UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-20531

In the Matter of

Horter Investment Management, LLC and Drew K. Horter,

Respondents.

DIVISION OF ENFORCEMENT'S OPPOSITION TO RESPONDENTS' BRIEF ON REVIEW OF THE INITIAL DECISION

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I. PRELIMINARY STATEMENT

The hearing officer's initial decision to impose (a) a two-year supervisory bar against Respondent Drew K. Horter ("Horter"), and (b) civil penalties of $250,000 and $125,000 against Respondents Horter Investment Management, LLC ("HIM") and Horter, respectively, is well supported by the evidence and applicable law and should be affirmed by the Commission. (Initial Decision, Rel. No. 1414 (Mar. 20, 2023) (hereinafter, "ID").)

The ALJ appropriately found that Respondents' misconduct was "egregious" and "recurrent" by failing reasonably to supervise Kimm Hannan ("Hannan"), a former HIM Investment Adviser Representative ("IAR") who fraudulently misappropriated $728,001 of HIM client assets in violation of the Investment Advisers Act of 1940 ("Advisers Act") and is now serving a 20-year term of imprisonment. (ID at 3-6.) Indeed, the ALJ found that HIM and Horter "facilitated Hannan's fraud" since, over a year and a half, HIM processed and executed Hannan's 17 separate requests to distribute nearly three-quarters of a million dollars of HIM clients' funds to his self-named outside business entity. (ID at 7.) When faced with red flags, Horter "affirmatively overlooked warning signs and rejected advice from his own staff concerning Hannan." (ID at 6.) In light of these and other conclusions, a two-year supervisory bar and third-tier civil penalties are in the public interest and should be affirmed.

II. THE PROCEEDINGS BELOW

On September 8, 2021, the United States Securities and Exchange Commission ("Commission") filed an Order Instituting Proceedings ("OIP") against HIM and Horter pursuant to Sections 203(e), 203(f), and 203(k) of the Advisers Act, alleging that HIM and Horter failed reasonably to supervise Hannan within the meaning of Sections 203(e)(6) and 203(f), and HIM willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder. On

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September 22, 2022, HIM and Horter submitted an offer of settlement, which the Commission determined to accept. (*See* Order Making Findings and Imposing a Cease-and-Desist Order and Ordering Continuation of Proceedings, Rel. No. IA-6182, 2022 SEC LEXIS 2976 (Nov. 3, 2022) (hereinafter, "Settlement Order").) In the Settlement Order, the Commission ordered HIM to cease and desist from committing or causing any violation and any future violation of Section 206(4) of the Advisers Act and Rule 206(4)-7 promulgated thereunder. (*Id.* at 13). The Settlement Order also specified that HIM and Horter agreed to continued proceedings to determine (a) what, if any, civil penalties are appropriate and in the public interest under Section 203(i) of the Advisers Act, and (b) what, if any, other remedial actions are appropriate and in the public interest under Sections 203(e) and (f) of the Advisers Act, and that, in connection with those proceedings, the findings of the Settlement Order "shall be accepted and deemed true by the hearing officer." (*Id*.)

On March 20, 2023, the ALJ issued an Initial Decision in which she found facts established in the Settlement Order, as well as some additional findings of fact, and ordered: (a) HIM censured; (b) Horter barred from associating in a supervisory capacity, with the right to reapply after a period of two years; and (c) HIM and Horter to pay third-tier civil penalties of $250,000 and $125,000, respectively. (ID at 6-8.) On April 10, 2023, Respondents filed a petition for review of the Initial Decision by the Commission, which was granted on May 1, 2023. Respondents to do not challenge the ALJ's decision to censure HIM. (Resp'ts Appeal Br. at 9 n.8.)

III. THE RECORD SUPPORTS THE INITIAL DECISION.

The ALJ deemed true the findings of fact in the Settlement Order and incorporated them into the Initial Decision. (ID at 3; Settlement Order § IV.)

HIM is a Cincinnati-based investment adviser that has been registered with the Commission since January 2007.[1] Horter is HIM's founder and, at all times relevant to the conduct at issue, was HIM's President, Chief Executive Officer, Managing Member, and 90% owner. (ID at 3; Settlement Order ¶¶ 5-6.) HIM employs IARs as independent contractors. HIM's IARs work from remote locations. (ID at 3; Settlement Order ¶ 8.)

A. Horter Failed to Monitor or Follow Up on his *Ad Hoc* Supervisory Delegations.

Horter had ultimate supervisory responsibility for HIM's policies and procedures and overall supervisory responsibility for HIM and its IARs generally. (ID at 3; Settlement Order ¶¶ 10, 14.) Horter also had final authority to hire, fire, or discipline HIM's IARs. (Settlement Order ¶ 10.)

Horter purported to delegate his supervisory responsibilities, but those delegations were *ad hoc* with no documentation evidencing the delegations or defining their nature and scope. Horter also failed to follow up on or oversee his delegations of supervisory responsibility. (ID at 3; Settlement Order ¶ 11.) For example, Horter delegated responsibility to a HIM compliance officer for the required annual review of HIM's policies and procedures in 2016 and 2017 and to both a consulting firm and a HIM compliance officer for the 2015 annual review, but did nothing to oversee those delegations or supervise the reviews. (Settlement Order ¶ 12.)

[1] On December 8, 2017, the Commission issued a settled order against HIM for misstatements in its advertisements and other related issues. HIM was censured and ordered to cease and desist, pay $482,595 in disgorgement and $46,209 in prejudgment interest, and pay a $250,000 civil penalty. *Horter Investment Management, LLC*, Rel. No. IA-4823, 2017 SEC LEXIS 3984 (Dec. 8, 2017). In determining to accept the offer of settlement, the Commission was influenced by HIM's retention of a compliance consultant in February 2015. (ID at 3; *see also* Settlement Order ¶ 5.)

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Horter delegated supervisory responsibility for individual HIM policies and procedures in a similar manner; Horter did not confirm whether his delegatee was following HIM's specific policies and procedures and was not aware of any problems or issues unless the delegatee raised them. (*Id*. ¶¶ 80-85.) Horter could not recall anything specifically he did to oversee his delegation of supervisory responsibility to HIM's compliance department to ensure it was adequately supervising Hannan, and Horter did not recall working with compliance regarding Hannan. (*Id*. ¶ 84.)

B. HIM and Horter Hired Hannan Over the Compliance Officer's Objection in a Rushed Onboarding Process.

Hannan was an IAR with HIM from December 1, 2014 through March 24, 2017, and during the time he was associated with HIM, Hannan worked from a remote office location. (ID at 3; Settlement Order ¶ 7.) Horter was primarily responsible for supervising Hannan. (Settlement Order ¶ 14.)

Before joining HIM, on October 22, 2014, Hannan voluntarily terminated his employment with his prior investment adviser following an internal review. (ID at 3; Settlement Order ¶ 13.) A Form U5 filed on November 14, 2014 confirmed the basis for Hannan's termination was his "use of marketing materials not approved by the firm and that checks were made payable to his DBA, rather than his RIA as required." (ID at 3 n.4; Settlement Oder ¶ 13.) On November 21, 2014, Hannan signed an IAR agreement with HIM and, on December 1, 2014, Hannan registered with HIM. (ID at 3; Settlement Order ¶ 14.)

The day after Hannan registered with HIM, the Financial Industry Regulatory Authority ("FINRA") sent Hannan a letter informing him it was initiating an inquiry regarding his conduct at his prior firm. A week later, Hannan forwarded the FINRA letter to HIM's compliance officer (the "Compliance Officer"). (ID at 3; Settlement Order ¶ 15.) After reviewing the FINRA letter,

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the Compliance Officer recommended to Horter that he fire Hannan. (ID at 3; Settlement Order ¶ 16.) Hannan's onboarding had been unusually fast and the Compliance Officer suspected that Hannan tried to rush it before any disclosures could be added to his publicly-available BrokerCheck report. (ID at 3; Settlement Order ¶¶ 67-71.) Horter rejected the Compliance Officer's recommendation and instructed the Compliance Officer to ask Hannan for an explanation of the conduct FINRA was investigating, which he did. Horter subsequently accepted Hannan's self-serving explanation without question or any further investigation. As a result, HIM and Horter failed reasonably to investigate the conduct identified by FINRA or to follow up on the FINRA inquiry. (ID at 3; Settlement Order ¶ 16.)

HIM designated Hannan as a high-risk adviser, but subjected him to no specific restrictions, requirements, or heightened supervision as a result of the designation. (ID at 3; Settlement Order ¶ 42.) Hannan continued as an IAR with HIM until his employment was terminated on March 24, 2017. (ID at 3; Settlement Order ¶ 17.)

C. HIM Facilitated Hannan's Fraud by Processing and Executing Hannan's 17 Requests to Distribute $728,001 from HIM Clients to his Outside Business Activity.

Hannan Properties, LLC ("Hannan Properties") was an outside business activity ("OBA") of Hannan's known to HIM and Horter through their onboarding of Hannan. (ID at 3-4; Settlement Order ¶¶ 18-19.) As a result of Hannan's repeated submissions of third-party distribution requests to HIM for distributions from his HIM clients to Hannan Properties, HIM was aware Hannan continued to operate Hannan Properties during his tenure at HIM. (ID at 3-4; Settlement Order ¶ 19.) As early as fall 2016, HIM and Horter were aware of HR Resources, LLC ("HR Resources"), another OBA of Hannan's for which he solicited and received funds from HIM clients. (ID at 3; Settlement Order ¶ 22.)

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Between November 19, 2015 and March 8, 2017, Hannan solicited and received distributions to Hannan Properties totaling $728,001 from the accounts of several HIM clients. (ID at 3; Settlement Order ¶ 20.) To receive those funds, Hannan submitted 17 requests to HIM to distribute HIM client funds to Hannan Properties, which the firm processed and executed. (ID at 3-3; Settlement Order ¶ 21.) Each of those third-party distribution requests clearly listed Hannan Properties as the recipient of the transferred client funds. (Settlement Order ¶ 21.) As a result, HIM knew, or should have known, Hannan was soliciting client funds for his OBA. (ID at 3-4; Settlement Order ¶¶ 21, 59.)

On or about March 17, 2017, HIM initiated an internal investigation after staff responsible for processing third-party distributions alerted HIM's Compliance Officer that she was having a problem processing a distribution from a HIM client to one of Hannan's OBAs. That investigation concluded Hannan violated investment related statutes, regulations, rules, or industry codes of conduct. HIM terminated Hannan's employment on March 24, 2017. (ID at 4; Settlement Order ¶¶ 25-26.)

In January 2019, following a jury trial, Hannan was convicted of violating various provisions of the Ohio state securities laws arising from his solicitation and receipt of funds from clients for his OBAs by means of material misrepresentations and omissions. Hannan is currently serving a 20-year prison term. (ID at 3; Settlement Order ¶ 32.) Hannan's misconduct also constitutes uncharged violations of Section 206(1) and (2) of the Advisers Act and was made possible by HIM's and Horter's failure reasonably to supervise Hannan and their failure to safeguard retail investors' assets against misappropriation. (Settlement Order ¶¶ 35-36.) Indeed, as the ALJ found, HIM and Horter "facilitated" and "enabled" Hannan's fraud. (ID at 7.)

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While HIM processed and executed 17 distributions, totaling $728,001, from three HIM clients to Hannan Properties, HIM only paid these three clients $360,000 – less than 50% of their losses from HIM's approving and processing distributions to facilitate Hannan's fraud. (*See* Chart of HIM Client Distributions to Hannan Properties, Exhibit 1 to Declaration of Nicholas Magina, filed on January 9, 2023.) HIM repaid Hannan's HIM clients pursuant to confidential settlement agreements, but did not repay their clients' claims in full. (ID at 4.)

D. HIM and Horter Ignored Red Flags Regarding Hannan.

HIM and Horter failed reasonably to follow up on multiple red flags concerning Hannan's potential and actual misconduct. As described above, HIM and Horter received notification of FINRA's inquiry into Hannan only days after Hannan started working at HIM. HIM's Compliance Officer specifically warned Horter that Hannan may have tried to conceal what happened at his prior firm and retrieved a new IAPD public disclosure report for Hannan, which, according to the Compliance Officer, looked different than the one HIM had reviewed as a part of its due diligence of Hannan. Based on the updated report, the Compliance Officer concluded that Hannan failed HIM's due diligence and recommended to Horter that Hannan be terminated. Horter rejected the Compliance Officer's recommendation, choosing instead to accept Hannan's self-serving explanation with no further inquiry or follow-up. (ID at 3; Settlement Order ¶¶ 74-75.)

HIM and Horter ignored another red flag by failing reasonably to monitor Hannan, whom the firm had designated a high-risk adviser. Despite designating Hannan a high-risk adviser, neither HIM nor Horter imposed any restrictions, required any heightened supervision, or did anything to ensure Hannan was monitored more closely than IARs not determined to be high-risk. (ID at 3; Settlement Order ¶ 76.)

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HIM also failed reasonably to follow up on the red flags raised by each of the 17 distribution requests submitted by Hannan to HIM over a year and a half to distribute HIM client funds to Hannan's OBA, Hannan Properties. HIM received, processed, and executed those 17 distribution requests, but did nothing beyond confirming the distribution with the client; HIM never inquired or investigated why clients were distributing hundreds of thousands of dollars to their IAR's outside business. Neither HIM nor Horter followed up even when half a dozen of those distributions were logged and purportedly subject to supervisory review. (Settlement Order ¶¶ 62-63, 77.) HIM's failure to follow up is particularly notable given that Hannan Properties was listed on each of the 17 third-party distribution requests (*id.* ¶¶ 21, 62), and ***both*** Hannan and Hannan Properties were prominently identified on the six entries included in the distribution log:

Horter Investm... Management
Client Distribution Request Log
Third Party Distributions

Date	Client Name	Account #	Adviser	Amount	3rd Party Payee	Processor	Authorization
2/5/17	Michael Maletich	[redacted]	Hannan	$4,740.00	Hannan Properties	Jessica	
2/6/17	Michael Maletich		Hannan	$18,225.00	Hannan Properties	Jessica	Kath
2/9/17	Bruce Peterson		B. Gray	$38,000.00	Organic Aloe Vera	Jessica	Kevin
3/1/17	Heinzman Properties		Hannan	$45,000.00	Hannan Properties	Jessica	Kevin

(*See* Excerpt of HIM Client Distribution Request Log at SEC-InvTestimony-000235-Long, Exhibit 3 to Declaration of Nicholas Magina, filed on January 9, 2023.) As a result, HIM "facilitated" Hannan's fraud. (ID at 7.)

Finally, HIM and Horter knew Hannan was aggressively attempting to raise money for HR Resources from sources other than Horter – Hannan had specifically told him – but neither did anything to supervise Hannan more closely or to investigate whether he might be soliciting HIM clients for funds for his OBAs, which he was. (Settlement Order ¶ 78.)

With each of these red flags, HIM and Horter failed reasonably to investigate in order to detect and prevent violations of the federal securities laws. To the contrary, HIM and Horter ignored indications of wrongdoing or the significant potential for wrongdoing, thereby allowing Hannan's misconduct to continue. (Settlement Order ¶ 79.)

E. HIM and Horter Failed Reasonably to Establish or Implement Supervisory Policies and Procedures.

HIM and Horter failed to adopt written policies and procedures reasonably designed to prevent violations of the Advisers Act in the areas of high-risk advisers heightened supervision, field visits and branch audits of remote IARs, and third-party distribution requests. (ID at 4; Settlement Order ¶¶ 38, 50.)

In December 2014, the Commission's examination staff issued a deficiency letter to Horter Investment, noting HIM "appears to have not taken our previous deficiency letters seriously," and had "failed to conduct adequate annual compliance reviews [and] failed to implement an effective compliance program." (ID at 3-4; Settlement Order ¶ 9.) In March 2015, a few months after HIM hired Hannan, the consultant HIM brought in to review its compliance program following that examination warned HIM that "higher risk IAR's (those with previous disclosures and without IAR experience) require a program of closer supervision, particularly during their first years with [HIM]. Currently, no procedures call for such a review." (ID at 4; Settlement Order ¶ 40.) In September 2016, still during Hannan's tenure with, HIM's Compliance Officer similarly warned of the need for HIM to "get our internal heightened supervision program developed." (ID at 4; Settlement Order ¶ 40.)

Despite those warnings, HIM and Horter had no policies or procedures for heightened supervision of high-risk advisers like Hannan until March 20, 2017, days before HIM terminated Hannan's employment. (ID at 4; Settlement Order ¶ 41.) HIM and Horter did not adopt a

heightened supervision agreement until November 2017, well after Hannan's employment had been terminated. (Settlement Order ¶ 41.) As noted above, HIM subjected Hannan to no specific restrictions, requirements, or heightened supervision despite designating him a high-risk adviser. (ID at 3; Settlement Order ¶ 42.)

HIM's 2014 deficiency letter noted that HIM had also failed to conduct supervisory inspections of IARs' branch offices. (ID at 4; Settlement Order ¶ 44.) In March 2015, HIM's consultant noted HIM's "growth has obviously outpaced its supervisory, compliance, and operational capabilities." The consultant advised HIM to "develop a more detailed procedure for supervising the activities of its remote IARs." (ID at 3; Settlement Order ¶ 44.)

Despite these warnings, HIM did not adopt or implement any policies or procedures regarding field visits or branch audits of either its high-risk IARs until March 2017 or its IARs generally until November 2017. HIM did not begin conducting field visits or branch audits until August 2017 and never conducted a field visit or branch audit of Hannan or his office. (Settlement Order ¶¶ 43-45.)

Prior to June 2016, HIM had no written policies or procedures regarding distributions from its clients to third parties. (Settlement Order ¶¶ 46-47.) Following an incident in which HIM mistakenly distributed more than $300,000 from a client's account to a third-party in response to a fraudulent email, in June 2016, HIM instituted practices requiring that third-party distributions be (1) verbally confirmed with the client by HIM and (2) documented in a log. However, HIM established no further procedures and no written instructions for either its third-party distribution procedures or the third-party-distribution log and HIM established no documented procedures for supervisory review. The new practices were miscommunicated or misinterpreted, not consistently followed, and not monitored by HIM's compliance department

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or its management, including Horter. (*Id.* ¶¶ 48-49.) HIM did not adopt written policies and procedures for third-party distributions until October 2017, eight months after Hannan was terminated, and the Compliance Officer did not begin monitoring compliance with HIM's third-party distribution log and procedures until December 2017. (*Id*. ¶ 49.)

Finally, HIM and Horter also failed reasonably to implement policies and procedures it had adopted to prevent violations of the Advisers Act with respect to OBAs and third-party distributions, among other things. (Settlement Order ¶ 50.)

HIM's only policy regarding OBAs was in the firm's April 1, 2016 Policies and Procedures Manual, which required that "any business other than an IAR's HIM advisory business": (1) be reported; (2) be described in a submission by the IAR on a form provided by HIM; (3) receive prior approval from firm management; and (4) receive sign-off from the Chief Compliance Officer ("CCO"). HIM's OBA policies and procedures also required that (a) firm management and the CCO consider whether a proposed OBA may be viewed by clients, customers, or the public as being part of HIM's advisory business, and (b) the firm determine whether any conditions or limitations should be placed on a proposed OBA, including prohibiting such activity. (*Id*. ¶ 52.) Notwithstanding the requirement in HIM's policy that IARs get prior approval from management for OBAs and signoff from the CCO, HIM and Horter allowed Hannan to operate HR Resources as an OBA without either and never evaluated any of the considerations required by its own policy. (*Id*. ¶ 55.)

As noted above, in June 2016 HIM began requiring that third-party distributions be verbally confirmed with the client and documented in a third-party distribution log. (Settlement Order ¶ 59.) Although the Compliance Officer explained to HIM staff that "[d]istributions to third parties are the highest risk transaction that our organization faces[]" and that requests for third-

party distributions "should never be executed unless verbally confirmed by the client" and [t]here will be no exceptions to this requirement," HIM provided inadequate training to the HIM employee responsible for processing third-party distributions. (Settlement Order ¶¶ 60, 65-66.) HIM processed at least one third-party distribution request from one of HIM clients to Hannan's OBA without speaking to the client as required and may have done so on other occasions. (*Id*. ¶ 60.) HIM also failed to log at least half a dozen third-party distributions from HIM clients to Hannan Properties as required. (*Id*. ¶¶ 61-62.)

Moreover, the third-party distribution log was intended to be something HIM could audit each month as part of its compliance program; however, no one in HIM's compliance department reviewed the log from its implementation in June 2016 until March 2017. (*Id*. ¶ 63.) Similarly, despite acknowledging HIM began the third-party distribution log "to be able to better watch over third-party distributions[,]" Horter never reviewed or monitored the log, did nothing to ensure the compliance department reviewed or monitored the log, and did not even know where it was kept. Moreover, Horter himself acknowledged that had he reviewed the log, which contained only about 50 entries between June 2016 and March 2017, he would have seen the half dozen distributions from HIM clients to Hannan Properties. (*Id*. ¶ 64.)

In February 2022, approximately five years after HIM terminated Hannan, HIM adopted various reforms to the firm's compliance functions and greatly reduced Horter's supervisory responsibilities. (ID at 4.)

IV. ARGUMENT

A. The AJL Fully Considered Respondents' Offer of Settlement and No Other Specific Finding Is Required.

Respondents first ask the Commission to amend the Initial Decision to reflect that Respondents accepted responsibility for their actions by agreeing to the Cease-and-Desist Order.

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(Resp'ts Appeal Br. at 9.) As the Initial Decision reflects that the ALJ considered Respondents' offer of settlement – and the mention or omission of any specific fact is not a grounds to appeal – there is no basis to amend the Initial Decision.

Contrary to Respondents' suggestion, the ALJ specifically recognized that the Commission accepted Respondents' offer of settlement. The Initial Decisions states: "On November 3, 2022, the Commission issued an Order that accepted Respondents' Offer of Settlement; made various findings of fact and conclusions of law; imposed a cease-and-desist order; and ordered continued proceedings" to determine what, if any, civil penalties and other remedial actions are appropriate and in the public interest. (ID at 1-2.) Addressing the censure and bar, the ALJ further stated: "Consistent with a vigorous defense of the charges against them, Respondents have minimized the wrongful nature of their conduct, but point to their after-the-fact compliance structure as assurance against future violations." (ID at 6.) While Respondents apparently agree that they have every right to mount a vigorous defense, they quarrel that the Initial Decision apparently did not give them any credit for acceptance of responsibility or for recognizing the wrongful nature of their conduct based on their offer of settlement. (Resp'ts Appeal Br. at 8-9.)

The Initial Decision specifically states that "[a]ll arguments and proposed findings and conclusions that are inconsistent with this ID were considered and rejected." (ID at 2.) The ALJ, therefore, fully considered and rejected crediting Respondents for recognizing the wrongful nature of their conduct, which is a factor in determining sanctions under *Steadman v. SEC*, 603 F.2d 1126, 1150 (5th Cir. 1979). Moreover, the ALJ's statement is simply a description of Respondents' own arguments below. Respondents dedicated the bulk of their initial brief addressing civil penalties and remedial actions and their response brief, which totaled

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approximately 35 pages, to blaming Hannan and Hannan's clients for the fraud, detailing numerous changes HIM implemented five years after Hannan's termination, and arguing that the ALJ should impose no sanctions whatsoever (or at most a censure). (Resp'ts Initial Br. at 3-8, 12-19; Resp'ts Resp. Br. at 7-8, 10-15.) Respondents simply argued, in a conclusory fashion, that they recognized the wrongful nature of their conduct solely by virtue of their consent to the Settlement Order, on a no admit no deny basis. (Resp'ts Initial Br. at 12; Resp'ts Resp. Br. at 8.)

But a Settlement Order, in which Respondents do not admit or deny the underlying facts, does not ***by itself*** establish that Respondents recognized the wrongful nature of their conduct. *Eugene Terracciano*, Rel. No. ID-1388, 2019 WL 5513382, at *1 (Oct. 22, 2019), on which Respondents rely, is not to the contrary. Terracciano, who was an AML Compliance Officer at a broker-dealer, consented to a Settlement Order that imposed a cease-and-desist order and civil money penalty for willfully aiding and abetting and causing the broker-dealer's violations of Section 17(a) of the Securities Exchange Act of 1934 and Rule 17a-8 thereunder, which requires broker-dealers to comply with various reporting, recordkeeping, and record retention requirements. *Id*. at *2-3. The Division sought a two-year bar and Terracciano argued that a supervisory suspension of approximately 12 months would be more appropriate and in the public interest. Terracciano testified at the remedies hearing and admitted that his actions "were insufficient and not a substitute for filing SARs" and that he "would not now seek or accept a position with AML reporting responsibilities." *Id*. at *2. Accordingly, given Terracciano's sworn testimony, the ALJ properly found that Terracciano had recognized the wrongful nature of his conduct. *Id*. at *3. There is nothing in the record to support such a conclusion here and the ALJ rightly did not credit Respondents for this factor.

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B. Horter's Egregious and Recurrent Misconduct Merits a Two-Year Supervisory Bar.

Section 203(f) of the Advisers Act empowers the Commission to sanction any person associated with an investment adviser, if the person has failed reasonably to supervise, with a view to preventing violations of the federal securities laws, another who commits such a violation, if such other person is subject to his supervision. 15 U.S.C. § 80b-3(f). To assess whether a bar is in the public interest, the Commission considers, among other things: "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," as well as the "deterrent effect." *Schield Management Co.*, Rel. No. 34-53201, 2006 SEC LEXIS 195, at *22-23 (citing *Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981)).).

The ALJ correctly concluded that Horter should be barred from association in a supervisory capacity with the right to reapply after two years. As the ALJ recognized, Horter's misconduct was "egregious and recurrent, continuing for more than two years." (ID at 6.) The Commission has consistently held that "failures to supervise cases are serious violations" because "[s]upervisors are the first line of defense against wrongdoing by their subordinates." *Brown, Collins, Walsh, & Wells*, Rel. No. 34-66752, 2012 SEC LEXIS 1127, at *6 (April 5, 2012). Moreover, Horter repeatedly ignored red flags, rejected advice from his Compliance Officer to fire Hannan, and failed reasonably to supervise Hannan, which resulted in fraud and over $728,001 in losses to HIM clients. (ID at 6.) *See George J. Kolar*, Rel. No. 34-46127, 2002 SEC LEXIS 3420, at *23 (June 26, 2002) ("Decisive action is necessary whenever supervisors

are made aware of suspicious circumstances, particularly those that have an obvious potential for violations."). Horter also failed to follow up on or monitor his supervisory delegations. (ID at 3.) *See Rita H. Malm & Robert W. Berg*, Rel. No. 34-35000, 1994 SEC LEXIS 3679, at *23 (Nov. 23, 1994) ("[I]t is not sufficient for the person with overarching supervisory responsibilities to delegate supervisory responsibility to a subordinate, even a capable one, and then simply wash his hands of the matter until a problem is brought to his attention. . . . Implicit is the additional duty to follow-up and review that delegated authority to ensure that it is being properly exercised."). Finally, while HIM's belated compliance reforms may reduce the opportunity for future violations, they have not been eliminated. (ID at 6.)

Respondents contend that the ALJ should have specified why a less severe sanction would not protect investors and that a two-year supervisory bar is improperly punitive. (Resp'ts Appeal Br. at 10-11.) Respondents' arguments miss the mark.

Nothing in *Steadman v. SEC*, 603 F.2d 1126 (5th Cir. 1979), requires the ALJ to demonstrate why a sanction less severe than a two-year supervisory bar would not protect investors. In *Steadman*, the court considered the propriety of a ***permanent bar*** from the industry, the most severe sanction available. *Id*. at 1141. The Division did not seek such a severe sanction here and the ALJ did not impose one. Therefore, *Steadman* does not require the ALJ to justify why a less severe sanctions would not protect investors.

The ALJ properly concluded that a two-year supervisory bar is justified by the aforementioned factors, standards of conduct in the securities industry generally, and deterrence. (ID at 6.) As the ALJ held, the two-year supervisory bar will encourage Horter and others similarly situated to take their supervisory responsibilities more seriously and thereby protect the public. (ID 6-7 (citing *Thomas C. Bridge*, Rel. No. 33-9068, 2009 SEC LEXIS 3367, at *61

(Sept. 29, 2009) (imposing five-year supervisory bar).) Further, the ALJ carefully "calibrated" Horter's the two-year supervisory bar to enable "Horter to continue to own and receive income from [HIM]." (ID at 7.) Accordingly, the ALJ precisely tailored Horter's two-year supervisory bar to reflect the level of his misconduct, deter similarly situated supervisors from neglecting their supervisory responsibilities, while allowing Horter to continue to own and receive income from HIM.[2] *See, e.g., Angelica Aguilera*, Rel. No. ID-501, 2013 SEC LEXIS 2195, at *62-65 (July 31, 2013) (investment adviser President who failed to supervise two IARs who engaged in markup and markdown scheme barred from association in supervisory capacity with broker or dealer). Accordingly, as a less severe sanction would not protect investors or be in the public interest, a two-year supervisory bar is not punitive and should be affirmed.

C. Respondents' Reckless Disregard for Regulatory Requirements that Enabled Hannan's Fraud Merits the Third-Tier Civil Penalties Imposed by the ALJ.

Section 203(i) of the Advisers Act authorizes the Commission to impose civil monetary penalties if it finds that such person or entity has failed reasonably to supervise another person who commits a violation of the federal securities laws if such other person is subject to their supervision, where such penalties are in the public interest. 15 U.S.C. § 80b-3(i)(1)(A)(iv). In determining whether civil penalties are in the public interest, the Commission may consider: (a) fraud; (b) harm to others; (c) unjust enrichment (taking into account restitution paid); (d) previous violations; (e) deterrence; and (f) such other matters as justice may require. 15 U.S.C. § 80b-3(i)(3).

[2] The other cases cited by Respondents (Respt's Appeal Br. at 12) are readily distinguishable. *See, e.g., SFX Financial Advisory Management Enterprises, Inc.*, Rel. No. IA- 4116, 2015 WL 3653814 (June 15, 2015) (CCO who caused compliance failures, but did not fail reasonably to supervise the employee who committed fraud, agreed to sanctions that did not include a suspension, revocation, or bar); *Ascension Asset Mgmt., LLC*, Rel. No. ID-1400, 2020 WL 1699565 (Apr. 3, 2020) (censuring investment adviser owner for compliance and custody violations where Division did not request any greater sanction).

The ALJ determined that third-tier civil penalties of $250,000 and $125,000 for HIM and Horter, respectively, are in the public interest under the circumstances here. (ID at 7-8.) In reaching this conclusion, the ALJ found that HIM's and Horter's misconduct: (a) "facilitated Hannan's fraud"; (b) caused $728,001 in harm to others; (c) "evidenced at least a reckless disregard for a regulatory requirements, including the antifraud statutes and regulations as well as their supervisory duties, and their failure created a significant risk of loss to other persons"; (d) "clearly created a significant risk of loss to other persons, as shown by the fact that actual losses, even if temporary, due to Respondents' full or partial repayment"; and (e) required a "substantial penalty to deter future misconduct because of the abuse of fiduciary duty owed" to HIM clients. (ID at 7.)

Respondents contend that the public interest does not support a civil penalty against HIM or Horter. Respondents complain that the ALJ found that Respondents were "reckless" without any evidentiary support and improperly referenced a Commission's staff deficiency letter. (Resp'ts Appeal Br. at 13-16.) Respondents' arguments again are mistaken.

The ALJ correctly concluded that third-tier civil penalties are appropriate because HIM and Horter enabled Hannan's fraud and acted recklessly in disregarding their regularly requirements, including their supervisory duties.[3] It is undisputed that HIM and Horter failed reasonably to supervise Hannan when he committed securities fraud, in violation of Section 206(1) and (2) of the Advisers Act, for over a year and a half, by misappropriating money from

[3] Under Section 203(i)(2)(C), third-tier civil penalties are appropriate if (i) the act or omission by a person or entity "involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement," and (ii) such act or omission "directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons or resulted in substantial pecuniary gain to the person who committed the act or omission." 15 U.S.C. § 80b-3(i)(2)(C).

HIM clients through third-party distributions approved, processed, and executed by HIM. (ID at 3; Settlement Order ¶¶ 27-35.) The Commission has held that supervisory lapses "involve[] fraud" when, as here, they "'allowed and were responsible, in part, for the success and duration of [a registered representative's] fraudulent misconduct.'" *George J. Kolar*, Rel. No. 34-46127, 2002 SEC LEXIS 3420, at *23 (June 26, 2002) (imposing second-tier penalties on deficient supervisor who failed to stop fraudulent misconduct resulting in $10 - $14 million in investor losses over a three-year period) (quoting *Consolidated Inv. Servs., Inc.*, Rel. No. 34-36687, 1996 SEC LEXIS 83, at *22 (Jan. 5, 1996)). Third-tier penalties are therefore warranted against HIM and Horter because their supervisory lapses enabled Hannan's fraudulent misconduct.

If that were not enough, HIM and Horter also recklessly disregarded a regulatory requirement, as required for a third-tier penalty. The record amply supports the ALJ's conclusion that HIM and Horter acted recklessly. As the ALJ recognized, HIM and Horter ignored numerous red flags that would have alerted them to Hannan's fraud.

- **Onboarding**. While HIM and Horter received notification of Hannan's FINRA inquiry days after Hannan began at HIM and the Compliance Officer recommended to Horter that Hannan be terminated, Horter instead accepted Hannan's self-serving explanation with no further inquiry or follow-up (ID at 3; Settlement Order ¶¶ 74-75);

- **High-Risk Adviser**. HIM designated Hannan as high risk, but neither HIM nor Horter imposed any restrictions, required any heightened supervision, or did anything to ensure Hannan was monitored more closely than IARs not determined to be high-risk – even though HIM was warned by Examination staff and an outside consultant about the need to develop an effective compliance program and to establish necessary supervisory policies and procedures (ID at 3; Settlement Order ¶ 76);

- **HIM Approved 17 Distributions to Hannan Properties**. HIM received, processed, and executed each of the 17 distribution requests submitted by Hannan over a year and a half to distribute HIM clients funds to Hannan's OBA, Hannan Properties, but did nothing beyond confirming the distribution with the client; HIM never inquired or investigated why clients were distributing hundreds of thousands of dollars to their IAR's outside business and neither Horter nor HIM

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followed up even when half a dozen of those distributions were logged and purportedly subject to supervisory review (ID at 3; Settlement Order ¶ 77); and

- **HIM and Horter Knew Hannan Was Aggressively Seeking Investors for HR Resources**. HIM and Horter knew Hannan was aggressively attempting to raise money for HR Resources from sources other than Horter, but neither did anything to supervise Hannan more closely or investigate whether he might be soliciting HIM clients for funds for his OBA, which he was (Settlement Order ¶ 78).

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.'" *Aguilera*, 2013 SEC LEXIS 2195, at *62-63. Red flags require heightened investigation, and ignoring those flags is reckless. *Graham v. SEC*, 222 F.3d 994, 1006 (D.C. Cir. 2000) ("[R]ed flags and suggestions of irregularities demand inquiry as well as adequate follow-up and review.") (affirming Commission's determination that back-office broker acted recklessly by ignoring "abundance of red flags"). Moreover, the Commission has held that a supervisor may "reckless[ly] disregard his supervisory responsibilities" where he ignores "numerous red flags." *John A. Carley*, Rel. No. 34-888, 2008 WL 268598, at *26 (Jan. 31, 2008), *rev'd in part on other grounds sub nom*. *Zacharias v. SEC*, 569 F.3d 458 (D.C. Cir. 2009). In this case, HIM and Horter ignored multiple red flags. Accordingly, the ALJ correctly concluded that HIM and Horter acted recklessly and warranted third-tier civil penalties.

Second, the ALJ properly referenced HIM's and Horter's response to Commission staff's deficiency letters. The ALJ stated: "Although they failed to take action in response to Commission staff's earliest deficiency letters, they have no record of previous violations." (ID at 7.) In December 2014, the Commission's examination staff issued a deficiency letter to Horter Investment, noting HIM "appears to have not taken our previous deficiency letters seriously," and had "failed to conduct adequate annual compliance reviews [and] failed to implement an

effective compliance program." (ID at 3-4; Settlement Order ¶ 9.) Thus, the record adequately supports the ALJ's conclusion that HIM and Horter failed to take action in response to the Commission staff's ***earliest*** deficiency letters. While HIM and Horter did take action in response to the 2015 deficiency letter by hiring a compliance consultant (ID at 3), it is undisputed that their actions were insufficient and did not fully address or remediate the deficiencies found by the staff concerning the supervision of high-risk advisors and inspections of IARs' branch offices. (ID at 4; Settlement Order ¶¶ 41-45.) Accordingly, the ALJ's references to HIM's deficiency letters are accurate and supported by the record.

CONCLUSION

The Division respectfully requests that the Commission affirm the ALJ's well-reasoned findings and conclusions and (a) bar Horter from association in a supervisory capacity with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization, with the right to reapply after a period of two years, and (b) impose civil penalties of $250,000 and $125,000 against HIM and Horter, respectively.

Dated: June 30, 2023

Respectfully submitted,

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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-20531

In the Matter of **HIM Management, LLC and Drew K. Horter,** **Respondents.**	**CERTIFICATE OF SERVICE**

I hereby certify that I caused a true copy of the foregoing Division of Enforcement's Opposition to Respondents' Brief on Review of the Initial Decision to be served on the following on this 30th day of June, 2023, in the manner indicated below:

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Dated: June 30, 2023

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