

MEMO# 18042

October 1, 2004

MUTUAL FUND INVESTMENT ADVISER SETTLES MASSACHUSETTS ACTION RELATING TO MARKET TIMING

[18042] October 1, 2004 TO: BOARD OF GOVERNORS No. 62-04 CHIEF COMPLIANCE OFFICER COMMITTEE No. 10-04 COMPLIANCE ADVISORY COMMITTEE No. 94-04 PRIMARY CONTACTS - MEMBER COMPLEX No. 89-04 SEC RULES MEMBERS No. 145-04 SMALL FUNDS MEMBERS No. 108-04 RE: MUTUAL FUND INVESTMENT ADVISER SETTLES MASSACHUSETTS ACTION RELATING TO MARKET TIMING The Massachusetts Securities Division has issued a consent order to settle an administrative action filed against a registered investment adviser to a group of mutual funds ("Funds") and one of its affiliated companies (collectively, "Respondents").* The action, which is summarized below, involves allegations that the Respondents allowed a known market timer to invest in certain Funds in exchange for an investment in a hedge fund. Solely for the purpose of settlement, the Respondents admitted to the Division's Statements of Fact set out in the Order. According to the Order, in 2001, a former executive with the affiliated company, without the authorization of the Respondents' senior management, negotiated an arrangement with an identified timer to provide market-timing capacity to trade up to \$45 million in one of the Funds in exchange for a substantial investment in a hedge fund. The order notes that this arrangement was a direct violation of the Fund's prospectus language, which specifically prohibited such activity. The Order further states that the arrangement provided the timer with three privileges: (i) the ability to use Fund/SERV to place market timing trades to circumvent the Respondents' internal market timing policy; (ii) the ability to make four exchanges or round trips per month (trading that exceeded the number of trades or exchanges provided for in the Fund's prospectus); and (iii) a waiver of the 2% redemption fee for any market timing trades. * See In the Matter of Franklin Advisers, Inc. and Franklin Templeton Alternative Strategies, Inc., Docket No. E-2004-007 (Sept. 20, 2004) ("Order"). Copies of the Order and accompanying press release are available on the Secretary of the Commonwealth's website at <http://www.sec.state.ma.us/sct/sctpdp/ftconsentorder.pdf> and <http://www.sec.state.ma.us/sct/sctpdp/ftpessrelease2.pdf>, respectively. 2 As a result of the conduct generally described above, the Order finds that the Respondents violated the anti-fraud section of the Massachusetts Uniform Securities Act. The Order requires the Respondents to cease and desist from violations of the Massachusetts Uniform Securities Act and imposes a fine of \$5 million. The Order notes that the Respondents have agreed not to seek or accept reimbursement or indemnification, such as payments made pursuant to an insurance policy, or claim or apply for a tax deduction or tax credit with regard to any state, federal, or local tax with respect to the \$5 million fine. Jane G. Heinrichs Assistant Counsel

Copyright © by the 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.