

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 70944 / November 26, 2013

INVESTMENT ADVISERS ACT OF 1940
Release No. 3726 / November 26, 2013

INVESTMENT COMPANY ACT OF 1940
Release No. 30810 / November 26, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15626

In the Matter of

**PARALLAX
INVESTMENTS, LLC,
JOHN P. BOTT, II, AND F.
ROBERT FALKENBERG,**

Respondents.

**ORDER INSTITUTING
ADMINISTRATIVE AND CEASE-AND-
DESIST PROCEEDINGS PURSUANT TO
SECTION 15(b)(6) OF THE SECURITIES
EXCHANGE ACT OF 1934, SECTIONS
203(e), 203(f) AND 203(k) OF THE
INVESTMENT ADVISERS ACT OF 1940,
AND SECTION 9(b) OF THE
INVESTMENT COMPANY ACT OF 1940
AND NOTICE OF HEARING**

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 15(b)(6) of the Securities Exchange Act of 1934 (“Exchange Act”), Sections 203(e), 203(f) and 203(k) of the Investment Advisers Act of 1940 (“Advisers Act”), and Section 9(b) of the Investment Company Act of 1940 (“Investment Company Act”) against Parallax Investments, LLC (“Parallax”), John P. Bott, II (“Bott”), and F. Robert Falkenberg (“Falkenberg”), (collectively, “Respondents”).

II.

After an investigation, the Division of Enforcement alleges that:

A. SUMMARY

1. Parallax, an investment adviser registered with the Commission from March 2010 to November 2012, willfully violated antifraud, custody and compliance provisions of the Advisers

Act and the rules thereunder. From at least 2009 through 2011 (“relevant period”), Parallax: engaged in thousands of securities transactions with advisory clients on a principal basis through an affiliated broker-dealer, without providing prior written disclosure to, or obtaining consent from, the clients; failed timely to provide pooled investment vehicle investors with audited financial statements as required by the Advisers Act custody rule; failed to adopt, implement, and annually review written policies and procedures reasonably designed to prevent violations of the Advisers Act and the rules thereunder; and failed to establish, maintain, and enforce a written code of ethics that met applicable regulatory requirements.

2. Bott and Falkenberg willfully aided and abetted and caused Parallax’s violations. During the relevant period, Bott was Parallax’s sole owner and manager, and Falkenberg was Parallax’s chief compliance officer (“CCO”).

B. RESPONDENTS

3. **Parallax** is a Texas limited liability company based in Houston, Texas. Parallax was created in 1998 and became a Commission-registered investment adviser on March 9, 2010. Effective November 26, 2012, it terminated its Commission registration. As of December 2012, it managed 370 accounts on a discretionary basis and had approximately \$81 million in assets under management.

4. **Bott**, age 61, resides in Houston, Texas. Bott is the sole owner and manager of Parallax, an investment adviser that was registered with the Commission from March 9, 2010 to November 26, 2012. He is also an officer and 40% owner of Mutual Money Investments, Inc. d/b/a Tri-Star Financial (“TSF”), an affiliated broker-dealer registered with the Commission.

5. **Falkenberg**, age 51, resides in Allen, Texas. He was a broker-dealer and investment adviser examiner for the State of California Department of Corporations for 13 years before joining FINRA in 2003. Upon his departure from FINRA in 2008, Falkenberg formed a compliance consulting firm, Falkenberg Ventures Corporation d/b/a Solid Rock Consulting (“SRC”); he is SRC’s sole owner and employee. He later became CCO of Parallax (January 2010 to September 2011) and TSF (October 2010 to April 2013).

C. OTHER RELEVANT ENTITY

6. **TSF** is a Texas corporation based in Houston, Texas. TSF has been a Commission-registered broker-dealer since 1993 and is jointly owned by Bott and two other individuals.

D. FACTS

Background

7. Parallax provides discretionary investment advisory services to individuals and entities, including a private fund, Parallax Capital Partners, LP (“PCP”). Parallax’s investment strategy focused almost exclusively on fixed income securities, such as mortgage-backed bonds.

To execute this strategy, Parallax relied on TSF, its affiliated broker-dealer, for fixed income analysis and trade execution.

8. Bott makes investment recommendations to Parallax clients and, upon the clients' consent, TSF executes the transactions. During the relevant period, TSF used its inventory account to purchase mortgage-backed bonds for Parallax advisory clients and then transferred the bonds to the applicable client account. TSF charged the advisory clients a sales credit for the trades, which was essentially a percentage mark-up (or mark-down). Bott, a registered representative of TSF for the trades, received 55% of the sales credit generated by each trade.

9. In January 2010, Bott hired Falkenberg, to become Parallax's CCO. Falkenberg had little if any practical experience with the regulatory requirements applicable to Commission-registered investment advisers when he joined Parallax.

10. Bott has overall responsibility for ensuring that Parallax complies with its regulatory requirements, including Advisers Act requirements. Bott assigned to Falkenberg, as CCO, the responsibility for establishing and administering Parallax's compliance program under Bott's direction. Falkenberg, however, devoted approximately nine hours per month to Parallax's compliance program. He did not maintain a permanent office at Parallax and delegated daily compliance tasks to other employees in his absence. Falkenberg served as Parallax's CCO during the relevant period.

Parallax Engaged in Thousands of Principal Transactions without Making Required Disclosures and Obtaining Client Consent

11. From at least January 2009 through November 2011, Parallax, through TSF, engaged in at least 2,000 principal transactions with its advisory clients ("Parallax Principal Transactions") without providing prior written disclosure to clients that it would effect the trades on a principal basis, or obtaining consent from clients.

12. TSF collected approximately \$1.9 million in gross sales credits from the Parallax Principal Transactions. TSF paid approximately \$1 million to Bott for the Parallax Principal Transactions while retaining the rest. None of the gross sales credits was paid to Parallax.

13. Bott initiated and executed the Parallax Principal Transactions. He knew that Parallax did not provide written disclosures to, or obtain consent from, Parallax clients before completing the Parallax Principal Transactions. A compliance manual purchased by Parallax in 2009 contained a chapter on principal transactions that described the policies and procedures for such transactions under Section 206(3) of the Advisers Act. However, Bott failed to read the manual before an SEC examination in April 2011.

Parallax Failed to Comply with the Custody Rule

14. Parallax serves as the adviser to PCP, a private fund with approximately \$8.7 million in total assets as of December 31, 2012.¹ PCP's portfolio substantially consists of fixed income products that are generally thinly traded and hard to value, such as inverse floating securities.

15. As a registered investment adviser, Parallax was required to comply with the custody rule as set forth in Rule 206(4)-2 of the Advisers Act. During the relevant period, the custody rule required that an adviser to a private fund must either obtain an annual surprise exam or distribute annual audited financial statements to its investors. In lieu of a surprise annual examination, Parallax elected to distribute GAAP-compliant financial statements audited by a PCAOB-registered auditor to each of PCP's limited partners within 120 days of the fund's fiscal year end. Because PCP's fiscal year end is December 31, Parallax was required to distribute audited 2010 financial statements to PCP's limited partners no later than April 30, 2011.

16. Parallax failed to distribute the 2010 PCP audited financial statements by the April 30, 2011 deadline. Instead, Parallax distributed the 2010 financial statements in early June 2011, more than a month after they were due. PCP's auditor did not begin the 2010 Parallax audit until April 27, 2011. Even though Falkenberg knew about the 120-day deadline by at least February or March 2011, he failed to take any steps to ensure that Parallax met the deadline.

17. Parallax's 2010 financial statement audit was not performed by a PCAOB-registered auditor. Falkenberg knew about the private fund auditor requirements as early as the third quarter of 2010, but he took no steps to ensure that PCP's auditor was PCAOB-registered. By mid-April 2011, Falkenberg discovered that PCP's current auditor was not PCAOB-registered. Falkenberg alerted Bott to the problem, but they decided to go ahead and use the current auditor for the 2010 audit even though they knew the auditor was not PCAOB-registered.

18. Parallax's 2010 financial statements contained fair value disclosures that did not conform with GAAP. As PCP's auditor completed his audit of PCP in late May 2011, he circulated a draft of the financial statements for Parallax's review. Both Bott and Falkenberg reviewed the financial statements and noted that the mortgage-backed securities, which comprised 94% of the fund's value, were categorized as Level One securities under ASC 820 – Fair Value Measurements and Disclosures. A Level One designation indicates that there are quoted prices in active markets for identical assets. Falkenberg told Bott that he believed a Level Two designation (which indicates that quoted prices in active markets do not exist for the identical asset, but the asset's fair value can be calculated directly or indirectly based on observable market inputs) was more appropriate given the difficulty in valuing the securities. Neither Bott nor Falkenberg discussed the valuation issue with the auditor. Instead, Bott ordered that the financial statements – with the Level One designation – be sent to PCP investors.

¹ Parallax Capital, LP is the general partner of PCP. Parallax, in turn, serves as the general partner of Parallax Capital, LP.

19. In August 2011, following an SEC examination, Parallax hired a PCAOB-registered auditor to re-issue PCP's 2010 audited financial statements. Although this auditor did not make any adjustments to the financial statement values, it categorized the fund's mortgage-backed securities as Level Two securities. The auditor issued its audit report for the 2010 PCP financial statements on October 25, 2011, and it was subsequently distributed to PCP investors.

Parallax Failed to Adopt and Implement Written Compliance Policies and Procedures and a Written Code of Ethics

20. For nearly two years after registering with the Commission, Parallax failed to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act. Parallax also failed to perform an annual review of the adequacy of such policies and procedures and the effectiveness of their implementation. Finally, Parallax failed to establish, maintain and enforce a written code of ethics that meets the minimum standards set out in Advisers Act Rule 204A-1. Parallax did not adopt and implement policies and procedures and a code of ethics until December 2011.

21. Following a 2009 Texas State Securities Board ("TSSB") examination of Parallax, the TSSB issued a deficiency letter to Bott citing, among other things, Parallax's failure to establish and maintain written supervisory procedures. In response, Bott approved the purchase of an "off the shelf" compliance manual that was not tailored to Parallax's business (the "2009 Manual"). Bott knew that the 2009 Manual was not tailored to Parallax's business when he hired Falkenberg in January 2010. After Falkenberg became Parallax's CCO, he reviewed the 2009 Manual and concluded that it needed updating.

22. Falkenberg prepared periodic compliance memos addressed to Bott to highlight the "progress and status of compliance efforts" at Parallax. Falkenberg prepared a total of three memos that covered the first and second quarters of 2010 and the full year of 2010.

23. Falkenberg's compliance memos to Bott were brief, consisting of two to three pages. Falkenberg stated in each of them that the 2009 Manual needed to be revised and tailored to the business. Falkenberg's first compliance memo dated April 2010 and emailed to Bott noted explicitly that the 2009 Manual needed "to be updated and made effective." Bott occasionally asked Falkenberg about the status of the compliance manual update and Falkenberg consistently told him that he was working on it. Falkenberg, however, never tailored the 2009 Manual to Parallax's business.

24. Parallax failed to conduct an annual review of its policies and procedures. In late March 2011, Falkenberg received a document request from Commission examination staff in advance of their planned April 2011 examination of Parallax. One of the items requested was documentation for any annual or interim reviews of Parallax's policies and procedures. In response, Falkenberg told exam staff that he performed the 2010 annual review in February 2011 and documented that review in an annual compliance memo. Falkenberg's undated 2010 annual compliance memo states in relevant part:

Rule 206(4)-7 requires that any Advisor registered with the Commission perform at least an annual review of our compliance

procedures. We are also required to record and report any violations of our firm's Code of Ethics under Rule 204A-1 ("Material Compliance Matters"). **This memo documents that I have performed that review and reported significant compliance events and Material Compliance Matters.** [emphasis added]

25. The meta data for Falkenberg's 2010 annual compliance memo indicates that Falkenberg created and completed the memo in approximately four hours on Friday, April 8, 2011, not February 2011. Falkenberg drafted the memo after exam staff had notified Parallax of its impending exam and just three days before exam staff was scheduled to begin field work. In addition, the memo is undated and contains no reference to when the annual review was supposedly performed. Falkenberg never emailed the 2010 annual compliance memo to Bott.

26. Parallax failed to establish, maintain, and enforce a written code of ethics. While Parallax's 2009 Manual contained a section titled "Code of Ethics," the ethics policy was never established, maintained or enforced. In addition, Parallax failed to (a) identify and designate all access persons, (b) obtain written acknowledgments from all access persons, and (c) require all access persons to report their securities transactions and holdings as required by Advisers Act Rule 204A-1.

E. VIOLATIONS

27. As a result of the conduct described above, Parallax willfully violated Section 206(3) of the Advisers Act, which prohibits an investment adviser from executing securities transactions with a client on a principal basis without disclosing to such client in writing, before the completion of such transaction, the capacity in which it is acting and obtaining the consent of the client to such transaction.

28. As a result of the conduct described above, Bott willfully aided and abetted and caused Parallax's violations of Section 206(3) of the Advisers Act.

29. As a result of the conduct described above, Parallax willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-2 thereunder, which requires an investment adviser with custody of client funds or securities to adequately safeguard those assets by implementing specific procedures.

30. As a result of the conduct described above, Bott and Falkenberg willfully aided and abetted and caused Parallax's violations of Section 206(4) of the Advisers Act and Rule 206(4)-2 thereunder.

31. As a result of the conduct described above, Parallax willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder, which require that an investment adviser adopt and implement written policies and procedures reasonably designed to prevent violation of the Advisers Act and the rules thereunder.

32. As a result of the conduct described above, Bott and Falkenberg willfully aided and abetted and caused Parallax's violations of Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder.

33. As a result of the conduct described above, Parallax willfully violated Section 204A of the Advisers Act and Rule 204A-1 thereunder, which require that an investment adviser establish, maintain and enforce a written code of ethics.

34. As a result of the conduct described above, Bott and Falkenberg willfully aided and abetted and caused Parallax's violations of Section 204A of the Advisers Act and Rule 204A-1 thereunder.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest that public administrative and cease-and-desist proceedings be instituted to determine:

A. Whether the allegations set forth in Section II hereof are true and, in connection therewith, to afford Respondents an opportunity to establish any defenses to such allegations;

B. What, if any, remedial action is appropriate in the public interest against Bott and Falkenberg pursuant to Section 15(b) of the Exchange Act including, but not limited to, disgorgement and civil penalties pursuant to Section 21B of the Exchange Act;

C. What, if any, remedial action is appropriate in the public interest against Parallax pursuant to Section 203(e) of the Advisers Act including, but not limited to, disgorgement and civil penalties pursuant to Section 203 of the Advisers Act;

D. What, if any, remedial action is appropriate in the public interest against Bott and Falkenberg pursuant to Section 203(f) of the Advisers Act including, but not limited to, disgorgement and civil penalties pursuant to Section 203 of the Advisers Act;

E. What, if any, remedial action is appropriate in the public interest against Respondents pursuant to Section 9(b) of the Investment Company Act including, but not limited to, disgorgement and civil penalties pursuant to Section 9 of the Investment Company Act; and

F. Whether, pursuant to Section 203(k) of the Advisers Act, Respondents should be ordered to cease and desist from committing or causing violations of and any future violations of Sections 206(3), 206(4) and 204A of the Advisers Act and Rules 206(4)-2, 206(4)-7, and 204A-1 thereunder, whether Respondents should be ordered to pay a civil penalty pursuant to Section 203(i) of the Advisers Act, and whether Respondents should be ordered to pay disgorgement pursuant to Section 203 of the Advisers Act.

IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened not earlier than 30 days and not later than 60 days from service of this Order at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondents fail to file the directed answer, or fail to appear at a hearing after being duly notified, the Respondents may be deemed in default and the proceedings may be determined against them upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondents personally or by certified mail.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 300 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Elizabeth M. Murphy
Secretary