Maximizing Returns Through Asset Protection and Recovery

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Pension trustees and staff are currently navigating a volatile and uncertain economic environment. Runaway inflation over the past two years and the resultant spike in interest rates (which appears primed to persist) have dented and jeopardized the predictability of returns across a variety of asset classes.[1]

To help maximize returns, certain trustees and staff have established procedures to monitor and ferret-out corporate misconduct that may have impacted the fund's portfolio. Through these procedures, a plan can pursue litigation to potentially recover funds lost as the result of misconduct, and thereby enhance the value of plan assets. Indeed, over the past ten years, investors have recovered nearly $39 billion through securities class action litigation.[2] Many of the largest and most significant of these cases were led by institutional investors, particularly public pension plans.[3]

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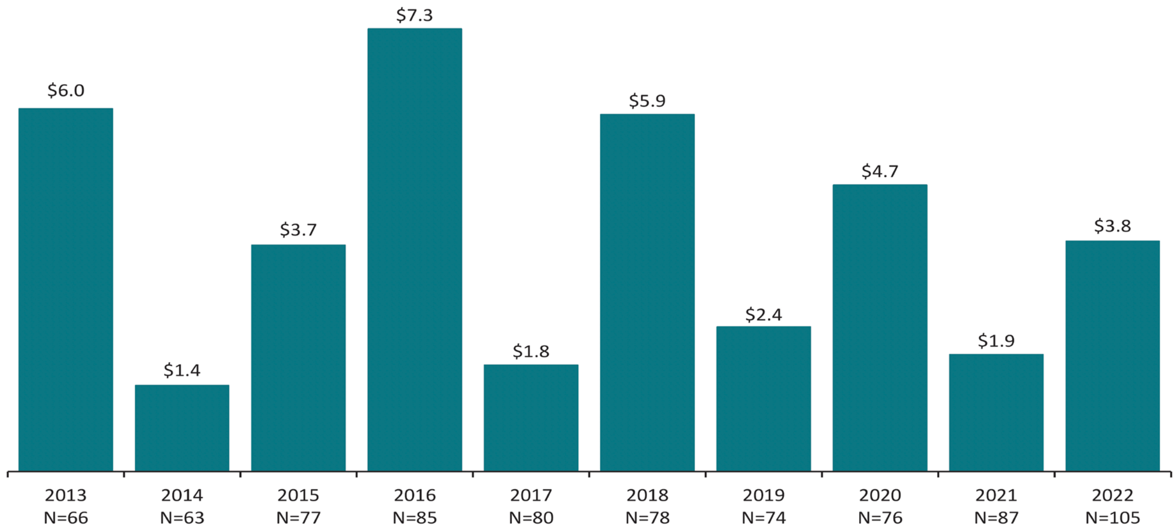
Recent scholarly work indicates that the opportunity to increase returns through securities litigation may be even more significant than these historical results might suggest. According to a recent academic study titled *How Pervasive is Corporate Fraud* published in *Review of Accounting Studies*—which seeks to publish original research that makes empirical, theoretical, or methodological contributions to demography or other population-related fields—"evidence suggests that in normal times only one-third of corporate frauds are detected. **We estimate that on average 10% of large publicly traded firms are committing securities fraud every year. . . . we estimate that corporate fraud destroys 1.6% of equity value each year, equal to $830 billion in 2021.**"[4] The authors further explained how "[a]ccounting violations are widespread: in an average year, 41% of companies misrepresent their financial reports, even when we ignore simple clerical errors."[5]

Total Settlement Dollars 2013-2022 (Dollars in billions)

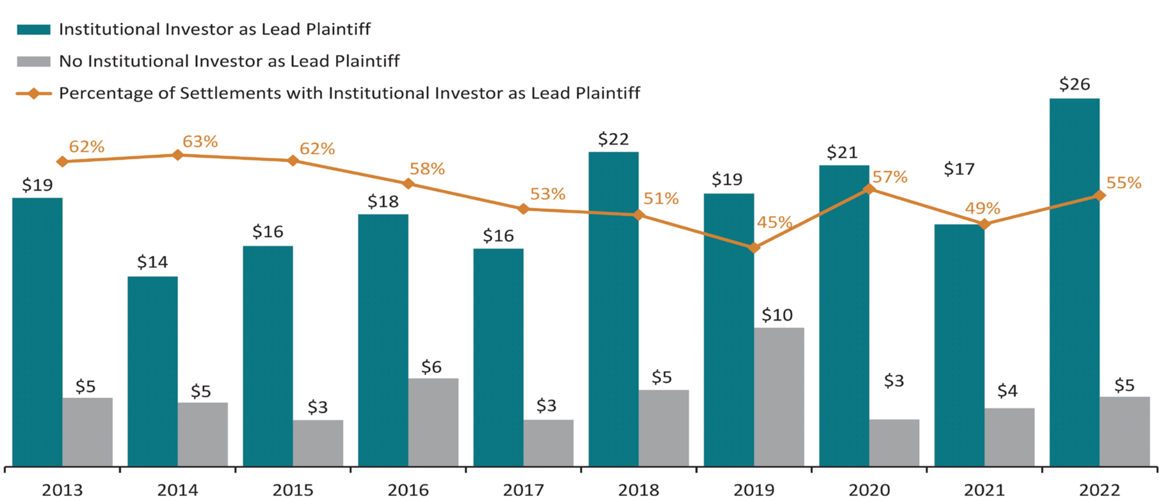


Note: Settlement dollars are adjusted for inflation; 2022 dollar equivalent figures are presented. "N" refers to the number of cases.

The New York Times wrote that the study made waves "in the world of academia" in 2023 and "has become a fascination among general counsels, corporate leaders and investors."[6] According to Professor Alexander Dyck, one of the lead authors for the study who serves as a Professor of Finance and Economic Analysis and Policy at the University of Toronto, "[w]hat people don't get is how widespread the problem of corporate fraud is. . . . the amount of fraud perpetrated at any given time stays pretty steady."[7] What's more, the study only involved audited public companies. Professor Dyck explained that "misconduct is likely even more pervasive in privately held business, particularly in crypto, which is only loosely regulated."[8]

Significantly, history further suggests that it remains important for public pension plans to continue to take the mantle and lead these cases to maximize potential recoveries and protect asset values. In every year over the past decade, securities class actions that were led by an institutional investor resulted in median settlement amounts that were multiples larger than those led by non-institutional investors.[9] Last year, institutional investors achieved median settlement amounts over five times larger than non-institutions, which represents one of the largest disparities over the past decade.[10]

Median Settlement Amounts and Institutional Investors 2013-2022 (Dollars in millions)



Note: Settlement dollars are adjusted for inflation; 2022 dollar equivalent figures are presented.

In short, recent academic research indicates that there is a raft of misconduct (both detected and undetected) that has been negatively impacting plan asset values. Public pension plans have achieved great results in identifying fraud and subsequently recovering assets through securities class action litigation. By continuing to take an active role in these matters, trustees and staff can help maximize asset values, particularly during this time of economic uncertainty. ◆

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Disclosures:

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Endnotes:

[1] *See e.g., What to do When Interest Rates Rise*, VANGUARD (Sept. 20, 2022), https://investor.vanguard.com/investor-resources-education/article/what-to-do-when-interest-rates-rise.

[2] See CORNERSTONE RESEARCH, SECURITIES CLASS ACTION SETTLEMENTS 2022 REVIEW AND ANALYSIS 3.

[3] *See Id.* at 12.

[4] See Alexander Dyck, Adair Morse, Luigi Zingales, How Pervasive is Corporate Fraud, REV. ACCOUNT. STUD., 1 (Jan. 5, 2023) https://doi.org/10.1007/s11142-022-09738-5 (emphasis added).

[5] *See Id.* at 3.

[6] *See* Ephrat Livny, *Just How Common Is Corporate Fraud*, N.Y. TIMES (Jan. 14, 2023) https://www.nytimes.com/2023/01/14/business/dealbook/how-common-is-corporate-fraud.html#:~:text=A%20new%20study%20estimates%20that,commit%20securities%20fraud%20each%20year.&text=The%20DealBook%20Newsletter%20Our%20columnist,power%2Dbrokers%20who%20shape%20them.

[7] *See Id.*

[8] *See Id.*

[9] *See* CORNERSTONE RESEARCH, *supra* note 2, at 12.

[10] *See* CORNERSTONE RESEARCH, *supra* note 2, at 12.