

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES ACT OF 1933**  
**Release No. 8583 / June 20, 2005**

**SECURITIES EXCHANGE ACT OF 1934**  
**Release No. 51887 / June 20, 2005**

**INVESTMENT ADVISERS ACT OF 1940**  
**Release No. 2399 / June 20, 2005**

**INVESTMENT COMPANY ACT OF 1940**  
**Release No. 26912 / June 20, 2005**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-11958**

<b>In the Matter of</b>	:	<b>ORDER INSTITUTING ADMINISTRATIVE</b>
<b>SIMON A. HERSHON,</b>	:	<b>AND CEASE-AND-DESIST PROCEEDINGS,</b>
<b>Respondent.</b>	:	<b>MAKING FINDINGS, AND IMPOSING</b>
	:	<b>REMEDIAL SANCTIONS AND A CEASE-</b>
	:	<b>AND-DESIST ORDER PURSUANT TO</b>
	:	<b>SECTION 8A OF THE SECURITIES ACT</b>
	:	<b>OF 1933, SECTION 21C OF THE</b>
	:	<b>SECURITIES EXCHANGE ACT OF 1934,</b>
	:	<b>SECTION 203(f) OF THE INVESTMENT</b>
	:	<b>ADVISERS ACT OF 1940, AND SECTION</b>
	:	<b>9(b) OF THE INVESTMENT COMPANY</b>
	:	<b>ACT OF 1940</b>

**I.**

The Securities and Exchange Commission (“Commission”) deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 (“Securities Act”), Section 21C of the Securities Exchange Act of 1934 (“Exchange Act”), Section 203(f) of the Investment Advisers Act of 1940 (“Advisers Act”), and Section 9(b) of the Investment Company Act of 1940 (“ICA”) against Simon A. Hershon (“Hershon”).

**II.**

In anticipation of the institution of these proceedings, Hershon has submitted an Offer of Settlement of Simon A. Hershon (the “Offer”), which the Commission has determined to accept.

Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, Hershon consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of 1933, Section 21C of the Securities Exchange Act of 1934, Section 203(f) of the Investment Advisers Act of 1940, and Section 9(b) of the Investment Company Act of 1940 ("Order"), as set forth below.

### III.

On the basis of this Order and Hershon's Offer, the Commission makes the following findings:<sup>1</sup>

#### Facts

##### Summary

1. This case involves the offer and sale by IBF Collateralized Finance Corporation ("CFC") and IBF VI – Secured Lending Corporation ("Fund VI") of about \$190 million in notes and bonds to 3100 investors between 1997 and early 2002.

2. CFC and Fund VI were two of what originally were seven special purpose corporations or funds (the "IBF Funds") that Interbank Funding Corporation ("IBF") formed in succession between 1996 and 1999 for the purpose of raising investment capital. IBF wholly owned CFC and Fund VI. Hershon was the sole owner of IBF.<sup>2</sup>

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<sup>1</sup> The findings herein are made pursuant to Hershon's Offer and are not binding on any other person or entity in this or any other proceeding.

<sup>2</sup> On July 23, 2002, the Commission commenced an injunctive action against CFC, Fund VI, IBF and Hershon, charging all defendants with violations of Section 17(a) of the Securities Act and Section 10(b) and Rule 10b-5 of the Exchange Act. The Commission's complaint also charged that CFC and Fund VI were operating unlawfully as unregistered investment companies in violation of Section 7(a) of the ICA. On December 5, 2002, the United States District Court for the Southern District of New York granted the Commission's motion for summary judgment on its ICA claims against CFC and Fund VI. The district court appointed a trustee (the "ICA Trustee") to assume control of CFC and Fund VI.

Shortly before the Commission filed its action, IBF, CFC and Fund VI filed for bankruptcy protection in the United States Bankruptcy Court for the Southern District of New York. On August 14, 2003, the bankruptcy court approved the ICA Trustee's plan (the "Plan") for the liquidation of CFC and Fund VI. The district court entered a similar order approving the Plan on September 6, 2003. In December 2003, the Plan went effective and the assets of CFC and Fund VI were transferred to a new entity, IBF Fund Liquidating LLC. The assets of IBF were transferred to a separate new entity, IBF Liquidating LLC. The ICA Trustee is the manager and liquidating agent for both Liquidating LLCs.

3. The IBF Funds invested the proceeds of note and bond sales primarily in loans to distressed entities having a supposed potential for superior profits. While the IBF Funds disclosed to investors that this investment program was risky, their offering materials also touted to potential investors (i) impressive historical loan return statistics ranging from 24 percent to 29.5 percent, (ii) income statements showing the IBF Funds to be profitable and (iii) charts depicting a long track record of uninterrupted, timely interest payments to investors. These representations were materially false or misleading.

4. As a result of the conduct summarized below, Hershon violated Section 17(a)(1), (2) and (3) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

### **The Respondent**

5. **Hershon**, age 57, resides in Washington, D.C. Hershon was the chief executive officer (“CEO”), president and director of CFC, and he was the CEO and a director of Fund VI. He obtained both a Masters and Doctorate in Business Administration from Harvard University in 1973 and 1975, respectively. As CEO and a director, Hershon was involved in the day-to-day management of IBF, CFC and Fund VI, including, but not limited to, deciding and controlling the investments and public disclosures that CFC and Fund VI made.

### **Other Relevant Individuals and Entities**

6. **CFC** was a Delaware corporation with its principal place of business in Washington, D.C. Formed in 1999, CFC was originally named IBF Special Purpose Corporation VII (“Fund VII”). Fund VII initially sought to raise \$25 million through the issuance of unsecured subordinated notes under a private placement memorandum dated May 10, 1999. It increased the offering to \$50 million under an amended private placement memorandum dated August 29, 2000, and it further increased the offering to \$100 million under a supplemental private placement memorandum dated June 27, 2001. In October 2001, Fund VII merged with two smaller IBF Funds and changed its name to CFC. At that time, CFC increased the total offering amount to \$200 million under a supplemental private placement memorandum dated October 1, 2001. In January 2002, CFC merged with a fourth IBF Fund, which had itself issued about \$50 million in subordinated notes in private placements. As a consequence of the mergers, CFC carried \$182 million in investor notes on its books. In January 2002, CFC ceased offering securities.

7. **Fund VI** was a Delaware corporation formed in 1999, having its principal place of business in Washington, D.C. In August 2000, it began offering \$50 million in current and accretion subordinated bonds in a public offering. The bonds were to mature on a rolling basis and bear or accrete interest at rates of eight percent to 10.75 percent per annum. Fund VI raised about \$7.2 million through the public offering and, at December 31, 2001, it had invested approximately \$2.5 million in three assets, two of which it acquired from the parent company, IBF. In 2001, it loaned \$1.3 million to IBF in the form of an unsecured, non-interest bearing loan. In January 2002, Fund VI suspended its offering of securities.

8. **IBF** is a Delaware corporation, wholly owned by Hershon, having its principal place of business in Washington, D.C. IBF was the parent of the IBF Funds. IBF presently is a debtor in a bankruptcy proceeding pending in the United States Bankruptcy Court for the Southern District of New York.

9. **IBF Funds** were formed in succession between 1996 and 1999 and are referred to herein as Funds I through VII. Funds I through IV and Fund VII issued private placement notes over the period 1996 through January 2002. Fund VI is separately described above. Fund V was a small private equity fund formed in 1999. Each private note fund issued five-year notes bearing interest at rates between 8 and 12 percent annually plus additional interest equal to the noteholder's pro rata share of 10 percent of the respective IBF Fund's gross profit. Fund I offered notes under a private placement memorandum dated February 16, 1996. Fund II offered notes under a private placement memorandum dated January 21, 1997. Fund III offered notes under a private placement memorandum dated April 10, 1998. Fund IV offered notes under private placement memoranda dated February 17, 1998, February 12, 1999, February 15, 2000 and supplemental private placement memoranda dated November 7, 2000, July 5, 2001 and October 30, 2001. In 2000, IBF redeemed Fund I's \$2.5 million in outstanding notes. In 2001 and early 2002, IBF merged Funds II, III and IV into CFC.

### **Discussion**

10. Between January 1997 and January 2002, CFC and four predecessor IBF Funds raised about \$182 million through the issuance of unsecured high yielding notes in private placements. Between August 2000 and January 2002, Fund VI raised about \$7.2 million in a public offering of unsecured high yielding bonds. The purpose of these offerings was to raise investment capital for IBF to invest in their behalf. The investors were predominately individuals, not institutions.

11. Hershon formed IBF in 1996 in order to create a pool of capital that would allow Hershon to buy distressed loans from the Resolution Trust Corporation or other sellers or to invest in turn around situations. IBF itself was just a holding company for the IBF Funds. Its principal sources of revenue were the management fees that it (or an affiliate) charged the IBF Funds and whatever profits the IBF Funds generated.

### **The Misleading Disclosures**

12. From the beginning, IBF's disclosures cautioned that IBF's investment strategy "involved a high degree of business and financial risk that can result in substantial losses." The offering circulars also disclosed that, given the nature of these risky investments, there was the risk that cash flows would not be sufficient to cover interest payments to investors. However, all of this generic disclosure about risk was cast in terms of potential future risk.

13. To support the sale of \$182 million in notes by CFC and \$7.2 million in bonds by Fund VI, CFC and Fund VI offset all of this generic risk disclosure with positive disclosures about historical fact, including that (i) the average loan return for the IBF Funds over a four and one-half year period ranged from 24 percent to 29.5 percent; (ii) the IBF Funds were profitable

as verified by their income statements; and (iii) the investments of the IBF Funds were generating cash sufficient to fund operations, as demonstrated by charts showing over \$20 million in total interest payments made over as many as 55 consecutive months.

14. These disclosures were materially false or misleading. As the CEO, president and director of CFC and CEO and a director of Fund VI, Hershon was responsible for and controlled the disclosures contained in offering memoranda of CFC, its predecessor companies, and Fund VI. He was also responsible for and controlled disclosures in materials circulated to broker-dealers and investors on a periodic basis.

### **Inter-Fund Transfers**

15. IBF depended upon fresh offering proceeds to operate. Throughout the history of the IBF Funds, forty to sixty percent of the loan portfolios were not producing any current cash income. To meet the cash needs of the IBF Funds, Hershon transferred loan assets between IBF Funds at par, meaning that the acquiring fund paid the selling fund all principal, interest and fees outstanding, without regard to the value of the loan. Hershon used these transfers as a means of tapping fresh offering proceeds to fund interest and principal payments to investors. He also used these fresh offering proceeds to enhance the return figures of IBF Funds that were losing money, by removing non-performing loans from their portfolios and substituting fresh cash in those IBF Funds. The impact of these transfers on the financial statements and various return and other statistics was never disclosed. Instead, the financial statements simply stated in a footnote that:

Although there is no contractual requirement, from time to time the Parent [IBF] or a subsidiary of the Parent purchases receivables from [the IBF Fund]. Such purchases may be made to balance portfolios or have the Parent eliminate a potential loss on [the Fund]. Such purchases are made at [the Fund's] carrying value. As the Parent expects to purchase any uncollectible receivables from [the Fund], there is no allowance for bad debts provided.

### **Omissions Concerning The Redemption Of Fund I**

16. An example of these inter-Fund transfers occurred upon the liquidation of Fund I in 2000. Hershon caused CFC (then Fund VII) to purchase, at Fund I's cost, about \$1 million (forty percent) of Fund I's loan portfolio for cash, so that Fund I could pay off the notes of its noteholders. These transfers were not at arms length, and were made without regard to the actual value of the assets CFC was acquiring. Both Fund I and CFC accounted for the transfer at the carrying value of the loans, without disclosing the effect of the related party transfer.

17. Under generally accepted accounting principles ("GAAP"), CFC was obligated to disclose these material related-party transfers. However, CFC's financial statements, as reported in the June 27, 2001 and October 1, 2001 private placement memoranda, did not disclose the purchase of these assets from Fund I, or the fact that the transactions were done without regard to the actual value of the acquired assets.

18. Hershon also used the redemption of Fund I to demonstrate IBF's success in the investment business. CFC's October 1, 2001 private placement memorandum contained a chart reporting on the performance of all seven IBF Funds. The chart disclosed that Fund I fully redeemed all of its outstanding investor notes, without disclosing that these redemptions were possible only because Hershon transferred offering proceeds from CFC to Fund I.

19. On July 16, 2001, Fund VI filed a post-effective amendment with the Commission, which disclosed a similar chart as containing facts that "may be material" to investors in Fund VI. Fund VI did not disclose the source of the Fund I redemptions.

### **Misrepresentations About Loan Losses**

20. CFC and its predecessor IBF Funds never disclosed loan losses in the investment loan portfolios. Instead, if a loan became uncollectible, Hershon would cause IBF to "purchase" the loan from the IBF Fund at its carrying value, and the "selling" IBF Fund would then account for the loan as if it had been repaid in full by the borrower. To pay for these loans, IBF used offering proceeds derived from the IBF Funds in the form of management fees and "equity" withdrawals.

21. With respect to these related party "sales," the financial statements of the affected IBF Fund contained only the same generic footnote disclosure recited above, namely, that from "time to time," IBF purchased receivables from the IBF Funds at their carrying value "to balance portfolios or have the Parent eliminate a potential loss on [the Fund]." This generic disclosure was boilerplate. The disclosure documents were never modified to disclose actual transfers in the reporting period, let alone the details of such transfers.

22. The effect of these undisclosed transfers was that, even if IBF wrote the loan off immediately upon purchasing it from an IBF Fund, the fact that the loan went bad was nowhere disclosed to prospective investors in the IBF Fund. Moreover, for statistical purposes, such as the publicly-disclosed average loan return data, the IBF Funds treated uncollectible loans purchased by IBF as if they fully performed. Under GAAP, the IBF Funds were obligated to disclose these related party transfers and their effect on the financial statements and return statistics.

### **Impact on the Financial Statements**

23. The undisclosed transfers had a material impact on the financial statements appended to CFC's June 2001 and October 2001 supplemental private placement memoranda, which increased CFC's offering from \$50 million to \$100 million and then \$200 million, respectively.

24. Both of these supplemental private placement memoranda contained a set of CFC's unaudited financial statements for 2000. According to the income statement, CFC's net income in 2000 was \$293,000. However, the income statement did not reflect that, on December 29, 2000, Hershon caused IBF to "purchase" from CFC a loan that had an outstanding balance, including interest and fees, of a little over \$1 million – a loan that IBF then wrote off in the same

reporting period. By effecting this transaction and not disclosing it, Hershon misled investors to believe that CFC was much more profitable than it actually was. CFC's income statement should have shown a substantial loss for the year.

25. CFC's October 2001 private placement memorandum also attached Fund II's financial statements for 1999 and 2000. Fund II was one of the IBF Funds merged into CFC. At year-end 1999, Fund II had total assets on its books of \$6 million and a net income for the year of \$244,000. Prior to December 30, 1999, roughly one-third of those total assets consisted of bad loans, which Fund II would have been required to write off. IBF did not disclose these substantial losses. Rather, Fund II transferred about \$2 million in uncollectible loans to IBF, which IBF later wrote off. IBF paid full face value for the loans. Fund II's financial statements did not disclose this transfer. However, but for this undisclosed transaction, Fund II's income statement would have shown a loss for the year of about \$1.75 million.

### **Impact on Return Statistics**

26. IBF published return statistics about the loans and the IBF Funds in private placement memoranda and prospectuses as well as in reports to investors and quarterly due diligence materials furnished to the brokers. For example, CFC's October 1, 2001 private placement memorandum contained a table that set out the "average loan return" for each of the IBF Funds through June 30, 2001. For purposes of calculating these statistics, Hershon disregarded loan losses, treating all loans IBF had purchased from the IBF Funds as if those loans had been repaid in full by the borrowers. In other words, the return statistics did not reflect the impact of write-offs. Moreover, if a loan was on the books of an IBF Fund at 24 percent interest, upon purchase by IBF, the IBF Fund reported the loan for statistical purposes as if it returned 24 percent.

27. The statistics contained in the table were materially overstated. Just the Fund II statistic, for example, reported an average loan return of 28.75 percent from inception. The actual return figure was very substantially less. IBF did not disclose that Hershon had transferred one-third of Fund II's total assets (about \$2 million) to IBF, which later wrote off these loan assets as uncollectible.

28. The same is true with respect to the 29.52 percent return statistic for Fund I. Fund I had about \$2.2 million in total invested assets. In 1998, Hershon caused Fund I to transfer one of its loans to Fund IV at carrying value. The loan amounted to nearly half the value of the Fund I portfolio. Fund IV later transferred the loan to IBF and IBF eventually wrote it off. Yet, according to the table in the October 2001 private placement memorandum, Fund I had the highest "average loan return" of all of the IBF Funds, and considerably higher than every other Fund except Fund II. This was a false statement.

### **Impact on Other Published Loan Statistics**

29. IBF published quarterly, for the brokers, a table that purported to set forth statistical data on all loans ever contained in the IBF Fund portfolios, and it published such a table at about the time of the supplemental CFC offerings in June and October 2001. One

column in the table was dedicated to the “disposition” of each loan. Every loan was listed as “repaid” or “outstanding.” No loan was identified as having been written off. Another column in the table set forth each loan’s individual return. Every “repaid” loan had a positive return. In every case in which IBF purchased a bad loan, the loan was treated for purposes of the chart as “repaid” and the return figure in those cases was based on all interest and fees accrued on the books of the IBF Fund at the time IBF acquired the loan. To the reader it appeared that the IBF Funds had no uncollectible loans.

### **Misrepresentations About The Wherewithal To Pay Interest**

30. The IBF Funds did not inform investors that, as a historical matter, cash earnings on their invested capital had never been enough to cover interest payments to investors. As late as 2001, both CFC and Fund VI published charts in their offering circulars suggesting that, from inception, the IBF Funds had been generating enough cash from their investments to fund their operations, including interest payments to investors. The charts touted over \$20 million in total interest payments to investors, made over as many as 55 “consecutive” months. The charts did not disclose that a very significant source of these interest payments was offering proceeds.

31. Although the offering materials recited in several places that there was a risk that the IBF Funds might not always generate cash flow sufficient to make interest payments, the disclosures never conveyed the essential point, which was that, historically, the IBF Funds had never generated sufficient cash earnings to cover interest payments.

### **Legal Discussion**

#### **Hershon Violated the Antifraud Provisions of the Securities Act and Exchange Act**

32. Section 17(a) of the Securities Act prohibits fraud “in the offer or sale,” and Section 10(b) of the Exchange Act and Rule 10b-5 prohibit fraud “in connection with the purchase or sale,” of securities. *SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1466-69 (2d Cir. 1996), *cert. denied*, 522 U.S. 812 (1997); *see Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 195 (1976); *SEC v. Manor Nursing Centers, Inc.*, 458 F.2d 1082, 1095-100 (2d Cir. 1972). The prohibited fraudulent conduct includes misrepresentations or omissions of material facts. *Basic, Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988).

33. To be actionable under the antifraud provisions, the misstatement or omission must be material. *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976). Information is considered material if there is a substantial likelihood that a reasonable investor would consider such information important in making an investment decision or if the information would significantly alter the total mix of available information. *Basic*, 485 U.S. at 231-32; *TSC Indus.*, 426 U.S. at 449; *SEC v. Coates*, 137 F. Supp. 2d 413, 423 (S.D.N.Y. 2001).

34. With respect to Section 17(a)(1) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, the false or misleading statements must be made with

scienter. *Aaron v. SEC*, 446 U.S. 680, 695-97 (1980). Scienter is “a mental state embracing intent to deceive, manipulate, or defraud.” *Ernst & Ernst*, 425 U.S. at 194 n.12.

35. Knowing or reckless disregard for the truth satisfies the scienter requirement. *Novak v. Kasaks*, 216 F.3d 300, 306 (2d Cir. 2000) (scienter is an intent to defraud, reckless disregard for the truth or a knowing use of a device, scheme or artifice to defraud (citing *Lanza v. Drexel & Co.*, 479 F.2d 1277, 1301 (2d Cir. 1973) (*en banc*))); *SEC v. U.S. Environmental*, 155 F.3d 107, 111 (2d Cir. 1998); *IIT v. Cornfeld*, 619 F.2d 909, 923 (2d Cir. 1980); *SEC v. McNulty*, 137 F.3d 732 (2d Cir. 1998); *SEC v. Schiffer* [1998 Supp. Tr. Binder] Fed. Sec. L. Rep. (CCH) ¶90,247, at 91,084 (S.D.N.Y. June 10, 1998) (citing *Rolf v. Blyth Eastman Dillon & Co.*, 570 F.2d 38, 46 (2d Cir. 1978)); *Gallard*, Fed. Sec. L. Rep. ¶90,144 at 90,382. A violation of Sections 17(a)(2) and 17(a)(3) of the Securities Act, however, requires only negligent misconduct. *See Aaron*, 446 U.S. at 696-97; *Gallard*, Fed. Sec. L. Rep. ¶90,144 at 90,382.

36. Hershon willfully violated Section 17(a) of the Securities Act and Section 10(b) and Rule 10b-5 of the Exchange Act by knowingly or recklessly making the misrepresentations described above.

#### IV.

In view of the foregoing, the Commission deems it appropriate, in the public interest, to impose the sanctions agreed to in Hershon’s Offer.<sup>3</sup>

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act, respectively, Hershon shall cease and desist from committing or causing any violations, or committing or causing any future violations, of Section 17(a) of the Securities Act and Section 10(b) and Rule 10b-5 of the Exchange Act.

B. Pursuant to Section 9(b) of the ICA, Hershon be and hereby is prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter.

C. Pursuant to Section 203(f) of the Advisers Act, Hershon be, and hereby is barred from association with any investment adviser, with the right to reapply for association after four (4) years to the appropriate self-regulatory organization, or if there is none, to the Commission.

D. With respect to paragraphs B and C above, any reapplication for association by Hershon will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the

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<sup>3</sup> Hershon has agreed to pay a \$500,000 civil penalty and disgorgement of \$400,000 in the parallel civil action.

satisfaction of any or all of the following: (a) any disgorgement ordered against Hershon, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Jonathan G. Katz  
Secretary