the same milestone at which the Balanced Buttafuccos had completely depleted their retirement portfolio. Id., p. 467. The dividend rate assumed for the REITs in the ’73 Backtest is not disclosed in either the slideshow or the Webinar, although because the ’73 Backtest contrasts what is essentially the Bold Bucketeers’ portfolio against the Balanced Buttafuccos’ portfolio, it is likely to be 7.75%. Div. Ex. 1, pp. 467-68; Div. Ex. 66, pp. 46-47.

##### b. The ’66 Backtest

Lucia next introduces backtests<sup>11</sup> for retirees who endure the market stagnation of the late 1960s.<sup>12</sup> Lucia introduced this section of his slideshow in 2005 or 2006. Tr. 1134-35. The first example, involving a 60/40 split of stocks and bonds (i.e., the Balanced Buttafuccos, although that name is not displayed in this portion of the slideshow), require \$50,000 a year in inflation-indexed income. Div. Ex. 1, p. 472. The Buttafuccos’ backtest, using actual S&P 500 returns for 1966-2003, actual United States Treasury Bill returns for 1966-2003, 3% inflation, and

---

<sup>11</sup> I use this term throughout the Findings of Fact only as a shorthand description of the contents of the slideshow. The meaning of the term, and its significance, is analyzed infra.

<sup>12</sup> The stock market between 1966 and 1982 produced stagnant returns. Tr. 1145-46, 1268. Lucia first began citing to the 1966 market stagnation period after consulting with his friend, actor and economic commentator Ben Stein. Div. Ex. 1, p. 470; Tr. 772. According to Lucia, the ’66 Backtest was first conducted because of Stein’s curiosity regarding BOM’s results in a stagnant market. Tr. 1137-38.

income from both stocks and bonds, are left with no income and a portfolio of just \$30,000 by 2003.<sup>13</sup> Div. Ex. 1, p. 473.

Shifting back to the BOM strategy, the slideshow shows backtest results for the Buttafuccos, which again begins with \$1 million in savings, requires \$50,000 of inflation-indexed income per year, splits its investments 60% in stocks and 40% in bonds – no REITs – but with income from bonds first. *Id.*, p. 474. Spending bond income first, according to the slide, allows the investors to collect \$150,000 in income (presumably \$50,000 indexed for inflation) in the year 2003, while maintaining a portfolio value of \$1.2 million. *Id.*, p. 475.

The next portfolio describes the BOM strategy, but with a 40-20-40 split with REITs (i.e., the Bold Bucketees, although that name is not displayed in this portion of the slideshow). *Id.*, pp. 476-77. The REITs are assumed to generate a 7% dividend rate. *Id.*, p. 471. Unlike with the previous comparison of the four fictional investors, there was no explicit disclosure that the 7% REIT rate was hypothetical in the slides, nor was there an explanation for why the rate changed from 7.75%. *Id.*, pp. 468-78.

With a pithy summary slide, Lucia declares, “[i]n 2003 . . . [a]fter adding REITs . . . [p]ortfolio value: \$4.7 million[,] [a]nnual income: \$150,000,” more than tripling the portfolio balance. Div. Ex. 1, p. 477. Significantly, there are no fine-print disclaimers on any of the slides pertaining to the ’66 Backtest, in contrast to virtually every other substantive slide, including those pertaining to the ’73 Backtest. Div. Ex. 1, pp. 467-78.

## **E. Webinar**

On February 16, 2009, Lucia broadcast a presentation (Webinar) over the internet. Div. Ex. 66, p. 1; Tr. 1244. Approximately the first two-thirds of the Webinar generally follows the same format and outline as the seminars, but does not use precisely the same slideshow.<sup>14</sup> For example, Lucia introduces a simplified version of the BOM strategy on pages 27-31 of the

---

<sup>13</sup> The Division’s expert testified that the S&P 500 Market average is a commonly-used proxy for historical stock market returns. Tr. 944. Lucia and Plum testified that they used the S&P 500 Market as a proxy for historical stock market averages for the backtests. Tr. 794, 1284. Lucia and Plum also testified that United States Treasury Bill yields are reliable historical proxies for average bond rates, and that they used them as such in the backtests. Tr. 794, 1284.

<sup>14</sup> For example, pages 364, 365, 367, 369, 370, 372, 373, 375, 378, 381, 384, 387, 390, 394, 406, 413, 416, 430, 438, 468, 469, 470, and 479 of the slideshow differ from the corresponding slides shown in the Webinar in certain non-substantive ways. Resp. Ex. 30; Div. Ex. 1. As another example, slides and hand drawings discussed on pages 13, 16, 17, 24-31, 34-38, 43, 47, and 56-58 of the Webinar do not appear in the slideshow, and pages 379, 389, 391, 415, 419, and 480-84 of the slideshow do not appear in the Webinar. Resp. Ex. 30; Div. Exs. 1, 66. Approximately the last third of the Webinar does not correspond to anything in the seminar slideshow. Div. Ex. 66, pp. 53-82. Oddly, the Webinar also states that Lucia only worked with salaried representatives. Div. Ex. 66, pp. 3, 51. In fact, the switch to purely salaried representatives occurred in 2011, well after the Webinar aired. Tr. 502, 1076-77, 1569.

Webinar, earlier than in the seminar slideshow. Div. Ex. 1, pp. 410-12; Div. Ex. 66, pp. 27-31. The evidence is unclear as to why the Webinar deviates from the seminar slideshow. It may be that Lucia used a different slideshow in his internet presentations, or it may be that the slideshow changed between February 2009, when the Webinar aired, and 2010, when OCIE obtained a copy of the slideshow.

In any event, there are certain substantive differences between the Webinar and the 2010 slideshow. The Webinar sometimes calls non-traded REITs simply “real estate,” and, if anything, the Webinar stresses the importance of REITs even more than does the slideshow. Div. Ex. 66, pp. 34:12-14 (“we really focus a lot on nontradeable direct ownership in real estate”), 35:4-6 (“direct ownership in real estate . . . [is] not only a staple, it is critical”), 35:10-16 (“the Ibbotson data proves it, . . . a twenty percent addition to real estate investment trusts, be it tradeable or nontradeable, you end up with a higher rate of return at lower risk”), 44:19 (“real estate,” in referring to the slide on page 449 of Div. Ex. 1, which states simply, “REIT”), 50:2-5 (“the real live [BOM] strategy . . . assume[s] we put . . . twenty percent in direct ownership in real estate,” while displaying a slide showing “20% REITs”), 58:5-6, 19-20, 23-24 (“I’m going to put 300,000 dollars in my real estate bucket . . . the real estate can also help produce annuitized income . . . [and] will produce about 19,000 dollars per year”), and 69:17-18 (“the nontradeable real estate and all the safe buckets that we’ve talked about”). The first “Notes & Disclaimers (REITS)” slide in the slideshow does not appear in the Webinar at all, and although the second “Notes & Disclaimers (REITS)” slide appears in the Webinar, it does not disclose the fact that REITs have limited liquidity, in contrast to the corresponding slide in the slideshow. Div. Ex. 1, pp. 415, 447; Div. Ex. 66, pp. 35, 44. When discussing the BOM strategy in detail, Lucia states “in the sixties, you could have got about \$15,000 per year income, dividends from that real estate investment.” Div. Ex. 66, p. 44:22-25. Before discussing the effects of REITs in connection with the ’66 Backtest, Lucia repeatedly uses the term “pretend” when introducing his assumptions. Div. Ex. 66, pp. 40, 48. However, when he discusses the effects of REITs, he does not use the term “pretend.” Div. Ex. 66, p. 50:5. He then summarizes the result of the BOM strategy: “the real Buckets portfolio, using real estate, 4.7 million dollars.” Div. Ex. 66, p. 51:18-19.

## **F. Backtest Designs**

Lucia testified that he did some of the work on the ’73 and ’66 Backtests used for the slideshow presentations, and that he “manually” calculated at least some of the results.<sup>15</sup> Tr. 1089, 1095. He also testified that he did not believe he had to produce any support for the backtests to the Commission during its examination, because he did not believe he had to maintain such records. Tr. 1094-95. Lucia and Plum testified that for the ’73 Backtest, and for the fictional investors’ results, Brian Johnson (Johnson) ran the calculations for the slides under Plum’s supervision. Tr. 782-83, 839, 1088. Johnson was a junior employee who dated Lucia’s daughter and, Lucia believed, had just graduated from United States International University, Lucia’s alma mater, when he prepared the slides. Tr. 783, 1089. Plum did not check Johnson’s

---

<sup>15</sup> Lucia also claimed to have backtested the BOM strategy to 1987, although he had no documentary evidence of this. Tr. 1094. There are, however, no allegations of Lucia having presented the results of a 1987 backtest to the public.

calculations, but he reviewed his methodology and agreed it was correct. Tr. 784. Supporting documentation for the '73 Backtest calculations has never surfaced. Tr. 788.

In response to an investigative request for backtest slide support, Ochs produced two spreadsheets that she had received from Plum. Div. Exs. 12, 13; Tr. 87-89, 539-40.<sup>16</sup> The first spreadsheet laid out calculations for a fictional 40-20-40 portfolio beginning in 1973, but did not match any of the numbers from the slideshow. Div. Ex. 13; Tr. 788. The first spreadsheet does not support the '73 Backtest, nor was it intended to; instead, it is an “illustration starting in 1973 with the difference between a distribution from a pro rata portfolio of 60/40 stocks and bonds and spend safe money first over volatile money.” Tr. 802.

The second spreadsheet, prepared by Plum at Lucia's direction, was intended as support for the '66 Backtest with REITs. Div. Ex. 12; Tr. 810. No support was provided for the '66 Backtest portfolio without REITs. Tr. 811. In the second spreadsheet, REITs provided a flat 7% dividend return, were invested on day one, January 1, 1966, and were held for ten years, liquidating at the end of 1975. Div. Ex. 12; Tr. 218. The REIT principal remained constant at \$200,000 through the ten year investment. Upon liquidation, the \$200,000 was reinvested in the stock market, where the rest of the portfolio remained, growing at actual historical returns. Div. Ex. 12.

### **G. REITs**

In its simplest form, a REIT is a company that procures capital from investors by selling equity shares, uses the capital to purchase income-producing real estate assets, collects income, such as rent, from the assets, and then distributes the earnings back to investors. Div. Ex. 70, p.10. REITs first became available to the investing public in the 1970s, but only became widely available in the 1990s. Tr. at 774.

As applicable here, there are two general categories of REITS, traded and non-traded. Div. Ex. 70, p. 10; Tr. 1622. Traded REITs are traded on exchanges, are priced regularly, and are highly liquid. Tr. 166, 218, 1622. Non-traded REITs are inherently illiquid securities due to the lack of public market. Tr. 728, 1380. They are considered long-term investments, and Lucia and RJLC encouraged investors to consider them as such. Tr. 1297, 1621-23. Lucia and RJLC usually told clients to hold REITs between ten and fifteen years. Div. Ex. 1, p. 447; Tr. 1623. Non-traded REITs are designed to liquidate, merge, or be offered publicly at the end of their expected life cycles. Tr. 1370, 1392, 1623. Cycles are often between five and eight years. Tr.

---

<sup>16</sup> It is undisputed that the first spreadsheet, Div. Ex. 13, which Ochs apparently believed was support for the '73 Backtest, was produced during the examination. Tr. 87-88, 541-42. It is disputed whether the second spreadsheet, Div. Ex. 12, produced as support for the '66 Backtest, was produced during the examination or later. Tr. 112, 540-41, 810-11. As explained *infra*, neither spreadsheet actually supports the slideshow's claims. Accordingly, the probative value of the date of production of the spreadsheets is minimal, and I assume without deciding that both were produced in the course of the 2010 examination.

1369, 1623.<sup>17</sup> Some non-traded REIT issuers offer redemptions at certain predetermined intervals, offering investors cash to liquidate their shares. Tr. 1298-99. Redemptions, however, usually offer less than the original principal investment. Tr. 1299.<sup>18</sup> According to Lucia, Jr., non-traded REIT liquidity events do not have an established history, because “they haven’t been around for more than a decade and a half or so.” Tr. 1623.

As noted, non-traded REITs were the lifeblood of Lucia and RJLC’s business, generating a substantial portion of revenues for them. Div. Ex. 4; Tr. 104, 1347. Additionally, non-traded REIT issuers offered the vast majority of marketing reimbursements to Lucia for hosting seminars and selling their products. Div. Exs. 4, p.5, 52; Tr. 104-05, 472, 483, 1077. Lucia himself was general partner or managing member of nine pooled-investment vehicles that invest in and manage real estate holdings. Div. Ex. 2, p. 9. Lucia and RJLC advocated, as an integral part of BOM, the use of real estate, specifically non-traded REITs, to prospective investors looking to “bucketize.” Div. Ex. 1, pp. 471-78; Tr. 76, 1296-97; Div. Ex. 66, p. 35. Lucia cited reasons for advocating non-traded REITS as their relative lack of volatility and their ability to pay higher dividend rates than most traded REITS. Tr. 76, 1297, 1373.

## **H. Commission Examinations**

In August 2003, compliance examiners from the Commission’s Division of Investment Management’s compliance office, a precursor office to OCIE, conducted an inspection of RJLC. Tr. 1478-79. That inspection uncovered several deficiencies, including inadequate disclosures of certain conflicts of interest and misleading statements about RJLC’s business in its marketing materials. Div. Ex. 2, p. 7. These findings were reported to RJLC in a deficiency letter issued to the company on December 12, 2003. Resp. Ex. 13; Tr. 1492. One such deficiency pertained to a financial plan (not a slideshow) prepared for a client, in which RJLC made unsubstantiated and “highly unlikely” claims regarding REIT returns. Resp. Ex. 13, p. 6. The financial plan specifically mentioned that “income from the [REIT] could be used to supplement your Bucket #1 income.” *Id.*, p. 6 (emphasis omitted). RJLC told the 2003 examiners that it would correct the deficiencies. Resp. Ex. 14.

In March 2010, OCIE conducted an examination of RJLC and Lucia Financial, and OCIE found that RJLC had committed significant violations of the Advisers Act. Div. Exs. 2, 4. The examination was the impetus for the enforcement action, and was triggered by a tip from the Division. Tr. 183, 185. OCIE issued a deficiency letter to RJLC on December 17, 2010. Div. Ex. 3; Tr. 70. Two of the noted deficiencies involved REITs, specifically that RJLC’s marketing materials neither (1) disclosed that non-traded REITs were not available during significant portions of the backtest period, nor (2) disclosed the illiquidity of non-traded REITs. Div. Ex. 2,

---

<sup>17</sup> Lucia, Jr. testified that the cycles typically lasted between seven and eight years, while Respondents’ expert, Gannon, testified that the average cycles lasted between five and seven years. Tr. 1623, 1369-70.

<sup>18</sup> Lucia testified that many non-traded REITs have one-year redemptions for repurchase of shares at about 90% of the original capital investment. Tr. 1299.

p. 14; Div. Ex. 3, pp. 6-7. OCIE also found that RJLC had corrected some but not all deficiencies identified in the December 12, 2003, deficiency letter. Div. Ex. 2, p. 7.

As part of the examination, Bryan Bennett (Bennett) drafted an examination report. Resp. Ex. 50; Tr. 182. The report's cover letter, or "buckslip," was initially signed by three OCIE staff members on November 4, 2010. Resp. Ex. 50, p. 1; Tr. 29. The fourth and most senior staff member, Martin J. Murphy (Murphy), Associate Regional Director of the Los Angeles Regional Office, signed the buckslip on November 8, 2010. Resp. Ex. 50, p. 1; Tr. 181. After reviewing the report, Murphy had the matter referred to the Division because of the "seriousness of the advertising deficiencies." Tr. 184. The buckslip indicated no referral had been made to the Division; it is unclear why Murphy signed it first, and then initiated a referral. Resp. Ex. 50, p. 1. At some point, the examination staff met with the Division, and it was decided to amend the examination report by adding allegations of violations of Sections 206(1), 206(2), and 206(4) of the Advisers Act, and rules thereunder, and by noting on the buckslip that a Division referral had been made. Tr. 200; Resp. Ex. 51. No later than November 22, 2010, the Division decided to open an investigation. Resp. Ex. 53, p. 2. A formal order of investigation (FOI) was approved on December 2, 2010, and the final version of the examination report was signed on December 16, 2010. Resp. Exs. 12, 51. Respondents first learned of the existence of the FOI in May 2011. Resp. Ex. 12. No Division staff asked Bennett to obtain information for the Division through the examination process. Tr. 214.

### **I. Expert Testimony on REITs**

Dr. Steven Grenadier (Grenadier) testified as an expert witness for the Division on all the various issues that it asserts made Respondents' slideshow presentations misleading.<sup>19</sup> Grenadier's expert report concluded that Lucia's assumed REIT dividend rates for the backtests were misleading, creating inaccurate returns for the fictional investors. Div. Ex. 70, pp. 10-11. Grenadier based his findings on indices published by the National Association of Real Estate Investment Trusts (NAREIT), specifically the FTSE NAREIT All REIT index.<sup>20</sup> Div. Ex. 70, p. 10 n.24; Tr. 944. NAREIT indices are well-known proxies for REIT returns. Div. Ex. 70, p. 11; Tr. 944. Grenadier found that there were very few publicly traded REITs available in 1966, at the start of the 1966 backtest. Div. Ex. 70, pp. 11-12. He found that public non-traded REITs were relatively more available as of 1966, but were illiquid. Div. Ex. 70, p. 12. Additionally, NAREIT, the most famous REIT index, began reporting in 1972, six years after the '66 Backtest began using its assumed 7% return. Div. Ex. 70, p. 11; Tr. 944. He also found that using the NAREIT All REIT index provided significantly lower returns for the REIT principal and total

---

<sup>19</sup> I only make findings regarding Grenadier's report and testimony as they pertain to the use of REIT data.

<sup>20</sup> Grenadier testified that he used the All REIT index instead of specifying the equity REIT index because the All REIT index represents a general proxy average for the industry, much like why Lucia used the S&P 500 Market as a proxy for the stock market in general. Furthermore, Grenadier considered the All REIT index over the equity REIT index because the proportion of mortgage REITS might have been higher in the 1970s, which was when the bulk of the '66 Backtest REIT investment was supposed to have occurred. Tr. 962.

portfolio for the '73 and '66 Backtests. Div. Ex. 70, p. 11 & n.24; Tr. 961-62. Grenadier also took issue with the assumption in the backtest that REITs could grow at a risk-free, flat rate, and then be easily liquidated. Div. Ex. 70, p. 12; Tr. 943.

Using actual historical data, Grenadier showed, lowered the REIT principal investment substantially. Div. Ex. 70, Ex. 5a. When the REIT investment ended in 1975 by liquidation, the backtest showed the REIT, with historical rates, at \$85,646, not \$200,000. Id.

Respondents called Kevin Gannon (Gannon) as an expert witness to testify on the issue of REITs as they were used in the '73 Backtest and '66 Backtest. Gannon's report concluded that the assumed REIT rates were reasonable. Resp. Ex. 34, p. 7; Tr. 1366. His report found that between 1972 and 2003, the internal rate of return was 12.9%, which was "so high that a 7% [rate] is clearly reasonable." Resp. Ex. 34, p. 4; Tr. 1390.

Gannon took issue with Grenadier's use of the NAREIT All REIT index. Tr. 1374-76. Gannon testified that the Equity REIT index, which includes REITs invested only in real estate equity, was the more reasonable index to consider. Tr. 1374. As part of his rationale, he found that the more widely used REIT index today is the Morgan Stanley REIT index, which is focused upon equity REITS. Tr. 1374, 1376. Gannon also concluded that equity REITs were the subject of the backtests because at least two slides in Lucia's slideshow cited statistics from the NAREIT Equity REIT index. Tr. 1374-75; Div. Ex. 1, p. 416.

Gannon's report recognized that REIT historical data was not available for the six-year period prior to 1972. Resp. Ex. 34, p. 6; Tr. 1366. He also admitted on cross-examination that REITs were generally not available between 1966 and 1971 and that non-traded REITs are illiquid. Tr. 1378-80. To compensate for the unavailability of REITs from 1966 through 1971, Gannon created a model security based upon structured real estate investments during that period. Tr. 1380. The model was based upon inputs backed by thirteen assumptions. Tr. 1367, 1381. The model security produced a 7.1% internal rate of return. Resp. Ex. 34, p. 7; Tr. 1367. The evidence gathered for the model consisted of a single article, The Long Cycle in Real Estate, by Ronald W. Kaiser (Kaiser Article), which summarized total real estate returns between 1919 and 1995. Tr. 1378-79; Resp. Ex. 34, p. 7 & Ex. D (14 Journal of Real Estate Research, no. 3, 1997). The Kaiser Article drew its empirical data for the 1966-1971 period in part from a study published in 1976, How Real Estate Stacks Up to the S&P 500, by D. Kelleher in (Kelleher Study).<sup>21</sup> Resp. Ex. 34, p. 7 & Ex. D.

---

<sup>21</sup> I find Gannon's testimony and expert report to be highly probative regarding the '66 Backtest. In addition to his significant concessions regarding REIT availability between 1966 and 1971 and REIT liquidity, both of which are specifically cited as deficiencies in the 2010 deficiency letter, a close examination of Gannon's supporting data is revealing. Div. Ex. 3, pp. 6-7. Gannon's report includes as Exhibit C a printout of the yearly NAREIT Equity REIT index averages. Resp. Ex. 34, Ex. C. Assuming without deciding that the NAREIT Equity REIT index was the appropriate data source, the price of an average REIT investment would have dropped substantially between 1972 and 1975, based on an index decline from 100 to 85.6. Id. Additionally, Gannon's starting assumption, that the "average total return" from real estate between 1966 and 1971 was 10.6%, was based on the Kelleher Study. Resp. Ex. 34, p. 7. The



John S. Hekman, Ph.D, the other expert witness for Respondents, could not recreate the '73 Backtest to achieve the same final portfolio figures presented in Lucia's slideshow. Tr. 1535-37. He testified that the term "backtest" was used on one slide in the slideshow, that the various examples in the slideshow were not, in his opinion, backtests, that his opinion was based on what an average investor would understand the term "backtest" to mean, and that the average investor would understand the term, in this context, to mean "using historical data to test a particular investment strategy."<sup>22</sup> Tr. 1402, 1423-26.

## **J. Client Testimony**

Two RJLC clients, Richard DeSipio and Dennis Chisholm, testified at the hearing. Both were attendees of a BOM presentation, DeSipio in Philadelphia, Pennsylvania, and Chisholm in Portland, Oregon. Tr. 247, 337. Chisholm also heard similar BOM discourse through Lucia's radio show and read about the same, presumably in Lucia's books. Tr. 358-60. Both clients testified that the BOM presentations inspired them to meet with an RJLC advisor. Tr. 280-81, 370-71, 378-79. Both clients also invested in REITs because of what they learned at the presentations. Tr. 281, 283, 380.<sup>23</sup> A convincing aspect of the show, in particular, was the

---

Kelleher Study, like the other studies cited in the Kaiser Article, and like Gannon himself, calculated "total return" or internal rate of return (IRR), i.e., the combination of dividends and price appreciation. Resp. Ex. 34, p. 3 & Ex. D, p. 237 n.4. Gannon ultimately estimates that the IRR between 1966 and 1971 for REITs would have been 7.1%. *Id.*, p. 7. But Lucia did not tout the IRR for REITs, he touted the dividend rate. Div. Ex. 1, pp. 460, 465, 471. In other words, Gannon and Lucia were discussing two different returns: Gannon analyzed dividends plus price appreciation, and Lucia discussed just dividends. Gannon's evidence, therefore, does not really support Lucia's position; to the contrary, it undermines it. Specifically with respect to the '66 Backtest, Lucia assumed a 7% return, which represents the "annual," i.e. dividend, rate, and no price appreciation, according to the second spreadsheet. Div. Exs. 12, 1, p. 471. But Gannon concludes that, at least for 1966-71, the combination of yearly dividend and price appreciation is 7.1%. *Resp. Ex. 34*, p. 7. For the '66 Backtest to be consistent with Gannon's evidence, price appreciation would have to be approximately 0.1% between 1966 and 1971. This is, of course, highly unlikely, and it is much more likely that the price appreciation would have been higher with a concomitant yearly dividend of less than 7%.

<sup>22</sup> Dr. Hekman's testimony on these last two points is disjointed and confusing because he was repeatedly impeached on the subject, but I believe this to be a fair interpretation of what he said.

<sup>23</sup> Q: Was it a large factor in your decision?

A [DeSipio]: Well, it was – it gave me – the whole purpose was – to me, I looked at it from the non-trade[d] REITs as another diversification which I was not aware of and did not have as far as financial asset allocation. Tr. 281.

backtests.<sup>24</sup> Especially convincing to both clients was the effect of non-traded REITs. Tr. 266, 359-61, 368-69.

Both clients remembered Lucia presenting the backtests and using that term in conjunction with the '73 Backtest and '66 Backtest slides. Tr. 258, 359. Both clients understood the slides to suggest that Lucia used actual historical returns, or at least accurately reflected the approximate returns for the historical periods. Tr. 267-69, 371-72, 378. Both clients testified that they would have liked to have known that the backtests did not use historically accurate information. Tr. 288-91, 371-75.

### III. DISCUSSION AND ANALYSIS

#### A. Backtests

##### 1. Definition

The parties vehemently dispute the definition of the term backtest. The Division asserts, through its expert, Grenadier, that, “[a] back-test of an investment strategy uses historical data to evaluate how that strategy would have actually performed had it been implemented in the past. Back-tests are generally conducted using actual, historical data – to the extent such data is available – especially for critical aspects of a particular investment strategy.” Div. Ex. 70, p. 5. Grenadier bases his definition on “numerous textbooks and articles,” discussing the importance of using actual, historical data. *Id.* Grenadier testified that he “very quickly” determined that the slideshow’s presentation did not include proper backtests, according to the definition he offered. Tr. 960-61. Bennett, the OCIE examiner, testified that a backtest was a “method used to go backwards in time to see how a certain strategy would have performed using actual data points to calculate the performance.” Tr. 114. Ochs had a similar understanding. Tr. 575. Bennett testified that what Lucia offered was not a proper backtest. Tr. 114.

Respondents’ experts, Gannon and Hekman, both provided similar definitions of backtests – “Q: Is that because you would use actual data in a backtest? A [Gannon]: Yes;” “Q: [Y]ou agree that back-testing is generally understood as a process of evaluating a strategy, theory, or model by applying it to historical data? A [Hekman]: I understand – yes, I agree with that definition.” Tr. 1387, 1421. Gannon testified that hypothetical rates of return should not be used in backtests and Hekman testified that Lucia’s analyses were not proper backtests. Tr. 1387, 1421.

Lucia disputes the backtest definitions given by the Division’s expert, as well as by his own experts. Lucia testified that a backtest, “in the financial planning industry,” was a “look back in history, but basing that on a forward-looking projection.” Tr. 1093. Plum, too, claimed that he understood a backtest to mean a “hypothetical what if.” Tr. 836. Lucia and Plum, the

---

<sup>24</sup> Chisholm testified, “If it was back-tested, I felt confident that somebody had done their homework and it proved somehow, some way, that this method was, indeed, a legitimate method of investing, of taking care of my retirement going forward.” Tr. 362-63.

principal architects of the slideshow backtests, were the only two individuals who characterized the definition of backtests as something other than what the experts offered.

Lucia went on to state that this definition was based on what the financial planning industry “almost uniformly used.” Tr. 1093. Despite Lucia’s invocation of the “industry standard,” none of the experts, including Respondents’, corroborated that definition. Respondents also offered examples of backtests from several large investment houses, but those examples actually undermine Respondents’ argument. Respondents point to Exhibit 46, a marketing pamphlet from American Funds, a large investment house, Exhibit 47, a marketing pamphlet from Fidelity Investments, and Exhibit 59, a marketing brochure from Financial Engines Income+ in support of what they assert is the industry usage of the term backtest. Tr. 1093; Resp. Br., p. 58. A review of Exhibit 46, however, reveals that actual “historical index returns” were used for the backtests, contradicting Respondents’ assertion of what they proffer as the industry definition. Resp. Ex. 46. The example in Exhibit 47 used “historical monthly performance . . . represented by S&P 500, U.S. Intermediate –Term Government Bonds, and U.S. 30-day T-Bills.” Resp. Ex. 47. Similarly, Exhibit 59, which does not specifically offer its models as backtests, uses only S&P 500 Market returns and Treasury Bond fund returns, both with factual, historical data. Resp. Ex. 59. I find the definition of “backtest” offered by all three experts the only consistent and intuitive one.

I also find that prospective investors would have understood the term in the same way as the experts. Dr. Hekman testified that the average investor would understand the term, in this context, to mean “using historical data to test a particular investment strategy.” Tr. 1423-26. DeSipio understood the term to mean that actual performance data and actual inflation had been used. Tr. 267-69. Chisholm understood the term as a way of “prov[ing] somehow, some way, that this method was, indeed, a legitimate method of investing.” Tr. 362-63. A prospective investor at one of Lucia’s seminars would have understood the term “backtest” to mean “using historical data to test a particular investment strategy.”

## 2. Respondents’ Use of Backtests

Lucia used the term backtest in his slideshow and narration, in his Webinar, in his training materials, and in his books. Div. Ex. 1, pp. 437, 467; Div. Ex. 50, p. 22; Div. Ex. 66, p. 47; Div. Ex. 68, p. 57. Lucia’s employees, Ochs and Plum, and Lucia, Jr., testified that Lucia told audience members on numerous occasions at his seminars that he had “backtested” his strategy. Tr. 537, 880, 1686.

Notwithstanding Lucia’s frequent invocation of the term backtest, the backtested slides used a jumble of actual historical returns and assumed returns. The slides for the both backtests state that they used S&P Market 500 averages and actual treasury rates of return. Div. Ex. 1, pp. 467, 471.<sup>25</sup> Meanwhile, they used assumed dividend rates, including 7% for the ’66 Backtest, an

---

<sup>25</sup> The use of “actual” S&P 500 Market and U.S. Treasury Bill returns may have also been inaccurate as to the ’73 Backtest. Lucia testified that the actual S&P 500 Market rates for 1973 and 1974 were used, but that a flat 10% annual rate was used for each year thereafter. Tr. 1078-80.

unknown dividend for the '73 Backtest, and a flat 3% inflation rate for both. Div. Ex. 1, pp. 467-78. It is quite clear that Lucia's backtest slides do not reflect properly conducted backtests.

Lucia, Lucia, Jr., and at least one senior employee of RJLC, after learning what the Division's definition of backtest was, tried to redefine what Respondents were providing with the backtest slides. Instead of a backtest, the slides represented: a "forward-looking hypothetical" (Lucia); "hypothetical forward-looking" scenarios (Plum); "a simulation" (Lucia, Jr.). Tr. 1127, 840, 1627-29. Lucia also described what he was doing, at least as far as the '66 Backtest was concerned, as "pretending today is 1966." Tr. 1138. In the face of Lucia's persistent allusions to backtesting his strategy, I do not accept the inconsistent, after-the-fact descriptions of what Lucia and others testified Lucia was actually portraying, instead of a backtest.

### 3. Scope of the Backtests

The OIP alleges that "it was materially misleading for Respondents to claim that their alleged backtesting validated the BOM strategy," in connection with the 1966 and 1973 backtests. OIP, p. 7. In particular, the OIP alleges that "the BOM strategy," when backtested as presented in the slideshow, yields better outcomes than when backtested using actual historical data. *Id.*, pp. 7-8. The OIP does not specifically allege that any claimed backtesting of the portfolios of the High Rolling Hendersons and the Balanced Buttafuccos, for comparative purposes, was misleading. Div. Ex. 1, pp. 432 (discussing High Rolling Hendersons, assuming retirement on January 1, 1973), 437 (discussing Balanced Buttafuccos' results when "backtested to 1973-74 (footnote omitted)). The many slides devoted to the initial discussion of the Bold Bucketees cover only 13 years, and it is not clear that either 1966 or 1973 is one of those years. *Id.*, pp. 438-65. Indeed, the initial Bold Bucketees discussion does not include any actual historical data, so it would not matter whether the discussion included 1966 or 1973; the outcome would be the same regardless of the period covered. *Id.*, p. 465. It is only after the "'73/'74 Grizzly Bear" is introduced, and the assumptions become a mix of actual historical data and assumed data (for inflation and REIT returns), that the slideshow purports to compare the Bold Bucketees with the Balanced Buttafuccos over a period including 1973. *Id.*, pp. 466-68. Accordingly, although the OIP's citations to the "1973 backtest" could be construed as referring to purported backtesting both of the BOM strategy and of the portfolios of the High Rolling Hendersons and the Bold Bucketees, it is more reasonable to construe it only as referring to purported backtesting of the BOM strategy starting in 1973 and 1966. Thus, although the entirety of the slideshow is relevant to this proceeding, I conclude that the focus of the OIP's allegations is on only thirteen pages of it. Div. Ex. 1, pp. 466-78.

### **B. The Central Importance of the Backtests**

The backtest slides are the capstone of the slideshows, and the '66 Backtest is the pinnacle. Respondents imply that the backtests were discrete, standalone slides and meant little to the overall message. Resp. Br., p. 32. On that point, Respondents cite the fact that the word backtest was used only twice in the entire slideshow. Resp. Br., p. 32. To the contrary, I find that the slideshow was a carefully orchestrated progression toward the backtests, which espoused the final proof that BOM, with REITs, is the best retirement strategy.

The first half of the slideshow is spent criticizing conventional investment wisdom and problems with following traditional portfolio models. It is only the second half of the presentation that begins the BOM strategy comparison. Lucia then uses a series of fictional investors who, following traditional investment advice, fail to obtain their retirement investment objectives. Div. Ex. 1, pp. 419-37. He makes certain assumptions for investment returns (actual returns for stocks and bonds and assumed returns for everything else) and inflation, runs the numbers, and presents the results. Id. He emphasizes that the High Rolling Hendersons and Balanced Buttafuccos suffer from the effects of the 1973 stock market, and ultimately characterizes his Balanced Buttafuccho analysis as “backtested to 1973-74.” Id., pp. 428, 435-37. He then analyzes the Bold Bucketees using the same approach, but with a different asset allocation and withdrawal strategy than the previous fictional investors. Id., pp. 437-65. A reasonable prospective investor, viewing the slideshow’s presentation of essentially the same methodology for the four different fictional investors, would understand that all four assumed portfolios had been backtested, just as the Balanced Buttafuccos’ had.

The ’73 Backtest slide, entitled “Back Tested Buckets,” compares the Bold Bucketees (who invest in REITs) to the Balanced Buttafuccos (who do not), over the period 1973 to 1994. Id., p. 467. The result is an investment principal in 1994 of \$1,544,789 for the Bold Bucketees, compared to \$0 for the Buttafuccos. Id., p. 467. The kicker comes, however, with the ’66 Backtest. The ’66 Backtest without REITs weathers thirty-eight years to provide an ending principal of \$1.2 million. Id., p. 475. The next slides introduce the same investment portfolio, but add a 20% investment in REITs, and the ending principal of the portfolio more than triples to \$4.7 million in the same period. Id., p. 478. To be sure, the slideshow does not explicitly display the term “backtest” in discussing the ’66 Backtest. Id., pp. 468-78. However, it does use the term “Back Tested Buckets” in discussing the ’73 Backtest, and in context the clear implication is that the 1966-2003 results were also backtested. Id., p. 467. For example, the slideshow asks, “what would have happened if you retired in 1966 . . .,” and lists various “Notes and Assumptions,” suggesting that the 1966-2003 results were analyzed in a way similar to the ’73 Backtest. Div. Ex. 1, pp. 470-71. Any reasonable prospective investor would have interpreted these slides, too, as suggesting that the results had been backtested.

Respondents nonetheless argue that a reasonable investor would understand that the slideshows did not present backtests, as the Division (and, now, this decision), define the term. Resp. Br., p. 17. Dr. Hekman testified that a reasonable investor would understand “that [the backtest slides] were not ‘back-tests’ of investment performance.” Resp. Ex. 35, p. 14; Tr. 1433. But Dr. Hekman was not offered as an expert on how reasonable investors would understand a slide, nor is there any reason to privilege his opinion over anyone else’s. Additionally, Respondents argue that statements made by Lucia at slideshows, and some made during the Webinar, are proof that reasonable investors would understand that the backtests were just hypotheticals using hypothetical rates. Resp. Br., p. 17. For example, Respondents cite to Lucia’s statement, “we know it was more, but we wouldn’t have known it at the time,” regarding the 3% rate of inflation utilized during the Webinar. Div. Ex. 66, pp. 48-49. Lucia also used the term “pretend” multiple times in the Webinar, and the slideshow contains numerous disclaimers regarding “hypotheticals.” Id., pp. 40, 48, 53; Div. Ex. 1, pp. 436, 448, 467. Respondents argue that such statements made it apparent that the backtests were hypotheticals with a forward-looking mentality. Resp. Br., p. 17; Resp. Reply, p. 22 n.29.

Nevertheless, the only two audience members to testify understood from the context that the backtests were presented as historically accurate. Tr. 267-69, 371-72, 377-78. No fine-print disclaimers appear on the slides discussing the '66 Backtest. Div. Ex. 1, pp. 472-78. In the Webinar, Lucia stopped using the term “pretend” after he started discussing the '66 Backtest. Div. Ex. 66, p. 50. The backtests use a mix of historical and ahistorical data, but the results are in every case presented as realistic enough to support substantial investments. Div. Ex. 1, pp. 467-78. Accordingly, I do not find Respondents’ arguments regarding a reasonable investor’s understanding of the backtests persuasive. That is, a reasonable investor would have understood that the '66 and '73 Backtests’ data and assumptions were realistic.

### **C. Importance of REITs in the Backtests**

Even assuming that a reasonable investor would have understood that some data and assumptions were not realistic, the REIT assumptions are presented misleadingly. I conclude that a major focus of the backtests was to sell REITs, and the backtest slides’ misleading statements on REITs were crucial to Lucia’s strategy. Respondents argue that the only purpose of the slideshow, and the backtests, was to demonstrate the effectiveness of the BOM strategy. Resp. Br., pp. 10-11. But selling REITs was at least an equally recognizable purpose. The progression from the “Buttafuccho” portfolio to the “Bucketeer” portfolio, that is, from a portfolio that failed to one that succeeded, included only two new variables, BOM and REITs. Div. Ex. 1, pp. 437, 467. The only factor shown to audience members that differed between the backtest slide showing principal of \$1.2 million and the following one, showing tripled principal of \$4.7 million, was REITs. Div. Ex. 1, pp. 475-78.

Any doubt on this issue is dispelled by the Webinar.<sup>26</sup> In the Webinar, Lucia stresses that REITs, which he generally calls simply “real estate,” are “critical” to the BOM strategy. Div. Ex. 66, pp. 34:12-14, 35:10-16. He states that REITs, both tradeable and nontradeable, provide “a higher rate of return at lower risk,” which is the “holy grail of investing.” *Id.*, p. 35:14-16. He characterizes the “real live” BOM strategy as including twenty percent interest in real estate, while displaying a slide showing “20% REITs.” *Id.*, p. 50:2-5. He emphasizes the value of “nontradeable” real estate, i.e., non-traded REITs. *Id.*, p. 69:17-18. He compares a “pseudo [BOM] strategy,” having no REITs, with “the real Buckets portfolio, using real estate, 4.7 million dollars.” *Id.*, p. 51:16-19. Plainly, the backtest slides’ misleading statements on REITs were crucial to Lucia’s strategy.

---

<sup>26</sup> Respondents place much emphasis on the Webinar, “urg[ing] this court to again review the Webinar prior to issuing a decision.” Resp. Reply, p. 17. Respondents offered the Webinar because, they say, it is the only recordation of one of Lucia’s slideshows. Resp. Br., pp. 16-17. The Webinar, according to Respondents, shows the full context of the slideshows with discussions that explain the slides that, viewed in a vacuum, are misconstrued. Resp. Br., pp. 16-17. As noted *supra*, there are numerous differences between the slideshow and the Webinar, some of them significant. Nonetheless, because consideration of the Webinar works almost entirely to Respondents’ disadvantage, I accept their invitation to consider it “the best evidence of the BOM seminar presentation.” Resp. Br., p. 16.

#### **D. The REIT Rates and Usage were Unreasonable and Misleading**

It is undisputed that neither the '66 nor '73 Backtest meets the definition of "backtest" that I have adopted. Tr. 115-16, 960, 1402; Resp. Br., p. 32. But a prospective investor would have understood the slideshow as presenting the results of backtesting. Given these findings, the spreadsheets do not provide sufficient support for either the '66 or the '73 Backtest, or for the Webinar's version of those Backtests, and the slideshow itself did not provide sufficient transparency to prospective investors regarding either Backtest. More importantly, the various slideshow statements regarding REITs were misleading.

Based upon the expert testimony of Grenadier and Gannon, I find that Lucia's use of an assumed 7% dividend rate for the '66 Backtest and 7.75%<sup>27</sup> dividend rate for the '73 Backtest was misleading. First, the '66 Backtest invested in REITs on January 1, 1966, at a time when data on REITs were unavailable, partly because there was no available index for REITs, but mainly because REITs themselves were largely unavailable. REIT data were unavailable until 1972, six years into the ten-year REIT investments in the '66 Backtest. There is no evidence that Lucia, Plum, or anyone else at RJLC did any sort of analysis like Gannon did for the period 1966-1971. Accordingly, the REIT returns for those years were essentially made up out of whole cloth. Furthermore, the rate that Gannon found with his model was based upon data from a single article, and was heavily burdened with subjective assumptions adopted solely by him. Tr. 1367, 1381. Additionally, as explained *supra*, even accepting Gannon's assumptions and model, his conclusion actually suggests that REIT dividends in 1966-1971, had there been any, would have been less than 7%.

Second, whichever index is used, the NAREIT All REIT or the NAREIT Equity REIT, it is clear that 1973 and 1974 produced significant losses for the REIT market as a whole. Div. Ex. 70, Ex. 5a (using NAREIT All REIT); Resp. Ex. 34, Exhibit C (showing NAREIT Equity REIT yearly returns for 1972-2003). Both the '66 Backtest and the '73 Backtest, because they began with REIT investments, would properly have shown substantial losses for any principal investment in 1973 and 1974. Using rates averaged through 2003 ignores the fact that the '66 Backtest invested in REITs in 1966 and held them for ten years, until 1975.<sup>28</sup> Div. Ex. 12. Thus, the principal invested in the stock market in 1975 following liquidation of the REITs, should properly have been less than \$200,000. Gannon's rationale that the dividend rates were reasonable for the period after 1972, because the average rate between 1972 and 2003 was 12.9%, ignores the fact that the REITs in the '66 Backtest were completely liquidated by 1975, leaving only a three-year sample, two of which were disastrous for REITs. Tr. at 1390; Div. Ex. 12.

---

<sup>27</sup> As noted, it is unclear if this was the actual rate used. Respondents produced no documentary support for the '73 Backtest numbers. However, the '73 Backtest slide contrasts the Bucketeeers against the Buttafuccos, whose portfolio had an assumed 7.75% yearly dividend. Accordingly, I conclude that a prospective investor attending one of Lucia's seminars would have understood the '73 Backtest to have assumed a 7.75% dividend rate.

<sup>28</sup> In context, it appears the REITs were purchased at the start of 1966 and sold at the end of 1975, a ten-year period. As noted, it is unclear how long the '73 Backtest held the REITs because no support was produced for it.

Third, the '66 Backtest liquidated the REITs after an arbitrary ten years, despite the significant downturn in the real estate market in 1973 and 1974. Gannon testified that average REIT lifecycles last between five and seven years. Tr. 1370. True enough, a REIT could have a ten-year cycle, but according to Gannon's testimony, that would occur outside the norm. Tr. 1369-70. It was also convenient for Respondents to use a ten-year cycle. Liquidating anywhere within the five to seven year period would have exposed that principal to the 1973-1974 bear market for stocks – an asset which Lucia was actually calculating using historical returns. Instead, the ten-year period allowed Lucia to time the market perfectly, investing in the stock market as it rose again. Without liquidity events, there are few options to liquidate non-traded REITs, other than redemption for a discount to the principal investment. Tr. 1298-99, 1675. The assumed timing for the liquidity of the REITs in the '66 Backtest was, thus, unreasonable and its effect on the final number presented to prospective investors contributed to the backtest slide being misleading.

Fourth, the '66 Backtest as presented in the slideshow discloses neither the length of time REITs were assumed to have been held, nor whether the REIT principal remained constant. Div. Ex. 1, pp. 471-78. The Webinar was similarly silent on these assumptions. Div. Ex. 66, pp. 48-50. A prospective investor would not have known either how long the REITs were assumed to have been held, or the ending REIT principal amount.

Fifth, the Webinar is even more misleading than the slideshow. The first “Notes & Disclaimers (REITS)” slide in the slideshow does not appear in the Webinar at all, and although the second “Notes & Disclaimers (REITS)” slide appears in the Webinar, it does not disclose the fact that REITs have limited liquidity, in contrast to the corresponding slide in the slideshow. Div. Ex. 1, pp. 415, 447; Div. Ex. 66, pp. 35, 44. Before discussing the effects of REITs in connection with the '66 Backtest, Lucia repeatedly uses the term “pretend” when introducing his assumptions. Div. Ex. 66, pp. 40, 48. But when he discusses the effects of REITs, he does not use the term “pretend.” *Id.*, p. 50:5. When discussing the BOM strategy in detail, Lucia states “in the sixties, you could have got about \$15,000 per year income, dividends from that real estate investment.” *Id.*, p. 44:22-25. This assumes a 7.5% dividend, which as noted *supra*, is false, and in context it is extremely misleading because it affirmatively avers that REITs were available for investment in the 1960's. Respondents' argument that the BOM strategy outperformed the comparative portfolios, “even assuming the actual historical rates were applied” to the '66 and '73 Backtests, is thus entirely unpersuasive. Resp. Br., p. 17.

#### **E. Misleading Impact of Historical Context**

Respondents used the 1973 and 1966 retirement start dates in the slideshows to provoke sentiment in audience members who were predominantly retirees and near-retirees. These historical start dates were not arbitrary. Respondents assert that the Backtests were merely “forward-looking” hypotheticals to show BOM's efficacy. Resp. Br., p. 14. I disagree. To accept that argument discounts Respondents' calculated use of specific historical milieus. If Respondents' only goal was to demonstrate that BOM portfolios outlast conventional portfolios under any set of market conditions, start dates of 1973 and 1966 were not required, nor would there be any reason to mix actual market with assumed market data.



The slideshow prefaces the backtests with historical context of the poor economic conditions plaguing the stock market from 1966 to 1982 and the acute problems in the market during 1973 and 1974. Div. Ex. 1. The presentation further primes the audience by representing how the non-bucketized – and non-REIT-invested – fictional investors would have fared, had they retired on January 1, 1966, and January 1, 1973. *Id.*, pp. 471, 478. Many audience members who were retirees and pre-retirees would have lived through the market stagnation in the 1960s and the bear market in 1973-74. DeSipio understood the backtests to mean that the portfolios “held up under the various market conditions that occurred over the years.” Tr. 268. Chisholm said, “It was my understanding that [the bear markets] would not be an issue because this was a proven method of investing, that it had been back-tested.” Tr. 358.

#### **F. The “Backtests” were not Merely “Hypotheticals”**

Respondents argue that their use of the term backtest is scrutinized unfairly, and that what they offered were merely a series of “hypotheticals.” Resp. Br., pp. 10-14, 32. Respondents support this argument by noting that the term “backtest” is only used twice in the slideshow; whereas, “hypothetical” is used thirty-seven times. Resp. Br., p. 32, n.38. Respondents also argue that, in hindsight, they would have used the term “hypothetical” instead. Resp. Br., p. 32. I do not find this convincing. Foremost, a backtest is, by definition, a realistic hypothetical. Tr. 115. Otherwise, there would be actual historical statistics for the actual portfolio. Similarly, the number of times the terms are used does not diminish the emphasis on what the backtest slides represented: the grand culmination of the slideshow, hailing the triumph of the BOM portfolios, with REITs, over all of the fictional investors’ portfolios. For the reasons discussed *supra*, the slideshow would be misleading even if the term backtest never appeared in it. The use of the term backtest by itself does not make the slideshow misleading – it only exacerbates it.

#### **G. The Backtests were Misleadingly Offered as Scientific Findings**

Respondents coated the backtest slideshows with the veneer of scientific methodology and due diligence. For example, Lucia stated during his Webinar that he told his friend Ben Stein, “You’d lose all respect for me if I hadn’t done my homework. I have.” Div. Ex. 66, p. 48. Lucia also began the Webinar by stating, “I’m going to show you the science behind retirement distribution planning, not really focusing on the art of speculation. There’s a big difference between science – that which has been proven in finance labs all around the country—and art, which is, I don’t know, pulling stuff out of the sky and trying to figure it out from there.” *Id.*, p. 4. Such language implies that Respondents applied proper diligence to prove that the strategy would endure the market conditions of the 1960s and 1970s. Despite what Lucia represented about backtesting to 1973 and 1966, he actually had no support for them. Even the minimal support produced by Plum includes arithmetical errors. Tr. 667, 1079-80; Div. Exs. 12, 13. RJLC had no procedures in place to determine whether calculations were accurate. Tr. 668. There is no evidence that anyone verified the numbers generated by Lucia’s daughter’s boyfriend, a recent college graduate. Tr. 784. In sum, Lucia did, in fact, “pull[] stuff out of the sky.” Div. Ex. 66, p. 4.

## **H. The Clients' Testimony Was Credible**

Respondents argue that the testimony of the two RJLC clients, DeSipio and Chisholm, should be discounted. Resp. Br., pp. 52-54. DeSipio filed a Financial Industry Regulatory Authority (FINRA) arbitration claim which contained false allegations against Lucia, having to do with a mortgage-backed investment but not the BOM seminars. Tr. 318-19. He ultimately released Lucia from the case and admitted in writing that his claims against Lucia were false. Tr. 319. Because I sustained the Division's objection to four proposed exhibits pertaining to the FINRA claim, the precise nature of the claim and release are unclear. Tr. 309-12. In particular, there is no evidence that DeSipio's claim was verified, or that he made any knowingly false sworn statements in any filings in the FINRA case. Accordingly, the fact that his FINRA claim made false allegations reduces DeSipio's credibility somewhat; on the other hand, the fact that he released Lucia from the case and admitted that his claims against him were false, apparently without any consideration, restores his credibility somewhat. Overall, DeSipio's testimony was straightforward, with essentially no evasiveness, and his demeanor was sincere. I do not discredit any of his pertinent testimony.

Respondents also denigrate Chisholm's credibility based upon his failure to remember the precise order of when he attended BOM seminars and when he first met with an RJLC advisor. Resp. Br., p. 54 & n. 72. Chisholm initially testified that he invested with RJLC after seeing a BOM presentation in late 2009 or 2010. Tr. 434. However, Chisholm admitted during cross-examination that he may have been influenced to invest through RJLC due to a show he attended in 2006, rather than the second one he attended in 2009 or 2010. Tr. 416. Or, alternatively, Chisholm was influenced to invest in REITs through RJLC based upon a combination of having seen the slideshow presentation, reading Lucia's books, and hearing his radio show. Tr. 336, 339, 1632. Admittedly, the holes in his memory would reduce his credibility if the timing of various events were crucial. But because Lucia offered the same backtest claims through all the media he used, I find it irrelevant whether Chisholm was mistaken about having contacted RJLC before or after the latest slideshow he attended. Even assuming that Chisholm became a client of RJLC after calling Lucia's radio show and asking to speak with a representative – as Lucia, Jr. testified, without any explanation for how he knew such facts – it is undisputed that Chisholm attended a BOM seminar prior to calling into the show. Tr. 1632. Respondents' argument that Chisholm became a client of RJLC "as a result of Lucia's radio show, not a BOM seminar" is not a reasonable inference from these facts. Resp. Br., p. 54, n. 72. Nor am I impressed by the fact that Chisholm has complained to multiple people about the REIT investment he made through RJLC, but not about the BOM seminar; to the contrary, that he complained to others actually bolsters his overall credibility, and that he complained only about his REIT investment actually supports the finding that Respondents had an overwhelming incentive to sell REITs, even to clients for whom they were not appropriate. As with DeSipio, I do not discredit any of Chisholm's pertinent testimony.

## IV. CONCLUSIONS OF LAW

### A. Sections 206(1) and 206(2) of the Advisers Act.

RJLC violated Sections 206(1) and 206(2) of the Advisers Act.<sup>29</sup> Section 206 provides:

It shall be unlawful for any investment adviser, by use of the mails or any means or instrumentality of interstate commerce, 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.

15 U.S.C. § 80b-6. To establish violations under sections 206(1) and (2) of the Advisers Act, the Division must prove that RJLC was an investment adviser, that it engaged in fraudulent activities by jurisdictional means, and that it negligently breached its fiduciary duty by making false or misleading statements or omissions of material fact.<sup>30</sup> SEC v. Merrill Scott & Assoc., Ltd., 505 F. Supp. 2d 1193 (D. Utah 2007); SEC v. Gotchey, No. 91-1855, 1992 WL 385284, \*2 (4th Cir. Dec. 28, 1992); See SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 191-92 (1963). To establish a violation of Section 206(1), the Division must also prove that Lucia and RJLC acted with scienter. SEC v. Steadman, 967 F.2d 636, 641 & n.3 (D.C. Cir. 1992).

#### 1. Registered Investment Advisers and Interstate Commerce

RJLC was a registered investment adviser from 2002 to 2011. RJLC Answer, p. 1. Lucia became a registered investment adviser in 1996 and, at least at the time of his Answer, was still a registered investment adviser. Lucia Answer, p. 2; Div. Ex. 2, p. 5. Lucia and RJLC engaged in interstate commerce. Lucia presented his slideshow to audience members and prospective investors across the country, visiting different cities around forty times a year. Tr. 1059, 1069-70. RJLC was a countrywide investment adviser, with at least fifteen offices in multiple states, including California, New Jersey, and Oregon. Tr. 280, 383, 1304.

#### 2. Misrepresentations

Lucia and RJLC misrepresented the veracity of the backtests by using a misleading mix of historical and ahistorical information. The Division showed that Respondents provided misleading information about having backtested the information and that Respondents omitted material information about the assumptions used for the backtests.

---

<sup>29</sup> RJLC was the “maker” of the fraudulent statements under Janus Capital Group, Inc. v. First Derivative Traders, 131 S.Ct. 2296, 2302 (2011), because it “created” the materials and had ultimate legal control and responsibility for them. Tr. at 457. Lucia’s statements and actions as the controlling and sole shareholder were offered as part of RJLC’s marketing, and thus are imputed to RJLC.

<sup>30</sup> RJLC was a registered investment adviser at all relevant times.

Respondents misled prospective clients by portraying their conclusions as having been actually backtested and that the backtests used scientific methodology with realistic historical data and assumptions. Using that backdrop, Respondents misleadingly portrayed the '73 Backtest conclusion that, after twenty-one years, the fictional investors would maintain \$1,544,789 in principal, as empirical proof of the veracity of BOM with REITs. Nevertheless, Respondents were unable to provide any support for the '73 Backtest and their own expert could not recreate the '73 Backtest conclusion.

Similarly, Respondents misleadingly presented to seminar audiences that they had backtested the BOM strategy to 1966, and that the BOM strategy, with the addition of REITs, culminated in a \$4.7 million portfolio for the fictional investors. The spreadsheets offered as support in conjunction with actual historical data on REITs show that the conclusion offered in the slideshows was inaccurate and misleading because the REIT rate utilized was historically inaccurate and inflated, the REITs were invested at a time when they were unavailable, the REITs' liquidity was never impaired despite undisputed evidence that it would be, stable REIT investments were artificially assumed to have been made during the stock market drops in the early and mid-1970s, and the calculations were flawed and incorrect.

Finally, the Commission is not required to prove reliance in an enforcement action and the lack of reliance is, therefore, not a defense. See e.g. SEC v. Simpson Capital Mgmt., Inc., 586 F. Supp. 2d 196, 201 (S.D.N.Y. 2008) (“Unlike private litigants, the SEC is not required to prove investor reliance . . . in an action for securities fraud.”); SEC v. Rana Research, Inc., 8 F.3d 1358, 1363 & n.4 (9th Cir.1993); SEC v. Blavin, 760 F.2d 706, 711 (6th Cir.1985).

### 3. Scienter

Scienter is defined as a “mental state embracing the intent to deceive, manipulate, or defraud.” Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 n.12 (1976); Aaron v. SEC, 446 U.S. 680, 686 n.5 (1980). A finding of recklessness satisfies the scienter requirement. David Disner, 52 S.E.C. 1217, 1222 & n.20 (1997); Hollinger v. Titan Capital Corp., 914 F.2d 1564, 1568-9 (9th Cir. 1990), cert. denied, 499 U.S. 976 (1991) (citing eleven circuits holding that recklessness satisfies scienter in Section 10(b) and Rule 10b-5 actions). Recklessness, in the context of securities fraud, is “highly unreasonable” conduct, “which represents ‘an extreme departure from the standards of ordinary care . . . to the extent that the danger was either known to the defendant or so obvious that the defendant must have been aware of it.’” Rolf v. Blyth, Eastman Dillon & Co., 570 F.2d 38, 47 (2d Cir. 1977) (quoting Sanders v. John Nuveen & Co., 554 F.2d 790, 793 (7th Cir. 1978)); see also S.W. Hatfield, CPA, Exchange Act Release No. 69930 (Jul. 3, 2013), – SEC Docket – , p. 29.

The standard of care for a registered investment adviser is based on its fiduciary duty. See Transamerica Mortg. Adviser, Inc. v. Lewis, 444 U.S. 11, 17 (1979); Capital Gains Research Bureau, 375 U.S. at 191-92. Investment advisers have an “affirmative duty of ‘utmost good faith, and full and fair disclosure of all material facts.’” Capital Gains Research Bureau, 375 U.S. at 194 (citations omitted); Blavin, 760 F.2d at 711-12. Respondents were required to “employ reasonable care to avoid misleading” clients. See Capital Gains Research Bureau, 375 U.S. at 194; SEC v. Moran, 922 F. Supp. 867, 895-96 (S.D.N.Y. 1996). Ultimately, the standard

is one of “reasonable prudence, whether it usually is complied with or not.” Vernazza v. SEC, 327 F.3d 851, 861 (9th Cir. 2003) (citation omitted). As applicable here, an investment adviser has a “professional duty to investigate the information upon which his recommendations [are] based” and to inform investors of risks. Blavin, 760 F.2d at 712; see SEC v. Fife, 311 F.3d 1, 10 (1st Cir. 2002).

Respondents acted at least recklessly in violating Sections 206(1) and 206(2) of the Advisers Act. Lucia authored the slideshows and maintained ultimate control over them. Tr. 568, 1691. Lucia also engineered the backtests. Tr. 568, 776, 791-92, 1130, 1191. In doing so, Lucia deliberately chose to present: the backtest slides and language; the historical contexts of the backtests; the misleading REIT rate of 7% for the ‘66 Backtest; the span of years of the backtests, which shielded the REIT investments from stock market volatility; and for the ‘66 Backtest, an initial investment date of 1966, five years before most REITs were available, and before any published rates were available.<sup>31</sup> Lucia had full control over, was fully aware of, and actually committed the violations in this case, and Lucia’s scienter is imputable to RJLC.

Lucia departed from the standards of care by not ensuring the accuracy of the information on which his recommendations were based, and this departure was extreme. The backtests were not supported by the spreadsheets or any other documentation, and Lucia testified that he did not think he was required to maintain such documentation. Allegedly, some backtest calculations were generated by a junior analyst who was a recent college graduate and who apparently got his job because he was dating Lucia’s daughter. Lucia’s employees, Ochs and Plum, apparently thought that the backtests were properly documented, because they produced documents that they believed constituted support for them, but were not, in fact, support. The inaccuracies discovered in the slideshow demonstrate that Lucia placed little emphasis on accuracy in the calculations he so enthusiastically presented to prospective investors. He also had no mechanism in place to correct inaccuracies. Tr. 667-68. Respondents contested the findings of the 2010 examination, and posted a video refutation of the OIP, before conducting the internal investigation which revealed errors in the ‘73 Backtest slides and the first spreadsheet. Tr. 1205-08. It was not reasonably prudent, and it was an extreme departure from the standards of ordinary care, for the extensive number-crunching required to support the crucial parts of the slideshow, including the claims regarding the ‘66 and ‘73 Backtests, to be undocumented and irreproducible even by Respondents’ own expert witness.

Lucia’s backtest presentations suggested to prospective investors that they used historical data to test a particular investment strategy, even though he knew that they did not. Lucia discussed how Ben Stein was skeptical of the BOM strategy. Div. Ex. 66, p. 47. Lucia, however, satisfied Stein with what he asserted was a backtest. He stated, “Well, I did a backtest for Ben [Stein].” Id.; Tr. 1318. Lucia was clearly not telling Stein that he created a true hypothetical like with his fictional investors; rather he was claiming to use an actual backtest to prove that BOM worked, and he then did the same with seminar attendees. Similarly, he touted the BOM strategy as a “time-tested” one based upon “empirical evidence” and “science, not art.”

---

<sup>31</sup> Respondents argued that the ‘66 Backtests were created only for the benefit of Ben Stein. Tr. 772, 1137. Even if the ‘66 Backtest was originally created for Stein’s benefit, Lucia chose to add that backtest to his slideshow. Tr. 1191.

Div. Exs. 10, 16; Tr. 624-25, 1050, 1111. Lucia knew that the BOM strategy had not been backtested, as seminar attendees would have understood that term, as opposed to how the “financial industry” allegedly would have understood the term. This is demonstrated by the fact that what are called backtests in the slideshow do not qualify as either backtests or hypotheticals even under Lucia’s definition. Lucia testified that a backtest is “forward-looking,” even though at least the ’66 Backtest was a mix of historical and assumed data. Tr. 1127.

Lucia also departed from the standards of care in an extreme way by failing to inform seminar attendees of the risks of investing in REITs. Lucia failed to put in disclaimers in the ’66 Backtest slides, from which a reasonable investor would have understood that the ’66 Backtest slides were less “hypothetical” than the preceding slides. Div. Ex. 1, pp. 471-78. Although not so much a risk as an extremely material fact, he also failed to inform seminar attendees that REITs were essentially unavailable prior to 1972, and that the spreadsheet allegedly supportive of the ’66 Backtest assumed an investment in REITs spanning a bear market in stocks.

Given Lucia’s extensive experience promoting REITs and long career as an investment adviser, and the large revenues he earned by selling them, he must have known that they were illiquid and essentially unavailable until 1971. Lucia nonetheless presented REITs, falsely and misleadingly, as if they were liquid and purchasable in 1966. When discussing the BOM strategy in detail during the Webinar, Lucia states “in the sixties, you could have got about \$15,000 per year income, dividends from that real estate investment.” Div. Ex. 66, p. 44:22-25. In the slideshow, REITs are allegedly backtested to 1966, and according to the spreadsheet, they are liquidated, conveniently, exactly when they are needed to refill the “safe” bucket. Div. Ex. 1, p. 478; Div. Ex. 12.

There is also evidence of actual intent, although it generally does not pertain to REITs. Lucia agreed that if actual inflation was used in the ’66 and ’73 Backtests, the portfolios would have been depleted more quickly, and would have been “damaging” to the ’66 Backtest. Tr. 1150-51, 1192:9. Lucia knew that disclosing that the BOM strategy would go bankrupt would not be helpful in attracting clients. Tr. 1151-52. The second spreadsheet, allegedly support for the ’66 Backtest, did not use the BOM strategy, a fact never disclosed to seminar attendees and an approach Lucia rejected in one of his radio shows. Tr. 1130; Div. Ex. 35. Lucia told Dr. Hekman that an error had been identified in the “Back Tested Buckets” slide. Tr. 1537-38; Div. Ex. 1, p. 467. However, Lucia testified disingenuously, as if he did not know of the error. Tr. 1080-81. An encounter between Bennett and Plum also supports a finding of intent, at least as to RJLC. During the 2010 examination, Bennett asked Plum about the ’66 and ’73 Backtests, in particular, he pointed out that use of actual inflation rates rather than an assumed inflation rate resulted in depletion of assets. Tr. 91. Plum replied that “of course, [the BOM strategy] would have gone broke, but all the portfolios would have gone broke.” *Id.* Plum, who attended a large number of seminars with Lucia, thus knew that the backtests were unrealistic and that the slideshow presented misleading results. Tr. 734-36.

Lastly, Respondents had a motive to misrepresent the facts about REITs: their non-traded REIT revenues were so significant to their bottom line that they had an overwhelming incentive to promote them. Lucia asserts now, and testified, that the BOM strategy is purely a “withdrawal” strategy, and is not an asset allocation strategy. Lucia’s assertion is knowingly

false. The backtest discussion in the slideshow is not merely a discussion of a withdrawal strategy, it is transparently a discussion of the benefits of investing in REITs, with the intent to lure prospective investors into buying them.

a. Lack of Investor Complaints

Respondents dispute the claim that they knew that the information they provided was misleading because, they argue, no audience members ever complained that such information was misleading. Resp. Br., p. 52-54. I do not find this argument convincing. It is not the responsibility of investors or prospective investors to make a respondent aware that something is misleading, it is the responsibility of advisors to act as their clients' and prospective clients' fiduciaries. Respondents cite no law in support of their argument, and indeed, Section 206 of the Advisers Act focuses upon the investment adviser and his or her actions. Clients and prospective clients are mentioned only in relation to the advisors. See SEC v. Gruss, 859 F. Supp. 2d 653, 662-63 (S.D.N.Y. 2012).

b. Reliance on Compliance Network and the Commission

Respondents argue that they could not have acted with scienter because multiple layers of internal and external compliance review vetted the materials, and none of them informed Lucia that the backtests were misleading. Resp. Br., p. 4, 54-56; Tr. 1607. In addition to its own compliance networks, Respondents argue that OCIE reviewed similar materials, including an earlier version of the slideshow, in 2003, and found no fault with it, essentially sanctioning the content. Resp. Br., p. 56. Respondents cite to SEC v. Slocum, Gordon & Co., 334 F. Supp. 2d 144 (D.R.I. 2004), in which the court found that the defendant relied upon independent external auditors and the Commission, neither of which raised issue with the defendant's account structure. I do not find merit in these arguments.

Respondents point to reviews by its network affiliated broker-dealers, first, Securities America, and second, First Allied, both of which cleared the slides, as wholesale endorsement of the backtests. Resp. Br., p. 54-55. These affiliates were not independent auditors, however. Both affiliates had joint venture agreements with Lucia and RJLC and drew substantial revenues from them. Tr. 445-46, 450. The affiliates, knowing the volume of leads generated by Lucia, which turned into revenue for them, could not be relied upon as true independent arbiters of the slideshow content. In 2003, while Ochs was with Securities America and reviewing Lucia's marketing material, she and her colleagues specifically requested that Lucia disclose the basis for the REIT return rates he used. Tr. 565; Resp. Ex. 20. There is no evidence that Lucia ever added those bases, and they do not appear anywhere in the slideshow. Div. Ex. 1. The '66 Backtest slides, unlike virtually every other section of the slideshow, bear no disclaimers at all, suggesting that there was in fact no advertising review of them. Div. Ex. 1, pp. 469-78. Furthermore, there is no evidence that anyone provided any support for the backtests to either affiliate, so that either would have a chance to consider the validity of the backtest slide figures.<sup>32</sup>

---

<sup>32</sup> In addition to ignoring compliance advice from its future chief compliance officer on the disclosure of the bases for REIT rates of return, one reason RJLC ended its relationship with

Respondents also cite to RJLC's internal compliance office to buttress the claim that the backtests were reasonable and in accordance with industry standards. Resp. Br., p. 32. Ochs, RJLC's Chief Compliance Officer, seriously undermined that argument. Ochs, who was in charge of the office tasked with reviewing the slideshows, testified that she understood a backtest to be in accordance with the definition provided by the Division and its expert. Tr. 574-75. Thus, the head of Lucia's compliance department did not understand that Lucia's claimed "backtests" were not proper backtests. She could not have concurred that the slides were not misleading if she did not even understand the material. Additionally, Ochs came from Securities America where she had been part of a compliance team tasked with reviewing Lucia's marketing materials, including the slideshows. Tr. 445. Thus, two of the three levels of compliance review involved a common denominator in Ochs, who understood the term backtest to mean something different from what Lucia now offers. Tr. 575. Accordingly, little significance can be assigned to the compliance reviews.

Respondents' argument that the 2003 Commission review concluded that the "'73 Illustration slides did not violate securities laws" is unpersuasive. The Respondents point to no evidence that the Commission review made any such conclusion. The 2003 examination report, stated only that RJLC did not advertise performance. Resp. Br., p. 19-20; Resp. Ex. 22, p. 3. That is a far cry from concluding the '73 Backtest did not violate securities laws. Moreover, it is not clear that the 2003 examiners asked for documentation of the backtest slide figures, which then comprised only the '73 Backtest, or that the examiners knew in 2003 that the slides were unsupported by any documentation, or that they examined any aspect of Respondents' REIT-connected activities. Resp. Ex. 22. It was only after Respondents produced a spreadsheet to OCIE in 2010, purportedly supporting the '73 Backtests, that OCIE knew how misleading the claims were. It was not reasonable for Respondents to assume, as they claim they did, that because the 2003 examination raised no issues regarding the '73 Backtest slides that the slides were not misleading. Even if the 2003 examination report (as opposed to the associated deficiency letter) had made such a conclusion, Respondents could not have relied upon it because they only received the examination report as part of discovery in this matter. Div. Reply, p. 52. Most significantly, the 2003 examination reviewed a version of the slideshow presentation that included only the '73 Backtest slides. Tr. 1484; Div. Ex. 21. That slideshow did not include the red flag-raising claim that the addition of REITs to a non-REIT BOM portfolio triples a portfolio's value, as the '66 Backtest does. Div. Ex. 21.

Slocum, where partial reliance on Commission examinations negated scienter, is inapplicable here. In Slocum, the defendants brought specific issues regarding account structure, which was later a basis of alleged fraud, to the Commission's attention during two examinations. 334 F. Supp. 2d at 160-61. Further, the defendants in Slocum relied upon the advice of counsel to structure its accounts, and after Commission and independent auditor recommendations regarding the specific account structures, tried to remedy them in accordance with those recommendations. Id., at 159-60. Here, the 2003 examination did not focus upon the backtest issue, the issue was not specifically brought to the examiners' attention, and there is no evidence of reliance on advice of counsel.

---

Securities America was an unfavorable audit by Securities America, at least one of the subjects of which was the BOM strategy. Tr. 454-60.



#### 4. Materiality

The Division proved that Lucia and RJLC's misrepresentations were material. The standard of materiality under Section 206 is whether or not a reasonable investor would have considered the information important in deciding whether or not to invest. See Basic, Inc. v. Levinson, 485 U.S. 224, 231-32, 240 (1988); TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976). Materiality is proved by showing 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.'" SEC v. Ginsburg, 362 F.3d 1292, 1302 (11th Cir. 2004) (quoting TSC Indus., 426 U.S. at 449 (1976)). Materiality does not require proof that accurate disclosure would have caused the reasonable investor to change his decision, but only that the omitted fact would have assumed actual significance in the deliberations of the reasonable investor. TSC Indus., 426 U.S. at 449.

A reasonable investor would consider the REIT investments in the backtests as dispositive proof that BOM with REITs was a wise investment choice. The contrasts between the fictional investor's "balanced" portfolio against the BOM portfolio with REITs, and the '66 Backtest without REITs against the '66 Backtest with REITs, could not have more clearly made the case for REITs. In the '73 Backtest, the fictional investors without REITs were left with no investment principal after thirty years while the fictional investors using BOM with REITs maintained a more than \$1.5 million investment. According to the '66 Backtest, a BOM portfolio without REITs would maintain a balance of \$1.2 million after thirty-eight years while a BOM portfolio with REITs would be worth \$4.7 million, more than triple the amount. Indeed, RJLC clients Richard DeSipio and Dennis Chisholm both testified that the discussion of REITs in their seminars was important in deciding to purchase non-traded REITs through RJLC. Tr. 281, 283, 380.

##### a. Investment Decision

Lucia argues that SEC v. Goble, 682 F.3d 934 (11th Cir. 2012), precludes this action because RJLC's misrepresentations were not material. The court held in Goble that misrepresentations influencing investors' choice of broker-dealer were not material because they did not encompass an investment decision. Id., at 944. In Goble, the defendant brokerage firm had misrepresented the level of its diminished capital reserves. The Commission's rationale for charging the defendant pursuant to Exchange Act Section 10(b) was that an investor client would consider it material whether its broker was solvent. Id. The court stated that such a rationale "cannot form the basis for [Section] 10(b) securities fraud liability." Id.

Lucia argues that, as in Goble, any misrepresentations would only influence a seminar attendee's decision to choose RJLC as an investment adviser, not to make a specific investment decision. To be sure, there is no evidence that RJLC or Lucia tried to sell specific securities at the seminars, nor are there any allegations by the Division that they did. But even assuming that the only basis for Lucia's violations of Sections 206(1) and 206(2) was that seminar attendees

were influenced to choose RJLC as their investment adviser, Goble would not preclude liability. Advisers Act Section 206(1) and 206(2) do not share the requirement of Exchange Act Section 10(b) that misrepresentations occur “in connection with the purchase or sale of any security.” Compare 15 U.S.C. § 78j(b) (Exchange Act Section 10(b)) with 15 U.S.C. § 80b-6 (Advisers Act Section 206). Though the basic test for materiality under the two statutes is similar, “[t]he elements for liability under . . . Section 10(b) and Rule 10b-5 of the Exchange Act . . . are more stringent than the requirements to violate Sections 206(1) and (2) of the Advisers Act.” SEC v. Lauer, 2008 WL 4372896, at \*24 (S.D. Fla. Sept. 24, 2008). “Congress intended the [Advisers Act] 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.” SEC v. Capital Gains Bureau, Inc., 375 U.S. 180, 195 (1963).

It is well established that investment advisers may be held liable under the Advisers Act even without misrepresentations specific to a client investment decision. See, e.g., Vernazza, 327 F.3d at 859 (investment adviser’s false representations of conflicts of interest in its Form ADV filed with the Commission was material); SEC v. K.W. Brown & Co., 555 F. Supp. 2d 1275, 1308 (S.D. Fla. December 19, 2007) (investment adviser’s scheme extending gains in favor of preferred clients while passing along losses to other clients was material because it was determinative as to whether clients would invest their money and trust with the defendant)<sup>33</sup>; SEC v. Moran, 922 F. Supp. 867, 896 (S.D.N.Y. 1996) (defendant investment adviser’s insider trading scheme allocated higher-priced shares to client accounts than its own, to the detriment of firm clients). Accordingly, Goble does not bar liability here.

#### b. Omission of Material Fact

Respondents never warned that REIT rates, for example, were hypothetical and not historically accurate, a material omission of fact. Respondents cite to disclaimer language used throughout the slideshows and invoked by Lucia in his narration as evidence that audience members could not have been misled, and that they would understand that the rates used for the backtests were entirely hypothetical. Resp. Br., p. 2 n.2. As noted supra, though, the slideshow’s assertions regarding REITs were misleading in multiple ways, including that they suggested that REITs were reasonably available as investments as far back as “the sixties.” Div. Ex. 66, p. 44. A reasonable investor would have wanted to know that REITs were not available at that time, and that REIT returns were not merely “hypothetical,” as the slideshow states, but effectively nonexistent. Additionally, the most frequently used disclaimer throughout the slideshow, including during the backtests, was that the slideshow was representing hypothetical investments and that past performance was not indicative of future returns. Div. Ex. 1; Tr. 227, 567. The proceeding does not allege that Lucia used actual examples, or that by using the

---

<sup>33</sup> K.W. Brown cited to Applicability of the Investment Advisers Act to Financial Planners, Pension Consultants, and Other Persons Who Provide Investment Advisory Services as a Component of Other Financial Services, Investment Advisers Act Release No. 1092 (Oct. 8, 1987), 39 SEC Docket 653, an interpretive release by the Commission, which stated that “the Commission has applied Sections 206(1) and 206(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.” Id., at 670-71.

backtests, he was guaranteeing future returns, which is what the disclaimers warned. Even if the disclaimers had been more direct, general cautionary language does not render omission of a specific misleading historical fact immaterial. See SEC v. Merchant Capital, LLC, 483 F.3d 747, 768 (11th Cir. 2007) (citing In re Westinghouse Sec. Litig., 90 F.3d 696, 710 (3d Cir. 1996)); Klein v. First Western Gov't Securities, Inc., 24 F.3d 480, 489 (3d Cir. 1994).

## **B. Section 206(4) of the Advisers Act**

Section 206(4) of the Advisers Act prohibits engaging in “any act, practice, or course of business that is fraudulent, deceptive, or manipulative,” and authorizes the Commission to prescribe rules designed to prevent such conduct. 15 U.S.C. § 80b-6(4). As with Section 206(2), which prohibits engaging in “any transaction, practice, or course of business which operates as a fraud or deceit,” scienter need not be proven under Section 206(4). 15 U.S.C. § 80b-6(2); Capital Gains Research Bureau, 375 U.S. at 195.

Just as Respondents’ misrepresentations constituted a practice or course of business which operated as a fraud or deceit under Section 206(2), they also constituted a practice or course of business that was fraudulent and deceptive under Section 206(4). Accordingly, Respondents violated Section 206(4).<sup>34</sup>

Rule 206(4)-1(a)(5) makes it a fraudulent, deceptive, or manipulative act, practice, or course of business within the meaning of Section 206(4) for a registered investment adviser to publish, circulate, or distribute any advertisement “[w]hich contains any untrue statement of a material fact, or which is otherwise false or misleading.” 17 C.F.R. § 275.206(4)-1(a)(5). Conduct under this Rule must be measured from the viewpoint of a person unskilled and unsophisticated in investment matters. See SEC v. C.R. Richmond & Co., 565 F.2d 1101, 1104-05 (9th Cir. 1977). Scienter is not an element. See Capital Gains Research Bureau, 375 U.S. at 195.

The Division alleges that the backtests constituted misleading performance advertising, a sub-category of prohibited Rule 206(4)-1(a)(5) advertisements. In furtherance of this allegation, the Division points to principles adopted in the Commission’s Division of Investment Management’s (IM) no-action letter to Clover Capital Management, Inc. (Clover). Div. Br., p. 41.<sup>35</sup> Years prior to Clover, IM considered advertising results of actual or model portfolios in advertisements per se fraudulent, but later relaxed its position. Clover, p. \*2. In place, IM staff considered performance advertising fraudulent if it implied “something about the adviser’s competence or about future investment results that would not be true had the advertisement included all material facts.” Id. Clover set forth eleven specific considerations that IM staff stated would render performance advertising misleading. Id., pp. \*2-\*3. Respondents dispute

---

<sup>34</sup> Violation of one of its associated Rules is not a precondition to finding a violation of Section 206(4). See Warwick Capital Mgmt., Inc., Advisers Act Release No. 2694 (Jan. 16, 2008), 92 SEC Docket 1410, 1411 n.3 (finding a violation of Section 206(4) without an associated violation of Rule 206(4)-1(a)(5)).

<sup>35</sup> Clover Capital Mgmt., Inc., SEC No-Action Letter, 1986 WL 67379 (Oct. 28, 1986).

Clover's authority and applicability to the matter at hand, arguing that the slideshows did not constitute performance advertising. Resp. Br., pp. 26-30.

I need not reach the issues raised by Clover. Rule 206(4)-1(b) defines what specific types of advertisements are included under Rule 206(4)-1(a). The term “advertisement” includes “written communication[s] addressed to more than one person . . . or any notice or other announcement in any publication or by radio or television.” 17 C.F.R. § 275.206(4)-1(b). The concept of advertisement has been construed liberally, and includes “investment advisory material which promotes advisory services for the purpose of inducing potential clients to subscribe to those services.” C.R. Richmond, 565 F.2d at 1105.

Lucia disseminated his misrepresentations in his books and through his radio and television shows, as well as via the seminars and at least one webinar. Tr. 1025-26; Div. Exs. 66-69. At the seminars, various printed materials were distributed, but they do not appear to have been summaries of the BOM strategy. Tr. 1052-55. The OIP asserts that Lucia promoted the BOM strategy on “his radio show and website, at seminars, and in his books.” OIP, pp. 2-4. Nonetheless, the core allegation of the OIP is that “it was materially misleading for Respondents to claim that their alleged backtesting validated the BOM strategy,” after which the OIP almost exclusively discusses the slideshow. OIP, pp. 7-9.

Consequently, there is some doubt about whether the OIP provides fair notice to Respondents that they stand accused of violating Rule 206(4)-1(a)(5) by misrepresentations other than those made at the seminars. In view of the limited scope of the Division’s argument in its post-hearing brief on this point – only that “Respondents’ seminar slideshow is an advertisement within the meaning of the Rule” – I conclude that only misrepresentations at the seminars may be found violative of Rule 206(4)-1(a)(5). Div. Br., p. 40.

Given this limitation, the Division has not proven that “written communications” include live slideshow presentations. The precedent, outdated as it may be, holds written communications to include only traditional media, including books, newsletters, and newspaper and magazine advertisements. See, e.g., SEC v. Suter, No. 81-3865, 1983 WL 1287, \*12 (N.D. Ill. Feb. 11, 1983) (newsletters); SEC v. Lindsey-Holman Co., No. 78-54-MAC, 1978 WL 1129 (M.D. Ga. Aug. 6, 1978) (newspaper advertisements); C.R. Richmond, 565 F.2d at 1104 (books and newsletters). There is no evidence that slideshow printouts or synopses thereof were handed out to seminar participants or otherwise published in printed or even handwritten form at the seminars. I do not find that the slideshow presentations were “written communications” as that term has been interpreted. Accordingly, Respondents did not violate Rule 206(4)-1(a)(5).

### **C. Section 204 of the Advisers Act**

Advisers Act Section 204 requires investment advisers to “make and keep for prescribed periods such records . . . as the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors.” 15 U.S.C. § 80b-4(a). Advisers Act Rule 204-2(a)(16) requires investment advisers to keep true and accurate record of:

All accounts, books, internal working papers, and any other records or documents that are necessary to form the basis for or demonstrate the calculation of the performance or rate of return of any or all managed accounts or securities recommendations in any notice, circular, advertisement, newspaper article, investment letter, bulletin or other communication that the investment adviser circulates or distributes, directly or indirectly, to 10 or more persons (other than persons connected with such investment adviser); provided, however, that, with respect to the performance of managed accounts, the retention of all account statements, if they reflect all debits, credits, and other transactions in a client's account for the period of the statement, and all worksheets necessary to demonstrate the calculation of the performance or rate of return of all managed accounts shall be deemed to satisfy the requirements of this paragraph.

17 C.F.R. § 275.204-2(a)(16). The plain language of the Rule encompasses only advertisements of performance or rates of return for managed accounts or specific securities recommendations. Though Lucia's seminars influenced individuals to purchase classes of securities from RJLC, particularly non-traded REITS, Lucia never advertised a specific security, nor is there evidence that the examples used in the slideshow were specific managed accounts. The same is true of the Webinar. Div. Br., p. 44 n.12. Accordingly, Lucia was not required to maintain the above-referenced records, and did not violate either Section 204 or Rule 204-2(a)(16) thereunder.<sup>36</sup>

#### **D. Aiding and Abetting**

Lucia willfully aided and abetted RJLC's violations of Sections 206(1), 206(4), and 206(2) of the Advisers Act. To establish a claim of aiding and abetting there must be: (1) a primary violation of the securities laws; (2) the aider and abettor must have knowledge of the primary violation; and (3) the aider and abettor must provide substantial assistance in the commission of the primary violation. SEC v. DiBella, 587 F.3d 553, 566 (2d Cir. 2009). Lucia acted with scienter, and provided much more than substantial assistance. He was not only the controlling sole shareholder of RJLC, but he was the creator of the slideshow, the seminar marketing, the backtests, and all of the components to the backtest, including the REIT rates, the length and timing of the REIT investments, and the historical periods to use as context. The finding that RJLC violated Sections 206(1), 206(2), and 206(4) of the Advisers Act inescapably leads to a finding that Lucia aided and abetted it.

---

<sup>36</sup> In contrast to Section 206(4), the language of Section 204 suggests that it may only be violated if one of its associated Rules is violated. 15 U.S.C. § 80b-4(a) ("as the Commission, by rule, may prescribe" (emphasis added)). In any event, the Division makes no argument regarding Section 204 separate from its argument regarding Rule 204-2(a)(16). Div. Br., pp. 43-44. I therefore find no separate violation of Section 204. Additionally, not being required to comply with this particular Rule is not mutually exclusive with Respondents' violations of Sections 206(1), 206(2), and 206(4) of the Advisers Act. That Respondents failed to properly maintain records is relevant at least to evaluating scienter and determining whether their statements were misleading, even though their failure was not a technical violation of the Rule.

## **E. Affirmative Defenses**

### **1. Statute of Limitations**

Respondents included as an affirmative defense that this proceeding is barred by the five-year statute of limitations for fraud claims, codified at 28 U.S.C. § 2462, because the violations were discovered, or should have been discovered, during the Commission's review in 2003. Lucia Answer, p. 8; RJLC Answer, p. 8; Resp. Br., p. 69. Under Gabelli v. SEC, 133 S.Ct. 1216, 1220-21 (2013), the statute of limitations clock begins running at time of accrual, that is, when the cause of action becomes enforceable. Each presentation of the misleading slideshow was a separate and distinct violation, and any resulting cause of action could not have accrued until the presentation occurred. See David Henry Disraeli, Exchange Act Release No. 57027 (Dec. 21, 2007), 92 SEC Docket 852, 875 (multiple material misrepresentations and omissions constituted "repeated violations"); Warwick Capital Mgmt., Inc., 92 SEC Docket at 1427 ("repeated instances of egregious . . . behavior" violative of Sections 206(1), 206(2), and 206(4)). The limitations clock thus runs from each violative presentation, not from the date of the first violative presentation.

In any event, the statute of limitations does not apply to this entire proceeding, but only to particular sanctions, specifically, civil penalties and any associational bar. See Gregory O. Trautman, Exchange Act Release No. 61167 (Dec. 15, 2009), 97 SEC Docket 23492, 23525-26.<sup>37</sup> The OIP makes no allegations regarding the time period, so it is important to consider when these acts occurred in evaluating those sanctions. As the record shows, Lucia has been giving some semblance of the BOM slideshow presentation since 2000, and was presenting the backtest slides as late as December 2010, when Respondents received OCIE's deficiency letter. Because each presentation was a new unlawful act, the clock began running anew each time Lucia presented the slideshow. The OIP was filed on September 5, 2012, and thus, seminars occurring any time after September 5, 2007, five years prior, can be considered in this proceeding as to those issues affected by the statute of limitations.

### **2. Due Process**

Respondents present two due process arguments: (1) that their rights were violated because the formal order of investigation (FOI) was approved while the OCIE examination was ongoing, and (2) that they lacked fair notice that their conduct was proscribed. Resp. Br., pp. 22-25, 66-69. It is not clear whether I have the authority to even entertain such due process claims. See Gregory M. Dearlove, CPA, Exchange Act Release No. 57244 (Jan. 31, 2008), 92 SEC Docket 1867, 1920-21, 1926 (resolving the claim that the Commission's Rules of Practice violated due process, an issue that the ALJ had declined to address as a matter better left to the

---

<sup>37</sup> An amended version of this Commission Opinion is available only on the Commission's website. In pertinent part, it is materially identical to the printed Release.

Commission), pet. denied, 573 F.3d 801 (D.C. Cir. 2009). Assuming that I do have such authority, I conclude that Respondents' due process arguments lack merit.

First, Respondents argue that the investigation in this matter violated their due process rights because the FOI was approved on December 2, 2010, fifteen days before the December 17, 2010 deficiency letter issued, but Respondents did not learn of the FOI until May 11, 2011. Resp. Br., p. 24. However, due process does not require notice, either actual or constructive, of an administrative investigation into possible violations of the securities laws. RNR Enters., Inc. v. SEC, 122 F.3d 93, 98 (2d Cir. 1997) (quoting Gold v. SEC, 48 F.3d 987, 991 (7th Cir. 1995)). The timing of the FOI may have been unusual or irregular, but neither party has pointed to any authority addressing that issue. Certainly, Rule 7(a) of the Commission's Rules Relating to Investigations, which by its own terms applies only to formal investigative proceedings, as opposed to examinations, does not require the Division to inform a party of its investigation merely because OCIE is simultaneously conducting a lawful examination of that party. See 17 C.F.R. § 203.7(a). Moreover, Respondents have shown no prejudice arising from the timing of the FOI. The evidence is uncontroverted that the Division did not use OCIE's examination as a "stalking horse" to obtain evidence outside the normal investigative process. Tr. 214. Respondents had a choice: respond to the deficiency letter or not. This choice would have been the same whether or not they had been aware of the investigation, and whatever response they made would have been just as accessible to the Division regardless of when the FOI issued. Respondents, as registered investment advisers, were required by law to cooperate with OCIE and provide documentation as needed. See 15 U.S.C. § 80b-4(a). It seems unlikely that, even if provided with the FOI, Respondents would have chosen to stop cooperating with OCIE, nor have they identified any particular thing that they would have done differently in that situation. It is difficult, therefore, to imagine that that not being aware of the FOI prejudiced Respondents.

Second, Respondents cannot "credibly claim lack of fair notice of the proscription against defrauding investors." Valicenti Advisory Servs., Inc. v. SEC, 198 F.3d 62, 66 (2d Cir. 1999). Respondents nevertheless offer four arguments in support of their contention that they lacked reasonable notice that their conduct was unlawful, none of which I find persuasive. Resp. Br., pp. 66-69. First, as discussed above in connection with Rule 204-2(a)(16), the slideshows did not constitute performance advertising, so any vagueness about the law of performance advertising is irrelevant. Second, even assuming that the slideshows "comport with industry standards" in part, they are also materially misleading, which is obviously not an industry standard. Id., p. 68. Third, the OIP alleges that "it was materially misleading for Respondents to claim that their alleged backtesting validated the BOM strategy," that is, Respondents are charged with making materially misleading factual assertions and omissions, particularly as to one security, non-traded REITs. OIP, p. 7. Respondents' assertion that they have been "prosecuted . . . for hypothetical illustrations which are a comparison of withdrawal strategies unrelated to any managed account or security," is simply false. Resp. Br., p. 68. Fourth, the 2003 slideshow devotes at most five slides to the 1973 backtest, has no discussion of backtesting to 1966, and does not compare REIT and non-REIT investment. Div. Ex. 21, pp. 74-76. The 2009-10 slideshow, by contrast, devotes thirteen slides to the backtests, discusses backtesting to 1966, and shows the alleged advantages of investing in REITs by comparing investments with and without them. Div. Ex. 1, pp. 466-78. The 2003 slideshow did not possess "identical issues to those in the OIP," and the OIP does not constitute a "change of course." Resp. Br., p. 68.

### 3. Other Defenses

Respondents' Answers originally included eight affirmative defenses, but the defenses of waiver and unclean hands were stricken by Order on November 7, 2012. Except for the seventh affirmative defense, addressed infra, Respondents apparently found insufficient merit in the remaining affirmative defenses to justify addressing them in their post-hearing brief or reply. I, too, find insufficient merit in them to warrant discussion.

## V. SANCTIONS

The Division requests that Lucia be barred from association with any investment adviser and broker-dealer, that Lucia and RJLC have their investment adviser registrations revoked, that they be ordered to cease and desist from further violations of the securities laws, and that they be required to pay civil money penalties of \$150,000 and \$725,000, respectively. Div. Br., pp. 46-47. The Division also requests that Lucia be required to "disclose at any future seminars that he has been sanctioned for providing misleading performance data about the BOM portfolio strategy." Id., p. 47.

### A. Willful Violations and the Public Interest

The Division seeks sanctions pursuant to Section 15(b) of the Exchange Act and Sections 203(e), 203(f), 203(i), and 203(k) of the Advisers Act. OIP, p. 10; Div. Br., pp. 44-47. To impose sanctions under some of these sections, Respondent's violations must be willful. 15 U.S.C. § 78o(b)(6)(A)(i); 15 U.S.C. §§ 80b-3(e), (f), & (i) (2010); see also Rapoport v. SEC, 682 F.3d 98, 108 (D.C. Cir. 2012). A finding of willfulness does not require intent to violate the law, but merely intent to do the act which constitutes a violation of the law. Wonsover v. SEC, 205 F.3d 408, 414 (D.C. Cir. 2000); Arthur Lipper Corp. v. SEC, 547 F.2d 171, 180 (2d Cir. 1976).

Lucia and RJLC acted willfully. Lucia's statements were not the result of a mistake or clerical error, they were made voluntarily and knowingly. See Wonsover, 205 F.3d at 413-15. As Lucia testified, he worked on the backtests and authored the slideshows. Tr. 1066-67, 1089, 1095. Therefore, Lucia acted willfully, and as its controlling person, his willfulness is imputed to RJLC.

When considering whether an administrative sanction serves the public interest, the Commission considers the factors identified in Steadman v. SEC, 603 F.2d 1126, 1140 (5th Cir. 1979), aff'd on other grounds, 450 U.S. 91 (1981): the egregiousness of the respondent's actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the sincerity of the respondent's assurances against future violations, the respondent's recognition of the wrongful nature of his or her conduct, and the likelihood that the respondent's occupation will present opportunities for future violations (Steadman factors). Gary M. Kornman, Advisers Act Release No. 2840 (Feb. 13, 2009), 95 SEC Docket 14246, 14255, pet. denied, 592 F.3d 173 (D.C. Cir. 2010). The Commission also considers the extent to which the sanction will have a deterrent effect. See Schield Mgmt. Co., Exchange Act Release No. 53201 (Jan. 31, 2006), 87



SEC Docket 848, 862 & n.46 (citations omitted). The Commission's inquiry into the appropriate sanction to protect the public interest is a flexible one, and no one factor is dispositive. See Gary M. Kornman, 95 SEC Docket at 14255.

In this case the public interest factors weigh in favor of a heavy sanction. Lucia has over thirty-eight years of experience as an investment adviser. He knew his fiduciary obligations as an investment adviser and he knew that he was violating them by misleading prospective clients for the purpose of selling REITs. He and RJLC became very financially successful as a result. He committed these violations many times between 2007 and 2010. Thus, Respondents' violative behavior was egregious, recurrent, and performed with scienter. Respondents have utterly failed to recognize the wrongful nature of their conduct. Lucia's current occupation as an investment adviser and media presence, and RJLC's registration, provide immediate opportunities to repeat the violations.

To his credit, Lucia has made efforts to end the violative conduct. However, following the 2003 deficiency letter, RJLC informed the Commission, in writing, that it would cease using misleading figures regarding the longevity of the firm, the number of clients serviced, and the amount of assets managed. Resp. Ex. 14. Despite those assurances, RJLC continued using those figures until OCIE discovered them and noted them in the 2010 deficiency letter. Div. Ex. 2. This is probably because they did not consider the figures misleading. Resp. Ex. 7. Respondents' inability to keep their promises to OCIE undercuts the credibility of similar assurances going forward. Admittedly, Respondents stopped using the backtest slides and recalled Lucia's books after OCIE's 2010 deficiency letter. Tr. 1275-77. Nevertheless, Respondents have demonstrated an inability to sustain such compliance efforts long term, and I find that they have not made sufficiently sincere assurances against future violations. Accordingly, all of the Steadman factors weigh against Respondents and in favor of a severe sanction.

## **B. Revocation of Investment Adviser Registrations**

Section 203(e) of the Advisers Act authorizes the Commission to revoke an investment adviser's registration if it, or any person associated with it, has willfully violated, or willfully aided and abetted the violation of, any provision of the Advisers Act, and if revocation is in the public interest. In light of the Steadman Factors, Respondents must not be allowed to continue to serve as investment advisers, and their registrations will be permanently revoked.

## **C. Associational Bars**

Section 203(f) of the Advisers Act authorizes the Commission to bar or suspend a person from association with an investment adviser for willful violations of the Advisers Act, if it is in the public interest. 15 U.S.C. § 80b-3(f). Section 15(b)(6) of the Exchange Act similarly authorizes the Commission to bar a person from association with any broker or dealer, if the person has willfully violated any provision of the Advisers Act and it is in the public interest. 15

U.S.C. § 78o(b)(6)(A)(i); John W. Lawton, Advisers Act Release No. 3513 (Dec. 13, 2012), 105 SEC Docket 61722, 61737.<sup>38</sup>

Again, all Steadman factors weigh in favor of a permanent associational bar. Furthermore, it is in the Commission's interest to deter others from behaving like Lucia. In addition to intentionally misleading clients and prospective clients, Lucia refused to accept responsibility for the abdication of his fiduciary duty to his clients. He now tries to shift partial blame to the Commission for failing to detect problems in the 2003 slideshow. Therefore, it is in the public interest to permanently bar Lucia from association with investment advisers, brokers, and dealers.

#### **D. Cease-And-Desist**

Advisers Act Section 203(k) authorizes the Commission to impose a cease-and-desist order for violations of the Advisers Act. See 15 U.S.C. §§ 80b-3(k). The Commission requires some likelihood of future violation before imposing a cease-and-desist order. KPMG Peat Marwick LLP, Exchange Act Release No. 43862 (Jan. 19, 2001), 54 S.E.C 1135, 1185, motion for reconsideration denied, Exchange Act Release No. 44050 (Mar. 5, 2001), 53 S.E.C. 1, pet. denied, 289 F.3d 109 (D.C. Cir. 2002). However, "a finding of a [past] violation raises a sufficient risk of future violation," because "evidence showing that a respondent violated the law once probably also shows a risk of repetition that merits our ordering him to cease and desist." Id. at 1185.

Respondents' egregious and repetitive misconduct in providing thousands of potential investor clients with misleading information, Lucia's current employment as an investment adviser and media presence, and his inability to satisfy his previous assurances against violative conduct presents sufficient risk of future violations. Respondents claim to have already ceased their violative conduct, which is the subject of their seventh affirmative defense. Tr. 1275-77; RJLC Answer, p. 8. Even assuming this is true, it is of little consequence. See Geiger v. SEC, 363 F.3d 481, 489 (D.C. Cir. 2004) (a single violation raises an inference that it will be repeated, especially when the misconduct is egregious and when the violator thinks he did nothing wrong); see also Hunter Adams, Exchange Act Release No. 51117 (Feb. 1, 2005), 84 SEC Docket 2928, 2929 n.6 (listing reasons why even duplicative injunctive relief may be warranted). Therefore, the imposition of a cease-and-desist order is warranted. In view of the fact that the associational bar and investment adviser registration revocation will presumably put Lucia out of business, I see no need to add the condition that Respondents disclose at any future seminars that they have been sanctioned for providing misleading performance data about BOM.

#### **E. Civil Penalty**

---

<sup>38</sup> A broker-dealer bar in this case is, alternatively, direct (assuming Lucia is affiliated with Lucia Securities or seeks to become so in the future) or collateral (assuming Lucia is considered not affiliated with Lucia Securities).

Under Section 203(i) of the Advisers Act, the Commission may impose a civil money penalty if a respondent willfully violated any provision of the Advisers Act, and if such penalty is in the public interest. 15 U.S.C. §§ 80b-3(i).

A three-tier system establishes the maximum civil money penalty that may be imposed for each violation found. Id. Where a respondent's misconduct involve fraud, deceit, or deliberate or reckless disregard of a regulatory requirement, and resulted in substantial pecuniary gain, the Commission may impose a "Third-Tier" penalty of up to \$150,000 for each act or omission by an individual and \$725,000 for an entity. Id.; 17 C.F.R. § 201.1004 (adjusting the statutory amounts for inflation). Within any particular tier, the Commission has the discretion to set the amount of the penalty. See Brendan E. Murray, Advisers Act Release No. 2809 (Nov. 21, 2008), 94 SEC Docket 11961, 11978; The Rockies Fund, Inc., Advisers Act Release No. 54892 (Dec. 7, 2006), 89 SEC Docket 1517, 1528.

In determining whether a penalty is in the public interest, the Commission may consider (1) whether the violation involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement, (2) the resulting harm to other persons, (3) any unjust enrichment and prior restitution, (4) the respondent's prior regulatory record, (5) the need to deter the respondent and other persons, and (6) such other matters as justice may require. 15 U.S.C. § 80b-3(i); Murray, 94 SEC Docket at 11978.

I find a third-tier penalty to be warranted and in the public interest. Respondents acted deceitfully and disregarded the law intentionally. This factor is particularly important given the recurrence of Respondents' deceitful conduct, and the substantial financial success Respondents have enjoyed at their clients' expense. They earned substantial REIT-related revenue. Also, the need to deter Respondents is strong, given Lucia's continued employment in the financial sector and his failure to acknowledge the wrongfulness of his conduct. See Murray, 94 SEC Docket at 11978. Sanctions imposed on Respondents will also deter others from engaging in the same misconduct. Id.

Nonetheless, the Division's requested penalty is excessive. Although the tier determines the maximum penalty, "each case has its own particular facts and circumstances which determine the appropriate penalty to be imposed" within the tier. SEC v. Murray, No. OS-CV-4643 (MKB), 2013 WL 839840, at \*3 (E.D.N.Y. Mar. 6, 2013) (quotation omitted); see also SEC v. Kern, 425 F.3d 143, 153 (2d Cir. 2005). In addition to the statutory factors cited above, courts consider:

- (1) the egregiousness of the violations at issue, (2) defendants' scienter, (3) the repeated nature of the violations, (4) defendants' failure to admit to their wrongdoing; (5) whether defendants' conduct created substantial losses or the risk of substantial losses to other persons; (6) defendants' lack of cooperation and honesty with authorities, if any; and (7) whether the penalty that would otherwise be appropriate should be reduced due to [respondents'] demonstrated current and future financial condition.

SEC v. Lybrand, 281 F. Supp. 2d 726, 730 (S.D.N.Y. 2003), aff'd on other grounds, 425 F.3d 143 (2d Cir. 2005) (Lybrand factors).

Most of the Lybrand factors weigh in favor of a severe sanction. Nonetheless, although the “dissemination of false and misleading financial information by its nature causes serious harm to investors and the marketplace,” in this case the evidence of actual losses to individual investors is virtually nonexistent. The Rockies Fund, 89 SEC Docket at 1527. Chisholm complained of being unable to liquidate his REIT, and DeSipio filed an arbitration which was later dismissed. But there is no evidence of any unjust enrichment as to any particular investor. Additionally, Respondents have a clean regulatory record and were cooperative with examiners and investigators. Accordingly, I believe the maximum civil penalty is too high, and a civil penalty of about one-third of the maximum is justified.

The Division requests that the third-tier civil penalty be imposed one time, for each Respondent. While the statute provides that a penalty may be imposed for “each act or omission,” it leaves the precise unit of violation undefined. See Colin S. Diver, The Assessment and Mitigation of Civil Money Penalties by Federal Administrative Agencies, 79 Colum. L. Rev. 1435, 1440-41 (1979). Although Respondents technically violated the statute hundreds of times, a one-time penalty prejudices them the least.<sup>39</sup> Therefore, a one-time, third-tier \$250,000 penalty for RJLC and \$50,000 penalty for Lucia is warranted.

### **TRANSCRIPT CORRECTIONS**

On February 1, 2013, Respondents submitted a Motion re Proposed Transcript Corrections to the Hearing Transcript (Transcript Motion). The Division filed its Objections thereto on February 25, 2013. Respondents did not file a reply.

With two exceptions, the proposed corrections generally pertain to clear typographic or scrivener’s errors, and they will be adopted. The first exception is the proposed change of “were back tests” to “were not back tests,” in a statement made by Respondents’ counsel in reference to Bennett’s testimony. Transcript Motion, p. 1 (citing Tr. 209:17). Although I agree with the Division that the referenced testimony is found at Tr. 99:25-100:3, I do not agree that the proposed change would mischaracterize Bennett’s testimony. To the contrary, the proposed change would harmonize Respondents’ counsel’s statement with Bennett’s testimony. The second exception is the proposed change of “him” to “me” on one page. Tr. 792:17. In fact, the transcript already says “me,” and in context the word should clearly read “him.” Id. Accordingly, the Transcript Motion is granted in part, the proposed corrections are adopted as outlined above, and the “me” on page 792, line 17 is ordered changed to “him.”

### **RECORD CERTIFICATION**

---

<sup>39</sup> Assuming, hypothetically, that Lucia gave forty seminars a year for the three years actionable under the statute of limitations, at most RJLC would be subject to an \$87 million penalty and Lucia would be subject to an \$18 million penalty. Such penalties would plainly be disproportionate and unreasonable.

Pursuant to Rule 351(b) of the Commission's Rules of Practice, 17 C.F.R. § 201.351(b), I certify that the record includes the items set forth in the Record Index issued by the Secretary of the Commission on April 19, 2013.

## **ORDER**

IT IS ORDERED that, pursuant to Section 203(e) of the Advisers Act, the registrations of Raymond J. Lucia Companies, Inc. and Raymond J. Lucia, Sr. as investment advisers are REVOKED.

IT IS FURTHER ORDERED that, pursuant to Section 203(f) of the Advisers Act and Section 15(b) of the Exchange Act, Raymond J. Lucia, Sr. is permanently BARRED from association with investment advisers, brokers, or dealers.

IT IS FURTHER ORDERED that, pursuant to Section 203(k) of the Advisers Act, Raymond J. Lucia Companies, Inc. shall CEASE AND DESIST from committing, and Raymond J. Lucia, Sr. shall CEASE AND DESIST from aiding and abetting or causing the commission of, any violations or future violations of Sections 206(1), 206(2), and 206(4) of the Advisers Act.

IT IS FURTHER ORDERED that, pursuant to Section 203(i) of the Advisers Act, Raymond J. Lucia, Sr. shall PAY A CIVIL MONEY PENALTY in the amount of \$50,000.

IT IS FURTHER ORDERED that, pursuant to Section 203(i) of the Advisers Act, Raymond J. Lucia Companies, Inc. shall PAY A CIVIL MONEY PENALTY in the amount of \$250,000.

IT IS FURTHER ORDERED that Respondents' Motion re Proposed Transcript Corrections to the Hearing Transcript is GRANTED IN PART, all proposed corrections except the proposed correction to page 792, line 17, are adopted, and the "me" on page 792, line 17 of the transcript is ORDERED changed to "him."

Payment of penalties and disgorgement plus prejudgment interest shall be made on the first day following the day this Initial Decision becomes final. Payment shall be made by certified check, United States postal money order, bank cashier's check, wire transfer, or bank money order, payable to the Securities and Exchange Commission. The payment, and a cover letter identifying the Respondent(s) and Administrative Proceeding No. 3-15006, shall be delivered to: Enterprises Services Center, Accounts Receivable Branch, HQ Bldg., Room 181, AMZ-341, 6500 South MacArthur Bld., Oklahoma City, Oklahoma 73169. A copy of the cover letter and instrument of payment shall be sent to the Commission's Division of Enforcement, directed to the attention of counsel of record.

This Initial Decision shall become effective in accordance with and subject to the provisions of Rule 360 of the Commission's Rules of Practice, 17 C.F.R. § 201.360. Pursuant to that Rule, a party may file a petition for review of this Initial Decision within twenty-one days after service of the Initial Decision. A party may also file a motion to correct a manifest error of fact within ten days of the Initial Decision, pursuant to Rule 111 of the Commission's Rules of Practice, 17 C.F.R. § 201.111. If a motion to correct a manifest error of fact is filed by a party, then that party shall have twenty-one days to file a petition for review from the date of the undersigned's order resolving such motion to correct manifest error of fact. The Initial Decision will not become final until the Commission enters an order of finality. The Commission will enter an order of finality unless a party files a petition for review or motion to correct manifest error of fact or the Commission determines on its own initiative to review the Initial Decision as to a party. If any of these events occur, the Initial Decision shall not become final as to that party.

---

Cameron Elliot  
Administrative Law Judge