FUNDWATCH

Payouts from fund scandal proceed, but slowly

Shareholders to get reimbursement, though checks will likely be small

By Robert Schroeder, MarketWatch
Last Update: 3:02 PM ET Sep 17, 2006

WASHINGTON (MarketWatch) -- If your mutual fund was caught in the industry's trading scandal, there's some good news for you: a reimbursement check may be on the way.

Now for the bad news: that check will likely be small, and it may take awhile to reach you.

Over the past few months, the Securities and Exchange Commission has collected comments on three plans to distribute money to harmed investors. The investor-protection agency plans to publish more proposed distribution plans for comment soon, and a spokesman says the first money should start flowing to individuals later this year.

However, the complexity of calculating payments to investors as well as finding some of them is threatening to make the payout process a lengthy one, creating a headache for some companies along the way.

Moreover, say advocates, despite about $2 billion in fines paid by the companies, investors shouldn't necessarily expect a big check.

"The losses per individual can be quite small," said Barbara Roper, director of investor protection at the Consumer Federation of America.

"There have to be a lot of these where it's pennies" in reimbursement, said Mercer Bullard, president of Fund Democracy, a fund shareholder advocacy group.

Part of the problem with paying restitution to investors is actually finding them. So-called "omnibus accounts" -- big accounts used by retirement plans, for example -- may have thousands of investors, and tracking them down can be difficult, said Niels Holch, executive director of the Coalition of Mutual Fund Investors. Holch said he's concerned that some investors in those accounts may not get their full share of payments.

"There may be some unfairness in the way the funds distribute this money," Holch said.

Companies won't have as hard a time finding investors who bought funds using direct methods like purchasing shares on their home computer. Holch's group is petitioning the SEC to require uniform treatment for omnibus and "direct purchase" shareholders.

Companies that track fund customers' account histories add that the proposed plans may impact them as well.

"Some of our members are extremely concerned about the fact that they are being required to play a significant role in this process which is the result of mutual fund scandals, with respect to which they are not at fault," the president and general counsel of the Spark Institute wrote to the SEC.

Dollars and details

So far the SEC has taken comments on three plans: Pilgrim Baxter; Columbia Funds, and Banc One Investment Advisors Corp. The agency is still accepting comments for the distribution plan for Veras Investment Partners, LLC, a hedge fund firm, and related units.

Payouts to scandal-plagued investors aren't new. So far, the SEC has distributed more than $750 million to investors who were harmed by abusive sales and trading practices.

In 2003, Morgan Stanley agreed to pay $50 million to regulators to settle fund-abuse allegations, and paid out checks to investors.

More recently, in late August, prosecutors won a $600 million settlement from Prudential Financial Inc.'s brokerage unit, which settled charges that its former employees defrauded fund investors by helping some clients rapidly trade those funds. As part of the settlement, Prudential (PRU) will pay $270 million to fraud victims. See full story.

Dollar amounts for forthcoming payouts to individuals haven't yet been determined. But advocates like Bullard say that with many of the reimbursements likely to be paltry, funds would do better to reinvest the money rather than spend more to locate investors and send them cash.

"It's an appropriate place to put it," said Mike Rosella, an attorney who chairs the investment management practice group at Paul, Hastings, Janofsky & Walker in New York.

That may not satisfy investors who feel scammed. But, attorneys point out, the dispossessed can always sue the fund either individually or through a class-action.

Meanwhile, regulators hope their prosecution of wrongdoers will prevent market-timing and other fraud in the future.

"Investors were dealt a bad hand by corporate con-men who stacked the deck against them," Deputy Attorney General Paul McNulty said, announcing the Prudential settlement Aug. 28. "This resolution sends a strong message to predatory traders who dupe the system to reap millions in illegal profits."

Robert Schroeder is a reporter for MarketWatch in Washington.