UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Admin. Proc. File No. 3-20531

In the Matter of HORTER INVESTMENT MANAGEMENT, LLC and DREW K. HORTER, Respondents.	**RESPONDENTS' RESPONSE BRIEF TO THE DIVISION OF ENFORCEMENT'S MOTION FOR SANCTIONS**

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Pursuant to the December 5, 2022 Order of Administrative Law Judge Foelak (the "ALJ"), Respondents Horter Investment Management, LLC ("HIM") and Drew K. Horter ("Horter") submit this brief in response to the Division of Enforcement's (the "Division") Motion for Sanctions Against Respondents (the "Motion").

I. INTRODUCTION

The Division's Motion seeks significantly harsh sanctions against HIM and Horter, but the factual record of this proceeding does not support such sanctions. The Division gives little, if any, credence to the fact that HIM no longer resembles the firm it was in 2017 and the likelihood of future violations has been materially reduced or eliminated. HIM has implemented substantial compliance and supervisory improvements and Horter has materially reduced his daily supervisory responsibilities. However, the Division dismisses the efforts of Respondents. The Division also seemingly ignores that HIM and Horter have accepted responsibility for any compliance program and supervisory deficiencies that may have enabled Hannan to further his conduct, as reflected in the Offer of Settlement.

Most significantly, the Division paints Respondents as having a "high-degree" of knowledge of Hannan's actions or that Respondents were "extremely reckless." [Motion at 19.] However, the cases to which the Division cites in support of that conclusion are inapposite. Those cases, detailed herein, reflect facts where the supervisor had actual knowledge of the wrongdoing and chose not to react. Quite simply, those are not the facts before the ALJ here. After a review of the actual facts and the various factors for the ALJ's consideration for the implementation of possible discipline, including protection of investors, and in light of the extraordinary compliance and supervisory measures taken by HIM and Horter, the Division's request for severe sanctions should be denied.

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II. FACTUAL BACKGROUND

The Division spends the bulk of its Motion detailing the background facts of this proceeding notwithstanding the fact that the background is already set forth in the *Order Making Findings and Imposing a Cease-and-Desist Order Pursuant to Sections 203(e), 203(f), and 203(k) of the Investment Advisers Act of 1940, and Ordering Continuation of Proceedings* (the "Cease and Desist Order") and those facts are to "be accepted as and deemed true by the hearing officer . . . ." [C&D Order at IV.] Consistent with the Respondents' acknowledgement of their wrongful behavior as set forth in the Cease and Desist Order, Respondents cannot dispute those facts. However, in the Motion's "Statement of Facts," the Division also interwove opinions from its expert witness regarding Respondents' actions for purposes of assessing sanctions. Those opinions are not indisputable. As such, Respondents address those expert opinions below.

First, the Division's expert witness opined that "Horter's failure to take any steps to satisfy himself that Hannan's supervision was being conducted in an adequate and reasonable manner was unreasonable." [Motion at 5.] As Respondents' expert, Lisa Roth, recognized, the SEC guidance at the relevant time established three cornerstones of a successful supervisory framework: (1) assigning responsibility, (2) to persons with demonstrated ability, and (3) granting those individuals the authority to perform their duties. [Roth. Rep.[1] at 24, citing NRS and IAA's 16th Annual Evolution Revolution (Aug. 23, 2016), found at https://www.nrs-inc.com/about/press-room/nrs-iaas-16th-annual-evolution-revolution-study/.] That model was adopted by HIM and Horter. [*Id.*] Horter's

[1] All references to "Roth Rep." are to the Expert Report of Lisa Roth, dated May 11, 2022 in this matter. A true and accurate copy of the Roth Report was attached to Respondents' Brief Addressing Civil Penalties and Other Remedial Actions (the "Initial Brief") as Exhibit F.

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delegation of duties to qualified individuals was the cornerstone of HIM's supervisory system. [*Id.* at 25.] Moreover, Horter's delegation was "in line with recommendations" made by Oyster Consulting, a third-party compliance consulting firm hired by HIM. [*Id.*; *see also*, Long Aff.[2] at ¶ 26.] The "design, organization and administration of HIM's supervisory model was well-tailored to the firm's business model and complied with relevant SEC guidance." [Roth Rep. at 27.]

Second, the Division's expert opined that "[t]he failure of HIM and Horter to establish policies and procedures for the supervision of higher risk IARs such as Hannan was unreasonable." [Motion at 10.] However, at the relevant time of Hannan's actions, the only regulatory body that had published any information or requirements related to how to determine a "high risk" adviser was FINRA. [Roth Dep.[3] at 117:15-19.] However, even if HIM was subject to FINRA regulation—which it is not—Hannan did not fit into the "high risk" categories established by FINRA. [Roth Rep. at 29.]

The Securities and Exchange Commission ("Commission") did not launch its own investigation into or sweep of high risk investment advisors until 2016, two years <u>after</u> Hannan's registration with HIM. [Roth Dep. at 116:18-25; Roth Rep. at 27.] As part of that "high risk" sweep, the Commission focused on advisors with significant disclosure events such as criminal events, administrative proceeds, regulatory proceedings, and license revocations. [Roth Rep. at 28.] HIM was not identified by the SEC as a sweep participant. [*Id.*] However, importantly, the Commission "did not publish guidance from the high risk sweep and supervisory initiative until 2019," two years <u>after</u> Hannan was terminated from

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[2] All references to "Long Aff." are to the Affidavit of Jason D. Long, which was attached to Respondents' Initial Brief as Exhibit A.

[3] All references to "Roth Dep." are to the Deposition of Lisa Roth, dated July 21, 2022 in this matter. True and accurate copies of all relevant pages are attached hereto as **Exhibit A**.

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HIM. [*Id.* at 29[4].] Even if the Commission had published its findings earlier than 2019, Hannan did not fit into any of the SEC's high risk categories. [*Id.*] To determine that Respondents' failure was unreasonable for purposes of severe sanctions is a bridge too far.

Third, the Division's expert determined that the "failure of HIM and Horter to establish policies for the examination of remote IAR offices such as Hannan's was unreasonable." [Motion at 11.] The Commission first highlighted potential risk associated with nationwide branch offices in 2016. [Roth Rep. at 22.] "Later, in 2017, the SEC priority became reality when the SEC launched its Multi-Branch Initiative . . . ." [*Id.*] Hannan's conduct, however, ended in 2017. HIM was "not required to perform branch inspections of its remote offices at any time relevant" to Hannan's registration with HIM. [*Id.*] However, despite not being required to do so, HIM hired an individual specifically to implement a branch examination program "two years before the [Commission] gave the industry guidance on what its expectations were for a branch exam program." [Roth Dep. at 225:10-15.] In fact, HIM identified geographically diverse IARs as a risk potential "as early as 2014," when the Commission's "initiative was not undertaken until 2016." [Roth Rep. at 22.] Due to the logistical challenges and high cost, HIM's compliance consultant in 2015 suggested that HIM could instead deploy enhancements through technology, which it did. [*Id.* at 23.] Quite simply, HIM designed a program that was directly relevant to its business model and doing so was not unreasonable. [*Id.*]

Fourth, the Division's expert witness opined that Respondents' "failure to take action to determine how Hannan planned to take to raise money for HR Resources,

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[4] Citing to Observations from Examinations of Investment Advisors: Compliance, Supervision and Disclosure of Conflicts of Interest (2019), found at https://www.sec.gov/files/OCIE%20Risk%20Alert%20-%20Supervision%20Initiative.pdf.

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including whether he intended to solicit money from HIM clients, was unreasonable." [Motion at 13.] However, there was no indication that Hannan planned to solicit that money from his clients for HR Resources. [Roth Dep. at 145:21-146:9.] In fact, Hannan had informed Respondents several times that he was working with Riskalyze, which is a company that HIM also uses. [*Id.* at 189:6-24.] It was reasonable for HIM to assume Hannan was going to seek money from the other entities with which he worked, rather than jump to a conclusion that Hannan had any kind of criminal intent. [*Id.* at 188:4-21.]

Fifth, the expert opined that it was unreasonable for Respondents to fail to investigate the subject of Hannan's FINRA inquiry. [Motion at 15.] Respondents, however, chose to wait for the results of the FINRA inquiry, which was a reasonable response. [Roth Rep. at 33.] FINRA is a self-regulatory body that has no motive other than to identify violations of securities laws and regulations. [*Id.*] In fact, a member's failure to cooperate with such an inquiry is grounds for a bar, and therefore, Respondents would know if Hannan did not cooperate with the inquiry. [*Id.*] As such, Hannan was required as part of his cooperation to provide FINRA:

> a signed statement regarding the receipt of checks, nature of the checks, the amount and names of individuals who wrote each check, the number of occasions checks were written, copies of checks, where and when the checks were deposited an all relevant documentation related to Hannan's receipt of checks to a dba.

[*Id.*] Because of the sheer scope of FINRA's inquiry, Respondents could rely on the fact that Hannan would be required to comply with the inquiry, FINRA would complete a thorough investigation, and FINRA would notify Respondents if it determined that a violation occurred. [*Id.* at 34.] FINRA inquiries—as opposed to investigations—are generally wrapped-up within thirty days, so Respondents would also have the results from

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FINRA in short order. [Roth Dep. at 100:15-101:13.] Relying on the results of an in-depth inquiry from a self-regulatory body is not unreasonable.

Lastly, the Division's expert opined that neither Respondent "established reasonable compliance and supervisory systems or reasonably carried out the compliance and supervisory systems that they did have in supervising Hannan." [Motion at 17.] Commission guidance provides that a firm should "identify the risks and conflicts of interest that are relevant to its business, noting that the identification process should be repeatable and firm-wide" and the "process should not be static." [Roth Rep. at 15.] This guidance proposes that a compliance program evolves to address the perceived risks in the particular firm. [*Id.*] Importantly, there is no Commission "rule, requirement, or guidance that would suggest that perfection is a mandatory component or even a reasonable expectation." [*Id.*] HIM's compliance program "exhibited the components of an activist compliance program . . . ." [*Id.* at 16.] It was "well-resourced and staffed" and had the "presence of professional skepticism regarding the program's implementation." [*Id.*] It was "formalized [and] tailored to its business model and evolved with the growth of the firm." [*Id.*]

III. LEGAL ANALYSIS

A. The Division's Basis for Sanctions is Unsupported.

In the Motion, the Division bases its request for "significant sanctions" on three factors that are entirely misplaced. The Division argues that "[t]o date, neither HIM nor Horter have offered any assurances against future violations, and continue to vigorously deny any wrongdoing." [Motion at 19.] The Division also argues that Respondents' actions were based on a "high-degree of knowledge or, at a minimum, were extremely reckless." [*Id.*]

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1. <u>Respondents have offered assurances against future violations.</u>

First, to state that Respondents have offered no assurances against future violations entirely ignores the record and is disingenuous at best. HIM is a different firm than it was when Hannan was terminated in 2017 and Horter's role within HIM has changed dramatically from the information included in the Cease and Desist Order.[5] The record (including expert reports, deposition testimony, and investigatory testimony) supports significant steps taken since Hannan's termination:

- HIM has spent hundreds of thousands of dollars implementing new compliance technology between 2017 and today [Long Test.[6] at 43:10-44:9, 46:16-47:7; *see also*, Long Aff. at ¶ 23];

- Horter never declined a request for additional compliance resources for the HIM compliance department [Roth Rep. at 19; *see also,* Long Aff. at ¶ 24.];

- HIM retained Oyster Consulting, a third-party compliance consultant, from February 2015 through April 2018 (that also failed to identify Hannan's actions) [Long Aff. at ¶ 26.];

- Horter is no longer responsible for the day-to-day operations of HIM [Horter Dep.[7] at 32:13-22];

- Horter no longer has ultimate supervisory responsibility for HIM's Investment Advisor Representatives ("IAR"), and that responsibility is now vested in HIM's Compliance Committee, of which Horter is <u>not</u> a member [*Id.* at 29:13-20, 31:3-6; *see also*, Long Aff. at ¶¶ 29, 32];

- HIM and the Compliance Committee instituted a Branch Office Supervisory Program ("BOSP")—of which Horter is not a member nor does he participate—that is a four-part supervisory program for HIM's IARs [*Id.* at 23:8-12, 25:13-16:6; *see also*, Long Aff. at ¶¶ 34-35];

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[5] Respondents set forth in detail the facts demonstrating that HIM has evolved as a firm and has undergone significant changes since the facts set forth in the Cease and Desist Order, in Section II.B. of its Initial Brief. That detail is incorporated as if fully restated herein.

[6] All references to "Long Test." are to the investigative testimony of Jason D. Long, relevant pages of which were attached to Respondents' Initial Brief as Exhibit E.

[7] All references to "Horter Dep." are to the Deposition of Drew K. Horter, dated May 25, 2022, relevant pages of which were attached to Respondents' Initial Brief as Exhibit G.

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- Counsel for Respondents retained ACA Foreside, a third-party compliance consulting firm, to complete an all-encompassing review of HIM's compliance program and assessment of the firm, which resulted in a finding of no recommendations for HIM's compliance program, oversight, and/or supervision programs [*Id.* at 27:2-20; *see also*, Woods Aff.[8] at ¶ 28].

To review that information and determine that Respondents have not offered any assurances against future violations is to ignore the truth. Instead, the Division's argument equates to "once a bad actor, always a bad actor." The law does not support such a conclusion. "To say that past misconduct gives rise to an inference of future misconduct is not enough" when considering sanctions. *Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979); *Thornton v. S.E.C.*, 199 F.3d 440 (5th Cir. 1999)[9] ("The Commission may not presume future wrongdoing merely on the basis of past misconduct.")

2. Respondents do not vigorously deny any wrongdoing.

Second, the Division argues that significant sanctions are warranted because Respondents continue to "vigorously deny any wrongdoing." [Motion at 19.] Respondents do not dispute that Respondents were defending the proceeding, and they assume that the Division is not suggesting that Respondents are not entitled to vigorously defend themselves, even though a Respondent may ultimately settle a matter and accept responsibility. A vigorous defense and acceptance of responsibility are not necessarily mutually exclusive. However here, the Division does not appear to give any credence to the fact that the Respondents have accepted responsibility for their actions by agreeing to the Cease and Desist Order. *In the Matter of Eugene Terracciano* involved a bifurcated process similar to this proceeding in that the respondent entered into an agreed cease and desist

[8] All references to "Woods Aff." are to the Affidavit of Nicole R. Woods, which was attached to Respondents' Initial Brief as Exhibit B.

[9] For ease of reference, copies of all authority cited herein is attached hereto as **Exhibit B**.

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order and agreed to "additional proceedings to determine what, if any, 'remediation action is appropriate in the public interest.'" *In re Eugene Terracciano*, SEC Rel. No. ID-1388, 2019 WL 5513382, at *1 (Oct. 22, 2019) (Foelak, J.). In considering sanctions, this ALJ noted that the Respondent "recognized the wrongful nature of his conduct" in part because of his consent to the Settlement Order, which was done on a "without admitting or denying the findings herein" basis. *Id.* at *3; *see also*, *In re Eugene Terracciano*, Advisers Act Rel. No. 4956, 2018 WL 3344228, at *1 (July 6, 2018). The same conclusion should be made here.

3. <u>Respondents did not act with a high-degree of knowledge or recklessly.</u>

The Division also argues that Respondents acted with a "high-degree of knowledge or, at a minimum, were extremely reckless." [Motion at 19.] First, there are no facts in the Cease and Desist Order that establish that either HIM or Horter had actual knowledge of Hannan's actions. Therefore, there is no "high-degree of knowledge."

Second, the facts also do not support a finding of "extremely reckless." Recklessness is "highly unreasonable conduct, which represents 'an extreme departure from the standards of ordinary care . . . to the extent that the danger was either known to the defendant or so obvious that the defendant must have been aware of it.'" *In re Angelica Aguilera*, SEC Rel. No. ID-501, 2013 WL 3936214, at *25 (July 21, 2013) (quoting, *Rolf v. Blyth, Eastman Dillon & Co.*, 570 F.2d 38, 47 (2d Cir. 1977)). In *Aguilera*—a case cited by the Division in its Motion—the Commission found that Angelica Aguilera, the President and Financial & Operations Principal of a broker-dealer, acted recklessly in her supervision of two registered representatives who committed significant fraudulent acts related to two pension funds. In determining that Aguilera's supervision was reckless, the Commission noted that during the

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representatives' fraudulent activities, Aguilera's compensation went from "four to six thousand dollars per month" to approximately "$15,000 biweekly," and ultimately approximately $1.8 million in total for 2009. *Id.* at *14. Moreover, Aguilera was responsible for paying revenue commissions to the two representatives. She recalled numerous payments and transfers totaling hundreds of thousands of dollars in a matter of days. *Id.* She also recalled transferring $2.7 million on November 4, 2019; $2.25 million on November 24, 2009; and $1.25 million on November 25, 2009, as commission payments to a single representative, but never inquired as to why. *Id.* As such, Aguilera had direct knowledge of something happening with the representatives and was reckless in her supervision.

Although Respondents acknowledge their wrongful actions, there are no facts to support a finding that they were somehow reckless.[10] Quite the opposite. HIM's third-party distribution policies changed when circumstances changed. HIM responded to a phishing incident by changing its policy and reacting to the risks at the time. [C&D Order at ¶ 48, Roth Rep. at 40-44.] At the time of Hannan's actions, the third-party distribution policy was not designed to root out the actions perpetuated by Hannan. [Roth Rep. at 44.] Instead, it was designed to confirm that clients were actually requesting the transfer of funds and wanted the funds to be transferred to the recipient listed on the form. When a risk became apparent, HIM adjusted policies and the policies worked. When the distributions of the Hannan Clients were finally discovered by HIM's compliance department[11], Hannan

[10] Indeed, had the Division believed that either Respondent was truly reckless or had actual knowledge, it could have asserted an intent-based claim. However, the Division only asserted negligence-based claims against Respondents.

[11] Unintentional human error is not reckless, and no policy or procedure can eliminate that risk.

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was terminated. [*Id.*; C&D Order at ¶¶ 25, 26.] None of the facts or findings set forth in the Cease and Desist Order state or support a finding of recklessness by Respondents.

B. "Substantial Civil Penalties" Are Neither Warranted Nor Appropriate.

The Division is seeking Third Tier civil penalties against Respondents in the amount of $250,000 for HIM and $125,000 for Horter. [Motion at 20.] These penalties are neither warranted nor appropriate in this matter. As set forth in detail in Respondents' Initial Brief in Section III.C.[12], Respondents respectfully request that no civil penalties be ordered; however, if the ALJ orders penalties, they should be First Tier for a single violation.

In support of its request for substantial penalties, the Division cites to multiple cases, which are ultimately distinguishable[13]. *Angelica Aguilera* involved a Third Tier penalty of $150,000, and as detailed above, Aguilera benefitted monetarily from the representatives' frauds and never asked questions or dug into why she was receiving and/or paying out millions of dollars in commissions. *Aguilera*, *supra*, 2013 WL 3936214.

The Division also cites to *In re Charles Rizzo*, which involved a civil penalty of $130,000 for a co-founder and director of a registered investment adviser based on failure to supervise. [Motion at 22.] *In re Charles Rizzo*, Advisers Act Rel. No. 3436, 2012 WL 2952236 (July 20, 2012). In *Rizzo*, however, Rizzo had actual knowledge, through reports sent to him daily, revealing over $1.9 million in withdrawals in client accounts. *Id.* at *3. He received notification that $600,000 was withdrawn from a single client account and another $500,000 was made from another client account. *Id.* In another instance, Rizzo

[12] For sake of brevity, Respondents will not repeat their argument from the Initial Brief, but instead incorporate as if fully rewritten herein.

[13] In addition to *Aguilera* and *Rizzo* discussed herein, the Division also cites to *WestEnd Capital Management*, which did not involve third tier penalties, and *H.D. Vest*, which does not discuss third tier penalties or recklessness. [Motion at 22.]

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received notification that showed over $900,000 in deposits into the accounts of the advisors' clients on a single day and then, four days later, received notification that most of the $900,000 was wired out of those accounts. *Id.* at *4. Yet, Rizzo never followed-up on his actual knowledge of the money transfers. More importantly, at no point did Rizzo contact the clients about the withdrawals. *Id.* Rizzo also received notification from Schwab that the signature of one of the advisor's clients had been forged and told Rizzo that he needed to investigate the issue. *Id.* Yet, Rizzo never called the client to investigate the issue. *Id.* These facts are patently distinguishable from those in this proceeding given that HIM contacted each of Hannan's clients to confirm transfers.[14]

As set forth in Respondents' Initial Brief, the more appropriate determination is no civil penalty or a single violation First Tier penalty. *See, In re Retirement Sur. LLC, et al.*, SEC Rel. No. ID-1392, 2019 WL 7284955 (Dec. 20, 2019) (order first-tier civil penalties because respondents did not act with scienter, despite the fact "their actions leave much to be desired."); *c.f.*, *ZPR Invest. Mgmt. Inc.*, 861 F.3d 1239, 1256-57 (11th Cir. 2017) (upholding maximum second tier penalties because the respondents "repeatedly violated the antifraud provisions with scienter" and their misconduct was "especially serious because it involved attempts to promote their firm through false claims").

C. A Two-Year Supervisory Bar is Not Appropriate for Horter.

The Division is seeking a two-year supervisory bar for Horter. [Motion at 23.] That sanction is not supported by the record. The Division argues that Horter acted with a "high-degree of knowledge or, at a minimum, was extremely reckless." [Motion at 23.] The facts

[14] Hannan clients Buddy and Gloria Scott did not complete any Distribution Request forms because, although they were HIM clients, none of the funds provided to Hannan by the Scotts were from their HIM accounts or appeared on HIM account statements. [Long Aff. at ¶ 5.] As a consequence, it was impossible for HIM or Horter to know that the Scotts were transferring money to Hannan.

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do not support such a finding, as set forth in Section III.A.3 above. The Division also argues that Horter "has not accepted the wrongful nature of his conduct." [Motion at 24.] As detailed in Section III.A.2. above, Respondents have accepted responsibility for their actions by agreeing to the Cease and Desist Order. *See*, *In re Eugene Terracciano*, *supra*, 2019 WL 5513382, at *3.

The Division further argues that while "HIM may have already taken steps to remove Horter from his supervisory role and compliance related duties . . . without a supervisory bar HIM will be able to reverse such restructuring at any time and reinstate Horter as a primary supervisor of IARs." [Motion at 24-25.] The Division has no basis for such an illogical conclusion. As detailed above in Section III.A.1, HIM has not just "taken steps," but has completely overhauled its supervisory and compliance structure, including the creation of a Compliance Committee, of which Horter is not a member. [Long Aff. at ¶¶ 29, 32.] There are no facts that would support any conclusion that HIM somehow has a nefarious intent to sneak Horter back into a supervisory role. When the Division seeks "to order the most drastic remedies at its disposal, it has a greater burden to show with particularly the facts and policies that support those sanctions and why less severe action would not serve to protect investors." *Steadman*, 603 F.2d at 1137. "It would be a gross abuse of discretion to bar an investment adviser from the industry on the basis of isolated negligent violations." *Id.* at 1141. The Division cannot do so.

Once again, the cases relied upon by the Division are distinguishable. In support of its request for a bar "from supervisory association [with] the right to reapply after two years" is in the public interest, the Division cites to *Aguilera* and *Rizzo*, both of which were discussed previously as to why the facts of those cases are significantly more egregious than

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those in this proceeding. In addition, the Division cites to *James T. Budden*. However, that case involved a supervisory bar for owners of the firm arising from the fraudulent actions of the firm's chief compliance officer, when the owners had actual knowledge of the officer's actions and yet failed to provide the officer with any training, funding, or resources for his role and provided no oversight whatsoever. *In re James T. Budden, et al.*, Advisers Act Rel. No. 4225, 112 SEC Docket 3701, 2015 WL 5935519 (Oct. 13, 2015). Similarly, the Division cites to *In re Advanced Practice Advisors, LLC*, Advisers Act Rel. No. 5670, 2021 WL 136246 (Jan. 14, 2021). That proceeding involved an agreed permanent bar by the firm's CEO. However, once again, the CEO had actual knowledge of the wrongdoing of the firm's adviser. In fact, the firm's clearing broker informed the CEO directly that the adviser's father had called the clearing house and impersonated the adviser on at least 38 different occasions. *Id.* at *3. After learning that information, however, the CEO chose not to follow-up. *Id.*

There is no actual knowledge or reckless behavior as it relates to Respondents and this proceeding. In addition, given the ample evidence that of Respondents' remediation and cooperation, including compliance assessments, restructuring of HIM's compliance and supervisory structure, and repayment to Hannan's harmed clients[15], Respondents respectfully request that no bar (or suspension) be issued. The greater penalties—as cited by the Division—are reserved for cases with a greater degree of scienter and where there is actual knowledge or reckless behavior. Severe types of sanctions where the actions are not

[15] A close reading of the Division's Motion reflects that the total amounts paid to Hannan's Clients by HIM was $740,500, not $360,000. [Motion at 22, fn 2.] Indeed, Respondents paid HIM clients Buddy and Gloria Scott in settlement despite the fact that the funds that they gave to Hannan did not flow from their HIM accounts.

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as great border on being punitive because they do not provide anything to any victims to make them whole or remedy their losses *Saad v. SEC*, 873 F.3d 297 (D.C. Cir. 2017).

As indicated in their Initial Brief, Respondents respectfully request that if the ALJ finds that a sanction is in the public interest, at most the ALJ censure Respondents. A censure is properly calibrated to punish Respondents for their misconduct and discourage future violations without the need for a suspension or bar. *See*, *In re Ascension Asset Mgmt., LLC, et al.*, SEC Rel. No. ID-1400, 2020 WL 1699565 (Apr. 3, 2020) (Foelak, J.) (initial decision final as of Jan. 1, 2021) (issuing censure and finding it was in the public interest).

IV. CONCLUSION

As set forth above, after a review of the facts involved in this matter and the various factors for the ALJ's consideration, including protection of investors, and in light of the extraordinary compliance and supervisory measures taken by HIM and Horter, Respondents respectfully request that no sanctions be issued in this matter. If the ALJ finds that sanctions are appropriate, Respondents request that they be censured, and a Tier One civil penalty be issued.

Dated: January 30, 2023

Respectfully submitted,

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Exhibit	**Description**
A	Excerpts from Deposition of Lisa Roth
B	Copies of all authority used in Respondents' Response Brief

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I hereby certify that I caused a true copy of the foregoing *Response Brief to The Division of Enforcement's Motion for Sanctions* on the following on this 30th day of January 2023 via email as indicated below:

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Dated: January 30, 2023

/s Nicole R. Woods
Nicole R. Woods

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EXHIBIT A

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1 UNITED STATES OF AMERICA

2 BEFORE THE

3 SECURITIES AND EXCHANGE COMMISSION

4

5 ADMINISTRATIVE PROCEEDING
File No. 3-20531

6

7 _______________________________________)

In the Matter of)

8)

Horter Investment Management, LLC)

9 and Drew K. Horter,)

)

10 Respondents.)

)

11 _______________________________________)

12

13

14

15 VIDEOTAPED VIDEOCONFERENCE DEPOSITION OF

16 LISA ROTH

17

18 Thursday, July 21, 2022

19 9:05 a.m. PT

20

21

22

23

Reported by:

24 Marcia S. McEntee

CSR No. 13399

25 Job No. 220721MSM

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1 UNITED STATES OF AMERICA

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In the Matter of)

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Horter Investment Management, LLC)

9 and Drew K. Horter)

)

10 Respondents.)

)

11 ____)

12

13

14

15 VIDEOTAPED VIDEOCONFERENCE DEPOSITION OF

16 LISA ROTH, taken on behalf of Agency, beginning

17 at 9:05 a.m. and ending at 4:29 PT, on Thursday,

18 July 21, 2022, before Marcia S. McEntee,

19 Certified Shorthand Reporter No. 13399.

20

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1 Properties. And that would have really meant -- would
2 have shed a window into the fraud that Mr. Hannan
3 committed at HIM --
4 A Right.
11:51:01 5 Q --- but I don't know; right?
6 A Yeah. I mean we can all sit here after the --
7 after the fact and try to imagine what we would have known
8 in this letter, but the reality of it is if the -- HIM's
9 investigation wasn't required to be perfect. It was
11:51:19 10 required to be reasonable. And this is -- this is a
11 reasonable approach.
12 Q Well, you said that -- that FINRA investigations
13 can take years; right?
14 A No. You said that. I just agreed.
11:51:30 15 Q Okay. So, well, it can take some number of
16 months; right? You know it can take a range of months;
17 right? Do you know --
18 A It --
19 Q -- how --
11:51:40 20 A It can. In -- in my experience these
21 inquiries -- could you scroll to the top again and let me
22 just confirm who this is coming from? Just to the --
23 there. Hold on.
24 Okay. And can you scroll to the very bottom?
11:52:02 25 Is there an address there? Oh, New York. Okay.

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1 Yeah, so had this gone to Enforcement, yes, this
2 could take months. But this is the preliminary step that
3 FINRA takes to decide whether or not the incident should
4 be referred to Enforcement, and this type of inquiry is
11:52:18 5 generally wrapped up in 30 days.
6 So FINRA's process is they send this letter to
7 the rep. They send a corresponding letter to LPL, and
8 they perform an initial analysis of the information.
9 Depending on that, they send it to Enforcement.
11:52:35 10 And yes, in Enforcement it could take years. But
11 sending it to Enforcement is a disclosure, and HIM would
12 have known if that happened, and that would not take
13 years.
14 Q Did -- but HIM never did -- took any steps to
11:52:58 15 determine what the outcome of the FINRA investigation was;
16 right?
17 A Well, sure. They monitored. They monitored
18 their regulatory systems. And so they would have known
19 that there was no action taken because no --
11:53:12 20 Q They never -- right. But they don't -- that's --
21 that's a negative; right? They never -- they don't know
22 what they don't know.
23 A Well, that is not their fault. That is the way
24 the system works. That is the way FINRA operates. FINRA
11:53:25 25 --

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1 had a customer complaint. I think that Mr. Long took a --
2 cast a fairly wide net here, and I -- and I support that.
3 Q What is the significance of a high risk
4 designation if there are no additional restrictions placed
12:15:51 5 on an IAR?
6 A Well, it is because they are called out. And
7 Mr. Long's testimony describes what he did. I think he
8 was asked what -- you know, what specifically he did. And
9 his answer I thought was -- was really solid.
12:16:03 10 He said he made everybody aware. Everybody was
11 aware. Not everybody. Every -- the -- the management
12 team were all aware of these individuals' status as high
13 risk advisers. And you can have all kinds of detailed
14 procedures on -- on what to do. But at the end of the
12:16:26 15 day, I think the awareness that he was on that list and he
16 didn't take him off of that list even though he could
17 have, I -- I think that is to his credit.
18 And I think that -- that in and of itself is --
19 is a notable -- notable course of action. You know, if a
12:16:41 20 broker/dealer and the States impose specific requirements
21 for heightened supervision, there is no such equivalent in
22 the SEC. And at this -- at this time the SEC hadn't even
23 launched its own investigation into or sweep into high
24 risk advisers, so I think expecting Mr. Long to have done
12:17:03 25 something more than he did is unreasonable.

1 Q So why -- so in -- it is your opinion that --
2 that -- that no additional requirements or restrictions
3 are necessary for an IAR that has a high risk designation?
4 A Yeah. I don't think there are specific
12:17:32 5 requirements that are mandatory for -- for a high risk
6 adviser. I mean depending on the circumstances.
7 I mean this is one page of a really robust report
8 that provides a lot of data and information and trends
9 which I think is really meaningful in the context of
12:17:53 10 creating an awareness to all of the executive team of --
11 about, you know, who they were as a company.
12 And to say that -- that these 30 reps should have
13 one special kind of procedure, I don't think enhances
14 that -- the process at all.
12:18:10 15 I think alerting -- taking -- taking the step of
16 identifying what is a high risk adviser. And remember, in
17 this time frame the only -- the only regulator that had
18 yet come out with any information about what a high risk
19 adviser is at FINRA and -- and these criteria don't fit.
12:18:30 20 And so instead of relying on FINRA's criteria or
21 ultimately on the SEC's criteria, which is frankly what
22 a lot of registered investment advisers do, Jason Long
23 took the extra step of determining what means risk to
24 them.
12:18:44 25 And -- and so this list of individuals includes

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1 comprehensive system of compliance and supervision. That
2 all applied to Hannan as well.
3 Q How did -- how did compliance verify his outside
4 business activities?
13:30:29 5 A Well -- well, they asked him. How does any SEC
6 investment adviser verify an outside business? I have --
7 I've been doing this for decades. I've never seen an
8 investment adviser take -- what would they do? Maybe like
9 ask for a -- like a tax return? I don't know what an
13:30:51 10 investment adviser would do to verify what that adviser is
11 doing.
12 They -- they asked for Web sites. They asked for
13 a description of the outside business activity. They
14 asked for the time he spent, whether or not it was
13:31:05 15 investment related. They asked all of the questions that
16 the regulatory document requires them to ask. They --
17 they did all of that.
18 Did they validate? I mean, would they give him a
19 lie detector test? I don't know what they should have
13:31:23 20 done that would have been better than what they did.
21 Q But they -- well, what -- when Hannan told Horter
22 that he was going to seek investors and HR resources from
23 other sources, they didn't do anything to follow up on
24 that; right?
13:31:49 25 A There was -- there was -- there was no indication

1 in -- in any of those communications that Hannan would
2 seek that information from clients. Hannan was talking to
3 reputable third parties. There was -- there was no
4 indication that that is what he was going to do.
13:32:09 5 And I would strongly disagree that they should
6 have pressed him on whether or not he's going to go to a
7 client. I just can't imagine that that was in the realm
8 of possibilities in their thinking, and I don't fault them
9 for that.
13:32:21 10 Q Well, in fact, he was going to clients; right?
11 A Yes. So I mean expecting them to say you can eat
12 $250,000, you are not going to go to your clients, are
13 you? I just -- I just can't imagine that that is a
14 reasonable question to expect the investment adviser.
13:32:38 15 With the benefit of hindsight, perhaps, but I just don't
16 think it ever crossed their mind. They -- they said that
17 it didn't, and I don't fault them for that.
18 Q Let's look at the -- let's go into the outside
19 business activities. I think it is at page 38 of your
13:33:17 20 report. You opine that it was reasonable for HIM to rely
21 on Hannan, an industry veteran in good standing with
22 nationally recognized professional credentialing
23 organizations, subject to more than 100 hours of annual
24 ethics training who had undergone a FINRA investigation to
25 understand and abide by --

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1 mean that's just a huge leap. And I don't think it is
2 reasonable in the business sense to think that he meant he
3 was going to go steal it.
4 Q Well, he could -- he could have asked his clients
14:47:14 5 to be investors; right? That wasn't -- that wouldn't be
6 stealing it?
7 A Well, which is -- which is what he did. I
8 shouldn't have said steal it. I mean that is what he did.
9 But -- but he knew he wasn't supposed to do that. I just
14:47:30 10 don't think that you can assume that in this sentence that
11 this triggers some obligation to the firm to imagine that
12 he is going to break a law. I just can't -- I just think
13 that's a huge leap.
14 And I wouldn't have read it that way myself. I
14:47:47 15 would have assumed -- I mean based on the communication,
16 the third parties he was working with, the fact that he is
17 trying to build a business based on the SEC's best
18 interest -- I mean on RAI. For all of those reasons, I
19 just think leaping to breaking the law is -- is too far.
14:48:02 20 And I would have assumed he is going to go to a bank or
21 something. I don't know.
22 Q You would agree with me, though, that they --
23 that HIM could have asked; right? HIM could have asked
24 Horter, "What -- what do you mean by that this?"
14:48:17 25 A I mean it's a big difference between what they

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1 could have done and what it was reasonable to do. They
2 could have asked anything. They could have asked, "Are
3 you going to stop paying your ex-wife?" I mean they could
4 have asked any of those questions. But was it reasonable
14:48:30 5 to expect them to ask that? I don't think so.
6 Q Wasn't it reasonable for them to have asked him a
7 question? How could that not be reasonable?
8 A Because he is -- he is 40-year veteran in the
9 industry with contacts that include RiskAlyze who has
14:48:54 10 demonstrated an interest in this product. To -- to ask
11 him when he is going to get the money, why would they ask?
12 Unless they knew -- I mean to ask him that question, they
13 would have had to presume that he was going to use some
14 inappropriate means. They would have had to assume that.
14:49:09 15 Because otherwise aside from that assumption, there would
16 be no reason to ask where -- where are you going to go?
17 Q Well, it could have been a conflict with -- with
18 HIM in some way, couldn't it?
19 A How? I mean he was talking to RiskAlyze. They
14:49:31 20 use RiskAlyze. There wasn't an entity that he mentioned
21 in this whole time that was -- was anything other than
22 potentially complimentary to him. I mean they would have
23 had to be assuming that he is going to do something,
24 you know, wrong or criminal to ask questions about where.
14:49:50 25 I just don't think it's logical from a business

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1 Kimm Hannan; right?
2 A Yes. I wonder how many times that happened in
3 the course of a day, in the course of a -- a business. It
4 happens -- it happens all the time. And -- and, you know,
15:42:06 5 Jason Long overrode Mr. Horter when it came to
6 implementing his monthly guidelines and when to putting
7 people on a list of high risk investment advisers.
8 No CEO wants a list floating around in their
9 office of high risk advisers. But Mr. Horter allowed
15:42:24 10 Mr. -- Mr. Long to do that and supported that process and
11 heard him out on the investments and heard him on hiring
12 a -- an individual specifically to implement a branch exam
13 program two years before the SEC gave the industry
14 guidance on what its expectations were for a branch exam
15:42:47 15 program.
16 So yeah, is there one incident where Mr. Horter
17 overruled Mr. Long? Yeah. That doesn't mean that -- that
18 he -- that he was a bad supervisor. It means he had an
19 opinion. And I can tell you that happens all the time in
15:42:59 20 the industry, sometimes for the better sometimes for the
21 worse; but it is perfectly appropriate for an industry to
22 exert authority and have an opinion. There is nothing
23 wrong that.
24 Q Mr. Long also wanted all the IAR's to be
15:43:15 25 supervised by a vice president, and Mr. Horter overruled

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1 REPORTER'S CERTIFICATE

2

3 I, the undersigned Certified Shorthand Reporter,

4 holding a valid and current license issued by the State

5 of California, do hereby certify:

6

7 That said proceedings were taken down by me in

8 shorthand at the time and place therein set forth and

9 thereafter transcribed under my direction and supervision.

10 I further certify that I am neither counsel for nor

11 related to any party to said action nor in any way

12 interested in the outcome thereof.

13

14 Before completion of the deposition, review of the

15 transcript [x]was [ ]was not requested.

16 The dismantling, unsealing, or unbinding of the

17 original transcript will render the Reporter's certificate

18 null and void.

19

20 IN WITNESS WHEREOF, I have subscribed my name on this

21 date: August 1st, 2022.

22

23

24 Marcia S. McEntee,
Certified Shorthand Reporter, No. 13399

25

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1 CERTIFICATE OF WITNESS

2

3

4 I, LISA ROTH, do hereby declare under
5 penalty of perjury that I have read the entire
6 foregoing transcript of my deposition testimony,
7 or the same has been read to me, and certify that
8 it is a true, correct and complete transcript of
9 my testimony given on July 21, 2022, save and
10 except for changes and/or corrections, if any, as
11 indicated by me on the attached Errata Sheet, with
12 the understanding that I offer these changes and/or
13 corrections as if still under oath.
14 ✓ I have made corrections to my deposition.
15 ____ I have NOT made any changes to my deposition.
16

17 Signed: ______________________________
LISA ROTH
18
19 Dated this 02 day of 08 of 2022.
20
21
22
23
24
25

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1 ERRATA SHEET

2 Deposition of: LISA ROTH
Date taken: JULY 21, 2022
3 In the Matter of Horter Investment Management, et al.

PAGE	LINE		
61	3	CHANGE:	The log required...
		REASON:	Typographical error
69	11	CHANGE:	regulator or the prior firm
		REASON:	Typographical error
98	2	CHANGE:	while Hannan was at HIM
		REASON:	Typographical error
140	16	CHANGE:	FINRA carrying out its
		REASON:	investigation; Typo error
150	24	CHANGE:	check him out on BrokerCheck
		REASON:	typographical error
160	11	CHANGE:	and to expect him (Horter)
		REASON:	typographical error
190	6	CHANGE:	it was not reasonable to expect
		REASON:	typographical error
197	6	CHANGE:	Vierling did know what her job
		REASON:	was; typographical error
		CHANGE:	
		REASON:	
		CHANGE:	
		REASON:	
		CHANGE:	
		REASON:	
		CHANGE:	
		REASON:	
		CHANGE:	
		REASON:	

24 Signed_______________________________

25 Dated_______________________________

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EXHIBIT B

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Release No. 5670 (S.E.C. Release No.), Release No. IA - 5670, 2021 WL 136246

S.E.C. Release No.
Investment Advisers Act of 1940

SECURITIES AND EXCHANGE COMMISSION (S.E.C.)

IN THE MATTER OF ADVANCED PRACTICE ADVISORS, LLC AND PAUL C. SPITZER, RESPONDENTS.

Administrative Proceeding File No. 3-20204
January 14, 2021

ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTIONS 203(e), 203(f) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER

I.

***1** The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 203(e), 203(f) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act"), against Advanced Practice Advisors, LLC and Paul C. Spitzer (collectively, the ""Respondents").

II.

In anticipation of the institution of these proceedings, Respondents have submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, and except as provided herein in Section V, Respondents consent to the entry of this Order Instituting Administrative and Cease-And-Desist Proceedings, Pursuant to Sections 203(e), 203(f) and 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-And-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondents' Offer, the Commission finds [1] that:

Summary

These proceedings arise out of violations of the Investment Advisers Act of 1940 by Advanced Practice Advisors, LLC ("APA"), an investment adviser formerly registered with the Commission, and its founder and CEO, Paul C. Spitzer ("Spitzer"). APA and Spitzer failed to make certain disclosures which allowed advisory clients to be deceived by, and also failed reasonably to supervise, an investment adviser representative who was associated with APA ("Adviser Representative"). Specifically, the Adviser Representative deceived advisory clients by allowing his father to advise APA clients even though his father was not formally associated with APA. APA and Spitzer knew that the Adviser Representative had no real experience, no clients of his own, and that his father, who had previously worked as an investment adviser representative at another firm, wanted to continue advising his clients and shared an office with his son. Spitzer, and therefore APA, knew or should have known that the Adviser Representative's father was advising APA clients under the guise of his inexperienced son's association with APA. APA and Spitzer failed to disclose to advisory clients that the Adviser Representative's father was not formally associated with

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APA. Additionally, APA failed to implement certain compliance policies and procedures, including those designed to prevent clients from being misled.

Respondents

***2** 1. **Advanced Practice Advisors, LLC,** owned by Spitzer and his wife, is a California limited liability company with its principal place of business in La Quinta, California. APA was registered as an investment adviser with the Commission from June 3, 2010 to October 11, 2018. On October 5, 2018, APA registered as an investment adviser with the state of California after its assets under management decreased. On December 15, 2020, APA filed a request to terminate its California registration as an investment adviser.

2. **Paul C. Spitzer**, 71, of La Quinta, California, founded APA in 2010, and is its CEO. Since July 2020, Spitzer has also been associated with a different California-registered investment adviser. Spitzer previously held series 7, 9, 10, 24 and 63 licenses. Spitzer supervised investment adviser representatives who were associated with APA during the relevant time period.

Background

3. In June 2010, Spitzer formed APA to service his own advisory clients and to provide other individual investment advisers and the clients they advised with a platform of compliance and back office services. APA collected advisory fees from those clients advised by the investment adviser representatives associated with APA based on the assets under management. In exchange for the compliance services APA provided, APA retained 10% of the clients' investment advisory fees collected and APA then paid the remaining 90% of the fees to the investment adviser representatives who were advising those clients. APA also charged a separate flat fee for technology services, including e-mail service. Spitzer required all advisory clients, including the other investment advisers' clients, to sign an agreement in which they agreed to "appoint" APA as their investment adviser. The agreement also stated that an investment adviser representative ("IAR") associated with APA would provide the clients with investment management services.

Failure to Disclose and Failure Reasonably to Supervise

4. In November 2015, the Adviser Representative, who had only recently passed series 7 and 65 exams and become licensed, became associated with APA as an IAR. During the relevant time period, Spitzer supervised the Adviser Representative and was therefore responsible for overseeing his investment advice, trading and client communications.

5. The Adviser Representative's father had previously worked as an investment adviser representative at another firm, and had a number of clients willing to move with him; consequently, he sought to associate with APA. Spitzer and APA determined that APA was not willing to associate with the father because he was the subject of an ongoing FINRA investigation and because APA's clearing broker had barred the father from its platform during the pendency of the investigation. Spitzer told the Adviser Representative's father that he was to have "no formal affiliation" with APA but that his son could associate with APA.

***3** 6. Thus, the son became associated with APA, but his father was never formally associated with APA. Nevertheless, the father continued to provide investment advice to the clients who had followed him from his prior firm to APA and who were supposed to be advised by his son, the Adviser Representative. These APA clients were thus misled into believing that the Adviser Representative's father was formally associated with APA, even though he was not.

7. APA and Spitzer failed to disclose to APA clients that the Adviser Representative's father was not formally associated with APA. Spitzer knew or should have known that the father was continuing to advise APA clients even though the father was not formally associated with APA. For example, Spitzer knew that the father and son shared office space and telephone lines, that all of the APA clients the son worked with had come from his father, and that the son lacked any significant experience and

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was just learning the business. In addition, Spitzer would often correspond directly with the father, rather than with the Adviser Representative, about things such as advisory fees.

8. Six months after Adviser Representative joined APA, Spitzer retained a new Chief Compliance Officer, who expressed concern that the Adviser Representative's father was not formally associated with APA but worked in the same office with his son and could therefore access APA client information and advise APA clients. The new Chief Compliance Officer was also concerned that APA clients might not know that the Adviser Representative's father was not formally associated with APA, was not permitted access to APA information and systems, and could not advise clients under APA's aegis. Nevertheless, Spitzer did not require that Adviser Representative maintain separate office space from his father or take other precautionary measures, such as implementing an ethical screen to prevent the Adviser Representative from sharing confidential client information with his father.

9. In May 2016, APA's clearing broker informed Spitzer that the Adviser Representative's father had called APA's clearing broker and impersonated his son on at least 38 occasions. In recorded calls, the Adviser Representative's father identified himself by his son's name and as a representative of APA, and discussed block trading, warrants trade allocation, and rebalancing APA client accounts. He also asked APA's clearing broker how to execute a trade for a client and repeatedly provided the clearing broker with the master account number for APA.

10. After learning that the Adviser Representative allowed his father to impersonate him on calls with APA's clearing broker, the Chief Compliance Officer at APA recommended that Spitzer terminate APA's association with the Adviser Representative. Spitzer, however, decided not to do so. Instead, Spitzer required the Adviser Representative to enter into an enhanced supervision agreement with APA, and, although the father of Adviser Representative was not formally associated with APA, Spitzer directed the father to sign the agreement as well. APA and Spitzer, however, failed to enforce several of the requirements set forth in that agreement.

Compliance Failures

***4** 11. As a registered investment adviser, APA was required to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and the rules thereunder by itself and its supervised persons.

12. APA had policies to prohibit the misconduct in which the Adviser Representative engaged, but APA failed to implement these policies. APA's policies stated that supervised persons have a fiduciary duty to clients that prohibits them from misleading clients and requires “full and fair disclosure of all material facts.” APA's policies also required supervised persons to “safeguard material non-public information about client transactions” and “maintain the confidentiality of information concerning the identity of security holdings and financial circumstances of clients.” The Adviser Representative's ongoing arrangement with his father, including his father's access to APA clients' financial information, demonstrates APA's failure to implement these policies.

13. Despite these policies, Spitzer and APA ignored the warning signs regarding Adviser Representative's arrangement with his father and did not require that APA put an ethical screen in place to prevent the Adviser Representative from sharing confidential client information with his father. Spitzer and APA also did not require the Adviser Representative to provide a written explanation to APA clients that his father was not formally associated with APA and could not provide investment advice to them on behalf of APA.

Violations

14. As a result of the conduct described above, Respondents willfully[2] violated Section 206(2) of the Advisers Act, which prohibits any investment adviser from engaging in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client. A violation of Section 206(2) may rest on a finding of simple negligence. *SEC*

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v. Steadman, 967 F.2d 636, 643 n.5 (D.C. Cir. 1992) (citing *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963)). Proof of scienter is not required to establish a violation of Section 206(2) of the Advisers Act. *Id*.

15. As a result of the conduct described above, APA willfully violated, and Spitzer willfully aided and abetted and caused APA's violations of, Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder, which require, among other things, that a registered investment adviser adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and its rules. Negligence is sufficient to establish a violation of Section 206(4) and Rule 206(4)-7. *Steadman*, 967 F.2d at 647.

***5** 16. As a result of the conduct described above, APA and Spitzer failed reasonably to supervise the Adviser Representative within the meaning of Section 203(e)(6) of the Advisers Act, which authorizes the Commission to institute an administrative proceeding against a supervisor who has failed to supervise, with a view to preventing violations of the federal securities laws, another person who commits such a violation, if such person is subject to the supervisor's supervision.

Undertakings

17. Respondents APA and Spitzer agree to cooperate fully with the Commission in any and all investigations, litigations, or other proceedings relating to or arising from the matters described in the Order. In connection with such cooperation, APA and Spitzer shall: (i) produce, without service of a notice or subpoena, any and all non-privileged documents and other information reasonably requested by the Staff; (ii) use their best efforts to cause APA's officers, employees, and directors (including Spitzer) to be interviewed by the Staff at such time as the Staff may reasonably direct; (iii) provide any certification or authentication of business records of the company as may be reasonably requested by the Staff; and (iv) use their best efforts to cause APA's officers, employees, and directors (including Spitzer) to appear and testify without service of a notice or subpoena in such investigations, depositions, hearings or trials as may be requested by the Staff.

18. Respondent Spitzer has agreed to:
a. within three months of the entry of this Order, complete thirty (30) hours of compliance training related to the Advisers Act; and

b. certify, in writing, compliance with this undertaking.
i. The certification shall identify the undertaking, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and Respondents agree to provide such evidence.

ii. The certification and supporting material shall be submitted to Victoria A. Levin, Assistant Regional Director, 444 S. Flower Street, Suite 900, Los Angeles, CA 90071 with a copy to the Office of Chief Counsel of the Enforcement Division, no later than sixty (60) days from the date of the completion of the undertakings.

19. In determining whether to accept the Offer, the Commission has considered the undertakings set forth in paragraph 17 above.

IV.

In view of the foregoing, the Commission deems it appropriate, in the public interest, to impose the sanctions agreed to in Respondents' Offer.

Accordingly, pursuant to Sections 203(e), 203(f) and 203(k) of the Advisers Act, it is hereby ORDERED that:

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A. Respondents APA and Spitzer cease and desist from committing or causing any violations and any future violations of Sections 206(2) and 206(4) of the Advisers Act and Rule 206(4)-7 promulgated thereunder.

***6** B. Respondent APA is censured.

C. Respondent Spitzer shall be, and hereby is, subject to the following limitations on his activities:

> Respondent Spitzer shall not act in a supervisory capacity with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization.

Any application to act in such a supervisory capacity will be subject to the applicable laws and regulations governing the reentry process, and permission to act in such a supervisory capacity may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

D. Respondent Spitzer shall comply with the undertakings enumerated in Section III, paragraph 18 above.

E. Respondent Spitzer shall, within thirty (30) days of the entry of this Order, pay a civil money penalty in the amount of $20,000 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. §3717.

Payment must be made in one of the following ways:
(1) Respondent Spitzer may transmit payment electronically to the Commission, which will provide detailed ACH transfer/ Fedwire instructions upon request;

(2) Respondent Spitzer may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondent Spitzer may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:
Enterprise Services Center

Accounts Receivable Branch

HQ Bldg., Room 181, AMZ-341

6500 South MacArthur Boulevard

Oklahoma City, OK 73169

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Payments by check or money order must be accompanied by a cover letter identifying Paul Spitzer as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Alka Patel, Associate Regional Director, Securities and Exchange Commission, 444 S. Flower Street, Suite 900, Los Angeles, CA 90071 with a copy to Victoria A. Levin, Assistant Regional Director, 444 S. Flower Street, Suite 900, Los Angeles, CA 90071.

***7** F. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent Spitzer agrees that in any Related Investor Action, he shall not argue that he is entitled to, nor shall he benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent Spitzer's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent Spitzer agrees that he shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent Spitzer by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

V.

It is further Ordered that, solely for purposes of exceptions to discharge set forth in Section 523 of the Bankruptcy Code, 11 U.S.C. §523, the findings in this Order are true and admitted by Respondent Spitzer, and further, any debt for disgorgement, prejudgment interest, civil penalty or other amounts due by Respondent Spitzer under this Order or any other judgment, order, consent order, decree or settlement agreement entered in connection with this proceeding, is a debt for the violation by Respondent Spitzer of the federal securities laws or any regulation or order issued under such laws, as set forth in Section 523(a)(19) of the Bankruptcy Code, 11 U.S.C. §523(a)(19).

By the Commission.
Vanessa A. Countryman
Secretary

1 The findings herein are made pursuant to Respondents' Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

2 "Willfully," for purposes of imposing relief under Section 203(e) or (f) of the Advisers Act, "'means no more than that the person charged with the duty knows what he is doing."' *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)). The decision in *The Robare Group, Ltd. v. SEC*, which construed the term "willfully" for purposes of a differently structured statutory provision, does not alter that standard. 922 F.3d 468, 478-79 (D.C. Cir. 2019) (setting forth the showing required to establish that a person has "willfully omit[ted]" material information from a required disclosure in violation of Section 207 of the Advisers Act).

Release No. 5670 (S.E.C. Release No.), Release No. IA - 5670, 2021 WL 136246

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Release No. 501 (S.E.C. Release No.), 106 S.E.C. Docket 4423, Release No. ID - 501, 2013 WL 3936214

S.E.C. Release No.
Initial Decision

SECURITIES AND EXCHANGE COMMISSION (S.E.C.)

IN THE MATTER OF ANGELICA AGUILERA

Administrative Proceeding File No. 3-14999
July 31, 2013

***1** APPEARANCES:
Laura R. Smith and Edward D. McCutcheon for the Division of Enforcement, Securities and Exchange Commission
Luis F. Biason for Respondent Angelica Aguilera

BEFORE: Cameron Elliot, Administrative Law Judge

INITIAL DECISION

SUMMARY

This Initial Decision finds that Respondent Angelica Aguilera (Aguilera) failed reasonably to supervise Fabrizio Neves (Neves) and Jose Luna (Luna) within the meaning of Sections 15(b)(4)(E) and 15(b)(6) of the Securities Exchange Act of 1934 (Exchange Act), with a view to preventing and detecting their violations of the antifraud provisions of the securities laws. The Initial Decision bars Aguilera from association with a broker or dealer in a supervisory capacity and bars Aguilera from the securities industry.

I. Introduction

A. Procedural Background

The Securities and Exchange Commission (Commission) issued its Order Instituting Administrative Proceedings (OIP) on August 29, 2012, pursuant to Section 15(b) of the Exchange Act. Aguilera filed her Answer on January 15, 2013.

A hearing was held from February 25 through February 28, 2013, in Washington, D.C. The admitted exhibits are listed in the Record Index issued by the Commission's Office of the Secretary on May 22, 2013. The Division of Enforcement (Division) and Aguilera filed their post-hearing briefs on April 19, 2013, and their reply briefs on May 10, 2013. [1]

B. Summary of Allegations

The instant proceeding concerns Aguilera's alleged failure to supervise Neves, a shareholder and registered representative associated with LatAm Investments, LLC (LatAm), and Luna, a back office operations employee at LatAm, who allegedly engaged in a fraudulent markup and markdown scheme to defraud two Brazilian public pension funds and another foreign institutional customer in the offer, purchase, and sale of structured notes. OIP, p. 2. The OIP alleges that Neves and Luna violated Section 17(a) of the Securities Act of 1933 (Securities Act), Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and willfully aided and abetted violations of Section 15(c)(1) of the Exchange Act, and that Aguilera, a shareholder, Financial & Operations Principal (FINOP), and President of LatAm from October 2007 through 2010, failed to effectively follow or

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implement LatAm's policies and procedures with a view to preventing violations by Neves and Luna. Id., pp. 1-2, 5-6. The Division seeks a supervisory bar, an industry bar, disgorgement, and civil penalties. Div. Br., pp. 44-53.

Aguilera denies that she held a supervisory role over trading at LatAm, despite her title as President and FINOP, and argues that other individuals at LatAm exercised de facto control over the firm. Resp. Br., pp. 3, 7. She argues that LatAm's Written Supervisory Procedures (WSPs) did not accurately reflect her job responsibilities and that her job primarily consisted of administrative, human resources, and marketing tasks, but not trading supervision. Resp. Reply Br., p. 6. Aguilera also contends that a cover-up was an integral part of Neves' and Luna's fraudulent scheme, which prevented her from discovering and preventing it. Id., pp. 1-5.

II. Findings of Fact

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

A. Respondent and Other Relevant Individuals and Entities

1. Angelica Aguilera

Aguilera, at the time the OIP issued, was a 46-year old resident of Boca Raton, Florida. OIP, p. 1; Answer, p. 1. She has worked in the financial services industry since 1994. [2] Tr. 361. She earned her Series 7 securities license in 1996, and also holds Series 24 and 27 securities licenses. Tr. 361-62. Aguilera was the relationship manager for Prime Brokerage accounts at Bear Stearns from 2001 through 2003, managing the reporting, day-to-day operations, and back office support groups in Bear Stearns' Boca Raton office. Tr. 362. While at Bear Stearns, Aguilera met Maximino “Jimmy” Acosta (Acosta), with whom she later formed LatAm. [3] Tr. 362-63.

Aguilera was LatAm's FINOP from 2004 until the firm withdrew its FINRA registration in 2010. OIP, p. 2; Answer, p. 1; Tr. 364. Aguilera was LatAm's Anti-Money Laundering Compliance Officer beginning in 2004, and held the position until Esdras Vera (Vera) joined LatAm as its chief compliance officer in October 2007. Tr. 364, 490. Aguilera became the President of LatAm when Acosta left LatAm in October 2007, and she remained President until LatAm ceased operations in 2010. OIP, p. 1, Answer, p. 1; Div. Ex. 17, pp. 2, 17.

2. Jose Luna and Fabrizio Neves

Luna, age 45, who came to the United States in 1987 from Lima, Peru, joined LatAm in 2006. [4] Tr. 55-56, 74-75. Prior to joining LatAm, Luna worked at Global Strategic Investments (Global Strategic) in Miami, Florida, where he met Neves, who also worked at Global Strategic at the time. [5] Tr. 64. After Neves left Global Strategic in 2005, he encouraged Luna to resign and work for him at Capital Investment Services, which Luna did. Tr. 66-68. At Capital Investment Services, Luna's job included processing and confirming Neves' trades with counterparties. Tr. 68. Neves' customers at the time were two pension funds for post office employees in Brazil, the Brazil Sovereign II Fund (Sovereign II) and the Atlantica Real Fund (Atlantica Real) (collectively, the Brazilian Pension Funds or Funds), and he traded sovereign debt for them. Tr. 68-71, 80-81.

In 2006, Neves and Luna joined LatAm. Tr. 74-75. According to Luna, Neves joined LatAm because he was interested in acquiring an ownership interest in a broker-dealer. Tr. 75. Luna served as operations manager at LatAm, and he processed trades for Neves and other brokers, confirmed trades with counterparties, and confirmed settlements with LatAm's custodian, Pershing, LLC (Pershing). Tr. 79-80.

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***3** Luna left LatAm in December 2009, following the departure of the Brazilian Pension Funds as clients of LatAm, because the firm could no longer afford to pay him. Tr. 63. In June 2010, the Financial Industry Regulatory Authority, Inc. (FINRA), permanently barred Luna, by consent, from association with any FINRA member in any capacity. Tr. 60-61; Div. Ex. 52. In SEC v. Neves, No. 1:12-cv-23131 (S.D. Fla. Aug. 29, 2012), a federal judge barred Luna from the securities industry as part of a consent to settle securities fraud charges with the Commission relating to conduct he engaged in at LatAm. [6] Tr. 61; Div. Ex. 52. Over the course of his career, Luna obtained Series 7 and 11 securities licenses, but no longer holds them. Tr. 60.

In May 2010, FINRA permanently barred Neves, by consent, from association with any FINRA member in any capacity. Div. Ex. 51. Neves was also named as a defendant in SEC v. Neves, and the case remains pending against him.

3. Acosta Financial Services/LatAm

Acosta Financial Services was formed sometime in 2003 and was the predecessor to LatAm. [7] Tr. 301-02, 363. Acosta contributed over $300,000 to start Acosta Financial Services, and Aguilera joined the company a little later and contributed $125,000 of her own funds to the firm. Tr. 659-60. At that time, Acosta and Aguilera shared ownership of the firm 70% and 30%, respectively. Tr. 660. Acosta was a principal of LatAm when it was founded, and he served as its CEO or President. Tr. 280-81.

In 2006, Neves invested approximately $300,000 in LatAm in exchange for an ownership interest in the firm. Tr. 366, 662-63. According to Aguilera, initially Neves had hoped to open his own broker-dealer, but when he could not reach an agreement with Pershing or receive the necessary approvals, he instead invested in LatAm. [8] Tr. 366, 662-63. The initial plan was to sell Neves an 80% ownership interest in LatAm, but because Neves did not have a principal license, Acosta only sold Neves a 1% interest. Tr. 285, 366, 661-63; Div. Ex. 17, p. 2. Aguilera understood that Neves would bring the Brazilian Pension Funds, which had business worth millions of dollars, to LatAm as clients when he joined the firm, and she and Acosta would provide operational support and the relationship with Pershing. [9] Tr. 367.

Acosta left LatAm as a principal in late 2007 to form a broker-dealer in Panama. Tr. 281. Acosta became a consultant to LatAm after he left, which allowed him to remain active in the firm and receive payment for his work; however, he was no longer a signatory of the firm. Tr. 281-83; Div. Ex. 16. After Acosta left, he placed his shares of LatAm in a voting trust, and Aguilera became the sole trustee and controlled the trust. Tr. 310, 669-70. According to Aguilera, she never used the trust to control the company and no vote was ever taken during her trusteeship. Tr. 310, 669-70. Aguilera assumed Acosta's role as President of LatAm when Acosta became a consultant. Tr. 284; Div. Ex. 17, p. 8. Acosta rejoined LatAm, possibly in May 2009, but he did not resume the role of President; Aguilera remained as President until LatAm ceased operations. OIP, p. 1; Answer, p. 1; Tr. 329, 676.

***4** In 2007, Acosta and Aguilera hired Vera to be LatAm's Chief Compliance Officer, and he remained in the position until September 2009. [10] Tr. 490-91. Howard Landers, principal at First Bridgehouse Consulting (Bridgehouse Consulting), which performed regulatory consulting work for LatAm beginning in 2004 or 2005, recommended Vera for the position. Tr. 491.

In July 2008, Marcos Konig (Konig) [11] joined LatAm as Chief Operating Officer. [12] Tr. 564-66. According to Aguilera, Konig was hired because LatAm needed someone with a Series 24 license to “look over all the operations,” including compliance. [13] Tr. 369-70. Konig understood his role to be to help LatAm establish an institutional equity trading business, since the firm's fixed-income business was already established, and to develop a piggyback or clearthough business. Tr. 566.

In November 2009, Darius Lashkari (Lashkari) was hired to replace Vera as Chief Compliance Officer at LatAm. [14] Tr. 447. One month after Lashkari joined LatAm, he began working to close down the firm. Tr. 449.

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In January 2010, LatAm ceased trading operations, and in April 2010, it filed a Form BDW, withdrawing its registration with the Commission. Div. Exs. 77, p. 5; 106.

B. Trading of Structured Notes

Neves brought the Brazilian Pension Funds to LatAm as clients when he joined the firm, and he directed trading for them. Tr. 80, 94. The majority of Neves' trading was for the Funds and he began trading structured notes for them in approximately 2007. Tr. 80-81, 94.

A structured note trade took between two days and a week for Neves to arrange. [15] Tr. 95. Neves first called issuing banks for pricing information and to inform them of the maturity and yield he sought in the note. Tr. 94-95. When Neves and the bank agreed upon the terms, Neves directed the bank to send the term sheet for the trade to Luna by email. Tr. 95-96. The bank would initially send a draft term sheet to Luna, and the final term sheet would be sent two or three days later. Tr. 96. When Luna received the term sheet, he would show it to Neves if Neves was at the office, or bring the term sheet to Neves' home to show it to him. [16] Tr. 96-97. Luna testified that Neves did not want him to send the term sheet to him by email. [17] Tr. 96-97.

The structured note transactions were usually done by the Deliver Versus Payment (DVP) method, which meant that LatAm only served as a pass-through account for the structured note, and LatAm would have a buyer ready to purchase the note at the same time that LatAm purchased the structured note from the bank. Tr. 98-99. Neves determined the amount of the structured note's markup. Tr. 100.

In addition to the Brazilian Pension Funds, Neves also sold structured notes to the Corporacion Autonoma Regional del Valle del Cauca (CVC), a Colombian institutional investor associated with a nonprofit organization. Tr. 97-98, 122-23. Andre Barbieri (Barbieri) was the broker of record and in charge of the CVC account at LatAm. Tr. 120. According to Luna, Neves brought Barbieri to LatAm as a foreign associate from Brazil, and Luna heard that Barbieri also worked at Atlantica Real. Tr. 121.

***5** When the Funds or the CVC purchased a structured note from LatAm, Luna would confirm the trade's execution, process it in the computer system, and send confirmation of the trade, usually the term sheet, to the purchaser. Tr. 81, 110. If the Brazilian Pension Funds had purchased a structured note, Luna would send the term sheet to Priscilla Lima (Lima) or one “Daniel” at Atlantica Asset Management, the investment adviser to the Funds. Tr. 110-11. Luna believed that Atlantica Asset Management would send the term sheet to the Funds' administrator, Bank of New York Mellon (Mellon Bank). Tr. 111.

1. Markups and Interpositioning

Luna testified that in some instances, after LatAm purchased the structured note from the bank, it would sell the note to an intermediary account and then repurchase it before selling it to the Brazilian Pension Funds or the CVC. [18] Tr. 102-04, 108-09, 121. The price of the structured note would increase when it was sold to the intermediary account, when it was repurchased by LatAm, and then when it was sold to the end customer. Tr. 108-09, 121. Neves determined the price at which to execute the intermediary sales and the price that would be paid by the end customer. Tr. 121. When a structured note was purchased, Pershing would automatically send a trade confirmation to the purchaser, but the trade confirmation would only indicate the price paid by that purchaser, not the amount LatAm initially paid for the structured note, the price of the note in intermediary transactions, or the amount of any commission or markup. Tr. 105-07, 109.

Included among the intermediary accounts were River Consulting, HAA International, Inc. (HAA), Sinfon, and the Spectra Trust (Spectra). Tr. 104-05, 144-45, 147-48, 178-79; Div. Ex. 72. River Consulting was a retail account located in the British Virgin Islands, opened at LatAm by Luna at the request of Neves, and Neves' mother-in-law was the beneficiary of the account. Tr. 82, 229. Luna and Christiano Arndt (Arndt), a broker at LatAm who Luna believed also worked at Atlantica Asset Management, were the registered representatives for the account. [19] Tr. 84. HAA was an offshore trust Luna set up with the help of Neves

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and the beneficiary of the account was Luna's sister-in-law.[20] Tr. 104, 148, 151-52; Div. Ex. 91. Luna's brother-in-law was the owner of the Sinfon account, and Luna directed the trading in the HAA and Sinfon accounts. Tr. 147-48.

Luna testified that there were three or four occasions when, at the direction of Neves, he changed or omitted the pricing information on the term sheets for the structured notes purchased by the Brazilian Pension Funds and the CVC. Tr. 113-114, 116. The methods Luna used to manipulate the price included: 1) ""whiting out" the price; 2) typing the new price into a Word document, cutting it out and pasting it onto the term sheet, and making a photocopy of the altered term sheet; and 3) modifying the term sheet electronically using Acrobat, a computer program. Tr. 115-16. Luna also made changes to the coupons or percentages on the term sheets on some occasions. Tr. 118. Neves reviewed the altered term sheets before Luna sent them to Atlantica Asset Management by email. Tr. 117-19. In the case of the CVC, Luna gave the term sheet to Neves and transmitted it to Pershing, but did not send it directly to the CVC. Tr. 122, 159-60. Luna retained the original, unaltered term sheets for LatAm's records. Tr. 247-48.

2. Examples of Interpositioning Trades and Markups

i. Commerzbank Structured Note Transaction

***6** On July 6, 2009, LatAm purchased a structured note from Commerzbank AG (Commerzbank) with a $10 million notional value at a price of 37% of the notional amount, or $3,700,000.[21] Tr. 124, 133; Div. Exs. 2; 25, p. 1; 72, p. 2.[22] At the same time, River Consulting purchased the note from LatAm at a price of 47% of the notional amount, or $4,700,000. Tr. 124-26, 133; Div. Exs. 25, pp. 1-2; 72, p. 2. On July 24, 2009, LatAm purchased the note back from River Consulting at 59.95% of the notional value, or $5,995,000. Div. Exs. 25, pp. 14-19; 72, p. 2. On the same date, LatAm sold the note to Atlantica Real for 60% of the notional value, or $6,000,000 Tr. 133; Div. Exs. 25, pp. 20-21; 72, p. 2. Atlantica Real paid a 62.16 % markup from the original price. Div. Ex. 72, p. 2.[23] River Consulting's gain on the transaction was approximately $1,295,000. Id.

On July 13, 2009, Commerzbank sent Luna a copy of the draft term sheet for the structured note; it listed the price as 37% of the notional value. Tr. 128-30; Div. Ex. 2. On July 27, 2009, Luna sent a copy of the final term sheet to Lima at Atlantica Asset Management; it listed the price as 60% of the notional value. Tr. 130-32; Div. Ex. 3. Luna testified that 60% was not the correct issue price, he had altered the term sheet at the request of Neves, and Neves had determined the 60% price. Tr. 130-32; Div. Ex. 3. Luna agreed that there was no way to determine from the trade confirmation sent by Pershing the amount by which the price of the structured note was marked up over the original price or the subsequent prices that the structured note was sold at in the intermediary transactions. Tr. 127. Luna testified that the transactions involving the Commerzbank structured note were representative of the scheme as it worked generally, it just depended on which accounts and the number of accounts that were used as intermediaries. Tr. 134.

ii. Barclays Bank Structured Note Transactions

In early July 2009, LatAm purchased a structured note from Barclays Bank with a $3.5 million notional value at a price of 56.95% of the notional value.[24] Tr. 147, 154; Div. Exs. 30, p. 1; 72, p. 1. At the same time, River Consulting bought $3 million of the note from LatAm at a price of 78.50% of the notional value. Tr. 147, 154; Div. Exs. 30, pp. 1, 3; 72, p. 1. On July 10, 2009, HAA bought $475,000 of the note and Sinfon bought $25,000 of the note from LatAm at a price of 78.50% of the notional value. Tr. 147, 154; Div. Exs. 30, pp. 2, 4-5; 72, p. 1. On July 15, 2009, River Consulting, HAA, and Sinfon all sold the portions of the note that they had purchased back to LatAm at a price of 89.9% of the notional value. Tr. 154-55; Div. Ex. 72, pp. 1-2. LatAm then sold the $3.5 million Barclays structured note to Soverign II for a price of 90% of the notional value. Tr. 155; Div. Ex. 72, p. 2. Sovereign II paid a markup of 58.03% of the original price. Div. Ex. 72, p. 2.

***7** On July 8, 2009, Barclays Bank sent the term sheet for the $3.5 million structured note by email to Luna and Neves and the term sheet reflected a price of 56.95% of the notional value. Tr. 153; Div. Ex. 6, p. 4. On July 16, 2009, Luna sent an email

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attaching the term sheet for the structured note to Lima; the term sheet did not indicate the price of the note and Luna testified that he probably removed it. Tr. 153-54; Div. Ex. 7.

According to Luna, Neves asked him to set up the HAA account so that Neves could pay him bonus commissions through the account without anyone at LatAm knowing about it. Tr. 148-49, 245-46. Luna testified that Neves paid $500,000 in bonus commissions into the HAA account. Tr. 149. Luna stated that the money Sinfon used to purchase the Barclays notes from LatAm came from his brother-in-law's own funds, and the money HAA used to purchase the Barclays notes from LatAm came from another account at LatAm for which Arndt was the beneficiary. Tr. 149-50. Arndt funded the account at the direction of Neves, and Luna testified that he shared the profits with his sister-in-law when the HAA account bought and sold the Barclays structured notes. Tr. 150-51.

On August 3, 2009, LatAm purchased a structured note from Barclays Bank with an $8.5 million notional value at a price of 56.75% of the notional amount.[25] Tr. 136-37, 144-45; Div. Exs. 27, p. 1; 72, p. 1. River Consulting purchased the structured note from LatAm at 69% of the notional value. Tr. 136-37, 145; Div. Exs. 27, pp. 1-2; 72, p. 1. On August 10, 2009, River Consulting sold the structured note back to LatAm for 94.90% of the notional value, and LatAm sold the same note to Sovereign II for 95% of the notional value. Tr. 137, 145; Div. Exs. 27, pp. 3-6; 72, p. 1. Sovereign II paid a markup of 67.40% of the original price. Div. Ex. 72, p. 1. Luna testified that LatAm and River Consulting profited approximately twelve points and twenty-four points, respectively, from this series of trades, and that River Consulting made the most profit. Tr. 145. Luna agreed that Sovereign II was the "account that really pays the bills." Tr. 145.

On August 3, 2009, Barclays Bank sent the term sheet for the $8.5 million structured note to Neves by email for his approval, and the term sheet indicated a price of 56.75% of the notional value and proceeds of $4,823,750. Tr. 138-39; Div. Ex. 28. On August 10, 2009, Luna sent an email to Lima at Atlantica Asset Management regarding the $8.5 million structured note, and he attached to the email a chart reflecting a price of 95%, and the term sheet from Barclays for the note; however, the term sheet did not include the price or the amount of proceeds.[26] Tr. 139-143; Div. Ex. 5. Luna testified that Neves directed him to include the price of 95% in the chart, and he eliminated the price and amount of proceeds from the term sheet that was sent to Lima at the direction of Neves. Tr. 140-42.

iii. J.P. Morgan Chase Bank Structured Note Transaction

***8** On November 24, 2008, LatAm purchased a structured note from J.P. Morgan Chase Bank with a $50 million notional amount at a price of 32.9% of the notional amount.[27] Tr. 160-61; Div. Exs. 10; 72, p. 4. LatAm then engaged in a series of purchase and sale transactions, selling portions of the structured note to intermediary accounts, repurchasing portions, and ultimately selling the entirety of the note to the CVC at a price that was marked up 61.91%.[28] Tr. 160-61; Div. Ex. 72, pp. 4-6. Treasure on the Bay, a LatAm account owned by Leandro Ecker (Ecker), was one of the accounts used as an intermediary in these transactions. Tr. 161. Ecker was a friend of Neves, and Luna eventually learned that Ecker was affiliated with Atlantica Asset Management. Tr. 161-62. Luna sent the term sheet for the structured note to Pershing to set up the newly issued note in Pershing's system; however, Luna testified that he omitted the issue price from the term sheet at the direction of Neves so that Pershing would not reflect the issue price in its system. Tr. 159-60; Div. Ex. 11.

The CVC eventually discovered the markup for this structured note. On April 7, 2010, the CVC emailed Konig asking why the term sheet it received from LatAm reflected an issue price of 53.27% and an accretion rate of 6.5%, while the term sheet it later received from J.P. Morgan Chase Bank reflected an issue price of 32.9% and an accretion rate of 11.75%.[29] Tr. 163-166; Div. Ex. 99A. Konig forwarded the CVC's email to Luna. Luna testified that he did not recall receiving the email from Konig and he would not have had an answer for him. Tr. 164-65.

iv. Lehman Brothers Structured Note Transaction

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On July 17, 2008, LatAm purchased a structured note from Lehman Brothers with a $7.168 million notional value. Tr. 178-79; Div. Ex. 72, p. 6. On that same date, Spectra purchased $1.568 million of that structured note. Tr. 178-79; Div. Ex. 72, p. 6. Spectra sold $5,000 of the note back to LatAm on August 8, 2008, and sold the remainder of the note back on August 12, 2008. Tr. 178-79; Div. Ex. 72, pp. 6-7. Luna testified that Spectra made approximately thirty-five cents per share as a result of those transactions. Tr. 179.

Alexej Predtechensky (Predtechensky) was the beneficiary of Spectra, a British Virgin Islands entity, and he was introduced to Luna as the President of the Brazilian Pension Funds. Tr. 168-70. Luna played a role in the creation of Spectra as an offshore account; Luna and Neves met with Amicorp Services Ltd., a Miami company that opens offshore accounts, about the creation of Spectra, and Neves signed the deed of trust executed between Spectra and Amicorp Trustees Ltd., the trustee designated for Spectra, as a witness for Predtechensky. Tr. 170-71, 173-75; Div. Exs. 35, 37. Spectra thereafter opened an account at LatAm, and on November 20, 2007, Aguilera signed the New Account Information sheet as a principal of LatAm. Tr. 175-77; Div. Ex. 92. The New Account Information sheet attached Spectra's deed of trust, which listed Predtechensky as the beneficiary of the trust, and which Neves signed as a witness. Tr. 174-75; Div. Ex. 92.

***9** Neves funded the Spectra account in November 2007, by directing a "“journal,” or an account-to-account transfer, of $1.5 million from Ecker's Treasure on the Bay account to Spectra's account at LatAm. Tr. 199-00, 206-07. Luna sent the transfer request to Pershing for clearance, attaching a letter from Ecker, which directed the transfer, and pages purportedly from Spectra's deed of trust, which reflected that Ecker was the settlor of the Spectra trust and had signed the deed of trust. Tr. 200-03; Div. Ex. 108. Luna testified that these pages from Spectra's deed of trust appeared to have been altered to make it look like Ecker was the owner of both the Treasure on the Bay and Spectra accounts so that Pershing could process the account transfer without requesting more information from LatAm or its customers. Tr. 202-05; Div. Exs. 37, 108. It was easier for Pershing to process the transfer when the owners of both accounts involved in the transfer were the same. Tr. 204-05. Luna understood Predtechensky to be the settlor of the Spectra Trust, not Ecker. Tr. 202-03. Luna testified that Neves directed the $1.5 million transfer, and that Neves directed trading in the Treasure on the Bay and Spectra accounts. Tr. 206-07.

3. Knowledge of the Structured Note Transactions

Although Aguilera learned of the structured note transactions for the Brazilian Pension Funds and the CVC in late 2006, and knew that profits from the trades were a substantial percentage of LatAm's revenue from 2007 through 2009, Aguilera never reviewed the notes' term sheets. Tr. 398-99. Aguilera testified that she was not involved in determining the markups or markdowns for the structured notes, and she was not concerned about the trades because the Funds were institutional clients who knew what they were buying. Tr. 399-400. Aguilera did not know whether markups were disclosed to purchasers of structured notes on trade confirmations, and she “didn't see the documentation because [she] wasn't paying attention.” Tr. 401. Aguilera testified that she first became aware of the alterations to the term sheets during the Commission's investigation. Tr. 684-85.

After being confronted with his previous investigative testimony, Luna acknowledged that he interacted with Aguilera regarding the markups on the structured note transactions a couple of times. Tr. 215-17. Luna testified that Acosta and Aguilera questioned him about the markups, and that he told them to speak to Neves. Tr. 217-18. Luna does not know if they spoke to Neves, but the markups remained the same. Tr. 218. Luna testified that no one other than him and Neves knew about the alterations to the term sheets, including Aguilera. Tr. 244.

Vera testified that he reported a structured note trade done by Neves involving a markup and interpositioning to Aguilera, and created an internal memorandum for the compliance file, which he also gave to Aguilera. [30] Tr. 514-16. According to Vera, he raised other instances of markups and interpositioning by Neves to Aguilera, and on one occasion, Acosta, who was also in the office, responded by stating, "‘You know, these are OTC instruments that are dealt with qualified institutional buyers. The price is whatever it is they want to pay for it. You don't have to worry about it.’" Tr. 515-16. Vera challenged Acosta and Acosta, who carried a gun in the office, leaned back and stated, “Things here are going to get done the way I want it to get done,” and tapped his gun. Tr. 516-17. Vera testified that he responded by stating "‘As long as you guys document it for me, I will write

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the memo, and you guys can come up with the explanation.'" [31] Id. Vera testified that he was not aware of the alterations to the term sheets until after an examination by FINRA because Luna sent the altered term sheets from his personal email account, rather than his LatAm email account; however, that testimony is not consistent with emails admitted as evidence reflecting that Luna sent the altered term sheets from his LatAm email account. Tr. 531-34; Div. Exs. 3A, 5A, 7A.

***10** Div. Ex. 1 is a series of LatAm internal memos from Vera to the compliance file, noting the trading of certain structured notes and identifying markup or markdown prices. Most of the memos state: "The matter was discussed with the principals of the firm and they have opted not to comment." Div. Ex. 1. Aguilera denies that Vera ever discussed these memos with her or that they were in the office, and claims she did not see them until the government investigation. Tr. 685. Lashkari also testified that he never saw the memos while he was at LatAm. Tr. 470.

Sometime in 2007, Aguilera learned that Neves was a principal of Atlantica Asset Management. Tr. 394-95; Div. Ex. 14. LatAm's outside counsel drafted a waiver of disclosure or consent to be signed by the Brazilian Pension Funds' administrator, Mellon Bank, disclosing Neves' relationship with LatAm and Atlantica Asset Management, which Aguilera knew was never signed. Tr. 395-96; Div. Ex. 14. Although she eventually asked Vera to draft an amendment to Neves' Form U4, the relationship was not actually disclosed on the Form U4 until close to the FINRA examination, and Aguilera admitted that it was negligent not to disclose it earlier. Tr. 396-98.

C. FINRA Examination of LatAm

During the course of a routine examination of LatAm during the fourth quarter of 2009, FINRA confirmed a significant increase in revenues, and Nick Hartofilis (Hartofilis), the examination manager at FINRA who oversaw the examination, testified that LatAm's revenues increased from approximately $50,000 per year in 2005 or 2006 to approximately $57 million between January 2006 and November 2009. Tr. 256-60. The examination revealed that 95% of LatAm's revenue was derived from two Brazilian funds. [32] Id.

FINRA reviewed the trading activity for the two Brazilian funds, including LatAm's trade blotter, and identified instances where there were excessive markups that appeared to involve structured notes related to the Brazilian funds and instances where nominee accounts that were opened by registered representatives at LatAm appeared to be "interposed between the firm's riskless principal trading account and the [Brazilian funds]." Tr. 259-60, 266-67. FINRA obtained indicative prices from Barclays Bank and Commerzbank and determined that "[t]here was no reason for the significant fluctuation in price that [it was] seeing on the LatAm trade blotter." Tr. 267-68. FINRA discovered that the pricing on the structured note term sheets received from the issuer appeared to have been changed in the term sheets sent to the Brazilian funds and discovered term sheets where the price had been removed altogether. Tr. 268-69.

Through its review of LatAm's trade blotter, general ledger, and operating accounts, FINRA learned that four or five registered representatives at LatAm appeared to control entities that received commissions derived from the transactions in which there were excessive markups or markdowns, and this included Neves or an entity he appeared to control. Tr. 261-62. FINRA questioned Aguilera about the purpose of the commissions, and, according to Hartofilis, Aguilera said that Ecker, Arndt, Neves, and Barbieri shared in the commissions from the trading of these accounts. Tr. 263.

***11** FINRA did not find any evidence that the excessive markups had been disclosed to the Brazilian funds, and it determined, in total, LatAm charged approximately $27 million in markups or markdowns to the Brazilian funds, with Neves being paid $22 million in commissions. Tr. 269-70. Hartofilis testified that FINRA would have expected Aguilera, as the President and FINOP of LatAm, to understand the sources of the revenues and who was responsible for the trading, and she would have been expected to ensure that the markups and markdowns were being charged in compliance with FINRA and Commission rules. [33] Tr. 270. Following the examination, FINRA took enforcement action against several of the individuals involved, including bars against Neves and Luna, and made referrals to the Commission and the CNB, a Brazilian regulator. Tr. 270-71.

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D. LatAm's WSPs and Reporting Structure

1. LatAm's WSPs

Bridgehouse Consulting drafted the LatAm WSPs on an as-needed basis. Tr. 280. A draft of LatAm's WSPs revised January 1, 2008 (January 2008 WSPs), reflected that Aguilera was the President, FINOP, and Anti-Money Laundering Compliance Officer, and Vera was a General Principal and Chief Compliance Officer. [34] Tr. 288-91; Div. Ex. 21, pp. 210-12. The January 2008 WSPs stated that both Aguilera and Vera had primary supervisory responsibility [35] for "Hiring, Registration, and Supervision of Registered Representatives and Associated Persons," and that Vera had primary, and Aguilera had secondary, supervisory responsibility for "Review and Approval of Mark-Ups, Mark-Downs, and Commission." [36] Div. Ex. 21, pp. 209-12. LatAm's WSPs revised May 1, 2008 (May 2008 WSPs), and June 15, 2009 (June 2009 WSPs), were in accordance with the delegations above, and reflected that Aguilera had primary anti-money laundering responsibilities, but, oddly, the June 2009 WSPs no longer reflected that Aguilera was the Anti-Money Laundering Compliance Officer. Div. Exs. 89, pp. 210-13; 90, pp. 209-12. The June 2009 WSPs also reflected that Konig was the Chief Executive Officer and shared primary supervisory responsibility over "Hiring, Registration, and Supervision of Registered Representatives and Associated Persons," and secondary supervisory responsibility over "Review and Approval of Mark-Ups, Mark-Downs and Commission." Div. Ex. 90, p. 213.

LatAm's WSPs revised September 15, 2009 (September 2009 WSPs), also reflected that Aguilera was the President and FINOP of LatAm and Vera was a General Principal and Chief Compliance Officer, as well as the Anti-Money Laundering Compliance Officer. Div. Ex. 24, pp. 213-16. Aguilera had primary supervisory responsibility over "Hiring and Supervision of Registered Representatives and Associated Persons," but Vera no longer had primary supervisory responsibility over that area. [37] Id. Vera had primary supervisory responsibility over "Review and Approval of Mark-Ups, Mark-Downs and Commission," but Aguilera no longer had secondary supervisory responsibility over that area. Id. Konig was no longer listed as the Chief Executive Officer, and he no longer was listed as having primary supervisory responsibility over "Hiring, Registration, and Supervision of Registered Representatives and Associated Persons," or secondary supervisory responsibility over "Review and Approval of Mark-Ups, Mark-Downs, and Commission." Id.

***12** The January 2008, May 2008, June 2009, and September 2009 WSPs all required the Designated Principal's prompt supervision of "pricing of securities transactions either by reviewing each order ticket or by reviewing the purchase and sales blotter containing commissions and/or markups," to ensure "that the company's mark-up/mark-down policies for principal transactions, and commission charges for agency transactions" were adhered to. Div. Exs. 21, p. 27; 24, p. 27; 89, p. 27; 90, p. 27. They provided that the mark-ups and commission charges would be based on a consideration of "all relevant factors," including: 1) type of security involved; 2) availability of the security in the market; 3) price of the security; 4) disclosure to the customer; 5) profit resulting from the transaction; and 6) dollar amount of money involved. Div. Exs. 21, p. 27; 24, p. 27; 89, p. 27; 90, p. 27.

2. LatAm's Supervisory Practices in Actuality

Aguilera acknowledged that the WSPs indicated that she was responsible for supervision of trading, but she testified that that designation was an oversight and she never supervised trading. Tr. 666. Aguilera knew that she had been assigned responsibilities that were beyond her capabilities, but she believed it was necessary for regulatory purposes to have a second principal with responsibility over trading. Tr. 667. Aguilera did not try to correct the WSPs until 2009. Tr. 667-68.

According to Aguilera, Neves and Acosta exercised joint control over LatAm from 2007 through 2009, and Acosta exercised control over LatAm even when he was a consultant. [38] Tr. 669. Aguilera testified that before Acosta left LatAm, he reviewed and signed trade tickets and blotters, but he stopped doing that when he became a consultant. Tr. 672. According to Aguilera, when Acosta returned to the firm in May 2009, he resumed exercising authority over trading, but no longer signed trade tickets or blotters. Tr. 672, 676-77. Aguilera approved the firm's wire transfers and checks after Acosta left LatAm, including those

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related to commission payments for transactions involving the Brazilian Pension Funds or the CVC, even though the January 2008, May 2008, June 2009, and September 2009 WSPs all gave Vera primary supervisory responsibility over wire transfers, and gave Aguilera only secondary supervisory responsibility. Tr. 393-94; Div. Exs. 21, pp. 210-12; 24, pp. 213-15; 89, pp. 211-13; 90, pp. 210-12.

Aguilera treated Neves as a majority owner of LatAm unofficially, and she testified that Neves determined her salary, the location of LatAm's offices, and which bank LatAm would open an account with. Tr. 665. After Acosta left, Aguilera did not get involved with Neves' business with the Brazilian Pension Funds because she believed Acosta would tell her if there was something she needed to know about the business. Tr. 369.

A Corporate Resolution of the Members of LatAm (Resolution), dated April 1, 2008, and signed by Vera, stated that Aguilera, as President, was "responsible for the overall supervision of the company." Tr. 371; Div. Ex. 17, p. 9. Aguilera agreed that she understood, as of the date of the Resolution, that her job as overall supervisor was to verify that everyone was doing their job. Tr. 372. According to Aguilera, her "responsibility was to make sure that [Vera] was reviewing the blotters and having a second reliable compliance auditor review the accuracy of that review." Tr. 373. Aguilera testified that outside consultants, specifically Landers, were responsible for reviewing Vera's work until 2008, and after 2008, Konig became responsible for reviewing the Chief Compliance Officer's work. Tr. 374-75, 378-79, 678, 682. This external compliance review occurred "a few times a year." Tr. 682. According to Aguilera, she could not be responsible for reviewing Vera's work because of her son's medical condition and because she "didn't have the knowledge that [she would] do a good job reviewing the trade activity." Tr. 379. She testified that as part of her supervisory review she reviewed a sample of approximately fifty trade confirmation statements once a year. Tr. 402. Aguilera agreed that she was not very knowledgeable about trading and that she thought she needed additional training to learn more, but she never received further training because she was involved with marketing the firm and taking care of her son. Tr. 374.

***13** Vera testified that he primarily reported to Aguilera as the President of the firm, but he may have reported to Acosta before he left the firm. Tr. 491. Vera reviewed LatAm's trade blotter, and if he had a question he would discuss it with Aguilera or Acosta. Tr. 493-94. Vera testified that Aguilera would review LatAm's trade blotter on a regular basis.[39] Tr. 498, 528. According to Vera, he did not sign off on the trade blotters, Aguilera did. Tr. 545. Vera believes he asked for access to LatAm's financial records early on, but was told that the FINOP, who may or may not have been Aguilera at the time, would take care of any questions regarding that information. Tr. 505-06. Vera believed that Steve Singer (Singer) at Mayben Strategic may have performed the day-to-day work that the FINOP would have done.[40] Tr. 506. Vera testified that if he ever asked Neves or Luna a question about their trading, Neves told him to ask Aguilera or Acosta. Tr. 500.

Aguilera testified that she did not believe Vera was an adequate compliance officer because he was not in LatAm's office regularly, LatAm's files were incomplete, and, due to Vera's negligence, the firm did not file a notification with FINRA when Acosta left. Tr. 390-91. According to Aguilera, she tried to fire Vera approximately three times. Tr. 678. In early 2008, Aguilera approached Acosta (who was a consultant to LatAm at the time) and Neves about firing Vera, but neither agreed with her. Tr. 678. In June or July 2008, Aguilera spoke to outside legal counsel about firing Vera and outside counsel recommended that he be fired, but, according to Aguilera, Acosta told her that they could not fire Vera because Vera was assisting Acosta with several side projects, and instead they hired Konig part time. Tr. 391-92, 679-81.

Konig testified that he joined LatAm as COO in July 2008, and he understood that he had been hired to help establish institutional trading in equities. Tr. 564-67. He had no responsibility over the fixed income side of LatAm's business, did not have access to the back office or accounts for fixed income, and was not invited to the fixed income meetings, many of which were held ""behind closed doors." Tr. 567-69. Specifically, he did not have access to the Pershing NetIQ Exchange system that would have allowed him to view the ownership and activity in fixed income accounts. Tr. 568. He testified that he understood that he would have supervisory responsibility over the business that he was going to bring in to LatAm. Tr. 569. Konig does not recall seeing LatAm's WSPs until late 2009, and he described them as "very insufficient." Tr. 568.

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Konig testified that he reported to Aguilera. Tr. 569-70. According to Konig, Aguilera handled the administration of LatAm and acted as supervisor of recruiting. Tr. 571-72. Konig described Aguilera's effectiveness as "deficient" because she came to the office sporadically and there was very little communication from her when she was not at the office. Tr. 572. Konig testified that there were many disagreements between Aguilera and Acosta on one side, and Vera on the other, and both sides thought the other side's performance was deficient. [41] Tr. 573. Konig did not know whose responsibility it was to review the trade blotters, but he ventured it was a "concerted effort between the CCO and the president." Tr. 584.

***14** Lashkari described compliance at LatAm in November 2009 as "need[ing] help," and "sloppy," although some of the general documents required by FINRA appeared to be present. Tr. 451. Lashkari testified that he was concerned when Vera told him that he should "never sign anything." Tr. 454-55. LatAm's trade blotters were not kept in good order, and Lashkari never recalled seeing signatures on any of the blotters, which he would have expected to see. Tr. 461. Vera told Lashkari that he did not sign off on the trade blotters, Aguilera did, but Konig and Aguilera told Lashkari that Vera should have signed the blotters. Tr. 462-64. When Lashkari told Aguilera about Vera's preference not to sign off on things at the firm, Aguilera said that was one of the reasons he was being replaced. Tr. 462-63. Lashkari testified that he did not know who the trading supervisor was at LatAm, but Aguilera did not have the necessary experience. Tr. 478-80. He never saw Aguilera review trade blotters or tickets or take any supervisory action as a trading supervisor. Tr. 479-80.

Aguilera agreed with the Division that with regard to her supervisory duties at LatAm, she "trusted but did not verify." Tr. 703.

E. Compensation

Prior to Neves joining LatAm, Aguilera earned four or six thousand dollars per month. Tr. 383. Between 2007 and 2009, Aguilera received a biweekly paycheck in an amount determined by Neves and Acosta. Tr. 384, 388. Generally, from October 2007 through August 2008, Aguilera was paid $9,000 biweekly, from August 2008 through February 2009, she was paid $10,500 biweekly, from March 2009 through September 2009, she was paid $12,500 biweekly, and beginning in October 2009, she was paid $15,000 biweekly. Tr. 385-86; Div. Ex. 107. Aguilera testified that she would not be surprised if her adjusted gross income in 2007 was $773,649, in 2008 was $826,850, and in 2009 was $1.8 million. Tr. 403. Neves also lent Aguilera $275,000 in 2007, $75,000 of which Aguilera paid back. Tr. 383.

Aguilera also received other payments from LatAm for her benefit. For example, on January 30, 2009, Aguilera signed a check on behalf of LatAm for $110,000 to M.C. Tiles Corporation, a company affiliated with Neves, to pay for constructing a home office. [42] Tr. 423-25; Div. Ex. 104, pp. 15, 19. On March 10, 2009, $43,192 was paid to Intercontinental Marble Company, on March 16, 2009, $35,606.37 was paid to Opus Stone, on March 16, 2009, $22,000 was paid to M.C. Tiles Corporation, and on March 25, 2009, $13,579.37 was paid to Opus Stone; all were for Aguilera's benefit. Tr. 425-28; Div. Ex. 104, pp. 28-29.

Aguilera testified Neves was paid 90% commissions on revenues made from his trades and Aguilera paid out his commissions. Tr. 388. All expenditures of money went through Aguilera. Tr. 429. Aguilera recalled numerous payments made to Neves, including a $100,000 transfer to Neves on April 14, 2009, a transfer of $500,000 to Neves three days later, a $100,000 transfer to Neves on April 22, 2009, a $200,000 transfer to Neves on May 13, 2009, and a $300,000 transfer to Neves on May 29, 2009. Tr. 430-37. She also recalled transferring to Neves $2.7 million on November 4, 2009, $2.25 million on November 24, 2009, and $1.25 million dollars on November 25, 2009, as commission payments. Tr. 437.

F. Expert Testimony of David E. Paulukaitis

***15** The Division called David E. Paulukaitis (Paulukaitis) [43] as an expert with experience in regulatory compliance in the areas of supervision, supervisory controls, and internal compliance systems for broker-dealers. Div. Ex. 96, p. 2. In his expert report, Paulukaitis opined that: 1) as President of LatAm, Aguilera was ultimately responsible for supervising the activities of LatAm and its registered representatives; 2) Aguilera could delegate certain of her responsibilities to other appropriately qualified principals of LatAm, but she had a duty to ensure that any duties she delegated were being adequately carried out;

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3) Aguilera's failure to closely monitor Vera's performance, to whom she had delegated supervisory responsibilities, in light of her concerns about his performance, constituted a failure to fulfill her supervisory responsibilities; and 4) the markups on the transactions at issue were of such significant size that they would have been easily identifiable through even a cursory review of LatAm's transaction blotters and should have warranted a comprehensive review to determine whether they were fair and reasonable. Id., pp. 6-7.

Paulukaitis opined that Aguilera, as President, was responsible for overall supervision of LatAm, but she could delegate supervisory responsibility to someone with sufficient knowledge and experience if she took reasonable steps to ensure the delegated duties were performed in a reasonable matter. Id., p. 9. He concluded that Aguilera's delegation of supervisory responsibilities to Vera appeared reasonable based on Vera's qualifications, but Aguilera failed to verify Vera was adequately performing his supervisory duties. Id., pp. 11-12. While Aguilera represented that she confirmed Vera was reviewing the trade blotters, she did not have a means to test the adequacy of his review, which made her delegation unreasonable. Id. Aguilera's reliance on Landers to monitor Vera's performance was insufficient because she failed to test the adequacy of Lander's monitoring. Id., p. 12. Aguilera had a duty to "more closely scrutinize" Vera's performance because she had concerns about his performance, which Paulukaitis opined she failed to do. Id., pp. 13-14.

Paulukaitis opined that broker-dealers have a duty to ensure that the prices they charge to customers on securities transactions are fair and reasonable, and that LatAm's markups on the structured notes were so high that "on their face they should have raised serious concerns as to any principal who saw them," and this was particularly true in light of the transactions' large size. Id., pp. 16, 18. He opined that Aguilera's lack of understanding of the structured note transactions was "noteworthy," given that they accounted for a significant portion of the firm's revenue in 2008 and 2009. Id., p. 17. Paulukaitis believed that had Aguilera fulfilled her supervisory responsibilities reasonably, she would have detected the markups on the structured notes. Id., p. 20.

III. Arguments of the Parties

***16** The Division argues that Neves and Luna violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder by knowingly engaging in a fraudulent scheme to charge undisclosed excessive markups in structured note transactions by using offshore nominee accounts as intermediaries before selling the notes to the end customers. Div. Br., p. 31. The Division asserts that Neves and Luna failed to disclose to the end customers that the structured notes were first sold to intermediaries, they sold the structured notes to the end customers at markups of approximately 19% to 67%, and they altered term sheets to misrepresent or omit pricing information in order to conceal the notes' actual price. Id., pp. 34-35. The Division argues that Neves and Luna aided and abetted LatAm's violations of Section 15(c)(1) of the Exchange Act based on the same conduct underlying their primary violations. Id., p. 38.

The Division argues that Aguilera, as President, had ultimate supervisory responsibility for the firm and failed to reasonably discharge her duty to effectively implement LatAm's procedures that sought to ensure fairness of markups to LatAm's customers. Id., pp. 40-41. Specifically, Aguilera failed to review Neves' and Luna's trading activity despite knowing of LatAm's substantial increase in revenues, Neves' large commission payments, Neves' potential conflict of interest with the Brazilian Pension Funds, and Vera's concerns about the transactions. Id. The Division asserts that Aguilera did not reasonably delegate supervisory authority to Vera because of her failure to verify Vera's work and her failure to revoke or remedy the delegation after becoming concerned about Vera's performance. Id., pp. 41-43. The Division argues that Aguilera should be barred from association with a broker-dealer in a supervisory capacity, barred from the securities industry, ordered to disgorge $1,243,762.76 plus prejudgment interest, and pay a third-tier civil penalty of $150,000. Id., pp. 44-52.

Aguilera does not deny that Neves and Luna violated the antifraud provisions or engaged in a scheme to charge undisclosed excessive markups to the Brazilian Pension Funds and the CVC; however, she claims the steps Neves and Luna took to cover up the fraud made it impossible for her to discover and prevent it. Resp. Br., p. 1; Resp. Reply Br., pp. 1-2, 4. She argues that she had no trading experience, no supervisory role in trading, and that the firm's WSPs did not accurately reflect job responsibilities. Resp. Br., pp. 3-4; Resp. Reply Br., pp. 5-7. Aguilera claims that she was conscientious about reviewing the trade blotters, and

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her review consisted of verifying that Vera had signed the trade blotters. Resp. Br., pp. 5-6. Finally, Aguilera asserts that Acosta and Neves exercised control over LatAm, and that a majority of the structured note trades took place prior to Acosta's departure in October 2007 and after his return in May 2009. Resp. Br., pp. 7-8; Resp. Reply Br., pp. 8-11. She requests that the case be dismissed and that she be awarded her costs and fees associated with defense of this matter. Resp. Br., p. 8.

IV. Discussion and Conclusions of Law

A. Neves and Luna Committed Fraud and Aided and Abetted LatAm's Violations of Exchange Act Section 15(c)(1):

***17** Neves and Luna willfully violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Exchange Act Rule 10b-5, and willfully aided and abetted LatAm's violations of Section 15(c)(1) of the Exchange Act, by engaging in a scheme to defraud the Brazilian Pension Funds and the CVC and to charge them excessive markups on structured note transactions. In furtherance of their scheme, Neves and Luna made material misrepresentations and materially misleading omissions by altering the price of the structured notes on the term sheets sent to the Funds through their representatives.

Section 17(a)(1) of the Securities Act makes it unlawful to employ devices, schemes, or artifices to defraud in the offer and sale of securities. Section 17(a)(2) of the Securities Act prohibits material misstatements or omissions of material facts, and Section 17(a)(3) of the Securities Act prohibits transactions, practices, or courses of business that operate as a fraud or deceit on the purchaser. Section 10(b) of the Exchange Act prohibits the use of "any manipulative or deceptive device or contrivance" in connection with the purchase or sale of any security. Exchange Act Rule 10b-5 makes it unlawful for any person to employ any device, scheme, or artifice to defraud, to make any misstatements or omissions of material fact, or to engage in any act, practice, or course of business which operates as a fraud or deceit.

To establish a violation of the antifraud provisions, the Division must establish that Neves and Luna made material misrepresentations or materially misleading omissions, or committed a deceptive act as part of a scheme to defraud, in connection with the offer, sale, or purchase of securities, either acting with scienter or negligently. See SEC v. Pirate Investor LLC, 580 F.3d 233, 239-45 (4th Cir. 2009); SEC v. Morgan Keegan & Co., 678 F.3d 1233, 1244 (11th Cir. 2012) (citing SEC v. Merch. Capital, LLC, 483 F.3d 747, 766 (11th Cir. 2007)); SEC v. Steadman, 967 F.2d 636, 641-43 (D.C. Cir. 1992). Violations of Section 17(a)(1) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder require a showing of scienter; Sections 17(a)(2) and (3) of the Securities Act require a showing of negligent conduct. See Steadman, 967 F.2d at 641 (citing Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 n.12 (1976) and Aaron v. SEC, 446 U.S. 680, 686 n.5, 696-97 (1980)). A finding of willfulness does not require intent to violate the law, but merely intent to do the act which constitutes a violation of the law. Wonsover v. SEC, 205 F.3d 408, 414 (D.C. Cir. 2000); Arthur Lipper Corp. v. SEC, 547 F.2d 171, 180 (2d Cir. 1976).

1. Scheme to Defraud and Material Misrepresentations and Omissions

***18** Neves was the architect of this fraudulent and deceptive scheme. He purchased the structured notes from issuing banks with the intention of selling the notes to the Funds or the CVC. Tr. 97-98, 103. In some instances, however, instead of selling the structured notes directly to the Funds or the CVC, he and LatAm first sold and repurchased the notes in intermediary transactions. Tr. 102-04, 108-09, 121. River Consulting, HAA, and Sinfon - intermediary accounts involved in the purchase and resale of the structured notes - were affiliated with Neves, Luna, or their relatives. Tr. 103-04, 147-48, 229. Another account used in the intermediary transactions, the Spectra Trust, was set up with the assistance of Neves and Luna for the benefit of Predtechensky, a friend of Neves and the president of the Brazilian Pension Funds. [44] Tr. 168-69, 178-79. Neves determined the price at which LatAm executed the intermediary sales and the price at which the structured notes were sold to the Funds or the CVC. Tr. 121. There is no evidence that Neves, Luna, or LatAm ever disclosed to the Funds or the CVC that the structured notes had been sold to affiliated accounts prior to their ultimate sale, and Luna testified that LatAm and the affiliated accounts involved in the intermediary transactions profited, while the ultimate purchasers of the notes "really pa[id] the bills." Tr. 145.

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The Commission has "long held that interpositioning can result in fraud where … it is done with scienter and results in the charging of excessive and undisclosed markups." Andrew P. Gonchar, Exchange Act Release No. 60506 (Aug. 14, 2009), 96 SEC Docket 19852, 19863 (citing Donald T. Sheldon, 51 S.E.C. 59, 78 (1992) (concluding that applicant's interpositioning resulted in fraudulent markups demonstrated clear scienter and was particularly egregious), aff'd45 F.3d 1515 (11th Cir. 1995)), petition denied, 409 F. App'x 396 (2d Cir. 2010). "Sales of securities by broker-dealers to their customers carry with them an implied representation that the prices charged in those transactions are reasonably related to the prices charged in an open and competitive market," and charging customers excessive markups without proper disclosure is fraudulent conduct that violates Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act. SEC v. First Jersey Sec., Inc., 101 F.3d 1450, 1469 (2d. Cir. 1996). Generally, a markup is deemed excessive "when it bears no reasonable relation to the prevailing market price;" however, whether a markup is excessive must be determined on a case-by-case basis. Grandon v. Merrill Lynch & Co., 147 F.3d 184, 190 (2d Cir. 1998) (internal quotation omitted). Typically, markups should not exceed 5%, particularly in transactions for debt securities. Id. at 191; Inv. Planning, Inc., 51 S.E.C. 592, 594 (1993) ("[I]t has long been recognized that debt securities markups normally are lower than those for equities, and that, in appropriate circumstances, markups under 5% may be subject to sanction."); FINRA Rule 2440, IM-2440-1 (Mark-Up Policy).

***19** There is no evidence that anyone at LatAm disclosed to the Funds or the CVC the amount of markups that were charged, or that markups had even occurred. The markups charged to the Funds and the CVC for the four transactions detailed in the Findings of Fact ranged from approximately 58% to 67% of the original value. Those markup calculations were not rebutted by Aguilera or any testimony in this proceeding. The markups on the eight structured note transactions set forth in Div. Ex. 72 ranged between 19% and 67% over the price the issuer originally charged. Div. Br., p. 11; Div. Exs. 72, 73. These markups were well above the generally accepted 5% threshold and there is no evidence to suggest that the markups were within the range of anything resembling a prevailing market price. Hartofilis testified that during the course of FINRA's investigation he obtained indicative pricing from some of the banks that issued the structured notes, and determined that there was no reason for the significant price fluctuations. Tr. 267-68.

Beyond failing to disclose the excessive markups to the Funds and the CVC, Neves and Luna, in fact, took steps to conceal the markups, thereby making material misrepresentations and omissions to the Funds and the CVC. Specifically, at Neves' direction, Luna altered the price on certain of the structured notes' term sheets from the original price that LatAm paid for the structured notes to the higher price at which Neves sold the structured notes to the Funds. Tr. 113-14. These term sheets were then sent to the Funds or their representatives at Atlantica Asset Management. Tr. 130-32; Div. Ex. 3.

The standard of materiality is whether or not a reasonable investor would have considered the information important in deciding whether or not to invest, and if disclosure of the misstated or omitted fact would have significantly altered the total mix of information available to the investor. See SEC v. Steadman, 967 F.2d at 643; see also Basic Inc. v. Levinson, 485 U.S. 224, 231-32, 240 (1988); TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976). The issue prices of the structured notes and the amount of any markups charged were undoubtedly material to the Funds. The issue prices, when compared to the prices at which the Funds purchased the structured notes from LatAm, would have indicated to the Funds that they were being charged a significant markup. [45] By altering the issue prices of the notes to reflect the higher price at which the Funds purchased the note from LatAm, Neves and Luna essentially made it appear that no markup was being charged. The CVC and Konig subjectively believed the markups to be material; the CVC's investment director contacted Konig when he found out about them, and Konig, in turn, contacted the authorities. Tr. 579-84; Div. Exs. 100A, 101A. Because the trading confirmations generated by Pershing and sent automatically to the Funds when they purchased a structured note only indicated the price at which the Funds had purchased the note from LatAm, and not the issue price, by altering the term sheets for the structured notes, Neves and Luna were able to further their scheme to defraud the Funds.

2. Scienter, Willfulness, Interstate Commerce, and "In Connection with the Purchase or Sale of Securities"

***20** Scienter is defined as a "mental state embracing the intent to deceive, manipulate, or defraud." Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 n. 12 (1976); Aaron v. SEC, 446 U.S. 680, 686 n.5 (1980). A finding of recklessness satisfies the scienter

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requirement. Hollinger v. Titan Capital Corp., 914 F.2d 1564, 1568-69 (9th Cir. 1990); David Disner, 52 S.E.C. 1217, 1222 & n.20 (1997).

The evidence is unequivocal that Neves and Luna acted willfully and with the intent to deceive or defraud in carrying out their fraudulent scheme and in making material misrepresentations and omissions. Neves intentionally arranged the fraudulent structured note transactions, determined the prices at which to execute the transactions, and chose which accounts to sell the structured notes to in intermediary transactions. Luna, at the direction of Neves, purposefully altered the term sheets sent to the Funds to conceal the excessive markups and the fraudulent scheme, and knowingly omitted the price from the term sheet sent to Pershing so that Pershing would not reflect the correct issue price of the November 2008 J.P. Morgan Chase structured note in its systems. Neves reviewed the altered term sheets before Luna sent them to the Brazilian Pension Funds' investment adviser. Tr. 117-19. Neves' desire not to discuss any trades by telephone or email, and his request to receive copies of the term sheets for the structured notes in hard copy, rather than by email, further reflect Neves' scienter.

Neves and Luna engaged in their fraudulent activities "in connection with" the offer, purchase, and sale of the structured notes to the Brazilian Pension Funds and the CVC. See SEC v. Zandford, 535 U.S. 813, 819-20 (2002) (embracing a broad reading of the "in connection with the purchase or sale of any security" requirement). Section 2(a)(1) of the Securities Act and Section 3(a)(10) of the Exchange Act include "any note" in the definition of ""security." 15 U.S.C. § 78c(a)(10); Reves v. Ernst & Young, 494 U.S. 56, 65 (1990). Because the Brazilian Pension Funds and the CVC are located outside the U.S., and they purchased structured notes from LatAm, a Florida-based broker-dealer, Neves' and Luna's fraudulent scheme was necessarily carried out through means of interstate and foreign commerce.

3. Neves and Luna Aided and Abetted LatAm's Violations of Exchange Act 15(c)(1).

Section 15(c)(1) of the Exchange Act prohibits broker-dealers from effecting transactions in, or inducing or attempting to induce, the purchase or sale of securities by means of a manipulative, deceptive, or other fraudulent device or contrivance. A violation of Exchange Act Section 15(c)(1) requires a finding of scienter. Gregory O. Trautman, Securities Act Release No. 9088 (Dec. 15, 2009), 97 SEC Docket 23492, 23523 n. 70 ("The scienter standards that apply to violations of Securities Act Section 17(a), Exchange Act Section 10(b), and Exchange Act Rule 10b-5 also apply to violations of Exchange Act Section 15(c)(1)."). [46] To establish an aiding and abetting violation, there must be a showing that: 1) a primary securities law violation by another occurred; 2) the aider and abettor was generally aware that his or her role was part of the overall activity that was improper or illegal; and 3) the aider and abettor provided substantial assistance in the conduct that constituted the violation. Graham v. SEC, 222 F.3d 994, 1000 (D.C. Cir. 2000).

***21** LatAm committed primary violations of Exchange Act Section 15(c)(1). As detailed above, LatAm's agents Neves and Luna defrauded the Funds and the CVC by charging them undisclosed, excessive markups on structured notes and made material misrepresentations and omissions by providing altered term sheets to the Funds in order to conceal the excessive markups. Neves and Luna plainly acted within the scope of their employment, and their scienter is imputable to LatAm. See vFinance Invs., Inc., Exchange Act Release No. 62448 (July 2, 2010), 98 SEC Docket 29918, 29934; Raymond James Fin. Servs., Inc., Initial Decision Release No. 296 (Sept. 15, 2005), 86 SEC Docket 711, 775-78 (collecting cases).

Neves and Luna aided and abetted LatAm's violations of Exchange Act Section 15(c)(1). The record indisputably reflects that Neves and Luna were aware of their role in charging excessive markups and providing altered term sheets, and they provided substantial assistance to LatAm's violations. As previously discussed, Neves and Luna, acting with scienter, were the masterminds of the fraudulent scheme, and they made the decision to interposition the accounts, charge the excessive markups, and alter the term sheets sent to clients.

B. Aguilera Failed Reasonably to Supervise Neves and Luna

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Aguilera failed reasonably to supervise Neves and Luna with a view to preventing their violations of the antifraud provisions of the securities laws. Exchange Act Section 15(b)(6), incorporating Section 15(b)(4)(E) by reference, allows the Commission to sanction a person associated with a broker-dealer if that person "has failed reasonably to supervise, with a view to preventing violations of [the securities laws], another person who commits such a violation, if such other person is subject to his supervision." Neither scienter nor willfulness is an element of a failure-to-supervise charge, although scienter may be considered in evaluating the reasonableness of supervision. Clarence Z. Wurts, 54 S.E.C. 1121, 1132 (2001); SEC v. Geon Indus., Inc., 531 F.2d 39, 53-54 (2d Cir. 1976).

The Commission has emphasized that "'the president of a brokerage firm is responsible for the firm's compliance with all applicable requirements unless and until he or she reasonably delegates a particular function to another person in the firm, and neither knows nor has reason to know that such a person is not properly performing his or her duties."' John B. Busacca III, Exchange Act Release No. 63312 (Nov. 12, 2010), 99 SEC Docket 34481, 34496 (quoting Richard F. Kresge, Exchange Act Release No. 55988 (June 29, 2007), 90 SEC Docket 3072, 3084); see also Donald T. Sheldon, 51 S.E.C. 59, 79 (1992), aff'd45 F.3d 1515, 1517 (11th Cir. 1995). Even when the president has delegated supervisory responsibilities, the president retains a duty to follow up on that delegation. Johnny Clifton, Securities Act Release No. 9417 (July 12, 2013), 2013 SEC Lexis 2022, at *49 ("[E]ven if we accepted [respondent's] claim that he delegated … the authority to review and approve e-mails, [respondent], as president, retained a duty to follow-up on that delegation, which he failed to do."); see also Midas Sec., LLC, Exchange Act Release No. 66200 (Jan. 20, 2012), 102 SEC 50351, 50372 ("It is not sufficient for the person with overarching supervisory responsibilities to delegate supervisory responsibilities to a subordinate … and then simply wash his hands of the matter until a problem is brought to his attention." (internal quotations omitted)).

***22** Aguilera was President of LatAm from approximately October 2007 until the firm ceased operations in 2010, and she was therefore responsible for the firm's compliance with all applicable requirements and the "overall supervision of the company" during that time. Tr. 371-72; Div. Ex. 17, p. 9. Aguilera testified that she understood that her job as overall supervisor was to verify that everyone else was doing their job. Tr. 372. LatAm's WSPs indicated that Aguilera had primary supervisory responsibility over the hiring and supervision of registered representatives from at least January 2008 through September 2009. The hearing testimony regarding who at LatAm was responsible for supervising the registered representatives and their trading is confusing and contradictory. Aguilera testified that she never supervised trading at the firm, Vera was responsible for reviewing the firm's trade blotters, and outside consultants were responsible for reviewing Vera's work until 2008, when Konig became responsible for reviewing Vera's work. Tr. 373-75, 378-79, 667, 678, 682. Vera, on the other hand, testified that he reviewed LatAm's trade blotter, but that Aguilera was responsible for signing off on it and that she frequently reviewed the trade blotters. Tr. 493-94, 498, 528, 545. Konig, who I find to be a credible witness, testified that he did not know whose responsibility it was to review the trade blotters, but he thought it was a "concerted effort" between the president and chief compliance officer. Tr. 584.

Even accepting as true Aguilera's testimony that she delegated supervisory responsibility over the registered representatives to Vera, Aguilera still failed reasonably to supervise within the meaning of Exchange Act Section 15(b)(4)(E) because she failed in her duty to follow up on that delegation. See Donald T. Sheldon, 51 S.E.C. at 79 (holding that the president of a brokerdealer was liable for failure to supervise where he delegated the duty to supervise sales to branch managers and "neither monitored, nor established procedures to monitor, [branch managers] to determine whether they were carrying out their supervisory responsibilities"). In her posthearing brief, Aguilera argues that she was "conscientious about verifying [Vera's] trade blotter signatures," and that her "trade blotter review consisted of verifying that [Vera] had signed off on the blotters." Resp. Br., p. 5. That argument, however, appears to conflict with testimony that she gave at the hearing; namely, that outside consultants and Konig were responsible for reviewing Vera's review of the trade blotters, not her. Tr. 374-75, 378-79, 678, 682. Lashkari, who I find to be a credible witness, testified that the firm's trade blotters were not kept in good order and he never recalled seeing signatures on any of the blotters. Tr. 460-61. In fact, Lashkari testified that he told Aguilera that Vera had told him that he did not sign off on anything at the firm, and Aguilera said that was one of the reasons Vera was being replaced. Tr. 461-63. Moreover, simply verifying that the trade blotters had been signed, without following up on the substance of Vera's review, does not constitute reasonable delegation.

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***23** Aguilera's assertion that she delegated her responsibility to verify Vera's work to outside compliance consultants, specifically Landers, and then to Konig when he joined the firm, was similarly inadequate because there is no evidence that she took any steps, or that there were any procedures in place, to verify that they were adequately reviewing Vera's work. Aguilera testified that this external compliance review only occurred "a few times a year." Tr. 682. Furthermore, I find Konig's testimony that he did not have access to the back office or accounts for fixed income trading and could not have exercised any supervisory responsibility over the fixed income trading to be credible. Tr. 567-69.

Aguilera also unreasonably continued to delegate supervisory responsibility to Vera after developing serious concerns about his performance. Aguilera testified that she did not believe Vera was an adequate compliance officer because the compliance files were incomplete and Vera was not in the office regularly, among other things. Tr. 390-91. As early as June or July of 2008, Aguilera spoke to outside counsel about firing Vera, but he was not let go until Lashkari was hired in November 2009. Tr. 390-92, 678-81.

Aguilera's argument that she cannot be held liable because the altered term sheets and use of affiliated accounts concealed Neves' and Luna's fraudulent scheme and prevented her from discovering it is misplaced. Resp. Br., pp. 1-3. Exchange Act Section 15(b)(4)(E) focuses on whether there were effective policies, procedures, and systems in place and whether there was adequate supervision. Whether a particular fraudulent scheme may nonetheless remain undetected does not shield a broker-dealer or supervisor from failing to adopt and implement adequate supervisory policies. See Consol. Inv. Servs., Inc., Exchange Act Release No. 36687 (Jan. 5, 1996), 61 SEC Docket 20, 25 (rejecting respondents' argument that no type of supervisory program could have prevented the "vast fraud" carried out where respondents took no steps to verify that the supervisory procedures in place were being followed). The cases cited by Aguilera regarding when concealment of fraud tolls the statute of limitations are irrelevant. Resp. Reply Brief, p. 2.

In further support of her position, Aguilera argues that the WSPs did not accurately reflect job responsibilities, and she points to Konig's testimony that the WSPs were "very insufficient" and "a complete mess." Resp. Br., p. 4. Instead of helping Aguilera, this argument hurts her. The fact that the firm's WSPs were inaccurate, and Aguilera, the firm's President, knew that they were inaccurate, reflects that her dereliction of duty was egregious. The steps Aguilera purportedly took in 2009 to correct the WSPs were steps in the right direction, but they do not absolve her of her previous inaction. During the hearing, Aguilera acknowledged that the WSPs assigned her responsibilities that were beyond her capabilities, stating: "I had all the responsibilities that were beyond my capabilities, but we left it like that, thinking that it was necessary for regulatory purposes to have a second person, a second principal be responsible for trading." Tr. 667-68. Aguilera's decision to assume supervisory responsibilities that she knew were beyond her capabilities for the purpose of satisfying a regulatory requirement contradicts the argument that she sought in good faith to amend the WSPs to make them accurate.

***24** Aguilera also appears to take the position that because she had no experience in trading and had never executed a securities transaction in her life, she cannot be held liable for failure to supervise Neves and Luna. Resp. Br., pp. 3-5. She quotes from a Commission settlement, John H. Gutfreund, 51 S.E.C. 93 (1992), for the proposition that I must consider whether Aguilera had the "'requisite degree of responsibility, ability or authority to affect the conduct of' employees." Resp. Reply Br., pp. 5-6. That quotation, however, related to the Commission's discussion of liability regarding the chief legal counsel of the firm who the Commission stated did not become a supervisor ""solely" because of his position, as opposed to the president of the firm, who the Commission stated "was responsible for compliance with all of the requirements imposed on his firm," pending reasonable delegation. John H. Gutfreund, 51 S.E.C. at 112-13. Aguilera does not offer any support for the position that her lack of substantive trading knowledge entitles her to an exception from the general rule that presidents of broker-dealers are responsible for the overall supervision of the company in the absence of reasonable delegation. The fact that Aguilera may have been unqualified for her position does not shield her from liability.

Finally, Aguilera argues, in essence, that she cannot be held liable because she was just a figurehead of LatAm. She asserts that Acosta exercised ""effective control," and Neves exercised "de facto" control over the firm and that the voting trust was a sham. Resp. Br., p. 7. She points to Konig's testimony that he eventually came to understand that Neves had more "control de

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facto" than Acosta or Aguilera did, and states that she felt "highly pressured" by Acosta. Id. The Commission has previously rejected the argument that a ""figurehead president" cannot be held liable for failure to supervise stating:

> We recognize that [respondent] was more or less a figurehead president. However, once he accepted that title, he was required to fulfill the obligations attached to his office for as long as he occupied the position, a duty he failed to discharge.

Kirk A. Knapp, 50 S.E.C. 858, 864-65 (1992) (rejecting respondent's argument that he "was only a 'temporary' president"). The law is not such that the president of a Commission-registered broker-dealer can abdicate her supervisory responsibilities as a result of pressure put on her by the firm's largest producer. See Albert Vincent O'Neal, 51 S.E.C. 1128, 1136 (1994) ("This case presents another illustration of the so-called 'big producer' who, despite a myriad of warnings to management, is allowed to continue his depredations to the detriment of public investors.").

V. Sanctions

A. Associational Bar

25** Sections 15(b)(4)(E) and 15(b)(6)(A)(i) of the Exchange Act authorize the Commission to bar or suspend a person from association with a broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization if it finds that such person failed reasonably to supervise, with a view to preventing violations of the federal securities laws, another person who commits such violations, if the other person is subject to the person's supervision, and if it is in the public interest. 15 U.S.C. §78o***(b)(4)(E), (b)(6)(A)(i); John W. Lawton, Investment Advisers Act of 1940 (Advisers Act) Release No. 3513 (Dec. 13, 2012), 105 SEC Docket 61722, 61737. In determining whether a sanction is in the public interest, the Commission considers the following factors: the egregiousness of the respondent's actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the sincerity of the respondent's assurances against future violations, the respondent's recognition of the wrongful nature of his or her conduct, and the likelihood that the respondent's occupation will present opportunities for future violations. See Vladimir Boris Bugarski, Exchange Act Release No. 66842 (Apr. 20, 2012), 103 SEC Docket 53374, 53378 (citing Steadman v. SEC, 603 F.2d 1126, 1140 (5th Cir. 1979), aff'd on other grounds, 450 U.S. 91 (1981)). The Commission also considers the extent to which the sanction will have a deterrent effect. See Schield Mgmt. Co., Exchange Act Release No. 53201 (Jan. 31, 2006), 87 SEC Docket 848, 862 & n.46.

Aguilera's conduct was egregious and recurrent in that supervisory procedures at LatAm, and supervision over Neves and Luna in particular, were woefully deficient during the approximately two years she was LatAm's President. Aguilera acknowledged that LatAm's WSPs were inaccurate, but she did not attempt to correct them until 2009. According to her testimony, Aguilera delegated supervisory responsibility to Vera; however, that delegation was evidently unreasonable given her significant concerns about his performance and her testimony that she believed he should have been fired due to his multiple failings.

Aguilera acted recklessly, that is, with a low degree of scienter. Recklessness, in the context of securities fraud, is "highly unreasonable" conduct, "which represents 'an extreme departure from the standards of ordinary care … to the extent that the danger was either known to the defendant or so obvious that the defendant must have been aware of it.'" Rolf v. Blyth, Eastman Dillon & Co., 570 F.2d 38, 47 (2d Cir. 1977) (quoting Sanders v. John Nuveen & Co., 554 F.2d 790, 793 (7th Cir. 1978)); see also S.W. Hatfield, CPA, Exchange Act Release No. 69930 (Jul. 3, 2013), - SEC Docket -, p. 29. Aguilera's supervision, such as it was, was highly unreasonable. This is evidenced by her testimony that she knew as overall supervisor of LatAm she was responsible for verifying that everyone was doing their job, but nonetheless continued to delegate supervisory responsibility to Vera and external consultants without ever conducting any meaningful verification of their work. Aguilera testified that she knew that the profits from Neves' and Luna's trading on behalf of the Brazilian Pension Funds were a substantial percentage of LatAm's revenue from 2007 through 2009, and yet she never reviewed the term sheets for the structured notes and testified

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that she wasn't concerned about the trading because, as institutional clients, the Brazilian Pension Funds knew what they were buying. Tr. 398. The evidence is overwhelming that she was oblivious to the danger that her brokerage may have been taken over by a confidence artist, a danger that would have been obvious had her supervision been reasonable.

***26** While Aguilera has not denied that Neves and Luna engaged in a scheme to defraud the Funds and the CVC, she has completely failed to recognize the wrongful nature of her conduct. Aguilera defended this proceeding by arguing that it was impossible to uncover Neves' and Luna's fraud because of the steps they took to conceal it, and she has consistently attempted to shift responsibility for the supervisory failings at LatAm to Vera, Acosta, Neves, outside consultants, and even Konig. Aguilera has not provided any assurances against future violations. Based on Aguilera's testimony, I am particularly concerned that if she were allowed to remain in the securities industry, the likelihood of future violations would be high. The securities industry relies on supervisors to help police itself, and Aguilera clearly cannot be relied upon for that purpose. By failing to perform her duties as President, and failing to even accept a modicum of responsibility, Aguilera has shown herself to be unfit to participate in the securities industry, especially in a supervisory capacity. Under the circumstances, and even considering her low degree of scienter, a bar from association with a broker or dealer in a supervisory capacity and a bar from association with a broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization is appropriate in the public interest.

B. Disgorgement and Prejudgment Interest

Pursuant to Section 21B of the Exchange Act, the Division seeks an order requiring disgorgement of ill-gotten gains by Aguilera. Disgorgement is an equitable remedy that requires a violator to give up wrongfully-obtained profits causally related to the proven wrongdoing. See SEC v. First City Fin. Corp., Ltd., 890 F.2d 1215, 1230-32 (D.C. Cir. 1989). It returns the violator to where he or she would have been absent the misconduct and deters others from violating the securities laws. Id.; Zacharias v. SEC, 569 F.3d 458, 471 (D.C. Cir. 2009) “Disgorgement need only be a reasonable approximation of the profits casually connected to the violation.” Guy P. Riordan, Securities Act Release No. 9085 (Dec. 11, 2009), 97 SEC Docket 23445, 23480 (quoting First City Fin. Corp., Ltd., 890 F.2d at 1231), petition denied, 627 F.3d 1230 (D.C. Cir. 2010). Once the Division shows that its disgorgement figure reasonably approximates the amount of unjust enrichment, the burden of going forward shifts to the respondent to demonstrate that the Division's disgorgement figure is not a reasonable approximation. Id. Any risk of uncertainty as to the disgorgement amount falls onto the wrongdoer whose illegal conduct created the uncertainty. See First City Fin. Corp., Ltd., 890 F.2d at 1232.

***27** The Division argues that Aguilera should be ordered to disgorge the compensation that she received apart from her salary during the period in which Neves and Luna charged excessive markups. Div. Br., pp. 49-50. The Division asserts that prior to Neves' arrival at LatAm, Aguilera's compensation was minimal, however, as revenues increased, Aguilera's compensation increased, and that it would be inequitable to allow Aguilera to keep the portion of her compensation that stemmed from revenues generated from the fraudulent conduct. Id. The Division contends that Aguilera received $1,019,384.76 in additional payments and $224,377 in funds used for improvements to her home, for a total of $1,243,761.76. [47] Id. at 50. In addition, the Division requests that Aguilera pay prejudgment interest of $161,311.99, calculated from September 1, 2009, to April 19, 2013. Id.

The Division's calculation of the $1,019,384.76 in additional payments is set forth in Div. Ex. 107, which reflects payments to or for the benefit of Aguilera from October 2007 through December 2009, not including the regular salary payments Aguilera received from Paychex, Inc., the company that handled LatAm's payroll. Tr. 345-47, 350; Div. Ex. 107. Fernando Torres, senior regional account at the Commission, testified that he created Div. Ex. 107 and calculated the additional payments figure by examining LatAm's bank accounts at HSBC and Bank of America. Tr. 347-48. Aguilera admitted on direct examination that the $224,377 was used to build a home office for her benefit. Tr. 423-29.

Aguilera does not explicitly challenge the Division's calculation of disgorgement in her post-hearing brief or reply brief. She does, however, identify several payments she received and provides further explanation of them. Resp. Reply Br., pp. 11-12. The payments are described as: 1) $200,000 of a $275,000 loan from Neves in 2007 under the terms of a promissory note for

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which she received a Form 1099 (Aguilera contends that she paid back $75,000 of the loan); 2) checks paid out of LatAm to home office construction vendors, which Aguilera personally assumed and were recorded as income payments to Aguilera in the amount of $224,377.74; 3) a distribution of capital of $300,000 that Acosta ordered Aguilera to use to pay off her mortgage so that her credit would not affect the company; and 4) a 2009 lump sum payment made by LatAm directly to the IRS for $305,845.00 for her 2008 taxes, which she contends was mostly used for LatAm's corporate taxes.

It is unclear whether Aguilera contends that these payments should not be included in the disgorgement calculation, but I will address each payment assuming that is her argument. The $200,000, or $275,000, loan from Neves to Aguilera in 2007 does not appear to be included in the Division's disgorgement calculation in Div. Ex. 107, and therefore this payment is not in dispute. Div. Ex. 107. The $224,377 used to construct a home office and $300,000 "“distribution of capital," were compensation for Aguilera's benefit that she received separate from her salary during the period in which the excessive markups were charged and therefore are properly subject to disgorgement. Aguilera admits that the $224,377 was not expensed to LatAm and was "clearly recorded as income payments" to her on her income tax filing as a distribution of capital. Resp. Reply Br., p. 12. While Aguilera testified that some of the money that she received to construct a new home office may have been spent on renovations for the company instead, Aguilera has failed to provide a reasonable approximation, or any evidence, of how much was actually spent on renovations for the company. Tr. 427. The mortgage payment plainly benefited Aguilera and the fact that it may have had an incidental benefit on LatAm's credit is irrelevant. Finally, while Aguilera asserts that the 2009 lump sum payment to the IRS was "mostly" used for LatAm's corporate taxes, she offers no evidence in support of her claim, and therefore I find that it was properly included in the disgorgement calculation.

***28** In sum, the Division has shown the reasonableness of the $1,243,761.76 disgorgement figure, and Aguilera has not met her burden of demonstrating that the figure is not a reasonable calculation. Aguilera did not object to the Division's request for $161,311.99 in prejudgment interest. [48]

C. Civil Penalty

Under Section 21B(a)(1)(D) of the Exchange Act, the Commission may impose a civil penalty if it is in the public interest and if respondent "has failed reasonably to supervise, within the meaning of section 15(b)(4)(E), with a view to preventing violations of the provisions of such statutes, rules and regulations, another person who commits such a violation, if such other person is subject to his supervision."15 U.S.C. § 78u-2(a)(1)(D).

A three-tier system establishes the maximum civil money penalty that may be imposed for each violation found. 15 U.S.C. § 78u-2(b). Where a respondent's misconduct involved fraud, deceit, or deliberate or reckless disregard of a regulatory requirement, and resulted in "substantial losses or created a significant risk of substantial losses to other persons or resulted in substantial pecuniary gain," the Commission may impose a "Third-Tier" penalty of up to $150,000 for each act or omission by an individual. Id.; 17 C.F.R. § 201.1004 (adjusting the statutory amounts for inflation). In determining whether a penalty is in the public interest, the Commission may consider: 1) whether the violation involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement; 2) the resulting harm to other persons; 3) any unjust enrichment and prior restitution; 4) the respondent's prior regulatory record; 5) the need to deter the respondent and other persons; and 6) such other matters as justice may require. 15 U.S.C. § 78u-2(c).

The Division seeks the imposition of a third-tier, $150,000 civil penalty on Aguilera. Under the circumstances, I find a third-tier penalty of $150,000 to be warranted and in the public interest. Aguilera acted in at least reckless disregard of a regulatory requirement in failing to supervise Neves and Luna, which resulted in substantial losses to the Funds and the CVC. The supervisory failures at LatAm were widespread and lasted for years, and Aguilera, as President, was ultimately responsible for them. Aguilera does not dispute that Neves and Luna defrauded LatAm's clients, and Hartofilis' testimony that FINRA identified approximately $27 million in markups and markdowns that were charged by LatAm to the Funds was not rebutted. Aguilera testified at the hearing that she would not be surprised if her adjusted gross income after Neves arrived in 2007 was $773,649,

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in 2008 was $826,850, and in 2009 was $1.8 million. Tr. 403. Aguilera has not recognized the wrongful nature of her conduct, and therefore the need to deter her is strong.

***29** The Division requests that the third-tier civil penalty be imposed one time. While the statute provides that a penalty may be imposed for "each act or omission," it leaves the precise unit of violation undefined. See Colin S. Diver, The Assessment and Mitigation of Civil Money Penalties by Federal Administrative Agencies, 79 Colum. L. Rev. 1435, 1440-41 (1979). Although it is at least arguable that Aguilera's conduct in failing reasonably to supervise Neves and Luna over the course of approximately two years constituted more than one "act or omission," a one-time penalty of $150,000 would prejudice Aguilera the least.

D. Ability to Pay

Under Section 21B(d) of the Exchange Act, in any proceeding in which the Commission may impose a civil penalty, a respondent may present evidence of her ability to pay the penalty. 15 U.S.C. § 78u-2(d). The Commission may, in its discretion, consider such evidence in determining whether a penalty is in the public interest. Id. Such evidence may relate to the extent of the respondent's ability to continue in business and the collectability of the penalty, taking into account any other claims of the United States or third parties upon the respondent's assets and the amount of the respondent's assets. Id.

Pursuant to Rule 630(a) of the Commission's Rules of Practice, the Commission also considers evidence of ability to pay as a factor in determining whether a respondent should be required to pay disgorgement and interest. 17 C.F.R. § 201.630(a). In First Sec. Transfer Syst., Inc., 52 S.E.C. 392, 397 (1995), the Commission stated that it is:

> [C]ognizant of the inadvisability of assessing penalties so heavy that the persons against whom they are assessed are unable to pay them. Such a situation results in the expenditure of agency resources in unsuccessful attempts to collect the penalties. Moreover, the imposition of a sanction that cannot be enforced may ultimately render the deterrent message intended to be communicated by the sanction less meaningful.

On June 24, 2013, Aguilera submitted a sworn and dated Form D-A, Disclosure of Assets and Financial Information (Form D-A), and on June 26, 2013, Aguilera submitted her Form 1040, U.S. Individual Income Tax Return for 2011 in further support of her Form D-A. [49] A review of Aguilera's sworn Form D-A supports her claim that the disgorgement, prejudgment interest, and civil penalties requested by the Division are beyond her ability to pay now or in the reasonably foreseeable future. The Form D-A is consistent with Aguilera's testimony at the hearing regarding her finances. [50] Aguilera described the current state of her finances as "bad," and testified that she paid no estimated taxes in 2008 or 2009 due to ignorance and approximately $600,000 of the money she received from LatAm was used to pay taxes. Tr. 701, 706, 708-09. According to Aguilera, she owes over a million dollars in taxes and the Internal Revenue Service has twice levied the accounts in which she receives child support payments for her children. Tr. 687. Aguilera stated that she originally paid $695,000 for her home, which is currently worth $300,000 and is in foreclosure. Tr. 707. Aguilera testified that she spent some of the money she received on her son's medical condition, which included traveling to medical research centers in Boston, Chicago, Las Vegas, and Brazil. Tr. 707. Aguilera testified that "money was [her] god," but now she realizes that was wrong. Tr. 708.

***30** Aguilera filed her Form D-A after post-hearing briefing was complete, and therefore the Division did not have the opportunity to address Aguilera's Form D-A in its post-hearing submissions. In its Reply brief, the Division noted that Aguilera failed to submit evidence concerning her ability to pay and therefore disgorgement, interest, and civil penalties should be imposed on her; however, since the Form D-A was filed, this Office has received no objection from the Division as to its filing. Div. Reply. Br., p. 9.

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The clear and overwhelming weight of the evidence is that Aguilera does not currently, and will not for the foreseeable future, have the ability to pay the disgorgement, interest, and civil penalties ordered in this proceeding. As a result of the imposition of the full collateral bar, Aguilera will not have the ability to continue working in the securities industry. Unlike in other cases, there is no contradictory evidence in the record to suggest that Aguilera does, in fact, have the ability to pay. See Robert L. Burns, Advisers Act Release No. 3260 (Aug. 5, 2011), 101 SEC Docket 44807, 44825 (denying claim of inability to pay where respondent's purported net worth was on its face sufficient to pay disgorgement, interest, and penalties, and where respondent stated his intention to re-enter the securities industry); Joseph John VanCook, Exchange Act Release No. 61039A (Nov. 20, 2009), 97 SEC Docket 22700, 22731 (denying respondent's claim of inability to pay $533,234.01 in disgorgement plus prejudgment interest of $228,901.89 and a $100,000 civil penalty where respondent had a net worth of $400,000 and had earned over $200,000 in the twelve months prior to filing his financial statements). Therefore, Aguilera will not be ordered to pay disgorgement, prejudgment interest, or civil penalties in this proceeding.

VI. Record Certification

Pursuant to Rule 351(b) of the Commission's Rules of Practice, 17 C.F.R. § 201.351(b), I certify that the record includes the items set forth in the Record Index issued by the Secretary of the Commission on May 22, 2013.

VII. Order

IT IS ORDERED that, pursuant to Section 15(b) of the Securities Exchange Act of 1934, Respondent Angelica Aguilera is BARRED from association with a broker or dealer in a supervisory capacity.

IT IS FURTHER ORDERED that, pursuant to Section 15(b) of the Securities Exchange Act of 1934, Respondent Angelica Aguilera is BARRED from association with a broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization.

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

***31** In the event that the Commission reviews this initial decision, Respondent is reminded of the need to update her sworn financial disclosure statement. See17 C.F.R. § 201.410(c) ("Any person who files a petition for review of an initial decision that asserts the person's inability to pay either disgorgement, interest or a penalty shall file with the opening brief a sworn financial disclosure statement containing the information specified in Rule 630(b).").

Cameron Elliot
Administrative Law Judge

1 Citations to the transcript of the hearing are noted as "Tr. ___.". Citations to Aguilera's Answer are noted as "Answer ___.". Citations to exhibits offered by the Division and Aguilera are noted as "Div. Ex. ___." and ""Resp. Ex. ___.", respectively. The Division's and Aguilera's post-hearing briefs are noted as "Div. Br. ___." and "Resp. Br. ___.",

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respectively. The Division's and Aguilera's reply briefs are noted as “Div. Reply Br. ___.” and ““Resp. Reply Br. ___.”, respectively.

2 Aguilera received a master's degree in business administration from California State University and a graduate degree in international management from a school in San Francisco, California. Tr. 361.

3 Acosta managed clearing operations for Bear Stearns, and, according to Aguilera, he was terminated in 2003 as a result of a dispute that arose regarding his alleged role in market timing of mutual funds. Tr. 362-63. Aguilera quit her job at Bear Stearns around the same time that Acosta was terminated. Tr. 363.

4 Luna holds a bachelor's degree in business administration in management and finance from Mercy College in New York. Tr. 55.

5 Luna was employed at Bankers Trust in New York from 1995 through 1999; Chase Manhattan Bank in Brooklyn, New York, in 1999; HWF Capital, a Florida hedge fund from 1999-2002; and Global Strategic in Miami, Florida, from 2002 through 2005. Tr. 55-60; Div. Ex. 52. He performed operations-related tasks, such as confirming and processing trades, sending wire transfers, and handling clients and account problems for these firms. Tr. 55-58.

6 Luna testified that the fact that the Commission has not yet made a recommendation as to the appropriate civil penalty to be imposed in Neves would not affect the truth or completeness of his testimony during the hearing. Tr. 62.

7 Acosta Financial Services and LatAm are referred to throughout the transcript and this Initial Decision as LatAm. Tr. 363.

8 Aguilera first met Neves at a restaurant sometime in 2006 with Acosta. Tr. 366, 661-63.

9 According to Aguilera, LatAm's legal counsel from Greenberg Traurig LLP conducted a background investigation of Neves when he joined LatAm. Tr. 663-64.

10 Vera graduated from the Inter-American University in Puerto Rico in 2003 and has worked in the financial industry for over twenty-four years. Tr. 489. He currently holds Series 7, 24, 66, and 79 securities licenses. Tr. 430. Vera currently owns Lali Consulting and is the chief compliance officer for two firms. Tr. 489.

11 Konig, age 67, received bachelor's degrees from Philadelphia College of Textiles and Science and Louisiana State University. Tr. 562. He holds Series 4, 7, 27, 44, 55, and 63 securities licenses. Tr. 563.

12 Konig testified that although his employment contract stated he was hired as the Sales and Branch Manager of LatAm's Miami office, his title at or shortly after joining LatAm was COO. Tr. 571; Div. Ex. 98.

13 In early 2008, Aguilera was working from home and sporadically came into LatAm's office because of her son's medical condition, which required hospitalization. Tr. 370.

14 Lashkari, age 39, graduated from Queens College of New York in 1998 with majors in urban planning and social studies. Tr. 440. He holds Series 4, 7, 9, 10, 24, 53, 63, 66, 79, and 99 securities licenses. Tr. 440-41.

15 The Division's expert witness, David Paulukaitis, opined in his expert report that structured notes are debt instruments generally issued by financial institutions such as brokers-dealers, banks, or their affiliates. Div. Ex. 96, p. 4. Unlike conventional bonds, most structured notes do not pay a specified nominal rate of interest, but returns are instead determined based on the relative performance of some other financial instrument or market index. Id. He testified that, generally, structured notes are not for broad retail sale but are created based on specific criteria identified by institutional investors, and, normally, no active secondary market exists. Id., p. 5.

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16 Luna testified Neves did not work regular office hours, would come to LatAm's office only once or twice a week, and primarily worked from home. Tr. 85-86. Luna mostly worked at LatAm's office, but approximately once a week would go to Neves' home to drop off documents or to talk. Tr. 87.

17 Luna testified that Neves did not want to discuss trading on the telephone and that he rarely communicated with Neves by email because Neves did not trust email or cellular telephones. Tr. 90. Initially, Luna and Neves communicated by cellular phone or Nextel point-to-point network, but at some point they instead began communicating through Skype. Tr. 87-88. Neves taught Luna how to destroy any previous or historical text messages that were exchanged on Skype. Tr. 93-94. According to Luna, they communicated through Skype for security purposes, although Luna did not know whom Neves wanted to keep information from. Tr. 230.

18 According to Luna, interpositioning or markups were done for five or six structured notes sold by Neves, involving no more than ten transactions. Tr. 99, 237-38. The Division has proven that Neves and Luna marked up a total of eight structured note transactions. Div. Br., p. 11; Div. Ex. 72.

19 Luna testified that he became the registered representative for River Consulting sometime after he became licensed in 2009. Tr. 83.

20 Luna believes he helped his sister complete the new account paperwork; he then processed the new account at LatAm, and had Aguilera sign off on the new account on behalf of LatAm. Tr. 152. Luna testified that he told Aguilera that it was a new account and that it needed to be opened. Tr. 152.

21 The ISIN number for this structured note was XS0439509240. Tr. 127-28; Div. Exs. 2; 72, p. 2.

22 Div. Ex. 72 is a document created by William Tudor (Tudor), a Commission examiner, setting forth each transaction by which the Division contends Neves and Luna marked up eight structured notes (or in one instance, marked down). Div. Ex. 73 is Tudor's declaration, explaining that he created Div. Ex. 72 based on trade blotter data contained in Div. Ex. 71, which FINRA produced to the Division.

23 Tudor stated that he calculated the "% Increase/Decrease In Price" found on Div. Ex. 72, which is the "percentage by which the price of each selected structured note increased or decreased over the course of the transactions in that structured note." Div. Ex. 73.

24 The ISIN number for this structured note was XS0439257766. Tr. 154; Div. Exs. 6; 7; 30; 72, pp. 1-2.

25 The ISIN number for this structured note was XS0445230781. Tr. 137; Div. Exs. 27; 72, p. 1.

26 The ISIN number listed on the chart and the term sheet sent to Atlantica Asset Management was XS0445230781. Tr. 144; Div. Ex. 5.

27 The ISIN number for this structured note was XS0401826754. Tr. 158; Div. Exs. 10; 72, p. 4.

28 Div. Ex. 72 reflects that the $50 million J.P. Morgan Chase Bank structured note was sold to the CVC by LatAm at 53.27% of the notional amount in the following pieces: $6.5 million on November 28, 2008; $9.6 million on December 3, 2008; $14.4 million on December 9, 2008; and $19.5 million on December 12, 2008. Tr. 162-163; Div. Ex. 72, pp. 5-6.

29 At some point Konig had met with the CVC, at the request of its investment director, to "make the client feel comfortable that [it was] dealing with a bona fide broker dealer in the [United] States." Tr. 575-76. Konig testified that he had not seen the term sheet for the structured note prior to the trip, and this was the one time that he had anything to do with the fixed income side of LatAm's business. Tr. 576-77. Konig testified that he checked with J.P. Morgan after receiving the email from the CVC and learned that the term sheet had been altered. Tr. 577-83. Immediately after learning of the

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alteration, Konig contacted a criminal attorney, who contacted the U.S. Attorney's Office, and Konig made an on-the-record declaration to the Federal Bureau of Investigation and was deposed by the Commission. Tr. 584.

30 Vera testified that he never reported this conduct to FINRA or the Commission because of the tough job market and the need to provide for his family. Tr. 520.

31 Aguilera testified that Vera never raised the issue of markups or markdowns with her, but she recalled one instance in 2008 when he brought a trade to her attention that she initially believed was customer related, but later learned it had to do with the principal trading accounts; Acosta, Landers, and Aguilera met regarding the trade and she believed the issue was resolved. Tr. 682-83.

32 The two funds are clearly the Brazilian Funds, although Hartofilis never refers to them by name. Tr. 256-60.

33 Hartofilis understood from speaking to FINRA's field examiners that Aguilera signed off on the wire transfers at LatAm. Tr. 273-74.

34 The January 2008 WSPs reflected that Vera was also President, but Landers testified that this appeared to be an error, and there is no other record evidence suggesting Vera was President. Tr. 291.

35 Landers testified that the primary supervisor had “front line responsibility for that particular program or task,” while a secondary supervisor was responsible if the primary supervisor was “not available, [was] gone for an extended period of time, or has been designated to have these roles by the primary supervisor.” Tr. 291-92.

36 Landers understood the January 2008 WSPs' Schedule of Designated Responsibilities to be correct. Tr. 291; Div. Ex. 21, pp. 209-12.

37 Landers understood the September 2009 WSPs' Schedule of Designated Responsibilities to be correct. Tr. 293-94; Div. Ex. 24, pp. 212-16.

38 Landers testified Acosta continued to make his presence felt at LatAm and was involved on a day-to-day basis after he left, but Landers agreed that the consulting agreement Acosta executed with LatAm removed him from day-to-day management of the firm. Tr. 283-84.

39 This testimony appears to be inconsistent with his investigative testimony. “Q: Would Ms. Aguilera review trade blotters or (sic) any sort of regular basis? A: Only when I would discuss it with her.” Tr. 498-99. When confronted with his investigative testimony, Vera stated, “she would take a closer look at the blotter when I would discuss it with her,” and “when she would come into the office, she would regularly pick up any of the binders to take with her.” Tr. 499.

40 According to Landers, he advised LatAm to hire someone to work with Aguilera as FINOP because FINRA had expressed concern about Aguilera's lack of experience when LatAm was attempting to get clearance to add third-party clearing as a business line, and LatAm subsequently hired Singer. Tr. 307-08.

41 Landers testified that he was aware of several disagreements between Aguilera and Vera as to their supervisory responsibilities, including the role of Anti-Money Laundering Compliance Officer and, separately, with respect to Neves' accounts. Tr. 294-95.

42 Aguilera testified that some of this money may also have been spent on renovations for the company. Tr. 427.

43 Paulukaitis received a degree in finance from the University of Alabama at Huntsville in 1981. Between 1982 and 2005, he was employed by National Association of Securities Dealers, Inc. (NASD), as an examiner, supervisor of examiners, and Associate District Director in Atlanta, Georgia. Div. Ex. 96, Ex. 1. Since 2005, Paulukaitis has been Managing Director at Mainstay Capital Markets Consultants, Inc. Id. Paulukaitis was acquainted with Konig and Landers prior to the hearing through his work at NASD supervising broker-dealers, but his last conversation with Landers was probably

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in May 2005, and his last conversation with Konig was approximately eight or ten months ago. Tr. 608. Paulukaitis testified that his previous acquaintance did not affect his opinion or his testimony. Tr. 608.

44 The use of the Spectra Trust as an account in the intermediary transactions is particularly noteworthy because it suggests that Neves and Luna acted in concert with Predtechensky to defraud the Funds for which Predtechensky was president.

45 It is not clear from the record that Neves or Luna sent a term sheet to the CVC in connection with its November 2008 purchase of a J.P. Morgan Chase structured note. Luna testified, however, that with respect to this note, he omitted the issue price on the term sheet before sending the term sheet to Pershing so that Pershing would not be able to reflect the issue price in its system. Tr. 159-60; Div. Ex. 11. By omitting the issue price on the term sheet sent to Pershing, Neves and Luna were effectively concealing the issue price from the CVC in connection with its purchase of the structured note.

46 An amended version of this Commission Opinion is available only on the Commission's website. In pertinent part, it is identical to the printed Release.

47 The Division lists the total as $1,243,762.76.

48 Pursuant to Rule 600(a) of the Commission's Rules of Practice, prejudgment interest is due “from the first day of the month following each such violation through the last day of the month preceding the month in which payment of disgorgement is made,” and therefore the Division's request for prejudgment interest only through April 19, 2013, the date the parties' post-hearing briefs were due, benefits Aguilera. 17 C.F.R. § 201.600(a).

49 I ruled that both submissions were covered by protective order and shall be maintained under seal. I also admitted, not under seal, Aguilera's tax returns for 2005-2009, and Forms W-2, as Div. Exs. 78-85.

50 Aguilera's testimony about her financial condition, although similar to some of the information contained in her confidential Form D-A, was made in open court and therefore it does not violate the protective order to include the substance of her testimony in this ID.

Release No. 501 (S.E.C. Release No.), 106 S.E.C. Docket 4423, Release No. ID - 501, 2013 WL 3936214

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Release No. 1400 (S.E.C. Release No.), Release No. ID - 1400, 2020 WL 1699565

S.E.C. Release No.
Initial Decision

SECURITIES AND EXCHANGE COMMISSION (S.E.C.)

IN THE MATTER OF ASCENSION ASSET MANAGEMENT, LLC, AND GRENVILLE M. GOODER, JR.

Administrative Proceeding File No. 3-19024
April 3, 2020

***1** APPEARANCES:

Joshua E. Braunstein and Luke A.E. Pazicky for the Division of Enforcement, Securities and Exchange Commission [1]
Thomas J. McGonigle, Alexandra J. Marinzel, and Macauley B. Venora of Murphy & McGonigle, P.C., for Ascension Asset Management, LLC, and Grenville M. Gooder, Jr.

Before: Carol Fox Foelak, Administrative Law Judge

SUMMARY

This Initial Decision orders Ascension Asset Management, LLC, and Grenville M. Gooder, Jr., jointly and severally, to pay a civil penalty of $50,000 and censures them.

I. INTRODUCTION

A. Procedural Background

The Securities and Exchange Commission instituted this proceeding with an Order Instituting Proceedings (OIP) on March 7, 2019, pursuant to Section 203(e), (f), and (k) of the Investment Advisers Act of 1940 and Section 9(b) of the Investment Company Act of 1940. On May 7, 2019, the Commission ordered that a hearing be convened before an Administrative Law Judge on September 9, 2019. *Ascension Asset Mgmt., LLC*, Advisers Act Release No. 5230, 2019 SEC LEXIS 1055, at *2. In the interim, the parties filed motions for summary disposition pursuant to 17 C.F.R. § 201.250, on which the undersigned ruled on August 29, 2019, making various findings of fact and conclusions of law. *Ascension Asset Mgmt., LLC*, Admin. Proc. Rulings Release No. 6665, 2019 SEC LEXIS 2290 (Summary Disposition Order). The undersigned held a one-day hearing in Washington, D.C., on September 9, 2019, to take additional evidence on the appropriate sanction, if any. The Division of Enforcement called one witness from whom testimony was taken, Patrick Smith, and Respondents called one, Respondent Gooder, in their case. [2]

The findings and conclusions in this Initial Decision are based on the record. Official notice pursuant to 17 C.F.R. § 201.323 is taken of the Commission's public official records and of Financial Industry Regulatory Authority, Inc., records as well. *See Joseph S. Amundsen*, Exchange Act Release No. 69406, 2013 SEC LEXIS 1148, at *1 n.1 (Apr. 18, 2013), *pet. denied*, 575 F. App'x 1 (D.C. Cir. 2014). Preponderance of the evidence was applied as the standard of proof. *See Steadman v. SEC*, 450 U.S. 91, 96-104 (1981). Pursuant to the Administrative Procedure Act, 5 U.S.C. § 557(c), the following post-hearing pleadings were considered: (1) the Division's Post-Hearing Brief; (2) Respondents' Counter-Proposed Findings of Fact and Conclusions of Law and Post-Hearing Brief; and (3) the Division's Post-Hearing Reply Brief. All arguments and proposed findings and conclusions that are inconsistent with this Initial Decision were considered and rejected.

B. Allegations and Arguments of the Parties

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***2** This Division requests that: Ascension and Gooder be censured and be ordered to cease and desist from further violations, to retain an independent compliance monitor, and to pay a civil penalty. Respondents urge that sanctions are not appropriate in that Respondents have remediated the violations, having even engaged a compliance consultant before the commencement of the Commission's examination that led to this proceeding and implemented the consultant's recommendations, even exceeding legal requirements, for instance by having monthly reviews instead of annual reviews. Respondents note that there is no evidence of client losses or misappropriation of client funds.

C. Procedural Issues

As the Summary Disposition Order stated, Respondents challenged the proceeding on the grounds that: it violates their Seventh Amendment right to jury trial; the presiding Administrative Law Judge is barred from adjudicating it under the Appointments Clause because of improper appointment and unconstitutional removal protections; claims based on conduct occurring prior to March 7, 2014, are barred by the five-year statute of limitations; and the Commission was not authorized to adopt Advisers Act Rule 206(4)-7, one of the rules that Respondents are charged with violating. The Summary Disposition Order denied Respondents' request that the proceeding be dismissed on these grounds. Post-hearing, Respondents reiterate their arguments and request reconsideration. The conclusions set forth in the Summary Disposition Order rejecting these challenges are adopted and incorporated herein. Respondents' objections are preserved for review.

II. FINDINGS OF FACT

A. Previous Findings Incorporated

For purposes of this ID, the findings of fact set forth in the Summary Disposition Order (at *9-15) are deemed true and incorporated herein as follows:

Ascension, located in New York City, registered with the Commission as an investment adviser in June 2004. It provides asset allocation and portfolio management services to high net worth investors, trusts, foundations, and a pension plan, with regulatory assets under management of $152,456,779 as of December 31, 2017. Gooder, a Chartered Financial Analyst, founded Ascension in 2004 after working in the securities industry for about 40 years, including for several SEC-registered investment advisers. Ascension's sole owner and operator, he signed its Forms ADV.

Ascension has been a member since 2005 of the Investment Adviser Association (IAA), which advocates for and provides compliance and educational resources to SEC-registered investment advisory firms. However, Gooder did not read the organization's monthly compliance bulletins and did not attend its training events on compliance issues. Nor did he visit the Commission's website or contact Commission staff for guidance on any investment advisory compliance issues.

Until November 2015, Ascension did not adopt and implement written compliance policies and procedures or conduct annual reviews. Accordingly, Ascension did not have records of these things during that period. Since then, following the initiation of an examination by the Commission's Office of Compliance Inspections and Examinations (OCIE), Ascension has been in compliance with these requirements.

***3** From September 2005 until March 2016, Respondents designated in Ascension's Forms ADV David N. Platt and Patrick L. Smith as Ascension's Chief Compliance Officer (CCO) at different times.

From about 2005, Ascension was an investment adviser to a private fund, which by 2007 had approximately 40 shareholders who collectively invested approximately $4.4 million. Gooder and Platt jointly managed the private fund. From about March 2010 until November 2015, Ascension did not retain an independent accountant to perform an annual audit of the private fund and did not distribute audited financial statements to its investors, nor did it retain an independent public accountant to conduct

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an annual surprise examination to verify the fund's assets.[3] The assets were in the possession of an independent qualified custodian. Since November 2015 the fund has been dissolved.

In or about July 2012, Gooder was named sole trustee of an approximately $5.2 million trust account, and from then through at least December 2015, Ascension was the investment adviser to the trust and received a fee for managing it. The assets were in the possession of an independent qualified custodian. As sole trustee, Gooder had the authority to obtain possession of and to withdraw client funds or securities maintained with a custodian. Through at least December 2015, Ascension did not engage an independent public accountant to conduct an annual surprise examination to verify the trust's assets. Since at least 2016 Ascension did do so.

Respondents concede that Ascension had what they describe as “technical” custody of the assets.[4] Respondents admit that through 2015 Ascension had “technical” custody of assets in the private fund and of at least some of the trust's assets and thus made “mistaken” statements in Forms ADV and in Form ADV brochures through February 2015 that it did not have custody of client assets.

Platt, listed in several Ascension Forms ADV filed between September 2005 and February 2015 as the adviser's CCO, has known Gooder for many years and owned and operated an investment adviser from 1980 to 2017, when he retired from business. He allowed Gooder to list his name as a convenience; Platt was not acquainted with the responsibilities of a CCO, and the two did not discuss it. He did not set up a compliance file, adopt or implement any written compliance policies and procedures, perform an annual review, or take any other action as Ascension's CCO.

Smith, listed in Ascension's Form ADV filed February 10, 2011, as the adviser's CCO, became acquainted with Gooder when both were associated with another investment firm. In 2009, when Smith was considering leaving that firm, Gooder suggested that he start his own firm and offered him shared office space rent-free until he became established. Smith began to pay rent in 2011 but found that he could not sustain it, and both made other arrangements for office space toward the end of 2011.

***4** At most, Gooder mentioned only briefly to Smith that he was naming him CCO: Gooder recalls telling Smith that he was naming him CCO, without, however, discussing the duties and responsibilities involved.[5]

Prior to the OCIE examination, Respondents did not maintain any ledgers reflecting the adviser's assets, liabilities, reserves, capital, income, and expense accounts; rather, Gooder “ran Ascension Asset Management out of a checkbook.” At year-end, he listed receipts and disbursements in different categories by hand on pieces of paper to provide to his accountant for tax purposes; he retained some of the papers.

Gooder did not read any IAA bulletins or Commission guidance regarding the custody rule that was published around the time of the 2010 amendment of the rule and did not have an understanding of the requirements of the rule.

B. Additional Findings of Fact

Evidence taken at the hearing focused on what sanctions, if any, are appropriate for the violations. In particular, Respondents introduced evidence to support their argument that their evidence of remediation obviated the need for any sanction and also argued that the evidence was insufficient to show ““willful” violations.

On November 2, 2015, OCIE notified Respondents of an impending examination, to start on December 1. Tr. 85-86; Resp. Ex. 2. Respondents immediately took steps that led to engaging compliance consultants on November 9 and 10. Tr. 86-89; Resp. Exs. 5, 7. The consultants immediately reviewed Ascension's operations, resulting in a compliance policies and procedures manual on November 25. Tr. 90-91; Div. Ex. 3. Respondents have taken a number of steps to remain in compliance. They engage in a monthly review with a compliance consultant or correctly appointed CCO to make sure that their operation is within the guidelines of the manual. Tr. 91-92, 97, 99. They engaged a PCAOB-registered accounting firm, Mazars, for surprise

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audits of the trust as of January 2016. Tr. 96, 111-13; Resp. Exs. 15-18. To assist with books and records, as of February 2016, Respondents hired a bookkeeper who prepares balance sheets, income statements, ledgers, and trial balances. Tr. 93, 114-16; Resp. Exs. 19-20. They responded to OCIE's June 16, 2016, deficiency letter on July 14, 2016. Div. Ex. 95; Resp. Ex. 4. As of and since that date, Ascension was in compliance with the custody rule and remediated the other deficiencies; currently it contracts with a consultant to be CCO. Tr. 95-99, 104-08, 118-19; Resp. Ex. 11.

Respondents spent over $100,000 on compliance - remediating the deficiencies and maintaining a compliance program - from November 2015 to date. [6] Tr. 119-20. Gooder now recognizes the importance of rules regulating investment advisers and intends to continue complying with them "enthusiastically" going forward. Tr. 120.

Ascension currently has assets under management of $160 million. Tr. 79. Most of the clients have been with Ascension or Gooder at his previous firm for ten to twenty years, some as long as forty years. Tr. 82. Ascension has lost no clients or assets under management as a result of the investigation and OIP, which were disclosed on Ascension's Forms ADV. Tr. 118.

III. CONCLUSIONS OF LAW

***5** As concluded in the Summary Disposition Order, Ascension willfully violated and Gooder caused Ascension's violations of Section 206(4) of the Advisers Act and Rules 206(4)-7 and 206(4)-2 thereunder; Ascension violated and Gooder caused Ascension's violations of Section 204 of the Advisers Act and Rule 204-2 thereunder; and Ascension and Gooder willfully violated Section 207 of the Advisers Act. These conclusions are adopted and incorporated herein.

Respondents argue that their conduct was not reckless, but merely negligent, and thus cannot be "willful," citing *Robare Group v. SEC*, 922 F.3d 468, 480 (D.C. Cir. 2019). The conclusion in the Summary Disposition Order that the conduct was reckless will not be revisited. A fiduciary who had decades of industry experience and who owned and controlled Ascension, Gooder failed to remain informed about compliance requirements - never attending IAA training events, reading IAA bulletins, visiting the Commission's website or otherwise obtaining Commission guidance on investment advisory compliance issues - and designated Platt and Smith as figurehead CCOs who would not undertake any actual compliance responsibilities. This shows that Respondents' conduct was at least reckless, amounting to scienter, and therefore willful. *See id.* at 479. No new evidence has been introduced to revisit that conclusion.

IV. SANCTIONS

The Division requests cease-and-desist orders, an independent compliance monitor, a civil penalty, and censures. As discussed below, a $50,000 civil penalty and censures will be ordered.

A. Sanction Considerations

In determining sanctions, the Commission considers such factors as:

> the egregiousness of the [respondent's] actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the sincerity of the [respondent's] assurances against future violations, the [respondent's] recognition of the wrongful nature of his conduct, and the likelihood that the [respondent's] occupation will present opportunities for future violations.

Steadman v. SEC, 603 F.2d 1126, 1140 (5th Cir. 1979) (quoting *SEC v. Blatt*, 583 F.2d 1325, 1334 n.29 (5th Cir. 1978)), *aff'd on other grounds*, 450 U.S. 91 (1981). The Commission also considers the age of the violation and the degree of harm to investors

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and the marketplace resulting from the violation. *Marshall E. Melton*, Exchange Act Release No. 48228, 2003 SEC LEXIS 1767, at *4-5 (July 25, 2003). Additionally, the Commission considers the extent to which the sanction will have a deterrent effect. *Schield Mgmt. Co.*, Exchange Act Release No. 53201, 2006 SEC LEXIS 195, at *35 & n.46 (Jan. 31, 2006). As the Commission has often emphasized, the public interest determination extends to the public-at-large, the welfare of investors as a class, and standards of conduct in the securities business generally. *See Christopher A. Lowry*, Investment Company Act Release No. 2052, 2002 SEC LEXIS 2346, at *20 (Aug. 30, 2002), *pet. denied*, 340 F.3d 501 (8th Cir. 2003); *Arthur Lipper Corp.*, Exchange Act Release No. 11773, 1975 SEC LEXIS 527, at *52 (Oct. 24, 1975). The amount of a sanction depends on the facts of each case and the value of the sanction in preventing a recurrence. *See Leo Glassman*, Exchange Act Release No. 11929, 1975 SEC LEXIS 111, at *7 (Dec. 16, 1975).

B. Cease and Desist

***6** Advisers Act Section 203(k) authorizes the Commission to issue a cease-and-desist order against a person who "is violating, has violated, or is about to violate" any provision of the Advisers Act or rules thereunder or who "is, was, or would be a cause of the violation" and "in addition . . . require such person to comply, or take steps to effect compliance, with such provision . . . upon such terms and conditions and within such time as the Commission may specify." 15 U.S.C. § 80b-3(k)(1). Whether there is a reasonable likelihood of such violations in the future must be considered. *See KPMG Peat Marwick LLP*, Exchange Act Release No. 43862, 2001 SEC LEXIS 98, at *101 (Jan. 19, 2001), *pet. denied*, 289 F.3d 109 (D.C. Cir. 2002). Such a showing is "significantly less than that required for an injunction." *Id*. at *114. In determining whether a cease-and-desist order is appropriate, the Commission considers the *Steadman* factors quoted above, as well as the recency of the violation, the degree of harm to investors or the marketplace, and the combination of sanctions against the respondent. *See WHX Corp. v. SEC*, 362 F.3d 854, 859-61 (D.C. Cir. 2004); *KPMG*, 2001 SEC LEXIS 98, at *116.

The violations were recurrent for ten years but ended four years ago, followed by a period of affirmative compliance. Respondents have recognized the wrongful nature of their conduct and given assurances against future violations. They acknowledged the deficiencies in their past conduct in words and action. While the Division argues that they may revert to their previous misconduct unless subject to a cease-and-desist order and monitoring, Respondents' claim to "enthusiastically" embrace compliance is made more credible by their affirmative compliance since November 2015. Thus, a cease-and-desist order will not be issued, and consequently the Division's request that Ascension be ordered to retain an independent compliance monitor for three years will not be granted.[7] Further, while such monitors have been ordered in settled proceedings, the undersigned is unaware of any litigated case in which the Commission itself has ordered a respondent to retain a compliance monitor.[8]

C. Civil Money Penalty

The Division requests that Respondents be ordered to pay a second-tier penalty of $50,000. Sections 203(i) of the Advisers Act and 9(d) of the Investment Company Act authorize the Commission to impose civil money penalties for willful violations of those Acts or rules thereunder. In considering whether a penalty is in the public interest, the Commission may consider six factors: (1) fraud or deliberate or reckless disregard of a regulatory requirement; (2) harm to others; (3) unjust enrichment; (4) previous violations; (5) deterrence; and (6) such other matters as justice may require. *See* 15 U.S.C. §§ 80b-3(1)(3), 80a-9(d)(3); *see, e.g.*, *Anthony Fields, CPA*, Securities Act of 1933 Release No. 9727, 2015 SEC LEXIS 662, at *101-02 (Feb. 20, 2015).

***7** Harm to others and previous violations are absent from the instant case. While the Division argues that Smith was embarrassed by having to explain it to his employer, he did not suffer financial harm, there is no evidence of harm to Respondents' clients, and none was alleged. However, the violations involved a reckless disregard of a regulatory requirement and resulted in unjust enrichment. Respondents argue that there was no unjust enrichment because they received no additional moneys, while the Division points to the expenses that Respondents avoided for over ten years by not paying for compliance services, which cost them $100,000 during the four years after November 2015. The undersigned construes the savings as a form of unjust enrichment for the purpose of the penalty analysis. Deterrence also requires penalties for the violations.

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Penalties in addition to the other sanctions ordered are in the public interest. Because Respondents' conduct was reckless, second-tier penalties are appropriate. 15 U.S.C. §§ 80b-3(i)(2)(B), 80a-9(d)(2)(B); *see SEC v. M&A W., Inc.*, 538 F.3d 1043, 1054 (9th Cir. 2008) ("[T]he imposition of second-tier penalties requires an assessment of scienter."). Pursuant to Sections 203(i)(2) of the Advisers Act and 9(d)(2) of the Investment Company Act, for each violative act or omission during the period of violation within the five-year statute of limitations through November 2, 2015, the maximum second-tier penalty for each violation for a natural person is $80,000 and for any other person is $400,000. 17 C.F.R. § 201.1001(a) & tbl. I. For violations after November 2, 2015, the maximum second-tier penalty for each violation for a natural person is $96,384 and for any other person is $481,920. 17 C.F.R. § 201.1001(b); Adjustments to Civil Monetary Penalty Amounts, 85 Fed. Reg. 1833, 1834 (Jan. 13, 2020).

The provisions, like most civil penalty statutes, leave the precise unit of violation undefined. *See* Colin S. Diver, *The Assessment and Mitigation of Civil Money Penalties by Federal Administrative Agencies*, 79 Colum. L. Rev. 1435, 1440-41 (1979).

The events at issue will be considered as one course of action, and the requested $50,000 penalty will be imposed jointly and severally on Ascension and Gooder. Combined with the other sanction ordered, this penalty is in the public interest.

D. Censure

Advisers Act Section 203(e) and (f) authorizes the Commission to censure an investment adviser or associated person who "has willfully made or caused to be made in any application for registration or report required to be filed with the Commission under [the Advisers Act] . . . any statement which was at the time and in light of the circumstances under which it was made false or misleading with respect to any material fact, or has omitted to state in any such application or report any material fact which is required to be stated therein." 15 U.S.C. § 80b-3(e)(1), (f). The statute also authorizes the Commission to censure an investment adviser or associated person who has willfully violated any provision of the Advisers Act or rules thereunder. *Id.* § 80b-3(e)(5), (f). The Division requests that Respondents be censured. In combination with the other sanction ordered, censures for Respondents' willful violations are in the public interest. The censures, like the civil penalty, are properly calibrated to punish Respondents for their misconduct and discourage future violations without a need for a cease-and-desist order or an independent monitor. *See Monetta Fin. Servs., Inc.*, Advisers Act Release No. 2438, 2005 SEC LEXIS 2491, at *7-8 (Oct. 4, 2005) (imposing censure and a civil monetary penalty but no cease-and-desist order after weighing the need for deterrence against mitigating factors).

V. RECORD CERTIFICATION

***8** Pursuant to Rule 351(b) of the Commission's Rules of Practice, 17 C.F.R. § 201.351(b), it is certified that the record includes the items set forth in the record index issued by the Secretary of the Commission on January 30, 2020.

VI. ORDER

IT IS ORDERED that, pursuant to Sections 203(i) of the Investment Advisers Act of 1940 and 9(d) of the Investment Company Act of 1940, Ascension Asset Management, LLC, and Grenville M. Gooder, Jr., jointly and severally, PAY A CIVIL MONEY PENALTY of $50,000.

IT IS FURTHER ORDERED that, pursuant to Section 203(e) and (f) of the Investment Advisers Act of 1940, Ascension Asset Management, LLC, IS CENSURED for violating Sections 206(4) and 207 of the Investment Advisers Act of 1940 and Rules 206(4)-7 and 206(4)-2 thereunder; and Grenville M. Gooder, Jr., IS CENSURED for violating Section 207 of the Investment Advisers Act of 1940.

Payment of civil penalties shall be made no later than twenty-one days following the day this Initial Decision becomes final, unless the Commission directs otherwise. Payment shall be made in one of the following ways: (1) transmitted electronically

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to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request; (2) direct payments from a bank account via Pay.gov through the SEC website at http://www.sec.gov/ofm; or (3) by certified check, United States postal money order, bank cashier's check, wire transfer, or bank money order, payable to the Securities and Exchange Commission.

Any payment by certified check, United States postal money order, bank cashier's check, wire transfer, or bank money order shall include a cover letter identifying the Respondent[s] and Administrative Proceeding No. 3-19024, and shall be delivered to: Enterprise Services Center, Accounts Receivable Branch, HQ Bldg., Room 181, AMZ-341, 6500 South MacArthur Blvd., Oklahoma City, Oklahoma 73169. A copy of the cover letter and instrument of payment shall be sent to the Commission's Division of Enforcement, directed to the attention of counsel of record.

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

***9** Carol Fox Foelak
Administrative Law Judge

Served by email on all parties.

1 Nicholas A. Pilgrim, who previously appeared for the Division, withdrew his appearance on August 9, 2019, and left the Commission's employ on that date.

2 Citations to the transcript will be noted as "Tr. ___." Citations to exhibits offered by the Division and by Respondents will be noted as "Div. Ex. ___" and "Resp. Ex. ___," respectively.

3 These steps were required as of March 12, 2010. *See* Custody of Funds or Securities of Clients by Investment Advisers, 75 Fed. Reg. 1456 (Jan. 11, 2010) (amending Rule 206(4)-2, effective Mar. 12, 2010).

4 This appears to refer to the definition of custody in Rule 206(4)-2(d)(2): "*Custody* means holding, directly or indirectly, client funds or securities, *or having any authority to obtain possession of them* . . . includ [ing] . . . (ii) any arrangement . . . under which you are authorized or permitted to withdraw client funds or securities maintained with a custodian upon your instruction to the custodian." (second emphasis added; "*Custody*" is italicized in the original). The definition of custody was added in 2003 (then numbered as Rule 206(4)-2(c)(1)). *See* Custody of Funds or Securities of Clients by Investment Advisers, 68 Fed. Reg. 56692-93, 56701 (Oct. 1, 2003) (amending Rule 206(4)-2, effective Nov. 5, 2003).

5 Weighing all the evidence, including Smith's testimony at the hearing, this finding will not be disturbed. As noted in the Summary Disposition Order, Smith testified in a June 2019 deposition that Gooder never talked to him about being CCO and that he was unaware he had been listed as CCO in the February 2011 Form ADV until Commission staff showed him a copy in 2017. Smith reiterated this at the September 9, 2019, hearing. Tr. 46-49. He also testified that he had been under great financial stress, was working a second job seven nights a week, and was sleep deprived. Tr. 47, 53-56. In the June 2019 deposition he testified that for those reasons, his "recollection of [the 2011] time frame is very fuzzy at best."

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Tr. 56-57. Smith has been inconvenienced by the investigation of Respondents in that he had to explain it to his employer (and to travel to the hearing on his wedding anniversary) but has not been demoted or lost any salary. Tr. 49-50, 57.

6 This sum does not include fees spent responding to the investigation and in this proceeding. Tr. 120.

7 The Division also cites Advisers Act Section 203(e), which authorizes the Commission to "place limitations on the activities, functions, or operations" of an investment adviser if "in the public interest" in support of its request that an independent monitor be ordered. 15 U.S.C. § 80b-3(e). In light of the conclusion that the likelihood of future violation is low, it is not in the public interest to impose the expense of an independent monitor on Respondents.

8 There was one litigated case, which the Division cites, in which an administrative law judge ordered a compliance monitor, and based on the request of the parties to declare the decision final on an expedited basis, the Commission did so. *Ernst & Young LLP*, Initial Decision Release No. 249, 2004 SEC LEXIS 831, at *173-78, *182-83 (A.L.J. Apr. 16, 2004), *finality order*, Securities Act of 1933 Release No. 8413, 2004 SEC LEXIS 885 (Apr. 26, 2004).

Release No. 1400 (S.E.C. Release No.), Release No. ID - 1400, 2020 WL 1699565

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Release No. 3436 (S.E.C. Release No.), Release No. 67479, Release No. 34-67479, Release No. IA - 3436, 104 S.E.C. Docket 966, 2012 WL 2952236

S.E.C. Release No.
Securities Exchange Act of 1934
Investment Advisers Act of 1940

SECURITIES AND EXCHANGE COMMISSION (S.E.C.)

IN THE MATTER OF CHARLES L. RIZZO AND GINA M. HORNBOGEN, RESPONDENTS.

Administrative Proceeding File No. 3-14641
July 20, 2012

SUMMARY

The Securities and Exchange Commission (SEC) accepted the joint offer of settlement submitted by Charles L. Rizzo and Gina M. Hornbogen. The Commission alleged that, among other things, the parties failed to reasonably supervise Steven Salutric, an investment adviser who misappropriated $7 million from clients, failed to investigate several indications of misconduct, and did nothing to contact clients who may have been involved or follow up on any indications of fraud, in violation of Section 203(e) of the Investment Advisers Act of 1940. The Commission barred the parties from associating in a supervisory capacity with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization, with reapplication subject to certain conditions, were ordered to pay disgorgement, prejudgment interests, and civil monetary penalties to be paid into a Fair Fund to be distributed by the Commission.

REGULATION
17 C.F.R.275

ORDER MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS PURSUANT TO SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940 AND SECTION 15(b)(6) OF THE SECURITIES EXCHANGE ACT OF 1934

I.

***1** On November 28, 2011, the Securities and Exchange Commission ("Commission") instituted proceedings pursuant to Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") and Section 15(b)(6) of the Securities Exchange Act of 1934 ("Exchange Act") against Charles L. Rizzo ("Rizzo") and Gina M. Hornbogen ("Hornbogen") (collectively, "Respondents").

II.

Respondents have submitted a joint Offer of Settlement ("Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and over the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Making Findings and Imposing Remedial Sanctions pursuant to Section 203(f) of the Investment Advisers Act of 1940 and Section 15(b)(6) of the Securities Exchange Act of 1934 ("Order"), as set forth below.

III.

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On the basis of this Order and Respondents' Offers, the Commission finds that:

A. SUMMARY

This matter concerns the failure of Charles L. Rizzo and Gina M. Hornbogen (collectively, "Respondents") reasonably to supervise Steven Salutric ("Salutric"), who, while acting as an investment advisor, misappropriated $7 million from fifteen clients. Respondents failed to investigate numerous serious red flags indicating misconduct while permitting Salutric's continued access to his victims' accounts. In 2004, Respondents were alerted to numerous suspicious transactions in Salutric client accounts, including a forged client signature. Rizzo had concerns that Salutric might be operating a Ponzi scheme but did nothing to investigate the matter. Moreover, Respondents were advised by the firm's attorney to contact all clients whose accounts contained the suspicious transactions, but this advice was ignored. Respondents did virtually nothing to follow up on these red flags or numerous additional indications of fraud between 2004 and 2009, permitting Salutric's fraud to continue.

B. RESPONDENTS

1. Charles L. Rizzo. Rizzo co-founded Results One Financial, LLC ("Results One"), a registered investment adviser, in 2000 in Elmhurst, Illinois. Rizzo was a director and 35% equity owner of the firm until it dissolved in 2010. Rizzo had supervisory responsibility over Steven Salutric from 2002 through 2009. Rizzo is currently a principal of RH Financial Group, LLC, a registered investment adviser located in Oak Brook, Illinois. Rizzo holds Series 7, 24, and 63 licenses and has been a registered representative of a broker-dealer since 1996. Rizzo, age 61, is a resident of Oak Brook, Illinois.

***2** 2. Gina M. Hornbogen. Hornbogen joined Results One in 2000 and served as the firm's chief compliance officer from 2004 until 2010. Hornbogen also became a director and 2.5% equity partner of the firm in 2008. Hornbogen had supervisory responsibility over Steven Salutric from October 2004 through 2009. Hornbogen is currently a principal of RH Financial Group, LLC. Hornbogen holds Series 6, 7, 24, 63, and 66 licenses and has been a registered representative of a broker-dealer since 2001. Hornbogen, age 37, is a resident of Carol Stream, Illinois. Throughout the time of the conduct described herein, Rizzo and Hornbogen were associated with broker-dealers including Waterstone Financial, Inc., Questar Capital Corp., and most recently American Portfolios Financial Services, Inc. Rizzo and Hornbogen are currently associated with a broker-dealer.

C. OTHER RELEVANT ENTITIES AND INDIVIDUALS

3. Results One Financial, LLC. Results One was an Illinois Limited Liability Company located in Elmhurst, Illinois and was registered with the Commission as an investment adviser from 2000 until early 2010. In early 2010, Results One dissolved as a corporate entity. In early 2010, Results One withdrew its registration as an investment adviser. Rizzo and Hornbogen then formed a new firm, RH Financial Group, LLC, a registered investment adviser that reported in its most recent Form ADV filed with the Commission that it had approximately $150 million in regulatory assets under management.

4. Steven Salutric. Salutric, age 51, is a resident of Carol Stream, Illinois. In 2000, Salutric co-founded Results One along with Rizzo and others. Salutric was a principal of Results One until early 2010. Salutric performed investment advisory services for Results One clients. Salutric was also a certified public accountant and performed accounting and tax services for Results One clients. On January 8, 2010, the Commission filed an emergency ex parte action against Salutric, seeking a temporary restraining order and preliminary and permanent injunctions against Salutric, alleging violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder and Sections 206(1) and 206(2) of the Advisers Act. SEC v. Salutric, 10-cv-1115 (N.D. Ill.) (J. Dow). In its complaint, the Commission alleged that Salutric misappropriated millions of dollars from his advisory clients at Results One. On January 8, 2010, the District Court granted the emergency relief sought by the Commission, including a temporary restraining order. On August 5, 2010, the Commission issued an Order Instituting Proceedings, pursuant to Section 203(f) of the Advisers Act, against Salutric based on a July 14, 2010 entry of a permanent injunction against him in the District Court

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action. On September 10, 2010, Chief Administrative Law Judge Brenda P. Murray entered an order, pursuant to Section 203(f) of the Advisers Act, that Salutric is barred from association with any investment adviser.

D. FACTS

Salutric misappropriated $7 million from his clients.

***3** 5. From 2002 through 2009, Salutric misappropriated approximately $7 million from fifteen advisory clients at Results One. About $2.3 million of this amount was misappropriated from 2007 through 2009.

6. Results One client funds and securities were held by Charles Schwab & Co. ("Schwab"), which served as custodian of client funds. Pursuant to investment advisory agreements with clients, Results One personnel had authority to trade in clients' accounts without prior approval.

7. However, Results One personnel did not have authority to withdraw funds from the client accounts. Moreover, Schwab's internal procedures did not permit disbursements of client funds to third parties unless the client signed a wire transfer request.

8. In order to misappropriate client funds, Salutric forged client signatures on wire transfer requests, directing Schwab to wire funds from the clients' accounts to entities linked to Salutric. On occasions when his clients' accounts lacked sufficient funds, Salutric liquidated client securities to generate cash. The clients were not aware of, and did not approve of, Salutric's withdrawals.

9. Salutric transferred stolen client funds to entities under his control, to business ventures with which he was involved, and to some of his accounting clients. A number of these transfers were purportedly loans to the recipients of the funds.

10. Salutric's fraud finally ceased in December 2009, when one of his advisory clients discovered that almost $600,000 was missing from his account. This client's attorney brought this issue to the attention of Schwab and Results One. Shortly thereafter, Salutric admitted to Results One that he had forged this client's signature on wire transfer requests.

11. From at least 2002 until December 2009, Rizzo had supervisory responsibility over Salutric in Salutric's capacity as advisory representative.

12. From at least 2004 until December 2009, Hornbogen had supervisory responsibility over Salutric in Salutric's capacity as advisory representative.

13. From at least 2002 until December 2009, Rizzo and Hornbogen failed reasonably to investigate or otherwise respond to numerous red flags indicating possible violations by Salutric.

From 2002 through early 2004, Rizzo and Hornbogen failed reasonably to respond to suspicious patterns of Salutric client withdrawals.

14. Nearly every business day from late 2002 through December 2009, Results One operations department personnel sent Rizzo and Hornbogen emails listing all "large withdrawals" and "large deposits" in client accounts the previous day.

15. These emails provided notice to Rizzo and Hornbogen of significant client withdrawals, including most, if not all, of the funds Salutric misappropriated from his clients.

16. These emails provided notice to Rizzo and Hornbogen of suspicious amounts and patterns of withdrawals from the accounts of Salutric's clients.

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17. For example, during the three months from April 2003 through June 2003, Rizzo and Hornbogen received emails revealing over $1.9 million in withdrawals, most of which were over $100,000. Six hundred thousand dollars of these withdrawals were made from the account of a single client, and another $500,000 in withdrawals was made from the account of one other client.

***4** 18. In another instance, Rizzo and Hornbogen received an email showing over $900,000 in deposits into the accounts of four Salutric clients on a single day, June 12, 2003. Then, just four days later, Rizzo and Hornbogen received emails revealing that most of the $900,000 was wired out of the four clients' accounts.

19. On occasion, Rizzo and Hornbogen asked Salutric to explain large withdrawals from his clients' accounts. However, they routinely accepted, without further inquiry, whatever explanation Salutric gave them. At no point did Rizzo and Hornbogen contact Salutric's clients about the suspicious withdrawals.

20. Had Rizzo and Hornbogen contacted Salutric's defrauded clients regarding the suspicious withdrawals, Rizzo and Hornbogen likely would have discovered that these clients were unaware of the transactions and had not authorized them.

Schwab warned Rizzo and Hornbogen that the signature of a Salutric client had been forged.

21. In April 2004, Schwab received a $30,000 wire transfer request for the account of a Salutric client ("Client A"). Schwab personnel noticed that Client A's signature on this request did not match his signature on other documents in Client A's file.

22. Schwab personnel called Jason Helms ("Helms"), the head of operations at Results One. They told Helms they were concerned that Client A's signature was not authentic. Helms relayed the warning on to Hornbogen.

23. In the meantime, Schwab personnel contacted Client A. He informed Schwab that his signature had been forged on the letter of authorization and that he had been unaware of the withdrawal, although he subsequently ratified the transaction. Schwab personnel telephoned Rizzo and alerted him to Client A's statements.

24. Schwab personnel told Rizzo that he needed to investigate this issue to determine who forged Client A's signature.

25. Neither Rizzo nor Hornbogen ever called Client A to ask about the forged signature or the $30,000 transfer.

In June 2004, Schwab informed Rizzo and Hornbogen of $2.5 million in suspicious transactions which indicated possible fraud by Salutric.

26. On June 8, 2004, Rizzo and Salutric spoke by telephone with Schwab personnel regarding $2.5 million in suspicious transfers among the Schwab accounts of Salutric and several of his clients. The suspicious transfers took place between March 2003 and June 2004. Some of the transactions were transfers between Salutric's account and several of his clients' accounts. Others were transfers between accounts of Salutric clients. Rizzo later informed Hornbogen as to the substance of this conversation.

27. Earlier, in April and May 2004, Schwab personnel had discussed some or all of these suspicious transfers with Rizzo in other telephone conversations.

28. During the June 8, 2004 telephone call, Salutric stated that the transfers were loans and that the documentation for the loans was at his home, not in Results One's offices.

***5** 29. During the June 8, 2004 call, Salutric stated that the transactions were none of Schwab's business because they were simply loans between clients.

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30. Schwab personnel responded by stating that Rizzo and Salutric had a fiduciary duty to all Results One clients and that they had an obligation to act in the best interest of their clients.

31. Schwab insisted that Salutric provide detailed supporting documentation for all of the transactions discussed during this phone call.

32. During this phone call, Rizzo told Schwab personnel that he was considering resigning from Results One because he was worried about these transactions. Schwab personnel responded that Rizzo should be worried about these transactions, as they could indicate fraudulent activity by Salutric.

33. Rizzo took notes during this phone call. On the second page of his notes, Rizzo wrote: "Concerns: (1) Making & receiving loans from clients (PONZI Scheme)."

34. Rizzo did not contact the clients whose accounts were flagged by Schwab regarding the suspicious transfers.

35. In a June 15, 2004 telephone call, Rizzo told Schwab personnel that he was conducting an internal investigation into the transactions flagged by Schwab and that the investigation would include contacting all the clients involved.

36. Rizzo did not conduct an internal investigation into the transactions flagged by Schwab or contact any of the relevant clients.

Schwab demanded that Rizzo and Hornbogen no longer permit Salutric to manage client accounts held by Schwab.

37. On July 19, 2004, Rizzo and Hornbogen participated in a telephone call with Schwab personnel.

38. Schwab personnel told Rizzo and Hornbogen that because of the suspicious transactions involving Salutric, Schwab was no longer comfortable doing business with Salutric.

39. Schwab personnel directed Rizzo and Hornbogen to remove Salutric as an authorized user of Schwab's trading platform.

40. Schwab personnel demanded that Rizzo and Hornbogen ensure Salutric no longer managed client accounts held by Schwab.

41. Schwab personnel added that if they ever found out that Salutric was managing any Schwab clients, the entire relationship between Schwab and Results One would be at risk.

42. Rizzo said that he understood Schwab's instructions and would follow them.

43. Rizzo also said that Results One was considering sending letters to all the clients involved in the suspicious transactions flagged by Schwab.

44. Results One, however, did not send letters to the clients involved in the transactions.

Rizzo deceived Schwab by causing Schwab personnel to believe that Results One was complying with their instructions.

45. Removing Salutric as an authorized user of Schwab's trading platform had little practical effect on his ability to manage client accounts at Schwab.

46. Specifically, Results One's procedures required advisory representatives to submit transaction requests to the operations department, primarily Helms, who would then submit the transactions to Schwab under his name - not the representative's name.

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***6** 47. Rizzo and Hornbogen were aware of this procedure. Schwab was not.

48. Rizzo submitted Schwab paperwork removing Salutric as an authorized user, knowing that this would have little effect on Salutric's management of Schwab accounts.

49. Despite Rizzo's assurances that Schwab's instructions would be followed, Rizzo and Hornbogen permitted Salutric to continue managing accounts held by Schwab.

50. After July 2004, Rizzo and Hornbogen permitted Salutric to continue routing instructions for his clients' accounts through Results One's operations department.

Rizzo and Hornbogen ignored their attorney's advice to contact all clients whose accounts had been flagged by Schwab.

51. On July 20, 2004, Rizzo and Hornbogen met with the firm's securities counsel ("Attorney A"). Rizzo and Hornbogen had previously sent Attorney A the supporting documentation that Salutric provided to Schwab on June 24, 2004.

52. During this meeting, Attorney A advised Rizzo and Hornbogen that one of the transactions flagged by Schwab "looked like 'borrowing from Peter to pay Paul.'"

53. Attorney A also advised Rizzo and Hornbogen that Results One should not engage in this type of transactions in the future.

54. Attorney A also advised Rizzo and Hornbogen to "send a letter to clients regarding these transactions making sure they agree and understand the transactions and realize that Results One did not play any role in these transactions."

55. Rizzo and Hornbogen never sent any letters to these clients or made any other attempt to verify that the clients agreed with and understood the transactions.

56. Had Rizzo and Hornbogen contacted the clients, they likely would have learned that the clients were unaware of, and had not authorized, the transactions flagged by Schwab.

From October 2004 through 2009, Rizzo and Hornbogen failed to respond to still more suspicious withdrawals from accounts of Salutric clients.

57. From October 2004 through 2009, Rizzo and Hornbogen continued to receive emails notifying them of large, suspicious withdrawals from the accounts of Salutric clients.

58. These emails alerted Rizzo and Hornbogen to virtually all the instances when Salutric misappropriated funds from his clients' accounts between October 2004 and late 2009.

59. For example, between October and December 2004, Rizzo and Hornbogen received emails alerting them to nearly $1.4 million in large withdrawals from the account of a single Salutric client—including withdrawals of $500,000 and $308,000. Despite these warnings, Rizzo and Hornbogen did not contact the client to inquire about the withdrawals. As a result, Rizzo and Hornbogen did not discover that Salutric had misappropriated the funds from the client's account.

From July 2006 through October 2006, Hornbogen failed reasonably to respond to red flags concerning IRA accounts of two Salutric clients.

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***7** 60. From December 2005 through October 2006, Schwab sent over thirty emails to Results One about two delinquent $100,000 loans previously made from Individual Retirement Accounts ("IRA") of two Salutric advisory clients ("Client B and Client C"). The loans had been made to a real estate company ("Company A"). Company A was one of Salutric's accounting clients. The $100,000 loans had matured the previous year, in July 2004.

61. The loans were required to be repaid into the clients' IRA accounts at Schwab when they matured. Otherwise, the transactions would likely be considered distributions for tax purposes, and the clients would be likely to incur liability for taxes and early withdrawal penalties. Schwab sought answers from Results One as to why these loans had not been repaid.

62. In reality, Salutric had fraudulently diverted the $200,000 to Company A without the knowledge or approval of Client B or Client C. Salutric falsely represented to Company A that his clients had approved the purported loans.

63. Moreover, the $200,000 had already been repaid by Company A; Salutric had diverted the $200,000 paid by Company A to a third party as yet another purported loan.

64. From July 2006 through October 2006, Salutric provided Hornbogen with various incredible excuses and unfulfilled promises that the purported loans would be repaid soon.

65. Hornbogen repeatedly accepted, without further inquiry, Salutric's increasingly incredible excuses as to why the loans had not been repaid, despite mounting indications that he was lying to stall for time.

66. In late August 2006, Salutric provided Hornbogen with a copy of a check dated August 3, 2006 from Company A to Client B. Salutric told Hornbogen that he would mail the original of the check to Schwab.

67. In fact, the copy Salutric gave Hornbogen in August 2006 was a doctored version of a May 2006 check that Company A had written to Client B to repay the purported loan from Client B's IRA account. Company A had given the check to Salutric in May 2006. Instead of forwarding the check to Client B, however, Salutric forged Client B's endorsement on the check and diverted the money to another party.

68. Hornbogen emailed a copy of the check to Schwab, promising that the original of the check would be overnighted to Schwab so it could be deposited into Client B's account.

69. Hornbogen later discovered that Salutric did not send the check to Schwab, but she did nothing to follow up on the issue.

70. Salutric also falsely told Hornbogen that Client B and Client C had both received loan repayment checks directly from Company A and that they had mailed the checks to Results One. Salutric later falsely told Hornbogen that both of these checks had been lost in the mail. Hornbogen did not follow up on this suspicious explanation by Salutric.

71. Had Hornbogen contacted Client B, Client C, or Company A, she likely would have discovered that the $200,000 from Client B and Client C, along with another $1.3 million belonging to seven other Salutric clients, had been fraudulently diverted to Company A.

Hornbogen concealed Salutric's involvement in these transactions.

***8** 72. From July 2006 through October 2006, Hornbogen acted as a buffer between Schwab and Salutric when answering Schwab's questions about the purported loans from Client B and Client C to Company A.

73. Whenever Schwab inquired about the purported overdue loans, Hornbogen relayed the question to Salutric and then passed Salutric's response on to Schwab by email.

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74. Hornbogen knew that Salutric was the person managing these advisory clients' IRA accounts, and she knew that Company A was Salutric's accounting client.

75. Hornbogen thus knew Salutric was the only person in the office who had communications with the individuals on both sides of the purported loans.

76. Hornbogen also knew that Salutric was not supposed to be managing the accounts of Client B and Client C—Schwab had instructed Rizzo and Hornbogen that Salutric was no longer permitted to manage client accounts held by Schwab back in July 2004.

77. Throughout her email exchanges with Schwab, Hornbogen refrained from using Salutric's name. Instead, she referred only to “the partner in charge of this client” or “the partner in charge at my firm.”

78. Through her actions, Hornbogen concealed the fact that Salutric was still managing client accounts held by Schwab.

79. After October 2006, Rizzo and Hornbogen continued to receive emails from the Results One operations department notifying them of large withdrawals from the accounts of Salutric clients.

80. Rizzo and Hornbogen failed reasonably to respond to these emails.

Rizzo and Hornbogen failed reasonably to respond to indications that Salutric had serious financial problems.

81. During a September 2006 meeting, Salutric informed Rizzo that, due to difficulties in distributing a motion picture Salutric co-produced, Salutric and his partners were at risk of defaulting on a $2 million bank loan. During this meeting, Salutric told Rizzo that he might have to declare personal bankruptcy to resolve his debts related to this business venture.

82. In November and December 2006, over $1 million in checks drawn on Salutric's personal Schwab account were returned for insufficient funds. In January and February 2007, a total of $1.7 million in checks drawn on Salutric's Schwab account were returned for insufficient funds. Most of these bounced checks were written to Salutric's clients as personal loans.

83. Rizzo and Hornbogen knew about several of the checks Salutric bounced between November 2006 and February 2007.

84. Nevertheless, Rizzo and Hornbogen did not inquire into the bounced checks.

85. After February 2007, Rizzo and Hornbogen continued to receive emails from the Results One operations department notifying them of large withdrawals from the accounts of Salutric clients.

86. Rizzo and Hornbogen failed reasonably to respond to these emails.

Rizzo failed reasonably to respond to emails raising still more red flags about Salutric.

***9** 87. Rizzo failed reasonably to respond to emails indicating that Salutric had facilitated purported loans from his Results One advisory clients to his business partner and had engaged in undisclosed outside business activities and investments.

88. For example, in December 2007, Rizzo reviewed a July 2007 email from Salutric to his business partner in connection with a motion picture (“Partner A”) revealing that Salutric had facilitated $640,000 in purported loans from four of his advisory clients to Partner A.

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89. Rizzo never took any steps to investigate these transactions. Had Rizzo contacted any of the clients identified in the email, he likely would have learned that they were unaware of the transfers and had not approved the purported loans to Partner A.

90. In December 2008, Rizzo reviewed an email between Salutric and another business partner revealing that Salutric was the managing partner of a company called Celluloid Distribution, and that this entity had an investment in a business venture called The Word of Promise, also with Partner A.

91. This email also revealed that Celluloid Distribution had purportedly borrowed over $900,000 from one of Salutric's advisory clients. In reality, Salutric misappropriated this $900,000 from the client.

92. Salutric never disclosed his interests in Celluloid Distribution and The Word of Promise on his Results One code of ethics forms, as was required.

93. Rizzo took no steps to verify that Salutric's investments in Celluloid Distribution and The Word of Promise had been disclosed on Salutric's Results One code of ethics forms.

94. Rizzo never contacted the client from whom Salutric had misappropriated the $900,000 purportedly loaned to Celluloid Distribution.

95. Despite being made aware of the numerous serious indications of misconduct by Salutric between 2002 and 2009 described above, Rizzo and Hornbogen conducted virtually no investigation into these red flags, thus permitting Salutric's fraud to continue unhindered until December 2009, when he was finally caught. Had Rizzo and Hornbogen conducted a reasonable investigation into any of the red flags described above, they likely would have discovered Salutric's fraud long before December 2009.

E. VIOLATIONS

96. In connection with the conduct described above, Salutric violated Sections 206(1) and 206(2) of the Advisers Act, which prohibit fraudulent conduct by an investment adviser.

97. In connection with the conduct described above, Salutric violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in connection with any purchase or sale of security.

98. As a result of the conduct described above, Respondents Rizzo and Hornbogen failed reasonably to supervise Salutric, a person subject to their supervision within the meaning of Section 203(e) of the Advisers Act, with a view to preventing and detecting his violations of the federal securities laws.

F. CIVIL PENALTIES

***10** 99. Respondent Hornbogen has submitted sworn Statements of Financial Condition dated August 17, 2011 and April 25, 2012 and other evidence and has asserted her inability to pay a civil penalty.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the actions agreed to in Respondents' Joint Offer.

Accordingly, pursuant to Section 15(b)(6) of the Exchange Act and Section 203(f) of the Advisers Act, it is hereby ORDERED that:

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A. Respondents Rizzo and Hornbogen be, and hereby are barred from associating in a supervisory capacity with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization.

Any reapplication for association by any Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

B. Respondent Rizzo shall, within 15 days of the entry of this Order, shall pay disgorgement of $35,079, prejudgment interest of $7,731, and civil penalties of $130,000, to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600 or pursuant to 31 U.S.C. 3717. Such payment shall be: (A) made by wire transfer, United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) if paid by money order or check, such payment shall be hand-delivered or overnight mailed to Enterprise Services Center, HQ Bldg, Room 181, AMZ-341, 6500 South MacArthur Blvd, Oklahoma City, OK 73169; and (D) submitted under cover letter that identifies Charles L. Rizzo as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Robert J. Burson, Division of Enforcement, Securities and Exchange Commission, 175 W. Jackson Blvd., Suite 900, Chicago, IL, 60604.

C. Respondent Hornbogen shall pay disgorgement of $15,592, prejudgment interest of $3,467, and civil penalties of $25,000 (as well as post-order interest on any amounts not paid within 30 days), to the Securities and Exchange Commission. Payment shall be made in the following installments:
***11** (1) $10,000 within 30 days of the entry of this Order;

(2) $5,676, plus applicable post-order interest, within 180 days of the entry of this Order;

(3) $5,676, plus applicable post-order interest, within 360 days of the entry of this Order;

(4) $5,676, plus applicable post-order interest, within 540 days of the entry of this Order;

(5) $5,676, plus applicable post-order interest, within 720 days of the entry of this Order;

(6) $5,676, plus applicable post-order interest, within 900 days of the entry of this Order; and

(7) $5,679, plus applicable post-order interest, within three years of the entry of this Order.

If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of disgorgement, prejudgment interest, and civil penalties, plus any additional interest accrued pursuant to SEC Rule of Practice 600 or pursuant to 31 U.S.C. 3717, shall be due and payable immediately, without further application. Payments shall be: (A) made by wire transfer, United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) if paid by money order or check, such payment shall be hand-delivered or overnight mailed to Enterprise Services Center, HQ Bldg, Room 181, AMZ-341, 6500 South MacArthur Blvd, Oklahoma City, OK 73169; and (D) submitted under cover letter that identifies Gina M. Hornbogen as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Robert J. Burson, Division of Enforcement, Securities and Exchange Commission, 175 W. Jackson Blvd., Suite 900, Chicago, IL, 60604.

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D. Based upon Respondent Hornbogen's sworn representations in her Statements of Financial Condition dated August 17, 2011 and April 25, 2012 and other documents submitted to the Commission, the Commission is not imposing a penalty against Respondent Hornbogen greater than $25,000.

E. The Division of Enforcement ("Division") may, at any time following the entry of this Order, petition the Commission to: (1) reopen this matter to consider whether Respondent Hornbogen provided accurate and complete financial information at the time such representations were made; and (2) seek an order directing payment of the maximum civil penalty allowable under the law. No other issue shall be considered in connection with this petition other than whether the financial information provided by Respondent Hornbogen was fraudulent, misleading, inaccurate, or incomplete in any material respect. Respondent Hornbogen may not, by way of defense to any such petition: (1) contest the findings in this Order; (2) assert that payment of a penalty should not be ordered; (3) contest the imposition of the maximum penalty allowable under the law; or (4) assert any defense to liability or remedy, including, but not limited to, any statute of limitations defense.

***12** F. Pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended, a Fair Fund is created for the disgorgement, interest and/or penalties referenced in paragraphs B and C above. Regardless of whether any such Fair Fund distribution is made, amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondents agree that in any Related Investor Action, they shall not argue that they are entitled to, nor shall they benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondents' payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that they shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the United States Treasury or to a Fair Fund, as the Commission directs. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondents by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.
Elizabeth M. Murphy
Secretary

Release No. 3436 (S.E.C. Release No.), Release No. 67479, Release No. 34-67479, Release No. IA - 3436, 104 S.E.C. Docket 966, 2012 WL 2952236

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Release No. 1388 (S.E.C. Release No.), Release No. ID - 1388, 2019 WL 5513382

S.E.C. Release No.
Initial Decision

SECURITIES AND EXCHANGE COMMISSION (S.E.C.)

IN THE MATTER OF EUGENE TERRACCIANO

Administrative Proceeding File No. 3-18414
October 22, 2019

***1** APPEARANCES:
Nicholas Margida and Daniel J. Maher for the Division of Enforcement, Securities and Exchange Commission
Gregg J. Breitbart of Kaufman Dolowich & Voluck LLP, for Respondent Eugene Terracciano

BEFORE: Carol Fox Foelak, Administrative Law Judge

SUMMARY

This Initial Decision (ID) suspends Respondent Eugene Terracciano from the securities industry for twelve months.

I. INTRODUCTION

A. Procedural Background

The Securities and Exchange Commission instituted this proceeding with an Order Instituting Proceedings on March 28, 2018, pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934, 203(f) of the Investment Advisers Act of 1940, and 9(b) of the Investment Company Act of 1940. On July 6, 2018, pursuant to Terracciano's offer of settlement, the Commission made various findings of fact and conclusions of law, imposed a cease-and-desist order and civil money penalty, and ordered additional proceedings to determine what, if any, "remedial action is appropriate in the public interest." *Eugene Terracciano,* Exchange Act Release No. 83604, 2018 SEC LEXIS 1663, at *20 (Settlement Order). The procedures for the additional proceedings were set with the agreement of the parties. *Eugene Terracciano,* Admin. Proc. Release Nos. 6139, 2018 SEC LEXIS 2733 (A.L.J. Oct. 3, 2018); 6343, 2018 SEC LEXIS 3261 (Nov. 19, 2018); 6458, 2019 SEC LEXIS 178 (A.L.J. Feb. 14, 2019). Accordingly, the Division of Enforcement filed a motion for sanctions, Respondent filed an opposition, and the Division filed a reply. A hearing session, at which Respondent testified, exhibits were admitted into evidence, and the parties presented oral arguments, was held on March 26, 2019. [1]

The findings and conclusions in this ID are based on the record. Official notice pursuant to 17 C.F.R. § 201.323 is taken of the Commission's public official records and of Financial Industry Regulatory Authority, Inc. (FINRA), records as well. *See Joseph S. Amundsen,* Exchange Act Release No. 69406, 2013 SEC LEXIS 1148, at *1 n.1 (Apr. 18, 20*l*3), *pet. denied,*575 F. App'x 1 (D.C. Cir. 2014). Preponderance of the evidence was applied as the standard of proof. *See Steadman v. SEC,* 450 U.S. 91, 97-104 (1981). All arguments and proposed findings and conclusions that are inconsistent with this ID were considered and rejected.

B. Allegations and Arguments of the Parties

***2** The Division argues that Terracciano should be barred from the securities industry with the right to reapply after two years. Terracciano urges that a lesser sanction, such as a supervisory suspension in the range of twelve months, would be more appropriate in the public interest.

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II. FINDINGS OF FACT

For purposes of this ID and pursuant to the offer of settlement, the findings and facts set forth in the Settlement Order are deemed true and incorporated herein. As detailed in the Settlement Order, the proceeding involves anti-money laundering (AML) failures at Aegis Capital Corporation, a FINRA registered broker dealer and Commission registered investment adviser, by Terracciano, who was the firm's AML Compliance Officer (AML CO) from September 2013 to approximately September 2015. Despite red flags and even despite alerts from Aegis's clearing firm, Aegis failed to file Suspicious Activity Reports (SARs), as required by 31 C.F.R. § 1023.320, on hundreds of suspicious transactions during that period. At most, after being alerted by the clearing firm, Terracciano closed customer accounts after allowing their high-volume questionable transactions in low-priced securities to settle and after becoming aware that no one at Aegis was flagging such transactions despite their raising red flags spelled out in Aegis's written supervisory procedures. [2]

Terracciano was employed in the securities industry in a capacity requiring FINRA (or predecessor) registration starting in 1988. Resp. Ex. 1; Eugene William Terracciano BrokerCheck Report, *available at* http://brokercheck.finra.org (last visited Oct. 11, 2019). His first compliance-related position started in 1995. Tr. 19; Resp. Ex. 1; Terracciano BrokerCheck Report. His last such employment was with Merrill Lynch, Pierce, Fenner & Smith, with which he was registered from November 2015 to January 2017. Tr. 41-45; Resp. Ex. 1; Terracciano BrokerCheck Report. He was let go by Merrill as a result of the investigation that led to this proceeding. Tr. 42-45. He has been unemployed since January 2017. Tr. 17, 50. Since then, he has sought, fruitlessly, employment in the securities industry. Tr. 46-47. None of the positions for which he applied related to AML compliance. Tr. 46. He realizes that if he were barred from the securities industry, even with a right to reapply after a specific time, his career in the securities industry would be over, due to the disincentive to any firm to sponsor him for re-registration. [3] Tr. 49. If he were suspended for a fixed period, he would attempt to reenter the industry as a compliance officer. Tr. 50.

Terracciano initially joined Aegis as a director of compliance; when he was interviewed for the position, there was no mention of AML responsibilities. Tr. 22-23. Soon after his arrival at Aegis, he was asked by the Chief Compliance Officer to be AML CO, which he was reluctant to accept. Tr. 23-24. Eventually he yielded to the importunity of the Chief Compliance Officer, who promised support and training, which never materialized. Tr. 24-26, 31-32, 35-36. Terracciano knew that low-price securities, such as those for which SARs should have been filed, might be used in questionable ways. Tr. 53. Terracciano now realizes that actions that he thought sufficient at the time - closing accounts to stop the activity - were insufficient and not a substitute for filing SARs. Tr. 40. He would not now seek or accept a position with AML reporting responsibilities. Tr. 50. In view of the consequences that he experienced from unwillingly accepting the AML responsibilities at Aegis, his representation that he would not do so again is credible.

III. VIOLATIONS

***3** As stated in the Settlement Order, Terracciano willfully aided and abetted and caused violations by Aegis of Section 17(a) of the Exchange Act and Rule 17a-8 thereunder. Rule 17a-8 requires broker-dealers to comply with the reporting, recordkeeping, and record retention requirements of the Bank Secrecy Act, which include filing SARs, as required by 31 C.F.R. § 1023.320. 17 C.F.R. § 240.17a-8. Failing to file SARs, as required by 31 C.F.R. § 1023.320, is a violation of Exchange Act 17(a) and Rule 17a-8.

IV. SANCTION

The Division requests that Terracciano be barred from the securities industry with the right to reapply after two years, while Terracciano urges a lesser sanction, such as a twelvemonth supervisory suspension. A collateral suspension for a period of twelve months will be ordered. [4]

A. Sanction Considerations

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The Commission determines sanctions pursuant to a public interest standard. *See*15 U.S.C. §§ 78***o***(b)(4)(E), 6(A)(i); 80a-9(b)(3); 80b-3(e)(6), (f). The Commission considers factors including:

> the egregiousness of the defendant's actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the sincerity of the defendant's assurances against future violations, the defendant's recognition of the wrongful nature of his conduct, and the likelihood that the defendant's occupation will present opportunities for future violations.

Steadman v. SEC, 603 F.2d 1126, 1140 (5th Cir. 1979) (quoting *SEC v. Blatt,* 583 F.2d 1325, 1334 n.29 (5th Cir. 1978)), *aff'd on other grounds,*450 U.S. 91 (1981). The Commission also considers the age of the violation and the degree of harm to investors and the marketplace resulting from the violation. *Marshall E. Melton,* Advisers Act Release No. 2151, 2003 SEC LEXIS 1767, at *5 (July 25, 2003). Additionally, the Commission considers the extent to which the sanction will have a deterrent effect. *Schield Mgmt. Co.,* Exchange Act Release No. 53201, 2006 SEC LEXIS 195, at *35 &n.46 (Jan. 31, 2006).

B. Sanction

As shown by Terracciano's consent to the Settlement Order as well as his testimony at the hearing, he has recognized the wrongful nature of his conduct. His conduct was recurrent over a period of two years. The egregiousness was somewhat mitigated by his eventually closing accounts that engaged in suspicious transactions. Scienter is not an element of violation of Exchange Act Section 17(a) and rules. However, Terracciano's state of mind was at least negligent, if not reckless. His most recent occupation as a compliance officer in the securities industry, if he were allowed to continue it in the future, would present opportunities for future violations. This factor is mitigated by his credible representation that he would not accept a position involving AML responsibilities. The violation is relatively recent, having ended four years ago. It is not possible to quantify the *direct* harm to the marketplace, but, as the Commission has often emphasized, the public interest determination extends beyond consideration of the particular investors affected by a respondent's conduct to the public-at-large, the welfare of investors as a class, and standards of conduct in the securities business generally. *See Christopher A. Lowry,* Investment Company Act of 1940 Release No. 2052, 2002 SEC LEXIS 2346, at *20 (Aug. 30, 2002), *aff'd,*340 F.3d 501 (8th Cir. 2003); *Arthur Upper Corp.,* Exchange Act Release No. 11773, 1975 SEC LEXIS 527, at *52 (Oct. 24, 1975).[5] Weighing these factors in conjunction with the sanctions ordered in the Settlement Order, the sanction requested by the Division is too severe, but a limited supervisory suspension would not suffice.

***4** A limited supervisory suspension would permit Terracciano to work at a regulated entity under supervision and is insufficient as a sanction and as a deterrent. A "collateral" suspension from the industry is appropriate because record-keeping and reporting provisions apply in all elements of the securities industry, even if the violative conduct is limited to the professional capacity in which Terracciano was acting. *See John W. Lawton,* Advisers Act Release No. 3513, 2012 SEC LEXIS 3855, at *42-43 (Dec. 13, 2012), *vacated in part on other grounds,*Advisers Act Release No. 4402, 2016 SEC LEXIS 1926 (May 27, 2016).

V. RECORD CERTIFICATION

Pursuant to Rule 351(b) of the Commission's Rules of Practice, 17 C.F.R. § 201.351(b), it is certified that the record includes the items set forth in the record index issued by the Secretary of the Commission on May 8, 2019.

VI. ORDER

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IT IS ORDERED that, pursuant to Sections 15(b) of the Exchange Act and 203(f) of the Advisers Act, EUGENE TERRACCIANO IS SUSPENDED for a period of twelve months from associating with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization and from participating in an offering of penny stock. [6]

IT IS FURTHER ORDERED that, pursuant to Section 9(b) of the Investment Company Act OF 1940, EUGENE TERRACCIANO IS PROHIBITED for a period of twelve months from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter.

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

***5** Carol Fox Foelak
Administrative Law Judge

1 Citations to the transcript are noted as "Tr. __." Citations to exhibits offered by the Division and Respondent are noted as "Div. Ex. __" and "Resp. Ex. __," respectively.

2 The Settlement Order, 2018 SEC LEXIS 1663, at *708, noted that the written supervisory procedures specified these red flags:
i. There is a sudden spike in investor demand for, coupled with a rising price in, a thinly-traded or low-priced security;
ii. The issuer has been through several recent name changes, business combinations or recapitalizations, or the company's officers are also officers of numerous similar companies;
iii. The issuer's SEC filings are not current, are incomplete, or [are] nonexistent;
iv. The customer appears to be acting as an agent for an undisclosed principal, but declines or is reluctant, without legitimate commercial reasons, to provide information or is otherwise evasive regarding that person or entity;
v. The customer's account has wire transfers that have no apparent business purpose to or from a country identified as a money laundering risk or a bank secrecy haven; and
vi. The customer, for no apparent reason or in conjunction with other "red flags," engages in transactions involving certain types of securities, such as penny stocks … which although legitimate, have been used in connection with fraudulent schemes and money laundering activity.

3 The Commission has stated that when it "issues an order pursuant to an administrative proceeding which specifically provides that an application for re-entry may be made after a certain time, the applicant may apply directly to the Commission … [and] the Commission upon a proper showing will generally act favorably upon the application." *Applications for Relief from Disqualification,* Exchange Act Release No. 11267, 1975 SEC LEXIS 2166, at *4-5 (Feb. 26, 1975); *see also*17 C.F.R. §§ 201.193(a)(2), 200.30-4(a)(5). The application must include supporting exhibits, including a written statement by the applicant's proposed employer with descriptions of the compliance and disciplinary history of the office and plan for supervising the applicant. 17 C.F.R. § 201.193(b)(4). Commission decisions describe the conditions in granting or denying such applications. *See, e.g., Brett Thomas Graham,* Exchange Act Release No.

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84526, 2018 SEC LEXIS 3056 (Nov. 2, 2018); *Michael L. Silver,* Advisers Act Release No. 4691, 2017 SEC LEXIS 1246 (Apr. 26, 2017); *Matthew D. Sample,* Exchange Act Release No. 75893, 2015 SEC LEXIS 3793 (Sept. 10, 2015).

4 The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, which became effective on July 22, 2010, provided collateral bars in each of the several statutes regulating different aspects of the securities industry. The conduct that led to the case against Respondents occurred after July 22, 2010. *See Bartko v. SEC,* 845 F.3d 1217 (D.C. Cir. 2017) (holding that a collateral bar cannot be imposed when the violative conduct on which a follow-on proceeding was based ended before the July 22, 2010, effective date of the Dodd-Frank Act). The same reasoning applies to suspensions.

5 The violation did not involve fraud, for which a severe sanction is required because opportunities for dishonesty recur constantly in the securities business. *See Vladimir Boris Bugarski,* Exchange Act Release No. 66842, 2012 SEC LEXIS 1267, at *18 n.26 (Apr. 20, 2012); *Richard C Spangler, Inc.,* Exchange Act Release No. 12104, 1976 SEC LEXIS 2418, at *34 (Feb. 12, 1976).

6 Thus, Terracciano will be suspended from acting as promoter, finder, consultant, or agent; or otherwise engaging in activities with a broker, dealer, or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock, pursuant to Exchange Act Section 15(b)(6)(A), (C).

Release No. 1388 (S.E.C. Release No.), Release No. ID - 1388, 2019 WL 5513382

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Release No. 4956 (S.E.C. Release No.), Release No. 33151, Release No. 83604, Release No. 34-83604, Release No. IA - 4956, Release No. IC - 33151, 2018 WL 3344228

S.E.C. Release No.
Securities Exchange Act of 1934
Investment Advisers Act of 1940
Investment Company Act of 1940

SECURITIES AND EXCHANGE COMMISSION (S.E.C.)

IN THE MATTER OF EUGENE TERRACCIANO, RESPONDENT.

Administrative Proceeding File No. 3-18414
July 6, 2018

ORDER MAKING FINDINGS, IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER PURSUANT TO SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940, AND SECTION 9(b) OF THE INVESTMENT COMPANY ACT OF 1940, AND ORDERING CONTINUATION OF PROCEEDINGS

I.

***1** On March 28, 2018, the Securities and Exchange Commission ("Commission") issued an Order Instituting Administrative and Cease-and-Desist Proceedings pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act"), and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") and Notice of Hearing as to Eugene Terracciano ("Respondent" or "Terracciano").

II.

In connection with these proceedings, Respondent has submitted an Offer of Settlement (the "Offer"), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Making Findings, Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934, Section 203(f) of the Investment Advisers Act of 1940, and Section 9(b) of the Investment Company Act of 1940, and Ordering Continuation of Proceedings ("Order") as set forth below:

III.

On the basis of this Order and Respondent's Offer, the Commission finds [1] that:

SUMMARY

This matter involves anti-money laundering ("AML") compliance failures at Aegis Capital Corporation ("Aegis" or "the firm") by Terracciano, who served as the firm's AML Compliance Officer ("AML CO") from September 2013 to approximately September 2015.

From September 2013 through early 2014, all while Terracciano was serving as Aegis' AML CO, Aegis failed to file Suspicious Activity Reports ("SARs") on hundreds of transactions when it knew, suspected, or had reason to suspect that the transactions

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involved the use of the broker-dealer to facilitate fraudulent activity or had no business or apparent lawful purpose. Many of the transactions involved red flags of potential market manipulation, including high trading volume in companies with little or no business activity during a time of simultaneous promotional activity. Aegis did not file SARs on these transactions even when it specifically identified AML red flags implicated by these transactions in its written supervisory procedures.

***2** Under Aegis' written supervisory procedures, the firm's AML CO (Terracciano) was responsible for filing SARs on the firm's behalf. Throughout the relevant period, Terracciano became aware of transactions that exhibited numerous AML red flags through alerts from Aegis' clearing firms (hereinafter defined as "AML Alerts"). Terracciano was the primary point of contact for the clearing firms as it related to suspicious activity. Although the AML Alerts raised many red flags - including many red flags listed in Aegis' written supervisory procedures as examples of suspicious activities - Terracciano did not file SARs on Aegis' behalf regarding these transactions and did not produce a written analysis or otherwise demonstrate that he had considered filing SARs for these transactions.

As a result of the foregoing, Terracciano willfully aided and abetted and caused Aegis' violations of Exchange Act Section 17(a) and Rule 17a-8 thereunder.

RESPONDENT

Eugene Terracciano, 56. Terracciano served as Aegis' AML CO from September 2013 until approximately September 2015.

OTHER RELEVANT ENTITIES

Aegis Capital Corporation is a dually-registered investment adviser and broker-dealer with multiple branches and is headquartered in New York, NY. Aegis' business consists of investment banking, venture capital, and debt market services as well as full-service retail and institutional advisory and brokerage services.

FACTS

A. <u>Aegis' Low Priced Securities Business</u>

1. During the relevant period, Aegis had various brokerage customers who transacted in low-priced securities. Several of these customers did so through Delivery Versus Payment/Receive Versus Payment accounts ("DVP/RVP"). In DVP/RVP accounts held at Aegis, the customer deposited their shares at another firm in a custodial account, and the sale transactions were effected through Aegis. During the relevant period, Aegis had relationships with various clearing firms that assisted in effecting low-priced securities transactions.

2. Aegis had customers at their branch offices who transacted in low-priced securities. Several of these customers were foreign financial institutions that effected transactions on behalf of their underlying customers, all of whom were unknown to Aegis.

B. <u>Aegis' Anti-Money Laundering Compliance Program - Written Supervisory Procedures Concerning SARs and Specific Red Flags Related to Market Manipulations</u>

3. During the relevant period, Aegis had specific written supervisory procedures concerning compliance with its AML responsibilities. Aegis' written supervisory procedures expressly identified Aegis' AML CO as the individual responsible for deciding whether Aegis needed to file a SAR. Moreover, Aegis' written supervisory procedures stated that all Aegis employees were obligated to "promptly report to the [AML CO] any known or suspected violations of anti-money laundering policies as well as other suspected violations or crimes."

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***3** 4. Pursuant to 31 C.F.R. § 1023.320 (the "SAR Rule"), Aegis was required to file SARs for transactions by, at or through the firm that involved or aggregated at least $5,000 if Aegis knew, suspected, or had reason to suspect that, among other things, the transactions involved funds derived from illegal activity, had no business or apparent lawful purpose, or involved using Aegis to facilitate criminal activity. Aegis explicitly cited the SAR Rule in its written supervisory procedures.

5. Aegis, in its written supervisory procedures, expressly identified certain trading in lowpriced securities as suspicious activity that could warrant a SAR filing:
Aegis will file [SARs] for transactions that may be indicative of money laundering activity. Suspicious activities include a wide range of questionable activities; ***examples include trading that constitutes a substantial portion of all trading for the day in a particular security … [and] heavy trading in low-priced securities.***

(emphasis added.)

6. Aegis, in its written supervisory procedures, also expressly identified specific AML red flags associated with low-priced securities transactions of which its employees should be aware. These specific AML red flags - many of which were also described as red flags in industry notices issued by FINRA (e.g., FINRA Notice to Members 09-05 and NASD Notice to Members 02-21) - included the following:
i. There is a sudden spike in investor demand for, coupled with a rising price in, a thinly-traded or low-priced security;

ii. The issuer has been through several recent name changes, business combinations or recapitalizations, or the company's officers are also officers of numerous similar companies;

iii. The issuer's SEC filings are not current, are incomplete, or nonexistent;

iv. The customer appears to be acting as an agent for an undisclosed principal, but declines or is reluctant, without legitimate commercial reasons, to provide information or is otherwise evasive regarding that person or entity;

v. The customer's account has wire transfers that have no apparent business purpose to or from a country identified as a money laundering risk or a bank secrecy haven; and

vi. The customer, for no apparent reason or in conjunction with other " "red flags," engages in transactions involving certain types of securities, such as penny stocks … which although legitimate, have been used in connection with fraudulent schemes and money laundering activity.

C. Terracciano Failed to File SARs on Aegis' Behalf Concerning Low-Priced Securities Transactions

7. Terracciano - throughout the relevant period - failed to file SARs on Aegis' behalf concerning low-priced securities transactions, and did not produce a written analysis or otherwise demonstrate that he had considered filing SARs for these transactions.

***4** 8. Terracciano failed to file SARs on Aegis' behalf despite the fact that numerous low-priced securities transactions affected through the firm exhibited several of the AML red flags that Aegis specifically identified in its written supervisory procedures.

9. In particular, Terracciano failed to file SARs on transactions in which Aegis' customers were:
(i) selling large quantities of low-priced securities that comprised a significant percentage of the issuers' daily trading volume and outstanding float;

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(ii) trading shares of issuers who had changed names and business lines;

(iii) selling substantial shares of low-priced securities during periods of spikes in price and volume of the issuers' securities and during paid promotional campaigns; and/or

(iv) trading in shares of issuers' that had little or no market activity until the promotions began.

10. Terracciano failed to file SARs on Aegis' behalf on low-priced securities transactions even when he received AML Alerts from its clearing firm about such suspicious transactions.

11. These AML Alerts were sent from a clearing firm that Aegis hired in July 2012 and transitioned its clearing business to by December 2012 (the " "New Clearing Firm").

12. Beginning in January 2013, the New Clearing Firm identified AML red flags in Aegis' low-priced securities business and described them in AML Alerts that continued throughout Terracciano's tenure as Aegis' AML CO. However, despite receiving these AML Alerts, Terracciano failed to file SARs on Aegis' behalf and did not produce a written analysis or otherwise demonstrate that he had considered filing SARs for these transactions. Nor did he follow up with others to learn why firm employees or Aegis' trade surveillance system had not brought the suspicious transactions identified in the AML Alerts to his attention.

13. Had Terracciano followed up to learn why suspicious transactions were not being brought to his attention through the firm's own internal systems, he would have learned that the firm's trade surveillance system did not analyze DVP/RVP transactions for suspicious activity. Rather, he would have learned that these transactions were simply batch approved by the applicable Aegis personnel.

D. <u>Illustrative Examples of Transactions in which Terracciano Failed to File SARs on Aegis' Behalf</u>

i. <u>Customer C</u>

14. In early November 2013, while Terracciano was serving as Aegis' AML CO, the New Clearing Firm sent an AML Alert to Aegis regarding Customer C. Customer C had a DVP/RVP account at Aegis.

15. On November 1, 2013, the New Clearing Firm sent Terracciano an AML Alert outlining Customer C's suspicious trading in several low-priced securities, including Issuers D and E and noting that in approximately six months Customer C had sold approximately *1 billion* shares of low-priced securities through Aegis (emphasis added). Both Issuers D and E were traded on OTC Link.

***5** 16. In its AML Alert, the New Clearing Firm noted that Customer C, between September 17 and October 31, 2013, had sold 31% of Issuer D's outstanding shares and that the average daily trading volume had increased by approximately five fold during Customer C's trading while the share price had dropped by approximately 90%.

17. Other evidence also indicates Issuer D may have been the subject of market manipulation. In particular, Issuer D had experienced a rapid increase in the company's stock price and volume that coincided with a promotional campaign that was inconsistent with the company's financial performance as reflected in its SEC filings.

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18. With respect to Issuer E, the New Clearing Firm noted in its AML Alert that Issuer E had reported no revenues and that Customer C had sold over 60% of the company's outstanding shares in two and a half months while the share price had dropped by approximately 50%.

19. In addition to suspicious trading in Issuers D and E, the New Clearing Firm identified in the AML Alert sent to Terracciano similarly suspicious trading by Customer C in other low-priced securities including that Customer C - in one particular low-priced security - had sold more shares in three months than the issuer had outstanding.

20. In the AML Alert, the New Clearing Firm requested a description of: (i) the due diligence performed on the customer; (ii) the due diligence performed on the securities Customer C liquidated in the account; and (iii) how Aegis was comfortable with the activity in the account.

21. On November 5, 2013, Terracciano informed the New Clearing Firm that Aegis had reviewed Customer C's account activity and its account opening paperwork and had decided to close the account, which it did, at least in part, because of the AML concerns outlined in the AML Alert.

22. Despite these red flags associated with the trading by Customer C and closing the account due to the presence of suspicious activity, Terracciano did not file a SAR on Aegis' behalf. Moreover, Terracciano did not produce a written analysis or otherwise demonstrate that he had considered filing SARs for these transactions. The fact that Customer C's account was a DVP/RVP account did not relieve Aegis of its SAR filing obligations with respect to that account.

ii. Customer D

23. Another Aegis customer - Customer D - engaged in suspicious low-priced securities transactions for which Aegis did not file a SAR. Customer D was a foreign financial institution with a DVP/RVP account at the firm and traded on behalf of underlying customers who were unknown to Aegis.

24. In early June 2013, Customer D traded shares of Issuer G, which traded on OTC Link. Specifically, between June 11 and 17, 2013 and during a paid promotional campaign for Issuer G, Customer D sold approximately 340,000 shares of Issuer G for proceeds of approximately $248,000.

25. Moreover, another Aegis customer, Customer F, traded suspiciously in Issuer G at the same time as Customer D did. In particular, Customer F sold approximately 760,000 shares of Issuer G through Aegis during the promotion for proceeds of approximately $840,000. Customer F was yet another foreign financial institution with a DVP/RVP account at the firm and traded on behalf of underlying customers who were unknown to Aegis.

***6** 26. On December 2, 2013, while Terracciano was serving as the AML CO, the New Clearing Firm sent an AML Alert to Terracciano regarding Customer D's trading in Issuer G, and wrote that the trading "exhibited characteristics commonly associated with a pump-and-dump scheme; including paid stock promotion, a significant increase in both price and trading volume, followed by a precipitous drop in price and volume."

27. In the AML Alert, the New Clearing Firm also noted that Issuer G had changed both its name and business line (to a medical device company from an auto parts manufacturer), had no revenue and minimal trading volume until the stock promotion began, and that Customer D's trading was similar to the suspicious trading by two other Aegis customers that had prompted the New Clearing Firm to request that those accounts be closed earlier in the year.

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28. Terracciano ordered that Customer D's account be closed and acknowledged in an email that the compliance department did "not have the bandwidth to monitor the account." This lack of compliance "bandwidth" was particularly relevant since Terracciano had learned that the branch manager who supervised the trading had not been conducting required reviews.

29. Customer D's accounts were ultimately closed, at least in part, because of the AML concerns associated with it. Terracciano knew that the accounts trading in low-priced securities was a serious concern. In fact, Terracciano did not finally act to close the accounts until he became aware that the branch manager had not, in fact, blocked the account from trading in low-priced securities.

30. Despite these red flags associated with the trading by Customer D and at least one other Aegis customer in Issuer G as well as the closing of Customer D's account due at least in part to concerns regarding low-priced securities transactions, Terracciano did not file a SAR on Aegis' behalf. Moreover, Terracciano did not produce a written analysis or otherwise demonstrate that he had considered filing SARs for these transactions. The fact that the above described accounts were DVP/RVP accounts did not relieve Aegis of its SAR filing obligations with respect to those accounts.

iii. November 18, 2013 DVP/RVP Update to Written Supervisory Procedures

31. On November 18, 2013 - in response to deficiencies identified by the Commission's Office of Compliance Inspections and Examinations - Terracciano sent an email to all Aegis employees containing an update to Aegis' written supervisory procedures that required low-priced securities transactions in DVP/RVP accounts to be subjected to the same due diligence as cash accounts when customers deposited physical securities.

32. In particular, Aegis' updated written supervisory procedures required Aegis' DVP/RVP customers to submit Deposited Securities Request Questionnaires ("DSRQs") for any low-priced securities it wished to trade and required Aegis to complete due diligence to identify red flags associated with the issuers of low-priced securities.

***7** 33. DSRQs include, among other things, information about how the customer obtained a particular security, whether the customer is an affiliate of the issuer, and how many shares of the security the customer owns. DSRQs had to be filled out by the customer and approved by the registered representative and a member of Aegis' management before any trading was to occur.

iv. Customer G

34. Notwithstanding this update to Aegis' written supervisory procedures, however, at least one of Aegis' DVP/RVP customers (Customer G) traded suspiciously in low-priced securities and did so before the required DSRQ process had been completed. Customer G, a New York corporation, is a microcap hedge fund that held a DVP/RVP account at Aegis.

35. Between February 10, 2014 and February 20, 2014, Customer G sold 705.9 million shares of Issuer H through Aegis for proceeds of approximately $1.24 million. Issuer H traded on OTC Link.

36. On February 19, 2014, the New Clearing Firm sent an AML Alert that Terracciano received explaining that it was going to block Customer G's account at market close because, among other reasons, Customer G had already sold 200 million shares of Issuer H that day and *2.7 billion* shares of low-priced securities since it opened its account.

37. In addition to the suspicious trading, there were other indicia that Issuer H may have been the subject of market manipulation. For example, Issuer H experienced a large increase in price and volume that coincided with a promotional campaign. Moreover, the company's name had changed several times before becoming Issuer H.

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38. The AML Alert was not limited to the suspicious Issuer H trades; it also described suspicious trading by Customer G in over *1.6 billion* shares of the securities of ten additional microcap issuers.

39. The New Clearing Firm subsequently asked for an explanation of: (i) the due diligence Aegis performed on the customer; (ii) the due diligence Aegis performed on the securities liquidated in the account; and (iii) how Aegis was comfortable with the activity.

40. Even after Aegis received the AML Alert concerning Customer G's trading, Customer G continued to trade in Issuer H. Indeed, on February 19 and 20, 2014, Customer G sold an additional 120 million shares of Issuer H.

41. At the time of Customer G's trading in February 2014, Aegis had already implemented its new DSRQ policy for trading in DVP/RVP accounts. The DSRQ packet for Customer G's trading in Issuer H, however, was not signed by any of the required Aegis personnel and, thus, Customer G should never have been allowed to liquidate any of its Issuer H shares through Aegis.

42. Despite the significant trading by Customer G in Issuer H and the other red flags associated with the transactions, Terracciano did not file a SAR on Aegis' behalf. Moreover, Terracciano did not produce a written analysis or otherwise demonstrate that he had considered filing SARs for these transactions. The fact that Customer G's account was a DVP/RVP account did not relieve Aegis of its SAR filing obligations with respect to that account.

VIOLATIONS

***8** 43. The Bank Secrecy Act ("BSA"), and implementing regulations promulgated by FinCEN, require that broker-dealers file SARs with FinCEN to report a transaction (or a pattern of transactions of which the transaction is a part) conducted or attempted by, at, or through the broker-dealer involving or aggregating to at least $5,000 that the broker-dealer knows, suspects, or has reason to suspect: (1) involves funds derived from illegal activity or is conducted to disguise funds derived from illegal activities; (2) is designed to evade any requirement of the BSA; (3) has no business or apparent lawful purpose and the broker-dealer knows of no reasonable explanation for the transaction after examining the available facts; or (4) involves use of the broker-dealer to facilitate criminal activity. 31 C.F.R. § 1023.320(a)(2).

44. Exchange Act Rule 17a-8 requires broker-dealers to comply with the reporting, record-keeping, and record retention requirements of the BSA. The failure to file a SAR as required by the SAR Rule is a violation of Section 17(a) of the Exchange Act and Rule 17a-8 thereunder.

45. By engaging in the conduct described above, Aegis violated Section 17(a) of the Exchange Act and Rule 17a-8 thereunder.

46. By engaging in the conduct described above, Terracciano willfully aided and abetted and caused Aegis' violations of Section 17(a) of the Exchange Act and Rule 17a-8 thereunder.

IV.

Pursuant to the Offer, Respondent agrees to continued proceedings on the record to determine, pursuant to Sections 15(b) of the Exchange Act, Section 203(f) of the Advisers Act, and Section 9(b) of the Investment Company Act, what, if any, remedial action is appropriate in the public interest.

In connection with such continued proceedings, Respondent Terracciano agrees that: (a) he will be precluded from arguing that he did not violate the federal securities laws described in the Order; (b) he may not challenge the validity of this Order; (c) solely for the purposes of such continued proceedings, the findings of this Order shall be accepted and deemed true by

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the hearing officer; and (d) the hearing officer may determine the issues raised in the continued proceedings on the basis of affidavits, declarations, excerpts of sworn deposition or investigative testimony, documentary evidence, and, if the hearing officer determines it necessary, hearing testimony.

V.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in the Offer and to order continued proceedings, consistent with the terms of Respondent's agreement as specified above in Section IV., against Respondent to determine what, if any, remedial action is appropriate.

Accordingly, pursuant to Sections 15(b) and 21C of the Exchange Act, Section 203(f) of the Advisers Act, and Section 9(b) of the Investment Company Act, it is hereby **ORDERED** that:

***9** A. Respondent Terracciano shall cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Exchange Act and Rule 17a-8 thereunder.

B. Respondent Terracciano shall pay civil penalties of $20,000 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). Payment shall be made in the following installments: (1) $4,000 within ten (10) days of entry of the Order; (2) $4,000 within ninety (90) days of entry of the Order; (3) $4,000 within one hundred eighty (180) days of entry of the Order; (4) $4,000 within two hundred seventy (270) days of entry of the Order; and (5) $4,000 within three hundred sixty (360) days of entry of the Order. If any payment is not made by the date the payment is required by the Order, the entire outstanding balance of civil penalties, plus any additional interest accrued pursuant to 31 U.S.C. § 3717, shall be due and payable immediately, without further application.

Payment must be made in one of the following ways:
(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices.ofm.htm; or

(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:
Enterprise Services Center

Accounts Receivable Branch

HQ Bldg., Room 181, AMZ-341

6500 South MacArthur Boulevard

Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Terracciano as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Antonia Chion, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F. St., NE, Washington, DC 20549.

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C. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, he shall not argue that he is entitled to, nor shall he benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that he shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

VI.

***10** It is further Ordered that, solely for purposes of exceptions to discharge set forth in Section 523 of the Bankruptcy Code, 11 U.S.C. §523, the findings in this Order are true and admitted by Respondent, and further, any debt for disgorgement, prejudgment interest, civil penalty or other amounts due by Respondent under this Order or any other judgment, order, consent order, decree or settlement agreement entered in connection with this proceeding, is a debt for the violation by Respondent of the federal securities laws or any regulation or order issued under such laws, as set forth in Section 523(a)(19) of the Bankruptcy Code, 11 U.S.C. §523(a)(19).

VII.

IT IS FURTHER ORDERED that, consistent with the terms of Respondent's agreement specified in Section IV. above and as provided by Rule 111 of the Commission's Rules of Practice, 17 C.F.R. § 201.111, the Administrative Law Judge shall designate the manner and method of taking evidence to determine what, if any, remedial action is appropriate.

IT IS FURTHER ORDERED that, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice, 17 C.F.R. § 201.360(a)(2), the Administrative Law Judge shall issue an initial decision no later than 120 days from the occurrence of one of the following events: (A) the completion of post-hearing briefing in a proceeding where the hearing has been completed; (B) where the hearing officer has determined that no hearing is necessary, upon completion of briefing on a motion pursuant to Rule 250 of the Commission's Rules of Practice, 17 C.F.R. § 201.250; or (C) the determination by the hearing officer that a party is deemed to be in default under Rule 155 of the Commission's Rules of Practice, 17 C.F.R. § 201.155 and no hearing is necessary.

If Respondent fails to respond to any motion by the Division concerning the issues set forth in Section IV. above or, if ordered by the Administrative Law Judge, otherwise fails to appear at a hearing, Respondent may be deemed in default and the allegations against him may be deemed as true by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

***11** By the Commission.
Brent J. Fields
Secretary

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[1] The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

Release No. 4956 (S.E.C. Release No.), Release No. 33151, Release No. 83604, Release No. 34-83604, Release No. IA - 4956, Release No. IC - 33151, 2018 WL 3344228

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Release No. 4225 (S.E.C. Release No.), Release No. IA - 4225, 112 S.E.C. Docket 3701, 2015 WL 5935519

S.E.C. Release No.
Investment Advisers Act of 1940

SECURITIES AND EXCHANGE COMMISSION (S.E.C.)

IN THE MATTER OF JAMES T. BUDDEN AND ALEXANDER W. BUDDEN, RESPONDENTS.

Administrative Proceeding File No. 3-16892
October 13, 2015

ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTIONS 203(f) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER

I.

***1** The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 203(f) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against James T. Budden ("J. Budden") and Alexander W. Budden ("A. Budden") (collectively, ""Respondents").

II.

In anticipation of the institution of these proceedings, Respondents each have submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, and except as provided herein in Section V, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Sections 203(f) and 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondents' Offers, the Commission finds [1] that:

SUMMARY

Respondents failed reasonably to supervise Douglas E. Cowgill ("Cowgill"), the former Chief Compliance Officer ("CCO") of Professional Investment Management, Inc. ("PIM"), an investment adviser registered with the Commission, within the meaning of Sections 203(e)(6) and 203(f) of the Advisers Act, with a view to preventing and detecting Cowgill's violations of the federal securities laws. Cowgill violated several antifraud provisions of the federal securities laws by misappropriating more than $840,000 in client assets. Respondents also caused [2] PIM to violate Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder (the "Compliance Rule"). J. Budden further caused PIM to violate Section 206(4) of the Advisers Act and Rule 206(4)-2 thereunder (the ""Custody Rule").

RESPONDENTS

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1. **James T. Budden**, age 73, is a former 50.2% shareholder of PIM. J. Budden was the President and a Director of PIM from approximately 1973 through approximately July 22, 2013, the date he sold all of his interest in PIM to Cowgill. While associated with PIM, J. Budden supervised several employees, including Cowgill. J. Budden resides in Columbus, Ohio.

***2** 2. **Alexander W. Budden**, age 68, is a former 48.7% shareholder of PIM. A. Budden was the Vice President and Secretary and a Director of PIM from approximately April 1981 through approximately July 22, 2013, the date he sold all of his interest in PIM to Cowgill. While associated with PIM, A. Budden supervised several employees, including Cowgill. A. Budden resides in Cleveland, Ohio.

OTHER RELEVANT PARTIES

3. **Professional Investment Management, Inc.** is an Ohio corporation with its principal place of business in Columbus, Ohio. At all times relevant to this proceeding, PIM was owned by J. Budden (50.2%), A. Budden (48.7%), and Cowgill (1.1%). PIM was registered with the Commission as an investment adviser from 1978 through September 30, 2013. PIM reregistered with the Commission on June 24, 2014. PIM provides third-party administration services and investment advisory services to approximately fifteen retirement plan clients (which consist of approximately 325 participants who, in turn, own approximately 425 individual retirement accounts that PIM advises), and also provides investment advisory services to approximately twenty-five individual clients for their own (non-retirement plan) accounts. PIM has approximately $120 million of regulatory assets under management, and has custody of client assets through three omnibus accounts. PIM has been operating under the control of a courtappointed receiver since on or about May 15, 2014.

4. **Douglas E. Cowgill**, age 60, began working for PIM in July 1981. Cowgill became the sole owner and President of PIM on or about July 22, 2013, when he purchased all of Respondents' interest in PIM. Cowgill remained the President of PIM until on or about May 15, 2014, when a court-appointed receiver took control of PIM. Cowgill resides in Columbus, Ohio.

5. The Commission filed suit against Cowgill and PIM in the United States District Court for the Southern District of Ohio on April 29, 2014 in *Securities and Exchange Commission v. Douglas E. Cowgill, et al.,* Case No. 2:14-CV-396, alleging that Cowgill and PIM violated the antifraud provisions of the U.S. securities laws by hiding a shortfall of more than $700,000 in client assets by sending false account statements to clients, and that PIM violated, and Cowgill aided and abetted and caused PIM's violations of, the registration provisions of the Advisers Act, and the Custody Rule. The Commission filed an Amended Complaint on August 7, 2014 that included additional counts against Cowgill and PIM. On August 21, 2014, the Court entered a Judgment by Consent against Cowgill as to all counts asserted in the Amended Complaint and permanently restrained and enjoined Cowgill from violating and/or aiding and abetting violations of Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 10b-5 thereunder, Sections 203(a), 204(a), 206(1), (2), and (4), and 207 of the Advisers Act, and Rules 204-2, 206(4)-2, and 206(4)-7 thereunder.

***3** 6. On September 8, 2014, the Commission entered an order barring Cowgill from associating with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization.

7. On July 2, 2015, a Grand Jury sitting in the United States District Court for the Southern District of Ohio indicted Cowgill in *United States v. Cowgill,* Case No. 2:15-CR-160, on thirteen counts of wire fraud, five counts of engaging in monetary transactions in property derived from specified unlawful activity, two counts of theft or embezzlement from an employee benefit plan counts, and one count of perjury. Each of these counts stemmed from the conduct alleged in the Commission's civil lawsuit against Cowgill. Cowgill's criminal matter is ongoing.

FACTS

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Failure to Supervise Cowgill

8. At all times from July 1981 through approximately July 22, 2013, Cowgill reported to Respondents and Respondents were Cowgill's supervisors. For instance, Respondents promoted Cowgill from Accounting Clerk to Vice President and Treasurer in 1983, and designated Cowgill as PIM's CCO on or about September 28, 2004.

9. As explained above, the United States District Court for the Southern District of Ohio entered an order on August 21, 2014 in *Securities and Exchange Commission v. Douglas E. Cowgill, et al.* that permanently restrained and enjoined Cowgill from violating and/or aiding and abetting violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, Sections 203(a), 204(a), 206(1), (2), and (4), and 207 of the Advisers Act, and Rules 204-2, 206(4)-2, and 206(4)-7 thereunder.

10. Respondents failed to adopt or implement any policies or procedures regarding their supervision of Cowgill. In fact, Respondents merely assumed, without ever confirming, that Cowgill performed his responsibilities in compliance with the federal securities laws. [3]

Violations of the Compliance Rule

11. After Respondents designated Cowgill as PIM's CCO, they never provided any funding, training, or resources to support Cowgill in the CCO role.

12. Respondents, as the majority owners of PIM and as required by the Compliance Rule, participated in annual compliance reviews with Cowgill in 2004, 2006, and 2007. [4] Respondents knew or should have known that Cowgill stopped performing compliance reviews after 2007, but took no steps to ensure that Cowgill or anyone else at PIM resumed conducting compliance reviews at least annually after 2007.

13. Respondents took no steps to ensure that PIM was complying with the federal securities laws after 2007, and did nothing after 2007 to ensure that Cowgill carried out his responsibilities as PIM's CCO.

14. Respondents did not ensure that PIM established policies or procedures to prevent client assets from being misappropriated via checks or wire transfers or to ensure that client statements were reviewed for accuracy. No such policies or procedures were ever established at PIM. During the period 2008 through 2013, Cowgill secretly wrote numerous checks and initiated numerous wire transfers from PIM's client asset-holding bank account and sent false account statements to PIM's clients to hide his misappropriation of client assets.

Violations of the Custody Rule

***4** 15. At all relevant times, PIM maintained client funds in an omnibus checking account held on an agency basis at Custodian 1, and client securities in two omnibus accounts held on an agency basis at Custodian 2 and Custodian 3. All client funds were initially deposited into the omnibus checking account held at Custodian 1. PIM then transferred these client funds for investment to various firms, including Custodians 2 and 3. PIM had custody of all of the client assets held at Custodian 1, 2, and 3 because it had the authority to obtain possession of these assets.

16. Each year from 1999 to 2009, J. Budden had, as required by the Custody Rule, engaged an independent accountant on behalf of PIM to conduct annual surprise examinations to verify all client assets of which PIM had custody and required the accountant to file Form ADV-E with the Commission within a prescribed amount of time. J. Budden delegated that responsibility to Cowgill during the summer of 2009 after J. Budden had engaged the accountant in May 2009 to perform the 2009 annual surprise examination. J. Budden continued to supervise Cowgill during this time period, but did not follow up with Cowgill to ensure that Cowgill had fulfilled this responsibility.

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17. J. Budden knew from past experience that, in order to comply with the Custody Rule, PIM was obligated to, among other things, require the accountant to file Form ADV-E with the Commission. Cowgill failed to require PIM's accountant to file Form ADV-E with the Commission in connection with the 2009 surprise examination, and J. Budden did nothing to ensure that that Cowgill had done so. J. Budden did nothing to confirm that Form ADV-E had been filed with the Commission or that PIM had complied with the Custody Rule in 2009. PIM violated the Custody Rule in 2009 by failing to ensure that the accounting firm filed with the Commission Form ADV-E.

18. Cowgill engaged these same accountants in 2010 and again in 2011 to perform annual surprise examinations in accordance with the Custody Rule. Cowgill did not cooperate with the accounting firm, and, ultimately, the accounting firm did not complete either of these annual surprise examinations. J. Budden did nothing to confirm that these annual surprise examinations had been completed, that Form ADV-E had been filed with the Commission in connection with either of these annual surprise examinations, or that PIM had complied with the Custody Rule in 2010 and 2011. PIM violated the Custody Rule in 2010 and 2011 by failing to have annual surprise examinations completed in each of those years.

19. Cowgill did not engage any accountants in 2012 to perform an annual surprise examination in accordance with the Custody Rule. J. Budden did nothing to confirm that Cowgill had engaged an accountant to complete the annual surprise examination in 2012, that the annual surprise examination had been completed, that Form ADV-E had been filed with the Commission in connection with the annual surprise examination, or that PIM had complied with the Custody Rule in 2012. PIM violated the Custody Rule in 2012 by failing to have an annual surprise examination completed that year.

***5** 20. In 2013, J. Budden realized that he had not seen any accountants at PIM for "some time," and sought to learn the status of PIM's compliance with the Custody Rule. Respondents spoke with the principal of the accounting firm that historically had completed annual surprise examinations for PIM. Respondents learned that the accounting firm was terminating its relationship with PIM because, among other reasons, Cowgill had not sufficiently cooperated with the accounting firm in 2010 and 2011 to enable it to complete the annual surprise exams during those two years as required by the Custody Rule. Respondents further learned that Cowgill had not engaged the accounting firm to perform any work on behalf of PIM since 2011.

21. In July 2013, Respondents spoke with an attorney to determine how to address PIM's delinquent ADV-E filings.

22. However, neither Respondent took any disciplinary action against Cowgill.

23. Instead, on July 22, 2013, each Respondent executed a stock purchase agreement in which they each agreed to sell all of their interest in PIM to Cowgill.

24. Respondents both knew at the time of the sale that PIM was not in compliance with the federal securities laws, including specifically, the Compliance Rule and the Custody Rule.

25. As a result of the conduct described above, Respondents failed reasonably to supervise Cowgill within the meaning of Section 203(e)(6) of the Advisers Act, with a view to preventing and detecting Cowgill's violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 203(a), 204(a), 206(1), (2), and (4), and 207 of the Advisers Act and Rules 204-2, 206(4)-2, and 206(4)-7 thereunder.

26. As a result of the conduct described above, Respondents caused PIM's violation of Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder, which require, among other things, that a registered investment adviser adopt and implement written policies and procedures reasonably designed to prevent violation of the Advisers Act and the rules thereunder by the adviser and its supervised persons, and review, no less frequently than annually, the adequacy of such policies and procedures.

27. As a result of the conduct described above, J. Budden caused PIM's violation of Section 206(4) of the Advisers Act and Rule 206(4)-2 thereunder, which require, among other things, that a registered investment adviser have client assets over which it has

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custody verified by an independent public accountant at least once a year without prior notice to the investment adviser and that the investment adviser require the accountant to file Form ADV-E with the Commission within a prescribed amount of time.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in each Respondent's Offer.

Accordingly, pursuant to Sections 203(f) and 203(k) of the Advisers Act, it is hereby ORDERED that:

Respondent J. Budden

***6** A. Respondent J. Budden cease and desist from committing or causing any violations and any future violations of Section 206(4) of the Advisers Act and Rules 206(4)-2 and 206(4)-7 thereunder.

B. Respondent J. Budden be, and hereby is:

> barred from association in a supervisory or compliance capacity with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization

with the right to apply for reentry after three (3) years to the appropriate selfregulatory organization, or if there is none, to the Commission.

C. Any reapplication for association by Respondent J. Budden will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against Respondent J. Budden, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

D. Respondent J. Budden shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of $125,000 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717. Payment must be made in one of the following ways:
(1) Respondent J. Budden may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondent J. Budden may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondent J. Budden may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center

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Accounts Receivable Branch

HQ Bldg., Room 181, AMZ-341

6500 South MacArthur Boulevard

Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Respondent J. Budden as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Paul Montoya, Assistant Director, Division of Enforcement, Securities and Exchange Commission, Chicago Regional Office, 175 West Jackson Boulevard, Suite 900, Chicago, IL 60604-2908.

Respondent A. Budden

***7** E. Respondent A. Budden cease and desist from committing or causing any violations and any future violations of Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder.

F. Respondent A. Budden be, and hereby is:

> barred from association in a supervisory or compliance capacity with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization

with the right to apply for reentry after two (2) years to the appropriate selfregulatory organization, or if there is none, to the Commission.

G. Any reapplication for association by Respondent A. Budden will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against Respondent A. Budden, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

H. Respondent A. Budden shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of $75,000 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717. Payment must be made in one of the following ways:
(1) Respondent A. Budden may transmit payment electronically to the Commission, which will provide detailed ACH transfer/ Fedwire instructions upon request;

(2) Respondent A. Budden may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondent A. Budden may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

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Enterprise Services Center

Accounts Receivable Branch

HQ Bldg., Room 181, AMZ-341

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Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Respondent A. Budden as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Paul Montoya, Assistant Director, Division of Enforcement, Securities and Exchange Commission, Chicago Regional Office, 175 West Jackson Boulevard, Suite 900, Chicago, IL 60604-2908.

***8** I. Pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended, a Fair Fund is created for the penalties referenced in paragraphs IV.D and IV.H, above. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondents agree that in any Related Investor Action, they shall not argue that they are entitled to, nor shall they benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondents' payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that they shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against any Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

V.

It is further Ordered that, solely for purposes of exceptions to discharge set forth in Section 523 of the Bankruptcy Code, 11 U.S.C. § 523, the findings in this Order are true and admitted by Respondents, and further, any debt for disgorgement, prejudgment interest, civil penalty or other amounts due by Respondents under this Order or any other judgment, order, consent order, decree or settlement agreement entered in connection with this proceeding, is a debt for the violation by Respondents of the federal securities laws or any regulation or order issued under such laws, as set forth in Section 523(a)(19) of the Bankruptcy Code, 11 U.S.C. §523(a)(19).

By the Commission.
Brent J. Fields
Secretary

1 The findings herein are made pursuant to each Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

2 "Negligence is sufficient to establish 'causing' liability …, at least in cases in which a person is alleged to 'cause' a primarily violation that does not require scienter." *KPMG Peat Marwick, LLP*, Rel. No. 43862, 2001 WL 47245, *19 (Jan. 19, 2001), *pet. denied*, 289 F.3d 109 (D.C. Cir. 2002).

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3 "Liability for failure to supervise may be imposed when a supervisor fails 'to learn of improprieties when diligent application of supervisory procedures would have uncovered them.'" *In the Matter of Stephen Jay Mermelstein*, Advisers Act Rel. No. 2961 (Dec. 14, 2009).

4 PIM did not conduct an annual compliance review in 2005.

Release No. 4225 (S.E.C. Release No.), Release No. IA - 4225, 112 S.E.C. Docket 3701, 2015 WL 5935519

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Release No. 1392 (S.E.C. Release No.), Release No. ID - 1392, 2019 WL 7284955

S.E.C. Release No.
Initial Decision

SECURITIES AND EXCHANGE COMMISSION (S.E.C.)

IN THE MATTER OF RETIREMENT SURETY LLC, CRESCENDO FINANCIAL LLC, THOMAS ROSE, DAVID LEEMAN, AND DAVID FEATHERSTONE

Administrative Proceeding File No. 3-18061
December 20, 2019

***1** APPEARANCES:
Jennifer K. Vakiener, Steven Rawlings, and Jack Kaufman for the Division of Enforcement, Securities and Exchange Commission
Jeffrey J. Ansley and Troy (T.J.) Hales, Bell Nunnally & Martin LLP, for Respondents Thomas Rose, David Leeman, and David Featherstone

BEFORE: James E. Grimes, Administrative Law Judge

Initial Decision

Summary

In this administrative proceeding, the Securities and Exchange Commission alleged that Respondents David Featherstone, David Leeman, and Thomas Rose sold securities in violation of the registration requirements of the Securities Act of 1933 and the Securities Exchange Act of 1934. The parties agreed to a partial settlement which included findings of fact and a finding of liability on a no-admit, no-deny basis. I partially granted the Division of Enforcement's motion for summary disposition and found that Featherstone, Leeman, and Rose should pay disgorgement and prejudgment interest. This initial decision resolves the remaining issues. I conclude that Featherstone, Leeman, and Rose did not act with scienter, first-tier civil penalties are in public interest, and the disgorgement to be paid by Featherstone and Leeman but not Rose should be reduced due to a demonstrated inability to pay.

Procedural Background

The Commission initiated this proceeding in July 2017, when it issued an order instituting proceedings alleging that Featherstone, Leeman, and Rose (Respondents), together with Retirement Surety LLC and Crescendo Financial LLC, violated Securities Act Section 5(a) and (c) by selling unregistered securities and Exchange Act Section 15(a)(1) by acting as brokers without registering with the Commission. In November 2017, the Commission entered an order accepting Respondents' settlement offer. [1] The settlement order made findings of fact and determined that they committed the charged violations.

The settlement order also resolved claims against Retirement Surety and Crescendo based on their agreement to each be legally dissolved. [2] As to Featherstone, Leeman, and Rose, the settlement order provided for additional proceedings to resolve whether they should be ordered to pay disgorgement, prejudgment interest, and civil penalties. [3] In these additional proceedings, Respondents cannot contest that they violated Section 5 and Section 15 or the settlement order's factual findings, which must be accepted as true. [4]

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Following issuance of the settlement order, the Division moved for summary disposition. A previously assigned administrative law judge granted that motion in April 2018 and issued an initial decision.[5] In August 2018, following the Supreme Court's decision in *Lucia v. SEC,* the Commission remanded all pending administrative proceedings on appeal from this office, including this one; ordered that each proceeding must be reassigned to an administrative law judge who did not previously participate in the matter, unless the parties expressly agreed otherwise; and directed the newly assigned judges to give each respondent the opportunity for a new hearing.[6]

***2** After initial reassignment, this proceeding was reassigned to me in March 2019.[7] The Division filed a new motion for summary disposition. Respondents opposed the motion and asserted inability to pay as an affirmative defense. I granted the Division's motion in part.[8] I determined, based on the violations found in the settlement order, that Featherstone, Leeman, and Rose should disgorge the commissions they received for selling the unregistered securities and that prejudgment interest was appropriate.[9] I concluded, however, that factual disputes prevented me from deciding whether Featherstone, Leeman, and Rose acted with scienter.[10] Because scienter is a factor to be weighed in determining civil penalties and whether disgorgement or penalties should be reduced due to an inability to pay, I was unable to resolve those questions.[11]

I asked the parties to jointly propose a procedure and schedule for resolving the remaining issues, and the parties proposed that I decide the proceeding based on the existing written record, supplemented by additional briefing and evidence, without an in-person hearing. Based on the parties' agreement and the Commission's order on the continuation of proceedings, I adopted this proposal.[12]

In conducting this proceeding, I gave no weight to the opinions, orders, or rulings of the administrative law judge who presided over this proceeding before the Commission's remand.[13]

Findings of Fact

The findings and conclusions in this initial decision are based on the record and on facts officially noticed.[14] After my summary disposition order, Featherstone, Leeman, and Rose each submitted a new declaration regarding his financial condition in support of the inability-to-pay defense. Otherwise, the factual record is the same as the summary disposition record. For this reason, the factual findings below are largely similar to those made in the order on summary disposition.[15] On summary disposition, however, I reviewed the evidence in light most favorable to Respondents. In this decision, I resolve any factual disputes by a preponderance of the evidence as the standard of proof.[16] In a separate section, I make new findings about Respondents' ability to pay.

Background

Respondents are in their 60s or 70s and at relevant times described themselves as licensed insurance agents.[17] None of them hold securities licenses and none of them has ever been registered as a broker-dealer or associated with a registered broker-dealer.[18]

The unregistered securities at issue in this proceeding were created by William R. Schantz.[19] Schantz was sanctioned and suspended in 2002 by the National Association of Securities Dealers for brokering the sale of unregistered nine-month promissory notes guaranteed by insurance companies without disclosing the sales to the NASD-member firm with which he was associated.[20] In 2006, he entered into a consent order with the New Jersey Bureau of Securities for the same conduct.[21] Schantz agreed to disgorge $7,000 in commissions to New Jersey.[22] Respondents were aware of the consent order.[23] In 2009, Schantz formed Verto Capital Management LLC.[24]

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***3** In late 2013, Verto began issuing 7% promissory notes that are central to the findings and charges in the settlement order. [25] From then until November 2015, Verto issued about $12.5 million of these notes. [26]

In May 2017, the Commission filed a civil complaint against Schantz and Verto in the United States District Court for the District of New Jersey. [27] Following settlement, the court entered judgment against Schantz and Verto, permanently enjoining them from violating Securities Act Sections 5 and 17(a) and, after amendment, ordering them to pay about $4.8 million in disgorgement, interest, and civil penalties. [28] About $1.5 million remains due to 36 investors, 32 of whom were Respondents' clients. [29]

Respondents managed Retirement Surety from 2013 through 2015. [30] It described itself on its website as an organization "comprised of a group of "state licensed partners,' all from 'career[s] outside of the financial services industry' who provide investment advice for retirement planning." [31] Retirement Surety has never been associated with a registered broker-dealer or registered as a broker-dealer. [32]

Rose and Leeman also managed Crescendo, which was formed in June 2013 to broker the sale of Verto notes. [33] Crescendo's website described its members as "licensed partners" using language almost identical to that found on Retirement Surety's website. [34] It also has never been associated with a registered broker-dealer or registered as a broker-dealer. [35]

Sales of Verto Notes

Turning to the events in this case, Schantz first contacted Leeman sometime in 2012. [36] Rose and Featherstone first met Schantz in late 2012. [37] Schantz proposed to offer "a nine month note product … that caught [Respondents'] eyes, because [they] thought it was not a security." [38] And Respondents knew that if the Verto notes were securities, they "should not be selling" the notes because Respondents held no securities licenses. [39]

Respondents began selling Verto notes in November 2013. [40] In order to satisfy themselves that Verto notes were not securities, they took certain steps, including conferring with Schantz and his attorney, John Pauciulo with the firm Eckert Seamans Cherin & Mellott, LLC, who told Respondents that the nine-month note "wasn't a security because of [certain] exemptions." [41] Before Respondents began selling Verto notes, Schantz told them that Pauciulo opined that the notes were not securities. [42] Rose testified that he, Leeman, and Schantz also had "a couple of phone call conversations" with Pauciulo, and "some" of those calls were before they started selling Verto notes. [43] Respondents and Schantz participated in phone conference calls with Pauciulo, during which Pauciulo told Respondents that the Verto notes were not securities. [44]

***4** As part of their "due diligence outside of the law firm" that Schantz retained—meaning Pauciulo and Eckert Seamans—Respondents performed internet research about what constitutes a security and exemptions from registration, including the nine-month note exemption. [45] Their research led Respondents to conclude that a nine-month note "may or may not be a security" depending on "different criteria." [46] When asked what criteria Respondents found, Rose stated: "One, the fact that it is nine months; two, it said even if it was longer than nine months, as long as the note is backed by assets of a company, then it is not a security." [47] Based on their research, Respondents "felt that [a Verto note] wasn't a security." [48]

Leeman emailed Schantz on November 15, 2013, to say that another individual, Dave Valencia, told Leeman that he (Valencia) would "not participate" because Valencia's attorney believed the Verto notes were securities. [49] Leeman added, however, that his internet research revealed nothing "that would call a 9 month note a security unless the laws are different in California." [50] Schantz responded that "[w]e use very good and expensive counsel to vet these issues and there is no problem at all with a 9

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month note. You may be correct that there is something in California …. I would be happy to have [Valencia's] counsel speak to ours ….”[51]

On November 19, 2013, Schantz emailed Leeman and attorney Thomas D. Sherman, of Locke Lord LLP, in order to introduce the two to each other.[52] Context shows that Sherman was the attorney who told Valencia that the Verto notes were securities. Schantz said he would be “happy to discuss our 9 month note program” and added that Pauciulo, who “has an extensive securities background and is an ex investigator for the SEC,” was “[o]ur counsel for the note program.”[53]

Sherman responded the next morning raising issues relating to whether the Verto notes could qualify for certain registration exemptions.[54] He also noted that California does not have a commercial-paper exemption and asked why the notes would not be securities under California law.[55] Leeman responded that he hoped “it's all OK because I wrote up $75,000 today!”[56] This statement by Leeman is the earliest evidence of when an investor purchased a Verto note brokered by Respondents. Based on a preponderance of the evidence, November 20, 2013, was the first day Respondents sold Verto notes.

***5** The next day, November 21, 2013, Leeman forwarded Sherman's email to Rose.[57] Among other things, Leeman said that if Schantz and Pauciulo convinced Sherman that “it's OK” for them to sell the notes, “we've scored a big win for future people who may question it.”[58] He added that he “hope[d] it all works out because I wrote about $85,000 yesterday.”[59] There is no evidence that Respondents had additional contact or discussions with Sherman.

At some point before November 21, 2013, Respondents also spoke to a securities attorney in Dallas named David Shelmire.[60] Leeman testified that Respondents spoke to Shelmire before November 21, 2013, about whether Verto notes were securities.[61] And when asked whether Respondents “consult[ed] any other attorney about” whether Verto notes were securities, Rose responded that Respondents spoke to Shelmire.[62]

The Division asserts that Respondents did not speak to Shelmire about whether the Verto notes were securities but instead consulted him on other issues.[63] Respondents did not disclose attorney-client communications with Shelmire. For this reason, I will not give any weight to Respondents' consultations with Shelmire in determining Respondents' mental state when selling the Verto notes.

In any event, as noted, Respondents began selling Verto notes in November 2013.[64] Over the next two years, Respondents sold 162 notes to 82 investors.[65] Respondents received a 7% commission for each note they sold, with 5% going to the individual seller and 2% to Crescendo.[66]

Respondents solicited investors, including their insurance clients; gave investors offering materials; advised investors; and monitored and managed investor repayments.[67] Rose and Leeman advertised the notes on two radio networks and directed listeners to Retirement Surety's website.[68] According to the site, a Verto note was “A Nine Month, Short-Term Investment with significantly higher returns than CDs or other safe money investments,” and was “200% collateralized” by life settlement policies.[69] Crescendo's website described an investment in the Verto notes as low risk and said the investment was “not a speculative investment influenced by market performance or the economy but rather an investment backed by 200% collateral with a known value.”[70]

Respondents also provided investors with a brochure.[71] In the brochure, Respondents stated that investments were “fully collateralized and secured by a collateral assignment and pledge agreement of the life settlements acquired and owned by Verto.”[72] They added that “life settlement assets will have a minimum ratio of 2:1 or 200% (loan to face value) in life settlements

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acquired and traded."[73] Respondents also stated that the investment was "not … speculative" and "[a]ll the risk of a life settlement maturing at an accurately determined life expectancy is born by the institutions that purchase them from Verto."[74]

***6** In late June 2014, Leeman emailed Schantz to ask about "the difference between" the notes that led to Schantz's consent order "and what we have?"[75] Leeman added that "it looks like" the notes Schantz previously sold ""were also 9 month notes."[76]

In early August 2014, Pauciulo responded to Leeman's forwarded email that the law in the area "is complex and can be confusing."[77] He said, however, "We have drafted the documents with the intent to meet the requirements of the 9 month note exemption."[78] Although Pauciulo thought the Commission or a court would agree they are exempt, he wrote that it "would not be feasible" to "provid[e] a formal legal opinion" on the subject.[79] He also offered that they could rely on the exemption in Securities Act "Section 4(2)" and ""possibly, Regulation D."[80] Finally, he suggested that rather than accepting commissions, Respondents "could serve as a purchaser representative and be retained and paid by the purchaser."[81]

Verto was sometimes unable to pay investors under the terms of their notes.[82] When that happened, Respondents negotiated and arranged "forbearance agreements" between Verto and the investors.[83] Respondents received an additional 4% commission for each forbearance agreement.[84]

Respondents received $565,419 in commissions for brokering Verto notes, $89,279 for obtaining signed forbearance agreements, and an additional $29,552 for obtaining second forbearance agreements.[85] In total, this broke down to $297,360 for Rose, $243,435 for Leeman, and $120,760 for Featherstone.[86]

For purposes of this proceeding, it is established that the Verto notes were securities and that no registration exemption applied to them.[87] No registration statement was ever filed for the offer and sale of the Verto notes.[88] Respondents knew that at least five of their investors were unaccredited.[89] Respondents did not provide investors with the financial information required by Securities Act Rule 502(b)(2), and no one ever filed a Form D with the Commission stating that Verto had complied with the exemptions in Securities Act Rule 506.[90]

Financial Condition of Respondents

The facts concerning Respondents' financial condition come from the Respondents' statements of financial condition and supporting documentation, which were prepared in May 2017, and supplemented by Respondents' August 2019 declarations.[91]

Featherstone

***7** Featherstone is 72 years old.[92] He is self-employed as a piano tuner and rebuilder, which can be a physically demanding job and becomes more difficult as he ages.[93] A significant portion of his income comes from Social Security benefits.[94] Featherstone provides for two adult dependents who require around-the-clock care.[95] Caring for his dependents reduces the time he has to work, although he relies on a friend to help when he needs to work or run errands.[96] Featherstone expects to incur "significant expenses" related to the care of his dependents.[97]

In 2017, Featherstone's monthly household income varied from month to month and was approximately $11,000.[98] His monthly household expenses were about $8,600.[99] Because of the need to devote additional time to the care of his dependents,

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Featherstone's household income decreased to approximately $4,000 per month as of August 2019. [100] He did not provide an update to his monthly expenses. Featherstone reported assets of about $1,500,000, including a home valued at $300,000, and liabilities of about $140,000, by far the largest of which was his home mortgage, on his 2017 statement of financial condition. [101]

Leeman

Leeman is 70 years old. [102] He is self-employed selling life insurance and a self-published book. [103] The vast majority of his household income comes from his wife, but she is 71 years old and wishes to retire. [104] Leeman has a significant medical condition that requires expensive treatment and hinders his ability to work. [105] Since 2017, Leeman's monthly household income has been approximately $6,300 and his monthly expenses were about $8,000. [106] In 2017, his total assets were over $430,000, including a home, and liabilities were about $200,000. [107]

Rose

Rose is 63 years old. [108] He is a self-employed insurance salesperson. [109] His combined household income is about $6,000 per month, the majority of which is Social Security benefits. [110] Rose's monthly expenses are about $9,200. [111] Rose's household income was significantly higher before 2017 due to changes in his wife's employment. [112] Including two homes with a combined value of about $650,000, Rose and his wife have over $1,000,000 in total assets and about $320,000 in total liabilities. [113]

Conclusions of Law

Civil Penalties

***8** I denied the Division's motion for summary disposition with respect to civil money penalties due to material questions of fact regarding whether respondents acted recklessly. Reviewing the record again, I do not find sufficient evidence to conclude that they were reckless. Applying the statutory factors and considering the other sanctions imposed, I find that first-tier civil money penalties are in the public interest.

Legal Standards

In this proceeding, the Commission may impose civil monetary penalties if a respondent has willfully violated a provision of the Securities Act or Exchange Act and the penalty is in the public interest. [114] The settlement order conclusively resolves against Respondents the question of whether they violated the Securities Act or Exchange Act and whether they acted willfully. [115] That leaves the public interest and the penalty tier.

In determining whether civil penalties are in the public interest, the Commission considers (1) whether the violation involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement; (2) the harm to others; (3) any unjust enrichment; (4) the respondent's history of securities-law violations or criminal offenses; (5) the need for deterrence; and (6) such other matters as justice requires. [116] The maximum civil penalty that may be imposed is based on the culpability of the respondent and is divided into three tiers. A first-tier penalty for the period at issue in this proceeding is limited to $7,500 and may be imposed for any violation. [117] A second-tier penalty, which has a maximum of $80,000, may be imposed if the violation involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement. [118] And a third-tier penalty, with a maximum of $160,000, may be imposed if the requirements for second-tier penalties are met and the violation resulted in either “substantial losses or created a significant risk of substantial losses to other persons” or “substantial pecuniary gain to the person who committed the act or omission.” [119]

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There is no allegation that Respondents' conduct involved fraud, deceit, or manipulation. The parties dispute whether Respondents acted in reckless disregard of a regulatory requirement. Recklessness is not a “heightened form of ordinary negligence” but requires “an ‘extreme departure from the standards of ordinary care … which presents a danger of misleading buyers … that is … so obvious that the actor must have been aware of it.”' [120] For example, the “‘egregious refusal to see the obvious, or to investigate the doubtful’ … is strong evidence of recklessness.” [121]

Parties' Arguments

***9** The Division argues that third-tier civil penalties should be imposed because Respondents recklessly disregarded the registration requirements of the Securities Act and Exchange Act. [122] In support of this, the Division contends that Respondents harbored concerns that the Verto notes could be securities and were on notice after hearing from Valencia that he would not participate due to his attorney's opinion that the Verto notes were securities. [123] The Division also argues that Respondents could not have reasonably relied on the information they received from Schantz and Pauciulo— who, as Verto's attorney, was not a disinterested party. [124] According to the Division, Respondents began selling the notes before hearing from Pauciulo, and Pauciulo stated that he could not provide a formal legal opinion. [125] The Division further contends that Respondents' sale of the notes created a substantial risk of loss to investors. [126]

Respondents assert that they acted in good faith. Because they were inexperienced in securities matters, they relied on others, including Schantz and Pauciulo, who repeatedly told them that the Verto notes were not securities. [127]

Recklessness

The evidence does not show that Respondents recklessly disregarded the registration requirements of the securities laws. Respondents knew they could not sell securities. [128] And they were interested in the Verto notes because they believed the notes were not securities under the nine-month exemption. [129] Although Respondents did some research on their own, because they did not have a securities background, they primarily relied on others' advice. [130] In this proceeding, Respondents did not assert a formal advice of counsel defense, but “reliance on the advice of counsel need not be a formal defense; it is simply evidence of good faith,” and therefore “a relevant consideration in evaluating … scienter.” [131]

Given Schantz's position and disciplinary background, if Respondents had relied solely on his word that the Verto notes were not securities, their reliance would have been misplaced and they consequently might have been reckless to sell the notes. But the same is not true about Respondents' reliance on Pauciulo. Respondents knew that he was “from a very large and reputable law firm in Philadelphia,” [132] and that he had extensive securities experience. [133] Rose and Leeman communicated with Pauciulo and received his assurance that the Verto notes were exempt before starting sales. [134] When Leeman raised questions about the exemption in 2014, Pauciulo again advised that the notes were created to meet the exemption's requirements. [135] It is true that Pauciulo conditioned his analysis with the statement that “a formal legal opinion” regarding the Verto notes was not ““feasible.” [136] Although this might have been a red flag to experienced securities practitioners, Respondents were not experienced. And while the Division remarks on Pauciulo's statement that he could not “provid[e] a formal legal opinion,” it has neither explained the significance Respondents as laymen should have attached to this qualifier nor denied that Pauciulo was, in fact, an experienced securities attorney.

***10** Respondents were unwise and perhaps overly credulous, but relying on Pauciulo's advice was not an egregious refusal to investigate the doubtful. [137] Although there were some red flags, the evidence does not show that it was so obvious the

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notes were securities that Respondents *must* have known it. Respondents, therefore, did not act with scienter when they failed to register as brokers and sold unregistered securities. The first public interest factor weighs in Respondents' favor.

Other Factors

Regarding harm to others, the Verto notes did not perform as advertised, causing some investors to lose money. The fair fund established in *SEC v. Schantz* is evidence of the significant overall harm caused by the Verto notes, and as of April 2019 Schantz still owed $1.5 million to investors under the terms of his judgment. [138] Respondents' conduct contributed to this harm, although their role in selling the notes based on Schantz's assertions was not as significant as Schantz's role in creating the notes and making unlikely assertions about them. Twenty-three investor customers of Leeman and Rose, who invested about $1.65 million or roughly 20% of the investments brokered by Leeman and Rose, submitted declarations stating that they were ""happy with the services provided." [139] Of those 23 investors, 11 had received a full return of principal and interest. [140]

Respondents received large commissions—7% on the original sales and 4% on the forbearance agreements. These commissions constituted unjust enrichment. On the other hand, Respondents do not have any history of violations of the securities laws or prior disciplinary history. And given Respondents' age, current employment, suspensions from industry association, and cease-and-desist order, the need for specific deterrence is minimal and the need for general deterrence is adequately covered by the other sanctions imposed.

As to "such other matters as justice requires," Respondents' liability hinges on whether the Verto notes were securities. Although Respondents now concede— and the settlement order confirms—that the notes were securities, Respondents were not reckless in determining that the notes were not securities. [141] I cannot ignore, however, the fact that Respondents "held themselves out as financial advisors providing specialized knowledge on investments," when they lacked any specialized knowledge. [142] And although they were aware of Schantz's background, Respondents accepted his unlikely assertions about Verto notes at face value without further investigation and without supporting documentation. [143] They therefore told prospective investors that Verto notes were non-speculative, low risk and "200% collateralized" based only on what Schantz told them. [144] So, while Respondents did not act with scienter in violating Section 5 and Section 15, their actions leave much to be desired.

Conclusion

***11** Because Respondents did not act with scienter, only first-tier civil penalties may be imposed. Respondents' misconduct led to serious harm to investors and Respondents received hundreds of thousands in unjust enrichment. Weighing Respondents' conduct and the other statutory factors, and Respondents' ability to pay, which is addressed below, a civil penalty within the first-tier range is appropriate and in the public interest. I will order each Respondent to pay a $3,750 civil penalty.

Ability to Pay

In determining whether disgorgement, interest, or monetary penalties are in the public interest, the Commission or its administrative law judges may consider evidence concerning ability to pay. [145] Considering this evidence is an exercise of discretion, and even if the Commission considers ability to pay, it "is only one factor … and is not dispositive." [146] Respondents bear the burden of proving their inability to pay. [147]

The Commission has not provided extensive guidance concerning inability to pay, but it has imposed penalties despite a demonstrated inability to pay when the misconduct at issue is "sufficiently egregious." [148] I will apply a twopart inquiry in determining whether to reduce monetary sanctions due to an inability to pay. [149] First, I will consider whether any Respondent has demonstrated an inability to pay in whole or in part. Second, if a Respondent has demonstrated an inability to pay, I will consider whether I should credit that in view of the seriousness or egregiousness of the violation in relation to the Commission's

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mission of "'protecting investors[,] … safeguarding the integrity of the markets,"' and "making securities law violations unprofitable." [150]

Featherstone

Although Featherstone reported significant assets on his statement of financial condition, review of that document shows that his net assets are not as significant as they appear. [151] Since he submitted that statement, his income has decreased substantially and he has an additional adult dependent. Featherstone's income is now insufficient to cover his monthly expenses, and his long-term earning potential is low.

I previously determined that Featherstone should disgorge $120,760. [152] While I did not calculate prejudgment interest, it is likely to be significant— more than $13,000. [153] Comparing this amount to Featherstone's current financial condition, he has established an inability to pay the entire amount. Turning to the second part of the inquiry, while the violations are serious, [154] Featherstone's conduct was not egregious. As discussed, he did not act with scienter. It is appropriate to credit his inability to pay.

***12** Because Featherstone's monthly cash flow is negative and not likely to increase in the future, and because of the economic challenges he faces resulting from the fact he must provide long-term, continuous care for two dependents, it is appropriate to discount his disgorgement amount. But because of the importance of Section 5 and Section 15, and because of the manner in which Respondents held themselves out as financial advisors and accepted and repeated Schantz's claims, I cannot waive the entire disgorgement amount. I will discount it by half, for a final disgorgement figure of $60,380, plus prejudgment interest. [155]

Leeman

Leeman reported a net worth of about $240,000, most of which is equity in his home. [156] His monthly household expenses exceed his monthly household income, and this income is likely to decrease in the future considering his significant medical condition and his and his wife's age. I previously determined that Leeman should disgorge $243,435, and prejudgment interest is likely to exceed $26,000. [157] I find that Leeman has established an inability to pay. Leeman did not act with scienter, and his conduct was not otherwise egregious. I will credit his inability to pay.

Leeman's financial condition is precarious and unlikely to improve in the future. Nevertheless, Leeman is not impecunious, and the seriousness of the violations and his behavior requires that some monetary sanction be imposed. Balancing these factors with Leeman's health, income, and expenses, I reduce the disgorgement amount to $24,343.50, or 10% of the determined total, plus prejudgment interest.

Rose

Rose is the youngest of the Respondents and in the best financial condition. Although he reported that his expenses currently exceed his household income, he has the highest prospects for increasing income in the future. Rose owns two homes with a combined value of about $650,000, he and his wife have over $1,000,000 in total assets and about $320,000 in total liabilities. [158] I previously determined that Rose should disgorge $297,360 and prejudgment interest is likely to exceed $31,000. [159] Comparing this amount to Rose's financial condition, I find that he has not demonstrated an inability to pay.

Although Rose reported negative monthly cash flow, his net worth is significant, and it appears likely that his household income will increase (or his expenses will decrease) in the future. He and his wife have not yet reached retirement age. For these reasons, I find that Rose can pay the amount of the disgorgement ordered, plus prejudgment interest. [160]

Order

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Under Rules of Practice 322 and 630(c), I ORDER that pages 1505 to 1514 of Respondents' appendix and accompanying exhibits be maintained under seal.

***13** Under Section 8A(e) of the Securities Act of 1933 and Sections 21B(e) and 21C(e) of the Securities Exchange Act of 1934, David Featherstone must DISGORGE $60,380; David Leeman must DISGORGE $24,343.50; and Thomas Rose must DISGORGE $297,360. Respondents must pay prejudgment interest on the amount of disgorgement imposed. The prejudgment interest owed will be calculated from January 1, 2017, to the last day of the month preceding the month in which payment of disgorgement is made. Prejudgment interest will be computed at the underpayment rate of interest established under Section 6621(a)(2) of the Internal Revenue Code, 26 U.S.C. § 6621(a)(2), and compounded quarterly.

Under Section 8A(g) of the Securities Act of 1933 and Section 21B(a)(1)- (2) of the Securities Exchange Act of 1934, David Featherstone, David Leeman, and Thomas Rose must each PAY A CIVIL MONEY PENALTY of $3,750.

Under Rule of Practice 1100, I ORDER that any funds recovered by disgorgement or civil penalties be placed in a fair fund for the benefit of investors harmed by the violations.

Payment of civil money penalties, disgorgement, and interest must be made no later than 21 days following the day this initial decision becomes final, unless the Commission directs otherwise. Payment must be made in one of the following ways: (1) transmitted electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request; (2) direct payments from a bank account via Pay.gov through the SEC website at http://www.sec.gov/ofm; or (3) by certified check, bank cashier's check, bank money order, or United States postal money order made payable to the Securities and Exchange Commission and hand-delivered or mailed to the following address alongside a cover letter identifying the Respondent and Administrative Proceeding No. 3-18061: Enterprise Services Center, Accounts Receivable Branch, HQ Bldg., Room 181, AMZ-341, 6500 South MacArthur Blvd., Oklahoma City, Oklahoma 73169. A copy of the cover letter and instrument of payment must be sent to the Commission's Division of Enforcement, directed to the attention of counsel of record.

This initial decision will become effective in accordance with and subject to the provisions of Rule 360. [161] Under that rule, a party may file a petition for review of this initial decision within 21 days after service of the initial decision. Under Rule of Practice 111, a party may also file a motion to correct a manifest error of fact within ten days of the initial decision. [162] If a motion to correct a manifest error of fact is filed by a party, then a party has 21 days to file a petition for review from the date of the order resolving such motion to correct a manifest error of fact.

***14** The initial decision will not become final until the Commission enters an order of finality. The Commission will enter an order of finality unless a party files a petition for review or motion to correct a manifest error of fact or the Commission determines on its own initiative to review the initial decision as to a party. If any of these events occur, the initial decision will not become final as to that party.

James E. Grimes
Administrative Law Judge

1 *Retirement Surety LLC*, Securities Act Release No. 10436, 2017 WL 5437486 (Nov. 14, 2017) (Settlement Order).

2 Settlement Order § III.E.

3 *Id.* § IV.

4 *Id.*

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5 *Retirement Surety*, Initial Decision Release No. 1250, 2018 WL 1872124 (ALJ Apr. 18, 2018).

6 *Pending Admin. Proc.*, Securities Act Release No. 10536, 2018 WL 4003609, at *1, *6 (Aug. 22, 2018); *see also Lucia v. SEC,* 138 S. Ct. 2044 (2018).

7 *Retirement Surety*, Admin. Proc. Rulings Release No. 6475, 2019 SEC LEXIS 294 (ALJ Mar. 4, 2019).

8 *Retirement Surety*, Admin. Proc. Rulings Release No. 6602, 2019 SEC LEXIS 1385, at *45 (ALJ June 13, 2019).

9 *Id.* at *27-29.

10 *Id.* at *29-41.

11 *Id.* at *41, *44.

12 *Retirement Surety*, Admin. Proc. Rulings Release No. 6634, 2019 SEC LEXIS 1794 (July 19, 2019); *see* Settlement Order § IV ("[T]he hearing officer may, in his discretion, determine the issues raised in the additional proceedings on the basis of the written record, without a hearing."); *Pending Admin. Proc.*, 2018 WL 4003609, at *1 (ordering administrative law judges to consider the parties' "proposals for the conduct of further proceedings" in remanded proceedings). The parties waived any claim on appeal that determining the outcome on the basis of a written record without an in-person hearing was error. *Retirement Surety*, 2019 SEC LEXIS 1794, at *1.

13 *See Pending Admin. Proc.*, 2018 WL 4003609, at *1.

14 *See* 17 C.F.R. § 201.323.

15 *See* 2019 SEC LEXIS 1385, at *6-24 & nn.18-101.

16 *See John Francis D'Acquisto*, Investment Advisers Act of 1940 Release No. 1696, 1998 WL 34300389, at *2 (Jan. 21, 1998).

17 Settlement Order ¶¶ 3-5. The Commission's factual findings in Section III of the Settlement Order are cited by paragraph number.

18 *Id.* ¶¶ 3-5, 29.

19 *Id.* ¶¶ 6, 12.

20 *Id.* ¶ 6.

21 *Id.* I take official notice of Schantz's consent order with the New Jersey Bureau of Securities. *See Clearing Servs. of Am., Inc.*, No. BOS 1796-02 (N.J. Bureau of Sec. Jan. 18, 2006), http://www.njconsumeraffairs.gov/Actions /20060117_ClearingServicesofAmericaIncschantz.pdf; 17 C.F.R. § 201.323.

22 Settlement Order ¶ 6.

23 *Id.* ¶ 27.

24 *Id.* ¶ 9.

25 *Id.* ¶¶ 9, 12.

26 *Id.* ¶12.

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27 *See* Complaint, *SEC v. Schantz,* No. 1:17-cv-03115 (D.N.J. May 4, 2017), ECF No. 1. I take official notice of the district court's docket and its orders and the parties' filings, as reflected in the docket. *See* 17 C.F.R. § 201.323.

28 Settlement Agreement, *Schantz* (May 4, 2017), ECF No. 3; Final Judgment as to Defendants William R. Schantz and Verto Capital Management LLC at 1-4, *Schantz* (May 8, 2017), ECF No. 4; *see* Amended Final Judgment as to Defendants William R. Schantz and Verto Capital Management LLC 1, 4, *Schantz* (Feb. 27, 2018), ECF No. 13.

29 Vakiener Decl. ¶ 14.

30 Settlement Order ¶ 1.

31 *Id.* (alteration in original).

32 *Id.*

33 *Id.* ¶ 2.

34 *Id.* (alterations in original).

35 *Id.*

36 Vakiener Decl., Ex. D at 106; *see* Resp'ts' App. 1509.

37 Resp'ts' App. 1506, 1512; *see* Vakiener Decl., Ex. D. at 107.

38 Vakiener Decl., Ex. D. at 107.

39 Resp'ts' App. 1430; *see* Vakiener Decl., Ex. D at 107.

40 Settlement Order ¶ 27.

41 Vakiener Decl., Ex. D. at 107; *see* Resp'ts' App. 1513. During investigative testimony, Schantz stated, “it's pretty clear. I've read the code” and “it specifically states that notes [that] would mature in nine months or less are not … securities.” Resp'ts' App. 1447.

42 Resp'ts' App. 1431. And Leeman testified that he believed Schantz: “most of all, we had the testimony of Mr. Schantz, who we believed would have never engaged in selling” Verto notes “if his attorney had said you better not, it is a security. He wouldn't do that.” Vakiener Decl., Ex. E at 106.

43 Vakiener Decl., Ex. D at 137. Leeman testified that they had received Pauciulo's “view” that the Verto notes were not securities before sales started, but he could not recall whether that view was expressed in a phone call or email exchange. Vakiener Decl., Ex. E at 106; *see* Resp'ts' App. 1513.

44 Vakiener Decl., Ex. D at 136-38.

45 Vakiener Decl., Ex. D at 108; *see id.* at 110 (“[J]ust doing Google searches, right, and trying to find SEC documents. We're obviously not securities licensed, so we wanted to make sure we weren't, you know, doing anything wrong.”); Vakiener Decl., Ex. E at 109; Vakiener Decl., Ex. F at 7917.

46 Vakiener Decl., Ex. D at 108, 110.

47 *Id.* at 109.

48 *Id.* at 108.

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49 Vakiener Decl., Ex. F at 7917.

50 *Id.*

51 *Id.*

52 Vakiener Decl., Ex. G at 271.

53 *Id.*

54 *Id.* at 269-70.

55 *Id.* at 270.

56 *Id.* at 269. He added, "Nice that we have an attorney vetting the company for us on Dave Valencia's nickel!!" *Id.*

57 Vakiener Decl., Ex. H at 31789.

58 *Id.*

59 *Id.*

60 Vakiener Decl., Ex. D at 108-10, Ex. E at 107-08.

61 Vakiener Decl., Ex. E at 107.

62 Vakiener Decl., Ex. D at 108-09.

63 Mot. at 8, 18.

64 Settlement Order ¶¶ 12, 27.

65 *Id.* ¶¶ 12, 20.

66 *Id.* ¶ 21.

67 *Id.* ¶¶ 13-20.

68 *Id.* ¶ 18.

69 *Id.*

70 *Id.* ¶ 19.

71 Vakiener Decl. ¶ 11.

72 Vakiener Decl., Ex. J at 3 (capitalization altered).

73 *Id.* (capitalization altered).

74 *Id.* at 4.

75 Settlement Order ¶ 27.

76 *Id.*

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77 Vakiener Decl., Ex. I at 1.

78 *Id.*

79 *Id.*

80 *Id.* The reference to Section 4(2) is presumably a reference to Securities Act Section 4(a)(2), which provides a registration exemption for issuer transactions not involving any public offering. 15 U.S.C. § 77d(a)(2). Regulation D under the Securities Act establishes exemptions for "limited offerings" and transactions deemed not to be public offerings. 17 C.F.R. §§ 230.504(a), .506(a).

81 Vakiener Decl., Ex. I at 1.

82 Settlement Order ¶ 22.

83 *Id.* ¶¶ 16, 22.

84 *Id.* ¶ 22.

85 *Id.* ¶ 23.

86 *Id.* ¶ 24.

87 *Id.* ¶¶ 26, 28.

88 *Id.* ¶ 28.

89 *Id.* Rule 506 under Securities Act Regulation D deals with unregistered offerings to accredited investors—those who meet certain income or sophistication requirements found in Rule 501(a). 17 C.F.R. §§ 230.501(a), .506.

90 Settlement Order ¶ 28. Rule 502(b)(2) governs the information that must be given to investors when securities are sold under Rule 506. 17 C.F.R. § 230.502(b)(2). Issuers that rely on Rule 504 or 506 use Form D to file notice with the Commission of an offering. 17 C.F.R. § 230.503(a).

91 Pages 1 to 1425 of Respondents' appendix are filed under seal. *Retirement Surety*, Admin. Proc. Rulings Release No. 6526, 2019 SEC LEXIS 665 (ALJ Mar. 28, 2019). For the same reasons, Respondents' supplemental filings, pages 1505 to 1514 of the appendix and accompanying exhibits, will be placed under seal. Because Respondents' ability to pay is one of the core issues in this proceeding, however, I will discuss some high-level details from those materials that do not reveal personally identifiable or otherwise sensitive information. *See* Rules of Practice, 60 Fed. Reg. 32,738, 32,792-93 (June 23, 1995) (comment to adoption of 17 C.F.R. § 201.630(c)).

92 Resp'ts' App. 1505.

93 *Id.* at 1506.

94 *Id.* at 1505.

95 *Id.* at 1505-06.

96 *Id.*

97 *Id.* at 1506.

98 *Id.* at 1015-16.

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99 *Id.* at 1016.

100 *Id.* at 1505-06.

101 *Id.* at 1012-13.

102 *Id.* at 6, 1508.

103 *Id.* at 1508.

104 *Id.* at 4-6, 1508.

105 *Id.* at 1508-09.

106 *Id.* at 1508. Leeman's household income was substantially higher in 2016. *Id.* at 5.

107 *Id.* at 1-3.

108 *Id.* at 1511.

109 *Id.*

110 *Id.*

111 *Id.* at 1512.

112 *Id.*

113 *Id.* at 420-22.

114 15 U.S.C. §§ 77h-1(g)(1), 78u-2(a)(1). Under Exchange Act Section 21B(a)(2), the Commission may also impose civil monetary penalties here because this proceeding was instituted as a cease-and-desist proceeding and Respondents violated a provision of the Exchange Act. 15 U.S.C. § 78u-2(a)(2). Section 21B(a)(2) does not explicitly require a finding that a Respondent acted willfully or that the penalty be in the public interest. *Id.*

115 Settlement Order § III.D.

116 15 U.S.C. § 78u-2(c). Although the Securities Act does not contain a statutory list of public-interest factors, the Commission considers the factors listed under the other securities statutes when assessing the public interest under the Securities Act. *See* *Thomas C. Gonnella*, Securities Act Release No. 10119, 2016 WL 4233837, at *14 & n.70 (Aug. 10, 2016), *pet. argued*, No. 16-3433 (2d Cir. Sept. 9, 2019); *see generally* 15 U.S.C. § 77h-1.

117 15 U.S.C. §§ 77h-1(g)(2)(A), 78u-2(b)(1); 17 C.F.R § 201.1001, tbl.I. Higher maximum penalty amounts apply to conduct occurring after November 2, 2015. *See* Adjustments to Civil Monetary Penalty Amounts, 84 Fed. Reg. 5122 (Feb. 20, 2019). Although the last Verto notes were sold in November 2015, Settlement Order ¶ 12, and Respondents earned commissions on forbearance agreements in 2016, *id.* ¶ 24, the vast majority of commissions were earned before November 2, 2015. Because the Division did not make any argument to the contrary, I will use the maximum civil penalty amounts in effect from March 6, 2013, to November 2, 2015.

118 15 U.S.C. §§ 77h-1(g)(2)(B), 78u-2(b)(2); 17 C.F.R § 201.1001, tbl.I.

119 15 U.S.C. §§ 77h-1(g)(2)(C), 78u-2(b)(3); 17 C.F.R § 201.1001, tbl.I.

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120 *SEC v. Steadman,* 967 F.2d 636, 641-42 (D.C. Cir. 1992) (quoting *Sundstrand Corp. v. Sun Chem. Corp.,* 553 F.2d 1033, 1045 (7th Cir. 1977)).

121 *Bernerd E. Young*, Securities Act Release No. 10060, 2016 WL 1168564, at *17 (Mar. 24, 2016) (quoting *Chill v. General Elec. Co.,* 101 F.3d 263, 269 (2d Cir. 1996)), *argued*, No. 16-1149 (D.C. Cir. Dec. 16, 2019).

122 Div. Supp. Reply at 2

123 *Id.* at 2-3; Settlement Order ¶ 27.

124 Div. Supp. Reply at 3.

125 *Id.*

126 *Id.* at 4-5.

127 Supp. Resp. at 7.

128 *See* Vakiener Decl., Ex. D. at 107.

129 *See Id.*

130 One court has observed that because "securities laws are 'complex and often uncertain"' a "'layman [*i.e.*, a non-lawyer] has no real choice but to rely on counsel."' *Howard v. SEC,* 376 F.3d 1136, 1147 n.20 (D.C. Cir. 2004) (quoting Douglas W. Hawes & Thomas J. Sherrard, *Reliance on Advice of Counsel as a Defense in Corporate and Securities Cases*, 62 Va. L. Rev. 1, 36 (1976) (alteration in original)).
Although a securities attorney familiar with the history of the nine-month exemption might think otherwise, the statute's plain language could be read to support a blanket exception for all nine-month notes. 15 U.S.C. §§ 77c(a)(3) (listing as exempted securities any note "which has a maturity at the time of issuance of not exceeding nine months"); 78c(a)(10) ("The term "security' … shall not include … any note … which has a maturity at the time of issuance of not exceeding nine months …."). *But see Reves v. Ernst & Young,* 494 U.S. 56, 63 (1990) ("[T]he phrase 'any note' should not be interpreted to mean literally 'any note,' but must be understood against the backdrop of what Congress was attempting to accomplish in enacting the Securities Acts."); *id.* at 73 (Stevens, J., concurring) (noting that the courts of appeals "have been unanimous in rejecting a literal reading" of the nine-month-note exemption); Interpretation of Section 3(a)(3), 26 Fed. Reg. 9158, 9159 (Sept. 20, 1961) (explaining the reach of the nine-month exemption).

131 *Howard*, 376 F.3d at 1147.

132 Vakiener Decl., Ex. E. at 105.

133 Vakiener Decl., Ex. G at 271.

134 Vakiener Decl., Ex. D at 136-38; Ex. E at 106; Resp'ts' App. 1513.

135 Vakiener Decl., Ex. I at 1.

136 *Id.*

137 Some securities professionals, including experienced registered representatives, have a duty to investigate "'where there are any unusual factors"D' and the failure to do so in the face of an "abundance of red flags" is evidence of extreme recklessness despite the approval of a compliance officer. *See Graham v. SEC,* 222 F.3d 994, 1005-06 (D.C. Cir. 2000) (quoting *Sharon M. Graham*, Exchange Act Release No. 40727, 1998 WL 823072, at *6 n.30 (Nov. 30, 1998)). But Respondents were inexperienced and unregistered—a violation of the securities laws for which they are liable. While they perhaps should have known better, in their position not further investigating the notes was not extremely reckless. *Cf.*

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id. at 1006. Indeed, in another case involving the sale of unregistered securities, the Commission held that consulting with others, including an attorney, "whom [the respondent] reasonably regarded as more sophisticated … than … himself" was a strong mitigating factor that weighed in favor of a minor sanction. *Charles C. Carlson*, Exchange Act Release No. 14246, 1977 SEC LEXIS 162, at *20 (Dec. 12, 1977).

138 Vakiener Decl. ¶ 14; Amended Final Judgment as to Defendants William R. Schantz and Verto Capital Management LLC, *Schantz* (Feb. 27, 2018), ECF No. 13. Schantz and the Commission have continued to litigate over the unsatisfied balance of the consent judgment. *See* Order, *Schantz* (July 1, 2019), ECF No. 28 (holding Schantz in contempt); Consent Order, *Schantz* (Sept. 23, 2019), ECF No. 45 (appointing an agent to sell a property).

139 Resp'ts' App. 1451-60, 63-78, 81-82, 1487-1504; *see* Settlement Order ¶ 24.

140 Resp'ts' App. at 1451, 1453, 1455, 1457, 1471, 1473, 1477, 1489, 1493, 1495, 1497.

141 Respondents' situation is similar to that in *Carlson*, where the Commission held that although Carlson sold unregistered securities, his liability was mitigated by the fact that he relied on the advice of others, including an attorney, "whom he reasonably regarded as more sophisticated … than he was." 1977 SEC LEXIS 162, at *20; *see Id.* at *20 n.40 (stating that although "those assurances [were] incorrect[,] … we cannot shut our eyes to the fact that some" authoritative sources "appear[ed] to have agreed with … the assurances on which Carlson relied.").

142 Settlement Order ¶ 25; Vakiener Decl., Ex. E at 112.

143 Vakiener Decl., Ex. D at 76, 89-90.

144 Settlement Order ¶¶ 18-19; Vakiener Decl., Ex. D at 76, 89-90.

145 17 C.F.R. § 201.630(a); *see* 15 U.S.C. §§ 77h-1(g)(3), 78u-2(d). Because the Division has not disputed Respondents' ability-to-pay evidence, I take it at face value.

146 *Thomas C. Bridge*, Securities Act Release No. 9068, 2009 WL 3100582, at *25 (Sept. 29, 2009), *pet. denied sub nom. Robles v. SEC,* 411 F. App'x 337 (D.C. Cir. 2010).

147 *Philip A. Lehman*, Exchange Act Release No. 54660, 2006 WL 3054584, at *4 & nn.29-30 (Oct. 27, 2006).

148 *Bridge*, 2009 WL 3100582, at *25; *Lehman*, 2006 WL 3054584, at *4.

149 *See Retirement Surety*, 2019 SEC LEXIS 1385, at *42-44.

150 *Gordon Brent Pierce*, Securities Act Release No. 9555, 2014 WL 896757, at *19 (Mar. 7, 2014) (quoting *SEC v. Rind,* 991 F.2d 1486, 1491 (9th Cir. 1993)) (describing the Commission's mission in the course of explaining the purpose of disgorgement), *pet. denied*, 786 F.3d 1027 (D.C. Cir. 2015).

151 In his May 2017 statement of financial condition, Featherstone declared that his net worth exceeded $1 million. Resp'ts' App. at 1012-13. His largest asset, however, was identified as the "Cash Surrender Value of Insurance." *Id.* at 1012. But in his explanation of assets, Featherstone stated that his insurance policies were "beneficial to [his] family as stated in the policy," and "[b]oth are term, not permanent life." *Id.* at 1013. Featherstone's next biggest asset is his home, but it is partially encumbered by a mortgage and is the home for two dependents who depend on him to provide constant care. *Id.* at 1012- 13. One of Featherstone's dependents is also the beneficiary of a trust that, in 2017, provided annual income of about $3,000. *Id.* at 1419-20.

152 *Retirement Surety*, 2019 SEC LEXIS 1385, at *27.

153 *See id.* at *27 n.106.

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154 The registration requirements in Securities Act Section 5 "are a keystone of the entire system of securities regulation, and set forth basic requirements for the protection of investors." *Sirianni v. SEC,* 677 F.2d 1284, 1289 (9th Cir. 1982). Similarly, the registration requirement in Exchange Act Section 15 "is 'of the utmost importance in effecting the purposes of the Act' because it enables the SEC 'to exercise discipline over those who may engage in the securities business and it establishes necessary standards with respect to training, experience, and records.'" *SEC v. Benger,* 697 F. Supp. 2d 932, 944 (N.D. Ill. 2010) (quoting *Celsion Corp. v. Stearns Mgmt. Corp.,* 157 F. Supp. 2d 942, 947 (N.D. Ill. 2001)).

155 Prejudgment interest will be calculated from January 1, 2017, as Respondents' earned Commissions "through 2016." Settlement Order ¶ 24.

156 Resp'ts' App. at 1-3.

157 *Retirement Surety*, 2019 SEC LEXIS 1385, at *27 & n.106.

158 Resp'ts' App. at 420-22.

159 *Retirement Surety*, 2019 SEC LEXIS 1385, at *27 & n.106.

160 *Cf. Robert L. Burns*, Advisers Act Release No. 3260, 2011 WL 3407859, at *12 (Aug. 5, 2011) (holding that, where a respondent's net worth exceeded the total amount of disgorgement, penalties, and interest, the respondent had not shown an inability to pay).

161 *See* 17 C.F.R. § 201.360.

162 *See* 17 C.F.R. § 201.111.

Release No. 1392 (S.E.C. Release No.), Release No. ID - 1392, 2019 WL 7284955

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873 F.3d 297
United States Court of Appeals,
District of Columbia Circuit.

John M.E. SAAD, Petitioner
v.
SECURITIES AND EXCHANGE COMMISSION, Respondent

No. 15-1430
|
Argued March 16, 2017
|
Decided October 13, 2017

Synopsis
Background: Broker-dealer who, based on violations of professional rules of conduct, had been permanently barred from registration with Financial Industry Regulatory Authority (FINRA) and from working with any of its affiliated members, petitioned for review of order of the Securities and Exchange Commission sustaining the disciplinary action.

Holdings: The Court of Appeals, Millett, Circuit Judge, held that:

mitigating and aggravating factors were appropriately considered, but

issue of whether lifetime ban was punitive, rather than remedial, required remand for Commission to determine in the first instance.

Petition denied in part and remanded in part.

Kavanaugh, Circuit Judge, concurred and filed opinion.

Millett, Circuit Judge, concurred dubitante and filed opinion.

***298** On Petition for Review of an Order of the Securities & Exchange Commission

Attorneys and Law Firms

Sara E. Kropf, Washington, DC, argued the cause for petitioner. With her on the briefs was Steven Nathan Berk.

Dina B. Mishra, Attorney, U.S. Securities and Exchange Commission, argued the cause for respondent. On the brief were Anne K. Small, General Counsel at the time the brief was filed, Sanket J. Bulsara, Deputy General Counsel at the time the brief was filed, John W. Avery, Deputy Solicitor, and Christopher Paik, Special Counsel.

Before: Garland, Chief Judge, and Kavanaugh and Millett, Circuit Judges.

Opinion

Concurring opinion filed by Circuit Judge Kavanaugh.

Dubitante opinion filed by Circuit Judge Millett with respect to Section II.B of the opinion.

Millett, Circuit Judge:

****10** John M.E. Saad, a broker-dealer, unlawfully misappropriated his employer's funds on two separate occasions, and then spent the next seven months misleading investigators in an effort to cover up his wrongdoing. After a lengthy review process, the Securities and Exchange Commission sustained a decision of the Financial Industry Regulatory Authority ("FINRA") permanently barring Saad from membership and from working with any of its affiliated members. Saad challenges the Commission's decision as insufficiently attentive to mitigating factors and argues that the permanent bar is impermissibly punitive rather than remedial. We hold that the Commission reasonably grounded its decision in the record, which extensively evidenced ***299 **11** Saad's acts of misappropriation, his prolonged efforts to cover his tracks through falsehoods, and his repeated and deliberate obstruction of investigators. With respect to the permanent bar on Saad's registration with FINRA and affiliation with its members, the court remands for the Commission to determine in the first instance whether *Kokesh v. SEC*, —— U.S. ——, 137 S.Ct. 1635, 198 L.Ed.2d 86 (2017), has any bearing on Saad's case. Accordingly, Saad's petition for review is denied in part and remanded to the Commission in part.

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I

A

FINRA is a private self-regulatory organization that oversees the securities industry, including broker-dealers. *Saad v. SEC*, 718 F.3d 904, 907 (D.C. Cir. 2013); *see Public Investors Arbitration Bar Ass'n v. SEC*, 771 F.3d 1, 2 (D.C. Cir. 2014). As part of its industry oversight, FINRA sets professional rules of conduct for its members. *See Saad*, 718 F.3d at 907; *see also* 15 U.S.C. § 78*o*–3(b)(2). One such rule—FINRA Rule 2010—requires "[a] member, in the conduct of its business, [to] observe high standards of commercial honor and just and equitable principles of trade."FINANCIAL INDUSTRY REGULATORY AUTHORITY, FINRA MANUAL, FINRA RULES, Rule 2010. [1] The high ethical standards enforced by Rule 2010 are vital because "customers and firms must be able to trust securities professionals with their money." J.A. 111–112. Trustworthiness and integrity thus are essential to the functioning of the securities industry.

1 http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=607.

FINRA has developed "Sanction Guidelines," which elaborate upon the contours of its rules of conduct. As relevant here, the Guidelines provide that conversion and the improper use of funds or securities will violate Rule 2010. J.A. 93. Conversion is defined as "an intentional and unauthorized taking of and/or exercise of ownership over property by one who neither owns the property nor is entitled to possess it." *Id*. In cases of conversion, the Sanction Guidelines provide that "a [lifetime] bar is standard," "regardless of [the] amount converted." *Id*.

In determining the appropriate sanction to be imposed for a violation of its rules, FINRA's Guidelines outline eight factors to be considered: (i) the need for the sanction to be remedial, to deter future misconduct, and to improve business standards in the securities industry, (ii) the violator's status as a repeat or one-time violator, (iii) the appropriateness of the sanction for the specific misconduct, (iv) the need in a particular case either to aggregate or to sanction individually similar violations, (v) the appropriateness of restitution or rescission, (vi) the remediation needed to ensure the individual does not benefit from ill-gotten gains, (vii) the necessity of requalification before permitting continued participation in the securities industry, and (viii) the violator's ability to pay any fine or restitution. J.A. 87–90.

In addition to those general principles, FINRA adjudicators must consider any other mitigating or aggravating factors. J.A. 91. FINRA's Sanction Guidelines provide a non-exhaustive list of nineteen potential aggravating or mitigating factors, including whether the violator (i) accepts responsibility for the misconduct, (ii) took voluntary corrective action prior to detection, (iii) engaged in a pattern of misconduct, (iv) perpetrated the misconduct over an extended period of time, (v) attempted ***300 **12** to conceal the misconduct, (vi) acted intentionally, or (vii) was already disciplined by the FINRA member firm. J.A. 91–92.

The disciplinary process begins when FINRA's Department of Enforcement or Department of Market Regulation files a complaint with the FINRA Office of Hearing Officers. FINRA Rule 9211. A panel of hearing officers then conducts a disciplinary proceeding, FINRA Rule 9213, and issues a final written decision addressing both liability and remedial sanctions, FINRA Rule 9268.

Either FINRA or the violator may appeal to the National Adjudicatory Council, FINRA Rule 9311, which "may affirm, modify, reverse, increase, or reduce any sanction, or impose any other fitting sanction," FINRA Rule 9349(a). The Council then provides a proposed decision to the FINRA Board. FINRA Rule 9349(c). If no Board member calls for review of the Council's decision, it becomes final. *Id.*

The violator may then seek review of FINRA's decision by the Securities and Exchange Commission, FINRA Rule 9370, which superintends the disciplinary decisions of financial industry self-regulatory organizations like FINRA, 15 U.S.C. § 78s(d)–(e). The Commission conducts its own review of the disciplinary action, and may modify, affirm, or set aside the sanction. *Id.* § 78s(e)(1)(A)–(B). The Commission will set a remedial order aside if the order "imposes any burden on competition not necessary or appropriate" to further the purposes of the Securities Exchange Act, or if the sanction "is excessive or oppressive." *Id.* § 78s(e)(2).

B

1

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John Saad was a regional director in the Atlanta Office of Penn Mutual Life Insurance Company, and was a FINRA-registered broker-dealer employed by Penn Mutual's affiliate Hornor, Townsend, & Kent, Inc. *Saad*, 718 F.3d at 906. Hornor, Townsend, & Kent, Inc. is a FINRA member firm. *Id.*

In July 2006, Saad scheduled a business trip from Atlanta, Georgia, to Memphis, Tennessee, but the trip was canceled at the last minute. *Saad*, 718 F.3d at 908; *see also* J.A. 107. Instead of going home to his wife and infant twins, Saad checked into an Atlanta hotel for two days. *Saad*, 718 F.3d at 908. Upon returning to his office, Saad submitted a false expense report for air travel to Memphis and a two-night stay in a Memphis hotel. *Id.* Attached to that false expense report were forged receipts for the fictitious airfare and hotel. *Id.*

Unconnected to the fabricated Memphis trip, Saad submitted another false expense report to his firm for a replacement cellphone. *Saad*, 718 F.3d at 908. Contrary to his representation in the expense report, Saad did not replace his own cellphone but instead purchased the cellphone for a female insurance agent at another firm. *Id.*; *see also* J.A. 62.

Saad's misconduct was soon discovered by an administrator in the Atlanta office of his firm because Saad submitted for reimbursement a receipt for four drinks purchased at an Atlanta hotel lounge on the same date that he was supposedly in Memphis. *Saad*, 718 F.3d at 908. When the administrator confronted him with the receipt, Saad grabbed the receipt and threw it away. *Id.* The administrator retrieved the receipt and sent it to Penn Mutual's home office. *Id.* In September 2006, Saad's employment was terminated. *Id.*

After Saad's termination, investigators from the National Association of Securities Dealers ("NASD")—FINRA's predecessor—questioned him about the false expense reports. *Saad*, 718 F.3d at 908. In a ***301 **13** November 2006 email, Saad falsely told investigators that the fabricated trip report was "for a business trip that had yet to occur[.]" *Id.* Five months later, in April 2007, Saad falsely stated to investigators that he did not know the person for whom he had purchased the cellphone. *Id.* The next month, Saad untruthfully told examiners that he could not remember if he had purchased a plane ticket for the fabricated Memphis trip. *Id.*

In September 2007, FINRA brought a disciplinary proceeding against Saad alleging "Conversion of Funds" in violation of FINRA Rule 2010. *Saad*, 718 F.3d at 908.[2] The hearing panel found that Saad had violated Rule 2010. Saad, in his own defense, explained that he had been experiencing significant personal and professional stress at the time he submitted the false expense reports because his sales had declined and one of Saad's one-year old twins was suffering from a stomach disorder that required frequent hospitalizations. *Id.* The hearing panel imposed a bar that permanently forbade Saad from associating with any FINRA member firm in any capacity. *Id.* at 909.

2 Saad was initially investigated for and charged with violating National Association of Securities Dealers Rule 2110. *See Saad*, 718 F.3d at 909. NASD Rule 2110 is identical to FINRA Rule 2010. *Id.* at 907; *see also*FINANCIAL INDUSTRY REGULATORY AUTHORITY, FINRA MANUAL, NASD RULES, Rule 2110, http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=605 ("A member, in the conduct of its business, shall observe high standards of commercial honor and just and equitable principles of trade."). At the time Saad's disciplinary proceeding was formally initiated in September 2007, the SEC had "approved the consolidation of NASD with certain functions of the New York Stock Exchange to create" FINRA. *Saad*, 718 F.3d at 907.

Saad appealed, and the National Adjudicatory Council affirmed. *Saad*, 718 F.3d at 909. In reviewing the lifetime ban, the Council concluded that Saad's misconduct involved several aggravating factors, such as "the intentional and ongoing nature of Saad's misconduct, Saad's efforts to deceive [Hornor, Townsend, & Kent] and Penn Mutual, [and] Saad's initial instinct to conceal the extent of his actions from state and FINRA examiners."*Id.* at 909 (second alteration in original and citation omitted). The Council further determined that no mitigating factors counseled a lesser sanction. *Id.*

The Securities and Exchange Commission affirmed, holding that, on this record, FINRA's sanction was not "excessive or oppressive." *Saad*, 718 F.3d at 909.

This court granted Saad's petition for review in part. We upheld the Commission's use of the Sanction Guideline governing conversion as a "starting point" for determining the appropriate sanction for Saad's two acts of misappropriation. *Saad*, 718 F.3d at 911. We remanded only because the Commission's analysis failed to address potentially mitigating factors, such as Saad's termination by his employer and Saad's

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personal and professional stress. *Id.* at 913. We left open the question whether the lifetime bar was an "excessive or oppressive" sanction, noting that the Commission had an obligation on remand to ensure its sanction was remedial rather than punitive. *Id.*

2

On remand, the Commission directed the National Adjudicatory Council to reconsider the imposition of the lifetime bar and, in particular, to address whether (i) a member firm's discipline of a rule violator prior to regulatory detection is a mitigating factor for the alleged violator, the member firm, or both, J.A. 36; (ii) the mitigating effect, if any, of Saad's termination ***302 **14** prior to regulatory detection, J.A. 38; (iii) the mitigating effect, if any, of Saad's personal and professional stress, J.A. 39; (iv) any other mitigating considerations, J.A. 45; and (v) the appropriateness of the lifetime bar for Saad's misconduct, J.A. 49.

The Council determined that (i) prior discipline by a member firm may be mitigating for an individual violator, J.A. 37–38; (ii) Saad's termination prior to regulatory detection was not mitigating on this record, J.A. 39; (iii) neither Saad's personal nor his professional stress was mitigating, J.A. 43–45; (iv) no other relevant mitigating factors existed in the case, J.A. 45–49; and (v) a permanent bar remained the appropriate remedy for Saad's misconduct, J.A. 49–50.

The Commission again affirmed. The Commission determined that Saad's repeated attempts over the course of seven months to conceal his misconduct from his employer and to mislead regulatory investigators were aggravating factors that supported FINRA's imposition of the permanent bar. J.A. 112. The Commission further concluded that the " 'collateral consequences' of misconduct, including loss of employment, reputation, and income, [were] not mitigating" on the facts of this case because they provided " 'no guarantee of changed behavior' and may not be enough to overcome [the Commission's] concern that he * * * 'poses a continuing danger to investors and other security industry participants (including would-be employers).' " J.A. 112–113 (quoting *Denise M. Olson*, Exchange Act Release No. 75838, 2015 WL 5172954, at *5 (Sept. 3, 2015)). The Commission also decided that, "under these circumstances," Saad's claims of professional and personal stress were not mitigating because his misconduct involved multiple instances of deliberate and deceptive conduct spread out over a long period of time, rather than a spontaneous or "unthinking" action triggered by stress and "later redressed." J.A. 113. The Commission found no mitigating value in Saad's arguments that his misconduct was "a series of blunders," his misappropriation did not involve customer funds, and he had a clean disciplinary record before his misappropriation. J.A. 114. Finally, the Commission reasoned that a permanent bar was the appropriate remedy in Saad's case because it "serves important deterrent objectives and reaffirms long-standing FINRA policy that such dishonesty by members or their associated persons will not be tolerated." J.A. 115. Accordingly, the Commission affirmed the permanent bar finding it to be "remedial, not punitive," and "necessary to protect FINRA members, their customers, and other securities industry participants[.]" J.A. 115.

II

We defer to the Commission's sanction decision if it is reasonable and reasonably explained, and will overturn it only if it is "arbitrary, capricious, or an abuse of discretion." *Saad*, 718 F.3d at 910 (quoting *Siegel v. SEC*, 592 F.3d 147, 155 (D.C. Cir. 2010)).

A

This court's prior decision remanded for the Commission to address Saad's mitigating evidence. *Saad*, 718 F.3d at 913–914. Saad now contends that the Commission failed to give his mitigating evidence sufficient heed. We disagree. The Commission reasonably balanced the relevant mitigating and aggravating factors before determining that the gravity of Saad's behavior warranted remedial action.

First, with respect to the mitigating relevance of Saad's termination by his employer for misconduct, the Commission ***303 **15** recognized that a FINRA Sanction Guideline provides that disciplinary action prior to regulatory detection may be considered mitigating. J.A. 112–113 (noting FINRA Principal Consideration in Determining Sanctions #14). But the Commission explained that his termination carried little weight in this case because "Saad repeatedly used dishonest means to overcome personal and professional disappointments and obstacles, and to mislead his employer and regulators." J.A. 113. Given those facts, the Commission reasonably concluded that "termination, while mitigating under certain circumstances, [did not] overcom[e] the threat

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[Saad] would pose to investors and other securities industry participants were he to return to the industry." J.A. 113.

Second, the Commission credited Saad's claims of personal and professional stress. The Commission nevertheless found them to lack mitigating force in this case because Saad's conduct was not a momentary or impulsive action driven by stress, but instead involved "deceptive conduct demonstrat[ing] a high degree of intentionality over a long period of time." J.A. 113. The Commission found it particularly significant that (i) Saad had not discussed the professional setbacks he was undergoing with his firm or otherwise sought assistance; (ii) his deception required planning and research; and (iii) he "methodically forg[ed] hotel and airfare receipts that bore logos that he had copied from the internet." J.A. 113. In addition, the Commission stressed that Saad did not own up to his missteps when the firm administrator confronted him about the fabricated expense report, but instead tried to destroy the evidence and repeatedly misled investigators for at least seven more months. J.A. 114. On top of that, Saad engaged in a second act of misappropriation by using firm funds to purchase a cellphone for a person who worked at another firm. J.A. 114. The Commission reasonably concluded that a pattern of such prolonged and repeated misbehavior could not be attributed to stress. J.A. 114.

Third, the Commission fairly addressed Saad's arguments that his misconduct did not involve the misappropriation of *customer* funds, and that he otherwise had a clean disciplinary record. J.A. 114. The Commission explained that it had not differentiated between the source of mistreated funds in the past, upholding bars even though "the underlying dishonesty did not relate directly to customers." J.A. 114; *see also* J.A. 114 n.24 (citing disciplinary proceedings involving misappropriation of non-customer funds). That makes sense. As the Commission previously has explained, it is the deception and fraud in the handling of others' property that endangers the integrity of the securities industry, and that threat remains the same whether the victim is a trusting employer or trusting client. *See* *Richard Dale Grafman*, Exchange Act Release No. 21648, 1985 WL 548687, at *2 (Jan. 14, 1985) (upholding a sanction even though the conduct did not involve public customers because "[t]he securities business presents a great many opportunities for abuse and overreaching, and depends very heavily on the integrity of its participants").

The Commission further noted that it has "repeatedly held that a clean disciplinary record is not mitigating." J.A. 114; *see also* J.A. 114 n.25 (citing a disciplinary proceeding holding that the lack of a disciplinary history is not mitigating); J.A. 91 n.1 (FINRA Sanction Guidelines manual, citing *Rooms v. SEC*, 444 F.3d 1208, 1214–1215 (10th Cir. 2006), for the proposition that disciplinary history can serve only as an aggravating factor and its absence cannot be mitigating). There is nothing unreasonable about the Commission concluding that individuals in a profession that depends ***304 **16** critically on public trust and honesty are already expected to have a clean record, so it is not something for which they get extra credit. *See**Rooms*, 444 F.3d at 1214 (noting that the violator "was required to comply with NASD's high standards of conduct at all times"); *see also**World Trade Fin. Corp.*, Exchange Act Release No. 66114, 2012 WL 32121, at *16 (Jan. 6, 2012) ("[F]irms and their associated persons should not be rewarded for acting in accordance with their duties.").

Accordingly, we hold that the Commission's thoroughgoing decision directly addressed the mitigating evidence, as required by our prior remand order, and provided a careful and comprehensive analysis of Saad's arguments seeking a reduction in his sanction. Its decision reasonably focused on the record of Saad's prolonged pattern of falsehoods and deception, as well as the direct threat that his misconduct posed to customers' and other participants' faith in the integrity of the securities industry.

B

Saad also challenges the Commission's affirmance of FINRA's lifetime bar on his affiliation with FINRA and its members as impermissibly punitive. We remand that question to the Commission to address, in the first instance, the relevance—if any—of the Supreme Court's recent decision in *Kokesh v. SEC*, ––– U.S. ––––, 137 S.Ct. 1635, 198 L.Ed.2d 86 (2017). Accordingly, Saad's petition for review is denied in part and remanded to the Commission in part.

So ordered.

Kavanaugh, Circuit Judge, concurring:
I add this brief concurrence to explain why I believe the Court is correct to remand this case to the SEC.

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Our precedents say that the SEC may approve expulsion or suspension of a securities broker as a remedy, but not as a penalty. Our cases in turn have upheld various expulsions or suspensions as remedial. *See, e.g.*, *PAZ Securities, Inc. v. SEC*, 566 F.3d 1172, 1175–76 (D.C. Cir. 2009). Our use of the term "remedial" to describe expulsions or suspensions finds its roots in a single, unexplained sentence in a 77-year-old Second Circuit case. *SeeWright v. SEC*, 112 F.2d 89, 94 (2d Cir. 1940). Applying those precedents here, the SEC concluded that the lifetime expulsion of Saad from the securities industry was permissible because the sanction was remedial, not punitive.

My fundamental problem with this line of cases is that the term "remedial" makes little sense when describing the expulsion or suspension of a securities broker. Like other punitive sanctions, expulsion and suspension may deter others and will necessarily deter and prevent the wrongdoer from further wrongdoing. Expulsion and suspension may thereby protect the investing public. But expulsion and suspension do not provide a remedy to the victim. Under any common understanding of the term "remedial," expulsion and suspension of a securities broker are not remedial. Rather, expulsion and suspension are punitive.

Of course, as a three-judge panel, we ordinarily must stick with our precedents. But here, the Supreme Court's recent decision in *Kokesh v. SEC*, — U.S. ——, 137 S.Ct. 1635, 198 L.Ed.2d 86 (2017), means that we can no longer characterize an expulsion or suspension as remedial. After the Supreme Court's decision in *Kokesh*, in other words, our precedents characterizing expulsions or suspensions as remedial are no longer good law.

In *Kokesh*, the Supreme Court ruled that disgorgement paid to the Government ***305 **17** is a "penalty" subject to the five-year statute of limitations in 28 U.S.C. § 2462. 137 S.Ct. at 1643–45. The Court reasoned that the disgorged money often does not go to victims and, moreover, is not limited to the amount of harm to victims—both of which would be required if the sanction were truly remedial rather than punitive. *See id.* at 1644–45. The Court stated: "Sanctions imposed for the purpose of deterring infractions of public laws are inherently punitive because deterrence is not a legitimate nonpunitive governmental objective." *Id.* at 1643 (internal quotations omitted). And the Court added: "A civil sanction that cannot fairly be said *solely* to serve a remedial purpose, but rather can only be explained as also serving either retributive or deterrent purposes, is punishment, as we have come to understand the term." *Id.* at 1645 (internal quotations omitted). Notably, the Supreme Court's decision in *Kokesh* overturned a line of cases from this Court that had concluded that disgorgement was remedial and not punitive. *See, e.g.*, *Zacharias v. SEC*, 569 F.3d 458, 471–72 (D.C. Cir. 2009).

As I see it, the *Kokesh* analysis matters here. The Supreme Court's reasoning in *Kokesh* was not limited to the specific statute at issue there. Like disgorgement paid to the Government, expulsion or suspension of a securities broker does not provide anything to the victims to make them whole or to remedy their losses. Therefore, in light of the Supreme Court's analysis in *Kokesh*, expulsion or suspension of a securities broker is a penalty, not a remedy.

Judge Millett's separate opinion cites cases such as *Smith v. Doe*, 538 U.S. 84, 123 S.Ct. 1140, 155 L.Ed.2d 164 (2003), for the proposition that occupational debarments are not punitive. But the question in *Smith v. Doe*, for example, was whether a particular sanction (there, required registration as a sex offender) was civil or criminal for purposes of the Ex Post Facto Clause. Some penalties are civil, and some penalties are criminal. The question of whether a penalty is civil or criminal is distinct from (although overlapping with) the question of whether a sanction is a penalty rather than a remedy. *See Hudson v. United States*, 522 U.S. 93, 105, 118 S.Ct. 488, 139 L.Ed.2d 450 (1997) (civil penalty at issue there was not "criminally punitive" for double jeopardy purposes). As I read it, nothing in *Smith v. Doe* or any of the other Supreme Court cases cited by Judge Millett's separate opinion says or suggests that occupational debarment is a remedy.

Judge Millett's separate opinion also states that Saad forfeited any argument that the sanction here was punitive, not remedial. I respectfully disagree. Saad expressly argued both to the SEC and to this Court that the lifetime expulsion in his case was punitive, not remedial. He of course did not cite *Kokesh* because *Kokesh* was not yet decided at the time. In my view, Saad preserved the argument that the sanction imposed on him was a penalty, not a remedy.

Judge Millett's separate opinion distinguishes this case from ordinary civil penalty cases by relying on FINRA's status as a self-regulatory organization. But by statute, FINRA is heavily regulated by the SEC, and a FINRA-sanctioned party has a right to appeal FINRA sanctions to the SEC. *See*15 U.S.C. § 78s; 78s(d).[1] FINRA ***306 **18** is therefore not akin to, for example, a state bar association or the National Football

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League—organizations that may impose discipline without statutorily required review by a federal agency.

1 "In their review of disciplinary orders, the federal courts of appeals do not distinguish between SEC orders that affirm FINRA disciplinary sanctions and SEC orders that affirm sanctions imposed through the SEC's administrative hearing system; both are considered SEC orders. Accordingly, parties rarely raise the objection that FINRA is not a government body, and if the objection is raised, courts quickly dispense with it." Barbara Black, *PunishingBad Brokers: Self–Regulation and FINRA Sanctions*, 8 BROOK. J. CORP., FIN. & COMM. L. 23, 41–42 (2013).

In appeals from FINRA sanctions, the SEC must determine whether the FINRA-imposed sanctions are "excessive or oppressive." 15 U.S.C. § 78s(e)(2). Our pre-*Kokesh* cases in turn say that the SEC may uphold FINRA sanctions as not being excessive or oppressive if the sanctions are remedial, not punitive. *See**Siegel v. SEC*, 592 F.3d 147 (D.C. Cir. 2010); *Paz*, 566 F.3d at 1175–76. And our pre-*Kokesh* cases further say that an expulsion or suspension can be considered remedial, not punitive.

My sole point here is to cast doubt on our pre-*Kokesh* cases' characterization of an expulsion or suspension as remedial rather than punitive. My point is not to suggest that FINRA lacks power to impose punitive sanctions such as expulsions or suspensions. After all, FINRA Rule 8310 expressly allows FINRA to impose expulsions and suspensions in appropriate cases. *See also*15 U.S.C. § 78***o***-3(b)(7) (authorizing FINRA to impose expulsions or suspensions). And the SEC may still approve an expulsion or suspension if such a FINRA-imposed sanction is an appropriate (that is, not "excessive or oppressive") penalty in particular cases. The question here therefore is whether the lifetime expulsion of Saad—what our prior opinion in this case called the "securities industry equivalent of capital punishment," *Saad v. SEC*, 718 F.3d 904, 906 (D.C. Cir. 2013)—was a permissible and appropriate penalty under the relevant statutes and regulations.

If FINRA and the SEC can still impose expulsions and suspensions in certain cases, why does the terminological distinction matter? In other words, why should we care that FINRA and the SEC must characterize certain sanctions as punitive rather than remedial? One answer is this: If FINRA and the SEC must justify expulsions or suspensions as punitive (as I believe they must after *Kokesh*), they will have to explain why such penalties are appropriate under the facts of each case. FINRA and the SEC will no longer be able to simply wave the "remedial card" and thereby evade meaningful judicial review of harsh sanctions they impose on specific defendants. Rather, FINRA and the SEC will have to reasonably explain in each individual case why an expulsion or suspension serves the purposes of punishment and is not excessive or oppressive. Over time, a fairer, more equitable, and less arbitrary system of FINRA and SEC sanctions should ensue. *Cf.*18 U.S.C. § 3553(a). [2]

2 Judge Millett's separate opinion suggests that the SEC on remand should not and, indeed, may not change its approach to this issue in the wake of *Kokesh*. To state the obvious, her separate opinion speaks for only one judge, as does my separate opinion. If a majority of the panel agreed with all of the sentiments expressed in Judge Millett's separate opinion, we presumably would not be remanding the case. If a majority of the panel agreed with all of the sentiments expressed in my separate opinion, we presumably would be remanding the case with specific directions about *Kokesh*. Instead, the Court is remanding for the SEC, in the first instance, to address the relevance of *Kokesh*. The *Kokesh* issue remains undecided for now in this Court.

With those observations, I join the Court's decision to remand the case to the SEC for the Commission to address in the first instance whether, in light of *Kokesh*, ***307** ****19** the penalty imposed on Saad was excessive or oppressive.

Millett, Circuit Judge, dubitante regarding Part II.B:
I have grave doubts about the propriety of remanding this case to the Commission yet again. This time, the remand seeks the Commission's views on the relevance—if there is any at all—of *Kokesh v. SEC*, ––– U.S. ––––, 137 S.Ct. 1635, 198 L.Ed.2d 86 (2017). But in my view, the Commission amply explained the remedial reasons for sustaining FINRA's permanent bar on Saad's affiliation with it and its members, and there is nothing in *Kokesh* that helps Saad. That presumably is why Saad himself has not whispered a word to this court about *Kokesh* having any bearing upon his case. Not one word. Accordingly, adding another round to this already decade-long saga does not seem worth the candle. Nor does further delay seem fair to FINRA's efforts to protect the integrity of the securities industry from securities brokers who exploit and abuse the trust of their employers and the investing public.

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In my view, the Commission did exactly what our earlier decision flagged for remand: It addressed Saad's mitigating evidence and quite reasonably concluded that FINRA's permanent bar on Saad's affiliation with its members is remedial, rather than "excessive or oppressive," 15 U.S.C. § 78s(e)(2). The Commission's affirmance of FINRA's decision about how best to deal with Saad's pattern of serious professional misconduct echoes the Supreme Court's recognition of "how essential it is that the highest ethical standards prevail in every facet of the securities industry." *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 186–187, 84 S.Ct. 275, 11 L.Ed.2d 237 (1963) (quotation omitted); *see Kokesh*, 137 S.Ct. at 1640 n.1.

In addition, in imposing Saad's bar, FINRA hewed to the remedy its Sanction Guidelines recommend, which we previously held FINRA could properly extend to this case. *See Saad v. SEC*, 718 F.3d 904, 911 (D.C. Cir. 2013) (upholding FINRA's reliance on the Sanction Guideline for conversion or improper use because "misappropriation is doubtless analogous to conversion") (internal quotation marks and citation omitted). That Sanction Guideline reflects a deliberate and objective assessment of the type of remedy needed to protect the securities industry and the investing public from misconduct involving mendacity and the misuse of entrusted property—misdeeds that strike at the heart of the investing public's trust in the securities industry. FINRA's evenhanded application of that prescribed remedy supports the sanction's remedial character.

As the Commission also explained, FINRA's determination in this case to permanently bar Saad from registering with FINRA or affiliating with its members was tailored to the individual circumstances of his case and Saad's serious and serial misconduct. In addition to two separate acts of misappropriating property entrusted to him—the fabricated Memphis trip and the abusive use of employer funds to purchase a cellphone for someone else—Saad forged documents, attempted to hide evidence of his misconduct after it was discovered by the Atlanta administrator, and deliberately deceived and misled regulators for more than half a year as they investigated his misconduct. The Commission thus had an adequate factual foundation to sustain FINRA's judgment that "Saad's actions betray a dishonest character * * * [and] demonstrate that he cannot be entrusted with firm or customer money[.]" J.A. 115. In an industry the functioning of which is predicated on the public trust, "[c]haracter is as important a ***308 **20** qualification as knowledge[.]" *Hawker v. New York*, 170 U.S. 189, 191, 18 S.Ct. 573, 42 L.Ed. 1002 (1898). For the same reason, the Commission reasonably concluded that Saad "would pose a continuing and unacceptable threat to investors and other industry participants if not barred." J.A. 115; *see Kokesh*, 137 S.Ct. at 1640 n.1 (emphasizing the need to "achiev[e] a high standard of business ethics in the securities industry") (quoting *Capital Gains Research Bureau*, 375 U.S. at 186, 84 S.Ct. 275).

Given all of that, *Kokesh* is of no help to Saad. *Kokesh* held only that "[d]isgorgement" ordered by the Commission in "enforcement proceedings" prosecuted by the Commission itself to punish violations of "public law" "operates as a penalty under [28 U.S.C.] § 2462," 137 S.Ct. at 1644, 1645. In multiple respects, that bears no resemblance to FINRA's private decision in this case to disaffiliate from Saad because of his repeated violations of FINRA's own professional rules of conduct.

First, the two cases implicate quite different remedial schemes and materially different statutory standards. As noted, *Kokesh* interpreted the term "penalty" under 28 U.S.C. § 2462, which prescribes a five-year statute of limitations for the imposition of any "civil fine, penalty, or forfeiture, pecuniary or otherwise" in proceedings brought to enforce Acts of Congress.

Commission review in this case, by contrast, does not involve a governmental entity enforcing an Act of Congress, federal regulation, or any other type of public law. Instead, in this case, the Commission is exercising discretionary superintendence over the decisions of a private self-regulatory organization (FINRA) to ensure only that its disciplinary decisions do not "impose[ ] any burden on competition not necessary or appropriate" and are not "excessive or oppressive." 15 U.S.C. § 78s(e)(2). If they are, the Commission "may" alter them. *Id*.

Those distinctions are critical. *Kokesh* is quite explicit that the defining feature of a "penalty" under 28 U.S.C. § 2462 is that it is "imposed as a sanction for violating *federal securitieslaw*." *Kokesh*, 137 S.Ct. at 1639 (emphasis added). Indeed, "violating a *public law*" is a "hallmark[ ] of a penalty." *Id.* at 1644; *see id.* at 1643 ("SEC disgorgement is imposed by the courts as a consequence for violating what we described in *Meeker [v. Lehigh Valley R Co.*, 236 U.S. 412, 35 S.Ct. 328, 59 L.Ed. 644 (1915)] as public laws.") (emphasis added); *id.* ("Sanctions imposed for the purpose of deterring infractions of *public laws* are inherently punitive[.]") (emphasis added); *id.* at 1641 ("The

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Commission sought civil monetary penalties, disgorgement, and an injunction barring Kokesh from violating *securities laws* in the future.") (emphasis added).

By contrast, all that Saad is charged with violating—and all that is being remediated in this proceeding—is FINRA's rules of professional conduct. *See* J.A. 109 ("FINRA instituted disciplinary proceedings * * * alleging [a] * * * violation of *NASD Rule* 2110.") (emphasis added); J.A. 110 (" '[P]ersonal problems' could be mitigating if they 'interfered with an ability to comply with *FINRA rules*[.]' ") (emphasis added).

The Supreme Court has ruled time and again that such "occupational debarment" is a "nonpunitive" sanction. *See Hudson v. United States*, 522 U.S. 93, 104, 118 S.Ct. 488, 139 L.Ed.2d 450 (1997) (order forbidding further participation in the banking industry is a nonpunitive sanction); *see also De Veau v. Braisted*, 363 U.S. 144, 156–160, 80 S.Ct. 1146, 4 L.Ed.2d 1109 (1960) (barring certain persons from work as union officials); ***309 **21** *Hawker*, 170 U.S. at 194–200, 18 S.Ct. 573 (permitting the revocation of a medical license); *see generally Smith v. Doe*, 538 U.S. 84, 100, 123 S.Ct. 1140, 155 L.Ed.2d 164 (2003). [1]

1 The Concurring Opinion dismisses the Supreme Court's debarment cases by suggesting that such discipline is, as a matter of law, a civil "penalty," and thus automatically "excessive or oppressive." Concurring Op. 306. But in upholding those measures, the Supreme Court recognized the important remedial role that such debarments can play in protecting the integrity of an industry and those members of the public who interact with it. *See Hudson*, 522 U.S. at 105, 118 S.Ct. 488 (holding that ancillary deterrence effects are not dispositive when a sanction's main purpose is "to promote the stability of the banking industry"); *Hawker*, 170 U.S. at 192, 18 S.Ct. 573 (upholding character requirements for medical licensing because of the "most intimate" relationship between the medical profession and the "life and health" of the general public).

This case is even easier than those Supreme Court cases. The question of whether debarments (or even suspensions, as the Concurring Opinion suggests) are "excessive or oppressive" is, at bottom, a pure question of statutory construction. And on that question, Congress has *mandated* that any securities-industry self-regulatory organization that wishes to register with the Commission include in its rules the ability to "discipline[ ]" members who violate "the rules of the association" by, *inter alia*, "expulsion, suspension, * * * [and] being suspended or barred from being associated with a member." 15 U.S.C. § 78*o*-3(b)(7); *see id*. § 78*o*-3(h)(3). Disciplinary tools required by Congress in Section 78*o*-3 cannot categorically be impermissibly "excessive or oppressive" under Section 78s(e)(2). [2]

2 Section 78*o*-3 does not mention disgorgement.

Second, *Kokesh* involved an order of disgorgement commanding the payment of funds into the United States Treasury. That sanction thus did nothing to protect or to compensate the victims of the crime. *Kokesh*, 137 S.Ct. at 1644 ("When an individual is made to pay a noncompensatory sanction *to the Government* as a consequence of a legal violation, the payment operates as a penalty.") (emphasis added); *id*. ("SEC disgorgement thus bears all the hallmarks of a penalty: It is imposed as a consequence of violating a public law and it is intended to deter, not to compensate.").

By contrast, Saad's offense harmed FINRA's members not just by misappropriating his employer's money, but also by imperiling, through both his fraud and his deceitful cover-up, the trust and confidence of the investing public that is the lifeblood of the securities industry. Saad's seven-month-long obstruction of investigators also squandered FINRA's and its members' resources, forcing them to expend time, personnel, and money unravelling the truth from his falsehoods. Under these circumstances, allowing an industry to protect itself and its clients from Saad's mendacity and purloining by disassociating from him is a remedial measure that protects the industry and its investors. *See* J.A. 115 ("Because we conclude that a bar is necessary to protect FINRA members, their customers, and other securities industry participants, we find that it is remedial, not punitive."); *see also id.* ("[Saad's actions] demonstrate that he cannot be entrusted with firm or customer money, and that therefore he would pose a continuing and unacceptable threat to investors and other industry participants if not barred."). Saad's discipline, unlike Kokesh's, does not surrender anything "to the Government." 137 S.Ct. at 1644. The remedy here thus bears no punitive resemblance to the disgorgement order in *Kokesh*.

***310 **22** *Third*, given the significant differences in the two statutory schemes, Saad cannot wrap himself in *Kokesh* without first establishing that the meaning of "penalty" in 28 U.S.C. § 2462's statute of limitations

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governing the enforcement of Acts of Congress both (i) directly dictates the meaning of "excessive or oppressive" under 15 U.S.C. § 78s(e)(2), *and also* (ii) overrides the Commission's discretionary judgment whether to correct a FINRA disciplinary measure, thereby mandating relief in his case, *cf. id*. (Commission "may" correct orders).

Saad, however, has never argued in any way at any point in these proceedings that we should extrapolate the meaning of "penalty" under 28 U.S.C. § 2462 to the determination of whether a sanction is "excessive or oppressive" under 15 U.S.C. § 78s(e)(2). Saad made no such argument before FINRA or the Commission. And before this court—giving Saad every benefit of the doubt—he at most indirectly bumped into the point by citing a case that arose under Section 2462—and even that appeared for the first time in his reply brief. Saad Reply Br. 2 (mentioning a case that involved a proceeding under 28 U.S.C. § 2462, but not citing the statute or arguing its extension to this context); *see*15 U.S.C. § 78y(c)(1) ("No objection to an order or rule of the Commission, for which review is sought under this section, may be considered by the court unless it was urged before the Commission or there was reasonable ground for failure to do so."); *United States v. TDC Mgmt. Corp.*, 827 F.3d 1127, 1130 (D.C. Cir. 2016) (undeveloped arguments are forfeited); *American Wildlands v. Kempthorne*, 530 F.3d 991, 1001 (D.C. Cir. 2008) ("We need not consider this argument because plaintiffs have forfeited it on appeal, having raised it for the first time in their reply brief.").

More to the point, Saad himself apparently sees no relevance to the Supreme Court's decision in *Kokesh* because, in the five months since *Kokesh* was decided, he has not said a single word to this court about that decision or its potential applicability. Because Saad himself does not consider the decision worth mentioning and has never argued at any point that 28 U.S.C. § 2462's definition of "penalty" controls this very different statutory scheme enforcing a different statutory standard ("excessive or oppressive"), he has forfeited any reliance on that argument. Or so the Commission could sensibly conclude.

Fourth, binding circuit precedent—indeed, law of the case —has established that the Commission "may approve 'expulsion not as a penalty but as a means of protecting investors.' " *Saad*, 718 F.3d at 913 (quoting *PAZ Securities, Inc. v. SEC*, 494 F.3d 1059, 1065 (D.C. Cir. 2007)). *See also Siegel v. SEC*, 592 F.3d 147, 158 (D.C. Cir. 2010) (consecutive suspensions permissibly imposed "to protect customers") (internal quotation marks omitted); *PAZ Securities, Inc. v. SEC*, 566 F.3d 1172, 1175 (D.C. Cir. 2009) (debarment permissibly imposed "to protect investors" and to redress "a significant harm to the self-regulatory system"); *McCurdy v. SEC*, 396 F.3d 1258, 1265 (D.C. Cir. 2005) (suspension permissibly imposed "to protect the public from [the violator's] demonstrated capacity for recklessness").

This court is not alone in that judgment. *See, e.g.*, *ACAP Fin., Inc. v. SEC,* 783 F.3d 763, 768 (10th Cir. 2015) (Gorsuch, J.) (suspension permissibly imposed where the violator's conduct "cast doubt on his ability to carry out his obligations as a securities professional in any capacity"). The Eighth Circuit, moreover, recently ruled that nothing in *Kokesh* called into question the authority of the Commission to sustain a disciplinary order enjoining the continued ***311 **23** violation of the securities laws. That prospective order remained remedial because it was designed "to protect the public prospectively[.]"*SEC v. Collyard*, 861 F.3d 760, 764 (8th Cir. 2017) (discussing *Kokesh*).

Nothing in *Kokesh* unravels our on-point circuit precedent. *Kokesh* involved a different sanction (disgorgement), imposed under a different statute under an entirely different type of Commission proceeding, to enforce public law not industry professional standards, and involved markedly different remedial and protective implications for private industry and private investors. Accordingly, nothing in *Kokesh* "effectively overrules" or "eviscerates" that binding precedent, which is what we require before abandoning law of the circuit. *See National Inst. of Military Justice v. Department of Defense*, 512 F.3d 677, 682–683 n.7 (D.C. Cir. 2008) ("[W]hether [a] Supreme Court opinion supersedes Circuit precedent * * * depends on whether [that] opinion 'effectively overrules,' i.e. 'eviscerates' precedent") (quoting *United States v. Williams*, 194 F.3d 100, 105 (D.C. Cir. 1999)).

Accordingly, under settled authority, the Commission's affirmance of a FINRA debarment decision is not "excessive or oppressive" when it is designed, as it was here, to remedially protect the industry and the investing public. This panel, and any panel reviewing the Commission's decision on remand, is bound by that precedent, and (absent an intervening en banc ruling) will continue to be bound by that precedent on review of any subsequent SEC decision. *See LaShawn A. v. Barry*, 87 F.3d 1389, 1393 (D.C. Cir. 1996) (en banc). [3]

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3 The Concurring Opinion says that *Kokesh* overturns circuit precedent characterizing "expulsion[s] or suspension[s]" as remedial. Concurring Op. 304. But the Concurring Opinion cites no language in *Kokesh* that even suggests such a sweeping holding, let alone that clearly "eviscerates" our precedent. Nor does the Concurring Opinion grapple with our strict circuit standard for relying upon intervening Supreme Court precedent to abandon circuit precedent.

The foundational premise of the Concurring Opinion is that only disciplinary sanctions that "provide a remedy to the victim" can qualify as "remedial." Concurring Op. 304; *see id*. at 305. But *Kokesh* does not go anywhere near that far. More to the point, it says nothing at all about what constitutes a remedial sanction in the context of a self-regulatory organization's enforcement of its professional standards, rather than public laws. This circuit has ruled that, in this exact statutory context, a disciplinary sanction that is "purely remedial and preventative" but *not* compensatory —such as a general order to cease-and-desist violating the securities laws—is "not a 'penalty' or 'forfeiture' " within the meaning of 28 U.S.C. § 2462. *Riordan v. SEC*, 627 F.3d 1230, 1234 (D.C. Cir. 2010); *see id*. at 1232 (labeling the cease-and-desist order "remedial"). A prospective cease-and-desist order of that general breadth "does not provide anything to the victims to make them whole or to remedy their losses," as the Concurring Opinion would require. Concurring Op. 305. Yet it certainly is remedial to ensure that, going forward, a harm stops.

The Concurring Opinion says that debarment and even a one-day suspension have to be treated as a penalties because, in its view, they do not "provide a remedy to the victim." Concurring Op. 304. But that argument conflates "remedial" with "compensatory." Victimization and harm entail more than just replacing lost dollars. There can be non-pecuniary harms too. There certainly were here. The harm that Saad inflicted and that FINRA remedied ***312 **24** did not stop with his employer's bank account. His conduct also sowed distrust in the industry, and his seven months of falsehoods and misrepresentations to regulatory investigators stole their time and scarce resources, while compounding the harms he caused to industry integrity.

FINRA's order of debarment directly remedied that full range of harms by making sure they stopped. Ordering the fox out of the henhouse falls comfortably within the "common understanding of the term 'remedial,' " Concurring Op. 304, and indeed provides to Saad's many victims a more comprehensive and realistic remedy than the Concurring Opinion's dollars-only approach. [4]

4 The Concurring Opinion's suggestion that FINRA "may" somehow be able to impose "civil penalt[ies]" is quite puzzling. Concurring Op. 305. Civil penalties punish violations of federal law, not private industry rules. *See*, *e.g.*, *Kokesh*, 137 S.Ct. at 1639, 1644. And nothing in the relevant federal securities laws empowers a *non-governmental* body like FINRA to prosecute and punish violations of *federal law* directly. Nor does federal law provide any avenue by which the Commission "may" be able to review FINRA's prosecution of civil penalties. Concurring Op. 305. More puzzling still is the Concurring Opinion's suggestion that FINRA was supposed to justify Saad's debarment as "punitive." Concurring Op. 306–07. This court remanded this case to the Commission to explain why its disciplinary measures were *not* "punitive." *Saad*, 718 F.3d at 913. Thankfully, law of the case and law of the circuit foreclose the Concurring Opinion's volte-face.

In sum, Saad's repeated turpitudinous misconduct, his nearly year-long venture in misleading and lying to his employer and investigating regulators, and the paramount need for the utmost honesty and integrity in the handling of others' property in the securities industry amply justified the Commission's decision to sustain FINRA's imposition of debarment as a remedy in this case. I do not see anything in *Kokesh* that bears on that decision by a private self-regulatory organization to disaffiliate with someone who repeatedly transgressed industry rules that are necessary to protect the investing public and the integrity of the securities industry. For those reasons, I have deep doubts about the decision to remand this case to the Commission to address a case that is so off-point that Saad himself has paid it no heed, especially because the remedial sufficiency of the Commission's order is controlled by circuit precedent. I have gone along only because nothing in our simple remand order says that *Kokesh* should alter the outcome of Saad's case.

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603 F.2d 1126
United States Court of Appeals,
Fifth Circuit.

Charles W. STEADMAN, Petitioner,
v.
SECURITIES AND EXCHANGE COMMISSION, Respondent.

No. 77-2415.
|
Oct. 4, 1979.
|
Rehearing Denied Nov. 27, 1979.

Synopsis

On petition for review of a Securities and Exchange Commission order that petitioner, the sole beneficial owner of an investment advisor, should, because of securities law violations, be permanently barred from associating with any investment adviser and prohibited from affiliating with any registered investment company, the Court of Appeals, Tjoflat, Circuit Judge, held, inter alia, that: (1) scienter need not be proved to establish violations of subsections 17(a)(2) and (3) of the Securities Act, but it is an element of a violation of subsection 17(a)(1), which makes it "unlawful for any person in the offer or sale of any securities * * * to employ any device, scheme, or artifice to defraud," and it is also an element of a violation of section 206(1) of the Investment Advisers Act, which contains similar language; (2) when the SEC imposes the most drastic sanctions at its disposal, it must articulate carefully the grounds for its decision, including an explanation of why lesser sanctions will not suffice; and (3) section 36(a) of the Investment Company Act may not be considered by the SEC in imposing sanctions for violations of other securities laws.

Remanded.

Attorneys and Law Firms

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Paul Gonson, Jacob H. Stillman, Mark B. Goldfus, Frank A. Wilson, Attys., Harvey L. Pitt, Gen. Counsel, Securities & Exchange Comm., Washington, D. C., for respondent.

On Petition For Review of an Order of the Securities and Exchange Commission.

Before WISDOM, GODBOLD and TJOFLAT, Circuit Judges.

Opinion

TJOFLAT, Circuit Judge:

The petitioner in this case, Charles W. Steadman, is the president, chairman of the board, and sole beneficial owner of all the voting stock in Steadman Security Corporation (SSC), an investment adviser registered with the Securities and Exchange Commission (SEC or the Commission). SSC, either directly or through wholly-owned subsidiaries, is the adviser to and manager of several mutual funds known collectively as the Steadman Funds. Steadman petitions for review of the SEC's decision of June 29, 1977, In re Steadman Security Corp., —- S.E.C. —-, (1977-1978 Transfer Binder) Fed.Sec.L.Rep. (CCH) P 81,243 (1977), which found Steadman, SSC, and the subsidiaries in violation of several provisions of the securities laws.[1] Because of these violations, the Commission entered an order that would (1) bar Steadman permanently from associating with any investment adviser, (2) prohibit his affiliation with any registered investment company, and (3) suspend him for one year from associating with any broker ***1129** or dealer. No sanctions were ordered against the corporate respondents, and they do not join in this appeal. Steadman raises several points of error in his petition, most of which we find to be without merit. We grant the petition in part, however, and remand the case to the Commission for reconsideration of the sanctions.

1 The Commission found the following violations:

1. Steadman, SSC, and SSC's wholly-owned broker-dealer subsidiary, Republic Securities Corp. (RSC), violated or aided and abetted violations of section 17(a) of the Securities Act of 1933 (Securities Act), section 10(b) of the Securities Exchange Act of 1934 (Exchange Act) and rule 10b-5 thereunder, and sections 206(1) and (2) of the Investment Advisers Act of 1940 (IAA) by failing to disclose that Steadman and SSC had borrowed money from the banks that maintained the custodian accounts for the Steadman Funds;

2. Steadman and SSC violated or aided and abetted violations of sections 20(a), 30, and 34

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of the Investment Company Act of 1940 (ICA) by failing to disclose the bank loans in proxy solicitation materials and annual and quarterly reports;

3. Steadman and SSC violated or aided and abetted violations of section 17(a) of the Securities Act, section 10(b) of the Exchange Act, and rule 10b-5 thereunder, sections 206(1) and (2) of the IAA, and subsection 15(a)(1) of the ICA by failing to disclose that SSC had received compensation from the mutual funds not precisely described in its management contracts;

4. Steadman and RSC violated or aided and abetted violations of section 17(e) of the ICA by receiving tender solicitation fees in connection with the tender of shares held by the funds and not remitting the fees to the funds;

5. Steadman, SSC, and its subsidiaries violated and aided and abetted violations of section 30(a) of the ICA and rules 30a-1 and 30a-2 thereunder, and section 17(a) of the Exchange Act and rule 17a-5 thereunder by failing to file annual reports of three mutual funds and four brokerage firms on time; and

6. Steadman and SSC aided and abetted technical violations of section 17(a) of the ICA by causing one fund under their control to buy and sell securities directly from other funds to which SSC was the adviser.

The violations found by the Commission relate to several different aspects of Steadman's management of the mutual funds through the corporations he controlled. See note 1 Supra. The violations we shall discuss concern Steadman and SSC's loan relationships with the banks used by the funds, the method of repayment to the funds of advisory fee overcharges, the retention by a broker-dealer subsidiary of tender solicitation fees paid for the tender of shares held by the funds, and the failure of Steadman and SSC to file timely reports with the Commission. We shall also examine the burden of proof to be applied in SEC disciplinary proceedings and the factual showing necessary to support the harsh sanctions in this case. As we review each of these areas, the relevant facts will be presented.

I. THE BANKING RELATIONSHIPS

Between 1965 and 1968, Steadman and SSC borrowed substantial amounts of money from the Riggs Bank of Washington, D.C.,[2] the same bank where the Steadman Funds kept their checking accounts.[3] In 1968, SSC began an expansion program to acquire the management rights to additional mutual funds. To finance these acquisitions, SSC applied to the Riggs Bank for a $2 million unsecured loan. The bank turned down the request, finding that the additional debt load on SSC, whose operations had not been profitable, would be too large. Steadman then retained two prominent investment bankers to aid his quest for capital; one of them successfully arranged a $3 million loan to SSC from the Chase Manhattan Bank in New York.

2 The Commission's opinion does not specify any of the banks involved in these dealings, but the Administrative Law Judge's Initial Decision identifies them and their names are not in dispute.

3 The Riggs Bank was the custodian for the securities and other investments owned by the funds and it also kept the funds' cash assets on deposit. Cash assets of a fund include proceeds from the sale of portfolio securities and any judgments realized by the fund. Checking accounts are used by the funds principally to pay dividend distributions and redemptions to fund shareholders.

At about the time the Chase loan was negotiated, Steadman and SSC recommended to the directors of several of the mutual funds that the funds transfer their bank accounts to Chase. The directors were told that the New York bank's custodial fees were lower, that it would be advantageous to be closer to the New York securities market, and that there had been problems with the Riggs Bank. They were not told about the loan to SSC. The transfer of accounts was approved.

Riggs called its personal loans to Steadman when the accounts were transferred (SSC had no loans outstanding from this bank at the time). Steadman obtained a collateralized loan from the First National Bank of Washington to repay the Riggs loans. The First National loan was called in 1970 when the value of the collateral declined, but Steadman received a 90-day extension. Two days later, one of the funds purchased a 90-day certificate of deposit from First National in an amount in excess of the loan. To repay his First National loan, Steadman obtained a loan from yet another bank, the National Bank of Washington. Soon afterwards, the custodial accounts for one of the Steadman funds were transferred from St. Louis to the National Bank. The fund's directors were not told about the loan to Steadman when they approved the transfer.

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Neither Steadman's nor SSC's loans were disclosed in the mutual funds' prospectuses. The Commission found that this was material information that Steadman had a duty to reveal. His failure to do so was in willful violation of section 17(a) of the Securities Act of 1933 (Securities Act), 15 U.S.C. s 77q(a) (1976), section 10(b) of the Securities Exchange Act of 1934 (Exchange ***1130** Act), 15 U.S.C. s 78j(b) (1976), rule 10b-5, 17 C.F.R. s 240.10b-5 (1978), and sections 206(1) and (2) of the Investment Advisers Act of 1940 (IAA), 15 U.S.C. s 80b-6(1), (2) (1976). Steadman contends that the Commission erred in finding the omitted information material, and that even if it were material, he cannot be held in violation of these statutes absent a finding that he acted with scienter, I. e., an intent to deceive or defraud.

A. Materiality

Steadman agrees that TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438, 96 S.Ct. 2126, 48 L.Ed.2d 757 (1976), defines the applicable standard of materiality but argues that the Commission misapplied that standard in this case. The TSC case states: “An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding (the matter before him)” Id. at 449, 96 S.Ct. at 2132. The Commission concluded that Steadman's practice of borrowing heavily, for himself and SSC, from the same banks where the funds had accounts created a potential for subordinating the funds' interests to his own. Deposits are the source of money that banks lend out for interest. Steadman needed large loans. His self-interest in currying the good favor of the banks might have led him, the Commission speculated, to keep unduly large amounts idle in the funds' non-interest-bearing accounts to the benefit of the banks but the detriment of the funds' shareholders. The SEC made no finding that this had in fact occurred and specifically declined to find that the funds' custodial accounts were a quid pro quo for the loans. Regardless of whether there was a connection between the loans and the accounts, the Commission decided that “Steadman had disabled himself from looking at the funds' checking account balances in a wholly disinterested way, with an eye single to the funds' best interest. Investors had a right to know this.” —- S.E.C. at —-, (1977-1978 Transfer Binder) Fed.Sec.L.Rep. (CCH) P 81,243, at 88,339-7 (footnote omitted). Therefore, the loans were material under the TSC standard. Id. at —- (1977-1978 Transfer Binder) Fed.Sec.L.Rep. (CCH) P 81,243, at 88,339-9.

Steadman argues that the SEC found only a Potential conflict of interest, and TSC requires an actual conflict before liability may be imposed. This misreads TSC. The relevant part of the TSC opinion involved the nondisclosure of facts that may have indicated possible market manipulation in the context of a proxy solicitation, a completely different context than what is involved here. More importantly, the Court was addressing the sufficiency of the plaintiff's case for summary judgment, I. e., whether the omission was material as a matter of law. The Court was not called upon to decide the quantum of evidence necessary to establish a material omission at trial. The Court reaffirmed in TSC that the issue of materiality is a mixed question of law and fact and that divining the significance of the inferences a reasonable investor would draw from a given set of facts is peculiarly within the competence of the trier of fact. Turning again to the facts of the case before it, the Court said that facts suggesting that one corporation controls another may be material even though in actuality there is no control; the influence of the one company over the affairs of the other would be of importance to shareholders. 426 U.S. at 453 & n.15, 96 S.Ct. at 2134-35. Here, the Commission is the trier of fact. It decided that, under the circumstances of this case, the potential for Steadman's abuse of his influence over where the funds did their banking was sufficiently great that shareholders would want to know about the loans. That finding is not wrong as a matter of law, and we affirm it.[4]

4 McDonough v. Champburger Corp., 488 F.2d 948 (5th Cir. 1974), does not require a contrary result. We there decided that the omitted facts were not material because other disclosed facts adequately revealed the possible conflict of interest, if indeed there was one at all. Id. at 952. Steadman and SSC disclosed no facts concerning their borrowings from the banks.

***1131** B. Scienter

Steadman strenuously urges that scienter an intent to deceive, manipulate, or defraud is a necessary element of any enforcement action by the SEC under the antifraud provisions of the securities laws. Since the Commission failed to find that Steadman acted with the requisite intent, he would have us set aside its decision and order. There is some support for this position. In Ernst & Ernst v. Hochfelder, 425 U.S. 185, 214, 96 S.Ct. 1375, 1391, 47 L.Ed.2d 668 (1976), the Supreme Court decided that scienter must be proved in a private damage action under rule 10b-5. Whether that holding should be extended to Commission enforcement actions under the statutes that Steadman was found to have violated is the

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question before us. We turn to an examination of each relevant section.

> of the Investment Company Act . . . are independent bases for liability.

1. Section 10(b) of the Exchange Act.

The Commission found that Steadman violated section 10(b) of the Exchange Act and rule 10b-5, section 17(a) of the Securities Act, and sections 206(1) and (2) of the IAA. In SEC v. Blatt, 583 F.2d 1325, 1333 (5th Cir. 1978), we held that the Commission must prove scienter in an injunctive action under section 10(b). Steadman contends that this holding compels the conclusion that scienter also is required in a disciplinary enforcement action such as this one.[5] Because the Commission failed to indicate whether it considered the other violations independent and sufficient bases for the sanctions imposed, the argument continues, we should reverse the decision.

5 The Blatt case was brought pursuant to section 21(d) of the Exchange Act, 15 U.S.C. s 78u(d) (1976), which authorizes the Commission to seek injunctive relief in district court for violations of that act. The case before us is an administrative proceeding under section 15(b) of the Exchange Act, 15 U.S.C. s 78O (b) (1976), section 9(b) of the ICA, 15 U.S.C. s 80a-9(b) (1976), and section 203(f) of the IAA, 15 U.S.C. s 80b-3(f) (1976).

We need not decide what state of mind must be shown in a disciplinary action for a violation of section 10(b), for the Commission has indicated to our satisfaction that the section 10(b) violation is mere surplusage in this case. In its opinion, in the context of distinguishing the Hochfelder case, the Commission stated:

> The instant case does not resemble Hochfelder. This is not a private action for money damages. It is a proceeding initiated by a public authority for the prophylactic purpose of preventing future harm to the public interest. Nor does this case rest solely on Rule 10b-5. 30 Indeed, it does not turn on 10b-5 at all. The references to that rule in the order for proceedings and in this opinion are merely cumulative. FP 30 Section 17(a) of the Securities Act and the provisions

--- S.E.C. at ---, (1977-1978 Transfer Binder) Fed.Sec.L.Rep. (CCH) P 81,243, at 88,339-10 (three footnotes omitted) (emphasis added). The clear import of these words is that section 10(b) and rule 10b-5 are not essential to the opinion and order.

2. Section 17(a) of the Securities Act.
Section 17(a) of the Securities Act provides:

> It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly
>
> (1) to employ any device, scheme, or artifice to defraud, or
>
> (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

15 U.S.C. s 77q (1976). In Hochfelder the Court noted that the language of rule 10b-5 appears to have been derived in significant ***1132** part from this section.[6] Hochfelder held that scienter is required under rule 10b-5. Petitioner argues that this indicates strongly that scienter also is required under section 17(a).

6 Rule 10b-5 provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
> (a) To employ any device, scheme, or artifice to defraud,
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary

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> in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

17 C.F.R. s 240.10b-5 (1978).

Hochfelder exposes the sophistry in this argument. The Court imposed a scienter element on rule 10b-5 because the rule can be no broader than its parent statute, section 10(b) of the Exchange Act, whose language the Court interpreted to require an intent to defraud. [7] Section 17(a) is, of course, a congressional enactment, not an administrative rule, and its language is quite different from that of section 10(b). Indeed, in a passage that cuts against Steadman's position, the Court stated:

> Viewed in isolation the language of subsection (b), and arguably that of subsection (c) (of rule 10b-5), could be read as proscribing, respectively, any type of material misstatement or omission, and any course of conduct, that has the effect of defrauding investors, Whether the wrongdoing was intentional or not.

425 U.S. at 212, 96 S.Ct. at 1390 (emphasis added). Subsections (b) and (c) of rule 10b-5 are nearly word-for-word identical with subsections (2) and (3) of section 17(a), respectively. We think that the Court would regard these subsections of section 17(a) as requiring no intent to defraud.

Steadman responds that the Securities Act and the Exchange Act have traditionally been construed in pari materia, and that to impose a scienter requirement under one but not the other would disrupt the "single comprehensive scheme of regulation" that these statutes form. Globus v. Law Research Service, Inc., 418 F.2d 1276, 1286 (2d Cir. 1969), Cert. denied, 397 U.S. 913, 90 S.Ct. 913, 25 L.Ed.2d 93 (1970). But Hochfelder observes that Congress fashioned standards of fault under these acts on a particularized basis. "Ascertainment of congressional intent with respect to the standard of liability created by a particular section of the Acts must therefore rest primarily on the language of that section." 425 U.S. at 200, 96 S.Ct. at 1384. We turn then to an examination of the language of section 17(a).

We are not the first to travel this road. In SEC v. Coven, 581 F.2d 1020 (2d Cir. 1978), Cert. denied, 440 U.S. 950, 99 S.Ct. 1432, 59 L.Ed.2d 640 (1979), the Second Circuit, in a well-reasoned opinion that included a canvass of the legislative history, concluded that scienter is not required in an SEC injunctive action under subsection 17(a)(2). We adopt that conclusion for the reasons given in the Coven opinion. Accord, SEC v. American Realty Trust, 586 F.2d 1001, 1005-06 (4th Cir. 1978); SEC v. Southwest Coal & Energy Co., 439 F.Supp. 820, 826 (W.D.La.1977), Appeal docketed, No. 78-1130 (5th Cir. Jan. 17, 1978). Moreover, we adopt the further suggestion in Coven that "the clear import of the critical phrase in subsection (3), 'operates ***1133** as a fraud,' is to focus attention on the Effect of potentially misleading conduct on the public, not on the culpability of the person responsible." 581 F.2d at 1026 (emphasis in original) (footnote omitted). When construing identical language in section 206(2) of the IAA, see note 10 Infra, language which was undoubtedly copied from subsection 17(a)(3), the Supreme Court said: "Congress, in empowering the courts to enjoin any practice which operates 'as a fraud or deceit' upon a client, did not intend to require proof of intent to injure . . . ." SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 195, 84 S.Ct. 275, 284, 11 L.Ed.2d 237 (1963). [8] Steadman objects that Coven is distinguishable as an Injunctive action in which the Commission need only prove that the defendant is about to engage in unlawful conduct, I. e., not every element of a section 17(a) violation need be proved. We think that Coven 's analysis of the statutory language does not depend on the character of relief sought; the words used by Congress carry the same meaning regardless of whether the SEC seeks an injunction or a stronger sanction. As we shall discuss, the severity of the sanctions affects the factual showing necessary to support them, but it does not affect the basic elements of the

7 Section 10(b) provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. s 78j(b) (1976).

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offense. Accordingly, we hold that scienter need not be proved to establish violations of subsections 17(a)(2) and (3).[9]

8 Read literally, subsection 17(a)(3) requires a finding that the course of business in which Steadman engaged operated as a fraud on the funds' shareholders. The Commission made no such finding in this case. A remand for rectification of this lapse would be a wasted gesture, however, because Capital Gains holds that nondisclosure of a material fact is conduct that "operates as a fraud or deceit" within the meaning of section 206(2) of the IAA. 375 U.S. at 198-99, 84 S.Ct. at 286. We think the same conclusion is inescapable under subsection 17(a)(3).

9 Steadman argues that Sanders v. John Nuveen & Co., 554 F.2d 790, 794-96 (7th Cir. 1977), suggests a contrary result. On the assumption that a private right of action for damages exists under subsection 17(a)(2), a question it did not resolve, the Seventh Circuit there commented that scienter must be proved in such an action, for to interpret the subsection otherwise would nullify other sections of the Securities Act that specifically provide for private actions. We cannot agree with Steadman's contention that the logic in Sanders should control in the type of proceeding now before us. Even if scienter may be required to harmonize a hypothetical implied private cause of action with the rest of the act, there is no reason to hold scienter an element of the action specifically contemplated by the statute.

We come now to subsection 17(a)(1). This clause contains the word "device" that the Supreme Court in Hochfelder found to be suggestive of intentional conduct when read together with "manipulative" and "deceptive." 425 U.S. at 197, 96 S.Ct. at 1383. The latter two words do not appear in subsection 17(a)(1), but the three words of that section device, scheme, and artifice must each be read in conjunction with the words "to defraud." The resulting phrases device to defraud, scheme to defraud, artifice to defraud carry strong implications of intentional conduct. We do not think Congress would have used such language if it meant to reach merely negligent actions. The use of the term "employ" further supports our reading of the section. See Hochfelder, 425 U.S. at 199 n.20, 96 S.Ct. at 1384.

In adjudicating a violation of section 17(a), the Commission failed to find that Steadman acted with an intent to defraud, and thus an essential element of a subsection 17(a)(1) violation is missing. There is an indication in a footnote to the Commission's opinion that the section 17(a) infraction rests only on subsections (2) and (3). See —- S.E.C. at —- n.31, (1977-1978 Transfer Binder) Fed.Sec.L.Rep. P 81,243, at 88,339-10. Perhaps this oblique footnote sufficiently conveys the SEC's intent to disclaim reliance upon subsection 17(a)(1). To the extent that the SEC relied upon subsections (2) and (3) of section 17(a), under which scienter is not a requirement, the violations are supported by substantial evidence and we would affirm; nevertheless, since we find other reasons to send this case back for reconsideration, the Commission on remand can clarify its opinion with regard to the subsections of section 17(a) that it considers were violated.

***1134** 3. Sections 206(1) and (2) of the IAA.

What we have said in discussing section 17(a) of the Securities Act applies equally to the language of subsections (1) and (2) of section 206 of the IAA.[10] The wording of these provisions, which make it unlawful for an investment adviser "(1) to employ any device, scheme, or artifice to defraud any client or prospective client; (2) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client," is drawn from subsections 17(a)(1) and (3), respectively. As we already have noted, the Supreme Court has ruled that scienter is not required under section 206(2). SEC v. Capital Gains Research Bureau, Inc., 375 U.S. at 195, 84 S.Ct. at 284. The Court in that case said nothing about part (1) of section 206. We think that the language of this subsection must be construed to have the same meaning as subsection 17(a)(1), for to do otherwise would produce a serious anomaly; language copied directly from the Securities Act would have a different meaning under the IAA. We are aware that in Capital Gains, the Court emphasized that the intent of the IAA was to impose fiduciary standards on investment advisers. This general purpose for the statute argues in favor of liability for negligence alone, but "(a) scertainment of congressional intent with respect to the standard of liability created by a particular section . . . must . . . rest primarily on the language of that section." Hochfelder, 425 U.S. at 200, 96 S.Ct. at 1384. The language of section 206(1) clearly connotes intentional conduct and nothing in either the House or Senate Committee reports indicates that this phrase in the IAA is to be interpreted differently than the same phrase in the Securities Act. See H.R.Rep.No.2639, 76th Cong., 3d Sess. (1940); S.Rep.No.1775, 76th Cong.,

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3d Sess. (1940). Although the violation of section 206(2) can be supported without a showing of scienter, here the Commission found a violation of section 206(1) without finding the requisite scienter. Because the Commission's findings do not support some of the violations, we remand so that the Commission can reconsider whether it would impose the same sanctions under the violations we uphold.

10 Section 206 provides in part:

> It shall be unlawful for any investment adviser, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly
>
> (1) to employ any device, scheme, or artifice to defraud any client or prospective client;
>
> (2) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client;
>
> 15 U.S.C. s 80b-6(1), (2) (1976).

II. ADVISORY FEES

SSC's management contract with at least two of the mutual funds limited SSC's annual advisory fee to one percent of each fund's average net assets. Apparently the fee was paid in installments throughout the year based on estimates of the assets under management. At the end of the fiscal year, [11] because of a sharp decline in value of these funds' assets, it became clear that payments to SSC had exceeded the contractual maximum. Thus SSC owed the two funds a total of $260,000. SSC did not refund the money immediately. Instead, it suggested, and the funds' directors agreed, that the overrun would be repaid in installments at six percent interest.

11 The relevant fiscal year ended on June 30, 1970, for one fund and on January 31, 1971, for the other.

On these facts the Commission found that SSC had received “compensation” within the meaning of subsection 15(a)(1) of the Investment Company Act of 1940 (ICA), 15 U.S.C. s 80a-15(a)(1) (1976), because the obligation to refund the fees arose as soon as the fiscal-year-end computations were made, and SSC reaped an economic benefit by stretching out the repayments. Subsection 15(a) (1) prohibits an adviser from receiving “compensation” not “precisely” described in the advisory contract. [12] Because ***1135** SSC's contracts did not provide for extended payment terms for fee overruns, the Commission held SSC in willful violation of the section and found that Steadman had aided and abetted the violations.

12 Section 15(a) provides in part:

> It shall be unlawful for any person to serve or act as investment adviser of a registered investment company, except pursuant to a written contract, which contract, whether with such registered company or with an investment adviser of such registered company, has been approved by the vote of a majority of the outstanding voting securities of such registered company, and
>
> (1) precisely describes all compensation to be paid thereunder;
>
> 15 U.S.C. s 80a-15(a)(1) (1976).

Steadman attacks these conclusions on several bases. He first argues that the arrangements made between SSC and the funds for repayment of the advisory fee overruns cannot reasonably be considered compensation to SSC. He cites as authority In re Imperial Financial Service, Inc., 42 S.E.C. 717, (1964-1966 Transfer Binder) Fed.Sec.L.Rep. (CCH) P 77,287 (1965), in which the SEC refused to hold that a loan, repaid at seven percent interest, constituted compensation to an affiliated borrower. The Commission responds that it explicitly noted in Imperial that in a given case an interest-bearing loan could be treated as compensation under the ICA, but because seven percent was a very generous rate at the time, the Commission did not decide whether that loan was compensation. Here, it points out, six percent was a very low rate for the time, and even if the interest were at market rate, [13] the funds' forbearance to demand immediate payment of the amount due was a substantial economic benefit to SSC.

13 Steadman and the Commission are unable to agree what the prime rate for commercial loans was at the time. The SEC says eight percent, Steadman says six to six-and-one-half percent. Even taking Steadman's best figure six percent it is clear that he was getting a good deal, because the best rate he was able to negotiate with a commercial bank on the loans discussed in Part I was one-half percent over prime. Moreover, the portfolio manager for one of the funds testified that in November 1970, the same time frame when these overruns were due, the funds could get eight-and-one-half to nine percent by investing in short term commercial paper. Joint App. at 94.

We think the Commission has the better argument. In Imperial, it did not foreclose itself from treating as compensation the type of repayment schedule involved

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here. The question presented is a rather technical one, and substantial deference is due the construction of a statute made by those charged with its execution. E. I. du Pont de Nemours & Co. v. Collins, 432 U.S. 46, 54, 97 S.Ct. 2229, 2234, 53 L.Ed.2d 100 (1977). The Commission's construction is not unreasonable, and we uphold it.

Steadman fares no better with his other contentions. That the arrangement was approved by the funds' directors and on the advice of counsel does not render the violation any less willful, for "willful" in this context simply means that the act constituting the violation was done intentionally; "(t)here is no requirement that the actor also be aware that he is violating one of the Rules or Acts." Arthur Lipper Corp. v. SEC, 547 F.2d 171, 180 (2d Cir. 1976) (footnote omitted) (quoting Tager v. SEC, 344 F.2d 5, 8 (2d Cir. 1965)), Cert. denied, 434 U.S. 1009, 98 S.Ct. 719, 54 L.Ed.2d 752 (1978). As to the finding that Steadman aided and abetted the violation, his control of SSC is a substantial ground for the inference that he was involved in every important activity of that company, and there is independent evidence in the record to support this inference.

Finally, Steadman points out that in finding that the failure to disclose the installment repayment arrangement was a violation of the antifraud provisions, see footnote 1, paragraph 3, Supra, the Commission failed to find that the omitted facts were material. It is true that the Commission did not explicitly state in its opinion that these facts were material, but it adopted the Administrative Law Judge's findings that the antifraud statutes had been violated, and we think it sufficiently clear that the SEC also adopted the finding that these facts were material.

***1136** III. TENDER SOLICITATION FEES

In 1969, tender offers were made for securities held by three of the Steadman funds. In accordance with the custom in the industry, the offerors paid tender solicitation fees to brokers who successfully solicited their clients to tender their shares. The funds' shares were tendered through Republic Securities Corporation (RSC), a wholly owned broker-dealer subsidiary of SSC. RSC collected tender solicitation fees equal to two percent of the value of the securities tendered about $32,000. RSC kept half of this amount and paid the other half to the tendering funds.

Subsection 17(e)(1) of the ICA, 15 U.S.C. s 80a-17(e)(1) (1976), prohibits an affiliated person of an investment company from receiving compensation for the sale of the company's property except in the course of his business as a broker.[14] The Commission found that RSC was not acting as a broker in this transaction and therefore should have paid all of the fees it received to the tendering funds:

14 The full text of section 17(e) provides:

> It shall be unlawful for any affiliated person of a registered investment company, or any affiliated person of such person
>
> (1) acting as agent, to accept from any source any compensation (other than a regular salary or wages from such registered company) for the purchase or sale of any property to or for such registered company or any controlled company thereof, except in the course of such person's business as an underwriter or broker; or
>
> (2) acting as broker, in connection with the sale of securities to or by such registered company or any controlled company thereof, to receive from any source a commission, fee, or other remuneration for effecting such transaction which exceeds (A) the usual and customary broker's commission if the sale is effected on a securities exchange, or (B) 2 per centum of the sales price if the sale is effected in connection with a secondary distribution of such securities, or (C) 1 per centum of the purchase or sale price of such securities if the sale is otherwise effected unless the Commission shall, by rules and regulations or order in the public interest and consistent with the protection of investors, permit a larger commission.
>
> RSC thought it was complying with the one percent limitation of subsection (2) (C) when it remitted half the fee to the funds.

> Where no brokerage is needed, no fee may be collected. These fees paid were to "soliciting brokers." Republic did no soliciting. It merely transmitted the tendered securities. No broker was needed for that.
>
> The decision to tender had already been made by the investment adviser. For making such decisions it received an advisory fee. It could not pocket a second fee for the very same service by donning its broker-dealer hat.

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—- S.E.C. at —-, (1977-1978 Transfer Binder) Fed.Sec.L.Rep. (CCH) P 81,243, at 88,339-15 (footnotes omitted). In support, the SEC cites its decision in In re Provident Management Corp., 44 S.E.C. 442, (1970-1971 Transfer Binder) Fed.Sec.L.Rep. (CCH) P 77,937 (1970), [15] where it found improper the retention of tender solicitation fees by an affiliated broker who performed no "compensable services."

15 Steadman's attack on the precedential value of Provident is without merit. Although that opinion was issued in connection with an offer of settlement, the Commission's construction of the securities laws in settled cases as well as litigated ones is entitled to great weight. E. I. duPont de Nemours & Co. v. Collins, 432 U.S. 46, 54, 97 S.Ct. 2229, 2234, 53 L.Ed.2d 100 (1977).

There is no dispute that RSC is an affiliated person of the tendering funds. Steadman contends, however, that RSC performed substantial services for the funds in gathering the shares and effecting the transfers and that these were brokerage services for which it could collect a fee. Steadman attacks the conclusion that "where no brokerage is needed, no fee may be collected" as novel and unsupported. He also argues that the funds accrued a net benefit on the transaction since the whole two percent fee would have been lost to them if they had used an unaffiliated broker, whereas by using RSC they collected half the fee.

We think that we must defer to the Commission's expertise on this issue also. Its argument that the services performed by RSC were part of what the funds were ***1137** paying their manager, SSC, to do is not unreasonable. Section 17(e) was intended to prohibit conflicts of interest between a fund and affiliated persons advising it on portfolio transactions. United States v. Deutsch, 451 F.2d 98, 109 (2d Cir. 1971), Cert. denied, 404 U.S. 1019, 92 S.Ct. 682, 30 L.Ed.2d 667 (1972). SSC faced such a conflict in advising the funds whether to tender, knowing that its subsidiary would pocket a fee if they did. That the funds might also gain is no answer. Accordingly, the Commission's finding of section 17(e) violations by RSC is affirmed. There is substantial evidence to support the conclusion that Steadman aided and abetted the violations. He personally reviewed the accounting treatment given the transaction and ordered the splitting of the fees between RSC and the funds. Hence, we also affirm the Commission's finding that Steadman violated section 17(e).

IV. REPORTING VIOLATIONS

By the terms of its management contracts with the funds, SSC undertook to see that the funds filed with the SEC reports required by law. The annual reports for at least three funds were filed late for three consecutive years, 1970 to 1972, and the annual reports for Steadman's four broker-dealer companies were late in both 1971 and 1972. In the Commission's view, the principal problem involved the 1971 reports. These were filed more than a year late, " 'so late as to be of minimal value in serving the purposes intended by the requirements for filing the reports.' " —- S.E.C. at —-, (1977-1978 Transfer Binder) Fed.Sec.L.Rep. (CCH) P 81,243, at 88,339-16 (quoting from Administrative Law Judge's Initial Decision).

Steadman does not deny that the reports were late. He does not dispute that the applicable statutes were thus violated, see note 1, paragraph 5, Supra ; he simply contends that there is no evidence that the violations were willful. He points out that it is uncontested that it took seven months to replace SSC's controller after he resigned in 1971, that SSC's independent auditor was changed in the same year, and that SSC sought but was denied extensions for at least some of the reports.

The Commission responds that these facts in mitigation do not excuse the violations or render them less willful. We agree. The record discloses that as early as 1969, SSC's auditors were advising Steadman of serious deficiencies in the accounting procedures and internal organization, including the lack of sufficient personnel, of SSC and its subsidiaries. They warned that the growth in assets under management had not been matched by changes necessary to handle the increased workload. In 1970, under pressure from the banks to meet his loan payments, Steadman implemented a stringent cost-cutting drive that included a significant reduction in personnel. His problems were thus of his own making. On these facts, the Commission was justified in concluding that Steadman was more interested in economizing than in maintaining the organization necessary to manage the funds properly.

V. SANCTIONS AND BURDEN OF PROOF

Steadman's principal argument for reversal of the Commission's order is that the wrong burden of proof was used in the administrative proceedings. We have reserved treatment of this issue for discussion in conjunction with his attack on the severity of the sanctions imposed upon him because, in our view, the two are closely related. We

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conclude that when the Commission chooses to order the most drastic remedies at its disposal, it has a greater burden to show with particularity the facts and policies that support those sanctions and why less severe action would not serve to protect investors.

A. Burden of Proof

The Commission applied a "preponderance of the evidence" standard in this case. Steadman cites Collins Securities Corp. v. SEC, 183 U.S.App.D.C. 301, 562 F.2d 820 (D.C.Cir. 1977), for the proposition that a "clear and convincing evidence" standard is required. In Collins, the defendant was ***1138** charged with manipulating the market for the shares of a particular company in violation of various antifraud provisions of the securities laws. The court acknowledged that the traditional standard of proof in administrative proceedings is the preponderance of the evidence. It expressed concern, however, that in a securities case involving allegations of fraud the evidence is often circumstantial in nature and requires to a significant degree the drawing of inferences to establish the violation. In addition, on the basis of this inferential proof the administrative agency may impose sanctions amounting in effect to a deprivation of livelihood. Thus the court discerned "a need to subject such evidence to a standard which will ensure that any remedial sanctions are imposed only in those circumstances where the evidence is of such a quality as to make the sanctions appear just and reasonable." Id. at 304, 562 F.2d at 823. After noting that the clear and convincing evidence standard has been imposed in certain other types of cases, most notably those involving civil fraud, the court concluded that, for SEC disciplinary proceedings in fraud cases, this standard drew the necessary "realistic correlation between the burden of persuasion and the available remedies." Id. at 307, 562 F.2d at 826.

Other cases cited by petitioner are relevant but not directly on point. In Addington v. Texas, 441 U.S. 418, 99 S.Ct. 1804, 60 L.Ed.2d 323 (1979), the Supreme Court decided that the fourteenth amendment requires at least the clear and convincing evidence standard in civil involuntary commitment proceedings. In a general discussion of the function of a standard of proof, the Court noted:

> One typical use of the (clear and convincing) standard is in civil cases involving allegations of fraud or some other quasi-criminal wrongdoing by the defendant. The interests at stake in those cases are deemed to be more substantial than mere loss of money and some jurisdictions accordingly reduce the risk to the defendant of having his reputation tarnished erroneously by increasing the plaintiff's burden of proof.

Id. at ——, 99 S.Ct. at 1808. The case before the Court did not, of course, involve allegations of fraud, and no holding was made respecting such cases. In requiring more than a mere preponderance of evidence for civil commitment, the Court focused primarily on the deprivation of liberty entailed in confinement; it also noted that "adverse social consequences" can result from involuntary commitment to a mental hospital. Id. at ——, 99 S.Ct. at 1809.

Spevack v. Klein, 385 U.S. 511, 87 S.Ct. 625, 17 L.Ed.2d 574 (1967), and In re Ruffalo, 390 U.S. 544, 88 S.Ct. 1222, 20 L.Ed.2d 117 (1968), also cited by Steadman, both hold that disbarment from the practice of law is a penalty that triggers the minimum protections of due process notice, a hearing, and the right not to testify against oneself. Steadman does not suggest that he was denied these protections in this case; rather, he argues that due process also requires a heightened standard of proof before he may be barred permanently from his profession.

To the extent that Collins rests on a concern that there are particular risks for a respondent in a fraud proceeding because the proof is necessarily circumstantial and inferential, we are not persuaded. In this proceeding, the only fact to which Steadman points as being based on disputed inferences is his state of mind whether he acted with an intent to defraud. But we have held that scienter is not an element of a violation of subsections (2) and (3) of section 17(a) of the Securities Act or of section 206(2) of the IAA, statutes on which the Commission relies to a significant degree in this case. These are commonly called "antifraud" provisions, but the offenses they define are fraud in the broadest "remedial" sense of that term and require no showing of intent to injure or injury. See SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 195, 84 S.Ct. 275, 284, 11 L.Ed.2d 237 (1963). The facts necessary to establish a violation of these sections nondisclosure of a material fact are capable of ***1139** proof by ordinary direct or circumstantial evidence as in any other administrative proceeding.

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We are more impressed by Steadman's argument that the potential for severe sanctions that results from violation of these sections demands a higher burden of proof. Before the Commission, Steadman faced indefinite exclusion from the investment advisory business and the forced sale of all his interest in SSC. The order the Commission rendered is indistinguishable in its effect on the respondent from disbarment from the practice of law. While many jurisdictions use a preponderance standard in disbarment proceedings, many others apply a higher standard. See 7 C.J.S. Attorney & Client s 33a(3) (1937 & Supp.1979); 7 Am.Jur.2d Attorneys at Law s 67 (1963 & Supp.1979) (collecting cases). The higher standard rests in large part on the concern that disbarment means deprivation of livelihood. See, e. g., In re Fisher, 179 F.2d 361, 369-70 (7th Cir.), Cert. denied, 340 U.S. 825, 71 S.Ct. 59, 95 L.Ed. 606 (1950).

We are reluctant to say, however, that in all disciplinary proceedings under the securities antifraud provisions the Commission must prove its case by clear and convincing evidence. Debarment from the industry is not the only sanction the SEC can impose. The available remedies also include mere censure, limitation of the respondent's activities, or suspension for up to twelve months. 15 U.S.C. s 80b-3(f) (1976).[16] Thus, the stakes are not as high for every respondent in a Commission proceeding as they came to be for Steadman.

16 In addition, 15 U.S.C. s 80a-9(b) (1976) permits the permanent or temporary, conditional or unconditional, prohibition of service of an officer, employee, or director of a registered investment adviser.

The burden of proof serves to allocate between the litigants the risk of erroneous decision in a proceeding. Addington v. Texas, 441 U.S. at ——, 99 S.Ct. at 1808. Balanced against the risk to Steadman is the risk that the investing public will be inadequately protected. The public interest in high standards of conduct in the securities business is a great one. If the burden of proof imposed on the Commission is too high, its ability to police the industry is impaired. We cannot say here, as the Court could in Addington v. Texas, id. at ——, 99 S.Ct. at 1810, that "the possible injury to the individual is significantly greater than any possible harm to the state." Accordingly, we do not see why they should not bear the risk of error equally.

We do not wish to minimize the seriousness of the sanctions laid upon Steadman. From his perspective, exclusion from the industry is clearly a penalty. See Arthur Lipper Corp. v. SEC, 547 F.2d 171, 180 n. 6 (2d Cir. 1976), Cert. denied, 434 U.S. 1009, 98 S.Ct. 719, 54 L.Ed.2d 752 (1978); Cf. In re Ruffalo, 390 U.S. at 550, 88 S.Ct. at 1226 (disbarment is a penalty). But see Blaise D'Antoni & Associates v. SEC, 289 F.2d 276, 277 (5th Cir.) (revocation of broker registration not a penalty), Cert. denied, 368 U.S. 899, 82 S.Ct. 178, 7 L.Ed.2d 95 (1961). But imposing a high burden of proof to establish the facts of a securities-laws violation is not the only means to protect a respondent. We are empowered to set aside Commission orders that are arbitrary and capricious. 5 U.S.C. ss 551, 702, 706 (1976). We subscribe to the common-sense notion that the greater the sanction the Commission decides to impose, the greater is its burden of justification. Where, as here, the most potent weapon in the Commission's "arsenal of flexible enforcement powers," Ernst & Ernst v. Hochfelder, 425 U.S. 185, 195, 96 S.Ct. 1375, 1382, 47 L.Ed.2d 668 (1976), is used, the Commission has an obligation to explain why a less drastic remedy would not suffice.

We have not lost sight of the limitations on our power to review administrative sanctions. Our role is to decide only whether, under the applicable statute and the facts as found, the agency has made "an allowable judgment in its choice of the remedy." Jacob Siegel Co. v. FTC, 327 U.S. 608, 612, 66 S.Ct. 758, 760, 90 L.Ed. 888 (1946), Quoted in ***1140** Butz v. Glover Livestock Commission Co., 411 U.S. 182, 189, 93 S.Ct. 1455, 1459, 36 L.Ed.2d 142 (1973). The fashioning of an appropriate and reasonable remedy is for the Commission, not this court, and the Commission's choice of sanction may be overturned only if it is found "unwarranted in law or . . . without justification in fact." American Power & Light Co. v. SEC, 329 U.S. 90, 112-13, 67 S.Ct. 133, 146, 91 L.Ed. 103 (1946), Quoted in Butz v. Glover Livestock Commission Co., 411 U.S. at 185-86, 93 S.Ct. at 1458. In our view, however, permanent[17] exclusion from the industry is "without justification in fact" unless the Commission specifically articulates compelling reasons for such a sanction. For example, the facts of a case might indicate a reasonable likelihood that a particular violator cannot ever operate in compliance with the law, See SEC v. Blatt, 583 F.2d 1325, 1334 (5th Cir. 1978), or might be so egregious that even if further violations of the law are unlikely, the nature of the conduct mandates permanent debarment as a deterrent to others in the industry, see p. 1142 Infra. We do not intend to limit the Commission by indicating these possible grounds for debarment, but rather give them as examples of the type

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of situation that would seem to justify that penalty.[18] With this in mind, we proceed to examine the sanctions imposed upon Steadman.

17 "Permanent" in this context really means "indefinite" since the Commission retains the power to modify its orders. See In re Steadman Securities Corp., —- S.E.C. at —- n.100, (1977-1978 Transfer Binder) Fed.Sec.L.Rep. (CCH) P 81,243, at 88,339-23. This does not make the sanction less severe, however.

18 The Commission might consider modelling its use of, and explanation for, debarment after the way in which disbarment has been enforced against certain members of the legal profession.

B. The Sanctions

In its brief, the Commission has candidly conceded that Steadman's status as a fiduciary to the funds was "vitally significant" in assessing the seriousness of his conduct. Respondent's Brief at 67. The opinion under review concludes that Steadman was "egregiously faithless" in that role because of (1) his intentional and protracted concealment of his banking relationships and (2) his causing flagrant and intentional breaches of his companies' contractual and fiduciary duties to see that the funds fulfilled their reporting obligations. —- S.E.C. at —- & n.90, (1977-1978 Transfer Binder) Fed.Sec.L.Rep. (CCH) P 81,243, at 88,339-20. Harsh sanctions were imposed because the misconduct in this case was particularly serious, and past misconduct gives rise to an inference of probable future misconduct. Leniency in this case, it was felt, would pollute the ethical climate in the industry and encourage others to act irresponsibly.

We do not agree with Steadman that the Commission has unconstitutionally made a conclusive presumption of future wrongdoing on the basis of past misconduct, but we do agree that a fuller explanation of the need for these sanctions is required. At least the Commission specifically ought to consider and discuss with respect to Steadman the factors that have been deemed relevant to the issuance of an injunction:

> the egregiousness of the defendant's actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the sincerity of the defendant's assurances against future violations, the defendant's recognition of the wrongful nature of his conduct, and the likelihood that the defendant's occupation will present opportunities for future violations.

SEC v. Blatt, 583 F.2d at 1334 n.29. To say that past misconduct gives rise to an inference of future misconduct is not enough. What is required is a specific enumeration of the factors in Steadman's case that merit permanent exclusion.

We heartily endorse the Commission's view that while scienter is not required to make out violations of several of the statutory sections involved here, the respondent's state of mind is highly relevant in determining the remedy to impose. ***1141** It would be a gross abuse of discretion to bar an investment adviser from the industry on the basis of isolated negligent violations. More than that was shown here, however. The Commission found that the concealment of Steadman's collateral banking relations was "systematic, calculated and protracted," —- S.E.C. at —-, (1977-1978 Transfer Binder) Fed.Sec.L.Rep. (CCH) P 81,243, at 88,339-11; accordingly, it found that he and his corporate instrumentalities intended to deceive. This conclusion is markedly undercut, though, by the Commission's refusal to adopt the Administrative Law Judge's finding that the funds' custodial accounts were intentionally offered to the banks as an inducement to make the loans.[19] Such a finding by the Commission would have significantly strengthened its conclusion that the failure to disclose the loans was intended to deceive. Use of the funds' custodial accounts as leverage to obtain loans for the adviser and its president would be an obvious and serious breach of fiduciary duty, the concealment of which clearly would have been fraudulent. In the absence of such a finding, we have only the coincidence that Steadman and SSC borrowed from the funds' custodians. We do not retreat from our affirmation that these facts were material, but they are less supportive of an intent to deceive than other conclusions the record arguably permits. We do not say there is a lack of substantial evidence to support the finding of scienter there is such support but in considering what sanctions the Commission's opinion will justify, we think the Commission has not articulated a sufficient justification for expulsion from the industry.

19 There is no satisfactory explanation for the Commission's failure to make this finding except

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> that it was considered unnecessary. The opinion notes that the live testimony at the hearing was against a causal link, and the documentary evidence supporting such a link was received by the Administrative Law Judge over Steadman's objections to its admissibility and probative weight. Therefore, the Commission concluded, "questions of fact are raised. We do not reach them." —- S.E.C. at —-, (1977-1978 Transfer Binder) Fed.Sec.L.Rep. (CCH) P 81,243, at 88,339-13 (footnote omitted).

We also are troubled by the Commission's position that it may consider violations of section 36(a) of the ICA, 15 U.S.C. s 80a-35(a) (1976),[20] in assessing sanctions for violations of other sections of the securities laws.[21] Section 36(a) permits the Commission to apply to a federal district court for an injunction against an officer of an investment adviser who has engaged or is about to engage in acts constituting "a breach of fiduciary duty involving personal misconduct." It gives no power to the Commission, an administrative agency, to adjudicate such breaches, and the Commission has held that it cannot do so. In re Carl L. Shipley, —-S.E.C. —-, (1973-1974 Transfer Binder) Fed.Sec.L.Rep. (CCH) P 79,833 (1974). Here, the Commission reaffirms a position it took in dicta in Shipley : in a proceeding where it finds willful violations of other provisions of the securities laws, on the issue of sanctions it may consider whether the respondent has also violated section 36(a). We agree that section ***1142** 36(a) is a "reservoir of fiduciary obligations imposed upon affiliated persons to prevent gross misconduct or gross abuse of trust not otherwise specifically dealt with in the Act." Brown v. Bullock, 194 F.Supp. 207, 238-39 n.1 (S.D.N.Y.), Aff'd, 294 F.2d 415 (2d Cir. 1961). But responsibility for its enforcement is vested in the courts, not the Commission. The statutory distinction between the functions of the agency and the courts would be effectively read out of the law if the Commission could bring section 36(a) into its own enforcement proceedings through the back door by professing reliance upon it only at the stage of assessing sanctions. We are aware that SEC v. Capital Gains Research Bureau, Inc., 375 U.S. at 191-92, 84 S.Ct. at 282-83, emphasizes that the purpose of the IAA (and, by implication, the ICA, see note 21 Supra) was to regulate the "delicate fiduciary nature of an investment advisory relationship." SEC v. Capital Gains Research Bureau, Inc., 375 U.S. at 191, 84 S.Ct. at 283 (quoting 2 L. Loss, Securities Regulation 1412 (2d ed. 1961)). We do not think this overall purpose is a warrant to read sections 206(1) and (2) of the IAA, the sections found to have been violated here, as the vehicle to reach all breaches of fiduciary trust. The Court in Capital Gains relied on the broad purpose of the statute to hold that section 206(2) does not require a showing of scienter, but that is far from adopting the position the Commission takes here. The Commission may impose sanctions only for violations of the statutes assigned to its jurisdiction, and that does not include section 36(a). This is not to say that in imposing sanctions, the Commission may not consider violations occurring in the context of a fiduciary relationship to be more serious than they otherwise might be. This is not due to any contribution from section 36(a), however, but because the "public interest" the Commission is required to consider in fashioning its orders must be construed liberally to effectuate the prophylactic purpose of the securities laws. See SEC v. Capital Gains Research Bureau, Inc., 375 U.S. at 195, 84 S.Ct. at 284-85.

20 15 U.S.C. s 80a-35(a) provides:

> The Commission is authorized to bring an action in the proper district court of the United States, or in the United States court of any territory or other place subject to the jurisdiction of the United States, alleging that a person serving or acting in one or more of the following capacities has engaged within five years of the commencement of the action or is about to engage in any act or practice constituting a breach of fiduciary duty involving personal misconduct in respect of any registered investment company for which such person so serves or acts

21 The statutes commonly referred to as the ICA and the IAA were enacted as titles I and II respectively of the Act of August 22, 1940, ch. 686, 54 Stat. 789 (codified at 15 U.S.C. ss 80a-1 to 80a-52, 80b-1 to 80b-21 (1976)). Section 9(b) of title I, 15 U.S.C. s 80a-9(b) (1976), and section 203(f) of title II, Id. s 80b-3(f), both authorize the Commission to bar persons from the investment adviser and investment company business for willful violations of any provision of title I or title II, the Securities Act, or the Exchange Act. The ICA and the IAA therefore overlap, and, as a general matter, it is not improper to refer to violations of one in assessing sanctions under the other. However, as we explain, this does not mean the Commission may poach on the jurisdiction entrusted solely to a federal district court.

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As we have indicated, see p. 1139 Supra, the Commission also may consider the likely deterrent effect its sanctions will have on others in the industry. [22] Permanent debarment, however, is not the only remedy at the Commission's disposal that acts as a deterrent; each of the remedies has that capacity to varying degrees. The Commission should articulate why a lesser sanction would not sufficiently discourage others from engaging in the unlawful conduct it seeks to avoid.

22 Arthur Lipper Corp. v. SEC, 547 F.2d 171 (2d Cir. 1976), Cert. denied, 434 U.S. 1009, 98 S.Ct. 719, 54 L.Ed.2d 752 (1978), is not to the contrary. The court there said, "(t)he purpose of such severe sanctions (as revocation of registration and debarment from the industry) must be to demonstrate not only to petitioners but to others that the Commission will deal harshly with egregious cases." Id. at 184. The court rejected the sanctions because it found that under the circumstances of that case, the violations were not egregious. It did not reject the notion of deterrence as a proper factor for consideration.

We remand this case to the Commission for reconsideration of its order in light of our holdings. We do not hold that the Commission abused its discretion here; we simply say that it impermissibly considered section 36(a) relevant to the issue of sanctions and failed to explain its reasoning in sufficient detail for us to assess the reasonableness of the remedies it ordered. [23]

23 Steadman's argument that the Commission's order violates the ex post facto clause of the Constitution, U.S. Const. art. 1, s 9, cl. 3, is without merit. He correctly notes that prior to 1970, the Commission was without power to sanction persons, as opposed to companies, for violations of the IAA and ICA. These powers were added by the Investment Company Amendments Act of 1970, Pub.L.No.91-547, 84 Stat. 1413 (codified in scattered sections of 15 U.S.C.). Hence, he contends, to the extent the order is based on pre-1970 conduct it is invalid. The Commission provides two answers, either of which is sufficient. First, the violations continued well after 1970 and the same order would have issued if only post-1970 conduct were considered. —- S.E.C. at —- n.93, (1977-1978 Transfer Binder) Fed.Sec.L.Rep. (CCH) P 81,243, at 88,339-21. Second, the amendments went only to remedy; they effected no substantive change in the law. Steadman's conduct was violative of the statute before and after 1970. Since it does not penalize an act innocent when done, the order is not ex post facto. Calder v. Bull, 3 U.S. (3 Dall.) 386, 390, 1 L.Ed. 648 (1798).

***1143** V. CONCLUSION

We summarize here our holdings adverse to the Commission, which will affect the proceedings on remand:

1. Scienter is an element of a violation of subsection 17(a)(1) of the Securities Act, and section 206(1) of the IAA.

2. When the Commission imposes the most drastic sanctions at its disposal, it has a duty to articulate carefully the grounds for its decision, including an explanation of why lesser sanctions will not suffice.

3. Section 36(a) of the ICA may not be considered by the Commission in imposing sanctions for violations of other securities laws.

The petition for review is therefore granted in part and denied in part; the order is set aside and the cause is remanded for reconsideration consistent with this opinion.

REMANDED.

All Citations

603 F.2d 1126, Fed. Sec. L. Rep. P 97,135

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199 F.3d 440
This case was not selected for
publication in the Federal Reporter.
Not for Publication in West's Federal Reporter See Fed.
Rule of Appellate Procedure 32.1 generally governing
citation of judicial decisions issued on or after Jan.
1, 2007. See also Fifth Circuit Rules 28.7, 47.5.3,
47.5.4. (Find CTA5 Rule 28 and Find CTA5 Rule 47)
United States Court of Appeals,
Fifth Circuit.

James Harvey THORNTON, Petitioner,
v.
SECURITIES AND EXCHANGE COMMISSION, Respondent.

No. 99-60201.
|
Summary Calendar.
|
Oct. 22, 1999.

On Petition for Review of an Order of the Securities and Exchange Commission (Admin. Proc. File No. 3-9046).

Before POLITZ, JOLLY, and WIENER, Circuit Judges:

Opinion

Per Curiam [*]

[*] Pursuant to 5th Cir. R. 47.5, the Court has determined that this opinion should not be published and is not precedent except under the limited circumstances set forth in 5th Cir. R. 47.5.4.

***1** Petitioner James Harvey Thornton ("Thornton") seeks review of an order of the Securities and Exchange Commission ("SEC" or "Commission") sustaining sanctions imposed on him by an administrative law judge ("ALJ") for violating sections 15(b)(4)(E) and 15(b)(6) of the Securities and Exchange Act of 1934. The violations involve Thornton's failure to supervise a registered representative, Gail Griseuk ("Griseuk") and, accordingly, to prevent her violations of section 17(a) of the Securities Act of 1933 and section 10(b) of the Securities and Exchange Act of 1934 and Rule 10b-5 thereunder. Thornton admits to violating the Act but challenges the sanctions imposed. We affirm.

I.

Facts and Proceedings

Thornton is a registered representative employed by and serving as president and compliance officer of a Houston, Texas securities brokerage firm, Payne & Thornton, Inc. d/b/a Retirement Investment Group ("Retirement"). Griseuk is a registered representative who worked for Retirement out of offices in Florida, from 1988 to late 1991. Under her employment agreement, Griseuk received ninety percent of all commissions she generated. She quickly became Retirement's most productive salesperson, by 1991 bringing in fifty percent of the firm's revenue.

At the time she was hired by Retirement, Griseuk represented that she had never been the subject of an investment-related, customer-initiated complaint or proceeding; but, in fact, at that time, she was the subject of two separate customer complaints alleging that she had placed her customers in unsuitable investments (both actions were dismissed). Immediately after Griseuk joined Retirement, another customer suitability lawsuit was filed against her. That suit resulted in a total judgment of $898,528, which forced her to file for bankruptcy protection. Less than one year later, thirty-two plaintiffs filed a class action lawsuit against her which was dismissed.

Thornton was notified of these suits by disclosure forms supplied by the National Association of Securities Dealers, Inc. ("NASD") and by a former employee of Griseuk's. Thornton testified that he received the disclosure forms but "missed" the information on them about Griseuk's disciplinary history. In addition to failing to inform himself about Griseuk's prior wrongdoing, Thornton failed to monitor her work, audit her client accounts, conduct surprise inspections, or interview her salespeople or employees, even though, according to written supervisory procedures, Thornton, as president, was the sole officer responsible for supervision of registered representatives employed by the firm. Not until the fall of 1991, when two Griseuk clients expressed concern to Thornton regarding her high-pressure sales tactics, did Thornton modify some of Retirement's procedures and supervisory policies.

In 1991, the Division of Enforcement of the SEC brought charges against Griseuk in connection with the offer, purchase, and sale of nearly $5 million worth of securities,

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mostly in the form of high-risk limited partnership interests. Griseuk settled the charges, consenting to findings that she violated securities laws by making false and misleading statements and material omissions regarding the risk, safety, and liquidity of certain securities, as well as making false statements about the compensation she earned from selling those securities. She was ordered to remit $370,786, the approximate amount of her commissions, plus interest, all but $20,000 of which was waived due to her insolvency.

***2** The Division of Enforcement of the SEC thereafter brought charges against Retirement and Thornton for failure to supervise Griseuk. The ALJ, in determining the appropriate sanctions, reviewed Thornton's own disciplinary history and discovered that he had been disciplined by the NASD and state securities regulators eight different times for failure to supervise the firm's registered representatives and for mishandling client funds. On those prior incidents, Thornton was censured, fined, and once had his license revoked for six days. The ALJ, after hearing Thornton's testimony and reviewing the documentary evidence, revoked Retirement's broker-dealer registration, imposed a civil monetary penalty of $50,000.00 on Retirement, permanently barred Thornton from acting as a broker-dealer, barred him from association with any broker-dealer, and imposed a civil monetary penalty of $5,000.00 on Thornton.

Thornton and Retirement petitioned the SEC for review of the ALJ's decision. The SEC did not dispute the ALJ's findings of fact, and accordingly affirmed the civil monetary penalties and the permanent ban on supervisory work but adjusted the severe sanction of a total ban on work as a registered representative to a three-year ban. The SEC also reversed the ALJ's sanction barring Thornton from participating in penny stock offerings, finding such a bar irrelevant to the type of fraud committed.

II.

Standard of Review

We review the Commission's decision to impose a particular sanction for gross abuse of discretion.[1] The choice of sanction will not be overturned unless unwarranted in law or without justification in fact.[2]

1 *Amato v. Securities and Exchange Commission,* 18 F.3d 1281, 1284 (5th Cir.1994).

2 *Butz v. Glover Livestock Commission Co.,* 411 U.S. 182, 186-87, 93 S.Ct. 1455, 36 L.Ed.2d 142 (1973).

III.

Discussion

Thornton does not appeal the monetary sanction or the ban on supervisory activities. He asserts, however, that the temporary ban on his license to serve customers individually was an abuse of discretion by the SEC. Thornton argues that as he was sixty-four years-old at the time of the hearing in 1996, a three-year ban has the same effect as a lifetime ban and would leave him with no means of supporting himself. Moreover, he contends that neither the alleged wrongdoing in connection with Griseuk nor his prior eight disciplinary proceedings regarding inadequate supervision in any way bear on his ability to serve the public in an individual capacity; therefore, the ban on his working directly with clients was an abuse of discretion. Thornton asks us to remove the three-year ban on his practice as a registered representative or, alternatively, to reduce the ban to not more than ninety days.

We conclude that the SEC did not abuse its discretion in banning Thornton from working as a registered representative for three years. Sanctions for securities violations must be administered with an eye towards protecting the public rather than merely punishing the wrongdoer.[3] Certainly, revocation of a professional license and exclusion from the industry is a severe sanction which, at first glance, might appear punitive. Accordingly, the Commission has an obligation specifically to articulate why a less severe sanction would not suffice.[4]

3 *Beck v. Securities and Exchange Commission,* 430 F.2d 673, 674 (6th Cir.1970) (citing U.S. Supreme Court precedent and cases from other circuits); *see also Meadows v. Securities and Exchange Commission,* 119 F.3d 1219, 1128 n. 20 (5th Cir.1997).

4 *Steadman v. Securities and Exchange Commission,* 603 F.2d 1126, 1139-40 (5th Cir.1979), *aff'd* 450 U.S. 91, 101 S.Ct. 999, 67 L.Ed.2d 69 (1981).

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***3** In complying with its duty to articulate such reasons, the Commission should consider "the egregiousness of the defendant's actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the sincerity of the defendant's assurances against future violations, the defendant's recognition of the wrongful nature of his conduct, and the likelihood that the defendant's occupation will present opportunities for future violations." [5] The Commission may not presume future wrongdoing merely on the basis of past misconduct. [6] Here, the ALJ and Commission sufficiently articulated reasons for imposing the sanction by pointing out the recurrent nature of Thornton's supervisory infractions, the perceived lack of sincerity in his testimony, his failure to recognize the wrongfulness of his prior conduct, and the likelihood of opportunities for future misconduct.

5 *Id.* at 1140.

6 *Id.*

In affirming the subject order of sanctions, we are particularly persuaded by the evidence that Thornton has been sanctioned eight times previously for violations in connection with the broker-dealer business. True, as he points out, all of the prior sanctions related to his failure adequately to supervise registered representatives employed by Retirement and not to his conduct as a registered representative; but the ALJ determined that in light of several past sanctions which did not curb Thornton's unlawful behavior, the more severe sanction is in the public interest. [7] Thornton demonstrated a continual pattern of culpable behavior, apparently reckless to the interests of customers who might be harmed. [8] As long as he has a license to work as a registered representative, he will have opportunities to act in a supervisory capacity and otherwise to compromise the interest of clients.

7 The ALJ stated, "Because Mr. Thornton refuses to acknowledge that he has ever done anything wrong, the probability that he will continue violating the securities laws and regulations is almost certain."

8 *See similarly Meadows,* 119 F.3d at 1228.

In addition, we are persuaded by the conclusions of the ALJ ---- the only adjudicator to view the witness's demeanor ---- who doubted Thornton's credibility in saying that he was unaware of Griseuk's conduct prior to or during her employment with Retirement, as well as his sincerity in expressing remorse about his admitted violations of securities laws by inadequate supervision. The ALJ found that Thornton "deliberately obfuscates," "uses excuses," and "gave blatantly untruthful testimony." In the ALJ's view, Thornton remained wilfully blind to Griseuk's violations because of the considerable revenue she was generating for Retirement.

On the basis of all the evidence before him, the ALJ permanently banned Thornton from working in his chosen profession as a registered representative. That evidence as well as the relevant legal standards were reviewed by the SEC which has already extended some appellate relief to Thornton by lessening the sanction to a three-year bar. [9] We agree that, in addition to the civil monetary penalty and the permanent ban on supervisory work, the three-year ban on Thornton's work as a registered representative is necessary to protect the investing public and to deter future violations. Based on our review of the Initial Decision of the ALJ and the Opinion of the Commission in light of the facts revealed by the record and the legal arguments advanced in the appellate briefs of counsel, we conclude that the three-year ban was warranted by law and justified in fact, and was not the product of an abuse of discretion. For essentially the same reasons as set forth in the well-reasoned opinions of the ALJ and the SEC, the modified order of sanctions is, in all respects,

9 *Meadows,* 119 F.3d at 1228 n. 21 (noting that the re-entry into the brokerage industry after a temporary bar is not entirely illusory).

***4** AFFIRMED.

All Citations

199 F.3d 440, 1999 WL 1068296

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861 F.3d 1239
United States Court of Appeals, Eleventh Circuit.

ZPR INVESTMENT MANAGEMENT INC., Max E. Zavanelli, Petitioners,
v.
SECURITIES AND EXCHANGE COMMISSION, Respondent.

No. 16-15322
|
(June 30, 2017)

Synopsis

Background: Investment firm and its president/sole shareholder petitioned for review of a decision of the Securities and Exchange Commission (SEC), 2015 WL 6575683, which found that firm and president/sole shareholder made material misrepresentations to prospective clients in violation of the Investment Advisers Act of 1940.

Holdings: The Court of Appeals, Martin, Circuit Judge, held that:

finding that investment firm's advertisements made material false claim of compliance with global investment performance standards was supported by substantial evidence;

finding that one of investment firm's newsletters made material false claim of compliance with global investment performance standards was supported by substantial evidence;

finding that investment firm's other newsletter made material false claim of compliance with global investment performance standards was not supported by substantial evidence;

finding that investment firm's president, and thus firm, acted with scienter when making false claim of compliance with global investment performance standards in firm's ads was supported by substantial evidence;

finding that investment firm's president, and thus firm, acted with scienter when making false claim of compliance with global investment performance standards in firm's newsletter was supported by substantial evidence;

finding that investment firm negligently reported to investment-research provider that it was not under investigation by SEC was supported by substantial evidence; and

SEC did not grossly abuse its discretion in imposing industry bar on president, in issuing cease-and-desist order, and in imposing monetary penalties, but amount of penalties needed to be redetermined.

Affirmed in part and vacated in part.

Attorneys and Law Firms

***1244** Philip J. Snyderburn, K. Michael Swann, Snyderburn Rishoi & Swann, LLP, Maitland, FL, for Petitioners.

Emily T.P. Rosen, Theodore Weiman, U.S. Securities & Exchange Commission, Washington, DC, Amie Berlin, Robert K. Levenson, U.S. Securities & Exchange Commission, Miami, FL, for Respondent.

Petition for Review of a Decision of the Securities and Exchange Commission, Agency No. 3–15263

Before MARTIN, JILL PRYOR, and MELLOY,[*] Circuit Judges.

[*] Honorable Michael J. Melloy, United States Circuit Judge for the Eighth Circuit, sitting by designation.

Opinion

MARTIN, Circuit Judge:

Max Zavanelli and his investment firm, ZPR Investment Management, Inc. (“ZPRIM”), are before us seeking review of a final order of the Securities and Exchange Commission (“SEC” or the “Commission”).[1] The Commission found that Mr. Zavanelli and ZPRIM (the “petitioners”) made material misrepresentations to prospective clients in violation of the Investment Advisers Act of 1940 (the “Advisers Act”), 15 U.S.C. § 80b–1. Based on these violations, the Commission imposed monetary and other sanctions. After careful consideration, and with the benefit of oral argument, we grant the petitioners some, but not all, of the relief they

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seek. We vacate the violations and monetary sanctions related to the newsletter ZPRIM published in December 2009, but we affirm all other violations and sanctions set out in the Commission's order.

1 For clarity, we use "SEC" to refer to the party opposing this appeal and "the Commission" to refer to the administrative tribunal whose decision we are reviewing.

I. BACKGROUND

A. THE FACTS

1. Mr. Zavanelli and ZPRIM

In 1994, Mr. Zavanelli founded ZPRIM, an investment firm registered as an "investment adviser" with the SEC. Mr. Zavanelli was ZPRIM's president and sole shareholder. As such, he "had ultimate authority over all aspects of ZPRIM's advisory business, including its advertising." ZPRIM employed Ted Bauchle as its operations manager from 1999 until early 2013. According to Mr. Bauchle, Mr. Zavanelli was ZPRIM's "boss man." Mr. Zavanelli "made all the decisions" and "was difficult to disagree" with "because he was under the impression that the company should be run his way and that he was always correct."

***1245** 2. Global Investment Performance Standards

The Global Investment Performance Standards ("GIPS") are "universal, voluntary standards to be used by investment managers for quantifying and presenting investment performance that ensure fair representation, full disclosure, and apples-to-apples comparisons." GIPS has two related components, which are the performance standards and the advertising guidelines. The performance standards establish how a firm should calculate and present its investment performance. As you might have guessed, those firms that comply with the GIPS performance standards may represent themselves as being "GIPS-compliant." It is generally understood that compliance with GIPS "provides a level of credibility" to the firm's performance results and gives prospective clients "a greater level of confidence" in the firm's performance presentations.

Under GIPS, if a firm chooses to advertise that it is GIPS compliant, that firm must also comply with the GIPS advertising guidelines.[2] The advertising guidelines require any advertisement claiming GIPS compliance to disclose specific information about the firm's investment returns. Specifically, the firm must provide: "(1) period-to-date composite performance results and (2) either one-, three-, and five-year cumulative annualized composite returns or five years of annual composite returns."

2 The GIPS rules say: "[S]hould a GIPS-compliant FIRM choose to advertise performance results, the FIRM MUST apply ... the GIPS Advertising Guidelines in order to include a claim of compliance with the GIPS standards."

3. ZPRIM Began Claiming It Was GIPS Compliant

Mr. Zavanelli knew that GIPS compliance was "very important" for marketing to institutional clients and he wanted ZPRIM to have those "bragging rights." To that end, ZPRIM hired a GIPS verification firm, Ashland Partners & Company LLP ("Ashland"), to help bring ZPRIM into compliance. In January, February, and April 2008, ZPRIM placed advertisements in financial magazines claiming it was GIPS compliant. Together with the claim of GIPS compliance, and in keeping with GIPS advertising guidelines, the ads included period-to-date returns and at least five years of annual returns.

4. In Fall 2008, ZPRIM Published Ads Omitting Information Required Under GIPS

In the fall of 2008, ZPRIM published three more magazine ads claiming GIPS compliance. But these ads had no period-to-date performance results, nor did they include either one-, three-, and five-year annualized results or five years of annual results. One effect of leaving out this GIPS-required information was that the ads hid ZPRIM's recent poor performance. Had ZPRIM shown its investment returns over the time periods required by GIPS, the ads would have revealed that the firm's performance lagged behind ZPRIM's benchmark index by as much as ten percentage points. Instead of disclosing the called-for returns with the unflattering information, ZPRIM showed its returns over a longer period of time during which ZPRIM outperformed its benchmark index.

Mr. Bauchle testified that before these ads were published, he told Mr. Zavanelli they didn't meet the GIPS requirements for showing investment return information. But Mr. Zavanelli dismissed Mr. Bauchle's concerns, saying it wasn't necessary to put the information in the ads because ZPRIM would give it to prospective clients before ***1246** they invested. Mr.

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Zavanelli "wanted to run those ads," so ZPRIM published them even though they did not comply with the GIPS advertising guidelines. Although Ashland had reviewed and approved ZPRIM's earlier ads, ZPRIM never asked Ashland to review the fall 2008 ads.

5. ZPRIM Published Newsletters Omitting Information Required Under GIPS

Mr. Zavanelli wrote a monthly investment newsletter for ZPRIM that contained information about ZPRIM's performance results. This newsletter went to ZPRIM's clients, dozens of investment consultants, and others in the industry.

In November 2008, Ashland told ZPRIM that if "[GIPS] compliance is being claimed" in ZPRIM's newsletters, the "GIPS Advertising Guidelines need to be followed." Ashland then explained precisely how investment returns should be listed in the newsletters in order to comply with the GIPS advertising guidelines. Nevertheless, ZPRIM sent out newsletters in April and December 2009 that claimed GIPS compliance, yet failed to include the required information.

In contrast to the April 2009 newsletter, the December 2009 newsletter contained several corrective statements. Although it is true the December 2009 newsletter said on one page that "[a]ll numbers are GIPS compliant," the next page contained a number of disclaimers. It said, for example: "The investment report you are reading is not GIPS compliant. It was never intended to be nor can it be.... Our report remains not GIPS compliant."

6. The SEC Notified ZPRIM of False Claim of GIPS Compliance

In January 2010, the SEC sent ZPRIM a letter. The letter noted that, while ZPRIM's December 2008 advertisement "claimed compliance" with GIPS, "the [SEC's] examination found that it did not comply with GIPS advertising guidelines." The letter told ZPRIM that "[a]s a result, ZPR[IM] may have violated Section 206 of the Advisers Act and Rule 206(4)-1, thereunder."

ZPRIM responded that it "did not intend to mislead with this ad." Beyond that, ZPRIM assured the SEC that "[w]e have changed our ads" going forward to comply with the GIPS advertising guidelines by including the "1–3–5 year annualized returns" as a "[c]orrective action[ ]."

In August 2010, the SEC sent ZPRIM another letter notifying the firm that the SEC was "conducting an investigation" into ZPRIM.

7. ZPRIM Represented in Two Morningstar Reports that It Was Not Under Investigation

In order to attract institutional clients, ZPRIM regularly gave information about itself to Morningstar, which is a major provider of independent investment research. Using the information it gets from investment firms, Morningstar creates a report about each firm, and investors use these reports to research potential money managers. It was Mr. Bauchle's job to submit ZPRIM's information to Morningstar.

One piece of information included in a Morningstar report is whether or not there are any "[p]ending SEC investigations" of a firm. This is important here because, even though the SEC told ZPRIM in August 2010 that it was investigating the firm, Mr. Bauchle continued to tell Morningstar there were "No" "[p]ending SEC investigations" of ZPRIM. Mr. Bauchle, on behalf of ZPRIM, made this misrepresentation to Morningstar twice: first for the period ending on September ***1247** 30, 2010, and, again, for the period ending on March 31, 2011.

8. In Spring 2011, ZPRIM Published Additional Ads Omitting Information Required Under GIPS

Despite ZPRIM's assurances to the SEC that it would change its ads to comply with the GIPS advertising guidelines, ZPRIM published three more ads—in February, March, and May 2011—claiming GIPS compliance but failing to include the returns required by the GIPS advertising guidelines. Mr. Zavanelli testified that he conceived of and approved these ads.

B. THE ADVISERS ACT

The Advisers Act sets "federal fiduciary standards for investment advisers." Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 471 n.11, 97 S.Ct. 1292, 1300 n.11, 51 L.Ed.2d 480 (1977). For our purposes here, we review the antifraud provisions of the Advisers Act—sections 206(1), (2), and (4).[3] In order to establish a violation, each of these sections requires the SEC to show the investment adviser made a material misrepresentation with a culpable mental state. See Steadman v. SEC, 603 F.2d 1126, 1129–34 (5th Cir. 1979) (Steadman I), aff'd, 450 U.S. 91, 101 S.Ct. 999, 67 L.Ed.2d 69 (1981) (interpreting sections 206(1)–(2));[4] SEC v. Steadman, 967 F.2d 636, 643, 647 (D.C. Cir.

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1992) (Steadman II) (interpreting section 206(4)). While the material-misrepresentation element is the same for all three sections, the mental-state element for section 206(1) is different than that for sections 206(2) and (4). See Steadman I, 603 F.2d at 1134; Steadman II, 967 F.2d at 647. Section 206(1) requires the SEC to show the adviser acted with scienter. Steadman I, 603 F.2d at 1134. Sections 206(2) and (4) require no showing of scienter, and a showing of negligence is sufficient. See id.; Steadman II, 967 F.2d at 643 & n.5, 647.

3 Section 206 says:

> It shall be unlawful for any investment adviser by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly—
>
> (1) to employ any device, scheme, or artifice to defraud any client or prospective client;
>
> (2) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client;
>
> ...
>
> (4) to engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative. The Commission shall, for the purposes of this paragraph (4) by rules and regulations define, and prescribe means reasonably designed to prevent, such acts, practices, and courses of business as are fraudulent, deceptive, or manipulative.

15 U.S.C. §§ 80b–6(1), (2) & (4).

4 In Bonner v. City of Prichard, 661 F.2d 1206 (11th Cir. 1981) (en banc), we adopted as binding precedent all decisions of the former Fifth Circuit handed down before October 1, 1981. Id. at 1209.

C. PROCEEDINGS BEFORE THE COMMISSION

In April 2013, the SEC began administrative proceedings against ZPRIM and Mr. Zavanelli. After a seven-day hearing, the Administrative Law Judge found both had violated the Advisers Act and imposed sanctions. ZPRIM and Mr. Zavanelli appealed to the Commission, which affirmed. [5]

5 There was one finding by the Administrative Law Judge that the Commission reversed, but that issue is not before us.

1. Violations

The Commission found ZPRIM violated sections 206(1), (2), and (4) of the Advisers Act by making false or misleading claims (a) in the fall–2008 and spring–2011 magazine ***1248** ads, and in the 2009 newsletters, that it was GIPS compliant; and (b) in the 2011 Morningstar report that it was not under SEC investigation. The Commission also found ZPRIM violated sections 206(2) and (4), which, again, require only a showing of negligence, for the 2010 Morningstar report.

As for Mr. Zavanelli, the Commission found him liable under sections 206(1) and (2) for all the charges involving misrepresentations of GIPS compliance. The Commission found him liable both directly and for aiding and abetting ZPRIM. It found him not liable for ZPRIM's misrepresentations in the Morningstar reports.

2. Sanctions

The Commission also affirmed the sanctions imposed on ZPRIM and Mr. Zavanelli. First, the Commission placed an "industry bar" on Mr. Zavanelli, which prohibits him from associating "with any investment adviser, broker, dealer, municipal securities dealer, municipal advisor, transfer agent, and nationally recognized statistical rating organization." Second, the Commission ordered ZPRIM and Mr. Zavanelli to cease and desist their misconduct. Third, the SEC imposed civil penalties of $570,000 against Mr. Zavanelli and $250,000 against ZPRIM. ZPRIM and Mr. Zavanelli timely petitioned this Court for review.

II. STANDARD OF REVIEW

When the Commission makes findings of fact, we must affirm them if they are "supported by substantial evidence." Orkin v. SEC, 31 F.3d 1056, 1063 (11th Cir. 1994). Substantial evidence is "such relevant evidence as a reasonable mind might accept as adequate to support a conclusion." Universal Camera Corp. v. NLRB, 340 U.S. 474, 477, 71 S.Ct. 456, 459, 95 L.Ed. 456 (1951) (quotation omitted). We review de novo the Commission's legal conclusions. Orkin, 31 F.3d at 1063.

"The fashioning of an appropriate and reasonable remedy is for the Commission, not this court...." Steadman I, 603 F.2d at 1140. "We may overturn the [Commission's] decision to impose a particular sanction only upon finding a gross abuse of discretion." Orkin, 31 F.3d at 1066.

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III. DISCUSSION

Petitioners challenge the Commission's order on two grounds. First, they say the Commission's factual findings about both materiality and mental state are not supported by substantial evidence. More specifically, they say substantial evidence does not support the Commission's findings that: (1) the false claims of GIPS compliance in ZPRIM's advertisements were material; (2) the false claims of GIPS compliance in ZPRIM's newsletters were material; (3) the false claims of GIPS compliance in ZPRIM's ads and newsletters were made with scienter; and (4) the false claims in the Morningstar reports that ZPRIM was not under investigation were made with the required mental state. Second, petitioners argue the Commission abused its discretion in imposing sanctions. We address each argument in turn.

A. MATERIALITY OF ZPRIM'S ADVERTISEMENTS

1. The Materiality Requirement

A false or misleading statement by an investment adviser violates the antifraud provisions of the Advisers Act only if the fact misrepresented or omitted is "material." See SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 200–01, 84 S.Ct. 275, 287, 11 L.Ed.2d 237 (1963); Steadman I, 603 F.2d at 1129–34. An "omitted fact is material if there is a substantial likelihood that a reasonable [investor] would consider ***1249** it important." Basic Inc. v. Levinson, 485 U.S. 224, 231, 108 S.Ct. 978, 983, 99 L.Ed.2d 194 (1988) (quotation omitted). "[T]here must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." Id. at 231–32, 108 S.Ct. at 983 (quotation omitted).

2. Materiality as to ZPRIM's Advertisements

ZPRIM published ads claiming GIPS compliance but omitted the investment return information required by the GIPS advertising guidelines. ZPRIM's claim of GIPS compliance was therefore false, and petitioners do not say otherwise. Rather, they argue their omission of the GIPS-required information was not material. We conclude to the contrary. Substantial evidence showed that reasonable investors would find it important that ZPRIM's ads did not actually comply with GIPS even while they claimed compliance.

To begin, the evidence showed that the status of being "GIPS compliant" is important to investors. Mr. Zavanelli himself testified that being able to market oneself as GIPS compliant "is very important" for attracting institutional clients. Mr. Bauchle explained that institutional clients "screen[ ]" for GIPS compliance and will not even consider firms that are not compliant. Given the significance of GIPS compliance as a marker in the industry, reasonable investors would have wanted to know that ZPRIM's claim of GIPS compliance was false.

Beyond the value of the label itself, the false claim of GIPS compliance was also material because it caused prospective clients to wrongly believe the performance results in ZPRIM's ads adhered to the GIPS advertising guidelines. As the Commission explained, the purpose of the advertising guidelines is to give investors the assurance that any GIPS-compliant firm will present its performance data in a way that is "complete, fair[ ], and comparable to those of other firms." The guidelines' requirements for presenting performance data provide "uniformity and comparability among investment managers." That meant investors looking at the ZPRIM ads could have believed they were looking at the uniform, standardized set of returns required by GIPS, when in fact ZPRIM was deviating from the standardized presentation and putting its investment performance in a more favorable light. ZPRIM presented its numbers as an "apples-to-apples comparison" with the data posted by other GIPS-compliant firms, when its numbers were not actually comparable. This discrepancy is something a "reasonable [investor] would consider [ ] important." Basic, 485 U.S. at 231, 108 S.Ct. at 983 (quotation omitted).

For the ads published in fall 2008, the showing of materiality was even stronger. If ZPRIM had listed its investment returns in those ads as required by GIPS, the information would have revealed that ZPRIM was significantly underperforming its benchmark. Certainly, a prospective investor would have wanted to know about those undisclosed, negative results. See SEC v. Merch. Capital, LLC, 483 F.3d 747, 769 (11th Cir. 2007) (holding that defendants made material omissions by marketing interests in their company to investors "without disclosing the poor performance of the interests that had already been sold").

Petitioners argue that ZPRIM's failure to disclose the GIPS-required information in its ads was not a material omission because the firm provided the information later. Petitioners say ZPRIM sent a fact sheet that disclosed the performance

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data ***1250** required by GIPS to every prospective client who responded to a ZPRIM ad. Petitioners also point to data the firm posted on its website. Because ZPRIM eventually gave prospective clients the GIPS-required information, petitioners say that information was "part of the total mix of information provided," and therefore its omission from the ads was not material. See Basic, 485 U.S. at 231–32, 108 S.Ct. at 983.

These after-advertisement disclosures do not carry the day. Materiality is "determined in light of the circumstances existing at the time the alleged misstatement occurred." Ganino v. Citizens Utils. Co., 228 F.3d 154, 165 (2d Cir. 2000) (emphasis added); see also SEC v. Morgan Keegan & Co., 678 F.3d 1233, 1253 (11th Cir. 2012) (per curiam) (holding that disclosures made "after the alleged oral misrepresentations" do not render the misrepresentations immaterial). Because our inquiry is limited to what investors knew at the time the false statements were made, ZPRIM's later disclosures cannot negate the materiality of the earlier misrepresentations. [6] See Morgan Keegan, 678 F.3d at 1253.

6 It could be argued that ZPRIM's publishing of the GIPS-required information on its website was not a subsequent disclosure, since the website was available at the same time as the ads. But, even assuming that ZPRIM put the correct information on its website, that would not render immaterial the false claims of GIPS compliance in ZPRIM's ads. That is because the ads never alerted investors that they needed to look to ZPRIM's website for the GIPS-required disclosure; neither did the website alert investors that it contained the GIPS-required information omitted from ZPRIM's ads. See Morgan Keegan, 678 F.3d at 1252 (finding disclosure of accurate information on firm's website did not render immaterial earlier misrepresentations where there was "no evidence that brokers directed customers" to the information on the web page).

Focusing the materiality inquiry on the time when the misrepresentations were made is especially important where, as here, the context of the false statements is advertising to attract new investors. A later disclosure would not have cured the misrepresentation that already occurred at the advertising stage because, again, many institutional investors "screen[ ]" for GIPS compliance. ZPRIM's false claims of GIPS compliance likely resulted in interest from investors who would not otherwise have considered or contacted ZPRIM. As the Commission explained, "[t]he adviser's false statement has succeeded because it has garnered interest, regardless of whether the adviser later provides enough information for an astute individual to detect its misstatement." The problems caused by a false ad cannot be cured by passing along corrected information to the very customers the company attracted through the misinformation in the first place. See id. at 1252 (holding that "adequate written disclosures" provided after a false statement did not render the false statement immaterial because the disclosure was "given to customers only upon a customer's request").

Petitioners also say the First Circuit's decision in Flannery v. SEC, 810 F.3d 1 (1st Cir. 2015), supports their argument. But the conduct at issue in Flannery was less egregious than the conduct we consider here. In Flannery, the Commission found that an investment firm made a material misrepresentation in a slide presentation to investors in which one slide said that a fund typically was 55% invested in a certain type of security, when the investment was actually around 100%. Id. at 5. The First Circuit reversed. Id. at 15. The court found the record supported only a "thin" showing of materiality because, among other things, (1) "the slide was clearly labeled 'Typical,' " and (2) the firm ***1251** had already distributed the correct data to clients six weeks before the presentation with the inaccurate slide. Id. at 10–11.

ZPRIM did not label its return information "typical," which would have cautioned a reasonable investor he should conduct further research. See id. at 11 n.8. ZPRIM claimed it was presenting the actual, complete set of performance returns required by GIPS. By claiming GIPS compliance, ZPRIM falsely signaled to investors there was no need to look any further for the performance data GIPS requires. Also, here the GIPS-required figures were distributed only after ZPRIM made the misrepresentations—not weeks before—and then only to those prospective clients who came forward.

As the Flannery court explained, "the mere availability of accurate information" does not "negate[ ] an inaccurate statement." Id. And it does not do so here. This record contains substantial evidence to support the Commission's finding that ZPRIM's false claim of GIPS compliance in its ads was material.

B. MATERIALITY OF ZPRIM'S NEWSLETTER STATEMENTS

Petitioners also challenge the Commission's finding of materiality for the false claims of GIPS compliance in

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ZPRIM's April and December 2009 newsletters. They argue that the two newsletters did not actually claim to be compliant with GIPS. We reject this argument with respect to the April 2009 newsletter. However, the record supports petitioners' argument that the December 2009 newsletter sufficiently disclaimed GIPS compliance. The Commission's finding of materiality for that publication cannot therefore stand.

1. The April 2009 Newsletter

The April 2009 newsletter unmistakably asserted GIPS compliance. A footnote to a table listing ZPRIM's investment returns said that ZPRIM's "compliance with the Global Investment Performance Standards (GIPS®) has been verified firm-wide by Ashland Partners & Company LLP from December 31, 2000 through September 30, 2008." The table listed investment returns for periods falling within this window of purported GIPS compliance, but omitted the GIPS-required information. This false claim of GIPS compliance in the newsletter was material for the same reasons the false claims of GIPS compliance in the advertisements were material. Thus for the April 2009 newsletter as well, substantial evidence supported the Commission's finding of materiality.

2. The December 2009 Newsletter

The December 2009 newsletter is different. On page three of the December 2009 newsletter, at the bottom of a list of ZPRIM's investment returns, the newsletter said: "All numbers are GIPS compliant." But on the next page, under a section titled "GIPS COMPLIANCE," the newsletter said: "The investment report you are reading is not GIPS compliant. It was never intended to be nor can it be.... Our report remains not GIPS compliant." Petitioners say these statements "disavowed a claim of GIPS compliance," rendering the initial false claim immaterial. We agree.

There is no question the newsletter's initial statement—"[a]ll numbers are GIPS compliant"—was not true. But our rule is that when a misrepresentation is "accompanied by meaningful cautionary statements and specific warnings ..., that language may be sufficient to render the alleged omissions or misrepresentations immaterial as a matter of law." Saltzberg v. TM Sterling/Austin Assocs., Ltd., 45 F.3d 399, 400 (11th Cir. 1995) (per curiam); see also Merch. Capital, 483 F.3d at 767 (stating the "well-established principle ***1252** that a statement or omission must be considered in context, [because] accompanying statements may render it immaterial as a matter of law" (quotation omitted)). While "general cautionary language" is not sufficient to render a misrepresentation immaterial, see Morgan Keegan, 678 F.3d at 1253, the disclaimer in the December 2009 newsletter did not use generic or vague language. It expressly and unequivocally said: "The investment report you are reading is not GIPS compliant." This statement was then followed by two more that reiterated the point. And these statements were all below a bold, underlined header titled "GIPS COMPLIANCE," which would have alerted reasonable investors that ZPRIM was calling attention to a GIPS compliance issue that investors should be aware of. Like the cautionary statements in Saltzberg, ZPRIM's disclaimer was "no[t] boilerplate and was not buried among too many other things, but was explicit, repetitive and linked to the [statement] about which [the SEC] complain[s]." See 45 F.3d at 400. In light of the clear cautionary statements in the December 2009 newsletter, we conclude that the Commission's finding of materiality for that newsletter is not supported by substantial evidence. We therefore reverse the Commission's finding that ZPRIM and Mr. Zavanelli violated sections 206(1), (2), and (4), and sections 206(1) and (2), respectively, based on the December 2009 newsletter.

C. SCIENTER FOR ZPRIM'S ADS AND NEWSLETTERS

1. The Scienter Requirement

To prove a violation of section 206(1) of the Adviser's Act, the SEC must show the adviser acted with scienter. Steadman I, 603 F.2d at 1134. Scienter is "a mental state embracing intent to deceive, manipulate, or defraud." Matrixx Initiatives, Inc. v. Siracusano, 563 U.S. 27, 48, 131 S.Ct. 1309, 1323, 179 L.Ed.2d 398 (2011) (quotation omitted). "Scienter may be established by a showing of knowing misconduct or severe recklessness." SEC v. Monterosso, 756 F.3d 1326, 1335 (11th Cir. 2014) (per curiam) (quotation omitted). Scienter can be established through direct or circumstantial evidence. Id. The scienter of a corporation is established by showing that the corporation's officers or directors acted with scienter. See Thompson v. RelationServe Media, Inc., 610 F.3d 628, 635 (11th Cir. 2010) ("Corporations have no state of mind of their own; rather, the scienter of their agents must be imputed to them.").

2. Scienter as to ZPRIM's Ads and Newsletters

The Commission found that Mr. Zavanelli (and thus ZPRIM) acted with scienter in publishing the false claims of GIPS compliance in ZPRIM's ads and newsletters. Petitioners

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challenge this finding. Because the facts underlying each set of publications differ, we discuss the issue of scienter separately for each, and conclude the scienter findings are supported by substantial evidence.

a. Scienter as to the Fall 2008 Ads

Substantial evidence supported the Commission's finding that Mr. Zavanelli (and thus ZPRIM) acted with scienter in making misrepresentations of GIPS compliance in the fall 2008 ads. In short, the evidence showed that Mr. Zavanelli knew the claims of GIPS compliance in the fall 2008 ads were false but approved them anyway. See SEC v. Carriba Air, Inc., 681 F.2d 1318, 1324 (11th Cir. 1982) (holding that scienter is established when the defendant "engaged in the dissemination of a known falsehood" (quotation omitted)).

***1253** The record supports a finding that Mr. Zavanelli knew exactly what was required of an ad that claimed GIPS compliance. He testified that he read the GIPS requirements, including its advertising guidelines, "[n]umerous times ... forward and backwards." He even described himself as "an expert" on GIPS. Beyond that, Mr. Zavanelli clearly knew how to present GIPS-compliant investment returns in advertisements because he was responsible for "ensuring that marketing materials [were] GIPS compliant." Indeed, from January to April 2008, ZPRIM published ads that contained the GIPS-required information.

Then in the fall of 2008, Mr. Zavanelli approved the new, non-compliant ads. Mr. Bauchle testified that before these ads were published, he told Mr. Zavanelli they didn't contain the return information required by GIPS. Yet Mr. Zavanelli ran the ads anyway. Indeed, he affirmatively directed Mr. Bauchle to leave the statement that ZPRIM is GIPS-compliant in the ad, even though he knew the investment returns in the ad did not comply with the GIPS advertising guidelines. In doing so, he "engaged in the dissemination of a known falsehood." Carriba Air, 681 F.2d at 1324 (quotation omitted).

There is also a strong inference of "intent to deceive" because the omitted GIPS-required returns resulted in covering up ZPRIM's poor investment performance. Matrixx, 563 U.S. at 48, 131 S.Ct. at 1323. There is certainly sufficient evidence to support the Commission's finding that the petitioners knowingly made false claims of GIPS compliance in the fall 2008 ads.

b. Scienter as to the Spring 2011 Ads

Substantial evidence also supported the Commission's finding of scienter for ZPRIM's false claims of GIPS compliance in the ads published in spring 2011. After the 2008 ads were published, the SEC notified ZPRIM that its ads falsely claimed compliance with GIPS and might violate the Advisers Act. With this letter, the SEC expressly put Mr. Zavanelli on notice that he needed to change the information on ZPRIM's ads to meet the GIPS advertising guidelines. In response, ZPRIM made clear it understood what was required of it. The firm told the SEC it would take "[c]orrective action[ ]" by "chang[ing] our ads" to include the investment returns required by GIPS. Yet despite ZPRIM's assurances, the firm published its 2011 ads without the GIPS-required information. Mr. Zavanelli concedes this omission made the claim of GIPS compliance "untrue," and also concedes he conceived of and approved the spring 2011 round of "untrue" ads. This establishes that he acted with scienter. See Carriba Air, 681 F.2d at 1324.

c. Scienter as to the April 2009 Newsletter

It is similarly clear that Mr. Zavanelli acted with scienter in publishing the April 2009 newsletter.[7] Of course he had the same knowledge of the GIPS requirements in April 2009 as he had when he decided to publish the false claims of GIPS compliance in the fall 2008 ads. Beyond that, by this time ZPRIM had received an express warning from Ashland that if "[GIPS] compliance is being claimed" on ZPRIM's newsletters, "the GIPS Advertising Guidelines need to be followed." Despite this direct admonition from the firm's GIPS verifier, Mr. Zavanelli—who wrote "most of the newsletter"—failed to include the GIPS-required data in the April 2009 newsletter. This is sufficient to support the ***1254** SEC's finding that the petitioners knowingly published the false claim of GIPS compliance in the April 2009 newsletter. See id.

7 We do not address scienter for the December 2009 newsletter because, as discussed earlier, substantial evidence did not support a finding of materiality for that newsletter.

D. REQUIRED MENTAL STATE FOR THE MORNINGSTAR REPORTS

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The Commission found ZPRIM liable for falsely stating in two Morningstar reports that it was not under SEC investigation. ZPRIM (through Mr. Bauchle) made this false statement in the report for the period ending September 30, 2010, and, again, in the report for the period ending March 31, 2011. The Commission found ZPRIM acted with negligence for the 2010 report and scienter for the 2011 report. ZPRIM challenges both findings. We conclude that both are supported by substantial evidence.

1. Negligence as to the 2010 Morningstar Report

As set out above, violations of sections 206(2) and (4) can be established by a showing of negligence. Negligence requires a showing that the investment adviser failed to exercise "reasonable care." Capital Gains, 375 U.S. at 194, 84 S.Ct. at 284 (quotation omitted). This record supports finding that Mr. Bauchle failed to act with reasonable care when he falsely reported to Morningstar in September 2010 that ZPRIM was not under SEC investigation.

Mr. Bauchle was responsible for submitting ZPRIM's information to the Morningstar database. He acknowledged he knew the Morningstar reporting form asked whether the firm was under SEC investigation. Thus, once the SEC sent ZPRIM a letter in August 2010 notifying it that the SEC was "conducting an investigation" into ZPRIM, Mr. Bauchle had a duty to update the Morningstar database to show the pending investigation. See Finnerty v. Stiefel Labs., Inc., 756 F.3d 1310, 1317 (11th Cir. 2014) ("[A] duty exists to update prior statements if the statements were true when made, but misleading or deceptive if left unrevised."). Mr. Bauchle did not do this. As a result, the Morningstar report for the period ending September 2010 falsely showed investors that there were "No" "[p]ending SEC investigations" of ZPRIM. A person exercising a reasonable degree of care would have updated the form once the firm received express notice from the SEC of the pending investigation. Id. Thus, the record supports the finding that ZPRIM's misrepresentation in the 2010 Morningstar report was negligent.

2. Scienter as to the 2011 Morningstar Report

The record also supports the Commission's finding that ZPRIM (through Mr. Bauchle) acted with scienter in failing to disclose the investigation in the 2011 Morningstar report. In October 2010, Mr. Bauchle gave investigative testimony as part of the SEC's proceedings in this case, and counsel for the SEC specifically informed him that he was testifying in connection with the SEC investigation into ZPRIM. This shows Mr. Bauchle had direct, personal knowledge of the SEC investigation yet failed to disclose it in the 2011 report. He thus "engaged in the dissemination of a known falsehood." Carriba Air, 681 F.2d at 1324 (quotation omitted). Also, Mr. Bauchle testified that the reason he "didn't go back and change the [pending investigation] box" on the Morningstar form was "[b]ecause whenever we would get a new letter from the SEC, we would have a meeting and it was downplayed as [ ] being anything significant and so that box wasn't changed." The fact that Mr. Bauchle made a deliberate decision not to disclose the SEC investigation because the ***1255** firm "downplayed" its significance supports a finding of an "intent to deceive" investors. Matrixx, 563 U.S. at 48, 131 S.Ct. at 1323. Thus, there is substantial evidence to sustain the finding of scienter regarding the 2011 Morningstar report.

E. SANCTIONS

The Commission imposed sanctions against both Mr. Zavanelli and ZPRIM. First, the Commission imposed an industry bar against Mr. Zavanelli. Second, the Commission ordered both petitioners to cease and desist their misconduct. Third, the Commission imposed civil penalties. Petitioners challenge each of these sanctions. For the reasons that follow, we affirm the Commission's sanctions except those imposed for the violations related to the December 2009 newsletter.

1. The Industry Bar Against Mr. Zavanelli

Under the Advisers Act, the Commission may impose an industry bar on an adviser if the Commission finds: (1) that the bar "is in the public interest," and (2) that the adviser "willfully violated" or "willfully aided, abetted, counseled, commanded, induced, or procured the violation" of federal securities law. 15 U.S.C. §§ 80b–3(e)(5), (6) & (f). To determine whether a bar is in the public interest, the Commission considers the following:

> [T]he egregiousness of the defendant's actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the sincerity of the defendant's assurances against future violations, the defendant's recognition of the wrongful nature of his conduct, and the likelihood that the defendant's

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occupation will present opportunities for future violations.

Steadman I, 603 F.2d at 1140 (quotation omitted). As for the willfulness prong, a violation is "willful" if the adviser "intentionally commit[ed] the act which constitutes the violation." Wonsover v. SEC, 205 F.3d 408, 414 (D.C. Cir. 2000) (quotation omitted). The adviser need not "also be aware that he is violating one of the Rules or Acts." Id. (quotation omitted).

The Commission did not commit a "gross abuse of discretion" in imposing the industry bar on Mr. Zavanelli. Orkin, 31 F.3d at 1066. In assessing the "public interest" prong, the Commission analyzed the Steadman factors and found that each factor showed the bar would be in the public interest. In particular, the Commission found Mr. Zavanelli "acted with a high degree of scienter" because "[d]espite his knowledge and familiarity with GIPS, [he] flouted the requirements of the GIPS Advertising Guidelines"; his "conduct was recurrent," continuing after "ZPRIM promised the previous year to take corrective action"; he "does not genuinely recognize the wrongfulness of his conduct"; and his "assurances against future misconduct" were not convincing because he "continues to provide investment advisory services." The Commission then made the required finding of willfulness. The Commission found the "willfulness standard is satisfied because Zavanelli intentionally authored or approved the advertisements and investment reports containing the misrepresentations at issue." Each of these findings is supported by the record. Thus, the Commission did not grossly abuse its discretion when it imposed the industry bar. Id.

2. Cease and Desist Order

Under the Advisers Act, the Commission may issue a cease and desist order against any person it found to have violated the Act. See 15 U.S.C. § 80b–3(k)(1). Because the Commission found petitioners violated the antifraud provisions, the Commission was entitled to issue the cease and ***1256** desist order against them. Id. The Commission also explained that a "cease-and-desist order will play a substantial remedial role with respect to ZPRIM considering that we have not revoked its registration as an investment adviser." In light of these findings, it was not a "gross abuse of discretion" to issue the order. Orkin, 31 F.3d at 1066.

3. Monetary Penalties

The standard for imposing monetary penalties is the same as for industry bars. See 15 U.S.C. § 80b–3(i)(1)(A). However, the factors for determining whether it would be "in the public interest," id., are different from the Steadman factors. The Advisers Act lists the following factors for making the public interest determination:

(A) whether the act or omission for which such penalty is assessed involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement;

(B) the harm to other persons resulting either directly or indirectly from such act or omission;

(C) the extent to which any person was unjustly enriched, taking into account any restitution made to persons injured by such behavior;

(D) whether such person previously has been found by the Commission, another appropriate regulatory agency, or a self-regulatory organization to have violated the Federal securities laws, State securities laws, or the rules of a self-regulatory organization ...;

(E) the need to deter such person and other persons from committing such acts or omissions; and

(F) such other matters as justice may require.

Id. § 80b–3(i)(3).

The Act also establishes a three-tier system of civil penalties, with each tier addressing increasingly serious misconduct and imposing progressively higher maximum penalties. Id. § 80b–3(i)(2). If the Commission applies the public interest factors listed in the Act and determines that some monetary penalty is warranted, the Commission must then decide which tier is appropriate. In this case, the Commission imposed second-tier penalties, which apply when the wrongdoing involves fraud or deceit. Id. § 80b–3(i)(2)(B). Specifically, the Commission imposed a maximum second-tier penalty on Mr. Zavanelli for each of his eight violations, totaling $570,000, and a single below-maximum second-tier penalty of $250,000 on ZPRIM. [8]

8 The maximum penalty for corporations is considerably higher than for "natural person[s]." 15 U.S.C. § 80b–3(i)(2)(B).

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Petitioners have not shown these penalties were a "gross abuse of discretion." Orkin, 31 F.3d at 1066. In deciding whether to impose the monetary penalties, the Commission discussed each of the public interest factors. The Commission found, among other things, that the petitioners "repeatedly violated the antifraud provisions with scienter"; the misconduct was "especially serious because it involved attempts to promote their firm through false claims"; and "[t]here is a need to deter [petitioners] from committing future" violations. These findings are supported by the record, and the Commission appropriately gave them significant weight. Also, while acknowledging that the SEC did not offer evidence to quantify the harm caused by the petitioners' misrepresentations, the Commission found the market was harmed insofar as the misrepresentations "denied investors the ability to make direct comparisons ***1257** between ZPRIM's performance and that of other investment advisers." On this record, we cannot say the Commission grossly abused its discretion in its choice of monetary penalties. See id.

Although we generally affirm the Commission's imposition of monetary penalties, the amount of the penalties imposed here must be reduced by any amounts related to the December 2009 newsletter violations, which we vacate. Because the Commission's order makes clear it assessed a $75,000 penalty on Mr. Zavanelli for the December 2009 newsletter, we vacate that portion of his monetary sanction. For ZPRIM, however, the Commission did not impose penalties for each violation, but instead a single $250,000 penalty. As a result, we vacate the ZPRIM penalty and remand for the Commission to determine the amount, if any, by which that penalty should be reduced.

IV. CONCLUSION

We affirm the Commission's finding that ZPRIM violated sections 206(1), (2), and (4) of the Advisers Act by making false or misleading claims (a) that it was GIPS compliant in the fall–2008 and spring–2011 magazine ads and in the April 2009 newsletter; and (b) that it was not under SEC investigation in the 2011 Morningstar report. We also affirm the Commission's finding that ZPRIM violated sections 206(2) and (4) for the 2010 Morningstar report. We vacate the Commission's finding that ZPRIM violated sections 206(1), (2), and (4) of the Advisers Act for the December 2009 newsletter. In light of that holding, we also vacate the monetary penalty against ZPRIM and remand this case to the Commission for it to determine whether the penalty should be reduced in light of our decision, and if so by how much.

We affirm the Commission's finding that Mr. Zavanelli violated sections 206(1) and (2) of the Advisers Act by making false or misleading claims that ZPRIM was GIPS compliant in the fall–2008 and spring–2011 magazine ads and in the April 2009 newsletter. We vacate the Commission's finding that Mr. Zavanelli violated sections 206(1) and (2) for the December 2009 newsletter. We therefore also vacate the $75,000 penalty the Commission imposed on Mr. Zavanelli for the December 2009 newsletter.

PETITION GRANTED AND REMANDED IN PART AND DENIED IN PART.

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