CHRISTOPHER LOMETTI
212.838.7797
clometti@cohenmilstein.com
V-CARD

RICHARD E. LORANT
202.408.3622
rlorant@cohenmilstein.com
V-CARD

SECURITIES LITIGATION 101:

PORTFOLIO MONITORING BEST PRACTICES

Securities fraud costs investors billions of dollars a year and shareholder lawsuits are the best available tool to recover fraud-related losses. The top 100 securities class action settlements alone have returned more than $68.6 billion to defrauded investors since 2001; approximately $10 billion in settlement proceeds awaited distribution as of September 30, 2022, according to ISS Securities Class Action Services.

Potential securities litigation claims are considered assets of the trust fund, giving trustees and staff a fiduciary duty to manage them effectively. For that reason, many pension funds have established portfolio monitoring programs to calculate their losses when new shareholder lawsuits are filed and keep track of settlements in which they are entitled to share. This article reviews the elements of a successful monitoring program.

Adopting and Maintaining a Securities Litigation Policy

A successful monitoring program begins with a comprehensive and up-to-date securities litigation policy. The Board should approve a policy that reflects its thinking about the factors that could tip the balance between remaining an “absent” class member, which is suitable for most shareholder lawsuits, or actively pursuing litigation as a lead or individual plaintiff. Spending time in this area bears dividends because a well-considered policy makes sure that staff will only spend their time on cases that the policy defines as worth the effort.

Tracking Settled Cases

For securities acquired in the United States, trustees should at least take steps to ensure their fund’s custodial bank is filing all class-action settlement claims to which the fund is entitled. Because U.S. class actions function on an “opt in” basis, settlement claims administrators will attempt to contact all class members via their custodian once a settlement receives final approval. At that time, any fund owed a recovery can decide whether to collect its share, opt out of the class to pursue individual litigation, or object to the settlement.

Monitoring New Cases

When a securities class action is filed in U.S. federal court, impacted shareholders have 60 days to ask the judge to appoint them lead plaintiff. For that reason, trustees arguably have a fiduciary duty to monitor newly filed lawsuits to decide if active involvement can boost a fund's recovery or is otherwise beneficial to fund members. Since custodian banks only concern themselves with settlement claims, investors often select law firms or other third-party providers to track all new cases, calculate a fund's initial losses, and evaluate the merits of active involvement (something discussed in greater detail below).

A securities litigation policy should list factors the fund wants evaluators to consider before recommending it consider pursuing active litigation. Policies sometimes include a minimum dollar loss threshold to trigger a full case evaluation. They may specify other factors to weigh: the strength of the legal claims at issue; the probability of a meaningful financial recovery; the opportunity for corporate governance improvements; the amount of staff time necessary to oversee counsel; and the egregiousness of the fraud, for example.

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Non-U.S. Litigation

Since many non-U.S. cases are litigated in "opt out" jurisdictions, where a fund must register earlier to collect in an eventual settlement and where a "loser pays" regime may expose plaintiffs to financial risk, policies may establish different criteria for U.S. and non-U.S. litigation.

The National Association of Public Pension Attorneys and other organizations have model policies to use as templates.

Selecting Monitoring Firms

If the policy calls for retaining monitoring law firms, staff should manage the process. The quality, selectivity, and number of law firms selected —together with the policy guidelines—will affect the number of cases flagged for consideration. Some funds issue open or targeted RFPs to select firms; others invite a group of reputable firms to submit proposals and select some to make "final" presentations to the board. While there is no magic number of monitoring firms to select, using more than one firm is a best practice; doing so offers checks and balances at no extra cost (since law firms do not charge a fee for monitoring), ensures a single firm won't be excluded from considering a case due to conflicts of interest, and allows for a mix of law firms with different approaches, strengths, and experiences. You'll want to consider reducing the number of monitoring firms if your staff feels overwhelmed by too many recommendations.

With a properly designed program, staff involvement will be limited largely to reviewing periodic reports from monitoring law firms and, on occasion, screening case recommendations. Monitoring firms should identify all new cases that impact the fund; investigate and evaluate their merits; properly assess initial losses and complications in collecting damages; and recommend the best course of legal action, focusing on the fund's policy goals. Most newly filed U.S. securities class actions will not require action before the settlement stage.

PUTTING A PORTFOLIO MONITORING PROGRAM IN PLACE TO ACCOUNT FOR SECURITIES LITIGATION ASSETS IS A BEST FIDUCIARY PRACTICE AND ENACTING A SECURITIES LITIGATION POLICY IS THE BEST WAY TO PROVIDE A FUND WITH CLEAR, CONSISTENT GUIDELINES ABOUT PROTECTING ITS INTERESTS IN SHAREHOLDER LAWSUITS.

Pursuing an Active Role in Litigation

There are cases, however, where a fund may want to become a lead plaintiff. Doing so may boost its recovery and will ensure proper management of a case in which it has a significant financial interest. Typically, the lead plaintiff signs off on major strategic decisions, reviews important filings, and is involved in any settlement discussions. It may be able to pursue corporate governance remedies. It selects lead counsel, negotiates attorneys' fees, and oversees class counsel. Some lead plaintiffs choose to do more. While there are no out-of-pocket costs—lead counsel reimburses the costs of travel and other expenses—the lead plaintiff should expect to dedicate some hours of staff time to the litigation. If the case is successful, lead counsel may petition the court to authorize compensating staff for time spent carrying out lead plaintiff duties.

Conclusion

Putting a portfolio monitoring program in place to account for securities litigation assets is a best fiduciary practice and enacting a securities litigation policy is the best way to provide a fund with clear, consistent guidelines about protecting its interests in shareholder lawsuits. Just as an investment policy is regularly reviewed to ensure consistency with the fund's evolving circumstances, a securities litigation policy should be regularly reviewed to ensure it accurately reflects the fund's evolving attitude toward involvement in securities litigation. ■

Christopher Lometti is Of Counsel to Cohen Milstein. Richard E. Lorant is the firm's Director of Institutional Client Relations. They are members of the firm's Securities Litigation & Investor Protection practice group.