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Leaving Money on the Table: Do Institutional Investors Fail to File Claims in Securities Class Actions?

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**Leaving Money on the Table: Do Institutional Investors
Fail to File Claims in Securities Class Actions?**

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Cox and Thomas, Leaving Money on the Table: Do Institutional Investors Fail to File Claims in Securities Class Actions?

ABSTRACT

In this paper, we examine the role of institutional investors in securities fraud class actions. We begin by surveying the first five years of experience with the Lead Plaintiff provision of the Private Securities Litigation Reform Act (PSLRA). In particular, we look at those cases where the lead plaintiff position has been contested and the outcome of those disputes. We find that institutional investors have been very successful in obtaining the position of lead plaintiff where they have sought it, but that there are a number of cases where they were unsuccessful.

In part two of the paper, we dissect institutional investors' fiduciary obligations in petitioning to become lead plaintiffs and in filing claims in securities fraud settlements. For each major type of institution, we analyze their legal obligations under different legal standards in an effort to answer the question what obligation do they have to act in these areas. We conclude that institutional investors have a duty to file claims in settlements, except what we believe are rare instances where their cost-benefit calculations show filing to be unjustified. The case for becoming lead plaintiffs in securities fraud class actions is much more tenuous though, as the costs of such a course of action may be substantial and the benefits are less certain.

The remainder of the paper focuses on the question of filing claims in settled securities fraud cases. Beginning with a discussion of the process of notifying claimants, we move to an empirical analysis of whether institutions actually file claims in these cases. We use a sample of 53 settlements. Our tentative findings are that only 25-33% of institutions that we can identify as having claims to file in these settlements are actually filing claims. The last section of the paper offers several theories as to why institutions are not filing claims. Among the theories proposed, we focus on three as the most likely candidates: first, that the institutions are making cost-benefit analyses of whether to file such claims, and concluding that they are not worth filing; second, that there are no internal personnel at the institutions that are responsible for filing the claims, and thus they never get made; and third, that the institutions may not be receiving notice of the settlements and claims forms from the banks and brokers that hold their shares for them. Each of these theories may explain some portion of the institutions' failure to file claims in securities fraud cases.

Introduction

Commencing two decades ago, and continuing today, the institutional investor is the most significant focus in reform efforts for securities markets and the American corporation. Whether the question is the type of disclosures that must be made in connection with a public offering,¹ the scope of non public offerings,² or making the corporation more responsive to owners,³ the focus is on the significant trading and ownership interest of institutional investors. As is well understood, such emphasis on financial institutions in reforming corporate and securities laws is based upon their ownership of, and trading in, the stock of publicly held corporations. For example, financial institutions own nearly fifty percent of the equity securities listed on the New

¹ The SEC's integrated disclosure procedures and shelf registration process is heavily dependent upon the view that the securities of companies eligible to use the integrated disclosure system traded in an efficient market. *See* Adoption of Integrated Disclosure System, Securities Act Release No. 6383 (1982); Randall S. Thomas and James F. Cotter, Measuring Securities Market Efficiency in the Regulatory Setting, 63 Law & Cont. Problems 105, 109 (2000). That determination in part rests upon a belief that institutional investors are both significant traders and owners of such securities.

² Though Rule 144A is technically a resale exemption, not an issuer exemption, it was developed to facilitate capital raising by issuers by permitting securities to be effectively syndicated to financial institutions, qualified institutional buyers, who are generally defined as an entity having a securities portfolio of at least \$100 million. Institutional investors also are swept within the definition of an accredited investor to whom the issuer has no obligation to provide investment information as a condition of selling its securities. *See* Rules 502(a) and 506.

³ *See generally*, Bernard S. Black, Agents Watching Agents: The Promise of Institutional Voice, 39 U.C.L.A. L. Rev. 811 (1992); John C. Coffee, Jr., Liquidity Versus Control: The Institutional Investor As Corporate Monitor, 91 Colum. L. Rev. 1277 (1991). Cf., Edward Rock, The Logic and (Uncertain) Significance of Institutional Shareholder Activism, 79 Geo. L. J. 445 (1991).

York Stock Exchange and account for approximately seventy-five percent of the daily trading volume on the NYSE.⁴ The ownership and trading percentages are equally high for securities listed on Nasdaq.⁵

Though we also champion the vast potential that has been accorded institutional investors, we examine here one area where financial institutions are claimed to be guilty of passivity equal to that of the “small investors:” do financial institutions fail to submit claims for their losses in *settled* securities class actions? In other words, do institutions frequently leave money on the table that is theirs for the asking?

I. The Uneven Role of the Institutional Investor in Prosecuting Securities Class Actions

In their now classic article, Professors Elliott Weiss and John Beckerman marshalled data collected from 82 class action settlements to reveal that the 50 largest claimants in 82 class actions had an average allowed loss of \$597,000 and accounted for 57.5 percent of the total allowed loss.⁶ More significantly, the largest and the second largest claimants accounted for

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⁶ Elliott J. Weiss & John Beckerman, Let the Money Do the Monitoring: How Institutional Investors Can Reduce Agency Costs in Securities Class Actions, 104 Yale L.J. 2053, 2089 (1995).

13.1 and 6.7 percent, respectively, of the total recognized losses of a subset of 20 class actions within their overall sample.⁷ From this finding, Weiss and Beckerman argued that judges considering settlements in securities class actions should harness the economic self interest of such a larger claimant(s) by designating those with significant losses as the suit's lead plaintiffs.⁸ Doing so would address the broadly recognized concern that class actions are "lawyer driven," and that it is the economic interests of the classes' attorneys, not the classes' representatives, that decide such important issues as whether the claim should be prosecuted, settled or pursued to the next level.⁹ Though Weiss and Beckerman reasoned that courts had the inherent power to take such steps, Congress decided not to leave such matters to the individual judgment of the presiding judge. Thus, with the enactment of the Private Securities Litigation Reform Act of 1995,¹⁰ formal procedures for the appointment of a lead plaintiff were mandated for securities fraud class actions.

⁷ *Id.* at 2090.

⁸ *Id.* at

⁹ The literature on this point is vast. *See e.g.*,

¹⁰

Section 21D(a)(3) of the Securities Exchange Act¹¹ sets forth the procedures and criteria for the appointment of lead plaintiffs. Within 20 days of the filing of the complaint, notice must be published “in a widely circulated national business-oriented publication or wire service” inviting class members to apply to be the suit’s representative.¹² Not later than ninety days after the publication of such notice, the court must appoint a lead plaintiff from those who have applied.¹³ The most significant factor supporting a presumption of who is the “most adequate plaintiff” is the claimant that “has the largest financial interest” in the suit.¹⁴ The next provision underscores the strength of this presumption by providing that it can only be overcome by proof that the party having the largest financial interest will not adequately represent the class, or is subject to unique defenses.¹⁵

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¹² Section 21D(a)(3)(A)(i), U.S.C. . Additional notice can be required by the presiding court. *Id.* at (ii).

¹³ (B)(i)

¹⁴ The other two factors listed are that the designee was the party to the original complaint or petitioned to be the lead plaintiff and “otherwise satisfies the requirements for Rule 23 of the Federal Rules of Civil Procedure.” Section 21D(a)(3)(iii)(I). Since any plaintiff must meet the latter requirement and the court is unlikely to be disposed to seek out a representative who is not before it, the relative size of the claimant naturally becomes the determining factor of whether the presumption applies.

¹⁵ *Id.* at (II).

Thus far the debate surrounding the selection of a lead plaintiff has focused on the propriety of aggregating investor losses so as to enjoy the benefits of the before described presumption.¹⁶ This, of course, is not just a tussle among competing class members but has serious ramifications for the plaintiffs' securities bar. Under the PSLRA, the lead plaintiff, subject to the approval of the court, has the power to select and retain counsel.¹⁷ Any doubt about the stakes class counsel has regarding who is the lead plaintiff was resolved by *In re Microstrategy, Inc. Securities Litigation*,¹⁸ where initially Mr. Mazza was appointed lead plaintiff because he had the greatest loss among the five applicants. His selection of Pomerantz Haudek Grossman & Gross LLP as class counsel was approved. Later, he withdrew as lead plaintiff for personal reasons. Thereafter, following motions to be appointed as lead plaintiff to replace Mr. Mazza, the Minami family and Local 144 Nursing Home Pension Fund were appointed co-lead plaintiffs. The Minami family losses of \$900,000 were the greatest among among the other petitioners and Local 144 losses of \$600,000 were deemed to qualify it as co-

¹⁶ See e.g., Jill E. Fisch, Aggregation, Auctions, and Other Developments In The Selection Of Lead Counsel Under The PSLRA, 64 Law & Contemp. Prob. 53, 65-78 (aggregation weakens the relationship between lead plaintiff and class counsel); R. Chris Heck, Comment, Conflict and Aggregation: Appointing Institutional Investors as Sole Lead Plaintiffs Under the PSLRA, 66 U. Chi. L. Rev. 1199 (1999)(courts must restrain aggregation to avoid lawyers assembling groups in ways that restore control over the litigation to themselves).

¹⁷ Section 21D(a)(3)(v), U.S.C.

¹⁸ Fed. Sec. L. Rep (CCH) ¶ 91,632 (E.D. Va. 2001).

lead plaintiff.¹⁹ They each had their own choice of counsel, Wolf Haldenstein Adler Freeman Herz LLP by the Minamis, and Milberg Weiss Bershad Hynes & Lerach LLP for Local 144. Both requests were approved by the court, with the effect that the Pomerantz firm ceased to be engaged in the suit,²⁰ and could only watch from the sidelines as the parties entered into a subsequent settlement ultimately resulting in the new class counsel being awarded \$27.6 million.²¹ Thus, who is the lead plaintiff matters, and matters a lot, to the attorneys who seek to represent the class.

Because class counsel appointments depend upon who is selected as the lead plaintiff,²² the lead plaintiff provision effectively stimulates a tournament among competing counsel to identify themselves with investors whose losses are so significant that they may qualify them as the most adequate plaintiff. As such, the lead plaintiff provision has not eliminated the strong

¹⁹ *Id.* at 97,736 n. 10.

²⁰ *Id.*

²¹ *Id.* at 97,740 n. 37.

²² And, with the decision in *In re Cendant Corporation Securities Litigation*, 264 F.3d 201 (3d Cir. 2001), the lead plaintiff is all the more important in identifying who will be class' council. *Cendant* held that in most instances where the court has appointed a lead plaintiff it would be inappropriate for the trial court to select council through a competitive bidding process. Prior to *Cendant*, many courts severed the process of appointing lead plaintiff from the selection of counsel and discharged the latter responsibility by inviting interested firms to engage in competitive bidding. *See generally* Fisch, note ___, *supra* at 78-95.

interest of class counsel in the initiation of securities class actions, so that they remain lawyer driven notwithstanding the PSLRA.²³

Table 1 presents the results of our search of the Westlaw AllFed library data base for opinions bearing on the courts' appointment of a lead plaintiff. Between January 1, 1996 and December 15, 2001, we found 36 reported opinions dealing with the presiding court's selection of a lead plaintiff.

TABLE 1	
SUMMARY OF FIVE-YEARS HISTORY OF SELECTING LEAD PLAINTIFF	
Cases without an Institutional Petitioner	11
Cases with Competing Institutional Petitioners	12
Cases with Single Institutional Petitioner and	
Institutional Petitioner Selected	8
Individual/Group Selected Over Institution	5

²³ See e.g., *In re Raxorfish, Inc. Securities Litigation*, 143 F. Supp. 2d 304 (S.D.N.Y. 2001)(describing the contest among law firms competing to be counsel for a securities class action by each law firm advancing their respective candidate to be the lead plaintiff, concluding “the instant case illustrates . . . securities class litigation continues to be lawyer-driven in material respects and the reforms Congress contemplated in the Reform Act can be achieved, if at all, only with some help from the courts.”).

The above data seems to show that when there is a contest between a financial institution and an individual, or group of individuals, vying to be the lead plaintiff, the institution generally is determined to be the most adequate plaintiff. In 20 out of 25 cases where institutions applied to be lead plaintiffs, they were selected. However, our curiosity is piqued by the absence of a petitioning institutional investor in one third of our sample. We also wonder what happened in the five instances in which the court selected a group of individuals over the petitioning institution.

Our intuition is that, on average, financial institutions are more likely to trade significantly larger blocks of shares than individuals over time. We further speculate that institutional trading overall is more likely to represent a significant percentage of the trading in a company's shares during the class action interval in a securities fraud settlement. If this so, why then do we see that in a significant portion of the reported decisions appointing a lead plaintiff there is not *any* financial institution seeking to represent the class? And, in the few instances where a group of individuals was preferred over a petitioning financial institution, why were they preferred? Why weren't there other financial institutions who sought to be appointed with larger losses, larger than both those of the institution that did petition, and also those of the group of individuals ultimately appointed lead counsel?

Another question to consider is whether some institutions traded more shares than were traded by the investor(s) who ultimately were selected as lead plaintiff.²⁴ Even though data sets

²⁴ A further possible refinement here would be to determine, pursuant to the award formula approved by the court, the losses on the shares traded by each comparative investor.

are never perfect,²⁵ our review leads us to the following conclusions. [This analysis is underway and thus we cannot at this time shed light on whether there was in the above 5 cases a suitable institutional investor to be appointed as lead plaintiff, and, more generally, whether there were other institutions who could have petitioned to be a lead plaintiff in the 8 cases in which there was but a single one petitioning.]

In section 4, we further address these concerns indirectly, by examining another phenomenon: whether institutions not only fail to step up to be a lead plaintiff, but whether they fail to submit claims to the settlement administrator who is dispensing funds from settled securities class actions. However, we first need to make clear the institutional investors' obligations, or lack thereof, to file suit or make claims in these cases.

This calculation would be necessary for cases where prior to the settlement there is reason to believe that shares traded during one segment of the class action interval would be entitled to greater damages per share than those traded in another segment. This refinement may well be seen of doubtful validity because of the great difficulty of any investor determining so early in the suit, within 20 days of the filing of the complaint whether there will be such a stratified recovery. And, even if such foresight was possible, whether its likelihood and magnitude would be so discounted so as not to change the perceived benefits of serving as the lead plaintiff.

²⁵ Evidence of trading by institutions is collected quarterly by the Securities and Exchange Commission pursuant to Form 13F filings that are mandated to be made by institutional investment managers with at least a \$100 million portfolio of equity security registered under Section 12 of the Exchange Act. For many institutions, it is possible to determine their trading in a particular company's security by comparing inter-quarterly changes in the institution's holdings of that security. However, a significant number of all Form 13F filings are made in the name of the manager or managers of a financial institution so that it is not possible to use Form 13F filings to determine completely the level of institutional holdings of an issuer. A review of the form filed by, for example, Go Go Advisors, does not always tell us whether it is trading for itself, a wealthy heiress, or State Pension Fund.

II. The Institutional Investor as a Fiduciary

What are the legal compulsions for the institutional investor to petition to be a lead plaintiff? To file a claim in a settled case? Should the institutional investor on both counts just stay in bed? When the institutional investor, such as an investment bank, acts for its own account, it has no obligation except the general social obligation to take care of itself without being an burden to others. Thus, it might refuse to harness its self-interest to the prosecution of the securities class action. And, should it choose not to file a claim when the case is settled, its slovenly action is celebrated by other class members because there is more money to distribute to them. But, typically institutional investors are acting as representatives for others. As such, they are easily classified as fiduciaries. The source of this obligation varies from institution to institution, but as will be seen, their obligation to file claims in settled securities class actions appears not to vary. This fiduciary commands fall on the fund's managers though, and not on the institution itself.²⁶

A. Private Pension Funds.

Since 1974, the fount of private pension funds managers' fiduciary obligations has been the Employee Retirement Income Security Act (ERISA) which, among other features, sets forth

²⁶ See Weiss & Beckerman, *supra* note __, at 2112 (“It is the managers of the institutional investors, not the institutions themselves, that are fiduciaries.”).

these fiduciary obligations.²⁷ The fiduciary obligation provisions of ERISA are a central aspect of its protections of employee benefit rights.²⁸ The exact boundaries of ERISA's fiduciary requirements are decided within its broad command in Section 404 that imposes on its managers a duty to use the degree of skill, care and prudence of the reasonable person "in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims."^{1/2} Though this standard has a similar ring to that found in everyday tort law decisions, it is generally understood that ERISA is even more exacting in its demands than what prevails at common law.³⁰ ERISA also imposes an affirmative obligation of loyalty on fund managers by its requirement that these plan fiduciaries must discharge their duties solely in the interests of the fund's participants and beneficiaries.³¹

²⁷ See 29 U.S.C. §§ 1001-1144 (2001).

²⁸ See generally Deborah A. Geier, ERISA: Punitive Damages for Breach of Fiduciary Duty, 35 Case W. Res. 743, 746 (1985). The act's duties extend not only to one who exercises control over the fund but also to those who render advice. *Id.* 747-48.

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³⁰ See e.g., Susan J. Stabile, 15 Yale J.Reg. 61, 71 (1998).

³¹ Cite to 404 ?. The force of each of these duties is underscored by ERISA's provision that damages or equitable relief can be sought against any fiduciary who breaches his or her duties under the act. See Section 409(a), 29 U.S.C. § 1109(a) (2001).

The fiduciary duty embodied in ERISA can be traced to the common law of trusts and therefore embodies the obligation to preserve and maintain fund assets.³² It is on this foundation that Professor Weiss and Beckerman extrapolate an obligation for fund managers to consider initiating suit where necessary to protect, maintain, or reclaim fund property that is the subject of their trust.³³ Pursuit, however, is not mandated if the manager's decision not to act is reasonably based. Thus, in *McMahon v. McDowell*, the court held an ERISA fiduciary did not breach its duty to the fund by failing to take steps to enforce a claim, and could even abandon the claim, if the fiduciary reasonably believes that action would be futile.³⁴

This holding has significant implications for our interpretation of PSLRA's provisions. Because the PSLRA bars discovery prior to the court addressing the defendants' motion to dismiss, the information bearing on the suit's merits that is available even to the most sophisticated investor is extremely limited.³⁵ Hence, to the extent there are non-trivial costs to an institution from petitioning to become a lead plaintiff, not to mention the uncertainty of

³² See e.g., *Central States Southeast & Southwest Areas Pension Fund v. Central Transport, Inc.*, 472 U.S. 559 (1985).

³³ See Weiss & Beckerman *supra* note ___, at 2116.

³⁴ 794 F.2d 100, 110 (3d Cir. 1986).

³⁵ Randall S. Thomas and Kenneth J. Martin, *Using State Inspection Statutes for Discovery in Federal Securities Fraud Action*, 77 B.U.L. Rev. 69, 71 (1997).

whether the institution will be selected, these costs may weigh more heavily than the expected benefits to the institution from the suit, not to mention its participation in the suit. Thus, though the private pension fund's managers may theoretically face liability for imprudently assessing whether to serve as a lead plaintiff for a securities class action claim, there would be many potential justifications for it to assume a posture of rational apathy. However, with respect to failing to submit a claim to an administrator in a settled action for proven losses, we think there would be far fewer instances in which apathy would be a reasonable response to its fiduciary obligations.³⁶

B. Public Pension Funds.

Though non-federal public pension funds are specifically exempted from ERISA,³⁷ the fiduciary obligations that apply to public pension fund managers are no less demanding than the ERISA standards for our purposes. State pension funds are governed by the general state laws pertaining to trusts and investment, plus there are special pension fund legislative requirements at

³⁶ See Weiss & Beckerman, *supra* note __, at 2117. To be sure, if the expected payment from the fund was dwarfed by the cost to prepare and submit the claim, the fiduciary, consistent with its fiduciary obligations, could choose not to submit the claim. Beyond this limited instance, it would be difficult to envision bases that would be consistent with the fiduciary being rationally apathetic.

³⁷ See 29 U.S.C. §1003(b)(1) (2001).

the state, county and even municipal level.³⁸ For example, California sets forth fiduciary obligations for its retirement pension fund in its Constitution, embracing a standard very similar to that found in ERISA.³⁹ By contrast, New York does not have either a constitutional or statutory standard, but because such managers are deemed trustees, they are subject to the common law fiduciary standard that applies to trustees generally.⁴⁰ Furthermore, a detailed list of similar fiduciary principles is set forth in The Uniform Management of Public Employee Retirement Systems Act that has now been adopted in sixteen states.⁴¹ Because of the great

³⁸ See generally Betty Linn Krikorian, *Fiduciary Standards in Pension and Trust Fund Management* (1989).

³⁹ See Cal. Const., Art. XVI § 17(c)(2001)(“discharge duties . . . with care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with these matters would use in the conduct of an enterprise of a like character and with like aims”).

⁴⁰ See Krikorian, *supra* note ___, at 346. See also N.Y. Retire. and Soc. Sec. Law §§ 176 - 179- a (McKinney 2001).

⁴¹ A Trustee or other fiduciary shall discharge duties with respect to a retirement system:

- (1) Solely in the interest of the participants and beneficiaries;
- (2) For the exclusive purpose of providing benefits to participants and beneficiaries and paying reasonable expenses of administering the system;
- (3) With the care, skill, and caution under the circumstances then prevailing which a prudent person acting in a like capacity and familiar with those matters would use in the conduct of an activity of like character and purpose;
- (4) Impartially, taking into account any differing interests of participants and beneficiaries;

similarity in the functions performed by public pension fund managers and private pension fund managers, and the nearly identical scope of their fiduciary obligations, there is every reason to expect that the obligations of public pension fund managers with respect to pursuing a securities claim will be the same as that for private pension fund managers.⁴²

C. Mutual Fund Managers.

The Investment Company Act of 1940⁴³ sought to protect investors in registered mutual funds by, among other steps, imposing on the fund advisors and their directors certain fiduciary obligations, as well as creating a wide range of prophylactic requirements. In addition to the fiduciary obligations imposed by the Investment Company Act, advisors are subject to the

(5) Incurring only costs that are appropriate and reasonable; and

(6) In accordance with a good-faith interpretation of the law governing the retirement program and system.

The Uniform Management of Public Employee Retirement Systems Act § 7 (1997) available at http://www.law.upenn.edu/bll/ulc/ulc_frame.htm (visited Feb. 9, 2002). Section 11 of the Act imposes personal liability upon fiduciaries who breach an obligation under the Act.

⁴² See The Uniform Act's obligations are derived from ERISA and the law of trusts. See Steven L. Wilborn, Public Pensions and the Uniform Management of Public Employee Retirement Systems Act, 51 Rutgers L. Rev. 141, 145 (1998).

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demands of the Investment Advisers Act of 1940.⁴⁴ Furthermore, the Investment Company Act does not preempt fiduciary state law fiduciary standards that apply generally to officers and directors of mutual fund companies,⁴⁵ so that the directors and managers of mutual funds have the same fiduciary obligations to their shareholders as do directors and managers of other corporations.⁴⁶ Of special interest here, is that the fund's advisor, a vendor of services to the mutual fund company, is seen as having a fiduciary obligation to the fund and the fund shareholders.⁴⁷ In this respect, mutual funds are quite different from, say General Motors, whose various suppliers of services and goods are not deemed to have a fiduciary relationship to the GM stockholders.

So understood, the mutual fund's directors, officers and advisor, are all subject to a fiduciary duty to not act negligently, although negligence in this context involves some element

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⁴⁵ See *Green v. Fund Management LP*, (3d Cir. 2001)(Congress did not intend by enacting Section 36(b) of the Investment Company Act authorizing suits for excessive management fees to preempt state law fiduciary principles that apply to the directors' decision to award excessive compensation).

⁴⁶ See generally *Mutual Fund Regulation in the Next Millennium Symposium* Panels: I. Fund Governance, 44 N.Y.L. Sch. L. Rev. 431 (2001).

⁴⁷ See Tamar Frankel, 2 *The Regulation of Money Managers: The Investment Company Act and the Investment Advisers Act 343* (2000)(advisor has a fiduciary relationship that calls for it to act primarily for the benefit of the other in matters connected to its undertaking). The advisor's duties are determined in this regard by reference to the principles of common law regarding agents and, because they are close analogous to brokers, they are subject to more demanding standards than agents. *Id.* at 372.

of intent so that the standard is more akin to that of recklessness.⁴⁸ Nevertheless, the objective standard applied remains that of the level of skill and prudence that the reasonable person would exercise in a similar undertaking for a similar institution.⁴⁹

D. Insurance Company Managers.

Insurance companies are exempt from the Investment Company Act⁵⁰ and are instead regulated by state insurance codes and commissioners.⁵¹ Most states do not impose a fiduciary obligation on insurance companies to their policyholders; fiduciary duties do exist on the part of directors and officers to shareholders for non-mutual insurance companies.⁵² This said some

⁴⁸ *Id.* at 645-46.

⁴⁹ *Id.* at 657-58.

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⁵¹ This arrangement reflects the impact of the McCarran-Ferguson Act, which exempts insurance companies from most federal regulatory provisions, except the antitrust laws.

⁵² *See* Theodore Allegaert, *Derivative Actions by Policyholders on Behalf of Mutual Insurance Companies*, 63 U.Chi. L. Rev. 1063, 1071 (1996):

The relationship between mutual insurance policyholders and their company derives historically from statutes under which mutual companies are chartered and from the contractual terms of issued policies. Incident to membership in a mutual company, the policyholder acquires certain proprietary interests, yet these

courts nevertheless have recognized that some functions are trustee-like and have imposed fiduciary obligations on the insurance company's management when performing such tasks collecting premiums and managing company funds.⁵³ Under this view, imprudence in pursuing assets that belong to the insurance company would constitute a breach of fiduciary duties if company reserves are reduced because of the failure.

When the insurance company has stockholders, the fiduciary demands on its directors and officers should be the same as with any corporation. Subsumed within the corporate directors' and officers' fiduciary obligations is the duty to be attentive to acts or practices that will harm the corporation.⁵⁴ To this end, there is a well-recognized obligation for boards of directors to assure compliance systems and standard operating procedures that are reasonable given the nature of the firm's activities.⁵⁵ This obligation is heightened by the general awareness

interests are not fiduciary and certainly are not akin to partnership. In addition, membership places the policyholders in a creditor-like contractual relationship with the company.

⁵³ See generally *Id.* at 1072.

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⁵⁵ See, e.g., *In re Caremark*, 698 A. 2d 959 (Del. Ch. 1996)

that class action settlements frequently yield large awards to financial institutions,⁵⁶ such as those described by Weiss and Beckerman. Thus, it is not a big step to conclude that just as the mutual funds (and insurance companies) must assure the safety of the securities that are within the firm's portfolio, they should assure that appropriate procedures are in place to claim material amounts that may be due the mutual fund (or insurance company) in a class action settlement. What is material is a relative inquiry. In the context of filing a claim with a claims administrator for a settled class action, it would seem that materiality is best assessed in terms of the relationship between the cost of submitting the claim and the expected payment from the settlement. The costs of filing such claims appear at first blush to be trivial, and therefore we would expect most funds that traded during the class period to seek a recovery.

On the other hand, there are many more persuasive reasons that can support the directors' or officers' decision not to become a lead plaintiff. There is a question of resources required to see that task through to the end. Those without experience in such matters may easily overestimate the burdens of being a lead plaintiff, or they may correctly estimate that given the firm's limited resources that, on average, the expected benefits of such intervention on its part are insufficient reward for the effort entailed. Also, there are distinct advantages to free riding on the efforts of others. If there is no reason to believe that the firm's position will be improved by

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it, rather than allowing another to be the lead plaintiff, rational apathy is both efficient and understandable.⁵⁷

E. Bank Common Trust Funds.

Common trust funds operated by banks are exempt from the Investment Company Act of 1940,⁵⁸ but their managers are subject to the common law fiduciary duties of trustees. Though the specifics of a trustee's fiduciary duty varies from state to state, the American Law Institute's Restatement 3d for Trusts captures the position adhered to by most of the states. The Commentary in the Restatement Third of Trusts states:

A fiduciary has a duty to take reasonable steps to realize on claims that are the property of the trust . . . but should do so only when she believes that the probable benefit to the trust will exceed the costs the trust reasonably expects to incur. On the other hand, a fiduciary cannot properly abandon claims affecting the trust property unless it reasonably

⁵⁷ A less acceptable reason is suggested by O'Barr and Conley, *Fortune or Folly*. Their study of the culture of selected financial institutions found that, with the exception of public pension funds, managers were sensitive to the fact that their employer was or could be a vendor of products that the class action defendant consumes. Hence, a visible participation in the suit would seriously jeopardize the company's, bank's, or insurer's long-term interests.

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appears that a suit would be futile or the expense of litigation or the character of the claim would make it reasonable not to bring.⁵⁹

In short, the obligations of the bank trustee are no different from those we have seen apply to other fiduciaries.

F. Synthesis: Institutions Are Normally Obligated To File Claims in Securities Settlements,
But May Rationally Choose Not to Be Lead Plaintiffs

Felix Frankfurter's famous observation⁶⁰ regarding fiduciaries underscores the opacity that surrounds the meaning and, more particularly the demands, of being a fiduciary. Whatever the vagueness of fiduciary obligations in other contexts, in the context of the institutional investor's obligations to its investors, beneficiaries, policyholders, etc., there is amazing

⁵⁹ Restatement 3d Trusts § 192, Comment a (2000).

⁶⁰ *See* SEC v. Chenery Corp., 318 U.S. 80 (1943).

uniformity. Though each such institution cannot abandon without reason a claim against a third party, financial institutions are not under an affirmative obligation to pursue inchoate claims. The speculative nature of the claim, coupled with the uncertainty that the institution's serving as a lead plaintiff will make a difference, makes apathy the reasonable and rational course much of the time.

But when the claim is no longer inchoate, so that money is to be received by submitting proof of the institution's trading during the fraud interval, the justifiable bounds of rational apathy are seriously constricted. The benefits of filing and perfecting these claims are much more concrete, especially when the fund managers are gauging their performance in comparison to market benchmarks. What is then a reasonable course of action should be guided again by comparing the costs to submit the claim with the expected award from the settlement, but we expect this to be a one-sided calculation in favor of filing for any actively trading institution.

In the next section, we review the procedural aspects of perfecting claims in securities fraud settlements.

III. Putting the Odor of Money in the Air: The Procedural Aspects Of Notifying Claimants

Settlements of securities class actions require the approval of the court. The truly final disposition of the case occurs when the claims administrator, who was earlier appointed by the court, submits its report of how the settlement was distributed. The claims administrator earns its fees not by simply writing checks, but also by its extensive efforts to assure that all reasonable

efforts have been taken to give potential claimants notice of the settlement and how investors can submit their claims so as to be eligible to participate in a settlement.

The first step of this process is ...[there will follow a synthesis of the approach followed by the three major claims administrators].

The reader should be impressed with the steps taken by the claims administrators to assure that those investors with claims learn of them and submit proof of their claim to the administrator. Assurance that their steps are reasonable occurs at several levels. First, all aspects of the settlement are subject to the court's watchful eye. Though some judicial eyes are sharper than others, the claims administrators have learned to apply the highest standards consistently across all settlements. Courts customarily ask the administrator to set forth in writing all of the steps they have taken to assure that potential claimants are duly informed. Second, the steps followed by claims administrators are much more demanding than those required by the Securities and Exchange Commission in an analogous area, the distribution of proxy materials, annual reports and other company notices to investors.

The SEC has long toiled in meeting the challenge of assuring that company communications, and particularly proxy statements, could reach the company's beneficial owners.⁶¹ With 70 and 80 percent of all outstanding shares held in street name,⁶² the SEC's task

⁶¹ For a complete analysis of the history and the details of the SEC's regulation in this area, *see* Randall S. Thomas & Catherine T. Dixon, *Aranow & Einhorn On Proxy Contests For Corporate Control*, ch. 8 (3d ed. 1999).

⁶² *See e.g.*, Exchange Act Release No. 38406 (March 17, 1997). Legal title customarily recorded in the name of CEDE & Co., the nominee of Depository Trust Company, an entity that owes much of its existence to the efficiency of not depending upon individual

is a formidable one. To assure that corporate releases reach those who have an economic stake in the company, the SEC rules impose a series of responsibilities upon banks and brokers who hold shares as nominees for the beneficial owners.⁶³ The baseline requirement is that companies registered under either the Securities Exchange Act, or the Investment Company Act of 1940, must, at least 20 days before the record date for a meeting, employ a search card procedure whereby they ask the nominee (broker, bank or other party) to tell them the number of copies of the company proxy materials they need in order to send them to all of the beneficial owners the nominee represents.⁶⁴ Nominees are also required to identify the number of shares owned by each beneficial owner.

Direct mailings of routine annual reports by the company to many beneficial owners are also possible if the company has compiled NOBO/COBO lists of non-objecting beneficial

owners to physically delivery share certificates to an intermediary each time the securities are sold.

⁶³ As originally enacted, Section 14(b) of the Exchange Act conferred upon the SEC very general rule making authority with respect to the obligations of broker-dealers with respect to proxy solicitations of their customers' shares in companies listed on a national securities exchange. A 1964 amendment not only expanded the scope of the SEC's authority to over-the-counter securities but clarified that its authority included "requiring . . . broker-dealers to transmit proxy solicitation materials to their customers. . . ." See Pub. L. No. 88-467, 78 Stat. 565, 88th Cong., 2d Sess. (1964). The final expansion occurred in 1985 when its authority was extended to banks. Pub. L. No. 99-222, 99 Stat.1737 (1985).

⁶⁴ Exchange Act Rule 14a-13(a). Banks frequently are themselves but nominees of other banks who are nominees of another bank or the beneficial owner. This results in a "piggyback" system whereby each bank nominee has one-day to respond by identifying their respondent bank. *Id.*

owners. Rules 14b-1 and 14b-2 of the 1934 Exchange Act govern this process and the obligations of brokers and banks to participate in it.

Thereafter, the issuer may forward to mail its materials directly to any non-objecting stockholders and provide the nominee with a sufficient number of the materials to be forwarded to the objecting owners, or alternatively, provide the nominee with enough sets of the materials for all the owners it represents, whether they are objecting or non-objecting holders.⁶⁵ As part of this process, the SEC has imposed an affirmative obligation upon the brokers and banks that serve as nominees to forward to these beneficial owners the proxy statements and other information given to them by the issuer, and to respond to requests by the issuer to provide a list of the non-objecting beneficial owners.⁶⁶

[Here we will compare and contrast the difference between the procedures followed by claims administrators with the present Section 14(b) procedures regarding shareholder directed communications.]

IV. Do Institutions File Claims in Securities Fraud Settlements?

⁶⁵ Exchange Act Rule 14a-13(b).

⁶⁶ Exchange Act Rule 14b-1 (broker-dealers) and Rule 14b-2 (banks).

In recent months, there have been allegations raised in the popular press and elsewhere that institutional shareholders are giving up “hundreds of millions of dollars in class-action settlements for which they are eligible simply by neglecting to file claims.”⁶⁷ These claims, however, are based largely on “informal and anecdotal evidence,” although there has been at least one attempt by the National Association of State Auditors, Comptrollers and Treasurers to collect survey data from a broad sample of institutions.⁶⁸ This survey showed that about one third of the 33 respondent institutions had made no recovery of any asset losses in the prior five years, a time period in which more than 700 securities class action cases were settled.⁶⁹ Given the enormous share of the stock market that is held by institutional shareholders (25% for public pension funds and another 35% by corporate funds), and the tremendous amount of money available in these settlements (estimated at \$8.39 billion over the past three years), a logical inference from these responses is that it is “highly unlikely *any* significant public fund invested in the market could possibly have been ineligible to participate in class action recoveries through this 5-year span.”⁷⁰ In other words, it appears based on the limited evidence compiled to date,

⁶⁷ See, e.g., Christiane Bird, Pension Funds Miss Out on Much Cash by Failing to File in Class-Action Cases, Wall St. J., Sept. 4., 2001, at A10.

⁶⁸Id.

⁶⁹Alan P. Cleveland, Class Action Claim Management: A Fiduciary Mandate, mimeo (2001).

⁷⁰Id.

that some institutional investors are not filing claims in securities fraud class action settlements, and are therefore leaving potentially large sums of money on the table.

In this section, we explain our efforts to develop a data set that can be used to test these claims. First, we explain in part A how we collected our data and some of the strengths and limitations of the sources that we have used. In part B, we give some very preliminary results based on the small number of settlements that we have been able to obtain sufficient information about to date.

A. The Data

In order to get a better sense of how many institutions are both eligible to make claims in these settlements, and who actually do perfect such claims, we needed to first generate a sample of securities fraud settlements. We enlisted the aid of three claims administrators to help us identify a group of securities fraud class action settlements and asked them to send us the settlement notices from these cases. We used these notices to gather a wide variety of information about these cases, including the identity of the lead plaintiff for post-PSLRA cases, and the class period for each case.

We then set about generating two additional types of data. First, for each settlement for which we received a settlement notice, we considered the company settling the case as a potential member of our sample. For each sample company, we needed to determine which institutions held stock in the company at the beginning of the class period, and which institutions traded in the company's stock over the fraud interval. To do this, we used data taken from Schedule 13Fs' filed by institutional investors. In particular, we used the Spectrum 3 database,

which lists each company for which institutional investors have reported stock ownership, the names of those institutional investors that report holding the company's stock, the size of the institutions' share holdings in each quarter, and the changes in these institutions share holding on a quarterly basis during the class interval. For those sample companies that were listed in Spectrum 3, we pulled out this information and used it to create a spreadsheet that reflected all of the institutions reporting trades, and the size of their trades, in the sample company during the class period.⁷¹

The reporting institutions for Schedule 13F include a very broad group of diffuse organizations. The list not only includes the types of financial institutions whose general fiduciary obligations were earlier examined in Part II - private and public pension funds, mutual funds, insurance companies, and bank common funds - but also hedge funds, foundations, endowments, and even partnerships. This means that our sample will include a wide range of different types of institutional investors, allowing us to determine if different groups of these investors vary in how frequently they file claims in these cases.

We realize that our reliance on data reported in the Schedule 13F's as our source of information about institutional shareholders' stock ownership and trading is subject to several criticisms, including that institutions often delay reporting changes in their holdings on a timely basis, and that they may not report all changes in their stock holdings. Equally limiting is that the Form 13F is frequently filed by an advisor to the financial institution under the advisor's

⁷¹Some companies were not listed in Spectrum 3, and are therefore not included in our sample. [insert general description of those omitted].

name and not under the name of the institution.⁷² These problems may in part be a result of the SEC's failure to review these filings and the lack of financial or other penalties for late or inaccurate institutional filings.

However, in the end, this is the only publicly available data source on institutional shareholder stock ownership in individual companies. The only alternative way of generating the data that we need on holdings and changes in holdings is to ask those institutions that held shares in the sample companies to provide us with this information directly, if they still have it. While we may choose to pursue this avenue farther down the road, at the moment we must be content with using the Spectrum 3 data to determine whether institutional investors have potential claims that they should file in these settlements.

After we generated a list of the institutional investors that held stock in the sample companies, and who traded in the stock during the class interval, we needed to check to see if these institutions filed claims in the securities class action settlements. We asked the three settlement claims administrators that had provided us with the notices of settlements if they would be willing to help us determine if the institutions that we had identified as potential claimants actually filed claims in the settlements that they administered. We provided them with our spreadsheets listing the institutions that we had identified as trading stock in the sample companies during the class period, and asked them to compare our list with the list of claimants in their databases so that we could determine how well the two data sets matched one another.

⁷² Moreover, advisors can, and frequently do, serve more than one institution and as a matter of expediency aggregate their holdings for all its advisees when reporting on Form 13F.

One problem with this methodology is that some institutional investors use third party advisors as money managers to manage some or all of their portfolio. In these circumstances, the third party advisors will often be responsible for filing claims in securities fraud settlements. If the third party advisor files the claim in its own name, and not in the institutional investors' name, then we also need to determine the name of the beneficial owner of the securities so that we can get the information that we need. For that reason, we asked the three claims administrators to search their data bases not only for those claims filed by institutional investors in their own names, but also for third party advisor claims that identified the institutional investors as the beneficial owners. We were informed that they would provide us with lists designating such beneficial owners.

One of the settlement administrators, who we will call Admin One, made the comparisons that we asked for and sent us a spreadsheet listing all of the institutional shareholders that we had identified, whether they had made a claim or not, the size of the claim that they made if any, and the amount of their recovery, for a group of 41 sample companies. Admin One advised us that they believed that they were able to accurately determine roughly 85-90% of the time whether the institutions that we had identified as potential claimants had made claims or not. They told us that for the remaining 10-15% of the institutions we identified, while they had no record of them as having either having filed a claim, or being the beneficial holder of securities on a claim filed by a third party adviser, they believed, based on their prior experience in administering settlements, that the third party advisors probably omitted to provide complete information about the beneficial ownership of the shares for some subset of the cases in which they filed claims. Thus, for the sample of companies that we obtained from Admin One, we

recognize that our data probably contain a reasonable number of omitted claims. We cannot correct the data for this problem without additional information from the institutional investors themselves.

The other two claims administrators, Admin Two and Admin Three, gave us different sets of information. Admin Two provided us with two sets of data about 11 sample companies: the first was a summary list of all claimants, including the size of their losses and amounts of their awards, and the second a more detailed listing of the particulars of each claimant's trading in the sample company's securities during the class period. Using this information, we were able to pull out a list of institutional investors making claims and the size of their claims that we compared to our data on the institutional investors that were eligible to make claims in these cases. As with the data provided by Admin One there are undoubtedly some claims misidentified as being made by third party advisors which should be classified as being made by institutions. We anticipate this error to affect our sample data for the same reasons given by Admin One. We note that we were unable to identify as many of the beneficial owners for claims filed by banks as custodians in the Admin Two data set because of the way the data were given to us. This will have the effect of decreasing the number of (usually small) claimants that we can identify because their claims are filed by the banks that are the custodians for their shares.⁷³

Admin Three provided us only with a list of the largest 100 actual claimants for a sample of 10 companies. We will be able to compare this list with the data that we had assembled on

⁷³ To make the data more comparable between the Admin One and Admin Two data sets, we will need to aggregate all of the beneficial owners claiming through banks in the Admin One data set. Although this will reduce the number of identified claimants, it will result in creating comparable numbers of institutional investor claims.

institutional investor holdings. However, we cannot determine for those institutions whose names do not appear on the list of the largest claimants if they actually filed claims. At the time of this writing, Admin Three has not provided us with any further data in this regard to this point. As a result, we decided to wait until we received more information from Admin Three before continuing to work with their data.

B. Preliminary Analysis

From the data provided by Admin One and Admin Two, we were able to perform some preliminary statistical analysis. Despite the differences in the two data sets, we extracted similar sets of results from them. For both samples, all of the settlements involved purchaser classes. We were able to determine the number of 13F filers that had reported purchases during the sample period, and to compare that list with the names of the beneficial owners that were filing claims in the settlements. Thus we are able to calculate the percentage of 13F traders that file claims in each settlement. Table 2 sets forth this information by sample company, as well as data on the average size of the claim for each institution that filed a claim. We note that we have incomplete information on several of the companies, which are indicated by - - - marks and do not include them in the totals for any of the columns.

<u>Table 2</u> Admin One Data on Settlements; 13F Data on Filing				
Sample Company #	# Filing	# Trading	% Filing	Av. Loss (\$)
1	4	22	18.18%	29,813
2	121	265	45.66%	19,640
3	3	29	10.34%	102,466
4	2	76	2.63%	13,998
5	1	41	2.44%	55,975
6	71	312	22.76%	26,317
7	0	13	0%	---
8	4	47	8.51%	8,049
9	---	---	---	---
10	9	73	12.33%	328,006
11	11	83	13.25%	54,152
12	---	---	---	---
13	25	76	32.89%	215,947
14	12	108	11.11%	10,178
15	7	22	31.82%	166,915
16	---	---	---	---
17	2	35	5.71%	270,811
18	2	12	16.67%	39,522
19	---	---	---	---
20	20	54	37.04%	137,309
21	---	---	---	---
22	---	---	---	---
23	---	---	---	---
24	221	820	26.95%	45,912
25	601	1,345	44.68%	2,551
26	180	452	39.82%	5,983
27	5	19	26.32%	17,467
28	0	6	---	---
29	31	145	21.38%	38,450
30	0	8	---	---
31	1	47	2.13%	26,371
32	39	180	21.67%	218,139
33	0	18	---	---
34	1	13	7.69%	775,395
35	15	54	27.78%	2,228
36	---	---	---	---
37	4	49	8.16%	31,915
38	0	4	---	---
39	12	37	32.43%	133,270
40	385	961	40.06%	5,803
41	2	34	5.89%	91,463
42	0	4	---	---

Total/Averages	1,791	5,464	32.78%	102,644
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The most obvious result that can be seen in Tables 2 and 3 is the low percentage of 13F traders that appear to file claims in these settlements. Looking at the last row of each table, we have calculated the averages across all of the settlements in the two samples to give the reader a flavor of the data. Looking across this row in Table 2, we find an average filing percentage for eligible claims of 32.78%, whereas in Table 3, the average percentage of 13F filers perfecting their claims is 23.01%.⁷⁴ If all those institutions filing Schedule 13F's indicating trades during the class period were also filing and perfecting claims in these settlements, we would see 100% averages here. Average loss is substantial in both samples. For Table 2, the average loss is \$102,644, as compared to Table 3, where the average loss is \$461,074. Although there are some large variations across the different settlements, the magnitude of these averages would seem to indicate that many institutions have suffered significant losses in these cases. Of course, what determines the value of filing a claim is not the loss suffered, but the recovery expected. Here, our data is less complete as we are only able to calculate average awards for the settlements in Table 3. With due regard for the small number of settlements in this group, we can see that average recovery rates are about one-third of losses, resulting in an average award for those eight companies of \$75,112. To our eyes, this would seem to be a significant return on the small costs (in terms of time and money) of filing a claim in a

⁷⁴ Note that this is the percentage whose claims are filed and accepted as valid by the claims administrators. At present, we are not calculating the percentage of 13F filers who file claims, and whose claims are disallowed. Based on our review of the data, adding in these ineligible claimants would slightly increase the number of filers in some settlements.

securities fraud class action settlement.

One implication of the recovery percentages in the Admin Two data set should also be pointed out. As these percentages are for the most part below 100%, increasing the number of claims filed by institutional investors will result in lower average recoveries for all of these investors. This will have the effect of reducing the monetary incentives for these shareholders to file claims, although we cannot be sure by how much.

We repeat again that caution must be exercised in interpreting these numbers. While we are sure that there is some under-reporting of claimants due to the problems in determining with complete accuracy the identities of the institutions filing claims in the settlements, we believe, based on our conversations with the claims administrators, that their process accurately identifies a high percentage of the beneficial owners that file in these settlements. In addition, the 13F data itself may be inaccurate, although we note in this regard that institutions that fail to file 13F's are not included in our sample. In fact, we only include those institutions that report their purchases during the class period, which should understate the number of institutions that could file claims in the settlements because it excludes institutions that traded during the class interval but failed to timely report these trades on their 13F's. Thus, we believe that we have been conservative in selecting the trading institutions that we are seeking to match up with the filing institutions in the settlements. Of course, we would prefer to correct for these problems before concluding that our results will hold up, but at this point, we do not see how we can make these corrections without getting information from the institutions themselves, assuming it still exists and they would be willing to share it.

Why Aren't Institutions Filing?: A Research Agenda

We have attempted to answer the question of whether institutional investors are leaving money on the table by failing to file claims in securities fraud class actions. We think that their fiduciary duties to file such claims are clearly established by existing law,⁷⁵ and that the costs of filing such claims are likely to be trivial. Thus, even if the benefits from filing are small, institutional investors should be filing claims in these settlements.

We conclude that it appears that many of these investors are failing to file such claims. Despite all of the flaws in our data, the percentage of institutional investors that we can identify that should be filing such claims is well below the number that are actually filing these claims. At the same time, the average recoveries in these settlements seem well in excess of what would cover the costs of making such claims. While we are well-aware that there are those in the field that believe otherwise, and we stand ready to be convinced by further evidence, we think that we have offered the most complete picture of the problem to date.⁷⁶

What we lack most at the moment is a convincing explanation of why these institutions are not filing claims in all securities fraud class action settlements. Two potential explanations have been offered: first, that there are potential misunderstandings by institutions of the amount that they

⁷⁵ It bears repeating that the 13F filers are a diverse lot. They are not restricted to the large public pension funds that are often discussed when shareholder activism, nor even to institutions that have fiduciary obligations to a set of beneficial owners. We hope to refine our results to try to sort out the different types of institutions into different categories as we work further with the data that we have and hope to get in the future.

⁷⁶ We note that our results are consistent with those in the only other systematic attempt to address this issue that we are aware of. See, e.g., Cleveland, Class Action Claim Management, *supra* note .

can recover in these cases;⁷⁷and second, that these shareholders do not understand that filing claims is part of their legal duties towards their beneficiaries.⁷⁸

Based on comments that we have received from attorneys that practice in the area, and our own research, we think that there are several more plausible hypotheses that should be explored. One strong candidate is that institutions are rational economic beings that make cost-benefit calculations concerning whether or not to file claims in these settlements. They may expect to receive small recoveries in these cases, even if their losses are large, because the settlements pay out only pennies on the dollar. Or the recovery amounts make seem large to outsiders but be very small in relationship to the size of their portfolios and therefore have no material impact on their returns. We think that this is an important avenue for further research that we intend to pursue. In particular, we need to dig further into the underlying claims for the different institutions to look at the distribution of claims, and ask such questions as whether the average figures reported in Tables 2 and 3 conceal a large number of small claimants for whom filing will result in small gains. We also need to look at the average recoveries for those institutions that did not file claims in order to calculate what they would have recovered if they had filed. Furthermore, we intend to get a better handle on the costs of filing claims, and whether these vary significantly over different investors with different trading volumes and patterns, or with the level of detail that is required for perfecting the claims. More generally, we intend to examine the effect of the size of the settlement, the size of the institution's potential recovery, the size of the institution's stake in the company being sued in the case, the size of the case, including how well publicized the settlement is, and the length of time

⁷⁷ Douglas McKeige, *Leaving Money on the Table: Are You Collecting On Your Claims?*, 3 Institutional Investor Advocate 1 (2001).

⁷⁸ Cleveland, *Class Action Claim Management*, supra note .

between the settlement and the time that the claims arose. All of these are important factors in determining filing rates for institutional investors.

A second potentially important explanation for the institutions' failure to file claims is that they do not have personnel that are assigned to handle these claims. In other words, if the notice of settlement comes in, who does it get routed to? If it goes to the trading desk, they may believe that their job is to make money for the firm through the purchase and sale of securities, not by filing claims, and thus do nothing with the claim. Similarly, if the institutional investor is delegating the responsibility for filing claims to the custodian of their securities, typically a bank or broker, they may fail to understand what they need to do in order to file and perfect a claim. Many potential pitfalls of this nature may exist at different institutions and play a major role in explaining their failure to file.

A third logical reason for institutions failure to file claims may be that they never receive the notices of settlement. Most institutions hold their stock in street name, with the beneficial owners holding legal title through a depository trust.⁷⁹ When a company settles a securities fraud case, the notice of settlement must filter its way through the chain from the depository trust to the broker or bank holding the shares in the institution's name, all the way down to the institutional investor. There is no legal obligation imposed on the banks or brokers to insure that these notices arrive at the door of the institutional investors.⁸⁰ So we cannot be sure that institutions are even aware of the

79 Thomas and Dixon cite

80 If it turns out that many notices are not being received by the institutions, then it may be necessary for the SEC to consider implementing rules that require banks and brokers to forward these notices to all the beneficial holders whose shares that they hold. New rules analogous to those adopted for shareholder voting would seem to be in order. See Thomas and Dixon, cite.

settlements when they arise.