

# **PBA FAIR FUND DISTRIBUTION** **STATEMENT TO ELIGIBLE INVESTORS**

## **INTRODUCTION**

You have received a distribution payment from a Fair Fund established by the U.S. Securities and Exchange Commission (“SEC”). Your payment has been calculated based on information contained in the records of Pilgrim, Baxter, and Associates. Ltd. (“PBA”), and of third party intermediaries. The distribution payment is intended by the SEC to compensate you for harm to your mutual fund investment(s) due to market timing.

This statement provides you with information to help you determine the U.S. federal income tax consequences of the distribution payment if you are a citizen or resident of the U.S. for U.S. federal income tax purposes.

**YOU SHOULD NOT RELY ON THIS STATEMENT AS TAX ADVICE. CONSULT YOUR TAX ADVISOR WITH RESPECT TO THE SPECIFIC TAX CONSEQUENCES OF THE DISTRIBUTION PAYMENT, INCLUDING THE EFFECTS OF U.S. FEDERAL, STATE, LOCAL AND NON-U.S. TAX RULES AND THE EFFECT OF POSSIBLE CHANGES IN LAWS.**

In 2004, in the proceedings *Pilgrim Baxter & Associates, Ltd.*, Admin. Proc. No. 3-11524; *Gary L. Pilgrim*, Admin. Proc. No. 3-11739; and *Harold J. Baxter*, Admin. Proc. No. 3-11740, the SEC issued Orders instituting and simultaneously settling public administrative and cease-and-desist proceedings against the respondents to those SEC proceedings (collectively, the “Respondents”). In the Orders, the SEC authorized and established a Fair Fund of \$250 million in disgorgement and penalties paid by the Respondents (the “PBA Fair Fund”). According to the Orders, the PBA Fair Fund is to be distributed to investors injured by market timing in the PBHG mutual fund complex (“PBHG Funds”) pursuant to a distribution plan (“Distribution Plan”) to be developed by an Independent Distribution Consultant (the “IDC”), Dr. Kenneth Lehn.

On November 22, 2006, the SEC approved the Distribution Plan, which provides for distribution to all eligible investors of their proportionate share of the disgorgement and penalties paid by Respondents. The Distribution Plan compensates such investors for harm they suffered as a result of market timing in the PBHG Funds for the period spanning June 1998 through December 2001. Prior to any distribution, the PBA Fair Fund held a total of \$250 million plus accumulated interest.

The PBA Fair Fund is a Qualified Settlement Fund (“QSF”) under the Internal Revenue Code. Damasco & Associates LLP was appointed as the Tax Administrator for the QSF. The SEC authorized Damasco & Associates LLP to

seek a Private Letter Ruling (“PLR”) from the Internal Revenue Service (“IRS”) on behalf of the PBA QSF. A PLR was obtained that provides guidance to the PBA QSF with respect to the tax reporting obligations of *the PBA QSF* in making a distribution to you.<sup>1</sup> The PLR does not address *your* tax compliance obligations as an investor receiving a distribution payment. Damasco & Associates LLP has participated in the preparation of this Statement, but is not providing services or advice to you or any other eligible investor receiving a distribution payment.

Some eligible investors may be subject to special tax rules, including, without limitation, if you are a non-U.S. investor, if you hold your shares in a tax-qualified retirement plan or an individual retirement account (“IRA”) (except as specifically discussed below), or if you are a tax-qualified retirement plan. This statement does not address the tax consequences under any state, local or non-U.S. tax laws, or the alternative minimum tax provisions of the Internal Revenue Code.

### **THE DISTRIBUTION PAYMENT**

Pursuant to the Orders, the Distribution Plan “shall provide for fund investors to receive, from the monies available for distribution, in order of priority, (i) their proportionate share of losses suffered by the funds due to market timing, and (ii) a proportionate share of advisory fees paid by funds that suffered losses during the period of such market timing.”

The IDC has concluded there is no advisory fee component in your distribution payment. Your payment is intended to compensate you for harm to the value of your mutual fund investment caused by market timing in certain PBHG funds. This harm has been measured as dilution in the share price. This payment is not income to you to the extent of your basis in your investment. You must adjust your basis downward by the amount of the payment.

Example 1: You have a basis in your shares of \$100. You have received a distribution from the PBA Fair Fund in the amount of \$10 as compensation for the harm to the value of your mutual fund investment caused by market timing in certain PBHG funds. You do not have gross income as a result of the dilution component of distribution *BUT* your basis is reduced to \$90 for purposes of determining gain or loss in the future.

---

<sup>1</sup> The Tax Administrator obtained the following PLRs: 200645008, 200645017, 200646010, 200701001, 200702006, 200702008, 200702009, 200702010, 200702011, 200702012, 200702048, 200703008, 200703009, 200703010, 200703034, 200712004, and 200712005. You may obtain copies of these PLRs from the IRS Web Site, [www.irs.gov/foia/lists/0..id=97705.00.html](http://www.irs.gov/foia/lists/0..id=97705.00.html). Scroll to the desired PLR number, select it, and click on “Retrieve Selected Files.” Two additional PLRs were obtained and will be available on June 1, 2007.

Example 2: You have a basis in your shares of \$400. You have received a distribution from the PBA Fair Fund in the amount of \$1,000 as compensation for the harm to the value of your mutual fund investment caused by market timing in certain PBHG funds. Your basis is reduced to zero for purposes of determining gain or loss in the future *AND* you have \$600 of gain.

**The QSF will not issue a Form 1099 to you for your payment representing harm to the value of your mutual fund investment. The IRS has ruled that the PBA QSF is not required to report these harm payments. Nevertheless, you should consult with your tax advisor as to how to report any gross income, such as that described in Example 2.<sup>2</sup>**

### **SPECIAL ISSUES FOR INVESTMENTS HELD IN IRA OR TAX-QUALIFIED RETIREMENT PLANS**

#### **A. PBA Fair Fund Distributions to IRA Accounts**

**Please follow the applicable instructions below if you received a check that is associated with an IRA.**

##### **1. For Checks Payable to the Custodian but Mailed to the Investor**

a. If you held some or all of your mutual fund shares through an IRA, in most cases the distribution check will have been made payable to your IRA custodian but mailed directly to you. You should deposit the check in your IRA account. Caution: If the check is cashed or deposited in any account other than an account eligible to receive the check, it may be subject to a 10% penalty and taxed as ordinary income in the year of receipt.

b. If your IRA custodian has changed, please contact the Administrator of the PBA Distribution Plan at (800) 920-5408 with that information. You may be able to transfer the payment to another custodian, or roll the payment over to another IRA or eligible account. Please consult with your tax advisor because the rules related to transfers and rollovers are complicated and failure to comply with those rules could subject the payment to income tax and a 10% penalty.

c. If you no longer hold your IRA, please contact the Administrator of the PBA Distribution Plan at (800) 920-5408 with that information.

---

<sup>2</sup> There may be some circumstances in which the QSF will issue information returns and will report payments to the IRS. These circumstances are beyond the scope of this Statement to Investors and are addressed in the PLR obtained on behalf of the QSF.

## 2. For Checks Payable to the Investor and Mailed to the Investor

If the distribution check was made payable to you (as opposed to the custodian of your IRA) because of the way your account was registered in the records obtained for the distribution, please contact the Administrator of the PBA Distribution Plan immediately at (800) 920-5408 to get a replacement distribution check made payable to the custodian of your IRA. Caution: If you cash the check, or deposit it in any account other than an account eligible to receive the check, it may be subject to a 10% penalty and taxed as ordinary income in the year of receipt.

Additional information on this topic is available on the IRS Web Site [www.irs.gov](http://www.irs.gov), Tax Topic 451 and Publication Number 590.

## B. PBA Fair Fund Distributions to Tax-Qualified Retirement Plans

### 1. Checks Mailed to Your Retirement Plan

If you held some or all of your mutual fund shares through a tax-qualified retirement plan, in most cases the distribution check was made payable and mailed to your tax-qualified retirement plan.<sup>3</sup> Plan fiduciaries are responsible for allocating these funds. Please contact your plan fiduciary if you have questions

### 2. Checks Mailed to You

In limited instances, the distribution check was mailed to you and made payable to either (i) your retirement plan or (ii) you because of the way your account was registered in the records obtained for the distribution. **Please follow the applicable instructions below if you received a check that is associated with a tax-qualified retirement plan.**<sup>4</sup>

---

<sup>3</sup> As a general rule, distribution payments from the PBA Fair Fund received as a result of the investment held by your tax-qualified retirement plan do not constitute a "contribution" to your plan for purposes of determining your maximum yearly contribution to your plan or for purposes of determining your employer's contributions to your plan.

<sup>4</sup> Many types of plans are eligible to accept rollover contributions (and the recently enacted Pension Protection Act of 2006 expanded the list of permissible recipient plans). More information on the Pension Protection Act of 2006 can be found at the IRS web site [www.irs.gov](http://www.irs.gov). Contact your tax advisor to determine the types of plans to which you may make a rollover contribution.

a. For A Check Payable to Your Retirement Plan but Mailed to You

In some instances the check payable to your tax-qualified retirement plan was mailed to you because your address was the address of record. If *you* received a check made payable to your tax-qualified retirement plan, please follow the directions in (i) or (ii) below.

(i) If you are still a participant in the tax-qualified retirement plan, contact your retirement plan trustee/administrator to coordinate the deposit of the check to your retirement plan.

(ii) If you are no longer a participant in the tax-qualified retirement plan to which the distribution is directed, please contact the retirement plan trustee/ administrator of your former tax-qualified retirement plan to determine the appropriate course of action. If you have difficulty making contact with your former plan trustee/ administrator, consult your tax advisor or contact the Administrator of the PBA Distribution Plan at (800) 920-5408.

b. For a Check Payable to You and Mailed to You

Distributions with respect to investments held by a tax qualified plan should not be payable to individual investors. If you received such a check, this is an error likely due to the data available for the distribution. If you received a distribution check made payable to you in connection with an investment held by your tax-qualified retirement plan, please contact the Administrator of the PBA Distribution Plan immediately at (800) 920-5408.

Additional information on this topic is available on the IRS Web Site, [www.irs.gov](http://www.irs.gov), Tax Topic 558.