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INVESTMENT ADVISER AND ITS PRESIDENT SETTLE SEC CHARGES RELATING TO ILLEGAL PERFORMANCE FEES CHARGED TO MUTUAL FUNDS

[18040] September 28, 2004 TO: BOARD OF GOVERNORS No. 60-04 CHIEF COMPLIANCE OFFICER COMMITTEE No. 9-04 COMPLIANCE ADVISORY COMMITTEE No. 93-04 INVESTMENT ADVISER MEMBERS No. 20-04 INVESTMENT ADVISER ASSOCIATE MEMBERS No. 10-04 PRIMARY CONTACTS - MEMBER COMPLEX No. 86-04 SEC RULES MEMBERS No. 141-04 SMALL FUNDS MEMBERS No. 106-04 RE: INVESTMENT ADVISER AND ITS PRESIDENT SETTLE SEC CHARGES RELATING TO ILLEGAL PERFORMANCE FEES CHARGED TO MUTUAL FUNDS The Securities and Exchange Commission has issued an order making findings and imposing disgorgement, penalties, and remedial sanctions in an enforcement action against a registered investment adviser to a group of mutual funds ("Funds") and the adviser's president (collectively, "Respondents").* The Respondents consented to the entry of the SEC order without admitting or denying the SEC's findings. The action, which is summarized below, involved allegations that the Respondents charged illegal performance-based fees to three of the Funds. Findings The SEC Order finds that between July 1995 and March 2004, the investment adviser, at the direction of its president, charged three of the Funds more than $4.4 million in performance- based compensation in violation of Section 205 of the Investment Advisers Act of 1940. Section 205 and the rules thereunder generally require that fund managers calculate performance-based fees using the average value of a fund's assets over the same performance period that is used to measure the fund's performance. According to the SEC Order, instead of using the average value of the Funds' assets over the five-year period the adviser used to measure the Funds' performance, the adviser calculated its performance-based fees using the Funds' current asset * See In the Matter of Bridgeway Capital Management, Inc. and John Noland Ryan Montgomery, SEC Release No. IA-2294, Admin Proc. File No. 3-11659 (Sept. 15, 2004) ("SEC Order"). The SEC Order also censures and imposes a cease and desist order on each of the Respondents. Copies of the SEC Order and accompanying press release are available at http://www.sec.gov/litigation/admin/ia-2294.htm and http://www.sec.gov/news/press/2004-131.htm, respectively. 2 values. As a result, the SEC Order finds that because the value of the three Funds' current assets typically exceeded the average value of the Funds' assets over the five-year performance period, the adviser received excess performance fees when it met or exceeded its performance benchmarks. The SEC Order notes that the advisory contracts between the adviser and the Funds accurately described the method actually used by the adviser to calculate its performance-based fees. This description was also included in the Funds' prospectuses and periodic SEC

reports. As a result of the conduct generally described above, the SEC Order finds that the adviser willfully violated and the president willfully aided and abetted and caused the adviser's violation of Section 205(a) of the Investment Advisers Act. Remedial Efforts In determining to accept the settlement offer, the SEC considered remedial acts promptly undertaken by the Respondents and cooperation afforded the SEC staff. Undertakings In the SEC Order, the adviser has undertaken to: • Retain experienced counsel to review the adviser's advisory contracts with the Funds to ensure that the performance-based fee provisions comply with the federal securities laws; • Pay the costs of soliciting shareholder approval of new advisory contracts with the Funds, which comply with the Investment Advisers Act; and • Hire or designate experienced compliance personnel to, among other things, ensure that the adviser applies its counsel-reviewed performance-based fee in accordance with the federal securities laws in the future. The SEC Order also sets forth the following additional undertaking by the adviser: • Independent Distribution Consultant – Within 60 days of the SEC Order, the adviser will retain an Independent Distribution Consultant acceptable to the SEC staff. The consultant will develop a plan to distribute the disgorgement and interest ordered to compensate the Funds' current and former shareholders who were overcharged as a result of the performance-based fee that violated Section 205 of the Investment Advisers Act. The adviser will require that the Independent Distribution Consultant submit the distribution plan to the SEC staff within 90 days of the SEC Order. Following the issuance of an SEC Order approving a final plan of disgorgement, the Independent Distribution Consultant and the adviser will take all necessary and appropriate steps to administer the final plan. 3 Disgorgement and Civil Penalties • The adviser will pay $4,893,414 in disgorgement and prejudgment interest and a civil money penalty of $200,000. • The president will pay a civil money penalty of $50,000. Jane G. Heinrichs Assistant Counsel

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