COLEMAN REPORT

The SBA Lender's Industry Information Source
P.O. Box 546, La Cañada Flintridge, California 91012
Tel (818) 790-4591 Fax (818) 790-7859
LinkedIn:Coleman Small Business Lending Group e-mail: bob@colemanreport.com www.colemanpublishing.com

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T.A. Seiber, Economic Analyst
Bob Coleman, Editor

SEC Closes SBA Lender In Ponzi Scheme Charges

SB Capital in SEC Receivership

It's Thursday, June 28th. Two days before quarter end.

Northern California-based SB Capital is having a banner year with its SBA 7(a) and 504 loan products,and is ready to fund another $10 million in loans to cap off its best quarter ever.

Last year, the non-bank lender, founded by Mark Feathers, ranked 143rd on the Coleman Report 500, approving 22 loans for $24 million.

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This year, production has doubled. The company boasts $60 million in SBA loan volume over the past 12 months.

The outlook looks promising and rosy.

Until the SEC walks through the front door, telling everyone to stop working and go home.

Two weeks later, 20 people are out of a job.

Loans never funded cause another series of cascading litigation.

Mark Feathers and SB Capital's assets are frozen, and Feathers voluntarily agrees to have his company placed in SEC receivership.

SEC

In response to scathing criticism for its mishandling of the Bernie Madoff affair, the SEC now requires private fund advisers to register with the agency and seeks to determine whether smaller firms are using above-market interest rates and inflated values to attract investors.

Feathers grabbed the attention of the SEC by promising to pay 7.5% on $42 million he raised for the company. Said the SEC, “The returns turned out to be too good to be true, and were funded in part with new investors’ money.”

A “ponzi scheme” they say.

In the past, the SEC hadn't focused on private firms, instead choosing to police public securities offerings and transactions. Firms that dealt with private equity had to mark down assets during the financial crisis of 2008, which prompted Dodd-Frank to propose more regulation of smaller firms. Since June, about 750 advisers were investigated for potential conflicts of interest, and have been forced to disclose information about their investors, outside activities, and employees, according to Bloomberg.

SEC investigators will examine fund investments, valuation of assets, as well as communication with clients. There will also be routine examinations of advisers and fund managers to discover problems in the practices of private equity firms. While publicly traded private equity firms were already filing detailed information quarterly and yearly, in June of 2012, the SEC voted on a mandate that requires private-fund advisers to register with the Commission.

Since they were not registered with the SEC, Feathers as well as SB Capital are charged with effecting transactions in fund securities without being registered as a broker-dealer with the Commission. The SEC also alleges that SB Capital and Feathers raised $42 million by selling securities issued by two mortgage investment funds under their control; SBC Portfolio Fund LLC (SPF) and Investors Prime Fund LLC (IPF).

The commission alleges that Feathers attracted more than 400 investors to these funds by promising investors their mortgage investments would produce an annual yield of 7.5% or more, and that from 2009 until the beginning of 2012, Feathers allegedly transferred over $6 million from these funds improperly. The transfers were allegedly used to pay SB Capital's operating expenses and included payments to Feathers.

According to the SEC, Feathers accounted for the improper transfers by disguising them in such a way that the depletion of the fund was hidden from investors. Thus, the SEC alleges Feathers was not forthcoming with information to his investors, and that SB Capital's ability to repay these funds was uncertain.

Furthermore, the SEC claims SB Capital was only able to make interest payments owed to the funds by borrowing more money from the funds themselves.

In February and March 2012, the SEC alleges investors were also kept in the dark when Feathers sold mortgages from one fund to the other at an inflated price to create a profit. The "profit" from the sale was then used to pay management fees of more than $575,000 to SB Capital. Since Feathers allegedly paid returns to his investors that came partly from other investors and partly from fund profits, the SEC claims he operated a "Ponzi-like" scheme.

Feathers Denies SEC Charges

Calling the charges “grossly” insulting and inaccurate, Feathers has communicated with the Coleman Report over the past several weeks. Here are the bullet points:

> For the SEC to posit a 'ponzi-like' reference of investors being paid from 'new capital' as opposed to receiving distributions from 'earnings,' is both grossly insulting and something we look forward to demonstrating as factually inaccurate.
>
> *Mark Feathers*
> *SB Capital*

· Our funds are liquid and profitable. For the SEC to posit a 'ponzi-like' reference of investors being paid from 'new capital' as opposed to receiving distributions from 'earnings,' is both grossly insulting and something we look forward to demonstrating as factually inaccurate.
· Small Business Capital LLC this past week received a line of credit facility prequalification and term sheet for $30 million from one of the country's largest national banks. This would not have occurred without a substantial amount of diligence on the fund.
· We have followed every guideline that we are aware of with the State of California in the sale of securities and the operations of the fund. To imply that we were not licensed to sell securities runs counter to the guidance and requirements that we have had in this matter from our securities attorney and the State of California.
· The statement that I "disguised" manager payments of any kind is absolutely ludicrous. I have spent my career in financial services, banking and in public service (U.S. Naval Officer and with the SBA). To leave safe banking jobs for the opportunity to "steal money" and out of greed is the most preposterous notion that I have ever seen or been accused of. Those who know me know that this is not something I would do.

Victim of SEC Overreaction?

On July 2nd Feathers wrote to the Coleman Report that he was a victim of the SEC’s overreaction to the Madoff Ponzi scheme. The rambling missive disclosed that with the freezing of all his personal assets, he would not be hiring legal counsel.

Also, fearing for his and his family’s safety, he has moved “out of the area,” and would be selling his 2009 Harley Davidson Heritage Softail.

Storm Clouds

As Mark Feathers voluntarily agreed to a SEC receiver on July 10th, the story won’t end there.

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There are storm clouds on the horizon.

Feathers wrote us, “Under the threat by SEC of non-stop depositions to myself and family members up through July 10th (the court date to review a ‘temporary’ vs. ‘permanent’ injunction), as well as indirectly communicated messages of FBI involvement if I was not cooperative, I was placed in an untenable position of signing the permanent injunction for a receivership of my company and funds, which is not what I had wished for as it was clearly not in the best interests of my company and my funds investors, which I hope to demonstrate through the facts of the lawsuit. You may shortly see some misleading information from SEC or the receiver about a $100,000 cashiers check.

The SB Capital case provides a stern warning for private firms: Never promise a specific rate of return on your investor's money if you don’t have the profits to back it up.

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“When informed that our fund accounts had been put into receivership, I did indeed process by phone a request for a check from my BUSINESS account. I had no idea that my personal and business accounts were also frozen. As the SEC and the receiver have positioned this, though, it makes it look like it was a ‘grab.’ This was not the case. Most of my net worth is tied up in the business, and it was necessary for me try to obtain enough liquidity for what I thought would be my family's living needs for some period. I hope that you understand.

“Additionally, my twins were in fact on payroll (at low amounts of income) of SB Capital, like many family owned small businesses. My wife left her banking job paying $250,000 a year eighteen months ago because we were so busy. Her new pay, for the record, was just slightly above 1/3 what she was receiving at banks. It was necessary to engage some level of child care, at affordable amounts to SB Capital, for her to be able to provide the high level services that her experience brought to the business.”

Coleman's Takeaway

In the future, lenders will face significantly more oversight and regulation of all of their activities. Whether or not you believe the SEC may have overreached in its case against SB Capital, it will be difficult for Feathers to explain his promise of a 7.5% return to his investors. The takeover of SB Capital exemplifies the far-reaching effects that more government regulation (e.g. Dodd-Frank) will have on lenders.

The SB Capital case provides a stern warning for private firms: Never promise a specific rate of return on your investor's money if you don’t have the profits to back it up.

Bob Coleman