



IN THE UNITED STATES DISTRICT COURT  
FOR THE NORTHERN DISTRICT OF CALIFORNIA  
NORTHSTAR FINANCIAL ADVISORS, INC.  
v.  
SCHWAB INVESTMENTS, ET AL.

## CLAIMS

- Section 11 of the Securities Act of 1933
- Section 12(a)(2) of the Securities Act of 1933
- Section 13(a) of the Investment Company Act of 1940

No registered investment company may, without a vote of a majority of its outstanding voting securities . . . “deviate from its policy in respect of concentration of investments in any particular industry or group of industries as recited in its registration statement, deviate from any investment policy which is changeable only if authorized by shareholder vote, or deviate from any policy recited in its registration statement pursuant to section 8(b)(3).”



## COURT RULING

In denying Schwab's Motion to Dismiss the Court

- Found that Section 13(a) provided an implied private cause of action
- Found that whether the Fund's investment in non-agency CMO's were, in fact, inconsistent with its investment objective of tracking the Index, was a factual matter that could not be resolved on the pleading
- Found that whether the Fund violated the concentration policy turned "on whether mortgage-backed securities are properly considered an "industry," a factual matter that could not be resolved on the pleadings

*IN THE UNITED STATES DISTRICT COURT  
FOR THE DISTRICT OF COLORADO*

*RONALD J. JANSSEN, individually and on behalf  
of all others similarly situated,*

*v.*

*OPPENHEIMER FUNDS, INC., ET AL.*



## ALLEGATIONS

- Fund altered investment policies and began taking on excessive risk in hopes of seeking higher returns as the returns on high-yield bonds generally began to wane. Questionable investments included, total-return swaps and credit-default swaps for companies such as, Lehman Brothers, AIG and General Motors
- Fund experienced 82 percent drop in NAV, one of the worst showings among the roughly 150 U.S. high-yield debt funds
- Morningstar gave the Fund an “F” for “failing investors” noting that “no attempt was made to communicate to shareholders that these funds were taking on additional risk.”
- On February 4, 2009, Morningstar included the Fund on its list of “The Eight Most Shocking Losses of the Past 12 Months”

## BASIS FOR BREACH OF CONTRACT CLAIMS

The State Claims allege

- The Registration Statements, Prospectuses and SAI's constituted a contract between each investor and the Fund and Trustees
- The Fund concentrated more than 25% of its total assets in high-risk mortgage-back securities which violated one of its “Fundamental Policies” to not invest 25% or more of its total assets in any one industry
- The “Fundamental Policies” could not be changed or diverged from without prior approval by vote of a majority of the Fund's outstanding voting securities and no vote was sought or obtained
- By changing or diverging from the “Fundamental Policies,” the Fund and the Trustee's breached the contract

## WHAT ARE THE INDUSTRY CONCENTRATION RULES?

- Section 8(b)(1) of 1940 Act and Form N-1A Item 2(b)
  - Every registered investment company must include in its registration statement its concentration policy
- SEC Guide 19
  - Provides general industry concentration guidance
  - Notes 8(b)(1) disclosure not applicable to investments in tax-exempt securities issued by governments or political subdivisions of government since such issues are not members of any industry
- Industry Classifications
  - Guide 19 notes a registrant can use industry classifications guides or select its own industry classifications but such classifications must be reasonable and should not be too broad
  - Standard Industry Classifications

## OTHER DISCLOSURE ISSUES

- SEC Administrative Proceeding
  - Pax World – July 30, 2008 – Civil penalty of \$500,000 – funds invested in certain stocks that the SAI disclosed were not permissible investments, SEC found Section 13(a)(3) violated
- Recent SEC Speech on Derivatives
  - Donahue speech on April 17, 2009
    - SAI risk disclosure is “quite extensive”
    - Real question is: how does an investor synthesize extensive derivative risk disclosure with a fund’s investment objective
    - SEC guidance - advised directors to review a fund’s disclosure to “ensure complete disclosure” with fund’s participation in derivatives

