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MUTUAL FUND INVESTMENT ADVISERS SETTLE SEC AND NEW YORK ENFORCEMENT ACTIONS RELATING TO MARKET TIMING

[18082] October 19, 2004 TO: BOARD OF GOVERNORS No. 66-04 CHIEF COMPLIANCE OFFICER COMMITTEE No. 15-04 COMPLIANCE ADVISORY COMMITTEE No. 99-04 PRIMARY CONTACTS - MEMBER COMPLEX No. 94-04 SEC RULES MEMBERS No. 151-04 SMALL FUNDS MEMBERS No. 112-04 RE: MUTUAL FUND INVESTMENT ADVISERS SETTLE SEC AND NEW YORK ENFORCEMENT ACTIONS RELATING TO MARKET TIMING The Securities and Exchange Commission has issued an order making findings and imposing disgorgement, penalties, and compliance and mutual fund governance reforms in an enforcement proceeding against two affiliated registered investment advisers (collectively, “adviser”) to a group of mutual funds (“Funds”) and two executives, the adviser’s Chief Executive Officer and the Funds’ Chairman of the Board of Trustees and the adviser’s Chief Financial Officer (collectively, with the adviser, “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 New York announced a settlement with the adviser of related state charges.2 Both actions involved allegations that the adviser (and, in some instances in the SEC action, the executives) permitted market timing by select investors in a Fund that violated the Fund’s prospectus disclosures. The SEC Order and the Attorney General’s announcement are summarized below. 1 See In the Matter of RS Investment Management, Inc., RS Investment Management, L.P., G. Randall Hecht and Steven M. Cohen, SEC Release Nos. IA-2310 and IC-26627, Admin. Proc. File No. 3-11696 (Oct. 6, 2004) (“SEC Release”). The SEC Order also censures and imposes cease and desist orders on the Respondents. According to the SEC Release, RS Investment Management, L.P. and RS Investment Management, Inc. are functionally the same entity with the same management. Copies of the SEC Order and accompanying press release are available at http://www.sec.gov/litigation/admin/ia-2310.pdf and http://www.sec.gov/news/press/2004-142.htm. 2 See Robertson Stevens Settles Market Timing Case (press release issued by Office of New York State Attorney General Eliot Spitzer, Oct. 6, 2004) (“Press Release”). A copy of the Press Release is available on the Attorney General’s website at http://www.oag.state.ny.us/press/2004/oct/oct6b_04.html. 2 I. SEC Order A. Findings According to the SEC Order, from at least 2000 through mid-2003, the adviser entered into undisclosed arrangements allowing certain investors in a Fund to engage in unlimited trading. These arrangements included the simultaneous investment of long-term (or sticky) assets in a Fund, generating additional fees for the adviser. The SEC finds that these arrangements were contrary to the language in the Funds’ prospectuses

that limited investors to four exchanges between the Funds in any 12-month period and were not disclosed to the Funds' shareholders or Board of Trustees. The SEC Order states that in the fall of 2002, the adviser determined to reduce the amount of market timing in the Fund by restricting its large short-term traders from engaging in frequent trading in the Fund. In response, several of the traders proposed to the adviser that they be allowed to continue their short-term trading in the Fund in exchange for placing a long- term asset into the Fund. The adviser accepted the proposal from one of the traders and, with the knowledge of the executives, entered into an arrangement that permitted an investor to make an unlimited number of trades of up to $65 million per transaction in return for a $130 million long-term investment in the Fund. According to the SEC Order, the investor made approximately 80 exchanges that generated millions of dollars in net profits to the adviser. As a result of the conduct generally described above, the SEC Order finds that the Respondents willfully violated, or willfully aided and abetted and caused violations of: • the antifraud provisions of Sections 206(1) and 206(2) of the Investment Advisers Act of 1940 by entering into arrangements with market timers that were inconsistent with the Funds' prospectus disclosures and not disclosed to the Funds' Board of Trustees or shareholders; • Section 34(b) of the Investment Company Act of 1940, by making material misstatements and omissions in the Funds' prospectuses regarding limitations on exchanges into certain of the Funds; and • Section 17(d) of the Investment Company Act and Rule 17d-1 under that Act for causing certain of the Funds to enter into joint arrangements with the adviser whereby the adviser accepted a long-term asset from an investor in a Fund pursuant to an arrangement allowing the same investor to market time the Fund. B. Voluntary Undertakings In determining to accept the settlement offer, the SEC considered the voluntary efforts undertaken by the adviser and the Funds: • Fund Governance – The adviser will use its best efforts to cause the Funds to operate in accordance with the following governance policies and practices: 3 o At least 75% of the Trustees of each Fund will be independent; o The chairman of the Board of Trustees of each Fund will be independent; and 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 the Funds' Board of Trustees will be taken without the approval of a majority of the independent Trustees, and any action approved by a majority of the independent Trustees but not by the full board will be disclosed in Fund shareholder reports. • 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. C. Required Undertakings Compliance, Ethics, and Legal Oversight Infrastructure • Chief Compliance Officer – The adviser will require that its chief compliance officer ("CCO") or a member of his or her staff review compliance with the policies and procedures established to address compliance issues under the Investment Advisers Act and the Investment Company Act and that any violations be reported to the Chief Executive Officer ("CEO") or Chief Operating Officer ("COO") and the Funds' Board of Trustees. In addition to these duties, the CCO will, among other things: o Identify potential or actual conflicts of interests issues; o Act as corporate ombudsman to the adviser's employees so that they may convey concerns about the adviser's business matters that they believe implicate matters of ethics or questionable practices. The adviser must establish procedures to investigate matters brought to the CCO's attention in his or her capacity as ombudsman, and these procedures must be presented for review and approval by the Funds' independent Trustees. The adviser will also review such matters with the independent Trustees of the Funds with such frequency as the independent Trustees may instruct; o Report regularly to the Risk Management Committee of the Trustees; o Assist the Board of Trustees to ensure that the adviser fulfills its fiduciary duties and complies with its Code of Ethics and the securities laws; and o Annually review the adviser's compliance with the policies and procedures established to

address compliance issues under the federal securities laws. • Chief Operating Officer – The adviser will require the CCO to communicate to the COO, for implementation and execution, any and all compliance-related activities and operations deemed necessary and appropriate by the CCO and/or the Board of 4 Trustees. The COO will have responsibility, in consultation with the CCO, for implementing and executing such compliance –related activities and operations. • Compliance Systems Committee – The adviser will establish a compliance systems committee ("Committee") that will coordinate compliance goals with operations. Members of the Committee will include the CEO, COO, CCO, chief financial officer, general counsel, and personnel representing sales and marketing. The Committee will meet weekly and the Funds Trustees will be invited to attend and participate in all Committee meetings. The Committee will review compliance issues throughout the business of the adviser, endeavor to develop solutions to those issues as they may arise form time to time, and oversee implementation of those solutions. The Committee will report on internal compliance matters to the Risk Management Committee of the Trustees at least quarterly. • General Counsel – The adviser will hire a full-time general counsel experienced in securities law regulation, who will oversee, in conjunction with the CCO, all legal and compliance personnel and practices. • Correspondence – The adviser will create procedures and rules to ensure that compliance personnel review all incoming and outgoing correspondence with investors. • Code of Ethics – The adviser will draft a new Code of Ethics and maintain a Code of Ethics Oversight Committee that has responsibility for all matters relating to issues arising under the adviser's Code of Ethics. • Adviser Compliance Rule – Effective, August 31, 2004, the adviser will comply with Rule 206(4)-7 under the Advisers Act, notwithstanding the October 5, 2004 compliance date for the Rule as adopted by the SEC. • Quarterly Compliance Reporting – The adviser's CCO and COO will report to the independent Trustees of the Funds at least quarterly any breach of fiduciary duty or the federal securities law of which the CCO or COO becomes aware. Any material breach will be reported promptly. • Lead Independent Trustee – The adviser will use its best efforts to cause the Funds to establish a "lead independent trustee." Compliance Consultant • Within 30 days of the SEC Order, the adviser must retain a Compliance Consultant acceptable to the SEC staff and to the majority of the Funds' independent Trustees to conduct a comprehensive review of its 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 adviser and its employees. The review must include, but not be limited to: (1) the adviser's market timing controls across all areas of its 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 adviser's policies and 5 procedures concerning conflicts of interest, including conflicts arising from advisory services to multiple clients. The Compliance Consultant must complete its review and provide its recommendations in a report to the adviser and the Trustees of the Funds no more than 120 days after the entry of the SEC Order. Other Undertakings • Periodic Compliance Review -- At least once every other year, commencing in 2006, the adviser must undergo a compliance review by a third party that is not an interested person of the adviser. The third party must issue a report of its findings and recommendations to the CCO and to the Compliance or Audit Committee of the Board of Trustees or Directors of each Fund. • Certification -- No later than 24 months after the entry of the SEC Order, the adviser's CEO must certify to the SEC in writing that the adviser has fully adopted and complied in all material respects with the undertakings in the SEC Order and the recommendations of the CCO or must describe any material non-adoption or non- compliance. • Recordkeeping -- Any record of the adviser's 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. • Ongoing

Cooperation -- The Respondents undertake to cooperate fully with the SEC in any investigations, litigations or other proceedings relating to or arising from the matters described in the SEC Order. Disgorgement, Civil Penalties, and Other Sanctions • The adviser will pay $11.5 million in disgorgement and a civil money penalty of $13.5 million. • The executives will each pay a civil money penalty of $150,000. • Independent Distribution Consultant -- Within 45 days of the SEC Order, the adviser 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 adviser and the SEC staff no more than 30 days after the date of the final payment required by the SEC Order. Following the issuance of an SEC order approving a final plan of disgorgement, the Independent Distribution Consultant and the adviser must take all necessary and appropriate steps to administer the final plan. • As described in the SEC Order, the SEC also imposed specific sanctions on the executives involved in these activities. 6 II. Settlement of Charges by Attorney General According to the Press Release, coordinated investigations by the Attorney General's office and the SEC revealed that the adviser entered into agreements with market timers that allowed them to engage in improper, frequent short-term trading of shares of an equity Fund at the expense of the Fund's shareholders. The Press Release states that the agreements the adviser made with timers were not disclosed to long-term investors and that the prospectus for the equity Funds disclosed that investors were limited to no more than four exchanges in any 12-month period. The Press Release describes the settlement agreement as follows: • The adviser will reduce fees charged to investors by $5 million fees over a five-year period; • The adviser will pay $11.5 million in restitution and disgorgement and $13.5 million in civil penalties, which payments were negotiated jointly by the Attorney General's office and the SEC; • The adviser will hire a full-time senior officer to help ensure that fees charged by the funds are negotiated at arm's length and are reasonable; • The agreement provides for enhanced compliance and ethics controls; • The chairman of the Funds' Board of Trustees will be independent, with no prior connection to the adviser; and • The agreement provides new requirements for disclosure of expenses and fees. Jane G. Heinrichs Assistant Counsel