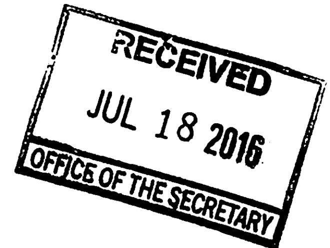
UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-16594



In the Matter of

EQUITY TRUST COMPANY,

Respondent.

PETITION FOR REVIEW OF THE DIVISION OF ENFORCEMENT

Pursuant to Rule of Practice 410(b), the Division of Enforcement respectfully petitions the Commission for review of the Initial Decision dated June 27, 2016 ("ID"), rendered by Administrative Law Judge Carol Fox Foelak. The Division seeks review of the findings and conclusions that Respondent Equity Trust Company ("Equity Trust") did not, under Section 8A of the Securities Act of 1933, cause violations by two investment sponsors, Ephren Taylor ("Taylor") and Randy Poulson ("Poulson").

PRELIMINARY STATEMENT

A custodian of Individual Retirement Accounts (IRAs) is expected to comply with a handful of basic duties: take custody of the customers' account documentation; avoid endorsing investments or investment sponsors; avoid conflicts of interests; and respond reasonably to red flags.[1] As the evidence proved, Equity Trust failed to fulfill these duties. Instead of operating as a passive custodian acting exclusively in its customers' interests, Equity Trust functioned as a

[1] Section 408(a) of the Internal Revenue Code defines "individual retirement account" as "a trust created or organized in the United States for the exclusive benefit of an individual or his beneficiaries[.]" 28 U.S.C. § 408(a). Equity Trust's trust company policy also required it to "administer accounts solely in the best interests of" account holders. Div. Ex. 49 at 11.

promotional and marketing juggernaut that urged investors to transfer retirement funds from relatively safe investments like mutual funds into highly risky investments – including Taylor and Poulson promissory notes – using self-directed IRAs. In doing so, Equity Trust processed millions of dollars in investments to Taylor and Poulson despite missing critical account documentation that it was required to custody. In short, although Equity Trust crossed the line and did not act as a passive custodian, the Initial Decision found otherwise and dismissed the causing claim. The Initial Decision was wrong and should be reversed.

The Initial Decision found that Equity Trust could not have known of any violations by Taylor or Poulson "unless [it] assumed the role of an investigator." ID at 32. Equity Trust, however, had actual knowledge of a critical element of Taylor's and Poulson's violations: the failure to secure the promissory notes. Equity Trust did not need to assume "the role of an investigator" because knowledge of the violations was in its own files.

In addition, the Initial Decision erroneously determined and applied the standard of care of an IRA custodian. Despite the admission into evidence of the report of the Division's expert witness, which Equity Trust consented to without objection, the Initial Decision erroneously chose as evidence of the standard of care two investor alerts issued by an SEC investor protection office and the North American Association of Securities Administrators (NASAA). These alerts, however, were intended to warn investors of the risks of investing in self-directed IRAs, and were not intended as evidence of the standard of care.

There are additional bases for reversal. The Initial Decision should have applied a heightened duty of care to Equity Trust given its promotion and endorsement of Taylor and Poulson, and it should have considered the significance of the red flags facing Equity Trust. The Initial Decision also erroneously required evidence that Equity Trust would have known of the

fraud. ID at 32. However, the "should have known" element of a causing claim is proven by establishing negligence; actual knowledge of fraud is not required. Finally, the Initial Decision made numerous factual findings that are unsupported by the evidence.

Nearly $100 billion in investor funds is held by self-directed IRA custodians. And as Equity Trust knew from its own experience, self-directed IRAs are a favorite vehicle for swindlers and fraudsters. Unless reversed, the Initial Decision will stand for the proposition that the conduct of Equity Trust, which was at least negligent and which endangered investor funds, is without consequences. As a result, the Commission should reverse the Initial Decision and impose appropriate sanctions.

THE INITIAL DECISION

Establishing liability for causing under Section 8A of the Securities Act requires proof: (1) of primary violations by Taylor and Poulson; (2) of acts or omissions by Equity Trust that were a cause of the violations; and (3) that Equity Trust knew or should have known that its conduct would contribute to the primary violations. ID at 30. Only negligence is needed to prove causing liability because the primary violations are nonscienter.

The Initial Decision first found that Taylor and Poulson committed the nonscienter primary violations through a "course of business that operated as a fraud on the purchasers of [their] notes." ID at 31. These violations wiped out the retirement savings of approximately 100 individuals, many of whom were unsophisticated investors, who invested through Equity Trust accounts. As for the second element, the Initial Decision found that Equity Trust's "account-opening, investment processing, record-keeping, and marketing activities" constituted acts or omissions by Equity Trust that were a cause of these violations. ID at 32. However, the third

element – that Equity Trust knew or should have known that its conduct would contribute to the primary violations – was found by the Initial Decision to be "unproven." ID at 32.

SUMMARY OF GROUNDS FOR REVIEW[2]

1. The Initial Decision Erroneously Found that Equity Trust Did Not Know or Should Not Have Known of the Primary Violations

The Initial Decision's finding that Equity Trust could not have known about the primary violations "unless [it] assumed the role of investigator," ID at 32, is contradicted by the evidence. In fact, Equity Trust had actual knowledge of a key element of the Taylor and Poulson frauds: the marketing and sale of the promissory notes as secured.

The Initial Decision correctly found that Taylor and Poulson each violated Sections 17(a)(2) and 17(a)(3) of the Securities Act through "a course of business that operated as a fraud on the purchasers of [their] notes." ID at 31. An essential element of their "course of business," and of their violations, was the failure to provide the security behind the note that was promised to investors.

Taylor represented to investors that his notes were secured when in fact they were unsecured. ID at 25. Poulson similarly represented to investors that his notes were secured by real property when they were not. ID at 27. In both instances, the security was illusory. Equity Trust, however, processed the Taylor and Poulson notes despite knowing of these deficiencies. The nonexistent security underlying the Taylor and Poulson notes was an essential element of the primary violations and of Taylor and Poulson's "course of business."

[2] Pursuant to Rule 410(b), the Division does not waive any ground for review based on the findings and conclusions in the Initial Decision that contradict the Division's pre-hearing and post-hearing proposed findings of fact and conclusions of law (including its reply brief). Nor does the Division waive any ground for review based on federal court or Commission decisions rendered after the filing of this Petition.

In a flawed conclusion, the Initial Decision held that the primary violations were both unknown and unknowable to Equity Trust. Equity Trust's own records, however, reveal Equity Trust's knowledge that a material element of the Poulson and Taylor investments – the existence of security – was absent. Equity Trust did not have to assume "the role of an investigator" to discover this fact, which was apparent from Equity Trust's own records. As a result, the "knew or should have known" element was proven.

2. The Initial Decision Erroneously Determined and Applied the Standard of Care of a Passive IRA Custodian

Rather than rely on the Division's undisputed evidence of the standard of care, the Initial Decision instead looked to two investor alerts that, by their own terms, were never intended to be representative of any standard of care. The errors regarding the standard of care were critical because the third causing element depends on whether Equity Trust acted negligently; in other words, whether it acted consistently with the standard of care.

During the hearing, there was little dispute between the parties as to the applicable standard of care. The Division's expert, William Ries, whose qualifications and conclusions were not challenged by Equity Trust, described the duties of a passive IRA custodian and testified that, consistent with Equity Trust's position, a "custodian's duties are typically determined by the terms of the custody agreement." Div. Ex. 39 at 8. Ries further testified that IRA custodians should remain passive; refrain from endorsing or promoting investments or investment strategies; take custody of documents evidencing the customers' intent; avoid conflicts of interest; adopt policies and procedures; and reasonably respond to red flags. Ries's conclusions were consistent with the testimony of Scott Kelly, an examiner from the South Dakota Division of Banking, Equity Trust's primary regulator. Tr. 1156-1200.

The Initial Decision, however, inexplicably stated that the Ries report was "essentially made up of whole cloth" and "did not address current industry practice but rather aspirational best practices." ID at 33 n.37; 36. To the contrary, Ries detailed the sources of his opinion – which included customer agreements, South Dakota law, the Internal Revenue Code, and other federal regulations – and testified as to the existing, as opposed to "aspirational," standard of care. Div. Ex. 39.

The Initial Decision then erred by adopting a standard of care derived from investor alerts issued by the SEC's Office of Investor Education and Advocacy (OIEA) and by NASAA. The Initial Decision incorrectly stated that the OIEA alert, which was designed to warn investors of the risk of fraud through self-directed IRAs, is a "statement of the Commission's view" of the standard of care. ID at 34. The alert, however, was released by OIEA, not the Commission, and a disclaimer to which the Initial Disclosure does not refer states that the release is "neither a legal interpretation nor a statement of SEC policy." Resp. Ex. 46 at 5. The Division also established at the hearing that the NASAA alert was not intended as an expression of the standard of care.[3] The Initial Decision's reliance on an incorrect standard of care to dismiss the action warrants reversal.

3. The Initial Decision Erroneously Failed to Subject Equity Trust to a Heightened Standard of Care

The evidence showed that Equity Trust, by endorsing and promoting Taylor and Poulson, among other things, did not conduct itself as a passive custodian. As a result, it should not be evaluated under the standard of care afforded to a passive custodian. Under this passive standard of care, which is also reflected in Equity Trust's customer agreements, Equity Trust assumed no

[3] The General Counsel of NASAA, Valerie Mirko, testified that the NASAA investor alert should not be considered as a statement of the standard of care, and was intended solely as a warning to investors of the risks of fraud associated with self-directed IRAs. Tr. 1833.

responsibility for customers' investment decisions but also committed to not endorse investments and to take custody of all account documents. As the Ries report found, "[i]f the custodian takes on duties and responsibilities that are outside the duties and responsibilities set forth in the custody agreement," then the custodian takes on a heightened standard of care. Div. Ex. 39 at 8. Thus, Equity Trust's active promotion and marketing of Taylor and Poulson, among other things, created a heightened duty on the part of Equity Trust, which included a heightened duty to respond to red flags.

4. The Initial Decision Erroneously Required Proof of Actual Knowledge of Fraud

The Initial Decision erroneously framed the causing inquiry as whether Equity Trust had actual knowledge of the fraud. ID at 32 (even if Equity Trust had behaved consistently with the standard of care, "it still would not have had knowledge of [the] fraud"). This is inconsistent with precedent that does not require proof that the party causing the violation would have had actual knowledge of fraud and elevates the level of proof required to demonstrate causing under Section 8A.

The phrase "knew or should have known" in Section 8A is "'classic negligence language,'" *KPMG, LLP v. SEC*, 289 F.3d 109, 120 (D.C. Cir. 2002), and "'negligence is sufficient to establish 'causing' liability...in cases in which a person is alleged to 'cause' a primary violation that does not require scienter.'" *Howard v. SEC*, 376 F.3d 1136, 1141 (D.C. Cir. 2004). As a result, the third causing element requires the Division to prove Equity Trust's negligence under the applicable standard of care. Proof that Equity Trust actually knew of the fraud, or would have known of the fraud, is not required.

5. The Initial Decision Erroneously Discounted the Importance of Red Flags and Found that Equity Trust Responded Reasonably

Equity Trust had actual knowledge of numerous red flags, including but not limited to Taylor's false representation that Equity Trust was his "personal banker" before thousands of potential investors at the New Birth Church event (ID at 14); the description of Taylor as "a crook" by a credible source (ID at 10); that Taylor marked his notes as "secured" on Equity Trust's Direction of Investment (DOI) form although no security agreement existed (ID at 25); that twenty-five out of twenty-five Poulson accounts were missing key documents (ID at 27; Div. Ex. 256 at 3); and that Taylor and Poulson failed to pay on almost all of the promissory notes (Div. Ex. 40 at 6-7, 33; Div. Ex. 41 at 3-4, 19).

These red flags should have alerted Equity Trust to the violations of Taylor and Poulson. At the very least, these red flags should have prompted Equity Trust to discontinue processing investments to Taylor and Poulson; instead, Equity Trust continued processing new investments.

6. The Initial Decision Contained Erroneous Factual Findings

The Initial Decision contains a number of erroneous findings of fact, including but not limited to the following. First, the Initial Decision found that "[Poulson and Taylor] promoted Equity Trust, not *vice versa*." ID at 35-36. This finding is contradicted by the Initial Decision itself, which found that an Equity Trust sales representative made a "recommendation to invest" to an Equity Trust customer, and that Equity Trust paid to sponsor one of Poulson's events. ID at 36, 20. The record contained other extensive evidence of promotion and endorsement.

Second, the Initial Decision stated that the Division's standard of care, if adopted, "would require custodians to charge much higher fees than did Equity Trust." ID at 34. There was no evidence, however, other than the testimony of Equity Trust management, that complying with the standard of care would increase fees.

Third, the Initial Decision stated that, other than Taylor and Poulson, "other fraudsters were only briefly addressed in the record." ID at 11 n.12. This ignores evidence – including Equity Trust's own "Do Not Process" list – which includes numerous criminals and wrongdoers who used Equity Trust as part of their schemes. Div. Ex. 578.

Fourth, the Initial Decision stated that, by creating a special "landing page" on the Equity Trust website for potential Taylor investors, Equity Trust "did not promote Taylor or City Capital." ID at 14. Taylor, though, regarded the landing page as promotional. Div. Ex. 36 at 19.

Fifth, the Initial Decision states that "no other SDIRA custodian was performing the level of review of customer accounts that Equity Trust pioneered." ID at 34. Equity Trust was not a "pioneer," however, and its South Dakota regulator testified that Equity Trust's compliance culture was "reactionary as opposed to proactive." Tr. 1193.

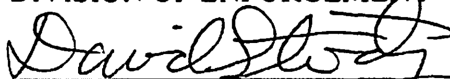
CONCLUSION

The Division of Enforcement respectfully requests that the Commission grant its Petition for Review.[4]

Dated: July 18, 2016
New York, NY

Respectfully submitted,

DIVISION OF ENFORCEMENT



David Stoelting (212.336.0174)
Andrew Dean (212.336.1314)
Luke Fitzgerald (212.336.0069)
Securities and Exchange Commission
200 Vesey Street, Suite 400
New York, NY 10281-1022
212.336.1323 (fax)

[4] If the Commission grants the Division's Petition for Review, and ultimately concludes that Equity Trust was a cause of the primary violations, the Commission should also impose appropriate sanctions and relief. At the hearing, the Division argued, in the event of a finding of liability, for a cease-and-desist order; disgorgement of fees received from the Taylor and Poulson accounts; a Second Tier or Third Tier penalty due to evidence that the conduct put investor funds at risk and recklessly disregarded regulatory requirements; the appointment of an independent compliance monitor for three years; and the creation of a Fair Fund.

CERTIFICATE OF SERVICE

I hereby certify that I served true copies by overnight courier and electronic mail of the foregoing Petition for Review of the Division of Enforcement on the following on the 18th day of July, 2016.

Brent J. Fields, Secretary (3 copies plus original)
Office of the Secretary
Securities and Exchange Commission
100 F Street N.E., Mail Stop 3628
Washington, DC 20549
Facsimile: (202) 772-9324

The Honorable Carol Fox Foelak (email only to alj@sec.gov)
Administrative Law Judge
U.S. Securities and Exchange Commission
100 F Street, NE
Mail Stop 1090
Washington, DC 20549

Stephen J. Crimmins, Esq. (email to Stephen.Crimmins@mmlawus.com and US Mail)
Murphy & McGonigle PC
555 13th Street NW
Washington DC 20004
(Counsel for Respondent)

Howard Groedel, Esq. (email to hgroedel@ulmer.com)
Ulmer & Berne LLP
Skylight Office Tower
1660 West 2nd Street, Suite 1100
Cleveland, OH 44113
(Counsel for Respondent)

Dated: July 18, 2016

Andrew Dean