**UNITED STATES OF AMERICA**
**BEFORE THE**
**SECURITIES AND EXCHANGE COMMISSION**

**ADMINISTRATIVE PROCEEDING FILE NO. 3-11572**

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| **IN THE MATTER OF** | ) | |
| **FRANKLIN ADVISERS, INC.,** | ) | **PROPOSED PLAN OF** |
| **RESPONDENT.** | ) | **DISTRIBUTION** |
| | ) | |

Establishing a minimum settlement distribution amount is a practice commonly employed in distributing class action settlements, as it has been observed that settlement recipients tend not to take advantage of distributions they consider trivial, and that the transaction costs associated with distribution of trivial amounts create economic waste. After consultation with the SEC staff, and consistent with what the IDC believes will be the common approach in other SEC market timing cases, the IDC directed LECG to apply a $10.00 minimum distribution threshold to the Base Case Account-Level Allocations here. The application of the minimum distribution threshold yields the "Adjusted Account-Level Allocation" scheme described in detail in Section IV, below.

As a result of this adjustment, Affected Shareholders with Base Case Account-Level Allocations less than a "Cut-Off" amount (calculated to be $4.01) will not receive any portion of the Fair Fund. The distributions that those accounts otherwise would have received are, instead, distributed to those Affected Shareholders whose Base Case Account-Level Allocations exceed the Cut-Off but are less than $10.00. Thus, each account whose Base Case Account-Level Allocation is between $4.01 and $10.00 will be paid exactly $10.00. The adjustment for a $10.00 minimum distribution does not affect the allocations to Non-Timer Accounts whose Base Case Account-Level Allocations are $10.00 or more.

Using this scheme, distribution of 88% of the Fair Fund is unaffected by the minimum-distribution threshold. The Non-Timer Accounts that would have received less than $4.01 will receive no distribution, but those Non-Timer Accounts that would otherwise have received between $4.01 and $9.99 will each instead receive a distribution of $10.00. This achieves the objective stated in Principle 4.

In addition to describing the methods that were used to calculate a fair and proportionate allocation of the Fair Fund among the shareholders of Affected Funds, this report describes the methods that will be employed to identify, notify, and pay Fair Fund Recipients in compliance with the Order and the Fair Fund Rules, in Sections V and VI, below.

**Step 3: Aggregating notional gains from market timing on a monthly basis for each Affected Fund**

The Next-Day NAV gains and losses for all Market Timing Trades in an Affected Fund in a particular month were aggregated to calculate the fund's "Monthly Gains" for that month.[9] Only the months with positive Monthly Gains were included in the calculation of the Fund-Level Allocation, which is described in Step 5 below. All positive "Monthly Gains" were aggregated across the Relevant Time Period and across all Affected Funds to calculate the "Aggregate Net Monthly Gains." Such Aggregate Net Monthly Gains amounted to $37,258,873.26.

**Step 4: Calculating the Incremental Portfolio Transaction Costs at the Fund Level Potentially Due to Market Timing Trades**

In addition to the potential for dilution, market timing could also potentially cause adverse economic impact by increasing transaction costs at the fund level.[10] If the Market Timing Trades significantly affect the fund's cash balance, then such trades could potentially increase the fund manager's securities trading activities. If the fund manager's "incremental" trading -- trading that would not have occurred absent the Market Timing Trades -- can be identified, then the transaction costs associated with such incremental trading can potentially be attributed to the market-timing activity. Such Incremental Portfolio Transaction Costs may arise even if the identified market timers did not realize any net next-day NAV gains.

A detailed discussion of the method that was used to calculate Incremental Portfolio Transaction Costs is set forth in Appendix 2. Using this method, the Incremental Portfolio Transaction Costs were calculated on a monthly basis for each of the Affected Funds. These

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Charles W. Hodges, 2002, "The dilution impact of daily fund flows on open-end mutual funds," *Journal of Financial Economics* (65), 131-158.

9 Such net NAV gains per fund were calculated on a *monthly* basis since they ultimately form the basis of calculating account-level distributions, which are based on accounts' average *monthly* balances. According to FT, higher frequency data concerning account balance information were unavailable.

10 It is understood, based on conversations with FT staff that the incremental administrative cost associated with market-timing trades to Franklin is nil because such costs are borne by the transfer agent who is paid a fixed fee by Franklin.

calculations were based on information for each fund-level transaction provided by Franklin. The Aggregate Incremental Transaction Costs (calculated across the Relevant Time Period and across all Affected Funds) amounted to $852,105.37.

**Step 5: Fund-Level Allocation of the Fair Fund**

The total Fair Fund of $50 million was then allocated to each of the Affected Funds on a month-by-month basis based on each fund's monthly share of the sum of (a) the Aggregate Net Monthly Gains ($37,258,873.26) and (b) the Aggregate Incremental Transaction Costs ($852,105.37). This sum of $38,110,978.63 ($37,258,873.26 + $852,105.37) is defined as the Fund Level Allocation Basis.

As described in the Executive Summary, the following example illustrates the Fund-Level Allocation process. In July 2000, the Monthly Gains and the Monthly Incremental Transaction Cost in the Franklin Small Cap Growth Fund were calculated at $1,551,125.48 and $16,720.15, respectively. The sum of these two numbers constitutes 4.11% of the Fund-Level Allocation basis $38,110,978.63 (as discussed above). Accordingly, under the methodology described above, all Non-Timer Accounts that were invested in Franklin Small Cap Growth Fund in July 2000 were collectively allocated a settlement of 4.11% of $50 million or $2,056,947.48.

Table 1 summarizes the five steps described above and shows: (a) the Market Timing Period for each Affected Fund; (b) the number of Market Timing Trades (buys and sells); (c) each Affected Fund's total positive Monthly Gains; (d) each Affected Fund's total Monthly Incremental Transaction Costs; and (e) the Affected Fund's share of the Fair Fund ($50 million).

For the Other Omnibus Accounts whose Adjusted Account-Level Allocation is more than $1,000.00, BFDS will make commercially reasonable efforts to obtain from each such omnibus accountholder the Shareholder Identifying Information for each of its "affected" sub-accountholders.[18] Other Omnibus Accounts may have several different tiers of sub-accountholders (for example, a sub-accountholder may itself be an entity with further sub-accountholders), but BFDS will only request first tier (or "tier 1") sub-account information. Once BFDS has obtained the tier 1 Shareholder Identifying Information, it will calculate each "affected" tier 1 sub-accountholder's ("Affected Tier 1 Sub-Accountholder") share of the Other Omnibus Account's Adjusted Account-Level Allocation using the methodology described above. Under the IDC's direction, BFDS will make the distribution to each Affected Tier 1 Sub-accountholder in exactly the same manner as distributions made to Known Individual Accounts.

Some of the Other Omnibus Accountholders may (1) fail within a reasonable time to respond to BFDS' request for Shareholder Identifying Information or (2) refuse to provide BFDS with the requested Shareholder Identifying Information. In those instances, BFDS will proceed as follows: BFDS will ask the Other Omnibus Accountholder to certify that it will make commercially reasonable efforts consistent with its legal, fiduciary, and contractual duties, as applicable, to disburse the Fair Fund distribution to its Affected Tier 1 Sub-Accountholders within the deadlines set forth in this Distribution Plan, and that the Other Omnibus Accountholder will return any undistributed money to an account that has been established to hold otherwise undistributed funds for ultimate disposition in accordance with this Distribution Plan. After each such Other Omnibus Accountholder has provided its certification to the IDC, which BFDS will make commercially reasonable efforts to obtain under the direction of the IDC, the portion of the Fair Fund allocated to the Other Omnibus Accountholder will be disbursed to the Other Omnibus Accountholder so that it can distribute the funds to its Affected Tier 1 Sub-Accountholders. In the event such Other Omnibus Accountholder refuses or fails to provide such certification, the amount of Fair Fund allocated to such Other Omnibus Accountholder shall

[18] These efforts include the following. BFDS will make a preliminary phone call to the omnibus firm's contact (primarily from their legal or compliance group), providing notice that underlying data may be requested. BFDS will then follow the call with an email containing the elements of an "Outreach Package": a summary of the SEC settlement action; the shareholder data elements that BFDS will require; the preferred file formats for the data; a Non-disclosure Agreement executed by BFDS; and contact information for the BFDS Outreach Coordinator.

### D. Commission Approval and Jurisdiction

This Distribution Plan is subject to approval by the Commission. The Commission retains jurisdiction over the Distribution Plan's implementation.

### E. Accountings

While the distribution is being implemented, the Fund Administrator will file an accounting during the first ten days of each calendar quarter, and will submit a final accounting for approval of the Commission prior to termination of the Fair Fund and discharge of the Fund Administrator.

### F. Payment of Costs and Expenses

Franklin shall pay all costs and expenses associated with administering the final Distribution Plan.

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Submitted on: May 31, 2007

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## TABLES 1 - 3