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SEC AND NEW YORK REACH SETTLEMENTS WITH INVESTMENT ADVISER RELATING TO MARKET TIMING, SELECTIVE DISCLOSURE

[17729] July 14, 2004 TO: BOARD OF GOVERNORS No. 48-04 COMPLIANCE ADVISORY COMMITTEE No. 72-04 PRIMARY CONTACTS - MEMBER COMPLEX No. 70-04 SEC RULES MEMBERS No. 103-04 SMALL FUNDS MEMBERS No. 79-04 RE: SEC AND NEW YORK REACH SETTLEMENTS WITH INVESTMENT ADVISER RELATING TO MARKET TIMING, SELECTIVE DISCLOSURE 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 a registered investment adviser to a group of mutual funds ("Funds") and the Funds' former President and Chief Executive Officer (together, "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 to resolve related allegations. 2 Both settlements involve allegations that the adviser (and, in some instances in the SEC action, the former executive): (1) wrongfully permitted select investors to engage in extensive short-term trading in the Funds; (2) failed to charge select investors redemption fees as required by the Funds' prospectuses when other investors were charged the redemption fees; and (3) repeatedly disclosed to select investors, prospective clients, and consultants the Funds' portfolio holdings, which at the time of the disclosures were material nonpublic information. The SEC Order also finds that the Respondents (1) failed to have written procedures in place to prevent the nonpublic disclosure of the Funds' holdings and (2) caused the Funds to participate in joint transactions with an affiliate of the adviser, raising a conflict of interest. The settlements are summarized below. 1 See In the Matter of Banc One Investment Advisors Corporation and Mark A. Beeson, SEC Release Nos. IA-2254 and IC-26490, Admin. Proc. File No. 3-11530 (June 29, 2004) ("SEC Order"). The SEC Order also censures and imposes a cease and desist order on the Respondents. Copies of the SEC Order and accompanying press release are available at http://www.sec.gov/litigation/admin/ia-2254.htm and http://www.sec.gov/news/press/2004-90.htm, respectively. 2 See Spitzer Announces Market-Timing Settlement with Banc One Investment Advisors Corporation (press release issued by Office of NY State Attorney General Eliot Spitzer, June 29, 2004), available at http://www.oag.state.ny.us/press/2004/jun/jun29d_04.html. A copy of the settlement document (entitled an Assurance of Discontinuance) is available at http://www.oag.state.ny.us/press/2004/jun/jun29d_04_attach.pdf. The Attorney General's settlement document does not mention Mr. Beeson. 2 I. SEC Order A. Findings The SEC

Order finds that from at least March 2002 through April 2003, the Respondents permitted a hedge fund manager to trade rapidly in and out of certain Funds, contrary to disclosures in the Funds' prospectuses limiting investors' ability to exchange Fund shares. According to the SEC Order, the Respondents failed to enforce anti-timing provisions against the hedge fund, while during the same period it sanctioned or expelled individuals or entities for exchange-privilege violations. The SEC Order finds that in connection with transactions in certain of the Funds, the adviser failed to charge the hedge fund with approximately $ 4.2 million in redemption fees, as required by the Funds' prospectuses. Conversely, the adviser charged other investors the redemption fees. For example, from January 2002 to September 20003, the adviser collected approximately $1.3 million in redemption fees from other investors in certain of the Funds. The SEC Order finds that the Respondents provided material, nonpublic information consisting of month-end portfolio holdings of the Funds to the hedge fund manager. The SEC Order further finds that the Respondents caused certain of the Funds to enter into joint arrangements with its parent, a bank holding company ("bank"), whereby the bank loaned money to the hedge fund with the express understanding that the loan proceeds would be invested in the Funds. It states that the bank earned interest on those loans and the adviser generated mutual-fund sales and associated fees by allowing approved timing activity in the Funds. The SEC Order notes that in contrast the affected Funds obtained little or no benefit from this unauthorized activity. The SEC Order also finds that from June 1999 to December 2001, the adviser, without the former executive's knowledge, allowed excessive short-term trading in the Funds by an investor in violation of the Funds' prospectuses and in March 2003 failed to collect required redemption fees from another hedge fund. Finally, the SEC Order finds that the adviser, at various times over the last decade, provided material, nonpublic information consisting of month-end portfolio holdings of the Funds to several clients, prospective clients, and consultants. 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 (1) permitting market timing in the Funds contrary to their prospectus disclosures; (2) failing to disclose to the Funds' Board of Trustees or to shareholders the conflicts of interest created when the adviser entered into market-timing arrangements with select investors; (3) failing to charge certain select investors with redemption fees required by certain of the Funds' prospectuses when other investors were charged the redemption fees; and (4) failing to have written procedures in place to prevent the nonpublic disclosure of the Funds' portfolio holdings and improperly disclosing material nonpublic information to select investors and others; • Section 204A of the Advisers Act, by providing nonpublic information regarding current portfolio holdings to select investors and others and failing to have written procedures in place to prevent the nonpublic disclosure of Funds' portfolio holdings; 3 • 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, the charging of redemption fees, and the conflicts of interest created when the adviser entered into market-timing arrangements; 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 bank without first disclosing the arrangements with the Board of Trustees of the Funds or obtaining an order from the SEC approving the transactions. B. Undertakings In determining to accept the settlement offer, the SEC considered the cooperation that the Respondents afforded the SEC staff and the various remedial measures undertaken by the adviser, the bank and the Funds' Board of Trustees. The SEC staff further considered the efforts voluntary undertaken by the adviser, which generally include the following: Fund Governance Policies and Procedures • At least 75% of the Trustees of the Funds will be independent. • The chairman of the Board of

Trustees of the Funds will be independent. • Any counsel to the independent Trustees of the Funds will be an "independent legal counsel," as defined under the Investment Company Act. • No action by the Funds' Board of Trustees or by any committee of the Board will be taken without the approval of a majority of the independent Trustees of the Board or of such committee. Any action proposed to be approved by a majority of the independent Trustees of a Fund that is not approved by the full Board of Trustees will be disclosed in the Fund's shareholder reports. • Commencing in 2005, the Funds will hold a shareholder meeting to elect the Board of Trustees at least once every five years. • The Funds will designate an independent compliance officer reporting to the Board of Trustees who will be responsible for assisting the Board and any of its committees in monitoring compliance by the adviser with the federal securities laws, the adviser's fiduciary duties to Fund shareholders and its code of ethics in all matters relevant to the operation of the Funds. The SEC Order also sets forth the following undertakings by the Adviser: • Compliance and Ethics Oversight – The adviser will ensure that a compliance and ethics oversight infrastructure is established and maintained within the adviser or elsewhere within the bank's investment management group, which will be responsible for monitoring compliance by the adviser with the relevant rules, regulations and 4 procedures applicable to its investment advisory responsibilities in relation to the Funds and which will include the following requirements: o The Adviser will establish an internal controls committee ("Committee") that will consider and review compliance issues and related policy with respect to the adviser's responsibilities to the Funds, including the adviser's compliance with its code of ethics, the handling of any conflicts of interests and compliance with its policies and procedures established to address compliance issues under the Advisers Act and the Investment Company Act. The Committee will meet at least quarterly and the Chief Compliance Officer ("CCO") of the Funds will be invited to attend and participate in all meetings of the Committee. The Committee will report to the Funds' Board at least quarterly on its activities, including violations and other compliance matters considered, recommendations made and actions taken. o Breaches of the adviser's code of ethics or other compliance policies and procedures relating to the Funds will be reported to the Committee. Any serious breaches will be reported promptly to the Funds' CCO and to the Funds' Board of Trustees. o From time to time, the adviser's CCO will provide to the Funds' CCO compliance information in connection with the latter's role in monitoring the adviser's compliance with its code of ethics, relevant rules, regulations, and procedures applicable to the adviser's performance of its investment advisory responsibilities to the Funds. o The Funds' CCO will generally act as liaison between the Funds' Board of Trustees and the adviser's CCO and will report promptly to the Board any material breach by the adviser of fiduciary duty, compliance policies and procedures, or the federal securities laws in relation to the Funds of which the Funds' CCO becomes aware. o The adviser will ensure that procedures are established and maintained so that its employees may report to an appropriate department within the bank on a confidential (and, if desired, anonymous basis) any concerns about possible violations of the adviser's code of ethics or of relevant laws and regulations. All issues of concern will be investigated and corrective action taken, if appropriate. The Funds' CCO will be informed of any issues that relate to the adviser's responsibilities to the Funds, along with any resolution of such issues. • Independent Distribution Consultant – Within 90 days of the SEC Order, the adviser will retain an Independent Distribution Consultant acceptable to the SEC staff and to the majority of the independent Trustees. The consultant will develop a plan to distribute the total disgorgement and penalties ordered to compensate the Funds' shareholders for losses attributable to market timing activity during the relevant period. The adviser will require that the Independent Distribution Consultant submit the distribution plan to the adviser and the SEC staff within 160 days of the SEC Order. Following the issuance of an SEC Order

approving a final plan of disgorgement, the Independent Distribution 5 Consultant and the adviser will take all necessary and appropriate steps to administer the final plan. • Independent Compliance Consultant – Within 90 days of the SEC Order, the adviser will retain an Independent Compliance Consultant acceptable to the SEC staff and to the majority of the 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 will 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; (4) possible governance changes in the Funds' Board of Trustees to include committees organized by market sector or other criteria to improve compliance; and (5) the adviser's policies and procedures concerning conflicts of interest, including conflicts arising from advisory services to multiple clients. The adviser will require that the Independent Compliance Consultant complete its review and provide its recommendations in a report to the adviser, the Board, and the SEC staff no more than 180 days after the entry of the SEC Order. • Periodic Compliance Review – At least once every other year, commencing in 2005, the adviser will undergo a compliance review by a third party that is not an interested person of the adviser. The third party will issue a report of its findings and recommendations to the Committee and the Funds' Board of Trustees. • Certification – No later than 24 months after the entry of the SEC Order, the adviser's President or Chief Executive Officer will certify to the SEC in writing that the adviser has fully adopted and complied in all material respects with the undertakings and the recommendations of the Independent Compliance Consultant, or will describe any material non-adoption or non-compliance. • Recordkeeping – Any record of the adviser's compliance with the undertakings will 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. • Continuing Application of Undertakings – The undertakings of the adviser will continue to apply to the adviser or its successors for as long as it continues to provide investment advisory services to the Funds or any successors to the Funds. Any successor to the adviser may petition the Commission and obtain relief from the undertakings if it can demonstrate that it has sufficient controls and procedures reasonably designed and implemented to detect and prevent the occurrence of the conduct summarized in the SEC Order. C. Disgorgement, Civil Penalties, and Other Sanctions • The adviser will pay $10 million in disgorgement and a civil money penalty of $40 million and the former executive will pay a civil money penalty of $100,000. 6 • The former executive is barred from association with any investment adviser, with a right to reapply to the Commission to serve or act in any capacity after two years from the date of the SEC Order. • The former executive is 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, with a right to reapply to the Commission to serve or act in any capacity after two years from the date of the SEC Order. • The former executive may not serve as an employee, officer, or director of any registered investment company or as a chairman, director, or officer of any investment adviser for three years from the date of the SEC Order. II. Settlement of State Charges The New York Attorney General's settlement document, which contains factual allegations that generally mirror those in the SEC Order, finds that certain practices of the adviser violated New York's Martin Act and other statutes. The adviser, without admitting or denying the allegations in the document, agreed to the entry of an Assurance of Discontinuance to resolve the investigation against it. The Assurance of Discontinuance imposes a cease and desist order on the adviser and generally

requires the following: • Disgorgement and Penalties – The adviser will pay disgorgement and penalties in the amounts and manner set forth in the SEC Order. • Reduction in Advisory Fees – The adviser will reduce the advisory fees charged to certain of the Funds by $8 million per year for five years. • Restrictions on the Adviser's Management of the Funds – On or after October 1, 2004, the adviser generally may manage or advise a Fund only if, among other things: o The Board has at least 75% independent Trustees and an independent chair. o The Board hires and retains a full-time senior officer, reporting to the Board at least quarterly, to monitor compliance and establish a process to ensure that the proposed management fees to be charged to the Fund are reasonable, negotiated at arm's length, and consistent with the Assurance of Discontinuance. The senior officer may also function as the Fund's CCO, provided that he or she is not otherwise an employee of the adviser. The senior officer may be terminated only with the approval of a majority of the independent Trustees of the Board. o The reasonableness of fees is determined by the Board through either competitive bidding (which must include at least three sealed bids) or an annual independent written evaluation that considers factors including: (1) the level of fees charged to institutional investors for like services; (2) the level of fees charged by other mutual funds for like services; (3) the costs of providing 7 services; and (4) the profit margins of the adviser and its affiliates. o The adviser publicly discloses a reasonable summary of any independent evaluation conducted in connection with the renewal of the Fund's advisory contract within 15 days of its completion. The summary must contain data regarding the factors considered in the evaluation and sufficient specifics so that an investor in the Fund can evaluate the reasonableness of the fees, but the summary does not have to include confidential, competitively sensitive data. Public disclosure must include at least: (1) continuous, prominent posting on the Fund's website of the two most recent summaries as part of the Fund description; (2) inclusion of the most recent summary in the Fund's annual and semi-annual reports; and (3) prominent notice of the summary's availability in shareholder account statements (if any) furnished by the Fund to individual direct investors. • Actual Cost Disclosures – In an easy-to-understand format, the adviser must disclose: o in periodic account statements sent by a Fund, the fees and costs in actual dollar amounts charged to each investor based upon (1) the investor's most recent quarterly closing balance and (2) a hypothetical $10,000 investment held for 10 years, assuming an annual return of 5% and continuation of the reduced management fee rates required by the Assurance of Discontinuance, and showing the impact of such fees and costs on Fund returns for each year and cumulatively. o in the Fund's prospectus and on the adviser's website, the fees and costs associated with the hypothetical example described above. o on the adviser's website, a calculator that will enable an investor to calculate the fees and costs, in actual dollars and on a Fund by Fund basis, charged to the investor based on the investor's most recent quarterly closing balance. • Cooperation – The adviser and its affiliates will cooperate fully and promptly with the Attorney General in any pending or subsequently initiated investigation, litigation or other proceeding relating to market timing or late trading. The adviser and its affiliates will use its best efforts to ensure that all the current and former officers, directors, trustees, agents, and employees of the adviser, its affiliates or the Funds will fully and promptly cooperate with the Attorney General. Among other things, such cooperation will include: (1) production of all documents or other tangible evidence and any compilations or summaries of information or data, with the exception of any information or documents that the adviser or its affiliates has a statutory or contractual obligation of confidentiality ("Confidential Information") or information or documents protected by the attorney-client and/or work product privileges ("Privileged Information"); (2) the availability of current officers, directors, trustees, agents, and employees to answer any and all inquiries regarding any proceedings, except to the extent such inquires call for the disclosure of Confidential Information or Privileged

Information; and (3) its best efforts to cause former officers, directors, trustees, agents, and employees to answer any and all inquiries regarding any proceedings, except to the 8 extent such inquires call for the disclosure of Confidential Information or Privileged Information. Such cooperation also will include making outside counsel reasonably available to provide comprehensive presentations concerning any internal investigation relating to all matters in the Assurance of Discontinuance and to answer questions, except to the extent such presentations or questions call for the disclosure of Confidential Information or Privileged Information. Jane G. Heinrichs Assistant Counsel

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