

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**INVESTMENT ADVISERS ACT OF 1940**  
**Release No. 2560 / September 29, 2006**

**INVESTMENT COMPANY ACT OF 1940**  
**Release No. 27508 / September 29, 2006**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-12448**

In the Matter of	:	<b>ORDER INSTITUTING ADMINISTRATIVE</b>
	:	<b>AND CEASE-AND-DESIST PROCEEDINGS,</b>
	:	<b>MAKING FINDINGS, AND IMPOSING</b>
<b>STRONG CAPITAL</b>	:	<b>REMEDIAL SANCTIONS PURSUANT TO</b>
<b>MANAGEMENT, INC.,</b>	:	<b>SECTION 203(e) OF THE INVESTMENT</b>
<b>Respondent.</b>	:	<b>ADVISERS ACT OF 1940 and SECTIONS 9(b)</b>
	:	<b>AND 9(f) OF THE INVESTMENT COMPANY</b>
	:	<b>ACT OF 1940</b>
	:	

**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 203(e) of the Investment Advisers Act of 1940 (“Advisers Act”) and Sections 9(b) and 9(f) of the Investment Company Act of 1940 (“Investment Company Act”) against Strong Capital Management, Inc. (“SCM” or “Respondent”).

**II.**

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the “Offer”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions Pursuant to Section 203(e) of the Investment Advisers Act of 1940 and Sections 9(b) and 9(f) of the Investment Company Act of 1940 (“Order”), as set forth below.

### III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

#### **Respondent**

1. SCM, a Wisconsin corporation, was registered with the Commission as an investment adviser from 1974 until May 9, 2005. SCM's principal place of business is in Menomonee Falls, Wisconsin. From 1974 until December 31, 2004, SCM provided investment advisory services to the Strong Funds Complex, which comprised 27 registered investment companies consisting of 71 mutual funds. On January 3, 2005, SCM completed an asset sale of most of its ongoing advisory business, reflecting about \$29 billion in assets under management by SCM, to an independent fund manager. On May 9, 2005, the Commission issued an order declaring SCM's deregistration effective.

#### **Other Relevant Entities**

2. During the relevant time period, Strong High-Yield Municipal Bond Fund, Inc. ("Fund") was an open-end diversified investment company registered with the Commission under the Investment Company Act. The Fund invested in lower-quality bonds, commonly known as high-yield bonds or junk bonds, and offered its shares for sale to the general public. SCM's January 3, 2005 sale of most of its assets did not include SCM's interest in advising the Fund. Effective May 28, 2004, the Fund closed to new shareholders. Subsequently, the Fund's Board of Directors approved a plan of liquidation for the Fund. In accordance with this plan of liquidation, the Fund redeemed all investor class shares on December 29, 2004. On January 18, 2006, the Commission issued an order declaring the Fund's deregistration effective.

#### **Overview**

3. This matter involves a materially misleading statement by SCM, and the failure of SCM to fully and effectively disclose material facts in the Fund's 2002-2003 shareholder reports concerning forbearance agreements that the Fund entered into with two obligors on bonds in the Fund's portfolio. During the period of 2001-03, the Fund entered into these forbearance agreements, under which the Fund agreed to temporarily accept partial payment of the original coupon interest rates. The projects for which the bonds were issued were in financial distress and requested temporary interest rate relief. The two bonds that were subject to these forbearance agreements together comprised between 9% and 15% of the Fund's net assets during the relevant period. The Fund and other mutual funds in the Strong Funds Complex were the sole or majority owners of these bonds. One of the bonds was the Fund's largest single holding during the relevant period. Absent these forbearance agreements, the bonds would have been in default for failure to make required interest payments.

4. SCM, which was responsible for making the Fund's disclosures and public filings, did not disclose to investors that the Fund had entered into forbearance agreements with the obligors on these bonds in the Fund's portfolio. Further, in the portfolio manager's letter for the Fund's April 30, 2003 semiannual report, SCM reported to investors that the percentage of defaulted securities in the Fund's portfolio had fallen below 10% of assets. SCM's statement that the default rate had fallen below 10% was misleading because the report failed also to disclose that bonds comprising an additional 14% of the Fund's net assets were subject to deferred-interest forbearance agreements.

5. Moreover, SCM did not designate the bonds subject to the forbearance agreements as partial-interest-paying bonds in the Fund's financial statements, as required by Regulation S-X. Note 5 of Article 12-12 of Regulation S-X requires investment companies' schedules identifying securities of unaffiliated issuers to denote those bonds that are producing "partial payment of interest" as of the bonds' last interest payment date. In the Fund's schedules of investments in the Fund's financial statements, SCM did not identify the bonds with forbearance agreements as partial-interest-paying bonds, even though the issuers were only paying part of the original coupon interest pursuant to forbearance agreements.<sup>1</sup>

#### **The Fund Enters Into Forbearance Agreements With Issuers of Two Bonds In the Fund's Portfolio**

6. In 1998, the Fund invested in the \$21,000,000 Indiana Health Facility Financing Authority ("IHFFA") Revenue Bonds, Series 1998, issued for the Hamilton Communities, a senior retirement community project located in New Carlisle, Indiana ("Indiana Hamilton Communities Bonds"). The Fund and one other Strong mutual fund were the sole purchasers of the Indiana Hamilton Communities Bonds. The original coupon (interest) rate for the bonds purchased by the Fund was 6.5% annually, to be paid in monthly installments, but due semiannually to the bondholders. As of April 30, 2002, the bonds represented 7.02% of the Fund's net assets. The Indiana Hamilton Communities Bonds represented the Fund's largest single holding during the years 2002 and 2003.

7. During 2001, the Hamilton Communities project experienced occupancy problems and resulting cash flow difficulties. SCM required that Hamilton Communities retain an independent consultant to review management and operations, and implement the consultant's recommendations. In October 2001, Hamilton Communities provided SCM with plans for financial operations from 2001 to 2006, including a proposal to restructure interest payments on the Indiana Hamilton Communities Bonds to permit payment at a 1% rate for the remainder of 2001 and 2002. In November 2001, the Fund agreed to allow temporarily the Hamilton Communities to pay partial interest at the rate of 1% on the Indiana Hamilton Communities Bonds through July 1, 2003, and deferred collection of the remainder of the 6.5% interest payable under the original terms of the bonds ("Indiana Hamilton Communities Forbearance

---

<sup>1</sup>SCM was correctly accruing the bonds at the then-current interest rate for accounting purposes.

Agreement”). As a result of this agreement, the Hamilton Communities’ failure to make current interest payments at the original coupon rate did not constitute a default on its payment obligation under the bonds during the forbearance period. Under the agreement, the deferred interest continued to accrue, and, as of July 1, 2003, the Hamilton Communities was to resume paying the full 6.5% original coupon rate.

8. On or before July 1, 2003, the Fund agreed to extend the Indiana Hamilton Communities Forbearance Agreement to allow the Hamilton Communities to continue to pay partial interest at the rate of 1% through December 31, 2003.

9. Pursuant to the Indiana Hamilton Communities Forbearance Agreement, the Hamilton Communities paid a 1% annual interest rate on the Indiana Hamilton Communities Bonds from January 2002 through January 2004.

10. In 1995, the Fund invested in the Delaware County, Pennsylvania Authority Health Care Facility First Mortgage Revenue Bonds Series 1995A, issued for the GF/Longwood Care, Inc. Naamans Creek Country Manor Project (“Delaware County Bonds”), a nursing care facility located in Philadelphia, Pennsylvania. The Fund was the majority bondholder for these bonds. The original coupon rates for the bonds were 8.5% and 9.0% annually, respectively, to be paid in monthly installments, but due semiannually to the bondholders. The bonds represented 2.63% of the Fund’s net assets as of April 30, 2002.

11. The project experienced financial difficulties, and the obligor sought a forbearance agreement from SCM. On April 10, 2002, the Fund, GF Longwood Care, Inc. (“GF Longwood”), and others entered into a forbearance agreement (“Delaware County Forbearance Agreement”) which, among other things, allowed GF Longwood to pay interest, in the language of the forbearance agreement, pursuant to a “temporary partial interest rate deferral schedule” that set “temporary partial interest rate[s]” of 1.89% and 2.00% for the Delaware County Bonds, and defer collection of the remainder of the interest to a later period. Interest continued to accrue on the bonds at the original coupon rates. As a result of this agreement, GF Longwood’s failure to make current interest payments at the original coupon rates did not constitute a default on its payment obligation during the forbearance period.

12. Under the agreement, as of February 15, 2003, GF Longwood was to resume paying interest at the rates of 8.5% and 9.0% and was to pay the interest that accrued but was not paid during the forbearance period.

13. On or before February 15, 2003, the Fund agreed to extend the Delaware County Forbearance Agreement, among other things to allow GF Longwood to continue to pay the forbearance “temporary partial interest rates” of 1.89% and 2.00% on the Delaware County Bonds through September 15, 2003. Subsequent amendments extended the Delaware County Forbearance Agreement through December 31, 2004, while two successive new project managers were hired in an effort to improve the project’s profitability.

14. Pursuant to the Delaware County Forbearance Agreement, GF Longwood paid partial interest at the 1.89% and 2.00% annual rates on the Delaware County Bonds from April 2002 through April 2004.

**SCM Makes A Misleading  
Statement About The Percentage Of  
Defaulted Bonds In The Fund's Portfolio**

15. SCM made a misleading statement about the percentage of defaulted bonds in the Fund's portfolio in the portfolio manager's investment review letter for the Fund in the Fund's April 30, 2003 semiannual report. In the portfolio manager's investment review letter for the Fund, SCM stated in pertinent part:

Although the Fund was able to deliver a high level of income over the period, it was not sufficient to entirely offset deterioration in several larger holdings . . . As discussed in past reports, we have continued to make progress on lowering overall position sizes in the Fund's portfolio, primarily with respect to lower-rated credits. The Fund's overall percentage of defaulted holdings has fallen to below 10% of assets.

16. SCM's statement that the overall percentage of defaulted holdings in the Fund's portfolio had fallen to below 10% of assets, coupled with the statements associating that decline with redirection of the Fund's overall portfolio composition, was misleading because the report failed to disclose that bonds comprising an additional 14% of the Fund's net assets were subject to deferred-interest forbearance agreements, including the Fund's single largest holding, the Indiana Hamilton Communities Bonds. Without the forbearance agreements, the Indiana Hamilton Communities Bonds and Delaware County Bonds would have defaulted because the obligors failed to fully pay the original coupon rates. The bonds that had defaulted, and the bonds subject to the forbearance agreements, in combination comprised 19.93% of the Fund's net assets at the time.

**SCM Fails to Designate Bonds with Forbearance Agreements As Partial-Interest-  
Paying Bonds**

17. SCM also failed to designate the bonds subject to the forbearance agreements as partial-interest-paying bonds in the Fund's financial statements, as required by Regulation S-X. Note 5 of Article 12-12 of Regulation S-X requires investment companies' schedules identifying securities of unaffiliated issuers to denote income-producing securities for which partial interest was paid or partial dividends declared on the last interest or dividend date. In the Fund's schedules of investments in the Fund's 2002-2003 shareholder reports, SCM failed to denote the Indiana Hamilton Communities and Delaware County Bonds as partial-interest-paying bonds, even though the issuers were only paying part of the interest that was due under the original bond coupons.

18. In the Fund's April 30, 2002 and October 31, 2002 shareholder reports for the Delaware County Bonds, and the Fund's April 30, 2002, October 31, 2002, and April 30, 2003 shareholder reports for the Indiana Hamilton Communities Bonds, SCM disclosed the original coupon rates for these bonds in the Fund's schedules of investments, rather than the forbearance interest rates. Beginning with the Fund's April 30, 2003 semiannual report for the Delaware County Bonds, and the October 30, 2003 annual report for the Indiana Hamilton Communities Bonds, SCM changed its disclosures to disclose the forbearance interest rates for these bonds in the Fund's schedules of investments. Even with this change, however, the Fund's shareholder reports were still materially misleading because SCM did not denote the financial statements to indicate that the rates set forth reflected only partial payment of the original coupon interest.

### **Violations**

19. As a result of the conduct described above, SCM willfully<sup>2</sup> violated Section 34(b) of the Investment Company Act, which prohibits any person from making any untrue statement of a material fact in any registration statement, application, report, account, record, or other document filed with or transmitted to the Commission.<sup>3</sup> Section 34(b) also prohibits any person filing or transmitting those documents from omitting to state any fact necessary in order to prevent the statements made in those documents from being misleading. A finding of negligent conduct is sufficient to establish liability under Section 34(b) of the Investment Company Act. *In the Matter of Byron G. Borghardt and Eric M. Banhazl*, Release No. 33-8274 (Aug. 25, 2003). SCM, together with its affiliates, prepared the semiannual and annual reports for the Fund and filed the reports with the Commission. Therefore, SCM violated Section 34(b) of the Investment Company Act.

20. As a result of the conduct described above, SCM caused the Fund to violate Section 30(e) of the Investment Company Act and Rule 30e-1 thereunder, which require investment management companies to send shareholders semiannual and annual reports that contain at least the information that the investment company's registration statement form, Form N-1A, directs shall be included in such reports. Item 22 of Form N-1A requires that a schedule of investments be prepared in accordance with Article 12-12 of Regulation S-X, which, as noted above, requires investment companies' schedules identifying securities of unaffiliated issuers to denote income-producing securities for which partial interest was paid or partial dividends declared on the last interest or dividend date. By causing the Fund to fail to denote the Indiana

---

<sup>2</sup>"Willfully" as used in this Order means intentionally committing the act which constitutes the violation. *Cf. Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000); *Tager v. SEC*, 344 F.2d 5, 8 (1965). There is no requirement that the actor also be aware that he is violating the law.

<sup>3</sup>Pursuant to Rule 30b2-1 under the Investment Company Act, investment companies are required to file their periodic shareholder reports with the Commission. Prior to March 1, 2003, these reports were filed with the Commission on Form N-30D. Since March 1, 2003, however, these reports have been required to be filed on Form N-CSR, which is also deemed a filing made under Sections 13(a) and/or 15(d) of the Securities Exchange Act of 1934. *See* SEC Rel. No. 34-47262.

Hamilton Communities and Delaware County Bonds as partial-interest-paying bonds, SCM caused the Fund to violate Section 30(e) of the Investment Company Act and Rule 30e-1 thereunder.

### **Undertakings**

21. Respondent has undertaken pursuant to Rule 1101 of the Commission's Rules on Fair Fund and Disgorgement Plans [17 C.F.R. § 201.1101], and in consultation with the staff of the Commission, to develop a plan for the distribution of the disgorgement and civil penalties ("Distribution Plan") to be submitted to the Commission for notice in accordance with Rule 1103 [17 C.F.R. § 201.1103]. Following a Commission order approving a Distribution Plan, as provided in Rule 1104 [17 C.F.R. § 201.1104], Respondent shall take all necessary and appropriate steps to assist the Commission-appointed Administrator in effecting the administration of the final Distribution Plan. Respondent shall bear the costs of administering and implementing the final Distribution Plan.

### **IV.**

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent SCM's Offer.

Accordingly, pursuant to Section 203(e) of the Advisers Act and Sections 9(b) and 9(f) of the Investment Company Act, it is hereby ORDERED that:

A. Respondent SCM be, and hereby is, censured.

B. SCM shall, within 10 days of the entry of this Order, pay disgorgement in the amount of \$1,004,371.50 and prejudgment interest in the amount of \$181,556.10 for a total amount of \$1,185,927.60, and a civil money penalty in the amount of \$1,000,000 to the Securities and Exchange Commission. Such payment shall be: (1) made by United States postal money order, certified check, bank cashier's check or bank money order; (2) made payable to the Securities and Exchange Commission; (3) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (4) submitted under cover letter that identifies SCM as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Robert J. Burson, Midwest Regional Office, Division of Enforcement, Securities and Exchange Commission, 175 W. Jackson Blvd., Suite 900, Chicago, IL 60604.

C. It is further ordered that, pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, a Fair Fund be created for the disgorgement, interest and penalties referenced in paragraph IV.B. above. Regardless of whether any such Fair Fund distribution is made, amounts ordered to

be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, SCM agrees that it shall not, after offset or reduction in any Related Investor Action based on SCM's payment of disgorgement in this action, argue that it is entitled to, nor shall it further benefit by offset or reduction of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, SCM agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the United States Treasury or to a Fair Fund, as the Commission directs. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against SCM by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

D. Respondent shall comply with the undertaking enumerated in paragraph 21 above.

By the Commission.

Nancy M. Morris  
Secretary