IGNITES

All that's hot in the mutual fund industry

A Financial Times Service

Print | Close Window

Bulk of Timing Settlements Remain Undistributed

Article published on April 2, 2009
By Peter Ortiz

It has been years since fund companies settled with regulators over their role in the market-timing scandal, but 57% of funds collected have yet to be authorized for distribution.

That's according to the Coalition of Mutual Fund Investors, which tracks the data. Of the $3.4 billion the SEC collected in disgorgement and penalties from the timing scandal, only $1.47 billion, or 43%, has been authorized for distribution.

"The process is too bureaucratic in that enforcement lawyers at the SEC control the distribution process," says Niels Holch, president of the CMFI.

It's not just shareholder groups like Holch's that are questioning the pace of the disbursements. Securities and Exchange commissioner Luis Aguilar has criticized the overall distribution process and how it relies too much on investigators from the Division of Enforcement, who are stretched for time. He also noted that investors are waiting too long to receive payment.

Under Sarbanes-Oxley, the SEC was empowered to compensate shareholders from civil penalties it collects. The penalties that were paid as part of settlements from the marketing-timing scandal became part of the overall Fair Fund, which is used to hold the funds before they are paid out to shareholders.

Aguilar acknowledged that the SEC Division of Enforcement did form an Office of Collections and Distributions (OCD) in 2007 to deal with challenges stemming from administration and disbursement of the Fair Fund. Former SEC chairman Christopher Cox announced in 2007 that the office would centralize the Fair Fund program. The Government Accountability Office also recommended that the agency centralize the distribution process. But despite these efforts, problems persist as OCD is taking investigators away from other responsibilities, Aguilar said.

"This office... does not yet have the personnel and expertise to shoulder full responsibilities for distribution," Aguilar said in a speech before the District of Columbia Bar on March 18. "Building out this capability seems a logical move, and the quicker this is done, the better. Besides better utilizing internal expertise, this would also free up the investigative staff to do what they do best and investigate other potential cases."

While the actual distribution occurs after the SEC grants authorization, the CMFI says there is no way to know when investors will receive their money. Firms settled and made payments to the Fair Fund dating back to 2004 and the money sits in a Treasury account earning millions in interest until distributions are finally authorized, says Holch. For example, MFS settled market-timing charges and made a payment to the Fair Fund of $225.6 million in 2004. That balance has since grown to $312 million. (For a full list click here)

Despite the significant payouts that remain, industry sources credit the SEC for speeding up distributions in recent years. The 43% of timing penalties that have been authorized for distribution represents a vast improvement over the $450 million, or 13%, that had been authorized for distribution as of November 2007.

One of the strategic goals of the OCD is to take responsibility for more of the collection and distribution process, SEC spokesman John Nester writes in an e-mail response. The collections and distribution process takes investigators away from cases, but as the OCD office grows, investigators will be freed from that work, he writes.

"Depending on several factors, some of the work necessary for the implementation of a distribution is currently outsourced, generally through a bidding process, to independent consultants, fund administrators, tax administrators, receivers, etc," he writes. The office "expects that this will continue, with oversight by staff and/or the courts."

Paul Huey-Burns, a partner in Dechert's white-collar and securities litigation group, says the distribution process has improved because SEC staff have had time to overcome challenges and have developed a "road map" they can use for other cases. Some of those challenges included difficulty in finding investors, the complexity of individual cases and tax issues that have all hampered disbursements. But he says the key is to empower the OCD to act on its own.

"Yes, the process has gotten better, but at what cost?" Huey-Burns asks. "The same staff [enforcement] that should be doing investigations has to devote substantial energy to implementing and monitoring the distribution program."

Authorized Fair Fund Distributions

As of March 31, 2009

Company	Fair Fund Contribution	Authorized Distribution Amount
Alliance Capital Management	$321.5 million	$188.5 million
Banc of America Capital	$375 million	$182.2 million
Banc One Investment Advisors	$50 million	$55.7 million
Columbia	$140 million	$144.2 million
Franklin	$50 million	$54.9 million
International Equity Advisors and Richard Roger Lund	$3.2 million	$3.4 million
Janus	$100 million	$80 million
Massachusetts Financial Services	$225.6 million	$312 million
Pilgrim Baxter & Associates	$250 million	$267.7 million
Putnam Investment Management	$153.6 million	$114.4 million
RS Investment Management	$25 million	$27.1 million
Veras	$37.7 million	$38.8 million

Source: Coalition of Mutual Fund Investors