

MEMO# 19451

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HEDGE FUND AND AFFILIATED ENTITIES AND INDIVIDUALS SETTLE SEC CHARGES RELATING TO MARKET TIMING

©2005 Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice. [19451] December 7, 2005 TO: BOARD OF GOVERNORS No. 62-05 CHIEF COMPLIANCE OFFICER COMMITTEE No. 65-05 COMPLIANCE MEMBERS No. 25-05 SEC RULES MEMBERS No. 124-05 SMALL FUNDS MEMBERS No. 97-05 RE: HEDGE FUND AND AFFILIATED ENTITIES AND INDIVIDUALS SETTLE SEC CHARGES RELATING TO MARKET TIMING The Securities and Exchange Commission has issued an order making findings and imposing disgorgement, penalties, and remedial sanctions in an enforcement action against a hedge fund, its investment advisers, a trader, and three senior managers (together, "Respondents").* The Respondents consented to the entry of the SEC Order without admitting or denying the SEC's findings. The action involves allegations that the Respondents participated in a fraudulent scheme to market mutual funds. Findings The SEC Order finds that from at least 1999 to 2003, the Respondents generated tens of millions of dollars in profits through market timing of mutual fund shares, despite knowing that mutual funds sought to detect market timers and frequently blocked the Respondents' trades. Specifically, the SEC Order states that the Respondents, through the senior managers and the trader, engaged in the following conduct: (i) created approximately 100 new legal entities, with unrelated names, to hide the Respondents' identity, thereby enabling the Respondents to execute market timing trades in mutual fund shares without detection by the mutual fund families; (ii) opened over 1,000 accounts at various brokerage firms in order to further conceal the fact that the Respondents' market timing was being conducted by the same entity; (iii) engaged in market timing through variable annuity contracts by employing a number of deceptive practices to avoid detection as a market timer; (iv) used brokers with multiple registered representative numbers in order to evade certain mutual funds' market * See In the Matter of Millennium Partners, L.P., Millennium Management, L.L.C., Millennium International Management, L.L.C., Israel Englander, Terence Feeney, Fred Stone, and Kovan Pillai, SEC Release Nos. 33-8639, 34-52863, IA-2453, and IC-27172 (Dec. 1, 2005) ("SEC Order"). The SEC Order also imposes a cease and desist order against the Respondents. Copies of the SEC Order and accompanying press release are available at <http://www.sec.gov/litigation/admin/33-8639.pdf> and <http://www.sec.gov/news/press/2005-170.htm>, respectively. 2 timing restrictions; (v) used a variety of other methods to avoid detection by mutual funds, such as breaking up large trades into smaller trades and using clearing brokers who aggregated trades in omnibus accounts that concealed the identities of the individual entities making the trades; and (vi)

deployed “sticky” assets, through broker-dealers, to obtain timing capacity that the brokers had negotiated with the mutual funds. Based on the conduct generally described above, the SEC found that the Respondents willfully violated the antifraud provisions of Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder. Undertakings In settling this matter, the Respondents agree to cooperate fully with the SEC in any and all investigations, litigations or other proceedings relating to or arising from the matters described in the SEC Order. In addition, the hedge fund and advisers (“Entities”) agreed to comply with the following undertakings:

- Compliance, Legal and Ethics Oversight Committee: The Entities will create a Compliance, Legal and Ethics Oversight Committee, comprised of senior management, that will be responsible for formulating the Entities’ compliance, legal and ethics rules, policies and procedures, and ensuring that the rules are appropriately implemented and enforced. The committee will hold at least quarterly in-person meetings to carry out its responsibilities.
- Independent Compliance Consultant: Within 120 days of the date of the SEC Order, the Entities will retain an Independent Compliance Consultant not unacceptable to the SEC staff. The consultant will (i) conduct a review of the Entities’ operations and its legal, compliance, and ethics structure; (ii) recommend any additional policies and procedures the consultant believes are reasonably designed to ensure that the Entities comply with federal and state securities law; and (iii) submit to the SEC staff, within 30 days of the completion of the review, a report outlining the results of its review, and what recommendations, if any, the consultant made.
- Independent Distribution Consultant: Within 30 days of the entry of the SEC Order, the Entities will retain an Independent Distribution Consultant not unacceptable to the SEC staff. The consultant will develop a plan to distribute the total disgorgement and penalties ordered under the SEC Order. The Entities will require that the consultant submit the distribution plan to the Entities and the SEC staff within 150 days after the entry of the SEC Order. Following the issuance of an SEC order approving a final plan of disgorgement, the consultant and the Entities will take all necessary and appropriate steps to administer the final plan.

3 Sanctions Based upon the SEC’s findings, it imposed the following sanctions:

- The Respondents who hold senior management positions are prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter for a period of three years;
- The Respondent who acts as the General Counsel is denied the privilege of appearing or practicing before the SEC as an attorney for six months; and
- The Respondent who is a trader is suspended from association with any investment adviser for a period of 12 months.

The Respondents were also ordered to pay a total of \$180 million in disgorgement and civil penalties. Jane G. Heinrichs Associate Counsel