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ADAM SAVETT on the importance of best practice procedures in securities class action settlements

> **"In an era of negative returns for many portfolios, it is more important than ever that investors claim every dollar, euro or pound that they are entitled to"**

During the period from 2006 to 2008, more than $35bn in securities class actions and regulatory settlements were finalised. It is fairly well settled that an institution cannot abandon (without reason) a claim to recover funds in a securities class action settlement, though an institution could, consistent with its fiduciary obligation to maximise the value of its beneficiaries' assets, decide not to file a claim on the basis of comparing the costs to submit the claim with the expected award from the settlement. But, according to a series of academic studies conducted over the last decade, as well as anecdotal evidence from market participants, anywhere from 30% - 70% of investors that are eligible to participate in a given settlement fail to file a claim form and thus leave the money on the table.

The costs of not filing, or not filing properly, can be very high. In January 2005, more than 40 mutual fund managers were sued by shareholders in class action lawsuits alleging that the funds had failed to collect nearly $2bn in settlement payouts to which the funds (and the funds' shareholders) were entitled. The lawsuits alleged that the funds' failure to claim this money was a breach of the manager's fiduciary duty, and was in violation of the Investment Company Act of 1940. The lawsuits sought compensatory damages for all of the money that the funds left on the table, as well as punitive damages and the forfeiture of all commissions and fees paid by fund shareholders. In 2007, a publicly traded investment advisor took a $56m charge as a result of having to reimburse certain clients for mistakes they made in filing claims for those clients.

Moreover, unclaimed funds are typically distributed on a pro-rata basis to those investors who do file claims in a particular settlement, providing them with an additional measure of recovery that they otherwise would not have received. In this era of negative returns for many portfolios, it is more important than ever to ensure that an investor claims every dollar, euro or pound that they are entitled to.

But, even when a fund has a system in place for monitoring, filing, and tracking claims, issues arise. A claim can be missed on three different levels: A fund may fail to file a claim form for the entire case or settlement; the fund might file for less security types or series than the settlement encompasses; lastly, the fund might miss a portion of their eligible accounts.

Lack of information

A number of reasons are posited for the seeming lack of interest in recouping money lost due to fraud or other malfeasance, but virtually all of them point back to just two issues – lack of information (or access to information) or a misunderstanding of the process. Fragmentation of the claims administration industry largely explains the former, and inconsistent or incomplete policies or contracts between funds and their prime brokers or custodial banks explains the latter.

In order to ensure that a fund has information about all settlements where they have potential eligibility, a vast array of sources need to be examined on a regular basis. There are an average of 130 or more settlements in any particular year, and in any given year, 40 different settlement administrators may have one or more of those cases. Each of these administrators has different methods of identifying and notifying impacted investors. But for a fund that does not keep its holdings in its own name, the task of identifying that fund as a possible member of the class will often fall to the fund's prime broker or custodial bank, which would have knowledge about the transactions. The service-level agreement regarding class action notification varies widely from one prime broker or custodial bank to another. As these contracts come up for renewal, it is critical that a compliance-minded fund adviser ensures that the language in the contract is sufficient to identify what each party is responsible for in the claims-filing process, and if the advisor is going to take on any of the responsibility themselves, that they have the proper resources, staff, and training to reliably perform the function.

Given the complexity of the securities class action claims landscape, it is imperative that a fund either commit to building the internal systems and knowledge to properly oversee the process or outsource some or all of the process to a trusted third party that has the global reach and resources necessary to cover this increasingly global phenomenon. The billions of dollars at stake are too high a price to let them slip through a fund's fingers. ■

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