

MEMO# 10284

September 15, 1998

ALJ ORDERS FUND ADVISER AND TRUSTEES TO CEASE AND DESIST FROM PRICING, SOFT DOLLAR VIOLATIONS; NO CIVIL PENALTIES IMPOSED

* In the Matter of Parnassus Investments, SEC Admin. Proc. File No. 3-9317, Initial Decision Rel. No. 131 (Sept. 3, 1998). A petition for review of the initial decision may be filed within 21 days of service of the decision. The SEC's order initiating proceedings in this matter was summarized in Memorandum to Compliance Advisory Committee No. 19-97 and SEC Rules Members No. 42-97, dated June 3, 1997. [10284] September 15, 1998 TO: COMPLIANCE ADVISORY COMMITTEE No. 25-98 SEC RULES MEMBERS No. 70-98 RE: ALJ ORDERS FUND ADVISER AND TRUSTEES TO CEASE AND DESIST FROM PRICING, SOFT DOLLAR VIOLATIONS; NO CIVIL PENALTIES IMPOSED

A Securities and Exchange Commission administrative law judge (ALJ) recently ordered a fund's investment adviser, an individual who is the president and a director of the adviser and the president and a trustee of the fund, and two independent trustees of the fund to cease and desist from violating certain provisions of the Investment Company Act and the Investment Advisers Act. The ALJ determined not to impose any civil penalties, however. The initial decision,* a copy of which is attached, is summarized below. The ALJ found that the fund purchased securities of an issuer that subsequently declared bankruptcy, and later purchased more of the securities and loaned the issuer \$100,000. The due date of the promissory note later was extended and the note was made convertible into restricted common stock. Because the fund's statement of additional information limited loans to repurchase agreements, the ALJ concluded that the fund violated Sections 13(a)(3) and 21(a) of the Investment Company Act in making the loan until the note became convertible. In addition, the ALJ found that the fund's adviser and the president of the adviser aided and abetted the fund's violation. In addition, the ALJ found that the fund overstated its NAV in violation of Rule 22c-1 under the Investment Company Act, and the fund's adviser and trustees aided and abetted the fund's violation, because the adviser and the trustees did not use a current sale methodology to fair value the fund's holdings in the issuer, and thus did not fair value them in good faith within the meaning of Accounting Series Releases (ASRs) 113 and 118. Specifically, the ALJ concluded that: (1) the adviser and the trustees did not value the note in good faith because they valued restricted securities at the same price as unrestricted securities; (2) the adviser and the trustees attributed a 10% premium to the note and the shares into which it could be converted with no supporting documentation in the board's minutes in violation of ASR 118's requirements that all indications of value be considered and judgment factors considered by the board be

documented in the board's minutes; and (3) the adviser and the trustees ignored or failed to give adequate consideration to a number of the general and specific factors set forth in ASR 118 in valuing the unrestricted securities. 2Finally, the ALJ concluded that the fund's adviser, aided and abetted by its president, violated Section 17(e) of the Investment Company Act by acquiring, in return for fund brokerage commissions, below-market transfer agent and accounting products and services. Because the adviser and its president failed to disclose the existence of a soft dollar arrangement and the products, research and services received from that arrangement on the adviser's Form ADV, the ALJ also found a violation of Section 207 of the Investment Advisers Act. The ALJ denied the Division of Enforcement's request for civil penalties against the fund's adviser and the trustees, noting that (1) their actions did not involve fraud, but rather violations of technical provisions; (2) their actions caused minimal harm to others and involved no unjust enrichment; (3) they had never before been the subject of enforcement proceedings; and (4) civil penalties were unnecessary as a deterrent to future violations. Frances M. Stadler Deputy Senior Counsel

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