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Firm Submits Pilgrim Baxter Timing Payout Plan

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The firm formerly known as **Pilgrim Baxter** has presented to the SEC its proposed plan to distribute settlement funds to shareholders hurt by market timing. It is believed to be one of the first firms to have done so.

The process still has a long way to go, however, before checks can be mailed to shareholders in funds that were hit by market timers. But it is an important development and may influence the many other distribution plans that are sure to follow from other firms.

Some industry executives say the [plan](#)¹, submitted by a consultant for what was once called Pilgrim Baxter, shows that the regulatory crackdown on market timing is in its final stages. Others maintain, however, that more work needs to be done to stamp out abusive market-timing practices.

Either way, many industry executives have been eagerly awaiting proposed distribution plans from firms that were caught up the market-timing scandal. Some have opined that figuring out which shareholders are entitled to distributions and the appropriate size of each distribution is an immensely complex undertaking.

Pilgrim Baxter, which has since dropped the scandal-plagued name, is no exception. The settlements against the firm and Gary Pilgrim and Harold Baxter total \$250 million. A spokesman for Old Mutual, the parent company of the firm, declined comment on the distribution plan.

However, the process may also shed insight into how other shops will manage their own distribution programs. Other firms that are required to create such plans include **Alliance**, **Columbia Asset Management**, **Janus**, **Putnam**, **Pimco Equity Entities** and what was previously **Strong Funds**.

Indeed, the project has been no modest undertaking, says Kenneth Lehn, the consultant in charge of creating the plan and a professor at the Katz Graduate School of Business. He estimates that as many as two dozen staffers at various consulting firms have worked over the past two years to develop the plan.

Lehn and his assistants have estimated that market timers made \$242 million in ill-gotten profits. He then estimated how much of those profits were made each day that market timing occurred.

The distribution plan then calls for assessing what portion of those profits should be returned to investors. The portions would be comparable to the percentage of a fund's shares owned by each shareholder on the day that profits from market-timing activities occurred.

It appears that the distribution plan has been designed to ensure that each shareholder receives an appropriate sum from the settlement, says Niels Holch, executive director of the Coalition of Mutual Fund Investors. "I think it's a fair system," he adds.

However, the plan is far from being finalized.

The SEC has put the proposed distribution plan out for public comment. Depending on the comments, SEC staffers may make changes to the plan or simply notify SEC commissioners of the comments, explains Catherine E. Pappas. She is a senior trial counsel in the SEC's Philadelphia district office.

As of yesterday, no comments had been submitted; the public comment period is scheduled to end on July 31, she adds.

After being approved by the commissioners, broker-dealers and other intermediaries will have 60 days to identify shareholders found within omnibus accounts. That will allow the SEC to distribute the appropriate payments to those investors. If intermediaries don't provide the identities of individual shareholders, then it will be up to each firm to distribute the money to each investor, she says.

With omnibus accounts, broker-dealers and other intermediaries don't notify fund firms of the underlying identity of

individual investors. The intermediaries instead roll up individual investors' trade orders into one big order that is then submitted to a fund firm.

In addition, a tax administrator for the assets generated from the market-timing settlement is currently seeking a private letter ruling from the Internal Revenue Service, she says. The ruling is needed to determine what type of tax reporting must be conducted when the distributions are made to shareholders, she explains. The payments won't be able to be made until a ruling is issued, she adds.

Despite those lingering complications, the SEC expects checks to be mailed to individuals before the end of the year, she says. At the same time, she expects a handful of additional firms to submit proposed distribution plans for public comment and SEC approval this summer.

Holch adds that the process illustrates the lack of transparency that omnibus accounts offer. Investors within omnibus accounts may not get their checks until other investors because of the amount of time it may take to find the identity of the shareholders, he maintains. That same lack of transparency, combined with accounting practices used by fund firms when redeeming shares, allows market timing to continue, he says.

Regarding accounting procedures, fund firms process redemption requests with first in, first out accounting. That means the fund shares held for the longest period of time are redeemed before other shares. That can allow investors to trade more frequently without getting hit by redemption fees, he maintains. As an alternative, fund firms should redeem shares that are held for the shortest period of time when processing redemption requests, he maintains.

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