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SEC Charges Investment Advisor for Misleading Disclosures About Its Work With Short Publishers

WRITTEN BY

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On June 11, the Securities and Exchange Commission (SEC) announced the first settled case in its ongoing review of collaborations between investment advisors and short publishers. The SEC fined affiliated investment advisors Anson Funds Management and Anson Advisors, Inc. (collectively, Anson) for failing to disclose their partnership with unnamed activist short publishers.

Activist short publishers employ trading strategies similar to those used by traditional short sellers. A key (and often controversial) distinction is that they also publicly disclose negative reports about the company to exert downward pressure on its stock price. This approach aims to expose perceived overvaluations or corporate misconduct, thereby accelerating the stock's decline.

Anson maintained various formal and informal research exchange agreements with short publishers and timed securities trades with the release of negative reports on independent social media sites operated by these short publishers. Under formal consulting agreements, Anson received early access to short publishers' reports in exchange for a percentage of its trading profits during a specified period around the report's release. Profits were often secured through the targeted security's post-publication decrease in value. The SEC specified one transaction involving a short publisher's payment of approximately $1 million from a cumulative $4.3 million in trading profits involving the targeted security.

The SEC specified two cannabis companies, India Globalization Capital and Namaste Technologies, as examples of targeted securities. Both companies were the subject of reports by Citron Research during the period immediately preceding Anson's short sale activity. The owner of Citron Research, Andrew Left, had previously been the subject of an unrelated Department of Justice investigation.

Anson also distributed a private placement memorandum (PPM) to investors that mentioned a short position investment strategy. However, the PPM omitted details of the collaborations with activist short publishers to time trades around report publications. It further failed to disclose payments to these short publishers, as well as the source of these payments being the fund's general trading profits. These omissions breached Anson's own written policy to "clearly articulate" risks associated with the trading strategy, which is a further violation of the Investment Advisors Act compliance rule.[i]

The SEC charged Anson with:

1) Failing to clearly articulate the short publisher strategy and its associated risks in a private placement memorandum to investors;

2) Omitting a $1 million payment from its trade profits to the short publisher;

3) Concealing payments to the short publisher through third-party intermediaries;

4) Mischaracterizing trading profit payments as unperformed "research services" and

5) Making corresponding omissions, misrepresentations, and fraudulent entries in recordkeeping documents.

Without admitting or denying the SEC's findings, Anson agreed to settle for a combined $2.25 million in civil penalties, a cease-and-desist order, and SEC censure.

The SEC has not explicitly stated whether incorporating activist short publishers into an investment advisor's trading strategy is prohibited. However, the enforcement action against Anson is a reminder that investment advisors must ensure transparency in their trading strategies and practices. Specifically, investment advisers must keep accurate books and records,[ii] and refrain from fraudulent, deceptive, or manipulative acts.[iii]

In October 2023, the SEC adopted a new Rule 13f-2 under the Securities Exchange Act of 1934, which requires institutional investment managers who meet certain thresholds to confidentially report short position data on Form SHO.[iv] Given the SEC's broader focus on enforcing heightened transparency in marketing, internal recordkeeping, and reporting obligations to regulators, the Anson settlement highlights the importance of accurate disclosures to investors. It also highlights the potential for further charges based on "misconduct that prevents effective oversight of the securities industry."

Transparency in investor communications is key to avoiding fraud, misrepresentation, and omission charges. Firms should also consider updating their compliance policies and procedures to include protocols for collaborations with short publishers and ensuring annual reviews.

If you have any questions, comments, or concerns regarding collaborations with activist short publishers or transparency in disclosures to investors, our Securities Investigations + Enforcement attorneys are available to guide you through these issues and evaluate the best strategy for your business.

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[i] *See* 17 C.F.R. § 275.206(4)7a.

[ii] *See* 15 U.S.C. § 80b-4; *see also* 17 C.F.R. § 275.204-2.

[iii] *See* 15 U.S.C. § 80b-6' *see also* 17 C.F.R. § 275.206(4)7-8.

[iv] *See* 17 C.F.R. § 240.13f-2.

Nam Kim, a 2024 summer associate with Troutman Pepper and not admitted to practice law in any jurisdiction, also contributed to this article.

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