UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-20531

In the Matter of **Horter Investment Management, LLC and Drew K. Horter,** **Respondents.**	**Judge Carol Fox Foelak**

DIVISION OF ENFORCEMENT'S RESPONSE TO RESPONDENTS' BRIEF ADDRESSING CIVIL PENALTIES AND OTHER REMEDIAL ACTIONS

The Division of Enforcement ("Division") writes in response to Respondents Horter Investment Management, LLC ("HIM") and Drew K. Horter's ("Horter") Brief Addressing Civil Penalties and Other Remedial Actions. In their brief, HIM and Horter mischaracterize the record and the law. Contrary to their argument, and as explained below and in the Division's Motion for Sanctions (the "Motion"), the requested two-year associational bar, censure, and civil penalties are appropriate sanctions to address HIM's and Horter's egregious misconduct and are necessary to protect the public interest.

ARGUMENT

I. HIM's and Horter's Conduct Was Egregious.

HIM and Horter seem to argue that their conduct was not at all egregious and that any sanctions should be *de minimis*. HIM and Horter claim they deserve deference because, among other things: (a) Hannan did not have any regulatory disciplinary history when they hired him; (b) clients never complained to HIM about Hannan; (c) HIM's Compliance Department successfully stopped one client distribution to Hannan Properties days before they fired Hannan

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(after letting 17 go through over 17 months); and (d) ***five years*** after firing Hannan, HIM has made "significant changes" to the firm's supervisory and compliance structure. (Resp. Br. at 3-8.) HIM and Horter conveniently ignore the facts to which they consented. (*See* Order Making Findings and Imposing a Cease-and-Desist Order and Ordering Continuation of Proceedings, Rel. No. IA-6182, 2022 WL 16709988 (Nov. 3, 2022) (hereinafter "Consent Order").) Under these facts, the relief requested by the Division is appropriate and in the public interest.

A. HIM and Horter Recklessly Ignored Red Flags.

HIM and Horter knew, or should have known, that Hannan was soliciting HIM client funds for his outside business activities, but failed reasonably to supervise Hannan's activities. Indeed, HIM approved and processed 17 client distributions to Hannan Properties, which Hannan ultimately used to gamble, pay personal expenses, and repay other investors in violation of the Investment Advisers Act of 1940 ("Advisers Act"). (Consent Order ¶¶ 17-26, 28, 42.) While *scienter* is not a requirement of a failure to supervise charge, the Commission has held that a supervisor may "reckless[ly] disregard his supervisory responsibilities" where he ignores "numerous red flags." *John A. Carley*, Rel. No. 34-888, 2008 WL 268598, at *26 (Jan. 31, 2008), *rev'd in part on other grounds sub nom*. *Zacharias v. SEC*, 569 F.3d 458 (D.C. Cir. 2009).

The undisputed evidence demonstrates HIM and Horter did just that. As set forth in the Consent Order, Horter overrode his Compliance Officer's suggestion to terminate Hannan due to the FINRA inquiry and due diligence failures, choosing instead to accept Hannan's self-serving explanation without any investigation. (Consent Order ¶ 16.) HIM and Horter knew, or should have known, that HIM designated Hannan as a high-risk adviser, yet neither HIM nor Horter took any steps to ensure Hannan was subject to any heightened supervision. (*Id*. ¶ 17.) Horter

could not remember *anything* he did to oversee his delegation of Hannan's supervisory responsibility to HIM's Compliance Department. (*Id*. ¶ 84.) HIM approved and processed 17 distributions to Hannan Properties, Hannan's approved outside business activity about which HIM neither performed due diligence nor determined whether Hannan was soliciting HIM clients (which was prohibited). (*Id*. ¶¶ 18-21 *see also* Mot. at 6 (citing Decl. Ex. 2, Feb. 27, 2017 Heinzman Third-Party Distribution, attached to the Declaration of Nicholas Magina ("Magina Decl.") filed January 9, 2023).) Six of these distributions were logged, reviewed, and approved by a HIM supervisor – even though "Hannan" was prominently listed as the IAR ***and*** the payee. (Consent Order ¶¶ 59-66; *see also* Mot. at 17 (citing Magina Decl. Ex. 3, HIM Client Distribution Log).) Finally, Horter knew Hannan was actively soliciting investors in HR Resources and yet did nothing to investigate whether Hannan was soliciting HIM clients. (*Id*. ¶¶ 22-23.)

HIM and Horter falsely depict themselves as simply honoring the wishes of their clients to make distributions to Hannan and the unfortunate victim of "human error" in failing to log the distributions or audit the log. In fact, the undisputed facts demonstrate that HIM and Horter acted recklessly and these facts cannot be ignored in determining whether remedial sanctions are in the public interest.

B. HIM's and Horter's Failures Involved More than Hannan.

In arguing for leniency, HIM and Horter argue also that "the actions at issue were isolated to Hannan." (Resp. Br. at 12.) That assertion is belied by the factual allegations contained in the Consent Order.

HIM and Horter neglected their critical duties as a registered investment adviser and supervisor, respectively, reasonably to supervise IARs and prevent Advisers Act violations, and

HIM failed to adopt and implement policies and procedures reasonably designed to prevent Advisers Act violations. (*See, e.g.,* Consent Order ¶¶ 39-45, 57-58, 80-86.) It is undisputed that HIM failed reasonably to establish policies and procedures designed to (a) prevent the misappropriation of client funds by IARs through third-party distribution requests, (b) provide heightened supervision to high-risk IARs, and (c) supervise remote IARs and conduct field visits. (*Id*. ¶¶ 38-50.) Similarly, it is undisputed that HIM failed reasonably to implement supervisory policies and procedures concerning third-party distributions, IAR onboarding, IAR outside business activities, and supervisory reviews (*id.* ¶¶ 51-72), or follow up on numerous red flags (*id*. ¶¶ 73-79). These failures occurred over a 17-month period and some even occurred ***after*** HIM was directed to develop and implement these policies and procedures by an independent consultant and Commission staff. (*Id*. ¶¶ 39-45.) It is also undisputed that Horter unreasonably delegated supervisory responsibility for HIM's policies and procedures, and for HIM's IARs generally, to the Compliance Officer and failed to follow up on any of those delegations. (*Id*. ¶¶ 80-84.)

Accordingly, these undisputed systemic failures are equally relevant to the determination of appropriate remedies here.

C. HIM and Horter Delayed Remedial Changes for Five Years.

It is undisputed that HIM failed reasonably to establish policies and procedures regarding third-party distributions, heightened supervision to high-risk IARs, and remote IARs and field visits (Consent Order ¶¶ 38-50), failed reasonably to implement supervisory policies and procedures concerning such distributions, IAR onboarding, IAR outside business activities, and supervisory reviews (*id.* ¶¶ 51-72), and failed to follow up on numerous red flags (*id*. ¶¶ 73-79). These deficiencies occurred ***after*** Commission staff issued a 2014 deficiency letter directing

HIM to develop and implement policies and procedures for branch audits and the supervision of remote IARs such as Hannan, ***after*** an independent consultant directed HIM in March 2015 to develop and implement policies and procedures concerning heightened supervision of high-risk advisers such as Hannan, and ***after*** HIM's Compliance Officer warned of the need for HIM to develop its heightened supervision program. (*Id*. ¶¶ 39-45.)

After HIM and Horter learned of Hannan's fraud in March 2017, it should have been their first priority to rectify these deficiencies by tightening the supervision of high-risk, remote IARs (like Hannan), preventing the misappropriation of client funds by IARs through third-party distributions (as Hannan did), and removing Horter from a supervisory and compliance role. Instead, HIM and Horter took a dilatory approach. HIM and Horter decided to wait until February 2022 to restructure its compliance and supervisory functions, policies, and procedures – five years after Hannan was fired and after the Division filed the OIP in September 2021. (Consent Order at 1; Magina Decl. Ex. 5, May 25, 2022 Horter Dep. Tr. 30:10-31:2 (testifying that Horter did not step away from supervisory and compliance functions until February 2022); *see also* Resp. Br. at 6 ("As of February 2022, overall supervisory authority was vested in HIM's Compliance Committee.").) Such lax and delayed remedial measures – which could be reversed at any time – do not justify leniency.

Moreover, while HIM and Horter may have belatedly accepted responsibility by agreeing to the Consent Order, they only elected to enter into a bifurcated settlement, on a no admit no deny basis, after vigorously defending his action for over a year. Accordingly, HIM and Horter are wrong to suggest that they "cooperated" with the Division (Resp. Br. at 10-11), and the hearing officer should not consider their purported cooperation as a mitigating factor.

Finally, contrary to Respondents' argument (Resp. Br. at 11), HIM has not repaid harmed investors in full for the 17 third-party distributions it approved and processed to facilitate Hannan's fraud. Indeed, HIM has only paid the three clients $360,000 – less than 50% of their losses. (Mot. at 22; Magina Decl. Ex. 1, Chart of HIM Client Distributions to Hannan Properties.)

II. A Two-Year Supervisory Bar for Horter Is Necessary to Protect the Public Interest.

The Division's requested relief is consistent with precedent and proportionate to Horter's egregious conduct. Horter argues, however, that it would be against the public interest to punish him more than the minimum, if at all. (Resp. Br. at 11.) This argument again mischaracterizes Horter's systematic failure to fulfill his important role in supervising Hannan, and his failure to follow up on his supervisory delegation to the Compliance Department, as simply a minor mistake. The Commission has consistently held that "failures to supervise cases are serious violations" because "[s]upervisors are the first line of defense against wrongdoing by their subordinates." *Brown, Collins, Walsh, & Wells*, Rel. No. 34-66752, 2012 SEC LEXIS 1127, at *6 (April 5, 2012). Moreover, as the Commission has held, a supervisor cannot delegate supervisory responsibility to a subordinate and then, as Horter did, "simply wash his hands of the matter until a problem is brought to his attention." *See Rita H. Malm & Robert W. Berg*, Rel. No. 34-35000, 1994 SEC LEXIS 3679, at *23 (Nov. 23, 1994). Where, as here, a Chief Executive Officer has repeatedly and egregiously failed to fulfill his professional obligations to supervise a high-risk IAR that engaged in fraud through soliciting nearly three-quarters of a million dollars from clients, a multi-year bar is appropriate.

Contrary to Respondents' suggestion, it is not a gross abuse of discretion to impose a two-year supervisory bar for the failure reasonably to supervise. (Resp. Br. at 10 (citing

Steadman v. SEC, 603 F.2d 1126, 1141 (5th Cir. 1979)).) The standards set forth in *Steadman*, which concerned a permanent bar, do not apply here. The Division's proposed relief is not "drastic" and the Division does not have a greater burden to show why a less severe sanction would not protect investors. The Division submits the requested relief is consistent with precedent and proportionate to Horter's serious, consequential violations.

As explained above, Horter's undisputed failure to follow up on numerous red flags was reckless. (Consent Order ¶¶ 73-79); *John A. Carley*, Rel. No. 34-888, 2008 WL 268598, at *26. Therefore, contrary to Horter's suggestion (Resp. Br. at 13), the degree of *scienter* involved was undisputedly high. Similarly, the misconduct at issue here was not isolated as Horter contends (Resp. Br. at 12); it occurred 17 times over 17 months. It also involved more than just Hannan. As detailed above, the Consent Order outlines numerous supervisory failures by Horter. (*See, e.g.*, Consent Order ¶¶ 16-17, 19, 24, 42, 53-56, 64, 80-84.) While HIM wisely removed Horter from any supervisory or compliance role in February 2022, without a two-year supervisory bar, Horter could be reinstated in a supervisory capacity at any time. Indeed, given Horter's revised duties, he would not be burdened by a two-year supervisory bar in any way. Finally, a two year bar is necessary to deter against future violations by others in the securities industry. *Schield Management Co.*, Rel. No. 34-53201, 2006 SEC LEXIS 195, at *22-23 (Jan. 31, 2006).

The settled order in *SFX Financial Advisory Management Enterprises, Inc.*, Rel. No. IA-4116, 2015 WL 3653814 (June 15, 2015), does not compel a different conclusion. In *SFX*, the Commission found, among other things, that (a) SFX, a registered investment adviser, failed reasonably to supervise an officer who misappropriated approximately $670,000 from three client accounts (by writing unauthorized checks from client bank accounts and making unauthorized wires from client accounts and credit cards) and committed various compliance

failures, and (b) the CCO caused SFX's compliance failures. *Id*. at *3-4. In the agreed order, the Commission censured Respondents, ordered them to cease and desist from committing and causing the compliance failures, and ordered them to pay civil penalties. While the sanctions did not include a suspension, revocation, or bar, the CCO was not charged with failure reasonably to supervise the employee who committed the fraud. Rather, the Commission found that he only caused the compliance failures. *Id*. Moreover, unlike here, the officer did not steal the client funds through a supervised process – he processed the checks and wires himself since he had signatory authority over the client accounts. Accordingly, the agreed remedies in *SFX* are irrelevant. Indeed, as Horter recognizes, greater penalties are appropriate in cases, like here, "with a greater degree of scienter and where there was reckless conduct or actual knowledge." (Resp. Br. at 15 (collecting cases).)

Horter's egregious failure reasonably to supervise Hannan, which resulted in fraud and substantial losses to HIM clients, his reckless failure to follow up on numerous red flags, his unreasonable delegation of supervisory authority, the repeated and prolonged nature of his supervisory failures, and the need to deter others, warrant a two-year supervisory bar for Horter. *See, e.g., See Angelica Aguilera*, Rel. No. ID-501, 2013 SEC LEXIS 2195, at *72 (July 31, 2013) (investment adviser President who failed to supervise two IARs who engaged in markup and markdown scheme barred from association in supervisory capacity with broker or dealer); *see also* Mot. at 25 (collecting cases). Accordingly, it is in the public interest to bar Horter from supervisory association with the right to reapply after two years.

III. A Censure for HIM Is in the Public Interest.

HIM concedes that if the hearing officer finds that a sanction is in the public interest, a censure is appropriate for HIM. (Resp. Br. at 14-15.) The Division agrees.

It is undisputed that over a 17-month period HIM failed reasonably to: (a) supervise Hannan (Consent Order ¶¶ 85-86); (b) establish policies and procedures concerning third-party distributions, heightened supervision of high-risk IARs, and remote IARs and field visits (*id*. ¶¶ 38-50); (c) implement supervisory policies and procedures concerning third-party distributions, IAR onboarding, IAR outside business activities, and supervisory reviews (*id.* ¶¶ 51-72) or; (d) follow up on numerous red flags (*id*. ¶¶ 73-79). Moreover, HIM neglected to develop and implement these policies and procedures after an independent consultant, Commission staff, and its own Compliance Officer directed them to do so. (*Id*. ¶¶ 39-45; *see also id*. ¶ 86.) Accordingly, a censure of HIM is in the public interest. *H.D. Vest Investment Securities, Inc.*, Rel. No. 34-74429, 2015 SEC LEXIS 860, at *19 (Mar. 4, 2015) (broker-dealer agreed to censure for failing to supervise registered representative who misappropriated $300,000 from brokerage customers).

IV. Substantial Civil Penalties Against HIM and Horter Are in the Public Interest.

Based on Respondents' over 17-month failure reasonably to supervise Hannan, with a view to preventing his fraud in violation of the Advisers Act, and their reckless failure to follow up on numerous red flags, as well as HIM's willful failure to adopt and implement policies and procedures reasonably designed to prevent violations of the Advisers Act, civil penalties for HIM and Horter are in the public interest.

As an initial matter, Respondents are wrong that this matter does not involve fraud, deceit, or manipulation. (Resp. Br. at 17.) The Commission has held supervisory lapses involve fraud when, as here, they "allowed and were responsible, in part, for the success and duration of a registered representative's fraudulent misconduct." *George J. Kolar*, Rel. No. 34-46127, 2002 SEC LEXIS 3420, at *23 (June 26, 2002) (imposing second-tier penalties on deficient supervisor

who failed to stop fraudulent misconduct resulting in $10 - $14 million in investor losses over a three-year period).[1] It is undisputed that while HIM and Horter failed reasonably to supervise Hannan, Hannan violated of Section 206(1) and (2) of the Advisers Act over a 17-month period by misappropriating money from HIM clients through 17 third-party distributions approved, processed, and executed by HIM. (Consent Order ¶¶ 27-35, 85-86.) In addition, HIM's and Horter's conduct also involved "reckless disregard of a regulatory requirement."

Contrary to Respondents' suggestion (Resp. Br. at 17), HIM's and Horter's failure reasonably to supervise Hannan caused actual harm to HIM clients and was not simply "derivative" of Hannan's fraud. "But for" HIM's and Horter's failure to supervise Hannan, HIM would not have processed and approved 17 third-party distributions from HIM clients to Hannan Properties, resulting in HIM client losses of $728,001. (Consent Order ¶ 20.) As explained in the Division's Motion, if HIM had established and implemented policies and procedures to "safeguard client assets from conversion or inappropriate use by advisory personnel" – one of the areas the Commission has identified, at a minimum, should be addressed in an investment advisory firm's written policies and procedures – Hannan's misconduct could have been prevented and his clients' funds protected. Moreover, HIM and Horter have not reimbursed HIM clients in full for their losses. (Mot. at 22.)

Finally, HIM and Horter fail to recognize (Resp. Br. at 18-19) that the deterrence of other industry participants – not just Respondents – from committing similar acts supports the conclusion that a civil penalty is in the public interest. 15 U.S.C. § 80b-3(i)(3). Substantial civil

[1] Respondents cite no case that supports a different conclusion. (Resp. Br. at 19 (citing *Retirement Surety LLC*, Rel. No. ID-1392, 2019 WL 7284955, at *9-10 (Dec. 20, 2019) (first-tier civil penalties ordered where no allegation of fraud and no evidence respondents were reckless in selling unregistered securities)).)

penalties would be a strong deterrent to registered investment advisers and supervisors, like HIM and Horter, from failing reasonably to supervise investment adviser representatives.

Having established that civil penalties are in the public interest, the remaining question is the appropriate penalty tier and amount. Here, as explained above, because the misconduct involved "fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement," and "directly or indirectly resulted in substantial losses . . . to other persons," Third Tier penalties are applicable. 15 U.S.C. § 80(b)-3(i)(2)(C). Accordingly, based on their failure reasonably to supervise Hannan from committing fraud, and HIM's willful violation of Section 206(4) of the Advisers Act and Rule 206(4)-7, the Division seeks civil penalties of $250,000 and $125,000 against HIM and Horter, respectively. These penalty amounts are reasonable in that they are within the maximum Third Tier penalties for entities and individuals, adjusted for inflation to the time period of the violations here. SEC Release Nos. 33-11021, 34-93925, IA-5938, IC-34466, dated Jan. 6, 2022 (effective Jan. 15, 2022), *Adjustment of Civil Monetary Penalties* (inflationary adjustment increasing statutory penalties for applicable time period). Finally, these penalty amounts are supported by legal precedent. (Mot. at 22-23 (collecting cases).)

CONCLUSION

In sum, as described above and in the Motion and Consent Order, HIM and Horter failed reasonably to supervise Hannan, within the meaning of Section 203(e)(6) and (f) of the Advisers Act, and HIM willfully violated Section 206(4) of the Advisers Act, and Rule 206(4)-7 thereunder, by failing to adopt and implement policies and procedures reasonably designed to prevent Advisers Act violations, and their egregious conduct readily establishes that the sanctions requested by the Division are in the public interest. Accordingly, the Division

respectfully requests that its Motion be granted and that the Court (a) impose civil penalties of $250,000 and $125,000 against HIM and Horter, respectively, (b) bar Horter from association in a supervisory capacity with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization, with the right to reapply after a period of two years, and (c) censure HIM.[2]

Dated: January 30, 2023

Respectfully submitted,

/s/ Alyssa A. Qualls

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[2] On November 3, 2022, the Commission ordered HIM to cease and desist from committing or causing any violation and any future violation of Section 206(4) of the Advisers Act and Rule 206(4)-7 promulgated thereunder. Rel. No. IA-6182. The Advisers Act does not provide authority for cease and desist proceedings for failing reasonably to supervise. 15 U.S.C. § 80b-3(k).

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I hereby certify that I caused a true copy of the foregoing Division of Enforcement's Response to Respondents' Brief Addressing Civil Penalties and Other Remedial Actions to be served on the following on this 30th day of January, 2023, in the manner indicated below:

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Dated: January 30, 2023

/s/ Alyssa A. Qualls
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