The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

MEMO# 18912

June 3, 2005

SEC SETTLES FRAUD CHARGES AGAINST FUND ADVISER AND AFFILIATE REGARDING TRANSFER AGENT SERVICES

 [18912] June 3, 2005 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 TRANSFER AGENT ADVISORY COMMITTEE No. 28-05 RE: SEC SETTLES FRAUD CHARGES AGAINST FUND ADVISER AND AFFILIATE REGARDING TRANSFER AGENT SERVICES The Securities and Exchange Commission has issued an order making findings and imposing disgorgement, civil money penalties and remedial sanctions in an enforcement action against a registered investment adviser to a group of mutual funds ("Funds") and an affiliated entity (together, "Respondents").* The Respondents consented to the entry of the SEC Order without admitting or denying the SEC's findings. The action involved allegations that the Respondents misrepresented and omitted material facts when recommending to the boards of the Funds that the Funds change from a third party transfer agent they previously used to a transfer agent that was an affiliate of the Respondents. Findings According to the SEC Order, from 1994 through September 1999, a third party transfer agent served as a full-service transfer agent for the Funds. As a result of a favorable fee schedule and the low cost of servicing the Funds, the third party transfer agent realized high profit margins throughout the 1990s, particularly in the late 1990s, when the fee structure changed from a per-account fee to a fee based on a percentage of assets. Pursuant to a non- compete agreement between the predecessors of the third-party transfer agent and the Respondents, affiliates of the Respondents were prevented from offering TA services until the expiration of that non-compete agreement in 1999. In anticipation of the expiration of the third- party transfer agent contract and the non-compete provision, the Respondents retained a * See 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) ("SEC Order"). The SEC Order also censures the Respondents and imposes a cease and desist order. Copies of the SEC Order and accompanying press release are available on the SEC's website at http://www.sec.gov/litigation/admin/34-51761.pdf and http://www.sec.gov/news/press/2005-80.htm, respectively. 2 consultant to assist it in reviewing the TA function and options going forward. After analyzing specific proposals it received from various vendors, in February 1998, the consultant recommended that the Respondents create an affiliated TA unit and contract with another vendor for technology. After learning that it was at risk of losing the business, the third party transfer agent offered

a substantial fee discount to the Respondents if the Funds renewed with the third party transfer agent as full-service TA. In early 1999, the adviser recommend the Funds contract with an affiliate of the Respondents, which would perform limited transfer agent services and sub-contract with the Fund's existing third-party transfer agent. The third- party transfer agent would perform almost all of the same services it had performed previously, but at deeply discounted rates, permitting the Respondents' transfer agent affiliate to keep most of the discount for itself and make a high profit for performing limited work. The SEC Order found that in making this recommendation, the adviser misled the boards by omitting material facts, which led the boards to believe that the adviser's recommendation was made in the Fund's best interests. The SEC Order noted that the proposal permitted the adviser and its affiliates to profit from the transfer agent function at the expense of the Funds. As a result of the conduct generally described above, the SEC Order found that Respondents willfully violated Sections 206(1) and 206(2) of the Investment Advisers Act of 1940 by knowingly or recklessly failing to disclose to the Funds' boards information in connection with the recommendation concerning transfer agent services. Undertakings • Retention of Service Providers – The Respondents will comply with a policy regarding retention of service providers that provides that for certain service provider contracts for the Funds, the adviser will, when requested by a Fund board, retain at its own expense an independent consulting expert to advise and assist the board on the selection of service providers and negotiation of service provider contracts. • Existing TA Contract – The adviser will provide the Funds' boards with a recommendation for a new contract within 180 days of the entry of the SEC Order. If the adviser determines that an affiliate may submit a proposal to serve as TA or sub-TA for the Funds, the adviser will retain an independent monitor, not unacceptable to the Commission staff, to oversee a competitive bid process. The adviser will also make reasonable efforts to obtain competitive proposals from one or more vendors unaffiliated with the Respondents. • Escrow – The Respondents will escrow all TA fees received from the Funds under the existing TA contract less sub-payments made to sub-TAs and the actual operational costs and expenses incurred by the affiliated TA in providing TA services for the Funds for the period from December 1, 2004 through the effective date of a new TA contract for the Funds. Any TA fees paid by the Funds to the Respondents that are greater than the TA fees that the Funds would have paid under a new TA contract will be distributed to the Funds. 3 Disgorgement and Civil Penalties • The Respondents will together pay more than $128 million in disgorgement. • The adviser will pay a civil money penalty of $80 million. Jane G. Heinrichs Assistant Counsel

---