SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES ACT OF 1933
Release No. 10420 / September 28, 2017

ADMINISTRATIVE PROCEEDING
File No. 3-16594

In the Matter of

EQUITY TRUST COMPANY

OPINION OF THE COMMISSION

CEASE AND DESIST PROCEEDING

Custodian of self-directed individual retirement accounts was charged with being a cause of third parties' primary violations of Securities Act Sections 17(a)(2) and 17(a)(3). *Held*, proceeding is dismissed because the record does not support a finding of liability.

APPEARANCES:

Howard M. Groedel, Ulmer & Berne LLP, and *Stephen J. Crimmins* and *Brian M. Walsh*, Murphy & McGonigle PC, for Equity Trust Company

David Stoelting and *Andrew Dean* for the Division of Enforcement

Appeal filed: July 18, 2016
Cross-appeal filed: July 28, 2016
Last brief received: November 14, 2016

The Division of Enforcement appeals the initial decision of an administrative law judge dismissing this proceeding against Respondent Equity Trust Company ("ETC"). ETC, a custodian of self-directed individual retirement accounts ("SDIRAs"), processed investments for clients who invested with two issuers who were later convicted of fraud. On June 16, 2015, we instituted proceedings charging ETC with secondary liability under Section 8A of the Securities Act of 1933[1] for having been a cause of the issuers' violations of the securities laws. The law judge dismissed the charges on the ground that the Division established only two of the three elements of liability under Section 8A. In its appeal, the Division's primary contention is that, contrary to the law judge's finding, it established the element that ETC knew or should have

[1] *See* 15 U.S.C. § 77h-1.

known that its conduct would contribute to the issuers' violations. We base our findings on an independent review of the record.

Our staff has explained that SDIRA custodians "generally do not evaluate the quality or legitimacy of any investment in the [SDIRA] or its promoters" and "most custodial agreements between a [SDIRA] custodian and an investor explicitly state that the [SDIRA] custodian has no responsibility for investment performance."[2] And while "[m]ost IRA custodians are banks and broker-dealers that limit the holdings in IRA accounts to firm-approved stocks, bonds, mutual funds and CDs," SDIRA custodians "may allow investors to invest . . . in an array of private investment opportunities that are not [otherwise] available through other IRA providers" and that "may have unique risks."[3] As a result, the staff has "warn[ed] investors of the potential risks associated with" SDIRAs.[4] We share the staff's view that "investors should be mindful of potential fraudulent schemes when considering a self-directed IRA."[5] Indeed, this proceeding demonstrates the risks of investing through SDIRAs; ETC's clients invested with promoters of promissory notes who were perpetrating Ponzi schemes, and lost most of their investments. The promoters were prosecuted for their frauds and are now incarcerated.[6]

Nonetheless, the record does not establish that ETC is liable as a cause of the fraudsters' primary violations. The Division has not carried its burden of proving by a preponderance of the evidence that ETC knew or should have known that its conduct would contribute to the promoters' frauds. The Division did not establish that ETC knew of the frauds or that it failed to exercise the standard of care that a reasonably prudent passive custodian of SDIRAs would have exercised. Nor did the Division establish that ETC was subject to duties to its clients beyond those of a passive SDIRA custodian. We do not reach this conclusion solely because ETC disclaimed a duty to investigate the legitimacy of its clients' investments in their custodial agreements. An SDIRA custodian, like any person or entity not registered with the Commission,

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[2] SEC Office of Investor Education and Advocacy, *Investor Alert: Self-Directed IRAs and the Risk of Fraud* at *1(Sept. 2011), https://www.sec.gov/investor/alerts/sdira.pdf.

[3] *Id.*

[4] *Id*.

[5] *Id.*

[6] *See United States v. Taylor*, No. 1-14-cr-217 (N.D. Ga. Mar. 24, 2015), ECF No. 65 (judgment and sentence), *appeal pending as to denial of motion to reduce sentence*, No. 16-14819-F (11th Cir. June 30, 2016); *United States v. Poulson*, No. 14-cr-309 (D.N.J. Jan. 22, 2016), ECF No. 27 (judgment and sentence), *aff'd in part as to sentence*, *United States v. Poulson*, --- F.3d ---, 2017 WL 4052256 (3d Cir. Sept. 14, 2017) (affirming sentence enhancement but remanding for the district court to correct sentence as to terms of supervised release).

may become subject to heightened duties by virtue of its conduct.[7] Rather, we find that the Division did not establish that ETC's actions in this case subjected it to any such duties. Accordingly, we dismiss the proceeding against ETC.[8]

I. Background

ETC is a state-chartered non-depository trust company regulated by the South Dakota Division of Banking with its principal place of business in Ohio.[9] South Dakota law authorizes trust companies to act as asset custodians, but does not specify the relevant duties of a non-depository trust company that acts as an asset custodian other than authorizing it to "take and hold property on deposit for safekeeping."[10] ETC's supervision by the South Dakota Division of Banking qualifies it to be an asset custodian for individual retirement accounts ("IRAs") under Section 408 of the Internal Revenue Code.[11] Traditional IRAs are funded with pre-tax contributions, and gains and income are not taxed until distributed.[12] IRA custodians hold title to assets for the beneficiary, carry out investment instructions, and make timely reports to the IRS.

ETC is a custodian for SDIRAs—individual retirement accounts that permit investments in assets such as promissory notes, real estate, and precious metals. ETC has at least 130,000 clients with at least $13 billion in assets under custody. The record reflects that the Commission does not regulate non-registrant SDIRA custodians, and ETC is not registered with the Commission in any capacity.[13]

Both parties called expert witnesses to opine on the statutory duties of SDIRA custodians under state and federal law. Although both of the Division's expert witnesses testified that an SDIRA custodian is subject to various duties under federal and state law, neither testified that an SDIRA custodian is ordinarily subject to the fiduciary duties of an investment adviser to his client or the duties of a broker to his customer. ETC's expert witness testified that an SDIRA

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[7] *See, e.g., Conrad P. Seghers*, Advisers Act Release No. 2656, 2007 WL 2790633, at *1, 7 (Sept. 26, 2007) (explaining that acting as an "unregistered investment adviser" placed the respondent into "a fiduciary role"), *petition denied*, 548 F.3d 129 (D.C. Cir. 2008).

[8] Our disposition moots ETC's cross-appeal.

[9] "ETC" refers to Equity Trust Company as well as affiliates that handle other operations such as sales and marketing.

[10] S.D. Codified Laws § 51A-6A-29(1) (specifying that a trust company's powers include acting as a custodian).

[11] *See* 26 U.S.C. § 408(a)(2), (n)(3).

[12] *See* 26 U.S.C. § 408(d)(1), (e)(1).

[13] Although some SDIRA custodians apparently may also serve in dual capacities as investment advisers, broker-dealers, transfer agents, or other entities regulated by the Commission, they need not serve in these dual capacities, and it is undisputed that ETC does not.

custodian would have no duty to investigate the merits or suitability of an investment unless such duties were specifically created by a custodial agreement.

ETC's client agreements stated that clients were solely responsible for investment decisions and that ETC was a passive custodian, was not a fiduciary, and had no duties or responsibilities with respect to selecting or monitoring the investments:

> We are acting solely as a passive custodian to hold IRA assets and we have no discretion to direct any investment in your IRA. Accordingly, we are not a fiduciary . . . . **It is not our responsibility to review the prudence, merits, viability or suitability of any investment directed by you . . . or to determine whether the investment is acceptable under ERISA, the Internal Revenue Code, or any other applicable law. We do not offer investment advice, nor do we endorse any investment, investment product . . . investment advisor, representative, broker, or other party selected by you. . . .**
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> It is your responsibility to perform proper due diligence with regard to any such representative, investment advisor, broker, or other party. . . .
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> **We shall be under no obligation or duty to investigate, analyze, monitor, verify title to, or otherwise evaluate or perform due diligence for any investment directed by you . . . .**
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> Any review performed by us with respect to an investment shall be solely for our own purposes of determining compliance with our internal policies, practices and standards . . . and the administrative feasibility of the investment and neither such review nor its acceptance should be construed in any way as an endorsement of any investment . . . We have no duty or obligation to notify you with respect to any information, knowledge, irregularities, or our concerns relating to your investment or your investment advisor, broker, agent, promoter or representative.
>
> You authorize and direct us to execute and deliver, on behalf of your IRA, any and all documents delivered to us in connection with your IRA investments; and we shall have no responsibility to verify or determine that any such documents are complete, accurate or constitute the documents necessary to comply with your investment direction.

ETC's direction of investment ("DOI") forms, which clients used to direct ETC to make a particular investment, contained similar language:

> Equity Trust Company (Custodian) does not offer any investment advice, nor does it endorse any investment . . . any financial advisor, representative, broker or other party. . . . It is my own responsibility to perform proper due diligence with respect to any such representative . . . . Any review performed by Custodian with respect to investment shall be solely for Custodian's own purpose of determining the administrative feasibility of the investment and in no way should be construed

> as an endorsement of any investment, investment company, or investment strategy. . . .
>
> Neither Custodian nor any employee or agent of Custodian has selected or recommended any investment for me . . .
>
> Custodian is acting solely as a passive custodian to hold Retirement Account assets and in no other capacity. . . .
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> Custodian shall be under no obligation or duty to investigate, analyze, monitor, verify title to or otherwise evaluate any investment . . .
>
> It is not the responsibility of the Custodian to review the prudence, merits, viability or suitability or any investment made by me . . .
>
> Custodian shall have no duty or obligation to notify the undersigned with respect to any information, knowledge, or irregularities or concerns of Custodian relating to any investment or my financial advisor, broker, agent, promoter or representative, except as to civil pleadings or court orders received by custodian. . . .
>
> Custodian's responsibilities and duties shall be limited to those expressly provided herein and under the Custodian's IRA Adoption Agreement. . . .
>
> **My Retirement Account is self-directed and I, alone, am responsible for the selection, due diligence, management, review and retention of all investments in my account. I agree that the Custodian is not a "fiduciary" for my account, as said term is defined in the Internal Revenue Code, ERISA, or any other applicable federal, state, or local laws. I hereby direct the custodian, in a passive capacity, to enact this transaction for my account, in accordance with my adoption agreement.**

ETC charged clients an annual maintenance fee based on the value of assets in the account; most clients paid between $300 to $400. ETC's CEO testified that ETC could not charge such low fees if it was required to do extensive due diligence on hard-to-value assets. Notwithstanding ETC's fee structure, as well as the clear and repeated disclaimers in ETC's client agreements and DOI forms, the Division alleges that ETC is liable for being a cause of the securities law violations of the promoters of two investments in which its clients invested.

A. Promotor Ephren Taylor

Ephren Taylor was a nationally prominent entrepreneur, speaker, and author as well as the Chief Executive Officer, chairman of the board, and majority shareholder of City Capital Corp., a publicly traded company that held itself out as helping incubate "socially conscious"

urban businesses.[14] To finance the business Taylor issued, through City Capital and other Taylor-controlled affiliates, short-term debt evidenced by promissory notes paying 10-20% interest in 9-month to 3-year terms. Taylor and his agents represented, during meetings and pitch phone calls with prospective investors, that the promissory notes were secured and that City Capital would use the funds to acquire real estate or businesses.

1. Taylor and ETC

Taylor attracted investors by hosting events around the country to promote socially conscious investment. He held events at churches, real estate seminars, and other venues, and appeared in infomercials and on broadcast shows. He was on a panel at the 2008 Democratic National Convention and at other significant events involving nationally prominent public figures. Although Taylor spoke at his events about entrepreneurship and building wealth, he also "disparage[d] whatever [the audience] was [already] investing in"—such as mutual funds, which he claimed could expose investors to adult-oriented businesses. He instead encouraged attendees to invest through SDIRAs.

Taylor worked with several SDIRA custodians, but he preferred ETC because it had the shortest delay in processing new investors' accounts before funds were released to City Capital. When attendees later sought alternative investments through SDIRAs, Taylor and City Capital assessed whether potential investors were eligible to open accounts at ETC, pitched investment opportunities, and provided them with pre-filled ETC account paperwork.

Taylor worked closely with ETC sales representative Robert Batt. ETC trained its employees, including Batt, on IRA eligibility requirements, and told them that ETC was a passive custodian and that they could not give investment advice or endorse any investment. Batt also provided training to City Capital employees about SDIRAs. Batt and Taylor spoke often but met only once, when Batt attended a pair of Taylor's events at a church outside Atlanta, Georgia, which around 7,000 congregants attended. Several prospective investors in attendance ultimately opened ETC accounts to invest in City Capital notes. In total, from April 2008 through December 2009, 81 ETC clients made 94 investments in Taylor notes, for a total of $5.3 million.

2. ETC's review of Taylor's notes

ETC's regulator, the South Dakota Division of Banking, conducted several examinations of ETC that covered the period 2009 to 2011 at issue here. Its examination reports concluded that "[o]verall risk management practices are satisfactory relative to the institution's size and complexity." These reports also contained recommendations for improving ETC's audit and review procedures, and the examiner who conducted the examinations testified that these procedures improved with each subsequent examination. In 2009, as a result of one such

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[14] We take official notice of City Capital's Forms 10-K and other filings with the Commission. *See* 17 C.F.R. § 201.323.

recommendation, ETC began to review investments from "some of [its] bigger [issuer] relationships" for its own risk-management purposes. ETC officials offered unrebutted testimony that, to their knowledge, no other SDIRA custodian performed such reviews.

ETC reviewed City Capital in one of its first reviews of client investments. ETC staff checked online to see whether Taylor was involved in litigation, had been accused of securities violations, or had otherwise been in the news. The researchers found no cause for concern. Indeed, Taylor's reputation in the marketplace was confirmed by several positive media articles.

Nonetheless, the review concluded, by at least October 2009, that some notes that were supposedly secured were either unsecured or were missing documents evidencing that they were secured. This had not prevented ETC from processing the investments because ETC's internal procedures provided that it could "accept notes secured by [City Capital] with the promissory note only. No security agreement is necessary." When ETC's compliance staff learned in January 2010 that in fact none of the notes was secured, it updated its records and changed the notes' designation from "secured" to "unsecured" on quarterly account statements sent to some clients. ETC also learned that some notes had matured but remained unpaid. City Capital told ETC that most of these notes had been extended to benefit from compound interest.

Citing the unpaid mature notes and City Capital's worsening financial condition, ETC put City Capital notes on "administrative hold" in December 2009, requiring supervisor override for new investments. In January 2010, ETC placed City Capital notes on a "do not process" list, describing the investments as "administratively not feasible" to process. Although ETC stopped processing any new City Capital investments after this date, ETC continued to process existing investors' requests to extend, renew, or convert 18 overdue notes from February 2010 onward. According to ETC's written policy and the unrebutted testimony of ETC officials, ETC did so because otherwise such notes would be distributed in kind to the client, who could face adverse tax consequences from an early IRA distribution.

City Capital and its affiliates were in reality a Ponzi scheme. They used investors' funds not to acquire real estate or businesses but for Taylor's personal expenses; City Capital's own marketing, overhead, and payroll; and repaying old investors. Taylor had also misrepresented the notes as secured. Taylor was eventually convicted of conspiracy to commit wire fraud and is now incarcerated. ETC's clients experienced almost a total loss of their investments.

B. Promoter Randy Poulson

1. Poulson and ETC

Randy Poulson bought and sold distressed residential real estate—flipping houses or entering into sale-leaseback arrangements with options to repurchase. He also held seminars on how to invest in real estate. Poulson financed his house-flipping business by selling promissory notes through Equity Capital Investments, LLC, and represented that he would use the funds to purchase, improve, and carry the costs of the real estate.

ETC and Poulson partnered on marketing and educational initiatives. Poulson worked closely with ETC sales representative Irene Berlovan, and was an important source of new-account referrals for her. Berlovan and another ETC employee attended an educational event Poulson hosted in April 2009, at which they spoke about SDIRAs. ETC sponsored other dinner events hosted by Poulson, at which ETC generated new client leads and sold its own educational recordings. ETC also solicited Poulson's sponsorship and presence at ETC's own events. From January 2007 to May 2011, 34 ETC clients invested $984,998 in 41 of Poulson's notes.

2. ETC's review of Poulson's notes

ETC conducted a review of Poulson notes in mid-2010 and learned that at least twenty-five notes had missing paperwork. Several months later, a compliance manager exchanged a series of emails with Poulson asking for the missing documents. Poulson did not have the missing documents and said that he had to "recreate some of the documents from scratch." He delayed sending the documents, but ultimately sent "promissory notes and extensions of promissory notes," and possibly "a couple" of recorded mortgages, to ETC in late January 2011.

Despite Poulson's delay in sending in the paperwork, ETC continued to actively solicit referrals from him. ETC processed its last new Poulson investment in May 2011. ETC conducted another review of Poulson notes in July 2011 and realized that Poulson had not provided all the missing documents he had promised. The reviewers recommended in September 2011 that Poulson's notes be placed on a "hold" list because of the document deficiencies and multiple mature but unpaid notes. ETC put Poulson on the hold list in November, and several weeks later ETC received a subpoena from the U.S. Attorney's Office about Poulson. Other than an extension of Poulson notes for an existing investor in January 2012, ETC did not accept new investments or process extensions of Poulson notes between May 2011 and October 2012, when ETC put Poulson on the "Do Not Process" list.

Poulson turned out to be running a Ponzi scheme. He diverted funds for personal use, and as his business failed during the financial crisis, he began repaying earlier investors with later investors' money. His representation that the notes would be secured by mortgages also turned out to be false as he failed to record several mortgages; he also failed to disclose multiple unrecorded mortgages that sometimes far exceeded the properties' values. Unbeknownst to ETC, he also forged and fraudulently backdated the promissory notes and extension documents that he provided in response to ETC's request for missing documentation. Poulson was later convicted of mail fraud and is now incarcerated. Out of the $984,998 that ETC clients invested in the 41 notes, Poulson repaid only $341,513, with a complete loss on 33 notes.

C. The proceedings below

On June 16, 2015, we issued an order instituting proceedings alleging that ETC was liable under Securities Act Section 8A as a cause of Taylor's and Poulson's primary violations of Securities Act Sections 17(a)(2) and (a)(3). The initial decision found primary violations by Taylor and Poulson. It also found that an act or omission by ETC was a cause of those violations: ETC's "services to its customers facilitated the receipt and retention of investor funds

by the fraudsters, making their frauds successful." But the initial decision dismissed the proceeding after finding that the Division failed to establish that ETC knew or should have known that its conduct would contribute to the primary violations. This appeal followed.

II. ANALYSIS

Securities Act Section 8A authorizes us to impose a cease-and-desist order and other sanctions upon "any person" who is violating the securities laws, as well as "any other person that is, was or would be a cause of the violation, due to an act or omission the person knew or should have known would contribute to such violation."[15] Liability for being a cause of a violation requires: (1) a primary violation; (2) that the respondent engaged in an act or omission that contributed to the violation; and (3) that the respondent knew, or should have known, that his or her conduct would contribute to the violation.[16]

The Division argues both that ETC knew of the primary violations, and that, even if ETC did not know of the primary violations and that its conduct would contribute to them, ETC "should have known." Section 8A's extension of liability to one who "'should have known'" that his or her conduct would contribute to the violations is "classic negligence language."[17] Negligence is the failure to exercise the standard of care that a reasonably prudent person would have exercised under the circumstances.[18]

We dismiss this proceeding because the Division did not establish by a preponderance of the evidence that ETC knew or should have known that its conduct would contribute to Taylor's and Poulson's violations.[19] There is no evidence that ETC knew that Taylor or Poulson were perpetrating Ponzi schemes. In addition, the record does not support a finding that ETC should have known that its conduct would contribute to Taylor's and Poulson's violations, because the Division has not shown that ETC, by not investigating purported red flags of which it was aware,

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15 15 U.S.C. § 77h-1(a) (emphasis added).

16 *Moshe Marc Cohen*, Exchange Act Release No. 78797, 2016 WL 4727517, at *9 (Sept. 9, 2016).

17 *KPMG, LLP v. SEC*, 289 F.3d 109, 120 (D.C. Cir. 2002) (holding that the "should have known" element of causing liability in Exchange Act Section 21C embodied a negligence standard); *see also Howard v. SEC*, 376 F.3d 1136, 1141 (D.C. Cir. 2004) (discussing *KPMG*).

18 *See, e.g., Schulz v. Penn. R.R. Co.*, 350 U.S. 523, 525 (1956) ("[N]egligence consists of doing that which a person of reasonable prudence would not have done, or of failing to do that which a person of reasonable prudence would have done under like circumstances."); *Gregory M. Dearlove*, Exchange Act Release No. 57244, 2008 WL 281105, at *31 (Jan. 31, 2008) ("Negligence is the failure to exercise reasonable care."); *cf.* Restatement (Third) of Torts § 3 (2016 update).

19 *See Steadman v. SEC*, 450 U.S. 91, 96 (1981) (preponderance of the evidence standard applies in Commission administrative proceedings).

failed to exercise the standard of care that a reasonably prudent passive custodian of SDIRAs would have exercised.

Nor do we find that the Division established that ETC was subject to heightened duties beyond those of a passive SDIRA custodian. As discussed above, a person or entity not registered with the Commission may be deemed to be subject to the heightened duties by virtue of their conduct. The existence and nature of a heightened duty of care will depend upon the facts and circumstances of each case. Here, ETC was not charged with acting as an unregistered investment adviser or unregistered broker, and the Division has not argued that ETC's conduct caused it to meet the definition of a broker or investment adviser. The Division also has not established that heightened duties apply to an SDIRA custodian that acts more than passively but not as an unregistered investment adviser or broker. Ultimately, the Division has not alleged and proved that ETC's conduct subjected it to the duties of a registered entity, or otherwise identified the legal basis for subjecting SDIRA custodians to heightened duties.

For these reasons, we dismiss this proceeding.

An appropriate order will issue.[20]

By the Commission (Chairman CLAYTON and Commissioners STEIN and PIWOWAR).

Brent J. Fields
Secretary

[20] We have considered all of the parties' contentions. We have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed in this opinion.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 10420 / September 28, 2017

ADMINISTRATIVE PROCEEDING
File No. 3-16594

In the Matter of

EQUITY TRUST COMPANY

ORDER DISMISSING PROCEEDINGS

On the basis of the Commission's opinion issued this day, it is

ORDERED that the proceedings instituted on June 16, 2015 against Equity Trust Company be, and hereby are, dismissed.

By the Commission.

Brent J. Fields
Secretary