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Fidelity Penalty May Win Grace With Regulators

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By Tom Leswing

Fidelity's decision to pump $42 million into its funds as a penalty for traders' accepting elaborate gifts from brokers will go a long way in addressing the matter with regulators and in preserving the firm's reputation, attorneys say.

They add that the firm's decision is noteworthy in that it is one of the few instances where a fund shop has decided to reimburse shareholders prior to regulatory settlements' being reached.

Independent trustees of Fidelity funds have been working externally with Judge John S. Martin Jr. and consultants since July 2005 to assess any potential damage to shareholders resulting from Fidelity traders' accepting expensive gifts from brokers at Jefferies. Those gifts included lavish trips aboard jets, expensive wine and paying for elaborate parties.

The trustees and consultants have concluded that it is impossible to assess whether any damages did or did not result for shareholders as a consequence of employees' accepting the gifts. The concern, of course, is that Fidelity traders selected Jefferies for trading in exchange for the gifts rather than because the broker could provide the best services. The trustees' report concluded, however, that the behavior of the Fidelity traders was unacceptable, and that the penalty should be imposed.

"Fidelity agrees that their conduct was serious and has agreed to make a penalty payment appropriate for the level of the conduct," explains Anne Crowley, a spokeswoman with the firm. "This payment further demonstrates our commitment to shareholders."

The decision could go a long way in helping Fidelity minimize any damage to its reputation that could result from the gift-giving scandal, adds Niels Holch, executive director of the Coalition of Mutual Fund Investors.

Niels Holch
Executive Director
Coalition of Mutual Fund Investors

"For asset management firms, reputation is the most important thing to protect," he says. "I think they are smart to get ahead [of regulators]. Any investigation can take years and during that time your reputation declines."

For the most part, fund firms involved in regulatory investigations have avoided making payments to shareholders prior to reaching settlements with regulators, points out Tom Westle, a partner at Blank Rome. Firms may simply be concerned over how regulators will perceive their efforts to address issues prior to reaching a settlement.

"It may be construed as an admission of guilt and it may open them up to people second-guessing their calculations," Westle says.

In many cases, it's difficult to calculate damages that may have occurred, he explains.

Firms may also have been unable to take corrective action prior to reaching SEC settlements simply because regulators may have moved quickly in resolving investigations into inappropriate activities, adds Jeffrey Plotkin, a partner with Pitney Hardin.

Jeffrey Plotkin
Partner

"Firms may not have had enough time to do it," he says.

At the same time, firms that do take action to reimburse shareholders face a variety of benefits by doing so, Plotkin says.

Regulators have listed a variety of things that firms can do to minimize the extent of penalties included in settlements, he says. For example, regulators have said they will consider firms' cooperation with investigators and efforts taken to correct problems when drafting settlements.

"When you're an attorney representing a firm, you are going to go through the list and say, 'What can I do to score brownie points with the

SEC staff when I'm going into negotiations?'" he says.

He agrees that preemptively addressing regulatory issues prior to reaching a settlement has other advantages. "It's just good business and good public relations," he maintains.

Attorneys point out that Seligman has already embraced that approach. In the spring of 2004, Seligman disclosed that it would pay approximately $2 million into funds that had been subjected to market timers. The firm has yet to reach a settlement with regulators over the matter.

Crowley adds that agreeing to pay the penalty is only one of many steps that Fidelity has taken to address the gift giving issue.

For example, the firm has revamped the management of its trading desk and has revised its policies for receiving gifts. It has also either dismissed or reassigned employees who inappropriately accepted the gifts.

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