



STATE OF WISCONSIN
Department of Employee Trust Funds
Eric O. Stanchfield
SECRETARY

801 W Badger Road
PO Box 7931
Madison WI 53707-7931
1-877-533-5020 (toll free)
Fax (608) 267-4549
TTY (608) 267-0676
<http://etf.wi.gov>

CORRESPONDENCE MEMORANDUM

DATE: October 3, 2006
TO: Wisconsin Deferred Compensation Board
FROM: Shelly Schueller, Director
Wisconsin Deferred Compensation Program
SUBJECT: Mutual Fund Investigations Update: Janus and American Funds

For the past several years, the Board has been monitoring and discussing several mutual fund investigations. Specifically, the Board has focused on two Wisconsin Deferred Compensation Program (WDC) investment providers: Janus and American Funds. While the Janus Fund was phased out of the WDC at the end of 2005, the WDC investment spectrum presently includes the EuroPacific Growth Fund, which is offered by American Funds. This memo provides an update on developments in the investigations of both investment options that have occurred since the May 2006 Board meeting.

Janus Fund

The Janus Fund was part of the WDC from 1994 through 2005. The Board has been concerned with potential collateral damage to WDC Janus Fund holders resulting from numerous redemptions that followed investigations into the mutual fund industry and the Janus Capital Group in particular.

The Board has regularly asked staff if there are any ways for the Board to join a lawsuit against Janus Capital Group. At the request of the Department, attorneys at the Wisconsin Department of Justice (DOJ) and Great-West Retirement Services have reviewed the Board's position regarding potential collateral damage claims against Janus Capital Group.

As outlined in the attached memo from Great-West Retirement Services, it appears that it would be extremely difficult for the Board and WDC participants to succeed in any claims against Janus Capital Group. The primary reason for this is because there were no alleged market timing activities within the Janus Fund, which is the only Janus Capital Group fund offered through the WDC. The response staff received from the DOJ corroborated this position.

Based on this information, the Investment Committee recommended at its September 12, 2006, meeting that the Board discontinue its active pursuit of a collateral damage claim against the Janus Capital Group. The Investment Committee also recommended that the Board require WDC staff to continue to monitor the Janus situation and report back to the Board if it appears circumstances arise that would permit a successful damage claim suit.

Reviewed and approved by Dave Stella, Deputy Secretary

Signature Date

Board	Mtg Date	Item #
DC	11/14/2006	10

American Funds

The EuroPacific Growth Fund, which is offered by American Funds Distributors (American Funds), opened to WDC participants on February 1, 2005. Shortly after the fund was opened, the National Association of Securities Dealers (NASD) alleged that American Funds violated the NASD Anti-Reciprocal Rule by directing approximately \$100 million in brokerage commissions to top sellers of the American Funds. American Funds has strongly denied the NASD allegation and believes there are no facts that support this allegation.

An NASD panel held a hearing on this matter in March 2006. On August 30, 2006, the hearing panel issued a decision in which it found that American Funds violated the rule in question. As a result, the NASD imposed a \$5 million fine on American Funds. American Funds has stated that it strongly disagrees with this decision and will appeal the decision to the NASD's National Adjudicatory Council.

On November 22, 2005, the Superior Court of California in the County of Los Angeles dismissed another complaint against American Funds, which was made by the California Attorney General. The claim related to the sufficiency of disclosure of additional payments American Funds made to broker-dealer firms in recognition of the cost and efforts involved in educating financial advisers about American Funds. However, on February 7, 2006, the California Attorney General filed a notice that he will appeal the Court's decision. This case is still pending.

Staff will continue to monitor each of the investigations discussed in this memo and will keep the Board informed of any new developments.

Attachment

Great-West Retirement Services®

DATE: August 30, 2006

TO: Gregg Seller, Senior Vice President, Great-West Retirement Services

FROM: Bev Byrne, Vice President and Counsel, Legal Department, 2T3

RE: State of Wisconsin

The State of Wisconsin Deferred Compensation Board (the "Board") has requested that Great-West Retirement Services® ("GWRS") provide information regarding potential claims against Janus Capital Group and/or its affiliates (the "Janus Group") arising out of market timing activity within one or more of the Janus family of funds.

Specifically, it is my understanding that the Board is concerned with potential "collateral damage" to participants in the Wisconsin Deferred Compensation Program (respectively, the "Participants" and the "Program"), who had plan account balances allocated to the Janus Fund from 1994 through late 2005. Potential collateral damage results from losses the Participants may have suffered by virtue of the decline in the Janus Fund's share value when, following the market timing investigations by various regulatory bodies into market timing within other Janus funds, many Janus Fund shareholders redeemed their Janus Fund shares; however, the Janus Fund was not one of the funds specifically identified as experiencing market timing problems.

GWRS is not aware of any cases that have sought collateral damages for market timing related losses suffered by investors in non-timed mutual funds. As a result, it appears that it would be difficult, if not impossible, for the Board, the Program and/or Participants (collectively, the "Wisconsin Group") to prevail in an action against the Janus Group (or other possible defendants, such as the persons or entities that market timed the Janus funds or the financial institutions that facilitated the execution of the market timing trades) on account of the market timing activities relating to other funds within the Janus family of funds.

As to claims by Participants who may have suffered diminished account balances, this conclusion is based, in large part, on the fact that there was no timing activity in Janus Fund, which creates a difficult nexus between any losses suffered by the Wisconsin Group as a result of actual or alleged wrongful activity by members of the Janus Group. As to claims by the Board or the Program, not only the hurdles applicable to the Participants would apply, but also these plaintiffs would face standing challenges predicated on the fact that the collateral damage would presumably have been suffered only by Participants.

These conclusions are based not only by longstanding experience with federal securities law and related litigation, but also by the Multidistrict Litigation involving market timing and late trading that is pending in the U.S. District Court for the District of Maryland (the "MDL actions"). Following the regulatory investigations that were made public in the fall of 2003, a number of federal and state law claims were brought against the Janus Group and others by Janus investors who held shares in Janus timed funds. These lawsuits alleged that certain members of the Janus Group (as well as the market timers and the financial institutions that facilitated the execution of the market timing trades) violated various provisions of the Securities Act of 1933 (the "Securities Act"), the Securities Exchange Act of 1934 (the "Exchange Act") and the Investment Company Act of 1940 (the "Investment Company Act"); the plaintiffs also asserted state law causes of action for breach of fiduciary duty, constructive trust and unjust enrichment. These lawsuits (together with other similar lawsuits against other mutual fund complexes) were consolidated into the MDL actions. In August 2005, the MDL court ruled on the Janus defendants' motions to dismiss the various causes of action against them, and this ruling provides a good benchmark

to predict how similar claims by the Wisconsin Group would likely be resolved. Specifically, based on the MDL rulings, it appears that any collateral damage claims by members of the Wisconsin Group against the Janus Group (and/or against the market timers and facilitating financial institutions) would be expected to face the following obstacles, which appear to be very difficult to overcome, if not insurmountable:

- Securities Act Claims – The primary obstacle would be proving that there were *material* misrepresentations or omissions in the Janus Fund prospectuses, given that the market timing activity took place in other Janus funds. And even if the Wisconsin Group were to prevail on this point, Sections 11 and 12 (a)(2) of the Securities Act limit damages to the excess of the purchase price over the sales price.
- Exchange Act Claims – The primary obstacle for any Section 10(b) or Rule 10b-5 claims¹ would be proving reliance, transaction causation and loss causation when the market timing took place in a different fund.
- Investment Company Act Claims – Section 36(b), relating to excessive compensation, provides the only private right of action. The primary obstacle would be the fact that any excessive fees or other compensation were paid by funds other than the Janus Fund.
- State Law Claims – Given the nature of the collateral damage claim, the primary obstacle to any state law causes of action would be preemption under the Securities Litigation Uniform Standards Act of 1998 for claims brought by the Participants, and standing challenges for claims brought by others, such as the Board or Program.

There is a very high likelihood that any federal or state claim brought by the Wisconsin Group would ultimately be consolidated into the MDL actions, which would subject the Wisconsin Group to the prior rulings by the MDL court on the motions to dismiss. These rulings have curtailed the legal grounds upon which aggrieved Janus investors may sue the Janus Group and the other defendants and, with respect to those claims that have survived the motions to dismiss, these rulings have narrowed the basis upon which any plaintiffs would be able to proceed.

Finally, any statutes of limitations of three years or less are likely to expire in the very near future given that the Janus market timing problems came to public light on September 3, 2003. Although this may not be the date that collateral damage claims accrued, because the collateral damage resulted from events occurring after the adverse publicity, it is likely the courts will find that any such claims would have accrued shortly thereafter.

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Please note that the scope or and basis for this memorandum is solely with respect to federal and state securities laws, rules and regulations and does not purport to address any other laws, rules or regulations including, but not limited to, Wisconsin laws, rules or regulations related or applicable to the Board or the Program and is further based on the laws, rule and regulations as in effect as of the date of this memorandum. Finally, this memorandum is based solely on the facts included herein.

If additional information or background is needed, please do not hesitate to contact me.

¹ Section 10(b) and Rule 10b-5 claims are based on the use of interstate commerce or the mails to employ any device, scheme or artifice to defraud; to make any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; or, to engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.