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TWO FUND ADVISERS AND AFFILIATED DISTRIBUTOR SETTLE SEC, CALIFORNIA ENFORCEMENT ACTIONS RELATING TO DIRECTED BROKERAGE

[18063] October 4, 2004 TO: BOARD OF GOVERNORS No. 63-04 CHIEF COMPLIANCE OFFICER COMMITTEE No. 11-04 COMPLIANCE ADVISORY COMMITTEE No. 95-04 PRIMARY CONTACTS - MEMBER COMPLEX No. 91-04 SEC RULES MEMBERS No. 146-04 SMALL FUNDS MEMBERS No. 109-04 RE: TWO FUND ADVISERS AND AFFILIATED DISTRIBUTOR SETTLE SEC, CALIFORNIA ENFORCEMENT ACTIONS RELATING TO DIRECTED BROKERAGE The Securities and Exchange Commission has issued an order making findings and imposing disgorgement, civil money penalties, and disclosure and compliance reforms in an administrative proceeding against a registered investment adviser to a group of equity mutual funds ("Funds"), a registered investment adviser serving as subadviser to certain of the Funds, and the Funds' distributor (collectively, "Respondents").1 The Respondents consented to the entry of the SEC Order without admitting or denying the SEC's findings. In addition, the Attorney General of California announced a separate settlement with the distributor of related state charges.2 Both actions involved allegations that the distributor's shelf space arrangements with various broker-dealers, which were paid for in part through the direction of Fund brokerage, were not adequately disclosed. The settlements are summarized below. 1 See In the Matter of PA Fund Management LLC, PEA Capital LLC, and PA Distributors LLC, SEC Release Nos. 34-50384, IA-2295 and IC-26598, Admin. Proc. File No. 3-11661 (Sept. 15, 2004) ("SEC Order"). The SEC Order also censures the Respondents and imposes a cease and desist order. Copies of the SEC Order and accompanying press release ("Press Release") are available at http://www.sec.gov/litigation/admin/34-50384.pdf and http://www.sec.gov/news/press/2004-130.htm, respectively. 2 See Attorney General Lockyer Announces $9 Million Settlement with PA Distributors in PIMCO Fund Case (press release issued by Office of CA Attorney General Bill Lockyer, Sept. 15, 2004), available at http://ag.ca.gov/newsalerts/2004/04-105.htm. Copies of the complaint and settlement agreement are available at http://ag.ca.gov/newsalerts/2004/04-105_complaint.pdf and http://ag.ca.gov/newsalerts/2004/04- 105_settlement.pdf, respectively. 2 I. SEC Order A. Findings According to the SEC Order, the distributor entered into shelf space arrangements with nine broker-dealers that were designed to promote the sale of all funds that it distributed, not just the Funds, and to provide heightened visibility at the brokerage firms, such as through greater access to registered representatives and placement on preferred lists. The adviser and distributor asked the subadviser to direct brokerage commissions from certain Funds to those broker-dealers, but did not tell the subadviser the details of the shelf space arrangements or that the distributor would receive credit for the commissions

and therefore be able to reduce its cash payments to the broker-dealers under the arrangements. The SEC Order finds that this use of Fund assets to defray the distributor's expenses created a conflict of interest that should have been disclosed to the Funds' Board. It also finds that the subadviser should have inquired of the adviser and distributor, and then disclosed to the Board, why the adviser and distributor asked it to direct brokerage commissions to certain broker-dealers for the benefit of the distributor. The SEC Order further finds that the adviser should have disclosed the details of the shelf space arrangements to Fund shareholders. Finally, the SEC Order finds that, by using the brokerage commissions of certain Funds to support shelf space arrangements that benefited other funds, the Respondents created a joint distribution arrangement that had not been approved by the SEC. As a result of the conduct generally described above, the SEC Order finds that: • the adviser and subadviser willfully violated (and the distributor willfully aided and abetted such violations of) Section 206(2) of the Investment Advisers Act of 1940, which makes it unlawful for an investment adviser to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon a client or prospective client; • the adviser willfully violated Section 15(c) of the Investment Company Act of 1940, which requires the investment adviser to a fund to provide such information as may be reasonably necessary for the fund's directors to evaluate the terms of the fund's investment advisory contract; • the adviser willfully violated Section 34(b) of the Investment Company Act, which prohibits the making of material misstatements or omissions in a registration statement or other document filed with the SEC; and • the Respondents willfully violated Section 17(d) of the Investment Company Act and Rule 17d-1 under that Act, which prohibits a Fund affiliate from participating, as principal, in any transaction in connection with joint arrangements in which the Funds are participants without an SEC order approving the transactions. B. Remedial Efforts In determining to accept the settlement offer, the SEC considered the following remedial efforts by the Respondents: 3 • No Directed Brokerage for Shelf Space – The subadviser had ceased directing brokerage commissions on portfolio transactions for shelf space arrangements by July 31, 2003. • Management Changes – The Respondents have substantially reorganized their governance structure and management team, replacing their chief executive officers and the chair of the Funds' Board. The Respondents also have reorganized and added staff to their legal and compliance functions, which are now supervised by the General Counsel of the Respondents' parent company. C. Required Undertakings Shelf Space Arrangements • Written Contracts – The Respondents will implement and maintain written procedures requiring the distributor to use its best efforts to enter into written contracts memorializing all future shelf space arrangements. The documentation must set forth, among other things, the payment arrangement and the services that the broker-dealer or other intermediary will provide. • Approvals – All shelf space arrangements must be approved in writing by the General Counsel of the Respondents' parent company (or his delegate) and presented to the Funds' Board prior to implementation. • Compliance Guidelines – The distributor will include in its compliance manual guidelines for entering into shelf space arrangements, which must be consistent with the SEC Order. The guidelines must be reviewed by the Funds' Board and approved by the distributor's chief legal officer. • Registration Statement Disclosures – Subject to approval by the Funds' Board, the adviser and distributor will cause the Funds to include disclosure in their prospectuses or Statements of Additional Information: (1) about any payments by Respondents that are in addition to dealer concessions, shareholder servicing payments, and payments for services that Respondents would otherwise provide; and (2) where applicable, that such payments are intended to compensate broker-dealers for various services provided in exchange for such payments, including, without limitation: shelf space arrangements, placement on the broker's preferred or recommended fund list, access to the broker's registered

representatives, assistance in training and education of personnel, and marketing support. • Periodic Reporting – At least annually, the adviser and distributor will present to the Funds' independent trustees an overview of the distributor's shelf space arrangements, including: the number and types of such arrangements, the types of services received, the identity of participating broker-dealers, and the total amounts paid. The overview will also cover the distributor's policies regarding shelf space arrangements and any material changes to the policies. On a quarterly basis, the adviser and distributor will 4 provide the Audit Committee with a report setting forth the amounts paid by the distributor for shelf space arrangements and the broker-dealers that received the payments.3 Brokerage and Best Execution • Trade Execution Through Selling Brokers – The Respondents will implement and maintain written procedures designed to ensure that when the trading desk of any subadviser to the Funds places trades with a selling broker, the person responsible for selecting that broker is not informed by the distributor of, and does not take into account, the broker's promotion or sale of fund shares (subject to modification only in the event that the Funds' independent trustees determine that it is not in the Funds' best interests). • Analysis of Brokerage Commissions – At least annually, the adviser will provide to the Audit Committee of the Funds' Board a detailed written analysis of the use by all subadvisers to the Funds of all brokerage commissions at broker-dealers, including the practices of directing brokerage commissions, if any, performed by each of the subadvisers. • Best Execution Analysis – At least annually for each of the next five years, the adviser will provide to the Audit Committee of the Funds' Board a written best execution analysis of the subadvisers to the Funds performed by a recognized independent portfolio trading analytical firm. The adviser will include lists of (1) the top ten executing broker-dealers used by the trading department of each subadviser to the Funds, and (2) the top ten selling brokers conducting business with the distributor. • Soft Dollar and Directed Brokerage Practices – The adviser's Chief Compliance Officer ("CCO") will be responsible for monitoring the soft dollar and directed brokerage practices of the Funds' subadvisers. At least quarterly for each of the next five years, the CCO will prepare a written report regarding such monitoring activities and present the report to the Funds' Board and to the General Counsel of the Respondents' parent company. Compliance • Internal Compliance Controls Committee – The Respondents will establish an Internal Compliance Controls Committee. The independent counsel to the Funds' Board will be invited to participate in all meetings of the committee relating to the Funds. The committee will report to the Funds' Board of Trustees at least quarterly on internal compliance matters. The Respondents will provide such reports to their respective Audit Committees and to the Audit Committee of the Funds' Board. 3 Although not specified in the SEC Order, "Audit Committee" likely refers to the Audit Committee of the Funds' Board. 5 • Senior Employee – The Respondents will designate a senior-level employee to have responsibility for compliance matters relating to conflicts of interests. He or she will report directly to the Respondents' CCOs. • CCO Compliance Reviews – The CCO for each Respondent will review adherence to the Respondent's compliance policies and procedures and to report any violations to the Internal Compliance Controls Committee. • Quarterly Compliance Reporting – The CCO for each Respondent will report to the Funds' CCO, who will report to the Funds' Board at least quarterly any breach of fiduciary duty owed to the Board or violation of the federal securities laws of which they become aware. Any material breach will be reported promptly. • Independent Compliance Consultant – Within 60 days of the SEC Order, the Respondents must retain an Independent Compliance Consultant acceptable to the SEC staff and a majority of the Funds' independent trustees to conduct a comprehensive review of the Respondents' supervisory, compliance, and other policies and procedures designed to prevent and detect conflicts of interest, breaches of fiduciary duty, and federal securities law violations by the Respondents and their employees. The review must include, but not

be limited to, the distributor's shelf space arrangements and the Respondents' compliance procedures, including those relating to conflicts of interest. The Independent Compliance Consultant must complete its review and provide its recommendations in a report to the Respondents, the Funds' Board, and the SEC staff no more than 120 days after the entry of the SEC Order. • Periodic Compliance Review – At least once every other year, commencing in 2006, the Respondents must undergo a compliance review by a third party that is not an interested person of the Respondents. The third party must issue a report of its findings and recommendations to the Internal Compliance Controls Committee and the Audit Committee of the Funds' Board. Disgorgement and Penalties; Other Provisions • Disgorgement and Penalties – The Respondents will pay approximately $6.6 million in disgorgement and prejudgment interest to the affected Funds, as specified in the SEC Order. The adviser and distributor jointly and severally will pay a civil money penalty of $4 million, and the subadviser will pay a civil money penalty of $1 million. • Certification – No later than 24 months after the entry of the SEC Order, the Respondents' chief executive officers must certify to the SEC in writing that the Respondents have fully adopted and complied in all material respects with the undertakings in the SEC Order and the recommendations of the Independent Compliance Consultant, or must describe any material non-adoption or non-compliance. • Recordkeeping – Any record of the Respondents' compliance with the undertakings in the SEC Order must be preserved for at least six years from the end of the fiscal year last used, the first two years in an easily accessible place. 6 II. Settlement in California Action In its complaint, the Attorney General alleges that the distributor entered into shelf space arrangements with at least fifty broker-dealers, under which the distributor agreed to make cash payments and direct Fund brokerage transactions to the broker-dealers in return for heightened visibility for the Funds in the broker-dealers' distribution systems. The complaint alleges that the distributor and the Funds' disclosure documents failed adequately to disclose the shelf space arrangements to Fund shareholders and prospective shareholders. According to the complaint, the distributor's omission of these material facts violated two of the antifraud provisions of California's Corporate Securities Law of 1968. The distributor agreed to settle the action without admitting or denying the allegations in the complaint. The settlement agreement – which contains no findings of fact or conclusions of law – states that the Attorney General considered efforts voluntarily implemented by the distributor, including making registration statement disclosures of all shelf space arrangements and memorializing future shelf space arrangements in written contracts (these two efforts are substantially identical to undertakings in the SEC Order). Pursuant to the settlement agreement, the distributor will pay $5 million in civil penalties and $4 million in costs. Rachel H. Graham Assistant Counsel