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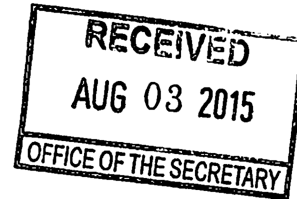

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File Nos. 3-16311

In the Matters of

RELIANCE FINANCIAL ADVISORS, LLC, TIMOTHY S. DEMBSKI and WALTER F. GRENDA, JR.,

Respondents.

DIVISION OF ENFORCEMENT'S RESPONSE TO RESPONDENT TIMOTHY S. DEMBSKI'S POST-HEARING MEMORANDUM

Dated: July 31, 2015

DIVISION OF ENFORCEMENT
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The Division of Enforcement ("Division") respectfully submits this brief in response to Timothy S. Dembski's ("Dembski") Post-Hearing Memorandum ("Dembski Mem.").

PRELIMINARY STATEMENT

Dembski's Post-Hearing Memorandum is long on sweeping proclamations about what the evidence shows in this case, but extraordinarily short on citations to actual evidence that supports his argument. Lacking such evidence, Dembski instead submits a 24 page plea to ignore each and every witness who testified to Dembski's fraud, and instead to credit Dembski's claims that he (i) never uttered *any* of the many misrepresentations his clients described in detail at the Hearing, and (ii) relied entirely on counsel when distributing a Private Placement Memorandum ("PPM") Dembski admits he knew was false and misleading.

But the testimonial and documentary evidence adduced at the Hearing is simply too great to disregard in favor of Dembski's self-serving denials. And to be sure, those denials are virtually the only "evidence" upon which Dembski relies in his Memorandum. While Dembski assured the Court that many of his clients do not find Dembski blameworthy, the Court never heard from even one investor in support of Dembski's defense. Rather than meet the Division's evidence with evidence of his own, Dembski instead has opted to attack the motivations and honesty of those investors who did testify.

Dembski also chose not to call as a witness either of the attorneys on whose advice he claims to have relied when he gave his clients a PPM with information Dembski himself found incorrect, confusing and unclear. When called to testify by the Division, those attorneys made clear why Dembski did not want the Court to hear their accounts, explaining that they never provided, or were asked for, any legal advice regarding the Prestige Fund PPM's description of Scott Stephan, the Fund's sole portfolio manager, in advance of Dembski using that PPM.

By blaming his lawyers and his own clients, Dembski has yet again failed to take responsibility for his misconduct and has offered another reminder as to why significant sanctions are appropriate in this case. Accordingly, and for the reasons set forth in the Division's July 2, 2015 Post-hearing Brief, Dembski should be ordered to cease and desist violating the securities laws, be barred from the securities industry, disgorge all profits earned from his misconduct, and pay significant third tier monetary penalties for each of his securities law violations.

ARGUMENT

Dembski's Memorandum, much like his conduct in dealing with Prestige Fund investors, disregards entirely the special obligations he owed to his clients as an investment adviser. Dembski, who sold Prestige Fund investments in his capacity as an investment adviser (Div. FoF ¶ 39), had a duty of full disclosure to his clients. Div. CoL ¶¶ 15-16. As set forth in the Division's Post-hearing Brief, Dembski violated Sections 206(1) and (2) of the Investment Advisers Act of 1940 ("Advisers Act") when he misrepresented material facts to his advisory clients (Div. Post-hearing Br. at 13-14), yet Dembski's 24-page brief makes no mention whatsoever of Sections 206(1) and (2) of the Advisers Act or of his obligations as an adviser.

Instead, Dembski spends much of his brief attacking the people he describes as "complaining witnesses" who are "blatantly self-interested" and motivated by "their obvious bias against Mr. Dembski in view of the litigations and arbitrations each of them has already initiated or intends to initiate against him." (Dembski Mem. at 2-3.) Dembski argues that his clients' testimony "lined up" according to which attorneys represented those investors, but Dembski fails to cite any evidence in support of his accusations. In fact, the record belies Dembski's description of his clients' testimony, as investors with different attorneys recalled many of the same misrepresentations. (*See, e.g.*, Div. FoF ¶¶ 52(a), 70(f), 103(a), 118(d) (Skop, Broderick, Haubrick

and Thuman, who were represented by different counsel, all testified that Dembski claimed he had invested his own and his family's money in the Fund).) Dembski also calls his clients' testimony "vague" and "contradictory" (Dembski Mem. at 3), but like Dembski's claims of collusion, those attacks are not based on anything in the factual record. And Dembski fails to offer any credible explanation as to why the investors' private litigation would motivate them to lie in this SEC proceeding about Dembski's sales pitch—Renee Broderick, for example, already settled her action against Dembski, and appeared to testify under oath only after the Court subpoenaed her to do so.

In response to his clients' damning testimony, Dembski asks the Court to consider that some of Dembski's clients remained with him even after the Prestige Fund collapsed. (Dembski Mem. at 12; Dembski Proposed FoF ¶ 203.) But even on that front, Dembski misrepresents the truth, claiming, for example, that Amy Burns remains his client despite Ms. Burns firing Dembski just last month. (Div. Response to Dembski Proposed FoF ¶ 203.)

The balance of Dembski's Memorandum is no more helpful to his defense. Dembski points to boilerplate warnings in the PPM, but as set forth in the Division's Moving Memorandum, such disclosures do not excuse his many oral misrepresentations or his knowing use of a PPM with a false biography of the Fund's sole money manager. (Div. Post-hearing Br. at 12-13.)[1] This is particularly true where the risk disclosures appear in a PPM Dembski (i) knew his clients would have trouble understanding, and (ii) told some clients they could disregard. (*Id.*)[2]

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[1] The Division is not clear if Dembski seeks to argue that his clients did not rely on the misrepresentations at issue, but the law is clear that the Division need not prove reliance. *SEC v. Morgan Keegan & Co., Inc.*, 678 F.3d 1233, 1244 (11th Cir. 2012) ("'Justifiable reliance,' however, is not an element of an SEC enforcement action because Congress designated the SEC as the primary enforcer of the securities laws..."), citing *SEC v. Rana Research, Inc.*, 8F.3d 1358, 1364 (9th Cir. 1993) (additional citations omitted).

[2] Regarding the PPM's risk disclosures, Dembski mistakenly claims that the "SEC stressed in its opening statement at the hearing that the PPM ... [included] 'the most dramatically

Next, Dembski implies that the "back-testing" Stephan performed should somehow support his defense (Dembski Mem. at 15-16), but that very back-testing undermines Dembski's own arguments. Stephan had concerns about the predictive value of his back-testing and shared those concerns with Dembski. (Div. FoF ¶¶ 14-15.) Because Stephan's back-testing relied on hypothetical trades, rather than trades using real money in real time, Stephan was concerned about whether the Fund would have trouble filling trade orders. (*Id.* ¶¶ 13-14.) Stephan's concerns proved to be well-founded, as the Fund did have trouble filling trade orders, leading Stephan to trade manually. (*Id.* ¶¶ 22-25.) Stephan shared these problems, and the fact that he had abandoned the Fund's computer-based trading model, with Dembski, but Dembski never expressed any concerns about Stephan's manual trading. *Id.* ¶¶ 24-26. Instead, Dembski went right on telling his clients about the Fund's trading algorithm as if Stephan was still utilizing it, even as late as May 2012, long after Dembski learned Stephan was trading manually. *Id.* ¶¶ 118(a), 120.

Finally, Dembski asks the Court to excuse his conduct because of the role he claims Holland & Knight played in creating the Prestige Fund and various Fund-related documents. (Dembski Mem. 17-22.) But Dembski cannot shift the blame for his misrepresentations to his lawyers. The Fund's lawyers had nothing to do with the oral sales pitch Dembski gave his clients that was so full of material misrepresentations. And as set forth in detail in the Division's Moving Memorandum, Dembski cannot establish—as is his burden—that he relied reasonably on advice from counsel when he gave his advisory clients a PPM he knew included false and misleading biographical information for the Fund's sole portfolio manager. (Div. Post-hearing Br. at 10-12.)

Dembski's advice of counsel argument rests entirely on two thin reeds. First, Dembski

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negative, cautionary terms that a hedge fund could utilize" (Dembski Mem. at 15), but that statement was made by Dembski's counsel (not the Division) and carries no evidentiary weight.

claims Stephan told him the misleading biography came from Holland & Knight. (Dembski Mem. at 19.) But the record does not support Dembski's claim at all. Stephan has no recollection of telling Dembski that the attorneys provided any advice regarding the biography, and the attorneys testified unequivocally that they never provided such advice. (Div. FoF ¶¶ 209-210.) Dembski, of course, is the person who sent the attorneys Stephan's draft biography, and Dembski never credibly explained—because he cannot—why he would have sent Holland & Knight a biography he believed Holland & Knight drafted.

Second, Dembski asks the Court to focus on two conversations with counsel that transpired *after* Dembski used the misleading PPM to sell Prestige Fund investments. (Dembski Mem. at 18.) The timing of these calls alone is fatal to Dembski's defense, as he could not have relied on anything learned from those calls *before the conversations occurred.* Dembski does not claim to have participated in the first conversation, a 2012 call between Stephan and Scott MacLeod ("MacLeod"). The only conversation Dembski had with any attorney that touched upon the contents of Stephan's biography came in 2013—the month the Fund collapsed—in a call he secretly—and illegally[3]—recorded. But that call does not provide any support for Dembski's claimed reasonable reliance on counsel. In addition to Dembski's temporal problem, Dembski cannot establish that he or Stephan "made a complete disclosure to counsel" of Stephan's actual work history. Div. CoL ¶ 17. To the contrary, nobody ever told MacLeod the truth about Stephan's professional experience. (Div. FoF ¶ 201.) Had anyone done so, MacLeod "wouldn't

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[3] Dembski's call was to Holland & Knight's Orlando, Florida office. (Trial Tr. at 820:15-18 ("Q: Where were you physically when you were on that call? A: I was in Orlando, Florida in my office at Holland & Knight.).) In Florida, prior consent from "all parties to the communication" is required before one may legally record a telephone conversation. *See* Fla. Stat. Ann. § 934.03(3)(d). Dembski has not claimed counsel ever consented to Dembski's recording of their conversation, and MacLeod testified that he never consented to Dembski taping the call. (Div. FoF ¶ 201 n.346.)

have said anything close to what [he] did" about the PPM's description of that experience. (*Id.* ¶ 201 n.347.)

CONCLUSION

Dembski's misconduct was entirely of his own doing. His counsel is not to blame for Dembski's many misrepresentations, and his clients are not to blame for trusting what their investment adviser told them about the Prestige Fund. Accordingly, and for the additional reasons set forth in the Division's Moving Memorandum, the Division respectfully requests that this Court make findings of fact consistent with those proposed by the Division, and impose sanctions including full disgorgement of Dembski's ill-gotten gains, third-tier civil monetary penalties, full advisory and collateral bars, and a cease-and-desist order. Indeed, in light of the industry bars imposed on Dembski's co-Respondents—a bar for Stephan with no right to reapply after a specified time period, and a bar for Walter F. Grenda, Jr. with a right to reapply after three years—an unqualified bar without the right to reapply is particularly appropriate for Dembski, whose oral and written misrepresentations cost many of his advisory clients their life savings.

Dated: New York, NY
July 31, 2015

Respectfully submitted,

DIVISION OF ENFORCEMENT

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