

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 61377 / January 19, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-13752

In the Matter of

MORTGAGES LTD.
SECURITIES, LLC

Respondent.

**ORDER INSTITUTING ADMINISTRATIVE
PROCEEDINGS PURSUANT TO SECTION
15(b) OF THE SECURITIES EXCHANGE
ACT OF 1934, MAKING FINDINGS, AND
REVOKING BROKER-DEALER
REGISTRATION**

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 (“Exchange Act”) against Mortgages Ltd. Securities, LLC (“MLS” or “Respondent”).

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (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,¹ except as to the Commission’s jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Revoking Broker-Dealer Registration, as set forth below.

¹ The findings herein are not binding on any other person or entity in this or any other proceeding.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

Summary

These proceedings arise out of the conduct of MLS, a registered broker-dealer and affiliate of Mortgages Ltd. ("MLtd."), an Arizona-based private lender that, through MLS, raised more than \$741 million from about 2,700 investors nationwide from February 2004 to June 2008. MLS made oral and written misrepresentations to investors concerning the safety and liquidity of the investment and risks associated with the investment. MLS led investors to believe that the loans MLtd. had underwritten were safer than they actually were, and investors were unaware that MLtd. was taking on larger and riskier loans. MLS misrepresented how the declining market conditions that worsened throughout 2007 impacted the safety of the investment, and how MLtd. and its principal had increasingly resorted to selling their personal assets to prop up MLtd.

Respondent

1. Respondent MLS is an Arizona limited liability company with its principal place of business in Phoenix, Arizona. MLS has been registered with the Commission since 2004 as a broker-dealer. MLS is solely owned by SMC Revocable Trust, a family trust established by MLS's deceased president and CEO, Scott M. Coles, who was also the sole trustee.

Other Relevant Persons and Entities

2. Mortgages Ltd. is an Arizona-based private lender which, from 2004 to June 2, 2008, raised more than \$741 million from about 2,700 investors nationwide through MLS. MLtd. also received more than \$197 million in the form of promissory notes from its largest investor, Radical Bunny, LLC.

3. Scott M. Coles ("Coles") owned, operated and managed MLtd. until his death on June 2, 2008.

4. Radical Bunny, LLC ("Radical Bunny") is an Arizona limited liability company co-managed by four individuals. Between 1996 and 2008, Radical Bunny raised funds from investors in a series of unregistered securities offerings and either invested or loaned the offerings proceeds to MLtd.

Background

5. From its inception in 2004 through June 2008, MLS raised \$741 million from approximately 2,700 investors nationwide through the offer and sale of securities issued by MLtd. MLtd. maintained an inventory of high interest, short-term loans it made to real estate developers, which MLtd. then securitized and sold through eleven private placement offerings made through MLS. Investors had the option to invest either in specific loans (the "pass-through

investors”) or in one of several funds (the “pooled fund investors”) that purchased various loans or portions of loans originated by MLtd. MLtd. typically created an “impound account” that would take a portion of the loan amount, set it aside, and use those funds to make the periodic interest payments to the investors for the term of the investment.

6. In lieu of commissions, MLtd. paid MLS a monthly placement fee. From January 2007 to June 2008 (the “relevant period”), MLS’s monthly placement fees totaled \$6,973,785. During the relevant period, MLS employed eight to ten registered representatives at a time. MLS did not advertise. New investors came to MLS through word-of-mouth referrals from existing investors.

7. Before investing, investors received a private offering memorandum (“POM”), subscription agreement, the most recent quarterly report for the funds, and current newsletter. Pass-through investors also received a loan summary sheet that detailed the specific loan. MLtd. also sent newsletters to existing investors. The POMs contained broad, general statements regarding MLtd.’s loan origination business and general risk factors. The POMs did not address the specific practices employed by MLtd. and related risks, and were never amended or updated to reflect these facts. Moreover, while investors received the audited financial statements for MLtd. for the years ended December 31, 2005 and 2006, there was very little discussion about its liquidity position, market risk and loan funding practices and investors received no information about Coles’s financial condition. Such information became increasingly important as Coles and MLtd. resorted to purchasing the non-performing loans to maintain the illusion that its loans were all “performing.”

8. In addition to the written materials, MLS registered representatives made a number of oral statements to investors. Those statements covered four common themes: MLtd. had never failed to pay back principal in its 40+ year history; the risk was low, minimal, or of “some” degree typically described as other than “high”; the rate of return was consistently above average or “higher than normal”; and a first deed of trust provided investors with security. Continuing to June 2008, MLS persisted in highlighting these themes.

9. From 2001 through 2006, Coles and MLtd. increasingly originated significantly larger, but fewer, loans. Many of these loans contained “delayed funding” terms which obligated MLtd. to fund substantial portions of the loan in stages rather than the entire amount upfront. The concentration of MLtd.’s loan portfolio in fewer, larger loans and the delayed funding commitments magnified the effects of deteriorating market conditions that began to impact MLtd. in late 2006 and continued throughout 2007. Coles and MLtd. pursued various strategies to stave off a liquidity crisis but these strategies only increased the risks to the investors.

10. Beginning around December 2006, Coles and MLtd. received indications that some of its borrowers were at risk of becoming delinquent. Such information was known to MLS because Coles was both the manager of MLtd. and the president of MLS. He also made available such information to MLS personnel. At the beginning of 2007, MLS management recognized, and warned Coles of, the potential threats to MLtd. posed by the concentration of few, big loans. Specifically, MLtd.’s vice-president of operations discussed with Coles MLtd.’s

liquidity issues, which were attributed to conditions in the real estate market and the fact that some of MLtd.'s borrowers were not paying off loans as they matured. Another officer alerted Coles that while MLtd.'s fundraising from investors was sufficient to meet its existing loan funding obligations, the amount of incoming investor funds was insufficient to originate new loans. He told Coles, as did MLS's president, that MLtd.'s individual loan commitments were too large and that it wasn't prudent to create this concentration of risk. Coles continually brushed these warnings aside, and marginalized those who disagreed with his management decisions. In addition, MLS's management was concerned about the risks that its largest investor, Radical Bunny, posed to MLtd. Radical Bunny was conducting its own unregistered securities offering to invest in MLtd. and already had become a significant source of capital for MLtd.

11. By summer 2007, MLtd. stopped writing new loans with one or two exceptions later in the fall. In October 2007, MLtd. faced increased loan workouts. In most instances, Coles and MLtd. negotiated an extension of time to repay principal, with interest payments due in the interim. As a result, Coles and MLtd. maintained the illusion that the loans were current. Further, the impound accounts masked nonperforming loans because interest payments continued to be made to investors from these prefunded accounts.

12. Conditions worsened in 2008. By February 2008, Coles and MLtd. expected \$70 million in loan payoffs but only \$1 – 2 million in payoffs occurred. From January through May 2008, MLtd.'s chief financial officer, at Coles' direction, called Radical Bunny daily to seek funding from it and used these funds to meet MLtd.'s delayed funding obligations (a portion of which went to the impound account to pay investors). Still, MLtd. continued to solicit and accept new investment capital until Coles's death in June 2008.

13. MLS registered representatives downplayed the true nature of the safety and risks associated with the investment. In fact, Coles routinely instructed MLS's registered representatives to go beyond the statements made in the POM by promising key aspects of the investment – such as promises of a guaranteed redemption – in order to induce individuals to invest. In early 2008, as MLtd.'s loan portfolio unraveled and its cash flow situation continued to deteriorate, Coles sent investor newsletters containing misrepresentations concerning the safety of investment, the performance of the loan portfolio, and strength of MLtd.

14. The POMs contained over twelve pages of disclosures relating to the investment risk, but these statements were broad and general and none of the disclosures discussed the risks, known to Coles and MLS by 2007, of MLtd.'s increasingly concentrated loan portfolio and the demands it placed on MLtd.'s liquidity. Similarly, rather than provide meaningful disclosure about these known risks, MLS registered representatives highlighted general information about MLtd., such as its consistent track record of performing as advertised.

15. MLS further misrepresented the level of risk to its pooled fund investors because Coles knew that MLtd.'s borrowers were experiencing difficulties in obtaining the takeout financing that would be used to repay MLtd. and, consequently, the risk of loss this presented to the investors' principal.

16. MLS misrepresented the strength of MLtd.s' business because Coles, and MLS registered representatives, knew that by the summer 2007, MLtd. stopped originating loans. This was a significant fact as it went directly to the financial health of MLtd., a loan originator that was no longer originating loans.

17. MLS misrepresented the performance of MLtd.'s loans. As the number of nonperforming loans grew significantly, which put the pooled fund investors' principal at risk of repayment, Coles simply bought up these loans to remove them from the portfolio.

18. When soliciting investors, MLS and its registered representatives emphasized the fact that during its long existence, no investor in MLtd. had ever lost any of his or her principal. This statement was misleading. In fact, contrary to what MLS's registered representatives told investors, by late 2007 MLtd. failed to honor its commitments to redeem investor requests for principal.

19. In addition, MLS made misleading statements regarding loan performance. In January 2008, MLS issued a newsletter that described MLtd.'s securities as "predictable investments." The newsletter states: "A predictable investment, by our definition, is an investment that is short-term, liquid and measurable – receiving monthly payments." This was misleading because MLS's definition of "predictable" focused only on one aspect – the issuance of monthly interest payments, which continued while MLtd. extended the payoff dates for its borrowers rather than exercise its option to foreclose – while ignoring the fact that investors who expected the return of their principal at the conclusion of their loan term would learn that those expectations were misplaced. According to MLS's chief compliance officer, Coles opted to use the word "predictable" in the newsletter over her objections against doing so.

20. Similarly, in an investor letter dated February 21, 2008, MLS stated that "[a]t the present time, all of our loans are current." In another investor letter dated March 26, 2008, MLS stated that "there are no current delinquencies to investors." Both of these letters misled investors into thinking that their investment was safe because MLtd.'s borrowers were impliedly making interest payments and satisfying payoffs at maturity. In actuality, MLtd. routinely plucked troubled loans from its investor pools, repackaged and sold them at a higher note rate to others, or Coles purchased them himself. Such practices cosmetically enhanced the appearance of the pools' performance.

21. Although MLtd.'s increased concentration in a few large loans was well known throughout MLS, and Coles was alerted to risks of making such loans, investors were not told of the risks that such concentration posed to them.

22. Coles and MLS registered representatives made oral misrepresentations, at times later confirmed in writing, regarding MLtd.'s obligation to repurchase the investment made by pass-through investors. MLS registered representatives commonly represented to pass-through investors that investors would receive back their principal upon notice (or an agreed upon term set at the outset of the investment). While the POMs state that MLtd. merely had to use its "best

efforts” to cause the repurchase, Coles authorized the registered representatives to make specific contrary representations.

23. In late 2007 through April 2008, however, when investors requested repayment of principal, citing representations that had been made about MLtd.’s repurchase obligation, Coles refused these requests, specifically citing the “best efforts” language in the POM as justification.

24. From September 2005 to June 2008, MLtd. borrowed \$197 million from Radical Bunny. Radical Bunny raised the money that it loaned to MLtd. from hundreds of investors to whom it issued promissory notes. By early 2007, notes held by Radical Bunny were maturing and MLtd. was obligated to pay them a much higher rate of return in exchange for Radical Bunny’s continued capital infusions. As MLtd. faced decreased payoffs of loans, Radical Bunny became increasingly important as a source of capital to MLtd.

25. Investors had no way of knowing of Radical Bunny’s critical role in providing capital to MLtd. These funds enabled MLtd. to continue its lending operations, which ultimately impacted MLtd.’s ability to pay investors’ principal.

26. In January 2007, MLtd. and Radical Bunny met and discussed a number of issues concerning their relationship. Among the concerns raised at that meeting, which Coles attended, were the following: (1) whether MLtd. had accepted money that Radical Bunny had raised pursuant to an unregistered offering of securities; (2) whether some of the monies that MLtd. accepted from Radical Bunny came from unaccredited investors; and (3) whether Radical Bunny had failed to provide its investors with offering documents making the appropriate disclosures and audited financial statements.

27. Radical Bunny’s offering was never registered; and MLtd. never ceased accepting the monies that Radical Bunny continued to raise through its unregistered offering. Neither MLtd. nor MLS ever disclosed to investors that Radical Bunny had failed and continued to fail to comply with the securities registration provisions, or that MLtd. had relied and continued to rely on Radical Bunny’s unregistered offering proceeds to fund virtually all of its business activity. Indeed, MLtd. accepted about \$120 million from Radical Bunny after the compliance issues first surfaced.

28. As a result of the conduct described above, MLS willfully violated Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in the offer and sale of securities and in connection with the purchase or sale of securities.

29. As a result of the conduct described above, MLS willfully violated Section 15(c) of the Exchange Act, which prohibits a broker or dealer from making use of the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce or attempt to induce the purchase or sale of any security (other than commercial paper, bankers’ acceptances, or commercial bills), otherwise than on a national securities exchange of which it is

a member, or any security-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act), by means of any manipulative, deceptive, or other fraudulent device or contrivance.

Disgorgement and Civil Penalties

30. Respondent has submitted a sworn Statement of Financial Condition dated February 28, 2009, a sworn affidavit providing updated financial information through July 31, 2009, and other evidence, and has asserted its inability to pay disgorgement plus prejudgment interest and has further asserted its inability to pay a civil penalty.

MLS's Remedial Efforts

In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by Respondent and cooperation afforded the Commission staff.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent MLS's Offer.

Accordingly, pursuant to Section 15(b) of the Exchange Act, it is hereby ORDERED that:

A. The registration of Respondent MLS as a broker or dealer with the Commission be, and hereby is, revoked pursuant to Section 15(b)(4) of the Exchange Act;

B. Respondent shall pay disgorgement of \$6,973,785 and prejudgment interest of \$331,048, but that payment of such amount is waived and the Commission is not imposing a penalty against Respondent based upon Respondent's sworn representations in its Statement of Financial Condition dated February 28, 2009, a sworn affidavit providing updated financial information through July 31, 2009, and other documents submitted to the Commission.

C. The Division of Enforcement (“Division”) may, at any time following the entry of this Order, petition the Commission to: (1) reopen this matter to consider whether Respondent provided accurate and complete financial information at the time such representations were made; and (2) seek an order directing payment of disgorgement and pre-judgment interest and civil penalty. No other issue shall be considered in connection with this petition other than whether the financial information provided by Respondent was fraudulent, misleading, inaccurate, or incomplete in any material respect. Respondent may not, by way of defense to any such petition: (1) contest the findings in this Order; (2) assert that payment of disgorgement and interest and civil penalty should not be ordered; (3) contest the amount of disgorgement and interest and civil penalty to be ordered; or (4) assert any defense to liability or remedy, including, but not limited to, any statute of limitations defense.

By the Commission.

Elizabeth M. Murphy
Secretary