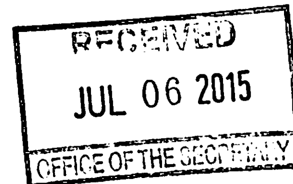
UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

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 POST-HEARING BRIEF AS TO RESPONDENT TIMOTHY S. DEMBSKI

Dated: July 2, 2015

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The Division of Enforcement ("Division") respectfully submits this post-hearing brief following the hearing ("Hearing") as to Respondent Timothy S. Dembski ("Dembski").

PRELIMINARY STATEMENT

Dembski lied repeatedly to his advisory and tax clients to convince them to invest their savings in the Prestige Wealth Management Fund, LP ("Prestige Fund," or "Fund"), a risky day-trading hedge fund Dembski founded with his longtime friend Scott M. Stephan ("Stephan"). Investor after investor—most of whom were elderly and financially unsophisticated—testified that they invested in the Prestige Fund because they placed their trust in Dembski, who had served as many of the victims' investment adviser and tax preparer for years, and believed Dembski's many misrepresentations about the Fund. Dembski preyed upon that trust, falsely telling his clients he personally would run, monitor, and oversee the Fund, and describing the Fund in glowing terms he knew to be false. Among other misrepresentations, Dembski claimed (1) the Prestige Fund was such a good investment that he invested his own and his family's money in the Fund; (2) Dembski could withdraw his clients' investments immediately if the Fund began to lose money; (3) Prestige Fund investments were insured by the FDIC; and (4) "big banks" were looking to invest in the Fund's trading formula, a formula he claimed to be working with Wall Street law firms to patent. Then, to buttress the oral misrepresentations in his sales pitch, Dembski provided his clients with a Private Placement Memorandum ("PPM") that boasted of an experienced investment manager (Stephan) who, among other things, "co-managed a portfolio of over $500 million" and "was responsible for portfolio management and analysis" for "a New York based investment company."

The truth about the Prestige Fund and its management, however, was radically different from the rosy picture Dembski painted. As Dembski now admits, he never invested his or his family's money in the Fund, and he did not—and was not permitted to—play any role in managing

or even monitoring the Fund's performance. The only person authorized to make investment decisions for the Prestige Fund was Stephan, the investment manager the PPM painted as highly experienced. But Stephan had virtually zero investment experience, having worked almost his entire career as a debt collector and never having traded any securities or managed any investment portfolio whatsoever. Dembski knew the PPM's description of Stephan's experience was false, admitting under oath that he understood, at the time, that the PPM's description of Stephan's career was, alternately, "incorrect" and "unclear." Stephan himself described the PPM's description of his experience as "highly misleading, if not outright false." And there were no big banks or Wall Street law firms expressing any interest in the Fund or helping to patent its trading formula; nor was the Fund insured by the FDIC or guaranteed in any way.

After hearing Dembski's materially false description of the Prestige Fund, Dembski's trusting clients invested over $4 million in the Fund from 2011 to 2012. What Dembski's clients were actually investing in was a start-up hedge fund created by one person, Stephan, who had virtually no relevant experience in the financial industry, and another, Dembski, who did not even know what a hedge fund was and was not permitted to play any meaningful role in running the Fund. Perhaps it should come as no surprise, then, that most of Dembski's clients who invested in the Prestige Fund lost more than 80% of their money when the Fund was so woefully mismanaged. But while Dembski's clients lost money, Dembski earned large fees on their investments—and investments in the Fund sold by another adviser, Walter F. Grenda, Jr. ("Grenda")—far in excess of what Dembski could have earned had his clients simply kept their money in the safer, more appropriate investments they cashed in to buy into the Prestige Fund.

Now—faced with the evidence of his fraud—Dembski blames others, including his own clients. Regarding his oral misrepresentations, Dembski testified that each and every one of the

eight investor witnesses who testified at the Hearing had it wrong (or worse, were motivated by "greed") when they described the many lies he told to induce them to invest in the Fund. And rather than take responsibility for knowingly using a PPM with a materially misleading biography of the Fund's portfolio manager, Dembski blames the Fund's lawyers, who Dembski claims—without any factual support—"urged" him to the misleading language. But Dembski's reliance on counsel argument is contradicted by the record evidence, which makes clear that the Fund's lawyers were never asked for, and never provided, any legal advice regarding the PPM's description of Stephan's professional experience. In fact, as Dembski acknowledges, the Fund's attorneys populated the PPM with a description of Stephan's work history Dembski himself provided to them. Like Dembski's blame-the-victim approach to his oral misrepresentations, his insistence that counsel is to blame for allowing him to distribute a false biography that he sent to them offers no viable defense, but demonstrates his unwillingness to accept any responsibility for his role in knowingly defrauding his clients.

As a result of his fraud, Dembski violated (and aided and abetted and caused violations of) Sections 206(1) and (2) of the Investment Advisers Act of 1940 ("Advisers Act"), Section 17(a) of the Securities Act of 1933 ("Securities Act"), and Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 10b-5 thereunder and aided and abetted and caused violations of Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder. In light of these violations, and for the additional reasons set forth below, the Division respectfully requests that this Court issue an order (i) barring Dembski from working in the securities industry, and (ii) requiring Dembski to (a) disgorge all fees collected on investments in the Prestige Fund and pay prejudgment interest thereon; (b) pay significant third-tier penalties for each of his violations of the securities laws, and (c) cease and desist violations of the federal securities laws as set forth herein.

STATEMENT OF FACTS

The Division relies on and incorporates herein its Proposed Findings of Facts ("FoF"), filed herewith, as its statement of facts that support the allegations against Dembski.

ARGUMENT

I. Dembski Violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 Thereunder

To establish a violation of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, the Commission must show that a respondent: "(1) made a material misrepresentation or a material omission as to which he had a duty to speak, or used a fraudulent device; (2) with scienter; (3) in connection with the purchase or sale of securities." Proposed Conclusions of Law, filed herewith ("CoL") ¶ 1. Rule 10b-5 implements the Commission's authority under Section 10(b) in three "mutually supporting" ways:

> Rule 10b-5(a) prohibits "directly or indirectly ... employ[ing] any device, scheme, or artifice to defraud." Rule 10b-5(b) prohibits "directly or indirectly ... mak[ing] any untrue statement of a material fact or [omitting] to state a material fact necessary in order to make the statements made ... not misleading." And Rule 10b-5(c) prohibits "directly or indirectly ... engag[ing] in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person." Liability under all three subsections requires a showing of scienter.

CoL ¶ 3 (citations omitted).

Section 17(a) prohibits conduct similar to that targeted by Rule 10b-5, though Rule 17(a) has no "in connection with" requirement and extends to "offers" of securities.

> Like Rule 10b-5, Section 17(a) expresses its prohibitions in three "mutually supporting" subsections. Section 17(a)(1) prohibits "employ[ing] any device, scheme, or artifice to defraud." Section 17(a)(2) prohibits "obtain[ing] money or property by means of any untrue statement of a material fact or any [material] omission." And Section 17(a)(3) prohibits "engag[ing] in any transaction,

> practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser." A showing of scienter is required under Section 17(a)(1), but a showing of negligence suffices under subsections (a)(2) and (a)(3).

CoL ¶ 5.

As the Commission has explained, misrepresentations like those for which Dembski is responsible violate not only Rule 10b-5(b) but also (a) and (c). CoL ¶ 6. The same is true of Securities Act Section 17(a)(1) (and, given the number of Dembski's misrepresentations, 17(a)(3)). CoL ¶ 7.

"Scienter is an 'intent to deceive, manipulate, or defraud.'" CoL ¶ 4. To satisfy this scienter requirement, extreme recklessness is sufficient; Dembski "need not have had actual knowledge that his misrepresentations would mislead investors." *Id.* "Extreme recklessness is an 'extreme departure from the standards of ordinary care, ... which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it.'" *Id.*

A. Dembski's Representations to Investors Were False

The record is full of false and misleading statements Dembski made to his clients in connection with sales of Prestige Fund investments. Dembski told investors that:

- Dembski would play an active role in running, managing, monitoring and/or overseeing the Fund (FoF ¶¶ 59(d), 70(c), 78, 82, 93(b), 118(b, c); *see also id.* ¶¶ 52(b), 104, 109);
- Dembski invested his own money, his mother's money and children's tuition in the Fund (FoF ¶¶ 52(a), 70(f), 103(a), 118(d));
- A big bank was interested in investing millions of dollars in the Fund or its trading formula (FoF ¶¶ 52(c), 93(c));
- The Fund was insured by the FDIC (FoF ¶ 93(d));

- The Fund's trading formula was Dembski's—not Stephan's—idea (FoF ¶¶ 59(a), 70(b));
- Dembski was engaged in efforts to patent the Fund's algorithm (FoF ¶ 70(e));
- The Fund was a "for sure thing," had little or no risk, and would gain 20% in value annually (FoF ¶¶ 59(b), 70(f), 93(a), 103(b)); and
- Investors could withdraw their money at any time. (FoF ¶¶ 70(g), 78.)

These statements were unambiguously false. (FoF ¶¶ 130-137, 222.)

Dembski also omitted material facts he was obligated to share with investors. For example, Dembski never told investors Stephan stopped using the Fund's computer to trade for the Fund in or around August 2011 (FoF ¶¶ 63, 70(d), 97), a particularly important fact in light of Dembski's testimony that one reason he trusted Stephan—someone with no investment management experience—to manage the Fund's money was that Stephan's role would largely be limited to turning on and off a computer that would drive the Fund's trading. (FoF ¶¶ 20-21.) Likewise, Dembski failed to disclose the strict prohibitions the Fund's operating documents imposed on Dembski playing any meaningful role in running or managing the Fund. (FoF ¶¶ 95, 139.)

B. Dembski Knew His Representations to Investors Were False

When Dembski told investors the misrepresentations set forth above, he made those statements fully aware of the falsity of his statements. For example, Dembski knew before he sold Prestige Fund investments that he was not permitted to have anything to do with the day-to-day management of the Fund, or to even ask Stephan "for information as to the investment performance of [the] Prestige" Fund. (FoF ¶¶ 35, 137.) Dembski and Stephan intentionally set the Fund up with these restrictions pursuant to their understanding that such a structure would allow Dembski to earn fees on Fund investments that he otherwise could not collect. (FoF ¶ 37.)

Dembski also knew his statements about personal investments in the Fund were highly misleading. The truth was that he never invested any money in the Fund beyond $1,000 in seed money. (FoF ¶ 133.) When Dembski claimed he was meeting with "Wall Street" lawyers to patent the Fund's formula, he did so despite knowing that he never made any effort to patent any formula (let alone meet with Wall Street lawyers about such patents), and was unaware of anyone else doing so on the Fund's behalf. (FoF ¶ 132.) And when Dembski told investors of interest expressed by a big bank in investing in both the Fund and its trading formula, he did so even though no bank had expressed any such interest. (FoF ¶¶ 130, 131.)

Asked about these and other misrepresentations—such as Dembski's representation that the Fund was insured by the FDIC—Dembski never claimed to believe the statements described by his clients were true. Rather, Dembski insisted that he simply never made those statements. (FoF ¶¶ 145, 146.) In other words, Dembski argues that every one of the eight clients who testified to his false statements was lying. This is simply incredible. And Dembski's credibility in disclaiming all of the oral misrepresentations his clients described is further undermined by the balance of the Hearing record. For example, while he (and his counsel) repeatedly claimed that there exist many clients who remembered his sales pitch as he did—*i.e.*, without the many material misrepresentations detailed by the eight Dembski clients the Division called to testify—Dembski was unable to find a single client to testify to his story at the Hearing. (FoF ¶ 152.) Moreover, as discussed in Section I.C. below, Dembski was perfectly willing to make demonstrably misleading statements in writing in the Fund's PPM concerning Stephan's investment experience.

C. Dembski Knowingly Utilized a Materially Misleading PPM to Sell Prestige Fund Investments

The PPM's description of Stephan was "highly misleading." (FoF ¶ 154.) After describing Stephan's title and explaining that Stephan had the "exclusive responsibility to make the Fund's investment decisions," the PPM boasted:

> Mr. Stephan has worked in the financial services industry for over 14 years. The first half of his career he co-managed a portfolio of over $500 million for First Investors Financial Services. Afterwards, Mr. Stephan took a position as Vice President of Investments for a New York based investment company in which he was responsible for portfolio management and analysis.

(FoF ¶ 153.)

But Stephan's actual work experience did not support these claims at all. Stephan (1) never managed a portfolio of any size, let alone $500 million, for any company (FoF ¶¶ 155, 156); (2) was never a Vice President of Investments for any New York based investment company (FoF ¶ 157); and (3) never had any responsibility for "portfolio management and analysis" at any such company. (FoF ¶¶ 167, 168.) Stephan's work experience prior to creating the Prestige Fund consisted mostly of working for companies in the business of collecting on past due car loans, either as the employee charged with calling delinquent car owners or managing a call center charged with making such calls. (FoF ¶ 170.) At those jobs, and even during a brief stint at Reliance Financial Group working for Dembski and Grenda just before launching the Prestige Fund, Stephan never managed any money, traded any securities or made any investment decisions whatsoever. (FoF ¶¶ 167, 171.)

Dembski was intimately familiar with Stephan's work experience and thus knew the Stephan biography was misleading. (FoF ¶¶ 169-171, 174-176.) As Dembski admitted, (1) he found the statement about Stephan managing $500 million in securities to be "incorrect" (FoF ¶

179); (2) he did not know what Stephan's biography referred to when it referenced 14 years in the financial services industry (FoF ¶ 180); and (3) he found portions of the biography to reflect "a gray area"—*i.e.*, statements that, according to Dembski, might not be accurate. (FoF ¶¶ 181.) Moreover, Dembski knew—or, as a co-owner of Reliance Financial Group to whom Stephan reported and who interacted daily with Stephan (FoF ¶¶ 173, 175), was extremely reckless in not knowing—that Stephan was not Vice President of Investments for Reliance Financial Group or any other company. (FoF ¶¶ 157, 183.)

Notwithstanding Dembski's knowledge that Stephan's biography was at least materially misleading, Dembski used the PPM to sell Prestige Fund investments. (FoF ¶ 153.) And when Dembski gave his clients the PPM, he never shared with them that he understood the biography of the Fund's sole portfolio manager to be false and misleading. (FoF ¶ 182.) To the contrary, he told the same lies about Stephan's professional experience in his oral representations to clients. (FoF ¶ 59(c).)

D. Dembski's Misrepresentations Are Material

A fact is material if there is a substantial likelihood that a reasonable investor would consider it important in making an investment decision. CoL ¶ 8. The PPM's description of Stephan, the fund manager with exclusive authority to make investment decisions for the Prestige Fund, was "of utmost importance." (FoF ¶ 158; *see also id.* ¶ 60 (investor Krajewski testifying as to the importance of Stephan's experience); *id.* ¶ 159 (Dembski testifying that investors should meet Stephan due to Stephan's role with the Fund).)

The materiality of Dembski's oral misrepresentations is similarly plain, and the investors who testified at the Hearing confirmed the significance of Dembski's false statements. (*See, e.g.*, FoF ¶ 103(a) (Dembski's statements about investing large sums of money in the Fund were

important to Haubrick); ¶ 95 (the Blaszkiewiczes would have wanted to know if Dembski was not permitted to monitor the Fund regularly); ¶ 59(d) (Dembski's claimed "oversight" role was important to Krajewski); ¶ 104 (Dembski's claim that he would run the fund on a daily basis was important to Haubrick); ¶ 70(c) (Broderick found Dembski's statement about managing the Fund "daily" to be important); ¶¶ 70(g), 78 (the liquidity Dembski described to Broderick and Barrett was important to them (though contrary to the PPM)). Indeed, the very fact that Dembski kept repeating the same misleading statements as part of his attempt to sell Prestige Fund investments confirms the materiality of those misrepresentations. CoL ¶ 9.

E. Dembski's Misrepresentations Were Made in Connection with the Sale of Securities Involving Means of Interstate Commerce and the Mails

Dembski's misrepresentations to his clients concerning the Prestige Fund were made in connection with his effort to sell those clients Prestige Fund investments. (*See, e.g.*, FoF ¶¶ 47, 153.) Investments in the Fund were limited partnership interests (FoF ¶ 7), which qualify as securities. CoL ¶ 2. The sale of those securities involved the means and instrumentalities of interstate commerce and the mails, including Dembski mailing the Fund's PPM from New York to addresses outside New York and instructing clients to wire their money from New York to Florida. (FoF ¶ 12.)

F. Dembski Did Not Reasonably Rely on Any Advice of Counsel in Using the False Prestige Fund PPM

As the party asserting an advice of counsel defense, Dembski bears the burden of establishing its essential elements. CoL ¶ 17. Thus, Dembski must "show that he made complete disclosure to counsel, sought advice as to the legality of his conduct, received advice that his conduct was legal, and relied on that advice in good faith." *Id.*

The evidence adduced at the Hearing does not support any of these elements. First, Fund counsel at Holland and Knight was never told the truth about Stephan's actual work history, so counsel lacked sufficient information to render legal advice about the biography. (FoF ¶¶ 202, 205.) Second, neither Dembski, nor anyone else, ever asked counsel for any legal advice regarding the professional background described in Stephan's biography. (FoF ¶ 208.) Indeed, Dembski did not need such advice because—as he also acknowledged—he understood that the facts in the biography were untrue. Furthermore, counsel had made clear that the Fund, through Stephan and Dembski, was responsible for providing the factual information that would populate the PPM. (FoF ¶¶ 188, 189, 194.) And that is precisely what Dembski did when he sent counsel a draft biography of Stephan that included the very false and misleading statements for which he now seeks to blame his lawyers. (FoF ¶ 198.)

Third, counsel never provided any legal advice about the substance of Stephan's professional biography. (FoF ¶ 209; *see also id.* ¶ 204.) Counsel simply received the draft biographies Dembski sent them, made certain grammatical changes, and "put them in the PPM." (FoF ¶ 203.) Dembski acknowledges he never received any legal advice concerning the Stephan biography before giving the PPM to his clients. (FoF ¶ 209.) Instead, Dembski maintains counsel provided legal advice concerning Stephan's biography to Stephan, who, in turn, passed that advice along to Dembski. But Dembski failed to present any evidence supporting that contention beyond his own self-serving testimony. Counsel testified unambiguously that they never provided Stephan with any such advice (FoF ¶ 209), and Stephan himself testified that he had no recollection of receiving or transmitting the purported legal advice on which Dembski claims to have relied. (FoF ¶ 210.)

Finally, Dembski cannot credibly claim to have relied in "good faith" on any legal advice. As explained above, Dembski admits he knew the Stephan biography as drafted was "incorrect" and otherwise "unclear," yet he never even shared those concerns with the counsel he claims to have relied upon for advice regarding that biography. (FoF ¶ 182.) As an investment adviser, Dembski had a duty of full disclosure that required him to tell clients the truth "regardless of what a lawyer might say." (FoF ¶ 212 (citing Prof. Arthur Laby testimony).)

In short, Dembski carries the burden to establish *each* of the four elements of his reasonable reliance on counsel defense but is unable to establish *any* of those elements. Simply claiming there were lawyers in the room is not sufficient to show reasonable reliance on counsel. CoL ¶ 19. Accordingly, the Court should hold Dembski responsible for disseminating the falsehoods about Stephan's experience that he knew were materially misleading at best.

G. Blanket Risk Disclosures in the PPM Do Not Excuse Dembski's Many Oral Misrepresentations

Dembski also may not avoid liability for his oral misrepresentations by pointing to boilerplate risk disclosures in the Fund's PPM. Such a defense is not supported by law or the facts of this case. *See* CoL ¶ 20. For cautionary statements to be "meaningful," they must "discredit the alleged misrepresentations to such an extent that the real risk of deception drops to nil." CoL ¶ 21.

Here, Dembski's attempt to hide behind the PPM's risk disclosures is particularly audacious, as Dembski admits he never even read portions of the PPM himself (FoF ¶ 218), found parts of it difficult to understand (FoF ¶ 219), and believed his clients would likewise be unable to understand the PPM's contents. (FoF ¶ 220.) Some of Dembski's clients even told him they were concerned about language in the PPM or had trouble understanding the meaning

of that document (FoF ¶¶ 53, 61, 123), but Dembski told his clients to disregard the PPM as "boilerplate" or "legalese." (FoF ¶¶ 54, 61.)

H. Dembski Negligently Violated Sections 17(a)(2) and (3) of the Securities Act

The record separately establishes Dembski's liability for negligent violations of Section 17(a)(2) and (3) of the Securities Act. As the Supreme Court explained in *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180 (1963), investment advisers have a duty to deal with their clients in "utmost good faith, and full and fair disclosure of all material facts, as well as an affirmative obligation to employ reasonable care to avoid misleading [their] clients." CoL ¶¶ 15, 16. And those duties were further heightened when Dembski dealt with vulnerable potential investors, such as his elderly, financially unsophisticated clients. (FoF ¶ 215.)

When Dembski told his clients, orally and by using the PPM, the many lies detailed herein, he was not acting in a manner consistent with the standards of care and his duties as an investment adviser. Dembski's fiduciary duties included "an affirmative duty of care, loyalty, honesty, and good faith to act in the best interest of [his] clients." (FoF ¶ 213.) Dembski failed to discharge his duties when he orally misrepresented material facts about the Fund to his clients and when he failed to even review the PPM before sharing it with his clients (or reviewed the PPM and distributed it notwithstanding his concerns about the veracity of statements describing Stephan's work experience). (FoF ¶ 216.)

II. <u>Dembski Violated Sections 206(1) and (2) of the Advisers Act</u>

"Section 206(1) of the Advisers Act prohibits 'any investment adviser' from 'employ[ing] any device, scheme, or artifice to defraud any client or prospective client,' and Section[] 206(2) ... prohibit[s] fraudulent and deceptive practices by investment advisers." CoL ¶ 11. Section 206(1) requires a showing of scienter; a showing of negligence is sufficient to prove a violation of

Section 206(2). CoL ¶ 12.

An investment adviser is "any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities . . . ." CoL ¶ 14. Dembski was associated with Reliance Financial Advisors, a registered investment adviser (FoF ¶ 5), and sold Prestige Fund investments to his advisory clients in his capacity as an investment adviser. (FoF ¶ 39.)[1]

The same conduct that supports Dembski's liability under the Securities Act and Exchange Act anti-fraud provisions also demonstrates his liability under Section 206(1) and (2) of the Advisers Act. CoL ¶ 13.

III. Dembski Aided and Abetted and Caused Prestige LLC's and Reliance Financial Advisors' Violations of the Securities Act, Exchange Act and Advisers Act

Aiding and abetting liability requires proof of (1) the existence of a securities law violation by the primary (as opposed to the aiding and abetting) party; (2) knowledge of the primary violation by the aider and abettor; and (3) substantial assistance by the aider and abettor in the achievement of the primary violation. CoL ¶ 22. "The knowledge or awareness requirement can be satisfied by recklessness when the alleged aider and abettor is a fiduciary or active participant." *Id.*

"To establish liability for 'causing' violations in the absence of aiding and abetting, the Division must prove three elements: (1) a primary violation; (2) an act or omission by the

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[1] Grenda and Reliance Financial Advisors also were investment advisers which, as discussed below, is relevant to the analysis of what primary violations Dembski aided and abetted and caused. (Grenda and Reliance Financial Advisors Answer ¶¶ 9, 11 (admitting Reliance Financial Advisors' status as an investment adviser and that Grenda provided investment advisory services to clients in his role at Reliance).)

respondent that was a cause of the violation; and (3) that the respondent knew, or should have known, that his conduct would contribute to the violation." CoL ¶ 25.[2]

A. The Division Has Demonstrated the Existence of Primary Securities Law Violations

Dembski aided and abetted and caused (i) Prestige LLC's and Reliance Financial Advisors' violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, (ii) Reliance Financial Advisors' violations of Sections 206(1) and (2) of the Advisers Act, and (iii) Prestige LLC's violations of Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder.

The entities' violations stem from the misconduct of Dembski, Grenda and Stephan. Grenda and Dembski were operating at all times relevant hereto as the controlling principals of Reliance Financial Advisors. Accordingly, their conduct—which included using a PPM that both Dembski and Grenda knew was false and misleading (FoF ¶¶ 153, 178-181 (Dembski), ¶ 184 (Grenda))—is imputed to Reliance Financial Advisors. *See* CoL ¶ 27. Likewise, both Stephan's and Dembski's conduct at all times relevant hereto is imputed to Prestige LLC, the general partner of the Prestige Fund. Stephan admits each of the allegations in the Order Instituting Proceedings against him ("Stephan OIP"), including that Stephan willfully violated the relevant provisions of the securities laws while a principal of Prestige LLC. (Stephan OIP ¶¶ 28, 29, 37, 38; Stephan Answer at 1).

Section 206(4) of the Advisers Act (the only primary violation not otherwise discussed herein) prohibits an investment adviser from engaging in "any act, practice, or course of business which is fraudulent, deceptive, or manipulative," and authorizes the Commission to prescribe rules

[2] For primary violations requiring only negligence, Dembski's negligence satisfies the state of mind element for their "causing" liability. CoL ¶ 26.

designed to prevent such conduct. CoL ¶ 24. Rule 206(4)-8(a)(1) prohibits an investment adviser to a "pooled investment vehicle"—which the Prestige Fund purports to be (FoF ¶ 3)—from making an untrue statement of material fact or omitting to state a material fact necessary to make the statements made not misleading to investors or prospective investors in those pools. CoL ¶ 24. Rule 206(4)-8(a)(2) provides that it is a fraudulent practice for an investment adviser to a pooled investment vehicle to engage in "fraudulent, deceptive, or manipulative" conduct with respect to any investor or prospective investor in a pooled investment vehicle. *Id.* As set forth above, Prestige LLC engaged in fraudulent, deceptive and manipulative conduct both through the use of the Fund's PPM and in failing to disclose the Fund's abandonment of the trading algorithm.

B. Dembski Knew, or Was Extremely Reckless in Not Knowing, of Reliance Financial Advisors' and Prestige LLC's Primary Violations

Dembski knew the PPM he and Grenda (and therefore Reliance Financial Advisors) employed in connection with sales of Prestige Fund investments was false and misleading. (FoF ¶¶ 153, 178-181.) Dembski also knew that the Prestige Fund was being managed entirely by one person—Stephan—with virtually no investment experience, let alone experience operating an algorithm-driven hedge fund (FoF ¶¶ 170-176), and Dembski knew of the Fund's growing problems, and its abandonment of the trading algorithm, even as he continued to solicit new investments. (FoF ¶¶ 24, 25, 27.) In addition, Dembski was also obviously aware of the false and misleading statements he was making orally to clients.

C. Dembski Provided Substantial Assistance to the Achievement of Reliance Financial Advisors' and Prestige LLC's Primary Violations

Dembski provided substantial assistance that contributed to Prestige LLC's and Reliance Financial Advisors' primary violations. The Second Circuit has explained that "substantial assistance" turns on whether each individual "in some sort associate[d] himself with the venture,

that he participate[d] in it as in something that he wishe[d] to bring about, [and] that he [sought] by his action to make it succeed." CoL ¶ 23. The venture here at issue is the effort to raise money for investments in the Prestige Fund. Dembski associated himself with that venture when he, among other things, solicited his clients—the ones he had through Reliance Financial Advisors—to invest in the Fund and provided those investors with the Fund's misleading PPM. Furthermore, Dembski co-owned the Prestige Fund, created its general partner, Prestige LLC, with Stephan, and was a principal of Reliance Financial Advisors. (FoF ¶¶ 1, 3-5.)

IV. Relief Requested

The Division seeks (i) disgorgement of ill-gotten gains and prejudgment interest thereon; (ii) civil penalties pursuant to Sections 21B of the Exchange Act, 203(i) of the Advisers Act and 9(d) of the Investment Company Act of 1940; (iii) advisory and collateral bars pursuant to Sections 8A of the Securities Act, 15(b) and 21C of the Exchange Act, 203(f) of the Advisers Act, and 9(b) of the Investment Company Act; and (iv) a cease-and-desist order. The Division seeks this relief to ensure Dembski does not profit from his fraud, is prevented from future violations victimizing the investing public, and is punished for violating the federal securities laws.

A. Dembski Should Disgorge His Ill-Gotten Gains and Pay Prejudgment Interest

Dembski should be ordered to disgorge all ill-gotten gains stemming from fraudulent sales of Prestige Fund investments. Dembski received $363,784.66 in total management and performance fees from investor money the Prestige Fund from July 11, 2011 to December 7, 2012. (FoF ¶ 40.) Dembski would not have collected these fees had he kept his clients in more appropriate, less risky investments. (FoF ¶ 42.) The Fund also "earned" an additional $123,505.91 in fees on the same pool of investments that was paid out to Stephan. (FoF ¶ 40.)

"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." CoL ¶ 29. Moreover, "effective enforcement of the federal securities laws requires that the SEC be able to make violations unprofitable." *Id.* "Management fees and incentive fees are appropriately disgorged where they constitute illgotten gains earned during the course of violative activities." CoL ¶ 30. Accordingly, Dembski should be ordered to disgorge all profits earned through all fraudulent sales of Prestige Fund investments—i.e., the $487,290.57 the Fund claimed as total management and performance fees (*i.e.*, the $363,784.66 paid to Dembski plus the $123,505.91 paid to Stephan). Holding Dembski jointly and severally liable for all Prestige Fund-related ill-gotten gains is appropriate where, as here, both individuals collaborated in the fraud. CoL ¶ 31.

The Court should also order Dembski to pay prejudgment interest of $28,175.37. (FoF ¶ 41.) That is the prejudgment interest amount calculated only for Dembski's share of the Fund-related fees—the Division does not seek prejudgment interest on the balance of the fees for which Dembski should be jointly and severally liable because he did not have the benefit of those funds, as the purpose of prejudgment interest is to deprive a wrongdoer of an interest-free loan, thereby preventing unjust enrichment. CoL ¶ 32.

B. Dembski Should Pay Substantial Penalties

Under Section 8A(g) of the Securities Act, 15 U.S.C. § 77h-1(g), Section 21B of the Exchange Act, 15 U.S.C. § 78u-2, and Section 203(i) of the Advisers Act, 15 U.S.C. § 80b-3(i), the Commission may impose civil monetary penalties for respondents who willfully violated, aided and abetted, or caused a violation of, the provisions of the respective Acts at issue here if such penalties are in the public interest. CoL ¶ 33. 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. CoL ¶ 34.

Section 21B(b) of the Exchange Act specifies a three-tier system identifying the maximum amount of civil penalties, depending on the severity of the respondent's conduct. Third-tier penalties are awarded in cases where, as here, violations involve fraud, deceit, manipulation or deliberate or reckless disregard of a regulatory requirement and 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.[3]

In this proceeding, the Division respectfully submits that third-tier penalties are appropriate against Dembski for his violations of the securities laws. First, penalties are in the public interest. Because this case involves violations of the antifraud provisions of the securities laws, a finding of liability under those statutes essentially answers the question of whether Dembski engaged in an act involving deceit or deliberate or reckless disregard of a regulatory requirement. Indeed, violations of the antifraud provisions of the securities laws are presumed to be the kind of misconduct that satisfies the "deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement" prong of the public interest test. CoL ¶ 39.

The record further reflects significant harm to investors—most of Dembski's investors lost more than 80% of the money they invested in the Prestige Fund (FoF ¶ 30)—and Dembski was enriched significantly by the fees earned from fraudulent sales of Prestige Fund investments. (FoF ¶¶ 40, 42.) Furthermore, Dembski's refusal to accept any responsibility for his actions makes clear

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[3] Second tier penalties are appropriate in cases involving fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement, but no loss, risk of loss, or gain for respondent is present.

that deterrence will not be accomplished absent a significant penalty. (FoF ¶¶ 149 (blaming clients' lawyers); 150 (blaming clients' "greed"); 225 (blaming his own attorney).) The only factor Dembski can credibly claim in his favor is the absence of prior disciplinary history, but that factor alone should not outweigh all other factors. *See* CoL ¶ 34 ("Not all factors may be relevant in a given case, and the factors need not all carry equal weight."). Moreover, Dembski's fraud reached approximately 43 investors over the course of nearly two years (FoF ¶ 6), so Dembski can hardly claim this case concerns the kind of isolated mistake that might make a lack of prior disciplinary record more relevant.

The Court is authorized to award third-tier penalties of $150,000 "for each" violative "act or omission." CoL ¶ 36. In this case, where Dembski violated multiple antifraud provisions of the securities laws each time he defrauded his many clients (at least 19 of whom purchased Prestige Fund investments), significant third-tier penalties should be levied against Dembski for each of his violations of the securities laws.[4] Indeed, the Division respectfully submits that deterrence demands a penalty in excess of Dembski's profits to make clear to investment advisers that defrauding one's clients does not pay.

C. Dembski Should Be Barred from Serving in the Securities Industry

The relevant provisions of the Exchange Act, Advisers Act and Investment Company Act authorize bars from association with a "broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization" where such bars are in the public interest. CoL ¶ 38. Such actions can be taken against any

[4] Penalties for Dembski should not be limited to misconduct relating to those investors who testified at trial. According to Dembski, he regularly used the materially misleading PPM when he sold Prestige Fund investments. (FoF ¶ 153.)

person who, among other things, willfully violated any provision of the Securities Act, Exchange Act or Advisers Act, or any of the rules and regulations promulgated under those statutes.

"The public interest requires a severe sanction when a respondent's past misconduct involves fraud because opportunities for dishonesty recur constantly in the securities business." CoL ¶ 41. The public interest analysis requires consideration of the following factors, frequently called the "*Steadman* factors": (1) the egregiousness of the respondent's actions; (2) the isolated or recurrent nature of the infractions; (3) the degree of scienter involved; (4) the sincerity of the respondent's assurances against future violations; (5) the respondent's recognition of the wrongful nature of their conduct; and (6) the likelihood that their occupation will present opportunities for future violations. CoL ¶ 40.

As discussed above, Dembski—over a period of many months—took advantage of the trust many of his advisory clients placed in them and put many clients' money at great risk. Dembski's fraud involved many different misrepresentations to his various clients. (*See supra* at I.A.) Dembski's scienter is particularly damning, as he knew without question the falsity of the statements he employed in pitching the Prestige Fund to his clients, including blatant lies about investing his own money in the Fund and promises to take an active role in a Fund he knew he was not even permitted to play any significant role in managing. (*See id.*)

Dembski has offered no sincere assurance against future violations. Rather than accept any responsibility for defrauding his clients—despite acknowledging under oath that he knew the written biography in the PPM was untrue—he accuses those clients of fabricating their testimony based on "greed." (FoF ¶ 150.) When confronted with written misrepresentations—namely, the false statements about Stephan in the PPM Dembski gave to investors—Dembski also finds others to blame, falsely accusing the Fund's attorneys of writing, approving, and even "urging" him to use

the biography Dembski himself sent to those lawyers. (FoF ¶ 185.)

Even as to a bank check bearing Dembski's signature produced on his behalf, Dembski is quick to blame others (this time his attorneys) for what appears to be tampering with relevant evidence. (FoF ¶¶ 225.) Such refusal to accept any responsibility for his actions, as well as the more troubling fact of the doctored document itself, militate strongly in favor of an industry bar here. *See* CoL ¶ 42. Finally, Dembski has made clear his intention, absent a bar, to remain in the securities industry (FoF ¶ 227), which also weighs in factor of barring him from the industry. CoL ¶ 43. Full industry bars for Dembski without the right to reapply are therefore in the public interest and warranted in this case.[5]

D. A Cease and Desist Order Against Dembski Is Warranted

The Commission is authorized to issue cease and desist orders where a person has, among other things, been found to have violated any provision of the Securities Act or Exchange Act, or the rules and regulations thereunder. CoL ¶ 44. As described above, Dembski willfully violated the anti-fraud provisions of the Securities Act, Exchange Act and Advisers Act and aided and abetted and caused others' primary violations as well. Dembski's actions demonstrate a conscious disregard of the federal securities laws, which is particularly troubling given his status as investment advisers charged with putting his clients' interests ahead of his own. Accordingly, cease-and-desist orders are appropriate to prevent violations and future violations of the statutes and rules set forth above.

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[5] A full industry bar is particularly appropriate when Dembski's conduct is considered relative to that of the Prestige Fund's co-founder, Scott Stephan. Stephan never communicated directly with Prestige Fund investors and has accepted at least some measure responsibility for his misconduct, but nevertheless agreed to a full industry bar as part of his offer of settlement.

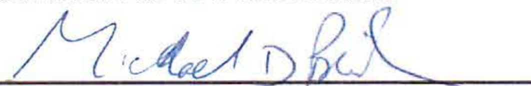
CONCLUSION

Based on the foregoing, the Division respectfully requests that this Court make findings of fact consistent with those proposed by the Division and imposes on Dembski the sanctions requested herein.

Dated: New York, NY
July 2, 2015

Respectfully submitted,

DIVISION OF ENFORCEMENT



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