

INITIAL DECISION RELEASE NO. 410  
ADMINISTRATIVE PROCEEDING  
FILE NO. 3-13337

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

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In the Matter of :  
: INITIAL DECISION  
DIANE M. KEEFE : December 8, 2010

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APPEARANCES: Rachel E. Hershfang and Kevin M. Kelcourse for the  
Division of Enforcement, Securities and Exchange Commission

Robert Knuts of Park & Jensen LLP for Respondent Diane M. Keefe

BEFORE: Carol Fox Foelak, Administrative Law Judge

### SUMMARY

This Initial Decision (ID) concludes that Diane M. Keefe (Keefe), while associated with an investment adviser as portfolio manager for an investment company (commonly known as a “mutual fund”), violated the antifraud provisions of the Investment Company Act of 1940 (Investment Company Act) by supplying, at the investment adviser’s request, purported records for inclusion in the investment company’s files of meetings of a non-existent committee. The ID imposes these sanctions: a cease-and-desist order and a censure.

## I. INTRODUCTION

### A. Procedural Background

The Securities and Exchange Commission (Commission) issued its Order Instituting Proceedings (OIP) on January 13, 2009, pursuant to Sections 9(b) and 9(f) of the Investment Company Act, Section 203(f) of the Investment Advisers Act of 1940 (Advisers Act), and Section 15(b) of the Securities Exchange Act of 1934 (Exchange Act). On April 3, 2009, an Initial Decision was issued, suspending Keefe from association with an investment adviser, broker, or dealer for twelve months. Diane M. Keefe, 95 SEC Docket 15899 (C.A.L.J. Apr. 3, 2009). Thereafter the Commission remanded the proceeding for further consideration. Diane M. Keefe, 98 SEC Docket 27511 (Apr. 16, 2010).

The undersigned held a six-day hearing on July 12-16 and 26, 2010, in New York City. Fourteen witnesses testified, including Keefe, and numerous exhibits were admitted into evidence.<sup>1</sup>

The findings and conclusions in this ID are based on the record. Preponderance of the evidence was applied as the standard of proof. See Steadman v. SEC, 450 U.S. 91, 97-104 (1981). Pursuant to the Administrative Procedure Act, 5 U.S.C. § 557(c), the parties' September 10, 2010, Proposed Findings of Fact and Conclusions of Law and Post-Hearing Briefs and September 20, 2010, replies were considered. All arguments and proposed findings and conclusions that are inconsistent with this ID were considered and rejected.

## **B. Allegations and Arguments of the Parties**

This proceeding concerns Keefe's admitted after-the-fact creation of notes (also referred to in the record evidence as "minutes") of meetings of a non-existent "investment committee" of an investment company's board of directors (Notes) in response to a request by an employee and officer of the investment company's investment adviser. The OIP alleges that Keefe thus willfully violated Section 34(b) of the Investment Company Act, which prohibits the making of any untrue statement of material fact in any document the keeping of which is required pursuant to Investment Company Act Section 31(a), in this case as required by Rule 31a-1(b)(11) thereunder.

Keefe admits an error in judgment. However, she urges that the Notes reflected her recollection of actual conversations with members of the purported investment committee, that no one was misled, and that the Notes were not "advisory material received from the investment adviser, any advisory board or advisory committee, or any other persons from whom the investment company receives investment advice" within the meaning of Investment Company Act Rule 31a-1(b)(11).

The Division is seeking broker-dealer, investment adviser, and investment company bars; civil money penalties; and a cease-and-desist order. Keefe argues that the charges are unproven and no sanctions should be imposed.

## **II. FINDINGS OF FACT**

### **A. Respondent and Other Relevant Individuals and Entities**

During the time at issue Keefe was employed by Pax World Management Corp. (Pax World Management), a registered investment adviser, as portfolio manager of the Pax World High Yield Fund (Pax HYF), an investment company.

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<sup>1</sup> Citations to the transcript will be noted as "Tr. \_\_\_." Citations to exhibits offered by the Division and by Keefe will be noted as "Div. Ex. \_\_\_" and "Resp. Ex. \_\_\_," respectively.

## 1. Diane M. Keefe

Keefe has worked in the financial industry since earning an MBA in 1984. Tr. 541. Thereafter, she worked for several financial firms and became interested in high yield bonds, commonly known as junk bonds. Tr. 542-43. She had long been interested in socially responsible investing (SRI)<sup>2</sup> when she approached the owners of Pax World Management with an idea of starting a high yield fund. Tr. 541-48. As a result, she began working at Pax World Management in April 1999, and the Pax HYF began operation in October 1999. Tr. 548-51, 656. Keefe was not an officer or director of the Pax HYF, but rather an employee of Pax World Management. Tr. 676. Keefe was eventually let go by Pax World Management. Tr. 671. However, there is no evidence in the record concerning the circumstances of her termination from the company. Keefe has been unemployed since April 2009 and does volunteer work for the national finance committee of the American Friends Service Committee. Tr. 538-39.

## 2. Pax World Management Corp. and Pax World High Yield Fund

Pax World Management is owned by Laurence Shadek (Shadek) and his family, who bought out the prior owners in 1996. Tr. 77, 655. In 2000, in addition to the Pax HYF, there were two other Pax World Funds – the Pax World Balanced Fund (Balanced Fund) and the Pax World Growth Fund (Growth Fund). Tr. 78, 484. The Balanced Fund had been established before the Shadeks' takeover, and the Growth Fund was established in 1997. Tr. 367-68, 658-59. During the time at issue, as was customary for mutual funds, the Pax HYF itself had no employees. Tr. 146, 151.

The address of Pax World Management and the Pax HYF was in Portsmouth, New Hampshire, where Janet Spates (Spates), infra, was located. Tr. 145; Div. Ex. 3 at 2, Div. Ex. 4 at 2, Div. Ex. 5 at 2, Div. Ex. 6 at 2, Div. Ex. 7 at 2, Div. Ex. 8 at 2. Keefe was located at the New York City office of a registered investment adviser and broker-dealer then known as H.G. Wellington and Company (Wellington), with which Pax insiders Shadek and Thomas "Tim" Grant (Grant) were associated.<sup>3</sup> Tr. 444, 654, 667, 674.

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<sup>2</sup> An articulation of SRI is found in a July 5, 2001, Pax HYF prospectus that indicates that the fund invests in companies that "produce goods and services that improve the quality of life and that are not, to any degree, engaged in manufacturing defense or weapons-related products or companies that derive revenue from the manufacture of liquor, tobacco and/or gambling products." Div. Ex. 3 at 69. Rather, it "will invest in such industries as building supplies, computer software, education, food, health care, household appliances, housing, leisure time, pollution control, publishing, retail, technology and telecommunications." Id. Also, its "portfolio will consist primarily of companies located in the United States." Id. The prospectus also noted that it was necessary to continuously monitor portfolio securities' companies and divest those that no longer complied with the promised limitations. Id. at 70.

<sup>3</sup> The Balanced Fund's portfolio manager, Chris Brown, Spates's brother, was located in Portsmouth, while the Growth Fund's portfolio manager, Paul Gulden, was co-located with Keefe, Shadek, and Grant in New York City. Tr. 78, 91, 130.

### **3. Other Relevant Individuals**

#### **a. Laurence Shaddek**

In addition to his ownership interest in Pax World Management, Shaddek was, and is, chairman of Pax World Management and each of the funds and an inside, interested director on each of the funds' boards. Tr. 658. He has been associated with Wellington since 1972. Tr. 654. His office was next to Keefe's. Tr. 470, 702. He devoted approximately 80% of his time to Wellington. Tr. 674.

#### **b. Thomas "Tim" Grant**

Grant was president and CEO of Wellington during the time at issue. Tr. 444. He was instrumental in persuading the Shaddek family to purchase Pax World Management in 1996 and then became president of the company. *Id.* When the Pax HYF was formed, he also became its president and a director. Tr. 445. He had brought Keefe to Shaddek's attention after hearing her speak at a meeting. Tr. 471. He would talk in the hallway or in Shaddek's office with Keefe about business matters. Tr. 456-57, 470. His and Keefe's offices were not far apart. Tr. 457. Grant was shocked when Keefe disclosed to him that she had created the Notes, because it was out of character. Tr. 471-73.

#### **c. Janet Spates**

Spates has worked at Pax World Management since 1992. Tr. 74. Her stepfather was one of the founders of the company, and Spates joined it after she graduated from college. Tr. 74-75. Spates was not an employee of the Pax HYF. Tr. 146. She has performed administrative duties and held several different titles at Pax World Management and the funds, including compliance officer during the years 1999-2004. Tr. 78-82; Resp. Exs. 12, 13, 21, 24, 72, 85. Additionally, during those years, she was co-treasurer, chief financial officer, and chief operating officer of Pax World Management and assistant treasurer of the Pax HYF. Tr. 80-81; Div. Ex. 3 at 96, Div. Ex. 4 at 101, Div. Ex. 5 at 105, Div. Ex. 6 at 132, Div. Ex. 7 at 99, Div. Ex. 8 at 192. As such, she would help in assembling files for Commission examinations; review annual reports, prospectuses, proxy statements, and statements of additional information (SAI); and add any additional information needed to drafts of filings prepared by attorneys Lee Unterman (Unterman) and Kevin Lake (Lake). Tr. 82-86.

#### **d. Lee Unterman**

Unterman is a lawyer who began performing services for Pax World Management in 1996 when the Shaddek family purchased the company. Tr. 366-67. His law firm formed the Pax HYF in 1999. Resp. Ex. 7. He was the secretary of the Pax HYF. Tr. 367; Div. Ex. 3 at 96, Div. Ex. 4 at 101, Div. Ex. 5 at 105, Div. Ex. 6 at 134, Div. Ex. 7 at 100, Div. Ex. 8 at 193; Resp. Ex. 8 at 1, Resp. Ex. 157 *passim*. Unterman was formally designated Chief Compliance Officer of the Pax HYF in about 2004 after several years of functioning in that capacity. Tr. 81.

**e. James Large**

James Large (Large), a banker, was a director of the Pax HYF between 1999 and 2007. Tr. 482-83; Div. Ex. 8 at 90.

**f. Mary Austin**

Mary Austin (Austin) is the current portfolio manager for the Pax HYF. Tr. 515. She was a high yield analyst at Pax World Management from 1999 to November 2005, when she became assistant portfolio manager of the Pax HYF. Tr. 516-17; Resp. Exs. 72, 85.

**g. Paul Gulden**

Paul Gulden (Gulden) was portfolio manager of the Growth Fund. Tr. 422; Resp. Exs. 72, 85.

**B. Formation of the Pax HYF**

Between April and October 1999, when the Pax HYF began operating, preparations to launch the fund included drafting the initial prospectus. Tr. 549-51; Resp. Ex. 10. The attorneys, Unterman and Lake, drafted the prospectus, as they did all prospectuses, SAIs, and proxy statements during the time at issue. Tr. 83-86, 549. Keefe's role regarding such disclosure documents was limited to providing information concerning securities held by the fund and the fund's strategy. Tr. 85-86, 550, 555-56; Resp. Ex. 10 at 1-11, Resp. Ex. 23 at 31-32. The record evidence does not show who was responsible for the language in disclosure documents that stated that the Pax HYF Board of Directors had an Investment Committee.

**C. Keefe's Role in the Pax HYF**

After being hired and in preparation for the fund's October launch, Keefe hired two research analysts, who researched securities and issuers and recommended transactions. Tr. 516-20, 549. As portfolio manager, Keefe decided on the transactions. Tr. 529, 584. Keefe did most of the trading, that is negotiating price with potential counter parties once she had decided to buy or sell a particular security. Tr. 520-21. At each of their quarterly meetings, Keefe made a detailed presentation to the fund's Board of Directors concerning the fund's holdings, transactions, strategy, and future direction and answered questions. Tr. 484-88, 503-14, 552-55; Resp. Ex. 157. The presentation included a listing of all transactions and holdings during the previous quarter, along with various charts. Tr. 487-99, 505-06, 510-11, 553-54; Resp. Exs. 16, 20, 30, 42. Large considered her well-prepared, speaking with clarity, especially on the credit issues of her junk bond portfolio. Tr. 485-86, 493-94. He took an active role at board meetings, particularly questioning Keefe concerning credit issues. Tr. 499-500, 555. Keefe also provided answers to the Q&A section of the Annual Report for Pax World Funds pertaining to the Pax HYF. Tr. 556; Resp. Ex. 23 at 31-32. Keefe also represented the fund at roadshows and provided information for marketing materials that were used by the fund's wholesalers. Tr. 557-65; Resp. Exs. 18, 26, 29, 37, 47, 77, 141.

## D. The Notes

As discussed below, the Pax HYF public disclosures falsely represented that its board had an investment committee and that the investment committee met two times a year. When Spates contacted Keefe to collect information about the investment committee for various disclosure documents, Keefe did not tell her that the investment committee did not exist. Further, accepting Spates's representation that the committee existed and that it had to meet twice a year, Keefe created notes of investment committee meetings that did not occur, as part of the Pax HYF's preparation for a 2003 Commission examination.

### 1. **The Non-Existent Pax HYF Investment Committee**

The July 5, 2001, December 26, 2001, August 15, 2002, May 15, 2003, November 28, 2003, and April 30, 2004, SAIs of the Pax HYF state it has an "Investment Committee [which] has the responsibility of overseeing [its] investments" and that Grant and Shadek are members of the Investment Committee.<sup>4</sup> Div. Ex. 3 at 92, 94, 98, Div. Ex. 4 at 98, 100, 103, Div. Ex. 5 at 102, 104, 107, Div. Ex. 6 at 127, 129, 134, Div. Ex. 7 at 94-95, 100, Div. Ex. 8 at 187-88, 193. That statement is false; the Pax HYF did not have an Investment Committee at the time of those SAIs.<sup>5</sup> Tr. 460, 664-65, 681, 715. There was not an Investment Committee before September 2004. Tr. 574, 664. The SAIs were signed by Grant and Shadek, among others.<sup>6</sup> Div. Ex. 3 at 122, Div. Ex. 4 at 128, Div. Ex. 5 at 132, Div. Ex. 6 at 186, Div. Ex. 7 at 143, Div. Ex. 8 at 240. Similarly, Pax HYF proxy statements dated April 24, 2000, April 19, 2001, April 19, 2002, April 23, 2003, and April 27, 2004, state that the Pax HYF Board of Directors has "an Investment Committee consisting of Messrs. Laurence A. Shadek and Thomas W. Grant and Ms. Diane Keefe (Portfolio Manager of the Fund) [that] has the responsibility of overseeing the investments of the Fund." Div. Ex. 21 at 14, Div. Ex. 9 at 12, Div. Ex. 10 at 13, Div. Ex. 11 at 19, Div. Ex. 12 at 17. The proxy statements were signed by Grant. Div. Ex. 21 at 6, Div. Ex. 9 at 6, Div. Ex. 10 at 6, Div. Ex. 11 at 7, Div. Ex. 12 at 6.

The April 30, 2004, SAI stated that the Pax HYF Investment Committee had two meetings during 2003. Div. Ex. 8 at 193. That statement is false. Tr. 452-53. The 2001, 2002, 2003, and

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<sup>4</sup> The same SAIs make the same representations as to the existence and membership of a Growth Fund Investment Committee. Div. Ex. 3 at 92, 94, 98, Div. Ex. 4 at 98, 100, 103, Div. Ex. 5 at 102, 104, 107, Div. Ex. 6 at 127, 129, 134, Div. Ex. 7 at 94-95, 100, Div. Ex. 8 at 187-88, 193. Those representations were false as well; the Growth Fund did not have an Investment Committee. Tr. 464. However, its portfolio manager, Gulden, assembled an ad hoc investment committee. Tr. 426. Grant does not recall attending any Growth Fund investment committee meetings. Tr. 451-52.

<sup>5</sup> Unterman has no recollection one way or the other as to whether the Pax HYF Board of Directors had formed an Investment Committee. Tr. 377-78.

<sup>6</sup> Grant relied on the attorneys for drafting and review of such documents. Tr. 445-50.

2004 proxy statements state that the Investment Committee held two meetings during the previous year. Div. Ex. 9 at 12, Div. Ex. 10 at 13, Div. Ex. 11 at 19, Div. Ex. 12 at 17. Those statements are also false. Tr. 452-53. This information came from Keefe; when told by Spates, who was compiling information for the documents,<sup>7</sup> that such a committee existed, Keefe provided the information regarding the number of committee meetings each year. Tr. 96-118; Div. Ex. 19. Keefe never told Spates that there were no meetings. Tr. 101, 103, 105-06.

## 2. The 2003 Examination

In August 2003, Commission staffer Liza Fine-Magnan (Fine-Magnan) conducted a routine compliance examination of the Pax World Funds and Pax World Management. Tr. 332-59, 363-65; Div. Ex. 13. On August 7, Fine-Magnan contacted Pax World Management, requested various records, and set the examination to commence on August 18 in Portsmouth. Div. Ex. 13. Spates contacted Keefe and said she was collecting documents for an upcoming Commission examination<sup>8</sup> and needed, among other things, records of the Pax HYF Investment Committee meetings. Tr. 120-24, 183-84, 565-66. Keefe asked her to identify the members, and Spates identified Keefe, Shadek, and Grant. Tr. 184-85, 566. Spates said there was a minimum requirement of two meetings a year, and Keefe responded in an e-mail on August 12, which included the following: “did you confirm with Kevin [Lake] or anywhere in your records that I need to provide evidence of investment committee meetings 2x per year.” Tr. 122-24, 566; Div. Ex. 2.

Keefe decided to look through the purchase and sales reports that were included in board meetings to identify conversations she had had with Shadek and Grant regarding investment decisions.<sup>9</sup> Tr. 567. In other words, she created the Notes based on conversations on topics that she recalled discussing with them. Tr. 568-69. The Notes are handwritten on eleven random pieces of paper, including Wellington letterhead, Plaza Hotel stationery, and unheaded lined and unlined paper. Div. Ex. 1. Keefe faxed the Notes to Spates on August 18, 2003. Tr. 125; Div. Exs. 1, 1A.

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<sup>7</sup> Spates did not ask Shadek or Grant for information about Investment Committee meetings. Tr. 161. This was despite the fact that the proxy statements claim, “Each director attended all the meetings of the . . . committee[s] upon which they served,” and specified names and dates of any exceptions. Div. Ex. 9 at 12, Div. Ex. 10 at 13, Div. Ex. 11 at 19, Div. Ex. 12 at 17.

<sup>8</sup> In August 2003, at Spates’s request, Gulden faxed to her “not minutes but records” of Growth Fund Investment Committee meetings. Tr. 129-30, 426-27; Div. Ex. 17; Resp. Ex. 62. It was his understanding that such meetings were required. Tr. 426. It was an ad hoc committee he assembled. Tr. 426. The records were not necessarily prepared contemporaneously with the meetings and the handwritten material that he faxed to Spates may have been transcribed from other notes. Tr. 427-34. The records consist of one or two handwritten sentences per date. Div. Ex. 17; Resp. Ex. 62.

<sup>9</sup> At the time, Spates formed the impression that Keefe had some unorganized notes in various files that she was going to use to write summaries of meetings she had with Shadek and Grant. Tr. 186-89.

They describe purported discussions about various issues concerning the Pax HYF investments with “Tim” and “Larry” on nine dates between February 2, 1999, and August 12, 2003. Div. Ex. 1. Spates placed the Notes in the “investment committee meeting High Yield file.”<sup>10</sup> Tr. 125-26.

There is no indication in the record that Fine-Magnan saw the Notes during the August 2003 examination. Fine-Magnan did not mention seeing the Notes in her testimony.<sup>11</sup> Tr. 330-65. Spates does not recall whether or not the Notes were provided to Fine-Magnan. Tr. 132-34. Unterman, who helped Pax World Management prepare for the examination was unaware of the existence of the Notes in 2003. Tr. 392-93. It is found that Fine-Magnan did not see the Notes during the August 2003 examination.

### **3. The 2004 Inspection**

In August 2004, Fine-Magnan, in an investigation of market timing, sought information and requested interviews of Spates and Keefe, among others associated with the Pax HYF. Tr. 359-61; Resp. Ex. 112. The questions she asked Keefe during her interview concerned market timing only. Tr. 361-62.

As the August 2004 inspection approached, Keefe advised Shadek and Grant that she had created the Notes. Tr. 468-69, 567-69, 665-67. They were dismayed. Tr. 471-72, 667. They advised her to call Unterman immediately, which she did.<sup>12</sup> Tr. 570-71, 667. Unterman received Keefe’s call advising him of the Notes while en route to Portsmouth to meet with her in anticipation of her market-timing interview with Fine-Magnan. Tr. 393-94. As a result, Spates, at his instruction, gave him the Notes, which he secured in a safe at his law firm. Tr. 135-36, 394, 413. He eventually concluded that the Notes did not have to be kept with the corporate records because they were false documents.<sup>13</sup> Tr. 395-98, 411-14.

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<sup>10</sup> When Spates received the faxed “records” from Gulden, she placed them in the “Growth Fund investment committee meeting file.” Tr. 130.

<sup>11</sup> However, Fine-Magnan was told that each of the three Pax World Funds had an Investment Committee composed of Grant, Shadek, and the respective fund’s portfolio manager. Tr. 363-64; Resp. Ex. 223 at 4. She cannot remember who told her this. Tr. 348. The meeting at which she was told this included Grant, Shadek, Brown, Gulden, and Keefe, in person or by phone. Tr. 347; Resp. Ex. 223 at 4.

<sup>12</sup> Unterman advised her to engage a lawyer. Tr. 571.

<sup>13</sup> He recalls generally discussing the Notes with other board members, including Shadek and Grant, but does not recall any details, such as whether they had discussed with Keefe the topics attributed to each of them in the Notes. Tr. 396-98, 412.

#### **4. Post-Notes Meetings**

In the fall and winter of 2004, there were meetings of an investment committee composed of Keefe, Shadek, and Gulden, with typed minutes. Tr. 574-79; Resp. Exs. 117, 140A.

#### **5. The Investigation**

Ernst & Young LLP (Ernst & Young) conducted the 2004 year-end audit of the Pax World Funds. Tr. 224-26. As the audit was wrapping up, Chris Strong (Strong), the audit principal, directed a standard fraud inquiry to Spates, who referred him to Unterman for a response. Tr. 226-27; Resp. Ex. 144. In response, Unterman divulged the Notes situation to Strong on January 28, 2005. Tr. 227, 400-02, 410-11; Resp. Ex. 144. Strong informed George Gorman (Gorman), the engagement partner, who considered the matter very serious, as bearing on management integrity; after discussing it with the independent review partner, they consulted Mike Doyle (Doyle), their professional practice director on February 7, 2005.<sup>14</sup> Tr. 227-35; Div. Ex. 22. Strong, Gorman, and Doyle then met with the Pax HYF Audit Committee on February 18, 2005, and required that it hire independent counsel to investigate the Notes situation before Ernst & Young would complete the audit. Tr. 235-36; Div. Ex. 25. At the Audit Committee's request, Ernst & Young provided specific questions to be answered by the investigation. Tr. 236-37; Div. Ex. 24.

Sullivan & Cromwell LLP (Sullivan & Cromwell) was engaged; following its investigation, conducted between approximately March 1 and March 7, 2005, it submitted a report to the Audit Committee on March 9 and to Ernst & Young on March 10. Tr. 18-22; Div. Exs. 23, 25. In reliance on Sullivan & Cromwell's report, including Pax World Management's agreement to disclose the Notes situation to the Commission, Ernst & Young determined that it could issue an unqualified opinion on the Pax World Funds. Tr. 240-45; Div. Ex. 25. A note was added to the 2004 audited financial statements contained in the Annual Report of the funds stating that Pax World Management and the Pax HYF "have determined to contact the . . . Commission regarding an internal control issue at the Adviser relating to certain corporate records of the Fund. As of March 10, 2005, it is uncertain what impact, if any, the resolution of this issue may have on the . . . Fund, including on the Adviser's ability to manage the Fund." Tr. 244-45; Div. Ex. 20 at 60.

#### **6. Pax Disciplines Keefe**

As a result of the Notes situation, Pax World Management placed Keefe on probation for one year, commencing October 1, 2005, reduced her annual compensation by at least \$25,000,<sup>15</sup> and

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<sup>14</sup> Among other things, the Ernst & Young accountants were "concerned about the way management has handled this, namely by removing the 'false records' from the files and not informing the SEC about what was found." Div. Ex. 22.

<sup>15</sup> Division Exhibit 33, Stipulated Testimony of Joseph Keefe, states that the terms of the discipline imposed against Keefe included a reduction in her compensation from \$150,000 to

demoted her to Co-Manager (with Austin) of the Pax HYF. Div. Exs. 27, 33. She (and Austin) were to report directly to Pax World Management's then-CEO Joseph Keefe (no relation), and she was to meet monthly in-person with the Chief Compliance Officer. Id. She was warned that, during the term of her probation, any material violation by her of Pax World Management or Pax HYF compliance policies or procedures would result in suspension or termination, rather than an oral or written warning. Id.

Prior to the Notes discipline, on September 16, 2005, Keefe received a written warning concerning the purchase of a security that was not on Pax World Management's approved list. Div. Exs. 26, 33. This resulted from the purchase by Austin of a health care company's bond, which the Pax HYF had owned previously but had not been rescreened within the requisite number of months of the violative purchase. Tr. 524-28, 584. Subsequently, on March 6, 2006, Keefe was suspended for one week without pay for another purchase of an unapproved security. Div. Exs. 28, 33. In that instance, Keefe believed, based on miscommunication with the analyst who recommended the purchase, that the security was on the approved list. Tr. 585-86. The violation was self-reported. Tr. 586; Div. Ex. 28. She was suspended for another week without pay on April 7, 2006, because of her husband's violation of Pax World Management's pre-clearance policy. Tr. 587; Div. Exs. 29, 33. Joseph Keefe noted that the husband's violation was accidental and that he almost immediately self-reported it. Div. Ex. 29. Keefe was let go sometime thereafter. Tr. 656, 671. The record evidence does not show the circumstances of her termination.

## **7. Keefe's Remorse**

Keefe is remorseful and would never engage in similar action in the future. Tr. 614-15.

### **III. CONCLUSIONS OF LAW**

The OIP charges that Keefe, through her actions with reference to the Notes, willfully violated Section 34(b) of the Investment Company Act. As discussed below, it is concluded that she willfully violated that provision.

#### **A. Section 34(b) Provisions**

Keefe is charged with willfully violating Section 34(b) of the Investment Company Act, which makes it unlawful "to make any untrue statement of a material fact in any . . . report, . . . record, or other document . . . the keeping of which is required pursuant to section 31(a)." The OIP identifies Investment Company Act Rule 31a-1(b)(11), authorized pursuant to Section 31(a), as the provision requiring "the keeping" of the Notes "pursuant to section 31(a)." Rule 31a-1(b)(11) provides that investment companies must keep "[f]iles of all advisory material received from the

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\$125,000 and refers to a letter dated October 21, 2005, that memorializes the terms. Div. Ex. 33 at 3. Division Exhibit 27, which is also attached to Division Exhibit 33, is an unsigned copy of an October 21, 2005, letter to her from Joseph Keefe and Shadek and states that her annual compensation will be reduced from \$150,000 to \$120,000. Div. Ex. 27 at 1.

investment adviser, any advisory board or advisory committee, or any other persons from whom the investment company accepts investment advice.” Scierter<sup>16</sup> is not required to establish a violation of Section 34(b) of the Investment Company Act. Fundamental Portfolio Advisors, Inc., 56 S.E.C. 651, 670 (2003), recon. denied, 85 SEC Docket 1754 (May 23, 2005).

In evaluating whether a misrepresentation or omission is material, the standard of materiality is whether or not a reasonable investor or prospective investor would have considered the information important in deciding whether or not to invest. See Basic Inc. v. Levinson, 485 U.S. 224, 231-32, 240 (1988); TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976); SEC v. Steadman, 967 F.2d 636, 643 (D.C. Cir. 1992).

Keefe, as an employee of Pax World Management, was an associated person of an investment adviser. See Advisers Act Sections 202(17), 203(f). Investment advisers and their associated persons are fiduciaries. Fundamental Portfolio Advisors, Inc., 56 S.E.C. at 684; see Capital Gains Research Bureau, Inc., 375 U.S. 180, 191-92, 194, 201 (1963); see also Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. 11, 17 (1979). As fiduciaries, they are required “to act for the benefit of their clients, . . . to exercise the utmost good faith in dealing with clients, to disclose all material facts, and to employ reasonable care to avoid misleading clients.” SEC v. DiBella, No. 3:04-cv-1342 (EBB), 2007 WL 2904211, at \*12 (D. Conn. Oct. 3, 2007) (citing SEC v. Moran, 922 F. Supp. 867, 895-96 (S.D.N.Y. 1996)), aff’d, 587 F.3d 553 (2d Cir. 2009); see also Capital Gains Research Bureau, Inc., 375 U.S. at 194.

In addition to requesting a cease-and-desist order pursuant to Section 9(f) of the Investment Company Act, the Division requests sanctions pursuant to Sections 9(b) and (d) of the Investment Company Act, Section 203(f) of the Advisers Act, and Section 15(b) of the Exchange Act. The Commission must find willful violations to impose sanctions pursuant to Sections 9(b) and (d) of the Investment Company Act, Section 203(f) of the Advisers Act, and Section 15(b) of the Exchange Act. A finding of willfulness does not require an intent to violate, but merely an intent to do the act which constitutes a violation. See Wonsover v. SEC, 205 F.3d 408, 413-15 (D.C. Cir. 2000); Steadman v. SEC, 603 F.2d 1126, 1135 (5th Cir. 1979); Arthur Lipper Corp. v. SEC, 547 F.2d 171, 180 (2d Cir. 1976); Tager v. SEC, 344 F.2d 5, 8 (2d Cir. 1965).

## **B. Section 34(b) Violation**

### **1. Material Misstatement**

Keefe’s Notes represented that Pax HYF Investment Committee meetings took place. That representation was false. Additionally, the misrepresentation was material. A reasonable investor would have considered it important that the fund’s portfolio manager created records, in anticipation of a Commission examination, of meetings that did not occur of an investment committee that did

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<sup>16</sup> Scierter is “a mental state embracing intent to deceive, manipulate, or defraud.” Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 n.12 (1976); see also Aaron v. SEC, 446 U.S. 680, 686 n.5, 695-97 (1980); SEC v. Steadman, 967 F.2d 636, 641 (D.C. Cir. 1992).

not exist. The investor might wonder what other records or representations of the fund were similarly fictitious. Thus, the Notes' representation that there were meetings of a Pax HYF Investment Committee was "an untrue statement of a material fact" within the meaning of Section 34(b) of the Investment Company Act. That the responsibility summarily ascribed in the Pax HYF's SAIs and proxy statements to the non-existent Investment Committee may have been carried out by the Pax HYF Board of Directors at their quarterly meetings does not lessen the materiality of the misrepresentation, made in records created in anticipation of a Commission examination, that meetings of the non-existent Investment Committee had occurred.

The misrepresentation was clearly willful, as Keefe acknowledges. The fact that others – Shadek, Grant, and Spates – contributed to the misrepresentation does not relieve Keefe from responsibility. See James J. Pasztor, 54 S.E.C. 398, 406-07, 411-13 (1999) (supervisor held liable for registered representative's execution of violative directed trades; supervisor had tried to stop the trading but was overruled by broker-dealer's owner who was friendly with the customer; these circumstances were considered in determining the sanction, however).

## **2. Rule 31a-1(b)(11)**

In urging that Keefe did not violate Investment Company Act Section 34(b), Respondent offers a number of arguments related to Rule 31a-1(b)(11). However, these arguments are unavailing.

Respondent argues that Keefe did not have fair notice of what constitutes a violation of Section 34(b) because Rule 31a-1(b)(11) is unclear, and that, further, the Notes did not constitute "advisory material" and the Pax HYF did not "receive" the Notes within the meaning of the rule. In that the Notes described purported discussions about various issues concerning the Pax HYF investments among three associated persons of the Pax HYF's investment adviser and were provided by one of them, Keefe, to Spates, who placed them in the "investment committee meeting High Yield file," the Notes can be fairly described as "advisory material" that the Pax HYF "received from the investment adviser." Respondent, in essence, argues that the Pax HYF could not have received the Notes because it had no employees; however, such an interpretation would render the rule meaningless since investment companies typically have no employees.<sup>17</sup> Concerning fair notice, it cannot seriously be urged that Keefe believed that the securities laws permitted her to create false documents for inclusion in the Pax HYF's files in preparation for a Commission examination.

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<sup>17</sup> External management has been a characteristic of investment companies since their unsavory past in the 1920s and 1930s, preceding the 1940 Advisers and Investment Company Acts; this arrangement has been criticized as resulting in monopoly prices, but never forbidden by law. JOEL SELIGMAN, *THE TRANSFORMATION OF WALL STREET: A HISTORY OF THE SECURITIES AND EXCHANGE COMMISSION AND MODERN CORPORATE FINANCE*, 222-30, 363-77 (3d ed. 2003).

## IV. SANCTIONS

The Division requests a cease-and-desist order, a second-tier civil money penalty of \$60,000, and broker-dealer, investment adviser, and investment company bars or at least suspensions of twelve months. As discussed below, these sanctions will be ordered: a cease-and-desist order and a censure.

### A. Sanction Considerations

In determining sanctions, the Commission considers such factors as:

the egregiousness of the defendant's actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the sincerity of the defendant's assurances against future violations, the defendant's recognition of the wrongful nature of his conduct, and the likelihood that the defendant's occupation will present opportunities for future violations.

Steadman v. SEC, 603 F.2d at 1140 (quoting SEC v. Blatt, 583 F.2d 1325, 1334 n.29 (5th Cir. 1978)). The Commission also considers the age of the violation and the degree of harm to investors and the marketplace resulting from the violation. Marshall E. Melton, 56 S.E.C. 695, 698 (2003). Additionally, the Commission considers the extent to which the sanction will have a deterrent effect. Schild Mgmt. Co., 87 SEC Docket 848, 862 & n.46 (Jan. 31, 2006). The Commission also considers the public-at-large, the welfare of investors as a class, and standards of conduct in the securities business generally. See Christopher A. Lowry, 55 S.E.C. 1133, 1145 (2002), aff'd, 340 F.3d 501 (8th Cir. 2003); Arthur Lipper Corp., 46 S.E.C. 78, 100 (1975). The amount of a sanction depends on the facts of each case and the value of the sanction in preventing a recurrence. See Berko v. SEC, 316 F.2d 137, 141, 143 (2d Cir. 1963); see also Leo Glassman, 46 S.E.C. 209, 211-12 (1975).

#### 1. Cease and Desist

Section 9(f) of the Investment Company Act authorizes the Commission to issue a cease-and-desist order against a person who "is violating, has violated, or is about to violate" any provision of the Investment Company Act or rules thereunder. Whether there is a reasonable likelihood of such violations in the future must be considered. KPMG Peat Marwick LLP, 54 S.E.C. 1135, 1185 (2001). Such a showing is "significantly less than that required for an injunction." Id. at 1183-91. In determining whether a cease-and-desist order is appropriate, the Commission considers the Steadman factors quoted above, as well as the recency of the violation, the degree of harm to investors or the marketplace, and the combination of sanctions against the respondent. See id. at 1192; see also WHX Corp. v. SEC, 362 F.3d 854, 859-861 (D.C. Cir. 2004).

## 2. Civil Money Penalty

Section 9(d) of the Investment Company Act authorizes the Commission to impose civil money penalties for willful violations of the Securities Act of 1933 or the Exchange, Investment Company, or Advisers Acts or rules thereunder. Under this provision, for each violative act or omission during the time in question, August 2003, the maximum second-tier penalty is \$60,000. 17 C.F.R. § 201.1002. In considering whether a penalty is in the public interest, the Commission may consider six factors: (A) fraud or deceit; (B) harm to others; (C) unjust enrichment; (D) previous violations; (E) deterrence; and (F) such other matters as justice may require. See Section 9(d)(3) of the Investment Company Act. See also New Allied Dev. Corp., 52 S.E.C. 1119, 1130 n.33 (1996); Jay Houston Meadows, 52 S.E.C. 778, 787-88 (1996); Consol. Inv. Servs., Inc., 52 S.E.C. 582, 590-91 (1996); First Sec. Transfer Sys., Inc., 52 S.E.C. 392, 395-96 (1995) (applying identical provision of the Exchange Act).

### B. Sanctions

Although creating a false document in anticipation of a Commission examination was an egregious action, the violation was isolated, occurring once. Scierter was not involved. While Keefe appeared oblivious to the wrongful nature of her conduct at the time she created the Notes, she sincerely regrets it. An unusual mitigating factor is that Keefe self-reported her misconduct to her employers. While she did not do so until preparing for a Commission inspection of the Pax HYF, it is unlikely that her misconduct would have come to light absent her self-reporting. See Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement Decisions, 76 SEC Docket 296 (Oct. 23, 2001) (announcing factors, including self-reporting by corporations that discover wrongdoing by employees, that the Commission may consider as mitigating conduct in its enforcement decisions). Keefe's occupation will provide opportunities for future violations in view of her age, education, and experience. Indeed, she is currently working on a volunteer basis for the financial committee of a philanthropy. The violation was neither recent nor distant in time. Although the violation involved deceit, there was no direct harm to investors or others and no unjust enrichment. Rather, Keefe eventually suffered negative consequences at the hands of her employer.

In consideration of the above, these sanctions will serve the public interest including preventing a recurrence and the purpose of deterrence: a cease-and-desist order and a censure.<sup>18</sup> In light of these sanctions, the financial penalty imposed on her by her employer, and Keefe's sincere awareness, although belated, of the wrongful nature of her conduct as shown by her self-reporting, neither a suspension or bar nor a civil money penalty is necessary to protect the public interest.

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<sup>18</sup> Sections 15(b) of the Exchange Act and 203(f) of the Advisers Act authorize censure as a sanction.

## V. RECORD CERTIFICATION

Pursuant to Rule 351(b) of the Commission's Rules of Practice, 17 C.F.R. § 201.351(b), it is certified that the record includes the items set forth in the revised record index issued by the Secretary of the Commission on November 24, 2010, as corrected on December 6, 2010.<sup>19</sup>

## VI. ORDER

IT IS ORDERED that, pursuant to Section 9(f) of Investment Company Act, Diane M. Keefe CEASE AND DESIST from committing or causing any violations or future violations of Section 34(b) of the Investment Company Act.

IT IS FURTHER ORDERED that, pursuant to Sections 15(b) of the Exchange Act and 203(f) of the Advisers Act, Diane M. Keefe IS CENSURED for violation of Section 34(b) of the Investment Company Act.

This Initial Decision shall become effective in accordance with and subject to the provisions of Rule 360 of the Commission's Rules of Practice, 17 C.F.R. § 201.360. Pursuant to that Rule, a party may file a petition for review of this Initial Decision within twenty-one days after service of the Initial Decision. A party may also file a motion to correct a manifest error of fact within ten days of the Initial Decision, pursuant to Rule 111 of the Commission's Rules of Practice, 17 C.F.R. § 201.111. If a motion to correct a manifest error of fact is filed by a party, then that party shall have twenty-one days to file a petition for review from the date of the undersigned's order resolving such motion to correct a manifest error of fact. The Initial Decision will not become final until the Commission enters an order of finality. The Commission will enter an order of finality unless a party files a petition for review or a motion to correct a manifest error of fact or the Commission determines on its own initiative to review the Initial Decision as to a party. If any of these events occur, the Initial Decision shall not become final as to that party.

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Carol Fox Foelak  
Administrative Law Judge

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<sup>19</sup> See Diane M. Keefe, Admin. Proc. No. 3-13337 (A.L.J. Dec. 6, 2010) (unpublished) (adding Respondent Exhibit 25, which was received in evidence on July 13, 2010, at Tr. 320).