

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

**INVESTMENT ADVISERS ACT OF 1940**  
**Release No. 5062 / November 6, 2018**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-18885**

**In the Matter of**

**MARK A. ELSTE**

**Respondent.**

**ORDER INSTITUTING ADMINISTRATIVE  
AND CEASE-AND-DESIST PROCEEDINGS,  
PURSUANT TO SECTIONS 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(f) and 203(k) of the Investment Advisers Act of 1940 (“Advisers Act”) against Mark A. Elste (“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 him and the subject matter of these proceedings, which are admitted, and except as provided herein in Section V, Respondent consents to the entry of this Order Instituting Administrative and Cease – and – Desist Proceedings, Pursuant to Sections 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 Respondent's Offer, the Commission finds<sup>1</sup> that:

#### **Summary**

From January 2012 to June 2014, Mark A. Elste ("Elste"), who was the Chief Executive Officer ("CEO") and Chief Investment Officer ("CIO") of Pennant Management, Inc. ("Pennant"), a formerly registered investment adviser, aided, abetted and caused Pennant's violations of Section 206(4) of the Adviser Act and Rule 206(4)-7 thereunder (the "Compliance Rule"). During this time, Elste was aware that Pennant's compliance program lacked sufficient resources but failed timely to address this deficiency, which contributed substantially to Pennant's Compliance Rule violations. Among other things, Pennant failed to implement its policies and procedures regarding periodic monitoring of employee e-mails, allocation of investment opportunities in its Small Business Administration ("SBA") and U.S. Department of Agriculture ("USDA") repurchase agreement ("Repo") program, and maintenance of Repo trade allocation records. Additionally, Elste learned of general issues related to Pennant's informal process for initial and ongoing due diligence and monitoring of Repo counterparties, but did not cause Pennant to amend its policies and procedures accordingly.

#### **Respondent**

1. Mark A. Elste, age 63, resides in Sturgeon Bay, Wisconsin. Elste founded Pennant in 1995 and was Pennant's CEO and Chairman of the Board of Directors until March 2015 and its CIO until October 2013. Elste is not currently associated with any investment adviser.

#### **Other Relevant Entities and Individuals**

2. Pennant, a Milwaukee, Wisconsin based corporation, was registered with the Commission as an investment adviser from April 1995 until May 2015. In 2004, Pennant became a wholly owned subsidiary of an Illinois holding company, (the "Holding Company"). Pennant filed Form ADV-W on May 28, 2015 to de-register with the Commission.

#### **Facts**

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<sup>1</sup> 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.

3. In January 2012, Elste asked one of Pennant's portfolio managers to assume the role of interim CCO for Pennant ("the CCO"). The CCO had no compliance experience, but accepted the position contingent upon having access to outside counsel and compliance consultants as needed. At that time, the CCO was already working extended hours to keep up with his portfolio manager duties, which he retained.

*Elste knew Pennant had insufficient compliance resources*

4. After educating himself about the compliance requirements of a registered investment adviser, and reviewing Pennant's compliance policies and procedures, the CCO concluded that Pennant's compliance program was deficient and advised Elste of his concerns. For example, in a March 2012 e-mail to Elste and others, the CCO raised questions about Pennant's policies and procedures manual and advised:

In my opinion, we need the experience of an outside resource right now to help us evaluate the status of our compliance program, including our investment adviser policies and procedures manual.

Pennant, however, did not retain additional outside resources at that time.

5. In May 2012, after attending a compliance conference, the CCO notified Elste that Pennant had never completed a formal risk assessment, which he believed was necessary for an effective compliance program. The CCO also noted his understanding was that the Commission was looking closely at compliance policies and procedures and warned that, "inadequate policies could lead to enforcement action." Consequently, the CCO indicated his "primary objective" would be to review the policies and procedures and complete a risk assessment. The CCO completed his review of the policies and procedures during 2012, and he completed a risk assessment for Pennant by September 2012.

6. In August 2012, Elste offered to make the CCO's interim position permanent. The CCO accepted on the condition that he would have access to outside counsel, Pennant would engage compliance consultants as needed to improve the compliance program, and he would relinquish his portfolio management duties to eliminate inherent conflicts. Elste agreed to these conditions, but soon afterwards gave the CCO additional compliance duties. Pennant did not add compliance resources at that time.

7. In December 2012, the CCO and Pennant's President and COO ("President A") gave Elste a list of high priority compliance projects that needed to be completed and requested more compliance resources. The CCO reported directly to President A, who reported to Elste. Elste rejected the request and told the CCO and President A to "re-task" Pennant's existing staff to help with compliance. Initially the CCO told Elste that the staff was very supportive and cooperating with the re-tasking, but later told Elste that he did not think the re-tasking was sufficient. Elste did not change his position to add more resources at that time. Therefore, the CCO went forward with re-tasking the staff.

8. Soon thereafter, based on Elste's and the Holding Company management's decision not to add compliance resources, Pennant cut \$80,000 from Pennant's proposed 2013 budget, which had been earmarked to hire another compliance staff member.

9. In January 2013, Elste and the Holding Company management expanded the CCO's compliance obligations and diverted the CCO's resources to new tasks. In particular, on January 16, 2013, Elste and the Holding Company management appointed the CCO as the CCO of a new registered investment company advised by Pennant ("Investment Company A"). In addition, in late January 2013, Elste and the Holding Company management decided to use Pennant's staff, including the CCO, to launch a new mutual fund ("Investment Company B") and a new investment adviser ("Adviser A").

10. In February 2013, the CCO presented his 2012 annual compliance review to Pennant's Board of Directors, including Elste. Although the CCO stated that executive management at Pennant had demonstrated its commitment to the compliance culture by the creation of a dedicated CCO position and the hiring of a Chief Legal Officer at the Holding Company, he identified several weaknesses in Pennant's compliance program, including, but not limited to, compliance program testing and training. The CCO also noted his limited experience, which necessitated his reliance on outside resources, and that he expected this need to increase in 2013 because of the additional demands placed on him. He closed by noting:

In my professional opinion, there is a risk that a compliance issue may go unnoticed due to limited resources available for testing and auditing of the numerous areas of the firm's compliance program. In 2012, I urged the firm's executive management to add a position for a compliance officer to the staff of Pennant to focus on compliance program testing, training and other issues. I will continue to suggest this in 2013.

Despite these warnings, Pennant did not hire additional compliance resources in 2013.

11. On multiple occasions during 2013, Elste denied requests from the CCO and President A for additional resources.

12. By the end of 2013, the CCO had compliance responsibilities for four registered entities: Pennant, Investment Company A, Investment Company B and Adviser A.

13. In October 2013, Pennant hired a new President and COO ("President B") to replace President A and Elste as CIO. The CCO reported to President B and the Chief Legal Officer of the Holding Company, who reported to Elste. Soon thereafter, President B also asked Elste for more compliance resources for 2014. While Elste and the Holding Company management approved the hiring of new business staff at Pennant for 2014, they did not approve additional resources for compliance at that time.

14. On January 28, 2014, the CCO presented his 2013 annual compliance review to Pennant's Board of Directors, including Elste. This review stated that in 2013 the CCO was involved in the day-to-day administration of Pennant's operations and two other affiliated entities (Investment Company A and Investment Company B), led the reorganization of two mutual funds, reorganized a short-term investment fund, and worked on aspects of operational system conversions, among other responsibilities. The report noted that since the last review, the CCO assumed responsibility for compliance oversight of three other entities (Investment Company A, Investment Company B and Adviser A) in addition to his role as Pennant's CCO. Consequently, the report noted that, "[s]ince the [compliance] program was recently updated, and because of limited resources and increased demands on my time, the review of Pennant's compliance program was not as in-depth in 2013 as it was in 2012."

15. As in the 2012 report, the CCO's 2013 report reiterated his concerns about the risk resulting from insufficient resources:

As stated in the Annual Review for 2012, there is a risk that a compliance issue may go unnoticed due to limited resources available for testing and auditing of the numerous areas of the firm's compliance program.

The CCO further explained that while 2013 was a year of transition for Pennant, his understanding was that there were plans in place to strengthen Pennant's compliance functions. The CCO also detailed the compliance actions that Pennant planned to take in 2014, including hiring another business person to allow a current staff member to focus on compliance related projects; and the engagement of an outside compliance consultant. At this time, however, no money was budgeted for additional compliance resources.

16. In February 2014, the CCO raised the need for additional compliance resources with the trustees of Investment Company A and Investment Company B. The independent trustees raised the issue with Elste. In June 2014, Pennant hired a compliance analyst, and in July 2014, Pennant engaged an outside compliance consultant to evaluate its compliance program.

#### *Pennant's compliance failures*

17. The denial of resources undermined the effectiveness of Pennant's compliance program resulting in compliance failures.

18. For example, Pennant did not regularly monitor staff e-mails as required by its written policies and procedures. As a result, Pennant failed to detect that one of its employees had repeatedly engaged in unauthorized activities, including violating Pennant's gift reporting policy.

19. Pennant also failed to test whether its staff was following its policies and procedures. For example, in April 2013, Pennant disclosed in its Form ADV Part 2A that it had implemented a new policy requiring allocation of investment opportunities in repurchase

agreement facilities to clients on a strict first come, first serve basis. Due to the scope of his duties and lack of resources, the CCO was unable to test compliance with this procedure.

20. The CCO learned in January 2014 that: (i) the employee responsible for Repo allocation likely was not following the allocation policy, and therefore certain clients may have received preferential treatment; and (ii) Pennant was not maintaining records formally documenting Repo client indications of interest and the basis for allocation decisions.

21. Further, Pennant's most significant line of business was its Repo program, which offered investment advisory clients the opportunity to purchase pro rata shares in nine facilities containing portions of loans intended to be guaranteed by either the SBA or USDA, backed by the full faith and credit of the federal government. Each facility contained loans sourced exclusively from any one of four counterparties. By the end of 2013, clients had invested a total of almost \$800 million in the program based on Pennant's advice.

22. As part of Pennant's ongoing due diligence of counterparties, the Repo agreements required counterparties to provide Pennant with quarterly unaudited and annual audited financial statements.

23. From 2012 through 2014, Pennant had a process, developed by Elste, for performing counterparty initial and ongoing due diligence and monitoring in its Repo program, which included a written checklist setting forth the information that would be obtained from prospective counterparties during initial due diligence. However, Pennant did not have a process in its written policies and procedures regarding initial and ongoing counterparty due diligence and monitoring.

24. Pennant's CCO stated that counterparty risk was a significant risk to Pennant in his 2012 and 2013 annual risk assessments, which he escalated to Elste and the Board of Directors.

25. In April 2013, after the CCO provided the risk assessment raising this concern, Elste contacted an officer at an affiliated entity to inquire if this individual would be willing to manage repo counterparty activities for Pennant. Elste's inquiry included advising this individual that he would be involved in developing the repo counterparty due diligence practices into a "process that requires absolute adherence." This did not occur, and Elste did not engage in any other efforts to amend Pennant's written policies and procedures to include counterparty due diligence and monitoring.

26. Elste was in a position to direct that Pennant's written policies and procedures be updated and amended to include Pennant's counterparty due diligence process and monitoring, but this did not occur.

*Subsequent compliance efforts by Pennant*

27. In June and July 2014, Pennant hired a full-time compliance analyst to report directly to and support Pennant's CCO, and engaged an outside compliance consultant to conduct a gap analysis of the firm's regulatory compliance program.

28. As a result of the conduct described above, Elste willfully aided and abetted, and caused Pennant's violations of Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder, which require a registered investment adviser to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and its rules, and to review, no less frequently than annually, the adequacy of the policies and procedures and the effectiveness of their implementation.

**IV.**

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

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

A. Respondent Elste 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 Elste is censured.

C. Respondent shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of \$45,000.00 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to the Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. §3717.

D. 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 Mark Elste 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 Paul A. Montoya, Division of Enforcement, Securities and Exchange Commission, 175 West Jackson Blvd., Suite 1450, Chicago, IL, 60604.

E. 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, he shall not argue that he is entitled to, nor shall he 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 he 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.

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, and further, any debt for disgorgement, prejudgment interest, civil penalty or other amounts due by Respondent 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 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.

Brent J. Fields  
Secretary