

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 97427 / May 4, 2023

INVESTMENT ADVISERS ACT OF 1940
Release No. 6300 / May 4, 2023

ADMINISTRATIVE PROCEEDING
File No. 3-21403

In the Matter of

**CLASSIC ASSET MANAGEMENT,
LLC and DOUGLAS G. SCHMITZ,**

Respondents.

**ORDER INSTITUTING ADMINISTRATIVE
AND CEASE-AND-DESIST PROCEEDINGS,
PURSUANT TO SECTION 15(b) OF THE
SECURITIES EXCHANGE ACT OF 1934
AND SECTIONS 203(e), 203(f) AND 203(k)
OF THE INVESTMENT ADVISERS ACT OF
1940, MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS AND A CEASE-
AND-DESIST ORDER**

I.

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 Classic Asset Management, LLC (“CAM”) and pursuant to Section 15(b) of the Securities Exchange Act of 1934 (“Exchange Act”) and Sections 203(f) and 203(k) of the Advisers Act against Douglas G. Schmitz (“Schmitz”) (collectively, “Respondents”).

II.

In anticipation of the institution of these proceedings, Respondents have submitted Offers of Settlement (the “Offers”), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over them and the subject matter of these proceedings, which are admitted, and except as provided herein in Section V, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Section 15(b) of the Securities Exchange Act of 1934 and Sections 203(e), 203(f), and 203(k) of

the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order (“Order”), as set forth below.

III.

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

Summary

1. These proceedings arise out of breaches of the fiduciary duty of care and compliance failures by CAM, a registered investment adviser, and breaches of the fiduciary duty of care by Schmitz, an owner and investment adviser representative of CAM, who invested advisory clients in leveraged exchange traded funds (“ETFs”) for extended periods of time and, in many cases, in significant concentrations. CAM and Schmitz purchased and held the ETFs in client accounts without having a reasonable basis to do so. This conduct was inconsistent with the prospectuses for the ETFs, which stated that the products carried unique risks, were designed to be held for no more than a single trading day, and required frequent monitoring. CAM and Schmitz misunderstood these fundamental characteristics of the ETFs and thus lacked a reasonable belief the ETFs were in their clients’ best interests. Further, despite the offering documents’ warning that the ETFs required frequent monitoring, CAM and Schmitz failed to appropriately monitor the products’ performance. They consequently did not evaluate whether the ETFs were in the clients’ best interest throughout the holding period. CAM also failed to adopt and implement policies and procedures reasonably designed to prevent violations of the Advisers Act.

Respondents

2. Classic Asset Management, LLC is a North Dakota limited liability company, with its principal place of business in Fargo, North Dakota, that has been registered with the Commission as an investment adviser since 2006. CAM provides investment advisory services to individuals, pension and profit sharing plans, trusts, estates, charitable organizations, and corporations. On its Form ADV filed on March 16, 2023, CAM reported approximately \$158 million in regulatory assets under management held in 1,891 accounts, representing 917 clients.

3. Douglas Schmitz, age 63, is a resident of Fargo, North Dakota. Schmitz is a one-third indirect owner and investment adviser representative (“IAR”) of CAM, where he provided investment advice to clients and received compensation for doing so. Schmitz is also an owner and registered representative of an affiliated broker-dealer of CAM.

Facts

4. From at least January 2017 through December 2020 (the “Relevant Period”), Respondents purchased and held ETFs in advisory client accounts. The ETFs are complex securities that carry significant risks and included at least fifteen different funds, all of which seek to deliver multiples of the performance of the index or benchmark they track.

5. Prospectuses for the LETFs that Schmitz reviewed contained warnings regarding the significant risks inherent in the products' structure, which were generally featured in bold type on the first page of the document. For example, one ETF that Respondents purchased and held for clients during the Relevant Period was the ProShares UltraPro Dow 30 ("UDOW"). Featured in bold type in the first paragraph of the first page of the UDOW Summary Prospectus issued on October 1, 2018 was the following statement:

The return of the Fund for periods longer than a single day will be the result of its return for each day compounded over the period. The Fund's returns for periods longer than a single day will very likely differ in amount, and possibly even direction, from the Fund's stated multiple (3x) times the return of the Fund's Index for the same period. For periods longer than a single day, the Fund will lose money if the Index's performance is flat, and it is possible that the Fund will lose money even if the level of the Index rises. Longer holding periods, higher index volatility and greater leverage each exacerbate the impact of compounding on an investor's returns. During periods of higher Index volatility, the volatility of the Index may affect the Fund's return as much as or more than the return of the Index. . . . Investors in the Fund should actively manage and monitor their investments, as frequently as daily.

The UDOW Summary Prospectus also informed investors that "[t]he Fund does not seek to achieve its stated investment objective over a period of time greater than a single day." Similar cautionary language featured prominently in the prospectuses for each of the other LETFs that Respondents purchased and held for clients.

6. During the Relevant Period, Respondents made investments for their clients in ETF positions, such that the clients' portfolios were often highly concentrated in these instruments, and Respondents caused the portfolios to hold these positions for periods substantially longer than one day. Of the approximately 290 clients Schmitz advised during the Relevant Period, he invested roughly 220 (76%) in LETFs. The LETFs often comprised large percentages of the overall assets held in the client accounts Schmitz managed. For instance, as of December 31, 2019, LETFs comprised an average of approximately 56% of the total market value of the client accounts that Schmitz managed. Additionally, Respondents routinely held LETFs in client accounts for weeks, months, and years. During the Relevant Period, Schmitz held LETFs in client accounts for an average of over 331 days. 90% of the LETFs were held longer than 100 days, 73% were held more than 200 days, and 33% were held more than 365 days. Less than 1% of the LETFs were sold in one day. As a result of CAM's and Schmitz's actions, certain clients invested in the LETFs experienced substantial losses during the Relevant Period.

7. Neither CAM nor Schmitz had a reasonable basis to conclude that the LETFs were suitable for their clients either generally or in the manner in which they intended to use them. Despite the language in the prospectuses, Respondents did not fully appreciate the LETFs' most consequential attributes, including that the LETFs were designed as short-term trading tools and that there were material risks to holding the LETFs in significant amounts for periods considerably longer than recommended by the issuers. For instance, Respondents did not account for the

ETFs' unique risks as detailed in the prospectuses, including compounding risk which can result in substantial index tracking error as volatility increases, correlation risk in which numerous factors cause the fund performance to deviate from the reference index, derivative risk relating to the swaps and other products the funds use to gain exposure to the reference index, and holding duration which can magnify all of the aforementioned risks. Because Respondents failed to consider fundamental characteristics of the ETFs, CAM and Schmitz used the ETFs in a manner that was unsuitable, including concentrating clients' portfolios in ETFs and holding them for extended periods of time.

8. Despite the prospectuses highlighting the need for frequent monitoring, after purchasing the ETFs for clients, Respondents failed to monitor the investments to assess whether they were in the clients' best interest throughout the holding period. Schmitz's ongoing monitoring of the ETF investments in client accounts focused on a general awareness of the performance of the reference index and market conditions, but did not include monitoring of the actual ETFs' performance or product-specific considerations relating to the unique risks associated with the structure and daily rebalancing of the ETFs.

9. During the Relevant Period, CAM also did not adopt or implement written policies and procedures that were reasonably designed to ensure CAM's representatives understood the material features and risks of complex products like ETFs before purchasing them for advisory clients. Although CAM permitted its representatives to purchase complex products like the ETFs, its policies and procedures did not address due diligence, product-specific disclosures to clients, or suitability assessments for these products. CAM also did not have policies and procedures addressing training required for ETFs and did not have procedures for supervisory review of recommendations or purchases of ETFs or monitoring of the products.

Violations

10. As a result of the conduct described above, Respondents willfully violated Section 206(2) of the Advisers Act, which makes it unlawful for any investment adviser, directly or indirectly, to "engage in any transaction, practice or course of business which operates as a fraud or deceit upon any client or prospective client." Scienter is not required to establish a violation of Section 206(2), but rather a violation may rest on a finding of negligence. *SEC v. Steadman*, 967 F.2d 636, 643 n.5 (D.C. Cir. 1992) (citing *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 194-95 (1963)).

11. As a result of the conduct described above, CAM willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder, which require a registered investment adviser to adopt and implement written compliance policies and procedures reasonably designed to prevent violations of the Advisers Act and the rules thereunder.

Disgorgement and Civil Penalties

12. The disgorgement and prejudgment interest ordered in paragraph D of Section IV is consistent with equitable principles and does not exceed Respondents' net profits from their violations, and will be distributed to harmed investors to the extent feasible. Upon approval of the distribution final accounting by the Commission, any amounts remaining that are infeasible to return to investors, and any amounts returned to the Commission in the future that are infeasible to return to investors, may be transferred to the general fund of the U.S. Treasury, subject to Section 21F(g)(3) of the Exchange Act.

Respondents' Remedial Efforts

13. In determining to accept the Offers, the Commission considered remedial acts promptly undertaken by Respondents and cooperation afforded the Commission staff.

IV.

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

Accordingly, pursuant to Sections 203(e) and 203(k) of the Advisers Act with respect to CAM, and pursuant to Section 15(b) of the Exchange Act and Sections 203(f) and 203(k) of the Advisers Act with respect to Schmitz, it is hereby ORDERED that:

- A. Respondents CAM and Schmitz cease and desist from committing or causing any violations and any future violations of Section 206(2) of the Advisers Act.
- B. Respondent CAM 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.
- C. Respondents CAM and Schmitz are censured.
- D. Respondents CAM and Schmitz shall pay disgorgement, prejudgment interest and a civil monetary penalty as follows:
 - (i) Respondent CAM shall pay disgorgement of \$81,824, prejudgment interest of \$13,404, and a civil monetary penalty of \$100,000 consistent with the provisions of this Subsection D.
 - (ii) Respondent Schmitz shall pay disgorgement of \$523,086, prejudgment interest of \$115,027, and a civil monetary penalty of \$100,000 consistent with the provisions of this Subsection D.
 - (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 in paragraphs IV.D. (i) and IV.D (ii) above. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondents agree that in any Related Investor Action, they shall not argue that they are entitled to, nor shall they benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondents' payments of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondents agree that they shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against a 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 entry of this Order, Respondent CAM shall deposit \$195,228 and Respondent Schmitz shall deposit \$738,113 (collectively the two deposits constitute the "Fair Fund") into an escrow account established by CAM at a financial institution not unacceptable to the Commission staff and Respondents shall provide the Commission staff with evidence of such deposit in a form acceptable to the Commission staff. The account holding the assets of the Fair Fund shall bear the name and the taxpayer identification number of the Fair Fund. If timely deposit into the escrow account is not made, additional interest shall accrue pursuant to Commission Rule of Practice 600 [17 C.F.R. § 201.600] and/or 31 U.S.C. § 3717.

(v) Respondent CAM shall be responsible for administering the Fair Fund and may hire a professional at its own cost 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 CAM and shall not be paid out of the Fair Fund.

(vi) Respondent CAM shall distribute from the Fair Fund to each affected investor an amount representing financial harm during the relevant period by the practices discussed above, and, if funds are available, reasonable interest on such amounts, pursuant to a disbursement calculation (the "Calculation") that will be submitted to, reviewed, and approved by the Commission staff in accordance with this Subsection D. The Calculation shall be subject to a *de minimis* threshold. No portion of the Fair Fund shall be paid to any affected investor account in which Respondents CAM or Schmitz, or any of their current or former officers, directors, investment adviser representatives, or associated persons (or any of their spouses or children) have a financial interest.

(vii) Respondent CAM shall, within 90 days of the entry of the Order, submit a Calculation to the Commission staff for review and approval. At or around the time of submission of the proposed Calculation to the staff, Respondent CAM shall make itself available, and shall require any third-parties or professionals retained by Respondent CAM to assist in formulating the methodology for its Calculation and/or administration of the distribution 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 CAM shall also 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 CAM's proposed Calculation or any of its information or supporting documentation, Respondent CAM shall submit a revised Calculation for review and approval of the Commission staff or additional information or supporting documentation within 10 days of the date that the Commission staff notifies Respondent CAM of the objection. The revised Calculation shall be subject to all of the provisions of this Subsection D.

(viii) Respondent CAM shall within 30 days of the written approval of the Calculation by the Commission staff, submit a payment file (the "Payment File") for review and acceptance by the Commission staff demonstrating the application of the methodology to each affected investor. The Payment File should identify, at a minimum: (1) the name of each affected investor; (2) tax withholding; (3) reasonable interest paid; (4) the amount of any *de minimis* threshold to be applied; and (5) the exact amount of the payment to be made from the Fair Fund to the affected investor (net tax withholding).

(ix) Respondent CAM shall complete the disbursement of all amounts payable to affected investors within 90 days of the date the Commission staff accepts the Payment File unless such time period is extended as provided in Paragraph (xiii) of this Subsection D. Respondent CAM shall notify the Commission staff of the date(s) and the amount paid for each distribution.

(x) If Respondent CAM is unable to distribute any portion of the Fair Fund for any reason, including an inability to locate an affected investor or a beneficial owner of an affected investor or any factors beyond Respondent CAM's control, Respondent CAM shall transfer any such undistributed funds to the Commission for transmittal to the United States Treasury in accordance with Section 21F(g)(3) of the Exchange Act once the distribution of funds is complete and before the final accounting provided for in Paragraph (xii) of this Subsection D is submitted to the Commission staff. Payment must be made in one of the following ways:

- (a) CAM may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
- (b) CAM 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
- (c) CAM 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 CAM and Schmitz as a Respondents 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 Nicholas Heinke, Associate Regional Director, Denver Regional Office, Division of Enforcement, Securities and Exchange Commission, Byron G. Rogers Federal Building, 1961 Stout Street, Suite 1700, Denver, Colorado 80294.

(xi) 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 CAM agrees to be responsible for 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. These responsibilities involve reporting and paying requirements of the Fair Fund, including but not limited to: (1) tax returns for the Fair Fund; (2) information return reporting regarding the payments to investors, as required by applicable codes and regulations; and (3) obligations resulting from compliance with the Foreign Account Tax Compliance Act (FATCA). Respondent CAM may retain any professional services necessary. The costs and expenses of tax compliance, including any such professional services, shall be borne by Respondent CAM and shall not be paid out of the Fair Fund.

(xii) Within 150 days after Respondent CAM completes the disbursement of all amounts payable to affected investors, Respondent CAM shall return all undisbursed funds to the Commission pursuant to the instructions set forth in this Subsection D. Respondent CAM shall then submit to the Commission staff a final accounting and certification of the disposition of the Fair Fund for Commission approval. The final accounting shall be in a format to be provided by the Commission staff. The final accounting and certification shall include: (1) the

amount paid to each affected investor, with the reasonable interest amount and withholding amount, if any, each reported separately; (2) the date of each payment; (3) the check number or other identifier of the money transferred to each affected investor; (4) the amount of any returned payment and the date received; (5) a description the efforts to locate or the reason for nonpayment of an affected investor 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 CAM has made payments from the Fair Fund to affected investors in accordance with the Calculation approved by the Commission staff. Respondent CAM shall submit the final accounting and certification under a cover letter that identifies the Respondents in these proceedings and the file number of these proceedings to Nicholas Heinke, Associate Regional Director, Denver Regional Office, Division of Enforcement, Securities and Exchange Commission, Byron G. Rogers Federal Building, 1961 Stout Street, Suite 1700, Denver, Colorado 80294, or such other address as the Commission staff may provide. Respondent CAM shall provide any and all supporting documentation for the accounting and certification to the Commission staff upon its request, and Respondent CAM shall cooperate with any additional requests by the Commission staff in connection with the accounting and certification.

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

V.

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

By the Commission.

Vanessa A. Countryman
Secretary