INVESTMENT COMPANY INSTITUTE

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NY ATTORNEY GENERAL FILES AND SETTLES COMPLAINT AGAINST HEDGE FUND ALLEGING FRAUDULENT CONDUCT INVOLVING MUTUAL FUNDS

[16497] September 4, 2003 TO: ACCOUNTING/TREASURERS MEMBERS No. 39-03 BOARD OF GOVERNORS No. 43-03 COMPLIANCE ADVISORY COMMITTEE No. 69-03 DIRECTOR SERVICES COMMITTEE No. 19-03 PRIMARY CONTACTS - MEMBER COMPLEX No. 72-03 SEC RULES MEMBERS No. 117-03 SMALL FUNDS MEMBERS No. 47-03 RE: NY ATTORNEY GENERAL FILES AND SETTLES COMPLAINT AGAINST HEDGE FUND ALLEGING FRAUDULENT CONDUCT INVOLVING MUTUAL FUNDS The New York Attorney General filed a complaint yesterday against a hedge fund, its principal, and two related affiliates (the "Defendants") alleging fraudulent conduct in connection with the purchase and sale of mutual fund shares.1 The Complaint alleges that the Defendants engaged in two fraudulent schemes involving the "late trading" and market timing of mutual funds.2 The Complaint alleges that these trading activities allowed the Defendants to achieve above-market results for their hedge fund investors at the expense of the funds' long- term shareholders. According to a press release issued by the Attorney General announcing this action, the Defendants have agreed to settle this matter by paying restitution of $30 million (representing illegal profits generated from the unlawful trading), paying a $10 million penalty, and cooperating with the Attorney General in his ongoing investigation of the mutual fund industry stemming from the trading activities that were the subject of the Complaint. 3 1 See State of New York v. Canary Capital Partners, LLC, Canary Investment Management, LLC, Canary Capital Partners, Ltd., and Edward J. Stern, (NY S. Ct. filed Sept. 3, 2003) (undocketed complaint) (the "Complaint"). The Complaint and the press release issued by the New York Attorney General announcing this action are available on the Attorney General's website at: http://www.oag.state.ny.us/press/2003/sep/sep03a_03.html. 2 Based upon the Defendants' trading scheme, the Complaint charged them with seven counts of fraudulent conduct under New York's General Business Law and Executive Law, for which the Attorney General sought the disgorgement of profits, payment of damages, and an injunction prohibiting them from engaging in fraud and from engaging in the sale, offer to sell, purchase, offer to purchase, promotion, negotiation, and distribution of any mutual funds. 3 Copies of the settlement have not yet been published by the Attorney General. 2 THE DEFENDANTS' LATE TRADING ACTIVITIES The Complaint alleges that from about March 2000 until the Attorney General began his investigation in July 2003, the Defendants engaged in late trading of mutual funds. In return for the Defendants agreeing to leave millions of dollars in various mutual funds or other accounts on a long-term basis, the Defendants were allegedly permitted to obtain that day's net asset value for mutual fund trades effected after 4:00

p.m., including some trades that occurred as late as 9:00 p.m. New York time. THE DEFENDANTS' MARKET TIMING The Complaint alleges that various mutual funds, notwithstanding disclosure in their prospectuses that they either do not permit or limit market timing by investors, permitted the Defendants to engage in market timing either without disclosing such arrangements to their shareholders or contrary to the funds' prospectus disclosure regarding market timing. The Complaint alleges that the funds tolerated and assisted the Defendants' timing activities in return for the fees that the fund managers or their affiliates made from the Defendants' accounts, including from loans that had been provided to the Defendants by one manager's affiliate, the proceeds of which were used by the Defendants to time the mutual funds. The Complaint identifies four fund families that allegedly permitted the Defendants to time their funds and alleges that thirty fund families may have entered into such written agreements with the Defendants. In addition to the Defendants trading pursuant to these agreements, the Complaint alleges that, beginning in 2000, they began to engage in "timing under the radar." This involved the Defendants placing trades in mutual fund shares in a way that the timing activity was difficult for the mutual fund family whose funds were targets of the trading to detect (e.g., by effecting the trades through omnibus accounts of a trust company). Craig S. Tyle
General Counsel
