Treasury Gets Rich on Market-Timing Compensation

By Peter Ortiz, Ignites, January 17, 2014 [subscription required]

Money set aside to compensate harmed investors from the market-timing scandal in the early 2000s are in some cases being disbursed too soon to the U.S. Treasury without enough effort to find investors, critics charge.

Most of the terminated Fair Funds disbursed less than .05% to the Treasury, but $6.4 million of the $16 million **Gabelli** Fair Fund, or 39%, went to the Treasury. **Invesco** returned 1.45% of its $375 million Fair Fund to the Treasury and **Pilgrim Baxter** returned 1.49% of its $250 million Fair Fund to the agency.

Fair Funds were created in 2002 as part of the Sarbanes-Oxley Act and have paid out billions of dollars to investors for illegal conduct, including accounting fraud, pump-and-dump schemes and mutual fund market timing.

A total of $3.4 billion was collected in Fair Funds, excluding interest, from about 30 entities involved in market timing as of Dec. 30, according to an analysis by Niels Holch, executive director of the Coalition of Mutual Fund Investors.

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But the outstanding Fair Funds need to do better to ensure investors get back as much as possible before sending any residuals to the Treasury, Holch says. He cites Putnam, which returned only $1,380.84 of its $154 million Fair Fund to the Treasury, as a model.

Fair Fund distribution plans are tailored for each firm, but typically an independent distribution consultant devises a methodology and works with a fund administrator to pay monies to aggrieved investors. Distributions also are made to funds that were harmed by market timing, and as a last resort any residuals are sent to the Treasury.

Although Holch would like to see greater effort in getting undistributed assets to aggrieved investors, as a last resort it should “go back to aggrieved funds rather than the Treasury, where it does not benefit any investors,” he says.

Holch also would rather see the money go to existing funds or investors not harmed by the market-timing scandal before giving anything to the Treasury.

Gabelli paid $16 million to create its Fair Fund, which included disgorgement of $9.7 million, interest of $1.3 million and a civil money penalty of $5 million.

Just over $9.7 million was distributed to 33,292 Gabelli Global Growth fund investors, with the average investor receiving $284.86 and distributions ranging from $10 to $110,419.98, according last year's SEC order terminating the Fair Fund.

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Gabelli's Global Growth fund also received a distribution. But the SEC order deemed that more than $6.3 million and "any future funds returned to the Fair Fund shall be transferred to the U.S. Treasury."

While $5 million that went to the Treasury was classed as a fine, the full $16 million should have been distributed to harmed shareholders, Holch says.

"There was a lot of market timing going on in these funds, and they are only distributing money from people who were caught, so they should not assume investors are getting full restitution," he says.