Mutual Fund Investment Firm Responses to November 2003 WDC Query

As of February 24, 2004, 11 of 13 mutual fund investment firms providing options through the WDC had responded (85%) to the Board's request for information related to the reports of inappropriate trading practices within the mutual fund industry. No response was received from Dreyfus or Great-West Life. The following is the list of questions and a summary of responses from the investment providers:

1. Has the firm been subpoenaed by regulators with regard to the firm's trading practices? If yes, by whom and when?

   The following mutual fund firms have received requests for information from the U.S. Securities and Exchange Commission (SEC), the National Association of Securities Dealers (NASD), the New York Attorney General's Office (NY AG) or other regulatory agencies: Barclays Global Investors (BGI), Charles Schwab, Dimensional Fund Advisors (DFA), Federated, Janus, T. Rowe Price, and Vanguard.

   Specifically, the following firms have been subpoenaed:

   - Federated, by the SEC, NASD and the NY AG in September 2003.
   - Janus, by the NY AG on July 17, 2003. The SEC has also commenced an examination of Janus in relation to the NY AG's investigation.
   - Fidelity, by the NY AG, the SEC, Massachusetts Secretary of State and other regulators.

2. Are there any current or pending litigation or administrative actions against the firm as a result? If yes, please describe them.

   As of January 28, 2004, none of the firms offering mutual fund options through the WDC that responded had any administrative actions pending related to the current regulatory focus on market timing or late trading. However, Federated, Janus and T. Rowe Price have all been named as defendants in several class action lawsuits.

3. Has the firm conducted an internal review to determine if excessive market timing and/or after hours trading have occurred in the funds? If yes, what was the outcome of the internal review?

   All firms that responded to the survey have or are in the midst of conducting internal reviews. Calvert, DFA, Fidelity, Galliard, T. Rowe Price, and M&I Bank did not find any evidence of market timing or late trading. These firms stated that their operational and system controls, policies and practices appear sound.

Four firms have discovered market timing or after hours trading:

- BGI identified one trade (under $5,000) that was placed after 4 p.m. Eastern Time (ET). The firm believes this was an administrative error, and that there are no other issues at BGI of significant concern or any practices that compromise the firm's fiduciary responsibilities to clients.

- Charles Schwab found that, inconsistent with the firm's stated policy, a limited number of trades were completed after 4 p.m. ET. They are still researching this.

- Federated discovered that two officers had a relationship with a hedge fund, and that some unreviewed frequent trading occurred from May through September 2003. The firm found no evidence of any late trading agreements but has acknowledged that some late trading occurred that resulted in several employees resigning or being terminated. There is no evidence that the firm's senior executives were aware of the improprieties. Federated has retained an independent audit firm to review the firm's policies and procedures, will hire an independent consultant to review its internal audit and compliance departments, is implementing previously planned redemption fees on international and high yield funds, and will be commencing remedial training for staff.

- As of December 23, 2003, Janus' internal review showed ten discretionary frequent trading arrangements. At peak, these arrangements accounted for approximately 0.25% of total assets under management at Janus. All frequent trading arrangements were terminated by the end of September 2003, resulting in outflows of about $310 million. Janus is conducting both an internal and external review of policies and procedures.

4. How does the firm monitor employees' personal trading activities?

   Most firms have a Code of Ethics outlining professional standards of conduct for their employees. The firms responding indicated that they review employee trading, require reporting on a quarterly basis, and usually require their employees to disclose their holdings. The firms also indicated that employee trading transactions must be pre-approved and request duplicate confirmations of security transactions made by employees.

5. Has the firm terminated or accepted the resignation of any employee in connection with the trading practice investigations? Please provide information regarding any such termination.

Only two firms indicated that they have terminated or accepted the resignation of employees in connection with these investigations.

- Federated has accepted resignations or terminated the employment of their employees found to have either set up a relationship with a hedge fund or deleted e-mail related to the arrangements.
- Janus reports that the employees who were central to the decision to accept discretionary trading have either left the firm prior to December 2003, or resigned.

6. What is the firm's policy regarding after hours trading?

   a. Are there any situations where an investor can purchase shares after 4 p.m. Eastern Time (ET), or after the fund's shares have been priced, and receive that day's closing price? If so, please explain.

      All eleven firms responding noted that they do not permit trades after 4 p.m. ET, per laws and company policy. They stated that trades received after 4 p.m. ET are processed with the next day's Net Asset Value (NAV).

   b. Are intermediaries, such as brokers and retirement plan record keepers, permitted to place orders after 4 p.m. ET, provided they received those orders before 4 p.m. ET? How does the firm verify that the intermediary received the original order before 4 p.m. ET?

      Applicable law prohibits this. Accordingly, the firms responding indicated that their contracts or agreements with intermediaries require the intermediaries to submit late trading orders only for those trade requests that the intermediary received prior to the 4 p.m. ET market close. Several funds have sent letters to their intermediaries requesting certification of the intermediaries compliance with the law and their agreements, and one fund has created an "Intermediary Oversight Committee" to formalize the review and oversight of third party clients.

7. What are the firm's guidelines regarding excessive trading, short-term trading and market timing? Are there different guidelines for the various classes of shares of the mutual funds the firm offers? What language is contained in the prospectus regarding excessive trading, short-term trading and market timing?

   Most firms, including Calvert, DFA, Federated, Fidelity, Janus, T. Rowe Price, M&I Bank and Vanguard indicated that their prospectuses reserve the right to reject or cancel exchanges and specifically reject any exchange considered market timing. The definition of frequent trading varies from firm to firm, and from fund to fund.

Some funds define excessive trading as four or more exchanges out of a fund in a calendar year (some Fidelity Select Portfolio funds, Janus and Vanguard), while others define it as more than one purchase and one sale involving the same fund within any 120 day period (T. Rowe Price). If a trade is questionable, the firms monitor the account and can limit or stop the transfer on accounts and reject any future activity.

- Galliard noted that they follow established stable value industry provisions and that the firm regularly reviews investors' accounts.
- M&I Bank charges a 2% short-term redemption fee on purchases exchanged in less than 90 days.
- BGI and Charles Schwab did not submit a response.

8. What does the firm do to protect against market timing and excessive trading? Do the firm's pricing policies protect against market timing? Are there back-end loads or expense charges on any funds? If the firm imposes such fees to discourage short-term trading, please explain how the firm developed this pricing, and why the firm would impose such fees on some of the funds and not on others, if applicable.

In their responses to this question, most funds said "see response to Question 7." Several firms provided additional information and noted that they had or would be revising their prospectuses to institute short-term redemption fees on more of their funds.

- Calvert charges a 2% redemption fee on purchases over $100,000 exchanged in less than 30 days in Calvert's International Fund, as historically international funds have been targeted by market timers. Calvert is considering additional redemption fees for its other funds.
- Per the prospectus, Federated can terminate an investor's purchase and exchange privileges and charges a redemption fee on two funds.
- Galliard applies a 90-day equity wash rule.
- Vanguard prospectuses include information explaining market timing and the policies designed to prevent it, including limiting or refusing transactions and delaying payment of redemption proceeds up to seven days.
- BGI, Charles Schwab and DFA did not submit a response.

9. Does the firm employ fair market value pricing? If so, please describe those practices and explain what types of securities they apply to and under what circumstances.

   The majority of the firms responding indicated that they utilize fair market value pricing when the need arises. In summary, fair market value pricing procedures are most frequently triggered by a change in the US market or other significant event that occurs after the close of the market or when market prices aren't readily available. Calvert and M&I Bank indicated that they use internal pricing committees in these situations, while DFA has retained a third party pricing vendor to assist in pricing non-US equities.

10. Does the firm permit hedge funds to invest in the mutual funds? If so, please describe the policies for monitoring the hedge fund investors.

    Most firms responding to this question, including BGI, Calvert, Galliard, Janus, T. Rowe Price and M&I Bank stated they do not permit hedge funds to invest in their products.
    - Federated, Fidelity and Vanguard do not discriminate against hedge funds, however, hedge funds are subject to the same monitoring for frequent trading patterns as other accounts; no special arrangements exist.

11. Please describe how hedge fund investors may be treated differently from other investors (e.g., individual investors and participants in 457 Plans), particularly with respect to other services that the firm may offer to hedge funds. Please describe how the firm is compensated for working with hedge funds.

    Only a few firms responded to this question, apparently because at least six of them do not permit hedge funds to invest in their funds. Federated, Fidelity and Vanguard noted that hedge funds are not treated any differently than other investors of comparable size; hedge funds are subject to the same restrictions and monitoring as other shareholders.

12. What provisions are in place or being considered to protect shareholders?

    Most firms say that in addition to the steps discussed in questions 7 and 8, they are continuing to do the following:

    - Reviewing large transactions and training service representatives to be proactive and advise clients of the firm's zero tolerance policy for market timing (Calvert).

- Reviewing company and industry provisions, prospectuses and policies to determine if they need tightening and considering or implementing redemption fees (Galliard, Janus, T. Rowe Price, M&I and Vanguard).

13. Please list the members of the Board(s) of Directors that oversee the mutual fund(s) offered through the WDC and named on the front page of this letter. Please provide their biographical information and describe how these directors were selected and whether they are independent directors. Are there any anticipated changes to the structure of the Board(s) of Directors? If yes, please explain.

    Calvert, Federated, Fidelity, Janus, T. Rowe Price, M&I Bank and Vanguard either submitted information on their respective Boards of Directors or provided a prospectus or link to an Internet site listing Board members for the various funds. No fund is anticipating any changes to its directors or board structures.

    Charles Schwab and Galliard stated that this request did not apply to them.

    BGI and DFA did not submit a response.

14. Does the firm have Errors and Omissions or Directors & Officers Liability Insurance? Who are the carriers and what are the limits?

    Nearly all firms carry insurance covering Errors and Omissions and Directors and Officers Liability. Some firms declined to provide any details, stating that coverage details are not publicly disclosed. Of those that did reply, common insurance carriers include Lloyd's of London, the Chubb Group, Zurich American Insurance Company, Superior Guaranty Insurance Company of Vermont and the ICI Mutual Insurance Company. Aggregate limits generally range from $50 million to $200 million.

    BGI and DFA did not submit a response.

15. What is the firm's view on the impact of these investigations on the future of the mutual fund industry?

    Most firms responding to this question indicated that they are in support of ensuring fair treatment of all investors and regulators' efforts to eliminate any improper trading that harms other investors. They agree that the investigations have raised concerns and have had an impact on the public's trust and confidence in mutual fund firms. Changes are coming to the mutual fund industry and it is likely that the SEC will require further industry enhancements to compliance-related functions and board oversight responsibility.