

**UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION**

**INVESTMENT ADVISERS ACT OF 1940
Release No. 5987 / March 30, 2022**

**ADMINISTRATIVE PROCEEDING
File No. 3-20806**

In the Matter of

**SPRUCE INVESTMENT
ADVISORS, LLC**

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 Spruce Investment Advisors, LLC (“Spruce” or “Respondent”).

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the “Offer”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over 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. Beginning with fiscal year end 2014, Spruce, a registered investment adviser, failed to timely distribute annual audited financial statements prepared in accordance with Generally Accepted Accounting Principles (“GAAP”) to the investors in certain private funds that it advised. Spruce also failed to timely distribute annual audited financial statements prepared in accordance with GAAP to the investors in certain funds of funds that it advised in each fiscal year 2018 through 2020. These failures resulted in violations of Section 206(4) of the Advisers Act and Rule 206(4)-2 thereunder, commonly referred to as the “custody rule.”

2. Spruce also failed to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and the rules thereunder, a violation of Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder.

Respondent

3. **Spruce Investment Advisors, LLC**, formed in 2001, is a Delaware limited liability company with its principal place of business in Stamford, Connecticut. Spruce has been registered as an investment adviser with the Commission since March 2003. As of March 31, 2021, Spruce had approximately \$182 million in regulatory assets under management, composed of approximately \$172 million in private funds and approximately \$10 million in separate accounts.

Other Relevant Entities

4. Spruce has been the investment adviser to approximately 100 private equity funds formed as limited liability companies that each have “AEI” in the fund name (the “**AEI Funds**”). Spruce became the investment adviser to the AEI Funds in 2014, when it formed Spruce Direct Investment Fund I (“SDIF”) and raised funds from SDIF investors for SDIF to acquire the managing membership interests in the AEI Funds.

5. **Spruce Direct Investment Fund I** is a private fund, formed as a Delaware limited partnership, that serves as managing member of the AEI Funds. SDIF operates as a fund of funds. At all relevant times, an affiliate under common control with Spruce was the general partner of SDIF. Spruce is the investment adviser to SDIF.

6. **Spruce Private Investments Fund II LP** (“SPIF II”) is a private fund, formed as a Delaware limited partnership, that, among other things, has invested in SDIF. Like SDIF, SPIF II

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

operates as a fund of funds. At all relevant times, an affiliate under common control with Spruce was the general partner of SPIF II. Spruce is the investment adviser to SPIF II. SPIF II, together with the AEI Funds and SDIF, are referred to herein collectively as “the Funds.”

Spruce Failed for Numerous Years to Distribute Required Audited Financial Statements

7. The custody rule requires that registered investment advisers who have custody of client funds or securities implement an enumerated set of requirements to prevent loss, misuse, or misappropriation of those assets.

8. An investment adviser has custody of client assets if it holds, directly or indirectly, client funds or securities, or if it has the ability to obtain possession of those assets. *See Rule 206(4)-2(d)(2).* A related person of Spruce has served as the managing member or general partner of each Fund at all relevant times, and has had the authority to make decisions for, and act on behalf of, the Funds. Spruce is therefore deemed to have custody of Fund assets as defined in Advisers Act Rule 206(4)-2.

9. An investment adviser with custody of client assets must, among other things: (i) ensure that a qualified custodian maintains the client assets; (ii) notify the client in writing of accounts opened by the adviser at a qualified custodian on the client’s behalf; (iii) have a reasonable basis for believing that the qualified custodian sends account statements at least quarterly to clients, except if the client is a limited partnership or limited liability company for which the adviser or a related person is a general partner or managing member, the account statements must be sent to each limited partner or member; and (iv) ensure that client funds and securities are verified by actual examination each year by an independent public accountant at a time chosen by the accountant without prior notice or announcement to the adviser. *See Rule 206(4)-2(a)(1) - (5).*

10. The custody rule provides an alternative to complying with the requirements of Rule 206(4)-2(a)(2), (3) and (4) for investment advisers to limited partnerships or other types of pooled investment vehicles, such as the Funds. The custody rule provides that an investment adviser “shall be deemed to have complied with” the independent verification requirement and is not required to satisfy the notification and accounts statements delivery requirements with respect to a fund if the fund is subject to audit at least annually and “distributes [the fund’s] audited financial statements prepared in accordance with generally accepted accounting principles to all limited partners (or members or other beneficial owners) . . . within 120 days of the end of [the fund’s] fiscal year” (“Audited Financials Alternative”). *See Rule 206(4)-2(b)(4)(i).* Advisers to funds operating as a fund of funds, like SDIF and SPIF II, may generally comply with the Audited Financial Alternative by distributing audited financials to investors within 180 days of the end of the fund of funds’ fiscal year. The accountant performing the audit must be an independent public accountant that is registered with, and subject to regular inspection by, the Public Company Accounting Oversight Board (“PCAOB”). *See Rule 206(4)-2(b)(4)(ii).* An investment adviser to a pooled investment vehicle that fails to meet the requirements of the Audited Financials Alternative to timely distribute audited financial statements prepared in accordance with GAAP would need to

satisfy all of the requirements of Rule 206(4)-2(a)(2) - (4) in order to avoid violating the custody rule.

11. With respect to the Funds, Spruce purported to rely on the Audited Financials Alternative to attempt to comply with the custody rule but failed to have the required audits performed or deliver the audited financials to the Funds' investors. Although Spruce engaged PCAOB-registered auditing firms to conduct annual audits of the Funds' financial statements, the auditing firms were not able to complete timely audits. This occurred in part because Spruce was not able to provide pertinent records. Spruce failed to distribute the requisite audited financial statements to investors within 120 days of fiscal year end 2014 forward for certain AEI Funds, or for fiscal year end 2015 forward for the other AEI Funds. It failed to distribute the required audited financial statements to SDIF and SPIF II investors within 180 days of fiscal year end 2018 forward. Accordingly, Spruce did not satisfy the requirements of the Audited Financials Alternative in Rule 206(4)-2(b)(4) for the Funds and was therefore obligated to comply with Rule 206(4)-2(a)(2), (3) and (4), which it also failed to do.

12. Spruce, through SDIF, also maintained physical possession of privately offered certificated securities belonging to the AEI Funds, in violation of the qualified custodian requirement of paragraph (a)(1) of the custody rule. Spruce relied on an exception to the qualified custodian requirement that is available for certain privately offered securities. That exception, contained in paragraph (b)(2) of the custody rule, only extends to pooled investment vehicles, such as the Funds, when they have audited financial statements distributed in keeping with the Audited Financials Alternative. Spruce failed to meet the requirements of the Audited Financials Alternative, and therefore could not avail itself of the exception for privately offered securities.

13. The failure to complete timely audited financial statements was attributable in part to Spruce's decision in late 2018 to reallocate to AEI Funds certain expenses that had previously been borne by SDIF. Spruce determined that applicable fund operating agreements required the AEI Funds to reimburse SDIF for all expenses attributable to the AEI funds, which was more than the AEI Funds had paid historically. Spruce then reallocated expenses to the AEI Funds without sufficient supporting documentation for some of the expenses. Spruce did not consult with or apprise Fund auditors at the time it adopted the new expense allocation methodology regarding either the general change in allocation methodology or specific reallocations, but informed auditors only after the methodology had been implemented. This then led to ongoing delays in the completion of AEI Fund and SDIF audits, because Spruce was required to substantiate and correct numerous categories of expense allocation. In turn, this delayed the completion of the SPIF II audit, because SPIF II is an investor in SDIF.

14. Spruce's 2018 decision to reallocate expenses not only contributed to its ongoing custody rule violation but also to Spruce's violation of the Advisers Act rule with respect to compliance policies and procedures. Spruce failed to adopt written policies and procedures regarding the allocation of expenses to and between SDIF and the AEI Funds. In 2016, a compliance consultant had recommended that Spruce prepare more detailed policies and procedures within its compliance manual to specify the manner of expense allocation as between SDIF, the AEI Funds, or SDIF's general partner, but Spruce failed to do so.

15. With respect to the custody rule, Spruce's written policies and procedures referenced the rule but were not reasonably designed and implemented to prevent violations of the rule. Spruce failed to comply with the requirement that every investment adviser registered with the Commission adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and the rules thereunder. *See Rule 206(4)-7(a).*

Violations

16. Section 206(4) of the Advisers Act prohibits an investment adviser from engaging in acts, practices or courses of business that are fraudulent, deceptive, or manipulative, as defined by the Commission in rules and regulations promulgated under the statute. Proof of scienter is not required to establish a violation of Section 206(4) of the Advisers Act and the rules thereunder. *SEC v. Steadman*, 967 F.2d 636, 647 (D.C. Cir. 1992). Among other things, Rule 206(4)-2 requires registered investment advisers with custody of client funds or securities to have independent public accountants conduct surprise examinations of those client funds or securities, or to have private fund clients timely distribute to their investors annual audited financial statements prepared in accordance with GAAP. Rule 206(4)-7 requires, among other things, that an investment adviser registered with the Commission adopt and implement written policies and procedures reasonably designed to prevent violation of the Advisers Act and rules thereunder.

17. As a result of the conduct described above, Spruce willfully² violated Section 206(4) of the Advisers Act and Rules 206(4)-2 and 206(4)-7 thereunder.

Undertakings

Respondent has undertaken to:

18. Notify past and current investors in the Funds of the settlement terms of this Order by sending a copy of this Order to each 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, within 30 days of entry of this Order.

19. Respondent shall certify, in writing, compliance with the undertaking set forth above. The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and Respondent agrees to provide such evidence. The certification and supporting material shall be submitted to: Robert Baker, Assistant Regional Director, Division of Enforcement, Securities and

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).

Exchange Commission, Boston Regional Office, 33 Arch Street, 24th Floor, Boston, MA 02110, with a copy to the Office of Chief Counsel of the Enforcement Division, no later than sixty (60) days from the date of the completion of the undertaking. For good cause shown, the Commission staff may extend any of the deadlines set forth with respect to the undertaking.

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 cease and desist from committing or causing any violations and any future violations of Section 206(4) of the Advisers Act and Rules 206(4)-2 and 206(4)-7 promulgated thereunder.

B. Respondent is censured.

C. Respondents shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of \$75,000.00 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717.

Payment must be made in one of the following ways:

- (1) Respondent 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 Spruce as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Robert B. Baker, Assistant Director,

Division of Enforcement, Securities and Exchange Commission, Boston Regional Office, 33 Arch Street, 24th Floor, Boston, Massachusetts 02110.

D. 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 Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

E. Respondent shall comply with the undertakings enumerated in Section III, paragraphs 18-19, above.

By the Commission.

Vanessa A. Countryman
Secretary