



Securities Bulletin

Ohio Department of Commerce, Division of Securities

Ohio Supreme Court Reviews Liability for Self-Directed IRA Custodians Under R.C. 1707.43

On December 6, 2017, in *Boyd v. Kingdom Trust Company*, the Ohio Supreme Court accepted review, with two justices dissenting and one abstaining, for a question of state law certified by the U.S. Court of Appeals for the Sixth Circuit in Case No. 17-3026, as follows:

“Does Ohio Rev. Code Ann. § 1707.43 impose joint and several liability on a person who, acting as the custodian of a self-directed IRA, purchased — on behalf and at the direction of the owner of the self-directed IRA — illegal securities?”¹

Background

The genesis of this matter is a massive Ponzi scheme organized by William Apostelos and his associates that operated from the Dayton area for at least five years beginning in 2009.² In 2015, Apostelos and his wife, Connie, were indicted in the U.S. District Court for the Southern District of Ohio on multiple counts including conspiracy to commit mail and wire fraud.³ Apostelos, his wife, and several associates entered guilty pleas to criminal charges related to the scheme. When the scheme collapsed, nearly 480 investors lost more than \$20 million collectively in what the U.S. Attorney’s Office called, “a massive and devastating fraud – the largest Ponzi scheme ever in Dayton.”⁴

On January 7, 2016, Cynthia Boyd and Thomas Flanders, victims of the Apostelos scheme, filed a class action complaint against Kingdom Trust Company and The Pensco Trust Company LLC, seeking damages based on R.C. 1707.43 and the trust companies’ alleged participation and aid in selling unregistered securities issued by Apostelos and his related companies in furtherance of the Ponzi scheme.⁵ The plaintiffs alleged they purchased the Apostelos securities through self-directed IRA accounts with one or more of the named defendants. The defendants subsequently filed motions to dismiss based on plaintiffs’ failure to state a claim upon which relief could be granted pursuant to Federal Rule of Civil Procedure 12(b)(6), which the District Court granted.⁶

¹151 Ohio St.3d 1451, 2017-Ohio-8842, 87 N.E.3d 220 http://supremecourt.ohio.gov/pdf_viewer/pdf_viewer.aspx?pdf=213793.pdf
²<https://www.justice.gov/usao-sdoh/pr/local-businessman-sentenced-180-months-prison-orchestrating-70-million-ponzi-scheme>
³*U.S. v. Apostelos et al.*, No. 3:15-CR-00148 (S.D. Ohio).
⁴<https://www.justice.gov/usao-sdoh/pr/local-businessman-sentenced-180-months-prison-orchestrating-70-million-ponzi-scheme>.
⁵*Boyd v. Kingdom Trust Co.*, No. 3:16-CV-00009, (S.D. Ohio, Jan.7, 2016), Class Action Complaint for Violation of the Ohio Securities Act, O.R.C. §1707.01 et. seq. (Jan. 7, 2016).
⁶*Boyd v. Kingdom Tr. Co.*, 221 F. Supp. 3d 975, 979 (S.D. Ohio 2016).

Save the Date - 2018 Ohio Securities Conference

The annual **Ohio Securities Conference** will return to the Westin Hotel in downtown Columbus on Friday, October 26. Conference topics, speakers and other details are being finalized so look for an update in the next issue of the Ohio Securities Bulletin.



Co-sponsored by the Division of Securities and the University of Toledo College of Law, the annual conference is the only continuing legal education program dedicated exclusively to Ohio securities law and practice.

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The plaintiffs appealed the dismissals to the Sixth Circuit Court of Appeals, which entered an order certifying the foregoing question of law to the Ohio Supreme Court.⁷

Overview of Party / Amicus Arguments

A review of the briefs filed with the Ohio Supreme Court for this case provides a more comprehensive understanding of the issues involved. In their merit brief, Petitioner Appellants (the “Boyd class”) argue that purchasing illegal securities on behalf of the owner of a self-directed IRA is sufficient to create liability under R.C. 1707.43(A) because the plain language of the statute broadly imposes liability on anyone who aids or participates “in any way” in the sale of illegal securities.⁸ To the extent the court finds ambiguity in this statutory language, the Petitioners argue that R.C. 1707.43(A) is a remedial statute that should be construed broadly to extend coverage as directed to protect the public from securities fraud as the statute has historically been construed by Ohio courts.⁹

Appellee Respondent Kingdom Trust counters in its merit brief that it (as a self-directed IRA custodian) plays no active role in customer investments and, therefore, does not participate in the “sale” side of the securities transactions.¹⁰ In its view, any involvement it would have with a customer would necessarily fall on the “purchase” side of a transaction. As a result, Kingdom Trust argues that the plain language of R.C. 1707.43(A) precludes imposing liability on a person who participates in the “purchase” rather than the “sale” of a security. Along those same lines, Kingdom Trust argues that there is no authority supporting the proposition that liability under R.C. 1707.43(A) extends to persons like itself and other self-directed IRA custodians who, it claims, do not assist securities sellers or participate in the sale of securities as part of their safe-keeping functions.¹¹

In its merit brief, Appellee Respondent Pensco similarly argues that the plain language of R.C. 1707.43(A) does not apply to aid given to “purchasers” of unlawful securities and that a financial institution engaging in normal commercial banking activities does not participate in the “sale” of unlawful securities.¹² Pensco further argues that the Boyd class improperly raised facts that are outside of the certified question and, therefore, should not be considered by the court.¹³

In its brief filed amicus curiae, the Retirement Industry Trust Association (RITA) discusses the distinction between the “sale” of a security and the “purchase” of a security, as both are separately defined terms within the Ohio Securities Act.¹⁴ RITA further argues that because passive custodians of self-directed IRA accounts are directed by purchasers, not sellers, during a transaction, they do not incur liability under R.C. 1707.43(A).¹⁵ Both Respondents and RITA also argue generally about the inequitable burdens that would be placed on them if the Supreme Court answered the certified question in the affirmative.

In its amicus curiae brief filed for the stated interest of protecting the public from schemes to defraud investors, the Public Investors Arbitration Bar Association (PIABA) rejects the interpretation of the statute advanced by the Respondents and asks the Court to make clear that a self-directed IRA custodian may be liable under R.C.

⁷ *Boyd v. Kingdom Trust Co.*, No. 17-3026, 2017 U.S. App. LEXIS 15908, at *1 (6th Cir. Aug. 18, 2017).

⁸ Merit Brief of Petitioners, *Boyd v. Kingdom Trust Co.*, No. 2017-1336, Ohio Sup. Ct. (2017) at 4-10 http://supremecourt.ohio.gov/pdf_viewer/pdf_viewer.aspx?pdf=839518.pdf.

⁹ Merit Brief of Petitioners, *supra* note 8, at 6-7 (citing *Passa v. City of Columbus*, S.D. Ohio No. 2:03-CV-81, 2007 U.S. Dist. LEXIS 78905, at *18-21 (Oct. 24, 2007) and *Cobb v. Contract Transport, Inc.*, 452 F.3d 543, 559 (6th Cir. 2006)).

¹⁰ Merit Brief of Respondent The Kingdom Trust Company, *Boyd v. Kingdom Trust Co.*, No. 2017-1336, Ohio Sup. Ct. (2017) at 5, 9-13 http://supremecourt.ohio.gov/pdf_viewer/pdf_viewer.aspx?pdf=842618.pdf.

¹¹ Merit Brief of Respondent The Kingdom Trust Company, *supra* note 10, at 14-16.

¹² Merit Brief of Respondent Pensco Trust Company LLC, *Boyd v. Kingdom Trust Co.*, Case No. 2017-1336, Ohio Supreme Court (2017) at 8-18 http://supremecourt.ohio.gov/pdf_viewer/pdf_viewer.aspx?pdf=842612.pdf

¹³ Merit Brief of Respondent Pensco Trust Company LLC, *supra* note 12, at 18-19.

¹⁴ Amicus Curiae Brief of the Retirement Industry Trust Association in Support of Defendants-Respondents, *Boyd v. Kingdom Trust Co.*, Case No. 2017-1336, Ohio Sup. Ct. (2017) at 3-7 http://supremecourt.ohio.gov/pdf_viewer/pdf_viewer.aspx?pdf=842456.pdf.

¹⁵ Amicus Curiae Brief of the Retirement Industry Trust Association, *supra* note 14, at 7-10.

1707.43(A) when its conduct extends beyond the role of passive custodian.¹⁶ PIABA explicitly asks the Court to reject the interpretation of the statute offered by Respondents as it “goes far beyond what appears to be the intent of the legislature in enacting the statute, i.e., to impose liability on persons participating in or aiding the seller in the sale of illegal securities.”¹⁷ To elucidate their position, PIABA provides an example of Bernie Madoff approaching a self-directed IRA custodian in order to assist in funneling money into a known Ponzi scheme. PIABA argues that an exemption from liability imposed by R.C. 1707.43(A) for self-directed IRA custodians would essentially give them blanket immunity, irrespective of their actual knowledge, aid, or participation with the seller in the unlawful sale.¹⁸

On April 16, 2018, Petitioners filed a Reply Brief and Respondent Kingdom Trust filed a Motion for Leave to File a response to PIABA’s amicus brief.¹⁹ The matter is set for oral argument on Tuesday, May 22, 2018.

The Statute

R.C. 1707.43(A) provides:

Subject to divisions (B) and (C) of this section, every sale or contract for sale made in violation of Chapter 1707 of the Revised Code, is voidable at the election of the purchaser. The person making such sale or contract for sale, and every person that has participated in or aided the seller in any way in making such sale or contract for sale, are jointly and severally liable to the purchaser, in an action at law in any court of competent jurisdiction, upon tender to the seller in person or in open court of the securities sold or of the contract made, for the full amount paid by the purchaser and for all taxable court costs, unless the court determines that the violation did not materially affect the protection contemplated by the violated provision. (emphasis added)

Violations of the Ohio Securities Act give purchasers a right of rescission in a civil judicial action. The plaintiffs must be “purchasers” and the defendants in such an action shall consist of “every person who has participated in or aided the seller in any way” and joint and several liability may be imposed on each such defendant. In the case at hand, there is no question that members of the Boyd plaintiff class were purchasers of securities sold in a Ponzi scheme and that Apostelos and his related companies were the sellers of those securities. The question for the courts is whether Kingdom Trust and Pensco, through their actions as custodians of the purchasers’ self-directed IRA accounts, “participated in or aided the seller in any way in making such sale or contract for sale.”

The terms “purchase” and “sale” are separately defined in the Ohio Securities Act.²⁰ Respondents and Amicus RITA construe these definitions as absolving Respondents of liability under R.C. 1707.43 where their actions aid only in the “purchase” of a security, not a “sale,” whereas the Boyd plaintiff class views those terms as opposite sides of the same coin. In their view, a completed purchase of securities, where value is given in exchange for a security, cannot occur without a corresponding sale of securities. Petitioners therefore argue that liability can lie for Respondents under a facts and circumstances review pursuant to R.C. 1707.43(A) if it can be proven that either or both participated in or aided the scheme of Apostelos and his related companies “in any way.”

¹⁶Amicus Brief of the Public Investors Arbitration Bar Association in Support of Neither Party, *Boyd v. Kingdom Trust Co.*, Case No. 2017-1336, Ohio Sup. Ct. (2017) at 3-4 http://supremecourt.ohio.gov/pdf_viewer/pdf_viewer.aspx?pdf=842628.pdf.

¹⁷Amicus Brief of the Public Investors Arbitration Bar Association, *supra* note 16, at 3-4.

¹⁸Amicus Brief of the Public Investors Arbitration Bar Association, *supra* note 16, at 4-5.

²⁰R.C. 1707.01(C)(1) states “‘Sale’ has the full meaning of ‘sale’ as applied by or accepted in courts of law or equity, and includes every disposition, or attempt to dispose, of a security or of an interest in a security. ‘Sale’ also includes a contract to sell, an exchange, an attempt to sell, an option of sale, a solicitation of a sale, a solicitation of an offer to buy, a subscription, or an offer to sell, directly or indirectly, by agent, circular, pamphlet, advertisement, or otherwise.” R.C. 1707.01(GG)(1) provides, “‘Purchase’ has the full meaning of ‘purchase’ as applied by or accepted in courts of law or equity and includes every acquisition of, or attempt to acquire, a security or an interest in a security. ‘Purchase’ also includes a contract to purchase, an exchange, an attempt to purchase, an option to purchase, a solicitation of a purchase, a solicitation of an offer to sell, a subscription, or an offer to purchase, directly or indirectly, by agent, circular, pamphlet, advertisement, or otherwise.” R.C. 1707(GG)(2) states, “‘Purchase’ means any act by which a purchase is made.”

The Certified Question

On its face, R.C. 1707.43(A) does not include a broad-based exemption from liability for any participant – let alone one specific to self-directed IRA custodians.²¹ The legislature did however recognize the broad applicability of R.C. 1707.43 and created limited exclusions under section 1707.431, deeming the activities of certain specified actors as not participating in or aiding the seller in making a sale. More specifically, section 1707.431(A) provides a safe harbor for attorneys, accountants, or engineers working in certain capacities where the sale of securities is incidental to the practice of their profession while section 1707.431(B) provides a safe harbor for certain “bringing together” activities, provided that the person engaging in the activities does not receive any commission, fee, or other remuneration based on the sale of securities. The Division also has authority under section 1707.431(C) to create additional exemptions. For 13 years, neither the legislature nor the Division has sought to expand the list of statutory safe harbors.

In granting the motions to dismiss filed by Pensco and Kingdom Trust, the District Court appears to imply a new safe harbor exemption for self-directed IRA custodians. Relying on a 2013 Twelfth District Court of Appeals decision in *Wells Fargo Bank v. Smith*,²² the Boyd trial court found that the Plaintiffs “failed to make any allegations outside of routine banking activities” and the trust companies’ “mere involvement in the sale of illegal securities does not amount to liability under §1707.43.”²³

The *Wells Fargo* decision upon which the Boyd court relied suggests a number of factors a court can consider when determining if a person or entity is responsible for aiding or participating in the sale of illegal securities under Section 1707.43, such as where the person or entity is:

- relaying information, such as the proposed terms of the sale from the sellers to the investors;
- arranging or attending meetings between the investors and the sellers;
- collecting money for investments;
- distributing promissory notes and other documents to the investors from the sellers;
- distributing principal and interest payments to the investors; and
- actively marketing the security or preparing documents to attract investors.²⁴

In reviewing the alleged facts set forth in the complaint in light of those factors, the *Wells Fargo* court concluded that there were no allegations that the defendant bank had engaged in anything but “normal banking activities” and, therefore, granted summary judgment in the bank’s favor for failure to plead actionable aiding and abetting activity.

²¹It is worth noting that neither Pensco nor Kingdom Trust are banks. Rather, Pensco is a privately held trust company chartered by the State of New Hampshire and Kingdom Trust is a non-depository trust company, registered in the state of South Dakota.

²²2013-Ohio-855, LEXIS 751 at *29 (Ohio Ct. App. Mar. 11, 2013).

²³*Boyd v. Kingdom Tr. Co.*, 221 F. Supp. 3d 975, 979 (S.D. Ohio 2016). Ohio courts and federal district courts interpreting Ohio law have recognized the pleading standards in an action brought under R.C. 1707.43 are more relaxed than when claims are brought under federal law:

“In contrast to Section 10(b), the Ohio statute [R.C. 1707.43] does not carry a heightened pleading standard, nor is it accompanied by a body of case law disfavoring group pleading and requiring particularized allegations of involvement with respect to outside directors. Ohio courts have stressed that ‘the securities laws are to be liberally construed.’ *Federated Mgmt.*, 137 Ohio App.3d at 392, 738 N.E.2d at 861 (citing *In re Columbus Skyline Sec., Inc.*, 74 Ohio St.3d 495, 1996 Ohio 151, 660 N.E.2d 427 (Ohio 1996)). Further, ‘[i]t must be emphasized that R.C. 1707.43 uses very broad language.’ *Federated Mgmt.*, 137 Ohio App.3d at 392, 738 N.E.2d at 861. This use of the phrase ‘in any way’ suggests that the statute is ‘broad in scope. *Id.*, 137 Ohio App.3d at 391, 738 N.E.2d at 860; see also *Hild v. Woodcrest Ass’n*, 59 Ohio Misc. 13, 28-29, 391 N.E.2d 1047, 1056-57 (Ohio Ct. Com. Pl. 1977). Liability extends beyond the seller of the security to any person who participates or aids the sale in any way, including ‘inducing the purchaser to invest.’ *Federated Mgmt.*, 137 Ohio App.3d at 391, 738 N.E.2d at 860; see also *Hild*, 59 Ohio Misc. at 28-29, 391 N.E.2d at 1056-57. An inducement is not required, but it is ‘one factor in determining liability.’ *Federated Mgmt.*, 137 Ohio App.3d at 391, 738 N.E.2d at 860-61.”

In re Natl. Century Fin. Ents., Invest. Litigation, 504 F.Supp.2d 287, 307-308 (S.D. Ohio 2007) (emphasis added).

²⁴*Wells Fargo Bank v. Smith*, 2013-Ohio-855, at 27-29 (10th Dist. Ct. App. 2013) (citing *Boland v. Hammond*, 144 Ohio App.3d 89, 94, 2001 Ohio 2680, 759 N.E.2d 789 (4th Dist. 2001)); *Gerlach v. Wergowski*, 65 Ohio App.3d 510, 513-514, 584 N.E.2d 1220 (1st Dist. 1989); and *Perkowski v. Megacorp.*, 55 Ohio App.3d 234, 563 N.E.2d 378 (9th Dist. 1990)).

The *Boyd* trial court also cited a Tenth District Court of Appeals case denying summary judgment on an aiding and abetting claim under section 1707.43 where there was an allegation of conduct outside normal banking activities.²⁵ In that case, *Federated Management Company v. Coopers & Lybrand*, the Tenth District Court of Appeals rejected the argument that a plaintiff must plead “inducement to purchase” in order to sustain a section 1707.43 claim where plaintiff alleged that the defendant had “conceived, organized and directly participated in the underwriting of the Note Offering,” which could be viewed as falling outside “normal commercial banking activities.” 137 Ohio App.3d 366, 392, 738 N.E.2d 842 (10th Dist. 2000) (“R.C. 1707.43 does not require control over the seller, rather, it merely requires aiding or participating ‘in any way.’”); *see also, Vasa Order v. Rosenthal Collins Group, LLC*, 2013 Ohio Misc. LEXIS 3 (Ohio C.P. Jan. 29, 2013) (“R.C. 1707.43 does not require that a person induce a purchaser to invest in order to be held liable. Rather, the language is very broad, and participating in the sale or aiding the seller *in any way* is sufficient to form a basis for liability under R.C.1707.43.”) (emphasis in original).

It has been the Division’s experience that some self-directed IRA custodians have been directly engaged in the promotion, offering, or placement of illegal securities, particularly private and alternative investments, in ways unseen in routine or normal commercial banking activities. It is not uncommon, for example, to see self-directed IRA custodian websites (and related marketing and advertising efforts) differentiating their services from those offered by traditional financial institutions, specifically touting the unique alternative investment opportunities provided on their platforms. Along those lines, such self-directed IRA custodians tend to promote their investment services to both sellers and purchasers alike.²⁶

While it is not clear at this stage (and may never be known if dismissal is affirmed) whether the Respondents in *Boyd* participated in or aided Apostelos or his affiliated companies in ways beyond routine or normal banking activities, the Division expects the Ohio Supreme Court will examine the *Boyd* complaint closely to determine whether the *Boyd* petitioners have successfully alleged activities constituting Respondents’ participation or aid, in any way, in the Apostelos scheme perpetrated through the sale of illegal securities. To be sure, the Ohio Supreme Court has repeatedly emphasized the remedial nature of the Ohio Securities Act and has instructed other Ohio courts to liberally construe the same:

The Ohio Securities Act, generally referred to as Ohio Blue Sky Law, was adopted on July 22, 1929, to prevent the fraudulent exploitation of the investing public through the sale of securities. Many of the enacted statutes are remedial in nature, and have been drafted broadly to protect the investing public from its own imprudence as well as the chicanery of unscrupulous securities dealers. In order to further the intended purpose of the Act, its securities anti-fraud provisions must be liberally construed.

Holderman v. Columbus Skyline Sec. (In re Columbus Skyline Sec.), 1996-Ohio-151, 74 Ohio St. 3d 495, 498, 660 N.E.2d 427, 429 (1996) (citing *United States v. Teahan*, 365 F.2d 191, 194 (6th Cir. 1966); *Hall v. Geiger-Jones Co.*, 242 U.S. 539 (1917) (upholding the constitutional validity of the former Ohio Blue Sky Law in regulating the sale of all securities); *Bronaugh v. R. & E. Dredging Co.*, 16 Ohio St. 2d 35 (1968)); *see also Baker v. Conlan*, 585 N.E.2d 543, 547-48 (Ohio Ct. App. 1990) (“The Ohio Securities Act, being a remedial law, should be construed liberally to provide relief to the victims of fraud it is designed to protect.”).

The Division anxiously awaits oral argument and the Ohio Supreme Court’s decision in the *Boyd* case. Ohio Supreme Court’s review of certified questions from the United States Court of Appeals for the Sixth Circuit on the Ohio Securities Act is itself exceedingly rare; its answer here will undoubtedly have a lasting impact on the securities industry and investors here in Ohio.

²⁵*Boyd v. Kingdom Trust Co.*, 221 F. Supp. 3d 975, 979 (S.D. Ohio 2016) (“Conversely, where a bank directly participates in the underwriting of unregistered securities, it is considered to have aided the seller in making the sales, in violation of Ohio Rev. Code § 1707.43”) (citing *Federated Mgmt. Co. v. Coopers & Lybrand*, 137 Ohio App. 3d 366, 738 N.E.2d 842, 862 (10th Dist. 2000)).

²⁶Investor Alert: Self-Directed IRAs and the Risk of Fraud (SEC Office of Investor Education and Advocacy) (Sept. 2011) <https://www.sec.gov/investor/alerts/sdira.pdf>; Self-Directed IRAs and the Risk of Fraud (SEC Office of Investor Education and Advocacy and the North American Securities Administrators Association) (Sept. 2011) <http://www.nasaa.org/5866/self-directed-iras-and-the-risk-of-fraud/>

Division News

Welcome Melissa Wood and Jennifer Coit

Two new employees have recently joined the division:



Melissa Wood started in January as our new enforcement attorney. She is responsible for investigating alleged violations of the Ohio Securities Act, which includes collecting relevant financial records and other data as evidence, and collaborating with law enforcement agencies and prosecutors on cases. Before joining the division, Melissa was an enforcement attorney for the State Medical Board of Ohio. Prior to that, she was an assistant prosecuting attorney in Shelby County, Ohio, during which time she also worked in a small law firm, focusing on civil litigation. Originally from the Cleveland area, Melissa attended the College of Wooster, graduating with a BA in Political Science. She earned her law degree from The Ohio State University, Moritz College of Law.



Jennifer Coit joined the division in February after working in the Division of Industrial Compliance's bedding section, where she oversaw regulation of Ohio's bedding laws and foreign manufacturers. She is responsible for handling a variety of daily office duties and administrative functions for the securities commissioner and the administrative assistant. Originally from Brooklyn, New York, she moved to Ohio eight years ago. She attended the University of Buffalo where she majored in Art History.

Outreach and Education Update

Our outreach efforts have kicked off in 2018, and it's already been busy. Here are a few examples of events we attended since the last issue of this newsletter:

Senior Forum on Wise Investing

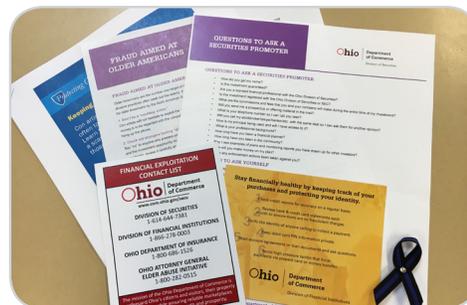
Hosted in January by the Erie County Serving Our Seniors organization, this event helped seniors better understand financial products and determine if certain products are right for their age group. The division provided information on the qualifications and credentials required of financial advisers in Ohio.

Attorney General's Office of Constituent Services

Division representatives held two training sessions in February for staff members who answer calls from the public to ensure they know when to refer calls to the division for investigation.

Community Discussion on Preventing Elder Financial Abuse

As part of the annual State of the State event in early March, representatives from the divisions of Financial Institutions and Securities joined with the Westerville Police Division's Community Crime Prevention Unit to share information with seniors to help them avoid becoming victims of financial fraud. We also took time to honor the Westerville police officers who died in the line of duty only a few weeks prior to the event.



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Consumer Protection Week Information Fair

Hosted in early March by the Attorney General’s Office of Consumer Protection, the divisions of Securities and Financial Institutions provided information to the public on how to prevent fraud.

Ohio Coalition of Adult Protective Services Annual Conference

For the fourth consecutive year, the division sponsored the annual conference for members who provide services for older adults who are at risk or who are victims of financial abuse, neglect and exploitation.

Serve Our Seniors Information Fair

The divisions of Securities and Financial Institutions participated in a day dedicated to educating Westerville seniors and caregivers on topics including scams, identity theft protection, personal safety, health services and estate planning. Our representatives answered questions and provided information on resources and services available to seniors to help them avoid becoming victims of financial abuse. The event was hosted by the Westerville Division of Police.



**Ohio Securities Bulletin
Issue 2018:1**

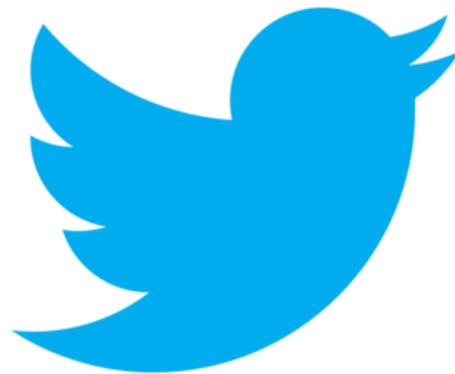
The Ohio Securities Bulletin is published quarterly by the Ohio Department of Commerce - Division of Securities. Past issues can be found on our website. Adobe Acrobat is needed to view all archived issues of The Bulletin.

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Follow Us on Twitter

We recently launched our own Twitter page, so please follow us [@OHSecuritesDiv](https://twitter.com/OHSecuritesDiv). We’ll post news and information about the Division, as well as tips to help Ohioans become more savvy investors and avoid getting scammed.

A to Z with L & E

Quarterly Question

What is the position of the Ohio Division of Securities regarding the Feb. 21, 2017, SEC No-Action Letter related to Standing Letters of Authorization (“SLOAs”) and custody?

The Division has received numerous inquiries regarding its position on Standing Letters of Authorization (“SLOA”) arrangements established by a client with a qualified custodian. The Division follows the position adopted by the United States Securities Exchange Commission (SEC) in its [February 21, 2017 No Action Letter](#) to the Investment Adviser Association in that the Division will require state-licensed investment advisers to disclose custody, for purposes of Form ADV Part 1A, Item 9 and Part 2A, Item 15, if the adviser acts pursuant to a standing letter of instruction or other similar asset transfer authorization arrangement established with a client and a qualified custodian.

Under the Ohio Securities Act, custody is defined in [Ohio Administrative Code 1301:6-3-44\(B\)\(3\)\(a\)](#). “Custody” means “holding, directly or indirectly, client funds or securities, or having any authority to obtain possession of them.” Custody includes “any arrangement, including a general power of attorney, under which the investment adviser or investment adviser representative are authorized or permitted to withdraw client funds or securities maintained with a custodian upon the investment adviser’s or investment adviser representative’s instruction to the custodian.” See [OAC 1301:6-3-44\(B\)\(3\)\(a\)\(ii\)](#).

Consistent with the SEC’s position stated in the [Feb. 21, 2017 No Action Letter](#) at Footnote [1], the Division also takes the position that a SLOA arrangement where “the investment adviser does not have discretion as to the amount, payee, and timing of transfers under a SLOA would not implicate the custody rule.”

All advisers with custody under Ohio law are required to meet the safeguarding requirements of the custody rule, set forth in [OAC 1301:6-3-44\(B\)\(1\) and \(2\)](#).

Ohio state-licensed investment advisers are encouraged to meet the seven SLOA conditions set forth in the [Feb. 21, 2017 No Action Letter](#), as the Division believes doing so is a best practice. The Division further acknowledges that some advisers may be required to follow these conditions as a requirement to do business with their custodian. The seven conditions are as follows:

- 1. The client provides an instruction to the qualified custodian, in writing, that includes the client’s signature, the third party’s name, and either the third party’s address or the third party’s account number at a custodian to which the transfer should be directed.**
- 2. The client authorizes the investment adviser, in writing, either on the qualified custodian’s form or separately, to direct transfers to the third party either on a specified schedule or from time to time.**
- 3. The client’s qualified custodian performs appropriate verification of the instruction, such as a signature review or other method to verify the client’s authorization, and provides a transfer of funds notice to the client promptly after each transfer.**

The Division’s Licensing and Examination Section (L & E) provides timely and important information covering a wide-range of topics from “A to Z” that affects licensees.

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4. The client has the ability to terminate or change the instruction to the client's qualified custodian.
5. The investment adviser has no authority or ability to designate or change the identity of the third party, the address, or any other information about the third party contained in the client's instruction.
6. The investment adviser maintains records showing that the third party is not a related party of the investment adviser or located at the same address as the investment adviser.
7. The client's qualified custodian sends the client, in writing, an initial notice confirming the instruction and an annual notice reconfirming the instruction.

Ohio Legislative Update

Protecting Seniors from Financial Exploitation

The Division is tracking [Ohio SB 158](#), legislation introduced in the Ohio Senate on May 2017 to "combat elder fraud and exploitation." SB 158 differs from the other recent legislative changes in this space, as it:

- Requires criminal offenders committing certain crimes involving theft, deception, identity theft and forgery against elderly persons to pay full restitution to their victims and a fine up to \$50,000.
- Expands the list of those who are required to make reports to county departments of job and family services to include securities **dealers and salespersons**.

Sub. S.B. 158 passed 33-0 by the Ohio Senate on March 21, 2018. The legislation is expected to go before the Ohio House of Representatives.

Federal Legislative Update

Legislation Introduced Would Require FINRA to Compensate Investors for Unpaid Arbitration Awards.

On March 5, Sen. Elizabeth Warren, D-Mass., introduced legislation to require the Financial Industry Regulatory Authority (FINRA) to use its existing authority to compensate investors for unpaid arbitration awards.

The bill, S.2499, the [Compensation for Cheated Investors Act](#) as introduced, directs FINRA to establish a pool funded by penalties from broker-dealer members that will "pay unpaid final arbitration awards and require it to track whether future arbitration awards are paid."

Warren cited a December 2015 report by FINRA's Dispute Resolution Task Force finding that investors were unable to collect more than \$62 million in unpaid arbitration awards in 2013 alone.

In a news release, Warren stated that "FINRA has the authority to make sure defrauded investors don't get stiffed — and this bill will make sure it uses it. Unpaid arbitration awards have cost ordinary investors hundreds of millions of dollars over the years. FINRA is supposed to be looking out for them, not the brokers and dealers who cheat them."

In a statement released by FINRA, the agency said it has taken many steps in recent years to use the tools within its power to help customers recover the awards they are owed. They point to a [discussion paper](#) released in February that outlined the options and issues that should inform the development of further measures to enhance customer recovery.

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A study by the Public Investors Arbitration Bar Association (PIABA) report released in March argues unpaid arbitration “is spiraling out of control,” growing to \$200 million in 2012-2016. The report also showed the percentage of cases with unpaid awards had grown by 3 percent.

U.S. Senate Special Committee on Aging Releases Top 10 Complaints

The most-reported scam in 2017 involved telephone callers pretending to be Internal Revenue Service staff seeking money from seniors.

That fraudulent attempt was highlighted by the U.S. Senate Special Committee on Aging in releasing its [2018 Fraud Book](#) that contains information on the top 10 types of complaints reported to the committee’s “fraud hotline” in 2017. The hotline received 1,463 complaints, representing a very small fraction of the illegal efforts to separate older adults from their funds.

Here are the 10 most-common types of complaints:

1. IRS scam

A caller pretending to be from the IRS accuses a senior of owing back taxes and penalties to the government.

2. Robocalls

Complaints from people who report getting unwanted telephone calls despite them being placed on the national Do-Not-Call Registry.

3. Sweepstakes scams

Callers make claims that someone has won a special prize, such as the Jamaican lottery, but the recipient has to offer up money to claim the prize.

4. “Are you there?”

This is a new type of automated call in which scammers search for phone numbers at which people will pick up and acknowledge themselves. It leads to their phone number going on a list as a potential target for future scam calls.

5. Grandparent scams

Someone calls an older person pretending to be a young relative in dire need, prompting a request for a wire transfer of funds or other urgent financial help.

6. Computer scams

Criminals reach out to inexperienced computer owners with offers of phony technical support or with threats related to the operation of

their computers, while seeking wire transfers or passwords through which they can access victims’ financial accounts.

7. Romance scams

Someone creates a fake online dating profile, gains a victim’s trust and then gets that person to send money to meet some need, which sometimes includes a phony proposal to travel to visit the victim.

8. Elder financial abuse

This covers the many ways in which relatives, acquaintances, strangers and even hired professionals sometimes use an older adults’ funds without consent for their own purposes.

9. Identity theft

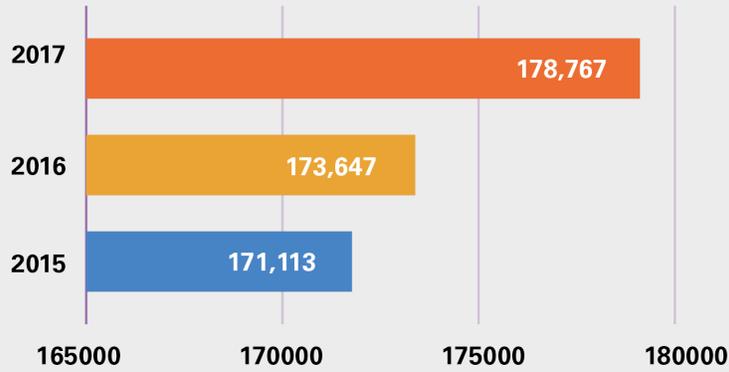
Criminals make attempts to gain personal information about an individual – such as a Social Security number – that can then be used to try to access their funds. To help address this, Medicare is planning to issue new cards to beneficiaries that will no longer contain their full Social Security numbers.

10. Government grants

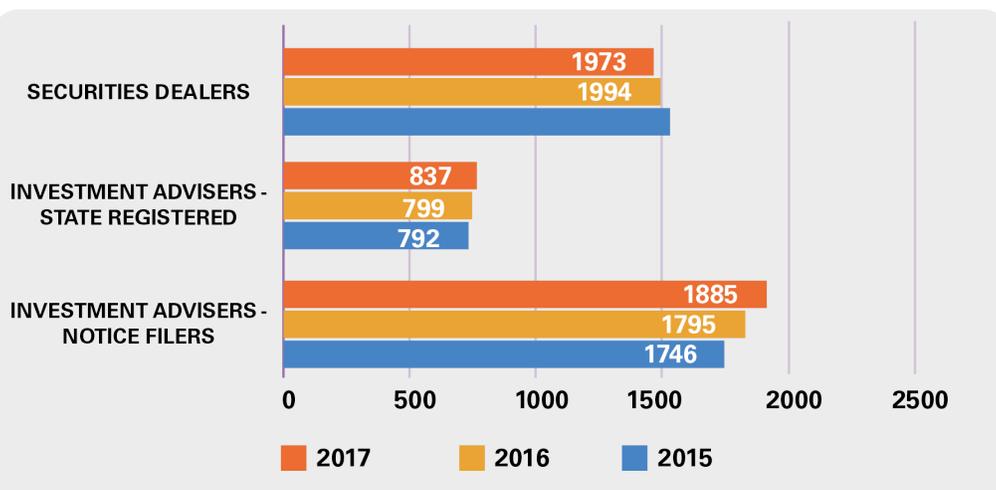
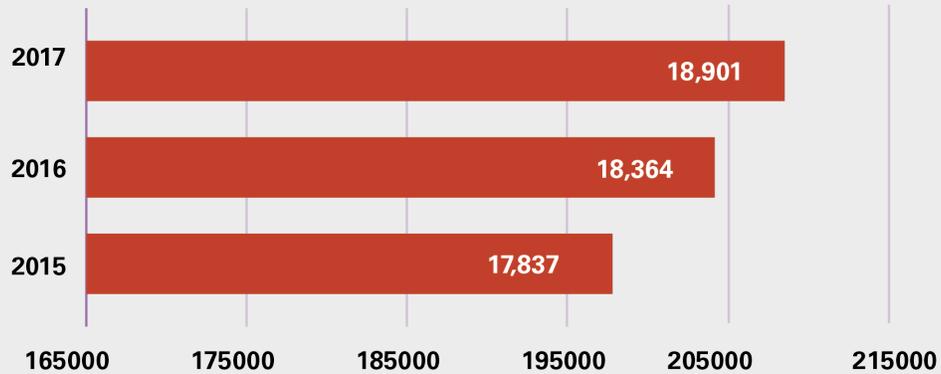
Thieves sometimes call and pretend to be from a “government grants department” that will issue funds in the form of a grant once certain fees are paid.

2017 Year-End Licensing Statistics

Securities Salespersons



Investment Adviser Representatives



Industry News

NASAA Survey: Rise of Fintech Raises New Concerns for Securities Regulators

Survey Shows Millennials at Greatest Risk for Fintech Fraud; Need for Increased Vigilance from Regulators, Industry and Investors

A new survey of by the North American Securities Administrators Association (NASAA), of which the Ohio Division of Securities is a member, underscores why regulators, the industry and investors, especially Millennials, must be vigilant amid the rapid pace of development spurred by advances in financial technology, also referred to as fintech.

The results, released in mid-February, come from NASAA's recent Pulse Survey on fintech and the technological innovations shaping new investment and financial products. The poll, conducted from mid-November to mid-December 2017, collected responses from NASAA members about the challenges of adapting to new financial technology products and changes in and how financial services are delivered to investors. The findings offer a unique insight into the concerns and perspectives of the investment industry's local cops on the beat.

One-third (34 percent) of securities regulators said the rapid development of financial technology is a positive development for investors, while 20 percent expressed concern with the potential negative impact of fintech on investors. Almost one-half (46 percent) said it is too soon to tell, citing benefits such as lower costs and greater accessibility to investments among groups not previously reached by traditional methods, but cautioning that sufficient investor protections must be in place so that easier access does not translate into greater exposure to risk or fraud.

Top takeaways from the survey include:

- **Millennials most at risk for fraud**

Regulators viewed Millennials as both most likely to use fintech products (84 percent) and also as most at risk of fraud from fintech products (41 percent). While Baby Boomers were viewed as least likely to use fintech, they were still viewed as the second most likely demographic group to be at risk of fintech fraud (38 percent).

- **Not all risks are created equal**

While all regulators viewed fintech at large as having a high (28 percent) or moderate (72 percent) chance of fraud, the risk varied widely by specific products with Initial Coin Offerings (ICOs) and cryptocurrencies being most commonly identified as high risk (94 percent) and robo-advising being least commonly identified as high risk (3 percent).

- **Fraudsters most knowledgeable**

More than half of regulators (56 percent) said they viewed fraudsters as the most knowledgeable about the risks of fintech, nearly all respondents felt that investors were the least knowledgeable about these risks (94 percent).

- **Fighting fintech fraud is getting harder**

Three-fourths of respondents (75 percent) felt that preventing fintech fraud is getting harder.

NASAA has developed a short animated video to help investors learn more about two aspects of fintech, Initial Coin Offerings and cryptocurrency. The video, "Get in the Know About ICOs," is available on NASAA's website at www.nasaa.org and at <https://vimeo.com/239995680>.

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SEC Adopts Statement and Interpretive Guidance on Public Company Cybersecurity Disclosures

On Feb. 28, the SEC voted unanimously to approve a statement and interpretive guidance to assist public companies in preparing disclosures about cybersecurity risks and incidents. The guidance provides the Commission's views about public companies' disclosure obligations under existing law with respect to matters involving cybersecurity risk and incidents. It also addresses the importance of cybersecurity policies and procedures and the application of disclosure controls and procedures, insider trading prohibitions, and Regulation FD and selective disclosure prohibitions in the cybersecurity context.

[Read the news release](#), which includes comments from SEC Chairman Jay Clayton.

Enforcement Section Update

ADMINISTRATIVE HEARINGS

Craig Alan Sutherland, CRD 2001873

Division Notice Order No. 17-018
August 7-10, 2018 (cont.)

Jeffrey Allan Mohlman, CRD 4431845 (inactive)

Division Notice Order No. 17-024
May 16, 2018 (cont.)

Katrina Farmer a/k/a Katrina Seiter; A Voice 4 U, LLC

Division Notice Order No. 17-037
July 9-10, 2018 (cont.)

ADMINISTRATIVE APPEALS

TAP Management, Inc. et al.

Case No. 17 CV 006942
Appeal from Division Final Order No. 17-022
Filed August 2, 2017

ADMINISTRATIVE ACTIONS

Division Order No. 18-001

Brian P. Kelly CRD No. 3065740
Canton, Ohio

On January 3, 2018, the Division issued a Cease and Desist Order with Consent Agreement against Brian P. Kelly based on findings that he engaged in discretionary trading without written authorization from a client and failed to timely update his licensure record to include an Ohio income tax lien and a client arbitration.

The Division's Enforcement Section is a criminal justice agency authorized to investigate and report on all complaints and alleged violations of the Ohio Securities Act and related rules. The Enforcement Section attorneys represent the Division in prosecutions and other matters arising from such complaints and alleged violations.

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Division Order No. 18-002

Capital Energy Group, LLC
Cap E Oil Fund IV, LLC
Donald J. Lutzko
William J. Milles
Austin Texas
Toronto, Ontario
Cherry Hill, New Jersey

On January 11, 2018, the Division issued a Cease and Desist Order against Capital Energy Group, LLC, Cap E Oil Fund IV, LLC, Donald J. Lutzko and William J. Milles based on findings that they engaged in the fraudulent sale of unregistered securities. The Order found that Respondents engaged in cold call solicitations to an elderly resident of Ohio for the purpose of selling investments in an oil platform with projections providing for up to 229-percent return on the investment. A hearing was not requested.

Division Order No. 18-003

BinaryRoom365
Amsterdam, Netherlands

On January 11, 2018, the Division issued a Cease and Desist Order against BinaryRoom365 based on findings that the company engaged in misrepresentations and fraud in the sale of securities through the operation of an internet-based trading platform at www.binaryroom365.com and soliciting an Ohio investor to invest \$33,500 with the platform. The Division further found that the website showed returns of 78 percent and 80 percent on the main page. The website has been deactivated.

Division Order No. 18-004

Thomas P. Gilmartin, Jr.
Capital Finance Group, LLC
Youngstown, Ohio

On January 11, 2018, the Division issued a Final Order to Cease and Desist against Thomas P. Gilmartin, Jr. and Capital Finance Group, LLC, after an administrative hearing in this matter. The Division found that Respondents engaged in fraud in the sale of securities through solicitations made to the Western Reserve Port Authority without disclosing his criminal record reflecting 35 felony convictions, including a conviction for securities fraud, and a nine-year prison sentence.

Division Order No. 18-005

Cunningham Energy, LLC
Charleston, West Virginia

On January 24, 2018, the Division issued a Cease and Desist Order with Consent Agreement naming Cunningham Energy, LLC, based on findings that the Respondents engaged in the sale of unregistered securities by soliciting and selling joint venture working interests in oil and gas drilling projects in West Virginia to at least 25 Ohio investors. The Division found that the securities were not registered with the Division prior to the sales.

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Administrative Actions continued from page 14

Division Order No. 18-006

Gabriel David Eddy
North Shiloh, Ohio

On January 31, 2018, the Division issued a Cease and Desist Order with Consent Agreement naming Gabriel David Eddy based on findings that Eddy acted as a securities dealer without proper licensure. The Division found that Eddy, while holding himself out on social media as a daytrader, initiated trades in the account of two clients with the expectation that he would receive a portion of the returns generated. The accounts sustained large monetary losses. As part of the Consent Agreement, Eddy agreed to repay restitution in the amount of \$5,000.

Division Order No. 18-007

MemberMap, LLC CRD No. 152523
Steven R. French CRD No. 1350269
Cincinnati, Ohio

On February 8, 2018, the Division issued a Cease and Desist Order with Consent Agreement naming MemberMap, LLC, and Steve R. French based on findings that Respondents provided false information to the Division related to the activities of MemberMap, LLC, and engaged in an act, practice or course of business that was fraudulent, deceptive or manipulative. The Order found, as part of an examination inquiry, that Respondents communicated to a Division examiner that MemberMap, LLC, had no individual asset management clients or asset under management. Upon further inquiry during the examination, French admitted that the majority of assets held by MemberMap, LLC, were not his personal, but rather were the assets of his 14 paying clients. The value of the assets was \$1,298,981.

Division Order No. 18-008

Jeffery Allan Mohlman CRD No. 4431845 (inactive)
Dayton, Ohio

On March 14, 2018, the Division issued a Notice Order against Jeffery Allan Mohlman, which amended previous Order No. 17-024. The Amended Notice of Intent to Issue a Cease and Desist Order alleges that Mohlman engaged in the sale of unregistered securities to six Ohio residents in an aggregate amount of \$907,000. The securities were issued by William Apostelos and his related businesses. In 2015, Apostelos was convicted in the U.S. District Court for the Southern District of Ohio, in part, for fraudulently inducing hundreds of individuals from around the country to invest collectively over \$70 million in his companies. On June 30, 2017, Apostelos was sentenced to 180 months in federal prison and ordered to pay over \$32 million to investors.

Division Order No. 18-009

Michael Patrick Spolar CRD No. 192992
Lyndhurst, Ohio

On March 29, 2018, the Division issued a Notice of Intent to Deny Application for the securities salesperson and investment adviser representative license of Michael Patrick Spolar based on allegations that he is not of "good business repute." The considerations set forth in the Notice Order include Spolar's termination from a prior broker-dealer for "discretionary trading in brokerage accounts in violation of firm policy," five customer complaints that resulted in aggregate settlements in excess of \$368,000, a FINRA AWC resulting in a one-month suspension, and Spolar's subsequent termination from his firm for contacting clients during his FINRA suspension.

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Administrative Actions continued from page 15**Division Order No. 18-010**

D.L. Yoho Investment Advisors, LLC, CRD No. 285214
Daniel Yoho CRD 1353988
Uniontown, Ohio

On March 29, 2018, the Division issued a Notice of Intent to Suspend or Revoke the Ohio investment adviser license of D.L. Yoho Investment Advisors, LLC, and the Ohio investment adviser representative license of Daniel Yoho based on allegations that they failed to respond to Division examiners, failed to maintain required financial records, and failed to update his Form U4 and parts 1 and 2 of his form ADV to disclose four State of Ohio tax liens.

Division Order No. 18-011

Garry N. Savage, Sr. CRD 1195330
Advanced Strategies Agency, Inc. CRD 121343
Huron, Ohio

On March 29, 2018, the Division issued a Notice of Intent to Suspend or Revoke the Ohio investment adviser license of Advanced Strategies Agency, Inc. and the Ohio investment adviser license of Garry N. Savage, Sr. based, in part, on allegations that they failed to timely disclose numerous customer complaints, including several civil judicial actions on their Form ADV. The Division further alleges, in part, that the Respondents did not disclose an administrative consent order issued by the Ohio Department of Insurance and that Respondents provided false information to the Division in response to an examination inquiry.

Division Order No. 18-012

Garry Savage, Jr. CRD 2338013
Huron, Ohio

On March 29, 2018, the Division issued a Notice of Intent to Suspend or Revoke the Ohio investment adviser license of Garry N. Savage, Jr. based, in part, on allegations that he failed to timely disclose customer complaints, including civil judicial actions, as well as his outside business activities on his Form U4. The Division further alleges, in part, that the Respondent provided false information to the Division in response to an examination inquiry.

Division Order No. 18-013

Katrina Farmer a/k/a Katrina Seiter
A Voice 4 U, LLC

On April 13, 2018, the Division issued a Notice of Opportunity for Hearing and a Notice of Intent to Issue a Cease and Desist Order, which amended Division Order Number 17-037, previously issued on December 6, 2017. The stated intent of the amended NOH was to provide more specific notice of the nature of the violations alleged. The Notice Orders allege that Katrina Farmer a/k/a Katrina Seiter and A Voice 4 U, LLC sold promissory notes and equity shares issued by A Voice 4 U, LLC to 17 Ohio investors for an aggregate amount over \$693,000 that were not properly registered for sale in Ohio. The Notice Order further alleges that investors were told that their investment would be used to build the business, when the funds were actually used for purchases at retail stores, including Victoria's Secret, Kings Island, and tanning and nail spas, as well as significant payments to Keen.com for e-mail, chat and telephone psychic readings.

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CRIMINAL TRIALS AND HEARINGS**State v.****Jeffrey W. Johnson**

Case No. 17 CR 020
Holmes County Court
of Common Pleas
Outstanding Bench
Warrant
Date: May 10, 2018
(pre-trail)

State v. Lovell Jones

Case No. 16 CR 004770/16
CR 004772
Franklin County Court
of Common Pleas
Date: TBD
(outstanding warrant)

State v.**Jeffrey B. Hall**

Case No. 17 CR 004124
Franklin County Court
of Common Pleas
Date: May 8, 2018
(cont. trial)

State v.**Ronald Lee Jennings**

Case No. CR 2017 12 1975
Butler County Court
of Common Pleas
Date: April 30, 2018
(plea or set trial date)

State v.**Wayne C. Moore, Jr.
and Jarrich K. Fowlkes**

Case No. 18 CR 000989
Franklin County Court
of Common Pleas
Date: May 23, 2018
(pre-trail)

State v.**John Case**

Case No. 18 CR 000991
Franklin County Court
of Common Pleas
Date: TBD
(outstanding warrant)

State v.**Kimm Hannan**

Case No. 2018CR0520
Stark County Court
of Common Pleas
Date: April 27, 2018
(pre-trail)

For further information on these cases, visit:

[Bulletin 2017 FourthQuarter.pdf](#)

[Bulletin 2017 ThirdQuarter.pdf](#)

[Bulletin 2017 SecondQuarter.pdf](#)

[Bulletin 2017 FirstQuarter.pdf](#)

[Bulletin 2016 ThirdQuarter.pdf](#)

CRIMINAL TRIALS AND HEARINGS**State v. Peter A. Beck**

Case No. 17-1278
United States Supreme Court
Appeal from Hamilton App.No. C-150539,
2016-Ohio-8122

On March 12, 2018, Peter A. Beck, through counsel, filed a Petition for Writ of Certiorari with the U.S. Supreme Court. On April 17, 2018, the Court denied the petition.

State v. Michael David Mathew

Case No. CT2017-0051
Fifth District Court of Appeals

On August 3, 2017, counsel for Michael Mathew filed a Notice of Appeal from his criminal case filed in Case No. CR2016-0415 in Muskingum County, Ohio. An overview of the case can be found at: http://com.ohio.gov/documents/secu_Bulletin2017ThirdQuarter.pdf

CRIMINAL CASES

State v. John Case

Case No. 18 CR 000991

Franklin County Court of Common Pleas

On February 8, 2018, John Case of Groveport, Ohio, was indicted for four counts of misrepresentation in the sale of a security, four counts of securities fraud, and one count of theft. The indictment stems from allegations that Case received \$27,500 from four investors in his company, Talent Overload, LLC, based on representations that the investments would be used to develop a mobile app. Instead of using the funds as proposed, the indictment alleges that Case use the funds for personal expenses. The case is being prosecuted by the Office of the Franklin County Prosecutor, Ron O'Brien, by Assistant Prosecuting Attorney Robert Lang.

State v. Philip Curtis et al.

Case No. 16 CR 004770/16 CR 004772

Franklin County Court of Common Pleas

On March 12, 2018, Philip Curtis of Chapel Hill, North Carolina, pled guilty to one count of securities fraud and four counts of theft and was sentenced to five years community control by Judge Colleen O'Donnell in the Franklin County Court of Common Pleas. He also was ordered to pay \$14,850 in restitution to five victims. Curtis originally was indicted in August 2016, along with Mary Hackney of Cook County, Illinois, and Lovell Jones of Franklin County. Hackney pleaded guilty to one count of misrepresentation in the sale of securities and five counts of theft in September 2017, and was sentenced to four years and 11 months in prison and ordered to pay restitution in the amount of \$66,850. A warrant for failure to appear in court is outstanding for Jones. Curtis solicited five individuals who invested in Hackney's company, Hackney Consulting Group, Inc., doing business as HCG and HCG-770, previously located in Columbus. Curtis retained a portion of the investments for himself and forwarded the remainder to Hackney Consulting Group, Inc. and its affiliated companies. The indictment alleged that the investment funds were used for personal expenses between September 2011 and February 2013. If you have information about the location of Lovell Jones, contact the Ohio Division of Securities at 800-788-1194. The case is being prosecuted by the office of Franklin County Prosecutor, Ron O'Brien, and presented by Thomas Allen, assistant prosecuting attorney.

State v. Wayne C. Moore, Jr. and Jarrich K. Fowlkes

Case No. 18 CR 000987

Franklin County Court of Common Pleas

On February 18, 2018, following a criminal referral by the Ohio Division of Securities, Jarrich K. Fowlkes and Wayne C. Moore, both residents of Franklin County, were indicted by a Franklin County grand jury on charges of securities fraud and misrepresentations in the sale of a securities, both felonies of the second degree, and grand theft, a felony of the fourth degree. The indictment alleges that, during the time period of June through October of 2015, Moore and Fowlkes solicited an investment of \$45,010 in their company, Rick and Wayne Wholesale Rehabs, LLC, from an Ohio investor for the purpose of purchasing and rehabbing real estate. Instead of applying the investment funds for the real estate business, the indictment alleges that Moore and Fowlkes misappropriated the funds for personal use. This case is being prosecuted by Assistant Prosecutor Robert Lang with the Office of the Franklin County Prosecutor, Ron O'Brien.

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State v. Catherine Schaper (North Shore Energy, LLC, et al.)

Case No. CR2015-03-0495

Butler County Court of Common Pleas

On February 13, 2018, Butler County Court of Common Pleas Judge Charles Pater sentenced Catherine M. Schaper, age 55, of Austin, Texas-based North Shore Energy, LLC, to six years in prison and ordered her to pay restitution to the victims and court costs. Schaper pled guilty to one count of securities fraud and one count of the sale of unregistered securities, both felonies of the second degree. Schaper is the last of the three defendants to be sentenced in this case. On June 5, 2017, company principal Troy West was sentenced to six years in prison, ordered to pay restitution to investors and ordered to pay the costs of prosecution. Company solicitor Robert McManus of West Chester, Ohio, was sentenced to five years in prison and ordered to pay restitution to investors. North Shore Energy, LLC, was ordered to pay additional fines of \$30,000. All of the defendants are jointly and severally liable to pay the full restitution amount to the investors in the amount of \$1,942,239.79. Both West and North Shore Energy pled guilty to one count of securities fraud and one count of the sale of unregistered securities, both felonies of the second degree. McManus pled guilty to one count of the sale of securities without a license and one count of the sale of unregistered securities, both felonies of the second degree. On July 3, 2017, West appealed his conviction and sentence. He remains in custody while his appellate case is pending. All of the convictions stem from the sale of promissory notes issued by North Shore Energy, LLC, to at least 18 investors residing in Ohio, Indiana and Kentucky in 2010 and 2011 for the purpose of investing in oil and gas drilling operations in Texas. The cases were prosecuted by Assistant Prosecutor Dan Ferguson with the Office of Butler County Prosecutor, Michael Gmoser.

State v. Keith Elsesser

Case No. 2017 CR 04 0102

Tuscarawas County Court of Common Pleas

On March 12, 2018, Keith Elsesser, 51, was sentenced to pay full restitution to both of his victims after pleading guilty in January to two felony counts of grand theft and four felony counts of unlawful securities practices for stealing a total of more than \$90,000 from the two victims. An investigation led by the Division of Securities found that Elsesser sold phony securities to two local investors between 2011 and 2013. Elsesser misled the victims into believing they were investing in an energy drink venture. The investigation found that he instead spent the funds on things like groceries, movies, rental cars, and other entertainment. Elsesser paid \$10,000 of the restitution and was ordered to pay \$1,500 in restitution each month hereafter. He was also sentenced to seven days in jail and five years of community control. A community control violation could result in six years in prison. The case was prosecuted by attorneys with Attorney General DeWine's Special Prosecutions Section. The case was investigated with the assistance of the Ohio Attorney General's Bureau of Criminal Investigation, the New Philadelphia Police Department, and the Tuscarawas County Sheriff's Office.

State v. Kimm Hannan

Case No. 2018CR0520

Stark County Court of Common Pleas

On March 14, 2018, after an investigation and referral by the Ohio Division of Securities, Kimm Hannan was indicted by a grand jury in Stark County, Ohio, on 55 criminal counts including securities fraud and theft from the elderly. The indictment was based on allegations that Hannan misappropriated more than \$1.7 million from Ohio investors who were solicited to invest in Hannan's various companies. Hannan owned several businesses, including Hannan and Associates, LLC, an investment adviser firm in Canton, Ohio.

The Ohio Securities Exchange provides a platform where views and opinions related to the securities industry can be shared from sources outside the Division of Securities. The Division encourages members of the securities community to submit articles pertaining to Ohio securities law and regulations.

If you are interested in submitting an article, contact the Editor, Dan Orzano, Daniel.Orzano@com.state.oh.us for the publication schedule and submission requirements. The Division reserves the right to edit submitted articles for publication.

Disclaimer

The views and opinions expressed in the Ohio Securities Exchange solely represent those of the contributors. The Division of Securities takes no position on the material presented.

New Rules Seek to Protect Seniors from Financial Exploitation

By: Brian P. Nally

Introduction

In recent years, there has been an increased focus on how the “aging population” will impact the financial services industry. The first wave of Baby Boomers began reaching the age of 65 in 2011, and the U.S. population continues to see a dramatic increase in the population aged 65 or older.¹

As of 2010, there were 40.3 million people aged 65 or older and that number is expected to more than double to 83.7 million by 2050.² This growth is expected to be most dramatic in the short-term, with the sharpest increase occurring between 2010 and 2030.³ With an aging population comes an increase in mental health concerns. Advancing age is the single-largest risk factor for dementia and Alzheimer’s disease.⁴ And because people aged 85 or older constitute the fastest-growing segment of the population, the pervasiveness of these cognitive impairments is expected to rise.⁵ Other issues impacting mental health, such as depression, loss of vision, loss of hearing, loss of mobility, and disability, will also become more prevalent in the later years of life. This reality has led regulators, self-regulatory agencies, states and financial services companies to take action.

New FINRA Rules Attempt to Address Financial Exploitation

On Feb. 5, 2018, two new rules from the Financial Industry Regulatory Authority (“FINRA”), the self-regulatory body overseeing broker-dealers and their registered persons, became effective: FINRA Rule 2165 (Financial Exploitation of Specific Adults), and amendments to FINRA Rule 4512 (Customer Account Information). These rules were passed to address the “serious and growing problem” of financial exploitation of our aging population.⁶ They also provide professionals in the securities industry with specific tools to more quickly and effectively address suspected financial exploitation of seniors.⁷

Under the new amendments to FINRA Rule 4512, broker-dealers are required to make reasonable efforts to obtain the name of and contact information for a “trusted contact person.”⁸ This applies upon account opening or when updating an existing account.⁹ This requirement goes hand-in-hand with the rule’s requirement that a member disclose in writing to the customer that it is authorized to contact the “trusted contact person” and disclose information about the customer’s account to address suspected financial exploitation.¹⁰ The

¹ U.S. CENSUS BUREAU, P23-212, 65+ IN THE UNITED STATES: 2010, 1 (2014), <https://www.census.gov/content/dam/Census/library/publications/2014/demo/p23-212.pdf>.

² *Id.* at 5.

³ *Id.*

⁴ *Id.* at 40.

⁵ *Id.*

⁶ Financial Industry Regulatory Authority, Regulatory Notice 17-11, 1 (MARCH 2017), <http://www.finra.org/sites/default/files/Regulatory-Notice-17-11.pdf>.

⁷ *Id.*

⁸ *Id.* at 2.

⁹ *Id.*

¹⁰ *Id.* at 2-3.

“trusted contact person” is intended to be a person who can be relied upon to protect the customer’s account. For example, the trusted contact person may be contacted if the registered representative for the account suspects the client is suffering from Alzheimer’s disease, dementia, or other forms of diminished capacity, or if the customer is ill or simply unresponsive.¹¹ This is an important change to who a financial professional may contact or provide information about an account. Previously, financial professionals could not contact a non-account holder to discuss information about an account under Regulation S-P, which generally prohibits financial institutions from providing customer information to third parties.

The amendments to FINRA Rule 4512 work hand-in-hand with the new FINRA Rule 2165. Under FINRA Rule 2165, a member is permitted to place a temporary hold on an account when the person reasonably believes that financial exploitation has occurred, is occurring, or has been attempted or will be attempted. While the action is not mandated, the rule provides a “safe harbor” if a member exercises discretion to place a hold on an account to investigate suspected financial exploitation. If a member places a temporary hold on an account, the firm must immediately initiate an internal review of the situation and provide written notice to the customer and trusted contact person that a hold has been placed on the account and the reason for it.¹² The original hold will expire within 15 business days, but can be extended once for 10 business days. At the end of this period, the member must reach a conclusion about whether the hold should be lifted or extended through some additional action (e.g., a court order).¹³

Rule 4512 applies to a person aged 65 or older or a person 18 or older who the member reasonably believes has a mental or physical impairment that renders the individual unable to protect his or her own interest.¹⁴ And the rule has been limited to “disbursements” only, not on any other transactions (e.g., a request to sell a stock).¹⁵ In defining “financial exploitation,” FINRA has been less clear. This phrase could include virtually any action that would lead to the wrongful or unauthorized taking of funds or securities from an account, even in situations where someone is acting pursuant to a power of attorney, guardianship or other authority. FINRA has also provided less-than-clear guidance on what constitutes a “reasonable belief” that financial exploitation is occurring, relying on a “facts and circumstances” approach without any set parameters.

The imprecise guidance provided by these FINRA rules will unquestionably lead to tremendous uncertainty. Financial professionals for elder clients – or younger clients with cognitive impairments – will now be placed in the precarious situation of assessing the mental health of their clients. Moreover, these rules suggest that financial professionals will now be expected to assess the validity or authenticity of legally binding documents, such as Powers of Attorney, to ensure the documents were not obtained through improper means, such as undue influence or deceit. And to make matters more challenging, the shift in our society’s method of communicating – away from in-person meetings and toward telephone and other electronic forms of communication – will mean financial professionals will be forced to make these determinations with potentially limited client interaction and imperfect information.

¹² *Id.* at 4.

¹³ *Id.* at 5.

¹⁴ *Id.* at 3.

¹⁵ *Id.* at 4.

There is no question that exploitation of our aging population is a sincere concern and something the financial services industry must take seriously. This is especially true with the growing sentiment that financial professionals should act in their client’s best interest and because financial professionals often act as the last line of defense between the “exploiter” and a client’s money. Although these new rules technically only apply in the FINRA context, all financial professionals should be on guard of potential financial exploitation of our aging population, and consider the following:

1. Know your client's family status.

As a client relationship develops, it is important to understand more than the basic information (e.g., single vs. married, the number of children, etc.). Understanding the dynamic between family members (e.g., a parent and child, brother and sister) and understand who is within your client's circle of trust.

2. Know your client's preferences.

Understand patterns in your client's method of communication. Pay attention to whether your client generally prefers communication in-person, over the telephone, or through electronic communication and be receptive to any material change to this pattern. Also pay attention to any patterns in the timing of communication. Some clients may habitually communicate about their financial issue early in the day while others do so at night. A significant departure from these habits could be a red flag for potential exploitation.

3. Understand life changes.

Understand if your client has lost a spouse, child, friend, caregiver, or someone close to them. These life changes could give rise to an opportunity for new and potentially exploitive relationships to develop.

4. Understand changes in environment.

As client's increase in age, they may relocate to a retirement community, downsize to a home in a new community, or move into a nursing home or long-term care facility. New environments will expose clients to new and to potentially exploitive relationships.

Conclusion

The new FINRA rules demonstrate the increased focus on protecting against financial exploitation of seniors. A noble endeavor, for sure, but the practical impact on the financial services industry will be significant. The investment industry must continue to develop appropriate training and education for their representatives and increase awareness about how to best detect and prevent financial exploitation.



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