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7  
8 BEFORE THE DEPARTMENT OF CORPORATIONS  
9 OF THE STATE OF CALIFORNIA

10  
11 In the Matter of ) FILE NO. 112566  
12 )  
13 THE CALIFORNIA CORPORATIONS ) STATEMENT IN SUPPORT OF ORDER TO  
COMMISSIONER, ) DISCONTINUE VIOLATIONS PURSUANT  
14 ) TO CORPORATIONS CODE SECTION 25249  
Complainant, ) AND COMMISSIONER'S INTENTION TO  
15 ) MAKE ORDER FINAL  
v. )  
16 PALISADES INVESTMENT ADVISORS, ) (CORPORATIONS CODE SECTION 25251)  
INC., )  
17 )  
18 Respondent. )

19  
20 Wayne Strumpfer, the Acting California Corporations Commissioner ("Commissioner") of  
21 the Department of Corporations ("Department") alleges and charges as follows:

- 22 1. Palisades Investment Advisors, Inc. ("Palisades") holds a valid and unrevoked  
23 investment adviser certificate issued by the Commissioner on August 19, 1999, pursuant to  
24 Corporations Code section 25230. Palisades is an investment adviser business located at 11601  
25 Wilshire Blvd., Suite 2460, Los Angeles, California 90025. Palisades is a California corporation.  
26 Mr. Stephen J. Hoshimi ("Hoshimi") is Palisades' president and chief executive officer.  
27 2. On or about February 17, 2004, the Commissioner commenced a regulatory  
28 examination of Palisades. The examination and subsequent follow-up inquiries revealed violations

1 of regulations promulgated pursuant to the Corporate Securities Law of 1968 (Corp. Code § 25000 et  
2 seq.).

3 3. These violations included Palisades' failure to meet net capital requirements (Cal. Code  
4 Regs., title 10, § 260.237.1, subd. (a).), and its failure to make and keep general and auxiliary ledgers  
5 (Cal. Code Regs., title 10, § 260.241.3, subd. (a)(2)). The books and records requirements provide  
6 the Department with a regulatory mechanism to protect the public by validating the investment  
7 adviser licensee's liquidity and financial integrity on a monthly and yearly basis. Palisades' failure  
8 to meet its books and records requirements prevented the Department from determining, at the time  
9 of its regulatory examination, if Palisades met the capital requirements imposed by the Corporate  
10 Securities Law and the regulations enacted thereunder.

11 4. Corporations Code section 25241 provides that investment advisers are required to  
12 maintain books and records that are subject to examination by, and to file such reports as required  
13 by, the Commissioner. Corporations Code section 25241 provides, in relevant part, as follows:

14 [E]very investment adviser licensed under Section 25230 shall make and keep  
15 accounts, correspondence, memorandums, papers, books, and other records and shall file  
16 financial and other reports as the commissioner by rule requires....

17 5. California Code of Regulations, title 10, section 260.241.3 requires that investment  
18 advisers maintain specific books and records. Subdivision (a)(2) of section 260.241.3 provides as  
19 follows:

20 (a) Every licensed investment adviser shall make and keep true, accurate and current the  
21 following books and records relating to such person's investment advisory business:

22 (2) General and auxiliary ledgers (or other comparable records) reflecting asset, liability,  
23 reserve, capital, income and expense accounts.

24 6. Prior to April 3, 2003, California Code of Regulations, title 10, section 260.237.1  
25 contained the capital requirements for investment advisers. Subdivision (a)(2) of section 260.237.1  
26 provided, in relevant part, as follows:

27 (a) No investment adviser who has any power of attorney from any investment advisory  
28 client to execute transactions . . . shall permit its total aggregate indebtedness to exceed 500%

1 of its tangible net capital or permit its current aggregate indebtedness to exceed its current net  
2 capital; and,

3 ...

3 (2) If the investment adviser has any power of attorney from any investment advisory client  
4 to execute transactions and does not have regular or periodic custody or possession of any of  
5 its investment advisory clients' securities or funds, except the receipt of prepaid subscriptions  
6 for periodic publications, or other investment advisory services, it shall at all times have and  
7 maintain tangible net capital of not less than \$5,000....

7 Subdivision (c) of section 260.237.1 provided that for purposes of section 260.237.1,  
8 subdivision (a), all financial information be determined in accordance with generally accepted  
9 accounting principles.

10 7. On April 3, 2003, California Code of Regulations, title 10, section 260.237.1,  
11 subdivision (a)(2) was amended to read as follows:

12 An investment adviser licensed prior to 03/01/03 may comply with either the minimum  
13 financial requirements in this section or in Section 260.237.2 until January 1, 2005, at which  
14 time this section shall become inoperative and an investment adviser shall comply with the  
15 minimum financial requirements in Section 260.237.2.

15 (a) No investment adviser who has any power of attorney from any investment advisory  
16 client to execute transactions. . . shall permit its total aggregate indebtedness to exceed 500%  
17 of its tangible net capital or permit its current aggregate indebtedness to exceed its current net  
18 capital; and,

19 ...

18 (2) If the investment adviser has any power of attorney from any investment advisory client  
19 to execute transactions and does not have regular or periodic custody or possession of any of  
20 its investment advisory clients' securities or funds, except the receipt of prepaid subscriptions  
21 for periodic publications, or other investment advisory services, it shall at all times have and  
22 maintain tangible net capital of not less than \$5,000;

22 8. On April 3, 2003, California Code of Regulations, title 10, section 260.237.2,  
23 subdivision (a) was added, and reads as follows:

24 An investment adviser licensed prior to 03/01/03 may comply with either the minimum  
25 financial requirements in this section or in Section 260.237.1 until January 1, 2005, at which  
26 time Section 260.237.1 shall become inoperative and an investment adviser shall comply  
27 with the minimum financial requirements in this section.

27 (a) Every investment adviser who has custody of client funds or securities shall maintain at  
28 all times a minimum net worth of \$35,000, and every investment adviser who has  
discretionary authority over client funds or securities but does not have custody of client

1 funds or securities, shall maintain at all times a minimum net worth of \$10,000.

2 9. The Department's examiner found during the regulatory exam on February 17, 2004,  
3 that Palisades had discretionary authority and power of attorney to execute transactions in the  
4 brokerage accounts of its investment adviser clients. Therefore, Palisades was required to meet either  
5 the net capital requirements provided for under section 260.237.1, subdivision (a), or the minimum  
6 net worth requirement provided for under section 260.237.2, subdivision (a).

7 10. At the time of the February 17, 2004 examination, Palisades had not maintained a  
8 general ledger accounting system, in violation of California Code of Regulations, title 10, section  
9 260.241.3, subdivision (a)(2). As a result of Palisades' violation, the Department's examiner was  
10 unable to determine if Palisades, at the time of the examination, was in compliance with either the  
11 net capital requirements of section 260.237.1, or the minimum net worth requirement of section  
12 260.237.2.

13 11. On April 20, 2004, the Department sent Hoshimi a regulatory letter explaining the  
14 violations discovered during the February 17, 2004 examination. On April 30, 2004, Hoshimi  
15 responded by letter, stating in part that the books and records requirements were not met because he  
16 thought they were only required for the Department's 2000 audit. He also stated that Palisades  
17 would comply with the capital requirement of section 260.237.1, until that section became  
18 ineffective on January 1, 2005. Hoshimi also submitted a trial balance sheet for March 31, 2004 and  
19 annual financial reports for 2000, 2001, 2002 and 2003.

20 12. However, after reviewing the trial balance sheet and the annual financial reports, the  
21 Department informed Hoshimi by letter dated November 3, 2004, that it had determined that  
22 Palisades had both tangible net capital and current net capital deficiencies for March 31, 2004 and  
23 for the years 2000, 2001, 2002 and 2003, in violation of California Code of Regulations, title 10,  
24 section 260.237.1, subdivision (a). The Department also directed Palisades to begin submitting  
25 monthly interim reports reflecting compliance with the net capital requirements.

26 13. A prior regulatory examination of Palisades in July 2000 also revealed record keeping  
27 and reporting violations, in the form of failure to meet net capital requirements (Cal. Code Regs.,  
28 title 10, § 260.237.1, subd. (a).), and failure to make and keep general and auxiliary ledgers (Cal.

1 Code Regs., title 10, § 260.241.3, subd. (a)(2). In correspondence between the Department and  
2 Hoshimi during 2000, Palisades was put on notice of these violations. Hoshimi acknowledged  
3 receiving the letters notifying him of the violations.

4 14. Corporations Code section 25249 authorizes the Commissioner to issue an order  
5 directing any investment adviser to discontinue any violation of any provision of the Corporate  
6 Securities Law and any rules promulgated thereunder. Specifically, Corporations Code section  
7 25249 provides, in relevant part:

8 If, after examination or investigation, the commissioner has reasonable grounds to believe  
9 that any broker-dealer or investment adviser has violated any law or rule binding upon it, the  
10 commissioner shall, by written order addressed to the broker-dealer or investment adviser,  
11 direct the discontinuance of the violation. The order shall be effective immediately, but shall  
12 not become final except in accordance with the provisions of Section 25251.

13 15. Corporations Code section 25251 provides as follows:

14 (a) No order issued pursuant to Section 25249 or 25250 may become final except after  
15 notice to the affected broker-dealer or investment adviser of the commissioner's intention to  
16 make the order final and the reasons for the finding. The commissioner shall also notify the  
17 broker-dealer or investment adviser that upon receiving a request the matter shall be set for  
18 hearing to commence within 15 business days after receipt of the request. The broker-dealer  
19 or investment adviser may consent to have the hearing commence at a later date. If no  
20 hearing is requested within 30 days after the mailing or service of the required notice, and  
21 none is ordered by the commissioner, the order may become final without a hearing and the  
22 broker-dealer or investment adviser shall immediately discontinue the practices named in the  
23 order. If a hearing is requested or ordered, it shall be held in accordance with the provisions  
24 of the Administrative Procedure Act (Chapter 5 (commencing with Section 11500) of Part 1  
25 of Division 3 of Title 2 of the Government Code), and the commissioner shall have all of the  
26 powers granted under that act. If, upon the conclusion of the hearing, it appears to the  
27 commissioner that the broker-dealer or investment adviser is conducting business in an  
28 unsafe or injurious manner or is violating any law of this state, or any rule binding upon it,  
the commissioner shall make the order of discontinuance final and the broker-dealer or  
investment adviser shall immediately discontinue the practices named in the order.

(b) The broker-dealer or investment adviser may within 10 days after an order is made final  
commence an action to restrain enforcement of the order. If the enforcement of the order is  
not enjoined within 10 days by the court in which the action is brought, the broker-dealer or  
investment adviser shall comply with the order.

16. By reason of the foregoing, Palisades has willfully violated California Code of  
Regulations, title 10, section 260.237.1, subdivision (a) and section 260.241.3, subdivision (a)(2),

1 justifying the issuance of an order to discontinue violations. Palisades as a licensee, was obligated to  
2 have knowledge of, and to comply with, the provisions of the Corporate Securities Law and the  
3 regulations thereunder to maintain its investment adviser certificate. The Department gave Palisades  
4 prior notice of the requirements of both sections after its regulatory examination in 2000. Despite  
5 this, Palisades continued to violate both sections.

6 17. Therefore, pursuant to Corporations Code section 25249, the Commissioner has  
7 issued an order directing Palisades to discontinue violating California Code of Regulations, title 10,  
8 section 260.237.1, subdivision (a) and section 260.241.3, subdivision (a)(2).

9 WHEREFORE, good cause showing, and pursuant to Corporations Code section 25251, the  
10 California Corporations Commissioner hereby notifies Palisades Investment Advisors, Inc. of his  
11 intention to make final the Order to Discontinue Violations Pursuant to Corporations Code Section  
12 25249.

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Dated: February 9, 2006

WAYNE STRUMPFER  
California Corporations Commissioner

By: \_\_\_\_\_  
NICHOLAS LANZA  
Senior Corporations Counsel  
Enforcement Division