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Columbia Market-Timing Mitigation Unveiled

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A proposed plan[1] for reimbursing **Columbia Funds'** investors for market-timing abuses is causing additional concerns over omnibus recordkeeping issues.

Columbia Funds has become the second firm to propose a method for reimbursing long-term shareholders with regulatory fines and penalties paid by the firm as part of a market-timing settlement. While most industry observers say the plan is based on sound methodology, they question if it will treat investors in omnibus accounts fairly.

Those concerns are an echo of previous views expressed on the industry's first proposed plan for distributing market-timing settlement penalties to long-term shareholders. That plan was created by a consultant on behalf of what was formerly called **Pilgrim Baxter** and involves distributing $250 million paid by the firm and former executives.

More recently, a consultant for Columbia Funds has proposed a plan for distributing $140 million in penalties and disgorged fees to long-term shareholders. Columbia paid that amount into the SEC's Fair Fund in February of last year. The fund was created by regulators to reimburse investors believed to have been harmed by inappropriate activities.

Like the Pilgrim Baxter plan, the plan Columbia's consultant has developed is a sound method for determining which investors should be entitled to a portion of the settlement money, says Niels Holch. He is the executive director of the Coalition of Mutual Fund Investors.

Yet, some investors may not receive appropriate payouts because of the lack of transparency inherent in many omnibus recordkeeping systems, he says. For example, the proposed plan specifies that investors that are entitled to payouts of less than $10 won't receive anything. The idea is that it's not worth bearing the costs of processing such small payments. Yet, if a shareholder invested in a variety of Columbia Funds and the combined payouts exceed that amount, the check will be cut. The problem is that with omnibus platforms, it may be difficult to identify each shareholder and the combined payouts from each fund that an individual should receive.

Intermediaries can also decline to distribute the payments to shareholders if they determine that the cost of processing the payment will exceed the amount of the distributions, Holch adds. In such a case, the amount of the distributions that would go to investors in omnibus accounts would instead be sent to other shareholders.

The bottom line is that intermediaries may have a long and difficult road ahead of them when they set out to identify investors that are entitled to payments.

"I'm sure it will be difficult and a burden for the omnibus recordkeepers," says Barbara Weidlich, president of the National Investment Company Service Association, or Nicsa.

Determining a fair method to distribute the assets isn't an easy task, adds Jay Baris, a partner with **Kramer Levin Naftalis & Frankel**. Indeed, distribution consultants are working within the constraints of omnibus systems and other factors, he says.

"It's an issue, and no allocation method will be perfect," he says. "You have to deal with limitations in the marketplace."

The plan has been developed by Lawrence Hamermesh, a professor of corporate and business law at Widener University School of Law. In creating the plan, Hamermesh worked with Navigant Consulting and economic advisor Lexecon. Hamermesh also retained Erik Sirri, a professor of finance at Babson College. Hamermesh didn't return calls seeking comment.

Unlike the Pilgrim Baxter plan, the Columbia distribution plan would calculate how much in excessive trading costs resulted from frequent trading conducted by market timers, points out Russel Kinnel, director of mutual fund research at Morningstar. It will also calculate the dilution to shareholders that resulted from market timers' exploiting stale pricing of NAVs. The plan calls for combining those expenses when calculating the payments to shareholders. It would distribute the payments on a prorated basis, which would be based on the percentage of a fund that each investor owns.

Factoring trading costs makes a lot of sense, he adds.

"In its simplest form, market timing involves dumping trading costs on everyone else," he says. Thus the costs resulting from such active trading should be considered when assessing the payments that each investor should receive, he maintains.

A Columbia spokesman declined to comment, explaining that the plan is now in a public comment session. The public comment on the plan ends on Aug. 18.

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