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Dreyfus to Pay $2.9 Million After Investigation of Fund

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The Dreyfus Corporation agreed yesterday to pay $2.95 million to settle charges that it failed to inform investors adequately about the risks of one of its mutual funds and that the fund's early performance had been manipulated by its being loaded with initial public offerings.

In addition, the fund's former manager, Michael L. Schonberg, agreed to a nine-month suspension from the investment management business and will pay a $50,000 fine.

Neither Dreyfus, a unit of the Mellon Financial Corporation, nor Mr. Schonberg acknowledged any wrongdoing under the terms of the settlement with the Securities and Exchange Commission and the New York attorney general's office.

An S.E.C. order and a finding from the attorney general's office said Dreyfus had not adequately informed investors of the risks associated with its Dreyfus Aggressive Growth Fund, particularly regarding investments in initial public offerings and small, illiquid companies in 1995 and 1996. The order also said Dreyfus did not adequately ensure that personal securities transactions by Mr. Schonberg did not pose a potential conflict of interest.

Mr. Schonberg's lawyer, Lee S. Richards III, said in a statement that it was "extremely important to note that the attorney general did not find that Mr. Schonberg's personal trading had violated any federal or state statute or rule."

Under the terms of the settlements, which came after a nearly four-year investigation, Dreyfus will pay $1.6 million to the State University of New York for an investor education program and $400,000 to the attorney general's office for investigation costs. Dreyfus also will pay a $950,000 fine to the S.E.C. Two proposed class-action suits on behalf of the fund's investors are pending, in federal court and in New York State.

"We're pleased with the outcome," Attorney General Eliot L. Spitzer of New York said yesterday. "It is always important to establish that any investment entity needs to explain the nature of the risk involved."

The fund, which was introduced in 1995, accumulated $154 million in its first eight months, and its portfolio gained 82 percent in its first year. But after the speedy start came a humbling fall. The fund lost 15.8 percent in 1997 and 36.7 percent in 1998, placing it in the bottom percentile of its peer group, according to Morningstar Inc., which tracks mutual funds.

Mr. Schonberg's substantial bets on initial offerings propelled the fund's early performance. But Dreyfus did not adequately explain in its prospectus and advertisements that such gains can be short-lived, according to the commission findings.

Investments in initial offerings generally have a far greater effect on new funds, which have a small base of assets, than on more mature funds. The result is that lofty returns driven by gains from initial offerings sometimes attract a tide of investor money to a fund, which eventually becomes too large to benefit greatly from more initial offerings.

In Mr. Schonberg's case, he appeared to allocate the majority of his initial offering stakes to the Aggressive Growth fund over three other funds he managed, even though documents Dreyfus filed with the S.E.C. said the allocation would be equitable, according to the S.E.C.'s finding. In its first year, Mr. Schonberg invested in 97 initial offerings for the Aggressive Growth fund, at least 70 more than for any of his other funds.

Mr. Schonberg was replaced as primary manager of the funds he still ran in April 1998 and was placed on paid administrative leave that July. He recently resigned, a Dreyfus official said yesterday.