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TWO MUTUAL FUND INVESTMENT ADVISERS AND AFFILIATED DISTRIBUTOR SETTLE SEC ENFORCEMENT ACTION RELATING TO MARKET TIMING

[18009] September 20, 2004 TO: BOARD OF GOVERNORS No. 59-04 CHIEF COMPLIANCE OFFICER COMMITTEE No. 8-04 COMPLIANCE ADVISORY COMMITTEE No. 91-04 PRIMARY CONTACTS - MEMBER COMPLEX No. 84-04 SEC RULES MEMBERS No. 137-04 SMALL FUNDS MEMBERS No. 103-04 RE: TWO MUTUAL FUND INVESTMENT ADVISERS AND AFFILIATED DISTRIBUTOR SETTLE SEC ENFORCEMENT ACTION RELATING TO MARKET TIMING The Securities and Exchange Commission has issued an order making findings and imposing disgorgement, civil money penalties, and compliance and mutual fund governance reforms in an administrative proceeding against two registered investment advisers to a group of equity mutual funds (“Funds”) and the Funds’ distributor (together with the advisers, “Respondents”).1 The Respondents consented to the entry of the SEC Order without admitting or denying the SEC’s findings.2 The SEC Order, which is summarized below, involved allegations that the Respondents defrauded investors in connection with an undisclosed market timing arrangement. I. Findings The SEC Order finds that from February 2002 to April 2003, the Respondents agreed to provide a hedge fund with market timing capacity in certain Funds in return for the hedge fund’s investment of “sticky assets” in two investment vehicles (a mutual fund and a hedge fund) from which the advisers earned management fees. According to the SEC Order, the 1 See In the Matter of PA Fund Management LLC f/k/a PIMCO Advisors Fund Management LLC, PEA Capital LLC f/k/a PIMCO Equity Advisors LLC, and PA Distributors LLC f/k/a PIMCO Advisors Distributors LLC, SEC Release Nos. 34-50354, IA-2292 and IC-26594, Admin. Proc. File No. 3-11645 (Sept. 13, 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/34-50354.pdf and http://www.sec.gov/news/press/2004-127.htm, respectively. 2 In May 2004, the SEC filed civil fraud charges in federal district court against the Respondents as well as the former chief executive officers of each adviser. See Institute Memorandum to Compliance Advisory Committee No. 51-04, Investment Company Directors No. 25-04, SEC Rules Members No. 74-04, and Small Funds Members No. 54-04 [17531], dated May 17, 2004. The Press Release states that, upon the entry of the SEC Order, the SEC will seek to dismiss with prejudice its federal charges against the Respondents, but that it will continue to pursue its federal charges against the two former executives. 2 undisclosed agreement with the

hedge fund was negotiated by the former chief executive officer ("CEO") of one adviser and approved by the former CEO of the second adviser, even though each executive knew that the hedge fund's market timing activity could run afoul of the Funds' market timing policies. The SEC Order finds that, during the relevant period, the hedge fund made approximately 108 round-trip transactions in the Funds even though: (1) the Funds' prospectuses created the impression that the Funds discouraged market timing and worked to prevent it, including by limiting an investor to six round-trip transactions per year; and (2) the distributor was issuing warning letters, freezing accounts, or blocking trades in response to market timing activity by other investors. The SEC Order further finds that the advisers failed to have written policies and procedures designed to prevent misuse of the Funds' nonpublic portfolio holdings and that one of the advisers disclosed Fund portfolio holdings to the broker- dealer that executed the hedge fund's trades. As a result of the conduct generally described above, the SEC Order finds that: • the advisers willfully violated (and the distributor willfully aided and abetted such violations of) the antifraud provisions of Sections 206(1) and 206(2) of the Investment Advisers Act of 1940 by entering into an agreement with a market timer that created a conflict of interest, which the advisers knowingly or recklessly failed to disclose to the Funds' Board of Trustees, and that was inconsistent with the Funds' prospectus disclosures; • the advisers willfully violated (and the distributor willfully aided and abetted such violations of) Section 34(b) of the Investment Company Act of 1940 by filing with the SEC fund prospectuses that failed to disclose the agreement with the market timer and gave the misleading impression that the Funds discouraged market timing; • the advisers willfully violated Section 204A of the Advisers Act by failing to have written procedures in place to prevent nonpublic disclosure of the Funds' portfolio holdings and improperly disclosing confidential portfolio holdings to broker representatives, who in turn disclosed some of the holdings to the market timer; and • the Respondents willfully violated Section 17(d) of the Investment Company Act of 1940 and Rule 17d-1 under that Act by participating, as principals, in transactions in connection with joint arrangements in which the Funds were participants without an SEC order approving the transactions. II. Voluntary Undertakings In determining to accept the Respondents' settlement offer, the SEC considered the following efforts voluntarily undertaken by the Respondents and the Funds: • Fund Governance – The Funds will operate in accordance with the following governance policies and practices, which the Funds have represented are currently in effect: o At least 75% of the trustees of each Fund will be independent. 3 o The chairman of the board of trustees of each Fund will be independent. o Any counsel to the independent trustees of a Fund will be an "independent legal counsel," as defined under the Investment Company Act. • Board Actions – No action by a Fund's Board of Trustees will be taken without the approval of a majority of the independent trustees. In the event that any action proposed to be taken is opposed by a majority vote of the independent trustees, the Fund will disclose in its shareholder report for that period: the proposal, the related board vote, and the reason (if any) for the independent trustees' vote against the proposal. • Election of Trustees – Commencing in 2005, each Fund will hold a shareholder meeting to elect its board of trustees at least once every five years. • Fund Compliance Rule – The Funds will comply with Rule 38a-1 under the Investment Company Act as of the date of entry of the SEC Order. • Cooperation – The Respondents will cooperate fully with the SEC in any investigations, litigations, or other proceedings relating to or arising from matters described in the SEC Order. III. Required Undertakings General Compliance • Code of Ethics Oversight Committee – The advisers will maintain a Code of Ethics Oversight Committee, comprised of senior executives of the Respondents' operating business, that will be responsible for all matters relating to issues under the adviser code of ethics. The advisers will report to the Audit Committee of the Funds' Board of Trustees at least quarterly on issues arising under the code of ethics,

including all violations of the code. Any material violations of the code will be reported promptly. • Internal Compliance Controls Committee – The Respondents will establish an Internal Compliance Controls Committee. The independent counsel to the Funds' independent trustees 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. • Reports – The Respondents will provide to their Audit Committee the same reports of the Code of Ethics Oversight Committee and the Internal Compliance Controls Committee that they provide to the Audit Committee of the Funds' Board. • Senior Employee – The Respondents will have a senior-level employee who has responsibility for compliance matters relating to conflicts of interests. He or she will report directly to the Chief Compliance Officers ("CCOs") of the Respondents. 4 • 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 the Funds' CCO becomes aware. Any material breach will be reported promptly. • Ombudsman – The Respondents will establish a corporate ombudsman to whom their employees may convey concerns about ethics matters or questionable practices. The Respondents must review any matters brought to the ombudsman's attention, along with any resolution of such matters, with the independent trustees of the Funds as frequently as the independent trustees may instruct. • Adviser Compliance Rule – Effective immediately, the Respondents will comply with Rule 206(4)-7 under the Advisers Act. Disgorgement, Civil Penalties, and Other Sanctions • Disgorgement and Penalties – The Respondents will pay $10 million in disgorgement and $40 million in civil money penalties. • Independent Distribution Consultant – Within 30 days of the SEC Order, the Respondents must retain an Independent Distribution Consultant acceptable to the SEC staff and to the independent trustees of the Funds. The consultant will develop a plan to distribute the total disgorgement and penalties to investors for (1) their proportionate share of losses suffered by the Funds due to market timing and (2) a proportionate share of advisory fees paid by Funds that suffered such losses during the period of such market timing. The Independent Distribution Consultant must submit the distribution plan to the Respondents and the SEC staff within 100 days of the SEC Order. Following the issuance of an SEC order approving a final plan of disgorgement, the Independent Distribution Consultant and the Respondents must take all necessary and appropriate steps to administer the final plan. • 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 breaches of fiduciary duty, breaches of the code of ethics, and federal securities law violations by the Respondents and their employees. The review must include, but not be limited to: (1) the Respondents' market timing controls across all areas of their business; (2) pricing practices that may make the Funds vulnerable to market timing; (3) utilization by the Funds of short-term trading fees and other controls for deterring excessive short term trading; and (4) the Respondents' policies and procedures concerning conflicts of interest, including conflicts arising from advisory services to multiple clients. 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 5 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. • Certification – No later than 24 months after the entry of the SEC

Order, the Respondents' CEOs 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. Rachel H. Graham Assistant Counsel

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