

In Calvert Valuation Case, a Tale of Two Distribution Channels

By Whitney Curry Wimbish, *BoardIQ*, November 1, 2016 [subscription required]

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Calvert will pay a \$3.9 million fine for failing to properly fair value illiquid bonds over a multiyear period, and although it already reimbursed shareholders \$27 million, regulators are requiring the fund group to conduct a more rigorous calculation of investor losses.

The Oct. 18 settlement involving more than \$1.2 billion in improperly priced bonds sheds light on how the Securities and Exchange Commission expects fund complexes to fix valuation errors and highlights how shareholders may be treated differently depending on whether they invest directly or through an intermediary.

Instead of the typical remedy for an error in net asset value – returning money to the funds – the SEC outlines an extensive analysis to determine which shareholders were affected by the error and how much they are owed. Among other steps, Calvert must obtain information from omnibus intermediaries about underlying account holders so the firm can make distributions to them. If the intermediary declines, the SEC outlines how that firm can make the distribution itself, at its own cost.

The long-running valuation errors weren't the only problem at the complex. On the same day the SEC released the settled administrative case against Calvert Investment Management, the fund group disclosed it had also discovered and self-reported a recent sub-transfer agent fee error that caused the funds wrongly to pay roughly \$18 million for distribution.

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Fund directors are not named in the SEC's administrative action against Calvert, but observers say it's still important to review because the situation illustrates how shareholders may be treated differently based on their method of investment. As shareholders' representatives, directors may want to discuss how their own funds ensure shareholders are fairly treated regardless of how they have invested.

Some also say that the issue once again shows how omnibus platforms have complicated the mutual fund industry. Omnibus accounting prevents funds from knowing who their ultimate investors are, they note, and in situations like Calvert's, it makes it difficult to return money to shareholders without the distributor's help.

“With so many omnibus accounts, you really do need to go to a subaccount level,” says Niels Holch, a partner at **Holch & Erickson** and the executive director of the Coalition of Mutual Fund Investors.

“The SEC recognized that a shareholder transacting through an intermediary was being treated differently than a shareholder transacting directly...I think it ought to be the standard for any type of restitution type payment that a mutual fund has to make when you’re looking back over a significant period of time. You should treat all shareholders in a uniform way independent of the investment channel in which they’ve chosen to invest with you.”

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The SEC’s distribution instructions echo the method used to distribute funds to shareholders harmed by market timing in the **Alliance** mutual fund complex between 2001 and 2003, some say. One noteworthy difference, though, is that the commission assigned a distribution specialist to oversee payments to Alliance shareholders. It didn’t do so in Calvert’s case.

And with no assigned advocate that reports to the SEC, it’s unclear what Calvert would need to do if an intermediary failed to provide underlying account information or failed to say if it has distributed money to the appropriate shareholder itself, observers note.

“If you had transparency into these omnibus accounts,” Holch says, “you wouldn’t have to go through all this work to compensate these shareholders.”