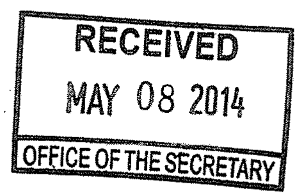

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-15006

In the Matter of

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

Respondents.

REPLY BRIEF OF RESPONDENTS RAYMOND J. LUCIA COMPANIES, INC. AND RAYMOND J. LUCIA, SR. ON APPEAL OF INITIAL DECISION ON REMAND

May 7, 2014

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I. INTRODUCTION

The Division of Enforcement largely sidesteps the core issue presented by Mr. Lucia: Whether a lifetime industry bar against the 64-year-old former investment adviser, who is no longer registered as an investment adviser or licensed as a broker, and whose company is essentially defunct, makes any sense whatsoever based on the actual facts of this case. In fact, such an extreme sanction is all but unprecedented. The Division fails to distinguish the litany of comparable recent cases in which no suspensions at all were imposed (much less permanent collateral bars); to the contrary, the Division references several additional cases which it contends are factually analogous, and in *none* of them is a suspension (much less a bar) ordered by the Commission.

The Division instead merely notes the truism that the relief ordered by the Commission is fact-specific. But the facts allegedly supporting the ALJ's conclusions are particularly weak, and are directly contradicted by the evidence introduced at the hearing. The central thesis of the Division's claim – that Mr. Lucia falsely claimed to have "backtested" the general retirement strategies illustrated at his seminars using actual rates of return – is belied by Mr. Lucia's actual words and his accompanying presentation materials, in which he expressly informed seminar attendees that he was using *hypothetical*, *pretend*, *assumed* rates of return.

Even if one were to posit that Mr. Lucia misused the term "backtest," it cannot be denied that he informed visitors of his seminars exactly how he was using it. It defies common sense, and precedent, to find that Mr. Lucia perpetrated a deliberated fraud, to say nothing of a fraud so egregious that it supports the imposition of a lifetime collateral bar, when the purely hypothetical nature of his illustrations was prominently featured in the very slides the Division claims were misleading.

II. LEGAL DISCUSSION

A. The Seminar Presentations Were Not Materially Misleading, And Certainly Not Egregious Enough To Warrant The ALJ's Extreme Sanctions

1. The Division's "Backtesting" Claim Completely Disregards The Plain Words Used In The Seminars.

The Division's Opposition Brief makes it perfectly clear that this case comes down entirely to their interpretation of the word "backtest," while ignoring the actual presentations that Mr. Lucia made to thousands of audience members over the years without complaint. The core thesis of the Initial Decision, as the Division repeats throughout its brief, is that Mr. Lucia supposedly misrepresented to investors that the illustrations used to compare general retirement philosophies were based on actual, historical financial data, rather than merely hypothetical suppositions. Yet the actual slides, and Mr. Lucia's actual words, show the precise opposite. Hence, the Initial Decision erred in finding any fraud was committed, much less a fraud so egregious that a lifetime associational bar is warranted under the standard set forth in *SEC v. Steadman*, 603 F.2d 1126 (5th Cir. 1979),

The weakness of the case is strikingly obvious by comparing the bottom-line conclusion of the Division and the ALJ with the actual words used by Mr. Lucia. The Division quotes the ALJ's determination that "'a reasonable investor would have understood that the '66 and '73 Backtests' data and assumptions were *factual, historical, and realistic.*'" (Division of Enforcement's Opposition Brief ("Opp. Brf.") at 17, *quoting* the Initial Decision on Remand ("Initial Decision") at 27) (emphasis added). But here is what attendees of Mr. Lucia's seminars actually saw, on slide after slide, in various iterations:

Rates are hypothetical in nature and for illustrative purposes only. Not representative of an actual investment. There is no guarantee that the strategy will achieve the desired results. An investor's results may vary

Rates of return are hypothetical in nature and are for illustrative purposes only.

(Excerpted from Division Exhibit ("DX") 1 at SEC-LA3937-00176 to 00201.) These explanations were repeated nearly 40 times when Mr. Lucia presented the comparative strategy illustrations. (By contrast, the word "backtest" appears twice.)

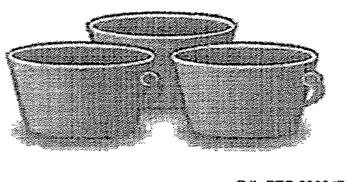
The Division, like the ALJ, all but reads these repeated disclosures right out of the slideshow. The Division dismissively argues that Respondents claim that they "meant to present 'hypotheticals' rather than backtests." (Opp. Brf. at 16.) The Division's seemingly pejorative inclusion of quotes around "hypotheticals" suggests that Respondents' reference to hypotheticals is somehow unfounded. But Respondents are simply quoting from the slides themselves.

The Division moves from simply disregarding the actual language used in the seminars to outright misstating it when they discuss the final seminar illustration, which the Division refers to as the "1966 backtest." Contrary to the evidence, the Division states: "[T]he slideshow claims the 1966 backtest results are based on 'actual market returns for the period(s) listed.' (Div. Ex. 1 at 204, IDOR at 12.)"

But that is not what the slide from which the Division quotes really says. Here is what the slide actually states:

Notes & Assumptions

- The following examples are based on actual market returns for the period(s) listed
  - Bond returns are based on US Treasury returns
  - Stock returns are based on S&P 500 returns
- REIT returns are based on a 7% annual return.
- Inflation is based at 3% annual



SEC-LA3937-00204

Confidential Treatment Requested by RJL Companies, Inc. RJL-SEC-0000471

(Excerpted from DX 1 at 204.) Moreover, as confirmed by the Webinar transcript, when Mr. Lucia covered this part of the presentation, he verbally stated, "Now, once again, these are the assumptions that we used…" (Webinar Transcript, Respondents' Exhibit ("RX") 66 at 48.)[1] Respondents thus expressly cautioned seminar attendees that the inflation rate and real estate return rate, unlike bond and stock returns, were based on **assumptions**, NOT actual market returns.

Beyond the Division's incorrect assertion as to what was actually told to seminar attendees, the Division argues that the slides showing the final, 1966 illustration omit the disclaimers about return rates being hypothetical. While the disclaimers do appear to have been inadvertently omitted from these final slides, it defies credibility to reach the ALJ's conclusion that, after some forty pages of disclaimers describing the illustrations as hypotheticals, a reasonable investor would believe the 1966 illustration to somehow *not* be a hypothetical. And

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[1] The Division's case is based entirely on the PowerPoint slides, viewed in isolation and without any context from the actual seminars. The Division has conceded that, at no point during the 2010 examination or the subsequent investigation, did they ever once attend an actual seminar presented by Respondents. The February 16, 2009 Webinar is thus the only evidence in the record showing the language used by Mr. Lucia in conjunction with his presentations.

of course the very first slide in the 1966 illustration – pictured above – describes the illustration as based on *assumptions*, not historical facts. Notably, in introducing this part of the presentation Mr. Lucia expressly qualified his backtesting illustration as follows: "Let's pretend that from that point forward, inflation was 3 percent. We knew it was more. But we wouldn't have known that at the time." (Webinar Transcript, RX 66 at 48-49.) No clearer disclaimer could be made to investors that the illustration was *hypothetical*, not *actual*.

Respondents appreciate that the Commission might conclude that Mr. Lucia did not use the term "backtest" as it is used by others in the industry. Of course, the evidence introduced at the hearing established that he would not have been alone – one of the country's largest mutual fund complexes, American Funds, uses promotional materials illustrating "back-testing" incorporating hypothetical inflation rates. (The ALJ casually dismissed this evidence by arguing that American Funds used a hypothetical inflation rate of 4% rather than the 3% used by Respondents, which utterly misses the point – namely, that others in the industry have similarly called illustrations "backtests" without relying exclusively on historical information. *See* Opp. Brf. at 23, citing Initial Decision at 35.) But even if one posits that Respondents did not use proper "backtests," it was legal error for the ALJ to conclude that this constitutes a fraud on investors where, as here, Mr. Lucia expressly informed seminar attendees exactly what his "backtesting" encompassed.

In short, the Division's entire case comes down to this: While Respondents repeatedly described the illustrations as hypotheticals, based on "assumed" or "pretend" rates rather than historical data, the Division contends that the mere use of the word "backtest" – twice, over the course of a 100-plus slide PowerPoint presentation – amounted to a massive fraud warranting a

lifetime industry bar. To find liability (much less impose a permanent collateral bar) on so flimsy a basis would be an abuse of discretion by the Commission.[2]

2. Respondents Plainly Disclosed, And Investors Understood, That The Illustrations Used A Non-Historical [Hypothetical?] Inflation Rate

The disconnect between the Division's conclusory assertions about the seminars, and the actual words used by Mr. Lucia, is most glaring when considering the use of hypothetical inflation rates in his illustrations. The Division, and the Initial Decision, fault Respondents for not using the actual year-by-year historical inflation rates. But the slides expressly provided that they were using an assumed 3% average inflation rate over an extended period of time. And as Mr. Lucia verbally cautioned attendees, in reality inflation was historically higher, but for purposes of the illustration, he would pretend it was lower.

Given Mr. Lucia's actual disclosures and explanations during the seminars, the Division argues that nevertheless, Respondents failed to disclose that using actual, historical inflation rates would have made the results of the illustrations look much worse. But as even the ALJ conceded in the Initial Decision, "seminar attendees would understand that a flat 3% rate did not reflect year-by-year historical rates, especially because attendees were mostly retirees and near-retirees who lived through the tumultuous high-inflation years" covered by the illustrations. (Initial Decision at 34.) If attendees of the programs understood that the strategies illustrated by Mr. Lucia would have faced higher inflation rates in reality – and, of course, any reasonable investor would understand that higher inflation would mean reduced returns – then the ALJ's conclusion that investors were defrauded was clearly erroneous.

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2 As noted in Respondent's Opening Brief, concluding that the word "backtest" has some sort of legal significance that it overrides any and all actual disclosures and representations made by the Respondents, when the word is not itself defined by any statute, regulation, or Commission guidance, constitutes unabashed regulation through enforcement, and raises serious due process concerns.

In general, the Commission should not lose sight of the fact that Respondents' seminars portrayed the relative merits of different retirement strategies, dividing holdings across different categories (or "buckets") of assets (stocks, bonds, cash equivalents and real estate) and withdrawing living expenses from the buckets in different orders. The Division concedes that Respondents used the same, arguably low inflation rate for each strategy. Hence, to the extent the strategy advocated by Mr. Lucia – a mix of stocks, bonds, and real estate investments, with living expenses drawn from safer assets first – would have suffered under a higher rate of inflation, so would the others. The Division never made any showing that, under a higher inflation rate, Mr. Lucia's strategy would not have nonetheless outperformed the alternatives he illustrated. Indeed, the Division concedes that it "did not challenge the merits of the [Buckets of Money] strategy, so its purported 'superiority' is not at issue." But that *is* the issue. The seminars simply illustrate that, using certain disclosed assumptions, one hypothetical approach to a general retirement strategy could be preferable to others.

Indeed, looking to Mr. Lucia's actual words, it is self-evident that the seminars were geared towards showing the relative merits of different withdrawal approaches, rather than portraying actual returns obtainable through a model portfolio. Citing several academic studies, Mr. Lucia explained to seminar attendees, "having a bucket of safe money and draining that bucket down, while you allow your risky money to grow over time, is the best of all retirement distribution methodologies." (Webinar Transcript, RX 66 at 33.) This was the heart of Respondents' presentation, and the Division, by their own admission, does not even challenge it.

3. The Other Purported "Omissions" Did Not Render The Presentation Misleading

As with the assumed inflation rate, the other grounds on which the Initial Decision found Respondents' seminar slides misleading – and so egregiously fraudulent as to warrant a lifetime

bar – are unsupported by the record and plainly rebutted by the disclaimers throughout the presentation.

The Initial Decision concluded that the real estate investment trust ("REIT") rates and usage in the illustrations were misleading. But, again, Respondents expressly disclosed that they were using an assumed, constant rate of return of 7% (for one period) and 7.75% (for another), and that these were hypotheticals. The reasonableness of these assumptions was supported at the hearing by Respondents' expert witness, Kevin Gannon. The Division inexplicably represents in its brief that "Gannon did not opine that 7.75% was reasonable." (Opp. Brf. at 25.) Respondents refer the Commission to Mr. Gannon's actual testimony:

> Q: In your opinion, would 7 and three-quarters percent be justifiable?
> A: Yes, it would be.

(Tr. 1369.) The Division cites Mr. Gannon for the proposition that he would not have used the term "backtest" to describe the illustrations. But Mr. Gannon went on to emphasize that, for purposes of a hypothetical illustration – which, as explained above, Mr. Lucia disclosed repeatedly that he was portraying – using 7% for the time period of these illustrations was reasonable. Indeed, "not only reasonable, it was way conservative. I thought the number should be much higher." (Id. at 1387-88.)

The Division goes on to challenge other details about the use of real estate left out of the illustrations, such as the length of time the investments were held before being liquidated – which might arguably be relevant had Mr. Lucia represented to investors that he was portraying

the performance of an actual portfolio, rather than explaining over and over that he was illustrating a generalized, hypothetical strategy using assumed return rates.[3]

The Division also challenges the omission of fee reductions from the illustrations, but this contention, like their challenge to the use of an assumed inflation rate, fails to take into account the fact that Respondents were not demonstrating the actual performance of an actual or model portfolio, but rather illustrating a comparison of multiple retirement strategies. The Division, like the Initial Decision, mischaracterizes Respondents' position as being that the impact of fees was "a wash across the various strategies." (Opp. Brf. at 36.) Rather, what Respondents have consistently argued is that the Division made no showing that the omission of fees worked to the benefit of the retirement strategy advocated by Mr. Lucia. The Initial Decision concluded that, "[i]f fees are different for different assets, the overall fee load for the four scenarios will be different." What the Initial Decision could not find, as the Division never proved, was that fees would have been materially *higher* for the "Buckets of Money" strategy. Absent any evidence that the purported omission allowed Mr. Lucia to falsely portray his recommended retirement strategy as preferable to the others, this omission was simply not materially misleading. *See generally In re Michael R. Pelosi*, Advisers Act Rel. No. 3805 (March 27, 2014) (Commission Opinion reversing Initial Decision where "the record lacks an evidentiary basis from which to determine that the returns reported by [respondent] to his clients were materially false or misleading").

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3 Likewise, the Initial Decision's assertion, reiterated by the Division, that Respondents "made up out of whole cloth" the hypothetical return rate for a period of time in which REIT's were not readily available is completely unfounded. As explained in Respondents' opening brief, and never rebutted, Mr. Lucia repeatedly referenced "direct ownership of real estate" when presenting this illustration. (DX 66 at 33-35, 50.) Mr. Lucia further gave unchallenged testimony that, citing U.S. Census Bureau statistics, a 7% rate of return for real estate during that period was conservative. (Tr. 1125-28.)

Finally, the purported omission of the fact that Respondents did not "rebucketize" in the illustrations must fail for the same reason. Respondents never claimed to be portraying the actual performance of an actual or model portfolio. In a hypothetical illustration of a general strategy, there was no way to determine exactly when or how to reallocate assets, something which Respondents informed seminar attendees was portfolio-specific. Indeed, the case cited by the Division in support of this claim, *In re William J. Ferry*, Advisers Act Rel. No. 1747 (Aug. 19, 1998) (Opp. Brf. at 21), illustrates exactly why it must fail. In *Ferry*, "none of the graphs disclosed that the performance results were hypothetical rather than based on actual performance." In contrast, Respondents here *repeatedly* disclosed that the illustrations were mere hypotheticals and *not* based on actual performance.

4. The Evidence Presented At The Hearing Confirmed Respondents Did Not Act With Scienter

The Initial Decision erred in concluding that Respondents acted with scienter. Even if the Commission were to conclude that Mr. Lucia's use of the word "backtest" was imprecise (notwithstanding the plain disclosures that he was illustrating hypotheticals based on assumptions), and that additional disclosures would have made the slides clearer, at worst Mr. Lucia was negligent, and hardly acting with the degree of scienter contemplated under *Steadman* as giving rise to a lifetime bar.

At the time in question, Mr. Lucia was associated with an investment adviser in a highly regulated space, with his presentations subject to review by both his firm's broker-dealers and the SEC examination staff itself. The hearing record establishes that the seminar slides were subjected to multiple reviews by Respondents' brokers over the years, as well as reviewed during an SEC compliance exam, and at no point was Mr. Lucia put on notice of any red flags suggesting the materials were misleading or otherwise problematic. The Division

mischaracterizes Mr. Lucia as "pointing the finger" at others, but, again, Mr. Lucia has consistently acknowledged that he, and he alone, was ultimately responsible for the contents of his presentations. But this is a far cry from establishing that the failure of the slides to comport with the ALJ's expectations constituted a knowing and deliberate fraud. The Division introduced no evidence showing that Mr. Lucia had actual, contemporaneous knowledge that the slides, accompanied by dozens of disclaimers identifying them as hypothetical illustrations based on assumed rates of return, were in fact false. The first time Mr. Lucia was put on notice of the Commission's concerns regarding the slides – in the deficiency letter provided to him following the staff's 2010 examination – he promptly removed the slides in question, in their entirety, from his seminars.

At no point during the hearing was there evidence introduced contradicting the testimony that the PowerPoint presentations were repeatedly reviewed by Mr. Lucia's supervising brokers, and that revisions were repeatedly made at their request. In response to an exhibit showing that 150 pages of slides were submitted for review in 2009, and subsequently approved, the Division counters only that this review does not appear to have been "robust." (Opp. Brf. at 29.) But the Division provides no evidentiary basis for reaching this conclusion, nor do they point to evidence establishing that Mr. Lucia should have known the review was not "robust," or to any support for the argument that an adviser who complies with a supervisory broker's requests for information is responsible for determining the quality of their review.[4]

A review of the slides by the SEC's exam staff in 2003 similarly failed to put Respondents on notice of any deficiencies in the seminar's disclosures. The Division argues that

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4 The Division contends that only one exhibit documenting review of the slides by a supervisory broker-dealer was introduced at the hearing (Opp. Brf. at 29). But the unrebutted testimony was that senior management of two successive broker-dealers reviewed the slides at varying times, without objection. (Tr. at 1305.)

the correspondence sent to Respondents following that exam did not explicitly discuss the seminar materials, but they do not dispute that the materials were in fact reviewed by the staff, with no concerns raised.[5]

In contrast, when Mr. Lucia was for the first time put on notice of concerns about the slides, upon received a deficiency letter in 2010 following a second SEC examination, he promptly removed the slides from all seminar presentations, as well as removing several of his books from circulation. (*See* RX 10.) The Division, attempting to sidestep the uncontroverted fact that Respondents responded promptly and completely to regulatory concerns, argues that Respondents "vigorously contested the deficiencies found by the examination staff." (Opp. Brf. at 31.) This is a troubling position for the Division to take. As discussed in Respondents' opening brief, and further below, the Division seeks to penalize Mr. Lucia for having the gall to defend himself. While Mr. Lucia, through counsel, has consistently explained that he believed the representations were not misleading, the bottom line is this: Respondents acted immediately to correct the SEC's perceived deficiencies, and did not wait for a judicial order that they do so, negating any inference that they acted with scienter, much less the "high level" of scienter urged by the Division in supporting a lifetime bar against Mr. Lucia.

5. The Initial Decision Erred In Finding The Purported Omissions Material

The ALJ had no basis to conclude that the purported omissions would have been material to reasonable investors. As noted above, Respondents' seminars simply illustrated the relative

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[5] The Division predictably argues that what they call the "1966 backtest" was not yet part of the seminar materials reviewed by the staff in its 2003 exam. But they, like the ALJ, fail to address the undisputed fact that every purported misrepresentation and omission relied upon by the Initial Decision – the use of assumed inflation and real estate return rates, the omission of fees and the failure to "rebucketize" – was present in the 1973 illustration reviewed by the staff in 2003.

merits of varying retirement strategies, and the Division concedes that it could not, and did not, prove that had Mr. Lucia's suggested strategy would not have nonetheless outperformed the others had his illustrations incorporated all the data points the Division contends were improperly omitted. Perhaps the potential returns from the "Buckets of Money" strategy would have been lower, but so would the returns from other strategies, and there is thus no basis to conclude that any such omissions were material viewed in context of the actual seminars.

Indeed, the Division has no response to the unrebutted evidence that, upon removing the illustrations from the seminars following the 2010 SEC exam, the proportion of seminar attendees subsequently deciding to seek advisory services from Mr. Lucia's then-firm was essentially unchanged. Hence, for all of the Initial Decision's references to the illustrations as the "grand culmination" and "pinnacle" of Mr. Lucia's seminars (Opp. Brf. at 2-3), the simple fact is that there was no showing that they were even relevant to attracting potential investors to Mr. Lucia and his former firm as investment advisers.

The cases cited by the Division as establishing materiality are inapposite. In each of these three cases, the SEC found that the adviser had misrepresented hypothetical performance results as representing actual historical trading by the firm. (Opp. Brf. at 15, *citing In the Matter of William J. Ferry*, Advisers Act Rel. No. 1747 (Aug. 19, 1998) (advertising materials presented hypothetical performance results without disclosing that they were not based on actual performance); *In the Matter of Meridian Inv. Mgmt. Corp.*, Advisers Act Rel. No. 1779 (Dec. 28, 1998) (adviser portrayed model portfolio results as representing actual trading); *In the Matter of LBS Capital Mgmt.*, Advisers Act Rel. No. 1644 (July 18, 1997) (advisory firm failed to disclose that advertised performance results were based on retroactive model rather than actual trading.) Notably, as discussed below, even though these cases found that the advisers had failed to

disclose that they were illustrating hypothetical rather than actual results – in contrast to the present case – in none of them was the adviser even suspended, much less barred for life.

B. The Initial Decision Erred In Finding That Respondents Pose A Significant Risk Of Future Violations

As previously briefed, two of the factors the Commission must consider under *Steadman* in imposing a collateral bar are the potential for future violations based on the respondent's occupation, and the respondent's recognition of the wrongful nature of his conduct. The Division fails to establish that these factors support the imposition of the extreme relief ordered by the ALJ.

First and foremost, Mr. Lucia is no longer in the advisory business. As the Initial Decision observed, by the time of the hearing Mr. Lucia was already winding down his business in order to focus on his media career. He sold the assets of RJLC, as well as his brokerage business, in 2010. He is no longer licensed as a broker and no longer registered as an investment adviser – and he raises no challenge to the Initial Decision's revocation of his and RJLC's investment adviser registrations.

The Division makes references to RJL Wealth Management ("RJLWM"), the firm owned by Mr. Lucia's son, and suggests – without any evidence – that Mr. Lucia could be affiliated with the firm and appearing publicly on behalf of RJLWM in some capacity. (Opp. Brf. at 36 n. 12.) *He is not.*[6]

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[6] The Division falsely and without any evidentiary basis contends that RJLC "lives on" in RJLWM (Opp. Brf. at 38 and fn. 15) – when in fact there is no ongoing legal affiliation – and thus argues that the Commission should impose significant penalties on RJLC, which the Division recognizes is defunct. The Division itself concedes that Mr. Lucia resigned from RJLWM. (Opp. Brf. at 34.) The Division investigated but never sued RJLWM or alleged any wrongdoing by RJLWM, and did not name it as a relief defendant. Their baseless attempt to link the two does not support the imposition of penalties against

Lucia's core concern here is his ability to eke out a living as a public speaker and media personality. The mere presence of the bar may cause others to refuse to do business with him out of concern that the Enforcement staff may come after them next. Indeed, the Division's brief confirms they have reason to be fearful. The Division cites Mr. Lucia's desire to continue serving as a public speaker and media personality as evidence that "Lucia's occupation presents opportunities for future violations." (Opp. Brf. at 36.) But as explained in Respondents' opening brief, and never challenged by the Division, these activities are constitutionally protected and outside the scope of the Investment Advisers Act and any suspension or bar. That the Division suggests that engaging in activities protected by the First Amendment puts Mr. Lucia at risk of future prosecution is troubling. When Respondents reference the need for a bright line sanction, it is exactly this threat – an overly broad interpretation of an associational bar that prevents Mr. Lucia from engaging in even those activities carved out of the Advisers Act – that motivates their concern.

The Division fails to explain why other, less draconian relief, such as the revocation of his investment adviser registration and the type of independent monitoring imposed in the very cases cited by the Division (see below), will not provide the sort of investor protection they believe is warranted, without eliminating the possibility that a 64-year-old man who has already left the industry may be able to earn some semblance of a living in his remaining years.

Finally, the Division insists the Mr. Lucia fails to recognize his wrongdoing. Specifically, the Division complaints that he did not proactively report minor errors found in the

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RJLC, which is no longer operational, is no longer registered as an investment adviser, and has no assets.

1973 illustration during the course of the litigation. (Opp. Brf. at 35.)[7] According to the Division, "Respondents were put on notice in 2010 by the examination staff that there were issues with their backtests, yet waited until late 2012, on the eve of the hearing, to check their slideshow for accuracy." (*Id.* at 29.) But as the Division elsewhere concedes, Respondents immediately ceased using the slides in question in 2010, and thus there was no reason for Mr. Lucia to engage in further analysis of the illustrations and report back to the SEC. It was only after the Division determined to nonetheless initiate an investigation and ultimately institute an enforcement action, despite this voluntary remediation, that Mr. Lucia was pressed to defend the slides he had long since stopped using. And when he identified errors in the slides, it was he, not the Division, who brought them to the attention of the ALJ.

Ultimately, one must ask what more Mr. Lucia could possibly have done once he was put on notice of the SEC's concerns. He removed the slides. He took his books out of circulation. Never does the Division identify what more Respondents could have done to establish their recognition of wrongdoing.[8] The only thing Respondents did not do, and apparently the basis for the Initial Decision's imposition of the lifetime bar, was admit to engaging in a deliberate fraud as alleged in the Order Instituting Proceedings ("OIP"). If that were sufficient basis for the remedy, then any respondent who opts to defend himself or herself, by definition, must be

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7 The Division repeatedly refers in its brief to minor errors in the illustration as further proof that the slides were "materially false and misleading in multiple ways." (Opp. Brf. at 31.) In fact, the Division never alleged any such misconduct, or sought to amend its Order Instituting Proceedings, much less did it prove such errors to have been material or made with scienter.

8 Interestingly enough, in the second *Steadman* case (cited by the Division, Opp. Brf. at 14), the D.C. Circuit vacated an injunction against an investment adviser in part because the alleged violations "were corrected immediately after the SEC notified the appellants that charges were pending." *SEC v. Steadman*, 967 F.2d 636, 648 (D.C. Cir. 1992). Here, again, Respondents acted long before the Division even informed them that they had begun an investigation, much less had charges pending against them.

permanently barred from the industry. Such a conclusion stands *Steadman* on its head and constitutes an error of law.

C. Respondents' Purported Omissions Caused No Demonstrated Harm To Investors

The Initial Decision concedes that, "in this case the evidence of actual losses to individual investors is virtually nonexistent… [T]here is no evidence of the amount of any unjust enrichment as to any particular investor." Initial Decision at 60. Yet while the Initial Decision purported to factor this into its determination that the Division's penalty request was "excessive," the Initial Decision completely ignores the absence of investor losses in ordering the lifetime collateral bar. Even this particular ALJ has recently acknowledged that investor losses are an important consideration in imposing an industry bar. *In the Matter of Corbin Jones*, Initial Decisions Rel. No. 568 (Feb. 21, 2014) (considering $1.8 million in misappropriation and $6 million in investor losses as bases for collateral bar). *See also In the Matter of Joseph C. Lavin*, Initial Decisions Rel. No. 363 (March 10, 2009) (imposing bar where respondent's "violations caused investors to lose millions of dollars"). Given the absence of any demonstrated losses to attendees of Respondents' seminars stemming from the purported fraud, the imposition of a lifetime bar was erroneous.

In responding to the Division's failure to show any losses, both the Initial Decision and the Division engage in a distortion of the record. As the Division writes, the ALJ found "that Respondents enjoyed substantial financial success at their clients' expense," based on Respondents' "commissions from REIT sales." (Opp. Brf. at 38.) Yet the Division did not charge any improprieties in connection with the sale of REITs.[9] There were no allegations,

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[9] As noted in the Opening Brief, it was an anonymous complaint about RJLC's purported failure to provide certain information in the sale of REITs that started the 2010 SEC

much less any evidence introduced at the hearing, showing that investors who ultimately chose to invest in REITs through RJLC were provided with anything short of complete and truthful disclosures, or were in any way defrauded in connection with the purchase of REITs. Hence, the Initial Decision's repeated references to REITs, and the commissions earned by Respondents (see also Opp. Brf. at 6-7), are simply red herrings. The Initial Decision's inference that Respondents' commissions came "at their clients' expense" when there is no allegation of wrongdoing in connection with the sale of these securities is entirely inappropriate, and should not be allowed to serve as a proxy for investor harm that was never demonstrated by the Division.

D. The Division Points To No Precedent For The Extreme Sanctions Ordered By The ALJ

Respondents' Opening Brief cited multiple recent cases involving investment advisers found to have made comparable misrepresentations to those charged here, none of which resulted in bars, or even suspensions. (Opening Brief at 22-24.) The Division responds that these are not comparable, but makes no effort to distinguish them factually. To the contrary, these cases involved the very misrepresentations and omissions that the Division alleges are at issue here, *e.g.*, the use of hypothetical illustrations purporting to convey actual historical results (*In the Matter of New England Investment and Retirement Group*) (*In the Matter of New England Investment and Retirement Group, Inc.*, Advisers Act Rel. No. 3516 (Dec. 18, 2012)); the failure to deduct advisory fees from illustrations of historical performance (*In the Matter of Modern Portfolio Management*) (*In the Matter of Modern Portfolio Management*, Advisers Act Rel. No. 3702 (Oct. 23, 2013)); calculating historical performance using unverifiable data (*In the Matter*

exam in the first place, and the examination found the complaint to have been baseless, finding no deficiencies in RJLC's sales practices relating to REITs.

of Equitas Capital Advisors) (*In the Matter of Equitas Capital Advisors*, Advisers Act Rel. No. 3704 (Oct. 23, 2013)).[10]

Notably, the Division cites additional examples of cases involving purported "backtests" deemed to have been misleading. (Opp. Brf. at 15.) Yet these cases (discussed above) only emphasize the excessiveness of the Initial Decision's sanctions: in none of the cases cited by the Division was a suspension or bar ordered; in one, the SEC did not even file charges against any individual respondents. *See William J. Ferry* (individual censured, fined $5,000, and ordered to retain an independent consultant to review his advertisements in the event he became associated with an SEC-registered adviser); *Meridian Inv. Mgmt. Corp.* (individual censured and fined $15,000); *LBS Capital Mgmt.* (advisory firm fined $25,000 and ordered to retain an independent consultant to review advertisements; no charge against individuals).

This case involves no misappropriation, no investor losses, and no fraud in connection with the sale of securities. Viewed in even the worst light, it is a case in which hypothetical illustrations of comparative retirement strategies were inartfully prepared. Imposing a lifetime collateral bar on these facts would be an unjust abuse of discretion by the Commission.

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[10] The Division argues these cases should be ignored because "Lucia provided knowingly false testimony to the hearing officer." (Opp. Brf. at 37.) The Division's repeated references to purported "false testimony" only highlight the improper bias against Mr. Lucia demonstrated by the ALJ throughout the Initial Decision. On multiple occasions, the ALJ concluded that characterizations made by Mr. Lucia with which the ALJ simply disagreed somehow constituted "knowing falsehoods." For example, Mr. Lucia has consistently referred to the BOM strategy as a "withdrawal strategy," in that it advises investors to withdraw money from safe buckets before riskier buckets (*see infra* at 7). The Division itself, in the OIP, described the strategy as one in which investors would "draw on the assets" in the safest buckets first. Yet the ALJ considered his disagreement with this terminology as rendering Mr. Lucia's testimony "knowingly false," and the Division relies on the ALJ's ill-considered characterizations as support for the position that Mr. Lucia must be barred permanently from the industry.

E. The Initial Decision Correctly Rejected The Division's Claims Under Rule 206(4)-1(a)(5)

In contrast to its sweeping and unsupported fraud findings, the Initial Decision applied a straightforward, plain English reading of Rule 206(4)-1(a)(5), which under the definitions set forth in subsection 206(4)-1(b), defines advertisements as including only "written communications." As the Initial Decision properly concluded, the OIP challenges only live slideshow presentations. While the ALJ may be correct in noting that the provisions in question are "outdated," the appropriate way to bring them up to date is through rulemaking.

The Division's insistence on vindicating their interpretation of this rule is consistent with their arguments throughout the case. The Division seeks to enshrine the term "backtesting" as having a legally binding definition, despite its absence from any rule or regulation, in the face of plain disclosures confirming that the term was not being used the way the Division believes it should have been. By the same token, the Division here attempts to expand the definition of "written" found in regulations promulgated under the Advisers Act. Whether in terms of "backtesting" or "written communications," the Commission is free to implement or revise regulations in the manner urged by the Division. But to impose such regulatory changes through litigation is an abuse of discretion, and should not come at the expense of an individual who was never put on notice of such legal requirements.

III. CONCLUSION

For each of the above reasons, the Commission should reverse the Initial Decision and overturn the sanctions ordered therein.

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Respectfully submitted,

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CERTIFICATE OF WORD COUNT

I hereby certify that this REPLY BRIEF OF RESPONDENTS RAYMOND J. LUCIA COMPANIES, INC. AND RAYMOND J. LUCIA, SR. ON APPEAL OF INITIAL DECISION ON REMAND complies with the length limitation set forth in Rule 450(c) of the Commission's Rules of Practice. According to the Microsoft Word word count function, this brief contains 6,059 words, excluding pages containing the tables of contents and authorities.

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