

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 5626 / November 13, 2020

ADMINISTRATIVE PROCEEDING
File No. 3-20149

In the Matter of

**SUMMIT FINANCIAL
GROUP, INC.,**

Respondent.

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

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 (“Advisers Act”) against Summit Financial Group, Inc. (“Summit Financial” or “Respondent”).

II.

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

III.

On the basis of this Order and Respondent's Offer, the Commission finds¹ that:

Summary

1. This matter concerns Summit Financial's failure to adopt and implement policies and procedures reasonably designed to prevent unsuitable investments in volatility-linked exchange-traded products ("ETPs") between 2016 and 2018 (the "Relevant Period"). As a result, Summit Financial investment adviser representatives ("IARs") recommended to their clients that they purchase and hold one of the ETPs for durations that were inconsistent with the purpose of the product, as described in its offering documents.

2. Beginning in early 2016, certain Summit Financial IARs expected the financial markets would experience volatility and potential decline over the coming year. In response, these representatives recommended that their clients invest long term in a security called iPath S&P 500 VIX Short-Term Futures ETN ("VXX") as a hedge, or as a means to profit, should the anticipated market decline occur. VXX is designed to provide exposure to equity market volatility by replicating a strategy of continuously maintaining a rolling portfolio of one and two-month futures contracts on the CBOE volatility index (the "VIX"). However, as disclosed in the VXX offering documents, the constant daily buying and selling of the VIX futures contracts generates roll costs in most instances. As these roll costs are deducted from VXX's returns, its value was likely to—and, in fact, did—decrease when held for longer than very short periods, even if the VIX remained flat or positive during that period.

3. In 2016 and 2017, at least 92 Summit Financial advisory client accounts held VXX for periods extending to several months and, in certain instances, more than a year. The increased risk from the extended holding periods resulted in meaningful losses in 91 of these accounts.

4. During the Relevant Period, Summit Financial maintained policies and procedures requiring its IARs to make only suitable investment recommendations. The firm's policies and procedures also mandated that its IARs receive training to address the investment features and risk factors of recommended products. Notwithstanding these obligations, Summit Financial failed to adopt adequate procedures reasonably designed to prevent unsuitable recommendations of volatility-linked ETPs like VXX, and also failed to implement its policy requiring adequate training concerning the investment features and risks of the products that its IARs recommended.

5. Under the circumstances described above, Summit Financial violated Section 206(4) of the Advisers Act and Advisers Act Rule 206(4)-7.

Respondent

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

6. Summit Financial, a Florida corporation, has been registered with the Commission as an investment adviser since 1999. Summit Financial's principal offices are located in Boca Raton, Florida. Approximately 335 registered employees perform investment advisory functions for Summit Financial at more than 249 branch locations across the country. Summit Financial is wholly owned by Summit Brokerage Services, Inc., a formerly registered broker-dealer, which is owned in turn by Summit Financial Services Group, Inc.

Background

The VXX Product

7. VXX, which was listed on the NYSE Arca, Inc. exchange during the Relevant Period, is a volatility-linked exchange-traded note ("ETN") that offers exposure to futures contracts of specified maturities on the VIX. The VIX attempts to track the expected volatility of the S&P 500 Index (the "S&P 500"). Futures contracts on the VIX allow investors to invest in forward volatility based on their view of the near-future direction of the VIX. The performance of VXX is linked to an index that tracks the price of futures contracts on the VIX: the S&P 500 VIX Short-Term Futures Index Total Return (TR) ("Futures Index"). The performance of the Futures Index is based on a rolling portfolio of one-month and two-month futures contracts targeting a constant weighted average of one-month maturity. The Futures Index, on a hypothetical basis, daily sells futures contracts closest to expiration and buys the next month out. When the longer-term contract costs less than the nearer-term contract, the futures market is in "backwardation," and the Index tends to benefit from positive "roll yield." However, when the longer-term contract costs more, the market is in "contango," resulting in negative roll yield, which tends to adversely affect the value of the Futures Index and, consequently, VXX.

8. The VXX pricing supplement in effect during the Relevant Period stated that, as a historical matter, the VIX futures market typically resides in contango, resulting in significant roll costs: "VIX futures have frequently exhibited very high contango in the past, resulting in a significant cost to 'roll' the futures." Because these roll costs tend to adversely impact the value of the Futures Index underlying VXX, especially over the longer term, an investment in VXX poses a risk of a substantial decline in value over time, a risk that increases the longer the product is held.

Summit Financial Failed to Adopt and Implement Reasonably Designed Policies and Procedures Concerning Volatility-Linked Products

9. Throughout the Relevant Period, Summit Financial maintained written policies and procedures recognizing a general obligation to make suitable investment recommendations. These policies and procedures also required that the firm's training materials address the investment features and associated risk factors of recommended products, as well as the basic factors that determine the value of those products.

10. Notwithstanding these obligations, Summit Financial, throughout the Relevant Period, failed to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and its rules regarding the suitability of recommending investments in volatility-linked ETPs such as VXX for retail advisory clients.

11. Summit Financial's written policies and procedures were not reasonably designed. For example, they contained no policies and procedures specifically governing volatility-linked ETPs other than an outright ban on such products, a policy that was introduced later in the Relevant Period and, even then, inconsistently implemented. In addition, Summit Financial lacked other reasonable safeguards regarding the suitability of volatility-linked ETPs, such as policies and procedures for documenting suitability assessments of the products; a process by which the firm reviewed or approved new volatility-linked ETPs available for recommendation to clients; and procedures by which the firm could identify and track holding periods beyond monitoring for excessive trading. The firm also adopted no training requirements expressly for volatility-linked ETPs and failed to implement its existing policy requiring that its training materials address the features and risks of all products recommended by its IARs, which included volatility-linked ETPs.

Summit Financial Failed to Fully Implement its Prohibition on Volatility-Linked ETPs

12. Summit Financial also failed to implement its own policy, adopted on November 7, 2017, which banned volatility-linked ETPs from client accounts. Pursuant to the policy, Summit Financial prohibited client accounts from purchasing volatility-linked ETPs, including VXX. It further instructed its IARs to work with clients already holding VXX to ensure they exit their positions as quickly as possible and to document all conversations concerning these efforts, especially when required liquidations were delayed. Both directives took effect immediately.

13. Notwithstanding the requirements of this policy, the firm took insufficient action to determine whether clients continued to maintain prohibited positions in VXX, to confirm that its IARs were advising clients to exit their positions, or to ensure that client conversations concerning any delays in exiting were being documented. Certain client accounts maintained prohibited positions in VXX for months after the institution of the ban.

Summit Financial IARs Recommended Their Clients Buy and Hold VXX For Extended Periods

14. In 2016 and 2017, certain Summit Financial IARs recommended to their advisory clients that they purchase and hold VXX for durations that were inconsistent with the purpose of the product.

15. The IARs made these recommendations notwithstanding the warnings in the VXX offering documents concerning the effect of contango and negative roll yield. At least 91 accounts holding VXX for extended periods lost money on their investments. And many of these accounts lost more than 75% of the value of their VXX investments.

16. Without the benefit of the training required by the firm's policies and procedures, certain of these Summit Financial IARs had a flawed understanding of VXX's operation and risks. As a result, these IARs could not make a reasonable determination as to whether VXX was suitable in light of their clients' buy-and-hold investment objective. In particular, these IARs could not determine whether it would be reasonable to hold VXX for extended periods as a hedge against a

distant potential market downturn during the Relevant Period, when the VIX futures market was exhibiting very high contango.

17. One Summit Financial IAR, who was responsible for nearly half of all client losses in VXX, did not understand that VXX's performance was tied to an index tracking the daily performance of futures contracts, that the costs of "rolling" the relevant futures contracts could drive down the value of VXX over time, even if the VIX was flat or positive during that period, or that VXX, in fact, had lost a substantial portion of its value since inception. He further did not understand how VXX was structured, the risks inherent in investing in VXX, or how certain features of VXX could negatively affect his clients' investment plans, particularly when used as a buy-and-hold investment. As a result, this IAR could not make a reasonable determination regarding whether VXX was suitable for his clients, as Summit Financial's suitability policy required him to do.

18. Summit Financial's failure to adopt and implement reasonably designed compliance policies and procedures subjected certain of Summit Financial's retail advisory clients to significant risk.

Violations

19. Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder require a registered investment adviser to adopt and implement written compliance policies and procedures reasonably designed to prevent violations by the investment adviser and its supervised persons of the Advisers Act and rules thereunder. As a result of the conduct described above, Summit Financial willfully² violated Section 206(4) and Rule 206(4)-7.

Remedial Efforts

20. In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by Respondent and cooperation afforded the Commission staff. In particular, Summit Financial adopted policies and procedures relating to volatility-linked ETPs such as VXX and banned the purchase of volatility-linked ETPs, including volatility-linked ETNs such as VXX, in client accounts. In addition, Summit Financial remediated the failure to implement the restrictions imposed in November 2017.

² "Willfully," for purposes of imposing relief under Section 203(e) of the Advisers Act, "means no more than that the person charged with the duty knows what he is doing." *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor "also be aware that he is violating one of the Rules or Acts." *Tager v. SEC*, 344 F.2d 5, 8 (2d Cir. 1965). The decision in *The Robare Group, Ltd. v. SEC*, which construed the term "willfully" for purposes of a differently structured statutory provision, does not alter that standard. 922 F.3d 468, 478-79 (D.C. Cir. 2019) (setting forth the showing required to establish that a person has "willfully omit[ted]" material information from a required disclosure in violation of Section 207 of the Advisers Act).

IV.

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

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

- A. Respondent Summit Financial cease and desist from committing or causing any violations and any future violations of Section 206(4) of the Advisers Act and Rule 206(4)-7 promulgated thereunder.
- B. Respondent Summit Financial is censured.
- C. Respondent Summit Financial shall pay disgorgement, prejudgment interest, and a civil monetary penalty totaling \$603,799.08 as follows:
 - i. Respondent shall pay disgorgement of \$3,083.59 and prejudgment interest of \$715.49, consistent with the provisions of this Subsection C.
 - ii. Respondent shall pay a civil monetary penalty in the amount of \$600,000, consistent with the provisions of this Subsection C.
 - iii. Pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended, a Fair Fund is created for the penalties, disgorgement, and prejudgment interest described above for distribution to affected investors' accounts. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, it shall not argue that it is entitled to, nor shall it benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this Subsection C, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.
 - iv. Within 10 days of the issuance of this Order, Respondent shall deposit \$603,799.08 (the "Fair Fund") into an escrow account at a financial institution not unacceptable to the Commission staff and Respondent shall provide the Commission staff with evidence of such deposit in a form acceptable to the Commission staff. If timely

payment into the escrow account is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600 [17 C.F.R. § 201.600] and/or 31 U.S.C. § 3717.

- v. Respondent shall be responsible for administering the Fair Fund and may hire a professional to assist it in the administration of the distribution. The costs and expenses of administering the Fair Fund, including any such professional services, shall be borne by Respondent and shall not be paid out of the Fair Fund.
- vi. Respondent shall disburse from the Fair Fund an amount representing a portion of the respective loss incurred from the investment of VXX to each client of Summit Financial (“Qualified Investor”) who incurred a loss as a result of solicited investments made in VXX between January 1, 2016 and November 7, 2017 plus reasonable interest at the Internal Revenue Service’s rate to calculate underpayment penalties compounded quarterly from the date of the purchase to January 30, 2019, pursuant to a disbursement calculation (the “Calculation”) that will be submitted to, reviewed by, and approved by the Commission staff in accordance with this Subsection C. Any client who has settled a Related Investor Action prior to the date of the Order shall not receive such a disbursement, unless the disbursement, as calculated, is greater than the amount of the settlement of the Related Investor Action, and shall be offset by any monies received in the settlement of the private damages action. No portion of the Fair Fund shall be paid to any Qualified Investor account in which Respondent or its affiliated broker-dealer(s), or any of their current or former employees, officers, directors, or representatives, has or had a financial interest.
- vii. Respondent shall, within 90 days from the date of this Order, submit a proposed Calculation to the Commission staff for review and approval. At or around the time of submission of the proposed Calculation to the staff, Respondent shall make itself available, and shall require any third-parties or professionals retained by Respondent to assist in formulating the methodology for its Calculation and/or administration of the Fair Fund to be available, for a conference call with the Commission staff to explain the methodology used in preparing the proposed Calculation and its implementation, and to provide the staff with an opportunity to ask questions. Respondent also shall provide the Commission staff such additional information and supporting documentation as the Commission staff may request for the purpose of its review. In the event of one or more objections by the Commission staff to Respondent’s proposed Calculation or to any of its information or supporting documentation, Respondent shall submit a revised Calculation for the review and approval of the Commission staff or additional information or supporting documentation within 10 days of the date on which the Commission staff notifies Respondent of the objection. The revised Calculation shall be subject to all of the provisions of this Subsection C.
- viii. After the Calculation has been approved by the Commission staff, Respondent shall submit a payment file (the “Payment File”) within thirty (30) days for review and

acceptance by the Commission staff demonstrating the application of the Calculation methodology to each Qualified Investor. The Payment File should identify, at a minimum: (1) the name of each Qualified Investor; (2) the exact amount of the payment to be made; (3) the amount of any *de minimis* threshold to be applied; and (4) the amount of reasonable interest paid.

- ix. Respondent shall complete the disbursement of all amounts payable to Qualified Investor accounts or, if a Qualified Investor no longer has an account with Respondent, to the Qualified Investor, within 90 days of the date that the Commission staff accepts the Payment File, unless such time period is extended as provided in Paragraph xiv of this Subsection C. Respondent shall notify the Commission staff of the dates and the amounts paid in the initial distribution.
- x. After the Commission accepts the Payment File, but before disbursement, Respondent shall notify each Qualified Investor of the settlement terms of this Order by sending a copy of this Order to each Qualified Investor via mail, email, or such other method not unacceptable to the Commission staff, together with a cover letter in a form not unacceptable to the Commission staff.
- xi. If Respondent is unable to distribute or return any portion of the Fair Fund for any reason, including an inability to locate a Qualified Investor or a beneficial owner of an affected account or any factors beyond Respondent's control, Respondent shall transfer any such undistributed funds to the Commission for further disposition as approved by the Commission. Payment must be made in one of the following ways:
 - 1. Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
 - 2. Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
 - 3. Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Summit Financial as the Respondent in these proceedings and the file

number of these proceedings; a copy of the cover letter and check or money order must be sent to Brendan P. McGlynn, Assistant Director, Division of Enforcement, Securities and Exchange Commission, 1617 JFK Blvd., Suite 520, Philadelphia, PA 19103.

- xii. A Fair Fund is a Qualified Settlement Fund (“QSF”) under Section 468B(g) of the Internal Revenue Code (“IRC”), 26 U.S.C. §§ 1.468B.1-1.468B.5. Respondent shall be responsible for any and all tax compliance responsibilities associated with the Fair Fund, including but not limited to tax obligations resulting from the Fair Fund’s status as a QSF and the Foreign Account Tax Compliance Act (“FATCA”), and may retain any professional services necessary. The costs and expenses of tax compliance, including any such professional services shall be borne by Respondent and shall not be paid out of the Fair Fund.

- xiii. Within 150 days after Respondent completes the disbursement of all amounts payable to Qualified Investors, Respondent shall return all undisbursed funds to the Commission pursuant to the instructions set forth in this Subsection C. Respondent shall then submit to the Commission staff a final accounting and certification of the disposition of the Fair Fund for Commission approval, which final accounting and certification shall include, but not be limited to: (1) the amount paid to each payee, with the reasonable interest amount, if any, reported separately; (2) the date of each payment; (3) the check number or other identifier of the money transferred; (4) the amount of any returned payment and the date received; (5) a description of the efforts to locate a prospective payee whose payment was returned or to whom payment was not made for any reason; (6) the total amount, if any, to be forwarded to the Commission for transfer to the United States Treasury; and (7) an affirmation that Respondent has made payments from the Fair Fund to Qualified Investors in accordance with the Calculation approved by the Commission staff. The final accounting and certification shall be submitted under a cover letter that identifies Respondent and the file number of these proceedings to Brendan P. McGlynn, Assistant Director, Division of Enforcement, Securities and Exchange Commission, 1617 JFK Blvd., Suite 520, Philadelphia, PA 19103. Respondent shall provide any and all supporting documentation for the accounting and certification to the Commission staff upon its request and shall cooperate with any additional requests by the Commission staff in connection with the accounting and certification.

- xiv. The Commission staff may extend any of the procedural dates set forth in this Subsection C for good cause shown. Deadlines for dates relating to the Fair Fund shall be counted in calendar days, except that if the last day falls on a weekend or federal holiday, the next business day shall be considered to be the last day.

By the Commission.

Vanessa A. Countryman
Secretary