

MEMO# 18210

November 19, 2004

FORMER EXECUTIVES OF FUND GROUP SETTLE SEC CHARGES RELATING TO MARKET TIMING

[18210] November 19, 2004 TO: BOARD OF GOVERNORS No. 78-04 CHIEF COMPLIANCE OFFICER COMMITTEE No. 28-04 COMPLIANCE ADVISORY COMMITTEE No. 113-04 SEC RULES MEMBERS No. 166-04 SMALL FUNDS MEMBERS No. 123-04 RE: FORMER EXECUTIVES OF FUND GROUP SETTLE SEC CHARGES RELATING TO MARKET TIMING The Securities and Exchange Commission has issued orders making findings and imposing disgorgement, penalties, and remedial sanctions in enforcement actions against the two founders of an investment adviser to a group of mutual funds ("Funds"), who formerly served as its President and as its Chairman and Chief Executive Officer ("Respondents").* Both actions involved allegations that the adviser, under the leadership of the Respondents, permitted select investors to engage in extensive short-term trading in the Funds. The action against the former Chairman and CEO also involved allegations that the former Chairman and CEO repeatedly disclosed to a brokerage firm the Funds' portfolio holdings, which at the time of the disclosure were material, nonpublic information. The Respondents consented to the SEC Orders without admitting or denying the SEC's findings. Findings The SEC Orders find that from 1998 through 2001, the investment adviser, under the Respondents' leadership, permitted a select group of investors in the Funds to conduct short-term trading in and out of certain of the Funds, contrary to disclosures in the Funds' prospectuses limiting investors' ability to exchange Fund shares. The SEC Orders further find that in 2000, a hedge fund in which the former President had a significant interest began market timing certain of the Funds, including a Fund managed by the President. The SEC Orders state that the former President sought and received the approval of the former Chairman and CEO for this trading arrangement, but that neither informed the Funds' board of trustees of the * See In the Matter of Gary L. Pilgrim, SEC Release Nos. 33-8505, 34-50680, IA-2328, and IC-26655, Admin. Proc. File No. 3-11739 (Nov. 17, 2004) and In the Matter of Harold J. Baxter, SEC Release Nos. 33-8506, 34-50681, IA-2329, and IC-26656, Admin. Proc. File No. 3-11740 (Nov. 17, 2004) ("SEC Orders"). The SEC Orders also impose cease and desist orders on the Respondents. Copies of the SEC Orders and accompanying press release are available at <http://www.sec.gov/litigation/admin/33-8505.htm>, <http://www.sec.gov/litigation/admin/33-8506.htm>, and <http://www.sec.gov/news/press/2004-157.htm>, respectively. 2 arrangement. The SEC Order against the former Chairman and CEO further states that, from as early as 1998 and up to as recently as September 2003, the adviser, acting through the former Chairman and CEO, provided, material, nonpublic information consisting of 30-day stale Fund portfolio holdings to a brokerage firm headed by a personal friend of the former Chairman and CEO. According to this SEC Order, customers of the brokerage firm used the information to

facilitate market timing of the Funds and to exercise hedging strategies through other financial and brokerage institutions. Finally, the SEC Orders find that when the adviser decided in mid 2001 to limit market timing activity in the Funds, it terminated the trading privileges of all identified timers except for those of the hedge fund and the brokerage customers described above, whose privileges were not terminated until December 2001. As a result of the conduct generally described above, the SEC Order against the President finds that he: • willfully violated Section 17(a) of the Securities Act of 1933, and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder; • willfully violated Sections 206(1) and 206(2) of the Investment Advisers Act of 1940; and • willfully violated Section 34(b) of the Investment Company Act of 1940. The SEC Order against the Chairman and CEO finds that he: • willfully violated Section 17(a) of the Securities Act, and Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder; • willfully aided and abetted and caused the adviser's violations of Sections 204A, 206(1) and 206(2) of the Investment Advisers Act; and • willfully violated Section 34(b) of the Investment Company Act.

Voluntary Undertakings In determining to accept the settlement offers, the SEC considered the efforts voluntarily undertaken by the Respondents to cooperate fully with the SEC in any investigations, litigation or other proceedings relating to or arising from matters described in the SEC Orders and/or set forth in the SEC's complaint. In connection with such cooperation, the Respondents agreed, among other things, to waive, upon written request from the SEC staff, any evidentiary privileges or protections from discovery in connection with the matters described in the SEC Orders and/or set forth in the SEC's complaint.

Required Undertakings The SEC Orders also set forth the following required undertakings: • **Distribution of Disgorgement and Penalty:** The Respondents will cooperate fully with the Independent Distribution Consultant retained by the adviser in connection with the adviser's settlement with the SEC of related charges ("Adviser's Order"). The 3 Respondents will pay their pro-rata share of all costs and/or expenses associated with the administration of the Distribution Plan developed in connection with the Adviser's Order and approved by the SEC. • **Recordkeeping:** Any record of the Respondents' compliance with the undertakings will be preserved for at least six years from the date of the SEC Orders, the first two in an easily accessible place.

Disgorgement, Civil Penalties and Other Sanctions • The Respondents will each pay \$60 million in disgorgement and a civil money penalty of \$20 million. • The Respondents are each barred from association with any transfer agent or investment adviser, and are 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. • The former Chairman and CEO is further barred from association with any broker or dealer.

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