

MEMO# 8966

June 3, 1997

SEC INSTITUTES PROCEEDINGS AGAINST FUND ADVISER, PRESIDENT AND TRUSTEES FOR ALLEGED PRICING, SOFT DOLLAR VIOLATIONS

* In the Matter of Parnassus Investments, SEC Admin. Proc. File No. 3-9317 (May 28, 1997).
June 3, 1997 TO: COMPLIANCE ADVISORY COMMITTEE No. 19-97 SEC RULES MEMBERS No. 42-97 RE: SEC INSTITUTES PROCEEDINGS AGAINST FUND ADVISER, PRESIDENT AND TRUSTEES FOR ALLEGED PRICING, SOFT DOLLAR VIOLATIONS

The Securities and Exchange Commission recently instituted public administrative and cease-and-desist proceedings against a funds 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. In the attached order instituting proceedings,* the SEC alleged that: (1) the respondents ignored relevant pricing and financial information about the issuer of a security held by the fund and, as a result, the funds net asset value was overstated for a two-year period; (2) the fund extended a loan to the issuer of the mispriced security in violation of its fundamental policy against making loans; and (3) the adviser improperly used the funds soft dollar credits for its own benefit. The SECs order is summarized below. According to the order, the fund purchased securities of an issuer that subsequently declared bankruptcy. The fund later purchased more of the securities and loaned the issuer \$100,000, memorialized by a promissory note with a one-year term. The due date of the note subsequently was extended and the note was made convertible into common stock. For two years after the issuers shares were delisted from NASDAQ, and despite actual sales prices that were much lower, the funds board continued to price the shares at the last NASDAQ price. In addition, the board valued the note as if it had been converted to stock and at an even higher rate than that used to value the shares. The order states that the adviser and its president ignored information in the issuers Form 10-K about the "fair market value" of its securities, and failed to put the securitys value on the agenda at certain board meetings. The boards valuation of the securities over the period in question allegedly failed to take into account an offer the fund received for the securities, relied on different financial data over time (depending on what was most favorable), and ignored a negative television report about the issuers single largest customer. The SECs order asserts that the respondents wilfully aided and abetted violations of Rule 22c-1 and also caused violations of that rule. In addition, in connection with the \$100,000 loan to the issuer, the investment adviser and its president aided and abetted and caused the violation of Sections 13(a)(3) and 21(a) of the Investment Company Act. The attached order further alleges that the fund earned soft dollar credits as a result of directing brokerage to a

national wirehouse firm and the adviser used those credits to purchase products and services for itself. Specifically, the credits were used to purchase computers (one-half of the use of which was for research-related functions and the other half for fund accounting and transfer agent functions). The adviser also purchased fund accounting software and updates. The order states that half of the computer expense and all of the software expense amount to improper use of soft dollars by the adviser. As a result of these actions, the adviser wilfully violated Section 17(e)(1) of the Investment Company Act and the president caused and wilfully aided and abetted this violation. In addition, because the advisers Form ADV did not disclose its use of the funds soft dollar credits to purchase non-research related products and services, the adviser and its president wilfully violated Section 207 of the Investment Advisers Act. The SEC has ordered that a public hearing be held on this matter no earlier than 30 days and no later than 60 days from service of the attached order. Frances M. Stadler Associate Counsel Attachment (in .pdf format) Note: Not all recipients of this memo will receive an attachment. If you wish to obtain a copy of the attachment referred to in this memo, please call the Institute's Information Resource Center at (202)326-8304, and ask for this memo's attachment number: 8966.

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