July 23, 1990

SEC REVOKES ADVISER'S REGISTRATION BASED ON VIOLATIONS OF ANTIFRAUD PROVISIONS, ADVISERS' ACT & INVESTMENT COMPANY ACT

July 23, 1990 TO: SEC RULES MEMBERS NO. 52-90 INVESTMENT ADVISER MEMBERS NO. 33-90 RE: SEC REVOKES ADVISER'S REGISTRATION BASED ON VIOLATIONS OF ANTIFRAUD PROVISIONS, ADVISERS ACT & INVESTMENT COMPANY ACT
_____ On the basis of finding willful violations of the antifraud provisions of the federal securities laws and of the Investment Advisers Act of 1940, as well as willful aiding and abetting of willful violations of the Investment Company Act of 1940, the SEC has revoked the registration of an investment adviser. A copy of the SEC's opinion is attached. In an appeal brought by the adviser from the decision of an administrative law judge, the SEC found that the adviser, in its capacity as investment adviser to a registered investment company ("Fund"), willfully violated Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, and Sections 206(1) and 206(2) of the Advisers Act by failing to disclose to the Fund's trustees, investors and potential investors the temporary nature of the Fund's advertised high yields and the specific risks associated with the strategy used to achieve those high yields. That strategy involved deliberately seeking to acquire so-called "failed bonds" (i.e., bonds not delivered by their settlement date) that would accrue interest payable to the Fund from the settlement date through the date of delivery but that the Fund did not have to pay for until they were delivered. During that interim period, the adviser purchased additional bonds with the money that otherwise would have been used to pay for the failed bonds; thus, the Fund collected two interest payments on the same money. The SEC also found that the adviser willfully violated antifraud laws and Section 206(4) of the Advisers Act and Rule 206(4)-1 thereunder by representing that distributions paid by the Fund were exempt from California income tax, even though the state tax exemption claimed by the Fund applied to dividends distributed by diversified management investment companies, while the Fund was a non-diversified management investment company. The SEC indicated in its opinion that the adviser failed to establish its claim of reliance on counsel as to the tax-free status of the Fund's distributions. In addition, the SEC found that the adviser willfully aided and abetted violations by the Fund of several provisions of the Investment Company Act and rules thereunder, as described below. First, violations of Sections 13(a)(2) and 13(a)(3) occurred when, in connection with the strategy of acquiring failed bonds as described above, the Fund on at least three occasions exceeded its fundamental investment limitation restricting borrowings to 20% of total assets. Second, the Fund violated Section 22(c) and Rule 22c-1

thereunder by calculating its net asset value using bond prices based on round lots, when its portfolio consisted mostly of odd lots. Odd lots generally are priced at a discount, so the Fund's pricing method caused it to overvalue its portfolio. Third, the Fund violated Section 12(b) and Rule 12b-1 thereunder by making payments for advertising services during a period when no written distribution plan was in effect. Finally, the Fund violated Section 31 and Rule 31a-1(b) thereunder by failing to maintain records reflecting the time of entry of brokerage orders. In expressing agreement with the administrative law judge's conclusion that the adviser's registration as an investment adviser should be revoked, the SEC noted that it had sanctioned the adviser and its president previously for very similar violations of the federal securities laws. Frances M. Stadler Assistant General Counsel Attachment