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Payback Time for Fund Investors

If you lost money because of the mutual fund rapid-trading scandal of the late 1990s and early 2000s, you may soon find a check in your mailbox. Investors are finally starting to receive compensation.

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Mutual fund investors who lost money because of the rapid-trading scandal of the late 1990s and early 2000s are finally starting to receive compensation. Shareholders will receive more than $3 billion that was collected from fund companies, execs and big investors who broke trading rules and, as a result, gained an edge over rank-and-file investors. All told, the money represents restitution and penalties from about 20 cases.

Millions of investors from dozens of different funds can expect payments. Some of the largest paybacks come from Invesco ($375 million), Janus ($225 million) and Bank of America ($675 million). The methodology used to determine individual payouts is highly complex, but most individual payouts won't exceed $500.

So far, only investors in the PBHG funds (a family that no longer exists) have seen any green. Shareholders who had money invested in certain PBHG funds between June 1998 and December 2001 will receive checks from a $267 million pot. That money includes $90 million collected from the company, and $80 million each from PBHG executives Gary Pilgrim and Harold Baxter. The rest -- $17 million -- represents interest earned as the money sat in the U.S. Treasury fund waiting for a distribution plan to be prepared and approved.

Because the trading scandal in many instances overlapped the 2000-02 bear market, some affected shareholders may expect the payouts to cover many of their market losses. That's a pipedream because the payouts are nowhere near that large. Consider, for example, that someone who had $10,000 in PBHG Emerging Growth at the market's peak in March 2000 saw the value of his or her investment shrivel to less than $1,700 by October 2002.

PBHG clients will receive payments of about $180, on average. This is according to Kenneth Lehn, a finance professor at the University of Pittsburgh who put together the payout plan for the Securities and Exchange Commission. Payouts will not be made if the amount is below $10, Lehn says. About $125 million of the kitty has been paid out already. Lehn adds that $75 million more will go out in June and that the rest will be paid out in July. "The game plan is to get all the money back to investors," he says. Money that can't be returned -- because of uncashed checks, for example -- will be added to funds in which rapid-trading occurred. But those additions will cause share prices of those funds to rise by only miniscule amounts.

The misdeeds stem from a practice that some have labeled market timing but which is more properly described as rapid trading. By trading in and out of funds quickly -- and illegally -- the traders exploited fund prices that didn't reflect the actual prices of the assets in those funds. Customers ended up paying for the illegal profits in the form of lower fund share prices.

Why has it taken so long to just begin restitution? Returning more than $3 billion to millions of shareholders isn't simple. First, regulators had to determine the amount of money that had been illegally skimmed and then had to make the culprits pay up. Then for each case an "independent distribution consultant," often a finance professor who has worked for the Securities and Exchange Commission, has to file a disbursement plan with the SEC. After a 30-day public comment period, the plan is approved and checks are cut and mailed. This can be done either by the mutual fund company itself or by an independent company hired for the job.

The real challenge is determining who is entitled to what. Investigators have to figure out which shareholders were in certain funds during which days, determine the amount of money skimmed from the funds during those days, then split the money among shareholders. If a shareholder owned funds directly with the fund company, identifying them is relatively easy. But it's not so simple for shareholders who owned affected funds through brokerage accounts, financial advisers and employer retirement plans. Now these intermediaries have to locate paperwork that's years old.

The SEC and state securities agencies have done a good job handling the rapid-trading cases and the payouts, says Niels Holch, executive director of the Coalition of Mutual Fund Investors, a consumer group that has been monitoring the cases. However, tracking these cases is difficult, says Holch.

The SEC has no central repository of trading-scandal data. Instead, investors must go through pages of cases written in legalese. The information in it is not official, but the Coalition of Mutual Fund Investors has a rundown of the cases on its Web site. If you want information specifically on the PBHG payout, you can go to www.pbafairfundsettlements.com.
