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SEC BRINGS FRAUD CHARGES AGAINST FORMER EXECUTIVES FOR MISLEADING FUND BOARDS REGARDING TRANSFER AGENT SERVICES

 [19108] August 22, 2005 TO: BOARD OF GOVERNORS No. 39-05 CHIEF COMPLIANCE OFFICER COMMITTEE No. 56-05 COMPLIANCE MEMBERS No. 11-05 SEC RULES MEMBERS No. 95-05 TRANSFER AGENT ADVISORY COMMITTEE No. 43-05 RE: SEC BRINGS FRAUD CHARGES AGAINST FORMER EXECUTIVES FOR MISLEADING FUND BOARDS REGARDING TRANSFER AGENT SERVICES The Securities and Exchange Commission announced the filing of a civil enforcement action in federal district court against a former senior vice president ("SVP") of a registered investment adviser ("Adviser") to a group of mutual funds ("Funds") and against the former CEO of the asset management division ("Division") of the adviser's parent company.1 The action involves the defendants' role in making material misrepresentations and omissions to the boards of the Funds in connection with a recommendation that the Funds replace their existing third party transfer agent ("Existing TA") with a newly established affiliated transfer agent ("Affiliated TA").2 According to the SEC's complaint, the Funds' long-term contract with the Existing TA was set to expire, as was a non-compete arrangement that had prohibited affiliates of the Adviser from offering transfer agent services to the Funds. In anticipation of these events, the Division engaged an outside consultant to review the TA function. The defendants, who were aware that the Existing TA had high profit margins on its contract with the Funds, directed the consultant to develop possible models that would permit the Division to enter the transfer agent business. The model seen by the Division as the most profitable called for the Division to 1 See SEC v. Thomas W. Jones and Lewis E. Daidone, 05 Civ. 7044 (S.D.N.Y. Aug. 8, 2005). Copies of the SEC's complaint and accompanying release are available on the SEC's website at http://www.sec.gov/litigation/complaints/comp19330.pdf and http://www.sec.gov/litigation/litreleases/lr19330.htm, respectively. 2 In a related SEC proceeding, the Adviser and an affiliated entity were each sanctioned for their role in this matter. See Institute Memorandum to Board of Governors No. 27-05, Chief Compliance Officer Committee No. 45-05, Compliance Advisory Committee No. 42-05, SEC Rules Members No. 75-05, Small Funds Members No. 54-05, and Transfer Agent Advisory Committee [18912], dated June 3, 2005 (summarizing In the Matter of Smith Barney Fund Management LLC and Citigroup Global Markets, Inc. SEC Release Nos. 34-51761 and IA-2390, Admin. Proc. File No. 3- 11935 (May 31, 2005)). 2 create the Affiliated TA and

contract with another vendor solely for technology. The complaint states that, upon learning that it was at risk of losing the Funds' business, the Existing TA offered significant fee discounts to renew its contract as the Funds' full-service transfer agent and twice improved its bid by offering even deeper discounts, technology improvements, and a guarantee of investment banking and asset management revenue to the Division and its affiliates ("revenue guarantee"). The complaint alleges that the Division, through the defendants, did not consider renewing the Existing TA's contract but instead negotiated a subcontract under which the Existing TA would continue to perform almost all of the services for the Funds at deeply discounted rates, thus permitting the Affiliated TA to keep most of the discount and make a high profit for performing limited work. The complaint charges the defendants with aiding and abetting a fraud perpetrated by the Division, the Adviser and an affiliated entity, in violation of Sections 206(1) and 206(2) of the Investment Advisers Act of 1940. Specifically, the complaint alleges that the CEO disregarded his fiduciary responsibilities to the Funds by approving the self-dealing transaction and by failing to ensure that the Funds' boards were fully aware of its terms, including the revenue guarantee and the amount of profit that the Affiliated TA would make for the limited work it would perform. It further alleges that, in order to sell the proposal to the Funds' boards, the SVP (who also served as the Funds' Treasurer and Chief Financial Officer) failed to make full and accurate disclosure regarding the proposal's material terms in both written materials to the boards and his own presentation before the boards. The SEC is seeking injunctive relief, disgorgement, civil monetary penalties, and such other and further relief as the Court may determine to be just and necessary. Rachel H. Graham Assistant Counsel

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