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Market-Timing Remediation Plan Faces Opposition

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At least two organizations are expressing serious concerns over the first proposed plan for distributing millions of dollars to shareholders from a market-timing settlement fund.

While their comments are directed at just a single distribution plan, they are significant because a large number of additional plans are expected to be released this summer and fall. Thus the latest round of comment letters could play a big role in influencing future distribution plans.

In June, a consultant for a firm previously known as **Pilgrim Baxter** rolled out a proposed plan for distributing \$250 million in market-timing penalties to long-term shareholders. Those shareholders are believed to have been harmed by abusive market-timing activities.

The proposed plan, however, won't adequately protect investors who purchased shares through omnibus recordkeeping systems, says Niels Holch, executive director of the Coalition for Mutual Fund Investors. The organization, along with the Spark Institute, also says intermediaries won't have enough time to identify which shareholders should receive a share of the settlement funds. Spark, which represents the interests of retirement plan service providers, also maintains that the program will place fiduciary responsibilities on retirement plan recordkeepers. That is a responsibility that recordkeepers strive to avoid.

The proposed plan doesn't go far enough to ensure that investors who purchased Pilgrim Baxter fund shares through omnibus accounts will receive their share of the settlement, explains Holch. With omnibus accounts, intermediaries such as brokers and retirement plan recordkeepers batch together individual trade orders. By doing so, the intermediaries only have to send a single trade order to a fund shop, rather than a large number of individual orders, he says. Since fund firms receive one big omnibus order from each intermediary, they have no way of identifying individual shareholders. Therefore, it's impossible to ensure that Pilgrim Baxter investors in omnibus accounts will receive their fair shake from the settlement funds, says Holch.

"It is CMFI's view that investors in these funds who chose to use third-party intermediaries are not adequately protected by these procedures involving omnibus accounts," Holch maintains.

As an alternative, the SEC should require all financial intermediaries to disclose the identity and transaction information at the investor level. That way, fund firms and regulators can ensure that all investors are receiving adequate distributions from the settlement fund, he maintains.

Yet, not everyone is convinced that investors in omnibus accounts won't get their fair share of the settlement. For brokers and retirement plan recordkeepers, failing to distribute the funds appropriately would be business suicide, says Bill Alsover. He is the chairman of Centennial Securities in Grand Rapids, Michigan.

"If you want to hang yourself, then go ahead, don't perform the distribution," he says. "If you don't do it, then regulators are going to say, 'We asked you to do it voluntarily, now we are going to force you to.'"

Along those lines, he believes that NASD staffers will scrutinize the processes when they conduct routine inspections of broker-dealers.

Holch, along with the Spark Institute, also maintains that giving intermediaries only 60 days to identify individual investors that held fund shares when the market timing occurred is inadequate. Intermediaries should instead be given six months to track down shareholders. Spark is proposing a slightly different alternative to the 60-day deadline, adds Larry Goldbrum, general counsel of the Spark Institute. The Spark Institute believes that intermediaries should be given 30 days to confirm receiving a request for the shareholder account information, he says. Along with confirming that they have received the request, the intermediaries should be required to identify which employees will be responsible for providing the information going forward.



Goldbrum points out that the Department of Labor has determined that retirement plan

recordkeepers involved with distributing payments to shareholders will be considered to be fiduciaries. As a fiduciary, they must follow a variety of rules intended to protect investors' interests. Recordkeepers don't have sufficient insurance to take on such roles or resources for making decisions as fiduciaries, he says.

The DOL has said that recordkeepers that handle the function under the direct supervision of plan administrators or plan sponsors will qualify for a "safe harbor." Safe harbors are procedures that individuals or firms can follow to minimize certain risks, such as those associated with being a fiduciary. Yet, it's highly unlikely that the long process of communicating back and forth with plan sponsors or administrators when making the distributions can be done within the proposed 60-day window, he says.

Goldbrum adds that identifying the shareholders won't always be an easy task. Many recordkeepers have been acquired or have merged with other recordkeepers. That will make it harder to cull data from prior years, he says. In some cases recordkeepers will have to gather data from as far back as 1998, he maintains.

Most recordkeepers, meanwhile, are also struggling to implement technology to comply with the Redemption Fee Rule, or 22c-2. The rule will require intermediaries to provide fund firms with information on individual investors' trading activities. That way, fund firms can ensure that procedures to wipe out market timing are being followed. The problem, however, is that recordkeepers need to develop technology to efficiently gather the data and transmit it to fund shops. Goldbrum believes that most technology departments at most recordkeepers are already stretched thin because of the rule. Expecting technology departments to also gather data needed for the distribution plan will only worsen that problem, he says.

Kenneth Lehn, a professor at the Katz Graduate School of Business, who penned the proposed plan, declined to comment on the matter until reviewing the Spark and coalition letters.

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