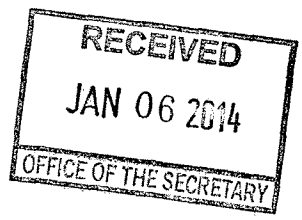
ADMINISTRATIVE PROCEEDING
FILE NO. 3-15006

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION



In the Matter of

RAYMOND J. LUCIA COMPANIES, INC.
and RAYMOND J. LUCIA, SR.

DIVISION OF ENFORCEMENT'S CROSS-PETITION FOR REVIEW OF INITIAL DECISION ON REMAND

January 6, 2014

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I. INTRODUCTION

On December 26, 2013, Respondents Raymond J. Lucia Companies, Inc. ("RJLC") and Raymond J. Lucia, Sr. ("Lucia") filed a petition for review of the Initial Decision on Remand ("Initial Decision") issued by the Administrative Law Judge ("ALJ") on December 6, 2013. The Division of Enforcement (the "Division") now files a cross-petition for review to ask the Commission to review only a narrow aspect of the ALJ's Initial Decision.

Respondents are registered investment advisers, and in this proceeding, the Division had alleged that they violated Sections 206(1), 206(2) and 206(4), and Rule 206(4)-1(a)(5), and Section 204 and Rule 204-2(a)(16) of the Investment Advisers Act of 1940 ("Advisers Act"). In short, the Division contended, and the ALJ correctly found, that Respondents had made false and misleading claims in seminars for prospective investors promoting the Respondents' proprietary "Buckets of Money"® ("BOM") investment strategy.

Specifically, the ALJ found that the Respondents' claims that they had "backtested" their BOM strategy and their claims about the performance of the BOM strategy during two specific time periods (from 1966 and from 1973) were false and misleading. In its Initial Decision, the ALJ ruled that Respondents had violated Sections 206(1), 206(2), and 206(4) of the Advisers Act by making false and misleading statements in their seminar slideshow about these supposed "backtests." The ALJ concluded that Respondents had used REIT rates that were unreasonable and misleading, inflation rates that were unreasonable and misleading, failed to deduct fees or disclose their failure to do so, and failed to disclose that their purported backtests did not follow their stated strategy. The ALJ also found that Lucia acted with a high level of scienter, and that at least one of Lucia's explanations for his conduct was "knowingly false." (*E.g.*, Initial Decision at 46.)

Upon finding that Respondents' behavior was "egregious, recurrent, and performed with scienter," and that Respondents "have utterly failed to recognize the wrongful nature of their conduct," (*id.* at 57-58), the ALJ issued a cease and desist order, revoked Respondents' registration as investment advisers, imposed associational bars on Lucia, and ordered Lucia to pay one-time third tier penalty of $50,000 and RJLC to pay a one-time third tier penalty of $250,000. (*Id.* at 56-62.)

The Division does not petition for review of any of these findings and conclusions, which were correct and supported by the preponderance of the evidence. Instead, the Division cross-petitions under Rule 410 of the Commission's Rules of Practice for review of the ALJ's finding that the Respondents' slideshow presentation was not "advertising" within the Commission's Rules and therefore did not violate Rule 206(4)-1(a)(5). That rule prohibits a registered investment adviser from publishing, circulating, or distributing any advertisement which "contains any untrue statement of material fact, or which is otherwise false or misleading." The ALJ concluded that the "precedent, outdated as it may be, holds" that Rule 206(4)-1(a)(5) does not govern slideshow seminar presentations, but covers "only traditional media, including books, newsletters, and newspaper and magazine advertisements." (*Id.* at 53.)

The Division respectfully submits that the ALJ applied an unduly narrow construction to Rule 206(4)-1(a)(5). The Commission has repeatedly announced that the antifraud provisions, including those in Section 206, apply to any information delivered electronically, just as it does to information delivered in paper. The record is clear that the Respondents' slideshows were presented to the public to generate business for Respondents. Indeed, the seminar slideshows were similar in many ways to an infomercial. These slideshows, therefore, clearly fit within the definition of "advertising" under Rule 206(4)-1.

Because the ALJ concluded otherwise, the Division respectfully requests that the Commission review that limited aspect of the ALJ's ruling, and find that the Respondents' false and misleading seminar slideshows were "advertisements" and thus violated Rule 206(4)-1(a)(5). The Division does not take issue with any other findings or conclusions of law of the ALJ in the Initial Decision.

II. BACKGROUND

The Commission instituted proceedings against Respondents 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.

Lucia was a registered investment adviser and the sole owner of RJLC at the time the OIP was filed. (Initial Decision at 3.) In 1996, Lucia registered with the Commission as an investment adviser, associated with RJLC; RJLC, in turn, registered as an investment adviser in 2002. (*Id.* at 4.)

Lucia developed the BOM strategy in the mid-1990s, and trademarked the term in 2000. (*Id.* at 7.) Respondents described the BOM strategy as an "asset allocation strategy" in their promotional literature, but asserted at the hearing that BOM was a "retirement asset withdrawal strategy," and the ALJ determined that the characterization of the BOM strategy was not relevant to the outcome. (*Id.* at 7 n.8.) Respondents presented BOM as a retirement strategy that would ensure long-term, inflation-adjusted income. (*Id.* at 8.) A common marketing phrase used by Lucia was "aim to retire in comfort and safety." (*Id.*) Lucia introduced BOM in his slideshow presentations at seminars, in his books, and on his website as a "time-tested" strategy based upon "empirical evidence" and "science, not art." (*Id.*) Lucia also frequently referred to it as a "'backtested' strategy." (*Id.*)

A. Respondents Marketed the BOM Strategy at Numerous Seminars Held Nationwide

Respondents promoted the BOM strategy at seminars held nationwide, and presented a slideshow to the audience during the presentations. (*See, e.g.*, Trial Tr. 1058:8-1; Lucia Answer ¶ 3; RJLC Answer ¶ 3.) Lucia estimated that he spent around 145 days a year on the road promoting his BOM at seminars. (Trial Tr. 1054:16-1055:3; 1070:9-12.) Indeed, the ALJ found that BOM seminars are the nucleus of Lucia's business. (Initial Decision at 8.) While the venues varied, each typically held a few hundred people, and Lucia estimates that he has given his BOM slideshow presentation to 50,000 people. (*Id.*)

At the seminars, Respondents were selling, and clients were buying, the BOM strategy and the services of RJLC. During the 2010 examination, Respondents informed the examination staff that clients were buying the BOM strategy, not individual securities. (Trial Tr. 215:15-23.) Respondents stated that "clients are buying the Buckets of Money strategy and not the individual underlying products. As such, the potential sale is generated by Mr. Lucia and not the advisor/registered representative." (Govt. Ex. 4 at SEC-LA3937-05032-33.) Indeed, Lucia testified at the hearing that the purpose of the seminars in the first instance was to market the BOM strategy. (Trial Tr. 1072:25-1073:6.) The context of the slideshow and the seminars was a sales presentation for the BOM strategy and RJLC's advisory services, and the goal was to generate commissions and fees for RJLC and Lucia.

Lucia testified that before he sold the business to his son, he made money when RJLC financial advisers sold BOM-approved financial products to attendees of the BOM seminars, generating commissions for Lucia. (Trial Tr. 1067:20-1068:3.) RJLC's financial adviser representatives signed over to Lucia the commissions generated from sales of BOM-approved

products to people who came to RJLC after attending a BOM seminar. (Trial Tr. 1073:21-1074:3.)

It is beyond dispute that the purpose of the BOM seminars and slideshow was to convince prospective investors to buy into the BOM strategy and to generate leads for RJLC. (*Id.* at 8-9.)[1] The BOM seminars were an advertisement for the Respondents' BOM strategy and for their financial advisory services. At the end of every BOM seminar, Respondents handed out contact cards, which attendees could fill out and return. (*Id.* at 9.) RJLC's financial advisers followed up on these leads, and it was from these leads that Respondents made money. (*Id.*) The seminar slideshow was an integral part of that advertisement.

B. The BOM Seminar Slideshow Was the "Heart" of the Seminars

The BOM seminar presentation uses a series of PowerPoint slides, introduced by Lucia, followed by, or preceded by, audience questions. (*Id.* at 9.) The slideshow is "[a]t the heart of this proceeding." (*Id.*) Lucia has been giving a variation of the slideshow since 2000, and while he has amended the slideshow over time, the principles and progression of the message have remained largely the same. (*Id.*) The first fifteen slides generally focus on investment concerns and goals, and the next thirty-nine focus on Lucia's debunking of conventional investment wisdom and strategies. (*Id.*) Lucia then progresses through a series of fictional investor portfolios (the "Conservative Campbells," "High Rolling Hendersons," "Balanced Buttafuccos," and "Bold Bucketeers") to explain his BOM strategy. (*Id.* at 9-10.) Lucia then presents two "backtests" of the BOM strategy, one starting in 1966 and one starting in 1973. These backtest slides are the "capstone" of the slideshow, and in particular, the alleged backtest from 1966 is the "pinnacle." (*Id.* at 28-29.)

[1] RJLC is now doing business as RJL Wealth Management, LLC. (*See* Initial Decision at 4.)

The ALJ found that the Respondents' claims to have backtested the BOM strategy were false and misleading, and that their claims made about the performance of the BOM strategy during two specific time periods, from 1966 and 1973, were also false and misleading. (*Id.*, *passim.*)

C. Respondents' Pre-Recorded Webinar Shows Lucia Was Drumming Up Business For RJLC And The BOM Strategy

As part of their defense, Respondents produced at the eleventh hour a video copy of a webinar of a BOM seminar made by Lucia in February 2009.[2] This webinar corroborates that the BOM seminars were an advertisement for BOM and RJLC. It shows that Respondents' BOM seminars were a sales pitch for the BOM strategy and RJLC's advisory services, and the webinar is akin to an infomercial. Throughout the webinar, Lucia urges viewers to contact RJLC to get their BOM consultation right away.

At the outset of the webinar, Lucia stated that it is "very important" for viewers to contact RJLC by clicking on a link on the screen, and he promised that one of Respondents' "salaried financial advisors" would provide assistance, including "your own personalized, complimentary, Buckets of Money retirement analysis." (Govt. Ex. 66 at 3:7-19; *see also* Resp. Ex. 30.) At least eight additional times during the webinar, Lucia urged viewers to click on the link on the screen to contact RJLC so that one of Respondents' salaried advisors could provide, among other

[2] Respondents did not produce the video copy of the webinar to the examination staff, did not produce the webinar to the Division in response to subpoenas, and did not produce the webinar during the Wells process. Respondents claimed to have found the video recording after the OIP was issued, on a server owned by one of Lucia's companies, but not in the records of the registered investment adviser or the registered broker-dealer owned by Lucia. Respondents claimed that the webinar was recorded on February 16, 2009, although as the ALJ noted, during the webinar Lucia made a claim to work only with salaried representatives, and that switch occurred in 2011 – well after the webinar aired. (Initial Decision at 12 n.15.) As the ALJ found, the webinar did not support the Respondents' defenses, as it works "almost entirely to Respondents' disadvantage" and, in fact, supported the Division's allegations against Respondents. (*Id.* at 30 n.28.) Had the webinar been produced during the investigation, it may well have been the basis for additional charges in the enforcement proceeding.

things, a "complimentary" BOM strategy. (*See id.* at 5, 37-38, 51-52, 69, 71, 74-75, 77, 82.) For example, at around the mid-point of the video-taped webinar, Lucia stated:

> So what's the summary? Get your buckets of money strategy right. I will do it for you. Through my salaried advisors, all around the country, they will do a Buckets of Money strategy for you. Just click on the little icon, and you can get a Buckets of Money strategy complimentary, no arm twisting, no nothing. These guys get paid salaries, whether you do business or not.

(*Id.* at 51:20-52:3.)

A few minutes later, Lucia again pitched RJLC's services during the webinar:

> Folks you need to get bucketized. Click on that little icon at the bottom right hand side of your screen, and get bucketized by one of my highly-trained advisors. I've got them all around the country. I've personally trained them. It'll be my eyeballs and my staff's eyeballs that look over these plans.
>
> And whether you choose to do this on your own, certainly your prerogative, or through your own advisor, fine and dandy. If you'd like us to help you fill the buckets with the nontradable real estate and all the safe buckets that we've talked about, and show you the money managers that we use, happy to help you.
>
> But please, if you do nothing, at least get your Buckets of Money strategy done today. We're offering you an opportunity to do that. Complimentary, at no cost, for having sat through this presentation.

(*Id.* at 69:5-25.)

Just a few minutes later during the webinar, Lucia again urged viewers to contact RJLC:

> Once again, if any of these situations apply to you, if you want information on nontradable real estate, and as I said, get your own personalized Buckets of Money strategy, then click on the icon at the bottom right, and you should be able to get one, lickety-split, without any cost, and of course, without obligation. As I said, everybody that's working on these plans are salaried employees. They're not incentivized one way or the other, to help you. I'm doing this to help you, my radio listeners and people that watch me on television all around the country, so that you can get bucketized, you can get financially organized.

(*Id.* at 74:18-75:9.)

Therefore, this webinar – introduced by Respondents at the hearing – shows that their seminars were advertisements in every sense of the word. As the webinar shows, the entire BOM seminar presentation was just as much of an advertisement as a written newsletter to investors, but much more technologically advanced.

D. Respondents Considered the Slideshow to be an Advertisement Subject to Compliance Review

At the hearing, Respondents pointed to internal and external reviews of the slideshow by compliance personnel to negate claims of scienter. (*Id.* at 47-48.) Respondents therefore considered the slideshow to be the type of advertising material that needed to be reviewed by appropriate compliance personnel.

Indeed, the ALJ specifically found that the slideshow was "marketing material." (*Id.* at 48). The ALJ also noted that the slides regarding the alleged backtest from 1966 do not have any disclaimers at all, "suggesting that there was in fact no advertising review of them." (*Id.*)

III. ARGUMENT

The ALJ's ruling that the Respondents made false and misleading claims about their alleged "backtested" BOM strategy in violation of Sections 206(1), 206(2) and 206(4) of the Advisers Act was correct, both as a matter of law and fact. However, the ALJ also concluded that the Respondents did not violate Rule 206(4)-1(a)(5) because their seminar slideshows did not qualify as "advertising" under that rule. (Initial Decision at 52-53.) The Division respectfully submits that this limited aspect of the ALJ's ruling was incorrect. The evidence established that each seminar and slideshow presentation was an advertisement for the Respondents' BOM strategy and their financial advisory services. Thus, the factual record and the findings of the ALJ clearly show that the Respondents' BOM slideshow seminars were "advertisements" under Rule 206(4)-1. Given this record and the ALJ's findings of numerous

fraudulent statements in the slideshow, the Divisions asks that the Commission find that the seminars were "advertisements" and that that Respondents thus violated Rule 206(4)-1(a)(5).

A. The Seminar Slideshows Were Advertisements Under Rule 206(4)-1

In concluding that the Respondents' seminar slideshows did not qualify as advertising (*id.* at 52-53), the ALJ found that "written communications" do not include live slideshow presentations. On this basis, the ALJ concluded that Respondents did not violate Rule 206(4)-1(a)(5). (*Id.*) The ALJ reasoned that since a written version of the slideshow was not printed and distributed to seminar participants "or otherwise published in printed or handwritten form at the seminars," the slideshow was not an advertisement. The ALJ found that the "precedent, outdated as it may be, holds written communication to include only traditional media, including books, newsletters, and newspaper and magazine advertisements." (*Id.*)

The ALJ's construction of Rule 206(4)-1(a)(5) and the ALJ's application of the factual record to this rule were too narrow. The rule itself shows that the term "advertisement" should be broadly construed. Section 206(4) of the Advisers Act states:

> It shall be unlawful for any investment adviser, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly –
>
> (4) to engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative.

15 U.S.C. § 80b-6(4). 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) of the Advisers Act for a registered investment adviser, "directly or indirectly, to publish, circulate, or distribute any advertisement" ... "which contains any untrue statement of a material fact, or which is otherwise false or misleading." 17 C.F.R. § 275.206(4)-1(a)(5). The rule defines "advertisement" broadly to include:

> *any notice, circular, letter or other written communication addressed to more than one person, or any notice or other announcement in any publication or by radio or television*, which offers (1) any analysis, report, or publication concerning securities, or which is to be used in making any determination as to when to buy or sell any security, or which security to buy or sell, or (2) any graph, chart, formula, or other device to be used in making any determination as to when to buy or sell any security, or which security to buy or sell, or (3) any other investment advisory service with regard to securities.

17 C.F.R. § 275.206(4)-1(b) (emphasis added).

Given this broad definition, courts have construed the term "advertisement" in the rule liberally. For example, in *SEC v. C.R. Richmond & Co.*, the Ninth Circuit affirmed liability under Section 206 for false and misleading statements made by an investment adviser in a book and in newsletters. 565 F.2d 1101 (9th Cir. 1977). The defendant-advisers in *C.R. Richmond* had argued that their newsletters and books were not advertisements under Rule 206(4)-1(b). *Id.* at 1104. The Ninth Circuit recognized that the term "advertisement" is broadly defined in the Commission's rule, and thus held that conduct with respect to the rule must be measured from the viewpoint of a person "unskilled and unsophisticated in investment matters." *Id.* So, it concluded that "[i]nvestment advisory material which promotes advisory services for the purpose of inducing potential clients to subscribe to those services is advertising within the Rule." *Id.* at 1105. This is a very broad interpretation of the term "advertising," encompassing materials such as books or newsletters that might otherwise not generally be considered to be advertising under a narrow construction of the term.

Given this precedent, and the plain language of the rule itself, the ALJ's interpretation of the term "advertisement" was too limited. Nothing in the rule indicates that advertisements must be on physical sheets of paper, like a newsletter. Nor does the rule state that the advertisement must be "handed out ... or otherwise published in printed or handwritten form," as the ALJ suggested. (Initial Decision at 53.) Rather, the rule merely states that the advertisement needs to

be some kind of "written communication" that is "addressed to more than one person." The seminar slideshows clearly meet that definition. These "PowerPoint" slideshows were written and shown on screens to more than one investor – often about a hundred potential clients at a time. And as discussed below, the Commission has long expressed the view that the antifraud provisions governing written communications include material disseminated through electronic formats.

Moreover, Respondents' seminar slideshow satisfies the Ninth Circuit's test in *C.R. Richmond.* The slideshow is plainly "material" that promoted Lucia and the Respondents' BOM strategy "for the purpose of inducing potential clients to subscribe to those services." *C.R. Richmond*, 565 F.2d at 1105. Indeed, the ALJ made numerous findings throughout the Initial Decision that the purpose of the statements in the slideshow was to deceive potential customers and induce them to sign up with RJLC, to fatten Respondents' bottom line. The ALJ found that Lucia "knew of the misstatements [in the slideshow] and kept them in the slide to deceive prospective customers." (Initial Decision at 46.) Further, the ALJ found that Respondents used the seminars to "lure" investors to buy their services:

> 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.... 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.

(*Id.* at 47.)

The investors who attended the seminars also viewed the seminars this way. At the hearing, two clients testified that the discussion of REITs in the seminars "was important in deciding to purchase non-traded REITs through RJLC." (*Id.* at 49.) As the ALJ reasoned, "[i]nvestors would surely not be interested in engaging RJLC as an adviser if they were told that

the backtested portfolios went bankrupt after twenty or even twenty-eight years, especially because BOM was trumpeted as one that withstood the effects of inflation." (*Id.* at 50.)

Thus, there can be little doubt that the ALJ's numerous factual findings support the conclusion that the slideshow was an advertisement under Rule 206(4)-1.

B. The Commission's Antifraud Rules Are Not Limited to Only Traditional Media

The Commission's antifraud rules are not limited to "only traditional media." (Initial Decision at 53.) The Commission has long expressed the view that the antifraud provisions of the federal securities laws apply to any information delivered electronically, as it does to information delivered in paper. *See, e.g.*, Securities Act Release No. 7233 (Oct. 6, 1995), 60 FR 53458 (Oct. 13, 1995 ("Use of Electronic Media for Delivery Purposes") ("1995 Release"); Securities Act Release No. 7288 (May 15, 1996) 61 FR 24644 (May 15, 1996) ("Use of Electronic Media by Broker-Dealers, Transfer Agents, and Investment Advisers for Delivery of Information") ("1996 Release"); Securities Act Release No. 7856 (May 4, 2000) ("Use of Electronic Media") ("2000 Release"). In the 1996 Release, the Commission noted that:

> the substantive requirements and liability provisions of the federal securities laws apply equally to electronic and paper based media. For example, the antifraud provisions of the Exchange Act and Rule 10b-5 thereunder, as well as section 206 of the Advisers Act and the rules thereunder, apply to information delivered and communications transmitted electronically, to the same extent as they apply to information delivered in paper form."

1996 Release at n.4 (citing 1995 Release at n.1.) And in the 2000 Release, the Commission explicitly recognized "the potential for electronic media, as instruments of inexpensive, mass communication, to be used to defraud the investing public," and noted that through March of that year, the Commission had filed approximately 120 internet-related enforcement actions. 2000

Release at n.4. Thus, the Commission has not limited the definition of the term "advertisement" or "written communications" to traditional media.

Here, Respondents delivered the written information electronically using a computer, a screen and a projector. The written information was delivered just as effectively – perhaps more effectively – than if Respondents had just handed prospective clients a written advertisement. While the ALJ distinguished a "live slideshow presentation" from a "written communication," this is a distinction without meaning. Respondents displayed the written material for all to see, on a large screen. The fact that they displayed the pages of the slideshow while Lucia was standing in the room, and in some cases reading the slides to the audience, does not remove it from the Commission's rules about advertising. This is especially true since Respondents admitted that the purpose of the seminars and slideshow was to sell the BOM strategy. Given this concession, it logically follows that the slideshows were advertisements under the Commission's rules.

C. Respondents Violated Rule 206(4)-1(a)(5) With Their False and Misleading Claims in the Seminars About Their Supposed "Backtested" BOM Strategy

Since the seminars are advertisements under Rule 206(4)-1, the Respondents clearly violated Rule 206(4)-1(a)(5) with their false and misleading claims in these seminars about their supposed "backtested" BOM strategy. It is well established that the dissemination of false or misleading performance information by an investment adviser violates Section 206(4) and Rule 206(4)-1(a)(5) thereunder. *See, e.g., Valicenti Advisory Services, Inc.*, Investment Advisers Act Rel. No. 1774 (Nov. 18, 1998), *aff'd, Valicenti Advisory Services v. SEC*, 198 F.3d 62 (2d Cir. 1999). Advertisements that are "deceptive and misleading in their overall effect" can be found to violate the Act "even though when narrowly and literally read, no single statement of a material fact was false." *C.R. Richmond*, 565 F.2d at 1106-07 (quotation omitted). Conduct with respect

to this rule "is to be measured from the viewpoint of a person unskilled and unsophisticated in investment matters." *Id.* at 1105.

False and misleading claims about backtesting by registered investment advisers have been found to violate Section 206(4) and Rule 206(4)-1(a)(5). *See, e.g., In the Matter of William J. Ferry*, Investment Adviser Release No. 1747 (August 19, 1998) (failure to disclose that performance results did not reflect the strategy and inherent limitations on strategy violated Act); *In the Matter of LBS Capital Management, Inc.*, Investment Adviser Release No. 1644 (July 18, 1997) (failure to adequately disclose use of a model found to be materially misleading); *In the Matter of Meridian Investment Management Corporation, et al.*, Investment Adviser Release No. 1779 (December 28, 1998) (investment adviser materially misstated its investment performance results by not deducting fees in performance results, even though materials disclosed fees would be charged); *see also, c.f., Clover Capital Management, Inc.* (No-Action Letter, File No. 801-27041, October 28, 1986) (stating staff's position that the use of model or actual results in an advertisement would be false or misleading, and violate Rule 206(4)-1(a)(5), "if it implies, or a reader would infer from it, something about the adviser's competence or about future investment results that would not be true had the advertisement included all material facts").

As the Commission staff explained in the *Clover Capital* no-action letter, an adviser using a model or actual results "must ensure that the advertisement discloses all material facts concerning the model or actual results so as to avoid these unwarranted implications or inferences." *Clover Capital* (No-Action Letter, File No. 801-27041). In the *Clover Capital* letter, the staff stated its view that any performance information that fails to disclose the effect of material market or economic conditions on the results portrayed would violate Rule 206(4)-1, as would any model or actual results that do not reflect the deduction of advisory fees, brokerage or

other commissions, and any other expenses that a client would have paid or actually paid. In addition, in *Clover Capital*, the staff stated its view that the rule would also be violated if an adviser used performance results but failed to disclose that the investment strategies of the model portfolio changed materially during the period portrayed, and the effect of such changes.

The evidence shows that Respondents violated Rule 206(4)-1(a)(5). As the ALJ found, the evidence demonstrated that Respondents presented their back-testing of the BOM strategy from 1966 and 1973 as showing how a BOM portfolio would have performed over those time periods. However, while Respondents disclosed that they assumed 3% inflation, the ALJ also found that the evidenced showed they failed to disclose how that deviation from historical data materially altered the results of their back-tests. The ALJ further found that the evidence showed that Respondents consciously chose not to disclose that they did not follow a BOM strategy in their tests, and instead concentrated the portfolio's assets 100% in stocks for the majority of the period tested.

In addition, the ALJ found that the evidence demonstrated that the Respondents used REITs in their 1973 and 1966 back-tests, but failed to disclose that REITs were not readily available for a portion of the period tested. The ALJ also found that the evidence showed that Respondents used assumed REIT returns, which they disclosed, but failed to disclose that using actual REIT returns would have materially depressed the performance of their BOM portfolios. Moreover, the ALJ found that the evidence demonstrated that the Respondents did not disclose that they assumed the REITs were a risk-free investment that was perfectly liquid, although such an investment does not exist in the real world. Finally, although Respondents' strategy would incur fees, the ALJ found that the evidence showed that Respondents failed to take fees into

account in calculating their results, which substantially overstated the performance of their BOM portfolios during the period tested.

Therefore, the evidence introduced at the hearing overwhelmingly demonstrated, and the ALJ ultimately found, that the Respondents' claims about their alleged backtested BOM strategy were knowingly false and misleading. Because these false and misleading claims were made in the BOM seminar slideshows, this evidence and these factual findings support a holding that the Respondents engaged in false and misleading advertising in violation of Rule 206(4)-1(a)(5).

IV. CONCLUSION

For all the reasons stated, the Division requests that the Commission grant its cross-petition for review and find that Respondents' seminar slideshows were advertising and so they violated the antifraud provisions of Rule 206(4)-1(a)(5).

Dated: January 6, 2014

Respectfully submitted,

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