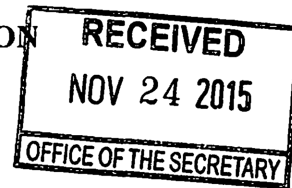
UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION



ADMINISTRATIVE PROCEEDING
File No. 3-16594

In the Matter of **EQUITY TRUST COMPANY,** **Respondent.**

PRE-HEARING BRIEF OF THE DIVISION OF ENFORCEMENT

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The Division of Enforcement respectfully submits this Pre-Hearing Brief.

PRELIMINARY STATEMENT

As a custodian of retirement funds held in Self-Directed Individual Retirement Accounts ("Self-Directed IRAs"), Respondent Equity Trust Company had a duty to comply with a straightforward standard of care. This standard of care, which Equity Trust recognized in its own custodial agreements and other customer materials, was not onerous: take custody of the asset as directed by the customer; ensure that the paperwork associated with the investment is submitted; safeguard the privacy of the customers' account information; and do not endorse issuers or investment promoters.

Equity Trust failed to meet this standard. Instead of remaining a passive custodian, Equity Trust embraced get-rich-quick promoters like Ephren Taylor and Randy Poulson as sources of customer referrals and fees. And rather than making sure investments were properly documented, Equity Trust allowed investments to be processed, and customer funds released to Taylor and Poulson, with missing documentation. Equity Trust also violated the privacy interests of its customers by routinely sharing confidential account information with Taylor and Poulson.

Equity Trust's deliberate disregard of its obligations had tragic results for its customers, who lost millions of dollars. Although Equity Trust had clear-cut information that the promissory notes sold by Taylor and Poulson were not what investors believed them to be – the security for dozens of investments was illusory, which Equity Trust knew but its customers did not – new investments were processed long after Equity Trust should have stopped.

The evidence will prove that Equity Trust was a cause of the violations by Taylor and Poulson of Sections 17(a)(2) and 17(a)(3) of the Securities Act of 1933. As a result, Equity Trust should be ordered to cease-and desist from causing future violations; disgorge all the fees it received

associated with the Taylor and Poulson accounts, with prejudgment interest; and pay a substantial second or third tier penalty. The Court should require Equity Trust to obtain an independent compliance monitor for a period of three years, and establish a Fair Fund for the benefit of Equity Trust's customers.

STATEMENT OF FACTS

Overview of Self-Directed IRAs

Self-Directed IRAs, like standard individual retirement accounts, provide favorable tax treatment for retirement funds. In a Self-Directed IRA, however, non-traditional investments such as promissory notes, real estate, and limited partnerships can be held. It is estimated that over $100 billion is currently held in Self-Directed IRAs.

The fact that non-traditional assets can be held in Self-Directed IRAs substantially increases their volatility and risk. In addition, Self-Directed IRAs have repeatedly been targeted by perpetrators of investment frauds, particularly frauds involving the issuance of unregistered promissory notes. As a recent SEC "Investor Alert" stated, there have been "numerous cases where a self-directed IRA was used in an attempt to lend credibility to a fraudulent scheme."

Equity Trust Company

Equity Trust is a privately held, family-run business with headquarters outside Cleveland, Ohio.[1] It was founded by Richard Desich Sr. ("Desich Sr.") in 2003. Along with his sons, Jeffrey Desich ("J. Desich") and Richard Desich, Jr. ("Desich Jr."), Desich Sr. has direct or indirect control over Equity Trust and its affiliated support entities.

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[1]Equity Trust and its affiliates, including Mid-Ohio Securities, were based in Elyria, Ohio prior to consolidating operations in Westlake, Ohio, in December 2013.

Equity Trust developed from the custodial business of a registered broker-dealer that had been started by Desich Sr. in 1973, Mid-Ohio Securities Corp. ("Mid-Ohio Securities"). In early 2003, Desich Sr. transferred Mid-Ohio Securities' custodial accounts to the newly created Equity Trust. Desich Sr., J. Desich, and Desich Jr. continued to operate Mid-Ohio Securities as the brokerage affiliate of Equity Trust until May 2013, when they withdrew Mid-Ohio Securities' broker-dealer registration.

Equity Trust operates as a chartered trust company that is regulated by the South Dakota Division of Banking. Through strategic acquisitions of other custodians and aggressive marketing, Equity Trust has grown substantially. It now claims to have 130,000 customer accounts and $12 billion in assets.

The Standard of Care of a Self-Directed IRA Custodian

Permitted by Section 408 of the Internal Revenue Code, 26 U.S.C. § 408, a Self-Directed IRA must be held by an account trustee or custodian. Under Section 408, a custodian such as Equity Trust must take custody of the asset and also handle certain reporting requirements.

The Self-Directed IRA custodian's standard of care, which is similar to that of other custodians, is straightforward. Its fundamental duty is to take custody of its customer's assets. A Self-Directed IRA custodian must also be passive, and must not promote or endorse any investment or issuer. The custodian is required to keep customers' account information strictly confidential. A custodian that exceeds the scope of its standard of care assumes additional duties and responsibilities.

Equity Trust recognized this standard of care, and incorporated it into its customer agreements and representations. Equity Trust sent marketing materials to customers that provided that: "All records pertaining to the investment (such as real estate deeds, original notes,

operating agreements for LLCs) are retained by Equity Trust for safekeeping." Equity Trust's website stated that: "An investment at Equity Trust isn't final until all records pertaining to the investment (such as real estate deeds, original notes, operating agreements for LLCs, etc.) are sent to Equity Trust for safekeeping." And the account opening application and Direction of Investment ("DOI") form state that Equity Trust acts "solely as a passive custodian to hold Retirement Account assets," and does not "endorse any investment, investment product or investment strategy, [] financial advisor, representative, broker, or other party [] selected by [the customer]." The Trust Company Policy stated that "[o]ur officers and employees should refrain from making any comments regarding the quality of investment decisions made by our customers or their investment advisor, representative, broker or other party." It also stated that a "custodian has a duty to avoid conflicts of interest" and that it "will administer accounts solely in the best interests of beneficiaries."

Equity Trust told its customers that Equity Trust would only provide account information to third parties under limited, enumerated circumstances, such as to a successor custodian or as permitted by law. Nothing in Equity Trust's privacy disclosure statement permitted it to share personal or account information with issuers or promoters.

Equity Trust's Account Review Procedures

Equity Trust had three levels of review for customer accounts. In the "primary review," the compliance department confirmed, among other things, whether Equity Trust was holding all of the required documents, whether those documents had been properly executed, and whether any security associated with the investment was demonstrated.

Equity Trust also conducted "secondary reviews" of investments when certain thresholds were met, such as the number of investments with one issuer or total amount invested with that

issuer. The stated purpose was to determine whether the investments were "administratively feasible," and to assess Equity Trust's "litigation risk due to such investments." As part of the review, Equity Trust's compliance department confirmed whether Equity Trust was holding all of the required documents, those documents had been properly executed, and income was being generated as expected.

After the secondary review was complete, compliance would make a recommendation to Equity Trust's Governance Risk Committee ("GRC"), which included J. Desich and Michael Dea, the President and CFO of Equity Trust, that the investment continue, be placed on the "hold" list, or be placed on the "do not process" list. The GRC then would decide whether the investment could continue to be processed, whether more information was needed, whether to continue holding the investment but not allow new investments, or whether to resign as custodian from the account "if it is deemed the investment sponsor does not fit into ETC's administrative feasibility or risk tolerance parameters." The investment could be placed on the "do not process" list for any number of reasons, including when a law enforcement agency has charged the issuer with wrongdoing, or when Equity Trust was unable to obtain account documentation.

Equity Trust Promoted Self-Directed IRAs as Wealth Creation Vehicles

Through its website, its frequent investor conferences, webinars, roadshows with issuers, and marketing materials, Equity Trust promoted Self-Directed IRAs as a tax-free way to achieve riches. For example, a promotional book entitled "Proven Wealth Building Secrets," authored by Desich Sr., Desich Jr. and J. Desich, described a "success story" of an Equity Trust customer whose "entire investment was paid back in less than 7 months" and who thereafter would receive "an infinite rate of return." The Desiches' book further stated that: "Many investors are

successfully earning 15-20%, even 25% and more, inside their Equity Trust self-directed IRAs." And they also wrote: "Who needs an Equity Trust Company Self-Directed IRA? Everyone!" These promotional materials rarely acknowledged the risk inherent in these investments, even though Equity Trust knew from its own experience that Self-Directed IRAs could frequently be vehicles for fraud.

Equity Trust devoted considerable resources to promoting Self-Directed IRAs through frequent "wealth building" seminars held around the country, and worked closely with issuers and promoters. Equity Trust frequently sent representatives to issuer events. At these events, Equity Trust promoted itself as a "highly regulated financial institution," and assured potential customers that "your account is protected at Equity Trust."

Equity Trust sales staff were trained in sales techniques such as making an "elevator speech" pitching Self-Directed IRAs and developing leads. The sales staff were not trained to include warnings about the risks associated with Self-Directed IRAs or the issuers with whom they associated. They received a small salary and, through additional payments for each account opened, were incentivized to pursue the goal of opening more accounts. Management established lofty account opening goals, and reaching these goals was easier with a close relationship with an issuer or promoter who could refer accounts. These referral sources – called "centers of influence," "COIs" or "investment sponsors" – were critical in meeting those quotas.

Equity Trust Knew that Self-Directed IRAs Were Vehicles for Fraud

Desich Sr., Desich Jr., and J. Desich, through their experience as the owners of Equity Trust and Mid-Ohio Securities, knew that fraudulent issuers and promoters frequently target Self-Directed IRAs. Even apart from Ephren Taylor and Randy Poulson, Equity Trust knew that it had taken custody of fraudulent assets. Indeed, Equity Trust's "do not process" list – intended

to address the risks of issuers – contained the names of hundreds of issuers, many of whom had been charged with offering frauds. Equity Trust also attended many events sponsored by Ronald LeGrand, who was charged by the SEC in 2011 with perpetrating a fraudulent investment scheme.

Despite this track record, Equity Trust failed to have adequate policies and procedures in place – and failed to adequately implement those policies and procedures it did have – governing the interactions between its employees and issuers. Sales and marketing staff, prior to attending "wealth building" seminars and issuer events, received no training concerning the risks associated with Self-Directed IRAs.

Ephren Taylor's and City Capital's Fraud and Equity Trust

Taylor's and City Capital's Violations

From 2008 through December 2009, Ephren Taylor, through City Capital, a public company, and other entities he owned and operated, raised funds from investors through the issuance of secured and unsecured promissory notes that paid interest rates from approximately 7% to 20% for terms of primarily nine months to three years, as well as two equity investments (the "Taylor Notes"). Taylor and City Capital misappropriated most of the investor funds for Taylor's personal use, City Capital operating expenses, and repayment of earlier investors. In addition, Taylor and City Capital represented to investors that many of the notes were secured by City Capital or other entities owned by Taylor. In fact, almost all of the Taylor Notes were unsecured. Taylor also made false statements to investors about Equity Trust's role at the October 2009 New Birth Church event.

On April 12, 2012, the SEC charged Taylor and City Capital with violating the antifraud provisions of the federal securities laws. *See SEC v. City Capital Corp.*, 12 Civ. 1249 (N.D.

Ga.). In August 2012, Taylor was enjoined from future violations of these provisions and, in October 2014, the SEC barred Taylor from the securities industry.

On June 10, 2014, a federal grand jury indicted Taylor on charges of conspiracy, mail fraud, and wire fraud. *United States v. Taylor*, 14 Cr. 217 (N.D. Ga.). Taylor pled guilty to one count of conspiracy on October 8, 2014. On March 17, 2015, Taylor was sentenced to 235 months in prison.

Equity Trust's Role in Facilitating Taylor's and City Capital's Violations

A total of eighty-one Equity Trust customers made ninety-four investments in the Taylor Notes, for a total of $5.3 million. Nearly all of these notes defaulted and investors received nothing.

In early 2008, Equity Trust assigned a salesman named Robert Batt to service accounts associated with Taylor. Batt communicated regularly with Taylor, actively sought referrals, and treated Taylor as a client, including essentially vouching for Taylor with customers. Batt also provided City Capital and Taylor with confidential customer information, including updates on referrals and the timing of funds transfers.

By 2009, Equity Trust knew or should have known that many of the Taylor Notes were in default, were not being repaid at maturity, and were being marked as secured even though no security existed. In addition, City Capital's public filings disclosed that the company's liabilities from the promissory notes held by Equity Trust far outweighed its meager assets. Nevertheless, Equity Trust continued to allow the Taylor Notes to be processed.

In addition, Equity Trust, on its own initiative, created and hosted a "landing page" on its website for potential investors of City Capital. This page displayed the Equity Trust logo at the top and, in bold font, the text "City Capital Corporation – Wealth Builder Network." It then

stated, "Welcome to the personalized Equity Trust Company page for members of the Wealth Builder Network. We're pleased to provide you with the support to grow your business and, in turn, help you grow your wealth." The web page included links to Equity Trust's self-directed IRA opening application and DOI form, and included Batt's picture and contact information.

When Taylor investors opened accounts at Equity Trust, their account opening documentation and the DOIs were frequently filled out by a City Capital employee, who then emailed the documents to Equity Trust. More than thirty-five of the DOI forms stated that the promissory notes were "secured" by City Capital or other Taylor entities, which, according to the DOI, required the submission of an "original note clearly stating the associated collateral." However, the notes City Capital submitted to Equity Trust made no mention of associated collateral and, in fact, were unsecured. Equity Trust nevertheless processed these investments. At one point, Equity Trust even created an exception for Taylor Notes that no collateral agreement was required to be provided. Equity Trust sent its customers account statements that falsely reflected that these notes were secured.

In June 2009, Equity Trust sent Batt to visit City Capital's headquarters in Raleigh, North Carolina for two days where he trained City Capital salespeople. Equity Trust encouraged its personnel to conduct these types of trainings with the purpose of opening new accounts.

In 2009, When City Capital's Funds Were Dwindling, Equity Trust Played a Critical Role in Helping Taylor Raise More Investor Funds

By the end of 2008, City Capital was running out of money as the liabilities from its Taylor Notes outstripped its assets. On two critical occasions, Equity Trust assisted Taylor in raising funds, which allowed Taylor's fraud to continue undetected.

First, in January 2009, Taylor was targeting an investment of more than $1 million in retirement funds controlled by an Equity Trust customer, for the benefit of the customer and her

mother. The customer's investment adviser, however, had warned her, in a heartfelt letter, against the Taylor Notes. Nevertheless, after a phone call with Batt, the customer transferred $1 million to City Capital. In an email to Taylor, Batt belittled the investment adviser's letter as "so cheesy it sounded like a 1st grader wrote it," and assured Taylor that: "I am on it...I will close it." The customer lost the $1 million in retirement funds of her and her mother.

Second, in October 2009, Equity Trust management – seeing an opportunity for more account openings – approved Batt's request to attend a Taylor speaking event at New Birth Church, a large, primarily African-American church, in Lithonia, Georgia. At the event, Taylor told thousands of church members about the pitfalls of mutual funds and the benefits of acquiring alternative assets through a Self-Directed IRA.

At the start of his presentation, Taylor introduced Batt as "my banker" and added that "if you have any questions specifically about what I do, I figured, why not just bring the expert with me?" Taylor then told the New Birth Church audience that "you know it's something when the bank flies out your banker to hang out with you," and later referred to Batt as his "qualified, educated, and informed financial professional." Batt knew that he was not Taylor's "banker"; nevertheless – as captured on video – Batt stood, smiled broadly when introduced by Taylor, and waved to the New Birth Church audience. In his October 2015 deposition, Taylor testified that "to have a representative from [Equity Trust] in the audience, it wasn't going to get any better than that. That was the – all the little endorsement I needed – to make it happen."

After Taylor's presentation, Batt greeted church members who were interested in the Taylor Notes, spoke highly of Taylor, and opened new Equity Trust accounts. The funds Taylor raised from this event allowed his fraud to continue.

Upon his return to Equity Trust, Batt told colleagues about Taylor's references to him as "my banker." Batt was not disciplined for failing to correct Taylor's misstatements; on the contrary, the event was the topic of light-hearted banter around the Equity Trust office. Equity Trust also continued to process investments for customers solicited at the New Birth Church event without telling them Taylor's statements about Equity Trust's role were false.

Equity Trust Put City Capital on Its Do Not Process List in January 2010, But Continued to Renew and Extend Taylor Notes

In September 2009, Equity Trust initiated a secondary review of the Taylor Notes. In October 2009, Sandra Sarudis, Equity Trust's Director of Compliance, expressed concern that numerous Taylor Notes had been marked as secured by Taylor and City Capital personnel on the DOI. As had been obvious for some time, the Taylor Notes did not reference any security and no security agreement was included. Equity Trust responded only by informing City Capital to start marking notes unsecured and changing only some account statements to reflect that the notes were unsecured. However, the first account statement to reflect the change was not until the period ending March 31, 2010 – more than five months after the issue was first identified, and during October, November, and December 2009, Equity Trust continued to process its customers' new investments in Taylor Notes. Equity Trust, moreover, did not bother to check all investments with Taylor, so more Taylor Notes were still falsely marked secured.

By December 23, 2009, Equity Trust knew that at least seventeen Taylor Notes were mature and unpaid, and put City Capital on "hold" status. By January 2010, Equity Trust put City Capital on the "do not process" list, in part because of City Capital's public filings disclosed a going concern opinion. Equity Trust did not inform its customers that it had placed Taylor or City Capital on "hold" or on the "do not process" lists.

By March 2010, Equity Trust knew that two customers with mature and unpaid Taylor Notes, with a total principal amount of $180,000, were having difficulty collecting on the notes and were threatening legal action. Nevertheless (and even though City Capital was on the "do not process" list), up until October 2010, Equity Trust replaced or extended twenty-one Taylor Notes after City Capital was put on hold. The original notes were deemed satisfied and replaced with new notes and new DOIs. Equity Trust also assisted City Capital with transferring a number of uninvested accounts to another custodian. Equity Trust did not inform these customers of any issues prior to replacing the Taylor Notes or transferring uninvested funds to another custodian. Equity Trust also continued to service the accounts of its customers invested in Taylor Notes, and to charge them annual fees. Equity Trust collected approximately $150,000 in fees in connection with the Taylor Notes.

Randy Poulson's Fraud and Equity Trust

Poulson's Violations

Randy Poulson promoted himself as an investor in residential real estate, and conducted seminars on how to invest in real estate. Beginning in at least 2007, Poulson, through his company Equity Capital Investment, LLC, offered investors secured promissory notes that paid interest rates from 12% to 20% for terms ranging between one and five years (the "Poulson Notes"). In many instances, Poulson failed to sign the promissory notes and mortgages, and many properties that purportedly secured the notes had multiple unrecorded mortgages associated with them. Poulson failed to record most of the mortgages securing the Poulson Notes, which helped conceal the fraud.

Poulson told investors that the funds invested in Poulson Notes would be used to purchase, maintain, and improve the respective properties, including making payments on the

existing mortgages. Instead, Poulson misappropriated a significant amount of the funds for his personal use.

On June 5, 2014, a federal grand jury returned an indictment charging Poulson with mail fraud and wire fraud in connection with the Poulson Notes. Poulson pleaded guilty on June 23, 2015. Sentencing is scheduled for December 16, 2015. *United States v. Poulson*, 14 Cr. 309 (RMB) (D.N.J.).

Equity Trust Promoted and Sponsored Poulson

Beginning in approximately 2007 through late 2011, Equity Trust opened Self-Directed IRAs for customers who then used their retirement funds to invest in Poulson Notes. Approximately thirty-four Equity Trust customers invested nearly $1 million with Poulson, the majority of which was lost as a result of Poulson's fraud.

In early 2008, Equity Trust assigned a salesperson, Irene Berlovan, to service accounts associated with Poulson, which included cultivating Poulson as a referral source. In December 2008, Berlovan referred Poulson to Equity Trust's marketing department and stated that they would "work to identify ways Equity Trust can support you from a marketing perspective."

In February 2009, Equity Trust's marketing department emailed Berlovan stating that it was "working" with Poulson "to see if he can be approved as a partner." In March 2009, Equity Trust's marketing department emailed compliance and J. Desich, noting that Poulson was "looking for an exclusive arrangement with Equity Trust." At this time, eleven Poulson investments did not have complete paperwork, most notably the recorded mortgage that secured the note.

In April 2009, Berlovan and an Equity Trust marketing specialist attended one of Poulson's seminars in New Jersey. In front of his audience, Poulson introduced Berlovan as a

member of his "power team," and handed her the microphone. Berlovan – also captured on video – told the seminar attendees that she was "very excited" to be there," that "I help investment sponsors like Randy," and that investing in a Self-Directed IRA was a "very neat concept" to make money and "not have to pay taxes."

The marketing specialist gave a presentation on the benefits of Self-Directed IRAs, and offered and sold Equity Trust's CD sets that promoted their benefits. Equity Trust split the proceeds with Poulson, paying Poulson approximately $4,800, which was not disclosed to attendees. In addition, Equity Trust opened self-directed IRAs for seminar attendees who then used the funds in their Equity Trust accounts to invest in Poulson Notes.

Several months later, Poulson asked Equity Trust to sponsor his monthly dinner events at which Poulson would distribute Equity Trust's materials, talk about Equity Trust, and make referrals to Equity Trust. Equity Trust agreed to do so because, as an internal Equity Trust email stated, "Randy has brought us numerous clients." Around the same time, Poulson agreed to sponsor a session at an Equity Trust conference at a reduced cost of $750. Equity Trust informed Poulson that sponsoring the session meant that he would receive "signage" and "mentions."

In May 2010, another Equity Trust salesperson replaced Berlovan as Poulson's contact. This salesperson provided Poulson with status updates on investors, including whether the investor had opened an account, the timing of any transfer of funds into the account, and the completion of any such transfer. Providing this information without customer approval was contrary to Equity Trust's privacy disclosures.

Equity Trust Processed Poulson Notes with Significant <u>Documentation Issues and Ignored Other Red Flags</u>

For Poulson Notes that were secured, the DOI form required, along with the DOI form, the submission of a signed promissory note and proposed deed of trust or mortgage. In many

instances, Equity Trust transferred customer funds to Poulson without receiving the required documentation. During Equity Trust's secondary review of Poulson Notes in June 2010, Mary Juristy, a senior compliance officer, determined that account documentation was missing for all twenty-five investments with Poulson under review.[2] Juristy attempted to collect the documentation from Poulson, but Poulson failed to provide it. During this same review, Equity Trust noted that four Poulson Notes had matured and were unpaid. Equity Trust continued to process new customer investments, and continued to permit extensions of already-existing Poulson Notes, both of which permitted Poulson's fraud to continue undetected.

In February 2011, in response to several emails from Juristy seeking the missing documents, Poulson emailed Juristy that he "had to re-create some of the documents from scratch." Although Poulson did not provide most of the documents that Juristy was seeking, Juristy never followed up.

In July 2011, Equity Trust conducted another review of Poulson Notes and identified missing account documentation for twenty-five of thirty-three of its customers' investments in Poulson Notes and determined that thirteen Poulson Notes were mature and unpaid. At that point, Equity Trust stopped processing new customer investments in Poulson Notes, although it did not inform its customers that it had taken this step, and it still permitted extensions.

Through 2014, Equity Trust collected approximately $28,000 in fees in connection with Poulson Notes.

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[2] According to that review, ten promissory notes were not signed, nine mortgages were signed but not recorded, and sixteen mortgages were not signed and not recorded.

ARGUMENT

I. Legal Standards for Causing Liability

To establish that Equity Trust was a cause of Taylor's and Poulson's violations, the Division must show: (1) a primary violation; (2) an act or omission by Equity Trust that was a cause of the violations; and (3) that Equity Trust knew, or should have known, that its conduct would contribute to the violations. *Robert M. Fuller*, Rel. No. 8273, 2003 WL 22016309, *4 (Aug. 25, 2003), *pet. denied*, 95 F. App'x 361 (D.C. Cir. 2004).

Negligence is sufficient to establish liability for causing a primary violation that does not require scienter. *See KPMG Peat Marwick LLP*, 54 S.E.C. 1135, 1175, 2001 WL 223378, *1 (Mar. 8, 2001) ("negligence is sufficient to give rise to causing liability"), *recon. denied*, Rel. No. 44050, 2001 SEC LEXIS 422 (Mar. 5, 2001), *pet. denied*, 289 F.3d 109 (D.C. Cir. 2002).

Section 17(a)(2) of the Securities Act makes it unlawful to obtain money or property by means of misstatements or omissions about material facts, and Section 17(a)(3) proscribes any transaction, practice, or course of business that operates as a fraud or deceit upon a purchaser. *SEC v. Softpoint, Inc.*, 958 F. Supp. 846, 861 (S.D.N.Y. 1997), *aff'd*, 159 F.3d 1348 (2d Cir. 1998). A showing of negligence suffices for liability under Sections 17(a)(2) and 17(a)(3). *Aaron v. SEC*, 446 U.S. 680, 697 (1980).

The Division need not show that Equity Trust's conduct was a proximate cause of the primary violations. *Rita J. McConville*, Rel. No. 51950, 2005 WL 1560276, *12 n.24 (June 30, 2005), *pet. denied*, 465 F.3d 780 (7th Cir. 2006); *Erik W. Chan*, Rel. No. 45693, 2002 WL 507022, *8 (Apr. 4, 2002) ("[T]he mere fact that others also may have caused [a primary violation of] the securities laws does not insulate [Respondent] from liability for his own acts and omissions.").

Equity Trust is liable for the conduct of its owners, managers and employees. *See, e.g., In re Parmalat Sec. Litig.*, 474 F. Supp. 2d 547, 550 n.12 (S.D.N.Y. 2007) (citing *Marbury Mgmt., Inc. v. Kohn*, 629 F.2d 705, 712-16 (2d Cir. 1980) (holding that respondeat superior applies in federal securities cases).

II. Equity Trust Was a Cause of Taylor's and City Capital's Violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act

A. Taylor's and City Capital's Primary Violations

The primary violations are undisputed. Taylor and City Capital violated Sections 17(a)(2) and 17(a)(3) of the Securities Act in offering and selling the Taylor Notes, by making misrepresentations and omissions, and in engaging in a course of business that operated as a fraud. Their conduct was, at a minimum, negligent.

B. Equity Trust's Acts and Omissions Were a Cause of Taylor's and City Capital's Violations

Equity Trust's negligent acts and omissions were a cause of Taylor's and City Capital's violations. Equity Trust failed to act reasonably and to comply with the standard of care of a reasonable custodian, which constitutes negligence. These failures, combined with the fact that a custodian is an indispensable element for Self-Directed IRAs, is sufficient proof to show that Equity Trust was a cause of Taylor's violations.

Equity Trust also engaged in intentional conduct that also establishes it was a cause of Taylor's violations. Equity Trust involved itself in the sales and marketing process of Taylor: Batt "closed" investments for Taylor; trained City Capital personnel on the benefits of self-directed IRAs so that they could use that information to solicit investors; attended Taylor's event at New Birth Church which lent Taylor an air of credibility; and provided confidential customer information to City Capital in order to facilitate its transactions. Equity Trust also hosted a

"landing page" on its website for Taylor investors that at the very least reflected the close marketing relationship.

Equity Trust processed investments for Taylor Notes, which is the only way that City Capital could have accessed the retirement funds of those individuals. Also, a significant number of the investments were processed despite the fact that the DOIs were marked secured when in fact they were unsecured, and the account statements reflected secured notes that were actually unsecured.

C. Equity Trust Knew or Should Have Known That Its Conduct Would Contribute to the Violations

Equity Trust's negligence satisfies this element. "The 'should have known' language is akin to negligence." *Phillip L. Pascale*, Rel. No. 251, 2004 WL 1103671, *15 (Init. Dec. May 17, 2004) (quoting *KPMG Peat Marwick LLP*, 74 SEC Docket 384, 421, 2001 WL 34138819 (Jan. 19, 2001).

Equity Trust acted negligently by, among other things, failing to follow its own policies and procedures and by failing to train its employees in view of its knowledge that Self-Directed IRAs are frequently vehicles for fraud. Even with this knowledge, Equity Trust trained sales and marketing staff promoted Self-Directed IRAs without telling investors of the risks that Equity Trust knew about but the investors did not.

The evidence will show that Equity Trust, and its predecessor and affiliate, Mid-Ohio Securities, were often used by fraudulent investment promoters, which was known by senior management, including Desich Sr., Desich Jr. and J. Desich. A 2009 Cease-and-Desist Order issued by the Ohio Division of Securities listed many such instances, and state regulators and Equity Trust's own customers have identified others. Just last week, the Ohio Court of Appeals ruled against Equity Trust in a fraud case brought by a customer who had invested in a

fraudulent scheme using funds from an Equity Trust Self-Directed IRA. Equity Trust argued that because it was a mere "passive custodian," the fraud claims against it "are barred by the express terms of the Custodial Agreement." The Court of Appeals rejected Equity Trust's argument. *Bentley v. Equity Trust*, 2015 WL 7254796, ¶4 (Nov. 16, 2015 Ct. App. Ohio) (reversing trial court's dismissal). And in 2011, Mid-Ohio Securities was order to pay a customer $280,683 following an arbitration in which the customer charged that "Mid-Ohio was required to perform basic due diligence with regard to its customers' holdings, and that it failed to do so . . . [and Mid-Ohio] should have realized that [an investment sponsor] was a fraud based on several red flags." *Mid-Ohio Securities Corp. v. Estate of Burns*, 790 F. Supp.2d 1263, 1265 (D. Nev. 2011) (confirming FINRA arbitration award).

Given its close relationship with issuers and the pressure on its salespeople to develop relationships with issuers, Equity Trust did not have appropriate policies and training in place. For example, Batt apparently had no relevant training prior to attending the New Birth Church event, and neither he nor his supervisors knew how to react when Taylor made false statements about Equity Trust to investors.

Equity Trust was aware of red flags concerning Taylor and the Taylor Notes and failed to respond reasonably. First, compliance personnel at Equity Trust knew or should have known that City Capital submitted DOIs that improperly stated that the investments were secured. A reasonable custodian would not have processed those investments and would have looked into the reason for the discrepancy. And when Equity Trust changed the notes from secured to unsecured, it did not inform its customers of the change. Instead, Equity Trust merely reflected the change on certain customers' account statements – and even then not until a statement sent as

early as April 2010, more than five months after discovering that the notes were in fact unsecured.

Second, when Batt attended the New Birth Church event in October 2009, he knew that Taylor made false statements about Equity Trust's role, which in itself was a violation of the securities laws by Taylor. A reasonable custodian would have at least informed customers of the misstatements before they opened accounts and invested in that issuer's securities, or discontinued processing investments for that issuer.

Third, as a result of its secondary review of City Capital that started in September 2009, Equity Trust compliance personnel knew that at least seventeen of the Taylor Notes were mature and unpaid. By early 2010, Equity Trust also knew that City Capital had a going concern opinion. As a result, Equity Trust put City Capital on the "do not process" list. A reasonable custodian would not have continued to service those investments, but Equity Trust continued to allow City Capital and Taylor to retire Equity Trust customers' expiring notes and issue new replacement notes – each of which was a new securities transaction.

Despite all of these red flags, Equity Trust nevertheless processed its customers' new investments in Taylor Notes and customers' replacement of their Taylor Notes with new notes and new maturity dates.

III. Equity Trust Was a Cause of Poulson's Violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act

A. Poulson's Primary Violations

Poulson engaged in misrepresentations and omissions and engaged in a scheme in violation of Sections 17(a)(2) and 17(a)(3) of the Securities Act, and Division need only prove negligence. Poulson's primary violations therefore cannot be disputed.

B. Equity Trust's Acts and Omissions Were a Cause of Poulson's Violations

Equity Trust committed acts and made omissions that, either individually or collectively, were a cause of Poulson's violations. Most fundamentally, Equity Trust knew at least after June 2010 that twenty-five out of twenty-five investments were missing critical documentation. Apart from Poulson, no other person or entity had this important information. Equity Trust acted unreasonably in failing to ensure that the documentation was provided, knowing that it had not been provided, continuing to process Poulson investments. In addition, Equity Trust involved itself in the sales and marketing process of Poulson. For example, Berlovan made positive comments about Poulson to investors; sought to develop a marketing relationship or "partnership" with Poulson; sought referrals from Poulson; provided a newsletter for Poulson to distribute to investors; and attended Poulson's event in April 2009 where she was introduced as a member of his "power team" and opened accounts for attendees. Equity Trust also sponsored Poulson's monthly dinner events and processed investments for Poulson Notes, which is the only way that Poulson could have accessed the retirement funds of those individuals.

C. Equity Trust Knew or Should Have Known that Its Conduct Would Contribute to the Violations

Through the conduct described above, Equity Trust acted negligently and failed to act reasonably and meet the standard of care of a reasonable custodian. As with the Taylor accounts, the complete lack of training on the risks of dealing with issuers was a significant area of negligence. For example, Berlovan had no relevant training prior to attending the Poulson event and did not correct Poulson when she was introduced as a member of his "power team," and did not give any disclaimer about not recommending Poulson while she was standing next to him.

Equity Trust was also aware of numerous red flags regarding Poulson and failed to respond reasonably. First, Equity Trust's compliance personnel knew or should have known,

based on its primary reviews, that each of its customers' investments in Poulson Notes was missing documentation at the time of the investments. Equity Trust's policies and marketing materials that were given to investors provided that where a DOI stated that a promissory note was secured, basic documentation, such as executed promissory notes, was required. A reasonable custodian would not have processed those investments at the time.

Second, by the time of the secondary review in mid-2010, Equity Trust compliance and audit personnel, including Juristy, knew that account documentation was missing for all of the Poulson accounts under review – twenty-five out of twenty-five – and that four notes were mature and unpaid. Juristy then attempted to obtain the documentation from Poulson, but Poulson made excuses for months and ultimately failed to provide it. A reasonable custodian would have discontinued processing investments in Poulson Notes until this issue was resolved. Indeed, according to its policies and procedures, Equity Trust should have placed investments in Poulson Notes on "hold" status by at least the time of the secondary review, but failed to do so.

IV. EQUITY TRUST'S VIOLATIONS DESERVE SIGNIFICANT SANCTIONS

A. A Cease-and-Desist Order is Appropriate

Section 8A of the Securities Act, 15 U.S.C. § 77h-1, authorizes the Commission to impose a cease-and-desist order upon any person who "is, was, or would be a cause of [a] violation" due to an act or omission the person "knew or should have known would contribute to such a violation." In determining whether a cease-and-desist order is appropriate, the risk of future violations is considered, and a single egregious violation can be sufficient. Other factors include whether the violation was isolated or recurring, whether the violation is recent, the degree of harm to investors or the marketplace, the respondent's state of mind, the sincerity of assurances against future violations, recognition of the wrongful conduct, and the opportunity to

commit future violations. Not all of these factors need to be considered, and none of them, standing alone, is determinative. *Rita J. McConville*, 2005 WL 1560276, *15.

Equity Trust's violations, which spanned a three-year period and two separate investment frauds, warrant a cease-and-desist order. Equity Trust's owners and senior managers, the Desiches, were already the subject of a C&D issued by the State of Ohio in 2009 for similar conduct. A cease-and-desist order is appropriate.

B. Equity Trust Should Be Required to Provide an Accounting, Disgorge Ill-Gotten Gains and Pay Prejudgment Interest

"The primary purpose of disgorgement as a remedy for violation of the securities laws is to deprive violators of their ill-gotten gains, thereby effectuating the deterrence objectives of those laws." *SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1474 (2d Cir. 1996). Moreover, "effective enforcement of the federal securities laws requires that the SEC be able to make violations unprofitable." *Id.* Accordingly, Equity Trust should be ordered to disgorge amounts collected from the relationships with Taylor and Poulson, including all account related fees. *See Matter of John Thomas Capital Mgmt. Group LLC*, Rel. No. 693, 2014 WL 5304908, at *30 (Init. Dec. Oct. 17, 2014) ("Management fees and incentive fees are appropriately disgorged where they constitute ill-gotten gains earned during the course of violative activities") (collecting cases) (review granted, Rel. No. 3978), 2014 WL 6985130 (Dec. 11, 2014).

Disgorgement should include the amounts that Equity Trust collected in connection with the Taylor and Poulson accounts, and amounts that City Capital sent to Equity Trust directly. This amounts to approximately $180,000, and Equity Trust should be ordered to prepare an accounting to determine the exact amount. Prejudgment interest is also appropriate and should be added to the disgorgement order.

C. <u>Equity Trust Should Be Required to Pay Substantial Penalties</u>

Under Section 8A(g) of the Securities Act, 15 U.S.C. § 77h-1(g), the Commission may impose civil monetary penalties where Respondent was a cause of another's violations. Six factors are relevant to determining whether civil monetary penalties are in the public interest: (1) deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement; (2) harm to others; (3) unjust enrichment; (4) prior violations; (5) deterrence; and (6) such other matters as justice may require. *See* Exchange Act Section 21B(c). "Not all factors may be relevant in a given case, and the factors need not all carry equal weight." *Matter of Robert G. Weeks*, Rel. No. 199, 2002 WL 169185, at *58 (Feb. 4, 2002).

Section 8A of the Securities Act specifies a three-tier system identifying the maximum amount of civil penalties, depending on the severity of the conduct. Second tier penalties are imposed in cases involving fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement. Third-tier penalties are awarded in cases where such state of mind is present, and, in addition, where, as here, the conduct in question directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons, or resulted in substantial pecuniary gain to the person who committed the act or omission.

In view of Equity Trust's egregious conduct, the maximum penalties allowable should be imposed. Equity Trust deliberately disregarded a regulatory requirement, and committed approximately twenty-one causing violations within the applicable period, including processing investments in the Taylor and Poulson Notes. *See* Securities Act, § 8A(g). The evidence presented at the hearing will warrant civil penalties to satisfy the criteria for First Tier, Second Tier and Third Tier ($75,000; $375,000; and $725,000, respectively, for each act or omission).

D. Respondents Should Be Required to Retain a Compliance Monitor and a Fair Fund Should Be Created

Section 8A(a) of the Securities Act, 15 U.S.C. § 77h-1(a), authorizes the Commission to seek an order requiring a person to take steps to effect compliance or future compliance with the securities laws. As Equity Trust continues the same business model that resulted in the harm to investors in Taylor and Poulson Notes, Equity Trust should be required to retain an independent compliance monitor for at least three years. For the benefit of their customers who were victims of the Taylor and Poulson frauds, the Court should order the establishment of a Fair Fund.

CONCLUSION

The Division of Enforcement respectfully requests that, following the parties' presentation of evidence at the hearing, this Court make findings of fact consistent with the evidence showing Respondent's illegal conduct, and that the requested sanctions be imposed on the Respondent.

Dated: New York, NY
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Respectfully submitted,

DIVISION OF ENFORCEMENT

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