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8
9 **UNITED STATES DISTRICT COURT**
10 **CENTRAL DISTRICT OF CALIFORNIA**

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13 **SECURITIES AND EXCHANGE**
COMMISSION,

14 **Plaintiff,**

15 **vs.**

16 **BRENDAN MATTHEW ROSS,**

17 **Defendant.**

Case No.

COMPLAINT

18
19
20 Plaintiff Securities and Exchange Commission (“SEC”) alleges:

21 **JURISDICTION AND VENUE**

22 1. The Court has jurisdiction over this action pursuant to Sections 20(b),
23 20(d)(1) and 22(a) of the Securities Act of 1933 (“Securities Act”), 15 U.S.C. §§
24 77t(b), 77t(d)(1) & 77v(a), and Sections 21(d)(1), 21(d)(3)(A), 21(e) and 27(a) of the
25 Securities Exchange Act of 1934 (“Exchange Act”), 15 U.S.C. §§ 78u(d)(1),
26 78u(d)(3)(A), 78u(e) & 78aa(a), and Sections 209(d), 209(e)(1) and 214 of the
27 Investment Advisers Act of 1940 (“Advisers Act”), 15 U.S.C. §§ 80b-9(d), 80b-
28

1 9(e)(1) & 90b-14.

2 2. Defendant Brendan Matthew Ross (“Defendant” or “Ross”) has, directly
3 or indirectly, made use of the means or instrumentalities of interstate commerce, of
4 the mails, or of the facilities of a national securities exchange in connection with the
5 transactions, acts, practices and courses of business alleged in this complaint.

6 3. Venue is proper in this district pursuant to Section 22(a) of the Securities
7 Act, 15 U.S.C. § 77v(a), Section 27(a) of the Exchange Act, 15 U.S.C. § 78aa(a), and
8 Section 214 of the Advisers Act, 15 U.S.C. § 80b-14, because certain of the
9 transactions, acts, practices and courses of conduct constituting violations of the
10 federal securities laws occurred within this district. In addition, venue is proper in
11 this district because Defendant Ross resides in this district.

12 **SUMMARY**

13 4. This civil enforcement action concerns an intricate, multi-year effort by
14 Ross, the former chief executive officer and the 100% owner of registered investment
15 adviser Direct Lending Investments, LLC (“DLI”), to fraudulently inflate the value
16 and returns for an investment position held by the investment funds that DLI advised
17 (the “Funds”), which resulted in misstatements to investors and at least \$5-6 million
18 in over-charges of management and performance fees to the Funds.

19 5. DLI advised a private fund structure with over \$865 million in assets
20 under management that invested in various lending platforms. DLI’s Funds’
21 investments included loans made by QuarterSpot, Inc. (“QuarterSpot”), an online
22 small business lender. Under the terms of this investment, the Funds funded
23 thousands of QuarterSpot loans and were entitled to the principal and interest
24 payments made by the underlying borrowers, subject to QuarterSpot taking a
25 servicing fee that was a set percentage of the loan interest collected each month.

26 6. Starting in or around early 2014, Ross orchestrated a scheme whereby he
27 secretly directed QuarterSpot, as part of its monthly reporting to DLI, to “rebate” a
28 portion of its servicing fees by making payments to the Funds, which gave the false

1 impression that borrowers were making principal payments on seriously delinquent
2 loans.

3 7. Under DLI's valuation policy, many of these non-performing loans
4 should have been marked down 50% or 100% and reserved against the Funds'
5 interest income, but instead were valued at par because of the false payments Ross
6 engineered.

7 8. As a result, between spring 2014 and fall 2017, DLI cumulatively
8 overstated the valuation of the Funds' QuarterSpot position by approximately \$53
9 million and materially misrepresented the Funds' returns. DLI collected at least \$5-6
10 million in extra management and performance fees from the Funds that it would not
11 have otherwise been able to collect. DLI's asset values were also materially
12 overstated in its required Forms ADV filed with the SEC.

13 9. To conceal his scheme, Ross hid information from others in DLI
14 management, from the Funds' auditors, and from other third parties, and when
15 irregularities in the QuarterSpot portfolio came to light, he lied to others in DLI
16 management about his knowledge of, and his role in, the "rebate" payments.

17 10. In March 2019, upon discovering Ross's misconduct with respect to
18 QuarterSpot after an internal investigation, a committee of senior DLI executives
19 demanded that Ross formally resign and relinquish control of DLI, to which he
20 acquiesced.

21 11. By engaging in this conduct, Ross violated Section 10(b) of the
22 Exchange Act and Rule 10b-5 promulgated thereunder, Section 17(a) of the
23 Securities Act, and Sections 206(1), 206(2), and 207 of the Advisers Act.

24 12. With this complaint, the SEC seeks a permanent injunction prohibiting
25 future violations of the federal securities laws and an order requiring Ross to disgorge
26 his ill-gotten gains with prejudgment interest thereon, and imposing civil penalties.

27 **THE DEFENDANT**

28 13. Defendant Ross, age 47, resides in La Canada, California. Ross founded

1 DLI in 2012, and from DLI's founding until March 2019, he was the adviser's 100%
2 owner, chief executive officer, and managing member. Ross resigned as CEO and
3 managing member of DLI in March 2019.

4 OTHER PERSONS AND ENTITIES

5 14. Direct Lending Investments, LLC is an SEC registered investment
6 adviser with its principal place of business in Glendale, California. It advised a
7 private fund structure comprised of two "feeder" funds (Direct Lending Income Fund,
8 L.P. and Direct Lending Income Feeder Fund, Ltd.) and a "master" fund (DLI
9 Capital, Inc.) (collectively, the "Funds"). Prior to October 2016, DLI was the sole
10 manager and general partner of a single fund, Direct Lending Income Fund, L.P.,
11 which then became the domestic feeder fund when DLI adopted the master-feeder
12 fund structure. DLI controlled the Funds and was solely responsible for their
13 management. According to its latest SEC Form ADV Part 1A filing on February 25,
14 2019, DLI had approximately \$866,300,000 in assets under management as of May
15 31, 2018.

16 15. On March 22, 2019, the Commission filed a civil action in federal
17 district court against DLI alleging violations of the antifraud provisions of the
18 Advisers Act, the Securities Act, and the Exchange Act, and seeking a preliminary
19 injunction and the appointment of a receiver, relief to which DLI stipulated. *SEC v.*
20 *Direct Lending Investments, LLC*, Case No. 2:19-cv-02188-DSF-MRW (C.D. Cal.).
21 On April 1, 2019, the Court entered the preliminary injunction and appointed a
22 permanent receiver over DLI, the Funds, and the Funds' holding subsidiaries.

23 16. **QuarterSpot, Inc.** is a corporation based in New York, New York that
24 makes online loans to small businesses. The DLI Funds invested in loans originated
25 by QuarterSpot starting in or around August 2013.

26 THE ALLEGATIONS

27 **A. DLI's Advisory Business**

28 17. Ross founded DLI in 2012, and in February 2016, registered it with the

1 SEC as an investment adviser.

2 18. From 2012 until March 2019, Ross was DLI's 100% owner, managing
3 member, and chief executive officer.

4 19. Ross had ultimate authority over all aspects of DLI's business.

5 20. DLI's investment focus was on buying loans, participating in loans, and
6 owning credit facilities and other structures where loans and other assets served as
7 collateral.

8 21. In its Form ADV Part 2A brochure provided to its clients, DLI described
9 its Funds' "typical investments" as consisting of "\$50-200 million asset-backed credit
10 facilities to a diverse group of specialty finance companies, special purpose vehicles
11 and other counterparties . . . across the small business, consumer, receivables, real
12 estate and other sectors."

13 22. DLI charged clients both a management fee and a performance fee on
14 the Funds' assets. The management fee was calculated as 1% of the master fund's
15 gross asset value plus beginning of month subscriptions less redemptions. The
16 performance fee was incurred when the master fund's net asset value exceeded its
17 prior high net asset value and was calculated as 20% of these earnings before interest
18 and taxes.

19 23. The number of investors in the Funds fluctuated over time, but there
20 were roughly 1,000 investors as of February 1, 2019, shortly before DLI and the
21 Funds were placed into receivership. The investors in DLI's Funds were generally
22 accredited individual and institutional investors.

23 24. During the relevant period, DLI used a fund administrator that, among
24 other things, aggregated the monthly financial information for the Funds' various
25 investments and provided the Funds' investors with monthly account statements that
26 detailed the value of their accounts and their monthly interest income.

27 25. During the relevant period, DLI's Funds were audited by three different
28 auditing firms that, among other things, purported to audit the Funds' financial

1 statements in accordance with generally accepted accounting principles and auditing
2 standards, and that issued annual audit reports for the Funds.

3 **B. DLI's Regular Communications with the Funds' Investors**

4 26. During the relevant period, DLI regularly communicated with the Funds'
5 investors through monthly investor letters, which it distributed through its fund
6 administrator.

7 27. Ross drafted the monthly investor letters.

8 28. Ross signed the monthly investor letters on behalf of DLI.

9 29. The monthly investor letters typically included, among other things,
10 statements regarding the amount of DLI's assets under management and the Funds'
11 historical returns broken out by month.

12 30. During the relevant period, DLI provided prospective and current
13 investors in the Funds with monthly fact sheets that, among other things, detailed the
14 amount of the Funds' assets and broke out the Funds' historical returns by month.

15 31. Ross drafted and ultimately approved the content of the monthly fact
16 sheets that DLI provided to prospective and current investors in the Funds.

17 32. Ross was often involved in directly distributing the monthly fact sheets
18 to prospective and current investors in the Funds.

19 33. During the relevant period, DLI also provided prospective and current
20 investors in the Funds with investor presentation documents that, among other things,
21 detailed the amount of the Funds' assets and broke out the Funds' historical returns
22 by month.

23 34. Ross drafted and ultimately approved the content of the monthly investor
24 presentation documents that DLI provided to prospective and current investors in the
25 Funds.

26 35. Ross was often involved in directly distributing the monthly investor
27 presentation documents to prospective and current investors in the Funds.

28 36. During the relevant period, DLI's fund administrator provided the

1 Funds' investors with monthly account statements that included account balance and
2 net profit/loss figures for each investor that were derived from the Funds' net asset
3 value, net interest income, and each investor's percentage allocation.

4 37. DLI and the Funds, under Ross's ultimate supervision, provided the
5 underlying data regarding DLI's investment positions that the fund administrator used
6 to create the monthly account statements for investors.

7 38. During the relevant period, DLI maintained an online investor portal that
8 provided investors with access to detailed information regarding the Funds' asset
9 portfolio and its specific counterparties, including the valuation of its various
10 counterparty positions by unpaid principal balance and the profits and losses
11 information (including gross income and changes in loss reserves data) for those
12 counterparty positions over different periods of time, including as to the QuarterSpot
13 position.

14 39. During the relevant period, Ross and others at DLI also provided or
15 made available to the Funds' prospective and current investors "default sensitivity
16 analysis" spreadsheets that detailed the amount of the Funds' historical write downs
17 and included graphs showing defaults as a percentage of the Funds' assets under
18 management.

19 40. In some cases, DLI representatives, including Ross himself, directly
20 emailed certain documents to prospective and current investors that provided
21 extensive detail regarding DLI's individual investment positions like QuarterSpot,
22 including returns and performance information, as well as the monthly loss reserves
23 data for those investments.

24 41. The Funds' audited financial statements, which DLI made available to
25 investors each year, contained information regarding the aggregate value of the
26 Funds' investments as well as values for the Funds' individual investments, including
27 QuarterSpot. The audited financial statements also included income information for
28 the Funds, including information concerning the Funds' "net realized gain (loss) on

1 investments” and “net change in unrealized appreciation (depreciation) on
2 investments,” which were impacted directly by the nonperforming loans that the
3 Funds took reserves against and wrote off. These audited financial statements also
4 included a “Financial Highlights” section that calculated a percentage “Total return”
5 for the Funds based on this underlying financial data.

6 42. DLI included information regarding its regulatory assets under
7 management, as well as the Funds’ gross asset value, in the Forms ADV it filed with
8 the SEC, most of which were signed by Ross.

9 43. For instance, during the relevant period, Ross signed DLI’s Forms ADV
10 Part 1A that were filed with the SEC in 2016 and 2017.

11 44. As 100% owner, chief executive officer, and sole manager of DLI, Ross
12 had ultimate authority and control over the content of DLI’s Forms ADV.

13 **C. Ross’s Consistent Emphasis on the Funds’ Returns**

14 45. DLI, and Ross in particular, had a history of touting the Funds’ strong,
15 consistent returns to investors.

16 46. Each month, the DLI monthly investor letters that Ross prepared and
17 signed included charts of the Funds’ historical monthly returns over time. The letters
18 also contained headings like “Consistent Performance” and for years articulated one
19 of the Funds’ principal objectives as being to “[m]aintain unlevered, double-digit,
20 investment returns.”

21 47. DLI’s monthly investor letters and fact sheets consistently marketed the
22 Funds’ 10-12% returns, no lock-up, and monthly (35-day) liquidity.

23 48. Ross routinely emphasized the Funds’ returns in individualized written
24 communications with potential and actual investors in the Funds.

25 49. For instance, on October 7, 2015, Ross emailed a prospective investor a
26 series of “highlights of the Fund,” emphasizing that Direct Lending Income Fund (at
27 that time the sole fund) “produces consistent, non-market-correlated returns.” Ross
28 further explained that the Fund has achieved “10-12% returns net to investors with no

1 down months.” In this same October 2015 email, Ross continued, “Defaults trending
2 down, now at 4% and could be as high as 20% without loss of principal,” and he
3 noted the Funds’ “[f]ull transparency.”

4 50. In another email dated February 15, 2016, Ross sent a prospective
5 investor one of the Fund’s investor presentations, directing him to “[n]ote the
6 historical returns on p3 of the Presentation.” Ross also represented that “[o]ur
7 investors receive double-digit unlevered returns, and we have had no down months,
8 and the Fund is suitable for regular and IRA accounts.” Ross also included the same
9 “highlights of the Fund” that he included in his October 7, 2015 email, again
10 emphasizing the Fund’s strong and stable returns, low default rate, and full
11 transparency.

12 51. In other communications dated April 19, 2016 and June 24, 2016, Ross
13 sent prospective investors the same “Fund highlights,” again attaching investor
14 presentations and specifically stating, “Our investors have received 10-12%
15 unlevered returns, and we have had no down months, and the Fund is suitable for on-
16 and offshore accounts.”

17 52. Ross also routinely highlighted the Funds’ historically high and stable
18 returns in his oral conversations with prospective and current investors in the Funds,
19 as well as in presentations he gave to them.

20 53. In multiple communications with prospective and existing investors up
21 into at least spring 2017, including in emails dated October 21, 2016, February 23,
22 2017, and March 13, 2017, DLI’s investor relations representative emphasized in the
23 “Fund Highlights” that DLI “continues to deliver **very stable, unlevered, double**
24 **digit returns** with **no down months** since the Fund’s inception in 2012 [bold in
25 original].”

26 54. Investors considered information about the Funds’ returns and net asset
27 value to be important, particularly insofar as DLI charged the Funds fees based on
28 those figures.

1 55. Related to the Funds' returns, Ross and DLI's representatives also
2 routinely highlighted the low default rates for the Funds' positions.

3 56. For example, on January 12, 2016, Ross sent an email to investors with
4 the subject line "Loan Loss Reserves + other files" that attached a spreadsheet titled
5 "DLIF – Default Sensitivity Analysis." This spreadsheet detailed Direct Lending
6 Income Fund's historical monthly write downs and expressed those write downs as a
7 very small percentage of the Fund's assets under management for each month,
8 arriving at an average monthly write down percentage. The same spreadsheet
9 included a tab with a graph that tracked the default rate each month over time.

10 57. Again, on August 21, 2016, in an email with the subject line "AUM and
11 Defaults," Ross sent an investor representative an updated default sensitivity analysis
12 with the same sort of historical write down information that showed Direct Lending
13 Income Fund write downs as a percentage of assets under management and included
14 a graph tracking default rates over time.

15 58. Up into mid-2017, DLI representatives at Ross's direction continued to
16 provide to prospective and current investors in the Funds "default sensitivity
17 analysis" documents that showed the historical default rates for the Funds' assets.

18 59. DLI's fact sheets for the months of January 2015 to July 2016, which it
19 provided to prospective and current investors, emphasized the Funds' high returns
20 relative to defaults, boldly directing investors, "But don't focus on the bad loans; we
21 write plenty of loans off but still achieve excellent returns."

22 60. In three distinct emails, one dated July 5, 2016 and two dated September
23 17, 2016, Ross circulated a document titled "Private Credit Investing Portfolio
24 Summary" to investors and their representatives. Among other things, this document
25 included specific information about the historical returns for the Funds' QuarterSpot
26 position, including the historical loss reserves taken on that position, while touting the
27 QuarterSpot position's consistently strong performance.

28 61. The Funds' investor presentations from April 2017 to at least June 2017

1 touted the performance of the Funds' QuarterSpot position and specifically its low
2 default rate. A graph in that presentation purported to quantify QuarterSpot's rate of
3 loan "charge-offs" (loan defaults) and compare that rate favorably as being lower
4 than the default rate for loans originated by a well-known public company small
5 business lender. The same presentation explained, "DLI's small business lending
6 partner QuarterSpot outperforms by mitigating charge-offs, not just attempting to
7 offset them with higher pricing."

8 **D. DLI's Relationship with QuarterSpot**

9 62. One of the Funds' earliest investments was with QuarterSpot, an online
10 lending company that makes small business loans.

11 63. In or around August 2013, DLI caused Direct Lending Income Fund to
12 enter into an agreement with QuarterSpot where Direct Lending Income Fund agreed
13 to purchase "unsecured payment dependent promissory notes ('Spots') from
14 QuarterSpot."

15 64. Subsequently, in or around December 2015, the Direct Lending Income
16 Fund and QuarterSpot entered into amended agreements that recast Direct Lending
17 Income Fund's interest as a participation interest in the underlying loans that
18 QuarterSpot originated.

19 65. The Funds funded loans that QuarterSpot originated, giving the Funds a
20 participation interest that entitled them to the economic benefits flowing from the
21 loans, namely the repaid principal and the interest on the loans.

22 66. Under the agreements, QuarterSpot continued to hold legal title to the
23 loans in which the Funds invested.

24 67. Under the agreements, QuarterSpot continued to service the loans in
25 which the Funds invested, allowing it to keep a servicing fee, or "investor fee."

26 68. The QuarterSpot servicing fee varied over time but was set at 17.5% of
27 interest received in a December 2015 agreement and generally was at or around
28 17.5% each month during the relevant period.

1 69. Under the terms of the agreements, the Funds’ right to receive payments
2 was entirely dependent on the underlying borrowers making payments on the loans.

3 70. The Funds eventually became QuarterSpot’s largest investor and
4 ultimately funded hundreds of millions of dollars in QuarterSpot loans.

5 71. Between August 2013 and June 2017, the Funds’ QuarterSpot position
6 grew from \$427,333 to \$149,608,733.

7 72. The Funds retained a roughly \$140 million position in the QuarterSpot
8 platform until September 2017, when they sold \$55 million of the QuarterSpot loans
9 to a third-party fund that raised money from overseas investors.

10 **E. DLI’s Valuation Policy for the QuarterSpot Position**

11 73. DLI had a written valuation policy for its small business whole loan
12 investments like its QuarterSpot position, which it first expressly articulated in its
13 January 2015 private placement memorandum that it provided to prospective
14 investors.

15 74. This valuation policy required that the QuarterSpot loans generally were
16 to be valued at par, *i.e.*, the amount of their remaining principal balances, with certain
17 exceptions for non-performing loans.

18 75. Loans that had not received any payment in the last 30 days were valued
19 at 50% of their remaining principal balances, and loans that had not received a
20 payment in the last 60 days were valued at 0% of their remaining principal balances.

21 76. The valuation policy provided that DLI could deviate from this stated
22 valuation rule on a case-by-case basis based on the individual facts of each loan.

23 77. Between January 2015 and mid-2017, DLI detailed this valuation policy
24 for its QuarterSpot position in a number of different documents that it provided to
25 investors and others.

26 78. DLI’s January 2015 private placement memorandum stated that under
27 DLI’s valuation policy, loans that had not received payments in the last 30 days
28 would be “[v]alued at 50% of remaining principal balance, and no accrual of

1 interest.” Loans that had not received a payment in the last 60 days would be
2 “[v]alued at 0% of remaining principal balance, and no accrual of interest.”

3 79. Likewise, DLI’s December 2015 private placement memorandum
4 expressed DLI’s valuation policy in the same manner: Loans that had not received
5 payments in the last 30 days would be “[v]alued at 50% of remaining principal
6 balance, and no accrual of interest,” while loans that had not received a payment in
7 the last 60 days would be “[v]alued at 0% of remaining principal balance, and no
8 accrual of interest.”

9 80. DLI provided its auditors with a document titled “Fair Valuation
10 Methodology, Direct Lending Income Fund, For the Calendar Year Ended 2015,”
11 which was noted as having been revised on June 18, 2016. In this document, DLI
12 described its valuation policy as follows: “Valuation is conducted monthly at the
13 individual investment level per the Fund’s Private Placement Memorandum, which is
14 essentially historical cost accounting. Management holds each asset at its amortized
15 cost, or outstanding principal balance less any un-accrued discount, and also less any
16 required loan loss reserves. In general, but subject to the facts of each loan, loss
17 reserves are created and reversed when payments have not been made on a loan
18 within 30 or 60 days (50% and 100% markdown, respectively) prior to the end of the
19 accounting period. An asset is *very* quickly written down when it experiences non-
20 payment, and it is impossible to be overvalued after Day 60.”

21 81. In an October 11, 2016 email to an investor asking about DLI’s
22 valuation processes and how it calculates its loan loss reserves, Ross stated, “For the
23 two remaining platforms where we continue to buy whole loans, Biz2Credit and
24 Quarterspot, we reserve 50% if loans are 30 days late and 100% if they are 60 days
25 late. There are some limited exceptions, but it’s generally according to that formula.”

26 82. The Funds’ January 2017 “Due Diligence Questionnaire” described
27 DLI’s valuation methodology, stating that “small business loan pricing methodology
28 is based on the payments history of the loans with a general valuation rule that assets

1 late in making payments for 30 days will be valued at 50% and those delinquent 60
2 days or more will be marked to 0%.”

3 83. The Ross-signed investor letter for the month ending February 28, 2017
4 summarized DLI’s January 2015 PPM valuation policy for its whole loan positions,
5 explaining that “[l]oans 30 days late in payment are marked at 50% of their principal
6 balance” and “[l]oans without a payment in 60 days are written down to 0%,” noting
7 that “[a]djustments can be made based upon the facts and circumstances of the
8 individual notes.” This investor letter further explained that “[b]ased on these rules,
9 we would then make necessary loss reserves and produce the Fund’s returns based on
10 interest income net of new loan loss reserves and fund expenses.” This same investor
11 letter indicated that even for its non-QuarterSpot investments structured as credit
12 facilities, “our goal in valuing positions is to remain consistent with the original,
13 granular approach,” explaining that “[w]e generally apply borrowing base eligibility
14 rules consistent with our original loan by loan valuation policy.”

15 84. In or around spring 2017, DLI provided a document dated March 1,
16 2017 and titled “Direct Lending Investments Valuation Policy Background and
17 Timeline” to both its outside auditor and to SEC staff conducting an examination of
18 DLI as an SEC registrant. In this document, DLI described its then current valuation
19 process for small business loans: “Generally, if a loan has gone 30 days without a
20 payment, it is reserved at 50%. If a loan has gone 60 days without a payment, it is
21 reserved at 100%.”

22 85. Both DLI’s chief financial officer and fund controller understood that
23 DLI’s valuation policy for its QuarterSpot position up until at least August 2017 was
24 to mark down loans that had not received a payment in 30 days by 50% and loans that
25 had not received a payment in 60 days by 100%.

26 86. While not explicit in its statement of its valuation policy, in practice DLI
27 applied the policy for its QuarterSpot position so that any payment whatsoever within
28 the last 30 days, even a payment of \$1, sufficed to keep a loan from being marked

1 down, regardless of how far the loan was behind its amortization schedule.

2 87. Ross routinely touted DLI's valuation policies as being conservative.

3 88. For example, in his investor letter for the month ending November 30,
4 2016, Ross listed various factors that affect DLI's returns, which included having to
5 write down bad loans. Ross emphasized that DLI writes down bad loans as soon as
6 it becomes aware of any impairment, contrasting DLI with other funds that failed to
7 be "conservative" in this respect and stating that "[b]ecause we at DLI intend to build
8 a private credit firm that will endure for decades to come, we take our responsibility
9 to properly mark assets very seriously."

10 89. As another example, in his investor letter for the month ending
11 December 31, 2016, Ross claimed that "[o]ne of the hallmarks of DLIF [the domestic
12 fund] has always been, in our opinion, its conservative approach to taking reserves
13 against late loans."

14 90. Similarly, in his investor letter for the month ending February 28, 2017,
15 under a section titled "Valuation: Common Sense at the Core," Ross discussed DLI's
16 valuation policies at length and explained the 30 days/50% markdown and 60
17 days/100% markdown policy for its whole loan positions like QuarterSpot. In this
18 letter he also stated that "[f]undamental to understanding our approach is knowing
19 that regardless of how we gain exposures, we always value positions as if we held the
20 collateral directly on our books, and for good reason: if any of our borrowers fail, we
21 expect to take over the collateral."

22 91. DLI's fact sheets provided to investors consistently described DLI as
23 being "ultra-conservative" in its practice of writing down bad loans to zero.

24 92. More specifically, for each of its monthly fact sheets from January 2015
25 to July 2016, DLI included a "frequently asked questions" section that contained the
26 question, "What happens to the defaulted loans?" The response stated, "We write
27 them down to \$0, then we work with our lending partners to pursue all defaulted
28 borrowers in a traditional collections process. Although we expect to collect 20 cents

1 on the dollar based on history, we take the ultra-conservative approach of writing bad
2 loans down to \$0. Any collections we receive are windfalls for fund investors.”

3 93. Ross fully understood the significant default risk for loans that had
4 missed payments.

5 94. For example, on August 6, 2017 Ross emailed QuarterSpot saying, “The
6 question is: When a loan is 5% or 10% behind, what is the likelihood of recovery. Of
7 course 25% behind matters too, but I suspect that even 5% behind means the loan is
8 done for. Doesn’t matter percent principal paid already. Matters % likely to be
9 collected AFTER it’s gone 5% behind.”

10 95. In its work papers, one of the Funds’ auditors noted that DLI
11 management had explained that DLI’s valuation policy was “determined through
12 [DLI’s] observations of the historical behavior of borrowers,” which showed that “if
13 a borrower defaults on a scheduled payment, there is a relatively high risk that he will
14 continue to default,” such that “[DLI] believe[s] the 50%/100% at 30/60 days
15 delinquent approximates the fair value of non-performing loans during these
16 respective periods.”

17 96. Ross also knew that DLI bore the direct risk of default on the
18 QuarterSpot position.

19 97. For instance, Ross noted in his investor letter for the month ending
20 November 30, 2016 that DLI bore “direct default risk” in its non-facility whole loan
21 deals like its QuarterSpot investment.

22 98. Again, in the investor letter for the month ending July 31, 2017 Ross
23 explained DLI’s movement away from whole loan deals to a facility lending structure
24 by saying that whole loan deals “less adequately align incentives between DLI and its
25 counterparties than do Facility Deals” because in those whole loan deals DLI bears “a
26 ‘first loss’ position.”

27 99. DLI’s former chief financial officer testified that for the Funds’
28 QuarterSpot position, where the Funds owned direct interests in the underlying loans,

1 every single dollar paid (or not paid) on a given loan impacted the Funds' financials.

2 **F. Ross's Multi-Year Manipulation of QuarterSpot's Payment Data**

3 100. During the relevant period, DLI required that QuarterSpot provide it
4 with loan-level data, including payment information for each loan, as part of a
5 monthly closeout process. QuarterSpot provided this data to DLI in various reports.

6 101. These reports, which included a cash history report and a daily payments
7 report reflecting all payments during the month, were available on QuarterSpot's
8 investor portal, to which DLI representatives had access.

9 102. Further, at Ross's direction, each month QuarterSpot emailed DLI a
10 "late loans report" that was not available on the investor portal.

11 103. This late loans report included various pieces of data for each loan,
12 including the remaining principal balance and a "LastPosted" date that reflected the
13 last payment received on the loan. The late loans report also included a "Status"
14 column that keyed off the LastPosted date. The underlying loans were typically on
15 weekly or daily repayment schedules. While the terminology varied over time,
16 generally loans that received payments within the last 30 days were marked "current"
17 or "late," while those that had not received any payments in the last 30 days had a
18 "default" status.

19 104. At the very end of 2013, Ross requested from QuarterSpot's chief
20 executive officer that QuarterSpot begin rebating part of its servicing fee, purportedly
21 as a form of credit enhancement to help DLI improve its returns.

22 105. QuarterSpot agreed to Ross's request to rebate part of its fees.

23 106. At Ross's direction, in or around spring 2014, QuarterSpot began
24 making monthly "rebate" payments to the Funds that took the form of individual
25 "principal payments" against particular delinquent loans that Ross specified each
26 month.

27 107. Ross and QuarterSpot would generally agree on parameters for the total
28 amount of "rebate" payments that QuarterSpot would provide each month, which was

1 either a percentage of the total servicing fee or a maximum dollar amount. Ross then
2 directed QuarterSpot how the agreed upon total “rebate” amount would be applied
3 across multiple individual loans as supposed principal payments.

4 108. The money for these payments came from QuarterSpot’s operating
5 account, *i.e.*, they were not payments made by the underlying borrowers.

6 109. From 2014 to September 2017, Ross followed a consistent pattern in
7 directing the “rebate” payments.

8 110. At the beginning of each month, QuarterSpot sent Ross a “late loans
9 report” spreadsheet for the month that had just ended. The spreadsheet showed
10 various metrics for the DLI-funded loans, including the LastPosted date for each loan
11 and the loan’s status keyed off this date, as well as the remaining principal balance
12 for each loan.

13 111. Typically within days of receiving the late loans report, Ross responded
14 by sending back to QuarterSpot a revised spreadsheet, usually with some variation of
15 “BR” or “BRpays” in the title, indicating that [Brendan] Ross himself had revised the
16 spreadsheet to direct the “rebate” payments. The revised spreadsheet that Ross sent
17 to QuarterSpot included a column directing whether “rebate” payments should be
18 made against particular loans (“Make Payment”) and another column specifying the
19 payment amounts (“Payment Amount”). The loans for which Ross directed payments
20 were always loans marked as “default” in the initial report Ross received from
21 QuarterSpot because they had not received payments in the last 30 days.

22 112. Ross generally directed a monthly “rebate” payment amount that was
23 only a fraction of what the borrower owed on a weekly basis or, if the payment
24 schedule called for daily payments, equivalent to a single daily payment.

25 113. Ross’s spreadsheet typically included columns where he calculated what
26 reserves he would be taking on other “default” loans for which he was not directing
27 that QuarterSpot make “rebate” payments that month.

28 114. Ross initially only directed payments across a dozen or so loans each

1 month, but over time this grew to hundreds of loans each month that together had
2 outstanding principal balances of many millions of dollars.

3 115. For example, on December 10, 2016, Ross sent QuarterSpot an email
4 and spreadsheet in connection with DLI's November 2016 close process for its
5 QuarterSpot position. In the email, Ross stated, "Lmk when you have applied and the
6 reports are ready, and then you can send the package with Late Loans and Balance
7 Sheet to [the DLI fund controller]." In the spreadsheet attachment, Ross directed
8 QuarterSpot to apply \$71,436 in "rebate" payments against 274 distinct "default"
9 loans that had not received payments within the last 30 days, with a total outstanding
10 principal balance of \$15,625,524.

11 116. As another example, on July 10, 2017, Ross sent QuarterSpot an email
12 and spreadsheet in connection with DLI's June 2017 close process for its QuarterSpot
13 position. In the email, Ross directed QuarterSpot, ""Hi [QuarterSpot representative]
14 – see payments. Note that there are three little sections of payments – they are not all
15 contiguous in column Q – there is some row spacing between them. Please double-
16 check before finalizing." In the attached spreadsheet, Ross directed QuarterSpot to
17 apply \$97,213 in "rebate" payments across 381 distinct "default" loans that had not
18 received payments within the last 30 days, with a total outstanding principal balance
19 of \$22,939,150.

20 117. QuarterSpot generally made tens of thousands of dollars in "rebate"
21 payments each month, getting near \$100,000 in a few months in mid-2017.

22 118. Ross never copied others at DLI on his emails directing QuarterSpot to
23 make "rebate" payments.

24 119. After receiving Ross's directions, QuarterSpot applied his specified
25 payment amount for each loan as a principal payment against the loan before sending
26 a new, revised spreadsheet back to DLI that contained Ross's payments.

27 120. The spreadsheet that QuarterSpot sent back to DLI generally included
28 tabs titled "Balance Statement" and "Late Loans."

1 121. In December 2014, Ross directed QuarterSpot to randomize the “rebate”
2 payments on weekdays throughout the month, which QuarterSpot did going forward.

3 122. In the revised balance statement and late loans spreadsheet that
4 QuarterSpot sent back to DLI, the LastPosted date for a loan that received a Ross-
5 directed payment was changed to reflect a payment against that loan on a completely
6 random date during the month, even though no borrower had made any payment on
7 that loan, and in fact QuarterSpot had not even made a “rebate” payment on that
8 specific date.

9 123. Nothing in the revised late loans report differentiated between payments
10 made by borrowers and “rebate” payments made by QuarterSpot at Ross’s direction.

11 124. The adjustment of the LastPosted dates for the loans that received
12 “rebate” payments changed their status designations from “default” to “current” (or in
13 some cases “late”), even though no borrowers had made payments.

14 125. The principal balance for each loan that received a “rebate” payment was
15 reduced by the amount of the payment.

16 126. The daily transactions report pulled from QuarterSpot’s website by Ross
17 and later others in DLI management as part of DLI’s monthly close process reflected
18 the “rebate” payments as individual principal payments against specific loans, with
19 the same random payment dates assigned.

20 127. The cash history report pulled from QuarterSpot’s website by Ross and
21 later others in DLI management as part of DLI’s monthly close process, which
22 included a column for QuarterSpot’s servicing fees, included only a gross servicing
23 fee amount not reduced by the Ross-directed payments, which were instead lumped
24 into the principal repaid category.

25 128. Neither the daily transactions report nor the cash history report
26 differentiated between “rebate” payments and actual borrower payments.

27 129. The scope of Ross’s manipulation grew over time and peaked by the
28 close process for the month of August 2017, when Ross directed nearly \$100,000 in

1 payments against 455 “default” loans that had not received a payment within the last
2 30 days, with a total outstanding principal balance of \$26,267,428. The Ross-
3 directed “rebate” payments led these “default” loans to be marked “current” in the
4 revised reports QuarterSpot sent back to DLI.

5 130. In total, between April 2014 and September 2017, at Ross’s direction,
6 QuarterSpot made over \$1.9 million in “rebate” payments to the Funds, which took
7 the form of thousands of principal payments across over 1,000 different loans.

8 131. Ross concealed his direction of the “rebate” payments from others in
9 DLI management.

10 **G. DLI’s Use of Ross’s Manipulated QuarterSpot Data**

11 132. DLI used the revised late loans report with the Ross-directed “rebate”
12 payments to determine what reserves to take on the QuarterSpot loans each month.

13 133. Ross was personally responsible for closing the QuarterSpot position up
14 until fall 2016, but thereafter DLI’s fund controller began managing the QuarterSpot
15 close process at Ross’s direction.

16 134. The fund controller received the manipulated, “final” monthly late loans
17 report and balance statement directly from QuarterSpot, with Ross usually copied.

18 135. The fund controller also accessed the other documents that included the
19 Ross-directed payments, such as the cash history and daily payments reports, directly
20 from the QuarterSpot investor portal.

21 136. While each of these reports incorporated the Ross-directed “rebate”
22 payments, none indicated that the purported principal payments (the rebates) were not
23 in fact payments made by borrowers.

24 137. Ross excluded the fund controller from the process by which he directed
25 QuarterSpot to make the payments.

26 138. For example, on November 9, 2016, after directing QuarterSpot to first
27 send him the October 2016 late loans report with his payments applied so he could
28 check it, Ross told QuarterSpot it was okay to send the revised report on to DLI’s

1 fund controller, saying, “[y]ou can remove the version number is [sic] its [sic]
2 effectively v1 for her.”

3 139. The fund controller did not know that any of the supposed principal
4 payments in the late loans report were not in fact borrower payments but rather
5 “rebate” payments that Ross had directed QuarterSpot to make.

6 140. Per Ross’s specific instructions, the fund controller relied entirely on the
7 loan “status” designations in the late loans report to determine whether to take
8 reserves on particular QuarterSpot loans.

9 141. As such, the fund controller, who understood the late loans report
10 reflected only borrower payment data for the underlying loans, valued the loans
11 receiving “rebate” payments at par (remaining principal balance) because the late
12 loans report misleadingly showed they had received payments within the last 30 days,
13 making them “current.”

14 142. The fund controller incorporated this reserves’ information and the
15 reports she received from QuarterSpot into DLI’s official monthly close file for the
16 QuarterSpot position, and she then reported the information to DLI’s fund
17 administrator, which used this data to prepare the Fund’s monthly income statement
18 and balance sheet, which were in turn used to arrive at the Funds’ net asset value and
19 the monthly returns that it reported.

20 **H. The Material Consequences of Ross’s Fraudulent Conduct**

21 143. The consequences of Ross’s fraud were significant and material.

22 144. Over a three and a half year period, Ross directed that QuarterSpot make
23 “rebate” payments against at least 1,081 distinct loans, each of which was generally
24 30 or more days delinquent at the time of the rebate.

25 145. The total principal balance of these loans for which Ross directed
26 payments was approximately \$53 million, which counts only a single time the
27 balance of each loan that received a rebate payment.

28 146. The great majority of these loans received payments for many

1 consecutive months, keeping them “current” long after they should have been
2 reserved and written off under DLI’s valuation policy.

3 147. While Ross eventually allowed some of these loans to be written off,
4 usually several months after directing payments be made against them, his fraud
5 allowed him to artificially inflate the Funds’ returns and overcharge fees over the
6 months where he delayed taking reserves.

7 148. Even though the Funds were still receiving money from QuarterSpot in
8 the form of “rebate” payments, the false payment data inaccurately designated the
9 affected loans as “current,” undermining DLI’s ability to properly assess the loans’
10 performance and apply its valuation policy.

11 149. Ross’s data manipulation led DLI to artificially inflate the Funds’
12 heavily marketed returns that it reported to investors each month in a meaningful and
13 material way.

14 150. Under DLI’s valuation policy and practice, DLI should have reserved the
15 principal balances of the non-performing QuarterSpot loans against the Funds’
16 monthly QuarterSpot gross interest income, which would have reduced the monthly
17 net interest income for the QuarterSpot position, as well as for the Funds’ full
18 portfolio.

19 151. The net interest income was the key input into the Funds’ monthly
20 returns calculations. Consequently, the net interest income amounts, which were
21 artificially high because DLI did not take reserves for delinquent QuarterSpot loans,
22 led to consistently inflated returns.

23 152. An internal DLI pre-receivership analysis of Ross’s fraud concluded that
24 Ross’s fraud led DLI to overstate its returns by two to three percent on an annual
25 basis.

26 153. In sworn testimony, DLI’s former CFO described the effect of Ross’s
27 fraud on the Funds’ reported returns as being “substantial” and “significant” even at
28 the “fund level.”

1 154. Ross's fraud also led DLI to overcharge the Funds millions of dollars in
2 management and performance fees.

3 155. DLI's performance fee was calculated as 20% of the Funds' monthly net
4 interest income.

5 156. Ross's data manipulation led DLI to apply the performance fee against a
6 net interest income figure that was inflated because reserves were not taken for the
7 non-performing QuarterSpot loans. As a result, DLI overcharged the Funds its
8 performance fees.

9 157. DLI likewise overcharged management fees because those fees were tied
10 to the Funds' net asset value, which was artificially high because the delinquent
11 QuarterSpot loans were not written off the balance sheet when they should have been.

12 158. A pre-receivership DLI internal analysis conducted in or about March
13 2019 concluded that, in total, Ross's fraud led DLI to overcharge the Funds roughly
14 \$11 million in fees.

15 159. Accounting for the fact that Ross ultimately wrote off certain of the
16 loans to which he directed payments (usually many months after they should have
17 been written off), and excluding certain loans for which Ross directed payments that
18 may have later re-commenced paying in some way, Ross's fraud led DLI to
19 overcharge the Funds at least \$5-6 million in performance and management fees
20 between spring 2014 and the end of 2017.

21 160. During this same period, DLI charged the Funds tens of millions of
22 dollars in fees, and Ross as 100% owner of DLI, and various limited liability
23 companies he controlled, received nearly \$30 million in transfers from DLI.

24 161. At least some of this money that Ross received from DLI is derived
25 directly from the inflated fees that DLI collected from the Funds as a result of Ross's
26 fraud with respect to the QuarterSpot position.

27 **I. Ross's Knowledge and Motivation**

28 162. Ross knew that the payments he directed made delinquent QuarterSpot

1 loans appear “current,” which delayed or prevented them from being marked down
2 under DLI’s valuation policy.

3 163. Each month, Ross personally received back from QuarterSpot the late
4 loans report that showed that the non-paying loans for which he had directed
5 “rebates” were now marked “current” or “late” with payment dates within the last 30
6 days.

7 164. Ross then either used that spreadsheet himself, or directed the fund
8 controller to use it, to determine what reserves to take on the QuarterSpot loans and
9 then close the monthly file for the QuarterSpot position.

10 165. Ross routinely directed QuarterSpot to be sure to adjust the LastPosted
11 dates for the loans that received “rebate” payments so those loans reflected payments
12 within the last 30 days, which would make them “current.”

13 166. On October 8, 2014, when addressing the application of his “rebate”
14 payments for the September 2014 close, Ross lectured QuarterSpot, “This is wrong.
15 Frustrating! This has Last Posted dates in August and has none of the full payments
16 in them. Please fix and look before you hit send.”

17 167. On May 11, 2015, in reference to the late loans report for April 2015,
18 Ross vented, “Last Posted is not accurate. It doesn’t reflect your payments. Please
19 do sanity checks on these files before sending to me. Please fix as soon as possible.”

20 168. On October 8, 2015, Ross emailed QuarterSpot saying, “I can’t use the
21 report you attached which just says ‘Current’ but has the old LastPosted (which wont’
22 [sic] make sense to [DLI’s third party fund administrator]).” Earlier that same day in
23 a distinct email, Ross directed QuarterSpot, “Please check that the Last Posted dates
24 reflect your payments before sending to me.”

25 169. On February 9, 2017, Ross directed QuarterSpot how to apply his
26 “rebate” payments in a way that prevented loans from showing up as more than 60
27 days late, which would require them to be marked down to zero under DLI’s
28 valuation policy, saying, “I got the math wrong last time: please avoid payments on

1 the first and second of each month. This avoids a loan with a payment on 12/1 or 12/2
2 from being 61 or 62 days late on 1/31. Last time I'd said to avoid payments at the
3 end of the month, but of course it is the beginning that is the problem!" Ross
4 continued, "Thanks and OK to send [the reports with Ross's "rebate" payments] to
5 [the DLI fund controller] when you are 100% on the payments. Please cc: me."

6 170. Ross's motivation in directing the payments was to delay or avoid
7 marking down QuarterSpot loans that were not performing so that those loans would
8 not lower the Funds' returns, allowing him to in effect smooth the Funds' returns.

9 171. On January 13, 2015, Ross told QuarterSpot, "I need to decide what
10 reserves I'm creating for the full month based on my return targets, etc.," expressly
11 acknowledging that he was basing his decisions about taking reserves on return
12 targets rather than loan performance.

13 172. On February 8, 2015, Ross expressed concern to QuarterSpot that "more
14 loans are going late each month than I can afford and still have normal returns, so that
15 the can we are kicking down the road is growing in size," and he then requested "a
16 version of the Late Loans report that has their true, non-quarterspot Last Posted date."

17 173. On October 8, 2015, when asking QuarterSpot for the late loans report
18 with his "rebate" payments applied, Ross stated, "I will use that to close the month. I
19 plan on booking \$300K in reserves for a 1.33% return for the month. I will do that
20 regardless of whether or not there are 'enough' late loans, so we will continue to
21 catch up as normal."

22 174. Throughout the relevant time period, Ross routinely calculated the
23 reserves he would be taking on certain "default" loans in the late loans report
24 spreadsheet columns adjacent to those columns where he directed QuarterSpot to
25 make "rebate" payments on other, distinct "default" loans, further indicating that he
26 was using the "rebate" payments to avoid taking reserves on delinquent loans after he
27 hit whatever reserves cap he had set for the month.
28

1 **J. The QuarterSpot Side Pocket and Sale of Delinquent Loans**

2 175. Ross’s monthly manipulation of the QuarterSpot loan-level data
3 continued unabated for over three years.

4 176. DLI hired a new CFO in or around July 2017.

5 177. DLI’s new CFO began exploring changes to DLI’s valuation policy.

6 178. As part of this process, in or around August 2017, DLI’s vice president
7 of research analyzed the QuarterSpot portfolio using a different valuation
8 methodology that compared actual payments for the loans against expected payments
9 under the loans’ amortization schedules.

10 179. This August 2017 analysis revealed that a significant number of
11 QuarterSpot loans had been receiving small partial payments and were far behind
12 their amortization schedules.

13 180. This internal study further concluded that the Funds’ QuarterSpot
14 position was impaired by approximately \$35 million.

15 181. Ross was informed of the study’s findings by the vice president of
16 research and discussed the findings and their implications extensively with senior
17 DLI executives throughout August 2017.

18 182. During these conversations with senior DLI executives, Ross did not
19 disclose that identified partial payments on many delinquent loans were not in fact
20 borrower payments but rather “rebate” payments he had directed QuarterSpot to
21 make.

22 183. Shortly thereafter in August 2017, DLI management decided to
23 segregate the Funds’ QuarterSpot investment into a side pocket account.

24 184. The investor letter for the month ending July 31, 2017, which was signed
25 by Ross, announced the side pocket, explaining that “[s]ide pockets are a tool used by
26 asset managers to hold any assets for which the estimated fair value cannot be
27 determined as of the measurement date, while still allowing the remainder of the
28 fund’s assets to be fair valued for financial reporting purposes.”

1 185. That same investor letter indicated that DLI had learned of the issue with
2 QuarterSpot as part of its regular reassessment of its valuation policies and suggested
3 that the issue arose from lack of visibility into QuarterSpot's loan-level data.

4 186. At the end of a long footnote, the investor letter disclosed that "[a]n
5 internal cash flow study was performed which indicated an impairment for a portion
6 of the QuarterSpot portfolio. We believe that additional information needs to be
7 considered and analyzed before the fair value of these assets can be determined."

8 187. The investor letter did not disclose details of the impairment, nor that the
9 partial payments that led to many of the loans being impaired were "rebate" payments
10 that Ross had directed to make delinquent loans appear current.

11 188. Ross said nothing about the "rebate" payments he directed and their
12 connection to the impairment of the QuarterSpot position when he spoke with various
13 investors in the Funds about the side pocket after DLI announced it.

14 189. Almost immediately after the discovery of the potential impairment of
15 the Funds' QuarterSpot position, DLI at Ross's direction began exploring a sale of
16 the worst performing QuarterSpot loans.

17 190. In an agreement dated August 24, 2017, DLI restructured its agreement
18 with QuarterSpot so a holding subsidiary of the master fund took actual title to the
19 loans.

20 191. In September 2017, DLI entered into a transaction to sell participation
21 interests in approximately \$55 million of QuarterSpot loans at par value (outstanding
22 principal balance) to a third-party entity backed by overseas investors.

23 192. This transaction involving the QuarterSpot assets was documented in
24 two distinct agreements dated September 25, 2017 and September 29, 2017.

25 193. This sale included hundreds of the worst performing QuarterSpot loans,
26 including the great majority of loans for which Ross had been directing "rebate"
27 payments.

28 194. The sale had the effect of removing these non-paying loans from the

1 Funds' balance sheet without the Funds ever having to take a loss on them.

2 195. As consideration for the transaction, Ross personally guaranteed the
3 performance of the collateral that the Funds sold to the third party, pledging his
4 equity interest in DLI.

5 196. Ross signed an investor letter for the month ending August 31, 2017 that
6 announced the sale of the QuarterSpot loans to the third party.

7 197. In this investor letter that announced the transaction, DLI did not
8 disclose to the Funds' investors Ross's personal guarantee or the pledging of his
9 equity interest in DLI.

10 198. The principals of the fund that purchased the QuarterSpot loans from the
11 DLI Funds have denied knowledge that any of the loans had stopped paying and that
12 the Ross-directed payments used to keep those loans "current" were not in fact
13 borrower payments.

14 199. The sale of the QuarterSpot loan participation interests to DL Global
15 resulted in the Funds' position in QuarterSpot dropping from \$139,756,336 to
16 \$71,506,605 between August and September 2017.

17 200. DLI resolved the QuarterSpot side pocket in or around September 2017
18 and moved the QuarterSpot loans that it had not sold out of the segregated account
19 back into the account with its other investments.

20 201. Around the same August and September 2017 timeframe, DLI's
21 valuation committee decided to revise DLI's long-standing valuation policy
22 applicable to the QuarterSpot position. The revised policy analyzed where a
23 borrower was at on its amortization schedule, rather than on whether the borrower
24 made a *de minimis* payment in a given month.

25 202. After the sale, DLI continued to be involved in the monthly close
26 process for the QuarterSpot participation interests that the Funds had sold to the third
27 party.

28 203. Ross took advantage of DLI's involvement to continue directing

1 QuarterSpot to make payments against delinquent loans that were not actually
2 receiving borrower payments. These payments were then incorporated into the
3 official reporting data that QuarterSpot sent to DLI for transmission to the third party.

4 204. In or around August 2017, Ross began using his personal email account,
5 instead of his DLI email account, to direct QuarterSpot to make token payments each
6 month to purportedly repay portions of hundreds of loans that had been sold to the
7 third party, and also to some loans that the Funds continued to own, creating the
8 appearance that borrowers were making payments on these loans, when in fact they
9 were not.

10 205. The process was essentially the same as what Ross had done for years
11 for the Funds' own QuarterSpot loans, though Ross began specifying smaller, round
12 numbers for the payments.

13 206. For example, on November 8, 2017, Ross from his personal email
14 address sent QuarterSpot a spreadsheet where he directed it to apply payments
15 totaling \$53,551 across 388 "default" loans with a total outstanding principal balance
16 of approximately \$23,500,000. Nearly all of these loans for which Ross directed
17 payments were ones that the Funds had sold to the third party fund backed by
18 overseas investors, but the Funds still owned approximately 32 of the loans. In this
19 email, Ross said, "[QuarterSpot representative]-here you go. First tab has simplified
20 list. OK to process and sent [sic] usual files to [DLI fund controller], etc."

21 207. As another example, on February 2, 2018, Ross, again from his personal
22 email address, sent QuarterSpot a spreadsheet where he directed it to apply payments
23 totaling \$18,018.54 across 332 distinct "default" loans with a total outstanding
24 principal balance of approximately \$19,700,000. Many of the Ross-specified
25 payments were small round numbers like \$50 or \$100. In his email to QuarterSpot
26 Ross said, "See first tab for the short list. Down to just the [principal of third-party
27 fund backed by overseas investors] loans!"
28

1 **K. Ross’s Active Concealment of His Misconduct**

2 208. During the relevant period, Ross actively concealed that he was directing
3 QuarterSpot to make “rebate” payments that made delinquent loans appear current.

4 209. Ross concealed his fraudulent scheme from others at DLI and was
5 always the only DLI employee involved in directing the “rebate” payments.

6 210. Even when the DLI fund controller began handling the monthly close
7 process for the QuarterSpot position in fall 2016, Ross continued to direct the
8 “rebate” payments without informing the fund controller, while directing her to use
9 the manipulated late loans report (which she did not know was manipulated) to
10 determine which loans should be marked down per DLI’s valuation policy.

11 211. DLI provided the Funds’ auditors and a third party valuation firm with
12 the spreadsheets that Ross manipulated that showed non-performing loans to be
13 “current” based on Ross-directed “rebate” payments, not because of actual borrower
14 payments.

15 212. The auditors and valuation firm then used as inputs in their valuation
16 analyses of the Funds’ QuarterSpot position inaccurate information about the loans’
17 status and payments histories, as well as incorrect historical default rate information.

18 213. None of the Funds’ audited financial statements mentioned or
19 incorporated any type of servicing fee rebate for the QuarterSpot position, as Ross
20 concealed the “rebate” payments from the Funds’ auditors.

21 214. Ross made or distributed a series of statements, including to investors,
22 falsely indicating that DLI did not receive fee rebates for its QuarterSpot position.

23 215. For example, on January 29, 2017, Ross explained by email to an
24 investor that DLI used a servicing fee rebate for a different whole loan platform and
25 contrasted that with QuarterSpot, for which he represented no such rebate
26 arrangement existed, citing QuarterSpot’s “good” and “stable” performance over
27 time.

28 216. Additionally, a June 2016 DLI “Private Credit Investing Portfolio

1 Summary” document, which Ross and others at DLI circulated to investors, discussed
2 DLI’s practice of using servicing fee rebates in some cases but expressly stated that
3 “QuarterSpot does not have a servicing fee rebate arrangement with the Fund.” That
4 same document included specific information about QuarterSpot’s historical returns,
5 including the historical loss reserves taken on the position, and it touted
6 QuarterSpot’s consistently strong performance.

7 217. In or around summer 2017, when others at DLI discovered the
8 impairment of the QuarterSpot position that led to the side pocket, Ross did not
9 disclose to executives at DLI or to investors that the partial principal payments at
10 issue were not borrower payments but instead “rebate” payments by QuarterSpot that
11 he had directed.

12 218. Instead, Ross arranged a quick sale to get the delinquent QuarterSpot
13 loans off the Funds’ books, failing to disclose key facts to the Funds’ investors.

14 219. Ross further concealed his rebate payments in his August and September
15 2017 communications with investors concerning QuarterSpot and the potential
16 impairment, side pocket, and sale to the third party fund.

17 220. Ross was evasive and lied when others at DLI began to uncover the
18 rebate payments at the end of 2018 and in early 2019.

19 221. In or around October 2018, a debt collector for DLI’s QuarterSpot loan
20 portfolio informed DLI’s chief financial officer and fund controller that certain
21 payment data in DLI’s records did not match data the collector had received directly
22 from QuarterSpot showing how much the underlying loan borrowers actually owed.

23 222. As some DLI representatives, including its chief financial officer and
24 fund controller, attempted to get more information from QuarterSpot’s
25 representatives to explain the discrepancies, Ross pressed them to back off their
26 inquiries.

27 223. For example, the fund controller, on or around October 2018, confronted
28 Ross in person regarding the payments.

1 224. At that time, Ross denied knowledge of the payments and instead
2 directed the fund controller to tell the debt collector that she should just collect on the
3 loan balances she had.

4 225. Others at DLI continually tried to determine the cause of the QuarterSpot
5 loan balance discrepancies between October 2018 and February 2019.

6 226. On or around early February 2019, when the fund controller told Ross
7 she needed to understand the cause of the discrepancies so she could explain them to
8 the Funds' auditors, Ross told her she was not going to get further information from
9 QuarterSpot and that she should just "make something up" for DLI's auditors.

10 227. Additionally, DLI's chief financial officer asked Ross in person about
11 the QuarterSpot payment discrepancies in or around January 2019.

12 228. Ross denied knowing anything about the "rebate" payments when
13 confronted by the chief financial officer, but said he always suspected the payments
14 could be fake.

15 229. Ross also told the chief financial officer that because the fake payments
16 identified at that point only related to loans already sold to the third party fund, DLI
17 had no obligation to disclose them because DLI did not owe a fiduciary duty to the
18 third party fund.

19 **L. Defendant Ross Was an Investment Adviser**

20 230. DLI was an investment adviser registered with the SEC and was at all
21 relevant times acting as an adviser to the Funds.

22 231. At all relevant times, Ross was an "investment adviser" within the
23 meaning of Section 202(a)(11) of the Advisers Act, 15 U.S.C. §80b-2(a)(11), as he
24 was engaged in the business of providing investment advice as to the value of
25 securities and as to the advisability of investing in, purchasing and selling securities.

26 232. In the relevant period, Ross was also an investment adviser due to his
27 ownership, management, and control of DLI, including his ultimate authority over all
28 aspects of DLI's business.

1 233. Ross was ultimately responsible for the overall investment strategy of
2 the Funds.

3 234. Ross received compensation for making investment decisions on behalf
4 of the Funds because DLI received fees in the form of a percentage of assets managed
5 and a performance fee, millions of dollars of which went to Ross as the 100% owner
6 of DLI.

7 235. As an investment adviser, Ross owed the Funds a fiduciary duty and was
8 prohibited from making untrue statements of material fact or from omitting to state
9 material facts necessary to make his statements not misleading.

10 **M. The Limited Partnership Interests in the Funds Are Securities**

11 236. Investor funds were pooled in the Funds to finance various businesses
12 that DLI would choose to invest in.

13 237. The investors in the Funds were dependent on the success of the
14 underlying businesses to generate their returns, while DLI was also dependent on the
15 success of the businesses because the DLI management and performance fees were
16 directly tied to how the positions grew and performed, respectively.

17 238. Ross, as 100% owner of DLI, in turn received money from DLI that was
18 derived from the fees DLI collected from the Funds.

19 239. The efforts of DLI and Ross in allocating capital and managing the
20 Funds' investments were critical to the enterprise's success, as the investors in the
21 Funds did not play any role in managing DLI's investment decisions.

22 **N. DLI's Materially False Forms ADV**

23 240. DLI filed required Forms ADV with the SEC starting in January 2016 up
24 until February 2019.

25 241. Ross had ultimate control over the content of DLI's Forms ADV.

26 242. Ross personally signed many of DLI's Forms ADV.

27 243. DLI's Forms ADV filed in 2016 and 2017 were materially misleading in
28 multiple respects.

1 244. For DLI’s Forms ADV filed in 2016 and 2017, DLI’s assets under
2 management figures were inflated because certain QuarterSpot loans should have
3 been written down but were not because of Ross’s data manipulation that created the
4 false appearance that the borrowers for the loans were continuing to pay.

5 245. For DLI’s Forms ADV filed in 2016 and 2017, the Funds’ gross asset
6 value figures were inflated because certain QuarterSpot loans should have been
7 written down but were not because of Ross’s data manipulation that created the false
8 appearance that the borrowers for the loans were continuing to pay.

9 246. Ross knew or was reckless in not knowing the Forms ADV were
10 misleading because he personally directed the data manipulation for the QuarterSpot
11 loans that led to the inflated figures.

12 247. Investors considered information about DLI’s assets under management
13 and the Funds’ gross asset value to be important and would have wanted to know if
14 such information was overstated.

15 **O. Tolling Agreement**

16 248. Ross entered into a tolling agreement with the SEC for the period July 7,
17 2019 through September 7, 2019. This agreement tolls the running of any limitations
18 period or any other time-related defenses alleged in this Complaint for a period of 60
19 days.

20 **FIRST CLAIM FOR RELIEF**

21 **Fraud by an Investment Adviser**

22 **Violations of Sections 206(1) and 206(2) of the Advisers Act**

23 **(against Defendant Ross)**

24 249. The SEC realleges and incorporates by reference paragraphs 1 through
25 248 above.

26 250. Ross breached his fiduciary duties when he defrauded DLI’s clients, the
27 Funds, by directing “rebate” payments that made it look like underlying, delinquent
28 QuarterSpot loans were current under DLI’s valuation policy, which artificially

1 inflated the Funds' net asset value and reported returns and caused the Funds to pay
2 materially inflated management and performance fees to DLI. Ross was fully aware
3 of the underlying manipulation of loan-level data because he directed that process,
4 seemingly for the very purpose of mismarking the Funds' assets and artificially
5 increasing their performance numbers, which fraudulently inflated DLI's fees,
6 resulting in DLI's misappropriation of the Funds' assets. Ross also took multiple
7 steps to conceal his misconduct both while he was engaged in it and after others at
8 DLI began to discover what he had done

9 251. By engaging in the conduct described above, Defendant Ross, directly or
10 indirectly, by use of the mails or means and instrumentalities of interstate commerce,
11 (a) knowingly or recklessly employed devices, schemes or artifices to defraud clients
12 or prospective clients; and (b) knowingly, recklessly, or negligently engaged in
13 transactions, practices, or courses of business which operated as a fraud or deceit
14 upon clients or prospective clients.

15 252. By engaging in the conduct described above, Defendant Ross has
16 violated, and unless restrained and enjoined, is reasonably likely to continue to
17 violate, Sections 206(1) and (2) of the Advisers Act, 15 U.S.C. §§ 80b-6(1) & 80b-
18 6(2).

19 **SECOND CLAIM FOR RELIEF**

20 **Fraud in the Connection with the Purchase and Sale of Securities**

21 **Violations of Section 10(b) of the Exchange Act and Rule 10b-5**

22 **(against Defendant Ross)**

23 253. The SEC realleges and incorporates by reference paragraphs 1 through
24 248 above.

25 254. Ross made false and misleading statements and engaged in deceptive
26 conduct towards the investors in the DLI Funds.

27 255. Ross engaged in a multi-year effort to manipulate data by secretly
28 directing "rebate" payments to create the appearance that QuarterSpot loans were

1 “current” when in fact they were seriously delinquent, which allowed the Funds to
2 delay or avoid recognizing losses on the QuarterSpot position. This in turn inflated
3 the Funds’ net asset value and heavily marketed returns and allowed DLI to
4 substantially overcharge the Funds for its management and performance fees, which
5 inured to the benefit of Ross as DLI’s 100% owner.

6 256. Ross’s manipulation of the QuarterSpot loan payment data led him to
7 make multiple false and misleading statements to the Funds’ investors about DLI’s
8 assets under management and the Funds’ net asset value, heavily-marketed returns,
9 and loan default rate. These misstatements were included in DLI’s monthly investor
10 letters, investor account statements, fact sheets, investor presentations, information
11 provided on DLI’s investor portal, and in various other documents provided to
12 investors, as well as in oral communications from Ross to investors. DLI and Ross
13 likewise made false statements to the Funds’ investors about the management and
14 performance fees they owed. Ross’s statements regarding DLI’s valuation policy
15 were false or misleading insofar as Ross was actively violating the stated policy, as
16 were Ross’s repeated statements that DLI was conservative or “ultra-conservative” in
17 how it marked down late loans. Ross’s representations to investors regarding the
18 August 2017 QuarterSpot side pocket were misleading because he did not disclose
19 that a key reason for the impairment of the position was that a number of loans
20 marked “current” were in fact seriously delinquent because of payments that were not
21 borrower payments at all but rather “rebate” payments engineered by Ross.
22 Likewise, Ross’s statements to the Funds’ investors about the September 2017 sale of
23 QuarterSpot loans at par were misleading insofar as he failed to disclose that he had
24 to personally guarantee the transaction and pledge his equity interest in DLI to
25 effectuate that sale.

26 257. Ross’s false statements were made “in connection with” the sale of
27 securities because investors and prospective investors in the Funds who received
28 these false and misleading representations either invested for the first time,

1 subsequently invested additional sums, or reinvested their monthly interest income.

2 258. Ross's misrepresentations were material because investors in the Funds
3 considered it important to have accurate information concerning the value of their
4 investments and historical returns data, as that could directly impact their ability to
5 receive back their principal investments and achieve the high returns that DLI and
6 Ross advertised. The misrepresentations were also material because they directly
7 impacted the management and performance fees that DLI charged the Funds,
8 inflating the fees and thereby diminishing the returns flowing to the investors.

9 259. Ross knew, or was reckless in not knowing, that the statements regarding
10 the Funds' QuarterSpot position, including the valuation and performance of that
11 position, were false or misleading because he personally directed the manipulation of
12 the underlying borrower payment information, creating a situation where the
13 QuarterSpot position could not be properly valued or its performance assessed.
14 Ross's efforts to conceal his misconduct, and his lies when confronted about it, are
15 further evidence of his fraudulent intent.

16 260. By engaging in the conduct described above, Defendant Ross, directly or
17 indirectly, in connection with the purchase or sale of a security, by the use of means
18 or instrumentalities of interstate commerce, of the mails, or of the facilities of a
19 national securities exchange: (a) employed devices, schemes, or artifices to defraud;
20 (b) made untrue statements of a material fact or omitted to state a material fact
21 necessary in order to make the statements made, in the light of the circumstances
22 under which they were made, not misleading; and (c) engaged in acts, practices, or
23 courses of business which operated or would operate as a fraud or deceit upon other
24 persons.

25 261. Defendant Ross, with scienter, employed devices, schemes and artifices
26 to defraud; made untrue statements of a material fact or omitted to state a material
27 fact necessary in order to make the statements made, in the light of the circumstances
28 under which they were made, not misleading; and engaged in acts, practices or

1 courses of conduct that operated as a fraud on the investing public by the conduct
2 described in detail above.

3 262. By engaging in the conduct described above, Defendant Ross violated,
4 and unless restrained and enjoined will continue to violate, Section 10(b) of the
5 Exchange Act, 15 U.S.C. § 78j(b), and Rules 10b-5(a), 10b-5(b), and 10b-5(c)
6 thereunder, 17 C.F.R. §§ 240.10b-5(a), 240.10b-5(b) & 240.10b-5(c).

7 **THIRD CLAIM FOR RELIEF**

8 **Fraud in the Offer or Sale of Securities**

9 **Violations of Section 17(a) of the Securities Act**

10 **(against Defendant Ross)**

11 263. The SEC realleges and incorporates by reference paragraphs 1 through
12 248 above.

13 264. Ross engaged in deceptive conduct and obtained money by means of
14 false and misleading statements to the investors in DLI's Funds.

15 265. Ross engaged in a multi-year effort to manipulate data by secretly
16 directing rebate payments to create the appearance that QuarterSpot loans were
17 "current" when in fact they were seriously delinquent, which allowed the Funds to
18 delay or avoid recognizing losses on the QuarterSpot position. This in turn inflated
19 the Funds' net asset value and heavily marketed returns, and allowed DLI to
20 substantially overcharge the Funds for its management and performance fees, which
21 inured to the benefit of Ross as DLI's 100% owner.

22 266. Ross's manipulation of the QuarterSpot loan payment data led him to
23 make multiple false and misleading statements to the Funds' investors about DLI's
24 assets under management and the Funds' net asset value, heavily-marketed returns,
25 and loan default rate. These misstatements were included in DLI's monthly investor
26 letters, investor account statements, fact sheets, investor presentations, information
27 provided on DLI's investor portal, and in various other documents provided to
28 investors, as well as in oral communications from Ross to investors. DLI and Ross

1 likewise made false statements to the Funds' investors about the management and
2 performance fees they owed. Ross's statements regarding DLI's valuation policy
3 were false or misleading insofar as Ross was actively violating the stated policy, as
4 were Ross's repeated statements that DLI was conservative or "ultra-conservative" in
5 how it marked down late loans. Ross's representations to investors regarding the
6 August 2017 QuarterSpot side pocket were misleading because he did not disclose
7 that a key reason for the impairment of the position was that a number of loans
8 marked "current" were in fact seriously delinquent because of payments that were not
9 borrower payments at all but rather "rebate" payments engineered by Ross.
10 Likewise, Ross's statements to the Funds' investors about the September 2017 sale of
11 QuarterSpot loans at par were misleading insofar as he failed to disclose that he had
12 to personally guarantee the transaction and pledge his equity interest in DLI to
13 effectuate that sale.

14 267. Ross's false statements were made "in the offer or sale" of securities
15 because the investors and prospective investors in the Funds who received these false
16 and misleading representations either invested for the first time, subsequently
17 invested additional sums, or reinvested their monthly interest income.

18 268. Ross's misrepresentations were material because investors in the Funds
19 considered it important to have accurate information concerning the value of their
20 investments and historical returns data, as that could directly impact their ability to
21 receive back their principal investments and achieve the high returns that DLI and
22 Ross advertised. The misrepresentations were also material because they directly
23 impacted the management and performance fees that DLI charged the Funds, thereby
24 diminishing the returns flowing to the investors.

25 269. Ross knew, or at a minimum was negligent in not knowing, that the
26 statements regarding DLI's QuarterSpot position, including the valuation and
27 performance of that position, were false or misleading because he personally directed
28 the manipulation of the underlying borrower payment information, creating a

1 situation where the QuarterSpot position could not be properly valued or its
2 performance assessed. Ross's efforts to conceal his misconduct, and his lies when
3 confronted about it, are further evidence of his fraudulent intent.

4 270. Ross's statements regarding DLI's assets under managements and the
5 Funds' returns and net asset value were pillars of DLI's marketing strategy that
6 brought investors to the Funds. By inflating those key metrics through manipulation
7 of the QuarterSpot collateral figures, Ross was able to recruit and maintain investors
8 in the Funds on whose assets DLI could charge management and performance fees
9 from which Ross, as 100% owner of DLI, ultimately received tens of millions of
10 dollars, thereby obtaining money by means of the misrepresentations.

11 271. By engaging in the conduct described above, Defendant Ross, directly or
12 indirectly, in the offer or sale of securities, and by the use of means or instruments of
13 transportation or communication in interstate commerce or by use of the mails
14 directly or indirectly: (a) employed devices, schemes, or artifices to defraud; (b)
15 obtained money or property by means of untrue statements of a material fact or by
16 omitting to state a material fact necessary in order to make the statements made, in
17 light of the circumstances under which they were made, not misleading; and (c)
18 engaged in transactions, practices, or courses of business which operated or would
19 operate as a fraud or deceit upon the purchaser.

20 272. Defendant Ross with scienter, employed devices, schemes and artifices
21 to defraud; with scienter or negligence, obtained money or property by means of
22 untrue statements of a material fact or by omitting to state a material fact necessary in
23 order to make the statements made, in light of the circumstances under which they
24 were made, not misleading; and, with scienter or negligence, engaged in transactions,
25 practices, or courses of business which operated or would operate as a fraud or deceit
26 upon the purchaser.

27 273. By engaging in the conduct described above, Defendant Ross violated,
28 and unless restrained and enjoined will continue to violate, Sections 17(a)(1),

1 17(a)(2), and 17(a)(3) of the Securities Act, 15 U.S.C. §§ 77q(a)(1), 77q(a)(2), &
2 77q(a)(3).

3 **FOURTH CLAIM FOR RELIEF**

4 **False Forms ADV**

5 **Violations of Section 207 of the Advisers Act**

6 **(against Defendant Ross)**

7 274. The SEC realleges and incorporates by reference paragraphs 1 through
8 248 above.

9 275. During 2016 and 2017, the regulatory assets under management figures
10 and gross asset values for the Funds that DLI reported in its Forms ADV were
11 materially inflated because they were based on a valuation of the QuarterSpot
12 position that was false due to Ross's manipulation of the underlying loan repayment
13 data through the QuarterSpot "rebate" payments he directed.

14 276. Ross, who personally signed many of DLI's materially inaccurate Forms
15 ADV and had ultimate control over the content of all its Forms ADV, knew or was at
16 least reckless in not knowing that these figures were inflated. He personally directed
17 the "rebate" payments that materially inflated DLI's regulatory assets under
18 management and the Funds' gross asset values and used those payments to delay and
19 avoid marking down non-performing loans under DLI's valuation policy.

20 277. By engaging in the conduct described above, Defendant Ross, directly or
21 indirectly, willfully made untrue statements of material fact in any registration
22 application or report filed with the Commission under Section 203, or 204, of the
23 Advisers Act and willfully omitted to state in any such application or report any
24 material fact which is required to be stated therein.

25 278. By engaging in the conduct described above, Defendant Ross has
26 violated, and unless restrained and enjoined, is reasonably likely to continue to
27 violate, Section 207 of the Advisers Act, 15 U.S.C. § 80b-7.

PRAYER FOR RELIEF

WHEREFORE, the SEC respectfully requests that the Court:

I.

Issue findings of fact and conclusions of law that Defendant committed the alleged violations.

II.

Issue judgments, in forms consistent with Rule 65(d) of the Federal Rules of Civil Procedure, permanently enjoining Defendant Ross, and his officers, agents, servants, employees and attorneys, and those persons in active concert or participation with any of them, who receive actual notice of the judgment by personal service or otherwise, and each of them, from violating Sections 206(1), 206(2), and 207 of the Advisers Act [15 U.S.C. §§ 15 U.S.C. § 80b-6(1), 80b-6(2), 80b-7]; Section 10(b) of the Exchange Act [15 U.S.C. §§ 78j(b)] and Rule 10b-5 thereunder [17 C.F.R. § 240.10b-5]; and Section 17(a) of the Securities Act [15 U.S.C. §77q(a)].

III.

Order Defendant to disgorge all funds received from his illegal conduct, together with prejudgment interest thereon.

IV.

Order Defendant to pay civil penalties under Section 20(d) of the Securities Act [15 U.S.C. § 77t(d)], Section 21(d)(3) of the Exchange Act [15 U.S.C. § 78u(d)(3)]; and Section 209(e)(1) of the Advisers Act [15 U.S.C. § 80b-9(e)(1)].

V.

Retain jurisdiction of this action in accordance with the principles of equity and the Federal Rules of Civil Procedure in order to implement and carry out the terms of all orders and decrees that may be entered, or to entertain any suitable application or motion for additional relief within the jurisdiction of this Court.

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VI.

Grant such other and further relief as this Court may determine to be just and necessary.

Dated: August 11, 2020

/s/ Amy Jane Longo

Amy Jane Longo
Christopher A. Nowlin
Attorneys for Plaintiff
Securities and Exchange Commission